Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Institutional Fund

U.S. Focus Real Estate Portfolio

GLOBAL LISTED REAL ASSETS TEAM | COMMENTARY | JUNE 30, 2022

Performance and Market Review

In the quarter period ending June 30, 2022, the Portfolio's I shares returned -16.93% (net of fees)[1], while the benchmark returned -14.68%.

U.S. real estate securities (FTSE Nareit All Equity REITs Index, -14.68%, the "Index") outperformed the broader equity markets (S&P 500 Index, -16.10%) for the quarter, as the impact of high inflation, rapidly rising interest rates and weaker sentiment moderated growth, increasing the odds for a recession in 2023. Ongoing global supply chain disruptions from the war in Ukraine and COVID-related lockdowns in China also weighed on the market. COVID-19 cases continued to rise due to omicron variants, although economies work to resume business as usual, and China's "zero-COVID" policy slowly began to loosen at the end of the quarter starting with the quarantine policy for incoming travelers. The Fund underperformed the Index, returning -16.93% for the quarter (Class I shares net of fees).

The Federal Reserve (Fed) approved an interest rate hike of 75 basis points[2] in June. Fed Chair Powell's testimony to Congress implied the Fed would raise rates to whatever level necessary to bring inflation down. Increased COVID-19 cases due to omicron subvariants continue to remain mild overall and businesses continued to operate normally. Within the Index, less economically sensitive sectors with more defensive cash flow growth profiles and strong balance sheets outperformed. Specifically, student housing outperformed on the heels of a take-private transaction by Blackstone[3] and the net lease sector outperformed given the relative stability of its cash flows. The more economically sensitive sectors of office (West Coast and NYC), regional malls, industrial and hotels underperformed.

The Fund's zero position to regional malls, the overweight to and security selection within the retail net lease sector, and security selection in apartment companies were relative contributors for the quarter. This was more than offset by security selection within and the overweight to shopping centers, zero position to gaming net lease, and the-out-benchmark position to gaming companies. Security selection within and the overweight to economically sensitive billboard companies further detracted from relative performance.

Strategy

The team uses internal proprietary research to invest in public real estate companies that we believe offer the best value relative to their underlying assets and growth prospects. The team combines a bottom-up approach, assessing the intrinsic value, equity multiples and growth prospects of each security, with a top-down view that incorporates fundamental inflection points, macroeconomic considerations and geopolitical risk, and actively selects positions in a limited number of equity securities. By incorporating both an equity market valuation and a more traditional real estate valuation with a top-down overlay, we believe the Fund will be better prepared to identify securities with the best expected total returns.

Outlook

Forecasted returns for the asset class have deteriorated in the intermediate term given the more challenging macro backdrop. However, we believe relative strength in cash flows can be expected given the unique nature of listed real estate. Specifically, the contracted rental streams with inflation-linked escalations and the necessity-based nature of real estate, coupled with limited new real estate supply additions, may portend limited downside in cash flows, despite near-term macro uncertainty. Additionally, we

1 Source: Morgan Stanley Investment Management. Data as of June 30, 2022. Performance for other share classes will vary.
2 One basis point = 0.01%
3 As of June 30, 2022, not held in the portfolio.

believe the relative valuation of real estate securities is attractive, specifically when compared to direct property investment, and could lead to continued merger and acquisition activity and privatizations, thereby crystalizing value and potentially outsized returns for investors.

Secular trends that have been unfolding over the past several years and accelerated by COVID-19 will result in winners and losers for real estate.

- In retail, secular headwinds remain given the continued growth in e-commerce and focus on omnichannel distribution, and COVID-19 has highlighted the importance of physical stores due to benefits from increased brand recognition and superior insulation from supply chain issues, among others. Discretionary spending and consumer confidence are declining amid record high inflation and growing tenant bankruptcy watch lists. Enclosed malls remain more challenged than open-air shopping.
- In office, work-from-home (WFH) policies will likely be an overhang on office demand, and related uncertainty regarding future office absorption is expected to remain an open question. However, increased focus on health, wellness and safety could offset some of the demand impairment as densification trends not only stop, but reverse. Layoff announcements and jobless claims are increasing with new job listings declining, and this bears watching.
- In lodging, pent-up demand for leisure travel is strong and exceeding forecasts, although it is anticipated to fall given the stretched consumer. Essential business travel and group/conference demand will return, but likely at below pre-pandemic levels. Regional gaming and casinos, where demand is more reliant on consumer/leisure activities, is stable. Increasing recession odds are a negative for corporate capex and lodging demand.
- In residential, affordability concerns regarding homeownership given increasing mortgage rates and home price appreciation will likely lead to increasing renter demand. Supply growth, regulation, weaker jobs and wage growth remain key risks for rental residential markets.
- In industrial, e-commerce drivers continue to fuel robust demand, resulting in strong fundamentals as evidenced by record low vacancies and double-digit rent growth. A pullback in Amazon[3] leasing announced in the second quarter is not likely to have a material impact on net absorption. Investor interest and capital flow into the sector remains robust given fundamental strength.
- In health care, the necessity-based nature of seniors housing demand is anticipated to insulate fundamentals from macro headwinds. Labor shortages and expense pressures are expected to dissipate. Supply remains well below the prior seven-year average, and demographics are forecasted to be a strong source of incremental demand over the next several years.
- In data centers/towers, data growth observed over the past decade is expected to continue and fuel the need for additional capacity with the 5G rollout providing incremental demand drivers for towers. New supply within the tower space will remain muted. However, data center supply will likely continue to be robust and serve as a governor to growth.
- In self-storage, demand is anticipated to remain strong across major markets, with fundamentals less reliant on macroeconomic indicators and the potential to be "recession-resistant." Forecasted new supply remains rational and below historical averages.

FUND FACTS

Inception Date	Minimum Initial Investment ($)*	Index
September 30, 2021	A Shares - 1,000 I Shares - 1,000,000	FTSE Nareit All Equity REITs Index

[3] As of June 30, 2022, not held in the portfolio.
* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

Performance (%)

As of June 30, 2022

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
Class I Shares at NAV	-7.06	-16.93	-20.35	--	--	--	--	-8.70
Class A Shares at NAV	-7.07	-17.02	-20.50	--	--	--	--	-8.96
Class A Shares (With Max 5.25% Sales Charge)	-11.94	-21.39	-24.65	--	--	--	--	-13.71
FTSE Nareit All Equity REITs Index	-7.10	-14.68	-19.17	--	--	--	--	-6.10

Class A shares have a maximum front-end sales charge of 5.25%. 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 8.45% for Class I shares and the net expense ratio is 0.90%. The gross expense ratio is 11.91% for Class A shares and net expense ratio is 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.

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.

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. **Real estate investments,** including **real estate investment trusts**, are subject to risks similar to those associated with the direct ownership of real estate and they are sensitive to such factors as management skills and changes in tax laws. **Nondiversified portfolios** often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility. Stocks of **small- and medium-capitalization companies** entail special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. **Exchange traded funds (ETFs)** shares have many of the same risks as direct investments in common stocks or bonds and their market value will fluctuate as the value of the underlying index does. By investing in exchange traded funds (ETFs), the portfolio absorbs both its own expenses and those of the ETFs it invests in. Supply and demand for ETFs may not be correlated to that of the underlying securities. **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.

INDEX INFORMATION

The **FTSE Nareit (National Association of Real Estate Investment Trusts)All Equity REITs Index** is a free float-adjusted market-capitalization weighted index of tax qualified REITs listed on the New York Stock Exchange, NYSE Amex and the NASDAQ National Market Systems. 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 **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 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.

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

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