A Sub-Fund of Morgan Stanley Investment Funds

Global High Yield Bond Fund

HIGH YIELD TEAM

Performance Review

In the one month period ending 31 January 2025, the Fund's Z shares returned 1.19% (net of fees)[1], while the benchmark returned 1.24%.

Air transportation and health care were two of the Fund's top-performing sectors relative to the benchmark in January. In air transportation, the primary individual driver of outperformance in the sector was an overweight position and selection within the capital structure of a Swiss private aviation company. The company continues to exhibit strong customer growth and high retention. At the end of January, it was rumored the company was in the later stages of a convertible preferred equity raise. The position generated more than 5% of total returns during the month for the portfolio. In health care, an overweight to a French laboratory testing business added value. Bond prices rose as positive regulatory developments in France provided a tailwind for the company.

Homebuilders & real estate and cable & satellite tv were two of the Fund's biggest detractors during the month. Relative underperformance in the latter was led by a significant underweight and positioning in the guaranteed bonds of a highly levered U.S. cable provider. The company has long been rumored to be a potential takeout candidate and saw its bonds rise by nearly 4% during the month.

From a credit quality perspective, credit selection in BB-rated and B-rated bonds detracted from relative returns, while an underweight to BB-rated bonds added value.

Selection in U.S. issuers was the biggest headwind from a geographic perspective.

Market Review

Performance in the global high yield markets was strong in January amid generally strong demand, a primary market calendar that was slow to gain momentum in the U.S. and a modest retreat in 5-year U.S. Treasury and German bund yields in the second half of the month. With a dearth of issuance and ample demand over the first three weeks of the year, lower-quality beta led performance. The dynamic shifted later in the month as a surge in acquisition-related financings reignited the U.S. primary market, and valuations in lower-rated structures within the cable & satellite TV sector came under modest pressure. 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. The month ended with the market squarely focused on the potential for impending trade tariffs.[2]

The technical conditions in high yield improved in January. Gross issuance increased month-over-month from $11.5 billion in December to $23.0 billion in January, on the back of a strong week of issuance to close the month. By use of proceeds, refinancing accounted for approximately 67% of monthly issuance and acquisition financing accounted for approximately 28%. In Europe, nearly €9 billion of new issuance came to the market in a vibrant start to the year. U.S. high yield retail funds recorded a net inflow of approximately $1.5 billion in January, following an outflow of approximately $3.8 billion in December. In Europe, net inflows were just over €200 million.[3]

In the U.S., January was the lightest month for default and distressed exchange activity in leveraged credit in more than two years. According to J.P. Morgan, the high yield trailing 12-month par-weighted default rate including distressed exchanges decreased by 4 basis points (bps), ending the month at 1.43%. Excluding distressed exchanges, the rate ended January 5 bps lower at 0.30%. For loans, the trailing 12-month par-weighted default rate including distressed exchanges decreased 7 bps to close the month at 4.42%. In these respective metrics, the gap between the high yield and loan markets is at the highest level since 2000. In Europe, 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 Developed Markets High Yield Excluding Subordinated Financial Index USD-Hedged posted a total return of +1.25% in January. The spread-to-worst fell 27 bps to end the month at 290 bps, while the yield-to-worst fell 0.32% to end the month at 6.61%.[2]

Broadcasting, cable & satellite tv, and building materials were the three top-performing sectors during the month. Containers, entertainment & film, and utility were three of the worst performing sectors.[2]

Once again, the lower quality segments of the market outperformed during the month, with CCC-and-below-rated bonds typically performing best within high yield, while the longer-duration BB-rated segment underperformed.[2]

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

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.

Global central banks have transitioned to an easing cycle, reflecting an environment across most global developed markets of moderating global economic growth, softer labor 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. For the year ahead there is only moderate dispersion between market participants' expectations and the Fed's dot plot, with the market generally expecting approximately one to two reductions in 2025, relative to the Fed's projections that indicate two. Ultimately, our base case expectation is for two rate cuts in 2025 and a year-end yield on the 5-year Treasury in the context of 4.00%-4.25%, reflecting a view of moderate economic growth, stickier inflation of closer to 3% than 2%, and a labor market that is balanced enough not to prompt more aggressive action by the Fed. The ECB looks set to adopt potentially more accommodative monetary policy, with less inflationary concerns and a weaker growth outlook leading to our expectations of policy divergence between the European Union and the U.S.

In line with consensus, our expectations are for weaker economic growth in Europe than in the U.S. However, valuations appear marginally more favorable in Europe than in the U.S., so we remain focused on bottom-up security selection to unearth relative value opportunities between the two markets. The tailwind of a more aggressive loosening of monetary policy may be more helpful in Europe than the U.S.

The Fund remains slightly under-risked relative to the benchmark, based on a duration-times-spread ratio (DTS). 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	27 April 2017
Base currency	U.S. dollars
Benchmark	ICE BofA Developed Markets High Yield Excluding Subordinated Financial Index USD-Hedged

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 Z Shares	1.19	8.08	12.96	-9.07	5.39	4.44	14.45	-1.63	--	--	--
ICE BofA Developed Markets High Yield Excluding Subordinated Financial Index USD-Hedged	1.24	8.59	13.77	-10.58	5.05	5.61	14.29	-1.90	--	--	--

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 is 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.
- 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, 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.

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