Frontier Emerging Markets Equity Strategy

The **Morgan Stanley Frontier Emerging Markets Equity Strategy** is a growth strategy that seeks absolute returns in capital appreciation by investing in equity securities of frontier emerging markets. To help achieve its objective, the strategy combines top-down country allocation with bottom-up stock selection and disciplined risk management.

**Investment Philosophy**

The Frontier Emerging Markets Equity team believes that frontier markets are in various stages of economic development—but generally lag the “mainstream” emerging markets in terms of economic and financial market reform, and, in many cases, are overlooked by many foreign investors. Their equity market performance correlation with other markets has been historically low because of their limited integration with the rest of the world’s financial markets, thus providing potential diversification benefits.¹

The strategy’s investment team defines a frontier emerging market as a developing country beyond the generally accepted 23 frontier emerging market countries within the MSCI Frontier Markets index.

The team regards these “non-core” emerging markets as attractive new investment destinations with unrealized economic potential. Further, it believes their rapid productivity gains, underpenetrated consumer markets and healthy infrastructure budgets are among the compelling catalysts likely to lead to strong and sustainable company-earnings potential.

- **Top-down and bottom-up analysis**: As frontier emerging markets vary significantly in their maturity and growth fundamentals, the team aims to capture the upside potential of emerging-market equities and drive the strategy’s performance by integrating top-down country analysis with bottom-up stock selection.

- **A growth style**: The team looks for companies with quality management, upward price and earnings momentum in underpenetrated industries, and identifiable catalysts to unleash earnings growth potential.

- **Risk management**: The team continually monitors its weightings to ensure that they do not exceed pre-defined limits of 20 percent of the portfolio at cost for country allocation and 10 percent of the portfolio at cost for security allocation. Further, the team periodically adjusts the strategy’s overall risk/return profile in accordance with its investment outlook.

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¹ Past performance is no guarantee of future results. Diversification does not protect an investor against a loss in a particular market; however it allows an investor to spread that risk across various asset classes.

² The MSCI Frontier Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of frontier markets. The MSCI Frontier Markets Index consists of the following 23 frontier market country indices: Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kenya, Kuwait, Lebanon, Lithuania, Kazakhstan, Mauritius, Morocco, Nigeria, Oman, Pakistan, Romania, Serbia, Slovenia, Sri Lanka, Tunisia, and Vietnam. It is not possible to invest directly in an index.

³ Weights and number of holdings provided are a typical range, not a maximum number. The portfolio may exceed this from time to time due to market conditions and outstanding trades.

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Investment Process

**TOP-DOWN COUNTRY ALLOCATION**

- **Global analysis:** The team analyzes global economic conditions—paying particular attention to the economies of the United States, Japan, China and Europe—and their impact on emerging and frontier market performance.

- **Frontier-market analysis:** The team closely analyzes an investment universe of more than 30 countries (including MSCI Frontier countries and others) to identify improving fundamentals and compelling catalysts among countries where the team believes that improving macroeconomic, social and political fundamentals are not yet fully reflected in market valuations and sentiment.

- **Country allocation:** Lead portfolio manager Timothy Drinkall decides upon the strategy’s country allocation and stock selection based on his frequent travel, meetings with government officials and company management, the input of the emerging markets team’s regional portfolio managers, and the macroeconomic assessment of the analyst team.

**BOTTOM-UP SECURITY SELECTION**

- **Investable universe:** The team reviews an investment universe of approximately 1,500 companies based on a liquidity analysis of trading volumes and on available information on each security.

- **Closely followed universe:** The team then conducts a deeper analysis of companies, focusing on a group of about 300 securities by making company visits, analyzing industries, and considering index representation. Because sell-side research on frontier companies is limited, original research and modeling by the team is paramount.

- **Security selection:** Among the closely followed universe, the team’s portfolio managers select a total of roughly 40 to 50 stocks from companies they believe exhibit quality management; a strong product line or business model with competitive advantages; good free cash-flow\(^4\) generation and the effective use thereof; a healthy balance sheet; and the potential for high earnings growth. Throughout this process, regional portfolio managers identify themes, contribute ideas and perspectives to the overall team, and collaborate on identifying what they believe to be the best stocks for their respective regions.

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\(^4\) Free cash-flow is operating cash flows (net income plus amortization and depreciation) minus capital expenditures and dividends.

Display 1: **Top-down country allocation integrated with bottom-up stock selection helps drive the strategy’s performance**

The diagram above represents how the portfolio management team generally implements its investment process under normal market conditions.

**Competitive Advantages**

- **Emerging-market experience:** Morgan Stanley Investment Management (MSIM) has been investing in emerging markets for more than 25 years, innovating country and regional investment products where it has identified opportunities for strong returns. Additionally, this strategy was among the first of its kind dedicated to investing in frontier markets.

- **Global presence:** Due to Morgan Stanley’s global presence, reputation and extensive resources\(^5\), the strategy’s investment team is able to access senior government leaders and company management. Such access helps the team perform original research and rigorous analysis, gain insights into country, industry and business fundamentals, and establish long-term relationships with leaders in both government and industry.

- **Top-down and bottom-up analyses:** The team believes its integration of country allocation with stock selection helps it drive performance.

**Investment Team**\(^6\)

Lead Portfolio Manager Tim Drinkall joined Morgan Stanley in 2007. Tim has 21 years of investment experience, and has been covering emerging markets since 1992.

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\(^5\) Subject to third party confidentiality agreement obligations and information barriers established by Morgan Stanley to manage potential conflicts of interest and applicable allocation policies.

\(^6\) Team members may change without notice from time to time.
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