Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley

Global Fixed Income Opportunities Fund

GLOBAL FIXED INCOME | GLOBAL FIXED INCOME TEAM | COMMENTARY | MARCH 31, 2019

Market Overview

Declining interest rates and spread tightening were the dominant market stories in the first quarter of 2019 as the U.S. Treasury curve inverted and the market's Federal Reserve (Fed) expectations shifted from further potential rate hikes this year to potential rate cuts. Yields on 2-, 5-, 10- and 30-year U.S. Treasuries fell by 23, 28, 28, and 20 basis points (bps), respectively, during the quarter.

Global investment grade spreads tightened in the quarter. Despite the precipitous drop in government bond yields and mixed economic data, the rally in corporate bonds barely paused, enabling the year-to-date (YTD) rally. Credit markets had a lot to digest in the quarter. Economic data was mixed, especially outside the U.S., but seemed to indicate that the worst of the slowdown is now behind us. Our bias to position portfolios long risk coming into 2019 has been, and could continue to be, rewarded.

Agency mortgage-backed securities (MBS) performed well in the quarter despite increased prepayment concerns and shortening durations. Credit-sensitive securitized assets also performed well due to spread tightening, as markets continue to believe in the strong consumer and housing market fundamentals, despite broader economic outlook concerns.

Emerging market (EM) fixed income assets rebounded in the first quarter after a tough 2018. Hard currency assets outperformed local currency bonds as EM currencies only marginally appreciated versus the U.S. dollar. Within the hard currency segment, high yield outperformed investment grade and sovereigns outperformed corporates. Commodity prices were broadly positive in the period, with continued strength in oil prices and a more mixed picture in precious metals and agricultural commodities. Investment flows started the year strong as investors allocated $36 billion into EM fixed income during the month, according to JPMorgan. The inflows were roughly split between institutional and retail flows, primarily in favor of hard currency strategies, followed by local currency and then blended.

Fund Strategy and Performance

During the quarter, macro and sector spread decisions contributed to performance.

Rates and Currencies (+): Rate positioning in developed markets (U.S. dollar, euro, Australian dollar), as well as emerging markets (Mexican peso, Brazilian real) benefited performance. Within currencies, exposure to the Egyptian pound and British pound contributed to performance as well. Currency exposure in Canada, Argentina and Mexico detracted from performance in the period.

Credit (+): Exposure to EM external debt, government-related bonds, investment grade and high yield corporates/loans, and convertibles also contributed to performance in the period. Credit default swap exposure detracted from performance in the period.

Securitized (+): The allocation to U.S. non-agency residential mortgage-backed securities (RMBS) was a contributor for the quarter.

During the period we added to duration, primarily in the U.S., eurozone, Mexico and U.K., while trimming in New Zealand.

Outlook

In spite of the incoming economic activity data being at best mixed, we think the current environment is supportive for risky assets and are constructive on emerging market debt, corporate credit and securitized debt, although we are not as bullish as we were at the beginning of the year. By contrast, we think the outlook for developed economy government bonds is more challenging and are underweight duration, even though central banks have pivoted towards a more dovish stance. These paradoxes can be partly explained by what financial markets have already priced in and by our expectations for the global economy going forward.

While there can be no doubting that central banks, concerned about the slowing global economy and facing little pressure to tighten policy due to weak inflationary pressures, have become more dovish, we think this is now generally in the price, and sometimes even more than that. While we agree the Fed may not raise rates further in 2019, the market is pricing in rate cuts. In Europe, the European Central Bank has pushed out its guidance on rate hikes into next year, but the market is not pricing increases until 2021. With valuations already rich, and carry declining due to flattening yield curves, the return outlook for high-quality government bonds has become unattractive.

However, we believe the accommodative monetary policy shift will still provide a supportive environment for emerging markets and corporate credit. In addition to monetary policy, Chinese fiscal and other economic stimulus measures should help buoy the global economy given China's importance as a source of external demand in many developing and European economies. From a technical perspective, the ongoing lack of market volatility makes carry trades attractive. A further source of positive impetus could be a resolution of the U.S.-China trade dispute. While the current economic data is still not strong, the trajectory is positive.

We also remain positive on securitized product given the health of the household sector in developed economies and accommodative monetary policy. While the temporary inversion of the U.S. yield curve rekindled discussion of an approaching U.S. recession, the curve has since re-steepened and it has also been pointed out that the time from curve inversion to recession has been long and variable.

Significant risks still persist, notably from trade and Brexit, and many of last year's idiosyncratic emerging market risks have not disappeared either. However, the main reason we are less bullish on risky assets than we were a few months ago is due to valuations being less attractive following the strong performance in the first quarter of the year. We have therefore taken steps to de-risk portfolios, taking advantage of strong market technicals which are consistent with inflows into credit product.

FUND FACTS

Launch date	Base currency	Index
July 28, 1997	U.S. dollars	Bloomberg Barclays Global Aggregate Hedged USD Index

Performance (%)

As of date March 31, 2019 (Class I Share at NAV)

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
MS Global Fixed Income Opportunities Fund - I Shares	1.02	3.87	3.87	3.30	5.50	3.44	7.63	4.32
Bloomberg Barclays Global Aggregate Hedged USD Index	1.79	2.99	2.99	4.93	2.82	3.64	4.09	5.08
Blended Index	1.79	2.99	2.99	4.93	1.35	0.96	3.01	4.40
Bloomberg Barclays Global Aggregate Index	1.25	2.20	2.20	-0.38	1.49	1.04	3.05	4.42

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 0.65% for Class I shares and the net expense ratio is 0.60%. 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.

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. 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 the current rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. **Longer-term securities** may be more sensitive to interest rate changes. In a declining interest-rate environment, the portfolio may generate less income. **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 unhedged 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 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.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

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