Morgan Stanley Investment Funds

US 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 -6.19% (net of fees)[1], while the benchmark returned -8.61%.

U.S. real estate securities posted declines (FTSE Nareit All Equity REITs Net Index, "the Index," -8.61%) and underperformed the broader equity market (S&P 500 Net Index, -3.39%) for the quarter, as listed real estate continues to lag equity markets on a year-to-date basis. The Fund outperformed the Index, returning -6.19% (Class I shares net of fees).

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.

The Fund's overweight allocation to data centers; security selection in the health care sector, particularly within seniors housing health care; security selection in apartments; and underweight allocation to towers were key relative contributors. These contributions were partially offset by the Fund's zero weight allocation to the office sector and underweight to hotels, both of which detracted from relative performance.

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 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.

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 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.

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[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 September 2023

- 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.[2]
- 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.

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

Fund Facts

Launch date	22 October 2021
Base currency	U.S. dollars
Benchmark	FTSE Nareit All Equity REITs Net 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	-1.51	-28.28	--	--	--	--	--	--	--	--	--
FTSE Nareit All Equity REITs Net Index	-6.49	-25.71	--	--	--	--	--	--	--	--	--

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 very 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.
- 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.

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

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INDEX INFORMATION

The **FTSE Nareit (National Association of Real Estate Investment Trusts) All Equity REITs Index** is a free float-adjusted market-capitalization-weighted index of tax qualified REITs listed on the New York Stock Exchange, NYSE Amex and the NASDAQ National Market Systems. 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 **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

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