Morgan Stanley Investment Funds

US Dollar Corporate Bond Fund

BROAD MARKETS FIXED INCOME TEAM

Performance Review

In the one month period ending 31 October 2023, the Fund's Z shares returned -2.01% (net of fees)[1], while the benchmark returned -1.87%.

The performance can be attributed to the following factors.

The portfolio's overall investment grade credit positioning had a negative impact on performance as spreads widened in October.

The portfolio is positioned to be overweight financials and underweight industrials when measured in duration times spread terms.

Positions within investment grade financials were drivers of negative performance, due to the overweights to banking and brokerage.

Likewise, positions within investment grade industrials were also drivers of negative performance, predominantly due to the overweight to technology and consumer cyclical.

The overweight to investment grade utility had a negative impact on performance, specifically the overweight to electric.

High yield positions had a negative impact on performance.

Government-related positions had a small positive impact on performance.

The overweight in convertible bond positions also had a small negative impact on performance during the period.

Overall, duration positioning had a positive impact on performance, driven by the underweight to U.S. dollar rates, as yields rose across the curve.

Market Review

October was another challenging month for global fixed income assets as yields continued to rise (curves bear steepened with the long end rising faster than the short end), spreads widened, and the dollar strengthened. As war broke out in the Middle East, economic data remained resilient in the U.S. and inflation remained sticky across the globe, it was evident that rates were to remain higher for longer. Central banks made it increasingly clear they were close to the end of their hiking cycle, if not likely done; however, they also noted that rate cuts were unlikely to happen anytime soon. The 10-year interest rate rose 36 basis points (bps) in the U.S., 18 bps in Japan, 25 bps in New Zealand and 44 bps in Australia. Yields in the eurozone were more mixed, with parts of the curve shifting lower as data came in softer than expected. The European Central Bank also opted to stay on hold with the market interpreting the commentary as marginally dovish.

October saw credit market spreads widen, with single-name volatility increasing where third quarter results missed expectations. Market tone in the month was driven by several factors. Firstly, geopolitical risk increased as tensions in the Middle East rose. Secondly, strong economic data in the U.S. was supported by strong employment data, retail sales and gross domestic product (GDP), in contrast to Europe where GDP at -0.1% for the third quarter confirmed the weak purchasing manager's index (PMI) and IFO business sentiment signals. Thirdly, reporting for the third quarter was on aggregate ahead of expectations, but saw weakness in energy and chemicals relative to expectations and some downgrades to growth expectations. Finally, the higher interest rate, along with commodity/energy and equity volatility, led to the market demanding increased risk premium, driving credit spreads wider.

Over the month euro investment grade corporate spreads widened +7 bps to +160 bps (+7 bps year-to-date). U.S. investment grade corporate spreads underperformed as they widened +8 bps to +129 bps (+8 bps year-to-date), while sterling investment grade corporate spreads widened +7 bps to +169 bps (+7 bps year-to-date. Equities were lower in the period, and volatility was 4% higher (VIX closed at 18). Notable in the month was the underperformance of high yield relative to investment grade (BBB underperformed A rated) and financials versus industrials in U.S. dollar (unlike euro where financials performed in line, supported by low supply with banks funding in the U.S. dollar market).

Portfolio Activity

No significant changes to note.

Strategy and Outlook

Strategy

In the portfolio, we continue our overweight position to credit risk, as we remain constructive on credit from a fundamentals perspective. We therefore prefer to take this position through default risk (duration times spread) rather than general market beta (spread duration).

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 October 2023.

We remain biased towards financials over non-financials. Financials continue to present strong fundamentals and attractive valuations relative to non-financial credits. We remain underweight industrials on concerns over continued downward ratings migration into BBBs, increased merger and acquisition risk, shareholder-interest focused activity (dividends and buybacks), technological disruption and increasing idiosyncratic news. We thematically prefer regulated business models over unregulated (i.e., utilities) to hedge these risks. We also remain selective in off-benchmark holdings of securitized and convertible bonds.

In terms of interest rate risk, we are broadly neutral in duration terms versus the benchmark. We also continue to look for new issues to take advantage of new opportunities in the primary market.

Outlook

A key theme again in October was "steeper curves", as the back end came under pressure while the front end remained largely locked. While attributed to many things, the still resilient economy, the shift in central bank guidance, and an increase in term premium likely explain most of it. Going forward, despite the steep sell-off for long-end yields, it's unclear if the full extent of selling is done. Given the uncertainty, it is difficult to concretely express an outright view on interest rates; however, we continue to find steepeners attractive at certain parts of the curve as they would keep benefiting from further increases in term premium and/or a more typical bull steepening if the Fed pivots in the face of economic weakness. We remain more neutral on the U.S. dollar, preferring to focus on other attractive opportunities.

Our base case remains unchanged with credit expected to trade around current levels (having widened from the summer tights at the end of July), making carry an attractive return opportunity. We expect supply to rebound in November but disappoint relative to expectations in aggregate for the fourth quarter. Although we do see risks of pre-financing 2024 supply needs given the inverted yield curve meaning holding cash is not expensive for corporates, and economic uncertainty into the first quarter of 2024 argues for taking advantage of the market today while it remains open. Finally, there are several factors we are closely watching that could shift the narrative: remaining third quarter reporting, the potential for economic policy support in China and higher energy prices.

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

Fund Facts

Launch date	20 May 2016
Base currency	U.S. dollars
Benchmark	Bloomberg U.S. Corporate 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 Z Shares	-0.84	-16.08	-1.56	10.75	16.78	-3.63	6.33	--	--	--	--
Bloomberg U.S. Corporate Index	-1.86	-15.76	-1.04	9.89	14.54	-2.51	6.42	--	--	--	--

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 Z 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 fixed income securities and the fund's simulated and/or realised return has experienced medium 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:

- 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.
- 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 31 October 2023 and subject to change daily.

Applications for shares in the Fund should not be made without first consulting the current Prospectus and the Key Information Document ("KID") or Key Investor Information Document ("KIID"), which are available in English and in the official language of your local jurisdiction at morganstanleyinvestmentfunds.com or free of charge from the Registered Office of Morgan Stanley Investment Funds, European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

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INDEX INFORMATION

The **Bloomberg U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable, corporate bond market.

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The **Volatility Index (VIX)** is the ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. It represents one measure of the market's expectation of stock market volatility over the next 30-day period. The VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualized.

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