Morgan Stanley Investment Funds

Global Brands Fund

Investors should note that, relative to the expectations of the Autorité des Marchés Financiers, this UCITS presents disproportionate communication on the consideration of extra-financial criteria in its management.

INTERNATIONAL EQUITY TEAM

Performance Review

In the one month period ending 31 October 2024, the Fund's Z shares returned -2.74% (net of fees)[1], while the benchmark returned -1.98%.

The portfolio has returned +9.13% for the year-to-date, versus +16.50% for the index. We seek to deliver attractive long-term absolute returns.

The October underperformance was mainly due to stock selection, as outperformance in financials was overshadowed by weakness in consumer staples and information technology. Sector allocation was slightly negative, due to the drag from the consumer staples overweight.

The largest contributors to absolute performance during the month were **Visa** (+30 basis points [bps]), on the back of better-than-expected fourth quarter results; **Booking Holdings** (+27 bps), having reported strong third-quarter results exceeding earnings and revenue estimates, boosted by an increase in travel bookings; and **AON** (+21 bps), as organic revenue growth bounced back to 7% after a weaker period earlier in the year.

The largest absolute detractors were **L'Oréal** (-62 bps), as third quarter results were weaker than anticipated, held back by low consumer demand in China and a poor summer impacting sun care; **Microsoft** (-43 bps), on the back of weak guidance for its cloud business Azure despite delivering robust third quarter earnings; and **Pernod Ricard** (-39 bps), hindered by weak fiscal first quarter 2025 results, driven by challenging U.S. and China spirits markets.

Market Review

Global equity markets declined in October, breaking a five-month streak of increases, with the MSCI World Index returning -1.98% in U.S. dollars (USD) and -0.92% in local currency. Cyclicals were the month's top performing sectors, with communication services (+1%), financials (+1%) and energy (+0.2%) the three sectors that were up in the month. Information technology (-1%) also marginally outperformed the wider index and remains well ahead year-to-date. All other sectors were down in the month and lagging the index. Materials (-6%) continued with its weak year-to-date performance and finished bottom of the pile, whilst the typically defensive sectors, health care (-5%) and consumer staples (-5%), also underperformed along with consumer discretionary (-3%).

In terms of geography, the U.S. (-1%) finished a touch ahead of the index in the month, meaning the other major markets tended to lag. In Asia, Singapore (-3% USD, -1% local) was slightly behind the index, followed by Japan (-4%, +2%), which outperformed in local currency, whereas Hong Kong (-6%, -6%) was the weakest geography. Elsewhere, Italy (-2% USD, +1% local) was in line with the MSCI World, while Spain (-4%, -1%), Germany (-5%, -2%), the U.K. (-5%, -1%), Switzerland (-5%, -3%) and France (-6%, -4%) all lagged.

Portfolio Activity

Portfolio activity is reported at quarter-end.

Strategy and Outlook

The Long-Term Case for Health Care

The health care sector has significantly underperformed the broader market over the past two years, delivering an 18% sector return compared to 49% for the MSCI World Index.[2] Excluding health care's own glamour names – Eli Lilly and Novo Nordisk – the sector's return drops to just 9%, trailing the MSCI World Index by 40%. With this lagging performance in mind, we believe it is a good time to reiterate what attracts us to the sector as a long-term investment.

Reflections on the sector

Firstly, it's important to reiterate the idiosyncratic demand, supply and funding environment that health care stocks have had to grapple with over the past five years. The onset of COVID-19 was certainly a driving force, particularly for the pharmaceutical companies making the vaccines, the life sciences companies providing testing kits, and the health care equipment companies manufacturing and supplying personal protective equipment (PPE) and other life-sustaining products such as ventilators. The

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 October 2024.
[2] Source: FactSet. Data as of 31 October 2024. Cumulative returns.

unwinding of this cyclical distortion, however, has been significantly less wonderful for companies' revenues, particularly in bioprocessing where acute overstocking of raw materials and vaccines occurred amid uncertainty over the pandemic's duration. Across the sector more broadly, companies have since faced rapidly rising costs, increasingly fragmented supply chains, a tighter funding environment, and weakness in China[3] due to a lack of government and private funding. Investors' recent preference for mega-cap growth stocks, coupled with political pressures from the U.S. presidential election, have also been further headwinds.

Despite these recent challenges, in our view, several factors drive a strong long-term outlook for health care:

- **Rapidly ageing global population.** The World Health Organisation projects that by 2050 the number of people over 60 will double to more than 2 billion, while those over 80 will triple to 436 million.[4] Wisdom isn't the only thing that comes with age; health spending typically increases.
- **Untapped market opportunities.** By 2050, two thirds of the world's elderly will reside in low- to middle-income countries, a dramatic shift from current trends in wealthier nations like Japan, where 30% of the population is already over 60.[4] This offers promising opportunities for those companies able to effectively pivot to where the growth is.
- **Non-discretionary nature of health care demand**. The products and services the sector offers are essential, regardless of economic conditions, making it more resilient to downturns than most sectors.
- **Innovation and digital transformation offer strong potential.** Advances in telemedicine, drug discovery, personalised medicine and genomics unlock new opportunities, while technologies like AI, electronic health records and remote monitoring are improving efficiency and patient outcomes.

Quality characteristics

On our two favoured quality metrics, ROOCE (return on operating capital employed) and gross margin, health care ranks among the top sectors. Additionally, it has delivered the second highest earnings per share (EPS) growth of any sector in the index over the past 20 years.[5] Importantly, due to the sector's resilience, this growth has been remarkably steady, with consistent relative earnings outperformance in negative years for the index.[5] The market has recently seemed to place very little value on predictability given the recent benign economic backdrop and the outperformance of cyclical stocks. In our view this is misguided, as predictability often demonstrates its worth just when investors least expect they need it.

Avoiding patent certainty…

As is the case with other sectors, we tend to find high quality compounders in certain sub-sectors and industries. While the health care sector's general lack of cyclicality lends itself to predictability in the short to medium term, we find it challenging to maintain confidence in all sub-sectors over the long term. A sizeable proportion of the health care sector is pharmaceutical and biotech companies, where high returns are primarily a result of patent protection – it is the patents that are the main intangible assets. However, these intangible assets fade away, as when a drug goes off-patent it is exposed to generic competition, which often results in a dramatic decline in sales – often up to 80%[6] – as generic versions undercut the originator on price. A new patented drug is needed to make up for the shortfall in revenues, but this requires a long research and development (R&D) process, which may or may not be profitable and is certainly not predictable. As such, pharmaceutical companies tend to not meet the high quality bar we maintain for our Global portfolios.

…and single product dependency

A key tenet of our investment philosophy is that compounding wealth over time requires a sharp focus on downside risks, which is doubly important when a company is singularly reliant on one product. GLP-1 producers are a prime example, with over 70% of leader Novo Nordisk's sales from GLP-1 medications.[7] While these drugs have enormous potential, our concern is that they too face patent expiry and in time likely extremely aggressive competition – if consensus numbers are anywhere near right about the size of the market. There's also the risk that governments and insurance companies may refuse to pay for patients to receive these drugs, limiting the potential opportunity size. With a price-to-earnings ratio (P/E) approaching 30x the next 12 months projected earnings, Novo Nordisk is significantly pricier than the 15x of a typical non-GLP-1 pharma company.[8] This elevated valuation renders the company even more vulnerable to these potential risks, currently making it an unappealing prospect for our quality portfolios.

Finding high ROOCE and growth without patent or concentration risk

We look for recurring revenues through consumables or services, where the incentive to change supplier is very low. Examples include "razor-razor blade"[9] business models found in providers of diagnostic tests, or in high quality mission-critical products and services that, for reasons of safety, regulatory compliance or scientific integrity, require a strong competing reason to switch suppliers.

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3 We are beginning to see signs of stabilisation and we believe the industry is positioned for future growth, given the continuing shift to more complicated drugs and gene therapies.
4 Source: World Health Organization (WHO) 1 October 2024. Available at www.who.int/news-room/fact-sheets/detail/ageing-and-health
5 Source: FactSet.
6 Source: "Effect of Patent Expiry on the Performance of Innovator Multinational Pharmaceutical Companies in a Low Middle Income Country", Farrukh Khalil, Joseph Odhiambo Onyango, Frontiers in Medical Technology 2022 April 4. Available at https://pmc.ncbi.nlm.nih.gov/articles/PMC9014174/
7 Source: Novo Nordisk company reports.
8 Source: FactSet, as of 30 September 2024.
9 A company using a "razor-razor blade" business model sells a core product (e.g. razors) at a low margin while also selling a related consumable product (e.g. razorblades) at a high margin to drive recurring revenue.

As an example, we hold Steris, a leading global provider of infection prevention products and services. Steris sells sterilisers and the associated consumables and services required to sterilise surgical instruments. For obvious reasons this is not something that you risk getting wrong to save a few cents, particularly given these products represent a low proportion of its customers' costs. As a result, customers tend to stick with this demonstrated high quality supplier. The company also provides outsourced sterilisation services for medical device producers. Again, a low cost but vitally important activity for its customers that notably is written into regulatory filings, meaning an expensive and time-consuming process to change supplier and an expensive and time-consuming process for those considering entering the market.

Charlie and Luna[10]

We believe global animal health is an attractive non-cyclical market largely without the patent and concentration risks we see in pharmaceuticals and biotech. Pets (like Charlie and Luna) need care, and owners do indeed care about their pets: a good recipe for resilience and growth. The industry was valued at US$304 billion in 2023 and is expected to grow at a compound annual growth rate of 6.8% to 2032.[11] We hold Zoetis, the world's leading, diversified, animal health company that develops, manufactures and commercialises vaccines, medicines and diagnostics for both pets and livestock. Its direct salesforce is a key barrier to entry, since most competitors are too small to justify having one. Generic drug penetration is very low, payment is out of pocket and customers are extremely fragmented with little incentive to change brands or use generics, particularly as prescriptions are issued by vets.[12] It is a very high quality company, with a return on operating capital more than twice that of the average company in the index at 53%, with pricing that has increased 2%-3% per annum, and supported by positive volume growth.[12] The earnings are resilient, having risen every year over the last decade, as against the MSCI World Index, which has seen two earnings falls in the last 10 years.[5]We consider this an unusual company in the health care sector, with the characteristics we look for to help support steady long-term compounding.

Diversified with a difference: scale and network effects

Our largest health care holding is UnitedHealth, the biggest U.S. health insurer with 55 million members and a 15% market share.[12] Well diversified, the company also owns a health care services business that includes general practitioner (GP) clinics, data services and a pharmacy benefit manager. Acting as an intermediary in the health system, the company operates between the buyers (employers, government) and the providers (hospitals, clinics, drug manufacturers). Leveraging its considerable membership scale, it achieves discounts from providers, creating a two-sided network with high barriers to entry. Further, the ability to vertically integrate into primary care GPs helps align financial incentives with doctors and generates efficiencies by paying based on quality of outcomes rather than volume of procedures. We believe this is a high quality, non-cyclical business which can compound attractively due to its membership scale and two-sided network effect.

Quality and resilience at a reasonable price

In a concentrated broader market with what we view as generally high valuations on lofty earnings expectations, we feel the risks to the market are appreciably higher than many anticipate. Our health care holdings are anchored by a focus on steady compounding, reasonable valuations and high returns on operating capital. The high quality attributes we prioritise in our health care holdings have historically contributed to consistent performance in difficult economic times, and we believe they are well positioned to continue to do so.

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

Fund Facts

Launch date	30 October 2000
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	9.13	16.53	-17.31	22.35	12.75	29.32	-2.01	26.06	5.16	5.75	5.44
MSCI World Net Index	16.50	23.79	-18.14	21.82	15.90	27.67	-8.71	22.40	7.51	-0.87	4.94

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.**

5 Source: FactSet.
10 The most popular dog and cat names in the U.S. Source: "The Most Popular Pet Names of 2023 in Each U.S. State" Chris Corlew, Mental Floss, 16 October 2024. Available at https://www.mentalfloss.com/posts/most-popular-pet-names-each-state#:~:text=Instead%20of%20Fido%2C%20the%20top,top%20five%20spots%20for%20boys
11 Source: Global Market Insights, June 2024.
12 Source: International Equity Team research.

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 funds 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 31 October 2024 and subject to change daily.

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INDEX INFORMATION

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