Morgan Stanley Investment Funds

Global Fixed Income Opportunities Fund

BROAD MARKETS FIXED INCOME TEAM

Performance Review

In the one month period ending 30 November 2024, the Fund's Z shares returned 1.03% (net of fees)[1].

During the month, both the Fund's macro decisions and positioning within spread sectors contributed to absolute performance.

The Fund's long duration exposures in the U.S. and euro area were the largest contributors to performance as global government bond yields fell over the month. The short Japanese duration position also added to performance as Japanese yields rose over the month.

Long duration exposures in the emerging markets, particularly in South Africa, also contributed.

Higher "risk-free" rates also continued to benefit performance.

Regarding the portfolio's positioning within spread sectors, the Fund's largest exposure, securitized credit, continued to add to performance, with particular contributions from the exposures to asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS).

The exposure to agency residential mortgage-backed securities (RMBS) also contributed.

Positioning within investment grade corporate bonds contributed to performance.

The exposures within high yield corporate bonds also contributed on the back of tightening spreads.

There were no material detractors from relative performance in the month.

Portfolio Activity

Regarding macro positioning, the Fund added 0.16 years of duration, mainly by increasing the exposures to the U.S. and euro area and initiating a long exposure to South Africa.

The Fund closed the long exposure to Canada, reduced the exposure to New Zealand and increased the short Japanese and Australian duration positions.

Within currency exposures, the Fund initiated a long yen vs. short euro position, initiated a long South African rand position and reduced the long U.S. dollar position.

Within spread sectors, the Fund increased the exposure to non-agency RMBS.

The Fund increased the exposure to high yield corporate bonds, mainly in industrials and financials.

The Fund marginally increased the exposure to investment grade corporate debt.

Strategy and Outlook

After the immediate surge in yields triggered by Donald Trump's election and the subsequent Republican sweep, government bond markets returned to a more normal state. By the month's end, global government bond yields showed a downward trend, with Germany leading the way among developed markets with the 10-year bund yield falling 30 basis points. The U.K.'s 10-year gilt yield followed closely, decreasing by 20 basis points, while the 10-year U.S. Treasury yield declined by 12 basis points. The U.S. dollar demonstrated strength during the month, outperforming a basket of other currencies by 1.7%.[2]

Emerging market local government bonds outperformed their developed market counterparts, as yields generally decreased across the board. However, Brazil deviated from this trend, experiencing a notable rise in its 10-year rate, which increased by 62 basis points.

In the corporate bond market, spreads in the U.S. tightened, with high yield spreads narrowing by 16 basis points and investment grade spreads tightening by 6 basis points. Conversely, European markets saw a widening of spreads, with European high yield spreads increasing by 11 basis points and European investment grade spreads widening by 4 basis points. Additionally, agency mortgage-backed securities spreads and securitized credit spreads also tightened over the month.

After a tumultuous September and October, bond yields stabilized and even rallied in November, despite the surprising Republican sweep of the U.S. election. The 10-year U.S. Treasury yield fell by 12 basis points during the month, with European government bond yields declining even more. In some ways, this marked a return to normalcy, as the U.S. employment report was weaker than expected and the Federal Reserve (Fed) cut rates by another 25 basis points at its November Federal Open Market Committee

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 November 2024.
2 Source: Bloomberg L.P. Data as of 30 November 2024. U.S. dollar performance is represented by the U.S. Dollar (DXY) Index.

(FOMC) meeting. However, inflation, particularly in the U.S., has proven to be fairly sticky lately, undermining the market's optimism regarding rate cuts in 2025. Nevertheless, it was a good month for bonds after a truly terrible October, with U.S. credit markets contributing to the strong performance.

U.S. yields proved resilient post-election, despite concerns that the Republican sweep could be inflationary due to the proposed tariff agenda. After initially pushing U.S. yields higher, they stabilized and then rallied to their lowest level since mid-October. Several factors are at play: the Fed is easing, and yields have paradoxically been rising since the Fed initiated its rate-cutting cycle in September. This is not typical; so November's recovery, characterized by the market's reluctance to push U.S. Treasury 10-year yields above 4.5%, is significant.

Additionally, economic conditions outside the U.S. have generally not improved. The threat of U.S. tariffs, particularly on Europe, which is already reeling from the implications of the Russia-Ukraine war and the China's economic slowdown, has led markets to increase the cumulative easing expected from the European Central Bank (ECB). This stands in stark contrast to the U.S. bond market, which has significantly reduced the amount of easing anticipated from the Fed going forward. Currently, there is only a 50/50 chance of a December rate cut, whereas this had previously been around 75/25 in favour of a cut. Thus, a combination of Fed rate cuts (even if expectations are diminished), weaker growth and good bond performance outside the U.S., along with technical support around the 4.5% level on the U.S. 10-year Treasury, stabilized the market and induced a small rally.

That said, we believe U.S. yields are likely to remain range-bound in the coming months as markets attempt to decipher the true state of the economy—considering growth, unemployment and inflation—as well as the likely scale of the incoming administration's policies, while also paying attention to how the Fed responds to all of the above. Tariff increases are likely to be inflationary and detrimental to growth (as seen in 2018-2019), as will reduced immigration; however, other policies may be beneficial for growth. The U.S. does appear to be experiencing a productivity boom, and if this continues, it could lead to strong non-inflationary growth. Overall, we believe growth is likely to be stronger in the medium term, but the sequencing of policies and the response of other currencies will be crucial in understanding the dynamic interplay of growth, inflation and Fed policy responses. Some central banks, like the ECB and the Bank of Canada, may accelerate rate cuts, while others, such as the Bank of Mexico and various emerging market central banks, may pause or slow their rate-cutting cycles in response to ongoing uncertainty and dollar strength. In summary, we remain agnostic about the near-term outlook for U.S. yields, anticipating a range of 4%-4.5% for the 10-year U.S. Treasury, with rate cuts unlikely to exceed those currently priced into the markets. Given that the U.S. yield curve remains very flat, we also continue to avoid longer-duration bonds, as yields outside the U.S. generally appear more attractive.

Credit markets remain well supported, and we expect this to continue. In November, U.S. credit spreads tightened once again as the Republican agenda, combined with solid U.S. economic performance and higher yields, bolstered buying. This central bank support, robust U.S. growth and strong corporate fundamentals (at both the investment grade and high yield levels) should persist. Assuming our forecast that the Republican administration's agenda is implemented to some degree (we are more confident about deregulation and tax cuts than about trade), U.S. corporate performance should remain solid, thus benefiting credit spreads. Conversely, European credit spreads underperformed in November due to deteriorating economic fundamentals and concerns about Trump's trade policies.

However, the longer-term impact of Republican policies is less clear. Greater opportunities and more regulatory leeway typically lead to riskier behaviour and greater leverage, which is not usually positive for creditors. With credit spreads on the tighter side (expensive by historical standards but not overvalued), opportunities remain attractive; however, we do not expect especially high returns. A very selective strategy seems appropriate given current valuations. We remain focused on avoiding problematic companies and industries while building as much yield as possible into the portfolio without taking undue risks. The absolute level of yields appears satisfactory, even amid significant uncertainty surrounding the Trump administration, particularly from a medium-term perspective. While spreads look historically tight, yields (when combining spreads with the "risk-free" U.S. Treasury yield) appear favourable by historical comparison. Concerning risks, there is little reason to expect spreads to materially widen when economic growth is decent and central banks are cutting interest rates. However, given current spread levels, it is challenging to be confident that they can tighten meaningfully further. On a positive note, yield-oriented buying should help contain spread widening. We remain modestly overweight in credit within our portfolios, with a slight bias toward higher quality. Despite their underperformance in November, we still identify better opportunities in many U.S. names and European banks in euro-denominated bonds.

Amid the current noise and uncertainty in the world, we continue — knowing it sounds like a broken record — to believe that the most attractive opportunities remain in securitized credit, particularly in U.S. mortgage-backed securities. U.S. households with prime credit ratings have maintained strong balance sheets, which should continue to support consumer credit and ancillary structures, especially as housing prices remain firm and the unemployment rate stays low. Changes in U.S. tax policy should also be supportive. Higher-coupon U.S. agency mortgage securities continue to be attractive compared to investment grade corporates, and we believe they are likely to outperform U.S. Treasury securities. Similar to our corporate credit positioning, we aim to enhance our securitized credit exposures by moving up in credit quality and out of non-U.S. structures, given tighter spreads and increased macroeconomic risks in Europe. One area within securitized credit that may be vulnerable to potential shifts in Fed policy is CMBS. If interest rates do not fall as much as expected, the refinancing of many U.S. office-backed deals could become problematic, leading us to generally steer clear of this sector.

Emerging market (EM) bonds are unlikely to thrive under a Trump-led Republican government. Stronger U.S. growth, combined with higher interest rates for a longer period and weaker global trade linkages, is not typically conducive to strong EM performance. Some of Trump's comments regarding the BRIC countries (Brazil, Russia, India and China) indicate a potentially volatile environment that these nations will need to navigate in the coming years. Nevertheless, we believe that countries with solid economic outlooks, decent growth, falling inflation and central banks willing and able to cut interest rates—despite policy changes in the U.S.—are likely to perform well. Country and security selection remain critical. We continue to avoid Mexican and Brazilian bonds as their respective markets contend with political uncertainty (Mexico), fiscal risks (Brazil) and Trump's policies. Some of the higher-yielding countries with weaker trade linkages to the U.S., like Egypt, are likely to perform relatively better.

In currency markets, the outlook for the U.S. dollar remains strong following the U.S. election. While the dollar appears stretched compared to its historical levels, its fundamental support remains robust. Easier fiscal policy, tighter monetary policy (relative to prior expectations), trade wars and stronger U.S. growth all bode well for the dollar. However, one caveat to this optimistic narrative could be a deterioration in the labour market and signs that the Fed may become more aggressive in cutting rates. Further deterioration would give the Fed room to continue cutting interest rates, as long as the Trump agenda does not disrupt the inflation outlook. The U.S. economy continues to excel in terms of its growth trajectory, productivity performance, profit results and yield levels. It will be challenging for other countries to generate the kind of fundamental support that the U.S. dollar enjoys, especially with a Republican administration focused on implementing a higher tariff strategy. This presents a high hurdle for other currencies to overcome in terms of fundamentals.

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

Fund Facts

Launch date	07 November 2011
Base currency	U.S. dollars

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class Z Shares	5.54	8.55	-7.29	0.10	4.65	9.98	0.23	7.73	5.04	-0.70	5.58

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 Z 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.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- 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 November 2024 and subject to change daily.

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INDEX INFORMATION

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