Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Institutional Fund

Emerging Markets Fixed Income Opportunities 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 3.23% (net of fees)[1], while the benchmark returned 3.24%.

Market Overview

The U.S. Treasury sell-off experienced in the first quarter of the year reversed itself in the second quarter, as the 10-year U.S. Treasury yield dropped 27 basis points (bps) to 1.47%, and the yield curve flattened.[2] At its Federal Open Market Committee (FOMC) meeting in June, the Federal Reserve surprised the market by signaling two rate hikes in 2023 (as opposed to expectations of no hike until 2024). Equity markets made new highs amid a global macro backdrop that was also generally supportive for emerging markets (EM).

EM assets performed positively over the quarter. Hard currency sovereigns benefited from tighter spreads and lower U.S. Treasury yields, as did corporate bonds, with high yield credit outperforming investment grade corporates. Local currency debt also generated positive returns as both local rates and stronger EM currencies against the U.S. dollar contributed.

In Latin America, the Central Bank of Brazil raised its policy rate to 4.25% after two hikes of 75 bps, citing that the adjustment was necessary to mitigate the dissemination of temporary shocks to inflation. At its last meeting, the central bank removed the "partial normalization" wording in its statement, foreseeing a similar move in policy rates at the next meeting, while adding that a deterioration of inflation expectations could trigger a faster reduction of monetary stimulus. The Central Reserve Bank of Peru kept rates on hold at 0.25% and maintained its forward guidance to keep a highly expansionary monetary policy.

Meanwhile, in Mexico, the central bank surprised the markets and increased its benchmark rate by 25 bps to 4.25%. The statement mentioned that the shocks to inflation, while expected to be temporary, may pose a risk to the price formation process and affect inflation expectations. S&P downgraded Colombia to high yield with a stable outlook and assigned a low probability of fiscal adjustment after the government's withdrawal of a required tax reform. The rating agency argued that Colombia's debt levels, expected to stabilize at about 60% of gross domestic product (GDP) during 2021-24, and large fiscal deficits are no longer consistent with an investment grade rating.

In Asia, central banks in Thailand, Indonesia, Malaysia and India kept rates unchanged as the new wave of COVID-19 cases continue to weigh on the regional economy. The Reserve Bank of India extended its quantitative easing program by $16.4 billion and revised its fiscal 2021-22 growth projection to 9.5% from 10.5%, while the Bank of Thailand downgraded growth in 2021 and 2022 and projected weaker external accounts on the back of reduced tourism inflows. In Malaysia, authorities tightened lockdown restrictions to curb rising COVID-19 cases and announced fiscal relief worth 2.6% of GDP, with 0.3% of actual fiscal outlays, signaling that fiscal space for additional relief is limited, and thus putting more pressure on the central bank to ease monetary policy via policy rate cuts and government-bond buying.

In Europe, central banks in Hungary and the Czech Republic started to tighten monetary policy, signaling further hikes in the coming months as inflation continues to rise. The National Bank of Ukraine also hiked its policy rate, bringing it to 7.5% with a 100 bp hike. Turkey left its benchmark interest rate unchanged at 19% and reiterated its commitment to keep the rate above inflation. Meanwhile, in Belarus, following the diversion of a Ryanair flight into Minsk and the subsequent arrest of an opposition

1 Source: Morgan Stanley Investment Management. Data as of June 30, 2021.
2 Source: Bloomberg L.P. Data as of June 30, 2021. One basis point = 0.01%

journalist, the European Union followed up with sectoral sanctions impacting petroleum products, potash fertilizer, tobacco products and the financial sector, banning institutions from buying and selling securities issued by Belarus after June 29. In Russia, the central bank hiked its policy rate by 100 bps during the quarter to 5.50% and anticipates further rate hikes at upcoming meetings, as it sees the balance of risks biased toward the pro-inflationary side. On the political front, the Biden-Putin summit yielded no major breakthroughs. Both leaders agreed to send ambassadors back to Moscow and Washington, and hinted at further talks on arms control and cybersecurity.

Fund Strategy and Performance

Overall, the Fund's allocation to EM dollar-denominated sovereign and quasi-sovereign debt was positive:

- The overweight allocations to Ecuador, Mexico and Senegal were the largest contributors, while the underweight exposures to Uruguay, the Philippines and Sri Lanka were negative.

The exposure to local currency bonds was also positive for performance, given the strengthening of EM currencies relative to the dollar:

- Most of the positive returns stemmed from the exposure to South Africa, Egypt and Chile.
- However, the overweight exposures to Mexico and Zambia detracted.

The exposure to EM corporates performed negatively:

- The allocation to corporates in Colombia, Mexico and Nigeria were the main positive drivers of performance, while the underweight to China and Turkey detracted.

Outlook

We remain generally constructive on EM fixed income assets in the weeks ahead on the back of continued stability in U.S. Treasury yields, a steady movement toward reopening in developed markets, and a pickup in vaccination rates in several EM economies. Within EM fixed income, we prefer high yield credit over investment grade, as high yield spreads offer a bigger cushion against rising yields in the developed world and exhibit higher beta to global growth. We also like EM currencies on the back of attractive valuations and a more positive correlation with commodity prices/terms of trade, though we acknowledge heightened risks to our view in the near term, stemming from U.S. dollar strength following the hawkish surprise at the June FOMC meeting.

Finally, we highlight other potential risks to EM assets. First, setbacks in the fight against COVID-19, evidenced as of late by the spread of the delta variant, could adversely impact EM economies with very low levels of immunity due to slow vaccine rollouts. This could translate into stricter lockdowns that could potentially weigh on growth and fiscal accounts. More generally, a delayed transition to fiscal consolidation may prompt the market to demand higher risk premiums in EM fixed income. Reemergence of geopolitical risks (as evidenced by volatile U.S.-Russia relations and a more assertive China) could also disrupt our benign outlook for EM. Finally, domestic political risks, such as upcoming elections in several Latin American economies, could negatively impact asset prices in those countries, though they are unlikely to have systemic implications for the asset class.

FUND FACTS

Launch date	Base currency	Index
May 24, 2012	U.S. dollars	JP Morgan Emerging Markets Blended Index - Equal Weighted

Performance (%)

As of June 30, 2021 (Class I Share at NAV)

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
MSIF Emerging Markets Fixed Income Opportunities Portfolio - I Shares	0.11	3.23	-1.06	9.54	5.89	4.75	--	4.51
JP Morgan Emerging Markets Blended Index - Equal Weighted	0.12	3.24	-0.92	7.63	6.17	4.69	--	4.17
Blended Index 1	0.12	3.24	-0.92	7.63	6.06	4.53	--	--
Blended Index 2	0.17	3.20	-1.03	7.39	6.09	4.55	--	--

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 1.53% for Class I shares and the net expense ratio is 0.85%. 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.

Please keep in mind that high double-digit returns are highly unusual and cannot be sustained. Investors should also be awarethat these returns were primarily achieved during favorable market conditions.

Effective close of business on December 31, 2019, the Fund's primary benchmark index has changed to **JP Morgan Emerging Markets Blended Index (JEMB) - Equal Weighted.**

The **JP Morgan Emerging Markets Blended Index - Equal weighted** is comprised of 1/3 **JP Morgan Emerging Markets Bond Global Diversified 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), 1/3 **JP Morgan GBI-EM Global Diversified Index** (a comprehensive global local emerging markets index that consists of regularly traded, liquid fixed-rate, domestic currency government bonds and includes only the countries which give access to their capital market to foreign investors (excludes China, India), and 1/3 **JP Morgan CEMBI Broad Diversified Index** (a global, liquid corporate emerging-markets benchmark that tracks U.S.-denominated corporate bonds issued by emerging-markets entities).

Blended Index 1 (Custom Benchmark) refers to performance of Fund's benchmarks since inception: Fund Inception - Sep 25, 2015: **JP Morgan Emerging Markets Bond Global Index** (EMBI Global Index); Sep 26, 2015 - 12/31/19: 1/3 **JP Morgan EMBI Global Index**, 1/3 **JP Morgan GBI-EM Global Diversified Index**, 1/3 **JP Morgan CEMBI Broad Diversified Index**; 12/31/19 and beyond - **JP Morgan Emerging Markets Blended Index (JEMB) - Equal Weighted.**

Blended Index 2 (Former Index) is comprised of 1/3 **JP Morgan Emerging Markets Bond Global Index**, 1/3 **JP Morgan GBI-EM Global Diversified Index** (the index is market capitalization weighted, with a cap of 10% to any one country) and 1/3 **JP Morgan CEMBI Broad Diversified Index.**

RISK CONSIDERATIONS

There is no assurance that a mutual fund 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 fund. Please be aware that this fund 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. **Duration** is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices. **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. Certain **U.S. government securities** purchased by the Strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **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. **Sovereign debt** securities are subject to default risk. **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). Due to the possibility that prepayments will alter the cash flows on **Collateralized mortgage obligations (CMOs)**, it is not possible to determine in advance their final maturity date or average life. In addition, if the collateral securing the CMOs or any third party guarantees are insufficient to make payments, the portfolio could sustain a loss.

INDEX INFORMATION

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 **JP Morgan CEMBI Broad Diversified Index** is a global, liquid corporate emerging-markets benchmark that tracks U.S.-denominated corporate bonds issued by emerging-markets entities.

The **JP Morgan GBI-EM Global Diversified Index** is a comprehensive global local emerging markets index that consists of regularly traded, liquid fixed-rate, domestic currency government bonds and includes only the countries which give access to their capital market to foreign investors (excludes China, India). The index is market capitalization weighted, with a cap of 10% to any one country.

The indexes are 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.

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.

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