Morgan Stanley
Global Fixed Income Opportunities Fund

Performance
In the quarter period ending March 31, 2021, the Portfolio’s I shares returned -1.06% (net of fees)\(^1\), while the benchmark returned -2.47%.

Market Overview
March was an exciting month if you were investing in or following U.S. Treasuries. Yields continued their seemingly relentless climb on the back of unremitting good news on vaccines, economic data and a repricing of Federal Reserve (Fed) policy. In fact, they reached their high for this year on March 31 with the 10-year U.S. Treasury yield closing the quarter at 1.75%, up 34 basis points (bps) on the month.\(^2\) However, outside of Canada, whose government bond yields are closely linked to their U.S. brethren, somewhat remarkably not much happened in other developed markets. Indeed, yields fell across Europe as the region saw an uptick in coronavirus cases with a potential for additional lockdowns, coupled with the slower-than-expected rollout of vaccines. U.S. exceptionalism once again.

Credit markets were somewhat bifurcated with investment grade spreads essentially unchanged on the month while U.S. high yield spreads compressed, although yields rose on the back of Treasuries. Emerging market external debt also outperformed as yields did not rise as fast as U.S. Treasury yields did. The real outlier for March was emerging market local debt. Disappointment with rate hikes in Russia, abrupt central bank leadership changes in Turkey, and a worsening pandemic in Brazil and India, along with rising U.S. Treasury yields, undermined local markets. While Polish government bond yields only rose 1 bp, Turkish yields rose over 400 bps!\(^2\)

What really changed in March was market expectations of Fed policy. The Fed has said over and over it has no intention of raising rates until there is overwhelming objective evidence (not forecasts) that the economy is fully recovered and on a sustainable, acceptable growth trajectory with an "inclusive" drop in unemployment rate back to pre-pandemic levels. On their reckoning, this means the Fed was unlikely to raise rates until late 2023/early 2024, with tapering of quantitative easing happening sometime before. The market disagrees. It views the Fed as being too optimistic about how low inflation will stay and underappreciating how fast labor markets will normalize. Therefore, based on those assumptions, it has brought forward the first hike and accelerated the path of hikes to get to a terminal rate of around 2.5% much faster than previously. By bringing forward and accelerating the forecasted path of short rates, longer-term yields repriced higher. Is this reasonable?

On one hand, it’s perfectly reasonable. Real yields are still negative, albeit less so; growth is fantastically strong; jobs are being created at a pace of almost one million per month; and financial conditions (e.g., credit spreads, equity market, etc.) remain historically easy. And, to top it off, what is the likely risk distribution of rate hikes versus rate cuts? The probability of additional easing by the Fed is essentially zero, and while the Fed is unlikely to raise rates this year or even next, the writing is on the wall. The market wants a risk premium in case the Fed acts sooner than it currently says it will.

On the other hand, the Fed has been steadfast in its commitment to FAIT (flexible average inflation targeting). Comments by the chairman and other members of the board of governors have reiterated this repeatedly. The Fed has emphasized its outcome-based approach, which implies policy makers think growth will not be strong enough, inflation high enough and unemployment low enough by the end of 2022 to start raising rates. Who is right? Unfortunately, no one knows. We do know that the market

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\(^2\) Source: Bloomberg L.P. Data as of March 31, 2021. One basis point = 0.01%

This document constitutes a commentary and does not constitute investment advice nor a recommendation to invest. The value of investments may rise as well as fall. Independent advice should be sought before any decision to invest.
tends to overpredict changes to monetary policy rates. And there is a reasonable risk premium in the yield curve when there was none at the beginning of the year.

What does this mean? Betting on higher yields is going to be less remunerative going forward unless there is a material upturn in inflation. But, yields are still likely to go higher in the medium term on the back of exceptionally strong growth and policy support. Interest rate/duration risk will continue to be a headwind for bond market performance. Stronger growth is good for corporate bottom lines and likely their balance sheets as well. We remain positioned to benefit from credit-sensitive assets outperforming government bonds and continue to believe duration will be a headwind to performance (though less so than year-to-date) over the remainder of 2021.

**Fund Strategy and Performance**

During the first quarter, sector spread decisions contributed positively, while macro decisions had a negative impact on performance. Securitized debt positioning in asset-backed securities (ABS), non-agency residential mortgage-backed securities (RMBS) and non-agency commercial mortgage-backed securities contributed the most to performance, followed by high yield corporate debt positioning and investment grade corporate debt positioning. From a macro perspective, developed market currency positioning (Swedish krona and Swiss franc) was additive to returns. Developed market rates positioning in the U.S., Europe and Australia were the largest detractors from performance as yields rose sharply in the first quarter of 2021. Emerging markets (EM) rates positioning in Mexico and Indonesia and long EM currency positioning (Mexican peso, Brazilian real and South African rand) also contributed negatively to performance. Within EM, we reduced EM domestic debt (Brazil, Indonesia, Mexico and South Africa) and EM external debt (Brazil, Russia, Serbia and Saudi Arabia). We marginally added to EM local exposure in Turkey and EM external exposure in Egypt. In developed markets, we trimmed exposure in investment grade corporates within financials, while adding to the industrials sub-sector. We increased exposure to high yield corporate debt in the industrials sub-sector. We also added to the allocation to convertible debt. Within securitized credit, we added to ABS and non-agency RMBS, while reducing agency RMBS exposure. Within currencies, we reduced Mexican peso and Swedish krona (to short positions), reduced Brazilian real and Indonesian rupiah (to flat positions) and reduced the euro long position. We added to the Swiss franc short position and initiated short positions in Hungarian forint and Polish zloty. We added to Norwegian krone and U.K. sterling long positions, initiated a long position in the Indian rupee, and reduced the U.S. dollar short position. Within rates, we reduced overall duration, primarily in the U.S., Europe, New Zealand, Australia, Austria and Italy.

**Outlook**

"It’s all about the economy," is what we said last month. It is. But it is also about the pandemic, and the U.S. seems to be winning the vaccination race, although the rise in new variants is slowing the pace of gains. Therein is this month’s title, "The Tide Turns: The Song Remains the Same." The vaccination tide seems to have turned, but, given market pricing and expectations, the strategy implications essentially remain the same.

U.S. nominal and real yields rose swiftly and uncomfortably in March. But markets survived. Volatility rose, undermining risky assets and rocking the equity boat a bit. But markets survived, if not thrived, as high yield external emerging market spreads compressed. With the U.S. economy performing more strongly than expected (economic surprise indexes continue to show data surpassing forecasts), it is logical for riskier, more cyclical, less interest rate sensitive assets to outperform. We do not view what has happened to U.S. rates as a “tantrum” but more a mark-to-market to reality: better-than-expected growth all around. Indeed, it is really only the U.S., Canada and emerging markets that suffered big yield increases in March. All of these were based on objective, reasonable interpretations of events.

It must be emphasized that this is primarily a U.S. phenomenon. Yields in most developed markets have not risen as much as in the U.S. And in many countries, yields fell in March. Just because data and events in many countries outside of North America have not been conducive to higher yields does not mean it will not happen over the second/third quarters as vaccines roll out faster and lockdowns end. Of course, the absence of yield or income in most countries does create a more asymmetric risk profile, meaning these markets are not necessarily less risky than U.S. Treasuries where a risk premium exists. Being underweight interest rate risk in Europe and/or Japan is in many ways less risky than in the U.S.

With the market now pricing in earlier and faster rate hikes in the U.S., do we have too much of a good thing? Is too-easy policy necessitating an earlier-than-expected end of zero rates? Central banks say no. Markets say yes, at least in terms of when it expects the Fed to raise rates. Basically, the market believes the Fed will relent and tighten policy sooner than they are saying. But, according to the Fed and the European Central Bank (and most other central banks), economies are far from achieving the inflation/labor market/growth targets necessary to tighten policy. Only more data will resolve this debate and, given the Fed's
desire to see a “string” of strong data, it might be a while before there is more clarity on who is winning. That said, given the data and information flow, we would not be surprised to see the market price in faster rate hikes.

Thus, given the continuation of strongly pro-cyclical policies in 2021 and beyond, high savings rates, mass vaccinations, the synchronized nature of the global business cycle, and the relatively low level of nominal and real yields, we believe fixed income asset allocation should continue to be oriented towards cyclical assets and away from high quality/high interest rate sensitive bonds. That said, there are levels at which government bonds are a buy. It’s just that we do not know where that is yet. As always, it is conditional on the state of the economy and the central bank’s view as to its appropriateness. However, discrimination remains key given valuation levels. Both investment grade and high yield spreads are near their historical lows. A lot of good news has been discounted, but with no real “bad” news on the horizon, we think adding extra yield (carry) and seeking to mitigate the risk of higher yields is the right strategy.

This means we continue to hold lower than average credit quality, overweight external emerging markets and look to own a reasonable level of risk premium where it seems appropriate. However, we remain wary of “land mines” as the performance, for example, of CCC rated corporate bonds has significantly outpaced BB rated bonds. On the other hand, fallen angels still look to have upside in a fast-growing economy. An idiosyncratic, bottom-up strategy seems appropriate given market pricing.

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<th>FUND FACTS</th>
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<th>Index</th>
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<tr>
<td>Launch date</td>
<td>U.S. dollars</td>
<td>Bloomberg Barclays Global Aggregate</td>
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<tr>
<td></td>
<td></td>
<td>Hedged USD Index</td>
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Performance (%)  
As of date March 31, 2021 (Class I Share at NAV)

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<tr>
<th></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>
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<tbody>
<tr>
<td>MS Global Fixed Income Opportunities</td>
<td>-0.30</td>
<td>-1.06</td>
<td>-1.06</td>
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<td>4.40</td>
<td>5.28</td>
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<tr>
<td>Bloomberg Barclays Global Aggregate</td>
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<td>-2.47</td>
<td>-2.47</td>
<td>1.50</td>
<td>4.32</td>
<td>3.29</td>
<td>3.94</td>
<td>4.99</td>
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<tr>
<td>Hedged USD Index</td>
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<tr>
<td>Blended Index</td>
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<td>-2.47</td>
<td>1.50</td>
<td>4.32</td>
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<td>2.11</td>
<td>4.37</td>
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<td>-4.46</td>
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<td>2.80</td>
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<td>4.42</td>
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<tr>
<td>Index</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 0.56% for Class I shares and the net expense ratio is 0.56%. 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.

Effective January 1, 2017, the benchmark index for the MS Global Fixed Income Opportunities Fund changed from Bloomberg Barclays Global Aggregate Index to the Bloomberg Barclays Global Aggregate Hedged USD Index. Blended Index performance shown is calculated using the Bloomberg Barclays Global Aggregate Index from inception through 12/31/2016 and the Bloomberg Barclays 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. 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 Bloomberg Barclays Global Aggregate Index provides a broad-based measure of the global investment grade fixed-rate debt markets. Total Returns shown is unheded USD.

The Bloomberg Barclays 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 Indexes are 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.

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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 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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