Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Institutional Fund

Global Concentrated Real Estate Portfolio

REAL ASSETS | GLOBAL LISTED REAL ASSETS TEAM | COMMENTARY | AUGUST 31, 2020

Performance

In the one month period ending August 31, 2020, the Fund's I shares returned 4.72% (net of fees)[1], while the benchmark returned 2.52%.

The Fund outperformed the benchmark FTSE EPRA Nareit Developed Real Estate Net Total Return Index ("Index") for the month. Key contributors were the Fund's exposure to Hong Kong real estate operating companies (REOCs), the underweight exposure to the U.S. industrial and U.S. data center sectors, and overweight exposure to the U.S. mall sector and Japan REOCs. This was partially offset by the Fund's stock selection in the U.S. diversified sector, the overweight exposure to Continental European retail and underweight exposure to Germany.

Analysis

The global real estate sector gained +2.5% in U.S. dollar terms in August, as measured by the Index, but has declined 17.1% year-to-date. Markets generally turned in a risk-on direction in August, with monthly market segment performance modestly offsetting year-to-date trends in certain market segments.

Retail assets faced challenges prior to the crisis, and the crisis has accelerated these challenges, resulting in retailer bankruptcies and greater scrutiny from surviving retailers as to the level of rents they are able to pay. As always, rents are ultimately driven by retailers' expectations of sales levels, which have become more uncertain during and post recovery. Retail assets have had the weakest rent collections.

In the office sector, an emerging narrative has been the potential structural impact of the work-from-home theme. Office companies have had high rent collections and limited tenant bankruptcies, but investors have turned negative on the group. We remain more concerned with the impact of a weaker economy on tenant demand and see some demand upside from the reversal of the office densification trend.

This crisis has significant dissimilarities from the Global Financial Crisis of 2008-09 as the rapid and significant actions by global central bankers have assured that this is not a financial crisis. As this is a health and economic crisis but not a financial crisis, we have focused on the likely impairment to cash flows relative to stabilized 2019 levels. Indeed, the consensus estimate is that cap rates will likely be flat to down in most sectors, but clearly there will be varying assumptions as to the resultant impact on cash flows. There is a discussion as to sectors that may face structural changes as a result of the crisis, which may negatively impact valuations. The primary sectors included in this discussion are malls and urban office, where there is heightened uncertainty as to post-recovery demand levels and a wider range of potential outcomes.

Strategy

Our research process is driven by our bottom-up analysis of each public real estate company. We maintain a strong conviction that a disciplined, bottom-up investment methodology will result in the highest returns and outperformance over the long term. As such, the stock selection process for the Fund is based on our bottom-up analysis of real estate companies. Pursuant to determining which real estate securities, in our view, offer the best value (versus peers and direct real estate valuations) based on our net asset value (NAV) models and other real estate valuation metrics (implied price per square foot, implied capitalization rate, etc.), we apply our analysis to select those securities that we believe offer the highest total expected returns

[1] Source: Morgan Stanley Investment Management. Data as of August 31, 2020.

on a risk-adjusted basis. This rigorous portfolio construction process is strictly implemented so that we include only our highest conviction ideas in the portfolio. Diversification is also a significant consideration in constructing and managing the Fund.[2]

We maintain a strong adherence to our value-oriented, bottom-up driven investment process, which focuses on investing in equity securities of publicly listed real estate companies we believe offer the best value relative to underlying real estate value and NAV growth prospects, irrespective of short-term market trends.

We have revised our estimated company NAVs to reflect limited activities as well as anecdotal evidence with regard to bid-ask spreads from assets that have been offered for sale and comments from private equity funds with regard to pricing levels that will be of interest to them to acquire assets. Our revised NAVs represent estimated spot value if assets were to be liquidated in today's challenging environment, with significant cash flow uncertainty and limited secured debt availability in certain sectors. The general range of reductions reflects declines of 20%-30% for retail assets, 5%-10% for office assets and 0%-5% for residential and industrial assets. Downward revisions for key retail markets include: U.S. malls 18%-28%, U.S. shopping centers 10%-18%, Continental European retail 20% to 25% and U.K. prime shopping centers 25%-35%. Downward revisions for key office markets include: NYC office 10%-15%, European office 5%-10%.

It appears that in the public listed markets, the economically sensitive sectors (such as office, high quality retail and hotels) have already priced in a significant decline in economic growth. In addition, based on relative valuations, select stocks within these sectors are trading at very attractive levels. Share price declines result in attractive valuations for stocks in various market segments, including NYC office, U.S. and Continental Europe high quality retail, U.S. CBD and Continental European office, hotels, U.S. residential, the Hong Kong commercial property companies and the U.K. diversified Majors, even after adjusting NAVs. Sectors perceived as benefiting from a secular theme (e.g. industrial, data centers) continue to trade at significant valuation premiums. Although these sectors are economically sensitive, they are expected to be less adversely impacted by the lockdown relative to other sectors.

Outlook

The Fund continues to be focused on stocks in market segments which trade at very attractive share price valuations that we believe more than reflect estimated declines in asset values. It is noteworthy that, as in past crises, we believe the only manner to capture current market dislocation in the real estate sector is through the public markets, given significant liquidity in the public markets and a lack of distressed selling in the private markets. Overall, we believe the Fund is well positioned to benefit from the continued reopening of the economy and related recovery in each market, as well as potentially reward investors seeking to play the current dislocation in the real estate sector.

FUND FACTS

Launch date	Base currency	Index
June 18, 2018	U.S. dollars	FTSE EPRA Nareit Developed Real Estate Net Total Return Index

2 Diversification neither assures a profit nor guarantees against loss in a declining market.

Performance (%)

As of August 31, 2020 (Class I Share at NAV)

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
MSIF Global Concentrated Real Estate Portfolio - I Shares	4.72	0.94	-32.07	-24.55	--	--	--	-15.11
FTSE EPRA Nareit Developed Real Estate Net Total Return Index	2.52	5.37	-17.11	-13.68	--	--	--	-1.85

Performance (%)

As of date June 30, 2020 (Class I Share at NAV)

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
MSIF Global Concentrated Real Estate Portfolio - I Shares	3.91	7.77	-32.70	-29.71	--	--	--	-16.64
FTSE EPRA Nareit Developed Real Estate Net Total Return Index	2.70	10.21	-21.24	-16.15	--	--	--	-4.49

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 6.15% for Class I shares and the net expense ratio is 0.95%. 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.

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 strategy. Please be aware that this strategy may be subject to certain additional risks. In general, **equities securities'**values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. The risks of investing in **emerging market** countries are greater than the risks generally associated with foreign investments. **Real estate investments, including real estate investment trusts,**are subject to risks similar to those associated with the direct ownership of real estate and they are sensitive to such factors as management skills and changes in tax laws. **Non-diversified portfolios** often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility. When investing in **value securities** (those believed to be undervalued in comparison to their peers), the market may not have the same value assessment as the manager, and, therefore, the performance of the securities may decline. Stocks of **small- and medium-capitalization companies** entail special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies.

INDEX INFORMATION

The **FTSE EPRA Nareit Developed Real Estate Index** is a free float-adjusted market capitalization weighted index designed to reflect the stock performance of companies engaged in specific aspects of the major real estate markets/regions of the developed world.

The Index is unmanaged and do 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.

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