

Morgan Stanley China A Share Fund, Inc.  
Form N-CSRS  
September 01, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED  
MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number 811-21926

Morgan Stanley China A Share Fund, Inc.  
(Exact name of registrant as specified in charter)

522 Fifth Avenue, New York, New York  
(Address of principal executive offices)

10036  
(Zip code)

John H. Gernon

522 Fifth Avenue, New York, New York 10036  
(Name and address of agent for service)

Registrant's telephone number, including area code: 212-296-0289

Date of fiscal year December 31,  
end:

Date of reporting period: June 30, 2016

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Item 1 - Report to Shareholders

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**Morgan Stanley China A Share Fund, Inc.**

**Directors**

Frank L. Bowman

Kathleen A. Dennis

Nancy C. Everett

Jakki L. Haussler

James F. Higgins

Dr. Manuel H. Johnson

Joseph J. Kearns

Michael F. Klein

Michael E. Nugent,  
*Chair of the Board*

W. Allen Reed

Fergus Reid

**Officers**

John H. Gernon

*President and Principal  
Executive Officer*

Stefanie V. Chang Yu

*Chief Compliance Officer*

Joseph C. Benedetti

*Vice President*

Francis J. Smith

*Treasurer and Principal  
Financial Officer*

Mary E. Mullin

*Secretary*

**Adviser and Administrator**

Morgan Stanley Investment Management Inc.

522 Fifth Avenue

New York, New York 10036

**Sub-Adviser**

Morgan Stanley Investment Management Company

23 Church Street

16-01 Capital Square, Singapore 049481

**Custodian**

State Street Bank and Trust Company

One Lincoln Street

Boston, Massachusetts 02111

**Stockholder Servicing Agent**

Computershare Trust Company, N.A.

211 Quality Circle, Suite 210

College Station, Texas 77845

**Legal Counsel**

Dechert LLP

1095 Avenue of the Americas

New York, New York 10036

**Counsel to the Independent Directors**

Kramer Levin Naftalis & Frankel LLP

1177 Avenue of the Americas

New York, New York 10036

**Independent Registered Public Accounting Firm**

Ernst & Young LLP

200 Clarendon Street

Boston, Massachusetts 02116

For additional Fund information, including the Fund's net asset value per share and information regarding the investments comprising the Fund's portfolio, please call toll free 1 (800) 231-2608 or visit our website at [www.morganstanley.com/im](http://www.morganstanley.com/im). All investments involve risks, including the possible loss of principal.

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## INVESTMENT MANAGEMENT

Morgan Stanley  
Investment Management Inc.  
Adviser

Morgan Stanley China A Share Fund, Inc.  
NYSE: CAF

Semi-Annual Report

June 30, 2016

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**Morgan Stanley China A Share Fund, Inc.**

**June 30, 2016**

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## **Morgan Stanley China A Share Fund, Inc.**

**June 30, 2016**

Letter to Stockholders (unaudited)

### **Performance**

For the six months ended June 30, 2016, the Morgan Stanley China A Share Fund, Inc. (the "Fund") had total returns of -9.97%, based on net asset value, and -10.30% based on market value per share (including reinvestment of distributions), compared to its benchmarks, the MSCI China A Index (the "Index")\*, which returned -18.89%, and the "China Blended Index", a custom blend of 80% of the MSCI China A Index and 20% of the MSCI China Index\*\*, which returned -16.07%. On June 30, 2016, the closing price of the Fund's shares on the New York Stock Exchange was \$17.86, representing a 15.5% discount to the Fund's net asset value per share. Past performance is no guarantee of future results.

### **Factors Affecting Performance**

- During the first half of 2016, gross domestic product (GDP) growth was relatively stable, at 6.7% for both first quarter and second quarter. Money supply growth (as measured by M2, which includes cash, checking and savings deposits, money market funds, and other time deposits) surged to a high of 14% in January and since slowed gradually to a more sustainable level of 11.8%.<sup>i</sup> In an attempt to further lower funding cost, the People's Bank of China (PBoC) announced further reserve requirement ratio cuts in February of 50 basis points. The recovery in the property market continued, as the rising new home sales that started in the second quarter of 2015 continued, helped by a surge in new mortgage loan supply. For the period from January to May 2016, the total gross floor area sold increased by 33% year-over-year.<sup>ii</sup> Home prices surged significantly in the tier-one cities, especially in Shenzhen and Shanghai, and even the nearby tier-two cities also saw sharp price rises. However, nationwide home prices remained relatively stable in spite of the surge in home prices in major cities. This is a welcome sign that the housing inventory destocking is ongoing, albeit slowly, as new home starts also rebounded only moderately in the first half of 2016 after declining in 2015. New home supply will likely remain elevated for the rest of 2016, and the policy easing measures will likely continue to help boost demand for properties. Growth in the shadow banking sector in which trust funds and off-balance sheet interbank activities are used to create credit slowed after the intervention by regulators. On the other hand, inflows into bank wealth management products has surged rapidly as investors chase the slightly higher yield offered compared to bank deposits. These inflows into bank wealth management products have supported bond prices, and in turn, stock prices as well. We expect the inflows into wealth management products to continue in the near term, but over the longer term it could be a potential source of risk that could put pressure on stock prices if the inflows slow. Margin financing and over-the-counter margin financing for equities, which were significant risks in the first half of 2015, have largely be resolved after the sharp correction in the second half of 2015.
- The renminbi currency depreciated roughly 2.2% in the first half of 2016, following the 4.6% depreciation in the second half of 2015 after the attempt by the Chinese government to liberalize the foreign exchange rate mechanism in August 2015. As the Chinese economy has been transforming from export-driven to domestic-demand driven growth, the impact of foreign exchange rate volatility on the Chinese economy has been lessening. Over the long run, the central bank will likely gradually increase flexibility in the FX system that could allow the exchange rate to be set by the market forces more freely, but the intervention will likely remain to manage market expectations. China's trade surplus remained high in the first half of 2016, primarily as the import price of energy and materials declined, while the competitiveness of Chinese exports improved. Also, domestic fund costs were noticeably lower after the central bank lowered interest rates and the reserve requirement ratios. This also led to significant





## **Morgan Stanley China A Share Fund, Inc.**

**June 30, 2016**

Letter to Stockholders (unaudited) (cont'd)

capital outflows, partly as corporations opted to raise renminbi-denominated debts in the local market as the foreign currencies debt matured and also partly driven by speculative activities.

- The main contributors to the Fund's relative performance during the period were an overweight exposure to the consumer staples sector, as well as our stock selection in the industrials and health care sectors.
- Detracting from relative performance were the Fund's underweight positions in the financials, materials and energy sectors, along with our stock selection in consumer staples stocks.
- The Fund occasionally utilizes P-notes (participation notes) to gain access to China's A-share market. P-note exposure is intended to mirror the performance of the underlying stock. There is no leverage associated with P-notes.

### **Management Strategies**

- Over the course of the period, the Fund held overweight positions in the consumer staples, health care and consumer discretionary sectors, the sectors which we believe could benefit from the economic transformation toward a more domestic-consumption driven economy, as noted earlier. In addition, we believe that rising income growth and urbanization could boost not only volume growth but also lead to rising demand for more branded and premium-priced items. Specifically, we prefer consumer discretionary and consumer staples companies with strong brand equity and pricing power, and consumer retailers with competitive distribution networks.
- We remain positive on the health care sector, as the expanding social medical coverage and facilities construction could continue to boost Chinese health care spending. In particular, we like pharmaceutical companies with strong brand power, superior quality control and strong distribution networks that can gain market share in a highly fragmented market.
- We are also positive on selected information technology (IT) companies, as we believe many Chinese corporations have now reached a scale that requires significant capital expenditures to upgrade their IT systems in an effort to boost and optimize operations and cost management. However, valuations for many of the stocks in this sector remain elevated and are pricing in "blue-sky" scenarios that will be difficult to achieve. As such, we have been and will continue to be disciplined in stock selection in this sector.
- We are positive on insurers, neutral on banks and cautious on brokers. The ongoing financial reforms should create growth opportunities for insurers and brokers at the expense of banks' profitability. Yet, valuations for most brokers are demanding, and we remain sensitive to valuations.
- Within the industrials sector, we are positive on selected infrastructure stocks that have low capital expenditures, high free cash flows, steady businesses and high dividend yields, and stocks that can benefit from Chinese outbound travel and tourism growth. We are also positive on power-grid equipment companies that can benefit from growing investment in the ultra-high voltage power grid network, electric car charging facilities, power grid automation and electricity pricing reform. We are cautious on companies in shipping, shipbuilding, construction and construction machineries.



**Morgan Stanley China A Share Fund, Inc.**

**June 30, 2016**

Letter to Stockholders (unaudited) (cont'd)

- The Fund held underweight positions in the materials and energy sectors on concerns over sluggish domestic demand, industry overcapacity, margin pressures, an expected slowdown in fixed-asset investment and weak overseas demand. We will continue to monitor the execution of the supply-side reforms. There has also been lot of focus on the "one-belt and one-road" or "Silk Road Economic Belt" plan, proposed by Chairman Xi, that would emulate the historic silk road that connected China to the Mediterranean region. This ambitious project will likely involve very significant infrastructure construction projects and potentially lead to large demand for materials, which could address the excess capacity in the industry. Yet, details released about the projects have been limited even as some of the senior members of the government have been trying to seek traction with meetings in Russia and surrounding countries.
- We are negative on the utilities and telecommunications sectors, as we believe they have limited growth potential, low profit margins and high capital expenditure needs. Yet, the current environment of declining interest rates could benefit some of the utilities companies, and we are searching for opportunities in this sector more actively.
- Looking forward, we remain positive on the very long-term prospect for China, given the vast amount of productive assets that China has been building and know-how that has been accumulated over the past few decades. As the economy adjusts itself, there will likely be a good amount of write-offs in unproductive assets, and it will likely take time to sort out the arrangements among various stake holders and re-allocate and re-tool the human resources to sectors that can maximize the productive power of the labor for future growth. Although this adjustment process will pose significant challenges in the short to medium term, the readjustment should be highly beneficial to the long-term potential growth of China and those companies that survive and emerge as market consolidators, problem solvers and innovators.

Sincerely,

John H. Gernon  
President and Principal Executive Officer July 2016

\*The MSCI China A Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of the China A share market. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends. It is not possible to invest directly in an index.

\*\*The MSCI China Index is designed to measure equity market performance of China. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends. It is not possible to invest directly in an index.

<sup>i</sup> Source: People's Bank of China and Bloomberg L.P.

<sup>ii</sup> Source: China Real Estate Information Corporation



**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Portfolio of Investments (unaudited)

	Shares	Value (000)
<b>COMMON STOCKS (97.4%)</b>		
<b>Automobiles (3.4%)</b>		
SAIC Motor Corp., Ltd., Class A	5,166,576	\$ 15,848
<b>Banks (9.3%)</b>		
Industrial & Commercial Bank of China Ltd., Class A	64,014,100	42,838
<b>Beverages (4.7%)</b>		
Tsingtao Brewery Co., Ltd., Class A	4,249,000	18,612
Tsingtao Brewery Co., Ltd. H Shares (a)	942,000	3,271
		21,883
<b>Chemicals (2.7%)</b>		
Kingenta Ecological Engineering Group Co. Ltd., Class A	10,238,432	12,481
<b>Electrical Equipment (4.1%)</b>		
Henan Pinggao Electric Co., Ltd., Class A	5,648,065	13,398
NARI Technology Co., Ltd., Class A	2,852,900	5,771
		19,169
<b>Electronic Equipment, Instruments &amp; Components (2.0%)</b>		
Universal Scientific Industrial Shanghai Co., Ltd., Class A	5,801,791	9,409
<b>Food &amp; Staples Retailing (2.8%)</b>		
Zhongbai Holdings Group Co., Ltd., Class A (b)	12,344,388	12,911
<b>Food Products (3.1%)</b>		
Inner Mongolia Yili Industrial Group Co., Ltd., Class A	5,645,500	14,211
<b>Health Care Providers &amp; Services (4.9%)</b>		
Shanghai Pharmaceuticals Holding Co., Ltd., Class A	7,391,000	20,157
Shanghai Pharmaceuticals Holding Co., Ltd. H Shares (a)	1,057,100	2,346
		22,503
<b>Hotels, Restaurants &amp; Leisure (9.5%)</b>		
China CYTS Tours Holding Co., Ltd., Class A	2,252,472	6,587
China International Travel Service Corp., Ltd., Class A	2,521,599	16,750
Shenzhen Overseas Chinese Town Co., Ltd., Class A	17,601,566	17,021

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Tsui Wah Holdings Ltd. (a)	22,214,000	3,648
		44,006
		<b>Value</b>
	<b>Shares</b>	<b>(000)</b>
<b>Household Durables (3.7%)</b>		
Qingdao Haier Co., Ltd., Class A	12,692,845	\$ 17,012
<b>Independent Power Producers &amp; Energy Traders (0.0%)</b>		
China National Nuclear Power Co., Ltd., Class A (b)	20,000	21
<b>Insurance (5.8%)</b>		
China Pacific Insurance Group Co., Ltd., Class A	6,604,600	27,036
<b>Media (2.9%)</b>		
China South Publishing & Media Group Co., Ltd., Class A	4,841,195	13,223
<b>Multi-line Retail (1.1%)</b>		
Wangfujing Group Co., Ltd., Class A	2,122,371	4,899
<b>Pharmaceuticals (18.2%)</b>		
China Resources Sanjiu Medical & Pharmaceutical Co., Ltd., Class A	13,253,512	48,533
Dong-E-E-Jiao Co., Ltd., Class A	1,759,690	14,066
Yunnan Baiyao Group Co., Ltd., Class A	2,229,360	21,630
		84,229
<b>Real Estate Management &amp; Development (2.2%)</b>		
China Overseas Grand Oceans Group Ltd. (a)(b)	23,302,000	6,886
Poly Real Estate Group Co., Ltd., Class A	2,715,429	3,533
		10,419
<b>Road &amp; Rail (2.1%)</b>		
Daqin Railway Co., Ltd., Class A	9,968,900	9,694
<b>Transportation Infrastructure (14.9%)</b>		
Jiangsu Expressway Co., Ltd., Class A	35,522,300	44,699
Shanghai International Airport Co., Ltd., Class A	1,768,397	6,957
Shenzhen Airport Co., Class A	13,278,534	17,088
		68,744
<b>TOTAL COMMON STOCKS</b> (Cost \$480,306)		450,536

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Portfolio of Investments (unaudited) (cont'd)

	Shares	Value (000)
<b>SHORT-TERM INVESTMENT (0.1%)</b>		
<b>Investment Company (0.1%)</b>		
Morgan Stanley Institutional Liquidity Funds Government Portfolio Institutional Class (See Note E) (Cost \$344)	344,021	\$ 344
<b>TOTAL INVESTMENTS (97.5%)</b> (Cost \$480,650) (c)(d)		450,880
<b>OTHER ASSETS IN EXCESS OF LIABILITIES (2.5%)</b>		11,457
<b>NET ASSETS (100.0%)</b>		\$462,337

(a) Security trades on the Hong Kong exchange.

(b) Non-income producing security.

(c) The approximate fair value and percentage of net assets, \$450,536,000 and 97.5%, respectively, represent the securities that have been fair valued under the fair valuation policy for international investments as described in Note A-1 within the Notes to the Financial Statements.

(d) At June 30, 2016, the aggregate cost for Federal income tax purposes approximates the aggregate cost for book purposes. The aggregate gross unrealized appreciation is approximately \$9,438,000 and the aggregate gross unrealized depreciation is approximately \$39,208,000 resulting in net unrealized depreciation of approximately \$29,770,000.

**Portfolio Composition**

Classification	Percentage of Total Investments
Other*	35.8%
Pharmaceuticals	18.7
Transportation Infrastructure	15.2
Hotels, Restaurants & Leisure	9.8
Banks	9.5
Insurance	6.0
Health Care Providers & Services	5.0
Total Investments	100.0%

\* Industries and/or investment types representing less than 5% of total investments.

The accompanying notes are an integral part of the financial statements.







**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Financial Statements

	<b>June 30, 2016</b> <b>(unaudited)</b> <b>(000)</b>
Statement of Assets and Liabilities	
<b>Assets:</b>	
Investments in Securities of Unaffiliated Issuers, at Value (Cost \$480,306)	\$ 450,536
Investment in Security of Affiliated Issuer, at Value (Cost \$344)	344
Total Investments in Securities, at Value (Cost \$480,650)	450,880
Foreign Currency, at Value (Cost \$12,204)	12,163
Cash	@
Receivable for Investments Sold	142
Dividends Receivable	50
Receivable from Affiliate	@
Other Assets	53
<b>Total Assets</b>	<b>463,288</b>
<b>Liabilities:</b>	
Payable for Advisory Fees	564
Payable for Custodian Fees	304
Payable for Professional Fees	31
Payable for Administration Fees	30
Payable for Stockholder Servicing Agent Fees	1
Other Liabilities	21
<b>Total Liabilities</b>	<b>951</b>
<b>Net Assets</b>	
Applicable to 21,881,465 Issued and Outstanding \$0.01 Par Value Shares (100,000,000 Shares Authorized)	\$ 462,337
<b>Net Asset Value Per Share</b>	<b>\$ 21.13</b>
<b>Net Assets Consist of:</b>	
Common Stock	\$ 219
Paid-in-Capital	505,499
Accumulated Undistributed Net Investment Income	1,452
Accumulated Net Realized Loss	(15,022)
Unrealized Appreciation (Depreciation) on:	
Investments	(29,770)
Foreign Currency Translations	(41)
<b>Net Assets</b>	<b>\$ 462,337</b>

@ Amount is less than \$500.

The accompanying notes are an integral part of the financial statements.



**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Financial Statements (cont'd)

	<b>Six Months Ended June 30, 2016 (unaudited) (000)</b>
Statement of Operations	
<b>Investment Income:</b>	
Dividends from Securities of Unaffiliated Issuers (Net of \$438 of Foreign Taxes Withheld)	\$ 3,944
Interest from Securities of Unaffiliated Issuers (Net of \$2 of Foreign Taxes Withheld)	21
Dividends from Securities of Affiliated Issuers (Note E)	1
<b>Total Investment Income</b>	<b>3,966</b>
<b>Expenses:</b>	
Advisory Fees (Note B)	3,374
Custodian Fees (Note D)	418
Administration Fees (Note C)	180
Professional Fees	146
Stockholder Reporting Expenses	32
Directors' Fees and Expenses	7
Stockholder Servicing Agent Fees	4
Other Expenses	25
<b>Total Expenses</b>	<b>4,186</b>
Rebate from Morgan Stanley Affiliate (Note E)	( @)
<b>Net Expenses</b>	<b>4,186</b>
<b>Net Investment Loss</b>	<b>(220)</b>
<b>Realized Loss:</b>	
Investments Sold	(17,792)
Foreign Currency Transactions	(476)
<b>Net Realized Loss</b>	<b>(18,268)</b>
<b>Change in Unrealized Appreciation (Depreciation):</b>	
Investments	(32,710)
Foreign Currency Translations	(56)
<b>Net Change in Unrealized Appreciation (Depreciation)</b>	<b>(32,766)</b>
<b>Net Realized Loss and Change in Unrealized Appreciation (Depreciation)</b>	<b>(51,034)</b>
<b>Net Decrease in Net Assets Resulting from Operations</b>	<b>\$ (51,254)</b>

@ Amount is less than \$500.

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Financial Statements (cont'd)

	<b>Six Months Ended June 30, 2016 (unaudited) (000)</b>	<b>Year Ended December 31, 2015 (000)</b>
Statements of Changes in Net Assets		
<b>Increase (Decrease) in Net Assets:</b>		
Operations:		
Net Investment Income (Loss)	\$ (220)	\$ 5,113
Net Realized Gain (Loss)	(18,268)	197,874
Net Change in Unrealized Appreciation (Depreciation)	(32,766)	(156,721)
<b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>	<b>(51,254)</b>	<b>46,266</b>
Distributions from and/or in Excess of:		
Net Investment Income		(2,994)
Net Realized Gain		(289,010)
<b>Total Distributions</b>		<b>(292,004)</b>
<b>Total Decrease</b>	<b>(51,254)</b>	<b>(245,738)</b>
<b>Net Assets:</b>		
Beginning of Period	513,591	759,329
<b>End of Period (Including Accumulated Undistributed Net Investment Income of \$1,452 and \$1,672)</b>	<b>\$ 462,337</b>	<b>\$ 513,591</b>

The accompanying notes are an integral part of the financial statements.

**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Financial Highlights

**Selected Per Share Data and Ratios**

	<b>Six Months Ended June 30, 2016 (unaudited)</b>	<b>2015</b>	<b>Year Ended December 31,</b>			<b>2011</b>
		<b>2014</b>	<b>2013</b>	<b>2012</b>		
<b>Net Asset Value, Beginning of Period</b>	\$ 23.47	\$ 34.70	\$ 25.18	\$ 23.25	\$ 22.46	\$ 27.87
Net Investment Income (Loss)†	(0.01)	0.23	0.27	0.11	(0.02)	(0.30)
Net Realized and Unrealized Gain (Loss)	(2.33)	1.89	10.97	1.93	2.85	(4.74)
Total from Investment Operations	(2.34)	2.12	11.24	2.04	2.83	(5.04)
Distributions from and/or in excess of:						
Net Investment Income		(0.14)	(0.26)	(0.11)		
Net Realized Gain		(13.21)	(1.46)	(0.00)‡	(2.04)	(0.37)
Total Distributions		(13.35)	(1.72)	(0.11)	(2.04)	(0.37)
<b>Net Asset Value, End of Period</b>	\$ 21.13	\$ 23.47	\$ 34.70	\$ 25.18	\$ 23.25	\$ 22.46
<b>Per Share Market</b>	\$ 17.86	\$ 19.91	\$ 30.37	\$ 23.81	\$ 24.05	\$ 19.35

**Value,  
End  
of  
Period**

**TOTAL INVESTMENT RETURN:**

Market Value	(10.30)%#	12.73%	34.85%	(0.49)%	36.27%	(27.94)%
Net Asset Value(1)	(9.97)%#	16.30%	45.69%	8.85%	13.09%	(17.63)%

**RATIOS, SUPPLEMENTAL DATA:**

**Net  
Assets,  
End  
of  
Period**

(Thousands)	\$2,337	\$513,591	\$759,329	\$550,958	\$508,668	\$491,374
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**Ratio  
of  
Expenses  
to  
Average  
Net  
Assets**

	1.85%+*	1.79%+	1.80%+	1.78%+	1.87%+	2.13%+
--	---------	--------	--------	--------	--------	--------

**Ratio  
of Net  
Investment  
Income  
(Loss)  
to  
Average  
Net  
Assets**

	(0.10)%+*	0.64%+	1.09%+	0.46%+	(0.08)%+	(1.14)%+
--	-----------	--------	--------	--------	----------	----------

**Ratio  
of  
Rebate  
from  
Morgan  
Stanley  
Affiliates  
to  
Average  
Net  
Assets**

	0.00%\$*	0.00%\$	0.00%\$	0.00%\$	0.00%\$	0.00%\$
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**Portfolio  
Turnover  
Rate**

	32%#	143%	98%	95%	93%	77%
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(1) Total investment return based on net asset value per share reflects the effects of changes in net asset value on the performance of the Fund during each period, and assumes dividends and distributions, if any, were reinvested. This percentage is not an indication of the performance of a stockholder's investment in the Fund based on market value due to differences between the market price of the stock and the net asset



value per share of the Fund.

† Per share amount is based on average shares outstanding.

‡ Amount is less than \$0.005 per share.

+ The Ratios of Expenses and Net Investment Income (Loss) reflect the rebate of certain Fund expenses in connection with the investments in Morgan Stanley affiliates during the period. The effect of the rebate on the ratios is disclosed in the above table as "Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets."

§ Amount is less than 0.005%.

# Not annualized.

\* Annualized.

The accompanying notes are an integral part of the financial statements.



## **Morgan Stanley China A Share Fund, Inc.**

**June 30, 2016**

### Notes to Financial Statements (unaudited)

The Morgan Stanley China A Share Fund, Inc. (the "Fund") was incorporated in Maryland on July 6, 2006 and is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the "Act"). The Fund applies investment company accounting and reporting guidance. The Fund's investment objective is to seek capital growth by investing, under normal circumstances, at least 80% of its assets in A-shares of Chinese companies listed on the Shanghai and Shenzhen Stock Exchanges. The prices of A-shares are quoted in Renminbi, and currently only Chinese domestic investors and certain Qualified Foreign Institutional Investors ("QFII") are allowed to trade A-shares. To the extent that the Fund invests in derivative or other instruments that are structured to be positively correlated and linked to China A shares, such investments will be counted for purposes of the Fund's policy as stated above. To the extent the Fund makes such investments, the Fund will be subject to the risks of such derivative or other instruments as described herein.

The adviser, Morgan Stanley Investment Management Inc. (the "Adviser"), has obtained a QFII license pursuant to which it is authorized to invest in China A-shares and other permitted China securities on behalf of the Fund up to its specified investment quota of \$200,000,000, as updated, modified or renewed from time to time (the "A-share Quota"). The Adviser has received an increase of \$250,000,000 to its A-share Quota, of which approximately \$138,000,000 was utilized through a rights offering in August 2010. There is no guarantee that the A-share Quota will not be modified in the future.

Securities purchased by the Adviser and/or the sub-adviser, Morgan Stanley Investment Management Company (the "Sub-Adviser"), in its capacity as a QFII, on behalf of the Fund, are credited to a securities trading account in China. All capital gains and income that the Fund earns on investments in China A-shares are held in that account, and may be repatriated subject to a tax filing clearance by the Shanghai Tax Bureau. Failure to obtain clearance on a timely basis could adversely affect the

Fund's ability to distribute taxable income and capital gains and cause the Fund to become liable for the payment of U.S. Federal income tax. See Note F. Federal Income Taxes.

**A. Significant Accounting Policies:** The following significant accounting policies are in conformity with U.S. generally accepted accounting principles ("GAAP"). Such policies are consistently followed by the Fund in the preparation of its financial statements. GAAP may require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results may differ from those estimates.

**1. Security Valuation:** (1) An equity portfolio security listed or traded on an exchange is valued at its latest reported sales price (or at the exchange official closing price if such exchange reports an official closing price), and if there were no sales on a given day and if there is no official exchange closing price for that day, the security is valued at the mean between the last reported bid and asked prices if such bid and asked prices are available on the relevant exchanges; (2) all other equity portfolio securities for which over-the-counter ("OTC") market quotations are readily available are valued at the latest reported sales price (or at the market official closing price if such market reports an official closing price), and if there was no trading in the security on a given day and if there is no official closing price from relevant markets for that day, the security is valued at the mean between the last reported bid and asked prices if such bid and asked prices are available on the relevant markets. Listed equity securities not traded on the valuation date with no reported bid and asked prices available on the exchange are valued at the mean between the current bid and asked prices obtained from one or more reputable brokers or dealers. An unlisted equity security that does not

trade on the valuation date and for which bid and asked prices from the relevant markets are unavailable is valued at the mean between the current bid

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Notes to Financial Statements (unaudited) (cont'd)

and asked prices obtained from one or more reputable brokers or dealers. In cases where a security is traded on more than one exchange, the security is valued on the exchange designated as the primary market; (3) when market quotations are not readily available, including circumstances under which the Adviser or Sub-Adviser determines that the closing price, last sale price or the mean between the last reported bid and asked prices are not reflective of a security's market value, portfolio securities are valued at their fair value as determined in good faith under procedures established by and under the general supervision of the Fund's Board of Directors (the "Directors"). Occasionally, developments affecting the closing prices of securities and other assets may occur between the times at which valuations of such securities are determined (that is, close of the foreign market on which the securities trade) and the close of business of the New York Stock Exchange ("NYSE"). If developments occur during such periods that are expected to materially affect the value of such securities, such valuations may be adjusted to reflect the estimated fair value of such securities as of the close of the NYSE, as determined in good faith by the Directors or by the Adviser using a pricing service and/or procedures approved by the Directors; (4) quotations of foreign portfolio securities, other assets and liabilities and forward contracts stated in foreign currency are translated into U.S. dollar equivalents at the prevailing market rates prior to the close of the NYSE; (5) investments in mutual funds, including the Morgan Stanley Institutional Liquidity Funds, are valued at the net asset value ("NAV") as of the close of each business day; and (6) short-term debt securities with remaining maturities of 60 days or less at the time of purchase may be valued at amortized cost, unless the Adviser determines such valuation does not reflect the securities' market value, in which case these securities will be valued at their fair market value determined by the Adviser.

The Directors have responsibility for determining in good faith the fair value of the investments, and the Directors may appoint others, such as the Fund's Adviser or a valuation committee, to assist the Directors in determining fair value and to make the actual calculations pursuant to the fair valuation methodologies previously approved by the Directors. Under procedures approved by the Directors, the Fund's Adviser has formed a Valuation Committee whose members are approved by the Directors. The Valuation Committee provides administration and oversight of the Fund's valuation policies and procedures, which are reviewed at least annually by the Directors. These procedures allow the Fund to utilize independent pricing services, quotations from securities and financial instrument dealers, and other market sources to determine fair value.

The Fund has procedures to determine the fair value of securities and other financial instruments for which market prices are not readily available. Under these procedures, the Valuation Committee convenes on a regular and ad hoc basis to review such securities and considers a number of factors, including valuation methodologies and significant unobservable valuation inputs, when arriving at fair value. The Valuation Committee may employ a market-based approach which may use related or comparable assets or liabilities, recent transactions, market multiples, book values, and other relevant information for the investment to determine the fair value of the investment. An income-based valuation approach may also be used in which the anticipated future cash flows of the investment are discounted to calculate fair value. Discounts may also be applied due to the nature or duration of any restrictions on the disposition of the investments. Due to the inherent uncertainty of valuations of such investments, the fair values may differ significantly from the values that would have been used had an active market existed. The Valuation

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## Notes to Financial Statements (unaudited) (cont'd)

Committee employs various methods for calibrating these valuation approaches including a regular review of valuation methodologies, key inputs and assumptions, transactional back-testing or disposition analysis, and reviews of any related market activity.

**2. Fair Value Measurement:** Financial Accounting Standards Board ("FASB") Accounting Standards Codification™ ("ASC") 820, "Fair Value Measurement" ("ASC 820"), defines fair value as the value that the Fund would receive to sell an investment or pay to transfer a liability in a timely transaction with an independent buyer in the principal market, or in the absence of a principal market the most advantageous market for the investment or liability. ASC 820 establishes a three-tier hierarchy to distinguish between (1) inputs that reflect the assumptions market participants would use in valuing an asset or liability developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in valuing an asset or liability developed based on the best information available in the circumstances (unobservable inputs) and to establish classification of fair value measurements for disclosure purposes. Various inputs are used in determining the value of the Fund's investments. The inputs are summarized in the three broad levels listed below.

- Level 1 unadjusted quoted prices in active markets for identical investments
- Level 2 other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 significant unobservable inputs including the Fund's own assumptions in determining the fair value of investments. Factors considered in making this

determination may include, but are not limited to, information obtained by contacting the issuer, analysts, or the appropriate stock exchange (for exchange-traded securities), analysis of the issuer's financial statements or other available documents and, if necessary, available information concerning other securities in similar circumstances

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities and the determination of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each security.

The following is a summary of the inputs used to value the Fund's investments as of June 30, 2016.

Investment Type	Level 1 Unadjusted quoted prices (000)	Level 2 Other significant observable inputs (000)	Level 3 Significant unobservable inputs (000)	Total (000)
<b>Assets:</b>				
<b>Common Stocks</b>				
Automobiles	\$	\$ 15,848	\$	\$ 15,848
Banks		42,838		42,838

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Beverages	21,883	21,883
Chemicals	12,481	12,481
Electrical Equipment	19,169	19,169
Electronic Equipment, Instruments & Components	9,409	9,409
Food & Staples Retailing	12,911	12,911
Food Products	14,211	14,211
Health Care Providers & Services	22,503	22,503
Hotels, Restaurants & Leisure	44,006	44,006

**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Notes to Financial Statements (unaudited) (cont'd)

<b>Investment Type</b>	<b>Level 1 Unadjusted quoted prices (000)</b>	<b>Level 2 Other significant observable inputs (000)</b>	<b>Level 3 Significant unobservable inputs (000)</b>	<b>Total (000)</b>
<b>Assets: (cont'd)</b>				
<b>Common Stocks (cont'd)</b>				
Household Durables	\$	\$ 17,012	\$	\$ 17,012
Independent Power Producers & Energy Traders		21		21
Insurance		27,036		27,036
Media		13,223		13,223
Multi-line Retail		4,899		4,899
Pharmaceuticals		84,229		84,229
Real Estate Management & Development		10,419		10,419
Road & Rail Transportation Infrastructure		9,694		9,694
		68,744		68,744
<b>Total Common Stocks</b>		<b>450,536</b>		<b>450,536</b>
<b>Short-Term Investment</b>				
Investment Company	344			344
<b>Total Assets</b>	<b>\$ 344</b>	<b>\$ 450,536</b>	<b>\$</b>	<b>\$ 450,880</b>

Transfers between investment levels may occur as the markets fluctuate and/or the availability of data used in an investment's valuation changes. The Fund recognizes transfers between the levels as of the end of the period. As of June 30, 2016, securities with a total value of approximately \$30,410,000 transferred from Level 1 to Level 2. Securities that were valued using unadjusted quoted prices at December 31, 2015 were valued using other significant observable inputs at June 30, 2016.

**3. Foreign Currency Translation and Foreign Investments:** The books and records of the Fund are maintained in U.S.



dollars. Foreign currency amounts are translated into U.S. dollars as follows:

investments, other assets and liabilities at the prevailing rate of exchange on the valuation date;

investment transactions and investment income at the prevailing rates of exchange on the dates of such transactions.

Although the net assets of the Fund are presented at the foreign exchange rates and market values at the close of the period, the Fund does not isolate that portion of the results of operations arising as a result of changes in the foreign exchange rates from the fluctuations arising from changes in the market prices of securities held at period end. Similarly, the Fund does not isolate the effect of changes in foreign exchange rates from the fluctuations arising from changes in the market prices of securities sold during the period. Accordingly, realized and unrealized foreign currency gains (losses) on investments in securities are included in the reported net realized and unrealized gains (losses) on investment transactions and balances.

Net realized gains (losses) on foreign currency transactions represent net foreign exchange gains (losses) from sales and maturities of foreign currency forward exchange contracts, disposition of foreign currencies, currency gains (losses) realized between the trade and settlement dates on securities transactions, and the difference between the amount of investment income and foreign withholding taxes recorded on the Fund's books and the U.S. dollar equivalent amounts actually received or paid. Net unrealized currency gains (losses) from valuing foreign currency denominated assets and liabilities at period end exchange rates are reflected as a component of unrealized appreciation (depreciation) in investments and foreign currency translations in the Statement of Assets and Liabilities. The change in unrealized currency gains (losses)

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on foreign currency translations for the period is reflected in the Statement of Operations.

A significant portion of the Fund's net assets consist of securities of issuers located in China which are denominated in foreign currencies. Changes in currency exchange rates will affect the value of and investment income from such securities. In general, Chinese securities are subject to greater price volatility, limited capitalization and liquidity, and higher rates of inflation than securities of companies based in the United States.

In addition, Chinese securities may be subject to substantial governmental involvement in the economy and greater social, economic and political uncertainty. Such securities may be concentrated in a single or a limited number of countries and regions and may vary throughout the year.

**4. Indemnifications:** The Fund enters into contracts that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

**5. Dividends and Distributions to Stockholders:** Dividend income and distributions to stockholders are recorded on the ex-dividend date. Dividends from net investment income, if any, are declared and paid annually. Net realized capital gains, if any, are distributed at least annually.

**6. Other:** Security transactions are accounted for on the date the securities are purchased or sold. Realized gains (losses) on the sale of investment securities are determined on the specific identified cost basis. Dividend income and distributions are recorded on the ex-dividend date (except certain dividends which may be recorded as soon as the Fund is informed of such dividends) net of applicable withholding taxes.

**B. Advisory/Sub-Advisory Fees:** The Adviser, a wholly-owned subsidiary of Morgan Stanley, provides the Fund with advisory services under the terms of an Investment Advisory Agreement, calculated weekly and payable monthly, at an annual rate of 1.50% of the Fund's average weekly net assets.

The Adviser has entered into a Sub-Advisory Agreement with the Sub-Adviser, a wholly-owned subsidiary of Morgan Stanley. The Sub-Adviser provides the Fund with advisory services subject to the overall supervision of the Adviser and the Fund's Officers and Directors. The Adviser pays the Sub-Adviser on a monthly basis a portion of the net advisory fees the Adviser receives from the Fund.

**C. Administration Fees:** The Adviser also serves as Administrator to the Fund and provides administrative services pursuant to an Administration Agreement for an annual fee, accrued daily and paid monthly, of 0.08% of the Fund's average weekly net assets.

Under a Sub-Administration Agreement between the Administrator and State Street Bank and Trust Company ("State Street"), State Street provides certain administrative services to the Fund. For such services, the Administrator pays State Street a portion of the fee the Administrator receives from the Fund.

**D. Custodian Fees:** State Street (the "Custodian") and its affiliates serve as Custodian for the Fund. The Custodian holds cash, securities, and other assets of the Fund as required by the Act. Custody fees are payable monthly based on assets held in custody, investment purchases and sales activity and account maintenance fees, plus reimbursement for

certain out-of-pocket expenses.

**E. Security Transactions and Transactions with Affiliates:** For the six months ended June 30, 2016, purchases and sales of investment securities for the Fund, other than long-term U.S. Government securities and short-term investments, were approximately \$151,601,000 and \$143,443,000, respectively.

**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

## Notes to Financial Statements (unaudited) (cont'd)

There were no purchases and sales of long-term U.S. Government securities for the six months ended June 30, 2016.

The Fund invests in the Institutional Class of the Morgan Stanley Institutional Liquidity Funds (the "Liquidity Funds"), an open-end management investment company managed by the Adviser. Advisory fees paid by the Fund are reduced by an amount equal to its pro-rata share of the advisory and administration fees paid by the Fund due to its investment in the Liquidity Funds. For the six months ended June 30, 2016, advisory fees paid were reduced by less than \$500 relating to the Fund's investment in the Liquidity Funds.

A summary of the Fund's transactions in shares of the Liquidity Funds during the six months ended June 30, 2016 is as follows:

Value December 31, 2015 (000)	Purchases at Cost (000)	Sales (000)	Dividend Income (000)	Value June 30, 2016 (000)
\$ 1,610	\$ 7,592	\$8,858	\$ 1	\$ 344

The Fund is permitted to purchase and sell securities ("cross-trade") from and to other Morgan Stanley Funds as well as other funds and client accounts for which the Adviser or an affiliate of the Adviser serves as investment adviser, pursuant to procedures approved by the Directors in compliance with Rule 17a-7 under the Act (the "Rule"). Each cross-trade is executed at the current market price in compliance with provisions of the Rule. For the six months ended June 30, 2016, the Fund did not engage in any cross-trade transactions.

The Fund has an unfunded Deferred Compensation Plan (the "Compensation Plan"), which allows each independent Director to defer payment of all, or a portion, of the fees he or she receives for serving on the Board of Directors. Each eligible Director generally may elect to have the deferred amounts credited with a return equal to the total return on one or more of the Morgan Stanley funds that are offered as investment options under the Compensation Plan. Appreciation/depreciation and distributions received from these investments are recorded with an offsetting increase/decrease in the deferred compensation obligation and do not affect the NAV of the Fund.

**F. Federal Income Taxes:** It is the Fund's intention to continue to qualify as a regulated investment company and distribute all of its taxable income. Accordingly, no provision for Federal income taxes is required in the financial statements.

The Fund may be subject to taxes imposed by countries in which it invests. Such taxes are generally based on income and/or capital gains earned or repatriated. Taxes are accrued based on net investment income, net realized gains and net unrealized appreciation as such income and/or gains are earned. Taxes may also be based on transactions in foreign currency and are accrued based on the value of investments denominated in such currency.

FASB ASC 740-10, "Income Taxes - Overall", sets forth a minimum threshold for financial statement recognition of the benefit of a tax position taken or expected to be taken in a tax return. Management has concluded that there are no significant uncertain tax positions that would require recognition in the financial statements. If applicable, the Fund recognizes interest accrued related to unrecognized tax benefits in "Interest Expense" and penalties in "Other Expenses" in the Statement of Operations. The Fund files tax returns with the U.S. Internal Revenue Service, New

York and various states. Generally, each of the tax years in the four-year period ended December 31, 2015, remains subject to examination by taxing authorities.

The tax character of distributions paid may differ from the character of distributions shown in the Statements of Changes in Net Assets due to short-term capital gains being treated as ordinary income for tax purposes. The tax character of

**Morgan Stanley China A Share Fund, Inc.****June 30, 2016**

Notes to Financial Statements (unaudited) (cont'd)

distributions paid during fiscal years 2015 and 2014 was as follows:

<b>2015 Distributions</b>		<b>2014 Distributions</b>	
<b>Paid From:</b>		<b>Paid From:</b>	
<b>Ordinary Income (000)</b>	<b>Long-Term Capital Gain (000)</b>	<b>Ordinary Income (000)</b>	<b>Long-Term Capital Gain (000)</b>
\$ 59,002	\$ 233,002	\$ 36,570	\$ 1,014

The amount and character of income and gains to be distributed are determined in accordance with income tax regulations which may differ from GAAP. These book/tax differences are either considered temporary or permanent in nature.

Temporary differences are attributable to differing book and tax treatments for the timing of the recognition of gains (losses) on certain investment transactions and the timing of the deductibility of certain expenses.

Permanent differences, primarily due to differing treatments of gains (losses) related to foreign currency transactions and on certain equity securities designated as issued by passive foreign investment companies, resulted in the following reclassifications among the components of net assets at December 31, 2015:

<b>Accumulated Undistributed Net Investment Income (000)</b>	<b>Accumulated Undistributed Net Realized Gain (000)</b>	<b>Paid-in- Capital (000)</b>
\$ (558)	\$ 558	\$

At December 31, 2015, the components of distributable earnings for the Fund on a tax basis were as follows:

<b>Undistributed Ordinary Income (000)</b>	<b>Undistributed Long-Term Capital Gain (000)</b>
\$ 12,199	\$ 5,237

The Fund must receive clearance from the Shanghai Tax Bureau to repatriate profits made from the sale of China A-shares. However, if the Fund does not receive clearance to repatriate funds on a timely basis, it will be unable to distribute taxable income and capital gains. Therefore, the Fund reserves the right not to pay any dividends, or to delay the payment thereof, in the event that the Adviser is not satisfied that the Fund can or will be able to fund such dividends through the repatriation of funds from China. This may cause the Fund to become liable for the payment of U.S. Federal income tax.

**G. Other:** The Corporate Income Tax ("CIT") Law took effect on January 1, 2008 and repealed the Income Tax Law of the People's Republic of China ("PRC") Concerning Foreign Investment Enterprises and Foreign Enterprises (the Old Foreign Investment Enterprise Income Tax Law) and the Enterprise Income Tax Provisional Rules of the PRC.

Under the CIT Law, a PRC tax resident enterprise is taxed at the CIT rate of 25%. Pursuant to the CIT Law and its detailed implementation rules, a non-PRC tax resident who does not establish a permanent establishment in China (or which has a permanent establishment in China but income derived is not effectively connected with such permanent establishment) is subject to PRC Withholding Income Tax ("WIT") of 10% on dividends, interest and other income (mainly referring to capital gain) from Chinese sources, unless the statutory WIT of 10% is subject to reduction or exemption in accordance with the applicable tax treaty signed with China.

In January 2009, China's State Administration of Taxation ("SAT") issued the Guoshuihan [2009] No.47 which imposed a withholding obligation on a Chinese tax resident to withhold a 10% WIT on dividends, bonus profits and interest paid to qualified foreign institutional investors ("QFIIs"). In other words, QFIIs were subject to a 10% WIT on dividends payable on China A shares.

**Morgan Stanley China A Share Fund, Inc.**

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Notes to Financial Statements (unaudited) (cont'd)

In November 2014, China's Ministry of Finance and SAT published Caishui [2014] No. 79 ("Circular 79"), which provided that QFIIs are temporarily exempt from WIT with respect to gains derived from the trading of shares on or after November 17, 2014. Circular 79 provided no indication on how long the temporary exemption would be extended. Circular 79 also confirmed that pre-November 17, 2014 gains derived by QFIIs were taxable according to prevailing laws. However, no specific published rules governing the taxation of pre-November 17, 2014 capital gains derived by QFIIs have been announced to date (including the application of treaty relief, application of the tax to gross vs. net gains, taxation of gains on the disposition of shares acquired prior to November 17, 2014 but disposed of on or after November 17, 2014).

Under the CIT Law, for an enterprise that is not a tax resident and has no permanent establishment in the PRC for CIT purposes, a 10% WIT shall apply to capital gains derived from the disposal of China A shares, subject to exemption/reduction under the current tax treaty between the PRC and the resident country of a QFII/foreign investor. The current U.S. and China tax treaty exempts gains realized on the sale of Chinese securities from the capital gain tax. The Fund has applied for and received approval for treaty protection from the PRC Tax Authorities.

Despite tax treaty protection, the Fund may be subject to WIT on gains from trading in land-rich companies which are companies that have greater than 50% of their assets in land or immovable properties in China. Consequently, on June 30, 2015, the Fund paid \$2,511,122 of WIT related to capital gains on land-rich companies realized from November 17, 2009 to November 16, 2014.

The tax law and regulations of China are subject to change, and may be changed with retrospective effect. The interpretation and applicability of tax law and regulations by PRC tax authorities are not as consistent and transparent as those of more developed nations, and may vary from region to region. Accordingly,

China taxes and duties payable by the QFII may change at any time.

On June 19, 2007, the Directors approved a share repurchase program for purposes of enhancing stockholder value and reducing the discount at which the Fund's shares trade from their NAV. Since the inception of the program, the Fund has not repurchased any of its shares in part because the Fund's ability to repatriate capital gains and income out of China is subject to clearance by the Shanghai Tax Bureau and is limited. The Directors regularly monitor the Fund's share repurchase program as part of their review and consideration of the Fund's premium/discount history. The Fund may only repurchase its outstanding shares at such time and in such amounts as it believes will further the accomplishment of the foregoing objectives and subject to review by the Directors and the Fund's ability to repatriate capital gains and income out of China.

At June 30, 2016, the Fund had record owners of 10% or greater. Investment activities of these shareholders could have a material impact on the Fund. The aggregate percentage of such owners was 15.3%.

**H. Results of Annual Meeting of Stockholders:** On June 21, 2016, an annual meeting of the Fund's stockholders was held for the purpose of voting on the following matter, the results of which were as follows:

Election of Directors by all stockholders:

**For**

**Against**



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Frank L. Bowman	14,202,060	810,231
Jakki L. Haussler	13,988,361	1,023,930
James F. Higgins	14,223,477	788,814
Manuel H. Johnson	14,104,047	908,244

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