Morgan Stanley Emerging Markets Corporate Debt Strategy

The Morgan Stanley Emerging Markets Corporate Debt Strategy is a value-oriented fixed income strategy that seeks to maximize total return from income and price appreciation by primarily investing across the credit spectrum in the debt securities of emerging market corporate issuers. Investments are mostly denominated in U.S. currency, and include non-U.S. and/or local currencies. To help achieve its objective, the team follows a disciplined investment process that combines top-down country allocation with bottom-up credit analysis to identify undervalued emerging market corporate debt securities.

Investment Philosophy

The investment team believes that corporate, sovereign and quasi-sovereign debt securities of emerging markets experiencing positive fundamental change may present attractive investment opportunities. Further, historical data shows that the performance correlation of emerging market debt with other asset classes can be low, thus providing potential diversification benefits.¹

The team aims to capture the upside potential of emerging market corporate debt securities through:

- **Country and security analysis:** As emerging markets vary significantly in their development, the team not only engages in bottom-up security selection, but also evaluates countries’ relative economic, political and social fundamentals.

- **Value orientation:** The team seeks to identify countries exhibiting fundamental improvements that have not yet been reflected in the prices of their debt securities. By following a country’s incremental rate of change in various areas over time—rather than simply analyzing a static snapshot of parameters—the team believes it can discern improvements at their early stages and monetize them through timely investments.

- **Credit analysis:** The team believes that prudent risk taking grounded in fundamental credit analysis will be the key to adding consistent alpha² over a full market cycle. Key factors driving credit quality include free cash flow³ generation and leverage⁴ trends, business volatility, sponsor reputation and track record, as well as legal/regulatory considerations. Good investment opportunities exist across the full credit quality spectrum and can be found in the corporate bonds of countries in which credit fundamentals are experiencing positive rates of change experiencing positive rates of change.

<table>
<thead>
<tr>
<th>Strategy at a Glance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inception</strong></td>
</tr>
<tr>
<td><strong>Benchmark</strong></td>
</tr>
<tr>
<td><strong>Country weight</strong></td>
</tr>
<tr>
<td><strong>Available vehicles</strong></td>
</tr>
</tbody>
</table>

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

² Alpha measures the difference between an investment’s actual returns and expected performance, given its level of volatility, measured by beta. A positive alpha indicates an investment has performed better than its beta would predict.

³ Free cash flow equals operating cash flows (net income plus amortization and depreciation) minus capital expenditures and dividends.

⁴ The use of various financial instruments or borrowed capital such as margin, to increase the potential return of an investment.

⁵ The strategy invests in the market capitalization of the JPMorgan CEMBI Broad Diversified Index (“CEMBI Broad Diversified”), which tracks US-dollar denominated debt issued by emerging market corporations. It includes fixed, floating, amortizing and capitalizing instruments. It is not possible to invest directly in the index.

⁶ Weights represent typical ranges, which a portfolio may exceed from time to time due to market conditions and outstanding trades.
Investment Process

The team follows a disciplined investment process that combines top-down country allocation with bottom-up security evaluation. All investment recommendations undergo peer review, and final decisions with respect to portfolio construction and market-risk exposure are made on a team basis based on the following analysis:

- **Macro analysis**: The team begins with a top-down macro analysis of the global environment and examines the impact of various geopolitical, economic, and business trends (including global economic growth, business and inflation cycles, and commodities prices) on the universe of emerging market countries. The output of the team’s macro analysis is an overall risk assessment and risk target for the overall portfolio.

- **Country analysis**: The team’s objective is to identify countries that exhibit signs of positive fundamental change using frameworks that meld economic, political and social assessments. In analyzing economic factors, it distinguishes between policies (such as fiscal, monetary, and exchange rate regimes), and objectives (for example, Gross Domestic Product growth, inflation, external accounts and debt serviceability). The team focuses on a government’s ability to formulate and implement policies and on an economy’s responsiveness to them. It also emphasizes socio-political factors including political risks, leadership, election calendars, regime changes, and social stability.

- **Credit analysis and industry outlook**: The team reviews a variety of indicators to evaluate the credit metrics of specific issuers. Additionally, the team considers the industry outlook for each issuer. Fundamental credit analyses incorporate financial models, competitive positioning, free cash flow generation, business volatility, liquidity capital structure, and legal/regulatory considerations. Risk analyses consider business risk, financial risk, management experience, shareholder reputation, earnings stability, free cash flow, balance sheet strength and the trajectory of the credit profile.

- **Security selection**: The team screens a universe of corporate, sovereign, and quasi-sovereign bonds in each country for the most attractive opportunities. Securities are selected based on yield, targeted duration, security, covenants and other considerations.

Display 1: Country and security analysis helps identify investment opportunities in emerging market corporate debt

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

Competitive Advantages

- **Global presence**: The team is supported by Morgan Stanley’s presence in nearly every major financial market and region, drawing on the scale and scope of the firm’s global franchise to help manage risks and identify opportunities throughout market cycles.

- **Experience and complementary skill set**: The team is comprised of investment professionals with complementary skills sets, which facilitate informed, well-researched investment decisions.

- **Morgan Stanley Investment Management’s (MSIM) structure**: The firm’s structure allows for entrepreneurial flexibility, equipping the investment team with the liberty to respond quickly to market developments and swiftly implement investment ideas.

Investment Team

The Emerging Markets Corporate Debt Strategy is managed by Eric Bauermeister and Warren Mar. MSIM has been investing in emerging market debt since 1993. The strategy’s investment team offers a blend of knowledge and experience in implementing emerging market debt strategies across a range of market conditions and fixed income securities, derivatives and debt instruments.

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7 Subject to certain restrictions.
8 Team members may change from time to time without notice.
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Risk Considerations

Past performance is not a guarantee of future performance. The value of the investments and the income from them can go down as well as up and an investor may not get back the amount invested. There can be no assurance that the strategy will achieve its investment objectives.

Investments may be in a variety of currencies and therefore changes in rates of exchange between currencies may cause the value of investments to decrease or increase. Furthermore, the value of investments may be adversely affected by fluctuations in exchange rates between the investor’s reference currency and the base currency of the investments.

For investments in emerging markets, the volatility and risk to your capital may be greater due to potential price volatility, political and/or economic risks. Debt securities may not be rated by a recognized rating agency.

High yield fixed income securities are considered speculative, involve greater risk of default and tend to be more volatile than investment grade fixed income securities. Securities of small capitalization companies: these securities involve greater risk and the markets for such securities may be more volatile and less liquid.

Strategies that specialize in a particular region or market sector are more risky than those which hold a very broad spread of investments. Where strategy concentration is in one sector it is subject to greater risk and volatility than strategies that are more diversified and its value may be more substantially affected by economic events in a particular industry.

Investments in derivative instruments carry certain inherent risks such as the risk of counterparty default and before investing you should ensure you fully understand these risks. Use of leverage may also magnify losses as well as gains to the extent that leverage is employed.