Morgan Stanley
INVESTMENT MANAGEMENT

COMMENTARY
September 30, 2024

Morgan Stanley Institutional Fund

International Equity Portfolio

INTERNATIONAL EQUITY TEAM

Performance Review

In the quarter period ending September 30, 2024, the Portfolio's I shares returned 8.50% (net of fees)[1], while the benchmark returned 7.26%.

The Fund's third quarter outperformance was driven by positive stock selection as the portfolio benefited from strength in information technology, financials, health care and consumer discretionary. Sector allocation, however, was negative, largely due to the overweight in information technology.

Market Review

Despite the volatility endured in the quarter, the MSCI EAFE Index managed to return an impressive +7.3% in U.S. dollars (USD), but was only up +0.8% in local currency given the weak USD. This improves the index's return to +13% (USD) for the year-to-date. Interest rate sensitive sectors saw strength after long-awaited interest rate cuts: real estate (+17%) and utilities (+15%) finished as the top performers while financials (+10%) was also strong. In addition to the interest rate sensitive sectors, communication services (+12%) and consumer staples (+11%) also fared well. Following a weak September, energy (-6%) finished as the worst performer in the quarter, while information technology (-2%) struggled due to ongoing uncertainty surrounding tech's return on potential generative artificial intelligence (GenAI) investments. All other sectors finished within 300 basis points[2] of the index. Geography-wise, Asia saw strength from Hong Kong, which ended up +24% (USD and local) following its impressive September, and from Singapore (+18%, +12%). Meanwhile, Japan (+6% USD, -6% local) was weaker following the unwind of the yen carry trade. In Europe, major markets performed well, as Spain (+14% USD, +9% local), Germany (+11%, +6%), Italy (+9%, +4%), Switzerland (+9%, +2%), the U.K. (+8%, +2%) and France (+8%, +3%) all finished ahead of the index. The U.S. (+6%) underperformed EAFE in the quarter.

Outlook

At the time of writing, consumer staples appear out of favour and somewhat overlooked. Since the end of the pandemic in 2022, while the sector's earnings have grown in the mid-single digits per year,[3] close to the broader market's growth, its stock prices have struggled in relative terms. Notably, compared to the MSCI World Index, consumer staples are now at a near 25-year low in terms of relative valuation and are at their lowest weight in the index this century.[3] In contrast, investor interest has shifted toward more fashionable sectors and themes such as artificial intelligence (AI), global mega-tech and health care innovations aimed at combatting obesity. Despite this trend, we believe the consumer staples sector still encompasses some of the world's most resilient and dependable companies.

High quality characteristics

High quality consumer staples companies can play a crucial role in a portfolio by delivering consistent, reliable growth, driven by recurring revenue from the everyday products they sell. Their typical operating resilience during economic downturns serves as a key advantage, offering relative downside resilience and acting as a stabilising force within the portfolio.

Challenging times

While recent stock price returns for some staples have not met expectations, over the past four years the sector has demonstrated impressive resilience, navigating the pandemic, soaring commodity costs and numerous emerging market currency devaluations. Despite these challenges, the USD sales and earnings of our staples holdings have managed to grow at mid-single-digit levels,[3] affirming their resilience and compounding potential.

The right company in the right categories

As investors, we don't allocate capital by sector but focus on reasonably valued individual companies with strong fundamentals and long-term growth potential. Not all consumer staples fit this profile. In our view, being in the right category where brands matter and

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

the consumer responds to innovation is key. Importantly, companies need to sustain high levels of investment in their brands in the form of marketing, research and development (R&D), supply chain capabilities and talent.

A good example of this is Haleon (2.4% of the portfolio),[4] a U.K.-based global leader in the consumer health sector recently added to the portfolio. The company is sharply focused, with nine powerhouse brands across just five categories, all addressing critical consumer needs – sensitive teeth being one example. Its dominance in the therapeutic oral care category is supported by direct relationships with one third of the 10 million health care professionals who serve as trusted influencers.[5] These partnerships play a vital role in driving consumer acquisition and retention, resulting in strong brand loyalty, industry leading margins and consistent, non-cyclical growth.

Being innovative and remaining relevant is crucial

Our holdings across beauty, home care, consumer health and beverages innovate to solve consumer needs. This expands consumer usage and drives category growth. Innovations range from energy efficient laundry detergents to improved solutions for sensitive teeth, "nolo" (no or low alcohol) and zero-sugar drinks, faster-acting antacids, or improved sun-filtering technology to help protect skin. These innovations are supported by well-invested supply chains and high levels of marketing support, meaning the brand's "share of voice" is above its market share. In so doing, the companies outpace their market and grow share. We avoid food retailers, which are typically low return, capital intensive, price takers – a well-known player in the space is successful precisely because it operates a high volume, low margin business and mass food producers, whose competitive moats may face threats from local or specialist producers.

Marketing matters

When we see a period of underinvestment, we seek to act. We reduced Heineken (1.4% of the portfolio)[4] this year, one of our global beer holdings, which had been reducing marketing spend. This may boost short-term earnings, but it harms long-term brand strength. Recovering from this is often challenging. Conversely, we've increased our position in L'Oréal (2.2% of the portfolio),[4] a leading global beauty company, which allocates over 30% of its sales to marketing.[6] This investment provides the company with a share of voice 1.5 times greater than its market share, enabling it to consistently outperform the market.[6]

Pivoting to where the growth is

Agility is a key attribute we seek in our selection of consumer staples. In a world of economic and geopolitical uncertainty, the ability of management teams leading global operations to swiftly allocate resources – capital, talent and marketing – to the most promising markets is essential.

China's current economic challenges, including rising local government debt, a struggling housing market, deflation and cautious consumers, have led to a marked slowdown in a once fast-growing market. Recent and sizeable stimulus measures may help, but also highlight policymakers' concern for the growth outlook. Fortunately, there is another market of approximately 1.4 billion consumers set to pick up the growth mantle. After years of being the next great hope, we believe India is showing signs its time has come, with its investment in infrastructure, from roads to electricity to digitalisation, contributing to strong gross domestic product and consumption growth.

India is a key growth market for the spirits category. From 2019 to 2023, whilst the overall spirits industry grew at 2.6% compound annual growth rate, the premium segment saw double-digit growth, driven by rising disposable incomes and demand for premium products, with premium's market share rising from 42% to 49%.[7] A French-based leading global player we hold, Pernod Ricard (1.8% of the portfolio),[4] already has 24 production sites in the country and is currently building one of India's largest malt distilleries.

Aside from India, the spirits industry has faced recent challenges

Market normalisation in the U.S. following the COVID-induced cocktail boom, coupled with a sluggish consumer recovery in China, has impacted the spirits industry's sales and earnings growth in 2024. The consumer slowdown was further exacerbated by distributor destocking.

We see these issues as cyclical rather than structural. And with the industry's valuation at historically low levels relative to the MSCI World Index, we believe our long-term mindset is likely to be rewarded as the spirits companies we own see their earnings and multiples recover from trough levels.

Why we believe our consumer staples holdings can continue to compound

Looking ahead, after an exceptionally turbulent four years in which the consumer staples sector faced its most challenging environment in a generation — yet demonstrated resilience, with mid-single-digit sales and earnings per share (EPS) growth (albeit below market EPS growth)[3] — we remain confident that staples justify a place in the portfolio for a number of reasons.

---

3 Source: FactSet. Data as of September 2024.
4 Holdings data as of September 30, 2024.
5 Source: International Equity Team research
6 Source: L'Oréal company reports and MSIM International Equity Team research.
7 Source: The Economic Times, "Make-in-India spirits poised for global growth" September 21, 2024.

Notably, our staples holdings are now at record levels of marketing and R&D spend,[8] setting them up to outgrow their markets. Further, efficiency gains are coming from investments in automation, upgraded enterprise resource planning systems, digitalisation and AI. As a result, we expect earnings growth to return to high-single-digit levels driven by a more balanced combination of volume, price mix, margin improvement and strong free cash flow. Additionally, valuations are attractive, with our holdings trading at their 20-year average, compared with what we view as a generally extended market.

Fund Facts

Inception Date	August 04, 1989
Minimum Initial Investment ($)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	MSCI EAFE Index
Class I expense ratio	**Gross 1.02 %**
	Net 0.95 %
Class A expense ratio	**Gross 1.38 %**
	Net 1.30 %

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.

Performance (%)

As of September 30, 2024	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	2.27	8.50	12.81	24.99	5.00	7.13	4.74
Class A Shares at NAV	2.25	8.43	12.54	24.48	4.69	6.83	4.42
Class A Shares (With Max 5.25% Sales Charge)	-3.14	2.73	6.63	17.98	2.82	5.68	3.86
MSCI EAFE Index	0.92	7.26	12.99	24.77	5.48	8.20	5.71

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.

INDEX INFORMATION

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada. 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 MSCI EAFE Index currently consists of 21 developed market country indices. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The **MSCI World Net Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed 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.The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

RISK CONSIDERATIONS

There is no assurance that a Portfolio will achieve its investment objective. Portfolios are subject to **market risk**

[8] Source: Company reports and MSIM International Equity Team research.
* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

, 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 strategy. Please be aware that this strategy may be subject to certain additional risks.**ESG strategies** that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance. In general, In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. Investments in **small- and medium-capitalization** companies tend to be more volatile and less liquid than those of larger, more established, companies. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **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).

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.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor 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.

Certain information herein has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information and the Firm has not sought to independently verify information taken from public and third-party sources.

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.

The whole or any part of this material may not be directly or indirectly reproduced, copied, modified, used to create a derivative work, performed, displayed, published, posted, licensed, framed, distributed or transmitted or any of its contents disclosed to third parties without MSIM's express written consent. This material may not be linked to unless such hyperlink is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright and other applicable law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.