Morgan Stanley Investment Funds

Sustainable Emerging Markets Equity Fund

EMERGING MARKETS EQUITY TEAM

Performance Review

In the three month period ending 30 September 2024, the Fund's I shares returned 4.44% (net of fees)[1], while the benchmark returned 8.72%.

Over the one-year period, the portfolio returned 28.11% (I shares net of fees), outperforming the index return of 26.05%.

During the quarter, our underweight allocation to China was the main detractor from returns as the market ended the month with one of the sharpest rallies in recent history following the government's announcements of several measures aiming to boost liquidity and ease property regulations. Positioning in Korea and Taiwan, the overweight to Poland and the overweights to and positioning in India and Mexico also detracted. Our stock selection in Brazil contributed to returns, as did our overweight to and stock selection in Indonesia. The portfolio also benefited from our overweight allocation to South Africa and the zero allocations to Saudi Arabia and Turkey.

Top contributors to performance during the quarter are outlined below:

Within Brazil, our aggregate stock selection added to returns, led by the allocations to WEG, Nu Holdings and Itau. WEG is among Brazil's largest industrial companies that manufactures electric motors, industrial automation equipment and energy generation/transmission equipment. The company is benefiting from strong demand driven by electrification and market share gains as it becomes an increasingly global player. Given market trends and the company's culture of innovation, we continue to believe in its path for growth.

Our positioning in and overweight allocation to Indonesia added to returns, through our allocations to Bank Rakyat, Bank Mandiri and Cisarua Mountain Dairy (Cimory). We are invested in quality Indonesian banks with strong deposit franchises, including Bank Rakyat and Bank Mandiri, and believe they are well positioned to continue gaining deposit market share and be resilient against credit risks.

The portfolio benefited from our overweight allocation to South Africa. Our allocations to AVI, Capitec and Standard Bank were among the top stock contributors to returns. We are constructive on South Africa given its improving macro environment, supported by the recent national elections and the formation of a government of national unity (GNU). We believe reforms will likely continue and economic growth can accelerate, particularly with the improving fiscal situation. With inflation declining, the central bank has begun to cut rates, which we think can also support growth.

The portfolio's zero allocation to Saudi Arabia added to returns as the market was negatively impacted by lower oil prices and increased conflicts in the region.

Turkey was the worst performing emerging market (EM) in the quarter as equities sold off after strong outperformance earlier this year and our zero allocation to the market contributed. The country is undergoing an economic adjustment, and the more orthodox economic policy and high interest rates have begun to hit the real economy. While inflation is slowing, it is still high. The market is also beginning to question whether the political commitment exists to continue with the tight monetary policy necessary to bring inflation lower, given the economic slowdown.

Top detractors from performance during the quarter are outlined below:

Our underweight to China was the chief source of detraction during the quarter. Chinese equities rallied sharply in the last week of September as the market reacted positively to the surprise coordinated policy efforts to stabilize the property market and stimulate growth in the hope of hitting official growth targets and easing deflationary pressure in the economy. While it is a positive signal that the government is making a coordinated effort to address the structural issues in the economy, given the scale of these issues, it is unclear whether both the amount and the structure of the policy response will address the underlying fundamental issues effectively. We will continue to monitor any further policy response as it is articulated and implemented. We had decreased our underweight in previous quarters and continue to look for stock-specific opportunities.

Our stock selection in Taiwan and Korea detracted, impacted by our overweight allocations to SK Hynix, Wiwynn, TSMC and Hon Hai Precision Industry. Semiconductor-related stocks fell after Nvidia's market value dropped a staggering $280 billion in September as the market had growing concerns on whether the immediate economics and benefits of artificial intelligence (AI) can justify the pace of AI-related spending growth. Our positive investment thesis in technology/semiconductor companies remains unchanged. We believe the longer-term secular growth is now being augmented by a cyclical recovery in semiconductors found in more mature end-market applications like handsets, computers and automotives.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 September 2024.

Our overweight to Poland through our positions in Allegro and PZU hampered returns. We remain confident on our positions in Poland. We expect growth to accelerate next year, driven by investment with consumption remaining solid. We continue to like our stocks based on a combination of strong fundamentals and attractive valuations.

Our overweight to and positioning in India detracted, led by our allocations to Reliance and Macrotech Developers (Lodha), as the overall market consolidated and slightly underperformed the broader index in the quarter.

Mexico underperformed EM, and our overweight allocation to the country and positions in Qualitas and Walmex detracted from returns. The economy has slowed given tight monetary policy and high real interest rates. The market has sold off following the June elections as political uncertainty remains high, particularly as congress passed judicial reform during former President AMLO's last few weeks in office. President Claudia Sheinbaum was inaugurated on 1 October, and we are closely monitoring the policy direction under the new administration.

Portfolio Activity

During the quarter we initiated an allocation to Malaysia through positions in CIMB and Maybank. The macro situation in Malaysia has improved at the margin, with signs of government stability after several years of political uncertainty. With the government's support, incremental reform on power networks and grid access should attract more data centers and investments in the country, which could bolster bank loan demand (through manufacturing loans and lending growth in infrastructure and construction). Malaysian banks should also continue to benefit from higher interest rates. CIMB has undergone a strategic transformation to derisk and has achieved its target of double-digit return on equity through operational expenditure rationalization. We expect the company's trajectory to continue under its new CEO. Maybank has been strengthening its liability franchise and maintains a strong small and medium-sized enterprise (SME) presence, which is likely to benefit in the current investment cycle.

We initiated positions in diversified global manufacturing specialist Samvardhana Motherson and IDFC First Bank in India. We are positive on IDFC's runway for growth and believe it has various levers to improve profitability, including new asset lines (especially with its notable transition into becoming a retail liability franchise). Potential rate cuts by the Reserve Bank of India could be an additional tailwind for Indian banks. Women's representation at Samvardhana Motherson has risen to approximately 40% of the employee base (with women holding middle and senior management roles reported at 18% and 9%, respectively).[2] Further, the company's expansion and business evolution—including new businesses in the smartphone manufacturing supply chain—has helped it quickly become one of the largest players in the India manufacturing space as part of the "China plus one" strategy.

We rebalanced our positions in Samsung Electronics and SK Hynix. Within Korea our positioning continues to be in select IT companies, banks, automakers and materials companies that are beneficiaries of greater electric vehicle adoption, and companies we believe can benefit from the value-up opportunity.

We exited our positions in Shenzhou International and China Mengniu Dairy on concerns of weak consumer spending. We also exited our position in Kasikornbank in Thailand on structural headwinds, including political instability and weak growth in credit, consumption and investment.

In Taiwan, we consolidated our financial holdings by initiating a position in Fubon Financial and exiting our positions in Chailease and CTBC Financial, the latter on uncertainties surrounding CTBC's tender offer for Shin Kong Financial Holdings. The merger would create the largest financial conglomerate in Taiwan, but the synergy may take time to materialize. We believe tailwinds for Fubon include additional U.S. Federal Reserve rate cuts (which should be positive for Fubon's earnings outlook given lowered hedging costs), high dividend yields benefiting from Taiwan's exchange-traded fund flows and improving consumer spending and wealth management demand in Taiwan. Elsewhere in Taiwan, we exited our position in Merida.

We trimmed our position in Walmex in Mexico and reallocated the proceeds to Clicks, a South African drugstore/pharmacy chain. Clicks has continued to gain market share across pharmacy, beauty and general merchandise through successful store openings in South Africa and the gradual improvement in retail, which we believe should help earnings growth increase. In addition, the company has a disciplined capital return to shareholders via dividend payouts and share buybacks.

Elsewhere in South Africa, we exited our position in Anglo American and initiated a position in Standard Bank. We had started to reduce our position in Anglo American following the buy-out offer from BHP, which led to the stock's rerating and partially closed its undervaluation relative to peers. Standard Bank is a leading bank in South Africa with a strong banking franchise in Sub-Saharan Africa (which in recent years accounted for nearly 50% of its earnings).[3] We believe the company can benefit from improving loan growth, disciplined cost execution and a potential pickup in investment and growth following the recent elections. We believe the rest of its Africa franchise can grow strongly in dollar terms and the bank is well diversified across countries and business segments.

In Brazil, we initiated a position in Rede D'Or, among the largest private hospital operators in Brazil. The company also owns the second largest health insurer in the country, following its acquisition of SulAmerica. We believe strong earnings growth over the next few years will likely be driven by organic growth in health care EBITDA[4] (the company plans to significantly increase bed capacity over the next five years) and improvement to SulAmerica's medical loss ratios.

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2 Source: Samvardhana Motherson. Data as of September 30, 2024.
3 Source: Standard Bank 2024 interim results overview published 2 September 2024.
4 Earnings before interest, taxes, depreciation and amortization

Strategy and Outlook

We believe that our integrated top-down and bottom-up analysis remains critical to identify the most attractive macro and stock investments across EM. Both levers continue to be balanced drivers of active risk. In what we expect to be a mixed growth environment and realigning global economy, we believe our portfolio is well positioned and diversified with active positioning across countries and stocks.[5]

We remain overweight **India** given secular, domestic-driven growth supported by a low base, supply-side investments and digitization. We are closely monitoring the delivery of earnings in the market. While there may be pockets of earnings consolidation in the market particularly where valuations are high, we believe the fundamental and structural growth story for India continues to be a mainstay in the economy and a market correction could help normalize equity valuations in certain industries. Key drivers for our secular outlook for India include the economy's ability to better withstand external shocks, continued growth outlook (led largely by increased investment), a large domestic market to drive consumption and a strong institutional framework. India remains one of the most sector- and industry-diverse markets in EM, offering an equity market with both depth and breadth of quality growth opportunities. Our exposure in India includes well-managed financials, industrials and consumer names, along with select IT, health care, energy and materials companies.

We maintain our overweight allocation to **Mexico**. President Claudia Sheinbaum has stated she will prioritize growth, fiscal responsibility and central bank independence. The risk for the market, however, is that the Morena party remains in position to continue to push former President AMLO's reform agenda, such as the recently passed judiciary changes. We think the current growth fundamentals for Mexico remain intact but will closely monitor how this reform agenda is legislated into practice with a particular eye toward its impact on the currently favorable conditions for foreign direct investment and the U.S.-Mexico-Canada Agreement (USMCA). Structurally, Mexico's gross domestic product (GDP) growth has remained strong with no major imbalances, growing real wages and continued investment (led by foreign direct investment and the country's attractive strategic positioning in the global supply chain). We believe many domestically focused companies trade at attractive valuations and are likely to continue to benefit from a strong macro outlook, which could translate into solid earnings growth and yields.

We are overweight **South Africa**. The African National Congress (ANC)-backed coalition government with the reform-oriented Democratic Alliance (DA) has formed a government of national unity (GNU), which could result in more effective governance, and the general improvement in business confidence could boost investment in the country after years of deleveraging. While reforms have taken place over the years—including energy reform, which led to significant investment in the sector and the end of "load-shedding"—the key issue has been on policy continuity and execution. The creation of the GNU and the replacement of dozens of government officials as part of the coalition agreement could improve both the prospects for reform and the capacity for implementation. We believe South Africa is on a better path following the elections and equity valuations remain attractive.

We remain overweight **Brazil.** Brazil's central bank began an interest rate-hiking cycle in September, raising the Selic rate by 25 basis points to 10.75% (the first increase since August of 2022). While most the rest of world is looking to cut rates, Brazil is raising rates as the economy continues to run hot and there is uncertainty around the long-term commitment of the Lula administration to fiscal consolidation. While we are monitoring the interest rate changes and fiscal risk in Brazil, we think this hiking cycle will be relatively short-lived. External balances remain in good shape and equity valuations are at low levels relative to its own history. Within the country our portfolio is focused on companies with quality management and solid earnings growth.

We maintain our structural underweight to **China** relative to other opportunities across emerging markets on concerns of high debt, government intervention and property inventory overhang. The recent policy shifts made by the People's Bank of China led to a significant rally in Chinese equities at the end of September; however, we believe the announcements made so far are unlikely to lead to a marked improvement in the economy's underlying fundamentals given the significant level of debt in the system.

Following the Golden Week holiday, China's National Development and Reform Commission hosted a press conference pledging further moves to boost the economy but the level of and detail around the announced stimulus broadly disappointed market expectations. Over the past year, we have tactically reduced the size of the underweight to the market and we continue to assess the size of the underweight, monitoring whether further policy announcements will translate into higher GDP growth and ultimately earnings growth. We remain selective in our exposure and are invested in companies that we believe have competitive advantages, strong corporate governance and solid medium-term growth prospects.

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

Fund Facts

Launch date	01 July 1993
Base currency	U.S. dollars
Benchmark	MSCI Emerging Markets Net Index

[5] Diversification neither assures a profit nor guarantees against loss in a declining market.

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 I Shares	16.04	13.96	-25.90	3.40	14.24	18.72	-17.05	35.20	5.83	-10.66	-4.30
MSCI Emerging Markets Net Index	16.86	9.83	-20.09	-2.54	18.31	18.42	-14.57	37.28	11.19	-14.92	-2.19

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 to see the latest performance returns for the fund's other share classes.**

Effective 1st November 2021 the Morgan Stanley Investment Funds Emerging Markets Equity Fund was renamed to Sustainable Emerging Markets Equity Fund.

Share Class I 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 funds ability to buy or sell securities.
- Investments in China involves a risk of a total loss due to factors such as government action or inaction, market volatility and reliance on primary trading partners.
- 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.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- 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 September 2024 and subject to change daily.

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INDEX INFORMATION

The **MSCI Emerging Markets Net Index** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging 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 MSCI Emerging Markets Index currently consists of 24 emerging-market country indices. The performance of the index is listed in U.S. dollars and assumes reinvestment of net dividends.

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