

Morgan Stanley Investment Funds

# Japanese Small Cap Equity 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.

**JAPANESE EQUITY TEAM**

## Performance Review

In the one month period ending 31 October 2024, the Fund's Z shares returned -5.02% (net of fees)<sup>1</sup>, while the benchmark returned 0.39%.

In October, the overall Japanese stock market closed higher than the previous month. The Japanese small-cap market also rose. Early in the month, the market rose mainly on the back of strong U.S. economic indicators and the depreciation of the yen against the U.S. dollar. In the middle of the month, the market declined mainly because of disappointing financial results of overseas semiconductor-related companies, which triggered the selling of related sectors. Later in the month, the market temporarily declined amid uncertain political trends, but rose after the House of Representatives election, as well as on the back of the depreciation of the yen against the U.S. dollar.

By sector, the portfolio was positively contributed to by our underweight position in real estate, while it was negatively affected by our underweight position in utilities. At a stock level, Dexerials, which manufactures and sells bonding materials and optics materials, and NEC Networks & System Integration, a system integrator with strengths in the communications field, positively contributed to the portfolio. On the other hand, it was negatively affected by AnyMind Group, an end-to-end commerce enablement company, and BuySell Technologies, which is engaged in the purchase and sale reuse business.

## Market Review

The government's DI (diffusion index) for current economic conditions in September (seasonally adjusted) fell by 1.2 points from the previous month to 47.8. The DI for future economic conditions in September (seasonally adjusted) also declined, dropping by 0.6 points from the previous month to 49.7. The inflation-adjusted real wage index fell 0.6% year-on-year in August, down for the first time in three months. As inflation remains high, there is a possibility that consumption may decline if wages fail to keep up with price increases.

The Bank of Japan (BOJ) decided at its 30-31 October monetary policy meeting to leave the overnight unsecured call rate at around 0.25%. While maintaining its normalization policy, the BOJ also expressed concern over overseas economies and market developments. At the recent policy board meeting, the BOJ reiterated its stance of supporting the stability of the economy and prices with a view to achieving the price stability target of a 2% increase in the consumer price index. We believe that speculation of an early interest rate hike will mount if the yen weakens again.

## Portfolio Activity

During the month, we increased shares in Rakuten Bank, Japan's largest internet bank, and Tomy, which is a toy manufacturer. On the other hand, we decreased our position in BuySell Technologies, which is engaged in the purchase and sale reuse business, and NEC Networks & System Integration, a system integrator with strengths in the communications field. Among individual names, our top holdings include Sansan, a sales-focused DX (digital transformation) service provider for the corporate sector; Dexerials, which manufactures and sells bonding materials and optics materials; and Maruwa, a company that develops and produces ceramic products.

## Strategy and Outlook

We expect the U.S. economy, which has a significant impact on Japanese stocks, to remain strong amid the Federal Reserve's monetary policy shift away from prioritizing inflation. We are carefully following the 2024 U.S. presidential and congressional elections given the likely impact on trade policy. On the other hand, from Japan's domestic perspective, we will be paying attention to foreign exchange market movements as well as the monetary policy stance of the Bank of Japan, in addition to real wages and private consumption.

We continue to focus on growth potential, an advantage of small-cap stocks, using a bottom-up approach. As the announcement of corporate earnings for the July-September 2024 period has begun gradually, in the evaluation of small-cap stocks, we will conduct research to identify companies that have the potential to achieve medium- to long-term growth, while paying attention not only to superficial performance figures but also to underlying supply-demand trends and changes in the competitive environment. Considering external factors such as Japan overcoming the deflation environment and the Tokyo Stock Exchange's request to increase corporate value, we are also conducting further extensive research among companies that have not previously been considered growth companies in the past but now have potential for growth through a business portfolio transformation.

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 31 October 2024.

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

## Fund Facts

Launch date	07 April 2022
Base currency	Japanese yen
Benchmark	MSCI Japan Small Cap Net Return Index (JPY)

## 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	2.72	11.04	--	--	--	--	--	--	--	--	--
MSCI Japan Small Cap Net Return Index (JPY)	13.02	21.09	--	--	--	--	--	--	--	--	--

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.**

## 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.

- 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

The **MSCI Japan Small Cap Index (JPY)** is a free-floated adjusted market capitalization weighted index that is designed to track the equity market performance of the small cap segment of the Japanese market. The MSCI Japan Small Cap Index (JPY) is constructed based on the MSCI Global Investable Market Indices Methodology, targeting a free-float market

capitalization coverage of approximately 14%.

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