Morgan Stanley Institutional Fund

Mortgage Securities Trust

SECURITIZED TEAM

Performance Review

In the quarter period ending December 31, 2023, the Portfolio's I shares returned 6.21% (net of fees)[1], while the benchmark returned 7.48%.

The Fund (I shares net of fees) underperformed the Bloomberg U.S. Mortgage-Backed Securities (MBS) Index (the "Index") by 127 basis points in the quarter.[2]

The Fund had no negative sector returns on an absolute basis for the quarter.

The largest source of underperformance was its underweight to U.S. agency MBS, as spreads tightened materially during this period and interest rates fell significantly. However, on a relative basis, even the Fund's allocation to agency MBS outperformed the Index due to pool selection.

The largest drivers of performance were the Fund's exposures to U.S. agency MBS and U.S. non-agency residential mortgage-backed securities (RMBS). This was due to the aforementioned spread tightening in the agency MBS sector, and that the majority of the U.S. non-agency RMBS market is fixed rate in nature, thus benefiting more from the drop in interest rates.

Although securitized credit spreads did tighten during the quarter, the fact that most European non-agency RMBS, global commercial mortgage-backed securities (CMBS) and global asset-backed securities (ABS) assets are floating-rate or short-duration structures meant that they were less positively impacted by the sharp drop in rates, and thus were the largest detractors from performance on a relative basis. That said, there were no sectors that posted negative returns for the quarter.

The Fund's duration positioning was also a positive contributor to performance during the quarter on an absolute basis, given the sharp fall in rates.

Market Review

U.S. interest rates fell sharply during the fourth quarter, with the markets now pricing in 150 basis points of Federal Reserve (Fed) rate cuts. The Fed kept rates unchanged at 5.25% during the quarter but indicated likely cuts in 2024 that would be largely data dependent. The Fed also continued letting its MBS holdings run off during the quarter, and the Fed's MBS holdings declined $48 billion during the quarter to $2.423 trillion.[3] The 2-year U.S. Treasury rate fell 79 basis points to 4.25% during the fourth quarter, and the 10-year U.S. Treasury rate dropped 69 basis points to 3.88% during the quarter.[4]

Nearly all markets, both fixed income and equities, performed well during the fourth quarter, buoyed by optimism that the Fed has finished raising rates and may shift to rate cuts in 2024. Markets are currently pricing in 150 basis points of rate cut projections for 2024. U.S. commercial banks' agency MBS holdings declined by approximately $21 billion during the fourth quarter to $2.518 trillion.[5] We expect both the Fed's MBS holdings and U.S. bank MBS holdings to continue to decline in 2024. Declining savings rates have reduced bank deposits, and higher short-term rates have increased funding costs for banks and reduced net interest margins on MBS. The 30-year mortgage rates fell 70 basis points during the quarter, from 7.31% to 6.61%.[4] MBS current coupon nominal spreads tightened 38 basis point during the quarter, to 139 basis points above interpolated U.S. Treasuries.[4] The Bloomberg U.S. MBS Index returned +7.48% during the quarter, underperforming U.S. Treasurys by 19 basis points on a duration-adjusted basis.[4] Agency MBS underperformed Treasurys by 76 basis points for all of 2023 on a duration-adjusted basis.[4] The duration of the Bloomberg U.S. MBS Index shortened by 0.4 years during the fourth quarter to 5.6 years, yet the majority of the outstanding U.S. mortgage market remains "out of the money" to refinance, with mortgage rates still at historically high levels.[4]

1 Source: Morgan Stanley Investment Management. Data as of December 31, 2023. Performance for other share classes will vary.
2 One basis point = 0.01%.
3 Source: Federal Reserve.
4 Source: Bloomberg L.P. Data as of December 31, 2023.
5 Source: Federal Reserve and Bloomberg L.P.

Securitized credit spreads tightened in the quarter as demand for yield increased — although not nearly to the same extent as agency MBS — and as supply, both new issuance and secondary trading volumes, was meaningfully lower. Overall securitized issuance in 2023 was lower than in 2022, led by significant declines in residential and commercial real estate lending. ABS loan origination and securitization increased in 2023, but not enough to overcome the declines in RMBS and CMBS issuance.

Portfolio Activity

We decreased our agency MBS exposure by 2% to 40% during the fourth quarter as spreads tightened considerably during the last two months of the year, providing an opportunity to trim back some of our agency MBS exposure.

Over the period, our U.S. RMBS holdings rose 1% to 32%, as this continues to be our favorite sector and we continue to seek to add exposure here and replace runoff; our non-U.S. RMBS holdings held at 7%. Our U.S. CMBS holdings held at 8% and our European holdings fell 0.5% to 0.5% as some deals paid. Our U.S. ABS exposures rose 2% to 11%, primarily through the increase of residential-related ABS, and our non-U.S. ABS holdings held at 3%.

Strategy and Outlook

We remain most constructive on RMBS, and residential-related investments total approximately 85% of the Fund. Most homeowners have locked in 30-year, fixed-rate mortgages at substantially lower mortgage rates and have not faced payment shocks from higher rates. Additionally, the substantial home price appreciation over the past few years has meaningfully increased homeowner equity — homeowner equity is at the highest level in more than 40 years. Lastly, residential mortgage lending standards have remained very conservative in the post-financial crisis era, and mortgage credit performance continues to be relatively pristine, with very minimal delinquencies and defaults.

We remain much more cautious on commercial real estate exposure, especially exposure to the office sector. Higher financing costs have stressed all commercial real estate sectors, but sectors such as hotels, multi-family housing and retail shopping centers have seen healthy revenue growth to help offset the higher financing costs. The office sector has felt the brunt of both declining revenue and higher financing costs.

We also remain cautious on consumer ABS, as inflation, higher rates and declining government stimulus have begun to strain consumer balance sheets, especially for lower-income borrowers. The savings surplus built up during the pandemic has now been depleted, and we expect more consumer stress in 2024. We are more constructive on business-related ABS, such as aircraft leases, mortgage-servicing rights and small business loans.

We believe that central banks are now at the end of their hiking cycles, and that rates have seen their peak levels and will likely decline in 2024. Much of the projected rate decline has now been priced into the market with the rally in rates during the fourth quarter, but we still expect the forward path for rates to likely be lower from current levels.

We continue to prefer U.S. securitized opportunities over U.K. and European securitized markets. U.S. spreads are currently wider than comparable credit profile European or U.K. opportunities, yet we believe the U.S. credit landscape is more favorable. European inflation has been slower to recede, and economic growth looks to be weaker in Europe. Geopolitical risks also remain higher in Europe.

Our base forecast is for a mild recession, which we do not believe would have a material impact on our securities' performance, but we also believe our securities could handle a severe recession, given that they were designed with the Global Financial Crisis as a stress test. We remain watchful of ongoing geopolitical risks as well as broader economic risks across the globe. Despite these risks, we remain excited about the Fund's return potential for 2024.

Overall, we believe the securitized market offers a unique opportunity to achieve competitive returns with solid credit fundamentals. Although volatility has increased and credit conditions are weaker, we remain constructive on securitized credit conditions overall — specifically in the U.S. — with the U.S. economy remaining strong, and housing and consumer credit conditions continuing to be relatively healthy. As a result of these views, we have a meaningful credit overweight in the Fund, but we have increased our U.S. agency MBS position to its highest level in several years (40%), given our concerns of deteriorating economic conditions.

Fund Facts

Inception Date	July 28, 1997
Minimum Initial Investment ($)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Bloomberg U.S. Mortgage Backed Securities (MBS) Index
Class I expense ratio	**Gross 0.91 %**
	Net 0.70 %
Class A expense ratio	**Gross 1.19 %**
	Net 1.00 %

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.

Performance (%)

As of December 31, 2023	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	3.29	6.21	8.77	8.77	0.21	2.14	3.43
Class A Shares at NAV	3.35	6.19	8.29	8.29	-0.14	1.77	3.04
Class A Shares (With Max 3.25% Sales Charge)	0.02	2.71	4.81	4.81	-1.22	1.09	2.70
Bloomberg U.S. Mortgage Backed Securities (MBS) Index	4.31	7.48	5.05	5.05	-2.86	0.25	1.38

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.

The fund has received proceeds related to certain non-recurring litigation settlements. If these monies were not received, any period returns which include these settlement monies would have been lower. These were one-time settlements, and as a result, the impact on the net asset value and consequently the performance will not likely be repeated in the future. Please visit www.morganstanley.com/im for additional details.

INDEX INFORMATION

The **Bloomberg U.S. Mortgage Backed Securities (MBS) Index:** tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

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The Indexes are unmanaged and do 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 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

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

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. 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. **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. **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. 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 strategy could sustain a loss. **High yield securities ("junk bonds")** are lower rated securities that may have a higher degree of credit and liquidity risk. **Foreign securities** are subject to currency, political, economic and market risks. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **Inverse floaters** are sensitive to early prepayment risk and interest rate changes and are more volatile than most other fixed-income securities. **Portfolio Turnover.** Consistent with its investment policies, the Fund will purchase and sell securities without regard to the effect on portfolio turnover. Higher portfolio turnover will cause the Fund to incur additional transaction costs. **LIBOR Discontinuance or Unavailability Risk.** The regulatory authority that oversees financial services firms and financial markets in the U.K. has announced that, after the end of 2021, it would no longer persuade or compel contributing banks to make rate submissions for purposes of determining the LIBOR rate. As a result, it is possible that commencing in 2022 , LIBOR may no longer be available or no longer deemed an appropriate reference rate upon which to determine the interest rate on or impacting certain derivatives and other instruments or investments comprising some of the Fund's portfolio.

IMPORTANT INFORMATION

The views and opinions and/or analysis expressed are those of the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

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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, download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

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