Performance Review

In the quarter period ending September 30, 2019, the Portfolio’s I shares returned -0.44% (net of fees)\(^1\), while the benchmark returned 0.74%.

Market Overview

Emerging markets (EM) fixed income asset performance was mixed in the quarter, as falling U.S. Treasury yields aided dollar-denominated assets. Within the dollar segment, corporate bonds outperformed sovereigns as higher yielding sovereigns weighed on performance. Within corporates the high yield segment lagged the long-duration investment grade segment. EM domestic debt performance was negative in the quarter as EM currency weakness wiped out gains from local bond performance. During the period, oil prices declined while agricultural and metal prices were mixed. After a sharp escalation in trade tensions in August, hostilities eased in September as both sides made goodwill gestures, such as the U.S. delaying tariff implementation and China exempting tariffs on certain products and purchasing U.S. agricultural goods. The slowdown in manufacturing and growth indicators prompted a global easing response from central banks and governments.

The most significant news in emerging markets during the period came from Argentina. The opposition ticket (Fernandez/Kirchner) garnered a surprisingly large 47% of the vote in primary elections. The market-friendly incumbent (Macri) attracted just 32%. The wider-than-expected gap between the two candidates (in contrast with polls released prior to the vote) points to a very likely first-round opposition win at the presidential elections in October. The ruling party’s underperformance extended also to the country’s main electoral district, where market-friendly incumbent governor Maria Eugenia Vidal lost by a 20-point margin to Cristina Kirchner’s former finance minister, Axel Kicillof. The market reacted poorly to the election surprise, driven by pessimism about the future of reforms and a possible return to unorthodox Kirchner economics. President Macri responded by announcing several fiscal easing measures, including the elimination of a value added tax for basic goods, freezing inflation adjustments on mortgages until year-end and increasing cost-of-living salary adjustments. The government also announced a re-profiling operation of its short-term debt and the Argentine Treasury committed to repay re-profiled short-term debt held by provinces for a total amount of $1.3 billion. The government will also send a bill to Congress to allow the restructuring of local law long-term debt and will engage banks to assist in re-profiling long-term external debt. The central bank also tightened foreign exchange (FX) controls in an effort to curb draining international reserves. In addition, the Treasury committed to keeping the official FX market open to the provinces, permitting them to service their hard currency debt obligations. S&P moved Argentina’s rating to selective default, to later change it to CCC- after the terms of the short-term debt re-profiling were announced. Fitch joined other ratings agencies in downgrading the country (to CC), citing elevated policy uncertainty following the primary elections, tightening of financing conditions and a deterioration in the macroeconomic outlook.

The administration of Mexico’s President Andres Manuel Lopez Obrador (AMLO) faced fresh scrutiny following Finance Minister Carlos Urzua’s resignation early in the quarter, allegedly motivated by accusations of conflicts of interest of public officials and a lack of technical expertise in policy decisions. Arturo Herrera, the undersecretary of finance, was appointed as the new minister. Mr. Herrera has been integral in the potential bailout of the state-owned energy company Pemex and the government’s debt program, which bodes well for continuity on these key issues. The Mexican state-owned energy company Pemex issued debt as part of a liability management exercise to improve its funding position. In addition, the government announced a $5 billion capital injection to alleviate the company’s near-term financing risk and increase liquidity. The government also announced that it

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\(^1\) Source: Morgan Stanley Investment Management. Data as of September 30, 2019.

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could use around 40% of the stabilization funds (FEIP) to stimulate the economy (around 0.5% of gross domestic product (GDP)) and to compensate for the decline in revenue shortfall to comply with fiscal targets. This is an indication to the market of the government’s commitment to meet the fiscal goals despite the deterioration in growth. Mexico’s central bank cut its overnight rate to 7.75%, motivated by subdued activity indicators and decelerating inflation.

In Brazil, the Central Bank of Brazil (BCB) cut rates 100 basis points (bps) to 5.5% in line with expectations. The accompanying statement was seen as dovish, given the gradual economic recovery in Brazil and the risks of a more pronounced slowdown in global growth. The next steps will depend on the evolution of economic activity, balance of risks and inflation expectations. The BCB also revised down its projections for inflation in 2020 to 3.6% from 3.9%, leaving the door open for further cuts as inflation expectations remained low at 3.89%, below the target for 2020. The government has made progress in pension reforms, which will aid the fiscal position, as the bill progressed in the Lower House. Peruvian assets suffered on the back of political uncertainty. President Martin Vizcarra called for early elections (May 2020), to break an impasse with the opposition-held Congress, which rejected the move. The ensuing political crisis, which led to Congress’ dissolution, weighed on Peruvian assets.

In Asia, economic indicators across the region slowed and political tensions escalat​ed. India and Pakistan traded fire over the disputed territory of Kashmir and protests in Hong Kong continued to challenge the local government. The Indian government surprised the market by announcing an ambitious fiscal stimulus package. The proposals included a major overhaul of corporate tax rates and measures to simplify the tax code and improve compliance. The government estimated the fiscal measures will imply a cost of 0.7% of GDP, putting the central government’s fiscal deficit target at risk (target: 3.3% of GDP). The Philippines central bank cut its policy rate to 4% and also cut the reserve requirement ratio by 100 bps. The People’s Bank of China also announced a cut in required reserve ratios by 50 bps to stimulate the economy. In Indonesia, Bank Indonesia cut rates to 5.25% and also eased macro-prudential policies to boost credit growth. Bank of Thailand held rates steady in its latest meeting despite a dovish statement, driven by a bearish outlook for the economy.

In Europe, Ukraine’s President Zelensky’s party scored a solid victory in parliamentary elections, obtaining an unprecedented outright majority that would allow government formation without needing a coalition partner and would also facilitate enactment of pending structural reforms. In the Parliament’s opening session, it approved the new Cabinet of Ministers and passed a law stripping lawmakers from immunity. The new government is led by Prime Minister Oleksiy Honcharuk, viewed as a technocrat. Acting Finance Minister Oksana Markarova will remain in her post, which bodes well for structural reform and continued International Monetary Fund (IMF) cooperation. The National Bank of Ukraine cut its policy rate by 50 bps to 16.5%, as expected, citing a steady disinflation trend and a well-behaved hryvnia. In Turkey, the government transferred approximately $4 billion from the central bank to the Treasury to help fund its deteriorating fiscal deficit, and the central bank’s quarterly inflation report reinforced the expectation of a deep cutting cycle. The Central Bank of the Republic of Turkey (CBRT) also cut interest rates by 750 bps, exceeding expectations. This followed after Murat Cetinkaya was fired as central bank governor by President Erdogan, who had expressed exasperation about the slow pace of cut rates. The sacking of the governor one year ahead of the end of his term was viewed by the market as further weakening the independence of the CBRT. The Central Bank of Russia cut its policy rate 50 bps to 7.0%, and struck a dovish tone hinting at a potential additional cut before year end, provided that conditions remain favorable. The Central Bank of Egypt cut rates by 100 bps, as expected. Recent anti-government protests, while small and contained, highlighted the social and governance challenges facing Egypt. Bucking the easing global trend, the National Bank of Georgia hiked its policy rate by 100 bps to 7.50%, both at a regular meeting and at an emergency meeting in late September, in an effort to curb rising inflationary pressures stemming from lari weakness.

**Fund Strategy and Performance**

Total returns were marginally negative over the quarter as the negative returns of domestic debt and provincial debt outweighed the positive contributions from dollar-denominated sovereign and corporate debt. The primary contributors from a country perspective were Mexico, Turkey, Indonesia, Qatar, Nigeria and Russia. Conversely, investments in Argentina, Venezuela, Poland, South Africa and Colombia were the primary detractors, with roughly half of the negative performance being driven by Argentina.

Over the quarter, we continued to reduce risk in the portfolio by trimming or selling investments that we thought had run their course, and we have been selective in deploying that cash to new ideas. We added to positions in Mexico, Turkey, China, Nigeria, Paraguay, Guatemala and Egypt, while reducing exposure in Argentina, Chile, Sri Lanka, Ecuador, South Africa, Colombia, Togo, Angola, Panama, Tajikistan and Azerbaijan.
Outlook

We remain cautious on EM debt. U.S.-China trade talks, scheduled to take place on October 11-12, will likely influence market sentiment, which has recently soured due to U.S. threats to restrict capital flows to China. The outcome of the October negotiations are difficult to predict, with some observers leaning towards a scenario of near-term escalation (that is, October 15 U.S. tariffs on China imports enacted), followed by a potential truce at a leaders summit around the Asia-Pacific Economic Cooperation conference in November. U.S. politics are also adding to volatility as impeachment proceedings initiated by the Democratic Party in the lower house may impact Trump’s calculus vis-à-vis China, as well as making the ratification of the U.S.-Mexico-Canada Agreement more challenging. This fragile backdrop for trade is weighing on global growth, with the latest high-frequency activity indicators mostly trending down and prompting central banks in both developed and emerging countries (as highlighted previously) to double down on monetary policy accommodation. Lax monetary policy should be supportive of long duration positions, whereas we are less constructive on the performance of EM currencies, as we envision an appreciating U.S. dollar in the near term, supported by a tighter monetary policy stance by the Federal Reserve relative to other central banks, and heightened risk aversion.

Though downward growth revisions have increased, primarily in Asia and in major Latin America economies, dovish central banks in developed economies and subdued domestic inflationary backdrops should be supportive of continued monetary accommodation in EM. Furthermore, fiscal policy is increasingly more supportive of EM economic growth as evidenced by stimulus unveiled in many economies, the latest example being India. Similarly, Chinese authorities are likely to respond to weakening growth via further fiscal easing (primarily tax cuts), though the available fiscal space to maneuver is not as large as has been in the past. We also remain optimistic on structural reforms in several EM countries. In Brazil, our constructive view relies on social security reforms making steady progress in Congress, an ambitious tax reform agenda, as well as the government’s renewed focus on microeconomic reforms aimed at reducing red tape and improving the “ease of doing business.” Similarly, a reform-oriented government in Ukraine is currently negotiating a new program with the IMF and promising fast implementation of several important structural reforms. Finally, we will monitor significant elections in selected EM countries. In Poland, the ruling PiS party appears to be on track to retain its absolute majority in Parliament after the October 13 general elections. Meanwhile, on October 27, opposition candidate Alberto Fernandez is heavily favored to win Argentina presidential elections, which could potentially lead to more heterodox policies in the country.

<table>
<thead>
<tr>
<th>FUND FACTS</th>
<th>Launch date</th>
<th>Base currency</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>May 24, 2012</td>
<td>U.S. dollars</td>
<td>Blended Index</td>
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</tbody>
</table>
Performance (%)  
As of September 30, 2019 (Class I Share at NAV)  

<table>
<thead>
<tr>
<th>Fund/Portfolio</th>
<th>MTD</th>
<th>QTD</th>
<th>YTD</th>
<th>1 YR</th>
<th>3 YR</th>
<th>5 YR</th>
<th>10 YR</th>
<th>SINCE INCEPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSIF Emerging Markets Fixed Income Opportunities Portfolio - I Shares</td>
<td>0.55</td>
<td>-0.44</td>
<td>10.24</td>
<td>8.99</td>
<td>4.00</td>
<td>4.51</td>
<td>--</td>
<td>4.57</td>
</tr>
<tr>
<td>Blended Index</td>
<td>0.41</td>
<td>0.74</td>
<td>10.22</td>
<td>10.55</td>
<td>4.04</td>
<td>4.96</td>
<td>--</td>
<td>5.24</td>
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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 1.98% 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 aware that these returns were primarily achieved during favorable market conditions.

The Blended Index is comprised of 1/3 JP Morgan Emerging Markets Bond Index 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), 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). The index is market capitalization weighted, with a cap of 10% to any one country) 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. The returns shown prior to September 28, 2015 are that of the JP Morgan Emerging Markets Bond Index Global, the fund’s benchmark prior to the merger. Returns since the merger are that of the Blended Index. These indices are unmanaged and do 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 mutual fund will achieve its investment objective. Funds are subject to market risk, which is the possibility that the market values of securities owned by the fund will decline and that the value of fund shares may therefore be less than what you paid for them. 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). If the 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. 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.

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.

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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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.

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