A Sub-Fund of Morgan Stanley Investment Funds

Global Asset Backed Securities Fund

MORTGAGE & SECURITIZED TEAM

Performance Review

In the three month period ending 31 December 2025, the Fund's Z shares returned 1.68% (net of fees)[1], while the benchmark returned 1.71%.

The Fund performed well in the fourth quarter on an absolute basis, and no sectors posted negative returns. The Fund's agency mortgage-backed securities (MBS) positions, namely the current coupon MBS, were the largest contributor over the period given the large allocation and as spreads tightened the most for current coupon agency MBS versus securitized credit. Commercial mortgage-backed securities (CMBS) also posted strong returns due to a combination of slight spread tightening, strong cash flow carry and their floating-rate nature, which buffered them from the rise in interest rates. The Fund's credit-oriented positions performed in line with agency MBS because, although spreads didn't tighten to the same degree, the higher carry offset this. Despite being underweight agency MBS overall, the Fund's allocation to agency MBS outperformed the Index due to pool selection and higher carry.

The Fund's duration position had a negligible impact on performance during the quarter as our exposure is on the short end of the yield curve, and it was the long end that experienced a sell-off during the quarter.

Market Review

U.S. Treasury yields were mixed and the curve steepened materially during the period due to heavy Treasury supply that was concentrated in longer maturities and as long-term inflation risk built in more term premia. The Federal Reserve (Fed) cut rates 0.50% to 3.5% during the quarter and indicated that the path of future cuts would be largely data dependent.

The 2-year U.S. Treasury yield fell 14 basis points to 3.47% during the fourth quarter, while the 10-year U.S. Treasury yield rose 2 basis points to 4.17% and 30-year yields rose 11 basis points to 4.84%.[2] The Fed also continued letting its MBS holdings run off during the quarter, which declined $47 billion to $2.031 trillion.[2] U.S. bank MBS holdings rose to $2.705 trillion; bank MBS holdings are still down $304 billion since early 2022 but holdings are expected to increase with supplementary leverage ratio easing and as short-term rates come down.[2] The 30-year mortgage rate fell 18 basis points during the quarter to 6.16%.[2] MBS current coupon nominal spreads tightened 16 basis points during the quarter to 110 basis points above interpolated U.S. Treasurys.[2] The Bloomberg U.S. MBS Index returned 1.71% during the quarter, outperforming U.S. Treasurys by 68 basis points on a duration-adjusted basis.[2] Agency MBS have outperformed Treasurys by 160 basis points in 2025 on a duration-adjusted basis.[2] The duration of the Bloomberg U.S. MBS Index rose 0.1 years to 5.3 years, and the majority of the outstanding U.S. mortgage market remains "out-of-the-money" to refinance with new origination mortgage rates still at historically high levels.[2]

Although the Fund underperformed the benchmark index on a net basis, the Fund's agency MBS positions slightly outperformed the benchmark and returned 1.81% due to pool selection and curve steepening bias. The Fund's securitized credit positions contributed similar/higher sector returns.

U.S. CMBS was the best performing sector, despite the floating-rate nature of these securities, and returned 2.53% due to more dramatic spread tightening versus other securitized sectors and strong cash flow carry.

Issuance picked up in a flurry to get deals done before year-end, but supply was well absorbed.

Portfolio Activity

Our agency MBS exposure increased 2% during the period to 48%, but we have already brought this down in the first few weeks of 2026 given the spread tightening that has occurred. We did this mainly by adding to our collateralized mortgage obligation (CMO) exposure, which rose 9%.

Over the period, our U.S. residential mortgage-backed securities (RMBS) fell 2% to 16% as several deals paid off, and our non-U.S. RMBS holdings held at 19%. The Fund's CMBS exposure fell 1% to 6% as some European industrial deals paid off; the CMBS exposure remains equally split between roughly 3% in the U.S. and 3% in Europe. The Fund's U.S. asset-backed securities (ABS) exposure fell 1% to 6% as some mortgage-related ABS deals paid off. The Fund's non-U.S. ABS exposure also held at 2%.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2025.
[2] Source: Bloomberg L.P. Data as of December 31, 2025. One basis point = 0.01%

Strategy and Outlook

Mortgage and securitized sectors performed well in 2025, buoyed by lower interest rates, tightening spreads and strong cash flow carry. As we enter 2026, we remain optimistic on the asset class. We are more neutral on the interest rate outlook and agency MBS given significant market developments in the new year. We expect returns in 2026 to be largely a function of cash flow carry, plus some additional benefit from continued spread tightening and portfolio optimization. We continue to favor non-agency RMBS, although we are also becoming more constructive on commercial real estate as well.

We began 2026 with a positive outlook for agency MBS given the relatively cheap risk-adjusted valuations versus other investment sectors, especially when compared to U.S. investment grade credit spreads, which still remain 30-40 basis points tighter than their 10- and 20-year averages.[2] However, after President Trump's announcement that the government would purchase $200 billion of agency MBS and the significant current coupon MBS spread tightening that followed, we have moved to neutral on the sector. Our base case assumes the 10-year Treasury yield remains rangebound near 4% in 2026, which would likely limit the risk of a renewed refinance wave and material increases in prepayment risk. Still, the market has reacted quickly and priced in the implications of the Trump administration's announcement, and current MBS valuations now look fair at best and no longer cheap.

We are positioned with an overweight to current coupon 30-year MBS with the goal of seeking to maximize income and carry, and we are less exposed to 15-year MBS and lower coupon 30-year MBS, where we believe carry is less compelling. In terms of structure, we favor specified pools and CMOs over to-be announced (TBA) MBS exposure, as these structures may reduce prepayment risk relative to generic MBS.

Following numerous headlines in 2025, Federal Reserve (Fed) and government-sponsored enterprises' (GSE) activity in the MBS market remains top of mind, in addition to the latest developments in the new year. Firstly, while we believe the privatization of Fannie Mae and Freddie Mac is possible (but far from certain) in 2026, our thesis is that agency MBS will likely maintain their U.S. government guarantee under any form of privatization and plausible reform paths. Secondly, the gradual runoff of the Fed's agency MBS holdings remains a technical headwind, especially if the $200 billion MBS buying is delayed or takes longer than expected. However, we believe U.S. banks will likely become more active buyers in 2026, particularly if a steeper curve improves bank net interest margins and capital rules evolve in a more favorable direction (e.g. Basel III Endgame). We also expect real estate investment trusts (REITs) to increase MBS holdings, while money managers may add exposure mainly via broad fixed income inflows rather than tactical sector re-allocations given most are already overweight MBS.

We are staying vigilant about potential challenges to the MBS market, which include a material rally in long-end interest rates (increasing prepayment risk) and/or a meaningful rise in rate volatility (pressuring MBS valuations).

Non-agency RMBS remains our favorite securitized credit sector. Residential mortgage fundamentals are strong, supported by record homeowner equity after the past five years of home price appreciation and, as a result, sub-50% average current loan-to-value ratios, which provide meaningful loss mitigation even under stress scenarios.

We expect home prices to remain broadly stable in 2026, similar to the modest 1%-2% appreciation observed in 2025 according to most measures. While home affordability remains challenged, we believe low levels of housing supply and high levels of demographic-driven demand should help keep home prices supported.

Mortgage credit performance has also been relatively pristine, with historically low delinquency and default rates, and we expect this trend to continue. We also see similar housing and mortgage performance dynamics in parts of the U.K. and Europe, with strong housing equity cushions, limited supply and low arrears.

After several years of headwinds from higher rates, pandemic-driven dislocations and shifting demand patterns, the CMBS outlook is improving. Vacancy rates that surged during the pandemic are trending back toward pre-pandemic levels in many markets, and lower rates are easing financing pressure for borrowers and sponsors. Another meaningful tailwind is supply; subdued new construction activity across many property types has improved the supply-demand balance.

The CMBS market remains very idiosyncratic, with a wide range of varying credit opportunities, but we view the overall opportunity set as improving across CMBS. Importantly, we maintain a strong quality bias within each subsector:

- Hotels: luxury leisure properties over economy or business-oriented hotels
- Multifamily: higher-quality, well-located apartments over affordable housing units
- Retail: high-income, destination-oriented malls over lower-end discount centers
- Office: "trophy" and Class A assets over commodity Class B/C buildings

After several years of reducing exposure, we are looking to selectively increase CMBS allocations in 2026, focusing on structures and collateral where we believe the margin of relative safety is most attractive.

Our overall ABS positioning remains light, reflecting both fundamental credit concerns in some consumer segments and relative value considerations.

We see the clearest stress among lower-income consumers following several years of elevated inflation and higher interest rates, with delinquency and default rates rising in non-prime consumer credit. By contrast, high-income consumer credit performance has been more resilient, supported by substantial wealth gains over the past several years due to homeowner equity mentioned earlier and stock portfolio gains. However, valuations in many of these higher-quality consumer ABS sectors screen tight, limiting their relative value appeal.

[2] Source: Bloomberg L.P. Data as of December 31, 2025. One basis point = 0.01%

This is why we generally favor business-oriented ABS, where we can find a better mix of spread opportunities more resilient fundamentals. Areas we continue to monitor include aircraft leases, data centers, mortgage servicing rights, small business loans and more.

Overall, we believe the securitized market offers a unique opportunity to achieve competitive returns with solid credit fundamentals. We enter 2026 with a constructive view on mortgage and securitized markets. While the rate environment may be less supportive than 2025, we believe all-in yields remain attractive, and securitized spread valuations offer room for incremental tightening relative to corporate credit. In our view, a disciplined focus on carry, security selection and structural risk management should remain a strong path to generating returns across securitized sectors in 2026.

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

Fund Facts

Launch date	03 December 2012
Base currency	U.S. dollars
Benchmark	Bloomberg U.S. Mortgage Backed Securities (MBS) Index

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2025	2024	2023	2022	2021	2020	2019	2018	2017	2016
Class Z Shares	8.26	8.26	5.40	8.18	-6.62	1.91	2.62	6.91	2.14	7.37	4.71
Bloomberg U.S. Mortgage Backed Securities (MBS) Index	8.58	8.58	1.20	5.05	-11.81	-1.04	3.87	6.35	0.99	2.47	1.67

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 Z 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.
- 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, available at www.morganstanleyinvestmentfunds.com. All data as of 31.12.2025 and subject to change daily.

Applications for shares in the Sub-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 language of countries authorized for fund distribution and is available online at Morgan Stanley Investment Funds Webpages or free of charge from the Registered Office at European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

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

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INDEX INFORMATION

The **Bloomberg U.S. Mortgage Backed Securities (MBS) Index:** tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

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