

Morgan Stanley Institutional Fund

Core Plus Fixed Income Portfolio

BROAD MARKETS FIXED INCOME TEAM

Performance Review

In the quarter period ending September 30, 2023, the Portfolio's I shares returned -2.55% (net of fees)¹, while the benchmark returned -3.23%.

Market Review and Outlook

Risk assets sustained their rally in July as economic data continued to show its resiliency and the soft-landing rhetoric gained credibility. Corporate credit spreads were largely tighter over the month as the U.S. led the way in producing strong economic data with inflation data surprising to the downside. The Chinese government also announced it would continue to support its economy with further stimulus. Within the corporate credit space, high yield outperformed investment grade, with lower-rated securities outperforming. Euro area credits broadly outperformed their U.S. counterparts. Securitized credits also tightened, albeit less so than corporate credit. Within the macro space, markets saw multiple rate hikes within the developed markets throughout July. These hikes were mostly supplemented by dovish overtones from central bankers signaling that the end may be near for the rate hiking cycle. On the other hand, emerging markets continued to rally as emerging market (EM) central banks either cut rates or broadcasted that rate cuts are imminent. EM central banks led the way in terms of hiking rates, and so far, are leading the way in terms of cutting. The U.S. dollar was broadly lower over the month, depreciating against a basket of developed market and EM currencies.

August saw government yields broadly higher across the globe. The developed markets saw curves steepening with the long end rising more than the front end as the possibility of rate cuts was pushed further into the future and the idea of rates staying higher for longer gained credibility. Emerging market yields also sold off as the inflation picture has not reversed course as dramatically as previously expected. The investment grade credit market lost steam following the rally during the first few months of summer. With weaker-than-expected data coming out of Europe and China and central banks reemphasizing their data dependency, credit spreads in the asset class widened over the month. High yield was a different story, where lower-rated securities outperformed their higher-rated counterparts. This was mainly due to the strength of the U.S. economy and the historically low levels of defaults remaining largely subdued. The U.S. securitized credit market had a decent month relative to corporate credits as fundamentals in the asset class, particularly in the residential mortgage market, remained strong. Like what was seen in the high yield markets, given relatively low historic delinquency levels remaining subdued, the asset class grinded tighter over the month. The European market marginally widened as the economic picture in the region continued to deteriorate.

Yields continued to climb in September, mainly along the longer part of the yield curve. The Federal Reserve (Fed) held rates constant but reduced its expected cuts over the next two years, sending the long end of the curve higher. The other big story over the month was the strength of the U.S. dollar. With the economic resilience of the U.S. along with the "higher for longer" rhetoric, the U.S. dollar strengthened 2.5% versus a basket of other currencies. The euro, Japanese yen, British pound and Swiss franc all fell more than 2.5% versus the dollar and most EM currencies fell even more.² Credit spreads in the U.S. widened over the month, with high yield widening more than investment grade. Spreads in European credits tightened, albeit marginally. EM debt had a difficult month with yields continuing to rise and corporate and external spreads continuing to widen.

After modest underperformance in August, bond yields across the world rose dramatically in September. Is it real? Without a doubt! It actually happened and is likely to hang around for a while — and yes, it was driven by a startling increase in real yields. This might be good for longer-term investors, but may be a problem in the short run. In fact, U.S. Treasury 30-year yields were up close to 50 basis points (bps), with approximately 32 bps of that due to a rise in real yields as measured by the yield on the U.S. Treasury 30-year Treasury inflation-protected security (TIPS).² Moreover, several EM countries' yields were up over 60 bps.² Interestingly, sovereign bonds bore the brunt of the sell-off as investment grade spreads barely moved with only U.S. high yield and U.S. CMBS meaningfully underperforming government bonds. It also looked peculiar, at least initially, that government bond yields rose so much as the S&P 500 equity index fell almost 5%.²

While there was no specific event in September to blame for the sell-off, accumulating data over the summer weighed on markets. In a quite unusual move, yield curves bear steepened — i.e., long-end yields rose more than shorter-maturity yields and they rose

¹ Source: Morgan Stanley Investment Management. Data as of September 30, 2023. Performance for other share classes will vary.

² Source: Bloomberg L.P. Data as of September 30, 2023. One basis point = 0.01%

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despite the absence of negative inflation surprises. In other words, real yields and term premiums rose. In addition, inflation was well behaved, so inflation worries were not the cause of the vicious sell-off. A reasonable explanation for market volatility goes as follows: U.S. economic growth has been accelerating all year, which surprised analysts; the U.S. budget situation looks bad, sending more and more Treasuries into the market at the same time that the Fed is shrinking its balance sheet; and the Fed has been adamant that the inflation game has not been won, so markets should expect the Fed to keep rates unchanged (at the September Federal Open Market Committee meeting, the Fed eliminated several rate cuts from its 2024 forecasts). In other words, rates would be kept higher for longer; market positioning seems to be skewed toward long interest rate risk, making bonds vulnerable to disappointing news; and lastly, the coup de grace so to speak is that the U.S. yield curve has been highly inverted, making longer-maturity bonds less attractive than shorter-maturity bonds. Cash has been king! Add it all up, and you have a good cumulative narrative as to why longer-term yields rose. Importantly, while the velocity of the sell-off looks extreme, the end point — U.S. Treasury 10-year yield ending September at 4.57% — does not.

Why does this matter? The attractiveness of bonds depends on the reason why yields are high. If it's because real yields are high, that is good, as high real yields usually lead to good bond market performance. That certainly is partially what happened in September. But term premium seems to have risen as well and that is a measure of riskiness. So, if the primary reason yields rose was increased riskiness and they still offer lower yields than cash, then rising yields are not a reason to get bullish. We remain concerned that the rise in real yields/term premiums is likely to continue as long as two things transpire: 1) the yield curve remains inverted, making longer-maturity bonds less attractive; and 2) the U.S. economy cools. An accelerating economy is not conducive to lower yields; in fact, it is usually associated with higher yields.

Economic growth outside the U.S. has been much less impressive, with Europe and China flirting with recessionary conditions. However, that has not stopped European and EM bond yields from rising (China's yields have essentially not moved at all). If growth outside the U.S. had not been so weak, U.S. yields probably would have moved even higher. While non-U.S. bond markets have generally outperformed U.S. Treasuries, absolute yields have been driven higher by the surprising strength of the U.S. economy and the doggedness of the Fed in combating inflation with high rates. Therefore, although most central banks are likely finished hiking rates, we are not finished with the era of high rates, the maintenance of which remains critical to win the war against inflation. Although valuations have improved considerably, we are not yet ready to declare they have peaked and remain cautious in interest rate positioning in our portfolios. While growth fundamentals are worse outside the U.S. (except ironically for Japan possibly), we do not think non-U.S. developed markets government bonds are much more attractive than U.S. Treasuries. There is a reasonable probability that growth dynamics are in the process of bottoming in Europe and Asia, and will turn up next year at the very time the surge in real yields slows the U.S. economy. As such, we are fairly neutral on developed market government markets on a relative basis.

We believe selective EM bond markets look attractive, but that attractiveness has been undermined by the strong U.S. economy, hawkish Fed and rising yields. Selectivity remains the name of the game, and patience is necessary to realize value in many of these markets while the U.S. economy and U.S. dollar outperform.

One potential casualty of higher yields, wider credit spreads and softer equity prices is the economy, particularly the U.S. economy. Until September, the probability of a "soft landing" grew as falling inflation, stable unemployment and reasonable growth looked increasingly feasible. However, the rise in yields on the back of increased confidence the Fed would not be lowering rates as much and as soon as expected — resulting in a meaningful rise in real interest rates — increases the chance of a harder landing and possibly a recession. While it is far too early to assign this as the most likely scenario given what we currently know about economic activity, credit and equity markets have had to price in this higher probability, resulting in poor performance. We are also concerned about the ability of higher risk assets to outperform in an era of inverted yield curves and high cash rates. The solid fundamentals we have witnessed year-to-date (low default rates, more credit rating upgrades than downgrades, etc.) could easily begin to deteriorate over the months ahead. Therefore, we remain cautious about maintaining anything above a modestly long position in lower quality fixed income. Selectivity will remain of paramount importance. Avoiding defaults and blow-ups will eventually be key as higher rates and refinancing risks feed into corporate performance and outlooks. The high yields on offer will help blunt underperformance if fundamentals do deteriorate. As always, caveat emptor!

We continue to favor shorter-maturity securitized credit — residential mortgage-backed securities (RMBS), asset-backed securities (ABS), selected commercial mortgage-backed securities (CMBS) — as offering the best opportunities in fixed income. That said, the outlook has modestly deteriorated as household balance sheets come under more pressure and excess savings run down. We are trying to take advantage of higher yields on higher quality issuers to achieve our target returns, rather than venturing down the risk/rating spectrum. Our favorite category of securitized credit remains non-agency residential mortgages, despite challenging home affordability. Somewhat surprisingly, U.S. housing looks like it may have bottomed out, with prices rising once again.

Recent good news on the U.S. economy and the surge in yields have helped the dollar strengthen further. While the U.S. dollar looks vulnerable in the medium term, other developed market currencies do not offer compelling advantages at the moment. Negative

growth dynamics in Europe and China are undermining the attractiveness of these and other EM currencies. The most undervalued currency continues to be the Japanese yen, but given the slow-moving nature of Japanese monetary policy and still exceptionally high hedging costs, it will be difficult for the yen to rally until Japanese rates move higher or U.S. rates fall. We have moved to a neutral stance on the dollar versus both developed and emerging markets currencies as the differentiated economic performances in the U.S. and China undermine the ability of EM currencies to strengthen. Likewise, we have downgraded our views and exposures in EM local rates. Longer term, many EM bond markets look attractive, but for now the combination of stronger U.S. growth, weaker Chinese growth and a stronger U.S. dollar undermines their case.

Portfolio Strategy and Analysis

During the third quarter of 2023, the portfolio generated a negative return but outperformed the benchmark, driven primarily by the portfolio's securitized positioning. The portfolio's overweights to ABS and CMBS contributed to performance, as did the allocation to non-agency RMBS as spreads tightened and securitized assets outperformed. The positioning within the portfolio's agency RMBS exposure also contributed over the quarter. The high yield corporate bonds and convertible bonds exposure contributed as corporate spreads tightened over the period. Interest rate positioning detracted from relative performance, particularly in the U.S., Mexico and the Dominican Republic. Positioning in the euro area and the U.K. contributed marginally to performance, as did the portfolio's exposure to EM government-related debt.

During the quarter, we maintained our duration targets flat overall relative to the benchmark (Bloomberg U.S. Aggregate Index). Within emerging markets sovereign debt, the portfolio closed positions in Egypt and Saudi Arabia. In spread sectors, we slightly reduced the underweight to investment grade industrials and trimmed high yield corporate holdings. The portfolio also reduced its collateralized loan obligations (CLOs) and convertible bonds exposure to flat. We increased the agency mortgage-backed securities (MBS) underweight in the portfolio, particularly in 2.5% and 3% coupon 30-year MBS, and trimmed our exposure to non-agency CMBS.

We believe the Fund remains well positioned given its sector allocation, which creates a relative yield advantage. The Morgan Stanley Institutional Fund Trust (MSIFT) Core Plus Fixed Income Portfolio can invest beyond traditional high quality fixed income sectors to actively seek a diversified set of opportunities.³

Fund Facts

Inception Date	November 14, 1984
Minimum Initial Investment (\$)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Bloomberg U.S. Aggregate Index
Class I expense ratio	Gross 0.63 %
	Net 0.42 %
Class A expense ratio	Gross 0.89 %
	Net 0.77 %

Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Directors acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus.

³ Diversification neither assures a profit nor guarantees against loss in a declining market.

* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

Performance (%)

As of September 30, 2023	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	-2.24	-2.55	0.36	2.03	-4.35	0.61	2.83
Class A Shares at NAV	-2.26	-2.72	0.04	1.59	-4.69	0.26	2.47
Class A Shares (With Max 3.25% Sales Charge)	-5.48	-5.88	-3.24	-1.73	-5.73	-0.39	2.13
Bloomberg U.S. Aggregate Index	-2.54	-3.23	-1.21	0.64	-5.21	0.10	1.13

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month end performance figures, please visit morganstanley.com/im. Investment returns and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.

Returns are net of fees and assume the reinvestment of all dividends and income. They are compared to an unmanaged market index. Returns for less than one year are cumulative (not annualized). Performance for one year or more is based on average annual total returns. The returns are reported for Class I and A shares. Performance for other share classes will vary.

The fund has received proceeds related to certain non-recurring litigation settlements. If these monies were not received, any period returns which include these settlement monies would have been lower. These were one-time settlements, and as a result, the impact on the net asset value and consequently the performance will not likely be repeated in the future. Rankings for the fund were more favorable due to these settlements and ratings may also have been positively impacted. Please visit www.morganstanley.com/im for additional details.

RISK CONSIDERATIONS

There is no assurance that a Portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the Portfolio will decline and that the value of Portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this Portfolio. Please be aware that this Portfolio may be subject to certain additional risks. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (**credit risk**), changes in interest rates (**interest-rate risk**), the creditworthiness of the issuer and general market liquidity (**market risk**). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Mortgage- and asset-backed securities** are sensitive to early prepayment risk and a higher risk of default and may be hard to value and difficult to sell (liquidity risk). They are also subject to credit, market and interest rate risks. **Municipal securities** are subject to early redemption risk and sensitive to tax, legislative and political changes. **High yield securities ("junk bonds")** are lower rated securities that may have a higher degree of credit and liquidity risk. **Public bank loans** are subject to liquidity risk and the credit risks of lower rated securities. **Foreign securities** are subject to currency, political, economic and market risks. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed countries. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance.

They also may be subject to counterparty, liquidity, valuation, correlation and market risks. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). Certain **U.S. government securities** purchased by the Strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **Portfolio Turnover**. Consistent with its investment policies, the Fund will purchase and sell securities without regard to the effect on portfolio turnover. Higher portfolio turnover will cause the Fund to incur additional transaction costs.

INDEX INFORMATION

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.

The **Bloomberg U.S. Aggregate Index** tracks the performance of all U.S. government agency and Treasury securities, investment-grade corporate debt securities, agency mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities.

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