Morgan Stanley Institutional Fund

International Equity Portfolio

INTERNATIONAL EQUITY TEAM

Performance Review

In the quarter period ending June 30, 2025, the Portfolio's I shares returned 11.18% (net of fees)[1], while the benchmark returned 11.78%.

The Portfolio is behind the benchmark index for the year-to-date, having returned +17.95% versus the index's very strong +19.45%.

In the second quarter, the slight underperformance was due to negative stock selection while sector allocation was positive. Stock selection was hurt by weakness in information technology and, to a lesser extent, consumer discretionary, which more than offset strength in consumer staples. For sector allocation, the portfolio primarily benefited from the overweight to information technology.

The largest contributors to absolute performance during the quarter were **Halma** after reporting an 11% year-on-year increase in revenue during its full-year results while continuing to see robust operating performance boosted by strong Avo Photonics growth;[2] **Safran** after reporting a 17% increase in the first quarter revenue and reconfirming financial year 2025 guidance;[3] **TSMC** as shares rose significantly along with the broader technology sector, rebounding from the tariff-induced troughs following the de-escalation of trade tensions between the U.S. and China; **L'Oréal,** which reported strong first quarter results while continuing to outperform the global beauty market; and **SAP,** which reported robust first quarter results underpinned by impressive 26% cloud revenue growth (constant currency).[4]

The largest detractors were **LVMH** as tariff pressures and weak consumer spending in China impacted first quarter results; **Shell,** which was impacted by falling oil prices; **AstraZeneca** and **Sanofi,** which have both suffered from the potential impacts of the new U.S. administration's policies including drug pricing reforms; and **Hexagon** after reporting disappointing first quarter results.

Market Review

Despite global geopolitical uncertainty and evolving policy changes in the U.S., the MSCI EAFE Index continued its spectacular year-to-date performance in the second quarter, returning +12% in U.S. dollars (USD), helped by the weakening dollar, and +5% in local currency. This leaves the index up an astounding +19% in USD for year-to-date 2025, while returning a lesser +8% in local currency. Communication services (+20%) and information technology (+19%) were top performing sectors in the quarter fuelled by strong earnings results and anticipated increasing generative artificial intelligence (GenAI) demand. Industrials (+18%), real estate (+17%) and utilities (+17%) were other strong performers. Despite making up some of its losses in June, energy (-2%) was the notable laggard in second quarter due to falling oil prices earlier in the quarter. Looking at geographies, major euroland markets were top performers in the quarter, as Spain (+17% USD, +8% local), Germany (+16%, +7%) and Italy (+15%, +6%) all comfortably outperformed the index in USD. Hong Kong (+16% USD, +17% local) was a strong performer thanks to easing tensions between the U.S. and China. Despite EAFE underperforming the U.S. in May and June, it finished slightly ahead of the U.S. (+11%) for second quarter overall and remains 6% ahead of the U.S. year-to-date.

Outlook

The Great Disconnect

The second quarter was dramatic. It started with a sharp market fall in early April following the "Liberation Day" tariff announcement, but the recalibration of tariff policy in the wake of the market turbulence helped fuel a very powerful rally, taking equity indices to all-time highs and turning a 10%+ drop in the MSCI World Index by April 8 into an 11% rise for the second quarter, the strongest quarter since the 2020 recovery from the COVID-era low. While an element of the recovery does seem justified given the improvement in the environment since early April, the current euphoric atmosphere, with stretched valuations and record retail inflows, does seem tough to justify given the modest growth outlook and multiple sources of uncertainty. Indeed, we see a sharp disconnect between the state of the markets and the state of the real world.

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[1] Source: Morgan Stanley Investment Management. Data as of June 30, 2025. Performance for other share classes will vary.
[2] Source: Halma Full Year Results 2024/25, 12 June 2025.
[3] Source: Safran reports first quarter 2025 revenue, 25 April 2025.
[4] Source: SAP Q1 2025 Results, 22 April 2025.

The economic outlook has improved from the trough of early April. While growth expectations have slowed this year, with the Bloomberg consensus now for 1.5% U.S. real gross domestic product (GDP) growth in 2025 as against around 2% earlier in the year, this is a far cry from the Wall Street base case of a U.S. recession in the immediate aftermath of the "Liberation Day" tariff announcement.[5] Equally, while inflation remains sticky and above the 2% Federal Reserve (Fed) target, we have yet to see a tariff-induced acceleration.

The more positive take is that the "Taco trade" – a concept introduced by the media which implies that the Trump administration tends to back down with respect to policies that hit markets hard – has paid off so far, and may well continue to work. The "Taco trade" talk has been mainly around tariffs following the step back from the "reciprocal" tariffs with the introduction of the 90-day pause on April 9.

The "Taco adjustments" go rather wider than just the trade arena. Business fears have also eased around immigration, or rather the repatriation of illegal immigrants in the U.S., with recent administration talk of more tolerance for undocumented workers, particularly in the farming sector. In addition, the rhetoric around deficit reduction, powered by a supposed massive DOGE[6]-driven cut in spending, which threatened to create a demand headwind in the U.S., has faded away, with the final version of the One Big Beautiful Bill Act set to increase the U.S. national debt by a further $3 trillion over the next decade, according to the Congressional Budget Office estimate. This should provide an expansionary boost to the economy in 2026, mitigating the contractionary effect of the tariffs.

The less positive take is that significant political headwinds still remain for the economy and markets, as the negative economic impacts of the recent policy changes have yet to fully take effect. The existing arrangements imply a 15% effective tariff rate overall,[7] up from 2.5%, acting as both an effective tax on consumers and an inflationary shock, even before any further tariff rises once the 90-day pause expires. The full effects of these existing tariffs on consumer prices may well not have come through yet. Equally, the growth in the U.S. labour market is set to slow sharply, with Barclays expecting only 0.1% growth in 2026 and 2027 as against the 1%+ level that the U.S. economy is used to, given both ageing populations and minimal net immigration, which threatens both aggregate demand and corporate margins. More broadly, general policy uncertainty still remains very elevated, not least around the expiry of the 90-day pause, with implications for both consumer and business confidence.

Outside the U.S. administration, there have been two further boosts to markets since early April. One is that hyper-scaler capital expenditure forecasts have continued to rise despite the DeepSeek shock earlier in the year as the tech giants still expect massive demand for compute. The other is the decline of the dollar, with the ICE Dollar Index (known as DXY) down over 10% year-to-date.[5] This helps overall revenues and earnings in dollar terms, given that other currencies make up half of MSCI World Index companies' revenue and even 40% of the revenue earned by S&P 500 Index companies.[8]

While some of the tail risks of April seem to have faded, the overall outlook suggests an environment of only ordinary growth, with the U.S. slated to grow at just 1.5% in 2025 and 2026, below levels expected at the start of the year, with the European Union slower still at around 1%.[8] There is also unusually high uncertainty around this unexciting outlook, given both raised geopolitical tensions and the unstable U.S. policy environment, leading to economists giving an elevated 38% chance of a U.S. recession in the next 12 months.[8] Although the worst fears of early April have not been realised, it is hard to argue that the environment is better than it was at the start of the year.

By contrast, markets seem to be priced for a very different world, seemingly disconnected from the actual economies. Equity valuations look distinctly elevated versus history. The MSCI World Index is on close to 20x forward earnings, with the S&P 500 Index at 22x.[8] These extended multiples are on forward earnings that are expected to grow double-digits on the back of margins improving further from record highs. All this is at a time when U.S. earnings are actually falling, with the S&P 500 expectations for 2025 and 2026 both down around 4% year-to-date, even measured in the fast-depreciating dollar.[8] The fixed income markets also seem pretty cheerful, with the ICE BofA BBB US Corporate Index spread down at 110 basis points,[9] close to the all-time lows achieved at the start of the year.

There is plenty of further evidence that markets are boisterous, euphoric or frothy — depending on your preferred adjective — beyond the extended overall valuations. Barclay's Equity Euphoria Indicator has bounced back through 10%, rivalling the levels of the dot-com boom and 2021's meme frenzy, perhaps unsurprisingly given that retail investors added a record $155 billion into equities in the first half of the year.[10] Looking at the drivers of the equity market advance, over half of the MSCI World's double-digit second quarter gain was concentrated in only two of the 25 industry groups, semiconductors and software & services, with 85% coming from

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5 Source: Bloomberg L.P.
6 U.S. Department of Government Efficiency
7 Source: The Budget Lab at Yale, as of June 17, 2025.
8 Source: FactSet and Morgan Stanley Investment Management
9 Source: The Federal Reserve Bank of St. Louis. The ICE BofA BBB US Corporate Index tracks the performance of securities with a given investment grade rating BBB within U.S. dollar-denominated investment grade rated corporate debt publicly issued in the U.S. domestic market. One basis point = 0.01%
10 Source: Financial Times, VandaTrack

just five groups, adding in the cyclical media & entertainment, banking and capital goods elements.

To summarise, our view is that the best estimate for the real world outlook is mediocre, with a great deal of uncertainty. By contrast, markets seem to be pricing in a higher-growth scenario with a high level of certainty. There is plenty of evidence of euphoric behaviour by retail investors, who will now feel even more justified in buying every dip. One comfort is that EAFE markets look distinctly less stretched than the U.S., still trading at a 34% discount to the U.S. despite the 13% outperformance year-to-date, helped by the fact that EAFE has outearned the U.S. year-to-date, in contrast to the last decade of U.S. dominance.[8] Within EAFE, a portfolio which owns higher quality companies, with gross margins of 39% versus 27% for the index, may well offer a further measure of downside mitigation, particularly as it is accompanied by faster top-line growth expectations (7% vs. 5%, respectively), with only marginal premium in free cash flow terms.[8]

Fund Facts

Inception Date	August 04, 1989
Minimum Initial Investment ($)*	A Shares - 1,000
	I Shares - 1,000,000
Benchmark	MSCI EAFE Index
Class I expense ratio	**Gross 1.05 %**
	Net 0.95 %
Class A expense ratio	**Gross 1.42 %**
	Net 1.30 %

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.

Performance (%)

As of June 30, 2025	MTD	QTD	YTD	1 YR	3 YR	5 YR	10 YR
Class I Shares at NAV	2.25	11.18	17.95	16.62	13.75	8.44	5.34
Class A Shares at NAV	2.30	11.22	17.78	16.31	13.38	8.13	5.02
Class A Shares (With Max 5.25% Sales Charge)	-3.07	5.36	11.64	10.20	11.37	6.98	4.45
MSCI EAFE Index	2.20	11.78	19.45	17.73	15.97	11.16	6.51

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.

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.

INDEX INFORMATION

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The MSCI EAFE Index currently consists of 21 developed market country indices. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The **MSCI World Net Index** is a free float adjusted market

[8] Source: FactSet and Morgan Stanley Investment Management

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

capitalization weighted index that is designed to measure the global equity market performance of developed markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **US Dollar Index (DXY)** is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of US trade partners' currencies.

The **ICE BofA BBB US Corporate Index** tracks the performance of securities with a given investment grade rating BBB within U.S. dollar-denominated investment grade rated corporate debt publicly issued in the U.S. domestic market.

The Index is unmanaged and does 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 Portfolio will achieve its investment objective. Portfolios are subject to **market risk**, which is the possibility that the market values of securities owned by the Portfolio will decline and that the value of Portfolio 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 strategy. Please be aware that this strategy may be subject to certain additional risks.**ESG strategies** that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance. In general, In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. Investments in **small- and medium-capitalization** companies tend to be more volatile and less liquid than those of larger, more established, companies. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio's performance. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk).

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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