

Morgan Stanley Investment Management, Inc.**PRODUCT: ASIA EX JAPAN EQUITIES****ASSET CLASS**

Equity

GEOGRAPHIC EMPHASIS

Asia ex Japan

STYLE

-

SUBSTYLE

-

OVERALL EVALUATION

We recommend that mutual clients actively evaluate replacement managers.

Updated By: Kathrine Husvaeg
Target Excess Return: 0 to 0 bp
Target Tracking Error: 0 to 0 bp
Time Period:-
Russell-Assigned Benchmark:-

DISCUSSION

We recommend that mutual clients actively evaluate replacement managers.

Morgan Stanley Investment Management's (MSIM's) Asia ex Japan equity product is based on fundamental bottom-up research within a top-down country and sector/thematic overlay. MSIM's approach emphasises bottom-up stock selection as the primary source of added value with the team seeking to identify stocks with attractive growth prospects. This approach can lead to significant bets against the index at sector and stock level. Under the leadership of Ashutosh Sinha we have observed a bias towards smaller companies in portfolios.

We expect the product to perform in line with its benchmark over 3-5 years within a tracking error of 5%-6% relative to the MSCI Far East Free ex Japan index.

INVESTMENT STAFF ① ② ③ ④ ⑤

Ashutosh Sinha is the product lead for Asia Pacific ex Japan products, reporting to Narayan Ramachandran, who leads MSIM's emerging market equity team. Ramachandran's relocation to Singapore in 2004 mitigates our previous concern over Ashutosh's ability to lead the Singapore team. Russell has a positive view on Ramachandran and we believe his oversight is beneficial to the Singapore based team. The team also draws upon research from the broader emerging markets team, on which Russell has a positive view.

The Asian equity team comprises five portfolio manager/analysts in Singapore, two in India and four in New York. The average investment experience of team members is over ten years and, in our view, they all come across as strong investment professionals.



MORGAN STANLEY INVESTMENT MANAGEMENT, INC.

However, the Korean research coverage is relatively thin currently following the departure of the experienced Korean analyst at the end of 2004, on which Russell had a strong positive view. Ashutosh is currently responsible for Korean research alongside his portfolio management responsibilities. This mitigates our positive view on the team, and we rank the overall team in line with peers.

ORGANIZATIONAL STABILITY ① ② ③ ④ ⑤

MSIM's Asian equity team has encountered significant turnover amongst its senior investment professionals over time. However, following the departure of the majority of the senior members of the team in 2001, MSIM's Asian equity team has had low turnover by industry standards. We are encouraged by the increased level of team stability.

The long term incentive plan in place is not extended to all of the investment team members. This is a negative in our view.

ASSET ALLOCATION ① ② ③ ④ ⑤

This category is unranked as MSIM targets fully invested portfolios in this asset class.

RESEARCH ① ② ③ ④ ⑤

MSIM undertakes detailed bottom-up analysis of stocks within its investment universe. The effectiveness of the research process is heavily dependent on the quality of research analysts, which we believe are in line with the peer group. Idea generation can be stock specific or driven by the firm's top-down themes or macro-economic views. The team carries out detailed economic research incorporating a wide variety of macroeconomic factors into its analysis. We do not feel that the firm has a competitive advantage in this regard.

COUNTRY SELECTION ① ② ③ ④ ⑤

The importance of country selection for this product has diminished as stock selection has evolved into the primary source of alpha generation. Country selection is determined by Ashutosh Sinha, with country PMs selecting stocks within each country. While we believe the integration of the Asian team with the emerging market team may see increased discipline applied to country selection going forward, we have yet to verify this view. We do not view country selection as a significant source of excess returns for this product.

PORTFOLIO CONSTRUCTION ① ② ③ ④ ⑤

Ashutosh Sinha has final responsibility for portfolio construction. He also makes country allocation decisions, while stock picking within each country rests with the country managers. There is a diversification risk in constructing country portfolios separately as you can end up with similar stocks being held across countries which can lead to unintended bets. In order to mitigate this risk, Ashutosh Sinha reviews the final portfolio to ensure that the firm's strategy is implemented at a total portfolio level. Recently, regional portfolios have become more diversified in terms of number of holdings, which raises the concern that Ashutosh cannot stay on top of his portfolio. This leads us to believe that country portfolios are not as effectively implemented as they could be and the regional portfolios end up being over-diversified. This is a negative in our view.



MORGAN STANLEY INVESTMENT MANAGEMENT, INC.**CURRENCY MANAGEMENT** ① ② ③ ④ ⑤

Currency management is not considered a core discipline of the firm and we recommend that clients do not specify active currency hedging. Accordingly, we assign a neutral rank in this area.

IMPLEMENTATION ① ② ③ ④ ⑤

Ashutosh Sinha has accountability for the Asian portfolios. He is responsible for assimilating the macroeconomic and company research performed by the broader group and ensuring that the combination of country portfolios into a regional portfolio does not lead to any unintended risks. Our discussions have shown him to have a good understanding of investment strategy, how this is reflected in the portfolio. However, given the large number of stocks held in the portfolio, we question how well country portfolios best ideas are implemented. We will investigate this further in our next meeting.

MSIM has a centralised dealing function to allow the investment team to dedicate more time to portfolio management and research. We view this mechanism positively from an efficiency and compliance standpoint. Asset levels are not an impediment to the process in our view.

SECURITY SELECTION ① ② ③ ④ ⑤

MSIM's stock selection process aims to identify stocks that have attractive relative growth prospects. We note that the team's high conviction/growth-oriented approach can lead to significant stock position at times. The firm has shown a preference for small to medium companies in recent years and the portfolio has a significant size bias relative to the index.

MSIM has increased the emphasis on stock selection as a source of added value in portfolios. The firm has assembled a team of experienced investors which effectively supports the firm's stock selection process, in our opinion.

SELL DISCIPLINE ① ② ③ ④ ⑤

Sell disciplines are primarily driven by a change in the fundamental investment rationale or a stock reaching its target price.

We note that the number of stocks in the portfolio has increased in recent years. This reflects a move to include more small to medium companies in the portfolio and is not reflective of poor sell discipline in our view.



MORGAN STANLEY INVESTMENT MANAGEMENT, INC.**Important Legal Information**

This material is confidential and proprietary, not to be shared, reproduced, transferred or distributed in any form to any party without prior written permission from Russell Investments. This material is confidential and is intended only for the recipient. This is delivered on an "as is" basis without warranty. It is not an offer, solicitation, or recommendation to purchase any security or the services of any organization unless otherwise noted. The opinions expressed herein are given in good faith, are subject to change without notice, and are only correct as of the stated date of their issue. The material is based on information that Russell considers to be reliable, but neither Russell nor its affiliates warrant its completeness, accuracy or adequacy and it should not be relied upon as such. Russell Investments, including its subsidiaries and affiliates, may have past, current or future commercial relationships with investment management firms it researches and evaluates and as a result you should be aware that Russell may have a conflict of interest that could affect the objectivity of this report. For example, managers may use Russell analytical or index products. They may also serve as managers in Russell's funds or participate in commission recapture, transition management or other services offered by a Russell broker/dealer. These other relationships are not a factor in Russell's ranking process, and we believe we have adequate controls to protect the integrity of the research process. Through these other relationships, Russell solicits additional data about investment management firms, which data is not shared with Russell's manager research analysts in order to maintain the independence of Russell's manager research activities. Russell's manager research analysts are generally unaware of any business relationships that may exist between a particular investment manager and Russell or a Russell affiliate except as may be known from public sources or as may be discovered in the course of Russell's manager research and due diligence activities. In order to isolate the manager research activities from possible conflicts of interest, information acquired in other areas or affiliates is not shared with the research department. As a result, the information in this report is not a complete representation of all data known to Russell about an investment management firm that, if known to the manager research analysts, could affect their opinions or the objectivity of this report.



Confidential Proprietary Information of Russell Investments not to be distributed to third party without express written consent of Russell Investments. This material is subject to the "Important Legal Information" disclosure contained on the final page of this report. That disclosure must be considered as part of this report.

