

Morgan Stanley Institutional Fund

Global Fixed Income Opportunities Fund

BROAD MARKETS FIXED INCOME TEAM

Performance

In the quarter period ending June 30, 2023, the Portfolio's I shares returned 0.39% (net of fees)¹, while the benchmark returned 0.06%.

Market Overview

While banking fears dominated the price action observed in the first quarter, market behavior coming into the second quarter seemed to be range-bound between two narratives. The first was a resilient labor market and sticky core inflation due to pressures from elevated services inflation. The second was the concern around an economic fallout and a potential credit crunch driven by regional banking fears. However, both narratives stood down during May as all eyes turned to the U.S. debt ceiling. Once a deal became imminent, that uncertainty subsided and all eyes turned back to the economic data. During the first quarter, we saw wider credit spreads and materially lower Treasury yields, as markets reflected concerns of a heightened risk of recession. However, economic and labor market data continuously surprised to the upside, conflicting with fears of a weak economy burdened by banking woes, persistent inflation and hawkish policymakers.

During the quarter, 2-, 5-, 10- and 30-year Treasury yields rose by 87, 58, 37 and 21 basis points (bps), respectively.² The upswing in rates was primarily due to the market repricing government yields to reflect a stronger economy and subsequent Federal Reserve (Fed) hikes.

The Bloomberg U.S. Corporate Index spread tightened 15 bps during the quarter to 123 bps.² The bulk of the tightening was due to the market repricing weakness in the financial sector lower, with financial spreads tightening 25 bps.² Though financial spreads remain wider than their pre-banking crisis levels, it is evident that the market has abandoned fears of a potential systemic financial crisis. U.S. investment grade spreads broadly performed well due to numerous factors. Firstly, there were several economic data surprises (particularly in the U.S.) exceeding weak expectations, with the labor markets remaining strong and inflation starting to fall. Secondly, corporate news was generally bondholder friendly. Finally, general risk sentiment improved as debt ceiling contention faded, risks of a recession accompanied by a spike in defaults receded, and equity market volatility fell to pre-COVID levels.

Broadly, securitized credit sectors were relatively unchanged, though AAA collateralized loan obligations (CLOs), asset-backed securities (ABS) and non-agency commercial mortgage-backed securities (CMBS) tightened 12 bps, 18 bps and 9 bps, respectively.² Within securitized markets, fundamental credit conditions remain stable despite recession risks. Although delinquencies across many asset classes are increasing slowly, overall delinquencies remain low from a historical perspective, and we believe delinquency and default levels will remain non-threatening to the large majority of securities. On the other hand, agency mortgage-backed securities (MBS) yields broadly tracked the rates market, with yields rising roughly 60 bps.² Securitized yields remain at historically wide levels, and we believe these wider spreads offer more than sufficient compensation for current market risks. Our favorite sector remains residential mortgage credit, despite our expectation that U.S. home prices will likely fall another 5% to 10% in 2023. We remain more cautious on commercial real estate, especially office, which continues to be negatively impacted in the post-pandemic world.

Fund Strategy and Performance

Overall performance was positive over the quarter. The portfolio's positioning within spread sectors drove performance.

Within macro decisions, the portfolio's long positions in developed market rates (U.S., Australia, New Zealand, U.K.) detracted from performance as yields rose broadly over the quarter. However, the long position in euro area rates was a small contributor. The allocation to emerging markets local rates also contributed positively overall (mainly Indonesia, Dominican Republic, Hungary, and Peru) given lower yields. The allocation to South Africa detracted, however, while Mexico breakeven inflation positioning contributed to performance.

¹ Source: Morgan Stanley Investment Management. Data as of June 30, 2023. Performance for other share classes will vary.

² Source: Bloomberg L.P. Data as of June 30, 2023. One basis point = 0.01%

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Within sector spreads, the allocation to investment grade (biased to financials, focused on significantly important institutions) and high yield corporates (predominantly industrials) both contributed. The allocation to securitized assets also contributed positively, with the exposures to ABS and non-agency commercial and residential MBS contributing the most.

Within currencies, the long position in emerging markets currencies expressed versus the U.S. dollar contributed overall as the Mexican peso and Brazilian real strengthened over the period. However, the long Japanese yen position detracted slightly.

Over the quarter, the duration of the portfolio decreased by -0.29 years, closing at 3.61 years. Most of the decrease was made through U.S. Treasuries, though the portfolio also reduced duration in the U.K., euro area (mainly Germany), and South Africa. We increased exposure to New Zealand and Australia rates given weaker-than-expected data (inflation and growth) as well as central banks surprising to the dovish side. We also added to Canadian versus U.S. duration on a relative value basis. Within emerging markets (local), we added duration in Indonesia, Peru and Hungary on attractive carry and valuations. We maintain a positive bias to emerging markets local overall given high real yields and steeper curves. The portfolio reduced credit default swap exposure while decreasing investment grade and high yield corporates risk, particularly in the industrials subsector. The portfolio increased exposure to agency and non-agency RMBS given attractive valuations (compared to investment grade credit) and strong fundamentals while trimming the allocation to ABS. The portfolio also trimmed emerging market sovereign debt (Dominican Republic and Egypt). Regarding currency positioning, we added long positions in emerging market currencies expressed versus the U.S. dollar (in particular Peruvian sol, Indonesian rupiah, Brazilian real and Mexican peso) on attractive valuations. The portfolio closed the short Swedish krona and Swiss franc positions and the long Thai baht position. The portfolio also reduced Japanese yen and Hungarian forint.

Outlook

Despite central bank behavior and rhetoric remaining focused on too high inflation, inflation data improved significantly. Disinflationary momentum is a major change from last year's massive inflation shock, when high and rising inflation undermined both equities and bonds. Indeed, records were broken regarding the magnitude and correlation of negative asset price moves: a generational inflation shock triggered a once-in-a-generation asset price shock. This year the opposite has happened. Significant inflation deceleration has supported strong asset price appreciation: equities up double-digits and high yield bonds returning over 5% through mid-year, despite continued central bank tightening.²

A key driver of this "goldilocks light" environment – in which all assets (save a few challenged sectors like commercial office) have been performing well – has been continued economic growth. Markets have been on recession alert for over six months with expectations having centered on a second half 2023 arrival. It has not happened, and forecasts keep pushing it forward. The resiliency of economic growth during a historically unprecedented monetary tightening cycle has been one of the big surprises in 2023. We can expect risk assets (equities, high yield, emerging markets) to continue avoiding major sell-offs if economies, particularly the U.S. and Europe, avoid meaningful recession, defined as significant rises in unemployment. So far, so good. But crunch time will arrive later in 2023 as the cumulative effects of central bank tightening continue to bite and residual strength from pandemic fiscal policy support wanes, if not disappears. Recession risks remain, but in our view remain overblown in terms of their likely severity.

Many of the difficulties in navigating financial markets relate to the peculiarities of this economic cycle. Economies are still equilibrating post pandemic. Manufacturing output is very weak. Using U.S. data from the Institute for Supply Management (ISM) survey, the manufacturing sector is in recession. On the other hand, service sector spending remains strong, with the ISM service survey remaining in expansionary territory. This combination is unusual. The question is how long it can last. Recent U.S. data on the consumer has begun to show some weakness: restaurant spending is down, credit card and loan delinquencies are rising (although still low), bank lending is slowing, as are consumer durable purchases. We believe the good news is that this bodes well for inflation because if consumer spending does not slow, neither will inflation. Policy is working. But, is it enough?

The major risk for bonds going forward is that inflation does not fall fast enough for central banks, necessitating higher policy rates and additional economic weakness, potentially leading to recession. Markets, having resisted central bank forecasts of ever-rising policy rates, have had to give into the reality that central banks mean what they say and show no signs of stopping raising rates. The Fed paused in June, but it emphasized it was a skip and not an indication that they were done. In the U.K., high inflation has pushed the expected terminal policy rate over 6%!² The highest policy rate since the turn of the century. Of course, inflation has not been this high for an even longer time.

A major challenge for policymakers and investors is knowing how high is high enough. To answer the question two things must be known. First, the target. We know that. Most countries' central banks have a 2% inflation target using some variation of core inflation. They seem intent on getting back to it. Second (and more challenging), over what time frame and at what cost do they want to get to 2%. Each central bank probably has different preferences depending on their specific circumstances. A central bank more willing to lengthen the time frame in getting back to target means lower probability of recession and less chance of a policy overshoot. We believe most central banks, including the Fed and ECB, are NOT in a rush to crush their economies to get inflation to

² Source: Bloomberg L.P. Data as of June 30, 2023. One basis point = 0.01%

target by end 2024. Both central banks forecast targeting inflation to be ABOVE target at end 2024, suggesting patience. Medium-term risks of an economic slowdown remain, with the impact of tighter lending conditions, tight monetary policy and a slowing labor market picture still to be fully felt by consumers and corporates. We envision a moderate recession in 2024 with no dramatic rise in defaults or risk premium – maybe a semi-soft landing?

Government bond yields are getting more attractive. U.S. Treasury 2-year yields moved back over 5% in early July, the highest they have been since 2006.² Real interest rates, as measured by U.S. Treasury inflation-protected securities (TIPS), are also at decade-plus highs.² Indeed, one measure of monetary policy success is how much real yields have risen. They are now up almost 3% from March 2022 lows.² Fed policy is working. U.S. nominal 10-year yields breached 4% once again in early July.² Not quite at their 2022 peak, but meaningfully higher. Similar moves occurred in other developed markets. Currently, our strategy is to remain modestly underweight interest rate risk, as evidence that labor markets are loosening enough to slow economies sufficiently remains scant. That said, we are analyzing data carefully for evidence that policy rates are high enough. On the other hand, emerging markets have performed very well in recent months, and we expect their outperformance versus developed markets is likely to continue. But, if higher real yields are required to break the back of developed country inflation, lower EM yields may have to wait.

Our strategy remains one of taking risk where opportunities suggest adequate yield to compensate for unexpected volatility or surprising bad news, whether geopolitical, economic or policy induced. Corporate bonds – both investment grade and high yield – had a strong second quarter. We do not believe spreads will tighten further in the third quarter. However, we do not see risk of a meaningful sell-off in investment grade bonds. Given the broader economic headwinds, but still positive momentum, we see carry rather than capital appreciation as the likely driver of investment grade corporate returns in the second half of 2023. High yield bonds' strong performance year-to-date suggests that with economic headwinds likely increasing in the second half of the year, their performance is likely to deteriorate. We are taking a more idiosyncratic approach to high yield, avoiding lower spread, more generic credits.

The securitized credit outlook has also modestly deteriorated as U.S. household balance sheets come under more pressure and excess savings are run down. We still think it offers the most compelling opportunities. We are trying to take advantage of higher yields on higher quality issuers to achieve our target returns, rather than venture down the risk/rating spectrum. Our favorite category of securitized credit remains non-agency residential mortgages, despite challenging home affordability. Somewhat surprisingly, U.S. housing looks like it may have bottomed out.

Recent upward movements in yields and incipient eurozone economic weakness have not helped the U.S. dollar. We continue to like being underweight the U.S. dollar, over the longer term, versus a basket of mostly emerging market currencies. However, given emerging markets' strong year-to-date performance, we are not in a rush to increase exposure. We also continue to like emerging market local government bonds versus hard currency debt and developed market government bonds.

Fund Facts

Inception Date	July 28, 1997
Minimum Initial Investment (\$)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Primary- Bloomberg Global Aggregate Hedged USD Index
	Custom- Blended Index Former- Bloomberg Global Aggregate Index
Class I expense ratio	Gross 0.56 %
	Net 0.56 %
Class A expense ratio	Gross 0.83 %
	Net 0.83 %

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.

² Source: Bloomberg L.P. Data as of June 30, 2023. 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 June 30, 2023	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	0.40	0.39	3.07	3.48	0.27	2.06	3.28
Class A Shares at NAV	0.38	0.34	2.97	3.25	0.00	1.81	2.97
Class A Shares (With Max 3.25% Sales Charge)	-2.94	-2.96	-0.46	-0.07	-1.10	1.13	2.64
Bloomberg Global Aggregate Hedged USD Index	-0.06	0.06	2.96	0.52	-2.88	0.93	2.11
Blended Index	-0.06	0.06	2.96	0.52	-2.88	0.93	0.95
Bloomberg Global Aggregate Index	-0.01	-1.53	1.43	-1.32	-4.96	-1.09	0.20

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.

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.

Effective January 1, 2017, the benchmark index for the MS Global Fixed Income Opportunities Fund changed from Bloomberg Global Aggregate Index to the Bloomberg Global Aggregate Hedged USD Index. Blended Index performance shown is calculated using the Bloomberg Global Aggregate Index from inception through 12/31/2016 and the Bloomberg Global Aggregate Hedged USD Index thereafter.

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. 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. **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. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **Collateralized mortgage obligations (CMOs)** can have unpredictable cash flows that can increase the risk of loss. **Portfolio Turnover.** Consistent with its investment policies, the Fund will purchase and sell securities without regard to the effect on portfolio turnover. Higher portfolio turnover will cause the Fund to incur additional transaction costs.

INDEX INFORMATION

The **Bloomberg Global Aggregate Index** provides a broad-based measure of the global investment grade fixed-rate debt markets. Total Returns shown is unhedged USD.

The **Bloomberg Global Aggregate Hedged Index** provides a broad-based measure of the global investment grade fixed-rate debt markets. Total Returns shown is hedged USD.

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

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