A Sub-Fund of Morgan Stanley Funds (UK)

MS Calvert Fixed Income Opportunities Fund

BROAD MARKETS FIXED INCOME TEAM

Performance Review

In the one month period up until 31 March 2025, the Fund's I ACC shares returned 0.13% (net of fees)[1].

The Fund had positive absolute performance in March.

Macro decisions contributed to positive performance, while spread sector positions detracted from absolute performance.

The Fund's long duration exposure in the euro area detracted from performance as duration in Europe sold off on the back of the new, ambitious fiscal expansion plan announced by newly elected German Chancellor Merz, which pushed yields higher. The yield curve steepener positions in the euro area and U.S. contributed to performance.

Higher "risk-free" rates continued to benefit performance.

The allocation to euro area spreads had a small positive impact on performance.

Exposure to both external and quasi spreads detracted from performance.

Exposure to investment grade and high yield corporate bonds detracted from performance.

The allocation to securitised assets also detracted from performance, specifically exposure to non-agency commercial mortgage-backed securities (CMBS), agency residential mortgage-backed securities (RMBS) and asset-backed securities (ABS).

Portfolio Activity

Overall, the duration of the Fund was reduced by -0.01 years, closing at 3.43 years.

The Fund re-initiated the short Japan duration given we are less concerned about the relationship with the U.S. as the markets seem to be more bifurcated now. Additionally, Japanese unions' wage demands are strong, which will keep the Bank of Japan more hawkish than the market is anticipating.

The Fund trimmed the exposure to the U.K. and New Zealand.

The Fund increased the exposure to the U.S., recognizing that the upside yield risks seem more limited, while growth risks have also increased given the administration's current stances. The Fund also increased exposure to the euro area.

Within spread sectors, the Fund trimmed exposure to investment grade corporate bonds and government-related bonds.

The Fund has an exposure to green bonds and social, sustainability and sustainability-linked bonds of 31.5%.

Strategy and Outlook

Reversing the weather adage, this March came in like a lamb and went out like a lion for financial markets. Any discussion of the outlook for economies, monetary and fiscal policies, and interest rates must now incorporate the epochal "Liberation Day," the Trump administration's tariff announcement day on 2 April. As widely covered in the media, the magnitude was much worse than expected as President Trump increased prospective tariffs to rates that could surpass those last seen in the early 1900s. Even fairly hawkish analysts expected average U.S. tariff rates to increase to only 11% (up from 2024's 2%-3% level). Taking the tariff numbers at face value, the U.S. average tariff rate will rise to the mid-20% level and could go higher if retaliation becomes widespread. China, as anticipated, has already retaliated, raising tariffs 34% on all U.S. imports and restricting exports of rare earth metals. Of course, the less bearish interpretation is that these measures are a gambit by the U.S. administration to negotiate tariffs down in return for easier access for U.S. goods and/or other favours.

The tariffs as currently envisioned by the U.S. administration will likely be a significant blow to U.S. and global growth as well as seriously inflationary, at least for the U.S., potentially generating a stagflationary outcome. In response, a range of policy actions — including monetary and fiscal policy easing, retaliatory trade actions, negotiating down tariffs, and appeasement — are likely to follow. Unfortunately, regardless of policy response, given the level of deterioration in both risk sentiment and confidence in U.S. policymaking, a 2025 global recession appears much more probable.

To avert such a negative 2025 outcome, policies need to change quickly. This may be possible in Europe and Japan, and to a lesser extent in Asia, where fiscal policy can be eased aggressively — but not so much in the U.S. At current tariff levels, duties collected would be over 3% of gross domestic product (GDP).[2] The previous highest tariff revenue collected was 0.5% of GDP in the

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 March 2025.
[2] Source: Minack Advisors 3 April 2025.

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mid-1930s.[2] Why is it so much higher now? Globalization. Global trade is much bigger now than in the 1930s and imports are a much larger percentage of the economy. Indeed, U.S. imports top $3 trillion per year.[3] As a reminder, tariffs are a tax on U.S. consumers and corporations, and this would represent the largest tax increase since the 1960s. The implications of this fiscal contraction are ominous and would result in a draconian tightening of fiscal policy. Estimates suggest a GDP reduction of 1%-2% of GDP, which would take the economic growth rate to zero or below.[3] The disposition of U.S. tariff revenue, ignoring the inflationary implications, will be critical to the U.S. economic outlook. Unfortunately, changes in fiscal policy are at the mercy of the U.S. Congress, which is stuck in a budget resolution process that will likely take until the end of summer to resolve. If tariff revenue was recycled back to the household and corporate sectors, the negative macroeconomic effects could be somewhat mitigated and reduce the probability of recession.

What about monetary policy? The inflation implications of the stated tariff structure are anticipated to put upward pressure on prices and complicate the Federal Reserve's (Fed) job. Estimates for core consumer price index (CPI) run from 3.5% to 5% for 2025 and, as Chairman Powell said on 4 April, the Fed needs to make sure the seemingly one-off price hikes do not feed permanently into inflation, reducing the Fed's ability to ease policy at least in the short term. Moreover, Institute for Supply Management (ISM) business surveys already show signs of incipient inflationary pressures at the corporate level with falling orders — evidence of stagflation already building. So, while it is reasonable to expect the Fed to cut interest rates if the economy weakens substantially, a more modest weakening will likely not catalyse a rate move. We expect the Fed to sit on the sidelines until more is known, which is unlikely before June at the earliest. Any rate cuts are likely to occur in the second half of the year.

This stagflationary dynamic looks worse in the U.S. than the rest of the world. The economic growth hit is global, but the inflationary impact is predominantly in the U.S. While U.S. growth could possibly be negative in the first and second quarters, inflation will likely be rising significantly. One indirect positive recent development is that energy prices have fallen substantially, which benefits U.S. firms by cushioning some of the inflationary shock of tariffs.

The rest of the world will also experience a growth shock. But the EU, Japan and China are large economies with fiscal space to respond to economic weakness by deploying aggressive fiscal easing, especially in the EU, in the months ahead. And, even if easing is not deployed immediately, expectations of a policy shift are likely to bolster confidence at both the household and corporate levels, supporting growth.

The bottom line is that recession risk has risen everywhere. The good news is that global economic fundamentals were solid coming into this year. This should help cushion the shock. Indeed, the U.S. may avoid a recession, but danger signs abound. Retaliation poses a downside risk, as do further big drops in business sentiment and concomitant deterioration in labour markets. In addition to solid fundamentals, policy easing, potentially aggressively, in much of the world could also provide an offset. Unfortunately, the U.S., the epicentre of the shock, is in the least favourable position to handle the shock given the logjams on fiscal policy and the Fed frozen (at least for now) by the potential rise in inflation.

Government bond yields have been well supported. U.S. Treasury bonds resumed their bull market, while the bear market that emerged in European bonds in March has flipped to a bull market. Yields have fallen meaningfully in the space of a few weeks. How much further they fall will depend on incoming news on tariffs, non-tariff policy responses and the performance of equities. So far, government bonds have rallied as equities have fallen (performing their diversifying function). For many U.S. equity sectors, the drop from peak to current levels has been substantial, suggesting the end might be near if the bad news ends. This would also suggest the 3.75% level in the 10-year U.S. Treasury yield, near the 2024 low, will likely be hard to break unless we get more bad news (such as U.S. fiscal policy tightening, tariff escalation). We are modestly overweight interest rate risk and modestly overweight credit exposure but keeping risk exposures low by historical standards.

Credit spreads, already beginning to widen in March, have followed equities' lead and are now underperforming at an accelerated pace. While continued pressure is likely given the tariff news, credit fundamentals were quite strong coming into the event, even if valuations were on the high side. While economies are slowing, the absence of private sector imbalances have made them well placed to absorb some of the shock. For example, the share of BBB- issuers in investment grade credit indexes is at a historical low. All-in yields on U.S. investment grade corporate bonds are still around 5%-5.5%, an attractive nominal and real yield as long as inflation returns, even if slowly, back to the recent level. Lastly, corporate behaviour tends to become more conservative during tumultuous periods, which usually benefits creditors. This suggests that spreads may not widen to the wides we have seen in previous recessionary periods. At some point, with some differentiation among sectors, we expect corporate bonds to be a more attractive buy. Euro investment grade exposure is preferred at the margin, given the EU's greater flexibility on monetary and fiscal policy to respond to the tariff shock. The high yield market is more vulnerable, but we also do not anticipate a widening to usual recessionary levels. There is always the chance that, per most investors' expectations, the current proposed tariff rates will be negotiated down over the next few months. Nonetheless, damage has been done already and the outlook is less positive than before given the tremendous uncertainty created by the U.S. administration's economic agenda.

Securitized credit and U.S. agency mortgage-backed securities (MBS) have been less ruffled by recent volatility than other sectors and remain our favourite overweight. However, the recent outperformance of this sector compared to corporate credit has marginally reduced its relative value. That said, securitized credit does not face the same issues as the U.S. corporate sector during this period of heightened economic uncertainty. Amid the current noise and uncertainty in the world, we believe this sector can continue to perform well.

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2 Source: Minack Advisors 3 April 2025.
3 Source: Deutsche Bank Research April 2025.

In currency markets, also somewhat paradoxically, the U.S. dollar weakened in response to Trump's tariff unveiling. The U.S. implementation of tariffs was supposed to be dollar-positive as it would encourage other countries to let their currencies depreciate to offset their effects. The opposite seems to be happening. Countries like China are digging in their heels and have resisted currency depreciation, looking for fiscal policy to offset tariff effects, while Europe, contrary to the naysayers, has now announced plans for historically unprecedented fiscal expansion. These policy mixes have, at least for now, undermined the dollar, as U.S. policy seems to be going in the other direction, i.e., tighter fiscal policy and easier monetary policy. How long this is likely to last is unknown and depends on policy implementation around the world. Certainly, we have become less convinced about the direction of currencies and prefer to sit on the sidelines during this transitional period.

For further information, please contact your Morgan Stanley Investment Management representative.

Fund Facts

Launch date	11 December 2020
Base currency	Sterling

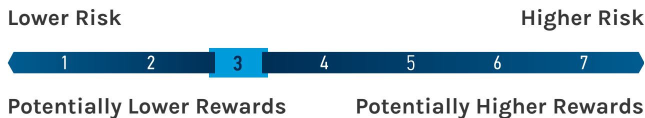
12 Month Performance Periods to Latest Month End (%)

Past performance is not a reliable indicator of future results.

	MARCH '24 - MARCH '25	MARCH '23 - MARCH '24	MARCH '22 - MARCH '23	MARCH '21 - MARCH '22	MARCH '20 - MARCH '21
OEIC MS Calvert Fixed Income Opportunities Fund - I ACC Shares	5.87	5.65	-3.55	-2.59	--

Returns may increase or decrease as a result of currency fluctuations. All performance data is calculated NAV to NAV, net of fees, and does not take account of commissions and costs incurred on the issue and redemption of shares. The sources for all performance and index data is Morgan Stanley Investment Management ('MSIM Ltd'). **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class I ACC Risk and Reward Profile



The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk-free investment.
- The Fund is in this category because it invests in fixed interest securities. and the Fund's simulated and/or realised return has experienced medium rises and falls historically.
- The Fund may be impacted by movements in the exchange rates between the Fund's currency and the currencies of the Fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- The value of bonds are likely to decrease if interest rates rise and vice versa.
- The value of financial derivative instruments can be complex and volatile, and may result in losses in excess of the amount invested by the Fund.
- Issuers may not be able to repay their debts, if this happens the value of your investment will decrease. This risk is higher where the Fund invests in a bond with a lower credit rating.
- The Fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the Fund to financial loss.
- Sustainability factors can pose risks to investments, for example: impact asset values and increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the Fund's ability to buy or sell securities.
- Investment in Fixed Income Securities via the China Interbank Bond Market may also entail additional risks, such as counterparty and liquidity risk.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the Fund will achieve its investment objectives.
- Investments may be in a variety of currencies and therefore changes in rates of exchange between currencies may cause the value of investments to decrease or increase. Furthermore, the value of investments may be adversely affected by fluctuations in exchange rates between the investor's reference currency and the base currency of the investments.

Please refer to the Prospectus for full risk disclosures. All data as of 31.03.2025 and subject to change daily.

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The use of leverage increases risks, such that a relatively small movement in the value of an investment may result in a disproportionately large movement, unfavourable as well as favourable, in the value of that investment and, in turn, the value of the Fund.

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