

Morgan Stanley Institutional Fund

Mortgage Securities Trust

MORTGAGE & SECURITIZED TEAM

Performance Review

In the quarter period ending June 30, 2025, the Portfolio's I shares returned 1.98% (net of fees)¹, while the benchmark returned 1.14%.

The Fund performed well in the second quarter on an absolute and relative basis, and no sectors posted negative returns. Securitized credit outperformed agency mortgage-backed securities (MBS). U.S. non-agency residential mortgage-backed securities (RMBS) performed well, which benefited from both tighter spreads and the rally in interest rates. Global commercial mortgage-backed securities (CMBS) also performed well due to tighter spreads and high cash flow carry. Agency MBS was the worst contributor to absolute performance, but still posted positive returns and only slightly underperformed the Bloomberg U.S. Mortgage-Backed Securities Index (the Index).

The Fund's relative duration positioning slightly detracted from relative performance as the Fund's duration remained shorter than that of the Index during the quarter.

Market Review

U.S. Treasury yields were mixed and the yield curve steepened materially during the period as soft inflation data pushed front-end rates down and inflationary concerns surrounding Trump administration tariffs pushed rates on the long-end upward. Interest rate cut expectations have fallen materially over the past few months as strong employment data continues surprise; the market is now pricing in two rate cuts for the entirety of 2025, down from four priced in at the beginning of the quarter, with the first cut to come in September. The Federal Reserve (Fed) left rates unchanged at 4.25% during the quarter and indicated that the path of future cuts would be largely data dependent and would likely need to wait until the impacts from the tariffs trickle through.

The Fed also continued letting its MBS holdings run off during the quarter, which declined \$50 billion to \$2.130 trillion.² The 2-year U.S. Treasury yield fell 16 basis points to 3.72% during the second quarter, while the 10-year U.S. Treasury yield rose 2 basis points to 4.23% and 30-year yields rose 20 basis points to 4.77%.² U.S. commercial banks increased their agency MBS holdings during the second quarter by approximately \$14 billion to \$2.682 trillion, but bank holdings are still down \$314 billion since early 2022.² The 30-year mortgage rate rose 3 basis points during the quarter from 6.64% to 6.67%.² MBS current coupon nominal spreads widened 3 basis points during the quarter to 147 basis points above interpolated U.S. Treasuries.² The Index returned 1.14% during the quarter, outperforming U.S. Treasuries by 17 basis points on a duration-adjusted basis.² Agency MBS have outperformed Treasuries by 10 basis points year-to-date on a duration-adjusted basis.² The duration of the Index remained at 5.7 years, and the majority of the outstanding U.S. mortgage market remains "out-of-the-money" to refinance with new origination mortgage rates still at historically high levels.²

Agency MBS slightly underperformed most other fixed income sectors during the quarter as most other sector spreads tightened and agency MBS spreads widened slightly. Securitized credit spreads tightened during the second quarter in line with other fixed income credit sectors and also performed in line with these sectors.

Issuance in the second quarter was mixed; there was light issuance during April following the Liberation Day tariff announcement, but issuance picked up in May and June, and this supply was well absorbed.

Portfolio Activity

Our agency MBS passthrough exposure rose 1% to 42% over the quarter as we added to fixed-rate passthroughs as this sector remains attractive from both a relative value and historical perspective. Our U.S. non-agency RMBS exposure fell 4% to 35% as we continue to try to replace run-off, as this remains our favorite sector, and our non-U.S. RMBS exposure rose 1% to 6%. The CMBS exposure rose 1% to 6%. The Fund's global ABS fell 1% to 9%.

Strategy and Outlook

We expect U.S. agency MBS spreads to continue to tighten as we expect inflows from relative value investors and banks due to the attractive return profile of this sector versus other core fixed income sectors and cash alternatives; however, we don't think this spread tightening will occur until the Fed likely cuts interest rates in the second half of the year.

¹ Source: Morgan Stanley Investment Management. Data as of June 30, 2025. Performance for other share classes will vary.

² Source: Bloomberg L.P. Data as of June 30, 2025. One basis point = 0.01%

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We expect credit securitized spreads to remain at current levels until we have more clarity about the economic impacts from tariff policies and agency MBS spreads tighten further.

We had reduced risk exposures over the first quarter, adding to our agency MBS positions and holding the highest-ever average credit quality. As spreads have tightened and volatility has eased, we are opportunistically looking for attractive relative value down the capital stack in sectors we feel confident about. This would allow us to rotate more exposure into securitized credit and reduce our U.S. agency MBS positioning due to the attractive relative value. As for duration, we continue to be on the longer end of the Fund's historical interest rate duration range as we expect the front end of the yield curve to fall with increased Fed rate cut expectations; we continue to maintain exposure to the front end and belly of the curve. We expect returns in the coming months to be driven primarily from cash flow carry as we enter the third quarter with higher yields, but could get an added tailwind from lower interest rates if the Fed cuts sooner if inflation prints run hot or the unemployment picture worsens.

We still believe that current interest rate levels remain stressful for many borrowers and will continue to erode household balance sheets, causing stress for some consumer ABS, particularly involving lower income borrowers. We think that household balance sheets are likely to be further stressed due to the inflationary impacts from the Trump administration's tariffs, and thus we are maintaining our underweight to consumer ABS. Commercial real estate also remains challenged by current financing rates and weaker occupancy levels – we remain underweight CMBS positioning relative to our historical holdings. Residential mortgage credit opportunities remain our favorite sector. Homeowner equity remains at historically high levels given home price appreciation over the past five years, and mortgage lending standards remain conservative. We continue to like agency MBS, as we believe the historically wide agency MBS spreads provided ample compensation for the increased rate volatility and prepayment risk. Agency MBS could also benefit from a flight-to-quality trade if economic concerns increase.

We continue to prefer U.S. securitized opportunities over U.K. and European securitized markets. U.S. spreads are currently meaningfully wider than comparable credit-profile European/U.K. opportunities.

While the risk of recession has increased, we do not believe a mild recession would have a material impact on our securities' performance. The securitized markets have largely been structured in the post-Global Financial Crisis (GFC) era using the GFC as a stress test, and thus should be able to withstand a recession relatively unscathed on a fundamental basis. We remain watchful of ongoing geopolitical risks as well as broader economic risks across the globe. Despite these risks, we remain excited about the Fund's return potential for 2025 as we enter the second half of the year with a high yield, historically high credit quality and the potential for additional return from lower interest rates.

Overall, we believe the securitized market offers a unique opportunity to achieve competitive returns with solid credit fundamentals. Although volatility has increased and credit conditions are weaker, we remain constructive on securitized credit conditions overall — specifically in the U.S. — with housing fundamentals continuing to be very healthy. As a result of these views, we have a meaningful U.S. residential credit overweight in the Fund, but we have increased our U.S. agency MBS position to its highest level in several years given the attractive yield/spreads that this government agency-guaranteed sector offers. We also like agency MBS due to the potential for a flight to quality and perhaps wider securitized credit spreads should economic conditions deteriorate.

Fund Facts

Inception Date	July 28, 1997
Minimum Initial Investment (\$)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	Bloomberg U.S. Mortgage Backed Securities (MBS) Index
Class I expense ratio	Gross 0.81 %
	Net 0.70 %
Class A expense ratio	Gross 1.08 %
	Net 1.00 %

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.

* Share class availability may vary by platform. For more information, please visit the specified fund page on the website.

Performance (%)

As of June 30, 2025	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	1.41	1.98	5.10	10.10	5.95	3.36	3.84
Class A Shares at NAV	1.36	1.87	4.99	9.75	5.58	3.00	3.44
Class A Shares (With Max 3.25% Sales Charge)	-1.99	-1.49	1.61	6.15	4.40	2.33	3.09
Bloomberg U.S. Mortgage Backed Securities (MBS) Index	1.78	1.14	4.23	6.52	2.32	-0.60	1.30

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.

Effective March 14, 2025, Andrew Szczurowski has been added as a Portfolio Manager on the Fund. Additionally, the Board of Trustees of the Fund has approved the reorganization of the Fund into a newly created exchange-traded fund (ETF), Eaton Vance Mortgage Opportunities ETF, a series of Morgan Stanley ETF Trust. The proposed reorganization is subject to shareholder approval. If approved, in connection with the reorganization, which is anticipated to occur on or about August 1, 2025, Brandon Matsui will be added as a Portfolio Manager on the Fund. Please see the supplement to the Fund's summary prospectus, prospectus and statement of additional information dated March 14, 2025 for more information.

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.

The fund has received proceeds related to certain non-recurring litigation settlements. If these monies were not received, any period returns which include these settlement monies would have been lower. These were one-time settlements, and as a result, the impact on the net asset value and consequently the performance will not likely be repeated in the future. Please visit www.morganstanley.com/im for additional details.

INDEX INFORMATION

The **Bloomberg U.S. Mortgage Backed Securities (MBS)**

Index tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

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The Indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an Index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor.

RISK CONSIDERATIONS

There is no assurance that a mutual fund will achieve its investment objective. Funds are subject to market risk, which is the possibility that the market values of securities owned by the fund will decline and that the value of fund 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 fund. Please be aware that this fund may be subject to certain additional risks. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (**credit risk**), changes in interest rates (**interest-rate risk**), the creditworthiness of the issuer and general market liquidity (**market risk**). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. Longer-term securities may be more sensitive to interest rate changes. Certain **U.S. government securities** purchased by the Strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **Mortgage and asset-backed securities** are sensitive to early prepayment risk and a higher risk of default and may be hard to value and difficult to sell (liquidity risk). They are also subject to credit, market and interest rate risks. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks. Due to the possibility that prepayments will alter the cash flows on **Collateralized mortgage obligations (CMOs)**, it is not possible to

determine in advance their final maturity date or average life. In addition, if the collateral securing the CMOs or any third party guarantees are insufficient to make payments, the strategy could sustain a loss. **High yield securities ("junk bonds")** are lower rated securities that may have a higher degree of credit and liquidity risk. **Foreign securities** are subject to currency, political, economic and market risks. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **Inverse floaters** are sensitive to early prepayment risk and interest rate changes and are more volatile than most other fixed-income securities. **Portfolio Turnover.** Consistent with its investment policies, the Fund will purchase and sell securities without regard to the effect on portfolio turnover. Higher portfolio turnover will cause the Fund to incur additional transaction costs. **LIBOR Discontinuance or Unavailability Risk.** The regulatory authority that oversees financial services firms and financial markets in the U.K. has announced that, after the end of 2021, it would no longer persuade or compel contributing banks to make rate submissions for purposes of determining the LIBOR rate. As a result, it is possible that commencing in 2022, LIBOR may no longer be available or no longer deemed an appropriate reference rate upon which to determine the interest rate on or impacting certain derivatives and other instruments or investments comprising some of the Fund's portfolio.

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.

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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.

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