

## Morgan Stanley Investment Funds Global Sustain Fund

INTERNATIONAL EQUITY TEAM

### Performance Review

In the one month period ending 30 November 2024, the Fund's Z shares returned 2.09% (net of fees)<sup>1</sup>, while the benchmark returned 4.59%.

The portfolio has returned +15.31% for the year-to-date, versus +21.85% for the index. We seek to deliver attractive long-term absolute returns.

The November underperformance was mainly due to stock selection, driven by weakness in information technology and, to a lesser extent, financials and consumer staples. Whilst health care was a positive contributor, it was insufficient to compensate. Sector allocation was also negative, driven by the hits from the health care overweight and consumer discretionary underweight. Combined, these were larger than the positive impact from the financials overweight and zero weight in materials.

The largest contributors to absolute performance during the month were **Visa** (+45 basis points [bps]), up on the back of market expectations of an easier U.S. regulatory landscape under a Republican administration; **Procter & Gamble** (+29 bps), as the company maintained its outlook for solid organic sales growth despite commodity headwinds, demonstrating its strong pricing power; and **Booking Holdings** (+28 bps), maintaining momentum on the back of strong revenue growth.

The largest absolute detractors were **L'Oréal** (-21 bps), down due to potential tariffs from the President-elect and continued low consumer demand in China; **Keyence** (-19 bps), which reported a mixed set of second quarter results due to a slowing Chinese economy undercutting earnings; and **Becton Dickinson** (-13 bps), down despite delivering fourth quarter results broadly in line with expectations.

### Market Review

In November, we saw global markets respond strongly to the Republican victory in the U.S. election. The MSCI World Index returned a healthy +4.6% in U.S. dollars (USD) and +4.9% in local currency. At the sector level, cyclicals were the month's top performers, with consumer discretionary (+9%) and financials (+8%) outperforming the MSCI World, while information technology and industrials (+5%) were roughly in line. Defensive sectors lagged, including consumer staples (+2%) and utilities (+2%). Health care (-1%) and materials (-1%) were the only negative sectors in the month.

In terms of geography, unsurprisingly given geopolitical events, the U.S. (+6%) outperformed the index, although Singapore was the best performing country, returning +8% in U.S. dollars (USD) and +9% in local currency. Other Asian markets – Japan (+1% USD, -1% local) and Hong Kong (-4%, -4%) – underperformed the MSCI World. Elsewhere performance was weak; Germany (-0% USD, +3% local), Switzerland (-2%, -0%), Spain (-4%, -1%) and France (-4% -2%) were all behind the index in USD and local currency. The U.K. showed a slightly positive return (+1%, +3%) but also lagged.

### Portfolio Activity

Portfolio activity is reported at quarter-end.

### Strategy and Outlook

#### The Great Distortion

"Events, dear boy, events" ... so said Harold MacMillan, former Prime Minister of the United Kingdom, when asked by a young journalist what politicians feared most.

We're in a charged and unpredictable landscape. East-West tensions simmer, the Middle East remains a powder keg, and the Russia-Ukraine war looks set to enter another harsh winter as tensions escalate. Meanwhile, former President Donald Trump is to return to the White House, backed by an emboldened Republican party holding both the House and Senate. All eyes are on the potential economic and societal shifts this new administration may bring.

We saw markets swiftly respond to Trump's victory with a "risk-on" rally in the U.S. and a stronger dollar, driven by expectations for deregulation, corporate tax cuts and an "America First" agenda. While there may well be positives for U.S. markets from the "Trump agenda", there are also many potential negatives, not least the inflationary risks inherent in many of his proposed policies. For example, tariffs could push up consumer prices and corporate costs, while mass deportations could increase labour costs in the U.S. Should an inflationary environment result, the U.S. Federal Reserve may need to alter its current path and hold interest rates higher for longer, potentially constraining economic growth and pressuring weaker balance sheets. In addition, tax cuts may boost corporates' profits at the expense of a higher government deficit, intensifying long-term concerns about U.S. fiscal sustainability.

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 30 November 2024.

Whatever the resulting policies and their ramifications, markets are facing greater uncertainty; uncertainty that does not seem to be reflected in prices, not least in the VIX index – the measure of expected S&P 500 Index volatility – which is currently trading below 15.<sup>2</sup>

### *The great distortion*

Any current unusual happenings are not just confined to politics. As we have previously covered, investors are having to contend with an increasingly narrow market environment. While the MSCI World Index is designed to be globally representative, capturing large- and mid-cap stocks across 23 developed markets, its market-cap weighted methodology has led it to become increasingly distorted, with the dominance of U.S. techy giants (aka the "Magnificent Seven"), propelling the U.S. to 70% of the overall index.<sup>2</sup>

Index distortion impacts valuation. The 10 largest companies in the index, which account for 25% of MSCI World's total market capitalisation and are nearly all tech or tech-adjacent, trade at an average 34x next 12-months (NTM) earnings.<sup>3</sup> If you compare this to the broader MSCI World Index, which trades at a near historical high of 19x NTM earnings, the equal weight index at 15.4x, and the ex-U.S. segment at just 14x, it becomes glaringly obvious that size and geography matter.<sup>3</sup> The valuation gap between the MSCI USA Index and the MSCI World ex-U.S. Index is now at its widest this century, with the U.S. trading at more than a 50% premium to the rest of the world.<sup>2</sup>

### *Index huggers beware*

For managers closely tied to the index, a tracking error-focused approach driven by recency bias may be far riskier in absolute terms than it may appear. In our experience, markets tend not to worry about high multiples so long as strong earnings growth perseveres. However, any knock or fade to earnings may spell trouble, particularly for a distorted index which seems to be priced for perfection...

As we explained in our June Global Equity Observer "Independent Thinking", we've always been cautious about the index. Though it appears diversified, it can steer investors toward a concentrated set of today's winners, chasing where the pendulum has swung, rather than to where it may swing. The index disregards quality and valuation and prioritises size over conviction. With this you own everything – indiscriminately, an approach that doesn't align with our long-term absolute investment approach.

### *The case for active*

As active managers, recent market distortions have presented opportunities that we've been able to take advantage of for the portfolio. So far this year, we've added eight new names from seven different industries, all at attractive valuations. Together, these companies' forward price-to-earnings ratio aligns with that of the broader market, yet they boast more than double the market average in both return on operating capital and gross margin (our key quality characteristics). Examples include AutoZone, the leading auto parts retailer in the U.S. with what we consider to be an exceptional capital allocation record, and CME, the leading U.S. futures exchange with incredibly high barriers to entry due to its network effects.<sup>4</sup> Turning to sales from the portfolio, increased valuations this year, combined with careful reviews of companies' fundamentals, have led us to exit certain positions where we felt either the multiple or business quality no longer justified ownership.

Our benchmark-agnostic approach is grounded in rigorous fundamental research. Over more than a quarter of a century of high quality investing, we have weathered it all – from recessions and wars to credit crises, pandemics, inflation and deflation, and now five U.S. presidents. Over these 28 years, we have remained committed to our disciplined investment philosophy focusing on the relentless pursuit of quality and a commitment to avoid overpaying. In these unusual times, our focus remains on what drives strong long-term performance – the compounding of high quality company fundamentals.

**For further information, please contact your Morgan Stanley Investment Management representative.**

## Fund Facts

Launch date	29 June 2018
Base currency	U.S. dollars
Benchmark	MSCI World Net Index

## Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class Z Shares	15.31	21.90	-21.02	19.32	15.79	29.73	--	--	--	--	--
MSCI World Net Index	21.85	23.79	-18.14	21.82	15.90	27.67	--	--	--	--	--

All performance data is calculated NAV to NAV, net of fees, and does not take account of commissions and costs incurred on the issue and redemption of units. The sources for all performance and Index data is Morgan Stanley Investment Management. **Please visit our website [www.morganstanley.com/im](http://www.morganstanley.com/im) to see the latest performance returns for the fund's other share classes.**

<sup>2</sup> Source: FactSet. Data as of 29 November 2024.

<sup>3</sup> Source: FactSet. Date 29 November 2024. NTM earnings are estimated.

<sup>4</sup> Source: FactSet, MSIM Research. All information is provided for information purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned. The holdings identified do not represent all securities purchased.

## Share Class Z Risk and Reward Profile

- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.
- The fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the fund to financial loss.
- Sustainability factors can pose risks to investments, for example: impact asset values, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the fund's ability to buy or sell securities.
- Investment in China A-Shares via Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs may also entail additional risks, such as risks linked to the ownership of shares.

- Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the Fund 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.

Please refer to the Prospectus for full risk disclosures. All data as of 30 November 2024 and subject to change daily.

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### INDEX INFORMATION

The **MSCI World Net Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends. The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

The **Volatility Index (VIX)** is the ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. It represents one measure of the market's expectation of stock market volatility over the next 30-day period. The VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualized.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **MSCI USA Index** is designed to measure the performance of the large and mid cap segments of the US market. With 631 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

The **MSCI World ex U.S. Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets – excluding the U.S. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

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