A Sub-Fund of Morgan Stanley Investment Funds

Global Fixed Income Opportunities Fund

BROAD MARKETS FIXED INCOME TEAM

Performance Review

In the one month period ending 28 February 2025, the Fund's Z shares returned 1.03% (net of fees)[1].

During the month, both macro decisions and the portfolio's positioning within spread sectors contributed to performance.

The portfolio's long duration exposure in the U.S. was the largest contributor to performance as U.S. yields fell over the month. The short duration position in Japan also contributed, as did the exposure to the euro area.

Long duration exposures in emerging markets also contributed.

Higher "risk-free" rates continued to benefit performance.

Within currency exposure, the long positions in yen and sterling contributed to performance.

Regarding the portfolio's positioning within spread sectors, the portfolio's long exposure to investment grade corporate bonds marginally detracted as spreads widened over the month. Strong security selection and a bias toward euro investment grade over U.S. investment grade benefited performance.

The exposure to high yield corporate bonds also detracted.

The portfolio's largest exposure, securitized credit, continued to add to performance. Particularly helpful were the exposures to commercial mortgage-backed securities (CMBS), asset-backed securities (ABS) and residential mortgage-backed securities (RMBS).

Portfolio Activity

Regarding macro positioning, the portfolio duration exposure was increased by 0.60 years, mainly by taking profit and closing the short exposure to Japan given the sell-off in Japanese government bonds and more expensive valuations.

The portfolio also increased the exposure to Mexico and Peru given attractive carry, and added exposure to the euro area. The portfolio closed the exposure to South Africa given increased volatility in the region.

Within currency positioning, the portfolio initiated a short Czech koruna vs. long Hungarian forint position (improving risk sentiment in Hungary and hawkish data surprises, while positioning has remained uncrowded), increased the long Japanese yen position by initiating short positions in Swedish krona (diversifying from short euro and central bank policy moving in the opposite direction) and South Korean won (the Bank of Korea could cut interest rates more given weakness in economy and tariff risk, as it trades at a high beta to China), trimmed the long Australian dollar vs. short Canadian dollar position to take profit, and reduced the long U.S. dollar position.

Within spread sectors, the portfolio continued to trim the exposure to investment grade corporates, mainly within some of the industrial and financial names trading at tight spreads.

Strategy and Outlook

Things are changing fast and remain fluid. Given the breadth and depth of changes, we could be witnessing an epochal event. Whether it is for better or worse we do not know, but the global landscape is shifting rapidly.

The scope of policy changes so far has been unprecedented. In little over a month since his inauguration, President Trump has unleashed a stream of directives on trade, foreign policy, immigration, government employment, taxes, social and environmental policy. Both the pace and direction of this torrent have been unparalleled in modern, post-World War II history. Notably, over the span of two days, President Trump announced the suspension of military aid to Ukraine, sided with Russia in a United Nations vote on resolutions on Ukraine and announced 25% tariffs on Canada and Mexico. This is provoking unprecedented responses from the rest of the world. The decision to suspend aid to Ukraine has triggered the biggest shift in German fiscal policy since reunification and an €800 billion defence spending package proposed by the European Commission. In a reference to former European Central Bank (ECB) President Draghi's comment during the 2012 sovereign debt crisis, prospective German Chancellor Merz vowed to do "whatever it takes" to defend Europe as he stiches together a coalition seeking to upend 50 years of German fiscal rectitude.

This is creating financial market volatility unseen outside of exogenous crises like COVID-19 or the 2008 Global Financial Crisis. For example, on 3 March, German equities had their best day since late 2022. The next day, 4 March, was their worst day since 2022. There are many more examples, but the bottom line is that when the most powerful country in the world decides to change/disrupt global trade, geopolitical alignments and fiscal policy all in one go, there will be fallout, which is what we are seeing in the markets today. Investors are faced with unprecedented uncertainty about the short- and long-run impacts to the U.S. and global economies, the global political structure, and asset prices.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 28 February 2025.

This means that the initial consensus post-inauguration that Trump's policies would reinforce "exceptional" U.S. economic performance has been upended. The assumption that an "S&P put" on his more aggressive policies would keep him in check does not seem to be playing out. His willingness to implement high tariffs seems based on two reasons: first, to raise revenue relatively costlessly (which is very debatable), and second, to remake global trade, reducing the large U.S. trade deficit as surplus economies (namely, China and the European Union) remain adamantly against boosting their economies. While markets were aware from Trump's first term and his 2024 campaign rhetoric that he liked tariffs as a policy tool — or at least as a threat to achieve other objectives — markets generally disbelieved that he would impose them to the extent announced so far, given the possible downside risks to U.S. growth and asset prices. Indeed, the risk of a major trade war along with relatively high tariffs and the administration's seemingly relentless drive to reduce the federal government's footprint has caused the U.S. economy to sputter and equities to fall in the first few months of the year. The U.S. economy's downshift in the first quarter — even before trade issues escalated — has led to legitimate questions about the economy's underlying health. Is the slowdown temporary, due to one-off events like wildfires, cold weather and rising imports seeking to front-run tariffs? Or, is it deeper and long-lasting, as weaker U.S. equities unnerve consumers, corporates postpone capital expenditure and U.S. fiscal policy tightens, at least in 2025? For now, we view the slowdown as temporary, barring a serious trade war.

Indeed, markets are now predicting three Federal Reserve (Fed) interest rate cuts this year and another cut in 2026, versus only one expected in 2025 as recently as January. U.S. bond yields have dutifully followed Fed rate expectations lower despite inflation showing no meaningful signs of slowing to the Fed's target and household inflation expectations ratcheting higher pre- and post-tariff announcements. With newfound worries about the robustness of the economy, the Fed is back in play — something we would not have said at the beginning of the year. That said, given the still negative inflation outlook and tariffs likely to worsen near-term economic performance, the Fed will likely only move if it sees a threat to growth and employment. If the unemployment rate rises again, breaching the Fed's previously stated undesirable 4.4% level, the Fed will likely cut rates. We are sceptical that the Fed will need to cut rates three times in 2025, but given the unusual position of the economy and outlook for policy, we cannot dismiss the possibility of a sooner-than-expected rate cut. The strong outperformance of U.S. dollar bonds in 2025 reflects market anxieties that Trump policies will be growth-destroying not growth-enhancing, at least for now, and that the "bad" policies will happen before the "good" stuff happens, e.g., more deregulation and tax cuts. Is it possible that Trump is frontloading the "bad" growth policies, to get the pain out of the way up front and set the stage for a strong rebound in the economy in 2026/2027?

Along these lines, we have conversely seen a reversal in the fortunes of bonds outside the U.S., which have underperformed U.S. Treasurys. Growth and fiscal policy expectations, particularly in Europe, have flipped relative to the U.S. The pressure exerted on Europe from subpar growth and, probably most importantly, the threat that Trump will withdraw security guarantees, has forced unprecedented change. The policy agenda from Europe and relative to the baseline just a month or two ago is now expected to be much easier fiscal policy and probably tighter (or at least less easy) monetary policy. The possibility of peace or the cessation of hostilities between Ukraine and Russia has also emboldened economic optimism, as rebuilding Ukraine and rapprochement with Russia would be perceived as a positive, at least to some degree. What this means is that the premium on exceptional U.S. economic performance is shrinking on both sides of the Atlantic. The outlook for European bonds is therefore murkier as bond markets will be asked to absorb hundreds of billions, if not trillions, of additional debt. Details about European fiscal policy — and importantly U.S. tariff policies and the extent of retaliation — won't be known for several months, and it remains possible that Trump could backtrack and ease the pressure if the pain is perceived to be too high. But this historic tilt toward European self-defence and its implications look like a train that cannot be stopped.

Given the uncertainties about these unprecedented policies and policy goals, it is difficult to predict the near-term impacts. The push/pull of Trump policies combined with Fed policy objectives appears to generate a somewhat stagflationary outcome with ambiguous implications for yields. The 10-year U.S. Treasury yield seems a bit too low, close to 4%, as definitive evidence of a slowdown big enough to elicit multiple Fed rate cuts is not yet evident. The key indicator will be the labour market — jobless claims, in particular. Any signs that consumers are pulling back as they grapple with uncertainty will undermine the "Goldilocks" (not too hot, not too cold) economy. Similarly, the massive underperformance of European bonds this year seems a bit premature given the information at hand and the likely volatility of Trump administration policies over time. But if recent trends continue, the direction of travel seems clear, meaning: the U.S. desire for a multipolar world with Europe responsible for its own defence; easier global fiscal policy; a revamped global trading system, with the U.S. less willing to be the consumer of last resort and using tariffs as the tool to achieve it; global supply chains revamped; and higher inflation than in the pre-pandemic years as populist policies are implemented worldwide. And, as expected, execution risks and the potential for unintended consequences during these transitions are likely to be high, generating more business cycle volatility than usual.

Credit markets do not like uncertainty and do not like weak/volatile equity markets. U.S. credit spreads have been widening under the tariff onslaught. We do not envision material widening absent greater economic underperformance, but spreads are not likely to regain their equilibrium until there is greater clarity on the macro outlook. Paradoxically, Trump's policies seem to have triggered a positive impact on European/non-U.S. equity markets while hurting U.S. stocks, through their impact on relative fiscal and trade policies. This change has helped euro investment grade bonds weather the storm better than U.S. investment grade. We have preferred euro investment grade credit over U.S. credit, and recent events do not change this preference. That said, the recent outperformance of euro credit has been large, and we are wary of chasing it given the recent volatility in markets and the tendency for mean reversion, i.e., markets overshooting then correcting. This backdrop requires being highly selective and actively managing rating, country and industry holdings to avoid the inevitable problems likely to arise in the next 12 months. We remain focused on avoiding companies and industries at risk (either from idiosyncratic underperformance, secular challenges or increased management aggressiveness) while building as much yield as is reasonable into the portfolio without jeopardizing returns from credit losses or spread widening. We still identify better opportunities in euro-denominated bonds of U.S. names and European banks, although we have been selectively reducing exposure to investment grade overall.

Securitized credit and U.S. agency mortgage-backed securities (MBS) have been less ruffled by recent volatility than other sectors and remain our favourite overweight. But even here, the recent streak of strong performance is diminishing its relative and absolute attractiveness. The recent rally in yields has reduced the outright attractiveness of fixed income, and the relative outperformance of this sector compared to corporate credit has marginally reduced its relative value. That said, securitized credit does not face the same issues as the U.S. corporate sector during this period of heightened economic uncertainty. New issues are frequently multiple times oversubscribed, making it difficult to accumulate large positions. Amid the current noise and uncertainty in the world, we believe this sector can continue to perform well. In the agency sector, higher coupon securities continue to be attractive compared to investment grade corporate bonds and other agency coupon structures, and we believe they are likely to outperform U.S. Treasury securities. More recently, given the rally in U.S. interest rates, European mortgage securities now offer better relative value. Selectivity remains key.

In currency markets, also somewhat paradoxically, the U.S. dollar has been weakening. The U.S. implementation of tariffs was supposed to be dollar-positive as it would encourage other countries to let their currencies depreciate to offset their effects. The opposite has tended to happen. Countries like China are digging in their heels and have resisted currency depreciation, looking for fiscal policy to offset tariff effects, while Europe, contrary to the naysayers, has now announced plans for historically unprecedented fiscal expansion. These policy mixes have, at least for now, undermined the dollar, as U.S. policy seems to be going in the other direction, i.e., tighter fiscal policy and easier monetary policy. How long this is likely to last is unknown and depends on policy implementation around the world.

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

Fund Facts

Launch date	07 November 2011
Base currency	U.S. dollars

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	1.97	5.34	8.55	-7.29	0.10	4.65	9.98	0.23	7.73	5.04	-0.70

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.
- Investment in Fixed Income Securities via the China Interbank Bond Market may also entail additional risks, such as counterparty and liquidity risk.
- 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 28.02.2025 and subject to change daily.

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