

Morgan Stanley Investment Funds

# Calvert Sustainable Developed Europe Equity Select Fund



## Performance Review

In the three month period ending 31 December 2023, the Fund's Z shares returned 7.22% (net of fees)<sup>1</sup>, while the benchmark returned 6.44%.

MS INVF Calvert Sustainable Developed Europe Equity Select Fund (the Fund) is designed to offer long-term shareholder return through exposure to companies that are leaders in the environmental, social and governance (ESG) landscape, or improvers in addressing environmental and social challenges and managing material ESG risks. Calvert believes that companies that demonstrate leadership and/or improvement in the management of financially material ESG risks and opportunities offer long-term value creation for shareholders. The investment approach identifies ESG leaders and improvers using a proprietary quantitative and qualitative analysis to construct a portfolio that manages active risk relative to the market benchmark, the MSCI Europe Index. The portfolio also aims to maintain a carbon footprint 50% lower than the benchmark and higher levels of board gender diversity compared to the benchmark.

The biggest contributors to fourth quarter outperformance were the portfolio's underweights to energy and consumer staples, combined with security selection in health care. Meanwhile, communication services dragged on the Fund's overall performance.

The underweight to energy is driven in part by the Calvert Principles for Responsible Investment research framework, which identifies outsize environmental risks among most energy companies that are often not addressed using appropriate management systems or strategies for the transition away from fossil fuels.

During the quarter, an underweight to consumer staples helped drive the Fund's excess return through both allocation and security selection. Within security selection, Nestle was not held by the portfolio because it does not meet the Fund's ESG criteria. Meanwhile, L'Oreal, which is a leader among waste management, materials use and packaging practices, had an overweight.

In health care, strong security selection performance was the result of avoiding positions in pharmaceutical firms Sanofi and Bayer. Neither of these companies meet our ESG leadership criteria for this strategy.

Communication services detracted from the Fund's overall performance. In particular, Orange SA, a leader in human capital management and diversity, Telenor ASA, a leader in privacy and data security, and Vodafone Group, a leader in human capital management and data security management, were relatively flat this quarter against a rising sector.

Along country lines, an underweight to the U.K. lifted returns, while an underweight to the Netherlands hampered them. Security selection within France and the U.K. also lifted returns, while the Netherlands once again detracted.

## Market Review

As 2023 came to a close, the question that had dogged markets the entire year — could the U.S. Federal Reserve (Fed) defy history and bring the U.S. economy in for a soft landing without sparking a recession — seemed about to be answered in the affirmative, and it appeared it might be time to lower the landing gear and turn on the seat belt sign. Capping a year of abrupt market reversals, one month into the fourth quarter investor sentiment seemed to change from "the sky is falling" to "everything's coming up roses," and it remained positive through the end of the year.

The quarter started, however, on a sour note. The equity downturn that began in August stretched into October — sparked by investor fears the Fed would keep interest rates higher for longer than previously expected. Virtually every major U.S. and global stock index was in negative territory during the first month of the quarter.

But as October faded into November, investors seemed to find the Goldilocks economic numbers they were looking for — not too hot, not too cold, with the U.S. economy still strong but cooling just enough for the Fed to end its monetary tightening program. On 3 November, a weaker-than-expected jobs report from the U.S. Bureau of Labor Statistics showed job growth was moderating. The same government agency later reported that inflation, as measured by the consumer price index, was continuing its downward trajectory, slowing to 3.2% year-over-year in October and 3.1% in November.

Recognizing its efforts to slow the economy were working, the Fed held rates steady at its November and December meetings, with Chair Powell noting for the first time that rate cuts were "a topic of conversation" at the December meeting. By the end of the quarter, investors were anticipating 75 basis points of rate cuts in 2024, with the first cut as early as March. As the 10-year Treasury yield declined nearly 1% during November and December,<sup>2</sup> investor fears of "higher for longer" had morphed into hope for "high for shorter."

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2023.

<sup>2</sup> Source: FactSet. Data as of 31 December 2023.

Consumers did their part as well. Defying predictions that stressed consumers would tighten their holiday spending, they continued to follow the American mantra: When the going gets tough, the tough go shopping. Mastercard reported that holiday retail sales rose 3.1% year-over-year, on par with pre-pandemic trends.

The result of all this good news was that stock prices came roaring back in November and December. Unlike the rally in the first half of 2023 — which was dominated by a group of U.S. stocks that Bank of America analyst Michael Hartnett dubbed the “Magnificent Seven” (Microsoft, Amazon, Meta, Apple, Alphabet, NVIDIA and Tesla) — the year-end rally was broad-based, both geographically and by market cap.

While U.S. equities outpaced most of the world for much of 2023, the November-December rally was global. The S&P 500 Index, Nasdaq Composite Index, MSCI EAFE Index and MSCI ACWI (All Country World Index) ex USA each rose about 9%-10% in November and 4%-5% in December.

The MSCI Emerging Markets Index — held back by its significant Chinese component — was not far behind, returning 8.00% in November and 3.91% in December. Dogged by an ailing real estate sector and the failure of many Chinese industries to bounce back after COVID restrictions were lifted, China’s stock market lagged behind most other markets for the fourth quarter and the year as a whole.

The November-December rally also marked a comeback for small-cap stocks, as investor enthusiasm broadened beyond the Magnificent Seven. The small-cap Russell 2000 Index and its growth and value variants, which had significantly lagged large-cap performance for much of 2023, all performed on par with large-cap indexes in November and trounced them in December — when the Russell 2000 delivered more than double the return of the large-cap Russell 1000 Index.

In an interview just five days into the new year, Treasury Secretary Janet Yellen expressed what many investors were feeling as the fourth quarter of 2023 came to a happy conclusion: “What we’re seeing now I think we can describe as a soft landing, and my hope is that it will continue.”

## Portfolio Activity

There was no significant portfolio activity to report during the period.

## Strategy and Outlook

As we look ahead with a focus on major factors that are shaping a multidecade transformation of the global economic system relevant to responsible long-term investors, four areas have the potential for the greatest impact from a risk and opportunity perspective: i) Changes to the global energy system — both in terms of the existing fossil fuel system and the development of a distributed, lower-carbon system — are accelerating and revealing challenges for companies globally; ii) Demographic changes, including educational attainment, continue to impact the workforce, as well as the ultimate size of consumer markets globally, with the vast majority of companies yet to fully adapt to these massive changes; iii) Higher costs, including interest rates, wages and raw materials, present unique challenges to every industry and will result in greater differentiation between companies that are able to manage their cost structure and improve productivity and those that are less efficient or trapped in a high fixed operating cost model; iv) Finally, various forms of pricing of externalities — either by governments or through market action — are taking effect and will act to raise costs and influence corporate and consumer behavior.

With this future state in mind, leadership on issues of sustainability across industries requires a company to evolve its product strategy, refine its corporate strategy and continually strengthen its ability to provide effective oversight and execution of the sustainable transition before us.

MS INVF Calvert Sustainable Developed Europe Equity Select Fund strategy is built on our belief that companies addressing the sustainability challenges presented by this multidecade transformation are better positioned to deliver shareholder return and positive societal outcomes. The Fund seeks to invest in companies that are leaders and improvers at managing this future business state, either through their operations and corporate strategy, or through the products and services that they offer.

Using ESG performance on financially material issues as the primary criteria for stock selection, the Fund uses a combined quantitative and qualitative approach process to identify and invest in the best-performing companies in the Calvert Research System from an ESG standpoint. The portfolio is then optimized to manage risk, lower the overall greenhouse gas emissions of the portfolio and increase the board level diversity of the portfolio against the benchmark. The result is an actively managed portfolio of large-cap European stocks designed to provide risk-controlled returns in excess of the MSCI Europe Index, with exceptional performance on environmental and social issues.

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

## Fund Facts

Launch date	08 April 2022
Base currency	Euro
Benchmark	MSCI Europe Net Index (EUR)

## 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	18.34	18.34	--	--	--	--	--	--	--	--	--
MSCI Europe Net Index (EUR)	15.83	15.83	--	--	--	--	--	--	--	--	--

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 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.

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.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities

- Sustainability factors can pose risks to investments, for example: impact asset values, increased operational costs.
- 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 December 2023 and subject to change daily.

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### INDEX INFORMATION

The **MSCI Europe (Net) Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. As of September 2002, the MSCI Europe Index consisted of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the

Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **Nasdaq Composite Index** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. It is used as an indicator of the performance of stocks of technology companies and growth companies. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not exclusively a U.S. index.

The **MSCI EAFE Index (Europe, Australia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada. 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 EAFE Index currently consists of 21 developed market country indices. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The **MSCI All Country World Ex USA Index** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets, excluding the U.S. 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 **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

The **Russell 2000® Index** is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The **Russell 1000® Index** is an index that measures the performance of the 1,000 largest companies in the Russell 3000 Index.

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