Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Institutional Fund Trust

Core Plus Fixed Income Portfolio

GLOBAL FIXED INCOME TEAM | COMMENTARY | CLASS I SHARES | JUNE 30, 2021

Performance Review

In the quarter period ending June 30, 2021, the Portfolio's I shares returned 2.25% (net of fees)[1], while the benchmark returned 1.83%.

Market Review and Outlook

The second quarter of 2021 turned out to be nothing like the first. Indeed, it was a remarkable quarter, with long maturity yields falling, credit spreads tightening, and equities and commodities rallying, despite ostensibly bearish data/news. With economies and corporate results strong, it is logical that credit and equity markets may do fine. But, if everything is good macroeconomically, and likely to stay good for at least another year, why are yields falling? The answer lies in expectations, market positioning and the Federal Reserve (Fed). And, maybe most importantly, the search for yield in an income-starved world.

One key event was the Fed's June Federal Open Market Committee (FOMC) meeting. The Fed signaled (via its dot plot) a liftoff for policy rates in 2023, with two rate hikes, which is earlier than previously communicated at its March meeting. While Chairman Powell downplayed the change in the dots, stating that they would not change the Fed's policy forecast until the FOMC saw "further substantial progress," and that "liftoff is well into the future," the tone of the press conference, the number of FOMC participants who brought forward their first hikes and the hawkish communications by other Fed members convinced the market that policy preferences had meaningfully changed. Maybe FAIT (flexible average inflation targeting) was already done!

The truly remarkable impact the Fed meeting had was on the shape of the U.S. yield curve and inflation expectations. It is very unusual for long maturity yields to fall and the curve to twist/flatten like this BEFORE the Fed has even begun to raise rates. In addition, over the second half of the month, the forward yield curve between 5-year and 30-year yields almost went to zero, which historically has not happened until the Fed has almost finished tightening! Moreover, even though the Fed did not indicate that it would increase the cumulative amount of tightening over the cycle (e.g., the projected terminal fed funds rate remained unchanged), the market believed the terminal rate would now be lower than pricing suggested before the meeting. Despite inflation surprising to the upside, inflation expectations as measured by U.S. breakeven inflation rates fell. Even more astonishingly, this dynamic played out in other countries as well.

Clearly, the Fed's actions, although a surprise, were unlikely powerful enough to unleash the market moves witnessed. Other factors that contributed to the rally in government bond yields included: market positioning, particularly among speculative investors; concerns over a growth slowdown in the U.S.; the delta variant and its implications; and excess liquidity/savings. We believe worries about growth will likely subside; the delta variant will likely not derail economies normalizing, given reduced hospitalization and mortality rates with growing vaccination levels; and market technicals will likely stabilize. On the other hand, excess liquidity/savings might be here for a while.

Credit and equity markets were fairly nonplussed by all of the hoopla in the government bond markets. Corporate bond spreads continued to tighten, seemingly impervious to other forces and continuing to make new lows. If the Treasury market was signaling trouble ahead, risk markets were not listening. If, as we believe, economic data stays strong (meaningfully above trend) and inflation does not prove to be a problem, then market worries about growth deceleration and the possibility of the Fed making a policy error by moving to tighten policy too soon look wrong. And long-term Treasury yields appear too low.

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1 Source: Morgan Stanley Investment Management. Data as of June 30, 2021.

In the second quarter, the 2-year Treasury yield rose 9 basis points (bps), while 5-, 10- and 30-year rates fell by 5, 27 and 32 bps.[2]

Investment grade corporate spreads tightened during the quarter, helped by slightly higher equities and lower volatility. The Bloomberg Barclays U.S. Corporate Index closed 11 bps tighter to end the quarter at 80 bps over government bonds. Financials and BBBs tightened the most.[3]

We remain constructive on corporates and see the asset class supported by a few key factors. First, expectations for a continued strong economy remain. This will be facilitated by continued positive support from monetary and fiscal policy as rates stay accommodative and quantitative easing creates strong demand. We also expect corporates to maintain conservative strategies until the real economy normalizes. Finally, there is likely continued demand for credit in general, as risk-free assets offer negative real and absolute yields. Though we do think that vigilance will be critical, as a correction is likely at some point in the future as merger and acquisition activity increases, quantitative easing is tapered, and fear of missing out turns into fear of owning valuations that look historically expensive.

Agency mortgage-backed securities (MBS) underperformed similar duration Treasuries during the quarter. Lower coupons lagged the rally in the 10-year Treasury by 5-10 bps as talk of the Fed potentially tapering its MBS purchases grew louder.[2] Higher coupons were hurt by a revival of prepayment fears as mortgage rates declined. However, nominal spreads on current coupon agency MBS still remained at historically tight levels, largely due to Fed and commercial bank purchases. We remain cautious on the agency MBS sector.

Securitized credit spreads were generally tighter during the quarter. Mortgage fundamental performance continues to be generally positive, as loan delinquencies and forbearance requests continue to decline. National home prices increased over 15% over the past year, fueled by record-low mortgage rates and historically low housing supply.[4] Credit fundamentals remain strong in the residential and consumer sectors of the securitized markets, and we continue to have a positive view on these markets. We think it is important to be selective in the commercial real estate market, as some sectors continue to face pandemic-induced stress. There is significant recovery potential in these sectors as they reopen, but also substantial risk.

In emerging market (EM) debt, the J.P. Morgan EMBI Global Index spread tightened by 11 bps in the second quarter to 313 bps above Treasuries.[5] Performance varied across countries, with lower rated, higher yielding ones generally doing better. Late in the quarter, virus concerns impacted a number of countries as the delta variant began to spread. 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) should be supportive for the emerging market asset class. Nevertheless, potential disappointments, including COVID-19 outbreaks, fiscal challenges from pandemic stimulus efforts, geopolitical risks and domestic political developments, could 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, agency residential MBS and asset-backed securities) as spreads continued to recover over the second quarter. Corporate credit positioning also contributed to relative performance as spreads tightened over the quarter, particularly the overweight to investment grade corporate and the allocation to high yield corporate debt. From a macro perspective, the short U.S. duration position contributed negatively as rates fell over the quarter.

The MSIFT Core Plus Fixed Income 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.

FUND FACTS

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

2 Source: Bloomberg L.P. Data as of June 30, 2021. One basis point = 0.01%
3 Source: Bloomberg Barclays. Data as of June 30, 2021.
4 Source: S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index. Data as of June 30, 2021.
5 Source: J.P. Morgan. Data as of June 30, 2021.

Performance (%)

As of date June 30, 2021 (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	0.81	2.25	-0.63	3.00	6.18	5.09	5.43	7.06
Bloomberg Barclays U.S. Aggregate Index	0.70	1.83	-1.60	-0.33	5.34	3.03	3.39	6.73

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 0.64% 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. 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- 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 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.

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 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.

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

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