A Sub-Fund of Morgan Stanley Investment Funds

European High Yield Bond

HIGH YIELD TEAM

Performance Review

In the one month period ending 31 January 2025, the Fund's I shares returned 0.71% (net of fees)[1], while the benchmark returned 0.64%.

Health care and telecommunications were two of the Fund's top-performing sectors relative to the benchmark in January. Security selection was the primary driver in health care, with an overweight to a French laboratory testing business the biggest positive contributor. A softening of the regulatory environment provided a tailwind for the bonds, with the Fund's holdings in the name returning more than 10% during the month. In telecommunications, an underweight to a European satellite provider added value as bonds fell on news that StarLink (a U.S. competitor) had won some large contracts in Europe.

Homebuilders & real estate and energy were two of the Fund's worst-performing sectors relative to the benchmark in January. In homebuilders & real estate, an underweight to a health care real estate investment trust (REIT) was the biggest detractor as the company completed a more favourable-than-expected refinancing transaction. In energy, an underweight to a rebounding Ukrainian issuer detracted the most value.

From a credit quality perspective, an underweight to BB-rated bonds and security selection in CCC-rated bonds added value, while selection in B-rated bonds detracted. Selection in euro-denominated bonds helped, while selection in sterling-denominated bonds marginally detracted.

Geographically, selection in French and Swiss issuers added value, while selection in the U.K. was a detractor.

Market Review

The European high yield market performed well again during January, but underperformed the U.S. market. The Federal Reserve's (Fed) decision in January to maintain its key policy rate and the European Central Bank's (ECB) decision to reduce its key policy rate by a quarter-point were well telegraphed and elicited little reaction. Higher than historically average yields continue to attract investors to the European high yield bond market, providing ample demand to help absorb what was an active month for primary market activity in Europe. Wavering growth expectations are colliding with an expectation for easier monetary policy, which is ultimately proving a positive environment for positive returns from bond markets.[2]

The technical conditions in high yield turned less supportive in January. In Europe, nearly €9 billion of new issuance came to the market. This marks a strong start to the year, with increased corporate activity expected on both sides of the Atlantic in 2025. Re-leveraging and creditor-unfriendly transactions remain in the minority. European high yield funds saw a month of marginal net inflows, with €200 million flowing into the market.[3]

One issuer defaulted during January, bringing the par-weighted default rate to just under 4%, eclipsing the pandemic-era peak and showing the highest reading since 2010. The distress ratio remains low, but there are two large, expected defaults in the coming months that may see the default rate move above 5%.[3]

The ICE BofA European Currency High Yield 3% Constrained Excluding Subordinated Financials Index (EUR-Hedged) returned 0.63% in January. The yield-to-worst fell 0.09% to 5.46%, while the spread-to-worst ended the month 18 basis points (bps) tighter at 335 bps.[4]

Cable & satellite tv, insurance, and homebuilders & real estate were three of the best-performing sectors during the month, with paper and containers two of the worst performers.

Bonds rated CCC and lower outperformed during the month, while BB-rated bonds were the worst-performing ratings band.

Strategy and Outlook

We are progressing through early 2025 with a relatively balanced view for the high yield market. This outlook includes the expectation for episodic volatility and the sober realization that, while yields remain historically attractive, on a spread basis the high yield market appears to be priced nearly to perfection. We come to this conclusion after a thorough analysis of factors including the evolving monetary policy of global central banks, global economic growth, consumer health, the fundamentals of high yield issuers, technical conditions, and valuations. Ultimately, we believe that, on average, the yield provides attractive compensation for the underlying credit risk, but reaching for risk in lower-rated credits will likely be punitive.

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1 Source: Morgan Stanley Investment Management Limited. Data as of 31 January 2025.
2 Source: Bloomberg L.P. Data as of 31 January 2025.
3 Source: J.P. Morgan. Data as of 1 February 2025.
4 Source: ICE Data Indices, Morgan Stanley Investment Management. Data as of 31 January 2025.

Global central banks have transitioned to an easing cycle, reflecting an environment across most global developed markets of moderating global economic growth, softer labour markets, and inflation that has been managed down from post-pandemic highs to levels closer to longer-term targets. Many central banks have taken substantially similar paths over the last several quarters; however, with potentially stickier inflation in certain regions and diverging growth backdrops in certain developed market economies, these paths may diverge in 2025. In the closing weeks of 2024, the Bank of Canada, ECB and Fed all reduced short-term interest rates, after the Bank of England's November cut, adding to multiple reductions by each that broadly began in mid-2024. The Fed's December cut was fully anticipated; however, commentary regarding a more cautious path forward was cause for some volatility.

The Fund remains slightly under-risked relative to the ICE BofA European Currency High Yield 3% Constrained Excluding Subordinated Financials Index, based on a duration-times-spread ratio that remained below 1. The high yield market has become bifurcated between sectors and issues experiencing strong secular growth and improving fundamentals with attractive positive convexity, and segments where growth and fundamental health are stagnant or eroding with convexity that ranges from unattractive to sharply negative. In aggregate, we remain encouraged by the fact that credit quality remains near record highs and a record percentage of our market is secured. However, due to full valuations across much of the landscape and what appears to be elevated complacency, we are not looking to broadly add market beta in the year ahead; instead we will focus our holdings in segments where growth and convexity remain most compelling.

In conclusion, we expect 2025 to be a competitive year for high yield, with global institutional investors likely to benefit from harvesting historically attractive yield in exchange for taking below-average credit risk. It will certainly not be a year without volatility, and we anticipate blind buyers of yield will likely be penalized. Geopolitical tensions and regional conflicts present the potential for expansion or ultimate resolution. Trade policy, U.S. and European fiscal affairs and advancing populism manifest additional risk and opportunity. Amid a shifting and uncertain backdrop, we will continue to spend our time concentrating on what we do best — focusing on bottom-up fundamental credit analysis with a discerning eye on relative value, as we seek to generate positive risk-adjusted alpha for our clients.

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

Fund Facts

Launch date	01 December 1998
Base currency	Euro
Benchmark	Custom- Blended Benchmark

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 I Shares	0.71	8.25	12.09	-11.05	3.33	2.21	10.49	-4.47	6.29	9.80	1.31
Blended Benchmark	0.64	8.56	12.14	-11.75	3.25	2.82	10.95	-3.34	6.22	10.07	0.85

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.**

Share Class I 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.
- Investment in Fixed Income Securities via the China Interbank Bond Market may also entail additional risks, such as counterparty and liquidity risk.
- 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 31.01.2025 and subject to change daily.

Applications for shares in the 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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The material has been prepared solely for informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. Investors should be aware that a diversified strategy does not protect against a loss in a particular market.

All investments involve risks, including the possible loss of principal. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

The use of leverage increases risks, such that a relatively small movement in the value of an investment may result in a disproportionately large movement, unfavourable as well as favourable, in the value of that investment and, in turn, the value of the Fund.

Investment in the Fund concerns the acquisition of units or shares in a fund, and not in a given underlying asset such as building or shares of a company, as these are only the underlying assets owned.

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Charts and graphs provided herein are for illustrative purposes only and subject to change.

INDEX INFORMATION

The Blended Index performance shown is calculated using the **ICE BofA European Issuers High Yield Index** from inception through 31 July 2002, the **ICE BofA European Currency Constrained High Yield Index** to 31 March 2009 and the **ICE BofA European Currency High Yield 3% Constrained Ex-Sub Financials Index** thereafter.

The **ICE BofA European Currency Constrained high yield index**: The index is designed to track the performance of euro- and British pound sterling-denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets by issuers around the world.

The **ICE BofA European Currency High Yield 3% Constrained Ex-Sub Financials Index**: contains all non-Sub Financial securities in the ICE BofA European Currency High Yield Index but caps issuer exposure at 3%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 3%.

The **ICE BofA European Issuers High Yield Index:** The index is designed to track the performance of USD, EUR and GBP denominated below investment grade corporate debt publicly issued by European corporations in the US, sterling or euro domestic or the eurobond markets.

The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

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A blended benchmark has been used because there has been a change in benchmark during the reporting period shown.

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