Performance Review

In the quarter period ending March 31, 2021, the Portfolio’s I shares returned -2.81% (net of fees), while the benchmark returned -3.37%.

Market Review and Outlook

During the first quarter, Treasury yields climbed higher as vaccines were rolled out faster than expected and economic data continued to improve. Recent data and information flow continue to imply 2021 economic activity will be very strong. A falling infection curve, vaccine rollouts, strong efficacy results, massive U.S. fiscal stimulus, high savings rates, economic reopenings and a quite dovish Federal Reserve (Fed) are buttressing a very positive outlook for economies. With the $1.9 trillion support/stimulus package being implemented, U.S. fiscal policy is on a trajectory to significantly improve growth globally, not just in the U.S. With a second package targeting infrastructure package also likely to be discussed in the fall, probably worth at least another $1 trillion, the tailwind for the U.S. and global economy is strong, even with the back-up in yields.

With the market now pricing in earlier and faster rate hikes in the U.S., do we have too much of a good thing? Is too-easy policy necessitating an earlier-than-expected end of zero rates? Central banks say no. Markets say yes, at least in terms of when it expects the Fed to raise rates. Basically, the market believes the Fed will relent and tighten policy sooner than they are saying. But, according to the Fed and the European Central Bank (and most other central banks), economies are far from achieving the inflation/Labor market/growth targets necessary to tighten policy. Only more data will resolve this debate, and given the Fed’s desire to see a “string” of strong data it might be a while before there is more clarity on who is winning. That said, given the data and information flow, we would not be surprised to see the market price in even faster rate hikes.

Thus, given the continuation of strongly pro-cyclical policies in 2021 and beyond, high savings rates, mass vaccinations, the synchronized nature of the global business cycle and the relatively low level of nominal and real yields, we believe fixed income asset allocation should continue to be oriented towards cyclical assets and away from high quality/high interest rate sensitive bonds. That said, there are levels at which government bonds are a buy. It is just that we do not know where that is, at least not yet. As always, it is conditional on the state of the economy and the central bank’s view as to its appropriateness.

During the first quarter, 2-, 5-, 10- and 30-year Treasury yields rose by 4, 58, 83 and 77 basis points (bps), respectively. Longer-maturity yields have recently exhibited more volatility than shorter maturities as Fed policy is keeping yields on shorter-maturity bonds in a tight range. Though the steep increase in the yield of the 5-year Treasury does suggest that the market might be beginning to question how long the Fed will be able to keep the fed funds rate at zero in the face of a strong recovery.

Investment grade corporate spreads tightened modestly during the quarter. The Bloomberg Barclays U.S. Corporate Index spread declined by 5 bps to end the quarter at 91 bps over government bonds. Financials (1 bps wider) underperformed non-financials (8 bps tighter) during the quarter. Sector stories saw merger and acquisition (M&A) activity remain a topic with low debt costs and excess liquidity providing support, particularly in pharmaceuticals, health care, energy and technology. Anecdotal comments suggest investment bankers are very busy with their corporate clients considering the optimal strategy to take advantage of the expected economic rebound.

2 Source: Bloomberg L.P. Data as of March 31, 2021. One basis point = 0.01%
3 Source: Bloomberg Barclays. Data as of March 31, 2021.

This document constitutes a commentary and does not constitute investment advice nor a recommendation to invest. The value of investments may rise as well as fall. Independent advice should be sought before any decision to invest.
Looking forward, we see a continued positive backdrop for credit, driven by an expectation of an economic rebound supported by accommodative monetary and fiscal policy. Demand should remain strong as risk-free rates are kept low. We expect corporates to maintain conservative strategies until the real economy normalizes, though M&A activity and re-leveraging could become a larger risk later in the year.

During the quarter, nominal spreads on current coupon agency mortgage-backed securities (MBS) were relatively stable as the Fed continued its voracious buying. It now owns over $2.2 trillion of agency MBS, which is more than a third of the outstanding market. This positive technical factor helped balance out market concerns about duration extension as rates rose. The Fed is expected to continue these purchases as it stays accommodative. Mortgage rates gapped higher, with the average 30-year mortgage rate climbing to 3.18% in March, up from 2.65% in early January.\(^4\)

Agency MBS durations have extended substantially as rates have risen so far this year. The duration of the Bloomberg Barclays U.S. MBS Index extended to 4.1 years, after beginning the year at 2.3 years.\(^3\) On the plus side, higher yields could somewhat diminish prepayment risk going forward. This helped higher coupons, such as 30-year 3% to 4% structures, perform especially well during the quarter.

Securitized credit spreads tightened significantly during the first quarter, though they showed signs of stabilizing by the end of March. Mortgage fundamental performance continues to be generally positive, as loan delinquencies and forbearance requests continue to decline. National home prices were up over 10% over the past year, fueled by record low mortgage rates and historically low housing supply.\(^5\) Credit fundamentals remain strong in the residential and consumer sectors of the securitized markets, while some sectors of the commercial real estate market continue to face pandemic-induced stress.

In emerging market (EM) debt, the J.P. Morgan EMBI Global Index spread was relatively stable during the quarter, closing at 324 bps above Treasuries.\(^6\) We still hold a constructive view on the asset class for the rest of 2021. A global backdrop of steady monetary and fiscal policy accommodation and further progress on vaccine rollouts in the developed world (and, increasingly, in parts of EM) is likely to be supportive for the emerging market asset class. Potential disappointments of optimistic expectations about Biden policies vis-à-vis growth and trade could negatively impact the performance of growth-sensitive assets. Finally, the re-emergence of geopolitical risks (as evidenced by recent escalation in U.S.-Russia and U.S.-China tensions) could also disrupt our relatively benign outlook for EM.

Portfolio Strategy and Analysis

The portfolio’s outperformance over the quarter was due to spread sector decisions, particularly the portfolio’s overweight to securitized credit (non-agency residential MBS, commercial MBS and asset-backed securities) as spreads continued to tighten over the quarter. Corporate credit positioning also contributed to relative performance as spreads tightened over the quarter, particularly in convertibles and high yield corporate debt. From a macro perspective, the short U.S. duration position contributed positively as rates rose over the quarter. This was offset by the portfolio’s long EM currency positioning (Brazilian real and Mexican peso) and long EM rates positioning, which detracted.

The MSIFT Core Plus Portfolio continues to be a well-diversified, bond fund aimed at providing investors with the flexibility to invest beyond traditional fixed income asset classes. We believe the Fund remains well positioned for the continued volatility that lies ahead. Our active approach to managing the portfolio allows us to simultaneously source attractive risk-adjusted opportunities in the markets while reducing exposure in any areas that we think may become problematic.

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\(^3\) Source: Bloomberg Barclays. Data as of March 31, 2021.
\(^4\) Source: Freddie Mac Survey Rate. Data as of March 31, 2021.
**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. Market values can change daily due to economic and other events (e.g., natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g., portfolio liquidity) of events. 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 a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Mortgage-backed 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.
securities, investment-grade corporate debt securities, agency mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities.

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

The Bloomberg Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment grade, fixed-rate, taxable, corporate bond market.

JP Morgan Emerging Markets Bond Global Index 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.

S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index measures U.S. residential real estate prices, tracking changes in the value of residential real estate nationally.

The Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage. The index is unmanaged and does 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.

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Please consider the investment objective, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund. To obtain a prospectus, download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

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