

Morgan Stanley Institutional Fund

International Equity Portfolio

INTERNATIONAL EQUITY TEAM

Performance Review

In the quarter period ending September 30, 2025, the Portfolio's I shares returned 1.44% (net of fees)¹, while the benchmark returned 4.77%.

In the third quarter, underperformance was primarily down to negative stock selection, driven by weakness in financials, industrials and, to a lesser extent, health care. Sector allocation was mildly negative due to the portfolio's overweight to information technology and underweight to financials.

Looking at year-to-date relative performance, with the Portfolio "only" returning 19.64% (I shares net of fees) against the index's very high 25.14%, the main relative issues have been the underweight to banks, up over 50%, where the team feels the industry is over-earning, and issues in software and services, where the portfolio is considerably overweight. Our holdings faced various concerns around potential generative artificial intelligence (AI) threats in the third quarter, which we discuss in greater detail below. On the positive side, stock selection in materials has been a notable contributor, with the portfolio's metals and mining holdings returning 64% versus 17% for the sector overall.

Two of the largest contributors to performance in the third quarter were **ASML** and **TSMC**, both bottlenecks in the semiconductor value chain. ASML has been bolstered by strong demand for its extreme ultraviolet lithography machines, while TSMC has continued to benefit from robust demand for advanced chips, particularly among its major clients. Other top contributors were **Samsung**, after signing a \$16.5 billion chip supply contract with **Tesla**; **Legrand**, after raising its revenue growth target following strong demand in its data-center segment; and **Murata**, with the company benefiting from pull-forward demand from tariff risks in the first half of 2025.

The third quarter was strong for the index overall; however, the market's nervousness about potential generative AI disruption applied a broad-brush concern to a wide range of data-rich businesses, without regard to important distinctions in industries and their underlying companies. This was demonstrated in software, where there are concerns that generative AI tools, notably cheap coding and agents, could weaken companies' moats, as well as data-rich pockets of financials (e.g., exchanges and data providers) and industrials (e.g., professional services) due to fears that generative AI may be able to replicate companies' proprietary data. These concerns impacted the share price of a range of differentiated models with multi-layered defences against disruption, specifically **Constellation Software**, **SAP** and **London Stock Exchange Group**, which were among the largest absolute detractors for the portfolio. Our view is that the portfolio's software companies, such as Constellation Software and SAP, are so much more than just coding. Constellation Software is a collection of small vertical niche businesses, buffered by its distribution; we think it should benefit from embedding generative AI into these businesses. SAP is deeply entrenched in customer workflows, backed by the technical complexity of the multi-year buildouts and stands to gain through embedding generative AI in its core cloud and enterprise products and using generative AI to help accelerate the lucrative transition to the cloud. Similarly, we believe generative AI should benefit London Stock Exchange Group as its core infrastructure could position it as a data "pipe" that will likely support AI-driven data businesses rather than be displaced by them. As such, we remain confident in these companies' compounding ability.

Other notable detractors were **Haleon**, which was weaker on the back of an earnings downgrade as U.S. distributors destocked; and **Capgemini**, which has been challenged this year due to cyclical headwinds and generative AI uncertainty, though following six consecutive quarters of revenue decline, organic growth has finally stabilised with results slightly ahead of expectations.

Market Review

The MSCI EAFE Index continued its strength, finishing up +4.8% for the third quarter and an astounding +25.1% for the year-to-date. The S&P 500 Index made up some ground against EAFE in the third quarter, returning +8.1%, helped by more-resilient-than-expected U.S. economic data and ongoing optimism around AI, but remains a full 10 percentage points behind EAFE for the year-to-date (+15%).

Looking at the sector performance for EAFE in the third quarter, financials (+8%) finished as the top-performing sector largely driven by banks, which finished up an impressive +13% in the quarter, while insurance and financial services finished up just +3%-4%. Other top performers included consumer discretionary (+7%), driven by ongoing strength in global consumption, and energy (+6%) and materials (+6%), which benefited from rising commodity prices and stronger global industrial demand. Meanwhile, investor

¹ Source: Morgan Stanley Investment Management. Data as of September 30, 2025. Performance for other share classes will vary.

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preference for growthier segments over companies with modest and predictable cash flows hurt the defensive sectors: consumer staples (-1%), utilities (+1%) and health care (+1%) all lagged the index. Going below the sector level, the generative AI fears meant that software and services were down 8%, as against a 3% rise for information technology overall while professional services (-9%) were well behind industrials (+6%). Turning to geographies, Asia was strong overall, with Hong Kong and Singapore both up around 10%. Japan was also ahead in USD for the third quarter, its dollar returns propped up by yen weakness and corporate reform momentum. Meanwhile, with the exception of Italy (+8% USD and local) and the U.K. (+6%, +8%), European markets – France, Germany and Switzerland – lagged the index during the quarter.

Outlook

The Tug of War

We spoke last quarter about the sharp reversal in market direction and leadership following the market trough post the “Liberation Day” tariff announcements in early-April. The third quarter saw a continuation of that upward trajectory, with global equity markets returning +7%, taking year-to-date MSCI World Index performance to an impressive +17%, despite numerous remaining uncertainties in terms of policy and geopolitics. The MSCI World Index is now on over 20x forward earnings, with the S&P 500 Index at 23x.² These extended multiples are on forward earnings that are meant to grow by double-digits for the next two years on the back of margins improving even further from record highs. Indeed, when we consider what is priced into today’s historically high market valuations, the market is betting on a continuation of the vigorous AI boom and a macro backdrop strong enough to deliver the double-digit earnings growth, with confidence that easing policy and AI-linked productivity will keep margins elevated. In short, expectations are high. Yet, the record gold price reminds us that uncertainties linger.

We see a tug of war within markets, between the bull argument that AI will be visibly transformational to corporate profitability in the near term and/or the U.S. economy sharply accelerates, and the bear argument where these high expectations are not met. The bear scenario may come from the scaled enterprise adoption of generative AI taking longer than expected, raising anxieties about the return on the hyperscalers’ massive investments or the macro environment not being strong enough to justify the double-digit earnings growth expectations. Our long-tenured team is also acutely aware of how painful it can be when elevated expectations reset downwards.

Taking data from the last 150 years, the market appears to be in its fourth “New Tech” era, with the associated extreme valuation, and the S&P 500 CAPE³ over two standard deviations above trend. Comparisons to the three previous episodes of extreme valuation, in the 1900s, the 1920s and most recently the dot-com bubble, highlight the risk of significant overall market drawdowns when market sentiment shifts (anything from a 15% to 50% drawdown). The most exposed areas suffer more heavily on the way down, while underappreciated segments get their turn in the sun; consumer staples in the dot-com crash, and potentially the supposed “AI victims” this time, be they in software or in data-rich financials and industrials.

While there are similarities to the over-exuberance seen during the internet “New Tech” era, we do see notable differences today: the companies at the centre of the boom are earning real money and their earnings momentum remains strong, while their current price-to-earnings ratios, though high, are not remotely extreme compared with 1999. Another critical difference is that today’s massive hyperscaler capital expenditure is largely being self-funded from operational cash flow, allowing for continued and even expanded investment with limited dependence on external funding.

However, uncertainty remains. There is a paradox currently at the core of the generative AI boom. It has garnered an unprecedented mindshare among C-suites for a new technology and the potential is clear to anyone who has used it, but the scale adoption and value realisation among corporates has been very limited. This could drive a classic Gartner Hype Cycle, with a shift from the period of “Inflated Expectations” to the “Trough of Disillusionment” as implementation proves hard and drawn out, even if it is eventually successful and transformative. In addition, the macroeconomic position is unclear given the high levels of policy uncertainty, not least around the eventual effect of tariffs, and worldwide geopolitical risks. It is worth remembering that while growth is positive, the macroeconomic outlook remains modest, with U.S. growth expected around 1.5%-2% for both 2025 and 2026 and EAFE markets closer to 1%.

During the quarter, markets became increasingly preoccupied with the question of whether AI will disrupt, in particular, data-centred businesses. The initial reaction has been quite broad-based, with investors indiscriminately punishing nearly all companies perceived to have exposure to data regardless of differences in business models, competitive positioning or adaptability. We believe this blanket

² Source for data cited in the Outlook commentary, unless otherwise stated: MSIM, FactSet, as of September 30, 2025.

³ CAPE: cyclically adjusted price-to-earnings ratio, a stock valuation measure usually applied to the S&P 500 Index.

approach by the market is wrong as it ignores important differences between the industries and companies involved. We carefully examine both the potential vulnerability to AI disruption and the revenue and cost opportunities on a case-by-case basis.

There are some general principles behind our company-specific analysis. In our view, those data-rich businesses that avoid disruption are likely to control proprietary datasets that cannot be imitated by generative AI bots scraping the internet, or are likely to be deeply embedded into clients' workflows or even core to whole ecosystems. On the positive side, they should have the financial and technical capacity to integrate AI into their offerings in a way that enhances client value, and also utilise the technology to remove significant costs, be it in client relations or coding. In the case of RELX, held in our portfolios, we are already seeing generative AI technology combined with its proprietary data sets accelerating revenue growth in its legal division. SAP, another holding, is buffered from disruption by being deeply embedded into mission-critical operations, and by its well-established domain and industry expertise. Its Joule copilots and agents are potential sources of extra revenue, while generative AI innovation could speed clients' lucrative transition to S/4 Hana, its next-generation enterprise resource planning system. It is precisely these sort of high quality, data-rich businesses we seek to own in our portfolio.

As the debate matures and the market develops a clearer view of which companies are truly vulnerable to disruption and which can harness AI as a competitive advantage, we expect to see much greater dispersion in returns across the sector. In the meantime, we see the broad-brush approach applied by the market as an opportunity to selectively upgrade some of our holdings in which some uncertainty exists on the impact of AI – where compounding babies have been chucked out with the disrupted bathwater.

In a market where investor "certainty" meets a very uncertain reality and valuations are stretched, we remain focused on companies we believe offer credible earnings per share growth, driven by strong revenue growth, which we consider a more reliable source of long-term compounding than supposed margin improvement. Our portfolio is set to deliver resilient top-line growth close to twice that of the index and is available at a free cash flow discount to the market not seen over the last decade, a very attractive proposition, particularly in relative terms.

Fund Facts

Inception Date	August 04, 1989
Minimum Initial Investment (\$)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	MSCI EAFE Index
Class I expense ratio	Gross 1.05 %
	Net 0.95 %
Class A expense ratio	Gross 1.42 %
	Net 1.30 %

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, in effect as of the date of this commentary. For information on the applicable fund's current fees and expenses, please see the fund's current prospectus.

* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

Performance (%)

As of September 30, 2025

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	1.44	1.44	19.64	9.03	19.31	8.00	6.51
Class A Shares at NAV	1.34	1.25	19.25	8.62	18.88	7.68	6.17
Class A Shares (With Max 5.25% Sales Charge)	-3.96	-4.03	13.04	2.89	16.76	6.52	5.60
MSCI EAFE Index	1.91	4.77	25.14	14.99	21.70	11.15	8.17

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.

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.

INDEX INFORMATION

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The MSCI EAFE Index currently consists of 21 developed market country indices. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The **MSCI World Net Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of 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.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The Index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an Index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor.

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. 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 strategy. Please be aware that this strategy may be subject to certain additional risks. **ESG**

strategies that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance. In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. Investments in **small- and medium-capitalization** companies tend to be more volatile and less liquid than those of larger, more established, companies. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio's performance. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk).

IMPORTANT INFORMATION

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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 (which includes the applicable fund's current fees and expenses, if different from those in effect as of the date of this commentary), download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

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