

## Morgan Stanley Institutional Fund

## Corporate Bond Portfolio

## BROAD MARKETS FIXED INCOME TEAM

**Performance**

In the quarter period ending March 31, 2024, the Portfolio's I shares returned 0.10% (net of fees)<sup>1</sup>, while the benchmark returned -0.40%.

The portfolio's overall investment grade credit positioning had a positive impact on performance.

The portfolio is positioned to be overweight financials and underweight industrials when measured in duration times spread terms.

Positions within investment grade financials were drivers of positive performance, specifically the overweight to banking and insurance. Furthermore, positions within investment grade industrials were also positive contributors to performance due to the overweight to energy and security selection in consumer cyclical. The overweight to investment grade utility had a positive impact on performance because of the overweight to the electric sector.

Elsewhere in the portfolio, the overweights to high yield and government-related debt had positive impacts on performance.

The duration positioning had a negative impact on performance due to the overweight to U.S. rates, which rose in the quarter, as the market unwound its aggressive expectations for cuts.

**Market Review**

Following a strong end to 2023, the first quarter of the year presented several challenges that dampened the spring in the step of many fixed income investors. Mixed inflation prints, resilient economic activity and the Federal Reserve (Fed) backpedalling somewhat on its dovish December tone combined to drive negative returns for bonds as the Bloomberg Global Aggregate Index fell -2.1%.

Bond yields seem to be settling into a broad holding pattern. After soaring in January and February, March brought a respite, at least in developed countries. Yields are up significantly from year-end 2023 after expectations of rate cuts have been meaningfully scaled back. Economic growth looks a bit better in Europe and China, although it is premature to believe in a robust rebound. Inflation looks like it is still falling in Europe, while the U.S. economy continues to defy skeptics who believed high interest rates would slow the economy. In fact, most historical data suggests that the economy is enjoying a bit of a resurgence with both the manufacturing and service sectors expanding. Gross domestic product (GDP) growth is also likely to expand more than 2% in the first quarter of 2024 after a 4% surge in the second half of 2023, and the second quarter of 2024 is seemingly off to a similar start.

While yields soared, the credit market continued to outperform as parts of the market tightened to historic lows. Stronger growth and continued pricing power have supported corporate results, while the pivots by central banks toward eventually easier policy provide an important backstop to downside economic risk.

Market sentiment in the quarter was driven by several factors.

- The focus remained on expectations of central bank rate cuts, rebounding economic growth and the mixed trajectory of inflation data.
- Geopolitical concerns fell to the background this quarter as there were no further escalations with the first uneventful March since 2020.
- Merger and acquisition (M&A) activity was concentrated in sectors that benefited from pandemic-related and supply-side disruption, and most deal structures did not significantly increase leverage, which is a positive sign for bondholders.
- The technical was supportive as record supply was matched with strong demand for high quality assets as evidenced by reducing new issue premiums.
- Fourth quarter corporate earnings were positive for credit with the confirmation that, although the economic outlook was uncertain, corporates were seeing limited stress in their business.

Over the quarter, euro investment grade corporate spreads tightened -24 basis points (bps) to +114 bps (-24 bps year-to-date).<sup>2</sup> U.S. investment grade corporate spreads underperformed as they tightened -9 bps to +90 bps (-9 bps year-to-date).<sup>2</sup> Sterling investment

<sup>1</sup> Source: Morgan Stanley Investment Management. Data as of March 31, 2024. Performance for other share classes will vary.

<sup>2</sup> Source: Bloomberg L.P. Data as of March 31, 2024. One basis point = 0.01%

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.

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

grade corporate spreads tightened -19 bps to +119 bps (-19 bps year-to-date).<sup>2</sup> Equities were higher in the period, and volatility was 4% higher (VIX closed at 13).<sup>2</sup>

## Portfolio Strategy and Analysis

Over the quarter, risk positioning was altered slightly to match market sentiment, with risk adjustments made on the margin to capture changing risk-adjusted valuations. We opportunistically trimmed exposure to high yield corporates, while adding to investment grade names, mainly financial institutions. Duration positioning was moved to neutral from underweight.

The portfolio's alpha sources remain financials (banks and insurance) and a small overweight to BBB-rated non-financials. We remain underweight A-rated or better non-financial bonds. The portfolio continues to hold small allocations to off-benchmark sectors such as convertible bonds, securitized debt and high yield corporates.

## Outlook

While central banks have suggested that rate cuts will begin this year, the exact timing of the first cut is less important than the pace and magnitude of the entire cutting cycle. Signs of still-sticky price pressures and an economy in good health suggest the cutting cycle may be shallow. Yet, central banks have recently shown a bias towards easier monetary policy, at the Fed in particular, where focus has turned to the dual mandate and the two-sidedness of risks.

Looking forward, our base case remains constructive for credit, supported by expectations of an economic soft landing, low-risk corporate strategies, accommodative fiscal policy and positive momentum. Considering current credit spreads valuation, we see a market that is fairly priced, and hence we see carry as an attractive return opportunity. But, given the uncertain medium-term fundamental backdrop, we have less confidence in expected spread tightening.

## Fund Facts

Inception Date	August 31, 1990
Minimum Initial Investment (\$)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Bloomberg U.S. Corporate Index
Class I expense ratio	<b>Gross 1.00 %</b>
	<b>Net 0.65 %</b>
Class A expense ratio	<b>Gross 1.21 %</b>
	<b>Net 1.00 %</b>

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.

<sup>2</sup> Source: Bloomberg L.P. Data as of March 31, 2024. One basis point = 0.01%

\* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

## Performance (%)

As of March 31, 2024	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	1.34	0.10	0.10	6.08	-1.67	1.77	3.42
Class A Shares at NAV	1.41	0.06	0.06	5.86	-1.95	1.50	3.11
Class A Shares (With Max 3.25% Sales Charge)	-1.85	-3.19	-3.19	2.44	-3.04	0.82	2.77
Bloomberg U.S. Corporate Index	1.29	-0.40	-0.40	4.43	-1.87	1.52	2.61

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](http://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.

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 and A 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. Please visit [www.morganstanley.com/im](http://www.morganstanley.com/im) for additional details.

## INDEX INFORMATION

The **Volatility Index (VIX)** is the ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. It represents one measure of the market's expectation of stock market volatility over the next 30-day period. The VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualized.

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

"Bloomberg®" and the Bloomberg Index/Indices used are service marks of Bloomberg Finance L.P. and its affiliates, and have been licensed for use for certain purposes by Morgan Stanley Investment Management (MSIM). Bloomberg is not affiliated with MSIM, does not approve, endorse, review, or recommend any product, and does not guarantee the timeliness, accurateness, or completeness of any data or information relating to any product.

The Indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an Index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor.

The **Bloomberg Barclays Global Aggregate Index** provides a broad-based measure of the global investment grade fixed-rate debt markets. Total Returns shown is unhedged USD. The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

## 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. **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).

## IMPORTANT INFORMATION

The views and opinions and/or analysis expressed are those of the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries

and affiliates (collectively “the Firm”), and may not be reflected in all the strategies and products that the Firm offers.

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 has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such

information and the Firm has not sought to independently verify information taken from public and third-party sources.

**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](https://morganstanley.com/im) or call 1-800-548-7786. Please read the prospectus carefully before investing.**

The whole or any part of this material may not be directly or indirectly reproduced, copied, modified, used to create a derivative work, performed, displayed, published, posted, licensed, framed, distributed or transmitted or any of its contents disclosed to third parties without MSIM's express written consent. This material may not be linked to unless such hyperlink is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright and other applicable law.

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