

### MORGAN STANLEY INSTITUTIONAL FUND

# Global Endurance Portfolio

COUNTERPOINT GLOBAL | COMMENTARY | December 31, 2022

Dear Clients,

Total returns for Global Endurance for the full year 2022 were -66.23% compared to -18.36% for the MSCI All Country World Index. We saw no relief in the second half of the year as the share prices of many of our companies continued to remain depressed.

I take full responsibility for last year's challenging performance. The intensity and the duration of this drawdown is certainly character-testing. While I appreciate and understand that performance this past year has not been ideal for clients, even for those with the highest pain tolerance, I believe there is a silver lining to this current moment. We were able to acquire shares of various businesses at a discount to fair value, reduce our cost basis wherever possible and focus on companies we believe have the highest potential upside.

We apply time-tested, value investing principles to growing businesses and remain steadfast in our investment strategy and process. However, it would be an understatement to say that our style of investing was out of favor as market participants fled to assets they perceived "safe" even though many of those valuations were already quite stretched.

As is the case with previous drawdowns, we once again find ourselves in an environment where the time horizon for most market participants has shrunk considerably. Focus has shifted to short-term metrics or quarterly earnings, as opposed to a company's long-term growth potential. Our investment philosophy is based on fundamentals, independent thinking and a long-term ownership mindset. However, in 2022, we were subject to the phenomena of price driving sentiment. We went from a "nothing can go wrong" to "nothing can go right" perspective within the span of 12 months. Currently, most market participants are skewing to be fearful (versus greedy) and are questioning everything from their assumptions regarding the quality of a company to their investment process and strategy. In most cases this is akin to uprooting saplings to see how the roots are growing! Many are delaying planting seeds – or in other words, are hesitant to put capital to work. Others want their portfolio companies to stop reinvesting and go straight to harvesting cash.

Suffice it to say we have kept our head when it seems like everyone around us has been losing theirs. From the inception of the Fund, we have never shied away from share price volatility as we do not believe it is an accurate representation of risk. In our view, real risk arises when our businesses are outcompeted by an incumbent or a disruptor, experiencing a deterioration of their consumer value proposition, facing the consequences of poor execution, running out of reinvestment runway and, last but not least, mismanaged, which can lead to deteriorating culture, increasing bureaucracy and stifling complacency.

In our portfolio, the businesses that saw the sharpest share price declines were cursed with high expectations going into the year. The management teams and the market expected sales growth to continue to be at a similar clip in 2022 as they saw in 2021. Many ended up over-investing on both the income statement as well as the cash flow statement. While it is easy to place blame on management, I will refrain from doing so as it was hard to predict how the sharpest increase in interest rates since the 1980s would impact budgets that were set in 2021. There is no denying that rising rates along with inflation led to a significant rise in uncertainty. This uncertainty, in turn, led to an elongation of the sales cycle, a pause in consumer purchases and a general decline in consumer and business sentiment. Given this backdrop, our businesses were hit with a triple whammy of decelerating growth, increasing expenses and significant multiple compression.

To make matters worse, many market participants increased exposure to perceived “safe” assets or sectors that had fared well during prior inflationary times. This contributed to the significant underperformance of the sectors we tend to favor. Furthermore, the mark-to-market nature of the public markets coupled with the nearly universal rush for the exit in fear of short-term losses exacerbated an already severe drawdown for investors like us who prefer to stay fully invested and not time the market.

As I review the sectors that outperformed last year, energy, utilities, financials and consumer staples stand out. We did not have a single investment in any one of these sectors, which led us to underperform on a relative basis given the index we compete against had roughly 30% allocated to these sectors combined. Now the natural line of query would be: why were we not diversified enough and did not have any holdings in these sectors? Our general aversion to these sectors stems from a myriad of factors specific to each one of them which I aim to briefly touch upon.

Typically, businesses in the energy and financials sectors are commodity-like in nature. The price of energy is hard to predict with certainty, capital intensity tends to be high, balance sheets typically have large liabilities and consumers tend to buy from the business that offers the product at the lowest price (low switching costs). This leads an investor in these sectors to spend much of their time focusing on uncertain macroeconomic factors such as interest rates, pricing cycles, OPEC actions, geopolitical issues, and the second and third-order effects of such decisions. We find that most of the time, investors focused on these non-fundamental factors end up placing directional bets that are vastly beyond their control and tough to predict even by the pundits purely focused on it. In many cases, these pundits, with their broad-based opinions and their affinity for endless charts, remind us of astrologists who rely on horoscopes. Spending additional time and research on macroeconomic factors is arguably even worse than acknowledging that the “field” itself may not be worth pursuing. Brandolini’s law – i.e. “the amount of energy needed to refute bulls\*\*\* is an order of magnitude bigger than to produce it” – certainly comes to mind when debating macroeconomic topics.

As we look to the consumer staples and utilities sectors, I do believe we can find businesses in these sectors that offer higher quality and predictable earnings. However, we run into two core concerns. First, many of these businesses have quite limited reinvestment opportunities. Second, these businesses are selling for relatively steep valuations and many are already showing signs of deteriorating operating performance given the current currency and inflation headwinds. Furthermore, the share prices of businesses that operate in these sectors should, at least in theory, also be affected by rising rates. Even the “safest” of assets can become an unsafe investment if one overpays for it. Price paid, especially for companies with limited growth runway or low optionality, is the most important factor in the determination of future return predictions.

To be clear, I am not excusing our poor performance. I own it. Disappointing long-term clients is painful even when expectations are high. If there is any consolation, I too share in the pain we suffered last year since my own capital is in the Fund. On a personal level, I have lowered my cost basis by adding to the Fund, have never sold a single share, and have no plans to do so in the foreseeable future. My operating motto tends to be “this too shall pass,” which has served me well during times of crisis as embedded within it is optimism in the free markets and the human race. We have been able to accomplish much despite the inevitable periods of high inflation, deflation, wars, shortages, pandemics, terror attacks, natural disasters and political turmoil. The topic *du jour* is that high inflation is expected to persist for a long time. This idea is centered on the belief that not only will the invisible hand and free markets fail us, but so too will the internet, which, for all its critics, has been a unifying force, leading to global information dissemination, bringing issues to the forefront and influencing supply and demand in real time.

All is not dreary when it comes to our companies. Our management teams, many of which are owner-operators with sizable ownerships, took the right, albeit painful, steps. These steps ranged from reductions in workforce, cuts to spending, and finding and increasing efficiencies. We believe these necessary steps will allow our companies to survive and, in time, thrive. I am proud of our management teams for once again rising to the challenge so shortly after the pandemic.

Another positive nuance that I’d be remiss to not mention would be the fact that not only have rising rates led to sound money and a strong dollar, but it has also increased the hurdle for funding of competition. Given there is now a real opportunity cost to capital, we assume that even venture capitalists or leveraged buyout

funds won't simply fund a business to go grab market share for the sake of grabbing market share. This, in turn, benefits companies which were able to build brands and products and reach scale in times of easy money.

From a portfolio management perspective, I made sure we concentrated our capital in our best ideas, harvested tax losses where appropriate and remained steady in our journey. Our businesses operate in end-markets which we believe are quite diversified, resilient and in most cases have powerful structural tailwinds behind them. Furthermore, we won't sell a business simply if it is underperforming if our thesis is intact, and the potential of our operating businesses remains largely unchanged or perhaps gotten even better.

Needless to say, we are seeing an abundance of opportunities. For example, some of our favorite businesses in the software sector are trading at compelling valuations. Software companies tend to have high gross margins (similar to consumer staples) and offer streams of low capital intensity royalties due to their nature of build once and sell over and over again. This ability to produce large dollar volume increases with minor additional capital also makes them particularly attractive. Many of these software companies have maintained high retention rates given their strong value proposition to the end customer. We have also been able to take advantage of the uncertainty in Europe to acquire high quality businesses that we've been eyeing for a while.

We continue to believe that equities will likely be the best-performing, long-term asset class because they provide ownership in the creativity, ingenuity and productivity of talented workers. While money can be inflated, talent cannot! It is my belief that owning a portfolio which consists of a select group of companies located throughout the world with durable competitive advantages, sustainable growth opportunities, valuable business models and strong management teams will lead to exceptional long-term returns. Therefore, the majority of our time has been and will continue to be focused on the operational truths of our underlying businesses.

Just like it is always darkest before dawn, it is my belief that continued patience and not letting emotions get the best of us is indeed the best course forward. If you wait for the perfect conditions, you will be waiting for a long time.

As a reminder, while our companies' share prices can vary significantly in any short time period, it is my belief that over time they reflect the intrinsic value of their underlying businesses. And given that we own a select group of companies – 25 to be exact – a number which is a fraction of the over 2,855 companies held in the index we compete against, the Fund's performance may vary in any given year. At the end of 2022, our top 10 companies accounted for 69.2% of the portfolio and top 20 companies accounted for 94.5% of the portfolio. From a geographic domicile weighting standpoint, our portfolio was 58.9% in the United States, 16.2% in the United Kingdom, 9.9% in Canada, 7.3% in Israel, 3.1% in the Netherlands, 1.9% in France, 1.4% in Sweden and 1.3% in Singapore.

I am grateful for your trust in Global Endurance.

With best wishes,

Manas Gautam

The views, opinions, forecasts and estimates 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. Portfolio holdings and sectors 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 the securities mentioned or securities in the sectors referenced. Past performance is no guarantee of future results. There can be no guarantee that the Fund will achieve its investment objectives or that a portfolio consisting of the team's "best ideas" will experience positive performance.

### Performance (%) as of December 31, 2022

Class I Shares – Net of Fees

	MTD	QTD	YTD	1 YR	3 YR	5 YR	Since Inception*
<b>MSIF Global Endurance Portfolio</b>	-6.21	-12.27	-66.23	-66.23	-8.06	--	0.32
<b>MSCI All Country World Index</b>	-3.94	9.76	-18.36	-18.36	4.00	--	9.24

\*The inception date of the MSIF Global Endurance portfolio is 12/31/2018.

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) or call 1-800-548-7786. 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 1.35% for Class I shares and the net expense ratio is 1.01%. 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 \$1,000,000.

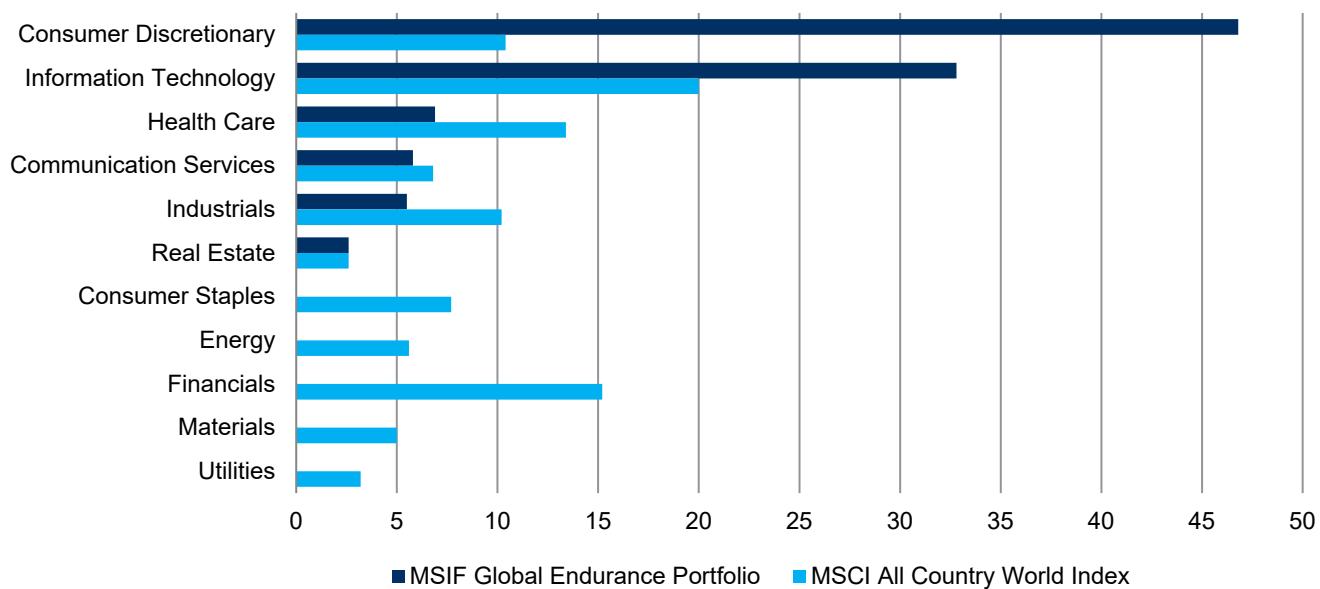
Returns are net of fees and assume the reinvestment of all dividends and income. They are compared to an unmanaged market index. Returns for less than one year are cumulative (unannualized). Performance for one year or more is based on average annual total returns. The returns are reported for Class I shares. Performance for other share classes will vary.

The **MSCI All Country (MSCI AC) World Index** is a free float-adjusted market-capitalization-weighted index designed to measure the equity market performance of developed and emerging markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The index does not include any expenses, fees or sales charges, which would lower performance. The index is unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

### Top Ten Holdings % of Total Net Assets, as of December 31, 2022. Subject to change.

Cricut, Inc.	13.8
Victoria, Plc	10.7
Floor & Decor Holdings, Inc	7.7
Global-e Online Ltd.	7.3
Appian Corp.	6.3
Babcock International, Plc	5.5
Royalty Pharma, Plc	4.8
Bill.com Holdings, Inc.	4.7
Constellation Software Inc.	4.2
Fastly, Inc.	4.2
<b>TOTAL</b>	<b>69.2</b>

## Sector Allocation As of December 31, 2022



Source: FactSet Research Systems, Inc. / Morgan Stanley Investment Management. Numbers may not add to 100 due to rounding and the exclusion of cash. Subject to change daily. Fund information is provided for informational purposes only and should not be deemed as a recommendation to buy or sell any security or securities in the sectors and countries that may be presented.

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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.

**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 portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks. In general, **equities securities'** values also fluctuate in response to activities specific to a company. **Privately placed and restricted securities** may be subject to resale restrictions as well as a lack of publicly available information, which will increase their illiquidity and could adversely affect the ability to value and sell them (**liquidity risk**). Investments in **foreign markets** entail special risks such as currency, political,

economic, market and liquidity risks. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed countries. Investments in **small- and medium- capitalization companies** tend to be more volatile and less liquid than those of larger, more established, companies. To the extent that the Fund invests in a limited number of issuers (**focused investing**), the Fund will be more susceptible to negative events affecting those issuers and a decline in the value of a particular instrument may cause the Fund's overall value to decline to a greater degree than if the Fund were invested more widely.

**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](http://morganstanley.com/im). Please read the prospectus carefully before investing.**

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