Morgan Stanley Investment Funds

European High Yield Bond

HIGH YIELD TEAM

Investors should note that, relative to the expectations of the Autorité des Marchés Financiers, this UCITS presents disproportionate communication on the consideration of extra-financial criteria in its management.

Performance Review

In the one month period ending 30 November 2024, the Fund's Z shares returned 0.52% (net of fees)[1], while the benchmark returned 0.45%.

Food & drug retail and diversified financial services were two of the Fund's top-performing sectors relative to the benchmark in October. Relative outperformance in food & drug retail was primarily driven by credit selection, with an underweight to a French grocery store operator continuing to add value. This recent fallen angel has continued to underperform. In diversified financial services, underweight positions in a couple specialty lending businesses in the U.K. and Sweden added value, as some of these more cyclically exposed parts of the economy have shown signs of weakness.

Health care and retail were two of the Fund's worst-performing sectors relative to the benchmark in October. Relative underperformance in health care was driven by overweight positions in a German pharmaceuticals business and a French laboratory testing business. In retail, an underweight allocation to the sector was the primary detractor.

From a credit quality perspective, an underweight to bonds rated lower than CCC and credit selection in BB-rated bonds contributed positively to the Fund's relative performance during the period. Conversely, credit selection in bonds rated CCC hurt relative performance.

The Fund's overall underweight duration positioning had a positive impact on performance during the month.

Market Review

The European high yield market performed well during October, driven by coupon income and credit spread tightening. The yield on the 5-year German government bond rose by approximately 30 basis points (bps) during the month.[2]

The technical conditions in high yield were balanced in October, with strong demand that more than offset positive net supply. Primary market issuance was robust for the second month in a row. We saw more than €18 billion of primary issuance during the month, which brings the year-to-date gross issuance to €110 billion. This remains on pace for the second-largest year ever for primary market issuance. The majority of issuance remains for refinancing purposes. According to preliminary Lipper estimates, European-domiciled high yield funds recorded a net inflow of more than €2.5 billion during October, bringing the total year-to-date inflow to €11.7 billion.[3]

In Europe, there were no defaults during the month, contributing to a marginal fall in the trailing 12-month rate to 2.6% (including distressed exchanges). Meanwhile, the distress ratio fell as a number of stressed issuers continued to rally.[3]

The ICE BofA European Currency High Yield Excluding Subordinated Financial Constrained Index (EUR-Hedged) returned 0.6% in October. The yield-to-worst fell 0.07% to 6.02%, while the spread-to-worst ended the month 31 bps lower at 351 bps.[4]

Homebuilders & real estate, retail, and cable & satellite TV were three of the top-performing sectors during the month. Metals & mining and building materials were two of the worst-performing sectors.

CCC-rated bonds outperformed during the month, while bonds rated lower than CCC performed worst.

Strategy and Outlook

Our outlook for the high yield market has marginally improved. It appears the preponderance of market participants also share this belief, and a scenario of reduced credit risk and below-historically-average default rates appears to be almost fully priced in at October-end. The catalysts with the potential to undermine this scenario are consistently present, and we remain focused on these in a continued effort to position our strategy to outperform, should market conditions deteriorate. These catalysts include the lagged effects of restrictive policy, economic conditions, consumer health and the fundamental health of high yield issuers. The high yield market ended October with an average spread near post-Global Financial Crisis lows, which was reached mid-month, and a historically attractive average yield that ended October above 6%.[3]

We enter the final weeks of the year in a familiar place — with an average credit spread at cycle lows and an average yield that remains well above the 10-year average.[3]There has been notable change, however, in relative valuations within high yield. What was

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 November 2024.
2 Source: Bloomberg L.P. Data as of 31 October 2024.
3 Source: J.P. Morgan. Data as of 1 November 2024.
4 Source: ICE Data Indices, Morgan Stanley Investment Management. Data as of 31 October 2024.

a growing divide between the CCC-rated segment and the remainder of the market reversed sharply over the last few months, and in our assessment, valuations in this cohort overshot fair value.

The Fund remains slightly under-risked relative to the ICE BofA European Currency High Yield Excluding Subordinated Financial Constrained Index, based on a duration-times-spread ratio that remained below 1. Despite some tailwinds currently on display in the market, we believe this posture remains appropriate for the Fund. Our lower-risk profile is primarily a function of our limited exposure to troubled situations where we anticipate a high likelihood of a liability management exercise (LME). We do not expect this to change. There is value remaining in the performing segment of our market, and it is worth emphasizing that a historically low average spread in the high yield market is warranted given the evolution of our market, and we do not view it as a source of significant concern. More than 60% of the ICE BofA European Currency High Yield Excluding Subordinated Financial Constrained Index remains BB-rated.[5]

We expect supportive capital inflows from global institutional investors will likely continue in the fourth quarter, due to the ongoing combination of the high yield market's historically attractive yield, generally supportive fundamentals and relatively high quality profile. Our base case is that the high yield market will likely generate attractive relative performance over the near-to-intermediate term. However, we expect intermittent volatility. In addition to the aforementioned risks, potential catalysts we are monitoring include: the continued expansion of the war in the Levant or the Russia-Ukraine conflict; one-party control of the U.S. presidency and, at the time of writing, likely both houses of Congress; and the European Union's budgetary process. Of course, these risks can also present opportunity. 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	01 December 1998
Base currency	Euro
Benchmark	Primary- ICE BofA European Currency High Yield 3% Constrained Ex-Sub Financials 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 Z Shares	7.78	12.17	-10.97	3.41	2.22	10.54	-4.46	6.36	9.84	1.38	4.47
Blended Benchmark	7.88	12.14	-11.75	3.25	2.82	10.95	-3.34	6.22	10.07	0.85	4.62

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.
- 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.

[5] Source: ICE Data Indices LLC, Morgan Stanley Investment Management. Data as of 30 September 2024.

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Information in relation to sustainability aspects of the Fund and the summary of investor rights is available at the aforementioned website.

If the management company of the relevant Fund decides to terminate its arrangement for marketing that Fund in any EEA country where it is registered for sale, it will do so in accordance with the relevant UCITS rules.

INDEX INFORMATION

The Blended Index performance shown is calculated using the **ICE BofA European Issuers High Yield Index** from inception through 31 July 2002, the **ICE BofA European Currency Constrained High Yield Index** to 31 March 2009 and the **ICE BofA European Currency High Yield 3% Constrained Ex-Sub Financials Index** thereafter.

The **ICE BofA European Currency Constrained high yield index**: The index is designed to track the performance of euro- and British pound sterling-denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets by issuers around the world.

The **ICE BofA European Currency High Yield 3% Constrained Ex-Sub Financials Index**: contains all non-Sub Financial securities in the ICE BofA European Currency High Yield Index but caps issuer exposure at 3%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 3%.

The **ICE BofA European Issuers High Yield Index:** The index is designed to track the performance of USD, EUR and GBP denominated below investment grade corporate debt publicly issued by European corporations in the US, sterling or euro domestic or the eurobond markets.

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