Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Institutional Fund Trust

Core Plus Fixed Income Portfolio

GLOBAL FIXED INCOME | GLOBAL FIXED INCOME TEAM | COMMENTARY | MARCH 31, 2019

Performance Review

In the quarter period ending March 31, 2019, the Portfolio's I shares returned 3.82% (net of fees)[1], while the benchmark returned 2.94%.

Market Review and Outlook

Returns were strong across bond markets during the first quarter. Government bonds rallied massively as more central banks turned dovish and economic data did not inspire. Typically, lower government bond yields suggest concern about the economic future. But we also saw a sharp snapback in credit spreads after they widened significantly during the last quarter of 2018. Markets seem to be optimistic that a benign monetary policy in 2019 and lower real interest rates will support economies and lengthen the business cycle.

There is now much less concern about overly aggressive Federal Reserve (Fed) tightening. And the Fed has definitely said it has no plans to ease – officials view themselves as being truly on hold. This to us is the conundrum. Market pricing of the Fed looks a tad optimistic (or pessimistic if viewed from the perspective of the economy), meaning too high a probability is being attached to the Fed cutting rates. That makes us cautious about the direction of yields and worried that some upward adjustment is coming. Though global central bank concern about economic weakness and desultory inflation behavior suggests that any increase in rates is likely to be modest. We also think that this combination of easy central banks and decent economic performance should continue to support risk assets.

Yields on 2-, 5-, 10- and 30-year Treasuries fell by 23, 28, 28 and 20 basis points (bps), respectively, during the quarter.[2]

Despite the precipitous drop in government bond yields and mixed economic data, corporate bonds spreads gapped tighter as they recovered from a rough finish to 2018. The most volatile sectors performed the best – BBBs and financials in the investment-grade universe. The Bloomberg Barclays U.S. Corporate Index spread narrowed by 34 bps to end the quarter at 119 bps over government bonds.[3] Leveraged loans performed well but lagged high yield, as some concerns are still evident in the loan market.

Credit markets had a lot to digest in the first quarter. Economic data continued to come in mixed, especially outside the U.S., but seemed to indicate that the worst of the slowdown is now behind us. Importantly, China's economy seems to be improving after months of stimulus by the government. Monetary policy firmly pivoted towards being more dovish. Stabilizing economic data and easy monetary policy should serve to extend the economic cycle, keep default rates subdued and keep borrowing costs low – all of which should be supportive of corporate credit.

We still find credit attractive at these levels, but we believe the bulk of capital gains for the year are likely behind us. With spreads now close to long-term averages, we expect the asset class to generate the majority of future excess returns from carry and rolling down the yield curve as opposed to aggressive spread tightening. Sector and issuer selection remains a focus as technology and behavioral change are both fast moving and disruptive for many traditional industry business models. These concerns, coupled with less attractive valuations, suggest a more tactical approach to corporate positioning is warranted in the months ahead.

1 Source: Morgan Stanley Investment Management. Data as of March 31, 2019.
2 Source: Bloomberg L.P. Data as of March 31, 2019.
3 Source: Bloomberg Barclays. Data as of March 31, 2019.

Agency mortgage-backed securities (MBS) performed reasonably well during the quarter, despite increased prepayment concerns and shortening durations. Current coupon spreads tightened by 15 bps to 60 bps.[4] The Fed reaffirmed its intent to let its MBS portfolio continue to run off in the coming years, despite its expectation to end its overall balance sheet reduction this fall. Essentially, the Fed plans to replace MBS run-off with Treasury purchases, which is positive for overall interest rate expectations but is still a potential headwind for MBS valuations.

Credit-sensitive securitized assets also performed well, tightening significantly along with other credit sectors. Markets continue to believe in the strong consumer and housing market fundamentals, despite broader economic outlook concerns. We continue to believe that U.S. and global economies are slowing but are not at material risk for recessions. We believe that a slow growth, low inflation economy is the ideal environment for credit-sensitive securitized assets as it sustains positive economic conditions while minimizing risks of potentially harmful interest rate shocks.

Emerging market (EM) fixed income assets also enjoyed a strong rally during the first quarter. EM external sovereign and quasi-sovereign debt returned +6.59%, as measured by the J.P. Morgan EMBI Global Index.

Despite recent softness in global growth and potentially market-disruptive events (in the near term, most notably Brexit), our outlook for EM debt remains constructive. In addition to factors such as dovish central banks and few signs of economic slowdown, EM debt should also be supported by significant stimulus in China and the potential of a U.S.-China trade deal.

Portfolio Strategy and Analysis

The portfolio is structured to have an overweight in non-Treasury sectors and a yield advantage relative to the benchmark. Its largest sector overweights are in financial corporates, non-agency MBS and asset-backed securities. It is short duration in the U.S. and long duration in emerging markets and other developed countries.

The strong performance over the quarter was a result of our overweight in spread sectors as the Fund remains overweight credit risk and carry. Duration positioning had little net impact as the underperformance from our U.S. dollar duration short position was offset by our Australian and EM local rates long positions. The Fund was slightly long overall duration: close to neutral in developed markets (long Australia and euro; short U.S. and U.K.) and long EM. Currency positioning over the quarter was neutral in terms of relative performance.

FUND FACTS

Launch date	Base currency	Index
November 14, 1984	U.S. dollars	Bloomberg Barclays U.S. Aggregate Index

4 Source: JP Morgan. Data as of March 31, 2019.

Performance (%)

As of date March 31, 2019 (Class I Share at NAV)

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
MSIFT Core Plus Fixed Income Portfolio - I Shares	1.92	3.82	3.82	4.41	4.85	5.15	6.20	7.12
Bloomberg Barclays U.S. Aggregate Index	1.92	2.94	2.94	4.48	2.03	2.74	3.77	6.84

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month end performance figures, please visit morganstanley.com/im. Investment returns and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.

The gross expense ratio is 0.70% for Class I shares and the net expense ratio is 0.42%. Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Directors acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus. The minimum initial investment is $5,000,000.

Returns are net of fees and assume the reinvestment of all dividends and income. They are compared to an unmanaged market index. Returns for less than one year are cumulative (not annualized). Performance for one year or more is based on average annual total returns. The returns are reported for Class I shares. Performance for other share classes will vary.

The fund has received proceeds related to certain non-recurring litigation settlements. If these monies were not received, any period returns which include these settlement monies would have been lower. These were one-time settlements, and as a result, the impact on the net asset value and consequently the performance will not likely be repeated in the future. Rankings for the fund were more favorable due to these settlements and ratings may also have been positively impacted. Please visit www.morganstanley.com/im for additional details.

RISK CONSIDERATIONS

There is no assurance that a Portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the Portfolio will decline and that the value of Portfolio shares may therefore be less than what you paid for them. Accordingly, you can lose money investing in this Portfolio. Please be aware that this Portfolio may be subject to certain additional risks. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In the current rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. Longer-term securities may be more sensitive to interest rate changes. In a declining interest-rate environment, the portfolio may generate less income. **Mortgage- and asset-backed securities** are sensitive to early prepayment risk and a higher risk of default and may be hard to value and difficult to sell (liquidity risk). They are also subject to credit, market and interest rate risks. **Municipal securities** are subject to early redemption risk and sensitive to tax, legislative and political changes. **High yield securities ("junk bonds")** are lower rated securities that may have a higher degree of credit and liquidity risk. **Public bank loans** are subject to liquidity risk and the credit risks of lower rated securities. **Foreign securities** are subject to currency, political, economic and market risks. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed countries. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk).

INDEX INFORMATION

The **Bloomberg Barclays U.S. Aggregate Index** tracks the performance of all U.S. government agency and Treasury securities, investment-grade corporate debt securities, agency mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities.

The **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixedrate, taxable, corporate bond market. The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly.

The **JP Morgan Emerging Markets Bond Index Global (EMBI Global)** tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million.

The Indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an Index.

IMPORTANT INFORMATION

The views and opinions expressed are those of the investment team at the time of writing 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 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.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor 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.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund. To obtain a prospectus, contact your financial advisor or download one at morganstanley.com/im. Please read the prospectus carefully before investing.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT