A Sub-Fund of Morgan Stanley Investment Funds

US Dollar Short Duration Bond Fund

BROAD MARKETS FIXED INCOME TEAM

Performance Review

In the one month period ending 31 May 2025, the Fund's Z shares returned 0.29% (net of fees)[1], while the benchmark returned 0.06%.

In May, the portfolio outperformed its benchmark. In a reversal of last month's trend, the portfolio's exposures to spread sectors, particularly investment grade financials and industrials, were the primary contributors to excess performance. Additionally, the portfolio's exposure to securitized credits such as non-agency residential mortgage-backed securities (RMBS), asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS) continued to contribute to excess performance.

Market Review

Risk assets continued their recovery throughout the month, driven by a de-escalation in the trade war between the U.S. and China coupled with generally subdued volatility throughout the period.

Developed market government bond yields were broadly higher over the month as a result of the general risk-on sentiment. Ten-year yields climbed by 24 basis points (bps) in the U.S., 18 bps in Japan, 21 bps in the U.K. and 6 bps in Germany.[2] Emerging market government bond yields exhibited mixed performance. Countries such as Hungary, Poland, South Korea and China saw their yields rise, while Thailand, Brazil, Mexico and notably South Africa experienced declines, with South Africa's yields dropping by an impressive 44 bps.[2] The U.S. dollar regained some stability and fell by a modest 0.1% versus a basket of other currencies over the month.[2]

Within spread sectors, U.S. investment grade spreads tightened by 18 bps, and euro investment grade spreads followed suit, tightening by 12 bps.[2] U.S. high yield spreads outperformed their European counterparts, with U.S. spreads tightening by 69 bps compared to 39 bps in Europe.[2] Securitized credit and agency mortgage securities spreads also narrowed throughout May.

Portfolio Activity

Over the month, the portfolio continued to slightly increase exposures to investment grade corporate bonds and to agency RMBS as we believe their yield and spread levels remain attractive. Meanwhile, we slightly reduced exposure to ABS and non-agency RMBS. Duration increased marginally over the month and remains short relative to the benchmark.

Strategy and Outlook

What a difference a month makes. By the end of May, investment grade credit spreads had fully retraced their post-Liberation Day sell-off, while high yield spreads tightened by 50 bps compared to 2 April—mirroring a more than 4% rise in equity markets over the same period.[2] Yields have edged slightly higher during this risk asset recovery. Despite ongoing trade policy uncertainty, the economy has shown resilience, though early signs of strain are emerging. While the outcome of tariffs remains unclear pending court rulings and trade negotiations, markets have taken comfort in the removal of worst-case scenarios. Attention now shifts to the One, Big, Beautiful Bill Act (OBBBA) and its implications for debt and deficits. The Congressional Budget Office (CBO) projects the OBBBA will add $3 trillion to the national debt—10% of gross domestic product (GDP)—over the next decade, with much of the impact front-loaded, pushing the deficit to 7% of GDP by 2026. Among G7 nations, only France approaches a similar deficit level. With the Federal Reserve (Fed) unwinding its balance sheet, foreign buyers largely absent from Treasury markets, and household savings below 5% of their income, the question looms: how will these deficits be financed without driving Treasury yields higher and negatively affecting other asset classes? Moody's downgrade of the U.S. credit rating to Aa1 from Aaa on 16 May underscores these concerns.

The future path of growth and inflation remains uncertain. The long-standing debate over whether tax cuts can pay for themselves by boosting growth has resurfaced with the OBBBA. While productivity is notoriously difficult to forecast, labour force growth—driven by demographic trends—is more predictable and points to a slowdown. These trends suggest a lower growth trajectory than the 2.4% annual average of the past decade.[2] The CBO forecasts just 1.8% annual growth over the next 10 years, with the Bureau of Labor Statistics offering a similar 1.9% estimate. Injecting stimulus into an economy already near full employment complicates the Fed's task, especially with core personal consumption expenditures (PCE) inflation still 0.5% above target. The Fed remains in a restrictive stance, with the fed funds rate nearly 200 basis points above core PCE. The U.S. Treasury yield curve remains inverted between 3-month and 7-year maturities. Market expectations for rate cuts have moderated from four to two since the Liberation Day tariff announcement; still one more than at the start of the year. This outlook may be optimistic unless inflation shows clearer signs of easing—which is unlikely in the near term as tariffs push goods prices higher.

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1 Source: Morgan Stanley Investment Management Limited. Data as of 31 May 2025.
2 Source: Bloomberg L.P. Data as of 31 May 2025.

Near-term growth prospects are clouded by policy uncertainty. Tariffs remain the primary concern, but the final form of the OBBBA and immigration policy also weigh heavily on sentiment. Consumer expectations have deteriorated sharply, with the University of Michigan survey hovering near lows last seen during the Global Financial Crisis and the 2022 inflation peak. The Institute for Supply Management (ISM) Services PMI has dipped below 50, and the winter rebound in the ISM Manufacturing PMI has faded in spring.[3] While employment has held steady, it remains the key variable to watch. If GDP growth slows by the expected 1.5% compared to 2023-24 levels, unemployment could easily rise to or exceed the consensus forecast of 4.4%. The median recession probability has climbed to 40%, up from 20% in February.[2] Overall, the economic environment remains stagflationary, leaving the Fed in a bind and keeping yields range-bound until data clearly break in one direction.

In contrast, the eurozone's monetary and fiscal outlook appears more straightforward. Fiscal sustainability is less of a concern—France being the notable exception—and several sovereigns have received ratings upgrades. Hopes for a major fiscal boost in Germany have tempered, as capital expenditure-related spending will take time to materialise, with economic impact not expected until late 2026. Inflation, including services, has been declining, and markets now anticipate inflation undershooting the European Central Bank's (ECB) target in the coming years. Tariffs are expected to dampen both growth and inflation in the eurozone, making it easier for markets to price in further ECB easing. This has led to 10-year German bunds outperforming 10-year U.S. Treasurys by 20 basis points in May.2 However, with the ECB already cutting rates in June and growth holding up better than expected, further cuts may be limited unless a negative shock materialises.

Japanese government bond (JGB) yields resumed their sell-off in May as Japan moved closer to a trade agreement with the U.S., reducing downside risks. The Bank of Japan surprised markets with a dovish tone, even as inflation continued to exceed expectations—strengthening the case for policy normalization. Long-dated JGBs faced significant pressure following weak auction results. Despite yields reaching levels previously considered attractive to domestic institutional investors, demand from this group has been notably absent, raising questions about future support for the long end of the curve.

Currency markets were once again dominated by the U.S. dollar. It initially rallied alongside recovering risk markets and easing tariff fears, but those gains faded by month-end as concerns over U.S. fiscal sustainability took centre stage. The U.S. trade deficit, fiscal deficit, and dollar valuation—already rich by conventional metrics—are deeply interconnected. A sharp move in any one of these could trigger disorderly adjustments in the others. While there is little evidence so far of non-U.S. investors reducing their U.S. asset exposure, any decline in foreign willingness to fund the U.S. trade deficit could have serious implications for the dollar and the broader economy.

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

Fund Facts

Launch date	22 April 2016
Base currency	U.S. dollars
Benchmark	ICE BofA 1-Year U.S. Treasury Note 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	1.91	5.57	5.90	-0.50	0.04	2.55	3.92	1.92	1.75	--	--
ICE BofA 1-Year U.S. Treasury Note Index	1.55	4.75	4.74	-1.02	-0.07	1.82	2.93	1.86	0.57	--	--

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.**

2 Source: Bloomberg L.P. Data as of 31 May 2025.
3 Source: Institute for Supply Management May 2025 Report on Business.

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.
- 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 31.05.2025 and subject to change daily.

Applications for shares in the Sub-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 language of countries authorized for fund distribution and is available online at Morgan Stanley Investment Funds Webpages or free of charge from the Registered Office at European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

The summary of investor rights is available in the aforementioned languages and website location under the General Literature section.

Information in relation to sustainability aspects of the Fund is available in English online at: Sustainable Finance Disclosure Regulation.

If the management company of the relevant Fund decides to terminate its arrangement for marketing that Fund in any EEA country where it is registered for sale, it will do so in accordance with the UCITS rules.

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