Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

US Property Fund

MARKETING COMMUNICATION | GLOBAL LISTED REAL ASSETS TEAM | MONTHLY COMMENTARY | 30 APRIL 2023

Performance and Market Review

In the one month period ending 30 April 2023, the Fund's I shares returned 1.89% (net of fees)[1], while the benchmark returned 0.79%.

U.S. real estate securities (FTSE Nareit Equity REITs Net Index, 0.79%, the "Index") underperformed the broader equity market (S&P 500 Index, 1.56%) for the month, as listed real estate continues to lag equity markets on a year-to-date basis. During the month, economic data modestly softened, and the high rate of inflation started to ease, which suggests we are moving toward a period of interest rate stabilization. The Fund outperformed the Index, returning 1.89% (Class I shares net of fees).

First Republic Bank released an extremely negative earnings report in late April and eventually failed in early May, representing the third failure of an American bank since March, which continued to fuel investor concerns around the availability and cost of debt capital. The Federal Reserve also met in early May and raised interest rates 25 basis points,[2] while signaling a potential pause in further increases. Within the Index, the continued strong fundamentals in seniors housing health care and residential led to these sectors outperforming for the month, while sectors historically more negatively impacted by weaker economic growth, including offices and hotels, underperformed. Self-storage also underperformed for the month over renewed concern of weakening fundamentals, but is still a standout performer year-to-date given announced merger and acquisition activity in the sector.

The Fund's overweight to seniors housing health care, security selection in storage and zero position in office companies were top relative contributors. This was partially offset by the overweight sector allocation within storage and security selection in industrial.

Strategy and Outlook

The team uses internal proprietary research to invest in public real estate companies that we believe offer the best value relative to their underlying assets and growth prospects. The team combines a bottom-up approach, assessing the intrinsic value, equity multiples and growth prospects of each security, with a top-down view that incorporates fundamental inflection points, macroeconomic considerations and geopolitical risk. By incorporating both an equity market valuation and a more traditional real estate valuation with a top-down overlay, we believe the Fund will be better prepared to identify securities with the best expected total returns.

Forecasted returns for the asset class have improved in the intermediate term given the expected stabilization in interest rates across the globe in 2023, despite the more challenging macro backdrop and tightening credit conditions. While liquidity issues at U.S. regional banks and the takeover of Credit Suisse have impacted credit conditions and capital availability, most listed real estate companies are well positioned to operate in a weaker and less certain macro environment. Moreover, we believe relative strength in cash flows can be expected given the unique nature of listed real estate. Specifically, the contracted rental streams with inflation-linked escalations and the necessity-based nature of real estate, coupled with limited new real estate supply additions, may portend limited downside in cash flows, despite near-term macro weakness and uncertainty. Additionally, we believe the relative valuation of real estate securities is attractive, specifically when compared to direct property investment and the broader equities market, and is presenting an interesting pricing arbitrage opportunity for investors.

Secular trends that have been unfolding over the past several years and that were accelerated by COVID-19 will result in winners and losers for real estate.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 April 2023.
[2] One basis point = 0.01%

- In retail, secular headwinds remain given the continued expectation for growth in e-commerce and the focus on omnichannel distribution; however, COVID-19 has highlighted the importance of physical stores due to benefits from increased brand recognition and stronger insulation from supply chain issues, among others. Discretionary spending and consumer confidence are declining amid high inflation and could negatively impact store plans for discretionary retailers; we therefore favor the outlook for nondiscretionary, grocery and convenience-oriented retail landlords. Tenant bankruptcy watch lists are increasing but remain manageable for the sector to navigate.
- Work-from-home policies will likely be a permanent overhang on office demand, and related uncertainty regarding future office absorption is expected to remain an open question. Utilization rates remain stubbornly low versus 2019 levels. Meanwhile, office-using labor markets are moderating, with increased layoffs and hiring freezes expected to continue.
- In lodging, leisure demand is exceeding expectations. Business travel is likely secularly impaired, and increasing recession odds are a negative for corporate capex and lodging demand.
- In residential, affordability concerns regarding homeownership given rising mortgage rates and home price appreciation will likely lead to increasing rental demand. However, supply growth is above historical trend, and increasing job layoffs will be a governor on new household formation and rent growth.
- In industrial, fundamentals remain robust, driven by the continued need to modernize logistics distribution, which has resulted in record-low vacancy and double-digit revenue growth for warehouses. While new market rent growth is moderating from historic highs, the embedded growth remains the highest within commercial real estate and is expected to remain strong for several years.
- In self-storage, fundamentals are strong, with below-average new supply and stable demand. Investors are increasingly focused on the moderation in new market rents and return to typical seasonality for the sector, after bucking those trends throughout the COVID-19 pandemic; however, cash flows are expected to remain strong.
- In health care, the necessity-based nature of seniors housing demand is anticipated to insulate fundamentals from macro headwinds. Labor shortages and expense pressures are dissipating.
- In data centers, data growth facilitating the digital economy and new technologies continues to provide a robust backdrop for new demand. New supply is more limited than historically given power availability challenges, which has resulted in a favorable environment for landlords to increase rents. These power availability challenges are anticipated to remain a critical issue going forward.

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

FUND FACTS

Launch date	Base currency	Index
09 January 1996	U.S. dollars	FTSE Nareit Equity REITs (Net) Index

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Class I Shares	4.44	-26.97	41.03	-18.55	16.61	-10.19	3.01	3.84	-0.46	30.69	2.98
FTSE Nareit Equity REITs (Net) Index	3.17	-25.17	41.66	-9.07	24.50	-6.17	3.95	7.34	2.02	28.65	1.31

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 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 property company shares and the fund's simulated and/or realised return has experienced very high 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:

- There are additional risks associated with investing in real estate.
- 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.
- 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 30 April 2023 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 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 **FTSE Nareit (National Association of Real Estate Investment Trusts) Equity REITs Index:** is a free float-adjusted market-capitalization-weighted index of tax qualified REITs listed on the New York Stock Exchange, NYSE Amex and the NASDAQ National Market Systems.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

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