

Morgan Stanley

INVESTMENT MANAGEMENT

Commentary

MSIFT Ultra-Short Municipal Income Portfolio – Update and Strategy

LIQUIDITY | GLOBAL LIQUIDITY TEAM | 1Q2019

Given the recent movements in the municipal bond market, the front end of the curve provides very attractive yields compared to longer-term securities. Launched in December 2018, the Morgan Stanley Institutional Fund Trust (MSIFT) Ultra-Short Municipal Income Portfolio is well-positioned to take advantage of these opportunities. The Portfolio seeks to provide current income exempt from federal income tax and capital preservation while maintaining liquidity and low volatility within a conservative investment approach.

At the short end of the curve, yields for variable rate demand obligations (VRDOs) fell during the month of March after rising during February. The SIFMA Index,¹ which measures yields for weekly VRDOs, fell from 1.74 percent at the beginning of the month to finish the month at 1.50 percent.

We are anticipating a rise in rates in the coming weeks as the effects of the looming tax season begin to be felt as market participants prepare for April 15th. VRDOs and other short-term instruments are typically liquidated in order to cover the tax payments and when this happens, VRDO yields start resetting higher.

Yields on variable-rate municipal securities that reset weekly have been near or exceeding those on five-year fixed-rate bonds for the first time in more than a decade and should remain higher throughout the month of April as investors pull cash from tax-exempt money market funds to pay taxes. Each time yields of the SIFMA Index and 5-year bullets have come close in the past several years, bullet bonds underperformed shortly thereafter.

Currently, we see more value in VRDOs than in short-dated bullet bonds as yields of the SIFMA Index will likely remain elevated for two to three months or even longer. In the period ahead, we will maintain our emphasis on high levels of liquidity and relatively short duration as we see how monetary policy unfolds and what impact the final tax reform changes may have on municipal yields.

CURRENT STRATEGY AND AREAS OF FOCUS:

- High-quality short-term municipal securities
- Variable Rate Demand Obligations
- Municipal Floating Rate Notes/Mandatory Put Issues
- Tax-Exempt Commercial Paper, Notes and Bonds
- Essential Revenue Service Bonds
- Healthcare: large issuers with scale and less impacted by Affordable Care Act repeal
- Industrial Development Revenue Bonds

AREAS OF THE MARKET WE HAVE BEEN AVOIDING:

- Headline sensitive credits
- Illinois, New Jersey, Puerto Rico

To learn more about how the MSIFT Ultra-Short Municipal Income Portfolio can help address your investment needs, please visit www.morganstanley.com/im.

¹ The SIFMA Index is issued weekly and is compiled from the weekly interest rate resets of tax-exempt variable rate issues included in a database maintained by Municipal Market Data which meet specific criteria established from time to time by The Bond Market Association. The index is unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

The Portfolio may invest a portion of its total assets in bonds that may subject certain investors to the federal Alternative Minimum Tax (AMT). Investors should consult their tax adviser for further information on tax implications.

This information represents how the investment team generally implements its investment process under normal market conditions.

Fund information is subject to change daily, provided for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the industries mentioned above.

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.

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. 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 the current rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. Longer-term securities may be more sensitive to interest rate changes. In a declining interest-rate environment, the portfolio may generate less income. 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. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (**liquidity risk**). **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.

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 1-800-236-0992. Please read the prospectus carefully before investing.

Morgan Stanley Investment Management (MSIM) is the asset management division of Morgan Stanley.

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