Morgan Stanley

INVESTMENT MANAGEMENT

MORGAN STANLEY INSTITUTIONAL FUND TRUST (MSIFT)

# Global Strategist Portfolio

SOLUTIONS & MULTI-ASSET | GLOBAL MULTI-ASSET TEAM | MARKET COMMENTARY | MARCH 2019

## Performance Review†

In March 2019, MSIFT Global Strategist Portfolio class I shares returned 1.14% net of fees. The Fund underperformed its custom benchmark, the MSIM Global Allocation Index, which returned 1.26%, and its primary benchmark, the MSCI All Country World Equity Index (ACWI), which returned 1.26%. During the month, the J.P. Morgan Global Government Bond Index returned 1.39%.

The Fund's asset allocation mix of an overweight in global fixed income and a neutral weight in global equities had a neutral effect on performance relative to the custom benchmark in March. At the sub-asset class level, contributors to performance included positions around our expectation for a slowdown in Australia (e.g. underweight Australian vs. developed market banks and overweight 3-year Australian government bonds and our overweight positions in China A-shares and in U.S. midstream energy stocks vs. U.S. equities. Detractors from performance included overweight positions in emerging market currencies, including, the Argentine peso, the Hungarian forint, and the Turkish lira. An overweight position in Eurozone banks vs. Eurozone stocks also detracted.

## Market Review‡

Global equities rose +1.6% in March, ending the strongest quarter since 2009 up +12.3%, as markets appeared to be discounting supportive central banks amid muted inflation and slowing but stable growth—an eventual soft landing for the economy. In economic data, global flash PMIs for March disappointed, as did a particularly weak February U.S. jobs report (nonfarm payrolls came in at 20k vs. 180k expected and 312k prior). Despite fundamental headwinds, several clouds hanging over markets began to part during March, helping risky assets rally: the EU granted an extension on Article 50 (meaning Britain did not crash out of the EU without a deal on March 29), and China and the U.S. appeared to be making progress on a trade deal.

Within regions, the U.S. (+1.9%) and Eurozone (+1.8%) led, while emerging markets (+0.8%) lagged, in part on strength in the U.S. dollar, which rose +1.2%.1 Emerging market bonds and currencies also fell -1.7% each (JP Morgan Emerging Markets Currency Index and JPM GBI-EM Index in USD).

In fixed income, global government bond yields collapsed, reflecting the dovish turn of global central banks, with the U.S. 10-year Treasury falling 31 basis points to 2.41%, the lowest level in over a year. German 10-year bund yields fell by 25 basis points into negative territory (-0.07%) for the first time since 2016. A number of U.S. yield curves lightly inverted in March, triggering concerns that this inversion is signaling a recession. Typically prior to a recession

Global Eequities = MSCI All Country World Index (USD); Global Bonds = JP Morgan Global GBI Total Return Index (USD); U.S. Equities = S&P 500 Total Return Index (USD), Eurozone Equities = Euro Stoxx 50 Index (EUR).
† MSIM Global Allocation Index, the secondary custom benchmark index of the Global Strategist Portfolio, consists of 60% MSCI All-Country World Index and 40% Bloomberg Barclays Global Aggregate Bond Index.
‡ All data in the performance review, market review, and investment outlook section is as of the date of this report, unless otherwise noted. Source: MSIM Global Multi-Asset Team Analysis.

you would see the yield curve (we look at 3m-10y) to go more deeply negative, and for a more prolonged amount of time, 6-18 months before a recession.

Commodities rose 1.6% in March, driven by higher oil prices (S&P GSCI Index in USD). Brent crude rose +3.6%, as OPEC+ agreed to keep supply cuts in place until June, while . Gold fell -1.6%.

The U.S. dollar strengthened by 1.6% (DXY Index), with high-beta emerging market currencies the largest underperformers: the Argentine peso fell 019%, and the Brazilian real and Turkish lira each fell -4%.

## Portfolio Activity

We believe that housing bubbles in Australia and Canada are beginning to deflate, and increased our underweight position in Australian banks. We also initiated an overweight in Australian 3-year rates and an underweight in Canadian banks vs. global equities.

We initiated an overweight directional position in China A-Shares, as Chinese liquidity and policy messages appear supportive of an equity re-rating, valuations are relatively cheap vs. history and retail-driven participation appears muted vs. prior episodes of liquidity fuelled re-ratings.

We continue to believe that Eurozone growth will rebound over the next 6-12 months and initiated an overweight in Eurozone autos vs. global equities, while increasing overweights in Eurozone domestic stocks vs. U.S. equities and in Eurozone banks vs. Eurozone equities.

We increased an overweight in the Hungarian forint vs. the euro, as well as a directional overweight in gold, and reduced our overweight in U.S. housing vs. U.S. equities, as well as an overweight in the Turkish lira.

We closed overweights in the British pound vs. the U.S dollar, and in U.S. 10-year TIPS, booking profits in each, and were stopped out of underweights in the U.S. dollar (via DXY Index) and in the Chinese renminbi vs. G10 currencies ex-USD.

## Investment Outlook

Despite the strong recovery in many risky assets since Christmas, the market's mood remains sober. Even as global equities have risen almost 17% over this period, the majority of investors have continued to be skeptical of the rally and lightly positioned.[1] Investor survey data in March showed that fund manager positioning in global equities is at levels last seen in the prior mid-cycle slowdown of 2016.[2]

The dovish policy turn, most notably by the Federal Reserve (the Fed) but also the European Central Bank (ECB), was a major force that lifted risky assets and led to a pronounced global rates rally. Yet both the central banks' dovishness and the lower rates themselves appear to have exacerbated growth concerns. The inversion of the U.S. yield curve (albeit brief and partial) and the lowering of official growth and inflation forecasts by the Fed and the ECB seemed to support the perceived inevitability of a continued slowdown. Intriguingly, many areas of the market still appear to be pricing in a severe slowdown or recession (e.g. U.S. banks, short-end bonds, many cyclical stocks, and certain areas of the Eurozone and Japanese equity market).

Global growth data have been mixed during the first quarter of this year, but appear to have begun to show reacceleration. We see accumulating evidence of resilience in what have been, until recently, perceived as the global economy's weak links. China's stimulus efforts have become more pronounced, and as supportive measures and policies have been introduced, credit growth has begun to accelerate. And growth in the Eurozone appears poised to stabilize in response to fiscal support and the reversal of one-off headwinds. We expect that a cyclical upturn and the perception of the global economy being in better structural shape than feared will likely drive outperformance of growth-sensitive assets. While the delayed effects of Fed tightening during the past two years and elevated fragility of China's credit system make this cyclical upswing potentially limited and tenuous, we believe that the probability of a soft landing rather than a recession in 2020 is now 60% (up from 40% previously).[3] As a result, we have added positions that could potentially stand to benefit from improving global growth but are still priced for a more bearish outcome.

The Fed's dovish pivot over the past six months has been a major change in global policy, and is likely to be appreciably supportive of growth conditions in the U.S. and globally. The Fed's overly-hawkish stance in the third quarter of 2018 that scared the markets has been largely walked back. In addition to pausing rate hikes, the Federal Open Market Committee (FOMC) has reduced its long-run neutral policy rate back to 2.8%—from 3% at the peak of optimism in the third quarter— and indicated it would hike rates only once in 2020, down from their expectation in November of last year of three hikes in 2019 and one in 2020.[4] The market has gone even further and is now pricing in 21 basis points of rate cuts by the end of 2019 (down from three hikes as of November 2018).[5] Further, the Fed has begun to reassess its framework, considering the possibility of adopting an average inflation target, rather than an upper limit. While it is not clear what the specific policy implications of this change would be, the probability that the Fed will allow inflation to accelerate above 2% while refraining from rate hikes has risen. With the latest inflation data below 2% and missing expectations (core PCE decelerated to a 1.8% annual pace in January 2019 from 2.0% prior and vs. the consensus expectation of 1.9%), the Fed appears to have additional room to remain dovish.[6]

A lower 'discount rate' is generally supportive for risky assets. The 10-year Treasury yield fell below 2.4% in March, briefly falling below the fed funds rate. Lower rates have clearly lifted many risky assets already—particularly rate-sensitive assets such as U.S. REITs and gold—yet their full effect remains to be fully felt. For example, even after the recent equity rally, the U.S. equity risk premium of 3.9% is excessive, and on our analysis is consistent with 2.6% global GDP growth for the remainder of this year. If global growth accelerates to 3%, in line with our forecast, this would suggest a 3.6% equity risk premium, or an 11% upside for stocks (assuming static bond yields).[7]

The 'discount rate' argument aside, cheaper financing is supportive for growth. Housing activity in the U.S.—the more rate-sensitive segment of the economy and the classic 'transmission mechanism' of monetary policy—appears to be rebounding after having decelerated in the second half of 2018. With the 30-year fixed mortgage rate having fallen ~80 basis points, from 4.8% to 4.0%, new home sales have spiked back to 5.6 million units (new and existing combined) in February from a low of 5.0 million in January, reversing the entire decline of last year. While the latest data point may overstate the rebound due to the volatility of the data, housing transactions appear to have bottomed even on a smoothed, three-month moving average, basis. Likewise, recent rebounds in the U.S. Mortgage Bankers Association (MBA) Purchase Index and the National Association of Home Builders (NAHB) Index also indicate that housing market activity has turned up. The housing recovery has been prolonged during this expansion but relatively shallow, such that activity levels are at approximately mid-cycle conditions. With household formation having recovered from under 650,000 new households per year in the first several years of this cycle to 1.5 million new households in 2018—the highest level in the last 30 years outside of 2005—it appears that structural, pent-up demand is there to support additional expansion of the housing sector, especially the more economically-impactful single-family housing sector. With close to a third of 18 to 34 year olds still living at home, there is potential for demand growth from these three million-plus additional house buyers. Interestingly, the homeownership rate among people under 35 has begun to grow over the past three years, but at 36% remains well below its peak of 44% fifteen years ago.[8]

The Fed's dovish turn also serves to alleviate corporate leverage risk, at least in the near term.

Elevated leverage in the U.S. high yield corporate sector, at 4.2x EBITDA, has been widely identified as an area of potential risk. While the corporate high yield sector's interest coverage ratio remains fairly high, at 3.8x, meaningfully higher rates would, in theory, weaken interest coverage. U.S. corporate health remains extremely strong, with 2018 EBITDA margins of over 15% for high yield and nearly 30% for investment grade, and strong cashflow generation.[9] The corporate sector is unlikely to be the economy's Achilles heel, while rates remain low.

From a structural point of view, we are open to the possibility of positive supply side developments that would extend the cycle. Recent deregulation measures notwithstanding, we note that it is rare for productivity growth to recover in later stages of the cycle (the late 1990's is an exception). However, it appears that the labour force has room to maintain a high growth rate (currently close to 1.25% on a three-month smoothed basis). This is because the labour force participation rate of the core 25 to 54 year old segment of the population is 82.5%, with room to continue to recover to the pre-crisis level of over 83%, and perhaps to catch up to the advanced economy average of over 85%.[10]

While we still expect a continued slowdown of the U.S. economy from the strong 3.5% GDP growth pace during the middle of 2018, we currently think growth can stabilize closer to (but likely below) a 2% pace by the end of this year, above the 1.5% pace we envisioned six months ago.[11]

China's more aggressive stimulus efforts over the past several months have been another consequential shift in the global policy setting. Although Chinese authorities began to loosen policy during the second half of 2018, these measures were insufficient, constrained by concerns about adding further leverage and, perhaps most importantly, by the need to prevent a disorderly devaluation of the renminbi, which was depreciating (and fell by 8% vs. the U.S. dollar)[12] during that period. But with GDP growth having slowed to below 6% in the fourth quarter of 2018 and a hawkish Fed less of a threat to the currency, the authorities have begun to open the taps.[13] New credit surged by Rmb 4.9 trillion in January and February combined, or 5.4% of 2018 GDP. Liquidity conditions improved as cuts in China's Reserve Requirement Ratio since mid-2018 have released an additional Rmb 5 trillion.[14] Taxes are slated to be cut by 2% of GDP (though we expect their net impact to growth to be under 0.5%) and various administrative easing measures with respect to housing and local government financing have been announced. Anti-private business rhetoric has been walked back, and supportive statements and specific measures for small and medium-size business have likely helped business sentiment. As a result of these measures and announcements, we have seen improvement in both survey and hard activity data. Car sales, luxury-related consumption measures (e.g., watch sales) and housing activity appear to have bottomed over the past several months. Retail sales growth has rebounded in year-over-year terms. China's industrial production growth reaccelerated sequentially over the past five months and manufacturing PMIs (both NBS and Caixin) have turned up.[15]

The apparent upturn in China's growth—and specifically in its industrial indicators—has profound implications not only for China, but also for the global industrial cycle. China's industrial activity has tended to lead global swings in the industrial cycle by one to three months since 2009 (with the exception of the European recession in 2012).[16] In the current environment, this signal is particularly significant because it helps tip the scales in the debate over the recent divergence between 1) the consumer and services sides of the global economy, which have remained largely resilient, and 2) the production and business side (as measured by industrial activity and capex), which have been weak. For example, global retail sales growth remained at a 3.4% pace in the first two months of this year, as compared to 3.5% during 2018. And the deceleration indicated by the fall in services PMI has been substantially less pronounced than the collapse in global manufacturing

PMI, which, in our assessment, fell to levels consistent with 2.6% global GDP growth in the first quarter of this year.[17]

During the height of U.S./China trade-related tensions, we expected that tariffs would reduce global growth by 14 basis points over two years.[18] Our expectation was based on the best available estimates at the time, however, because the scale of these measures would have been unprecedented, our confidence in these assessments has been low. It is likely that markets priced in a much more dire economic outcome for the trade conflict. While the worst case scenario appears to have been averted for now, trade fluctuations did prompt growth concerns in the fourth quarter of 2018. Global exports fell nearly 3% sequentially (annualized), and were the weakest they have been during this expansion, except for the second quarter of 2015 during a significantly more pronounced global slowdown. Although the trade data were worrisome for the markets, we believe they overstated the underlying economic weakness. First, the weak fourth quarter came after strong 4.5% sequential annualized growth in the prior quarter. Second, trade weakness was substantially lower than other, generally closely-related indicators such as industrial production, would have suggested. And third, the trade slowdown was disproportionately more pronounced for China and the U.S. (which together accounted for almost half of the drop in exports) while representing about a quarter of global trade. Although the slowdown in China in the second half of last year likely played a role, it appears that the weakness was exacerbated by dispute-related shifts in the trade patterns during 2018.[19]

The Eurozone's growth weakened significantly in the second half of last year, and we believe it is poised to improve imminently. Eurozone GDP growth fell to 0.7% (annualized) in the second half of 2018, and industrial production collapsed by nearly 5% (annualized) in the second half. Exports growth also slowed sharply from 6.4% year-over-year in the fourth quarter of 2017 to a 1.5% pace in the fourth quarter of 2018.[20] However, as global growth rebounds, led by China, Europe's trade should also recover (albeit with the typical delay of approximately three months). In addition, several idiosyncratic factors detracted approximately 30 basis points from the Eurozone's growth in the second half of last year which we expect to reverse this year. These include the emissions-related slowdown in car production and the disruption of transport traffic on the Rhine River, which we estimate reduced Eurozone growth by 5 and 7 basis points, respectively, in the second half of 2018.[21]

We now place a greater probability in a scenario where global growth remains resilient over the next two years, i.e. that it will slow, but remain above potential. Over the next two quarters it has the potential to accelerate from 2.3% in the first quarter of this year to 3.0% in the third quarter.[22] If global growth accelerates, growth-sensitive assets whose performance lagged this year will likely outperform. Some of dovish policy plays— such as government bonds and rate-sensitive assets—may underperform as the monetary policy outlook is reassessed to be less dovish, especially in the U.S. We expect bond yields to rise, with the 10-year yield reaching 2.7%. Although higher rates may be an emerging headwind to stocks, we still expect stocks to outperform bonds over the next six months. A steeper yield curve and improving growth are likely to be supportive of many 'value' assets and we prefer U.S. financials and European equities such as banks, domestically-oriented stocks, German equities and auto manufacturing stocks. Many China-related assets such as A-shares and global metals and mining stocks also remain undervalued and we expect them to outperform as growth and liquidity in China improve.

There remain substantial risks to the near term growth acceleration scenario as well as a soft landing in 2020. First, although the Fed may have paused its hiking cycle just in time to avert a disaster, the come-down from the U.S. fiscal stimulus 'sugar high' is still likely to cause the U.S. economy to slow. We estimate that the fiscal impulse will detract -60 basis points from U.S. GDP growth in 2019 as compared to

2018, although the exact timing and magnitude of its impact are uncertain. Second, after three substantial credit-acceleration cycles, fragilities in China's financial system are a major concern. The ability of the Chinese economy to lever up for the fourth time since 2008 sufficiently to meaningfully affect growth may be limited. Lastly, while many one-off headwinds that depressed growth in the Eurozone last year are likely to wear off shortly, the persistently slow growth, below-target inflation and negative policy rate represent signs of malaise that may be becoming entrenched. With this in mind, our embrace of the near-term cyclical rebound is only partial and the cyclicality of our portfolios is modest. We watch for the above mentioned risks to reassert themselves in the near future.

## FOOTNOTES

1. MSIM Global Multi-Asset Team analysis; Bloomberg, December 25, 2018 to March 31, 2019.
2. MSIM Global Multi-Asset Team analysis; EPFR Global.
3. MSIM Global Multi Asset Team estimates.
4. MSIM Global Multi-Asset Team analysis; Board of Governors of the Federal Reserve System.
5. MSIM Global Multi-Asset Team analysis; Bloomberg, as of March 31, 2019.
6. MSIM Global Multi-Asset Team analysis; Bloomberg.
7. MSIM Global Multi-Asset Team estimates.
8. MSIM Global Multi-Asset Team analysis; Bloomberg; Haver; U.S. Census Bureau.
9. MSIM Global Multi-Asset Team analysis; Deutche Bank Research; JP Morgan Research; as of 4Q18.
10. MSIM Global Multi-Asset Team analysis and estimates; Bloomberg.
11. MSIM Global Multi-Asset Team estimates.
12. MSIM Global Multi-Asset Team analysis; Bloomberg; CNY vs. USD from May 31 – October 31, 2018.
13. MSIM Global Multi-Asset Team analysis; National Bureau of Statistics of China; Haver Analytics.
14. MSIM Global Multi-Asset Team analysis; National Bureau of Statistics of China; People's Bank of China; Haver Analytics.
15. MSIM Global Multi-Asset Team analysis; National Bureau of Statistics of China; China Passenger Car Association; Markit Economics; Haver Analytics.
16. MSIM Global Multi-Asset Team analysis; National Bureau of Statistics of China; Markit Economics; Haver Analytics.
17. MSIM Global Multi-Asset Team analysis; Bloomberg; Haver Analytics.
18. Assumed existing tariffs remained in place, with 80% probability that 10% tariffs on $200b in Chinese goods would rise to 25% (with partial retaliation from China), 50% probability that the U.S. imposed 25% tariffs on the remaining $267 in Chinese goods (with partial retaliation from China), and 10% probability that the US imposed 25% tariffs on non-USMCA autos and parts imports (with full dollar-for-dollar reciprocation).
19. MSIM Global Multi-Asset Team analysis; Bloomberg; Haver Analytics.
20. MSIM Global Multi-Asset Team analysis; Bloomberg; Haver Analytics.
21. MSIM Global Multi-Asset Team estimates.
22. MSIM Global Multi-Asset Team estimates; as of March 31, 2019. Note that the 1Q19 was particularly weak due to the U.S., where a government shutdown helped slow the pace of growth to 1.0%, and that the 2Q19 bounce-back may be exaggerated as a result. Excluding the impact of the first-quarter government shutdown in the U.S., global growth is accelerating from a 2.6% pace during 4Q18-1Q19 to 3.0% in 3Q19.

**Performance (%) as of March 31, 2019**
**(Class I Shares at NAV)**

| | MTD | QTD | YTD | 1 YEAR | 5 YEAR | 10 YEAR | SINCE FUND INCEPTION 12/31/1992 |
|---|---|---|---|---|---|---|---|
| MSIFT Global Strategist Portfolio | 1.14 | 8.14 | 8.14 | 0.91 | 3.40 | 9.18 | 7.14 |
| MSCI All Country World Index[1] | 1.26 | 12.18 | 12.18 | 2.60 | 6.45 | 11.98 | 7.57 |
| Global Multi-Asset Index[2] | 1.26 | 8.14 | 8.14 | 1.64 | 3.84 | 8.14 | -- |

***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 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 0.82%. The net expense ratio is 0.74%. The net expense is lower than the gross expense ratio because 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 Trustees acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such fee waivers/reimbursements returns would have been lower. Expenses are based on the fund's current prospectus. The minimum initial investment is $5,000,000 for Class I shares.***

Returns are net of fees and assume the reinvestment of all dividends and income. Returns for less than one year are cumulative (not annualized). Performance of other share classes will vary.

1. The **MSCI All Country World Index** is a free float-adjusted market capitalization weighted index designed to measure developed and emerging equity market performance. The index is listed in U.S. dollars and assumes reinvestment of net dividends. The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.
2. **Global Multi-Asset Index** performance is a performance linked benchmark of the old and new benchmark of the Portfolio, the old represented by 60% MSCI All-Country World Index, 30% Bloomberg Barclays Global Aggregate Bond Index, 5% S&P GSCI Light Energy Index, and 5% ICE BofAML U.S. Dollar 1-Month LIBID Average Index from inception through 5/31/2017 and the new Blended Index which consists of 60% MSCI All-Country World Index and 40% Bloomberg Barclays Global Aggregate Bond Index for periods thereafter. The composition of the Customized MSIM Global Allocation Index (Blended Index), the secondary benchmark index of the Global Strategist Portfolio, has been changed effective May 31, 2017. The investment team manages the Portfolio relative to this Blended Index. It is not possible to invest directly in an index.
3. Calculated using the custom Global Multi-Asset Index, which is a better representation of the Portfolio's global multi-asset strategy.
4. Fixed income exposures are not duration-adjusted.

**Fund Facts**

| | |
|---|---|
| Inception Date | December 31, 1992 |
| Primary Benchmark | MSCI All Country World Index[1] |
| Custom Benchmark | Blended Index[2] |

**Fund Risk/Returns Statistics**
**(3 Year Annualized %)**

| | |
|---|---|
| Excess Return[3] (versus Custom Benchmark) | -0.23 |
| Excess Return (versus Primary Benchmark) | -3.81 |
| Tracking Error[3] | 1.55 |
| Information Ratio[3] | -0.15 |

**Asset Allocation (% of NAV)**

| | Portfolio | Active Weight |
|---|---|---|
| Global Equities | 60.12 | 0.12 |
| Global Fixed Income[4] | 54.16 | 14.16 |
| Commodities | 1.55 | 1.55 |
| Volatility | 0.00 | 0.00 |
| Cash | -15.82 | -15.82 |

**Regional Allocation (% Net of Cash)**

| | Equities | Fixed Income[4] |
|---|---|---|
| **Developed Markets** | **52.25** | **44.95** |
| North America | 30.65 | 19.63 |
| Europe | 15.85 | 8.61 |
| Japan | 5.11 | 6.47 |
| Asia ex-Japan | 0.64 | 10.25 |
| **Emerging Markets** | **7.86** | **8.46** |

**Currency Exposure (% of NAV)**

| | |
|---|---|
| **Developed Markets** | **89.78** |
| North America | 50.64 |
| Europe | 22.60 |
| Japan | 11.43 |
| Asia ex-Japan | 5.12 |
| **Emerging Markets** | **10.22** |

The views, opinions, forecasts and estimates expressed are those of the portfolio management 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.

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**RISK/RETURN DEFINITIONS**

**Alpha** is the excess return or value added (positive or negative) of the portfolio's return relative to the return of the benchmark.

**Tracking error** is the amount by which the performance of the portfolio differs from that of the benchmark. Information ratio is the portfolio's alpha or excess return per unit of risk, as measured by tracking error, versus the portfolio's benchmark.

**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. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks.

In general, **equity securities'** values also fluctuate in response to activities specific to a company. 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. **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 (MBS and ABS)** 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 Portfolio, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the United States. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **Sovereign debt securities**. The issuer or governmental authority that controls the repayment of sovereign debt may not be willing or able to repay the principal and/ or pay interest when due in accordance with the terms of such obligations. 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 risks associated with investments in foreign developed countries. **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. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the Portfolio's performance. Trading in, and investment exposure to, the **commodities** markets may involve substantial risks and subject the Portfolio to greater volatility. **Nondiversified 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. By investing in **investment company securities**, the portfolio is subject to the underlying risks of that investment company's portfolio securities. In addition to the Portfolio's fees and expenses, the Portfolio generally would bear its share of the investment company's fees and expenses. **Subsidiary and Tax Risk** the Portfolio may seek to gain exposure to the commodity markets through investments in the Subsidiary or commodity index-linked structured notes. The Subsidiary is not registered under the 1940 Act and is not subject to all the investor protections of the 1940 Act. Historically, the Internal Revenue Service ("IRS") has issued private letter rulings in which the IRS specifically concluded that income and gains from investments in commodity index-linked structured notes or a wholly-owned foreign subsidiary that invests in commodity-linked instruments are "qualifying income" for purposes of compliance with Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). The Portfolio has not received such a private letter ruling, and is not able to rely on private letter rulings issued to other taxpayers. If the Portfolio failed to qualify as a regulated investment company, it would be subject to federal and state income tax on all of its taxable income at regular corporate tax rates with no deduction for any distributions paid to shareholders, which would significantly adversely affect the returns to, and could cause substantial losses for, Portfolio shareholders.

The **ICE BofAML U.S. Dollar 1-Month LIBID Average Index** tracks the performance of a basket of synthetic assets paying LIBID to a stated maturity. The index purchases a new instrument each day, priced at par, having exactly its stated maturity and with a coupon equal to that day's fixing rate. All issues are held to maturity. Therefore, each day the index is comprised of a basket of securities. The index is not marked to market. The returns of the index represent the accrued income generated by the equally weighted average of all the coupons in the basket for a given day. It is not possible to invest directly in an index.

The **Bloomberg Barclays U.S. Corporate High Yield Index** measures the U.S. market of non-investment grade, fixed-rate corporate bonds, excluding bonds from emerging market issuers. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

The **J.P. Morgan Global Government Bond Index** is a market value weighted fixed income index comprised of government bonds in developed countries.

**The J.P. Morgan Global Aggregate Bond Index (JPM GABI) Index** is a U.S. dollar denominated, investment-grade index spanning asset classes from developed to emerging markets, and the JPM GABI extends the U.S. index to also include multi-currency, investment-grade instruments.

The **J. P. Morgan Government Bond Index Emerging Markets (GBI EM)**, is local emerging markets debt benchmark that tracks local currency government bonds issued by emerging markets.

The **MSCI All Country World Index (MSCI ACWI)** is a free float-adjusted market-capitalization-weighted index designed to measure the equity market performance of developed and emerging markets.

The **S&P 500 Index** comprises 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The index is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The **Euro Stoxx 50 Index** is a market capitalization-weighted stock index of 50 large, blue-chip European companies operating within Eurozone nations. The universe for selection is found within the 18 Dow Jones EURO STOXX Supersector indexes, from which members are ranked by size and placed on a selection list

The **MSCI Emerging Markets Index (MSCI EM)** is a free-float, market-capitalization weighted index that is designed to measure the equity market performance of emerging markets.

The **S&P GSCI Total Return Index** is a composite index of commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

The **U.S. Dollar Index (DXY)** tracks the performance of a basket of leading global currencies versus the U.S. dollar. The index represents both developed and emerging market currencies that have the highest liquidity in the currency markets.

The **CBOE Volatility Index® (VIX® Index®)** is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

The indices are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

**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**.

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