Morgan Stanley Investment Funds

Global Focus Property Fund

GLOBAL LISTED REAL ASSETS TEAM

Performance Review

In the three month period ending 30 September 2023, the Fund's I shares returned -4.63% (net of fees)[1], while the benchmark returned -6.82%.

Global real estate securities posted declines (FTSE EPRA Nareit Developed Extended Net Total Return Index, "the Index," -6.82%) for the quarter and underperformed the broader equity markets (MSCI World Net Index, -3.46%), as listed real estate continues to lag equity markets on a year-to-date basis. After gains in July, both global equities and bonds pulled back in August and September and posted negative returns for the quarter, as central banks maintained a "higher for longer" mindset on interest rates and the threat of a U.S. government shutdown weighed on markets. Further rattling markets, Saudi Arabia and Russia announced they would keep crude oil production cuts in place through 2023, which led to a surge in oil prices. The Fund outperformed the benchmark, returning -4.63% for the quarter (Class I shares net of fees).

In the U.S., the real estate investment trust (REIT) market declined as the threat of a government shutdown loomed and the Federal Reserve hinted at an additional interest rate hike before year-end. Within the Index, skilled nursing health care was the top-performing sector for the quarter as it benefited from positive regulatory news. The office sector outperformed for the quarter from very depressed levels, but it continues to underperform on a year-to-date basis amid anemic fundamentals and continued hybrid work pressures. The data center sector also outperformed, as it benefited from favorable secular demand trends driven by data growth and digital transformation combined with limited new supply growth. The towers sector was a key underperformer, due to the now well-flagged deterioration in leasing activity. The net lease sector was another key underperformer, as the spike in the U.S. 10-year Treasury yield negatively impacted the sector. The storage sector underperformed due to weakening demand versus 2022 levels, given slowing housing markets. The billboards sector also underperformed, as did apartments due to the softening rental market.

In the U.S., the Fund's overweight to data centers; security selection in data centers and the health care sector, particularly within seniors housing health care; security selection in apartments; and the sector underweight to towers were key relative contributors for the quarter. Security selection in Canada was also a top contributor for the quarter. These contributions were partially offset by the Fund's zero weight allocation to the office sector and underweight allocation to skilled nursing health care, both of which detracted from relative performance.

In Europe, real estate stocks had a strong quarter overall and outperformed the general European equity market, with July being a particularly positive month. German residential stocks had another strong quarter, making the segment the best performer in the European index, as the market became more comfortable with managements' ability to refinance upcoming debt maturities through disposals and new bond issuance. Swiss stocks, which are regarded as a relative safe haven during uncertain periods, performed well during the quarter as they benefited from the lowest "risk free" rates in the sector. Despite elevated government bond yields and macroeconomic concerns, Sweden had a positive quarter as the investment market showed some movement with troubled SBB's disposal of educational real estate assets to Brookfield.[2] Belgium was an area of underperformance, specifically in the health care and logistics subsectors. The U.K. also underperformed, responding to higher interest rates.

In Europe, the Fund's country overweights to Germany and Spain were top relative contributors; this was partially offset by the zero weight allocation to Switzerland and security selection in Sweden.

In Asia, markets continued to weaken due to negative sentiment from higher bond yields, the possibility of global rates staying higher for longer, and continued negative sentiment from mainland China. In the quarter, the Reserve Bank of Australia kept cash rates unchanged, but the Australian 10-year yield rose to its highest level since 2011. Similarly, the Bank of Japan kept monetary policy unchanged in the quarter, although 10-year Japanese government bond yields edged higher. In contrast, the People's Bank of China cut policy rates to support economic activity. Australia underperformed in the quarter, with Goodman Group a significant outperformer due to its enhanced push into data centers and the adoption of higher sustained development volumes and margins. Japan outperformed, led by developers and J-REIT (Japan REIT) hotels. Hong Kong underperformed in the quarter, due to higher interest rates and concerns on growth in mainland China. In Singapore, office REITs underperformed on softer economic data, weaker tenant demand and a softer rental outlook.

In Asia, the Fund's security selection in Japan and Australia were key contributors for the quarter; this was offset by security selection within and the overweight to Hong Kong, and adverse security selection in Singapore.

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[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 September 2023
[2] As of September 30, 2023, neither SBB nor Brookfield Asset Management were held in the Fund.

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Strategy and Outlook

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

Despite the challenging macro backdrop and tight credit conditions, forecasted returns for the asset class have improved in the intermediate term given the expected stabilization in interest rates across the globe. Moreover, we believe relative strength in cash flows can be expected given the unique nature of listed real estate. Specifically, the contracted rental streams with inflation-linked escalations and the necessity-based nature of real estate — the listed real estate market evolves and grows with the broader needs of society and the economy and sits at the epicenter of how people live, work, shop and communicate — coupled with limited new real estate supply additions may portend limited downside in cash flows, despite near-term macro weakness and uncertainty. Additionally, we believe the relative valuation of real estate securities is attractive, specifically when compared to direct property investment and the broader equities market, and is presenting an interesting pricing arbitrage opportunity for investors.

Within North America, secular trends that have been unfolding over the past several years and that were accelerated by COVID-19 will result in winners and losers for real estate.

- In retail, secular headwinds remain, given the continued expectation for growth in e-commerce and the focus on omnichannel distribution; however, COVID-19 has highlighted the importance of physical stores due to benefits from increased brand recognition and stronger insulation from supply chain issues, among others. Discretionary spending and consumer confidence are declining amid high inflation and could negatively impact store plans for discretionary retailers; we therefore favor the outlook for nondiscretionary, grocery and convenience-oriented retail landlords. While tenant bankruptcy watch lists are increasing, they remain manageable for the sector to navigate, and the pipeline of new tenants looking to enter high quality retail centers is surprisingly strong.
- Work-from-home (WFH) policies will likely be a permanent overhang on office demand, and related uncertainty regarding future office absorption is expected to remain an open question for several more years. Utilization rates remain stubbornly low versus 2019 levels. Meanwhile, office-using labor markets are moderating, with increased layoffs and hiring freezes expected to continue.
- In lodging, leisure demand is strong but beginning to see some moderation from record high levels. Business travel is likely secularly impaired, and increasing recession odds are a negative for corporate capital expenditure and lodging demand.
- In residential, affordability concerns regarding homeownership given rising mortgage rates and home price appreciation will likely lead to increasing rental demand for both traditional multi-family and single-family rentals. However, supply growth in multi-family is above the historical trend, particularly in Sunbelt markets, and increasing job layoffs could serve as a governor on new household formation and rent growth.
- In industrial, fundamentals remain robust, driven by the continued need to modernize logistics distribution, which has resulted in record-low vacancy and double-digit revenue growth for warehouses. While new market rent growth is moderating from historic highs, the embedded growth remains the highest within commercial real estate and is expected to fuel outsized growth for several years.
- In self-storage, fundamentals are moderating, most notably with declines in new market rents and a return to typical seasonality for the sector, after bucking those trends throughout the pandemic; despite moderation, cash flows are expected to remain strong, with below-average new supply and continued demand.
- In health care, the necessity-based nature of seniors housing demand is anticipated to insulate fundamentals from macro headwinds. Labor shortages and expense pressures are dissipating. The aging of the population, as evidenced by the growth in the 80+ age cohort, is expected to serve as a significant demand driver for seniors housing through the remainder of the decade, with a compound annual growth rate in that age cohort in excess of 4% through 2030.[3]
- In data centers, data growth facilitating the digital economy and new technologies, including artificial intelligence (AI), continues to provide a robust backdrop for new demand. New supply is more limited than in the past, given power availability challenges, which has resulted in a favorable environment for landlords to increase rents. These power availability challenges are anticipated to remain a critical issue going forward, and advancements in AI are proving to be an incremental demand driver to the sector.

Within Europe, we see many similar trends unfolding.

- In office, the WFH impact on the Continent is expected to be more modest than in the U.S. or U.K. Landlords on the Continent are reporting rising tenant demand, particularly for higher quality stock, supported by improving return-to-office levels. London office tenant demand is increasingly pointing to a bifurcated market, with "green," best-in-class space significantly outperforming.

[3] Source: U.S. Census Bureau.

- In retail, the Continent's traffic and retail sales are not far off pre-pandemic levels, although secular challenges remain. In the U.K., further deterioration in shopping center rents and values is anticipated, but there are signs of stabilization for retail parks. Given continued high inflation and recession fears, discretionary spending has deteriorated in both the U.K. and the Continent, and we favor the outlook for nondiscretionary and convenience-oriented retail landlords.
- Industrial demand remains robust, as logistics and supply chain remain front of mind and low vacancy continues to drive up rental growth.

Within Asia:

- In Japan, global capital continues to be attracted to Tokyo office assets. While Grade A office vacancy rates remain among the lowest globally, there will be moderate headwinds for the sector, with new supply, a slowing economy and hybrid working arrangements continuing to dominate. In Japan hotels, the reopening of international borders and government stimulus supporting domestic travel have led to improving sentiment toward the sector, and cash flows are expected to improve significantly. Japan residential is expected to benefit from increasing wage growth.
- In Australia office and residential, fundamentals are challenged. In Australia retail, while secular challenges remain, capital values appear to have bottomed, and cash flows and occupancies are recovering. Central business district retail is likely to be under pressure for some time due to the fall in international travel, as well as WFH policies that have led to fewer office workers visiting these retail establishments. Across the real estate spectrum, transaction volumes and pricing in Australia have begun to decline, and continued repricing of risk is expected.
- In China, fundamentals remain below trend. Uncertainty regarding government policies, balance sheet and solvency issues, and geopolitical relationships with Western countries remain front of mind and continue to warrant an elevated level of scrutiny.
- In Hong Kong, while geopolitical risks remain a concern, the lifting of COVID-19 restrictions and the potential for a strong return of travelers from mainland China are expected to be beneficial to demand for all forms of commercial and residential real estate. Specifically, pent-up demand for discretionary goods from mainland China is expected to be strong. Additionally, residential transaction volumes are expected to recover on stronger economic activity and the return of mainland Chinese buyers.

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

Fund Facts

Launch date	15 October 2021
Base currency	U.S. dollars
Benchmark	FTSE EPRA Nareit Developed Extended Net Total Return Index

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Class I Shares	-2.37	-27.24	--	--	--	--	--	--	--	--	--
FTSE EPRA Nareit Developed Extended Net Total Return Index	-6.79	-25.28	--	--	--	--	--	--	--	--	--

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 units. The sources for all performance and Index data is Morgan Stanley Investment Management. **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class I Risk and Reward Profile

The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- The fund is in this category because it invests in property company shares and the fund's simulated and/or realised return has experienced high rises and falls historically.
- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- There are additional risks associated with investing in real estate.
- 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.
- Investment in China A-Shares via Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs may also entail additional risks, such as risks linked to the ownership of shares.
- 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. All data as of 30 September 2023 and subject to change daily.

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INDEX INFORMATION

The **FTSE EPRA Nareit Developed Extended Net Total Return Index** is a market capitalization weighted index designed to represent general trends in eligible real estate stocks worldwide. Relevant real estate activities are defined as the ownership, trading and development of income-producing real estate. The FTSE EPRA Nareit Developed Extended Index represents the extension of real estate property sectors (e.g. Infrastructure and Timber) and additional securities beyond what is currently eligible for the FTSE EPRA Nareit Developed Index. The performance of the Index is listed in U.S. dollars and assumes reinvestment of dividends.

The **MSCI World Net Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

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