Morgan Stanley

INVESTMENT MANAGEMENT

NOT FOR DISTRIBUTION OR USE WITH HONG KONG GENERAL PUBLIC

Morgan Stanley Investment Funds

US Dollar High Yield Bond Fund

FIXED INCOME | GLOBAL FIXED INCOME TEAM | MONTHLY COMMENTARY | 31 JANUARY 2019

Performance Review

In the one month ending 31 January 2019, the Fund's Z shares returned 4.11% (net of fees)[1], while the benchmark returned 4.52%.

Over the month, the portfolio's overweight positioning to capital goods, specifically building materials and diversified manufacturing, contributed positively to performance, while underweights to the technology and communications sectors detracted.

Market Review

Following the tumultuous market sell-off in December, January helped offset some of the losses that investors incurred in the fourth quarter. Sentiment moderated during the month, with the VIX falling below 17 for the first time in several months. U.S., U.K. and German 10-year yields continued to fall in January by 6, 6 and 9 basis points (bps), respectively. Federal Reserve (Fed) Chairman Jerome Powell appeased investors early in the month, signaling to the markets that the Fed will be patient regarding the timing of future rate hikes. Powell's tone set the stage for the rest of the month, quelling fears of tighter monetary policy. The 2-year–10-year Treasury yield spread remained relatively unchanged compared to levels seen at the end of December at approximately 17 bps, and the U.S. dollar saw broad-based declines against developed market and emerging market currencies.

Chairman Powell's speech on January 4, the minutes from the December Federal Open Market Committee (FOMC) meeting and the January FOMC meeting itself all indicated that the Fed will watch and see how the economy evolves amid an uncertain economic outlook and muted inflationary pressures. While the Fed maintained its view that the economy is still strong, proven by continued strong economic data, a number of downside risks were cited by FOMC participants. Examples include concerns around a slowdown in global economic growth, a more rapid waning of fiscal stimulus, trade policy developments, a further tightening in financial conditions and a greater-than-expected negative impact from monetary policy tightening. Crucially, it communicated the next rate move may not be a hike.

The U.S. federal government reopened following the longest partial government shutdown (35 days) in U.S. history. President Trump signed a bill that allows the government to operate until February 15, while the government continues its negotiations on securing the southern border. While the bill provides relief to federal employees for approximately three weeks, significant progress must be made to ameliorate the points of contention between Republicans and Democrats. U.S. Treasury yields dropped across the curve, albeit less than they dropped in December.

The month of January proved to be a productive month for U.S.-China trade discussions. While President Trump asserted that he would like to keep tariffs in place, the trade relationship between the two countries appears to be more amicable. Chinese President Xi Jinping agreed to purchase more soybeans from American producers, as well as make significant changes to Chinese economic policies. Progress was also made around agriculture and energy policies.

U.S High Yield

Following a volatile December, the U.S. high yield market rebounded sharply amid a strong equity rally, rising oil prices and a dovish pivot by the Fed. Spreads snapped 100 bps tighter to end the month at +442 bps while yields declined 105 bps to 6.90%, recouping all of December's widening. This resulted in total returns of +4.52% for the Bloomberg Barclays U.S. Corporate High Yield Index.

From a ratings perspective, lower-quality bonds outperformed higher-rated credits. CCCs returned +5.29%, followed by Bs at 4.49% and BBs at 4.24%. At the sector level, all sectors were up in January with commodity-related sectors leading the way, as oil was up 18% month-over-month. The best performing sectors were oil field services (+7.06%), exploration & production (+7.00%) and pharmaceuticals (+6.36%). Conversely, the worst performing sectors were aerospace/defense (+2.92%), media

---

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 January 2019.

entertainment (+3.08%) and financial other (+3.33%), which underperformed largely due to negative credit-specific developments.

Following no new issuance in December, the U.S. high yield market priced $16.6 billion in U.S. dollar-denominated bonds this month, which was more than double the prior two months' combined issuance. There were no defaults in January, and we expect high yield bond defaults to remain modest and track below long-term averages.

Portfolio Activity

We remain focused on middle market-sized credits and continue to be overweight transports and building materials and remain underweight communications, a sector that tends to have the lowest coupon and longest duration capital structures.

Strategy and Outlook

Despite the recent volatility, our base case remains that a recession is not imminent and that high yield remains an attractive asset class on relative value. Valuations began the year at multi-year highs and priced in a lot of bad news. However, we believe that the economic outlook is for economies to just grow more slowly, but not collapse. Economic growth expectations in the U.S. remain positive at 2.5%, and weak inflation limits the pressure on central banks to tighten policy quickly. Furthermore, central banks have noticed the deceleration in economic activity and have become considerably more dovish. Most prominent is the shift at the Fed, which after raising rates eight straight quarters, may not raise interest rates at all in 2019. This significantly reduces the risks of a 'hard landing' to the U.S. economy due to the Fed overtightening. We think that moderate growth, stable inflation and a patient Fed is an excellent recipe for engineering a soft landing for the U.S. economy and welcoming back good performance for risky assets.

We expect spreads to tighten across markets, default rates to stay below historical averages and company earnings to continue to grow. Continued earnings growth will give BBB rated companies time to manage their debt profiles, and we see the risks being overstated on the number of expected downgrades to BB (we would note corporates have the ability to reduce dividends, sell businesses and reduce leverage through retained earnings). Given all of this, we feel that markets have overshot, and with spreads around +450 bps and index yields approaching 7% in the U.S., we think valuations are compelling.

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

FUND FACTS

Launch date	Base currency	Index
02 December 2014	U.S. dollars	Bloomberg Barclays US Corporate High Yield Index

12 Month Performance Periods to Latest Month End (%)

	JANUARY '18 - JANUARY '19	JANUARY '17 - JANUARY '18	JANUARY '16 - JANUARY '17	JANUARY '15 - JANUARY '16	JANUARY '14 - JANUARY '15
MS INVF US Dollar High Yield Bond Fund - Z Shares	0.51	7.37	21.77	-4.14	--
Bloomberg Barclays US Corporate High Yield Index	1.73	6.60	20.77	-6.62	--

Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. 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 Z Risk and Reward Profile

Lower Risk **Higher Risk**

1	2	3	4	5	6	7

Potentially Lower Rewards **Potentially Higher Rewards**

The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- The fund is in this category because it invests in fixed income securities and the fund's simulated and/or realised return has experienced medium rises and falls historically.
- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- 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.
- 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. All data as of 31 January 2019 and subject to change daily.

INDEX INFORMATION

The **Bloomberg Barclays U.S. Corporate High Yield Index:** is a multi-currency measure of the global high yield corporate debt market.

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations. In particular, the Shares are not for distribution to US persons.

Ireland: Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's, Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland 4th Floor Junghofstrasse 18-26, 60311 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branchl Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41 (0) 44 588 1074.

Australia: This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accepts responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. **Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. In particular, for investment funds that are not authorized or recognized by the MAS, units in such funds are not allowed to be offered to the retail public; any written material issued to persons as aforementioned in connection with an offer is not a prospectus as defined in the SFA and, accordingly, statutory liability under the SFA in relation to the content of prospectuses does not apply, and investors should consider carefully whether the investment is suitable for them. This material has not been reviewed by the Monetary Authority of Singapore.

IMPORTANT INFORMATION

EMEA: This marketing communication has been issued by Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's, Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Authorised and regulated by Central Bank of Ireland. ("MSIM Ireland").

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Investment Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Investment Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December 2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

Applications for shares in the Fund should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192. In addition, all Italian investors should refer to the 'Extended Application Form', and all Hong Kong investors should refer to the 'Additional Information for Hong Kong Investors' section, outlined within the Prospectus. Copies of the Prospectus, KIID, the Articles of Incorporation and the annual and semi-annual reports, in German, and further information can be obtained free of charge from the representative in Switzerland. The representative in Switzerland is Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva. The paying agent in Switzerland is Banque Cantonale de Genève, 17, quai de l'Ile, 1204 Geneva. The document has been prepared solely for informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

The views and opinions expressed are those of the portfolio management team at the time of writing/of this presentation and are subject to change at any time due to market, economic, or other conditions, and may not necessarily come to pass. These comments are not representative of the opinions and views of the firm as a whole. Holdings, countries and sectors/ region weightings are subject to change daily. All information provided is for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the sectors and regions referenced. Information regarding expected market returns and market outlook is based on the research, analysis, and opinions of the team. These conclusions are speculative in nature, may not come to pass, and are not intended to predict the future of any specific Morgan Stanley Investment Management investment. Past performance is no guarantee of future results.

All investments involve risks, including the possible loss of principal. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM Ireland has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM Ireland shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Investment Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.