

## Morgan Stanley Funds (UK)

## Global Sustain Fund

## INTERNATIONAL EQUITY TEAM

## Performance Review

In the one month period ending 30 November 2023, the Fund's I ACC shares returned 6.21% (net of fees)<sup>1</sup>, while the benchmark returned 4.84%.

The portfolio is behind the index for the year-to-date, returning +10.38% versus the index's +12.12%.

The November outperformance was due to both stock selection and sector allocation. For stock selection, strength in health care and industrials more than offset weakness in financials. Within sector allocation, the benefit from the information technology overweight and the portfolio's avoidance of energy easily counteracted the drag from the overweight in health care.

The largest contributors to absolute performance during the month were SAP (+72 basis points [bps]), Microsoft (+50 bps) and Accenture (+48 bps). The largest absolute detractors were Becton Dickinson (-39 bps), Steris (-10 bps) and AIA (-10 bps).

## Market Review

After a three-month dip, November saw a strong rebound by global equity markets, with the MSCI World Index steadily rising during the month and ending up +9.4% in U.S. dollars (USD) and +8.3% in local currency, its best monthly performance in over two years. The market seems to have concluded that the federal funds rate has peaked for this cycle, with four to five rate cuts now priced in for next year, as against two to three a month ago. The favourable U.S. consumer price index inflation reading in November (3.2% year-on-year overall, and 4.0% for the core index) also helped sentiment. The MSCI World Index is now up +18.0% year-to-date in USD and +18.2% in local currency. Looking at sectors, the growth-tilted, artificial intelligence-fuelled information technology (+14%) sector was the strongest performer in November, adding further to its impressive year-to-date return (+47%). Other cyclical sectors were also strong; consumer discretionary, financials (both +11%) and industrials (+10%) were all up double digits. The portfolio's key defensive sectors, health care (+6%) and consumer staples (+4%), unsurprisingly lagged in this cyclical rally, although both sectors were ahead of energy (0%), which struggled amid falling oil prices.

The geographical performance pattern was also varied in the month. The U.S. (+9%) was close to the index in the month. In euroland, Spain (+15% USD, +11% local currency) and Germany (+13%, +10%) outperformed, whilst Italy (+11%, +7%) and France (10%, +6%) were weaker in local currency. Elsewhere in Europe, Switzerland (+9% USD, +4% local) and the U.K. (+7%, +2%), while close to the overall index in USD, struggled in local currency terms. In Asia, Japan (+9% USD, +6% local) was stronger, while Hong Kong (+0%, +0%) and Singapore (+2%, -0%) finished bottom of the pack.

## Portfolio Activity

Portfolio activity is reported at quarter-end.

## Strategy and Outlook

**GLP-1: the weight of speculation**

Obesity is one of the most prevalent health crises, with almost a quarter of the global population expected to be classified as obese by 2035, up from 14% in 2020.<sup>2</sup> Beyond the mental and physical impacts that obesity poses to the individual, it has far-reaching implications for the global economy: the negative macroeconomic impact is estimated to be 3.6% of U.S. gross domestic product with a potential \$1.24 trillion in indirect costs from lost productivity.<sup>3</sup> GLP-1 (glucagon-like peptide 1) drugs have been heralded as game changers in tackling obesity, with certain drug manufacturers building out capacity following recent U.S. Food and Drug Administration (FDA) approvals.<sup>4</sup>

GLP-1 is a natural hormone released to the gut and brain in response to food, helping to regulate blood sugar by stimulating insulin-producing cells in the pancreas when blood sugar levels get too high. GLP-1 analogues have been around since 2010, largely as a treatment for Type 2 diabetes. What's new? Previously, when injected, GLP-1 did not last long enough to reach the pancreas. The new drugs on the market have managed to solve this problem. This is a significant leap forwards in tackling obesity; studies show that it reduces body weight by 10% to 20%, may reduce consumption volume by up to 50%, and may cause patients to avoid more processed foods and snacks when taking GLP-1. Beyond this, patients have anecdotally reported a reduction in consumption of alcohol, drugs and tobacco, as GLP-1 drugs can weaken the brain's association between stimulus and feelings associated with pleasure.

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 30 November 2023.

<sup>2</sup> Source: Redburn Atlantic and World Obesity Atlas 2023.

<sup>3</sup> Source: Morgan Stanley Thoughts on the Market podcast, "Anti-Obesity Meds Could Bite Into Food Sales", 30 November 2023.

<sup>4</sup> Source: Eli Lilly "FDA Approves Lilly's Zepbound™ (tirzepatide) for Chronic Weight Management, a Powerful New Option for the Treatment of Obesity or Overweight with Weight-Related Medical Problems" press release, 8 November 2023.

This has led to interesting reading on the potential impact of widespread use of this medication across multiple industries, e.g., airlines saving on fuel given lighter passengers.<sup>5</sup> The market has recently rewarded the GLP-1 drug manufacturers as immediate beneficiaries and medtech and U.S. food and beverage stocks as losers. As long-term investors conducting bottom-up, in-depth research, we believe that the medium- to long-term impact on our portfolios is minimal, but that is not to understate the broader effect. Today less than 1% of the U.S. population is on GLP-1 drugs for weight loss, while approximately 30% of the U.S. population is clinically obese. In the interest of keeping things simple, we hypothesise that approximately 10% of the U.S. population may be on the drug come 2034.

### **Consumer Staples**

Some analysts estimate that GLP-1 drugs could reduce calorie intake by 15% to 20%. Extrapolating this figure and projecting that 25 million to 50 million Americans may be taking the drug by 2030 could see the nation's calorie intake reduce by 1% to 3%.<sup>6</sup> Whilst the evidence of GLP-1 drugs negatively affecting consumption in these categories remains unproven, the advent of these new drugs may significantly challenge the U.S. food/beverage industry's ability to compound at mid-single-digit rates going forwards. The market has made its judgement, with the U.S. food, beverage and tobacco sub-sector down 9.9% year-to-date, trading at a price-to-earnings discount of over 10% relative to the U.S. market.<sup>7</sup>

In terms of the impact on our portfolio, we do not own food manufacturers, as we consider them low-growth, low-return businesses with limited pricing power. Coca-Cola may, at first glance, appear to be an example of a company at risk; but an assessment of the business model suggests otherwise. Almost 70% of its product mix comes from no- or low-calorie drinks – categories that are less likely to be affected – while around 80% of sales come from outside the U.S.,<sup>8</sup> where the uptake of the drugs may well be slower. While there is a tail risk around tobacco and alcohol, the evidence of the GLP-1 drugs negatively impacting consumption in those categories is yet to be proven.

### **Health Care**

In health care, the immediate winners have been the companies that manufacture GLP-1 drugs, with one of the two main providers now worth more than the entire Danish domestic economy.<sup>9</sup> We don't hold these companies in our global portfolios as pharmaceutical companies typically don't meet our high quality criteria; whilst they can generate significant profits on a patented drug – GLP-1 analogues are a case in point – these revenues are reliant on patent protection. Once this patent expires, sales and profits may be decimated by generic competition. This issue is exaggerated further when a company is dependent on a small number of drugs to fuel its success.

The potential impact on life science and health care equipment providers is more relevant for our portfolios. We believe that the negative share price reaction for at least some diabetes-related products may have been overdone; ultimately, patients with diabetes will still need to monitor blood sugar levels and administer their medication. Abbott Laboratories, a medical devices and health care company we own, recently reported that those patients who used their glucose monitors alongside taking GLP-1 medication had higher therapy compliance. Meanwhile IQVIA, a clinical trial provider, that we hold has benefited from its involvement in GLP-1 drug trials and may also continue to benefit throughout the lifecycle of the drugs should the manufacturers wish to monitor "real-world" evidence, monitoring usage patterns and side effects. Thermo Fisher – another of our holdings – may benefit from providing the sterile injectables for GLP-1 drugs, with potential second-degree benefits in its laboratory equipment business and sale of bioscience reagents if there is reinvestment in research and development as a result of increased revenues flowing to the health care sector.

### **The weight of speculation**

While the hype around GLP-1 analogues continues, the long-term side effects of the drugs are not yet known. Some initial studies have suggested an association between GLP-1 drugs and gastrointestinal side effects and/or loss of muscle mass, and the FDA has committed to a review after accounts of depression from some users. Drug manufacturers are already working on improvements to address these issues. From a practical viewpoint, production capacity and insurance reimbursement factors may restrict the extent of penetration, not to mention the time it can take to reach peak penetration – it took 20 years in the case of statins.<sup>10</sup> U.S. insurance companies will have a key part to play, as take-up will be underpinned by their willingness to cover prescriptions. Outside the U.S., uptake will also rely on health care systems agreeing to provide coverage, and on local regulatory approvals.

Whilst the emergence of GLP-1 drugs has caused waves across industries, we remain sanguine about its effect on our portfolios and will continue to monitor developments. Long term, what will matter is the companies' fundamentals, their future earnings' potential and the sustainability of their long-term returns.

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

<sup>5</sup> Source: Barron's "Why the weight-loss drug hype looks overdone", 2 October 2023.

<sup>6</sup> Source: Barron's "Weight-loss drugs are threatening food stocks. The fears are exaggerated", 6 October 2023.

<sup>7</sup> Source: FactSet. As of 31 October 2023.

<sup>8</sup> Source: MSIM International Equity Team research and Company Annual Report 2022.

<sup>9</sup> Source: Bloomberg News "Novo's value surpasses Denmark GDP after obesity drug boost", 9 August 2023.

<sup>10</sup> Statins are a medication used for treating elevated cholesterol.

## Fund Facts

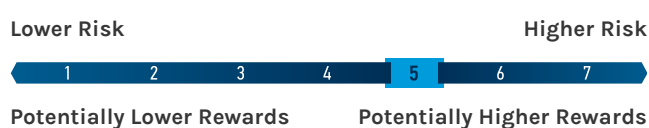
Launch date	23 September 2019
Base currency	Sterling
Benchmark	MSCI World Net Index

## 12 Month Performance Periods to Latest Month End (%)

	NOVEMBER '22 - NOVEMBER '23	NOVEMBER '21 - NOVEMBER '22	NOVEMBER '20 - NOVEMBER '21	NOVEMBER '19 - NOVEMBER '20	NOVEMBER '18 - NOVEMBER '19
OEIC Global Sustain Fund - I ACC Shares	9.88	-6.94	16.42	11.43	--
MSCI World Net Index	6.29	-0.97	22.89	10.96	--

**Past performance is not a reliable indicator of future results.** 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 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 I ACC Risk and Reward Profile



The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- 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.
- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- 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 and 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 Stock Connect program 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 2023 and subject to change daily.

## 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.

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