A Sub-Fund of Morgan Stanley Investment Funds

US High Yield Middle Market Bond Fund

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 31 December 2025, the Fund's Z shares returned 1.17% (net of fees)[1], while the benchmark returned 0.57%.

Retailers and packaging were the Fund's top-performing sectors relative to the benchmark in December, both due to favorable credit selection. In retailers, a lack of exposure to a struggling department store chain was the top relative contributor. The company continues to come under pressure as investors question its liquidity and ability to pay its vendors and creditors. Further, the company missed an interest payment at the end of December. The primary individual contributor in packaging was an overweight position in a Canadian reusable packaging company. The company released third quarter earnings that were better than expected.

Gaming and cable & satellite were the Fund's worst-performing sectors relative to the benchmark during the month. Relative underperformance in gaming was driven by adverse credit selection and was led by an overweight position in a Canadian casino operator. In cable & satellite, an underweight position and challenging credit selection drove relative underperformance. The primary individual detriment was an underweight position and selection within the capital structure of U.S. cable operator. The company's bonds partially rebounded after underperforming in November, following the company's paydown of one of its loan facilities, which potentially allows it to take on additional debt that would negatively impact current lenders.

In terms of performance by ratings segment, favorable credit selection in BB-rated bonds contributed positively to relative performance during the month. Sound credit selection and an overweight position in B-rated bonds also helped relative returns. Conversely, an overweight to bonds rated CCC or below detracted from relative performance.

Market Review

December was the strongest month in the fourth quarter for the U.S. and global high yield markets, capping a strong year. Investors' risk appetite generally improved amid a supportive backdrop that included a dovish outcome from the Federal Reserve's (Fed) December meeting, and a third quarter U.S. gross domestic product (GDP) print that far exceeded consensus expectations. Within U.S. high yield, inflows into retail funds, an elevated volume of called bonds, healthy rising star volume (bonds upgraded from high yield to investment grade) and a lack of fallen angels (bonds downgraded from investment grade to high yield) contributed to positive technical conditions that benefited trading levels in the primary and secondary markets. By the end of the year, the average yield settled approximately in line with the 10-year average, putting it near multiyear lows. The average spread ended the year 19 basis points (bps) off post-Global Financial Crisis lows, reached in January 2025.[2]

The Bloomberg U.S. Corporate High Yield Index returned 0.57% in December. The yield-to-worst finished the month 4 bps lower at 6.53%. The spread-to-worst closed the period 5 bps lower at 292 bps.[2]

Performance across high yield sectors remained mostly positive for the one-month period. The top-performing sectors for the month were other basic industry, transportation, and banking, with respective returns of 1.02%, 0.81%, and 0.79%. The natural gas utility, consumer non-cyclical, and other financial sectors were the worst-performing sectors in December, with respective returns of -0.05%, 0.33%, and 0.40%.[2]

The middle-to-lower quality segments of the high yield market generally outperformed in December amid the improved appetite for risk. The B-rated segment led performance with a return of 0.89% for the one-month period. Meanwhile, the CCC and BB segments posted respective one-month returns of 0.67% and 0.41%.[2]

Total gross issuance decreased from $24.9 billion in November to $21.8 billion in December. By use of proceeds, refinancing increased to 76.8% of monthly issuance, acquisition-related financing decreased to 11.7%, and general corporate purposes accounted for approximately 11.1%. Lower-rated issuance increased modestly, though only accounted for 3.6% of issuance for the full year. U.S. high yield retail funds recorded a net inflow of approximately $1.1 billion in December, bringing the net inflow for 2025 to $18.3 billion. The high yield market experienced a net supply shortfall of approximately $5.7 billion in December, contributing to a shortfall of $12.9 billion for the full year.[3]

Default volume in leveraged credit remained elevated in December due to the large volume of liability management exercises (LMEs) that occurred during the month. According to J.P. Morgan, the high yield trailing 12-month par-weighted default rate including

1 Source: Morgan Stanley Investment Management. Data as of 31 December 2025.
2 Source: ICE Data Indices, Bloomberg L.P., Morgan Stanley Investment Management. Data as of 31 December 2025.
3 Source: J.P. Morgan. Data as of 5 January 2026.

distressed exchanges increased 4 bps, ending December at 1.88%. Excluding distressed exchanges, the rate increased to 0.99%, a 17-month high. For loans, the trailing 12-month par-weighted default rate including distressed exchanges decreased by 45 bps, closing the year at 2.87%. Excluding distressed exchanges, the rate settled at 1.46%.[3]

Strategy and Outlook

As we enter 2026, the high yield market finds itself on improved footing. In the year ahead, we anticipate an environment characterized by decent economic growth across much of North America and Europe, softening labor markets, elevated but likely declining core inflation, evolving monetary policy complicated by political pressure on central banks, and supportive fiscal policy in the U.S. ahead of the midterm elections. While 2026 will not be a year without volatility, we expect corporate balance sheets to largely remain resilient, with increasing dispersion in earnings, and valuations that adjust to more accurately reflect this reality. The average spread in high yield begins the year only marginally above post-Global Financial Crisis (GFC) lows, and we expect this to adjust modestly wider as risk premium appropriately continues to transition from a beta-led compression trade to reflect a range of idiosyncratic outcomes. At the same time, we think the quality and health of high yield issuers, coupled with a historically attractive yield, should continue to attract global institutional capital.[4] This outlook is informed by a thorough analysis of macroeconomic and fundamental factors, including the trajectory of U.S. and global economic growth, evolving monetary and fiscal policy, consumer health, issuer fundamentals, technical conditions, and valuations.

The resilience of the U.S. economy continues to surpass expectations, and even as we likely experience moderate deceleration in growth this year, we expect the backdrop to remain supportive. Bloomberg's consensus economic forecast (Bloomberg consensus) calls for 2.1% U.S. real GDP growth in 2026 and 2027.[5] This estimate is broadly in line with the Fed's Summary of Economic Projections released in December, where the median forecast called for 2.3% U.S. real GDP growth in 2026, followed by 2.0% in 2027.[6] The trajectory of the Institute for Supply Management (ISM) Services Purchasing Managers' Index (PMI) is also supportive, with the December report for November solidly in expansion territory at 52.6, an increase of 0.2 month-over-month.[7] Additional notable factors that we think will likely play a supportive role in 2026 include growth in exports and a meaningful drop in imports, consumer support from the 2025 tax and spending bill, an improving housing market, and continued growth in services. Bloomberg consensus forecasts growth in new and existing home sales and building permits in 2026, after consistent contraction in the balance of these metrics over the last several years.[5] This has been a particular weak spot in U.S. economic activity amid elevated interest rates, and this improvement should feed through to associated sectors of the economy, particularly building products. These supportive indicators are balanced against several indicators that should give investors reason for caution. The ISM Manufacturing PMI for November indicated consistent contraction in manufacturing activity for nine months, showing a month-over-month deceleration of 0.5 to 48.2, with backlog of orders and manufacturing labor two areas of particular weakness.[7]Softening labor conditions were also clearly evident in the December U.S. Bureau of Labor Statistics (BLS) report, with the unemployment rate touching more than a four-year high in November at 4.6%, and the government's U-6 underemployment rate reaching a new cycle high of 8.5%.[8] Labor conditions warrant ongoing monitoring; however, we assess the lion's share of softening in the labor market to be in the rear view, and we expect some stabilization in the context of current levels in 2026.

Growth in Europe and the U.K. appears to have stabilized in 2025 after a period of softness, with the expectation for slightly slower, still positive growth in 2026 and some level of reacceleration in 2027. Bloomberg consensus calls for real GDP in the European Union (EU) of 1.6% in 2025 to slow slightly to 1.4% in 2026, before returning to 1.6% in 2027.[5] There is a similar trend in expectations for the United Kingdom, where growth is expected to slow from 1.4% in 2025 to 1.1% next year, returning to 1.4% in 2027.[5] In early December, the Organisation for Economic Co-operation and Development released its growth outlook for 2026, showing growth projections of 1.7%, 1.2%, and 1.2% in the U.S., U.K., and euro area, respectively.[9]

Global central banks continue to navigate a precarious period, with disparate and uncertain inflation backdrops across regions. In the U.S., the Fed's December median projections showed the core personal consumption expenditures (PCE) price index slowing from an expected 3.0% in 2025 to 2.5% in 2026.[6] This expected trajectory, coupled with a weakening labor market that is expected to stabilize in 2026, prompted the Fed to reduce its key policy rate by a quarter-point in December, and contributed to median Fed expectations of approximately one additional interest rate cut in 2026.[6] Meanwhile, market pricing calls for approximately two cuts in 2026.[5] Later in December, an arguably distorted BLS report on inflation for the month of November supported this path, registering well below expectations with a core inflation reading of 2.6%. In Europe, inflation appears lower relative to both the U.S. and the U.K, and current monetary policy reflects this. In November, core inflation in the EU was approximately 2.4%, unchanged from the prior month, with the expectation of softening to 1.9% in 2026.[10] The European Central Bank (ECB) maintained its key policy rate at 2.0% in December. In the U.K., the consumer prices index including owner occupiers' housing costs (CPIH) reportedly decreased from 3.8% in October to 3.5% in November.[11] Though moving in the right direction, this preferred measure of inflation remains historically high.[11] Consensus expectations are that inflation will continue to decline in 2026, toward the Bank of England's 2% target.[5] The Bank of England made the decision to reduce its key policy rate to 3.75% in December. While the paths of monetary policy for certain central banks has recently shown relative consistency, the risk of stickier inflation in certain regions, divergence in

3 Source: J.P. Morgan. Data as of 5 January 2026.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 31 December 2025.
5 Source: Bloomberg L.P.: Consensus Economic Forecast, Bloomberg World Interest Rate Pricing. Data as of 5 January 2026.
6 Source: Federal Reserve Summary of Economic Projections. Data as of 10 December 2025.
7 Source: Institute for Supply Management. Data as of 3 December 2025.
8 Source: U.S. Bureau of Labor Statistics. Data as of 16 December 2025.
9 Source: Organisation for Economic Co-operation and Development. Data as of 2 December 2025.
10 Source: European Central Bank Data Portal. Data as of 2 December 2025.
11 Source: United Kingdom's Office for National Statistics. Data as of 17 December 2025.

growth backdrops, and the possibility of political influence in an election year has the potential to cause some level of divergence in policy paths in 2026.

U.S. consumer health remains a focal point, especially for lower-end cohorts; however, we are encouraged by recent signs of stabilization. The delinquency rate on credit card loans decreased to 2.98% in the third quarter of 2025, relative to a peak of 3.22% in the second quarter of 2024. At the same time, the delinquency rate on consumer loans decreased to 2.72% in the third quarter from 2.75% in the prior quarter, and relative to a peak of 2.77% in the first quarter of 2025.[12]Both of these metrics remain near levels last reached in 2012, but current trends suggest stabilization. This encouragement is tempered, however, by consumer sentiment, which we would generally characterize as weak. The Conference Board's Consumer Confidence Survey fell sharply in November to 88.7, from 95.5 in October, reaching its lowest level since peak post-tariff announcement hysteria in April.[13] Consumer expectations regarding both business conditions over the next six months and labor market conditions in mid-2026 were remarkably poor. Consumer confidence can be somewhat fickle, however, and we expect to see some improvement in the near term, based in part on the Trump administration's expected push to bolster public approval leading into the midterm elections.

The fundamentals of high yield issuers remain relatively healthy in a historical context, and, in aggregate, third quarter earnings released in the fourth quarter depict modest improvement. Top- and bottom-line growth remained positive but have failed to break out of the low single digits for the balance of the last two years. Earnings margins improved to their highest level since the first quarter of 2024, leverage remained slightly above average but decreased sequentially, and interest coverage remained slightly below average, though also exhibited slight improvement. According to J.P. Morgan, third quarter earnings released in the fourth quarter showed revenue growth of 4.0% and EBITDA[14] growth of 1.7%.[15] At the same time, profit margins strengthened in the third quarter for the first time in nearly two years, increasing from 14.5% to 15.5%, relative to a recent peak of 16.5% in the first quarter of 2023.[15] Earnings across sectors remained significantly bifurcated, with the notable laggards being transportation, media and automotive, with transportation experiencing a year-over-year earnings decline of nearly 20%.[15] At the same time, metals & mining, technology, and services experienced strong growth. The average leverage (debt-to-EBITDA ratio) of high yield issuers remained healthy, though above average in a historical context, and decreased from 4.40x to 4.37x in the third quarter.[15] Telecommunications, automotive and transportation are the most aggressively levered sectors in high yield. Meanwhile, interest expense increased only 2.1% for the trailing 12-month period ending 30 September, and coverage (EBITDA-to-interest expense) improved from 4.12x to 4.18x.[15] Though well below post-pandemic peaks, interest coverage of high yield issuers remains healthy and only modestly below the long-term average.[15]Moving forward in 2026, we will be closely watching the fundamentals of high yield issuers for any signs of material degradation. On average, we expect the fundamentals to remain supportive, but there are clear pockets of weakness that warrant scrutiny.

The pace of primary issuance in the high yield market remained seasonally elevated in the fourth quarter while slowing significantly quarter-over-quarter. Ultimately, the fourth quarter saw healthy issuance characterized by a high level of refinancing activity, contributing to a total gross issuance volume of $65.4 billion in the fourth quarter and $332 billion for the full year.[3] With limited exceptions, issuers generally found a receptive investor base. The quality of fourth quarter issuance remained high, with approximately 70% of issuance rated split-BB (rated BB by at least one major rating agency) or higher.[3] Lower-rated issuance remained remarkably limited. While a single quarter of limited issuance from lower-rated issuers is not statistically significant, CCC issuance has not broken above 5% since 2022.[3] It bears watching given the greater portion of CCC-rated bonds that mature in the next two to three years relative to the single-B or BB-rated segments. Approximately 33% of outstanding CCC-rated bonds mature before January 2029.[4] In 2026, we expect gross issuance to increase by approximately 15%. Refinancing volume is expected to grow slightly as issuers look to term out debt at financing costs that most expect to be marginally more attractive. We expect the primary driver of increased issuance in 2026 will likely be an approximate doubling in the volume of acquisition financing-related issuance, which would represent a year-over-year increase to 20%-25% of gross volume. This will likely be driven, in part, by an elevated volume of previously announced acquisitions that need to be financed in 2026, and a continued theme of consolidation within certain sectors in the crosshairs of deregulation. The increase in net issuance, and the elevated level of lower-rated debt maturing over the course of the next two years, should result in increased dispersion within the high yield primary market, and likely the secondary market as well, particularly within lower-rated capital structures. We welcome the prospect of enhanced idiosyncratic differentiation. While we expect net issuance to increase in 2026, we anticipate a supportive technical balance as global institutional demand for high yield credit should remain supportive, based on the combination of historically attractive yield coupled with record credit quality and adequate fundamental health.

The volume of LMEs among high yield bond and leveraged loan issuers increased in the fourth quarter. Traditional defaults in high yield bonds also ticked higher, while the aggregate volume of LMEs and traditional defaults remained well below long-term averages. The trailing 12-month par-weighted default rate for high yield issuers, inclusive of distressed exchanges, increased from 1.39% at the end of the third quarter to 1.88% by year-end.[3] The same metric for loan issuers fell to 2.87%.[3] It is worth noting that LME activity across leveraged credit decreased significantly in 2025, but for the trailing two-year period, LME volume was higher than during any other two-year period. Over the next several quarters, our base case is that default and LME activity will remain

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3 Source: J.P. Morgan. Data as of 5 January 2026.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 31 December 2025.
12 Source: Board of Governors of the Federal Reserve System. Data as of 21 November 2025.
13 Source: The Conference Board: Consumer Confidence Survey. Data as of 25 November 2025.
14 Earnings before interest, taxes, depreciation and amortization.
15 Source: J.P. Morgan. Data as of 11 December 2025.

elevated, with a notable contribution coming from companies that have executed an LME over the past couple of years in an unsuccessful bid to fix their capital structure. LMEs accounted for 48% of default volume in 2025 and 68% of default volume in 2024.[3] Approximately half of all LMEs re-default in the subsequent three years, with the subsequent default resulting in lower recovery rates.[16] 40% of default actions in 2025 and 35% of default actions in 2024 were from companies that had previously defaulted or completed a LME.[3] We expect the default rate for high yield bonds inclusive of distressed exchanges to remain below the long-term average and likely finish 2026 in the context of 2%-2.5%. Meanwhile, credit risk in private credit is notably higher. According to Bank of America Global Research, the current issuer-weighted default rate in private credit, including distressed exchanges and non-accruals, ended the year above 5%. Private credit also carries more artificial intelligence (AI) disruption risk, with technology sector exposure of over 20%, 80% of which are software companies.[17]

We begin 2026 with an average yield and spread in close proximity to 2025 starting levels, despite intra-period volatility. At year-end 2025, the average spread was approximately 20 bps above post-GFC lows, reached in January 2025, and the average yield was approximately in line with the 10-year historical average.[4] Additionally, yield per unit of duration increased in 2025, ending the year approximately 10% above the long-term average, as the average yield remained historically high and the average duration decreased.[4] The notable compression in the incremental spread relationship between the CCC and single-B segments that took place in the third quarter reversed in the fourth quarter, as lower-rated credit underperformed.[4] This relationship widened from 510 bps at the beginning of the fourth quarter to 577 bps at quarter-end.[4] We believe valuations across several segments of the high yield market adjusted closer to fair value in the fourth quarter, more accurately reflecting the many risks facing our market. This decompression trade is likely to continue and, at the ICE BofA U.S. High Yield Index level, we expect to reach modestly wider peak spreads in 2026. The increase in dispersion in the high yield market in the final months of the year also created opportunity. We continue to identify idiosyncratic situations to capture spread compression, even in segments where we think valuations at the sector level are full. Additionally, we anticipate an increase in net issuance volume, and acquisition-related financing in particular, will likely lead to interesting relative value opportunities in the primary market and also potentially lead to wider spreads in the secondary market, within select segments of the high yield market. At the sector level, we continue to evaluate new opportunities in more cyclical segments that appear to be at or near cycle troughs. A prime example is the building materials sector. Finally, we believe there remains opportunity in challenged segments where neatly structured covenants, adequate loan-to-value ratios, and appropriate risk compensation form to represent compelling investment opportunities.

Our strategy remains slightly under-risked relative to the Bloomberg U.S. Corporate High Yield Index, based on a duration-times-spread (DTS) ratio modestly below 1. We think the slightly more conservative positioning should continue to benefit our investors in times of market turbulence, and complementing this core with sizable opportunistic positions in high conviction situations should provide attractive positive convexity as these idiosyncratic credit stories play out. Despite our expectation for additional spread widening, we remain encouraged by the fact that credit quality remains near record highs, with over 57% of the high yield bond market rated BB and less than 10% rated CCC or lower.[4] Additionally, average duration is more than a year below the long-term average.[4] This was certainly not the case in 2007. We believe that our current risk positioning is justified, all-in yield remains historically appropriate, and yield per unit of duration appears compelling. At the same time, credit risk is increasing and complacency will likely continue to be penalized. We will focus our holdings in segments where we believe growth and free cash flow are most durable and convexity remains most attractive.

In conclusion, we are transitioning into an environment where we expect growth in the U.S. to slow from the surprising high level experienced over the last few quarters, but ultimately remain supportive, and where we think the trajectory of inflation and labor data will likely remain top of mind and the primary sources of episodic volatility. Fundamentals and technical conditions remain largely favorable and, on average, yield compensation is broadly appropriate. A modest increase in spread dispersion in the fourth quarter was both welcome and presented opportunity; however, average spreads remain in close proximity to post-GFC lows, leaving valuations exposed to future bouts of volatility. We expect 2026 will likely be a competitive period for high yield, where starting yield ultimately generates attractive return, while average spreads move modestly wider. Geopolitical tensions in the Middle East, Eastern Europe and South America remain elevated, and the evolving situation in Venezuela presents the possibility for deterioration or successful conclusion. Meanwhile, legislative dysfunction continues to stymie the passage of meaningful legislation, funding-related or otherwise, in the U.S., and the midterm elections will likely add to the political circus. Amid an uncertain and potentially volatile 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	02 December 2014
Base currency	U.S. dollars
Benchmark	Bloomberg US Corporate High Yield Index

3 Source: J.P. Morgan. Data as of 5 January 2026.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 31 December 2025.
16 Source: Goldman Sachs. Data as of 12 September 2025.

17 Source: Bank of America Global Research. Data as of 18 September 2025.

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2025	2024	2023	2022	2021	2020	2019	2018	2017	2016
Class Z Shares	8.26	8.26	8.83	13.34	-11.97	5.30	5.24	15.60	-2.53	8.15	16.30
Bloomberg US Corporate High Yield Index	8.62	8.62	8.19	13.44	-11.19	5.28	7.11	14.32	-2.08	7.50	17.13

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 shares. The sources for all performance and index data is Morgan Stanley Investment Management ('MSIM Ltd'). **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.
- 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 31.12.2025 and subject to change daily.

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The summary of investor rights is available in the aforementioned languages and website location under the General Literature section.

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INDEX INFORMATION

The **Bloomberg U.S. Corporate High Yield Index:** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The Index excludes emerging market debt.

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