Morgan Stanley Investment Funds

European High Yield Bond

HIGH YIELD TEAM

Performance Review

In the one month period ending 31 May 2024, the Fund's I shares returned 1.05% (net of fees)[1], while the benchmark returned 0.91%.

Health care and services were two of the top-performing sectors in the Fund relative to the ICE BofAML European Currency High Yield 3% Constrained Ex-Sub Financials Index (the Index) during the month. Outperformance in both sectors was driven by positive credit selection. The primary individual contributor in the health care sector was an overweight to a French laboratory testing business that has rallied back amid better-than-expected earnings and the announcement of a small asset sale to repay some debt.

Homebuilders & real estate and containers were two of the worst-performing sectors in the Fund relative to the Index during the month. The former was driven by a lack of exposure to some rebounding bonds, primarily from Northern European issuers. In containers, a lack of exposure to a packaging company was the primary individual detriment. The company's bonds have modestly improved but remain distressed following pronounced operating weakness.

The Fund benefited from credit selection in CCC-rated and B-rated bonds, while selection in BB-rated bonds detracted marginally.

From a geographical perspective, credit selection in France and the U.K. contributed to relative performance in May. However, credit selection in Sweden hindered relative performance, driven by underweight positions in some rebounding companies in the homebuilders & real estate sector.

Market Review

European high yield markets were positive in May. Credit markets outperformed government bond markets, with spreads tightening once again during the month. Government bond yields were more volatile, ending the month slightly higher than they started, despite growing expectations for a June rate cut from the European Central Bank. The balance of European macroeconomic data remains neutral to trending positive. At the same time, the distress ratio in high yield has inflected higher amid idiosyncratic earnings weakness and ongoing discussion and execution of liability management exercises.

The ICE BofAML European Currency High Yield 3% Constrained Ex-Sub Financials Index returned +0.91% in May. The yield-to-worst fell by 23 basis points (bps) to 6.71%. The spread-to-worst decreased by 23 bps to end the month at 368 bps. Homebuilders & real estate and energy were two of the best-performing sectors in the Index, while building materials was the worst performing.[2] From a ratings perspective, CCC-rated bonds performed the best within the Index, while BB-rated bonds performed the worst.[2]

The technical conditions in the European high yield market were mixed during May, with elevated supply of high yield corporate bonds in the primary market balanced by strong investor demand. It was the strongest month for primary market issuance so far this year, with more than €15 billion of bonds hitting the market. Strong demand returned with more than €500 million of net inflows during the month, bringing the year-to-date total beyond €5 billion. This equates to more than 6% of total assets under management.[3]

In Europe, the default rate remains at around 2%. However, distress ratios have risen this year, and we expect liability management exercises to be more prevalent as companies look to address 2025 and 2026 maturities.[3]

Strategy and Outlook

Our outlook for the high yield market is somewhat cautious as we progress through the second quarter. The market is contending with several elements of uncertainty and potential sources of volatility, including the forward path of monetary policy, U.S. fiscal and regulatory policy, the labor market and consumer health, and, ultimately, economic growth and the health of the corporate fundamentals of high yield issuers. High yield faces this uncertainty with the unique combination of historically attractive yields and an average spread that ranks near cycle lows.[3] Further inspection of valuations reveals a market with ample dispersion, significant bifurcation and continued opportunity at the sector and security level.

We begin June with a relatively tight range of valuations across most rating segments, but with a widening spread differential between CCC-rated bonds and the remainder of the market. There exists a healthier range across sectors and individual issuers in high yield. This range implies opportunity as well as caution. The average yield in our market ended May ranked in the widest quintile relative to the preceding 10-year period, and we expect the yield will likely prove sufficient to drive competitive relative returns in coming quarters, shielding investors from wider peak credit spreads. The average spread in high yield ended May marginally lower, in close proximity to the 10-year lows.[2]

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 May 2024.
[2] Source: ICE Data Indices, Morgan Stanley Investment Management. Data as of 31 May 2024.
[3] Source: J.P. Morgan. Data as of 31 May 2024.

Our Fund remains slightly under-risked relative to the Index, based on a duration-times-spread ratio that continued to trend modestly below 1. We are not becoming more defensive at this time; we are cognizant of the many supportive attributes of our market and are actively waiting for opportunities to add risk when idiosyncratic opportunities arise or market levels appropriately adjust. Wider peak spreads feel likely; however, expectations for peak spread levels are tempered, as the BB share of the Index remains close to 70%.[3] Sector overweights included some defensive and cyclical sectors, trading with what we assess to be attractive long-term value, and underweight positions in cyclical sectors with asymmetric risk/return characteristics as well as several defensive sectors suffering from deep fundamental deterioration. We expect to continue to find many attractive idiosyncratic opportunities amid elevated dispersion that will benefit from healthy cash generation in non-cyclical and counter-cyclical sectors.

Despite a desire and intent to smartly add risk in select opportunities, and at appropriate levels, we continue to evaluate the horizon and see multiple sources of potential volatility for risk markets. Of most immediate concern are large, over-levered capital structures that are beginning to crack on both sides of the Atlantic. We will continue to spend our time concentrating on what we do best — focusing on bottom-up fundamental credit analysis with a discerning eye on relative value, as we seek to generate positive risk-adjusted alpha for our clients.

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

Fund Facts

Launch date	01 December 1998
Base currency	Euro
Benchmark	Custom- Blended Benchmark

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 I Shares	2.80	12.09	-11.05	3.33	2.21	10.49	-4.47	6.29	9.80	1.31	4.43
Blended Benchmark	2.53	12.14	-11.75	3.25	2.82	10.95	-3.34	6.22	10.07	0.85	4.62

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.**

Share Class I Risk and Reward Profile

- 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 value of bonds are likely to decrease if interest rates rise and vice versa.
- The value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the Sub-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, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the funds 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.
- 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 May 2024 and subject to change daily.

Applications for shares in the Fund should not be made without first consulting the current Prospectus and the Key Information Document ("KID") or Key Investor Information Document ("KIID"), which are available in English and in the official language of your local jurisdiction at morganstanleyinvestmentfunds.com or free of charge from the Registered Office of Morgan Stanley Investment Funds, European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

Information in relation to sustainability aspects of the Fund and the summary of investor rights is available at the aforementioned website.

If the management company of the relevant Fund decides to

[3] Source: J.P. Morgan. Data as of 31 May 2024.

terminate its arrangement for marketing that Fund in any EEA country where it is registered for sale, it will do so in accordance with the relevant UCITS rules.

INDEX INFORMATION

The Blended Index performance shown is calculated using the **ICE BofAML European Issuers High Yield Index** from inception through 31 July 2002, the **ICE BofAML European Currency Constrained High Yield Index** to 31 March 2009 and the **ICE BofAML European Currency High Yield 3% Constrained Ex-Sub Financials Index** thereafter.

The **ICE BofAML European Currency Constrained high yield index**: The index is designed to track the performance of euro- and British pound sterling-denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets by issuers around the world.

The **ICE BofAML European Currency High Yield 3% Constrained Ex-Sub Financials Index**: contains all non-Sub Financial securities in the ICE BofAML European Currency High Yield Index but caps issuer exposure at 3%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 3%.

The **ICE BofAML European Issuers High Yield Index:** The index is designed to track the performance of USD, EUR and GBP denominated below investment grade corporate debt publicly issued by European corporations in the US, sterling or euro domestic or the eurobond markets.

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