Morgan Stanley
INVESTMENT MANAGEMENT

COMMENTARY
September 30, 2024

Morgan Stanley Institutional Fund

Dynamic Value Portfolio

GLOBAL MULTI-ASSET TEAM

Performance Review

In the quarter period ending September 30, 2024, the Portfolio's I shares returned 7.75% (net of fees)[1], while the benchmark returned 9.43%.

During the quarter, the portfolio's security selection process detracted from performance. The portfolio held a neutral allocation to Value stocks.

Market Review

U.S. equity markets gained +5.9% (S&P 500 Index) during the third quarter, driven by a dovish pivot from the Federal Reserve (Fed) and resilient economic data. A series of stimulus measures announced in China also helped to bolster expectations for global economic growth. The beginning of the period experienced some material turmoil as disappointing earnings releases from big tech stocks pressured lofty valuations and the sudden unwind of the yen carry trade, which caused the VIX to temporarily reach a four-year high of 65.7.[2] Following the weak July U.S. jobs report (non-farm payroll gain of only 114,000 vs. 175,000 expected and an uptick in the unemployment rate to 4.3%), investors repriced their expectations for year-end Fed rate cuts from -72 basis points (bps) of cuts to -94 bps.[3] With this repricing of Fed rate cuts coming just days after the Bank of Japan's surprise rate hike to 0.25%, investors rapidly unwound extreme positioning in foreign exchange carry trades, which fueled a two-day rally of +4.0% in the yen and created further market turmoil.[2]

However, markets recovered in the second half of the quarter as the Fed delivered a larger-than-expected 50 bp rate cut in September. The jobs report for August also offset some of the fears caused by the July report, showing a stabilization in payrolls and downtick in the unemployment rate to 4.2%. Following its decision to cut rates by 50 bps, the Federal Open Market Committee also shared its updated rate projections, which included an additional 50 bps of cuts by year-end while the year-end rate for 2025 remained unchanged, reinforcing the narrative that the Fed is ready to lower rates quickly without materially changing its longer-term baseline view. Although the Fed increased its forecasted unemployment rate for year-end 2025 to 4.4%, it continued to forecast above-trend growth, prompting Chair Powell to describe the Fed's dual mandate as broadly balanced.

Meanwhile, Chinese officials delivered a sweeping set of policy announcements including both monetary and fiscal stimulus intended to restore confidence in the country's struggling economy. The People's Bank of China announced several rate cuts and additional relief for the beleaguered housing and equity markets while the Politburo vowed to increase its fiscal expenditures and increased its emphasis on improving employment and domestic consumption.

U.S. equities were led by rate-sensitive sectors such as utilities and real estate (S&P 500 Utilities +19.4%, S&P 500 Real Estate +17.2%). The equal-weighted index (S&P 500 Equal Weight Index) completed its best quarter since 2010 with a +9.4% gain as the rally in equities broadened. Contrary to previous quarters, which were dominated by large gains in mega-cap tech stocks, the Magnificent 7 gained only +5.4% in the third quarter while the NASDAQ Composite only increased +2.8%, marking the first quarter in which the S&P 500 outperformed the Magnificent 7 since 2022. Energy was the only sector that fell in the third quarter (S&P 500 Energy -2.3%) as West Texas Intermediate (WTI) and Brent oil fell -16.9% and -16.4%, respectively.

Within factors, global Value stocks outperformed global Growth and Momentum stocks, which were weighed down by the Magnificent 7 slowdown and fears of overinvestment into artificial intelligence (AI) (MSCI All Country World Index [ACWI] Value +9.4%, MSCI ACWI Growth +4.1%, MSCI ACWI Momentum +3.0% in USD). U.S. Value also outperformed Growth peers by +5.8% (Russell 1000 Value Index +9.4%, Russell 1000 Growth Index +3.2%) while U.S. small caps outperformed large caps by +3.4% (Russell 2000 Index +9.3%, S&P 500 Index +5.9%).

1 Source: Morgan Stanley Investment Management. Data as of September 30, 2024. Performance for other share classes will vary.
2 Source: Bloomberg L.P.
3 One basis point = 0.01%

Portfolio Activity

Throughout the quarter, the portfolio held a full exposure (100%) to Value stocks (defined by the GMA Team as the cheapest 20% of stocks in the Russell 1000 Index on our multi-factor metrics). The portfolio held neutral exposure to Value stocks during the quarter. As a reminder, the strategy does not take active sector/industry positions versus the Russell 1000 Value Index benchmark.

Outlook

Over an almost 14-year period through 2020, we saw a near-record derating of Value stocks relative to Anti-Value stocks. On forward earnings multiples, Value stocks' relative valuations reached a peak discount in 2007 (at a 47% discount relative to Anti-Value, we note that Value always trades at a discount), followed by a 14-year decline that reached a record low discount of 81% in 2020 (compared to a 58% discount historically on average).[4] Between the Global Financial Crisis (GFC) in 2007-08 and the COVID-19 pandemic in 2020, the macro environment was defined by abnormally low nominal growth and interest rates (with persistently negative real interest rates), and returns and multiples favored higher growth and longer duration stocks. Coming out of the pandemic, however, we believe that the macro regime has shifted back to a more normal environment of higher growth and interest rates, which we see as a leading catalyst for unlocking a multi-year Value bull market. Since its pandemic low, the Value factor, as defined by the GMA team, has rallied 63% relative to Anti-Value, and yet it still remains historically cheap, trading at 53% discount from its "normal" relative valuation.[5] This is also true outside of the U.S. as the Value factor in Europe, Asia and emerging markets have been in a bull market since late 2020, yet still trade at or near historically low relative valuations, setting the stage for potentially significant continued outperformance over the coming years.

We continue to highlight the importance of relative valuation metrics because our analysis indicates that, over the long term, relative valuations are the most powerful indicator of future returns to the value factor, not the growth and interest rates factors that dominated in the post-GFC period. Specifically, Value trades at only 11x forward price-to-earnings (P/E) compared to 37x for Anti-Value.[6] In addition, Growth, Quality, and (until recently) Momentum factors all trade near record high valuation levels. In fact, defensive quality names are at relative levels usually reserved for the midst of recessions, leaving little space for further upside and plenty of downside during an eventual reversal. Value has historically been negatively correlated to these factors, and if the market reversal occurs, we believe our investment process can enable us to capture the anticipated rally in Value stocks. From a contrarian perspective, we are also encouraged by the fact that assets under management flows and investor surveys indicate persistent pessimism and bearish positioning in U.S. Value stocks.

Looking forward, we believe that the U.S. Value bull market is set to resume in line with global Value stocks (after a recent hiatus that had been driven by a combination of impending recession fears, regional banking concerns and AI optimism) as the valuation gap between cheap and expensive stocks reverts toward the long-term mean. It is our view that the recent strength in Quality and Growth stocks that has stalled Value's post-COVID recovery has reached its peak in July and is now in the process of reversing. Especially relative to Anti-Value, we see more room for outperformance for Value as the AI enthusiasm starts to fade and investors begin to question elevated earnings forecasts, causing extreme valuations to normalize.

Fund Facts

Inception Date	March 19, 2021
Minimum Initial Investment*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Primary- Russell 1000 Value Index
Class I expense ratio	**Gross 0.82 %**
	Net 0.55 %
Class A expense ratio	**Gross 1.20 %**
	Net 0.90 %

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 Source: Haver Analytics, MSIM GMA Team analysis. Data as of September 30, 2024.
5 Source: Haver Analytics, MSIM GMA Team analysis. Data as of September 30, 2024. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. Past performance is no guarantee of future results.
6 Source: Haver Analytics, MSIM GMA Team analysis. Data as of October 18, 2024.
* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

Performance (%)

As of September 30, 2024	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR	SINCE INCEPTION
Class I Shares at NAV	0.17	7.75	7.27	20.39	8.47	--	--	8.46
Class A Shares at NAV	0.00	7.62	6.95	19.89	8.04	--	--	8.03
Class A Shares (With Max 5.25% Sales Charge)	-5.28	1.95	1.35	13.55	6.10	--	--	6.41
Russell 1000 Value Index	1.39	9.43	16.68	27.76	9.03	--	--	9.14

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.

Please keep in mind that high double-digit returns are highly unusual and cannot be sustained. Investors should also be aware that these returns were primarily achieved during favorable market conditions.

Value/Anti-Value Portfolio Characteristics	VALUE	RUSSELL 1000	RUSSELL 1000 VALUE
Price/earnings (NTM)†	10.33	22.29	17.50
Price/Book	1.74	4.84	2.85
Net Margins (ex Financials & REITS)	4.30	8.79	6.44
Net Debt/EBITDA (ex Financials and REITS)	3.19	1.87	2.60
Dividend Yield (LTM)††	2.37	1.14	1.97

Characteristics	FUND
Active share (%)	87.34
Number of holdings	200
Median market capitalization ($B)	10.64

Value/Anti-Value Portfolio Allocation (%)	CURRENT ALLOCATION (%)	TYPICAL MIN/MAX RANGE (%)
Value Portfolio	98.17	70.00/130.00
Anti-Value portfolio	0.00	-30.00/30.00
Net Exposure (ex Cash)	98.17	100.00

†NTM=Next Twelve Months.
††LTM=Last Twelve Months.

INDEX INFORMATION

The **Russell 1000® Index** is an index that measures the performance of the 1,000 largest companies in the Russell 3000 Index.

The **Russell 1000® Value Index** is an index that measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000® Index is an index of approximately 1,000 of the largest U.S. companies based on a combination of market capitalization and current index membership.

The **Russell 2000® Index** is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **S&P 500® Equal Weight Index (EWI)** is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight — or 0.2% of the index total at each quarterly rebalance

The **MSCI All Country World Index (ACWI)** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

RISK CONSIDERATIONS

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. In general, **equity securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed countries. Value Investing. **Value investing** is an investment style. Value stocks are those believed to be undervalued in comparison to their peers due to market, company-specific or other factors. Value stocks can perform differently from the market as a whole and other types of stocks and may fail to increase in price as anticipated or may decrease in price. The Fund may outperform or underperform other funds that invest in similar asset classes but employ different investment styles. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the Portfolio's performance. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **LIBOR Discontinuance or Unavailability Risk**. The London InterBank Offered Rate ("LIBOR") is intended to represent the rate at which contributing banks may obtain short-term borrowings from each other in the London interbank market. 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. However, subsequent announcements by the FCA, the LIBOR administrator and other regulators indicate that it is possible that certain LIBOR tenors may continue beyond 2021. As a result, it is possible that commencing in 2022 (or on a late date, if a particular LIBOR tenor is expected to continue beyond the end of 2021), 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.

DEFINITIONS

Active Shareis the fraction of the portfolio or fund that is invested differently than its benchmark as of the last day of the reporting period. A portfolio with a high degree of Active Share does not assure a fund's relative outperformance. Active Share calculation may consolidate holdings with the same economic exposure. For MSIFT Dynamic Value Portfolio, active share is calculated based on all long positions in the portfolio. **Dividend yield**is the ratio between how much a company has paid out in dividends each year relative to its share price. **Median market capitalization**is the midpoint of market capitalization of the stocks in a portfolio. Half the stocks in the portfolio will have higher market capitalizations; half will have lower. **Net Debt/EBITDA** is a measurement of leverage, calculated as a company's interest-bearing liabilities minus cash or cash equivalents, divided by its EBITDA. The net debt-to-EBITDA ratio is a debt ratio that shows how many years it would take for a company to pay back its debt if net debt and EBITDA are held constant using a share weighted approach. **Net Margins** is the ratio of net income or profit, divided by revenues using a share weighted approach. **Price/book** compares a stock's market value to the book value per share of total assets less total liabilities. This number is used to judge whether a stock is undervalued or overvalued. **Price/earnings** (NTM) This forward P/E ratio estimates a company's likely earnings per share for the next 12 months. **Value stocks** are defined by the GMA Team's proprietary screening process. **Anti-Value stocks** are defined as the most expensive Value stocks based on the GMA Team's proprietary screening process.

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 (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 1-800-548-7786. Please read the prospectus carefully before investing.

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