Performance

In the quarter period ending December 31, 2019, the Portfolio’s I shares returned 2.82% (net of fees), while the benchmark returned 2.61%.

This brings year-to-date performance to 13.89% (net of fees) for the Fund’s I shares, while the benchmark returned 14.32%.

Market Review

The final quarter of 2019 provided a remarkable ending to a remarkable year. The world’s issues seemed to vanish as financial markets rallied. Government bond yields rose, driven by reduced trade tensions, better economic data and renewed optimism that the economic malaise that had consumed the world for the past two years was coming to an end. Credit markets enjoyed meaningful tightening in their spreads.

As 2019 came to a close, optimism grew, data improved and trade tensions relaxed. Most importantly, the monetary easing seen in 2019 will not likely be repeated any time soon. Indeed, one of the risks for 2020 might be a surprise rise in inflation, which could lead central banks to reverse their easy policies. Moreover, risk events are still out there; to name just a few, (1) renewed Middle East tensions, (2) Trump’s impeachment, (3) disappointing U.S. business confidence data and (4) U.S.-China trade. While we do not think these issues are likely to change the direction of the global economy, with asset prices now high, we do not think there is a lot of upside for financial markets in the near term. A focus on security selection remains of paramount importance to take advantage of pockets of opportunity — and to avoid overvalued sectors.

At its December meeting, the Federal Reserve suggested that it will keep interest rates on hold through 2020, unless the economic landscape deteriorates drastically and warrants additional action. With central banks likely to be firmly on hold in 2020, the lagged positive effects of monetary easing still to be felt, inflation stable to slightly higher and defaults low, we think the environment is still supportive for high yield.

Over the quarter, the Bloomberg Barclays U.S. Corporate High Yield Index returned 2.61%, which brings year-to-date returns to 14.32%. Yields tightened 46 basis points (bps) over the quarter to end the year at 5.19%, while spreads tightened 45 bps to end the year at 357 bps. On a year-to-date basis, spreads and yields have tightened 276 bps and 184 bps, respectively.

Despite strong performance in December (4.99%), CCC-rated bonds lagged significantly in 2019, generating 9.52% compared to 14.80% for Bs and 15.5% for BBs.

The new issue market was robust in 2019. Gross and net high yield bond volumes, totaling $286.6 billion and $93.3 billion, are up +52% and +28% year-over-year, respectively. This was absorbed well by the market as high yield mutual funds and exchange-traded funds experienced year-to-date inflows of $17.5 billion, according to Lipper. Meanwhile, year-to-date gross and net loan issuance, totaling $391.6 billion and $192.2 billion, are down 44% and 36% from a year ago, respectively, and loan funds saw record outflows of $42.7 billion in 2019.

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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.
In 2019, 43 companies defaulted, with debt totaling $51.5 billion in bonds and loans.\(^3\) This is up from last year, which saw 32 companies default, totaling $43.1 billion.\(^3\) Default activity has been higher than expected in 2019, largely due to elevated activity in commodity-related sectors. Combined energy and metals & mining account for 47% of the defaults year-to-date by count and 52% of total volume.\(^3\)

**Portfolio Strategy and Analysis**

Overweight positioning within capital goods, specifically to building materials and diversified manufacturing, contributed positively over the period. A small overweight to exploration & production was also additive; however, this was offset by an underweight to oil field services, which detracted from returns as this was one of the best-performing sectors in the fourth quarter. Security selection with consumer non-cyclicals also contributed positively to performance. An underweight to communications detracted from performance, as did security selection within technology.

From a ratings perspective, the portfolio’s overweight to B and CCC rated bonds contributed positively to performance as lower-quality credit outperformed higher-quality in the fourth quarter. This was particularly acute in December, when CCCs were up 4.99%.\(^2\) In fact, December’s performance accounted for 52% of CCCs total year-to-date return.\(^2\) Despite the strong December performance, CCCs still significantly lagged BB rated bonds, which returned 15.51% in 2019.\(^2\) Currently, BB yields are at a record low of 3.56%, which is the lowest since Bloomberg Barclays Index records began, and spreads are at post-crisis lows.\(^2\) We do not believe BBs have much more room to tighten and, given this, think lower-quality credit is set up well to outperform in 2020. We see further room for tightening in B and CCC rated bonds and believe the Fund, which is overweight Bs and CCCs as a result of our middle-market focus, is well-positioned to capitalize on this.

The Fund remains overweight consumer-related sectors such as building materials and gaming, given the strength of the U.S. consumer. Over the year, we reduced our overweight to exploration & production as valuations became less compelling. We have also reduced the Fund’s bank loan exposure from 8% at the beginning of the year to 5%, and increased exposure to the cable & satellite sector. The Fund continues to remain broadly underweight financials, as many companies in this sector cater to subprime clients, which we tend to avoid.

The Fund remains focused on middle-market credits, and we continue to maintain the Fund’s overweight in B and CCC rated bonds, which we believe offer the best risk-adjusted return given the economic backdrop.

**Outlook**

While easy financial conditions support low defaults and technical demand created positive momentum into year end, valuations feel stretched. Central banks have become more accommodative, particularly in the U.S. and eurozone, and we expect that to continue as uncertainty in the geopolitical and economic landscape remains prevalent. Second and third quarter corporate reporting did not signal weakness, but looking forward we wait to see whether weaker economic growth is reflected in fourth quarter results.

From a technical standpoint, high yield net supply has bounced back from last year’s steep decline into negative territory and is up 28% year-over-year. Supply and demand dynamics remain positive overall, given investors’ appetite for higher yields and accommodative central banks. We have seen a trend of new bond issuance benefiting from weaker leveraged loan demand. This has been absorbed well by the market, which has simultaneously seen large amounts of inflows. Furthermore, the bulk of this year’s gross issuance has been earmarked for refinancing or debt repayment.

Going into 2020, we expect default rates to remain below long-term averages and B and CCC spreads to continue to tighten relative to BBs. We also believe yield-seeking investors will continue to drive positive net cash inflows into the asset class. Nevertheless, as valuations remain rich given the year-to-date rally, we remain selective on new opportunities going into the new year.

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\(^3\) Source: J.P. Morgan. Data as of December 31, 2019.
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. 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. High yield securities ("junk bonds") are lower rated securities that may have a higher degree of credit and liquidity risk. 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. Public bank loans are subject to liquidity risk and the credit risks of lower rated securities. 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. Distressed and defaulted securities are speculative and involve substantial risks in addition to the risks of investing in junk bonds. The Portfolio will generally not receive interest payments on the distressed securities and the principal may also be at risk. These securities may present a substantial risk of default or may be in default at the time of investment, requiring the portfolio to incur additional costs. Preferred securities are subject to interest

FUND FACTS
Launch date
February 07, 2012

Base currency
U.S. dollars

Index
Bloomberg Barclays U.S. Corporate High Yield Index

Performance (%)
As of December 31, 2019 (Class I Share at NAV)

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<th>MTD</th>
<th>QTD</th>
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<th>1 YR</th>
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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 1.00% for Class I shares and the net expense ratio is 0.65%. 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.

Base currency
U.S. dollars

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rate risk and generally decreases in value if interest rates rise
and increase in value if interest rates fall. **Mezzanine investments** are subordinated debt securities, thus they carry
the risk that the issuer will not be able to meet its obligations
and they may lose value. **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.

**INDEX INFORMATION**

The **Bloomberg Barclays U.S. Corporate High-Yield Index**
measures the market of USD-denominated, non-investment
grade, fixed-rate, taxable corporate bonds. Securities are
classified as high yield if the middle rating of Moody’s, Fitch,
and S&P is Ba/BB+/BB+ or below. The Index excludes
emerging market debt. The index is unmanaged and does not
include any expenses, fees or sales charges. It is not possible
to invest directly in an index.

**IMPORTANT INFORMATION**

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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
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advisor or download one at morganstanley.com/im. Please
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GOVERNMENT AGENCY | NOT A DEPOSIT**