Morgan Stanley

INVESTMENT MANAGEMENT

Global Brands Capital Return

MARKETING COMMUNICATION | July 3 2023

Dear client,

Given our commitment to transparency, we are writing to you as a Morgan Stanley Investment Funds (MS INVF) Global Brands Fund investor with a minor update to our investment criteria. From now on we shall be more flexible regarding the need for companies in the MS INVF Global Brands Fund to pay a dividend.

Our philosophy has been consistent over the 27 years since the inception of the strategy. We have endeavoured to own the high-quality companies which can grow steadily over the long term while sustaining high returns on operating capital employed, thanks to their strong intangible assets and pricing power. We also require companies to be run by people we can trust to manage the business prudently over the long term and to allocate capital well. We aim to purchase and hold companies at reasonable valuations, agreeing with Charlie Munger's observation that there is no great company that cannot become a lousy investment if you pay too much for it.

This intellectual bedrock has never changed and is extremely unlikely to change in the future, as it is based on what Albert Einstein described as the 8th Wonder of the World, the power of compound interest. Our clients have seen the benefit of attractive compounding of their initial investment over the long term with an asymmetric profile.

While our approach hasn't changed over time, the source of the compounders has. A decade ago, over 60% the portfolio was in Consumer Staples. Now, that has fallen to about a quarter, with another quarter in the Software and IT Services element of Information Technology and close to 20% in non-pharma Health Care. Life has become more complicated in parts of the Consumer Staples universe, notably Tobacco and Food. Meanwhile, the Cloud has brought recurring revenues to the world of Technology, for instance Office365 and Azure for Microsoft. In addition, a mixture of self-help and corporate actions in the Health Care sector has created a pool of high-quality compounders amongst the Life Science and Medical Technology players, notably Danaher and Thermo Fisher.

Another shift is that we have become selectively more positive about the use of capital for acquisitions. Good acquirers generally focus on relatively small targets, and can drive organic growth from the acquisitions, for instance by plugging them into a distribution network. The smaller deals are also often better priced. Danaher, Accenture and L'Oréal are three of the companies that we believe have delivered decent returns on their acquisitions within a few years, creating significant value for shareholders. That said, we still remain cautious when most companies announce large deals, particularly when they deploy buzzwords such as "accretive" or "strategic".

Given this more positive attitude to acquisitions, in a few special cases, and a shift in weighting away from Consumer Staples to sectors where buy-backs are more common, going forward we shall be more flexible regarding the need for companies in the MS INVF Global Brands Fund to pay a dividend. The essential requirement to prioritise long-term organic growth at high returns on operating capital has not changed, but we have learnt to become a little more open minded about the use of capital for acquisitions and for steady share buybacks.

Best regards,

William Lock
Managing Director, Head of the International Equity Team
Morgan Stanley Investment Management

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- 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.
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