

A Sub-Fund of Morgan Stanley Investment Funds Japanese Small Mid Cap Equity Fund

JAPANESE EQUITY TEAM

Performance Review

As the Fund is less than a year old, we are constrained from commenting on its performance.

In December, the performance of the overall Japanese stock market was higher than the previous month. Although the rise in Japanese domestic long-term interest rates exerted some pressure on the market, the Japanese stock market remained firm. This resilience was supported by factors such as gains in U.S. stocks, driven by expectations of interest rate cuts, and the depreciation of the yen in the foreign exchange market following the Bank of Japan's (BOJ) decision to raise its policy rate. The Japanese small-cap market also advanced.

By sector, the portfolio benefited from an underweight position in utilities, while it was negatively impacted by an overweight position in communication services. At the stock level, positive contributions came from SKY Perfect JSAT Holdings, which operates paid multi-channel broadcasting and satellite communications as part of its space business, and DAIHEN, a manufacturer of transformers, welding machines and power supplies for semiconductor manufacturing equipment. On the other hand, negative contributions came from The Japan Steel Works, a manufacturer specializing in resin production machinery and forged & cast steel products for energy infrastructure, and Dexerials, a manufacturing and distributor of electronic components, bonding materials and optics materials.

Market Review

The BOJ's December Tankan survey showed resilience, with the business conditions diffusion index for large manufacturers (current) improving slightly for the third consecutive quarter. The easing of uncertainty over U.S. tariffs and the continued depreciation of the yen appear to have supported sentiment among export-oriented companies. On the other hand, due to worsening Japan-China relations, the outlook for large non-manufacturing companies has declined, particularly in retail trade and accommodation and food services. In addition, concerns over declining housing demand due to rising loan interest rates also led to deterioration in construction and real estate sectors.

Overall, corporate sentiment remains relatively firm, and Japan's domestic economy is expected to maintain a moderate recovery trend in 2026, driven primarily by domestic demand. The government has released the outline of the 2026 tax reform, reflecting agreements such as raising the income threshold. By some estimates, expanding income tax exemptions will allow roughly 80% of taxpayers to benefit from tax cuts, and measures are expected to drive active capital investment and research and development (R&D) by companies. The economic impact of these tax reforms, which form the core of the Takaichi administration's policy package, is expected to start showing effects in the first quarter of 2026. Although caution is warranted regarding the risk of yen depreciation pushing up import prices, inflation in items such as food is expected to moderate. In addition, improvement in real wages is expected to lead to a recovery in household sentiment and private consumption.

Portfolio Activity

During the month, we increased our positions in ROUND ONE, a company operating indoor multi-entertainment facilities offering a wide range of leisure activities such as bowling, amusement and karaoke, and FOOD & LIFE COMPANIES, a global operator of food service brands, including the conveyor-belt sushi restaurant chain Sushiro. On the other hand, we completely sold our shares in MEIDENSHA, a manufacturer of heavy electrical equipment supporting power infrastructure such as power generation, transmission and distribution, and JINS HOLDINGS, a company engaged in the planning, manufacturing and retail of eyewear, including prescription glasses and sunglasses.

Among individual names, our top holdings include Yokohama Financial Group, a regional financial group with The Bank of Yokohama at its core; Meiko Electronics, which engages in the design, manufacture and sales of printed circuit boards; and Chugoku Marine Paints, a manufacturer specializing in marine coatings and related products.

Strategy and Outlook

Although we believe the U.S. economy generally remains strong, we will continue to monitor trends in employment, consumption and monetary policy. As for the Japanese stock market, we expect it to remain firm, driven by the Takaichi administration's growth strategy and growing expectations for further progress in corporate governance.

From the perspective of small- and mid-cap growth stocks, which have significantly lagged in recent years, we are paying attention to the potential for companies with unique growth drivers that are relatively unaffected by the external environment to be re-evaluated.

We will continue to focus on growth potential, an advantage of small- and mid-cap stocks, using a bottom-up approach. Considering

external factors, such as Japan overcoming the deflationary environment and the Tokyo Stock Exchange's request to enhance corporate value, we are also conducting further extensive research among companies that have not previously been considered growth companies in the past but now have potential for growth through a business portfolio transformation.

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

Fund Facts

Launch date	27 August 2025
Base currency	Japanese yen
Benchmark	MSCI Japan Small Cap Net Return Index (JPY)

Share Class A 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 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 fund's 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 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](http://MorganStanleyInvestmentFunds)

[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. Luxembourg 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 **MSCI Japan Small Cap Index (JPY)** is a free-floated adjusted market capitalization weighted index that is designed to track the equity market performance of the small cap segment of the Japanese market. The MSCI Japan Small Cap Index (JPY) is constructed based on the MSCI Global Investable Market Indices Methodology, targeting a free-float market capitalization coverage of approximately 14%.

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