Morgan Stanley
INVESTMENT MANAGEMENT

Marketing Communication

MONTHLY COMMENTARY
31 August 2024

Morgan Stanley Investment Funds

US Property Fund

GLOBAL LISTED REAL ASSETS TEAM

Important Information

- The Fund invests primarily in equity securities of companies in the US real estate industry.
- Investment involves risks. Key risks for this fund include Risk of Investment in the Real Estate Industry and REITs, Risk of Investment in Equity and Risk of Exposure to the Euro and Eurozone.
- There is a risk that you may potentially lose your entire investment in this Fund.
- The investment decision is yours but you should not invest unless the intermediary who sells it to you has advised you that it is suitable for you and has explained why, including how buying it would be consistent with your investment objectives. You should not make any investment decision solely based on this document. Please read the relevant offering document carefully for further fund details including risk factors.

Performance and Market Review

In the one month period ending 31 August 2024, the Fund's A shares returned 5.60% (net of fees)[1], while the benchmark returned 6.35%.

U.S. real estate securities surged (FTSE Nareit Equity REITs Net Index, "the Index," 6.35%) and significantly outperformed the broader equity market (S&P 500 Net Index, 2.38%) for the month. The Fund underperformed the Index, returning 5.60% (Class A shares net of fees).

Equities ended August higher, but the month began with extreme market volatility and some sharp stock market declines, as investors reacted to weak economic data and priced in several interest rate cuts by the end of the year. However, data later in the month along with strong corporate earnings provided some reassurance as equities lagged listed real estate for the period. Within the Index, the self-storage sector was a top performer in August, benefiting from high operating margins, low capital expenditure needs and need-based demand. Apartments was another outperformer as the for-sale housing market remains challenged. Seniors housing health care was also a top performer for the month, given the continued favorable operating environment, with a decline in new construction over the last two years and population growth within the 80+ age cohort accelerating. Skilled nursing also outperformed, as tenant operations appear to have bottomed and are improving. The cold storage industrial sector was a key underperformer and the only sector posting negative returns for the month as throughput volumes remain depressed. The logistics industrial sector also underperformed as new supply remains elevated and leasing demand slows. The office sector was another underperformer, as depressed leasing, pricing and occupancy, in conjunction with an elevated expense structure, continue to present major headwinds for sector.

The Fund's security selection in single-family rentals and net lease (excluding retail), the underweight to the logistics industrial sector, and overweight to self-storage were top contributors to relative performance. These contributions were partially offset by the Fund's overweight to the cold storage industrial sector, out-of-benchmark position in towers, and security selection in shopping centers and life science health care.

Strategy and Outlook

The team uses internal proprietary research to invest in public real estate companies that we believe offer the best value relative to their underlying assets and growth prospects. The team combines a bottom-up approach, assessing the intrinsic value, equity multiples and growth prospects of each security, with a top-down view that incorporates fundamental inflection points, macroeconomic considerations and geopolitical risk. By incorporating both an equity market valuation and a more traditional real estate valuation with a top-down overlay, we believe the Fund will be better prepared to identify securities with the best expected total returns.

Given the expected stabilization in interest rates across the globe, the start of interest rate cuts in certain countries, and strong and growing expectations of imminent interest rate cuts by the Federal Reserve in the second half of 2024, forecasted returns for the asset class are positive. While changing market sentiment and expectations about the magnitude of interest rate cuts may cause volatility in the overall real estate sector returns, the longer-term outlook remains favorable. Moreover, we believe relative strength in cash flows can be expected given the unique nature of listed real estate. Specifically, contracted rental streams with inflation-linked escalations and the necessity-based nature of real estate—the listed real estate market evolves and grows with the broader needs of society and the economy and sits at the epicenter of how people live, work, shop and communicate—coupled with limited new real estate supply additions in the vast majority of sectors, should result in cash flow growth.

Additionally, secular themes driving demand for necessity-based real estate, including Technology and Innovation, Aging Demographics, Housing Shortages and Affordability, Global Supply Chain Reorganization and Onshoring, and External Growth Opportunities, are powerful catalysts that we believe can propel growth above expectations for years to come and ultimately reset

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 August 2024.

valuations higher in exposed sectors. Finally, we believe the relative valuation of real estate securities is attractive, specifically when compared to direct property investment and the broader equities market, and is presenting an interesting pricing arbitrage opportunity for investors.

Secular trends will result in winners and losers for real estate.

- In retail, secular headwinds remain; however, the physical store remains an important point of distribution for retailers. We favor the outlook for nondiscretionary, grocery and convenience-oriented retail landlords. Tenant bankruptcy watch lists are stable, and the pipeline of new tenants looking to enter high quality retail centers is surprisingly strong. New supply is non-existent.
- Work-from-home (WFH) policies will likely be a permanent overhang on office demand, and related uncertainty regarding future office absorption is expected to remain an open question for several more years. Utilization rates remain stubbornly low versus 2019 levels, with high levels of vacancy and sublease space available across key markets. Despite value and demand deterioration broadly, the market is beginning to recognize and appreciate that well located, class A office buildings will likely remain a store of value and could present interesting opportunities for investment.
- In lodging, leisure demand is seeing some moderation from record high levels; however, business and group travel is improving, although is expected to remain below pre-COVID levels. New supply remains below historical averages.
- In residential, affordability concerns regarding homeownership, given high mortgage rates and home prices, has led to increasing rental demand for both traditional multi-family and single-family rentals. However, we are closely monitoring the impacts of lower interest rates and mortgage costs on the rental market, as this could dampen demand in the medium term. New supply growth in multi-family is above the historical trend, particularly in Sunbelt markets, but is beginning to moderate.
- In industrial, longer-term trends remain solid, driven by the continued need to modernize logistics distribution and a growing trend towards onshoring, which has resulted in record-low vacancy and double-digit revenue growth for warehouses. However, new supply is significantly above average and currently outpacing demand, despite these favorable secular tailwinds. Additionally, tenants are displaying less urgency in decision-making, elongating the sales cycle for lease signing. While new market rent growth is moderating and vacancy is modestly increasing, the embedded growth remains among the highest within commercial real estate and is expected to fuel outsized cash flow growth for several years. Additionally, new supply growth is expected to moderate significantly into 2025.
- In self-storage, fundamentals are moderating but are beginning to show very early signs of stabilization. The slowdown in the broader housing market has negatively impacted demand for self-storage, and a turnaround in the housing transaction market will likely fuel increased demand for storage. New market rents are deteriorating; however, existing customer renewals remain positive. New supply remains below historical averages.
- In health care, the necessity-based nature of seniors housing demand is anticipated to insulate fundamentals from macro headwinds. The aging of the population, as evidenced by the growth in the 80 years and above age cohort, is expected to serve as a significant demand driver for seniors housing through the remainder of the decade, with a compound annual growth rate in that age cohort in excess of 4% through 2030.[2] New supply is below historical averages.
- In data centers, data growth facilitating the digital economy and new technologies, including artificial intelligence (AI), continues to provide a robust backdrop for new demand. New supply is more limited than in the past, given power availability challenges, which has resulted in a favorable environment for landlords to increase rents. These power availability challenges are anticipated to remain a critical issue going forward, and advancements in AI are proving to be an incremental demand driver to the sector.

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

Fund Facts

Launch date	09 January 1996
Base currency	U.S. dollars
Benchmark	FTSE Nareit Equity REITs (Net) Index

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class A Shares	9.82	13.45	-27.48	40.04	-19.10	15.79	-10.82	2.30	3.09	-1.17	29.71
FTSE Nareit Equity REITs (Net) Index	12.09	12.28	-25.17	41.66	-9.07	24.50	-6.17	3.95	7.34	2.02	28.65

Investment involves risks. All performance data is calculated NAV to NAV, net of fees, and assume the reinvestment of all dividends and income. The sources for all performance and Index data is Morgan Stanley Investment Management. Please refer to the relevant offering documents for fund details, including risk factors.

[2] Source: U.S. Census Bureau.

INDEX INFORMATION

The **FTSE Nareit (National Association of Real Estate Investment Trusts) Equity REITs Index:** is a free float-adjusted market-capitalization-weighted index of tax qualified REITs listed on the New York Stock Exchange, NYSE Amex and the NASDAQ National Market Systems.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy. The **S&P 500 Net Index** assumes reinvestment of net dividends.

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