Morgan Stanley Institutional Fund

Mortgage Securities Trust

MORTGAGE & SECURITIZED TEAM

Performance Review

In the quarter period ending March 31, 2024, the Portfolio's I shares returned 0.51% (net of fees)[1], while the benchmark returned -1.04%.

The Fund (I shares net of fees) outperformed the Bloomberg U.S. Mortgage-Backed Securities (MBS) Index (the "Index") by 155 basis points in the quarter.[2]

The Fund had no sectors that underperformed the Index for the quarter. The only sector that posted a slight absolute negative return was the agency MBS allocation; however, this allocation far outperformed the Index due to the Fund's overweight to higher-coupon MBS, which outperformed lower-coupon MBS due to their shorter duration.

The largest drivers of outperformance were the Fund's exposures to global commercial mortgage-backed securities (CMBS) and global asset-backed securities (ABS) given that securitized credit spreads tightened and that most of these assets are floating-rate or short duration in nature, meaning they were less negatively impacted by the rise in interest rates. U.S. non-agency residential mortgage-backed securities (RMBS) also performed well due to their strong cash flow carry.

The Fund's duration positioning was an absolute detractor from performance given the rise in rates, but contributed slightly to relative outperformance versus the Index given that the Fund maintained a shorter duration position for the period.

Market Review

U.S. interest rates rose and the yield curve bear flattened during the first quarter as inflation remained high and strong economic data led the Federal Reserve (Fed) to signal that it will likely wait longer to cut interest rates, and market expectations for rate cuts fell from 150 basis points to 75 basis points for 2024. The Fed kept rates unchanged at 5.25% during the quarter and indicated cuts in the remainder of 2024 would be largely data dependent.[3] The Fed also continued letting its MBS holdings run off during the quarter, declining $43 billion to $2.380 trillion by quarter-end.[3] Two-year U.S. Treasury rates rose 37 basis points to 4.62% during the first quarter, and the 10-year U.S. Treasury rate rose 32 basis points to 4.20%.[4] U.S. commercial banks' agency MBS holdings increased during the first quarter by approximately $22 billion to $2.540 trillion, but bank holdings are still down $460 billion from early 2022.[4] We expect both the Fed's and U.S. banks' MBS holdings to decline through the remainder of 2024. Declining savings rates have reduced bank deposits, and higher short-term rates have increased funding costs for banks and reduced net interest margins on MBS. The 30-year mortgage rate rose 18 basis points during the quarter from 6.61% to 6.79%.[4] MBS current coupon nominal spreads were unchanged during the quarter at 139 basis points above interpolated U.S Treasurys. The Index returned -1.04% during the quarter, underperforming U.S. Treasurys by 13 basis points on a duration-adjusted basis.[4] Agency MBS underperformed Treasurys by 76 basis points for all of 2023 on a duration-adjusted basis. The duration of the Index lengthened by 0.1 years during the first quarter to 5.7 years, and the majority of the outstanding U.S. mortgage market remains "out-of-the-money" to refinance with new origination mortgage rates still at historically high levels.[4]

Despite spread tightening in March, agency MBS still look attractive, both from a historical perspective and relative to other asset classes. Agency MBS supply-demand dynamics have improved as the Fed continues to let its agency MBS holdings run off, but U.S. banks and foreign entities have increased their holdings recently. New MBS supply remains low as mortgage origination has been very slow due to higher mortgage rates, but MBS demand also is also expected to be weak. We expect U.S. home prices to remain relatively stable, as the difficult affordability is counterbalanced by the lack of housing supply. We expect mortgage rates to decline slightly, but not sufficiently enough to meaningfully impact affordability.

Securitized credit spreads tightened in the first quarter of 2024, but yields still remain very attractive, both from a relative value and historical perspective. Fundamental credit conditions have deteriorated with high inflation (although real wages have now turned

1 Source: Morgan Stanley Investment Management. Data as of March 31, 2024. Performance for other share classes will vary.
2 One basis point = 0.01%
3 Source: Federal Reserve
4 Source: Bloomberg L.P. Data as of March 31, 2024.

positive) and higher debt costs eroding consumer balance sheets, but we still believe that high quality RMBS, CMBS and ABS remain well protected from a structural perspective, even under more stressful conditions.

Portfolio Activity

We decreased our agency MBS passthrough exposure by 1% to 30% during the first quarter as spreads tightened materially in March and we took this opportunity to trim back some of our agency MBS passthrough positions. We increased our agency collateralized mortgage obligation (CMO) positioning by 2% to 9% during the quarter as we continue to favor agency CMOs versus agency passthrough MBS, as they offer higher yields.

Over the period, our U.S. RMBS holdings held at 39%, as this continues to be our favorite sector and we continue to seek to add exposure and replace runoff. Our non-U.S. RMBS holdings fell 1% to 5% as we continue to favor U.S. securitized credit opportunities over their European counterparts. Our U.S. CMBS holdings fell 2% to 6% as we remain cautious of CMBS overall. Our U.S. ABS exposures held at 10%, and our non-U.S. ABS holdings fell by 1% to 2%.

Strategy and Outlook

After several months of spread tightening across securitized products, we expect spreads to stabilize at current levels in the second quarter as securitized credit spreads are approaching agency MBS spread levels given the differentiated performance over the past several months. Overall demand levels remain strong, but we believe it will be challenging to push spreads much tighter from current levels. Securitized credit sectors have been among the best performing sectors in 2024, but we believe performance should normalize in the coming months. We also believe that rates will likely remain range-bound for much of 2024, and that returns will result primarily from cash flow carry in the coming months. We still believe that current interest rate levels remain stressful for many borrowers and will continue to erode household balance sheets, causing stress for some consumer ABS, particularly involving lower income borrowers. Commercial real estate also remains challenged by current financing rates, and some sectors may see declines in operating revenue in 2024. Residential mortgage credit opportunities remain our favorite sector currently, and it is the one sector where we remain comfortable investing lower down the credit spectrum, as we remain more cautious regarding lower-rated ABS and CMBS.

We continue to have a neutral view on agency MBS valuations, which are more expensive than 2023 levels, but remain cheap from a longer-term historical perspective. Despite the tightening of MBS spreads in March, they still remain attractive versus investment grade corporate spreads and versus historical agency MBS spreads. But we believe that further agency MBS spread tightening is less likely in the near term.

We remain most constructive on RMBS and residential-related investments. Most homeowners have locked in 30-year fixed-rate mortgages at substantially lower mortgage rates and have not faced payment shocks from higher rates. Additionally, the substantial home price appreciation over the past few years has meaningfully increased homeowner equity – in fact, homeowner equity is at the highest level in more than 40 years.[4] Lastly, residential mortgage lending standards have remained very conservative in the post-financial crisis era, and mortgage credit performance continues to be pristine with very minimal delinquencies and defaults.

We remain much more cautious on commercial real estate exposure, especially in the office sector. Higher financing costs have stressed all commercial real estate sectors, but sectors such as hotels, multi-family housing and retail shopping centers have seen healthy revenue growth to help offset the higher financing costs. The office sector has felt the brunt of both declining revenue and higher financing costs.

We also remain cautious on consumer ABS, as inflation, higher rates and declining government stimulus have begun to strain consumer balance sheets, especially for lower-income borrowers. The savings surplus built up during the pandemic has now been depleted, and we expect more consumer stress for the remainder of 2024. We are more constructive on business-related ABS, such as aircraft leases, mortgage-servicing rights and small business loans.

We believe that central banks are now at the end of their hiking cycles, and that rates have seen their peak levels and will likely decline through the remainder of 2024. Much of the projected rate decline has now been priced into the market with the rally in rates during the fourth quarter, but we still expect the forward path for rates will likely be lower from current levels.

We continue to prefer U.S. securitized opportunities over U.K. and European securitized markets. U.S. spreads are currently wider than comparable credit-profile European/U.K. opportunities, yet we believe the U.S. credit landscape is more favorable. European inflation has been slower to recede, and economic growth looks to be weaker in Europe. Geopolitical risks also remain higher in Europe.

Our base forecast is for a mild recession, which we do not believe would have a material impact on our securities' performance, but we also believe our securities could handle a severe recession given that they were designed with the Global Financial Crisis as a

[4] Source: Bloomberg L.P. Data as of March 31, 2024.

stress test. We remain watchful of ongoing geopolitical risks as well as broader economic risks across the globe. Despite these risks, we remain excited about the Fund's return potential for the remainder of 2024.

Overall, we believe the securitized market offers a unique opportunity to achieve competitive returns with solid credit fundamentals. Although volatility has increased and credit conditions are weaker, we remain constructive on securitized credit conditions overall — specifically in the U.S. — with the U.S. economy remaining strong and housing and consumer credit conditions continuing to be relatively healthy. As a result of these views, we have a meaningful credit overweight in the Fund, but we have increased our U.S. agency MBS position to its highest level in several years (39%) given our concerns of deteriorating economic conditions.

Fund Facts

Inception Date	July 28, 1997
Minimum Initial Investment ($)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Bloomberg U.S. Mortgage Backed Securities (MBS) Index
Class I expense ratio	**Gross 0.91 %**
	Net 0.70 %
Class A expense ratio	**Gross 1.20 %**
	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.

Performance (%)

As of March 31, 2024	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	1.12	0.51	0.51	5.48	0.47	1.85	3.27
Class A Shares at NAV	1.07	0.29	0.29	4.90	0.03	1.43	2.86
Class A Shares (With Max 3.25% Sales Charge)	-2.27	-2.97	-2.97	1.47	-1.07	0.75	2.52
Bloomberg U.S. Mortgage Backed Securities (MBS) Index	1.06	-1.04	-1.04	1.39	-2.84	-0.39	1.12

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. Mortgage Backed Securities (MBS) Index:** tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

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fees or sales charges. It is not possible to invest directly in an Index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor.

RISK CONSIDERATIONS

There is no assurance that a mutual fund will achieve its investment objective. Funds are subject to market risk, which is the possibility that the market values of securities owned by the fund will decline and that the value of fund 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 fund. Please be aware that this fund 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. 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. **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. **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. Due to the possibility that prepayments will alter the cash flows on **Collateralized mortgage obligations (CMOs)** ,it is not possible to determine in advance their final maturity date or average life. In addition, if the collateral securing the CMOs or any third party guarantees are insufficient to make payments, the strategy could sustain a loss. **High yield securities ("junk bonds")** are lower rated securities that may have a higher degree of credit and liquidity risk. **Foreign securities** are subject to currency, political, economic and market risks. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **Inverse floaters** are sensitive to early prepayment risk and interest rate changes and are more volatile than most other fixed-income securities. **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. **LIBOR Discontinuance or Unavailability Risk.** The regulatory authority that oversees financial services firms and financial markets in the U.K. has announced that, after the end of 2021, it would no longer persuade or compel contributing banks to make rate submissions for purposes of determining the LIBOR rate. As a result, it is possible that commencing in 2022 , LIBOR may no longer be available or no longer deemed an appropriate reference rate upon which to determine the interest rate on or impacting certain derivatives and other instruments or investments comprising some of the Fund's portfolio.

IMPORTANT INFORMATION

The views and opinions and/or analysis expressed are those of the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

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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, download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

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