Morgan Stanley

The Universal Institutional Funds, Inc.

Semi-Annual Report – June 30, 2016

Global Infrastructure Portfolio

The Portfolio is intended to be a funding vehicle for variable annuity contracts and variable life insurance policies offered by the separate accounts of certain life insurance companies.

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Expense Example (unaudited)

Global Infrastructure Portfolio

As a shareholder of the Global Infrastructure Portfolio (the "Portfolio"), you incur two types of costs: (1) insurance company charges; and (2) ongoing costs, which may include advisory fees, administration fees, distribution (12b-1) fees and other Portfolio expenses. This example is intended to help you understand your ongoing costs (in dollars) of investing in the Portfolio and to compare these costs with the ongoing costs of investing in other mutual funds.

This example is based on an investment of $1,000 invested at the beginning of the six-month period ended June 30, 2016 and held for the entire six-month period.

Actual Expenses

The table below provides information about actual account values and actual expenses. You may use the information in this table, together with the amount you invested, to estimate the expenses that you paid over the period. Simply divide your account value by $1,000 (for example, an $8,600 account value divided by $1,000 = 8.6), then multiply the result by the number in the table under the heading entitled "Actual Expenses Paid During Period" to estimate the expenses you paid on your account during this period.

Hypothetical Example for Comparison Purposes

The table below provides information about hypothetical account values and hypothetical expenses based on the Portfolio's actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Portfolio's actual return. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses you paid for the period. You may use this information to compare the ongoing costs of investing in the Portfolio and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds.

Please note that the expenses shown in the table are meant to highlight your ongoing costs only and do not reflect any insurance company charges. Therefore, the table below is useful in comparing ongoing costs, but will not help you determine the relative total cost of owning different funds. In addition, if these insurance company charges were included, your costs would have been higher.

	Beginning Account Value 1/1/16	Actual Ending Account Value 6/30/16	Hypothetical Ending Account Value	Actual Expenses Paid During Period*	Hypothetical Expenses Paid During Period*	Net Expense Ratio During Period**
Global Infrastructure Portfolio Class I	$1,000.00	$1,175.60	$1,020.59	$4.65	$4.32	0.86%
Global Infrastructure Portfolio Class II	1,000.00	1,174.20	1,019.34	6.00	5.57	1.11

* Expenses are calculated using each Portfolio Class' annualized net expense ratio (as disclosed), multiplied by the average account value over the period, and multiplied by 182/366 (to reflect the most recent one-half year period).

** Annualized.

Portfolio of Investments

Global Infrastructure Portfolio

	Shares	Value (000)
Common Stocks (95.2%)		
Australia (3.2%)		
Macquarie Atlas Roads Group	266,489	$ 1,034
Sydney Airport	99,459	517
Transurban Group	145,718	1,307
		2,858
Brazil (0.2%)		
CCR SA	28,074	147
Canada (12.7%)		
Enbridge, Inc. (a)	105,049	4,450
Hydro One Ltd. (b)	10,619	213
Inter Pipeline Ltd. (a)	73,092	1,550
Pembina Pipeline Corp. (a)	39,732	1,208
TransCanada Corp. (a)	89,926	4,069
		11,490
China (5.4%)		
China Everbright International Ltd. (c)	446,000	500
Guangdong Investment Ltd. (c)	1,270,000	1,940
Hopewell Highway Infrastructure Ltd. (c)	4,918,000	2,448
		4,888
France (3.6%)		
Eutelsat Communications SA	7,054	134
Groupe Eurotunnel SE	85,960	915
SES SA	23,179	501
Vinci SA	23,780	1,694
		3,244
Italy (2.3%)		
Atlantia SpA	41,746	1,041
Infrastrutture Wireless Italiane SpA (b)	176,280	781
Snam SpA	41,750	250
		2,072
Japan (1.3%)		
Japan Airport Terminal Co., Ltd. (a)	4,800	173
Tokyo Gas Co., Ltd.	253,000	1,038
		1,211
Mexico (0.2%)		
Infraestructura Energetica Nova SAB de CV	49,346	208
Spain (5.9%)		
Abertis Infraestructuras SA	29,915	440
EDP Renovaveis SA	6,644	50
Ferrovial SA	60,912	1,183
Saeta Yield SA	364,348	3,651
		5,324
Switzerland (1.1%)		
Flughafen Zuerich AG (Registered)	5,650	1,000
United Kingdom (12.3%)		
John Laing Group PLC (b)	1,391,573	$ 4,202
National Grid PLC	265,799	3,909
Pennon Group PLC	63,226	798
Severn Trent PLC	32,416	1,059
United Utilities Group PLC	80,189	1,117
		11,085
United States (47.0%)		
American Tower Corp. REIT	56,790	6,452
American Water Works Co., Inc.	9,470	800
Atmos Energy Corp.	11,370	925
CenterPoint Energy, Inc.	7,557	181
Cheniere Energy, Inc. (d)	6,284	236
Columbia Pipeline Group, Inc.	42,770	1,090
Crown Castle International Corp. REIT	41,206	4,180
Enbridge Energy Management LLC (d)	376,591	8,665
Eversource Energy	21,689	1,299
Kinder Morgan, Inc.	72,983	1,366
NiSource, Inc.	30,270	803
Pattern Energy Group, Inc.	154,450	3,548
PG&E Corp.	63,567	4,063
SBA Communications Corp., Class A (d)	13,862	1,496
Sempra Energy	34,009	3,878
Spectra Energy Corp.	66,266	2,427
TransCanada Corp.	5,084	230
Union Pacific Corp.	8,900	777
		42,416
Total Common Stocks (Cost $68,099)		85,943
Short-Term Investments (10.3%)		
Securities held as Collateral on Loaned Securities (4.7%)		
Investment Company (3.8%)		
Morgan Stanley Institutional Liquidity Funds — Treasury Securities Portfolio — Institutional Class (See Note H)	3,454,362	3,454
	Face Amount (000)	
Repurchase Agreements (0.9%)		
Barclays Capital, Inc., (0.42%, dated 6/30/16, due 7/1/16; proceeds $798; fully collateralized by a U.S. Government obligation; 2.00% due 8/15/25; valued at $814)	$ 798	798
Merrill Lynch & Co., Inc., (0.44%, dated 6/30/16, due 7/1/16; proceeds $33; fully collateralized by a U.S. Government agency security; 4.50% due 4/20/44; valued at $33)	33	33
		831
Total Securities held as Collateral on Loaned Securities (Cost $4,285)		4,285

Portfolio of Investments (cont'd)

Global Infrastructure Portfolio

	Shares	Value (000)
Investment Company (5.6%)		
Morgan Stanley Institutional Liquidity Funds — Treasury Portfolio — Institutional Class (See Note H) **(Cost $5,045)**	5,044,999	$ 5,045
Total Short-Term Investments (Cost $9,330)		9,330
Total Investments (105.5%) (Cost $77,429) Including $8,607 of Securities Loaned (e)(f)		95,273
Liabilities in Excess of Other Assets (-5.5%)		(5,006)
Net Assets (100.0%)		$90,267

(a) All or a portion of this security was on loan at June 30, 2016.

(b) 144A security — Certain conditions for public sale may exist. Unless otherwise noted, these securities are deemed to be liquid.

(c) Security trades on the Hong Kong exchange.

(d) Non-income producing security.

(e) The approximate fair value and percentage of net assets, $31,682,000 and 35.1%, respectively, represent the securities that have been fair valued under the fair valuation policy for international investments as described in Note A-1 within the Notes to the Financial Statements.

(f) At June 30, 2016, the aggregate cost for Federal income tax purposes approximates the aggregate cost for book purposes. The aggregate gross unrealized appreciation is approximately $19,500,000 and the aggregate gross unrealized depreciation is approximately $1,656,000 resulting in net unrealized appreciation of approximately $17,844,000.

REIT Real Estate Investment Trust.

Portfolio Composition*

Classification	Percentage of Total Investments
Oil & Gas Storage & Transportation	35.6%
Communications	14.9
Electricity Transmission & Distribution	10.5
Toll Roads	9.9
PPA Contracted Renewables	7.9
Water	6.8
Diversified	6.1
Short-Term Investments	5.6
Other**	2.7
Total Investments	100.0%

* Percentages indicated are based upon total investments (excluding Securities held as Collateral on Loaned Securities) as of June 30, 2016.

** Industries and/or investment types representing less than 5% of total investments.

The accompanying notes are an integral part of the financial statements.

Global Infrastructure Portfolio

Statement of Assets and Liabilities

	June 30, 2016 (000)
Assets:	
Investments in Securities of Unaffiliated Issuers, at Value[1] (Cost $68,930)	$86,774
Investments in Securities of Affiliated Issuer, at Value (Cost $8,499)	8,499
Total Investments in Securities, at Value (Cost $77,429)	95,273
Foreign Currency, at Value (Cost $107)	106
Receivable for Investments Sold	945
Dividends Receivable	368
Receivable for Portfolio Shares Sold	195
Tax Reclaim Receivable	29
Receivable from Affiliate	1
Other Assets	11
Total Assets	96,928
Liabilities:	
Collateral on Securities Loaned, at Value	4,285
Payable for Investments Purchased	1,871
Payable for Portfolio Shares Redeemed	289
Payable for Advisory Fees	91
Payable for Servicing Fees	46
Payable for Custodian Fees	31
Payable for Professional Fees	23
Payable for Distribution Fees — Class II Shares	6
Payable for Administration Fees	6
Payable for Transfer Agency Fees	1
Other Liabilities	12
Total Liabilities	6,661
NET ASSETS	$90,267
Net Assets Consist of:	
Paid-in-Capital	$71,943
Accumulated Undistributed Net Investment Income	1,488
Net Realized Loss	(992)
Unrealized Appreciation (Depreciation) on:	
Investments	17,844
Foreign Currency Translations	(16)
Net Assets	$90,267
CLASS I:	
Net Assets	$56,643
Net Asset Value, Offering and Redemption Price Per Share Applicable to 7,375,061 Outstanding $0.001 Par Value Shares (Authorized 500,000,000 Shares)	$ 7.68
CLASS II:	
Net Assets	$33,624
Net Asset Value, Offering and Redemption Price Per Share Applicable to 4,396,606 Outstanding $0.001 Par Value Shares (Authorized 500,000,000 Shares)	$ 7.65
[1] **Including:**	
Securities on Loan, at Value:	$ 8,607

Global Infrastructure Portfolio

Statement of Operations

	Six Months Ended June 30, 2016 (000)
Investment Income:	
Dividends from Securities of Unaffiliated Issuers (Net of $62 of Foreign Taxes Withheld)	$ 1,505
Income from Securities Loaned — Net	22
Dividends from Security of Affiliated Issuer (Note H)	3
Total Investment Income	1,530
Expenses:	
Advisory Fees (Note B)	334
Servicing Fees (Note D)	56
Professional Fees	46
Distribution Fees — Class II Shares (Note E)	32
Administration Fees (Note C)	31
Custodian Fees (Note G)	30
Shareholder Reporting Fees	12
Directors' Fees and Expenses	3
Pricing Fees	3
Transfer Agency Fees (Note F)	3
Other Expenses	2
Total Expenses	552
Waiver of Advisory Fees (Note B)	(178)
Rebate from Morgan Stanley Affiliate (Note H)	(2)
Net Expenses	372
Net Investment Income	1,158
Realized Gain:	
Investments Sold	301
Foreign Currency Transactions	71
Net Realized Gain	372
Change in Unrealized Appreciation (Depreciation):	
Investments	11,537
Foreign Currency Translations	(14)
Net Change in Unrealized Appreciation (Depreciation)	11,523
Net Realized Gain and Change in Unrealized Appreciation (Depreciation)	11,895
Net Increase in Net Assets Resulting from Operations	$13,053

Global Infrastructure Portfolio

Statements of Changes in Net Assets

	Six Months Ended June 30, 2016 (unaudited) (000)	Year Ended December 31, 2015 (000)
Increase (Decrease) in Net Assets:		
Operations:		
Net Investment Income	$ 1,158	$ 2,213
Net Realized Gain	372	3,826
Net Change in Unrealized Appreciation (Depreciation)	11,523	(18,500)
Net Increase (Decrease) in Net Assets Resulting from Operations	13,053	(12,461)
Distributions from and/or in Excess of:		
Class I:		
Net Investment Income	(1,205)	(1,136)
Net Realized Gain	(3,193)	(6,657)
Class II:		
Net Investment Income	(651)	(391)
Net Realized Gain	(1,889)	(2,588)
Total Distributions	(6,938)	(10,772)
Capital Share Transactions:[1]		
Class I:		
Subscribed	505	384
Distributions Reinvested	4,398	7,793
Redeemed	(4,873)	(12,118)
Class II:		
Subscribed	8,664	8,492
Distributions Reinvested	2,540	2,979
Redeemed	(2,832)	(5,692)
Net Increase in Net Assets Resulting from Capital Share Transactions	8,402	1,838
Total Increase (Decrease) in Net Assets	14,517	(21,395)
Net Assets:		
Beginning of Period	75,750	97,145
End of Period (Including Accumulated Undistributed Net Investment Income of $1,488 and $2,186)	$90,267	$ 75,750
[1] **Capital Share Transactions:**		
Class I:		
Shares Subscribed	64	44
Shares Issued on Distributions Reinvested	573	962
Shares Redeemed	(651)	(1,440)
Net Decrease in Class I Shares Outstanding	(14)	(434)
Class II:		
Shares Subscribed	1,122	1,015
Shares Issued on Distributions Reinvested	332	369
Shares Redeemed	(381)	(684)
Net Increase in Class II Shares Outstanding	1,073	700

Financial Highlights

Global Infrastructure Portfolio

Selected Per Share Data and Ratios	Class I** Six Months Ended June 30, 2016 (unaudited)	Year Ended December 31, 2015	2014	2013	2012	2011
Net Asset Value, Beginning of Period	$ 7.08	$ 9.31	$ 9.64	$ 9.19	$ 8.72	$ 8.13
Income (Loss) from Investment Operations:						
Net Investment Income†	0.11	0.22	0.20	0.20	0.22	0.21
Net Realized and Unrealized Gain (Loss)	1.14	(1.36)	1.16	1.32	1.30	1.07
Total from Investment Operations	1.25	(1.14)	1.36	1.52	1.52	1.28
Distributions from and/or in Excess of:						
Net Investment Income	(0.18)	(0.16)	(0.25)	(0.26)	(0.23)	(0.23)
Net Realized Gain	(0.47)	(0.93)	(1.44)	(0.81)	(0.82)	(0.46)
Total Distributions	(0.65)	(1.09)	(1.69)	(1.07)	(1.05)	(0.69)
Net Asset Value, End of Period	$ 7.68	$ 7.08	$ 9.31	$ 9.64	$ 9.19	$ 8.72
Total Return ++	17.56%#	(13.76)%	15.63%	17.91%	18.69%	16.07%
Ratios and Supplemental Data:						
Net Assets, End of Period (Thousands)	$56,643	$52,323	$72,815	$57,746	$57,628	$58,998
Ratio of Expenses to Average Net Assets (1)	0.86%+*	0.87%+	0.87%+	0.90%+	0.87%+	0.86%+
Ratio of Net Investment Income to Average Net Assets (1)	3.04%+*	2.56%+	2.12%+	2.12%+	2.51%+	2.48%+
Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets	0.01%*	0.00%§	0.00%§	0.00%§	0.00%§	0.00%§
Portfolio Turnover Rate	28%#	50%	40%	25%	28%	36%
(1) Supplemental Information on the Ratios to Average Net Assets:						
Ratios Before Expense Limitation:						
Expenses to Average Net Assets	1.32%*	1.35%	1.26%	N/A	N/A	N/A
Net Investment Income to Average Net Assets	2.58%*	2.08%	1.73%	N/A	N/A	N/A

** On April 28, 2014, the Portfolio acquired substantially all of the assets and liabilities of the Morgan Stanley Select Dimensions Investment Series — Global Infrastructure Portfolio (“SD Global Infrastructure”) and Morgan Stanley Variable Investment Series — Global Infrastructure Portfolio (“VIS Global Infrastructure”). The Portfolio adopted the financial and performance history of VIS Global Infrastructure. Therefore, the per share data and the ratios of Class I shares reflect the historical per share data of Class X shares of VIS Global Infrastructure for periods prior to April 28, 2014.

† Per share amount is based on average shares outstanding.

++ Calculated based on the net asset value as of the last business day of the period. Performance does not reflect fees and expenses imposed by your insurance company’s separate account. If performance information included the effect of these additional charges, the total return would be lower.

\+ The Ratios of Expenses and Net Investment Income reflect the rebate of certain Portfolio expenses in connection with the investments in Morgan Stanley affiliates during the period. The effect of the rebate on the ratios is disclosed in the above table as “Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets.”

§ Amount is less than 0.005%.

Not Annualized.

* Annualized.

The accompanying notes are an integral part of the financial statements.

Financial Highlights

Global Infrastructure Portfolio

Selected Per Share Data and Ratios	Class II** Six Months Ended June 30, 2016 (unaudited)	Year Ended December 31, 2015	2014	2013	2012	2011
Net Asset Value, Beginning of Period	$ 7.05	$ 9.27	$ 9.60	$ 9.16	$ 8.69	$ 8.10
Income (Loss) from Investment Operations:						
Net Investment Income†	0.10	0.19	0.17	0.17	0.20	0.19
Net Realized and Unrealized Gain (Loss)	1.13	(1.34)	1.16	1.32	1.29	1.06
Total from Investment Operations	1.23	(1.15)	1.33	1.49	1.49	1.25
Distributions from and/or in Excess of:						
Net Investment Income	(0.16)	(0.14)	(0.22)	(0.24)	(0.20)	(0.20)
Net Realized Gain	(0.47)	(0.93)	(1.44)	(0.81)	(0.82)	(0.46)
Total Distributions	(0.63)	(1.07)	(1.66)	(1.05)	(1.02)	(0.66)
Net Asset Value, End of Period	$ 7.65	$ 7.05	$ 9.27	$ 9.60	$ 9.16	$ 8.69
Total Return ++	17.42%#	(13.88)%	15.28%	17.54%	18.44%	15.82%
Ratios and Supplemental Data:						
Net Assets, End of Period (Thousands)	$33,624	$23,427	$24,330	$14,511	$14,506	$14,472
Ratio of Expenses to Average Net Assets (1)	1.11%+*	1.12%+	1.12%+	1.15%+	1.12%+	1.11%+
Ratio of Net Investment Income to Average Net Assets (1)	2.79%+*	2.31%+	1.87%+	1.87%+	2.26%+	2.23%+
Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets	0.01%*	0.00%§	0.00%§	0.00%§	0.00%§	0.00%§
Portfolio Turnover Rate	28%#	50%	40%	25%	28%	36%
(1) Supplemental Information on the Ratios to Average Net Assets:						
Ratios Before Expense Limitation:						
Expenses to Average Net Assets	1.57%*	1.63%	1.59%	N/A	N/A	N/A
Net Investment Income to Average Net Assets	2.33%*	1.80%	1.40%	N/A	N/A	N/A

** On April 28, 2014, the Portfolio acquired substantially all of the assets and liabilities of the Morgan Stanley Select Dimensions Investment Series — Global Infrastructure Portfolio ("SD Global Infrastructure") and Morgan Stanley Variable Investment Series — Global Infrastructure Portfolio ("VIS Global Infrastructure"). The Portfolio adopted the financial and performance history of VIS Global Infrastructure. Therefore, the per share data and the ratios of Class II shares reflect the historical per share data of Class Y shares of VIS Global Infrastructure for periods prior to April 28, 2014.

† Per share amount is based on average shares outstanding.

++ Calculated based on the net asset value as of the last business day of the period. Performance does not reflect fees and expenses imposed by your insurance company's separate account. If performance information included the effect of these additional charges, the total return would be lower.

\+ The Ratios of Expenses and Net Investment Income reflect the rebate of certain Portfolio expenses in connection with the investments in Morgan Stanley affiliates during the period. The effect of the rebate on the ratios is disclosed in the above table as "Ratio of Rebate from Morgan Stanley Affiliates to Average Net Assets."

§ Amount is less than 0.005%.

\# Not Annualized.

* Annualized.

Notes to Financial Statements

The Universal Institutional Funds, Inc. (the "Fund") is registered under the Investment Company Act of 1940, as amended (the "Act"), as an open-end management investment company. The Fund is comprised of eleven separate active, diversified and non-diversified portfolios (individually referred to as a "Portfolio", collectively as the "Portfolios"). The Fund applies investment company accounting and reporting guidance.

The accompanying financial statements relate to the Global Infrastructure Portfolio. The Portfolio's adviser, Morgan Stanley Investment Management Inc. (the "Adviser") and sub-advisers, Morgan Stanley Investment Management Limited ("MSIM Limited") and Morgan Stanley Investment Management Company ("MSIM Company") (together, the "Sub-Advisers"), seek to provide both capital appreciation and current income. The Portfolio offers two classes of shares — Class I and Class II. Both classes of shares have identical voting rights (except that shareholders of a Class have exclusive voting rights regarding any matter relating solely to that Class of shares), dividend, liquidation and other rights.

The Fund is intended to be the funding vehicle for variable annuity contracts and variable life insurance policies offered by the separate accounts of certain life insurance companies.

A. Significant Accounting Policies: The following significant accounting policies are in conformity with U.S. generally accepted accounting principles ("GAAP"). Such policies are consistently followed by the Fund in the preparation of its financial statements. GAAP may require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results may differ from those estimates.

1. **Security Valuation:** (1) An equity portfolio security listed or traded on an exchange is valued at its latest reported sales price (or at the exchange official closing price if such exchange reports an official closing price), and if there were no sales on a given day and if there is no official exchange closing price for that day, the security is valued at the mean between the last reported bid and asked prices if such bid and asked prices are available on the relevant exchanges; (2) all other equity portfolio securities for which over-the-counter ("OTC") market quotations are readily available are valued at the latest reported sales price (or at the market official closing price if such market reports an official closing price), and if there was no trading in the security on a given day and if there is no official closing price from relevant markets for that day, the security is valued at the mean between the last reported bid and asked prices if such bid and asked prices are available on the relevant markets. Listed equity securities not traded on the valuation date with no reported bid and asked prices available on the exchange are valued at the mean between the current bid and asked prices obtained from one or more reputable brokers or dealers. An unlisted equity security that does not trade on the valuation date and for which bid and asked prices from the relevant markets are unvailable is valued at the mean between the current bid and asked prices obtained from one or more reputable brokers or dealers. In cases where a security is traded on more than one exchange, the security is valued on the exchange designated as the primary market; (3) when market quotations are not readily available, including circumstances under which the Adviser or Sub-Advisers determine that the closing price, last sale price or the mean between the last reported bid and asked prices are not reflective of a security's market value, portfolio securities are valued at their fair value as determined in good faith under procedures established by and under the general supervision of the Fund's Board of Directors (the "Directors"). Occasionally, developments affecting the closing prices of securities and other assets may occur between the times at which valuations of such securities are determined (that is, close of the foreign market on which the securities trade) and the close of business of the New York Stock Exchange ("NYSE"). If developments occur during such periods that are expected to materially affect the value of such securities, such valuations may be adjusted to reflect the estimated fair value of such securities as of the close of the NYSE, as determined in good faith by the Directors or by the Adviser using a pricing service and/or procedures approved by the Directors; (4) quotations of foreign portfolio securities, other assets and liabilities and forward contracts stated in foreign currency are translated into U.S. dollar equivalents at the prevailing market rates prior to the close of the NYSE; (5) investments in mutual funds, including the Morgan Stanley Institutional Liquidity Funds, are valued at the net asset value ("NAV") as of the close of each business day; and (6) short-term debt securities with remaining maturities of 60 days or less at the time of purchase may be valued at amortized cost, unless the Adviser determines such valuation does not reflect the securities' market value, in which case these securities will be valued at their fair market value determined by the Adviser.

The Directors have responsibility for determining in good faith the fair value of the investments, and the Directors may appoint others, such as the Fund's Adviser or a valuation committee, to assist the Directors in determining fair value and to make the actual calculations pursuant to the fair valuation methodologies previously

Notes to Financial Statements (cont'd)

approved by the Directors. Under procedures approved by the Directors, the Fund's Adviser has formed a Valuation Committee whose members are approved by the Directors. The Valuation Committee provides administration and oversight of the Fund's valuation policies and procedures, which are reviewed at least annually by the Directors. These procedures allow the Fund to utilize independent pricing services, quotations from securities and financial instrument dealers, and other market sources to determine fair value.

The Fund has procedures to determine the fair value of securities and other financial instruments for which market prices are not readily available. Under these procedures, the Valuation Committee convenes on a regular and ad hoc basis to review such securities and considers a number of factors, including valuation methodologies and significant unobservable valuation inputs, when arriving at fair value. The Valuation Committee may employ a market-based approach which may use related or comparable assets or liabilities, recent transactions, market multiples, book values, and other relevant information for the investment to determine the fair value of the investment. An income-based valuation approach may also be used in which the anticipated future cash flows of the investment are discounted to calculate fair value. Discounts may also be applied due to the nature or duration of any restrictions on the disposition of the investments. Due to the inherent uncertainty of valuations of such investments, the fair values may differ significantly from the values that would have been used had an active market existed. The Valuation Committee employs various methods for calibrating these valuation approaches including a regular review of valuation methodologies, key inputs and assumptions, transactional back-testing or disposition analysis, and reviews of any related market activity.

2. **Fair Value Measurement:** Financial Accounting Standards Board ("FASB") Accounting Standards Codification™ ("ASC") 820, "Fair Value Measurement" ("ASC 820"), defines fair value as the value that the Fund would receive to sell an investment or pay to transfer a liability in a timely transaction with an independent buyer in the principal market, or in the absence of a principal market the most advantageous market for the investment or liability. ASC 820 establishes a three-tier hierarchy to distinguish between (1) inputs that reflect the assumptions market participants would use in valuing an asset or liability developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in valuing an asset or liability developed based on the best information available in the circumstances (unobservable inputs) and to establish classification of fair value measurements for disclosure purposes. Various inputs are used in determining the value of the Fund's investments. The inputs are summarized in the three broad levels listed below.

- Level 1 – unadjusted quoted prices in active markets for identical investments
- Level 2 – other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 – significant unobservable inputs including the Fund's own assumptions in determining the fair value of investments. Factors considered in making this determination may include, but are not limited to, information obtained by contacting the issuer, analysts, or the appropriate stock exchange (for exchange-traded securities), analysis of the issuer's financial statements or other available documents and, if necessary, available information concerning other securities in similar circumstances

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities and the determination of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each security.

The following is a summary of the inputs used to value the Portfolio's investments as of June 30, 2016.

Investment Type	Level 1 Unadjusted quoted prices (000)	Level 2 Other significant observable inputs (000)	Level 3 Significant unobservable inputs (000)	Total (000)
Assets:				
Common Stocks				
Airports	$ —	$ 1,690	$—	$ 1,690
Communications	12,128	1,416	—	13,544
Diversified	181	5,385	—	5,566
Electricity Transmission & Distribution	5,575	3,959	—	9,534
Oil & Gas Storage & Transportation	31,105	1,288	—	32,393
PPA Contracted Renewables	3,548	3,651	—	7,199
Railroads	777	—	—	777
Toll Roads	147	8,879	—	9,026
Water	800	5,414	—	6,214
Total Common Stocks	**54,261**	**31,682**	**—**	**85,943**

Notes to Financial Statements (cont'd)

Investment Type	Level 1 Unadjusted quoted prices (000)	Level 2 Other significant observable inputs (000)	Level 3 Significant unobservable inputs (000)	Total (000)
Short-Term Investments				
Investment Companies	$ 8,499	$ —	$—	$ 8,499
Repurchase Agreements	—	831	—	831
Total Short-Term Investments	**8,499**	**831**	**—**	**9,330**
Total Assets	**$62,760**	**$32,513**	**$—**	**$95,273**

Transfers between investment levels may occur as the markets fluctuate and/or the availability of data used in an investment's valuation changes. The Portfolio recognizes transfers between the levels as of the end of the period. As of June 30, 2016, securities with a total value of approximately $147,000 transferred from Level 2 to Level 1. Securities that were valued using other significant observable inputs at December 31, 2015 were valued using unadjusted quoted prices at June 30, 2016. At June 30, 2016, the fair value of certain securities were adjusted due to developments which occurred between the time of the close of the foreign markets on which they trade and the close of business on the NYSE which resulted in their Level 2 classification.

3. **Repurchase Agreements:** The Portfolio may enter into repurchase agreements under which the Portfolio lends cash and takes possession of securities with an agreement that the counterparty will repurchase such securities. In connection with transactions in repurchase agreements, a bank as custodian for the Portfolio takes possession of the underlying securities which are held as collateral, with a market value at least equal to the amount of the repurchase transaction, including principal and accrued interest. To the extent that any repurchase transaction exceeds one business day, the value of the collateral is marked-to-market on a daily basis to determine that the value of the collateral does not decrease below the repurchase price plus accrued interest as earned. If such a decrease occurs, additional collateral will be requested and, when received, will be added to the account to maintain full collateralization. In the event of default on the obligation to repurchase, the Portfolio has the right to liquidate the collateral and apply the proceeds in satisfaction of the obligation. In the event of default or bankruptcy by the counterparty to the agreement, realization of the collateral proceeds may be subject to cost and delays. The Portfolio, along with other affiliated investment companies, may utilize a joint trading account for the purpose of entering into repurchase agreements.

4. **Foreign Currency Translation and Foreign Investments:** The books and records of the Portfolio are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars as follows:

— investments, other assets and liabilities at the prevailing rate of exchange on the valuation date;

— investment transactions and investment income at the prevailing rates of exchange on the dates of such transactions.

Although the net assets of the Portfolio are presented at the foreign exchange rates and market values at the close of the period, the Portfolio does not isolate that portion of the results of operations arising as a result of changes in the foreign exchange rates from the fluctuations arising from changes in the market prices of securities held at period end. Similarly, the Portfolio does not isolate the effect of changes in foreign exchange rates from the fluctuations arising from changes in the market prices of securities sold during the period. Accordingly, realized and unrealized foreign currency gains (losses) on investments in securities are included in the reported net realized and unrealized gains (losses) on investment transactions and balances. However, pursuant to U.S. Federal income tax regulations, gains and losses from certain foreign currency transactions and the foreign currency portion of gains and losses realized on sales and maturities of foreign denominated debt securities are treated as ordinary income for U.S. Federal income tax purposes.

Net realized gains (losses) on foreign currency transactions represent net foreign exchange gains (losses) from foreign currency forward exchange contracts, disposition of foreign currencies, currency gains (losses) realized between the trade and settlement dates on securities transactions, and the difference between the amount of investment income and foreign withholding taxes recorded on the Portfolio's books and the U.S. dollar equivalent amounts actually received or paid. Net unrealized currency gains (losses) from valuing foreign currency denominated assets and liabilities at period end exchange rates are reflected as a component of unrealized appreciation (depreciation) in the Statement of Assets and Liabilities. The change in unrealized currency gains (losses) on foreign currency translations for the period is reflected in the Statement of Operations.

Foreign security and currency transactions may involve certain considerations and risks not typically associated with those of U.S. dollar denominated transactions as a result of, among other factors, fluctuations of exchange rates in relation to the U.S. dollar, the possibility of lower

Notes to Financial Statements (cont'd)

levels of governmental supervision and regulation of foreign securities markets and the possibility of political or economic instability.

Governmental approval for foreign investments may be required in advance of making an investment under certain circumstances in some countries, and the extent of foreign investments in domestic companies may be subject to limitation in other countries. Foreign ownership limitations also may be imposed by the charters of individual companies to prevent, among other concerns, violations of foreign investment limitations. As a result, an additional class of shares (identified as "Foreign" in the Portfolio of Investments) may be created and offered for investment. The "local" and "foreign shares" market values may differ. In the absence of trading of the foreign shares in such markets, the Portfolio values the foreign shares at the closing exchange price of the local shares.

5. **Securities Lending:** The Portfolio lends securities to qualified financial institutions, such as broker-dealers, to earn additional income. Any increase or decrease in the fair value of the securities loaned that might occur and any interest earned or dividends declared on those securities during the term of the loan would remain in the Portfolio. The Portfolio would receive cash or securities as collateral in an amount equal to or exceeding 100% of the current fair value of the loaned securities. The collateral is marked-to-market daily by State Street Bank and Trust Company ("State Street"), the securities lending agent, to ensure that a minimum of 100% collateral coverage is maintained.

Based on pre-established guidelines, the securities lending agent invests any cash collateral that is received in an affiliated money market portfolio and repurchase agreements. Securities lending income is generated from the earnings on the invested collateral and borrowing fees, less any rebates owed to the borrowers and compensation to the lending agent, and is recorded as "Income from Securities Loaned — Net" in the Portfolio's Statement of Operations. Risks in securities lending transactions are that a borrower may not provide additional collateral when required or return the securities when due, and that the value of the short-term investments will be less than the amount of cash collateral plus any rebate that is required to be returned to the borrower.

The Portfolio has the right under the lending agreement to recover the securities from the borrower on demand.

The following table presents financial instruments that are subject to enforceable netting arrangements as of June 30, 2016.

	Gross Amounts Not Offset in the Statement of Assets and Liabilities		
Gross Asset Amounts Presented in Statement of Assets and Liabilities (000)	Financial Instrument (000)	Collateral Received (000)	Net Amount (not less than $0) (000)
$8,607(a)	$—	$8,607(b)(c)	$0

(a) Represents market value of loaned securities at period end.

(b) The Portfolio received cash collateral of approximately $4,285,000, which was subsequently invested in Repurchase Agreements and Morgan Stanley Institutional Liquidity Funds as reported in the Portfolio of Investments. In addition, the Portfolio received non-cash collateral of approximately $4,702,000 in the form of U.S. Government obligations, which the Portfolio cannot sell or repledge, and accordingly are not reflected in the Portfolio of Investments.

(c) The actual collateral received is greater than the amount shown here due to overcollateralization.

The Portfolio has adopted the disclosure provisions of FASB Accounting Standards Update No. 2014-11 ("ASU No. 2014-11"), "Transfers & Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures". ASU No. 2014-11 is intended to provide increased transparency about the types of collateral pledged in securities lending transactions and other similar transactions that are accounted for as secured borrowing.

The following table displays a breakdown of transactions accounted for as secured borrowings, the gross obligations by class of collateral pledged, and the remaining contractual maturity of those transactions as of June 30, 2016.

	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous (000)	<30 days (000)	Between 30 & 90 days (000)	>90 days (000)	Total (000)
Securities Lending Transactions					
Common Stocks	$ 4,285	$—	$—	$—	$ 4,285
Total Borrowings	**$4,285**	**$—**	**$—**	**$—**	**$4,285**
Gross amount of recognized liabilities for securities lending transactions					**$4,285**

6. **Indemnifications:** The Fund enters into contracts that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

7. **Security Transactions, Income and Expenses:** Security transactions are accounted for on the trade date (date the order to buy or sell is executed). Realized gains

Notes to Financial Statements (cont'd)

and losses on the sale of investment securities are determined on the specific identified cost method. Dividend income and other distributions are recorded on the ex-dividend date (except for certain foreign dividends which may be recorded as soon as the Portfolio is informed of such dividends) net of applicable withholding taxes. Interest income is recognized on the accrual basis except where collection is in doubt. Discounts are accreted and premiums are amortized over the life of the respective securities. Most expenses of the Fund can be directly attributed to a particular Portfolio. Expenses which cannot be directly attributed are apportioned among the Portfolios based upon relative net assets or other appropriate methods. Income, expenses (other than class specific expenses) and realized and unrealized gains or losses are allocated to each class of shares based upon their relative net assets.

The Portfolio owns shares of real estate investment trusts ("REITs"), which report information on the source of their distributions annually in the following calendar year. A portion of distributions received from REITs during the year is estimated to be a return of capital and is recorded as a reduction of their cost.

Settlement and registration of foreign securities transactions may be subject to significant risks not normally associated with investments in the United States. In certain markets, ownership of shares is defined according to entries in the issuer's share register. It is possible that a Portfolio holding these securities could lose its share registration through fraud, negligence or even mere oversight. In addition, shares being delivered for sales and cash being paid for purchases may be delivered before the exchange is complete. This may subject the Portfolio to further risk of loss in the event of a failure to complete the transaction by the counterparty.

8. **Dividends and Distributions to Shareholders:** Dividend income and distributions to shareholders are recorded on the ex-dividend date. Dividends from net investment income, if any, are declared and paid annually. Net realized capital gains, if any, are distributed at least annually.

B. Advisory/Sub-Advisory Fees: The Adviser, a wholly-owned subsidiary of Morgan Stanley, provides the Portfolio with advisory services under the terms of an Investment Advisory Agreement, paid quarterly, at an annual rate of 0.85% of the daily net assets of the Portfolio.

The Adviser has agreed to reduce its advisory fee and/or reimburse the Portfolio so that total annual portfolio operating expenses, excluding certain investment related expenses, taxes, interest and other extraordinary expenses (including litigation), will not exceed 0.87% for Class I shares and 1.12% for Class II shares. The fee waivers and/or expense reimbursements will continue for at least one year from the date of the Portfolio's prospectus or until such time as the Directors act to discontinue all or a portion of such waivers and/or reimbursements when they deem such action is appropriate. For the six months ended June 30, 2016, approximately $178,000 of advisory fees were waived pursuant to this arrangement.

The Adviser has entered into a Sub-Advisory Agreement with the Sub-Advisers, each a wholly-owned subsidiary of Morgan Stanley. The Sub-Advisers provide the Portfolio with advisory services subject to the overall supervision of the Adviser and the Fund's Officers and Directors. The Adviser pays the Sub-Advisers on a monthly basis a portion of the net advisory fees the Adviser receives from the Portfolio.

C. Administration Fees: The Adviser also serves as Administrator to the Fund and provides administrative services pursuant to an Administration Agreement for an annual fee, accrued daily and paid monthly, of 0.08% of the Portfolio's average daily net assets.

Under a Sub-Administration Agreement between the Administrator and State Street, State Street provides certain administrative services to the Fund. For such services, the Administrator pays State Street a portion of the fee the Administrator receives from the Portfolio.

D. Servicing Fees: The Fund accrues daily and pays quarterly a servicing fee of up to 0.17% of the average daily value of shares of the Portfolio held in an insurance company's account. Certain insurance companies have entered into a servicing agreement with the Fund to provide administrative and other contract-owner related services on behalf of the Portfolio.

E. Distribution Fees: Morgan Stanley Distribution, Inc. ("MSDI" or the "Distributor"), a wholly-owned subsidiary of the Adviser and Sub-Advisers and an indirect subsidiary of Morgan Stanley, serves as the Distributor of the Portfolio and provides the Portfolio's Class II shareholders with distribution services pursuant to a Distribution Plan (the "Plan") in accordance with Rule 12b-1 under the Act. Under the Plan, the Portfolio is authorized to pay the Distributor a distribution fee, which is accrued daily and paid monthly, at an annual rate of 0.25% of the Portfolio's average daily net assets attributable to Class II shares.

F. Dividend Disbursing and Transfer Agent: The Fund's dividend disbursing and transfer agent is Boston Financial Data Services, Inc. ("BFDS"). Pursuant to a Transfer Agency Agreement, the Fund pays BFDS a fee based on the

Notes to Financial Statements (cont'd)

number of classes, accounts and transactions relating to the Portfolios of the Fund.

G. Custodian Fees: State Street (the "Custodian") serves as Custodian for the Fund in accordance with a Custodian Agreement. The Custodian holds cash, securities, and other assets of the Fund as required by the Act. Custody fees are payable monthly based on assets held in custody, investment purchases and sales activity and account maintenance fees, plus reimbursement for certain out-of-pocket expenses.

H. Security Transactions and Transactions with Affiliates: For the six months ended June 30, 2016, purchases and sales of investment securities for the Portfolio, other than long-term U.S. Government securities and short-term investments, were approximately $22,329,000 and $21,618,000, respectively. There were no purchases and sales of long-term U.S. Government securities for the six months ended June 30, 2016.

The Portfolio invests in the Institutional Class of the Morgan Stanley Institutional Liquidity Funds (the "Liquidity Funds"), an open-end management investment company managed by the Adviser, both directly and as a portion of the securities held as collateral on loaned securities. Advisory fees paid by the Portfolio are reduced by an amount equal to its pro-rata share of the advisory and administration fees paid by the Portfolio due to its investment in the Liquidity Funds. For the six months ended June 30, 2016, advisory fees paid were reduced by approximately $2,000 relating to the Portfolio's investment in the Liquidity Funds.

A summary of the Portfolio's transactions in shares of the Liquidity Funds during the six months ended June 30, 2016 is as follows:

Value December 31, 2015 (000)	Purchases at Cost (000)	Sales (000)	Dividend Income (000)	Value June 30, 2016 (000)
$8,569	$18,753	$18,823	$3	$8,499

During the six months ended June 30, 2016, the Portfolio incurred less than $500 in brokerage commissions with Morgan Stanley & Co., LLC, an affiliate of the Adviser/Administrator, Sub-Advisers and Distributor, for portfolio transactions executed on behalf of the Portfolio.

The Portfolio is permitted to purchase and sell securities ("cross-trade") from and to other Morgan Stanley Funds as well as other funds and client accounts for which the Adviser or an affiliate of the Adviser serves as investment adviser, pursuant to procedures approved by the Directors in compliance with Rule 17a-7 under the Act (the "Rule"). Each cross-trade is executed at the current market price in compliance with provisions of the Rule. For the six months ended June 30, 2016, the Portfolio did not engage in any cross-trade transactions.

The Portfolio has an unfunded Deferred Compensation Plan (the "Compensation Plan"), which allows each independent Director to defer payment of all, or a portion, of the fees he or she receives for serving on the Board of Directors. Each eligible Director generally may elect to have the deferred amounts credited with a return equal to the total return on one or more of the Morgan Stanley funds that are offered as investment options under the Compensation Plan. Appreciation/depreciation and distributions received from these investments are recorded with an offsetting increase/decrease in the deferred compensation obligation and do not affect the NAV of the Portfolio.

I. Federal Income Taxes: It is the Portfolio's intention to continue to qualify as a regulated investment company and distribute all of its taxable and tax-exempt income. Accordingly, no provision for Federal income taxes is required in the financial statements.

The Portfolio may be subject to taxes imposed by countries in which it invests. Such taxes are generally based on income and/or capital gains earned or repatriated. Taxes are accrued based on net investment income, net realized gains and net unrealized appreciation as such income and/or gains are earned. Taxes may also be based on transactions in foreign currency and are accrued based on the value of investments denominated in such currency.

FASB ASC 740-10, "Income Taxes – Overall", sets forth a minimum threshold for financial statement recognition of the benefit of a tax position taken or expected to be taken in a tax return. Management has concluded that there are no significant uncertain tax positions that would require recognition in the financial statements. If applicable, the Portfolio recognizes interest accrued related to unrecognized tax benefits in "Interest Expense" and penalties in "Other Expenses" in the Statement of Operations. The Portfolio files tax returns with the U.S. Internal Revenue Service, New York and various states. Each of the tax years in the four-year period ended December 31, 2015, remains subject to examination by taxing authorities.

The tax character of distributions paid may differ from the character of distributions shown in the Statements of Changes in Net Assets due to short-term capital gains being treated as ordinary income for tax purposes. The tax character of distributions paid during fiscal years 2015 and 2014 was as follows:

2015 Distributions Paid From:		2014 Distributions Paid From:	
Ordinary Income (000)	Long-Term Capital Gain (000)	Ordinary Income (000)	Long-Term Capital Gain (000)
$2,030	$8,742	$2,137	$9,953

The amount and character of income and gains to be distributed are determined in accordance with income tax

Notes to Financial Statements (cont'd)

regulations which may differ from GAAP. These book/tax differences are either considered temporary or permanent in nature.

Temporary differences are attributable to differing book and tax treatments for the timing of the recognition of gains (losses) on certain investment transactions and the timing of the deductibility of certain expenses.

Permanent differences, primarily due to differing treatments of gains (losses) related to foreign currency transactions, resulted in the following reclassifications among the components of net assets at December 31, 2015:

Accumulated Undistributed Net Investment Income (000)	Accumulated Undistributed Net Realized Gain (000)	Paid-in-Capital (000)
$(25)	$25	$—

At December 31, 2014, the components of distributable earnings for the Portfolio on a tax basis were as follows:

Undistributed Ordinary Income (000)	Undistributed Long-Term Capital Gain (000)
$2,188	$4,858

J. Credit Facility: As of April 4, 2016, the Fund and other Morgan Stanley funds participate in a $150,000,000 committed, unsecured revolving line of credit facility (the "facility") with State Street. This facility is to be used for temporary emergency purposes or funding of shareholder redemption requests. The interest rate on borrowings is based on the federal funds rate or one month libor rate plus a spread. The facility also has a commitment fee of 0.25% per annum based on the unused portion of the facility. During the period ended June 30, 2016, the Fund did not have any borrowings under the facility.

K. Other: At June 30, 2016, the Portfolio had record owners of 10% or greater. Investment activities of these shareholders could have a material impact on the Portfolio. The aggregate percentage of such owners was 70.7%.

Investment Advisory Agreement Approval (unaudited)

Nature, Extent and Quality of Services

The Board reviewed and considered the nature and extent of the investment advisory services provided by the Adviser (as defined herein) under the advisory agreement, including portfolio management, investment research and equity and fixed income securities trading. The Board reviewed similar information and factors regarding the Sub-Advisers (as defined herein), to the extent applicable. The Board also reviewed and considered the nature and extent of the non-advisory, administrative services provided by the Adviser under the administration agreement, including accounting, operations, clerical, bookkeeping, compliance, business management and planning, legal services and the provision of supplies, office space and utilities at the Adviser's expense. The Board also considered the Adviser's investment in personnel and infrastructure that benefits the Portfolio. (The Adviser and Sub-Advisers together are referred to as the "Adviser" and the advisory, sub-advisory and administration agreements together are referred to as the "Management Agreement.") The Board also considered that the Adviser serves a variety of other investment advisory clients and has experience overseeing service providers. The Board also compared the nature of the services provided by the Adviser with similar services provided by non-affiliated advisers as reported to the Board by Broadridge Financial Solutions, Inc. ("Broadridge").

The Board reviewed and considered the qualifications of the portfolio managers, the senior administrative managers and other key personnel of the Adviser who provide the administrative and advisory services to the Portfolio. The Board determined that the Adviser's portfolio managers and key personnel are well qualified by education and/or training and experience to perform the services in an efficient and professional manner. The Board concluded that the nature and extent of the advisory and administrative services provided were necessary and appropriate for the conduct of the business and investment activities of the Portfolio and supported its decision to approve the Management Agreement.

Performance, Fees and Expenses of the Portfolio

The Board reviewed the performance, fees and expenses of the Portfolio compared to its peers, as determined by Broadridge, and to appropriate benchmarks where applicable. The Board discussed with the Adviser the performance goals and the actual results achieved in managing the Portfolio. When considering a fund's performance, the Board and the Adviser place emphasis on trends and longer-term returns (focusing on one-year, three-year and five-year performance, as of December 31, 2015, or since inception, as applicable). When a fund underperforms its benchmark and/or its peer group average, the Board and the Adviser discuss the causes of such underperformance and, where necessary, they discuss specific changes to investment strategy or investment personnel. The Board noted that the Portfolio's performance was better than its peer group average for the one- and three-year periods but below its peer group average for the five-year period. The Board discussed with the Adviser the level of the advisory and administration fees (together, the "management fee") for this Portfolio relative to comparable funds and/or other accounts advised by the Adviser and/or compared to its peers as determined by Broadridge. In addition to the management fee, the Board also reviewed the Portfolio's total expense ratio. The Board noted that the Portfolio's contractual management fee was higher than but close to its peer group average and the actual management fee and total expense ratio were lower than its peer group averages. After discussion, the Board concluded that the Portfolio's (i) performance was competitive with its peer group average; and (ii) management fee and total expense ratio were competitive with its peer group averages.

Economies of Scale

The Board considered the size and growth prospects of the Portfolio and how that relates to the Portfolio's total expense ratio and particularly the Portfolio's management fee rate, which does not include breakpoints. In conjunction with its review of the Adviser's profitability, the Board discussed with the Adviser how a change in assets can affect the efficiency or effectiveness of managing the Portfolio and whether the management fee level is appropriate relative to current and projected asset levels and/or whether the management fee structure reflects economies of scale as asset levels change. The Board has determined that its review of the actual and/or potential economies of scale of the Portfolio supports its decision to approve the Management Agreement.

Profitability of the Adviser and Affiliates

The Board considered information concerning the costs incurred and profits realized by the Adviser and its affiliates during the last year from their relationship with the Portfolio and during the last two years from their relationship with the Morgan Stanley

Investment Advisory Agreement Approval (unaudited) (cont'd)

Fund Complex and reviewed with the Adviser the cost allocation methodology used to determine the profitability of the Adviser and affiliates. The Board has determined that its review of the analysis of the Adviser's expenses and profitability supports its decision to approve the Management Agreement.

Other Benefits of the Relationship

The Board considered other direct and indirect benefits to the Adviser and/or its affiliates derived from their relationship with the Portfolio and other funds advised by the Adviser. These benefits may include, among other things, fees for trading, distribution and/or shareholder servicing and for transaction processing and reporting platforms used by securities lending agents, and research received by the Adviser generated from commission dollars spent on funds' portfolio trading. The Board reviewed with the Adviser these arrangements and the reasonableness of the Adviser's costs relative to the services performed. The Board has determined that its review of the other benefits received by the Adviser or its affiliates supports its decision to approve the Management Agreement.

Resources of the Adviser and Historical Relationship Between the Portfolio and the Adviser

The Board considered whether the Adviser is financially sound and has the resources necessary to perform its obligations under the Management Agreement. The Board also reviewed and considered the historical relationship between the Portfolio and the Adviser, including the organizational structure of the Adviser, the policies and procedures formulated and adopted by the Adviser for managing the Portfolio's operations and the Board's confidence in the competence and integrity of the senior managers and key personnel of the Adviser. The Board concluded that the Adviser has the financial resources necessary to fulfill its obligations under the Management Agreement and that it is beneficial for the Portfolio to continue its relationship with the Adviser.

Other Factors and Current Trends

The Board considered the controls and procedures adopted and implemented by the Adviser and monitored by the Fund's Chief Compliance Officer and concluded that the conduct of business by the Adviser indicates a good faith effort on its part to adhere to high ethical standards in the conduct of the Portfolio's business.

General Conclusion

After considering and weighing all of the above factors, with various written materials and verbal information presented by the Adviser, the Board concluded that it would be in the best interest of the Portfolio and its shareholders to approve renewal of the Management Agreement for another year. In reaching this conclusion the Board did not give particular weight to any single piece of information or factor referenced above. The Board considered these factors and information over the course of the year and in numerous meetings, some of which were in executive session with only the independent Board members and their counsel present. It is possible that individual Board members may have weighed these factors, and the information presented, differently in reaching their individual decisions to approve the Management Agreement.

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Director and Officer Information

Directors
Frank L. Bowman
Kathleen A. Dennis
Nancy C. Everett
Jakki L. Haussler
James F. Higgins
Dr. Manuel H. Johnson
Joseph J. Kearns
Michael F. Klein
Michael E. Nugent, *Chair of the Board*
W. Allen Reed
Fergus Reid

Officers
John H. Gernon
President and Principal Executive Officer
Stefanie V. Chang Yu
Chief Compliance Officer
Joseph C. Benedetti
Vice President
Mary E. Mullin
Secretary
Francis J. Smith
Treasurer and Principal Financial Officer

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Counsel to the Independent Directors
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Independent Registered Public Accounting Firm
Ernst & Young LLP
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Reporting to Shareholders

Each Morgan Stanley fund provides a complete schedule of portfolio holdings in its semi-annual and annual reports within 60 days of the end of the fund's second and fourth fiscal quarters. The semi-annual and annual reports are filed electronically with the Securities and Exchange Commission (SEC) on Form N-CSRS and Form N-CSR, respectively. Morgan Stanley also delivers the semi-annual and annual reports to fund shareholders and makes these reports available on its public website, www.morganstanley.com/im. Each Morgan Stanley fund also files a complete schedule of portfolio holdings with the SEC for the fund's first and third fiscal quarters on Form N-Q. Morgan Stanley does not deliver the reports for the first and third fiscal quarters to shareholders, nor are the reports posted to the Morgan Stanley public website. You may, however, obtain the Form N-Q filings (as well as the Form N-CSR and N-CSRS filings) by accessing the SEC's website, www.sec.gov. You may also review and copy them at the SEC's Public Reference Room in Washington, DC. Information on the operation of the SEC's Public Reference Room may be obtained by calling the SEC toll free at 1 (800) SEC-0330. You can also request copies of these materials, upon payment of a duplicating fee, by electronic request at the SEC's email address (publicinfo@sec.gov) or by writing the Public Reference Room of the SEC, Washington, DC 20549-0102.

Proxy Voting Policies and Procedures and Proxy Voting Record

You may obtain a copy of the Fund's Proxy Voting Policy and Procedures and information regarding how the Fund voted proxies relating to portfolio securities during the most recent twelve-month period ended June 30, without charge, upon request, by calling toll free 1 (800) 548-7786 or by visiting our website at www.morganstanley.com/im. This information is also available on the SEC's website at www.sec.gov.

This report is submitted for the general information of the shareholders of the Portfolio. For more detailed information about the Portfolio, its fees and expenses and other pertinent information, please read its Prospectus. The Fund's Statement of Additional Information contains additional information about the Portfolio, including its Directors. It is available, without charge, by calling 1 (800) 548-7786.

This report is not authorized for distribution to prospective investors in the Portfolio unless preceded or accompanied by an effective Prospectus. Read the Prospectus carefully before investing.

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