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 30 September 2025, the Fund's Z shares returned 0.74% (net of fees)[1], while the benchmark returned 0.82%.

Midstream and building materials were the Fund's top-performing sectors relative to the benchmark in September, both due to favorable credit selection. In midstream, a lack of exposure to a struggling gas-to-power energy infrastructure company was the top relative contributor. While the company has made progress in securing an important contract with Puerto Rico, it reported poor second quarter earnings during the month. The top relative contributor in building materials was an overweight position and positioning within the capital structure of a provider of bathroom remodeling products. The company still faces challenging industry conditions; however, the position began to rebound from more depressed levels earlier in the year.

Media & entertainment and consumer cyclical services were the Fund's worst-performing sectors during the month. Relative underperformance in media & entertainment was driven by an underweight position and challenging credit selection. The primary individual detriment was a lack of exposure to a media company that was recently downgraded from investment grade. In September it was announced that the company was likely being acquired. In consumer cyclical services, relative underperformance was driven by challenging credit selection and was led by an overweight position in a provider of legal litigation support services, specializing in areas such as depositions and legal videography. The company's bonds were down nearly 4%, likely on speculation regarding future impacts from artificial intelligence.

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

Market Review

Performance in the U.S. and global high yield markets moderated in September as primary market volume surged to a record level. Ultimately, firm institutional demand was sufficient to absorb the heavy volume as managers worked down cash balances. The Federal Reserve's (Fed) September decision to reduce its key policy rate by a quarter-point was fully priced into the market well in advance, and minutes from the meeting did little to dissuade bullish sentiment. The quarter concluded with the announcement of the largest leveraged buyout on record, worth a reported $55 billion. As spreads grinded moderately tighter, dispersion fell to the lowest level since January this year.[2]

The Bloomberg U.S. Corporate High Yield Index returned 0.82% in September. The yield-to-worst finished the month 5 basis points (bps) lower at 6.70%. The spread-to-worst closed the period 2 bps lower at 300 bps.[2]

Performance across high yield sectors was positive for the one-month period. The top-performing sectors for the month were natural gas utility, banking, and communications, with respective returns of 3.91%, 1.19%, and 1.11%. The basic industry, capital goods, and technology sectors were the worst-performing sectors in September, with respective returns of 0.47%, 0.52%, and 0.57%.[2]

The lower quality segments of the high yield market generally outperformed in September amid a continued bid for risk. The CCC-rated segment led performance with a return of 0.98% for the one-month period. Meanwhile, the single-B and BB segments posted respective one-month returns of 0.83% and 0.82%.[2]

Total gross issuance shot up month-over-month, from $25.7 billion in August to a September record-high $58.8 billion. By use of proceeds, refinancing accounted for 73% of monthly issuance, acquisition-related financing increased to 16%, and general corporate purposes accounted for approximately 9%. Lower-rated issuance was notably light, accounting for only 2.7% of issuance. U.S. high yield retail funds recorded a net inflow of approximately $1.7 billion in September, bringing the year-to-date net inflow to $14.9 billion. The high yield market experienced a net supply surplus in September of approximately $31.4 billion. Year-to-date, the high yield market moved from net negative supply to a net supply surplus of only $15.1 billion.[3]

Default activity in leveraged credit increased in September on the back of two large loan-only defaults, though there were no distressed exchanges. According to J.P. Morgan, the high yield trailing 12-month par-weighted default rate including distressed

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 September 2025.
2 Source: ICE Data Indices, Bloomberg L.P., Morgan Stanley Investment Management. Data as of 30 September 2025.
3 Source: J.P. Morgan. Data as of 1 October 2025.

exchanges decreased by 6 bps, ending September at 1.39%. Excluding distressed exchanges, the rate ended September at 0.49%. For loans, the trailing 12-month par-weighted default rate including distressed exchanges increased by 17 bps, closing the month of September at 3.49%. Excluding distressed exchanges, the rate increased to 1.53%.[3]

Strategy and Outlook

We begin the fourth quarter of 2025 with an outlook that is slightly improved, while still cautious. Peak risk and volatility emanating from evolving trade policy are likely behind us, strong second quarter U.S. economic growth metrics released in the third quarter exceeded expectations, corporate earnings were largely resilient, and a weakened lower-end consumer in the U.S. showed signs of stabilization. However, third quarter indicators, including a downshift in job growth in the U.S., a mixed bag of industry and consumer surveys and an acceleration in growth of consumer prices, are among reasons for continued caution. Ultimately, moving forward we expect a backdrop of much slower but positive growth, coupled with stickier inflation, from a starting point where the average spread in high yield is only marginally above post-Global Financial Crisis (GFC) lows, but where a historically attractive yield should continue to attract capital.[4] We come to this conclusion after a thorough analysis of factors including U.S. and global economic growth, the evolving monetary policy of global central banks, consumer health, the fundamentals of high yield issuers, technical conditions, and valuations. On balance, conditions appear marginally better quarter-over-quarter, but the question ultimately is how much of this improvement is reflected in current valuations.

The U.S. economy appears to have modestly downshifted in the third quarter, from a second quarter in which U.S. gross domestic product (GDP) was upwardly revised to 3.8%, fueled by a drop in imports and an increase in consumer spending, representing a sharp rebound from a modest contraction in the first quarter.[5] In mid-September, the Federal Reserve Bank of Atlanta's GDPNow forecasting model indicated growth likely slowed to a still robust 3.3% in the third quarter, well above trend growth of 1%-2%.[6] This slightly softening trend is consistent with the balance of purchasing managers' index (PMI) and employment data published in the quarter. The Institute for Supply Management (ISM) PMI Reports for August, released in September, depicted a continued contraction in manufacturing activity and expansion in services. The Manufacturing PMI registered a still sluggish 48.7, while improving sequentially, and new manufacturing orders rebounded back into expansion territory with a reading of 51.4, following a six-month period of contraction. The Services PMI was also strong at 52.0, an increase of 1.9% from July and the third consecutive month of expansion.[7] Perhaps the most consistently weak aspect of the ISM report was with regard to labor, where its employment index remained in contraction territory in August for the third month in a row and for the fifth time in the last six months.[7] This softness is also evident in the government's U-6 underemployment rate, which rose month-over-month in both July and August, with the August reading reaching a cycle high 8.1%.[8] While perhaps soft on balance, the employment data appeared to improve in the second half of the quarter, as the four-week moving average of continued unemployment claims successively moderated since 16 August, offering evidence of stabilization.[9] Looking forward, we anticipate the potential for improving labor conditions amid record equity valuations, improving animal spirits, and diminishing uncertainty emanating from evolving trade policy. The most recent CEO Confidence Index indicated that only 28% of CEOs expected deteriorating conditions in the year ahead.[10] We assess the likelihood of a recession over the near term as low, given the fiscal tailwinds on both the corporate and consumer sector from the tax bill. We expect growth in the U.S. will likely slow in the fourth quarter relative to the elevated growth experienced in the second and third quarters, before modest improvement in 2026, likely in the context of 1.5%-2% growth. Our view is not dissimilar from projections released at the September Fed meeting. The Fed raised expectations for 2025 full-year U.S. GDP from 1.4% to 1.6%, and 2026 expectations from 1.6% to 1.8%.[11]

Forward economic growth expectations for the United Kingdom and euro area are of similar magnitude to expectations for the U.S., with slightly slower growth expected in the euro area. GDP growth in the U.K. reportedly slowed from 0.7% in the first quarter to 0.3% in the second quarter, and the U.K. Office for Budget Responsibility is projecting GDP to grow at 1.0% for calendar year 2025, and to accelerate to 1.9% in 2026.[12] Growth was slower in the euro area over the first half of the year, reportedly accelerating from 0.1% in the first quarter to 0.2% in the second.[13] The European Central Bank (ECB) is projecting the euro area economy to grow at a rate of 1.2% in 2025, 1.0% in 2026 and 1.3% in 2027.14 In late September, the Organisation for Economic Co-operation and Development released its expectations for 2026 economic growth of 2.2%, 1.0%, and 1.0% in the U.S., U.K., and euro area, respectively.[14]

Global central banks are navigating a precarious period, with disparate and uncertain inflation backdrops across regions. In Europe, inflation appears tame relative to both the U.S. and U.K., and current monetary policy reflects it. In August, headline inflation in the eurozone was approximately 2.0%, and core inflation 2.3%. The ECB is projecting headline inflation will average 2.1% in 2025 and

3 Source: J.P. Morgan. Data as of 1 October 2025.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 30 September2025.
5 Source: U.S. Bureau of Economic Analysis. Data as of 25 September 2025.
6 Source: Federal Reserve Bank of Atlanta. Data as of 17 September 2025.
7 Source: Institute for Supply Management. Data as of 4 September 2025.
8 Source: U.S. Bureau of Labor Statistics. Data as of 5 September 2025.
9 Source: U.S. Employment and Training Administration via Federal Reserve Bank of St. Louis. Data as of 19 September 2025.
10 Source: Chief Executive Research. Data as of September 2025.
11 Source: Board of Governors of the Federal Reserve System. Data as of 17 September 2025.
12 Source: Office for Budget Responsibility, United Kingdom. Data as of 30 September 2025.
13 Source: European Central Bank Data Portal. Data as of 5 September 2025.
14 Source: Organisation for Economic Co-operation and Development. Data as of 23 September 2025.

slow to 1.7% in 2026.[15] The ECB maintained its key policy rate at 2.0% in September. In the U.K., the 12-month consumer price index (CPI) was reportedly 3.8% in August and expected to increase modestly in September, before beginning to fall back toward 2% thereafter.[16] The Bank of England made the decision to maintain its key policy rate at 4.0% in September. Meanwhile, in the U.S., inflation showed definitive signs of acceleration in late summer, and the forward path of inflation is of clear concern. The Bureau of Labor Statistics (BLS) reported U.S. headline CPI rose 0.4% month-over-month in August, and on a 12-month basis increased 2.9% year-over-year in August. U.S. core CPI rose 0.2% month-over-month in August, and on a 12-month basis increased 3.2% year-over-year, according to BLS data. At its September meeting, the Fed increased its projections for 2026 headline and core inflation to 2.6% apiece.[11] We expect inflation in 2026 will likely prove sticky and remain closer to 3% as businesses look to continue to defend margins and pass on rising input costs. Complicating the Fed's decision on its key policy rate was a concern over the potential for further softening in the labor market. This concern clearly weighed on the Fed's decision in September as it chose to reduce its key policy rate to 4.0%.[11] Our expectation is for the Fed to make one more quarter-point reduction in the fourth quarter if current labor market conditions persist, with the potential for an additional cut before year-end should labor data further deteriorate.

U.S. consumer health remains a point of focus for us given the weakening and ultimately compromised health of the lower-end consumer. The aforementioned challenges with regard to a softer labor market and hotter inflation are further potential headwinds; however, we believe that recent data supports a level of stabilization in the lower-end consumer. The delinquency rate on credit card loans decreased to 3.05% in the first quarter and remained unchanged in the second quarter. At the same time, the delinquency rate on consumer loans decreased in the second quarter from 2.77% to 2.63%.[17] Both of these metrics remain near levels last reached in 2012, but the fact that one appears to have troughed and the other is potentially moving out of a trough is encouraging. This encouragement is tempered by the Conference Board's Consumer Confidence Survey, which declined 1.3 points in August to 97.4, with consumers citing a weaker appraisal of current job availability and increased pessimism about future job availability.[18] Over the near term, we are not concerned by the low probability of a sharp decline in consumer health, though we will continue to cast a discerning eye on these metrics given the importance of this cohort.

The fundamentals of high yield issuers remain healthy in a historical context, but second quarter earnings released in the third quarter depict a continued trend of modest softening. 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 continued to weaken, reaching their lowest level since the first quarter of 2021, leverage increased, and interest coverage was unchanged. According to J.P. Morgan, second quarter earnings released in the third quarter show revenue growth of 2.1% and EBITDA[19] growth of 1.1%. At the same time, profit margins deteriorated for the fourth consecutive quarter, falling from 14.4% to 14.2% in the second quarter, relative to a recent peak of 16.6% in the first quarter of 2023.[20] Earnings across sectors were significantly bifurcated, with the notable laggards being housing, automotive, media, and chemicals, with the first two experiencing a year-over-year earnings decline of over 17% and 15%, respectively.[20] At the same time, technology, services and consumer products experienced strong growth. The average leverage (debt-to-EBITDA ratio) of high yield issuers remained healthy in a historical context, though increased from 4.08x to 4.20x in the second quarter.[20] Automotive, media and telecommunications are the most aggressively levered sectors in high yield. Meanwhile, interest expense increased only 0.1% for the trailing 12-month period ending June 30, and coverage (EBITDA-to-interest expense) remained stable at 4.71x.[20] Though well below post-pandemic peaks, interest coverage of high yield issuers remains historically healthy relative to a long-term average of 4.5x.[20]

The pace of primary issuance in the high yield market remained elevated in the third quarter, with only a modest slowdown in August, before leaping to a multiyear record in September. Ultimately, the third quarter saw healthy issuance characterized by a high level of refinancing activity, contributing to a total gross issuance volume of $121.9 billion.[3] With limited exceptions, issuers generally found a receptive investor base. The quality of issuance remained high, with approximately 56% of issuance rated split-BB (rated BB by at least one major rating agency) or higher.[3] Lower-rated issuance remained remarkably limited. While one-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 25% of outstanding CCC-rated bonds mature before October 2028.[4] Our estimate for full-year gross issuance volume has increased given the surge in third quarter issuance and the pickup in acquisition-related activity that will need to be financed, including the largest planned leveraged buyout in history. A shift toward deregulation under the current U.S. administration and a lower regulatory hurdle for strategic consolidation should spur additional acquisition-related issuance across sectors such as oil and gas, cable, media, and telecommunications. Finally, institutional demand from global yield-based investors in the third quarter remained remarkably firm, in aggregate. We expect demand from this cohort to remain supportive given average yields that, while materially lower quarter-over-quarter, remain attractive in a historical context. We also expect that investors will likely remain less receptive to aggressive and lower-rated opportunities over the near-to-intermediate term.

3 Source: J.P. Morgan. Data as of 1 October 2025.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 30 September2025.
11 Source: Board of Governors of the Federal Reserve System. Data as of 17 September 2025.
15 Source: European Central Bank Data Portal. Data as of 17 September 2025.
16 Source: Bank of England. Data as of 18 September 2025.
17 Source: Board of Governors of the Federal Reserve System. Data as of 18 August 2025.
18 Source: The Conference Board: Consumer Confidence Survey. Data as of 26 August 2025.
19 Earnings before interest, taxes, depreciation and amortization.
20 Source: J.P. Morgan. Data as of 15 September 2025.

The pace of liability management exercises (LMEs) among high yield bond and leveraged loan issuers remains elevated; however, the aggregate volume of distressed exchanges and traditional defaults in high yield bonds remains manageable and well below long-term averages. The trailing 12-month par-weighted default rate for high yield issuers, inclusive of distressed exchanges, decreased modestly from 1.41% at the end of the second quarter to 1.39% by quarter-end. The same metric for loan issuers decreased to 3.49%.[3] Over the next several quarters, our base case is that default and LME activity in leveraged credit will likely continue to creep higher, 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 57% of default volume over the first eight months of 2025 and 68% of default volume in 2024.[21] Approximately half of all LMEs re-default in the subsequent three years, with the subsequent default resulting in lower recovery rates.[22] We expect the default rate for high yield bonds inclusive of distressed exchanges to remain below the long-term average and likely finish 2025 in the context of 2%-2.5%. It is worth taking note of the higher relative risk of credit losses that is building in private credit. According to Bank of America Global Research, the current issuer-weighted default rate in private credit in mid-September was 5%. Another 2.5% of the private credit market is classified as "bad PIKs," comprised of issuers that converted from cash coupon payment to payment-in-kind (PIK), or said another way, paying coupons by issuing additional debt, at some point after issuance due to an inability to service their debt with cash payments.[23] Furthermore, approaching maturity walls in private credit are significantly higher than the benign maturity walls currently found in public leverage credit markets. 17% of private loans mature over the next two years, relative to approximately 3% of broadly syndicated loans and 9% of high yield bonds. Additionally, 30% of all private loans classified as PIK come due in the next two years, and an estimated 25% of these loans are currently paying-in-kind.[23] We expect this risk to be partially mitigated by the continued flow of capital into private credit, which will, in part, serve to provide bailouts for a portion of these troubled credits.

We begin the fourth quarter with an average spread that is approximately 20 bps lower quarter-over-quarter and only approximately 25 bps above post-GFC lows, reached in January, and an average yield that is roughly 30 bps lower quarter-over-quarter and approximately in line with the 10-year historical average.[4] The notable decompression in the incremental spread relationship between the CCC and single-B segments that began after reaching a low of 409 bps in January and continued through the second quarter reversed in the third quarter, as lower-rated credit outperformed.[5] This relationship tightened from 566 bps at the beginning of the three-month period to 510 bps at quarter-end.[5] We believe valuations across several segments of the high yield market have compressed below fair value in light of the many risks facing our market, and we expect to reach wider peak spreads in the coming months. However, we believe there remains opportunity. We continue to identify idiosyncratic situations to capture spread compression, even in segments where we think valuations, at the sector level, will likely widen moving forward. We are also evaluating new opportunities in more cyclical segments that appear to be at or near cyclical troughs. Finally, 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.

In conclusion, we remain in an uncertain environment, but one where we assess the risk of recession over the near term to be low. Fundamentals and technical conditions remain largely supportive and, on average, yield compensation is broadly appropriate; however, additional spread compression has resulted in valuations that are more exposed to future bouts of volatility. We expect the balance of 2025 will likely be a competitive period for high yield, and our base case calls for relatively range-bound spreads, but with risk skewed toward higher spreads. Geopolitical tensions are perhaps more heightened than just three months ago, particularly between NATO-member countries and Russia, and hopes for an ultimate resolution in the Russia-Ukraine war in the near term appear to have all but vanished. Meanwhile, legislative dysfunction over differing fiscal priorities has stymied the passage of long-term government funding bills in the U.S. and in several European countries. 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 1 October 2025.
4 Source: ICE BofA U.S. High Yield Index, Morgan Stanley Investment Management. Data as of 30 September2025.
5 Source: U.S. Bureau of Economic Analysis. Data as of 25 September 2025.
21 Source: J.P. Morgan. Data as of 3 September 2025.
22 Source: Goldman Sachs. Data as of 12 September 2025.
23 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	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
Class Z Shares	6.41	8.83	13.34	-11.97	5.30	5.24	15.60	-2.53	8.15	16.30	-0.52
Bloomberg US Corporate High Yield Index	7.22	8.19	13.44	-11.19	5.28	7.11	14.32	-2.08	7.50	17.13	-4.47

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.
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- 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.
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Please refer to the Prospectus for full risk disclosures, available at www.morganstanleyinvestmentfunds.com. All data as of 30.09.2025 and subject to change daily.

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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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