

A Sub-Fund of Morgan Stanley Funds (UK)

American Resilience Equity Fund

INTERNATIONAL EQUITY TEAM

Performance Review

In the one month period ending 31 December 2025, the Fund's I ACC shares returned -1.16% (net of fees)¹, while the benchmark returned -1.43%.

For the fourth quarter, the portfolio returned -1.97% while the index delivered +2.75%.

At the start of 2025, during the market drawdown between mid-February and early April, the portfolio's defensive characteristics contributed positively, delivering 500 basis points (bps) of relative outperformance. However, from April onwards market returns became increasingly driven by a narrow set of macro and thematic exposures, most notably cyclicality and artificial intelligence (AI)-linked operating leverage. In this environment the portfolio did not keep pace with the index, resulting in a full-year return of -8.36% versus +9.76% for the S&P 500 Index.

Our approach continues to prioritise businesses with the ability to compound earnings over time, underpinned by strong competitive positions, durable moats, world-class brands and networks, and pricing power. With valuation dispersion elevated and quality as an investment theme trading at a meaningful discount to recent history, we believe the current environment presents a rare opportunity to take advantage of quality on sale. If market focus shifts back towards fundamentals, this would likely provide a favourable backdrop for the portfolio's disciplined emphasis on earnings resilience, capital discipline and sensible valuation.

The largest absolute contributors to performance in the fourth quarter were companies reporting positive quarterly results: **Alphabet** (+149 bps) rose almost 30%, supported by continued strength across its core search and YouTube franchises, improving Google Cloud profitability, and the successful rollout of its latest Tensor Processing Unit (TPU), which reinforced confidence in its AI capabilities; **Thermo Fisher** (+60 bps) exceeded analysts' expectations on organic revenue growth and benefited from a broad health care sector rally as regulatory and pricing risk perceptions eased following the Trump administration-Pfizer agreement; **S&P Global** (+29 bps) raised full-year revenue guidance following sustained strength across its core business areas; **Coca-Cola** (+27 bps) reported strong organic growth for the quarter and further progress toward the near-completion of its well-received refranchising programme; and **Visa** (+16 bps) saw growth in payment volumes top estimates, supported by continued healthy consumer spending.

On the downside, at the strategy level, **AutoZone** (-71 bps) struggled following mixed fiscal year 2026 first quarter results, missing on earnings due to growth investments and a non-cash LIFO (last in, first out) accounting charge. We added to the position on share price weakness. **AJ Gallagher** (-67 bps) and **Microsoft** (-56 bps) detracted in the quarter as both stocks pulled back following strong runs earlier in the year. Shares in animal health player **Zoetis** (-57 bps) were down following third quarter results that fell short of investor expectations, with weaker-than-expected demand and heightened competitive pressures in certain categories promoting cautious guidance and earnings downgrades. Finally, **ADP** (-43 bps) underperformed as softer momentum in its core pays-per-control metric drove multiple compression despite the resilience of its highly recurring payroll franchise.

Stock selection appears as a relative detractor in the fourth quarter partly due to the market's indiscriminate punishing of a diverse range of data-rich and software-enabled business models that has been underway since August, driven by heightened concerns around advanced AI (generative AI [GenAI] and agentic AI) disruption. This weighed on several of the portfolio's overweight subgroups, most notably within information technology, industrials and, to a lesser extent, financials. Within information technology, the portfolio's preferred software group declined 7%, while investor preference for AI infrastructure exposure saw the hardware and semiconductor subsectors both rise 6%. In financials, balance-sheet-light areas held by the portfolio – payments (-2%), insurance brokers (-9%), and exchanges and data providers (-1%) – lagged a +7% gain in banks, which the portfolio does not own. A similar pattern was evident in industrials, where the portfolio is skewed to capital-light professional services – a subsector which returned -11% versus a flat overall sector. Outside these areas, Zoetis' share price fall meant the portfolio lagged the very strong health care sector, while AutoZone was a drag within consumer discretionary, partially offset by strong performance in communication services due to Alphabet.

For 2025 overall, the largest contributors to absolute performance were the cloud hyperscalers **Alphabet** (+267 bps), after its very strong fourth quarter, and **Microsoft** (+100 bps), where the absolute impact was boosted by the large position size. Hyperscaler **Oracle's** (+60 bps) success with its OCI (Oracle cloud infrastructure) business also contributed positively ahead of our sale in the third quarter, an exit driven by the sharp shift in its business model, reduced free cash flow and stretched valuation. The stock is down over 40% since peak. **Booking Holdings** (+35 bps) was strong as, despite periodic investor concerns around potential AI-driven disruption to online travel platforms, resilient global travel demand and effective execution drove earnings upgrades. Fundamentals remain solid for **Philip Morris International** (+29 bps), supported by continued growth in smoke-free products, favourable pricing and positive investor reception to its dividend increase and debt-reduction actions announced in November, although these supportive factors were outweighed late in the fourth quarter by improving risk appetite, which reduced demand for traditionally defensive names.

¹ Source: Morgan Stanley Investment Management. Data as of 31 December 2025.

Accenture (-149 bps) was the largest absolute detractor in 2025. Share price weakness over the year reflects a continuation of sub-trend industry growth, the demand hit from U.S. government cost-cutting initiatives, along with concerns about advanced AI's potential deflationary pressure on industry profit pools, which led to our exit in the fourth quarter. AI disruption concerns weighed on **FactSet** (-99 bps) and **Roper Technologies** (-94 bps), alongside investment-led margin pressure at FactSet and a downgrade to full-year guidance at Roper Technologies. We exited the FactSet position in the fourth quarter but continue to hold Roper Technologies given the company's resilient recurring revenues, strong cash generation and management's view that AI should expand its total addressable market. In health care, **Zoetis** (-107 bps) was weak due to near-term pressures related to it osteoarthritis treatment and investor fear surrounding increased competition, although we continue to view the company as an industry leader with a defensive revenue profile and an attractive pipeline, while **UnitedHealth** (-102 bps) cut and then abandoned its 2025 earnings guidance. We exited the position in the second quarter.

Relative performance for 2025 reflects both the persistence of narrow market leadership among cyclical and AI-infrastructure-exposed segments and the broad-based derating of a diverse range of quality business models, impacting names even where underlying fundamentals remained intact. In information technology, software (+12%), where the portfolio is significantly overweight, delivered a decent positive return for the year but this materially lagged the exceptional gains in semiconductors (+46%) where the portfolio is underweight. A similar dynamic was evident in financials and industrials, where the more resilient payments, insurance brokers and professional services segments were negative, while lower quality, highly cyclical areas including banks (+34%) and aerospace and defence (+42%) delivered unusually elevated returns. Index concentration further impacted relative performance as a small number of stocks accounted for a disproportionate share of benchmark performance, most notably Nvidia, Broadcom, JP Morgan and Meta, which the portfolio has not owned due to its quality and valuation discipline. Outside of these dynamics, health care weakness was due to idiosyncratic stock-specific issues, although we remain supportive of the long-term case for high quality names in specific sub-sectors such as life science, animal and consumer health, while communication services saw relative outperformance. Sector allocation was mildly negative for the year.

Market Review

Equity markets delivered solid gains in the fourth quarter (Q4), closing a year characterised by persistent narrow leadership and pronounced dispersion across sectors and investing styles. The S&P 500 Index rose +2.6% in Q4 and +17.4% for the year. Health care (+12%) led during the quarter, driven by a rebound in pharmaceuticals (+24%); however, ongoing concerns around U.S. policy risk weighed on the overall sector for much of 2025, leaving it behind the index for the year (+14%), along with the other classic defensive sector consumer staples, up just 3% in 2025. Communication services (+7%) also did well in Q4 and was the strongest sector for the year (+33%), supported by continued strength in Alphabet and Meta. Information technology was more subdued in Q4 (+1%), although the sector still outperformed the S&P 500 in 2025 (+24%), largely due to outsized AI-driven gains in semiconductors (+46%). Industrials (+25%) also saw strong performance in 2025, while financials (+15%) and materials (+10%) were up double digits, if lagging the overall S&P 500. Returns within these sectors were highly uneven, with cyclical areas such as capital goods (+26%), banks (+34%), and metals and mining (+80%), respectively, accounting for much of the upside. Weak oil prices meant that energy lagged, returning +1% in Q4 and +8% for 2025.

Portfolio Activity

During the fourth quarter we made one new purchase and three final sales.

We initiated a position in **Ferrari**, a high quality luxury auto franchise with consistent earnings growth, pricing power and exceptional returns on capital (approximately 60% return on operating capital employed). Despite operating in a cyclical and capital-intensive industry, Ferrari benefits from a resilient business model, underpinned by recurring demand from a wealthy client base, a two-year order book and industry-leading gross margins of around 50%.² The shares derated on modest medium-term growth guidance during the quarter, which offered an attractive entry point into a franchise that has compounded earnings at approximately 20% per annum since its initial public offering, with strong revenue visibility and, unlike many of its luxury peers, limited China exposure.

During the quarter, we sold our position in **Accenture**. Despite its exceptional long-term track record of earnings compounding, we are concerned about the growing uncertainty around the net impact of GenAI on industry profit pools. While Accenture is well positioned to support enterprise AI adoption, the pace, scale and economics of that adoption remain unclear, with a risk that AI-driven efficiency gains prove net deflationary for consulting revenues. Given the widening range of potential outcomes and reduced relative conviction versus alternative opportunities in the portfolio, we chose to redeploy capital into higher-conviction names.

We sold out of the small position in **FactSet**, following a reassessment of its quality profile amid emerging structural risks to data aggregation businesses. We see greater clarity and defensibility in other financial services names that we believe should offer better insulation from advanced AI-related risks and more reliable long-term earnings visibility.

Finally, we exited our position in **Constellation Software**. While recent results have been decent, the growing reliance on larger-than-usual acquisitions increases uncertainty around the durability of returns on capital and the consistency of the historic playbook. We also reassessed the company's exposure to AI disruption, where we judge 20%–30% of the portfolio to be at risk directly or indirectly, which matters more when underlying organic growth is only around 2%. With the range of outcomes widening, we chose to reallocate capital toward opportunities with greater visibility on its continued ability to compound earnings over time.

² Source for all Ferrari data: Ferrari company reports; International Equity Team analysis

During the quarter, we added to several positions where we saw attractive valuation opportunities following short-term dislocations. This included recent third quarter additions **Uber** and **Synopsys**, along with **AutoZone** and **Intercontinental Exchange** where there was upside to our price targets. Reductions were also largely valuation driven. We trimmed **ADP** to manage relative valuation risk and maintain flexibility amid macro and technology transition uncertainty, along with **Roper Technologies** as the shares reflected a high degree of optimism at a time when near-term growth visibility has moderated. **Alphabet**, **Microsoft**, **Booking Holdings** and **Thermo Fisher** were also clipped after the share prices rerated on good results.

Looking back over the year as a whole, 2025 saw higher portfolio turnover than is expected for the strategy, reflecting an environment characterised by sharp valuation dispersion, AI-driven narrative shifts, and a number of stock-specific developments. Periods of market dislocation created opportunities to selectively initiate new positions where we believed long-term compounding potential was not reflected in valuations; in addition to **Ferrari**, these included **Synopsys**, **MSCI** and **Uber**. Similarly, we remained agile with existing holdings, adding to several positions where conviction remained high and valuations became particularly attractive, notably **Microsoft** and **Alphabet** in the first quarter after the shares derated on DeepSeek concerns; **Booking Holdings**, **S&P Global** and **Roper Technologies**, which wobbled on AI disruption concerns; and **AJ Gallagher**, **AutoZone**, **Coca-Cola**, **Thermo Fisher** and **Zoetis** where the risk-reward profile remained attractive.

On the other side, we exited a number of holdings where the medium-term outlook had become less compelling, in doing so upgrading the overall quality and resilience of the portfolio and recalibrating the number of positions back towards a more typical level from the top end of its range earlier this year. We also sold Oracle, which returned 40% since our purchase in the first quarter. As in prior years, valuation discipline remained central to position sizing and capital allocation decisions: we trimmed **Booking Holdings** following strong results in the first quarter, and reduced **Microsoft**, **Alphabet** and **Visa** as earnings momentum drove share price strength over the year. We also scaled back **Aon** on relative valuation grounds, along with **Thermo Fisher** after a strong rally second-half rally on good results.

In our view, the actions taken during 2025 have strengthened the overall quality, resilience and long-term compounding potential of the portfolio, leaving it well positioned for an environment in which earnings durability, pricing power and valuation discipline once again matter.

Strategy and Outlook

Quality “on sale”

After a very strong 2025, with the MSCI World Index up 21%, a third boom year after a +19% return in 2024 and +24% in 2023, global equity markets enter 2026 at a pivotal juncture. The close of 2025 was marked by a dynamic tension between those optimistic that artificial intelligence (AI) will drive a visible transformation in corporate profitability in the near term, justifying the massive capital expenditures, and the growing voice of those questioning whether these high expectations can be realised in the near term. Against this backdrop of uncertainty, not just around the path of AI adoption, but also growth, inflation, trade policy, government debt and geopolitics to name just a few, the MSCI World Index continues to trade at around 20x forward earnings, with the S&P 500 Index at 22x, valuations that imply far more certainty than seems to be warranted.³ And these steep valuations rest on the assumption of robust 14% earnings growth for the MSCI World over each of the next two years, driven by further margin expansion from already elevated levels.

A regime of seeming market certainty in a distinctly uncertain world has naturally not been favourable for quality as a style, which has underperformed the broader market to an extent not seen since the dot-com era.⁴ In terms of our outlook, **historically, such periods of quality underperformance have been followed by a meaningful relative resurgence in quality stocks**, which contributes to our view that **quality offers one of the greatest opportunities in markets today**.

In fact, we’d argue many of the companies we own across a range of sub-industries are double-discounted, being punished not just for being “quality” but also viewed as being at risk from advanced AI disruption. This has hit software companies within information technology, a variety of professional services within industrials, and information services within financials. Our view is that the market has taken an indiscriminate view, not differentiating enough between industries and business models. We believe companies such as MSCI, S&P Global, RELX and Experian are not only likely to be robust against the advanced AI threat but should actually be long-term beneficiaries. As such, we disagree with the market about these companies’ prospects. This is not to say that we are complacent; we continue to reassess our holdings’ moats and focus on names where we are most confident about their resilience against advanced AI risks. While their derating has adversely affected performance in 2025, it does improve their prospects going forward.

Our quality portfolio also has exposure to those providing advanced AI, mainly through select hyperscalers – companies that have decent growth prospects even without advanced AI – alongside reasonable valuations, which we believe should limit the downside from any deflation of advanced AI expectations. Where we have limited direct exposure to semiconductors, we prefer businesses that serve as key bottlenecks in the supply chain with broad use cases that are not wholly reliant on generative AI prospects. We are particularly wary of players where planned capital expenditures are highly dependent on debt financing rather than their own cash flow generation. These advanced AI exposures are deliberately balanced by holding traditional defensives such as high quality consumer and health companies.

³ Source for all data cited in the outlook commentary, unless otherwise stated: MSIM and FactSet. Data as of 31 December 2025.

⁴ Source: S&P 500 Quality Index, as at 31 December 2025.

Overall, the portfolio is built around companies with the capacity for sustained earnings growth, supported by pricing power and recurring revenues. These are businesses that have demonstrated resilience through cycles, with lower earnings and price volatility than the broader market, showing a pre-tax return on operating capital employed (ROOCE) of close to 70% for the portfolio versus 28% for the S&P 500 Index, and gross margins at close to 60% versus 37% for the index. In the past, the market has charged an insurance premium for this resilience, with quality significantly pricier than the overall index. This is far from the case today. The portfolio is projected to grow faster than the market, with projected topline growth of over 8% per year over the next two years, well ahead of the S&P 500 Index at 7.1%. Despite the attractive combination of this higher topline growth and its traditional resilience, **the portfolio actually trades at a significant free cash flow discount to the market**, a level of discount not seen in the past decade – a rare opportunity.

Looking forward, we expect fundamentals to reassert themselves, as they have typically done historically. Against the uncertain backdrop, a portfolio of some of the highest quality companies in the world, trading at an unusually discounted price versus the market, suggests a generational opportunity to take advantage of quality on sale. Our conclusion? That this is a great portfolio, full of great companies, that are continuing to deliver resilient earnings growth, with strong fundamentals, but are trading at the wrong price, particularly relative to the stretched market.

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

Fund Facts

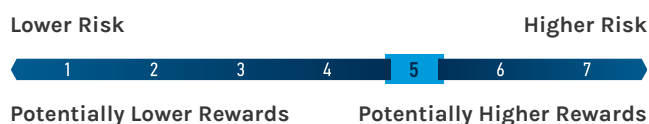
Launch date	31 October 2023
Base currency	Sterling
Benchmark	S&P 500 Index

12 Month Performance Periods to Latest Month End (%)

	DECEMBER '24 - DECEMBER '25	DECEMBER '23 - DECEMBER '24	DECEMBER '22 - DECEMBER '23	DECEMBER '21 - DECEMBER '22	DECEMBER '20 - DECEMBER '21
OEIC American Resilience Equity Fund - I ACC Shares	-8.36	12.21	--	--	--
S&P 500 Index	9.76	27.26	--	--	--

Returns may increase or decrease as a result of currency fluctuations. 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 shares. The sources for all performance and index data is Morgan Stanley Investment Management ('MSIM Ltd'). **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class I ACC Risk and Reward Profile



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- As such this category may change in the future.
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- The Fund is in this category because it invests in company shares and the Fund's simulated and/or realised return has experienced high rises and falls historically.
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- Where information is sourced from ESG third party providers, there may be limitations in the accuracy, completeness and availability of this information. How ESG factors are considered may vary between different investments.
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