A Sub-Fund of Morgan Stanley Investment Funds

Global Asset Backed Securities Fund

MORTGAGE & SECURITIZED TEAM

Performance Review

In the three month period ending 30 June 2025, the Fund's Z shares returned 1.59% (net of fees)[1], while the benchmark returned 1.14%.

The Fund performed well in the second quarter on an absolute basis and relative basis, and no sectors posted negative returns. The Fund's credit-oriented positions, specifically global non-agency residential mortgage-backed securities (RMBS) and global non-agency commercial mortgage-backed securities (CMBS), performed the best due to both spread tightening and strong cash flow carry. The Fund's agency mortgage-backed securities (MBS) positions were the weakest performing sector for the quarter; however, the Fund's allocation to fixed-rate passthroughs outperformed the Bloomberg U.S. Mortgage-Backed Securities Index (the Index) due to pool selection and higher carry.

The Fund's relative duration positioning slightly detracted from relative performance as the Fund's duration remained shorter than that of the Index during the quarter.

Market Review

U.S. Treasury yields were mixed and the yield curve steepened materially during the period as soft inflation data pushed front-end rates down and inflationary concerns surrounding Trump administration tariffs pushed rates on the long-end upward. Interest rate cut expectations have fallen materially over the past few months as strong employment data continues surprise; the market is now pricing in two rate cuts for the entirety of 2025, down from four priced in at the beginning of the quarter, with the first cut to come in September. The Federal Reserve (Fed) left rates unchanged at 4.25% during the quarter and indicated that the path of future cuts would be largely data dependent and would likely need to wait until the impacts from the tariffs trickle through.

The Fed also continued letting its MBS holdings run off during the quarter, which declined $50 billion to $2.130 trillion.[2] The 2-year U.S. Treasury yield fell 16 basis points to 3.72% during the second quarter, while the 10-year U.S. Treasury yield rose 2 basis points to 4.23% and 30-year yields rose 20 basis points to 4.77%.[2] U.S. commercial banks increased their agency MBS holdings during the second quarter by approximately $14 billion to $2.682 trillion, but bank holdings are still down $314 billion since early 2022.[2] The 30-year mortgage rate rose 3 basis points during the quarter from 6.64% to 6.67%.[2] MBS current coupon nominal spreads widened 3 basis points during the quarter to 147 basis points above interpolated U.S. Treasurys.[2] The Index returned 1.14% during the quarter, outperforming U.S. Treasurys by 17 basis points on a duration-adjusted basis.[2] Agency MBS have outperformed Treasurys by 10 basis points year-to-date on a duration-adjusted basis.[2] The duration of the Index remained at 5.7 years, and the majority of the outstanding U.S. mortgage market remains "out-of-the-money" to refinance with new origination mortgage rates still at historically high levels.[2]

Agency MBS slightly underperformed most other fixed income sectors during the quarter as most other sector spreads tightened and agency MBS spreads widened slightly. Securitized credit spreads tightened during the second quarter in line with other fixed income credit sectors and also performed in line with these sectors.

Issuance in the second quarter was mixed; there was light issuance during April following the Liberation Day tariff announcement, but issuance picked up in May and June, and this supply was well absorbed.

Portfolio Activity

Our agency MBS held at 41% during the second quarter as this sector remains attractive from both a historical and relative value perspective. However, within agency MBS we trimmed our collateralized mortgage obligation (CMO) exposure from 7% to 5% and increased our 30-year pass-through exposure by 2% to 37% with the addition of 5.5% coupon pools and to-be-announced (TBAs) securities.

Over the quarter, our U.S. RMBS holdings were little changed at 20% as this sector remains our favorite, and our non-U.S. RMBS rose 2% to 20% as we sought to add European duration through adding to our Danish MBS allocation. Excluding the Danish MBS market, we continue to seek opportunities to exchange European securities for comparable U.S. securities as spreads are more attractive versus their European counterparts. Our U.S. CMBS held at 4%, and our European CMBS holdings held at 3%. Our U.S. ABS exposures fell 2% to 7% as we sold some solar panel exposure due to increased concerns surrounding this industry and the Trump administration's policies. Our non-U.S. ABS holdings rose slightly to 2%.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 June 2025.
[2] Source: Bloomberg L.P. Data as of 30 June 2025. One basis point = 0.01%

Strategy and Outlook

We expect U.S. agency MBS spreads to continue to tighten as we expect inflows from relative value investors and banks due to the attractive return profile of this sector versus other core fixed income sectors and cash alternatives; however, we don't think this spread tightening will occur until the Fed likely cuts interest rates in the second half of the year.

We expect credit securitized spreads to remain at current levels until we have more clarity about the economic impacts from tariff policies and agency MBS spreads tighten further.

We had reduced risk exposures over the first quarter, adding to our agency MBS positions and holding the highest-ever average credit quality. As spreads have tightened and volatility has eased, we are opportunistically looking for attractive relative value down the capital stack in sectors we feel confident about. This would allow us to rotate more exposure into securitized credit and reduce our U.S. agency MBS positioning due to the attractive relative value. As for duration, we continue to be on the longer end of the Fund's historical interest rate duration range as we expect the front end of the yield curve to fall with increased Fed rate cut expectations; we continue to maintain exposure to the front end and belly of the curve. We expect returns in the coming months to be driven primarily from cash flow carry as we enter the third quarter with higher yields, but could get an added tailwind from lower interest rates if the Fed cuts sooner if inflation prints run hot or the unemployment picture worsens.

We still believe that current interest rate levels remain stressful for many borrowers and will continue to erode household balance sheets, causing stress for some consumer ABS, particularly involving lower income borrowers. We think that household balance sheets are likely to be further stressed due to the inflationary impacts from the Trump administration's tariffs, and thus we are maintaining our underweight to consumer ABS. Commercial real estate also remains challenged by current financing rates and weaker occupancy levels – we remain underweight CMBS positioning relative to our historical holdings. Residential mortgage credit opportunities remain our favorite sector. Homeowner equity remains at historically high levels given home price appreciation over the past five years, and mortgage lending standards remain conservative. We continue to like agency MBS, as we believe the historically wide agency MBS spreads provided ample compensation for the increased rate volatility and prepayment risk. Agency MBS could also benefit from a flight-to-quality trade if economic concerns increase.

We continue to prefer U.S. securitized opportunities over U.K. and European securitized markets. U.S. spreads are currently meaningfully wider than comparable credit-profile European/U.K. opportunities.

While the risk of recession has increased, we do not believe a mild recession would have a material impact on our securities' performance. The securitized markets have largely been structured in the post-Global Financial Crisis (GFC) era using the GFC as a stress test, and thus should be able to withstand a recession relatively unscathed on a fundamental basis. We remain watchful of ongoing geopolitical risks as well as broader economic risks across the globe. Despite these risks, we remain excited about the Fund's return potential for 2025 as we enter the second half of the year with a high yield, historically high credit quality and the potential for additional return from lower interest rates.

Overall, we believe the securitized market offers a unique opportunity to achieve competitive returns with solid credit fundamentals. Although volatility has increased and credit conditions are weaker, we remain constructive on securitized credit conditions overall — specifically in the U.S. — with housing fundamentals continuing to be very healthy. As a result of these views, we have a meaningful U.S. residential credit overweight in the Fund, but we have increased our U.S. agency MBS position to its highest level in several years given the attractive yield/spreads that this government agency-guaranteed sector offers. We also like agency MBS due to the potential for a flight to quality and perhaps wider securitized credit spreads should economic conditions deteriorate.

For further information, please contact your Morgan Stanley Investment Management representative.

Fund Facts

Launch date	03 December 2012
Base currency	U.S. dollars
Benchmark	Bloomberg U.S. Mortgage Backed Securities (MBS) Index

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
Class Z Shares	4.19	5.40	8.18	-6.62	1.91	2.62	6.91	2.14	7.37	4.71	1.77
Bloomberg U.S. Mortgage Backed Securities (MBS) Index	4.23	1.20	5.05	-11.81	-1.04	3.87	6.35	0.99	2.47	1.67	1.51

All performance data is calculated NAV to NAV, net of fees, and does not take account of commissions and costs incurred on the issue and redemption of shares. The sources for all performance and index data is Morgan Stanley Investment Management ('MSIM Ltd'). **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class Z Risk and Reward Profile

- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.
- The value of bonds are likely to decrease if interest rates rise and vice versa.
- The value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the Sub-Fund.
- Issuers may not be able to repay their debts, if this happens the value of your investment will decrease. This risk is higher where the fund invests in a bond with a lower credit rating.
- The fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the fund to financial loss.
- Sustainability factors can pose risks to investments, for example: impact asset values, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the Fund will achieve its investment objectives.
- Investments may be in a variety of currencies and therefore changes in rates of exchange between currencies may cause the value of investments to decrease or increase. Furthermore, the value of investments may be adversely affected by fluctuations in exchange rates between the investor's reference currency and the base currency of the investments.

Please refer to the Prospectus for full risk disclosures, available at www.morganstanleyinvestmentfunds.com. All data as of 30.06.2025 and subject to change daily.

Charts and graphs provided herein are for illustrative purposes only and subject to change.

INDEX INFORMATION

The **Bloomberg U.S. Mortgage Backed Securities (MBS) Index:** tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

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