A Sub-Fund of Morgan Stanley Investment Funds

American Resilience Fund

INTERNATIONAL EQUITY TEAM

Performance Review

In the one month period ending 30 June 2025, the Fund's Z shares returned 0.54% (net of fees)[1], while the benchmark returned 5.09%.

The portfolio returned +2.83% for the second quarter versus +10.94% for the index. Year-to-date, the portfolio has returned +2.89% versus S&P 500 +6.20%.

For the quarter, three of the five largest contributors to absolute performance were information technology (IT) stocks, which saw a recovery from mid-April due to a combination of strong results and improved market sentiment. **Microsoft** (+242 basis points [bps]) climbed +33% (in USD) in the second quarter following better-than-expected fiscal third quarter results. Revenues were up +15%, with Azure growth accelerating (constant currency),[2] while **Oracle** (+96 bps) surged to record highs after raising its annual revenue growth forecast, driven by strong demand for artificial intelligence (AI) services. Also within the IT sector, **Texas Instruments** (+63 bps) reported better-than-expected first quarter results at the end of April, with the cyclical recovery in the semiconductor markets boosting investor sentiment. Elsewhere, **Booking Holdings** (+102 bps) delivered strong first quarter results helped by the continued demand for international travel, while **Alphabet** (+71 bps) benefited from the broader tech rally in the second quarter coupled with strong results.

Four of the largest absolute detractors during the quarter were health care stocks. The sector as a whole has suffered a series of blows from the U.S. administration, including tariff threats, NIH (U.S. National Institutes of Health) funding cuts, and threats of enforced lower drug pricing. While the main target of the U.S. administration has been pharmaceutical companies (which the portfolio doesn't own), these developments have demand implications for much of the rest of the sector, which are either a supplier to or a customer of pharmaceutical companies. At a company-specific level, **UnitedHealth** (-102 bps) sharply derated during the quarter following April's unprecedented 12% downgrade to full-year EPS (earnings per share) guidance.[3] This weakness was further compounded by the company subsequently abandoning full-year profit guidance, the CEO Andrew Witty departing, and increasing publicity around Wall Street Journal claims of a U.S. Department of Justice fraud investigation into its Medicare business. **Becton Dickinson** (-68 bps) derated following a disappointing set of second quarter results, leading analysts to downgrade long-term growth forecasts. Also within health care, **Thermo Fisher** (-73 bps) fell -18% (USD) in the quarter as the share price was suppressed by ongoing concerns around biopharma spending, while **IQVIA** (-40 bps) fell primarily due to concerns about the pharmaceutical industry's appetite to conduct trials given pressures from the U.S. administration. We exited the positions in UnitedHealth, Becton Dickinson and IQVIA given the quality concerns but continue to hold Thermo Fisher as we believe the longer-run prospects for the life science industry remain positive despite current headwinds. Elsewhere, **Aon** (-53 bps) shares gave back some of their strong first quarter gains following April results, which fell modestly short of expectations, and concerns about an end to the hard insurance pricing cycle that has provided a tailwind to growth.

In terms of **relative performance**, the pattern was very similar for both the month and the quarter, with neutral sector allocation and negative stock selection. In both cases, the issue was underperformance in financials, health care, information technology and industrials, which outweighed the decent consumer staples performance in the quarter. Looking at the second quarter specifically, health care underperformance is largely explained by the stock-specific issues discussed above, while in other sectors a lack of exposure to some of the more cyclical sub-sectors, notably banks in financials, semiconductors in IT and capital goods in industrials, were the cause of relative underperformance.

Market Review

At the end of a particularly tumultuous quarter in which global equity markets rebounded strongly from mid-April, the S&P 500 Net Index returned a respectable +5.0% in U.S. dollars (USD) in the month of June, and a remarkable +10.8% for the second quarter. Investor confidence over the course of the quarter was buoyed by a number of factors which underpinned risk sentiment: tariff pullbacks announced in April, a de-escalation of trade tensions between the U.S. and China, a relaxation in the U.S. fiscal stance with the passing of the One Big Beautiful Bill Act. Markets seemed to look through the unfolding conflict in the Middle East and seem unfazed by the looming deadlines for the U.S. administration's pause on tariffs. The U.S. was roughly in line with MSCI World Index (+11% USD) for the quarter.

June and the second quarter as a whole showed a similar sector pattern, with information technology rebounding strongly after a weak first quarter, up 24% in the quarter. By contrast, the traditionally defensive sectors, health care (-7% in second quarter), consumer staples (+1%) and utilities (+4%) all lagged the overall index. It may make sense to look below the sector level, with much of the variation in performance happening within sectors, as mentioned above. Nearly 70% of the S&P 500's double-digit second quarter gain was concentrated in only two of the 25 industry groups — semiconductors (+43%) and software & services (+26%) —

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 June 2025.
2 Source: Microsoft Earnings Release FY25 Q3, 30 April 2025.
3 Source: UnitedHealth Group Reports First Quarter 2025 Results, 17 April 2025.

and 99% came from just five groups, adding in the cyclical media & entertainment (+21%), banks (+15%) and capital goods (+17%) elements. By contrast, while software & services did thrive in the quarter, several of the other important sub-sectors for the portfolio such as commercial & professional services and payments behaved more like the defensive consumer staples and health care sectors and did not keep up with the more cyclical areas. (Sector performance is shown in USD.)

Portfolio Activity

We made five final sales in the quarter: **UnitedHealth**, **Becton Dickinson**, **Hologic, Revvity** and **IQVIA.**

Regarding **UnitedHealth**, our original investment thesis centred on the company's essential role in the U.S. health care system and its historically metronomic earnings profile – until April this year, the company had beaten earnings per share expectations for 60 consecutive quarters.[4] The issues in the quarter discussed above severely challenged our investment thesis and prompted our exit. We concluded that **Becton Dickinson** no longer met our quality standards due to weakness in cash conversion and disappointing capital allocation under the CEO. Our decision to exit was further underscored by the company's weak second quarter results. We also exited our smaller position in **Hologic**, as breast health revenue (36% of sales)[5] slowed as clients deferred expenditure while waiting for the release of a new gantry model. We interpreted management's cautious outlook as a signal that macroeconomic pressures are weighing on the business, with potential further impact to revenue and earnings. We sold the position in **Revvity** after a period of relative outperformance**,** reallocating the capital into **Thermo Fisher,** which we consider to be a higher quality play at a more attractive valuation. We also completed the sale of **IQVIA**, due to our concerns around the underlying business momentum given elongating of decisions cycles and reduced biotech funding, as well as the postponement of key trials.

Year-to-date, we are aware that health care as a sector has been a laggard relative to most other sectors, and that the portfolio has seen turnover within the sector due to stock-specific issues. Notwithstanding the second quarter sales, we believe there continues to be compelling, long-term structural growth drivers for the health care sector, including demographics, and the non-discretionary nature of health care demand, as well as innovation and the digital transformation advances that are underway. We remain supportive of the long-term case for high quality health care names in specific sub-sectors such as life science, animal and consumer health, and we added to names such as **Thermo Fisher** and **Zoetis** during the quarter.

The additions and reductions during the second quarter were mainly driven by valuation and stock moves. We trimmed **Oracle** on the back of strong share price performance, along with **Booking Holdings** and **Thermo Fisher** after adding to the positions on stock weakness earlier in the quarter. On the other side, we added to names where we maintain conviction in the long-term quality thesis and valuations were supportive. Other than **Coca-Cola** and **Zoetis,** these were tech stocks (**Microsoft**, **Alphabet**, **Texas Instruments** and **Roper Technologies**), which had derated in the first quarter, and financials names (**FactSet, Aon, S&P Global** and **Jack Henry**).

Strategy and Outlook

The Great Disconnect

The second quarter was dramatic. It started with a sharp market fall in early April following the "Liberation Day" tariff announcement, but the recalibration of tariff policy in the wake of the market turbulence helped fuel a very powerful rally, taking equity indices to all-time highs and turning a 10%+ drop in the MSCI World Index by 8 April into an 11% rise for the second quarter, the strongest quarter since the 2020 recovery from the COVID-era low. While an element of the recovery does seem justified given the improvement in the environment since early April, the current euphoric atmosphere, with stretched valuations and record retail inflows, does seem tough to justify given the modest growth outlook and multiple sources of uncertainty. Indeed, we see a sharp disconnect between the state of the markets and the state of the real world.

The economic outlook has improved from the trough of early April. While growth expectations have slowed this year, with the Bloomberg consensus now for 1.5% U.S. real gross domestic product (GDP) growth in 2025 as against around 2% earlier in the year, this is a far cry from the Wall Street base case of a U.S. recession in the immediate aftermath of the "Liberation Day" tariff announcement.[6] Equally, while inflation remains sticky and above the 2% U.S. Federal Reserve (Fed) target, we have yet to see a tariff-induced acceleration.

The more positive take is that the "Taco trade" – a concept introduced by the media which implies that the Trump administration tends to back down with respect to policies that hit markets hard – has paid off so far and may well continue to work. The "Taco trade" talk has been mainly around tariffs following the step back from the "reciprocal" tariffs, with the introduction of the 90-day pause on 9 April.

The "Taco adjustments" go rather wider than just the trade arena. Business fears have also eased around immigration, or rather the repatriation of illegal immigrants in the U.S., with recent administration talk of more tolerance for undocumented workers, particularly in the farming sector. In addition, the rhetoric around deficit reduction, powered by a supposed massive DOGE[7]-driven cut in spending, which threatened to create a demand headwind in the U.S., has faded away, with the final version of the One Big Beautiful Bill Act set to increase the U.S. national debt by a further $3 trillion over the next decade, according to the Congressional Budget Office estimate. This should provide an expansionary boost to the economy in 2026, mitigating the contractionary effect of the tariffs.

[4] Source: FactSet and UnitedHealth company data.
[5] Source: FactSet and Hologic company data.
[6] Source: Bloomberg L.P.
[7] U.S. Department of Government Efficiency

The less positive take is that significant political headwinds still remain for the economy and markets, as the negative economic impacts of the recent policy changes have yet to fully take effect. The existing arrangements imply a 15% effective tariff rate overall,[8] up from 2.5%, acting as both an effective tax on consumers and an inflationary shock, even before any further tariff rises once the 90-day pause expires. The full effects of these existing tariffs on consumer prices may well not have come through yet. Equally, the growth in the U.S. labour market is set to slow sharply, with Barclays expecting only 0.1% growth in 2026 and 2027 as against the 1%+ level that the U.S. economy is used to, given both ageing populations and minimal net immigration, which threatens both aggregate demand and corporate margins. More broadly, general policy uncertainty still remains very elevated, not least around the expiry of the 90-day pause, with implications for both consumer and business confidence.

Outside the U.S. administration, there have been two further boosts to markets since early April. One is that hyper-scaler capital expenditure forecasts have continued to rise despite the DeepSeek shock earlier in the year as the tech giants still expect massive demand for compute. The other is the decline of the dollar, with the ICE Dollar Index (known as DXY) down over 10% year-to-date.[6] This helps overall revenues and earnings in dollar terms, given that other currencies make up half of MSCI World Index companies' revenue and even 40% of the revenue earned by S&P 500 Index companies.[9]

While some of the tail risks of April seem to have faded, the overall outlook suggests an environment of only ordinary growth, with the U.S. slated to grow at just 1.5% in 2025 and 2026, below levels expected at the start of the year, with the European Union slower still at around 1%.[9] There is also unusually high uncertainty around this unexciting outlook, given both raised geopolitical tensions and the unstable U.S. policy environment, leading to economists giving an elevated 38% chance of a U.S. recession in the next 12 months.[9] Although the worst fears of early April have not been realised, it is hard to argue that the environment is better than it was at the start of the year.

By contrast, markets seem to be priced for a very different world, seemingly disconnected from the actual economies. Equity valuations look distinctly elevated versus history. The MSCI World Index is on close to 20x forward earnings, with the S&P 500 Index at 22x.[9] These extended multiples are on forward earnings that are expected to grow double-digits on the back of margins improving further from record highs. All this is at a time when U.S. earnings are actually falling, with the S&P 500 expectations for 2025 and 2026 both down around 4% year-to-date, even measured in the fast-depreciating dollar.[9] The fixed income markets also seem pretty cheerful, with the ICE BofA BBB US Corporate Index spread down at 110 basis points, close to the all-time lows achieved at the start of the year.[10]

There is plenty of further evidence that markets are boisterous, euphoric or frothy — depending on your preferred adjective — beyond the extended overall valuations. Barclay's Equity Euphoria Indicator has bounced back through 10%, rivalling the levels of the dot-com boom and 2021's meme frenzy, perhaps unsurprisingly given that retail investors added a record $155 billion into equities in the first half of the year.[11] Looking at the drivers of the equity market advance, over half of the MSCI World's double-digit second quarter gain was concentrated in only two of the 25 industry groups, semiconductors and software & services, with 85% coming from just five groups, adding in the cyclical media & entertainment, banking and capital goods elements.

To summarise, our view is that the best estimate for the real-world outlook is mediocre, with a great deal of uncertainty. By contrast, markets seem to be pricing in a higher-growth scenario with a high level of certainty. There is plenty of evidence of euphoric behaviour by retail investors, who will now feel even more justified in buying every dip. Given this level of market optimism, it is unsurprising that the second quarter was not a great environment for high quality companies with low operational and financial leverage that are likely to be robust in tough times… after all the market seems to discounting any possibility of tough times! However, if our view of the great disconnect between markets and reality is close to being correct, then high quality companies are likely to get a chance to show their mettle.

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

Fund Facts

Launch date	15 December 2022
Base currency	U.S. dollars
Benchmark	S&P 500 Index

6 Source: Bloomberg L.P.
8 Source: The Budget Lab at Yale, as of 17 June 2025.
9 Source: FactSet.
10 Source: The Federal Reserve Bank of St. Louis. The ICE BofA BBB US Corporate Index tracks the performance of securities with a given investment grade rating BBB within U.S. dollar-denominated investment grade rated corporate debt publicly issued in the U.S. domestic market.
11 Source: Financial Times, VandaTrack.

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
Class Z Shares	2.89	10.59	19.11	--	--	--	--	--	--	--	--
S&P 500 Index	6.20	25.02	26.29	--	--	--	--	--	--	--	--

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 units. The sources for all performance and Index data is Morgan Stanley Investment Management. **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

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- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.
- 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, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- 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, available at www.morganstanleyinvestmentfunds.com. All data as of 30.06.2025 and subject to change daily.

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The summary of investor rights is available in the aforementioned languages and website location under the General Literature section.

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The **ICE BofA BBB US Corporate Index** tracks the performance of securities with a given investment grade rating BBB within U.S. dollar-denominated investment grade rated corporate debt publicly issued in the U.S. domestic market.

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