Morgan Stanley

INVESTMENT MANAGEMENT

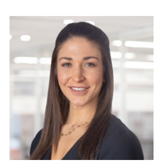
2022 Securitized Outlook

Déjà vu in 2022 for the Securitized Market

Despite an eventful 2021 which saw the competing forces of increasing vaccination rates offset by new COVID variants, and rising inflationary pressures met with a pivot of central bank policies, we enter 2022 with a similar outlook as we did the previous year. Much like in 2021 we expect there will be three essential drivers of solid performance in the securitized space in 2022: relatively short **interest rate** duration exposure, an underweight to agency mortgage-backed securities (MBS), and the improving **fundamentals** of the securitized credit markets.

GREGORY A. FINCK

Head of Securitized
Global Fixed Income Team



ERIN GLENN

Portfolio Specialist
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1. Inflation and the Risk of Rising Interest Rates:

Rising inflationary pressures will be a dominant theme in 2022 in both the U.S. and Europe. While central banks have taken a more hawkish tone recently, we nonetheless expect financial conditions to remain relatively easy, despite the expected rate hikes in 2022. As a result, inflationary pressures should be less transitory than many market forecasts, and interest rates should rise further over the course of the new year. In our view, maintaining a relatively short interest rate positioning will be essential to successful returns in 2022 *(Display 1)* much like last year.

2. The Federal Reserve's (Fed), and possibly the European Central Bank's (ECB) tapering of asset purchases

2021 featured record gross and net issuance volumes of agency MBS fuelled primarily by the refinance wave, a result of plunging interest rates, and by strong home purchase activity.[1] This record supply has been purchased entirely by a combination of the Fed and U.S. commercial banks, and as a result, MBS spreads have tightened more than 20 basis points (bps) from pre-pandemic levels. Since March 2020, the Fed has purchased over $2.8 trillion of MBS and increased their MBS holdings to $2.64 trillion in December.[2] U.S. banks have also purchased large amounts of agency MBS as bank deposit growth remains high, increasing their net MBS holdings by $800 billion during the past 22 months to $2.94 trillion.[3] With the Fed now accelerating its tapering of MBS purchases, and with bank demand for MBS likely to be reduced by slowing deposit growth, we expect Fed and bank MBS purchases to decline sharply in 2022. We also expect MBS supply to remain high given rising home pricing and increasing housing starts. The big question then for the MBS market is, who will fill the void left by the decline of Fed and bank buying?

In our view this market gap will be filled primarily by relative-value investors such as money managers during 2022. Considering that money managers' MBS holdings are at their lowest levels in more than 20 years and that U.S. agency MBS spreads are tight compared to times when money managers were net buyers, we believe that spreads will need to widen materially in order bring money managers back into the market as buyers. And although we still prefer agency

DISPLAY 1

Duration Versus 2021 Return

MS Mortgage Securities Trust (Class I) Versus Traditional Fixed Income Indexes

Source: MSIM, as of December 31, 2021. The indexes are provided for illustrative purposes only and are not meant to depict the performance of a specific investment. **Fund performance data represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown.** See pages 4-5 for Fund performance and index definitions.

[1] Source: Bloomberg, as of December 31, 2021.

[2] Source: N.Y. Federal Reserve

[3] Source: Bloomberg, as of December 31, 2021.

MBS to U.S. corporates *(Display 2)*, we enter 2022 with an underweight to agency MBS, in favor of securitized credit opportunities, with the expectation for agency MBS spreads to widen this year.

3. Improving Securitized Fundamental Credit Conditions

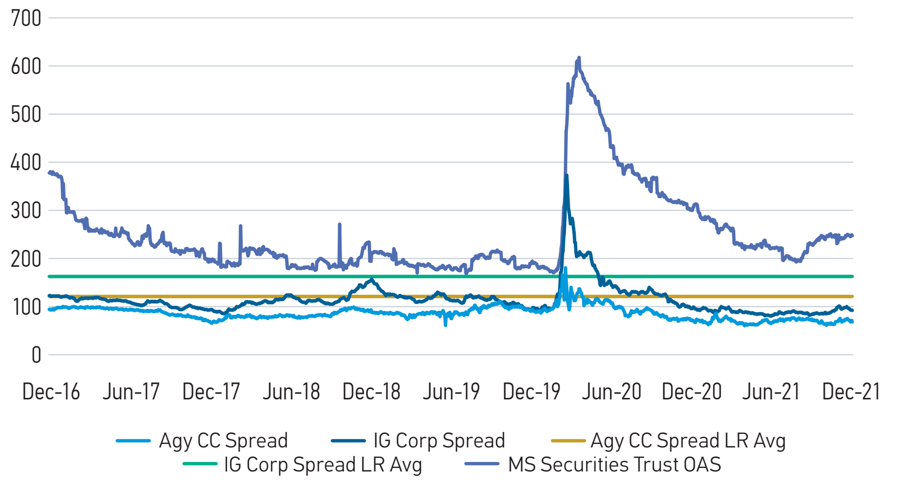
Fundamental credit conditions remain robust in much of the securitized market, especially the housing and consumer credit sectors, and we believe that these conditions should drive strong performance in 2022. Over the past year, home prices are up 19% in the U.S., and between 6% to 10% across Europe, driven by a number of factors: an improving employment outlook; healthy household balance sheets; historically low mortgage rates helping home affordability; low housing supply; increasing housing demand from both the millennial generation (largest U.S. demographic cohort ever); the evolving work-from-home (WFH) dynamics.[4] Consumer savings rates have seen record highs for much of the past two years and household balance sheets remain near their strongest levels in more than twenty years, while household debt levels also hover around historical lows.

The commercial real estate sector (CMBS) has been the most severely impacted by the pandemic, but sector challenges are evidencing substantial improvement as the pandemic eases and the economy slowly continues to normalize. While our views diverge materially by subsector and individual property, we expect to see further improvements across all areas of CMBS in 2022. Even in the most negatively impacted sectors, such as shopping centers and business-oriented hotels, which appear less likely to fully recover even in a post-pandemic world, we expect further positive developments in 2022. We also have some uncertainties about office buildings and multifamily apartment buildings post-pandemic, given the ever evolving WFH dynamic, but the impact on these sectors is less severe and we again expect continued improvement. Logistics centers and warehouse spaces have been the area in CMBS that have experienced the most upside post-pandemic, benefitting from the sharp rise in e-commerce.

DISPLAY 2

Both MBS and IG Corporate Spreads Appear Expensive, Especially When Compared With Securitized Opportunities

Corporate Credit Spreads Have Tightened Significantly Relative to Historical Averages (in bps)



Source: Bloomberg, as of December 31, 2021. The indexes are provided for illustrative purposes only and are not meant to depict the performance of a specific investment. **Fund data represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown.** See pages 4-5 for Fund performance and index definitions.

Opportunities and Challenges for Securitized Investors in 2022

Residential and consumer credit sectors remain our highest conviction trades for the upcoming year. As mentioned earlier, we expect the healthy fundamental credit conditions supporting the housing market and consumer balance sheets to remain strong, and believe attractive investment opportunities still exist. We expect home prices to continue to rise in both the U.S. and Europe, albeit at a more modest pace than in 2021, and for consumer credit conditions to remain quite solid, especially as the employment picture continues to improve.

New origination and issuance of residential mortgage-backed securities (RMBS) have increased significantly over the past year, and we expect continued healthy supply in 2022, creating a wide variety of residential-related investment opportunities. Consumer asset-backed securities (ABS) activity has also surged, although we currently do not see the same relative value opportunity in consumer ABS as we see in the various RMBS markets.

The more COVID-challenged sectors—commercial real estate, aircraft leases, and small business loans for example—continue to present credit concerns, especially if pandemic-related effects linger with new variants or a resurgence of COVID cases. While we believe these sectors could represent attractive recovery stories for 2022, we also approach these opportunities cautiously, keeping in mind that they also bear material risk should any of the aforementioned scenarios take place.

[4] Sources: S&P Case-Shiller Core-Logic Home Price Index & the ECB, as of December 31, 2021.

The Rationale for MSIM's Approach to Securitized Assets

We believe that our securitized funds are favorably positioned to perform well in 2022 for three key reasons: Our strategies are managed with relatively low interest rate duration, have modest agency MBS exposure, and focus on those securitized credit sectors with solid fundamentals. In our minds, successful management of these areas will be critical in order to generate returns in the securitized market in 2022. More importantly however, our active and worldwide investment approach allows us to take advantage of evolving opportunities across the global securitized markets. The team actively invests across a variety of geographies and securitized asset classes, including agency mortgage-backed securities, non-agency residential mortgage-backed securities, commercial mortgage-backed securities, and asset-backed securities in the United States and globally. The flexibility of our investment approach allows us to reposition our portfolios, attempting to capitalize on the most attractive risk-adjusted opportunities across the world's securitized markets, designed to deliver alpha from both active sector selection as well as specific security selection.

DISPLAY 3

Average Annual Total Returns

As of December 31, 2021

	1 YR	3 YRS	5 YRS	10 YRS	SINCE INCEPTION (7/28/1997)
Class I (%)	1.06	3.74	4.01	4.67	4.61
Bloomberg U.S. Mortgage Backed Securities (MBS) Index (%)	-1.04	3.01	2.50	2.28	4.55

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please select the "month" timeframe or call 1-800-548-7786. Investment returns and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.

The fund has received proceeds related to certain non-recurring litigation settlements. If these monies were not received, any period returns which include these settlement monies would have been lower. These were one-time settlements, and as a result, the impact on the net asset value and consequently the performance will not likely be repeated in the future.

The gross expense ratio is 0.91% for Class I shares and the net expense ratio is 0.70%.Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Trustees acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus. The minimum initial investment is $5,000,000 for Class I shares.

Risk Considerations

There is no assurance that a Portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the Portfolio will decline and may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this Portfolio. Please be aware that this Portfolio may be subject to certain additional risks. **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. **Mortgage- and asset-backed securities** are sensitive to early prepayment risk and a higher risk of default, and may be hard to value and difficult to sell (liquidity risk). They are also subject to credit, market and interest rate risks. Certain **U.S. government securities** purchased by the Strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **High-yield securities ("junk bonds")** are lower-rated securities that may have a higher degree of credit and liquidity risk. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **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.

INDEX DEFINITIONS

The **Bloomberg Euro Investment Grade Corporate** measures the investment grade, euro-denominated, fixed-rate bond market for corporate issues. Inclusion is based on currency denomination of a bond and not country of risk of the issuer. The **Bloomberg Pan-European High Yield Index** covers the universe of fixed-rate, sub-investment-grade debt denominated in euros or other European currencies (except Swiss francs). This index includes only euro-and sterling-denominated bonds, because no issues in the other European currencies now meet all the index requirements. To be included, the bonds must be rated high-yield (Ba1/BB+ or lower) by at least two of the following ratings agencies: Moody's, S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine index eligibility. If only one of the three agencies rates a security, the rating must be high-yield. Bonds must have at least one year to maturity and an outstanding par value of at least EUR50 million. The index does not include non-rated bonds, and it excludes debt from entities in countries that are designated as emerging markets. The **Bloomberg U.S. Corporate Index** is a broad-based benchmark that measures the investment-grade, fixed-rate, taxable, corporate bond market. The **Bloomberg U.S. Mortgage Index** covers the mortgage-backed, pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). This index is the mortgage-backed securities, fixed rate component of the Barclays U.S. Aggregate Index. The **Bloomberg Global Aggregate Index** provides a broad-based measure of the global investment grade fixed-rate debt markets. Total Returns shown in unhedged USD. The **Bloomberg Euro Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, euro-denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues. Inclusion is based on currency denomination of a bond and not country of risk of the issuer. The **S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index** seeks to measure the value of residential real estate in 20 major U.S. metropolitan areas: Atlanta, Boston, Charlotte, Chicago, Cleveland, Dallas, Denver, Detroit, Las Vegas, Los Angeles, Miami, Minneapolis, New York, Phoenix, Portland, San Diego, San Francisco, Seattle, Tampa and Washington, D.C.

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