

Morgan Stanley Institutional Fund

Municipal Income Portfolio

GLOBAL FIXED INCOME TEAM | COMMENTARY | CLASS I SHARES | JUNE 30, 2021

Performance Review

In the quarter period ending June 30, 2021, the Portfolio's I shares returned 1.76% (net of fees)¹, while the benchmark returned 1.42%.

The Fund's relative outperformance was driven by a combination of macro and sector positioning. The Fund held an underweight duration position, which benefited performance. The overweight allocation to the industrial development revenue/pollution control revenue (IDR/PCR) sector contributed positively over the course of the second quarter, as did the underweight position to the special tax sector. This was partially offset by the Fund's overweight to health care and underweight to education, which slightly detracted from relative performance.

Market Review and Outlook

U.S. financial markets broadly performed well in the second quarter of 2021, as the economic recovery and investor optimism continued to propel equity markets while a shift in posture, from dovish to hawkish, from the Federal Reserve supported fixed income markets. The unemployment rate, which topped out at approximately 15%, reached 5.9% as of the end of June.² The U.S. economy continued its streak of adding jobs every month since April 2020 and added over 850,000 in June, which was the strongest one-month gain since last summer.² The strong economic backdrop helped boost the equity markets, with the S&P 500 returning 8.55%, finishing the second quarter at an all-time high. Fixed income markets caught their breath in the second quarter of the year, driven by a move lower in U.S. Treasury rates. At the conclusion of its June meeting, the Federal Open Market Committee (FOMC) announced a shift in its posture to address rising concerns over inflation and an overheating U.S. economy. According to its most recent release, the median forecast for the first interest rate increase is now expected to occur in 2023 instead of 2024. Over the quarter, the 10-year U.S. Treasury yield declined 30 basis points.²

The Treasury market, U.S. corporate bond market and municipal bond market all generated positive performance in the second quarter, although municipal bonds are the only asset class of the three in positive territory year-to-date. As measured by the Bloomberg Barclays Municipal Bond Index, municipals generated a positive return of 1.42% in the second quarter, bringing year-to-date performance to 1.06%.

In addition to a declining interest rate environment, the municipal market also benefited from a favorable supply and demand backdrop. According to the Investment Company Institute, as of June 23, flows into municipal mutual funds totaled approximately \$21 billion in the second quarter. Year-to-date flows have topped \$48 billion. New municipal issuance totaled approximately \$110 billion in the second quarter, bringing the year-to-date total to approximately \$222 billion.³

Over the three-month period, municipal yields moved lower across the curve. Five-year AAA municipal yields moved 2 basis points lower, 10-year yields declined 13 basis points and 30-year yields decreased 25 basis points.⁴ Despite this sharp move,

¹ Source: Morgan Stanley Investment Management Limited. Data as of June 30, 2021.

² Source: Bloomberg L.P. Data as of June 30, 2021. One basis point = 0.01%

³ Source: SIFMA. Data as of June 30, 2021.

⁴ Source: Refinitiv. Data based on the Refinitiv/Thomson Reuters Municipal Market Data (MMD) AAA Curve, a proprietary yield curve that provides the offer-side of "AAA" rated state general obligation bonds, as determined by the MMD analyst team. Data as of June 30, 2021.

municipals still underperformed U.S. Treasuries. U.S. Treasury yields moved 6, 30 and 36 basis points lower across the 5-year, 10-year and 30-year parts of the curve, respectively.²

Lower-quality municipals outperformed high quality over the quarter, driven largely by investor demand for higher yields and improving credit fundamentals. The Bloomberg Barclays High Yield Municipal Bond Index returned 3.93% while the Bloomberg Barclays Municipal Bond Index returned 14.2%.⁵

Portfolio Strategy and Analysis

During the quarter, the Fund traded duration actively, starting the quarter with a modest underweight position, before ending the quarter with a more notable underweight duration position.

The Fund maintained a focus on essential service revenue bonds over general obligation debt, with an overweight to revenue sectors we believe are positioned to flourish in the reopening trade such as transportation and IDR/PCR as well as the power sector. The largest revenue bond underweight was in the special tax sector.

The Fund added an overweight position to Alabama. We also increased the overweight to New York, which is also the largest overweight position. The largest state underweight position was California.

FUND FACTS

Launch date

September 30, 2020

Base currency

U.S. dollars

Index

Bloomberg Barclays Municipal Index (USD)

Performance (%)

As of June 30, 2021 (Class I Share at NAV)

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
MSIF Municipal Income Portfolio - I Shares	0.32	1.76	1.11	--	--	--	--	34.9
Bloomberg Barclays Municipal Index (USD)	0.27	1.42	1.06	--	--	--	--	2.90

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 1.33% for Class I shares and the net expense ratio is 0.55%. 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.

Short-term returns may not be indicative of the fund's long-term performance potential. A fund's performance, especially for very short time periods, should not be the sole factor in making your investment decision.

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.

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

² Source: Bloomberg L.P. Data as of June 30, 2021. One basis point = 0.01%

⁵ Source: Bloomberg Barclays. Data as of June 30, 2021.

to the ability of an issuer to make timely principal and interest payments. **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. **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. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk).

INDEX INFORMATION

The **Bloomberg Barclays Municipal Index** is an index that covers the USD-denominated long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds.

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 **Bloomberg Barclays Municipal High Yield Bond Index** is an unmanaged index that tracks non-investment grade and non-rated municipal bonds.

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

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.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

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 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.

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

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