Morgan Stanley Investment Funds

# Calvert Sustainable Euro Corporate Bond Fund

Calvert

## Performance Review

In the one month period ending 30 September 2024, the Fund's I shares returned 1.19% (net of fees)[1], while the benchmark returned 1.23%.

The performance can be attributed to the following factors.

The portfolio's overall investment grade credit positioning had a small negative impact on performance as spreads tightened in September.

The portfolio is positioned to be overweight financials and underweight industrials when measured in duration times spread terms.

Positions within investment grade financials were drivers of positive performance, due to the overweight to banking and insurance.

Investment grade industrials had a negative impact on performance, driven by the underweight to basic industry, consumer non-cyclical and technology.

Security selection within investment grade utility had a small negative impact on performance.

The overweight in high yield positions also had a small positive impact on performance.

The overweight in government-related positions had a positive impact on performance.

Overall, duration positioning had a negligible impact on performance.

## Market Review

September was a month of two halves for fixed income markets. First, bond yields fell as investors began to price in more aggressive rate cuts by the Federal Reserve (Fed), including a greater likelihood of a 50 basis point cut at the September meeting. This was despite activity data coming mostly in line with expectations and the August consumer price index release showing signs of a rebound in shelter inflation, although the labour market report did confirm previous evidence of slowing. At its September meeting, the Fed delivered a 50 basis point cut and underscored its commitment to averting further weakness in employment. At the same time, it maintained its optimistic view on the current labour market and its estimates of the policy rate in the longer term – as reflected in the Summary of Economic Projections – shifted higher, leading to a steepening of the yield curve. Longer-maturity bond yields also rose in the latter half of September, as economic data including jobless claims came in stronger than expected. Outside the U.S., eurozone economic data showed further signs of deterioration. Purchasing managers' indexes (PMIs) for both manufacturing and services came in materially below expectations, while inflation data was also weaker than expected. European Central Bank (ECB) Governing Council members including President Lagarde acknowledged that disinflation was taking place faster than anticipated. This led to the market pricing a quicker pace of interest rates cuts than the quarterly intervals expected previously.

Heavy primary issuance kept European investment grade credit spreads broadly unchanged in September, while government bonds rallied. Sentiment was dominated by several factors. Firstly, on the data front, PMIs in Europe and the U.K. were once again weaker than expected. Secondly, eurozone inflation came in line with consensus, rising 1.8% year-over-year in September, down from 2.2% in the previous month as energy costs fell sharply, according to Eurostat. Thirdly, notable profit warnings in the auto sector led to its position as the worst performing sector in September. In financials, UniCredit acquired a 4.5% stake in Commerzbank from the German government, later disclosing that it raised its stake to 21%. Finally, primary issuance in August came in much higher than expected. Despite the higher-than-expected supply, investor demand for risk was strong, with large new issue order books and limited new issue concessions. Inflows into the asset class remained strong with investors continuing to reach for the "all-in" yield offered by investment grade credit.

We are neutral on duration in developed markets ex-Japan and retain our long-standing steepening exposures. Cross market, we favour duration in New Zealand and Canada, where we think there is more scope for central banks to cut more than the market is pricing. By contrast, we are short duration in the U.S. and continue to believe that, for the Fed to meet current pricing, economic data will have to deteriorate significantly from its current trajectory. We are also short duration in Japan, where the acceleration in wage growth suggests stronger inflationary trends are becoming entrenched, which should lead the Bank of Japan to raise interest rates as labour and goods markets continue to suggest domestic demand is strengthening.

## Portfolio Activity

No significant changes to note.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 September 2024.

## Strategy and Outlook

In the portfolio, we continue our overweight position to credit risk, as we remain constructive on credit from a fundamentals perspective. We therefore prefer to take this position through default risk (duration times spread) rather than general market beta (spread duration).

We remain biased towards financials over non-financials. Financials continue to present strong fundamentals and attractive valuations relative to non-financial credits. We remain underweight industrials on concerns over continued downward ratings migration into BBBs, increased merger and acquisition risk, shareholder-interest focused activity (dividends and buybacks), technological disruption and increasing idiosyncratic news. We thematically prefer regulated business models over unregulated (i.e., utilities) to hedge these risks. We also remain selective in off-benchmark holdings of high yield and government-related bonds.

In terms of interest rate risk, we are broadly neutral in duration terms versus the benchmark. We also continue to look for new issues to take advantage of new opportunities in the primary market.

The Fund has an exposure to green bonds and social, sustainability and sustainability-linked bonds of 28.0%, versus 12.1% in the index.

Looking forward our base case remains constructive for credit, supported by expectations of a "soft landing"; fiscal policy that remains supportive of growth, employment and consumption; and strong corporate fundamentals. Lighter gross issuance in the second half of 2024 coupled with strong demand for the "all-in" yield offered by investment grade credit is expected to create a supportive technical dynamic. When looking at credit spreads, we view the market as offering some value but see carry as the main driver of return. Given the uncertain medium-term fundamental backdrop, we have less confidence in material spread tightening.

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

## Fund Facts

| | |
|---|---|
| Launch date | 31 July 2020 |
| Base currency | Euro |
| Benchmark | Bloomberg Euro Aggregate: Corporates Index |

## 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 I Shares | 4.10 | 8.49 | -14.35 | -1.01 | -- | -- | -- | -- | -- | -- | -- |
| Bloomberg Euro Aggregate: Corporates Index | 3.83 | 8.19 | -13.65 | -0.97 | -- | -- | -- | -- | -- | -- | -- |

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 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. All data as of 30 September 2024 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 official language of your local jurisdiction at morganstanleyinvestmentfunds.com or free of charge from the Registered Office of Morgan Stanley Investment Funds, European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

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**INDEX INFORMATION**

The **Bloomberg Euro-Aggregate: Corporates bond index** is a rules based benchmark measuring investment grade, EUR denominated, fixed rate, and corporate only. Only bonds with a maturity of 1 year and above are eligible.

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