

Morgan Stanley Institutional Fund

Corporate Bond Portfolio

BROAD MARKETS FIXED INCOME TEAM

Performance

In the quarter period ending March 31, 2025, the Portfolio's I shares returned 2.32% (net of fees)¹, while the benchmark returned 2.31%.

The portfolio's overall investment grade credit positioning had a positive impact on performance. 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 because of the overweights to banking and brokerage. Similarly, the overweight to investment grade utility had a negative impact on performance because of the overweight to the electric sector. This negative performance was more than offset by the positions within investment grade industrials, which drove positive performance, because of the underweight to capital goods and consumer non-cyclical.

Elsewhere in the portfolio, the overweight to high yield credit had a negative impact on performance.

The broadly neutral duration positioning was the main driver of positive performance as a result of the U.S. Treasury yield curve steeper position between 10- and 30-years, as the curve steepened over the quarter.

Market Review

The first quarter of 2025 has been marked by significant volatility and uncertainty in financial markets, driven largely by the aggressive policy actions of the Trump administration. The administration's rapid and unprecedented policy directives on trade, foreign policy and fiscal matters have created a challenging environment for investors.

In January, the Trump administration began the year with a flurry of executive orders aimed at fulfilling campaign promises, focusing initially on immigration and government efficiency. Markets were initially relieved that tariffs were not immediately targeted, but this reprieve was short-lived. By the end of January, President Trump announced a 25% blanket tariff on all Mexican and Canadian goods, with additional tariffs on China. The announcement caught markets off guard, leading to increased volatility and uncertainty about the future direction of U.S. trade policy. Additionally, economic data continues to play a crucial role, and the divergence in economic conditions and central bank policies has become increasingly apparent, with the U.S. economy appearing to maintain a strong lead across the globe. There was positive news out of France on the last day of the month as France's 2025 budget cleared a key parliamentary hurdle. The budget plan will now advance to a vote in both chambers of the French legislature.

February saw significant volatility in financial markets, driven by the Trump administration's policy actions. President Trump's announcement of the suspension of military aid to Ukraine and the imposition of tariffs on Canada and Mexico led to unprecedented changes in German fiscal policy and a significant defense spending package by the European Commission. The U.S. economy showed signs of slowing down, with markets predicting multiple Federal Reserve (Fed) rate cuts in 2025. The outlook for European bonds became murkier as the U.S. exceptional economic performance premium began to shrink. In the German elections, the Christian Democratic Union (CDU) won the most seats, as projected, with Friedrich Merz becoming the next Chancellor. A grand coalition with the Social Democratic Party (SPD) seems like the most plausible government outcome. A blocking minority against the "debt brake" reform was avoided, meaning German fiscal rules are likely to be eased at some point in the next few months.

The late March/early April period marked a significant turning point for financial markets with the Trump administration's tariff announcement on April 2. As widely covered in the media, the magnitude was much worse than expected as President Trump increased prospective tariffs to rates that could surpass those last seen in the early 1900s. Even fairly hawkish analysts expected average U.S. tariff rates to increase to only 11% (up from 2024's 2%-3% level). Taking the tariff numbers at face value, the U.S. average tariff rate will rise to the mid-20% level, and could go higher if retaliation becomes widespread. China, as anticipated, has already retaliated, raising tariffs 34% on all U.S. imports and restricting exports of rare earth metals. Of course, the less bearish interpretation is that these measures are a gambit by the U.S. administration to negotiate tariffs down in return for easier access for U.S. goods and/or other favors.

¹ Source: Morgan Stanley Investment Management. Data as of March 31, 2025. Performance for other share classes will vary.

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In conclusion, the first quarter of 2025 has been characterized by significant policy-driven volatility and uncertainty. The aggressive actions of the Trump administration have created a challenging environment for investors, with the potential for further disruptions in the months ahead. Investors need to remain vigilant and selective in their investment strategies, focusing on sectors and assets that can weather the storm.

Portfolio Strategy and Analysis

Over the quarter, top-down risk was marginally increased (we retain a small overweight to credit, as measured by active duration times spread). Activity was focused on taking advantage of elevated primary supply to add credit beta, skewed towards investment grade financials, while rotating out of names that had reached our fair value estimates.

The portfolio's alpha sources remain financials (banks and brokerages) and it continues to hold small allocations to off-benchmark sectors such as securitized debt and high yield corporates.

Outlook

Looking forward, the tariffs as currently envisioned by the U.S. administration will likely be a significant blow to U.S. and global growth as well as seriously inflationary, at least for the U.S., potentially generating a stagflationary outcome. In response, a range of policy actions — including monetary and fiscal policy easing, retaliatory trade actions, negotiating down tariffs, and appeasement — are likely to follow. Unfortunately, regardless of policy response, given the level of deterioration in both risk sentiment and confidence in U.S. policymaking, a 2025 global recession appears much more probable.

To avert such a negative 2025 outcome, policies need to change quickly. This may be possible in Europe and Japan, and to a lesser extent in Asia, where fiscal policy can be eased aggressively — but not so much in the U.S. At current tariff levels, duties collected would be over 3% of gross domestic product (GDP).² The previous highest tariff revenue collected was 0.5% of GDP in the mid-1930s.² Why is it so much higher now? Globalization. Global trade is much bigger now than in the 1930s and imports are a much larger percentage of the economy. Indeed, U.S. imports top \$3 trillion per year.³ As a reminder, tariffs are a tax on U.S. consumers and corporations, and this would represent the largest tax increase since the 1960s. The implications of this fiscal contraction are ominous and would result in a draconian tightening of fiscal policy. Estimates suggest a GDP reduction of 1%-2% of GDP, which would take the economic growth rate to zero or below.³ The disposition of U.S. tariff revenue, ignoring the inflationary implications, will be critical to the U.S. economic outlook. Unfortunately, changes in fiscal policy are at the mercy of the U.S. Congress, which is stuck in a budget resolution process that will likely take until the end of summer to resolve. If tariff revenue was recycled back to the household and corporate sectors, the negative macroeconomic effects could be somewhat mitigated and reduce the probability of recession.

What about monetary policy? The inflation implications of the stated tariff structure are anticipated to put upward pressure on prices and complicate the Fed's job. Estimates for core consumer price index (CPI) run from 3.5% to 5% for 2025 and, as Chairman Powell said on April 4, the Fed needs to make sure the seemingly one-off price hikes do not feed permanently into inflation, reducing the Fed's ability to ease policy at least in the short term. Moreover, Institute for Supply Management (ISM) business surveys already show signs of incipient inflationary pressures at the corporate level with falling orders — evidence of stagflation already building. So, while it is reasonable to expect the Fed to cut interest rates if the economy weakens substantially, a more modest weakening will likely not catalyze a rate move. We expect the Fed to sit on the sidelines until more is known, which is unlikely before June at the earliest. Any rate cuts are likely to occur in the second half of the year.

This stagflationary dynamic looks worse in the U.S. than the rest of the world. The economic growth hit is global, but the inflationary impact is predominantly in the U.S. While U.S. growth could possibly be negative in the first and second quarters, inflation will likely be rising significantly. One indirect positive recent development is that energy prices have fallen substantially, which benefits U.S. consumers by cushioning some of the inflationary shock of tariffs.

The rest of the world will also experience a growth shock. But the EU, Japan and China are large economies with fiscal space to respond to economic weakness by deploying aggressive fiscal easing, especially in the EU, in the months ahead. And, even if easing is not deployed immediately, expectations of a policy shift are likely to bolster confidence at both the household and corporate levels, supporting growth.

The bottom line is that recession risk has risen everywhere. The good news is that global economic fundamentals were solid coming into this year. This should help cushion the shock. Indeed, the U.S. may avoid a recession, but danger signs abound. Retaliation poses a downside risk, as do further big drops in business sentiment and concomitant deterioration in labor markets. In addition to solid fundamentals, policy easing, potentially aggressively, in much of the world could also provide an offset. Unfortunately, the U.S., the epicenter of the shock, is in the least favorable position to handle the shock given the logjams on fiscal policy and the Fed frozen (at least for now) by the potential rise in inflation.

² Source: Minack Advisors, April 3, 2025.

³ Source: Deutsche Bank Research, April 2025.

Government bond yields have rallied as equities have fallen (performing their diversifying function).⁴ For many U.S. equity sectors, the drop from peak to current levels has been substantial, suggesting the end might be near if the bad news ends. This would also suggest the 3.75% level in the 10-year U.S. Treasury yield, near the 2024 low, will likely be hard to break unless we get more bad news (such as U.S. fiscal policy tightening, tariff escalation). We are modestly overweight interest rate risk and modestly overweight credit exposure, but keeping risk exposures low by historical standards.

Credit spreads, already beginning to widen in March, have followed equities' lead and are now underperforming at an accelerated pace. While continued pressure is likely given the tariff news, credit fundamentals were quite strong coming into the event, even if valuations were on the high side. While economies are slowing, the absence of private sector imbalances have made them well placed to absorb some of the shock. For example, the share of BBB- issuers in investment grade credit indexes is at a historical low. All-in yields on U.S. investment grade corporate bonds are still around 5%-5.5%, an attractive nominal and real yield as long as inflation returns, even if slowly, back to the recent level. Lastly, corporate behavior tends to become more conservative during tumultuous periods, which usually benefits creditors. This suggests that spreads may not widen to the widths we have seen in previous recessionary periods. At some point, with some differentiation among sectors, we expect corporate bonds to be a more attractive buy. Euro investment grade exposure is preferred at the margin, given the EU's greater flexibility on monetary and fiscal policy to respond to the tariff shock. The high yield market is more vulnerable, but we also do not anticipate a widening to usual recessionary levels. And, there is always the chance that, per most investors' expectations, the current proposed tariff rates will be negotiated down over the next few months. Nonetheless, damage has been done already and the outlook is less positive than before given the tremendous uncertainty created by the U.S. administration's economic agenda. Securitized credit does not face the same issues as the U.S. corporate sector during this period of heightened economic uncertainty. Amid the current noise and uncertainty in the world, we believe this sector can continue to perform well. In currency markets, we have become less convinced about the direction of currencies and prefer to sit on the sidelines during this transitional period.

Fund Facts

Inception Date	August 31, 1990
Minimum Initial Investment (\$)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Bloomberg U.S. Corporate Index
Class I expense ratio	Gross 0.95 %
	Net 0.65 %
Class A expense ratio	Gross 1.12 %
	Net 1.00 %

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, in effect as of the date of this commentary. For information on the applicable fund's current fees and expenses, please see the fund's current prospectus.

⁴ Diversification neither assures a profit nor guarantees against a 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 March 31, 2025

	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	-0.45	2.32	2.32	4.96	1.53	1.91	3.23
Class A Shares at NAV	-0.38	2.26	2.26	4.67	1.25	1.62	2.93
Class A Shares (With Max 3.25% Sales Charge)	-3.63	-1.06	-1.06	1.24	0.14	0.95	2.59
Bloomberg U.S. Corporate Index	-0.29	2.31	2.31	4.90	1.14	1.51	2.43

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. Please visit www.morganstanley.com/im for additional details.

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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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. **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. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk).

IMPORTANT INFORMATION

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Please consider the investment objective, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund. To obtain a prospectus (which includes the applicable fund's current fees and expenses, if different from those in effect as of the date of this commentary), download one at morganstanley.com/im or call

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