Morgan Stanley
INVESTMENT MANAGEMENT

COMMENTARY
June 30, 2023

Morgan Stanley Institutional Fund

Passport Overseas Equity Portfolio

EMERGING MARKETS EQUITY TEAM

Portfolio Commentary

In the quarter period ending June 30, 2023, the Portfolio's I shares returned -0.13% (net of fees)[1], while the benchmark returned 2.44%.

The first half of 2023 was filled with multiple real and potential perils including bank failures, risk of a U.S. debt default and a widely forecasted recession that has yet to materialize. However, despite these worrying headlines, markets have posted strong gains from the 2022 lows seen in October. In the month of June, international equities rallied 4%, finishing the second quarter with a return of 2% (MSCI All Country World Index ex USA).

For the second quarter, the MSIF Passport Overseas Equity Portfolio (I shares) was flat with a net of fees return of -0.13% versus a gain of 2.44% for the MSCI All Country World ex USA Index. Significant detractors from performance included the overweight to and positioning in metals & mining, particularly gold mining and platinum group metals (PGM) companies; stock selection in pharmaceuticals; and the overweights to Alibaba (3.6% of the portfolio)[2] and a Singapore-based e-commerce and entertainment company. Japan was the strongest performing market in the second quarter, and the Fund's below-benchmark allocation hurt portfolio performance, although this was somewhat offset by stock selection within the market including the overweight to Nikon (2.7% of the portfolio).[2] Zero allocations to autos and software were also a drag to the second quarter portfolio return. Notable contributors to portfolio performance were travel-related, including positions in the largest online travel agency in Latin America and low-cost European airline Ryanair (1.7% of the portfolio).[2] Having added to semiconductors and tech hardware in the third quarter of 2022 and then increasing our allocation even more this year, the portfolio benefited from both the overweight position as well as stock selection in the second quarter and year-to-date. Financials are the largest portfolio underweight (5% in the Fund versus 20% in the index) and this was additive to second quarter performance.

For the overall portfolio, we maintained our strategic positioning of overweight to Europe (both eurozone and U.K.), neutral emerging markets, underweights to Japan and Canada, and zero allocations to Australia and Hong Kong. From a sector perspective, the portfolio is overweight to materials (particularly mining and industrial gases), health care (European pharma) and consumer discretionary (consumer durables and European luxury); underweight to financials (zero weight in European, Japanese, Australian and Canadian banks); and zero allocations to industries that we consider structurally challenged including autos, telecom, real estate and utilities.

During the second quarter we added to several stocks with both compelling valuations and fundamentals that complement the existing portfolio. We increased the portfolio weight in the leading Latin American online travel agency as recent quarterly results show bookings and margins improving, while its valuation is near an all-time low. The stock price is at a significant discount to our expectations, and we think it can have attractive upside if it can meet the company management's guidance for 2023.

Materials, the largest portfolio sector overweight (15% in the Fund versus 8% in the index), suffered during the quarter as fears of recession escalated initially and China's post-COVID recovery underwhelmed. Our investment case for copper, PGMs and bulks is driven by challenges in meeting supply growth and higher-than-forecast demand, as the global need for better infrastructure and the transition to cleaner/renewable forms of energy results in increased demand, market tightness and pricing power for miners. During the quarter we added to the portfolio position in PGMs through several South African-based companies, as we expect prices to respond to supply concerns and higher demand from rebounding auto production. We believe the stocks are attractively valued with a positive cash position and high free cash flow during the bottom of the cycle. Similarly, we added to the energy allocation with a small increase to the weight in a South African thermal coal producer. Our view is that coal, along with oil, natural gas and uranium, are likely to be part of how the world meets its expanding energy needs.

Strategy and Outlook

In May the European Central Bank (ECB) slowed the rate of deposit rate increases from 50 basis points (bps)[3] to 25 bps and continued to raise rates for the eighth consecutive time to 3.5%, its highest level since 2001. Eurozone inflation dropped to 6.1% in

[1] Source: Morgan Stanley Investment Management. Data as of June 30, 2023. Performance for other share classes will vary.
[2] Holdings data as of June 30, 2023.
[3] One basis point = 0.01%

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.

May from its +10% high in the third quarter of 2022, but ongoing wage pressures are a concern. Importantly, officials also announced the start of quantitative tightening this summer, which should further constrict financial conditions. The ECB also cut its forecast for 2023 and 2024 growth to 0.9% and 1.5%, respectively. As a result of the ECB's actions, private sector and household bank lending has contracted significantly in recent months. Another headwind to growth is likely to come from fiscal tightening. Germany has proposed cutting fiscal spending markedly to bring its budget to pre-pandemic levels and back into compliance with the eurozone fiscal pact that was in force before the pandemic. The vast majority of our portfolio holdings in both the eurozone and the U.K. are multinationals in global industries such as metals & mining, pharma and staples, with the majority of their demand coming from outside their home markets. We continue to see broad challenges to economic growth in both the eurozone and the U.K., with tightening financial conditions. This dynamic is keeping us from investing in domestic-facing industries such as banks.

In the U.S., the Federal Reserve (Fed) kept its monthly tenor of rate hikes until it paused in June, with expectations for a final rate hike in July growing. Notably, while the Fed is hiking and doing quantitative tightening of $40 billion to $65 billion a month, it did expand its balance sheet as a support measure during the bank failures seen in March and April. This seemingly contradictory action provided liquidity to the banking system, and the non-systemic nature of the Silicon Valley Bank fallout helped propel risk assets during the quarter. U.S. equity performance was driven by multiple expansion that outpaced earnings growth, and both the S&P 500 Index and NASDAQ Composite have shown strong gains during the quarter. Underpinning this optimism was not only the supportive Fed balance sheet action, but also peaking inflation. This is leading many investors to believe in a soft-landing scenario, giving hope that the Fed will relent on its tightening stance; with the forward markets pricing in cuts to the fed funds rate in early 2024. However, each strong economic data point challenges the consensus calls on a sustained pause by the Fed, and the markets gyrate as a result.

Following the selected bank failures and pressure on mid-small banks, U.S. banks recovered nearly 5% in the second quarter (measured by the MSCI U.S. Bank Index).[5] We are, however, wary of the second-round effects of higher rates and the ongoing impacts of changes wrought by the pandemic on demand for commercial real estate and the health of small and medium-sized businesses. According to the National Federation of Independent Business (NFIB) June 2023 report, "inflation and labor quality are tied as the top business concerns," while "the average rate paid on short maturity loans was 9.2%, 1.4% above May's reading." These companies employ nearly three-quarters of the U.S. workforce, so their health is important to the economy and this segment is bearing the brunt of higher rates. We think that headwinds for banks are growing, as they're facing not only higher funding costs, but also increasing delinquency and charge-off rates in consumer credit that may portend the start of a negative credit cycle ahead. Certainly, the longer interest rates stay high, the more problems we can expect from bank balance sheets.

After years of underperforming other global markets, investors have taken notice of Japan's attractive valuations, a revival of inflation after decades of deflation, the highest wage increases since 1993 and a central bank with seemingly no near-term plans to raise rates. Global funds have been almost uniformly underweight, and recently Japan has outpaced other markets (although yen weakness has hurt returns in U.S. dollar terms) as foreign money inflows have been added to the market. The Topix Index is now back to levels last seen in 1990.[4] Our portfolio is underweight Japan due to structural macro concerns especially around debt and demographics. In our view, while many investors are rushing into Japan based on a change in structural drivers, we think the real reason has more to do with abundant liquidity provisions and loose policy, at a time when the other large developed central banks are being restrictive. Having said that, we have over the years identified many thematic and structural winners in Japan and will likely look to add to these positions on a valuation pullback. Our portfolio is invested in industry-leading companies in entertainment, consumer durables, semiconductors and industrial automation, with zero weight to banks and domestic-facing industries.

India is the portfolio's third largest country overweight based on its secular, endogenous growth driven by a young and growing population, supply-side investments, and digitization, as well as a variety of quality companies. We are constructive on India's ability to withstand external shocks, continued growth outlook (led largely by increased investment and digitization), a large domestic market to drive consumption, and a stronger institutional framework, particularly relative to other emerging markets. Portfolio positions are in financials, health care and energy.

The portfolio is underweight China, which despite a rebound following the COVID-19 reopening, has remained a global laggard in terms of performance. While we are underweight, we have exposure to several large consumer and technology platform companies, which we expect can benefit from the end of a period of regulatory inquiry as well as structural consumption trends that are expected to see the backing of the government. In addition to the above tailwinds, the portfolio is invested in highly dominant businesses with significant cash on the balance sheet, and cash generation that is currently very undervalued, as demonstrated by very high free cash flow yields. We think these stocks will likely rerate as the discount from government intervention diminishes if the companies continue to deliver solid results.

Macro data in recent months, including purchasing managers' index (PMI) and factory activity, has come in weaker than expected, and private sector investment and new real estate construction starts have yet to recover. Our medium-term view of the market hinges on whether China can implement long-term structural reforms to achieve an economic transformation that features more sustainable

[4] Source: Bloomberg L.P. Data as of June 30, 2023.
[5] Source: Bloomberg L.P.

growth—driven by technological innovation and productivity gains. Policy support measures are highly anticipated and could be rolled out in the coming months to boost economic growth and confidence.

We have a slight overweight to Brazil through a leading bank, a fast-growing e-commerce platform and one of the lowest-cost global commodity producers. Brazil is a very rate sensitive market; historically, equities perform well when interest rates, which are currently high in real terms, decline. Brazil's central bank was among the most aggressive in emerging markets in raising rates to fight inflation in 2021 and 2022. Now that inflation has peaked and continues to fall, leading to a rise in real interest rates, we expect the central bank could begin cutting rates in the second half of the year.

Overall, we are cautiously optimistic on the global outlook and believe that public equities can generate competitive returns based on troughing earnings growth and attractive valuations in non-U.S. equity markets. We believe a weaker U.S. dollar could provide support to the markets and enhance returns for dollar-based investors. Non-U.S. equities have lagged the U.S. for a sustained period, and trade at a marked discount to the U.S. market. On a 12-month forward price-to-earnings basis, the U.S. trades at 19.4x while eurozone equities are at 12.2x, Japan at 14.9x and emerging markets at 12.1x.[6] The Fund remains fully invested while we continue to monitor the data and news flow for indications that would change our outlook.

Fund Facts

Inception Date	January 17, 1992
Minimum Initial Investment ($)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Primary- MSCI All Country World ex USA Index
	Custom- Blended Index
	Former- MSCI EAFE Index
Class I expense ratio	**Gross 1.08 %**
	Net 0.90 %
Class A expense ratio	**Gross 1.34 %**
	Net 1.25 %

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 June 30, 2023	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	4.64	-0.13	11.16	11.24	6.73	4.91	4.92
Class A Shares at NAV	4.60	-0.19	10.97	10.92	6.43	4.60	4.59
Class A Shares (With Max 5.25% Sales Charge)	-0.88	-5.43	5.16	5.13	4.54	3.48	4.03
MSCI All Country World ex USA Index	4.49	2.44	9.47	12.72	7.22	3.52	4.75
Blended Index	4.49	2.44	9.47	12.72	7.22	3.52	5.04
MSCI EAFE Index	4.55	2.95	11.67	18.77	8.93	4.39	5.41

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.

Effective May 31, 2023 the Morgan Stanley Institutional Fund Active International Allocation Portfolio was renamed to Morgan Stanley Institutional Fund Passport Overseas Equity Portfolio.

[6] Source: MSIM, Bloomberg L.P., FactSet, Global Insight. Data as of June 30, 2023.

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

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 portfolio. Please be aware that this portfolio may be subject to certain additional risks. 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. 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).

INDEX INFORMATION

The **MSCI All Country World Ex-U.S. Index** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets, excluding the U.S. 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 **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 **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 **Nasdaq Composite Index** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. It is used as an indicator of the performance of stocks of technology companies and growth companies. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not exclusively a U.S. index.

The **Tokyo Stock Price Index (TOPIX)** is the composite index for the Tokyo Stock Exchange (TSE) tracking all domestic stocks from the First Section of the exchange. The index is a measure of the market value changes of the common stocks on the TSE.

The **MSCI U.S. Bank Index** is a price index of bank stock performance in the U.S.

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.

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