

Morgan Stanley

INVESTMENT MANAGEMENT

Global Stewardship Report 2019

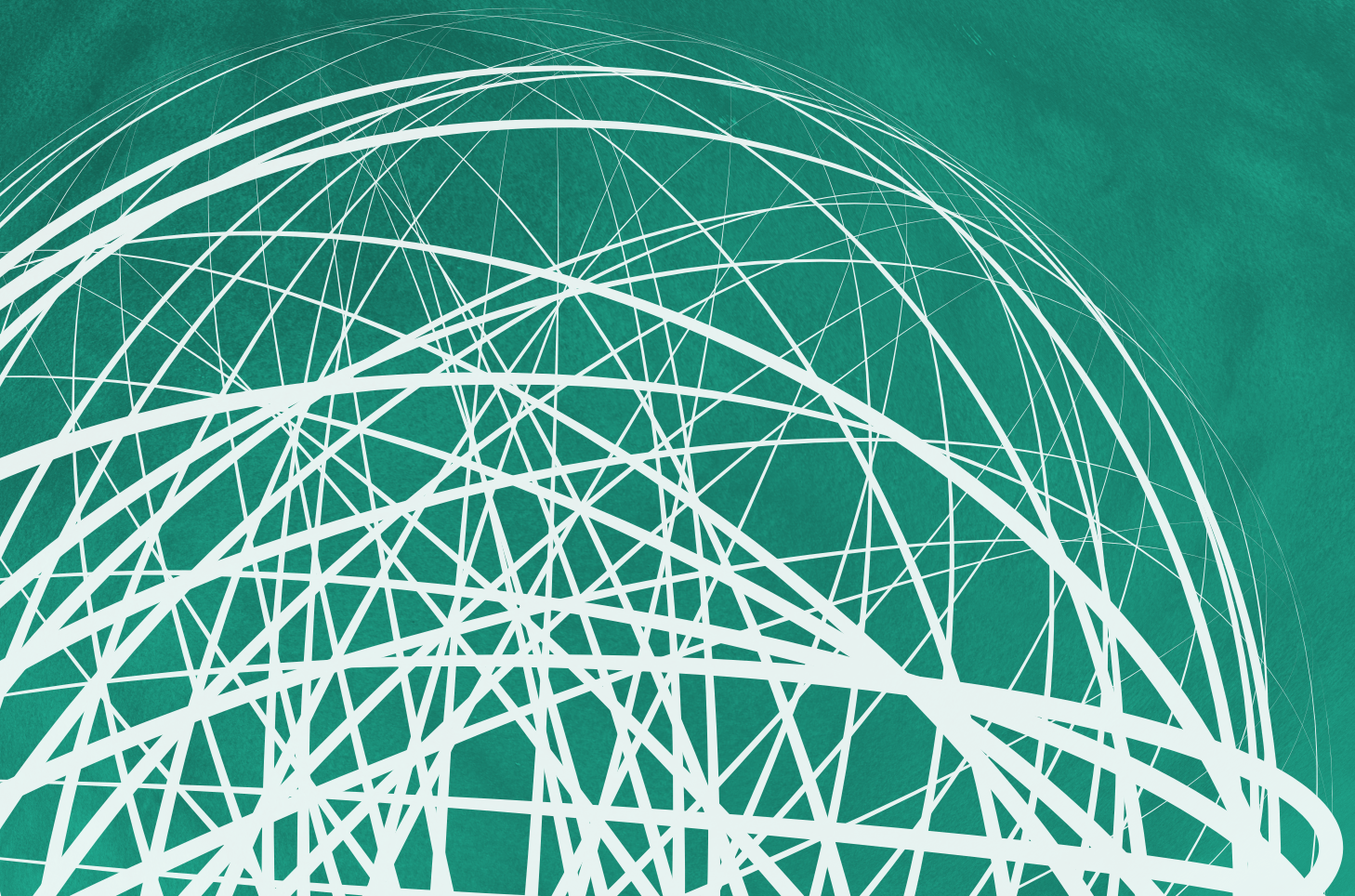
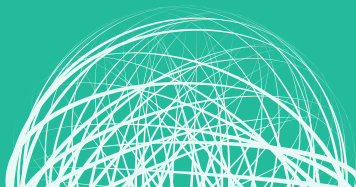


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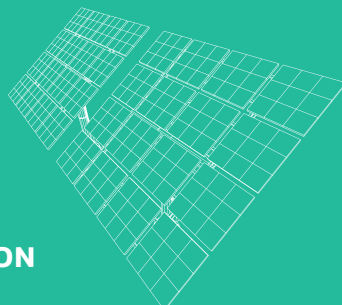


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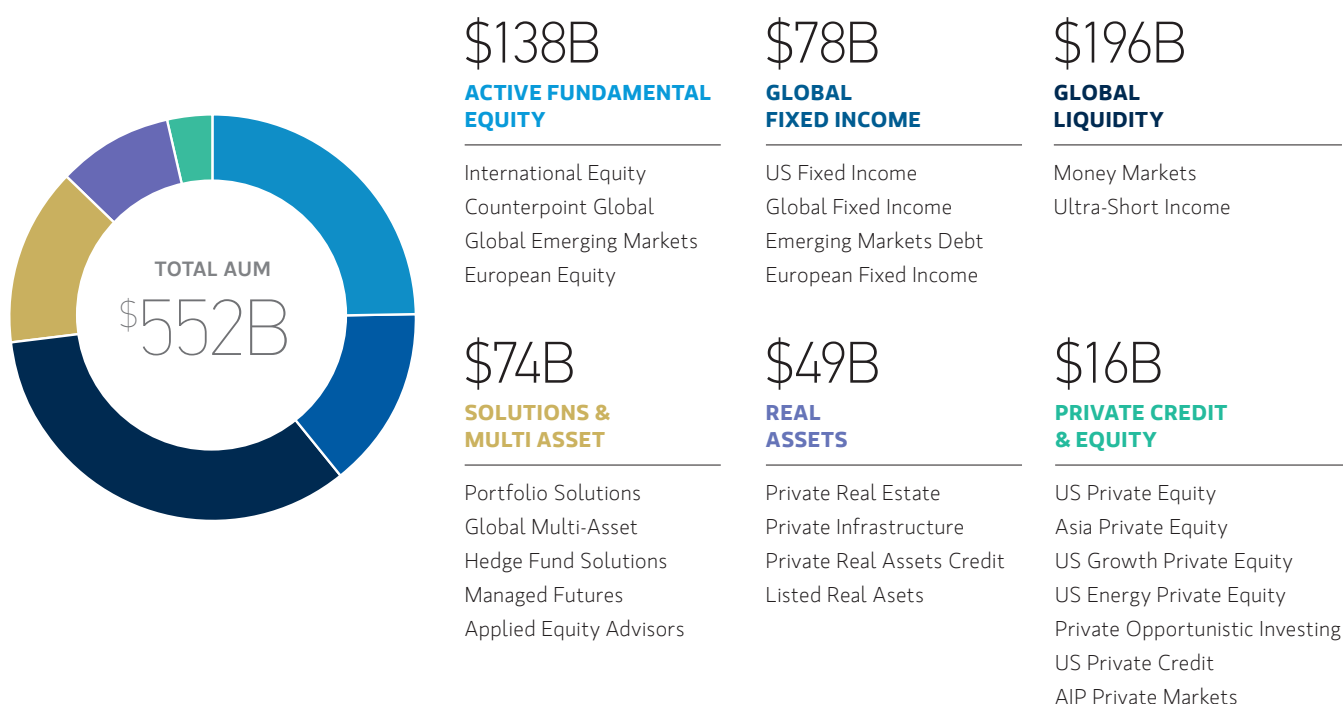


About MSIM

At Morgan Stanley Investment Management (MSIM), our mission is to serve clients by helping them achieve their investment objectives, and providing a comprehensive array of investment solutions, competitive results and enduring relationships. Our global suite of products and services span the risk/return spectrum across geographies, investment styles and asset classes, including equity, fixed income, alternatives and private markets.

Across our diverse range of investment strategies, our philosophy is to generate alpha through active management grounded in sound fundamental research and analytics. Our portfolio managers' demonstrated expertise is built on innovative research, rigorous analysis and high-conviction investment decisions.

MSIM is composed of a series of investment teams — each staffed by talented, experienced investment professionals and backed by the broad reach, access and resources of one of the world's largest financial institutions. Harnessing these resources, we provide unparalleled knowledge of economies, markets and industries to governments, institutions, corporations and individual investors around the world.



¹ AUM figures within each business line may not sum to total AUM due to rounding. Data as of December 31, 2019.

Fund of Fund assets represent assets under management and assets under supervision.

Direct private investing assets represents the basis on which the firm earns management fees, not the market value of the assets owned.

**STATEMENT FROM MSIM
SUSTAINABILITY COUNCIL
CO-CHAIRS**

“The MSIM Sustainability Council brings together leaders from across the business who are actively integrating sustainability considerations into their investment processes. The council provides a forum for MSIM investors to collaborate and share leading practices on sustainable investing. Through this forum we are able to ensure the integrity of our sustainable investing approaches and push for continuous improvement and innovation to meet the needs of our clients.”



TED ELIOPOULOS

*Vice Chairman and Head
of Strategic Partnerships*



RUI DE FIGUEIREDO

*Co-Head and Chief Investment
Officer of the Solutions and
Multi-Asset Group*

MSIM Sustainability Council

MSIM takes a holistic approach to sustainable investing to promote long-term value for our business and clients. Our differentiated investment teams lead this process, with support from the MSIM Sustainability Council. An advisory forum, the Council convenes cross-functional leaders, including portfolio managers and investment analysts. Members share approaches to sustainable investing, product development, measurement, education, client engagement and reporting. The Council is supported by MSIM’s Global Stewardship team, which comprises sustainable investing professionals who facilitate proxy voting and collaborate with our investment teams on company engagements and sustainable investing initiatives. The Council is also supported by Morgan Stanley’s Global Sustainable Finance team and the Institute for Sustainable Investing.

In 2019, the Council surveyed best practices for sustainable investing, facilitated third-party sustainable investing training for investors and promoted greater alignment across MSIM’s strategies that apply sustainable investing approaches. To make our sustainability solutions more accessible for clients, we launched a new webpage, Sustainability Insights, and published our Principles for Responsible Investment (PRI) Transparency Report.

In 2020, the Council’s priorities will include exploring how to enhance our sustainability reporting and approach to climate change, drawing on the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

Sustainability at Morgan Stanley

Morgan Stanley's Global Sustainable Finance (GSF) group is responsible for driving sustainability integration across policies, activities, products and services. Positioned under the firm's Chief Sustainability Officer and Morgan Stanley's Vice Chairman, the team partners with senior leadership across Institutional Securities, Wealth Management and Investment Management, as well as support services and risk functions such as Environmental and Social Risk Management and Firm Risk Management. The Morgan Stanley Institute for Sustainable Investing is housed within GSF. The Institute aims to accelerate the adoption of sustainable investing in the capital markets and drive strategic sustainability initiatives across Morgan Stanley. Chaired by the firm's CEO and Chairman, James Gorman, an advisory board of prominent leaders from business, academia and leading nongovernmental organizations guide the Institute's priorities.

MSIM Partnership with Global Sustainable Finance and the Institute for Sustainable Investing

MSIM leverages and benefits from Morgan Stanley's decade-plus commitment to sustainable finance. Positioned at the nexus of the firm's business units and the broader sustainable finance market, the Morgan Stanley Institute for Sustainable Investing serves as a unique resource and partner on innovation, knowledge sharing and thought leadership.

OUR RECENT JOINT EFFORTS INCLUDE:

- Partnering to drive sustainable investing innovation by informing product development and environmental, social and governance (ESG) data analytics across all asset classes in MSIM.
- Collaborating on thought leadership related to climate resilience, market trends, and insights for asset owners about developing a sustainable investing strategy.
- Knowledge sharing at the firm's inaugural Sustainable Investing Summit, where Dan Simkowitz, Head of MSIM moderated a panel on Finding Alpha and Long-Term Value through Sustainability.



SUSTAINABILITY INSIGHT

Debunking Six Myths About Climate Investing

April 29, 2019

AIP Private Markets' Head of Impact Investing finds that solutions to climate change are nuanced and may generate compelling investment opportunities.

[Read More >](#)



Dan Simkowitz leading discussion about the ESG edge in long-term investing at Morgan Stanley's inaugural Sustainable Investing Summit, where he was joined by Vice Chairman Ted Eliopoulos and Managing Director Seema Hingorani.



Morgan Stanley
INVESTMENT MANAGEMENT

SUSTAINABLE INVESTING WORKSHOP Action Items for Your Organization

Developing a Sustainable Investing Strategy
Consider the following four stages of developing a long-term and institutional sustainable investing strategy.

<p>DEFINITION Why do you want sustainable investing within the portfolio?</p>	<p>ASSESSMENT What are the current environmental and social risks and opportunities?</p>	<p>INVESTMENT STRATEGY Where can sustainable investments be made within the investment portfolio?</p>	<p>IMPLEMENTATION How will investors and investors be able to deliver the sustainable investing strategy?</p>
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Getting Started
Each organization will approach the stages of developing a sustainable investing strategy in its unique and specific way. Each organization should consider the following:

- TO DEFINE:**
 - Engage senior leadership to establish a strategic vision for sustainable investing.
 - Identify a working group or committee to coordinate, monitor, and report on sustainability.
- TO ASSESS:**
 - Identify and assess current environmental and social risks and opportunities in the investment portfolio.
 - Identify if any sustainability themes or factors are relevant to the investment portfolio.
 - Determine if the existing asset and asset classes should be reviewed for sustainability.
 - Check how resources will be defined, how impact will be measured and tracked, and reported or monitored internally.
 - Define frequency of communication, for which internal and external stakeholders, and how to report.
- TO INVEST:**
 - Identify and assess current environmental and social risks and opportunities in the investment portfolio.
 - Identify if any sustainability themes or factors are relevant to the investment portfolio.
 - Determine if the existing asset and asset classes should be reviewed for sustainability.
 - Check how resources will be defined, how impact will be measured and tracked, and reported or monitored internally.
 - Define frequency of communication, for which internal and external stakeholders, and how to report.
- TO IMPLEMENT:**
 - Identify and assess current environmental and social risks and opportunities in the investment portfolio.
 - Identify if any sustainability themes or factors are relevant to the investment portfolio.
 - Determine if the existing asset and asset classes should be reviewed for sustainability.
 - Check how resources will be defined, how impact will be measured and tracked, and reported or monitored internally.
 - Define frequency of communication, for which internal and external stakeholders, and how to report.

- Capacity building to develop the next generation of sustainable investing leaders through the Morgan Stanley Sustainable Investing Fellowship and the Kellogg-Morgan Stanley Sustainable Investing Challenge.

Sustainable Investing and Engagement



2019 Highlights

Key engagement themes:

- Climate resilience and transition risk
- Plastic waste reduction
- Diversity and inclusion: gender pay gap, parental leave
- Sustainability disclosure

Supporting the Sustainable Development Goals*



Morgan Stanley supports the United Nations' Sustainable Development Goals (SDGs), a global blueprint to achieve a better and more sustainable future. The 17 goals and 169 targets cover a broad range of sustainability issues, from eradicating poverty and hunger to affordable and clean energy, to good health and a quality

education for all. The SDGs provide a framework to advance sustainable economic growth, gender equality and climate action, among other priorities. They increasingly inform MSIM's approach to investing, engagement and impact reporting. We use SDG icons in this report to highlight where we believe our engagement efforts promote the goals.

600+

sustainability-related engagements with company management or boards

Our PRI** Score:

A+ in Engagement, sub-score under listed equity active ownership

A in **4** of **8** categories reported, including strategy and governance, listed equity incorporation, listed equity active ownership and property

* The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States. See <https://www.un.org/sustainabledevelopment/sustainable-development-goals> for more details on the Sustainable Development Goals.

** PRI Assessment Report for Morgan Stanley Investment Management, 2019. Signatories report on their responsible investment activities by responding to asset-specific modules in the Reporting Framework. Each module houses a variety of indicators that address specific topics of responsible investment. Signatories' answers are then assessed and results are compiled into an Assessment Report. The Assessment Report includes: indicator scores –summarizing the individual scores achieved and comparing them to the median; section scores –grouping similar indicator scores together into categories (e.g. policy, assurance, governance) and comparing them to the median; module scores –aggregating all the indicator scores within a module to assign one of six performance bands (from E to A+). More information is available on PRI website at <https://www.unpri.org/signatories/about-pri-assessment/3066.article>



Sustainable Investing at MSIM

By endeavoring to advance sustainability, we aim to support a healthier planet and more inclusive economy while delivering long-term value for our clients and shareholders.

At MSIM, investment teams have differentiated approaches for incorporating sustainability factors into their investment process. MSIM empowers investment teams to design sustainable investing approaches that best suit their strategies and investing styles. This investor-led approach allows for greater flexibility and enhances our ability to respond to clients' varied needs with a wide range of approaches – from screening out unwanted sectors to ESG integration and thematic and impact investing. Through our collective sustainable investing efforts, our objective is to enhance market-rate financial returns, while driving positive social and/or environmental benefits and strong governance practices.

Our teams' strategies typically span the sustainable investing approaches below and continually evolve to best deliver value to our clients. At the heart of our approach is portfolio company engagement. We see this as central to our role as active managers as well as a critical tool in promoting sustainable business practices.

RESTRICTION SCREENING

Intentionally avoiding investments in certain sectors or issuers based on values or risk-based criteria

ESG INTEGRATION

Considering ESG criteria alongside financial analysis to identify risks and opportunities throughout the investment process, which may lead to decisions to avoid, include or size certain investments

THEMATIC INVESTMENTS

Tilting investments toward certain themes and sectors positioned to solve global sustainability-related challenges, includes 'Sustainable Funds' as defined by EU Taxonomy or other regulatory frameworks

IMPACT INVESTING

Allocating to funds or enterprises intentionally structured to deliver a specific and measurable set of positive social and/or environmental impacts alongside market-rate financial returns

COMPANY ENGAGEMENT

Seeking to drive improvement in ESG activities or outcomes through proxy voting and/or active dialogue with invested companies

For more information on our approach to sustainable investing, please see our [ESG Approach and Principles](#) on [msim.com](#).

Engagement

Active ownership is the hallmark of our approach and sets us apart from peers. As long-term investors and active managers, we believe we have both a duty and an opportunity to act as stewards of the capital we manage. Our investment teams embrace this opportunity by engaging directly and often with their portfolio companies on sustainability topics and by exercising proxy voting rights.

MSIM investors attend company presentations, road shows, conferences and analysts' calls. They also proactively engage in direct dialogue with company management and boards of directors in-person and on the phone about sustainability issues. These engagements drive our active ownership strategy, enabling us to guide portfolio companies toward better governance and sustainability practices, which we believe enhance long-term returns.

In addition to direct engagement carried out by our investment teams, Morgan Stanley's Global Stewardship team also engages with portfolio companies on sustainability topics. The team engages with companies around annual general meetings, and throughout the year on emerging, material sustainability issues.

For more details on our approach to engagement please see MSIM's [Engagement and Stewardship Principles](#) on [msim.com](#).

COLLABORATING TO DRIVE PROGRESS

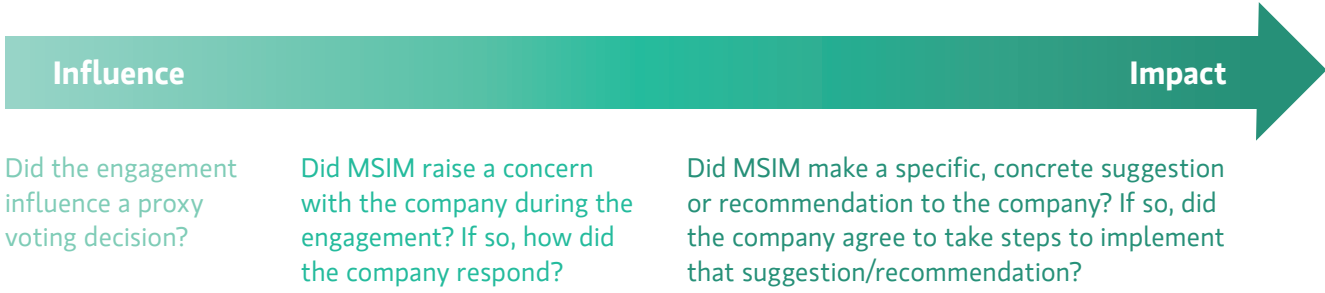
Our investment teams generally find that one-on-one discussions are the most effective way to deliver our views to portfolio company management and board members. In addition, the Global Stewardship team joins selective collaborative efforts to enhance our understanding of a company or amplify our message, as well as broader initiatives that promote the sustainability of the global financial system.

For example, in 2019, the Global Stewardship team joined an investment community engagement with a large, U.S.-based oil and gas producer. The event was hosted by a peer asset manager and led by a major U.S.-based asset owner. Attendees urged the company to adopt greater climate risk disclosure, reduce routine methane flaring and focus more on supporting human rights.



Tracking our Engagements – the Global Stewardship Team

The Global Stewardship team’s overarching goal through engagement is to gain a better understanding of how a company, or group of companies, manage an emerging sustainability risk or opportunity and to encourage companies to adopt leading sustainability practices. The team extends this work by analyzing the results of their engagements to identify sector leaders and laggards on specific sustainability topics. The Global Stewardship team uses this categorization process to inform future engagements and the way we vote on related proxies at relevant companies’ annual meetings.



This process also give us valuable information on how effective our engagements are, and allows for more meaningful follow up with companies.

PROMOTING SUSTAINABILITY DISCLOSURE THROUGH THE SASB INVESTOR ADVISORY GROUP

As a member of the Sustainability Accounting Standards Board’s (SASB’s) Investor Advisory Group, MSIM’s Global Stewardship team supported efforts in 2019 to encourage companies to adopt its reporting standards. We believe the framework helps companies disclose material and decision-useful sustainability information, and improves the overall quality and comparability of sustainability-related information available to investors. In partnership with another U.S.-based asset management firm, we engaged with an energy company and a real estate investment trust about adopting the SASB standards. Both agreed to consider taking steps toward implementation.

In addition, our Global Stewardship team now recommends the SASB reporting framework to all companies during its regular engagement program. As of January 2020, 120 companies, report to these standards.²



² <https://www.sasb.org/company-use/>

Engagement Case Studies

By Theme

By Investment Team



Climate Risk and Decarbonization

MSIM's Focus on Climate Change

At MSIM, sustainable investing includes consideration of climate-related issues. Portfolio managers and investment teams may evaluate, as applicable, the carbon footprint and intensity of their investments, as well as climate resiliency and adaptation strategies. Our understanding of climate change risks and opportunities is deepened through our engagement with companies, as we aim to better understand their emissions profiles, controls and preparedness to manage climate-related risks.

Climate Risk in the Insurance Sector

In 2019, MSIM's **Credit Research and Global Stewardship** teams partnered on a thematic engagement series about climate risk in property & casualty (P&C) insurance and re-insurance sectors. The objective of the engagement was to understand how insurance companies are assessing climate risk in their investment portfolios and product offerings. The teams engaged with seven different global insurance companies, three U.S.-based and four European-based. The team believes the most important environmental concern when investing in the P&C (re)insurance sector centers around natural catastrophe risk. Among engaged insurers, there is agreement that current science supports the thesis that climate change will lead to rising sea levels, which will lead to increased severity of natural wind disasters. There is less consensus around the future frequency of these disasters. Despite the sector's agreement on this problem, there was significant variation in how insurers model natural catastrophe risk, calibrate their models, and most importantly, disclose their modeled results with investors. We noted that reinsurers place a high degree of comfort in the fact that they can reprice business each year, which does bring us some comfort as investors, too. However, we favor insurers that publicly disclose metrics such as the probable maximum loss, even with its limitations, as it provides an enhanced level of transparency into natural catastrophe risk.

Decarbonization in Emerging Markets Equities

In 2019, MSIM's **Global Emerging Markets** team conducted an in-depth research project to better understand the investment risks and opportunities related to climate change and the energy transition. Some emerging and frontier countries are more susceptible to physical risks of climate change given higher average temperatures, greater dependence on agriculture, more limited infrastructure, and large populations living near sea levels. In terms of transition risk, the team analyzed how certain countries could face higher transition risk due to high reliance on fossil fuels for gross domestic product (GDP) and power generation. The team discussed and debated topics such as the use of nuclear energy and the investment opportunities that are likely to emerge as economies decarbonize and transition to renewable energy sources. From a top-down perspective the team reviewed the risks specifically pertinent to countries with high fossil fuels use and high carbon intensity of GDP, such as South Africa where significant privatization will need to take place in order for more renewable sources to play a larger role in the economy. This collaborative research project provided a strong foundation for the team's ongoing efforts to apply a climate lens to its investment process.

MORGAN STANLEY'S APPROACH TO CLIMATE CHANGE

Climate change is a growing risk that businesses and investors must understand and address in order to mitigate, respond to and adapt to its environmental and economic impacts. At Morgan Stanley, we see tremendous opportunity to be part of the solution to climate change, working alongside public policy makers, regulators, civil society, our clients and the private sector. We seek to support the transition to a low-carbon economy through our policies, activities, products and services that support the mitigation of and adaptation to climate change. The firm is exploring ways to strengthen our approach to climate change by drawing on the TCFD recommendations in ways that benefit our company and stakeholders.

MORGAN STANLEY FIRM-WIDE COMMITMENTS:

- Mobilizing \$250 billion in low-carbon solutions by 2030, among other business activities.
- Achieving carbon neutrality for our global operations by 2022.

MSIM support for shareholder proposals on climate change

90%

SUPPORT FOR CLIMATE-RELATED PROPOSALS AT U.S.-BASED COMPANIES

64%

SUPPORT FOR PROPOSALS REQUESTING THAT COMPANIES ADOPT GREENHOUSE GAS EMISSION REDUCTION TARGETS



Addressing Plastic Waste

MSIM's Focus on Addressing Plastic Waste

At MSIM, our investment teams use their influence as investors and thought leaders to encourage portfolio companies to reduce plastic waste and find innovative solutions for plastic waste.

MSIM Plastic Waste Engagements

In 2019, the **International Equity** team met with numerous companies along the plastic supply chain, including eleven of its fast-moving consumer goods sector (FMCG) holdings, such as beverages, household and personal care companies, to discuss plastic waste. Through direct engagement with company management, it discussed strategies and targets around plastic waste, as well as hurdles to achieving them. While there is no single solution, the most practical near-term solution for FMCG companies is increasing the proportion of recycled content in their packaging and reducing the overall amount of packaging. As part of the Ellen MacArthur Foundation's Global Commitment, most large consumer companies, including the team's holdings that are exposed to plastic packaging, have now publicly committed to significantly increase recycled content, from less than 10% in most cases to 20-50% by 2025-30. Many of the companies are also investing in nascent chemical recycling technologies and trialing refillable packaging among other initiatives. While this will not solve the problem itself, these incremental commitments should provide a material boost for the currently small recycled plastic market. This research helped inform the team's analysis of whether the issue represents a material risk to the sustainability of returns on capital of its holdings.

The **Counterpoint Global** team has been engaged on the topic of marine plastic waste since 2017, when the team convened experts in the field – including sustainability experts from Fortune 100 companies, ocean conservationists, academics and non-profit think tanks – to explore the topic and potential solutions. Through this process, the team identified a global coffee retailer in their portfolio holdings with disproportionate brand risk exposure to plastic waste. The team began engaging with the company's management and Sustainability team to reduce their plastic waste footprint. In 2018, the coffee retailer announced specific plans and targets to minimize their single-use-plastic footprint and a collaboration with industry competitors to innovate new sustainable packaging. By proactively tackling this issue, the company turned a brand risk into a brand strengthening opportunity. This engagement highlights the impact we can have as investors in creating win-win outcomes that are good for the environment, the company, and the team's clients as shareholders.



The Morgan Stanley Plastic Waste Resolution

In 2019, Morgan Stanley committed to tackling the growing global challenge of plastic waste in the environment. **Through the capital markets and partnering with our clients and employees, Morgan Stanley is committed to facilitating the prevention, reduction and removal of 50 million metric tons of plastic waste from entering rivers, oceans, landscapes and landfills by 2030.** This effort is being led by the Morgan Stanley Institute for Sustainable Investing and Global Sustainable Finance group.

PLASTIC WASTE RESOLUTION



Committed to facilitating the prevention, reduction and removal of

50m

metric tons of plastic waste by 2030

ACTIVE FUNDAMENTAL EQUITY

Counterpoint Global

Courting the Conscious Consumer

The **Counterpoint Global** team is invested in a global cosmetics company. In addition to our analysis of the company’s strong fundamentals and its compelling risk versus reward as an investment opportunity, our confidence in this company has been increased through our engagement with company management. Our engagements with the company signaled its focus on authenticity and success in harnessing its sustainability program to target the conscious consumer and drive loyalty and retention.

The company has a deep understanding of the potential brand risks that could result from breaking this consumer trust by introducing unsustainable or unethical products or sourcing practices. In addition, the company has been proactive in tackling newly emerging ESG risks, for example by developing innovative ways to address plastic waste in its packaging. We believe the company’s appreciation for these longer term risks stems in part from its incentive structure and significant family ownership. Executives have longer vesting schedules than most peers and the sustainability team is expected to deliver financial returns on sustainability initiatives. We have confidence in the company’s strategic integration of sustainability as a both a growth driver and risk mitigation tool, and in the robust nature of its governance structure, which enables this forward thinking.



ACTIVE FUNDAMENTAL EQUITY

Global Opportunity

Pursuing More Sustainable Supply Chains in Luxury Retail

The team engaged the management team and two board members of a European luxury goods company to understand how sustainability is integrated into the company’s governance structure. The company includes sustainability key performance indicators (“KPIs”) in executive compensation plans and has formally integrated sustainability into the Audit and Risk Committee charter. The company demonstrated a strong approach to supply chain governance by doubling the number of supplier audits in 2018 from 2017. We also discussed the company’s commitment to environmental initiatives and to promoting gender diversity in the workforce through maternity programs and onsite childcare facilities. The engagement provided an opportunity for us to learn more about the company’s leading sustainability practices and to provide suggestions for continual improvement. As long term investors, we are committed to working in partnership with our portfolio companies to improve their sustainable competitive advantage.

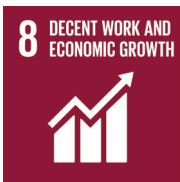


ACTIVE FUNDAMENTAL EQUITY

Global Emerging Markets

Promoting Sustainable Fashion

The **Global Emerging Markets** team invested in a Brazilian fast fashion retailer in 2016. The company’s strong balance sheet enabled it to continue its expansion plan during Brazil’s economic downturn while competitors were closing stores. Simultaneously, the company was investing in its logistics systems and tightening its global supply chain safety standards. By 2019, the company’s valuation had risen, and we re-examined our investment case and conducted an additional in-depth ESG engagement with management. This engagement confirmed that the company remains ahead of peers in identifying and mitigating long-term risks, including climate change. The company has adopted ambitious targets for the use of recycled and environmentally friendly materials, positioning the company well from a cost and brand standpoint as Brazilian consumers and regulators begin to focus more on climate in the coming years. These engagements demonstrated how this company is successfully integrating sustainability into its strategic plans. Furthermore, they provided an additional perspective on this proactive, long-term minded management team.



ACTIVE FUNDAMENTAL EQUITY

International Equity

Lessons from Best-in-Class

Engagement is not always triggered by emerging concerns. The **International Equity** team regularly engages with companies to monitor improvements in behavior and to check that things are on the right track. As an example, in 2019, the International Equity team engaged with one of its personal care holdings to discuss its sustainability strategy. The company is one that the team considers to be “best-in-class”, and they monitor its progress to ensure it remains on the right track. In-depth knowledge of the ESG-related processes of this industry leader is also very useful when engaging with the company’s peers, providing a benchmark of good practice the team can refer to when assessing others’ progress.

For example, in 2013, the company launched a sustainability plan, which included linking the CEO’s pay, and eventually the pay of other senior managers, to achieving certain sustainability key performance indicators. This has resulted in significant progress over the last five years. For example, the company took several years to develop a tool to measure the environmental footprint of all individual products, which has enabled a continuous product footprint reduction program through re-engineering of formulas and packaging. The company has also secured the necessary volumes of recycled plastic to fulfil its ambitious target of increasing recycled content in its packaging and it already has one of the lightest shampoo bottles on the market. On the social side, it is one of very few companies independently verified as having closed the gender pay gap over the last several years, an action led by the CEO. These examples highlight the importance of having the right culture and management incentives in place to focus on the long-term strength of the business. The in-depth engagement with the company reassured us that the company is positioned well for future challenges and that its ESG performance adds to its competitive advantage versus peers.



FIXED INCOME

Global Fixed Income

Drug Pricing

In 2019, MSIM's **Credit Research and Global Stewardship** teams launched an engagement series with healthcare companies to discuss regulatory and reputational risks linked to drug pricing. The objective is to identify which companies are best positioned to navigate regulatory and market changes around drug pricing in an industry confronting the hot button issue of escalating healthcare costs.

Per capita pharmaceutical spending in the U.S. is 54%-209% higher than in other high-income countries, and rising.³ Many pharmaceutical companies warn in recent 10-K reports that they face financial risks associated with looming regulatory interventions to control drug pricing. The team is concerned about these firms' potential brand erosion as consumers grow weary of high drug costs. In addition, we support the Sustainable Development Goals (SDGs), in particular SDG 3 'Ensure healthy lives and promote well-being for all at all ages', and believe that affordable access to medicines is a critical component of fulfilling this goal.

In our discussions with companies, we gained valuable insights and found data that suggests list price increases are highly discretionary choices made by management teams, and companies are making divergent decisions on how to approach pricing policies. For example, one company has set a goal for low, single digit net price decline in 2020 while another company decided to increase prices on key drugs by more than 9%. This varied landscape adds complexity for all stakeholders, especially consumers, and underlines the pressing need for greater transparency on drug pricing. As MSIM continues this engagement series, we will promote transparency across all parts of the drug pricing value chain, and explore how companies can integrate affordability into their overall strategies.



REAL ASSETS

Global Listed Real Assets

Sustainable retail assets

In 2019, our **Global Listed Real Assets and Global Stewardship** teams engaged with a European real estate investment trust (REIT) that owns and operates malls and shopping centers. Our goal was to gain a deeper understanding of the company's ESG initiatives including tenant sustainability engagement and climate change preparedness. On tenant engagement, we were encouraged to learn that the company leverages the technical expertise of its own staff to engage tenants on energy management and waste reduction. Rather than hire their own sustainability experts at considerable cost, retail tenants can rely on the REIT's onsite technical staff for these programs, a perk which has helped to attract and retain high-quality tenants. The mall operating company's climate change actions were also aligned with best practice. It is developing targets in line with the global Science Based Targets Initiative, with the aim of making five of its largest assets carbon neutral or even carbon positive as soon as 2022. We believe these actions position the company well for climate-related regulation in the European Union. Our interactions enhanced the investment team's view of the company, and provided leading practices for us to share with other portfolio companies.



³ "Trends in prices of popular brand-name prescription drugs in the United States", JAMA Network Open, May 2019

SOLUTIONS & MULTI-ASSET

Global Balanced Risk Control

Low carbon transition, water risk management and plastic waste

In 2019 the team spoke to several European electric utilities about their transition to a low carbon economy. The team was pleased to hear that many companies had comprehensive plans for expanding their solar and wind operations. The team also spoke to a major U.S. oil producer and encouraged it to set a CO₂ intensity target and to consider linking executive compensation to CO₂ reduction targets as other oil companies have begun to do. The company shared that it will set further CO₂ reduction targets in late 2020 following a gap analysis on carbon for its newly acquired assets.

In addition, the team spoke to companies about water risk management and noted that forward looking companies had moved beyond managing efficiencies in their own operations to thinking about how they can preserve the watersheds in which they operate. The team appreciates this holistic view and believes that investment in watershed management will make businesses more sustainable long term.

Separately, following the announcement of Morgan Stanley's Plastic Waste Resolution, the team also spoke to several forward-looking packaged food companies to push for an ambitious approach to plastic packaging recyclability and to encourage industry collaboration for research and innovation.



SOLUTIONS & MULTI-ASSET

Portfolio Solutions Group

Engaging to improve early childhood development

In 2019, the **Global Stewardship** team undertook an engagement series on early childhood development based on a client of the Portfolio Solutions Group's interest in the topic. The primary objective of this engagement series was to use the investment portfolio as a platform to promote greater corporate awareness of and investment in early childhood development. A secondary objective was to encourage companies to align with the UN Sustainable Development Goal (SDG) 3 'Ensure healthy lives and promote well-being for all at all ages', which includes sub-goals on newborn and child health.

Given the volume of scientific evidence demonstrating how extended parental leave contributes to positive early childhood development outcomes, MSIM positioned early childhood development as part of the business case for extended paid parental leave. To select companies for engagement, MSIM reviewed the portfolio's holdings against leading gender equality indexes and rankings that track paid parental leave programs. Through the engagements series the team found that companies with policies supporting longer paid parental leave periods tended to have a stronger understanding of how paid parental leave can promote positive development outcomes for newborns and infants and solicited feedback from employee resource groups for working families. The Global Stewardship team suggested that lagging companies they revisit their policies in consultation with employee resource groups, and in line with peers. None of the companies the team spoke to had considered the role they can play in supporting UN SDG 3 through paid parental leave, but all were open to considering it based on our suggestion.



SOLUTIONS & MULTI-ASSET

Applied Equity Advisors

Engaging on Material Issues

The goal of Applied Equity Advisors' investment process is a portfolio of stocks which they believe will benefit from quantitative investment styles likely to outperform for a given region and that represent compelling investment opportunities. The team's stock selection process focuses on companies that meet material sustainability criteria for a particular industry, seeking to add to the portfolio's potential long term performance results. The team uses the SASB Materiality Map[®] to guide the sustainability analysis integrated into its stock selection. Research has shown that companies that invest more in areas deemed material by SASB should demonstrate better stock price performance over the longer term.⁴

In early 2019, the Applied Equity Advisors investment process indicated the need to increase exposure to value factors, following the broad market drawdown in late 2018. The team sought to diversify beyond financials, and zeroed in on a building products company that had the added benefit of offering exposure to the then improving housing market.

To better understand this company's performance on material sustainability issues, the team used the SASB materiality map to identify material sustainability topics for the industry and engaged company management on those topics. Guided by the SASB framework, the engagement centered upon employee safety and supply chain management. Specific conversation topics included the basis for employee safety initiatives resulting in lower injury rates relative to their peers and company systems and procedures with regard to the company's supply chain footprints in China and Mexico.

Engagement with the company confirmed that it is investing in areas that are likely to be high priority to the financial condition or operating performance of the company and most relevant to its stakeholders. The team plans to engage with the company regularly to encourage continued improvement in these areas.

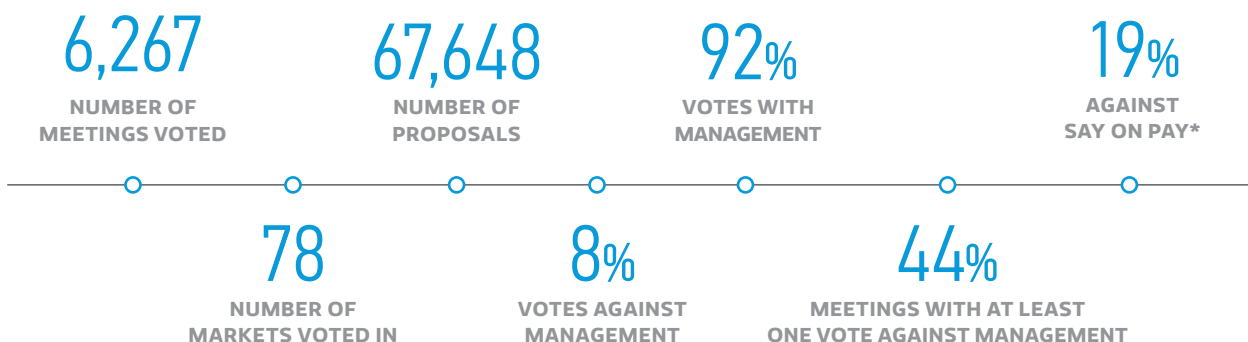


⁴ Corporate Sustainability: First Evidence on Materiality. Mozaffar Khan, George Serafeim, and Aaron Yoon, 2015. Period of the study from 1992 – 2013.

Proxy Voting



Firmwide 2019 Proxy Voting Statistics



Source: ISS Proxy Exchange

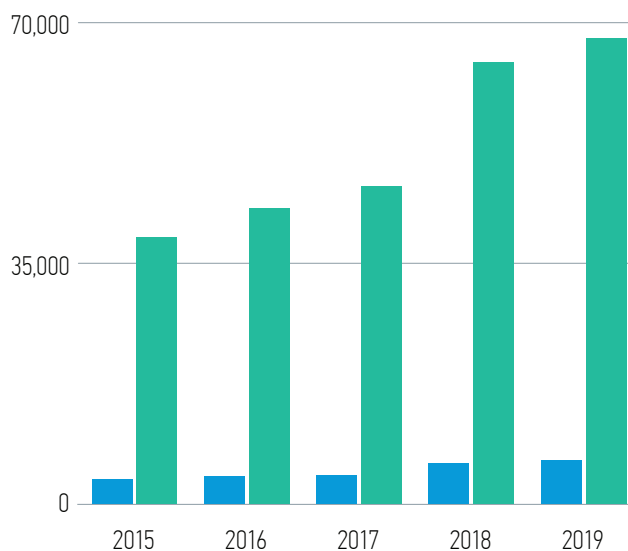
* Refers to advisory votes on executive remuneration for U.S.-listed companies

Voting Approach

MSIM views proxy voting as an integral part of the investment process and ownership oversight. All proxy voting decisions are made in-house by investment teams with input from the Global Stewardship team and in line with the principles laid out in our Proxy Voting Policy and Procedures. We do not automatically support management recommendations. The Global Stewardship team has an internal voting system that facilitates communication with the investment teams and documents vote rationale. We combine the in-depth knowledge of the investment teams with the global governance expertise of the Global Stewardship team to make informed voting decisions, rather than relying on external advisory firms or making proxy voting a rote, box-ticking exercise. The Global Stewardship team oversees the proxy voting process to ensure policies and procedures are applied consistently across our global portfolios.

The MSIM Proxy Review Committee has overall responsibility for our firm's voting policy and procedures. The committee meets at least quarterly and considers changes to the voting policy at least annually. The committee is composed of the Global Stewardship team, portfolio managers and other investment staff.

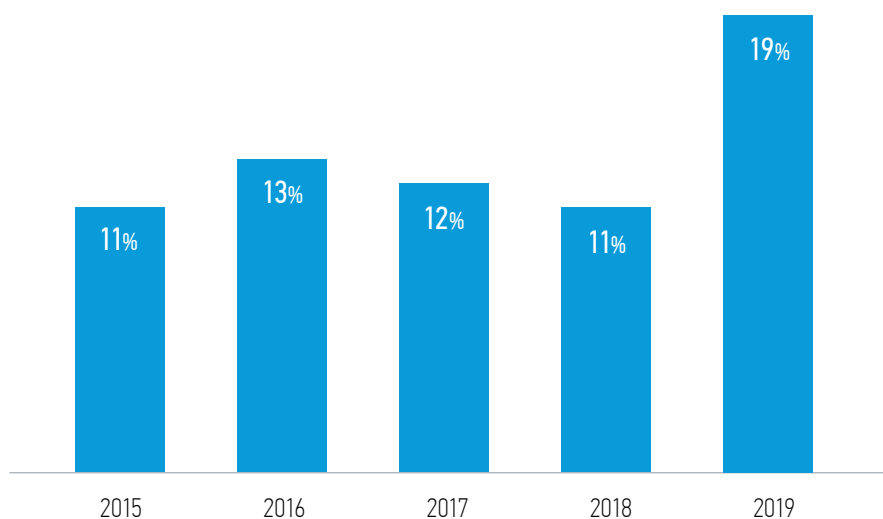
Number of Meetings and Proposals Voted 2015 – 2019



■ Meetings Voted ■ Proposals Voted

Source: ISS Proxy Exchange, FY2019 data

Firmwide Votes Against Say-on-Pay 2015-2019



Source: ISS Proxy Exchange, FY2019 data

Executive Compensation

MSIM has a long history of focusing on corporate governance. We believe that good corporate governance is a signal of quality management and that well-managed companies will produce long-term returns for our clients. Executive compensation is an important indicator of good board oversight and we consider advisory votes on remuneration on a case-by-case basis. Considerations include a review of the relationship between executive remuneration and performance based on operating trends and total shareholder return over multiple performance periods. In addition, we review remuneration structures and potential poor pay practices, including relative magnitude of pay, discretionary bonus awards, poorly defined target metrics, tax gross ups, change-in-control features, and internal pay equity.

As long-term investors, we support remuneration policies that align with long-term shareholder value. In 2019, our votes against say-on-pay increased as the 2018 year-end drop in total shareholder return across the market was not reflected in year over year CEO pay. In fact, we saw significant increases in CEO pay despite lower returns for shareholders.

The chart below illustrates the percentage of votes for and against management sponsored say-on-pay proposals voted during the period from 2015-2019.

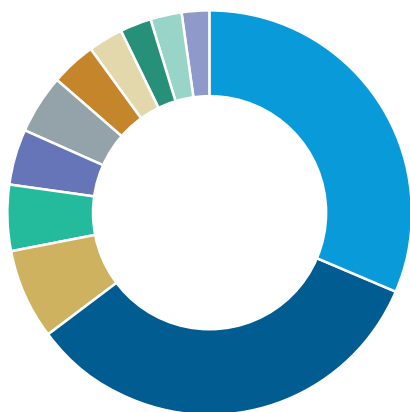
In 2019, MSIM supported 81% of say-on-pay proposals⁵ and voted against 19% of proposals.

INTERNATIONAL EQUITY TEAM: PAY X-RAY

The International Equity team has developed a proprietary scoring mechanism to assess the executive pay plans of the companies they invest in and to inform voting decisions on those pay plans. The Pay X-Ray assesses performance metrics and ambition level of goals set for executives. It favors plans that include return on capital targets and where awards are delivered via performance shares. The Pay X-Ray also looks at minimum share ownership levels for executives and the length of vesting and deferral periods.

⁵ Refers to advisory votes on executive remuneration for U.S.-listed companies. Note: Votes against say-on-pay proposals reference MSIM votes in aggregate. Individual investment team votes against say-on-pay vary.

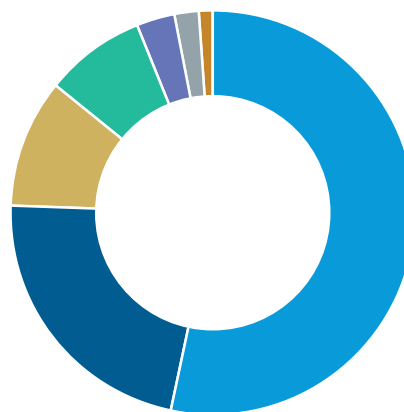
Meetings Voted by Market



● USA	31%	● Australia	4%
● Other Markets	34%	● Germany	3%
● UK	7%	● France	3%
● Canada	5%	● Sweden	2%
● Japan	5%	● Cayman Islands	2%
● China	5%		

Source: ISS Proxy Exchange, FY2019 data

Categories of Proposals Voted in 2019



● Directors Related	53%	● Mergers	3%
● Routine	22%	● Shareholder Proposals	2%
● Compensation	10%	● Antitakeover Related	1%
● Capitalization	8%		

Source: ISS Proxy Exchange, FY2019 data

Shareholder Proposals

Shareholders in the U.S. and certain other markets submit proposals encouraging changes in company disclosure and practices related to particular sustainability issues. Investment teams, with support from the Global Stewardship team, consider how to vote on such proposals on a case-by-case basis by determining the relevance of the issues identified in the proposal and their likely impacts on shareholder value. We also take into account a company's current disclosures and our understanding of its management of material social and environmental issues in comparison to peers.

We seek to balance concerns about reputational and other risks that lie behind a proposal against costs of implementation, while considering appropriate shareholder and management prerogatives. We may abstain from voting on proposals that do not have a readily determinable impact on shareholder value and we may oppose proposals that intrude excessively on management prerogatives and/or board discretion.

50%
overall support for shareholder proposals in 2019⁶

Climate Related Proposals

MSIM recognizes that climate change poses risks to the global economy. When voting on environmental and social proposals teams may take into consideration a company's disclosures compared to peers, which is why we tended to supported more climate resolutions at U.S.-based companies, which tend to lag behind their global peers on climate reporting and transitioning to a low carbon economy. We also supported several proposals requesting companies to set greenhouse gas (GHG) emissions reduction targets where we felt the company was lagging peers or that GHG emissions were a material risk.

90%
support for climate-related proposals at U.S.-based companies in 2019

64%
support for proposals requesting that companies adopt greenhouse gas emission reduction targets in 2019

⁶ U.S. shareholder proposals only

Gender Pay Gap Proposals

In 2019, several U.S.-based companies in the financial services and information technology sectors received shareholder proposals requesting that they report on the gender pay gap across their global employee base. MSIM was supportive of these proposals for two main reasons. First, because all targeted companies already provide gender pay gap data for their UK operations, making the prospect of rolling this reporting out globally less burdensome. Second, because we believe pay gap data provides a helpful lens alongside pay equity data. Most companies that received these proposals already disclose pay equity data, which illustrates pay disparities between men and women in similar roles. Pay gap data shows the unadjusted difference between what women in an organization are paid as compared to men. This raw number can be helpful in illuminating a company's 'leadership gap' or the extent to which women are disproportionately in lower paying positions than men.

100%

support for proposals on gender pay gap disclosure in 2019

Diversity & Inclusion Proposals

MSIM believes that diverse and inclusive workplaces lead to more productive and innovative work environments and that the boardroom plays a powerful role in laying the foundation for more diverse and inclusive workplaces. In 2019, votes generally supported proposals asking companies to disclose more information on the diversity breakdowns of their workforces or on their policies and programs for improving diversity and inclusion.

45%

support for proposals to increase board and employee diversity in 2019

Political Lobbying and Spending Proposals

Shareholders targeted U.S.-based companies with resolutions related to their transparency around political contributions and lobbying. MSIM believes that excessive or undisclosed spending on political contributions and lobbying can present reputational and regulatory risks for both companies and investors. To inform our vote, we review a company's existing disclosure relative to peers.

71%

support for proposals to report on political contributions and lobbying in 2019

Human Rights Proposals

In 2019, we mainly supported proposals requesting companies to provide disclosure on how they approach human rights risks in their own operations or on their human rights due diligence processes in their supply chains. We believe that human rights violations not only present legal and reputational risks for companies, but they also detract from the value and sustainability of the global economy.

45%

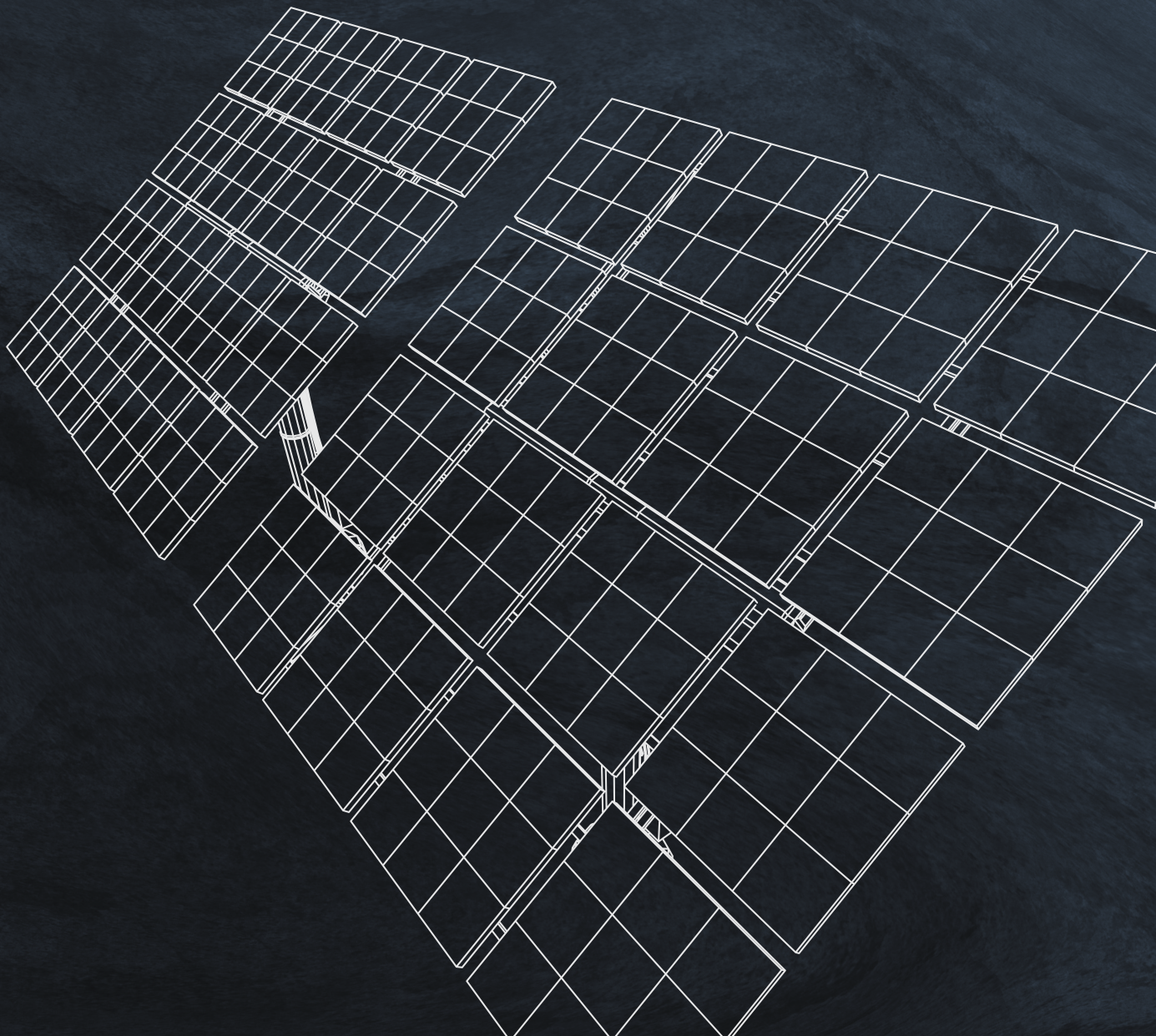
support for proposals to improve human rights disclosure and risk management in 2019

PROXY ADVISOR OVERSIGHT

MSIM reviews proxy research from Institutional Shareholder Services and Glass Lewis to inform its voting recommendations, but makes all voting decisions in-house according to the [MSIM Proxy Voting Policy and Procedures](#). MSIM's Global Stewardship team conducts annual due diligence of its proxy advisors to review their research processes and procedures.

For more information on MSIM's approach to Proxy Voting including reporting and disclosure and conflicts of interest please see our [Proxy Voting Policy and Procedures](#) on [msim.com](#)

Industry Collaboration



Industry Collaboration

SUSTAINABILITY INITIATIVES	KEY AREA OF FOCUS	SINCE
Ceres Investor Network on Climate Risk and Sustainability	A nonprofit working with investors and companies to drive sustainability solutions. Morgan Stanley is a member of the Ceres Investor Network on Climate Risk and Sustainability, and the CEO of Ceres is on the Morgan Stanley Institute for Sustainable Investing Advisory Board.	2013
EMPEA (Emerging Markets Private Equity Association)	EMPEA is a global industry association for private capital in emerging markets. MSIM's AIP team lead chairs the Impact Investing Council.	2015
The Global Impact Investing Network (GIIN)	GIIN is a nonprofit industry group focused on infrastructure, education and research to accelerate impact investing around the world. Morgan Stanley is a member of the GIIN's Investors Council and actively engages with the GIIN and is members on a variety of topics including impact measurement and management.	2011
Global Real Estate Sustainability Benchmark (GRESB)	GRESB is the ESG benchmark for real assets. It collects and catalogues ESG data for property companies, real estate investment trusts (REITs), funds and developers, including infrastructure funds and assets. Morgan Stanley is an investor member of GRESB and MSIM's Real Assets team both provides and consumes GRESB data.	2012
One Planet Summit Asset Managers Initiative	MSIM is a member of the One Planet Summit asset manager initiative, which is aimed at supporting the One Planet Sovereign Wealth Fund Framework in accelerating the integration of climate change analysis into the management of large, long-term and diversified asset pools.	2020
Principles for Responsible Investment (PRI)	The PRI works with its international signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of ESG issues and to support signatories in integrating these issues into investment and ownership decisions. MSIM is a signatory.	2013
Sustainability Accounting Standards Board (SASB)	SASB is dedicated to enhancing the efficiency of capital markets by fostering high-quality disclosure of material sustainability information that meets investor needs. Morgan Stanley's Chief Sustainability Officer is a board member of the SASB Foundation, helping ensure sustainability metrics are relevant to investors. Morgan Stanley's own reporting follows certain aspects of SASB guidance.	2012
UK, Japan and Hong Kong Stewardship Codes	Dozens of investment markets around the world have adopted stewardship codes to promote greater transparency around how institutional investors exercise their shareholder rights and responsibilities. These codes address conflicts of interest, voting, monitoring, engagement and ESG factors in the investment process. As a signatory to these codes investors must provide enhanced disclosure on stewardship activities (voting and engagement) and to disclose voting records. MSIM is a signatory of all three.	UK 2010 Japan 2015 Hong Kong 2019
Task Force on Climate-Related Financial Disclosures (TCFD)	The TCFD developed a framework for voluntary climate-related financial risk disclosure for use by companies in providing information to investors and other stakeholders. Morgan Stanley's CEO signed the TCFD Statement of Support in 2017.	2017

RISK CONSIDERATIONS

ESG strategies that incorporate impact investing and/or environmental, social and governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance.

In general, **equity securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed countries. **Fixed income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Real estate investments**, including real estate investment trusts, are subject to risks similar to those associated with the direct ownership of real estate.

Alternative investments are speculative, involve a high degree of risk, are highly illiquid, typically have higher fees than other investments, and may engage in the use of leverage, short sales, and derivatives, which may increase the risk of investment loss. These investments are designed for investors who understand and are willing to accept these risks. Performance may be volatile, and an investor could lose all or a substantial portion of its investment.

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