A Sub-Fund of Morgan Stanley Investment Funds

Global High Yield Bond Fund

HIGH YIELD TEAM

Investors should note that, relative to the expectations of the Autorité des Marchés Financiers, this UCITS presents disproportionate communication on the consideration of extra-financial criteria in its management.

Performance Review

In the one month period ending 31 March 2025, the Fund's Z shares returned -1.37% (net of fees)[1], while the benchmark returned -1.02%.

Retail and cable & satellite TV were the Fund's top-performing sectors relative to the benchmark in March. Outperformance in the retail sector was driven by positive credit selection. The primary contributor in the sector was a lack of exposure to multiple large brick-and-mortar retailers and an online shopping network; these companies' bonds were down approximately 10%, due in part to a combination of growth and tariff concerns. In cable & satellite TV, positioning within the capital structure of a stressed U.S. issuer added value, as the Fund was underweight to the higher-risk, unsecured part of the capital structure.

Health care and energy were two of the worst-performing sectors in the Fund relative to the benchmark during the month. In health care, an overweight to a French laboratory testing business detracted as the unsecured bonds fell by more than 30% amid ongoing operational challenges. In energy, an underweight to the sector was a marginal detractor, while security selection within the sector was a bigger driver of underperformance. The primary individual detriment was an overweight position in a midstream services provider in the Appalachian Basin in the Eastern U.S.

From a credit quality perspective, an underweight to BB-rated bonds and an overweight to CCC-rated bonds detracted value, while selection in B-rated bonds helped.

Geographically, selection in U.K. and German issuers added value, while selection in French issuers detracted most. Credit selection in euro-denominated bonds detracted, as did selection in dollar-denominated bonds.

Market Review

Performance in global high yield markets turned negative in March amid high volatility, a sharp period of spread widening and a further decline in government bonds yields. The Federal Reserve's (Fed) March decision to hold its key policy rate steady was seen as a non-event, and its projection of two interest rate cuts later this year was quickly overshadowed by the market's growing expectations for a greater number of cuts, driven by mounting concerns over an expanded scope of tariffs and the potentially dire near-term economic consequences. Amid the volatility, the high yield market remained orderly and relatively well-bid, with healthy March issuance volume that was generally well received by a receptive investor base. In the U.S., the lower-rated segment of the high yield market broadly underperformed, with the average spread differential between the single-B and CCC segments ending the quarter at nearly 550 basis points (bps), relative to a January-end level of just over 400 bps.[2]

The technical conditions in high yield were less supportive in March than February. In the U.S., gross issuance increased month-over-month from $18.7 billion in February to a five-month high of $26.6 billion in March. By use of proceeds, refinancing accounted for approximately 77% of monthly issuance and acquisition financing accounted for only 11%. Over 56% of March issuance was rated BB. In Europe, issuance levels rebounded after a slow February, with more than €10 billion of high yield bonds coming to market (compared with only €3 billion in February). This brings year-to-date gross issuance to more than €22 billion, with more than 50% of that issuance coming in senior secured form and the vast majority of issuance used to refinance outstanding debt. U.S. high yield retail funds recorded a net inflow of approximately $2.1 billion in March, following an inflow of approximately $2.9 billion in February. In Europe, the recent trend of inflows reversed with funds seeing a small net outflow of €200 million.[3]

In the U.S., default and distressed exchange activity in leveraged credit rose modestly off the two-year low set in February. According to J.P. Morgan, the high yield trailing 12-month par-weighted default rate including distressed exchanges decreased by 5 bps, ending March at 1.20%. Excluding distressed exchanges, the rate ended March unchanged at 0.27%. For loans, the trailing 12-month par-weighted default rate including distressed exchanges decreased 4 bps to close the month at 3.86%. Excluding distressed exchanges, the rate dropped to 1.24%. In Europe, default rates remain elevated (above 3%) compared to the cycle lows, with expectation for increased default activity during 2025. However, there were no individual defaults during March.[3]

The ICE BofA Developed Markets High Yield Excluding Subordinated Financial Index USD-Hedged posted a total return of -1.02% in March. The spread-to-worst rose 56 bps to end the month at 370 bps, while the yield-to-worst rose 0.48% to end the month at 7.29%.[2]

1 Source: Morgan Stanley Investment Management Limited. Data as of 31 March 2025.
2 Source: ICE Data Indices, Bloomberg L.P., Morgan Stanley Investment Management. Data as of 1 April 2025.
3 Source: J.P. Morgan. Data as of 1 April 2025.

Food & drug retail and banking were the two top-performing sectors during the month. Publishing & printing, diversified media and paper were three of the worst-performing sectors.[2]

The higher quality segments of the high yield market generally outperformed in March, driven by a rotation away from the highest-risk parts of the market as credit spreads decompressed. The BB-rated segment performed best. Meanwhile, the CCC-rated segment performed worst.[2]

Strategy and Outlook

We continue to be cautious on the high yield market as we begin the second quarter. The basis for this outlook includes the dynamic and uncertain evolution of trade, immigration and tax policy, as well as the expectation for slowing economic growth with an increased probability of recession, and elevated volatility. Yields remain historically attractive and the average spread in the high yield market, while approximately 98 bps above post-Global Financial Crisis (GFC) lows, reached in January, remains susceptible to further widening.[4] We come to this conclusion after a thorough analysis of factors including the evolving monetary policy of global central banks, economic growth, consumer health, the fundamentals of high yield issuers, technical conditions, and valuations. Ultimately, we believe that caution is warranted and expect more comprehensive price realization, particularly in the lower-rated and more challenged segments of leveraged credit.

Global central banks are navigating a precarious period where sticky U.S. inflation, uncertain trade and economic growth backdrops and shifting fiscal priorities are complicating the projected and perhaps intended path of key policy rates. In March, the European Central Bank reduced its key policy rate by 25 bps, supported by a recent February reading on eurozone inflation of 2.3%.[2] This decision was complicated by the pro-growth and potentially inflationary stated German intent to materially increase defense and infrastructure spending. The Bank of England held its key policy rate at 4.5%, a decision supported by annualized wage growth that is holding at nine-month highs at 5.9% (ex-bonus).[5]

Meanwhile, the Federal Reserve maintained its key policy rate at its March meeting and reduced quantitative tightening from $25 billion per month to $5 billion, while continuing the pace of mortgage-backed securities (MBS) runoff. The U.S. headline and core personal consumption expenditures (PCE) price indexes were under 3% in February, but core PCE increased 0.4% month-over-month.[2] Furthermore, Fed Chair Powell struck a patient and perhaps cautious tone in addressing future impacts from evolving trade policy and tariffs. The likely pro-inflationary effects of tariffs are complicated by a labor market that has recently showed additional signs of softening. Average hours worked, temporary labor, and weekly earnings have drifted lower, while the number of employed holding multiple jobs has increased and the U-6 underemployment rate registered 7.8% in February, at cycle highs.[6] The Fed's dot plot indicates two reductions in its key policy rate through year-end, with the skew in favor of fewer cuts. Our base case expectation is for one to two rate cuts, with a skew in favor of more cuts, and given the quarter-end yield on the 5-year Treasury, we anticipate potential cuts through the balance of the year to likely be broadly offset by widening in credit spreads.

While the economic outlook in Europe made an enormous shift following the announcement of fiscal easing in Germany, with hundreds of billions of euros expected to be spent on infrastructure and defense, the recessionary impulses of a potential worsening in global trading dynamics cannot be ignored. The volatility being generated in government bond markets and credit markets alike makes us wary of certain higher risk parts of the market that might be more impacted by tariff policy, like retail and chemicals.

We expect that as the ultimate landscape of trade policy and tariffs matures, sectors directly impacted by new trade policy, as well as higher-risk credits most negatively exposed to an up-in-quality trade, have room to materially widen. While we believe valuations across several segments of the high yield market will likely reach wider peak spreads in coming months, we believe there remains opportunity. We continue to identify idiosyncratic situations to capture spread compression in segments experiencing secular growth, where issuers are able to decrease leverage through a combination of earnings growth and prudent capital allocation. Additionally, we have recently found select opportunities in challenged segments where neatly structured covenants, adequate loan-to-value ratios, and appropriate risk compensation form to represent compelling investment opportunities.

In conclusion, we are in a less certain world relative to just three months ago. Fundamentals and technical conditions remain supportive and, generally, valuations have grown marginally more compelling. The elephant in the room, at present, is trade policy, and the tremendous follow-on effects. We expect the balance of 2025 will likely be a competitive period for high yield, but certainly not a period without volatility. Geopolitical tensions and regional conflicts continue to present the potential for expansion or ultimate resolution. Amid a volatile and uncertain backdrop, 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.

2 Source: ICE Data Indices, Bloomberg L.P., Morgan Stanley Investment Management. Data as of 1 April 2025.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 31 March 2025.
5 Source: Office for National Statistics, United Kingdom. Data as of 20 March 2025.
6 Source: U.S. Bureau of Labor Statistics. Data as of 7 March 2025.

Fund Facts

Launch date	27 April 2017
Base currency	U.S. dollars
Benchmark	ICE BofA Developed Markets High Yield Excluding Subordinated Financial Index USD-Hedged

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	0.56	8.08	12.96	-9.07	5.39	4.44	14.45	-1.63	--	--	--
ICE BofA Developed Markets High Yield Excluding Subordinated Financial Index USD-Hedged	0.98	8.59	13.77	-10.58	5.05	5.61	14.29	-1.90	--	--	--

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 is 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 31.03.2025 and subject to change daily.

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