

Morgan Stanley Institutional Fund

Ultra-Short Municipal Income Portfolio

GLOBAL LIQUIDITY TEAM | COMMENTARY | JUNE 30, 2021

Performance Review

In the quarter period ending June 30, 2021, the Portfolio's IN shares returned 0.00% (net of fees)¹, while the benchmark returned 0.01%.

Market Review

Municipals have outperformed most other fixed income asset classes year-to-date. The outlook for municipal credit fundamentals has improved significantly in light of strengthening economic growth and further reopening, recovering tax revenues and relief from the federal government. Technicals have also remained favorable. While supply issuance has been strong in 2021 so far, municipal fund inflows have stayed consistently positive amid investors' search for yield and municipals' improving credit fundamentals. The municipal yield curve flattened in the second quarter after steepening in the first quarter. Rates on the short end rose slightly in response to the Federal Reserve moving its rate hike projection forward a year (to 2023) in June, up from no rate hikes in 2023 at its March update, while yields declined across intermediate and longer maturities. Despite the slight uptick at the short end, the short-term municipal yield curve remains relatively flat with short-term rates at historical lows.

The short-term tax-exempt market is expecting to see good demand throughout the next month as the July coupon payment inflows peak and maturities outweigh new issue supply. If rate volatility stays contained this summer, municipal yields will likely end up moving in a narrow range with relatively subdued trading activity.

However, the road ahead will be much more challenging. While the yield curve flattening trend may continue a while longer, as the start of the next rate hiking cycle approaches, yield curves will likely steepen, although not until next year.

Municipal investors will also be focused on the proposed federal infrastructure bill and potential tax law changes. While the announcement of a bipartisan infrastructure framework is significant, proceeding with a concurrent or delayed budget reconciliation narrows the path. Additionally, there are still questions about whether such a deal could pass. A number of progressives have voiced reservations about the bill, as it does not include new proposals on climate, education and child care, and details about how the bill would be paid for remain a sticking point.

Portfolio Activity and Outlook

A2/P2 rated bonds remain an attractive investment option, as they allow us to diversify away from more traditional state and local government credits to corporate entities issuing in the tax-exempt market.²

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

² Diversification neither assures a profit nor guarantees against loss in a declining market.

We continue to hold a bias toward higher quality assets overall and continue to advocate careful security selection as the impact of the pandemic varies across market segments. We have a preference for essential service revenue issues like water & sewer, public power, pollution control and health care.

FUND FACTS

Launch date

December 19, 2018

Base currency

U.S. dollars

Index

Bloomberg BVAL Municipal AAA Yield Curve (Callable) 3-Month Index

Performance (%)

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

| | MTD | QTD | YTD | 1 YR | 3 YR | 5 YR | 10 YR | SINCE INCEPTION |
|---|------|------|-------|------|------|------|-------|-----------------|
| MSIF Ultra-Short Municipal Income Portfolio - IN Shares | 0.00 | 0.00 | -0.09 | 0.05 | -- | -- | -- | 0.81 |
| Bloomberg BVAL Municipal AAA Yield Curve (Callable) 3-Month Index | 0.00 | 0.01 | 0.03 | 0.08 | -- | -- | -- | 0.68 |

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 0.49% for Class IN shares and the net expense ratio is 0.35%. 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 \$10,000,000.

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 IN shares. Performance for other share classes will vary.

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. 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 these portfolios. Please be aware that these portfolios 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. **Municipal securities** are subject to early redemption risk and sensitive to tax, legislative and political changes. **Tender option bonds.** The risks of tender option bonds include the risk that the owner of such instrument may not be considered the owner for federal income tax purposes and thus will not be entitled to treat such interest as exempt from federal income tax. **Taxability risk.** Changes in tax laws or adverse determinations by the Internal Revenue Service ("IRS") may make the income from some municipal obligations taxable. By investing in **investment company securities**, the portfolio is subject to the underlying risks of that investment company's portfolio securities. In addition to the Portfolio's fees and expenses, the Portfolio generally would bear its share of the investment company's fees and expenses. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). 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.

INDEX INFORMATION

Bloomberg BVAL Municipal AAA Yield Curve (Callable) 3-Month Index: BVAL Municipal AAA Benchmark Bloomberg's evaluated pricing service, BVAL, provides a municipal "AAA" 5% coupon benchmark yield curve that is the baseline curve for BVAL tax-exempt municipals. It is populated with high quality US municipal bonds with an average rating of "AAA" from Moody's and S&P. The yield curve is built using non-parametric fit of market data obtained from the Municipal Securities Rulemaking Board, new issues calendars, and other proprietary contributed prices. The benchmark is updated hourly and utilizes eligible "AAA" traded observations throughout the day and accessible on through Bloomberg services. The 3-Month curve is one data point of the overall BVAL Municipal AAA Benchmark Curve. 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 rating given by a **Nationally Recognized Statistical Rating Organization ("NRSRO")** is the rating firms' subjective opinion concerning the ability and willingness of an issuer to meet its financial obligations in full and on time. Ratings apply only to portfolio holdings and do not remove the Fund's market risk.

Securities purchased by the Fund (or the issuers of such securities) will carry a rating in the highest two rating categories, A-2, P-2 or F2 or better by S&P, Moody's or Fitch, respectively, or the equivalent by another NRSRO, or if unrated, considered by the Adviser to be of equivalent quality.

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.

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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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