

Morgan Stanley

INSTITUTE FOR SUSTAINABLE INVESTING



# Sustainable Reality

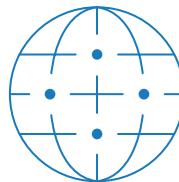
Sustainable funds deliver strong returns in 1H 2025;  
Flows positive but tracking below prior years

# Key takeaways for 1H 2025



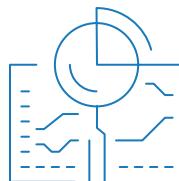
## 1 Sustainable funds' AUM up to \$3.92 trillion

Assets under management (AUM) in Sustainable funds globally reached a new high of \$3.92 trillion at the end of June 2025, up 11.5% on December 2024 according to Morningstar data. Sustainable funds make up 6.7% of total AUM, just ahead of 6.6% at end of 2024 but down from a high of 7.2% in June 2023, as Traditional funds have seen stronger net inflows.



## 2 Sustainable funds outperform by more than three points

The majority of the growth in AUM during 1H 25 was due to performance, with Sustainable funds generating median returns of 12.5%, outperforming Traditional funds at +9.2%. Reversing the 2H 24 pattern, the key driver of the 1H 25 outperformance was Sustainable funds' greater exposure to global and Europe investment areas, which saw stronger returns than Americas and APAC, especially in fixed income. As the Sustainable Reality series shows returns in US dollar terms, they may have been influenced by currency volatility during the period.



## 3 Flows positive, but tracking below prior years

First half inflows to Sustainable funds were \$16.0 billion, with small outflows in the first quarter more than offset in the second. However, year to date, 2025 flows are tracking below prior years: 2022 and 2023 both totalled over \$100bn on a full year basis, with 2024 now restated to \$80.6 billion. European funds drove the inflows, both in terms of fund domicile and fund investment area, while there were small outflows in the Americas. Traditional fund flows remain ahead, at +2.1% of prior year-end AUM in 1H 25.

# About the Sustainable Reality series

## TRACKING AUM, FLOWS AND PERFORMANCE FOR SUSTAINABLE FUNDS

Sustainable Reality is a long running series from Morgan Stanley's Institute for Sustainable Investing. It uses Morningstar data to track AUM, flows and performance for Sustainable funds in comparison to Traditional funds across a universe of 99,000 global funds.

### TERMINOLOGY

“Sustainable” and “Traditional” use Morningstar’s definitions.

### MEDIAN RETURNS

We refer to median returns, both because of the very wide range of potential outcomes common for investment funds, but also to reflect the likelihood of an individual investor selecting a fund that achieves the return. Returns are shown in USD terms.

### METHODOLOGY

For the full [methodology](#), see page 20.

### CONTACT US

For any questions related to the report, please reach out to the Institute for Sustainable Investing team at [globalsustainability@morganstanley.com](mailto:globalsustainability@morganstanley.com).

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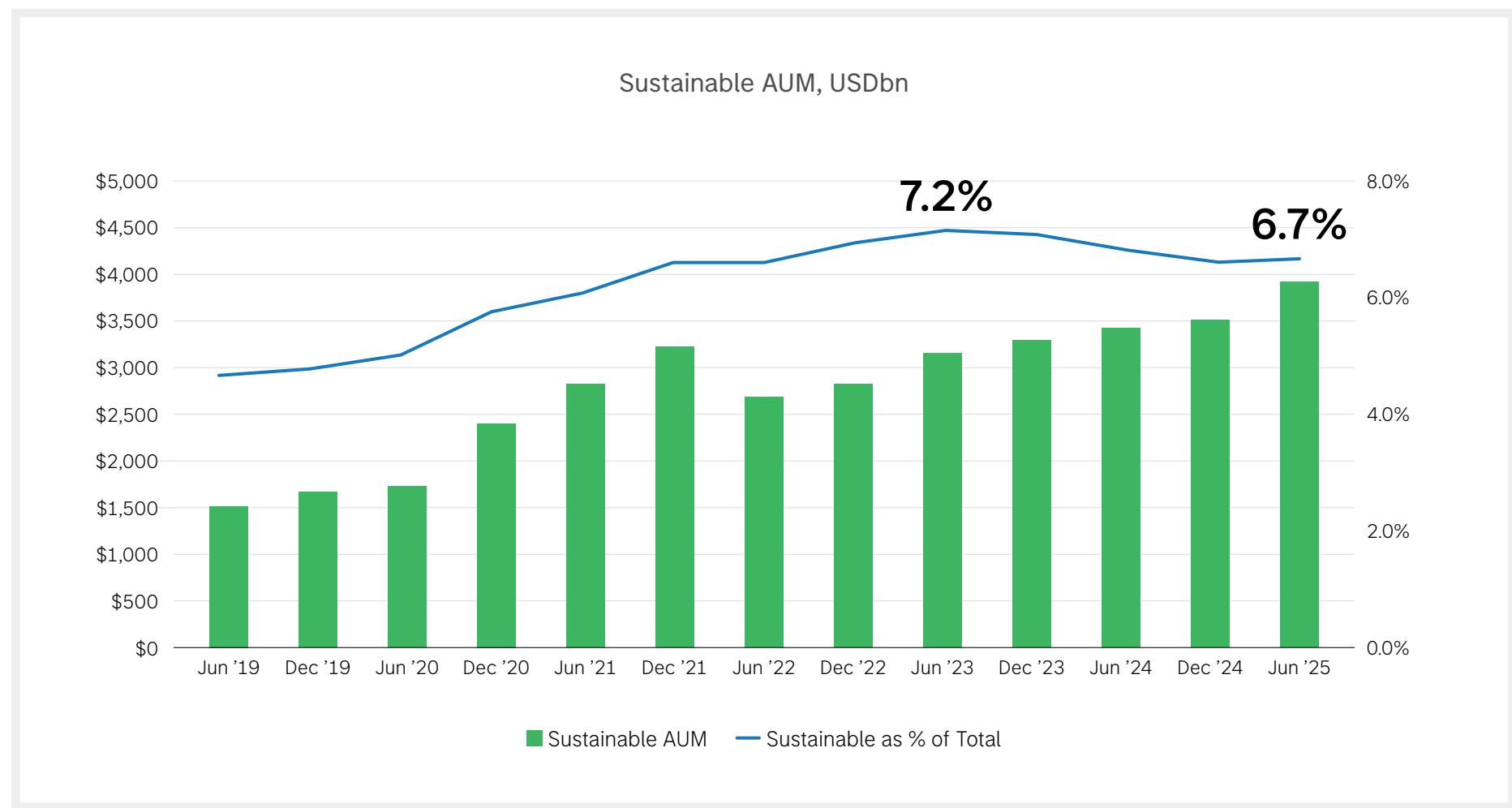


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# AUM in Sustainable funds rose to \$3.92 trillion

At the end of June 2025, Sustainable funds' AUM reached a new absolute high of \$3.92 trillion (+11.5% on December 2024, and +14.3% year over year, mostly driven by returns). This represents 6.7% of total AUM, down from 7.2% at the end of June 2023 but a little ahead of December 2024 at 6.6%. The decline as a proportion of overall AUM over the past two years mostly reflects stronger flows into the Traditional fund universe.



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025. Note: that all datapoints are restated based on the current period classification, which can result in small changes to prior period numbers.

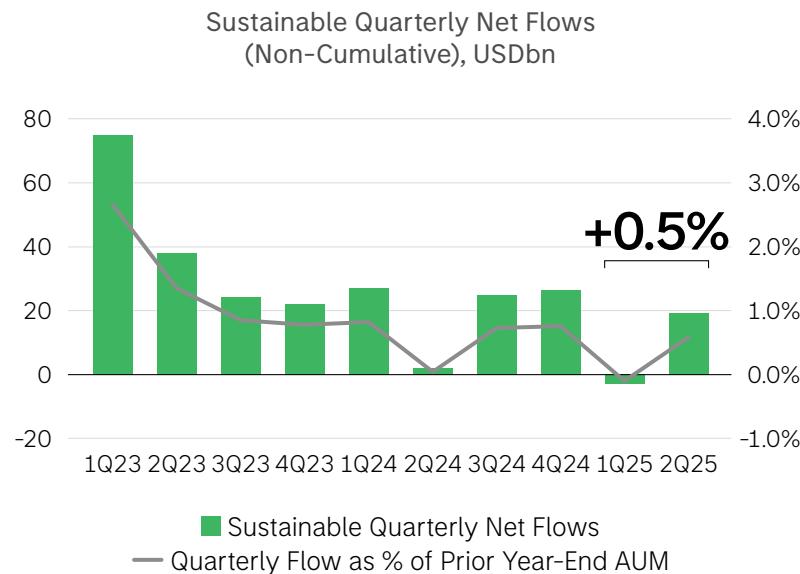
# Sustainable fund flows were positive in 1H 2025, but are tracking below prior years

Overall, Sustainable funds saw inflows of \$16.0 billion during 1H 25, or +0.5% of prior year-end AUM. The first quarter saw small outflows, at -\$3.2 billion, more than offset by inflows of \$19.3 billion in the second quarter.

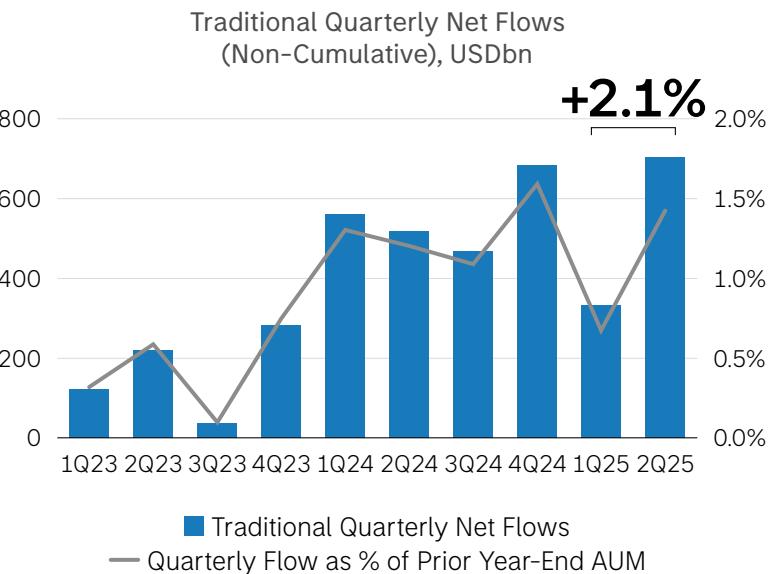
Inflows into Sustainable funds remain notably lower than in recent years, with 2022 and 2023 full-year inflows both over \$100 billion, and 2024 (following some revisions higher\*) at \$80.6 billion in the second quarter.

Traditional fund flows continue to outpace Sustainable peers, with 1H 25 inflows at +2.1% of prior year-end AUM maintaining the pace seen throughout 2024.

## Sustainable flows positive but below prior years



## Traditional funds maintained the stronger 2024 trend



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

\* The prior edition of Sustainable Reality, based on data as of February 4, 2025, put FY 2024 flows at \$54.7 billion.

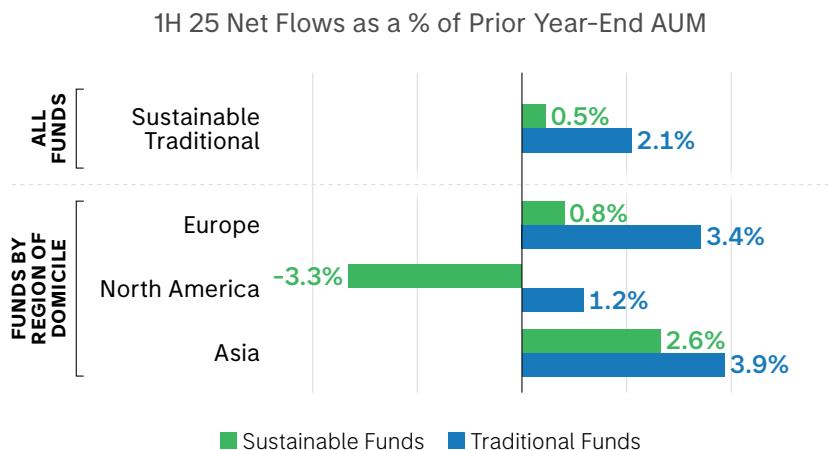
# By fund domicile, European funds drove the weakness in 1Q

On an absolute basis, Europe-domiciled Sustainable funds continue to dominate, with inflows of \$24.7 billion for 1H 25 compared to \$2.7 billion for Asia and outflows of \$11.3 billion for North America. However, as in 2Q 24, the overall weakness in Sustainable fund flows in 1Q 25 was driven by Europe-domiciled funds with inflows of just \$0.9 billion, well below the ~\$20 billion quarterly average over the past two years.

Sustainable funds domiciled in North America have reported outflows for eleven quarters, starting in 4Q 22.

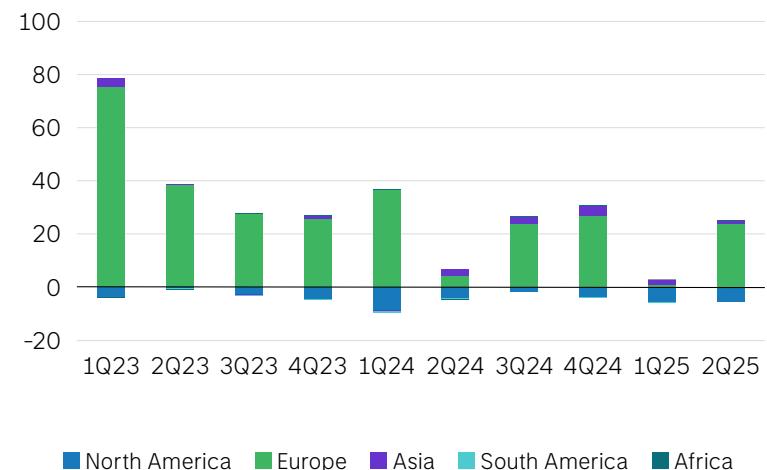
Relative to prior year-end AUM, Asia saw the strongest inflows for 1H 25, at +3.9%, ahead of Europe at +0.8% and North America at -3.3%.

## Asia inflows were strongest relative to AUM



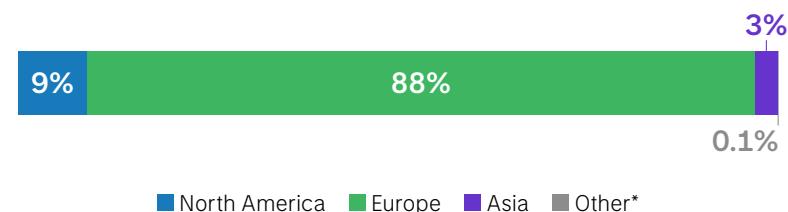
## Europe-domiciled flows dominated in absolute terms

Sustainable Fund Quarterly Net Flows by Region of Domicile, USDbn



## 88% of AUM in Sustainable funds is Europe-domiciled

Sustainable AUM by Domicile, Jun 25



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

\* Other includes South America and Africa, which account for 0.09%/0.01% of AUM respectively. Note that a fund can be domiciled in one region but invest globally or in another regions. Investment area refers to the latter.

# By fund investment area, Europe saw the strongest flows

Sustainable funds that invest in Europe had the strongest flows in 1H 25, both in absolute terms (\$24.8 billion) and relative to AUM (+2.2% of prior year-end AUM). Global and APAC Sustainable funds both saw inflows, at \$4.0 billion and \$2.3 billion respectively.

Americas Sustainable funds saw outflows for the first time since 1Q 20, at \$12.2 billion or +2.2% of prior year-end AUM; Traditional funds in the Americas also saw small outflows.

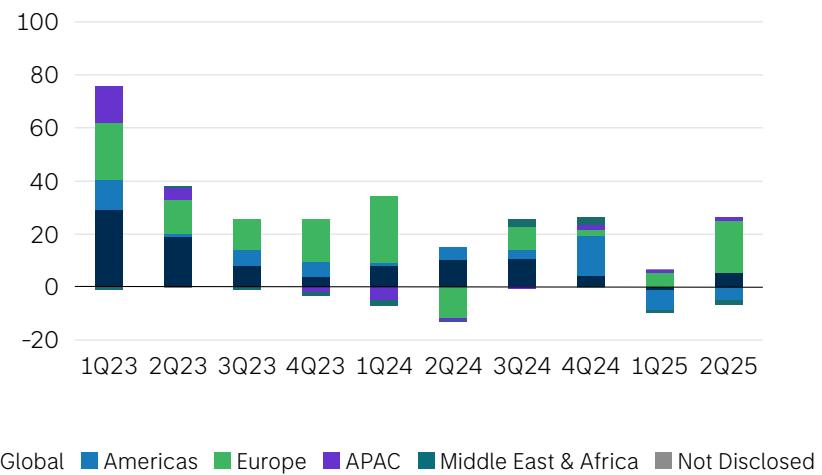
## Relative to AUM, Americas saw the strongest inflows

1H 25 Net Flows as a % of Prior Year-End AUM



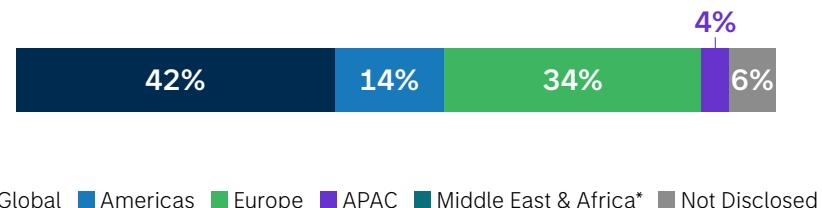
## Flows to funds investing in the Americas picked up in Q4

Sustainable Fund Quarterly Net Flows  
by Investment Area, USDbn



## >75% of Sustainable funds invest globally or in Europe

Sustainable AUM by Investment Area, Jun 25



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

\* Middle East and Africa accounts for 0.003% of AUM. Note that a fund can be domiciled in one region but invest globally or in other regions. Investment area refers to the latter.

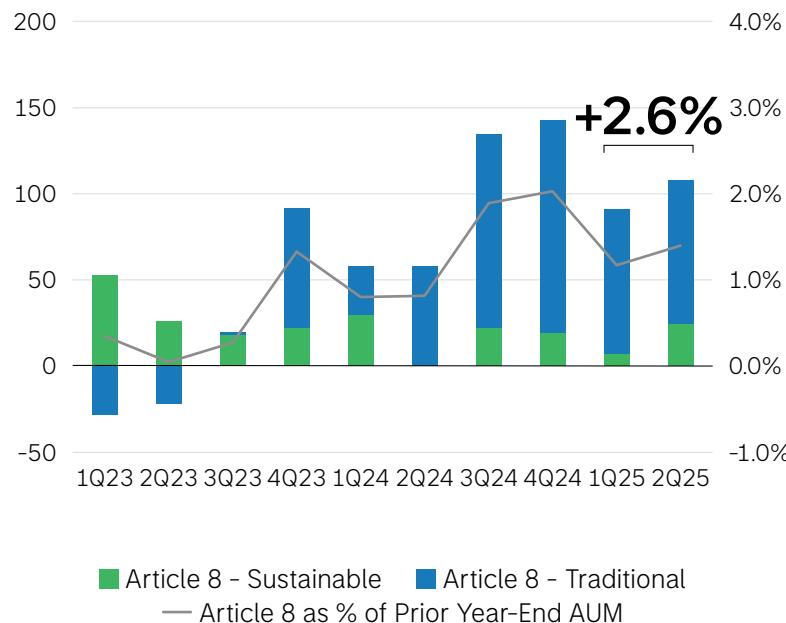
# Flows to Article 8 and Article 9 funds

During 1H 25, Article 8 funds saw inflows of \$203.4 billion, or +2.6% of prior year-end AUM. This was mostly driven by Article 8 funds classified as Traditional by Morningstar, while Article 8 funds classified as Sustainable accounted for \$31.5 billion of the total (+1.5% of prior year-end AUM).

Article 9 funds saw outflows of -\$8.7 billion in 1H 25, -2.5% of prior year-end AUM. This marks seven straight quarters of outflows for Article 9 funds, although 2Q 25 saw some recovery.

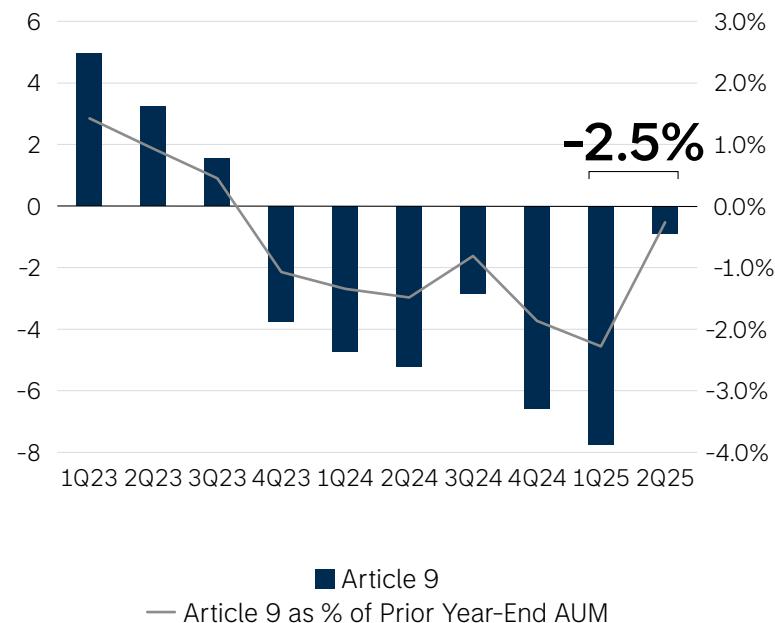
## Article 8 Fund Flows

Article 8 Quarterly Net Flows (Non-Cumulative)



## Article 9 Fund Flows

Article 9 Quarterly Net Flows (Non-Cumulative)



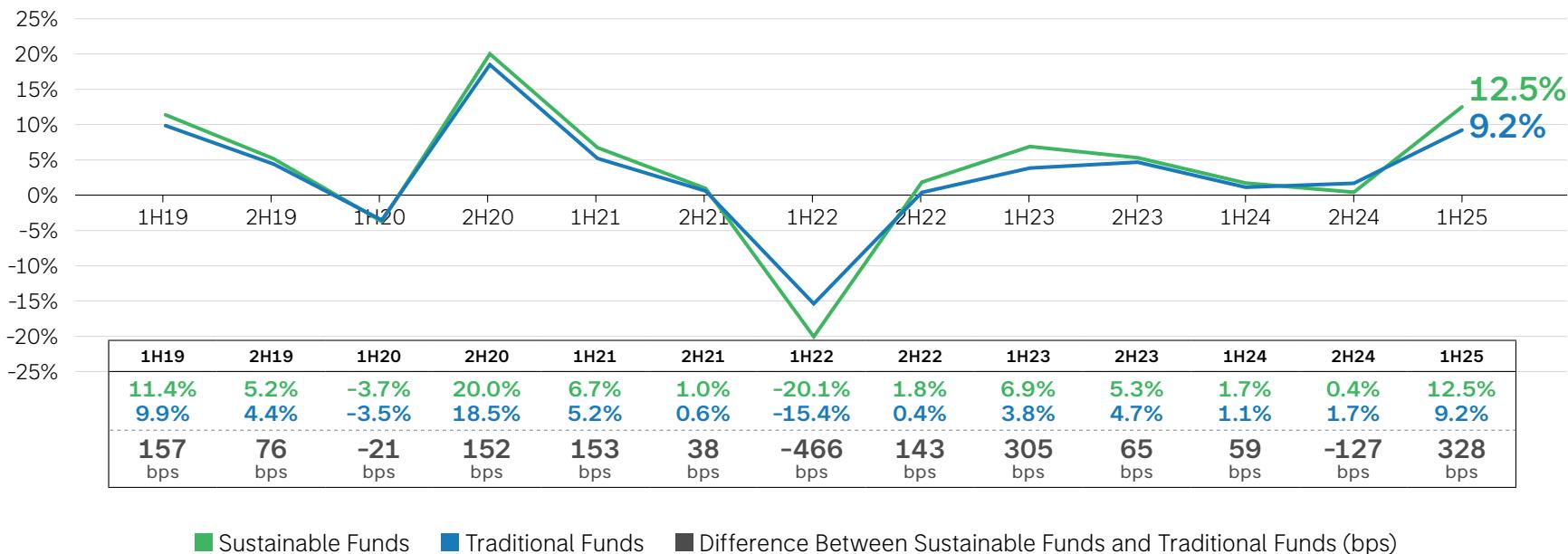
Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

# Sustainable funds median return of +12.5% strongly outperformed traditional peers

1H 25 was the strongest period of outperformance for Sustainable funds since our data starts in 2019, with a median return of +12.5% compared to +9.2% for Traditional peers. As in 2H 24, this was primarily driven by geographic differences. Sustainable funds over-index to Global and Europe investment regions, which had the strongest returns in 1H 25, reversing the 2H 24 dynamic where weak returns in these regions drove underperformance for Sustainable funds. However, Sustainable funds also outperformed within most regions, and across all asset classes.

## The median return for Sustainable funds strongly outperformed that of Traditional peers in 1H 25

Median Return—Sustainable vs. Traditional Funds

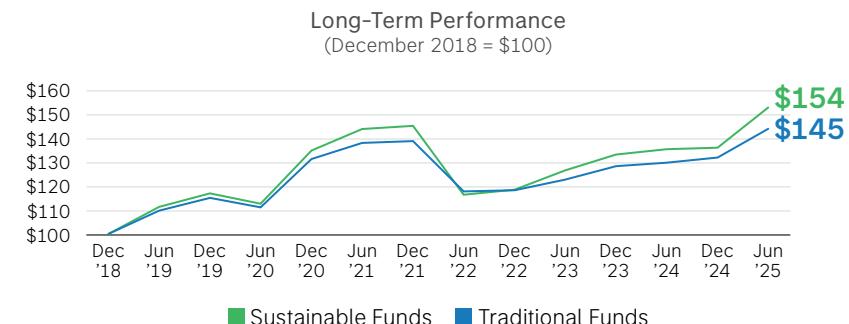


Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

# Downside deviation and long-term returns

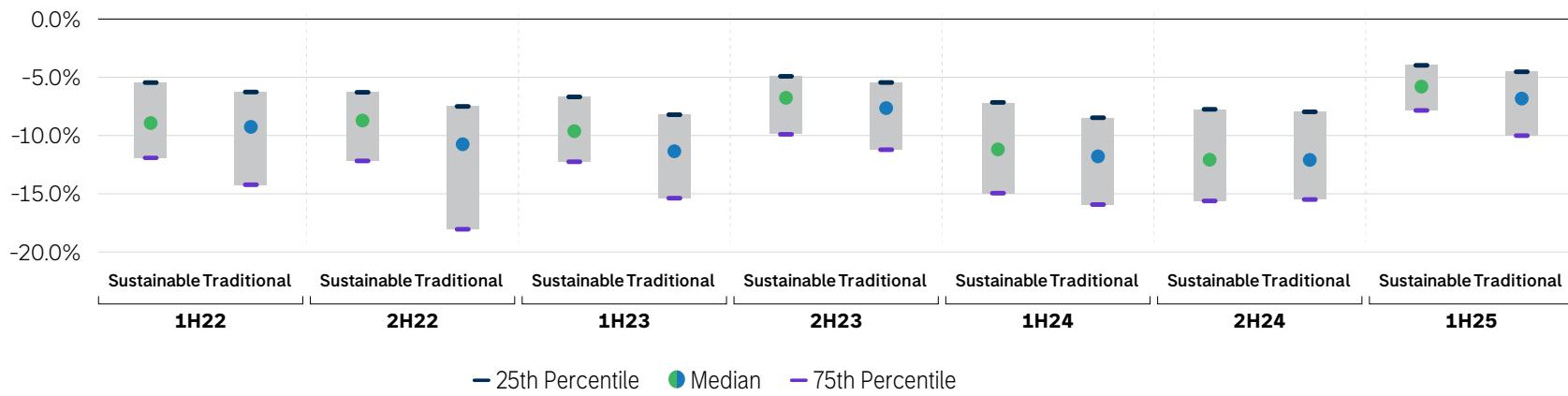
Downside deviation is a measure of the likelihood of negative returns in a set of funds in the period. A lower number means a higher likelihood of negative returns against a chosen benchmark, here the S&P 500. For 1H 25, downside deviation was -4.5% for Sustainable Equity funds and -5.5% for Traditional Equity funds, meaning that Traditional funds had greater potential for relative losses.

**\$100 invested in Dec 2018 would be \$154 today, at median Sustainable fund returns**



**Downside deviation measures the likelihood of negative returns against a chosen benchmark**

Downside Deviation, Equity Funds



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025. Past performance is no guarantee of future results.

# Sustainable funds skew to global and Europe investment areas drove most of the overall outperformance in 1H 2025

Sustainable funds have over-indexed to Global and Europe investment areas for some time. Prior to 2024, this was not a major driver of performance relative to Traditional funds\*.

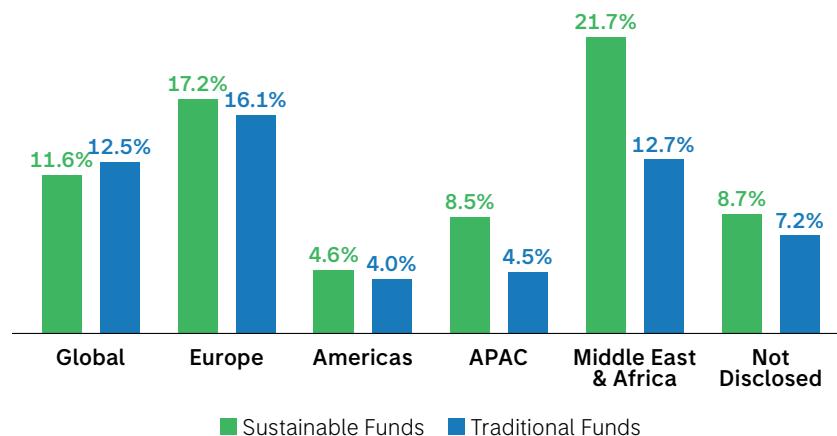
Almost half of Sustainable funds invest globally, where 1H 25 returns of 11.6% were outpaced by Traditional peers at 12.5%. Europe makes up another quarter of the universe, where Sustainable fund returns of 17.2% outperformed by 115bps.

Sustainable funds also outperformed in Americas (by 65bps) and in APAC (by 403bps), but these regions did not perform as strongly overall. Greater exposure to the regions with double-digit returns was the main driver of the whole Sustainable fund universe's outperformance.

This reverses the 2H 24 dynamic, when weak returns for Global and Europe funds meant that Sustainable funds underperformed Traditional peers. As the Sustainable Reality series shows returns in US dollar terms, currency volatility may also have had an influence.

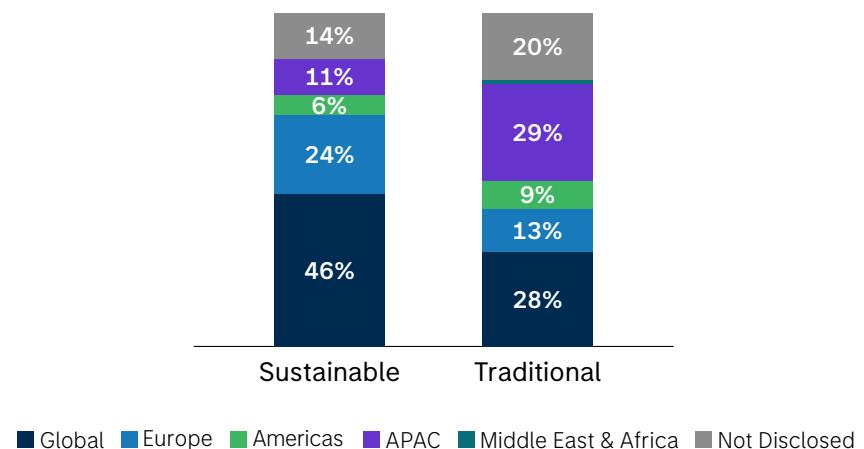
## Global and Europe had the strongest returns

1H 25 Median Return by Investment Region



## Sustainable funds over-index to Global and Europe

1H 25 Split of Fund Count by Investment Region



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025. Note: bps stands for basis points; 10 bps is 0.1%.

\*Generally, stronger returns in Americas were offset by weaker returns in APAC.

# Outperformance continues across asset classes

In 1H 25, Sustainable funds outperformed across all asset classes:

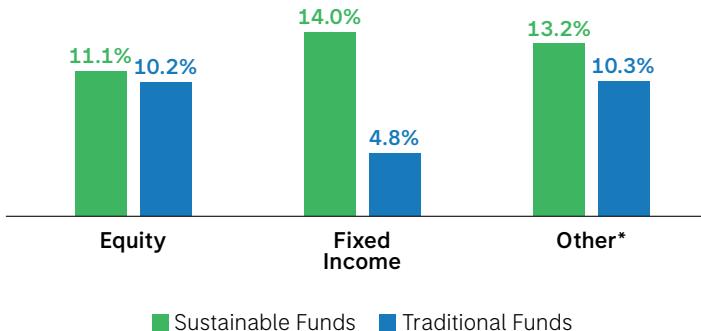
**Equities:** Sustainable funds outperformed by 83bps with a median return of +11.1% ahead of Traditional equity funds at +10.2%.

**Fixed income:** Sustainable funds performed strongly at +14.0%, more than 900bps ahead of Traditional peers at +4.8%. Outperformance was particularly strong in short and medium duration funds averaging BBB credit ratings\*. It was also influenced by investment area performance, as both Sustainable and Traditional fixed income funds invested globally and Europe performed much more strongly than those invested in Americas and APAC, as before with currency volatility potentially also playing a role.

**“Other” funds:** (multi-asset, property, commodities and alternatives) Sustainable funds generated median returns of +13.2%, outperforming +10.3% for Traditional funds.

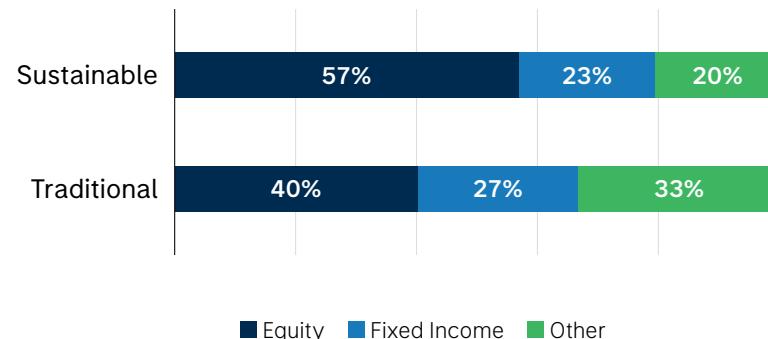
**Sustainable funds were relatively strongest in fixed income**

1H 25 Median Return by Asset Type



■ Sustainable Funds ■ Traditional Funds

Split of Fund Count by Asset Class, 1H25



■ Equity ■ Fixed Income ■ Other

Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025. \* See p. 16 for returns by fixed income style.

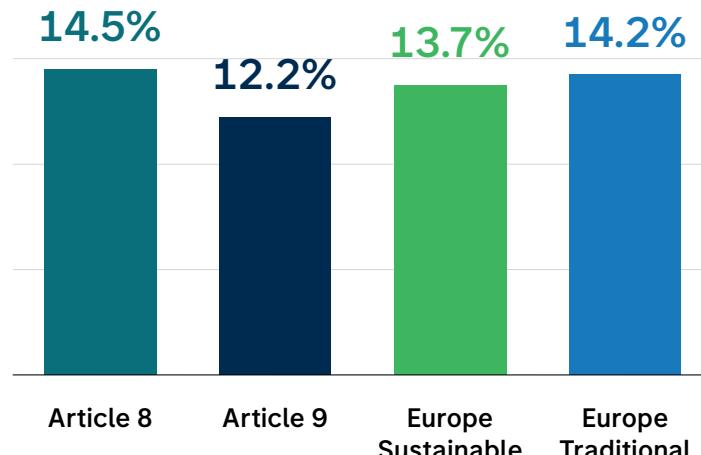
# Analyzing performance for Europe-domiciled funds

Europe-domiciled Sustainable funds delivered a median return of 13.7% in 1H 25, modestly underperforming Traditional peers at 14.2%. Article 8 funds had a median return of +14.5%, with Article 9 median return at +12.2%.

Half of Europe-domiciled AUM is classified as Article 8 (50% of total Europe AUM) or Article 9 (2% of total), with the remainder under Article 6.

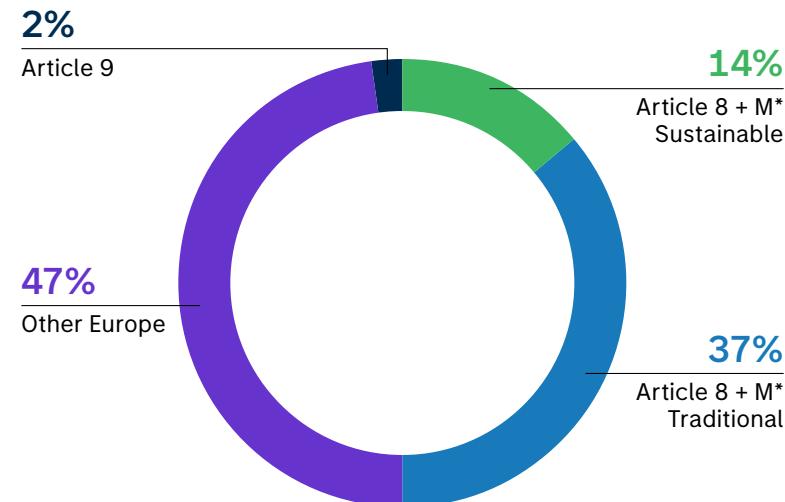
All Article 9 AUM, and 27% of Article 8 AUM, are classified as “Sustainable” by Morningstar. Overall, 19% of Europe-domiciled AUM fall under Morningstar’s Sustainable classification.

**1H 25 median return by SFDR classification**



The EU's Sustainable Finance Disclosure Regulation (SFDR) sets out mandatory ESG disclosure requirements for asset managers with the goal of creating more transparency about Sustainable investment strategies. According to the SFDR's classification system, which went into full effect on Jan. 1, 2023, a fund is either classified as Article 6 (funds without a sustainability scope), Article 8 (funds that promote environmental or social characteristics) or Article 9 (funds with Sustainable investment as their primary objective).

**Europe domiciled AUM, Jun 25**



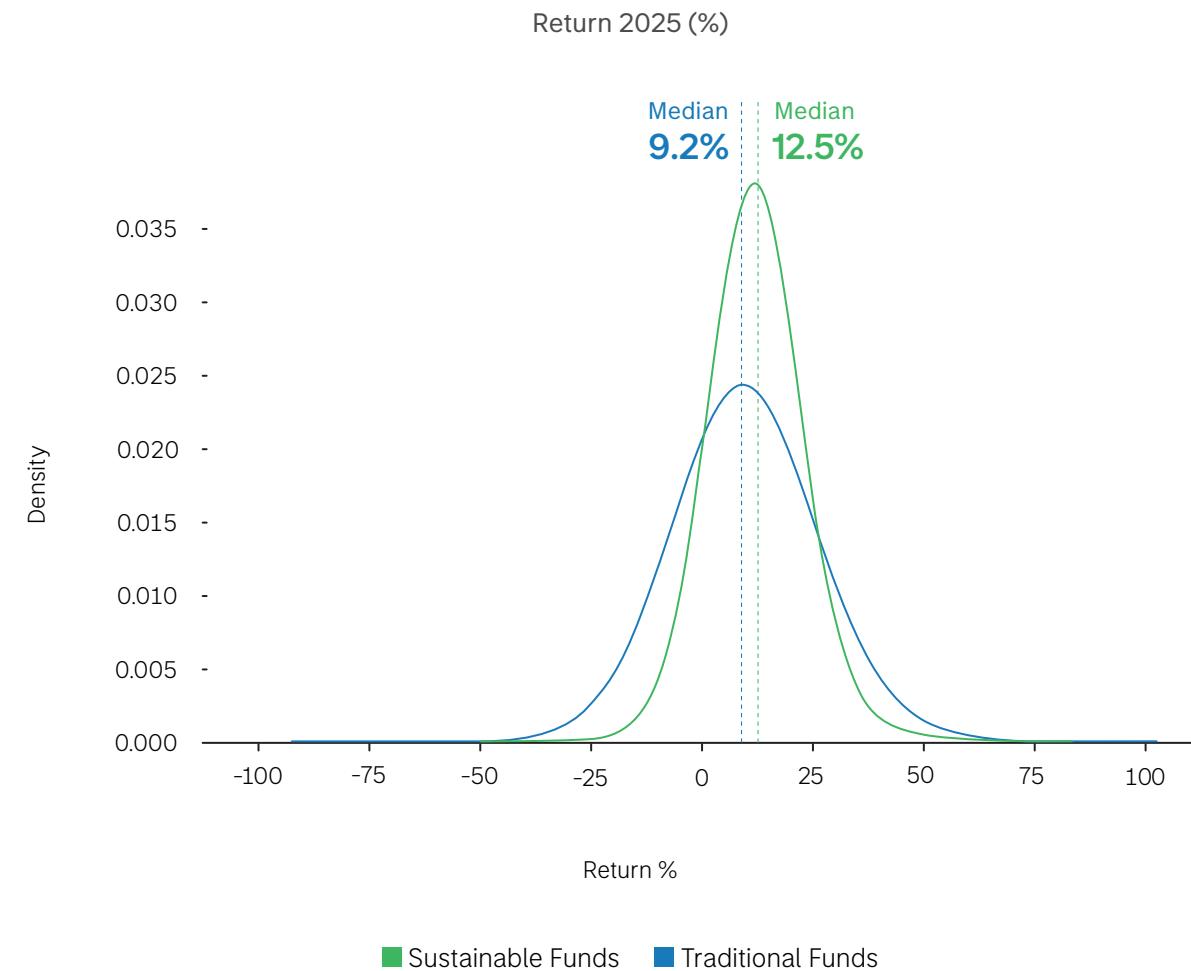
Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

# 92% of Sustainable funds had positive returns in 1H 2025

A larger proportion of Sustainable funds had positive returns in the first half of 2025, at 92% vs. 85% for Traditional funds. Investors were more likely to select a better performing fund in the Sustainable universe. Both curves have long tails, with the highest returning funds +100% and the lowest nearly -100%, resulting in a very wide range of fund performance outcomes. Using mean, or simple average, returns would be disproportionately affected by these long tails and not represent the likelihood of achieving that return across a selection of funds.

The “Sustainable Reality” series uses median fund returns as the primary metric without any weighting to account for different fund sizes. Median is the more appropriate return value given the non-normal distribution of the entire universe of fund return. The median value also better represents the likelihood of an investor selecting a fund and achieving that specific return value.

**Density chart of Sustainable and Traditional fund returns**

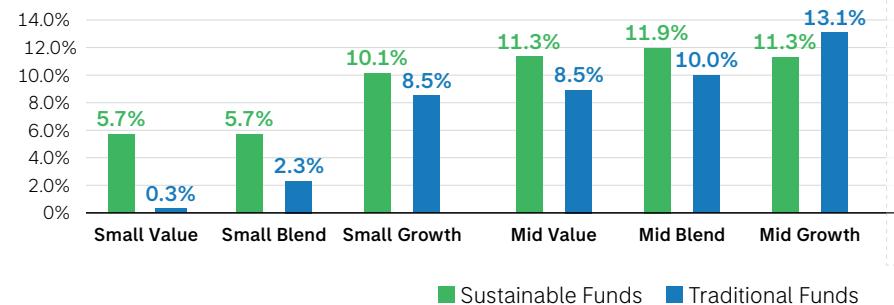


Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

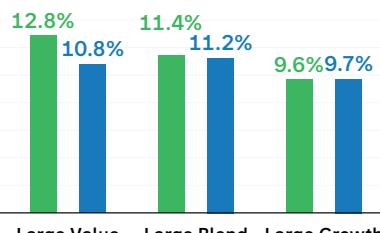
# Equity and fixed income returns by style

Relative exposures to fund styles have influenced Sustainable fund returns in the past, but not materially in 1H 25

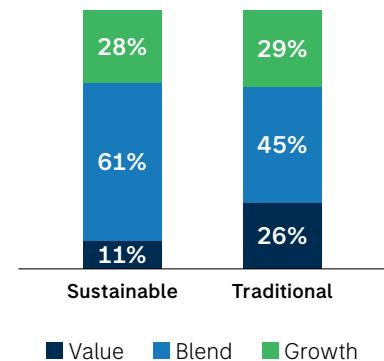
## 1H 25 median equity fund return by style



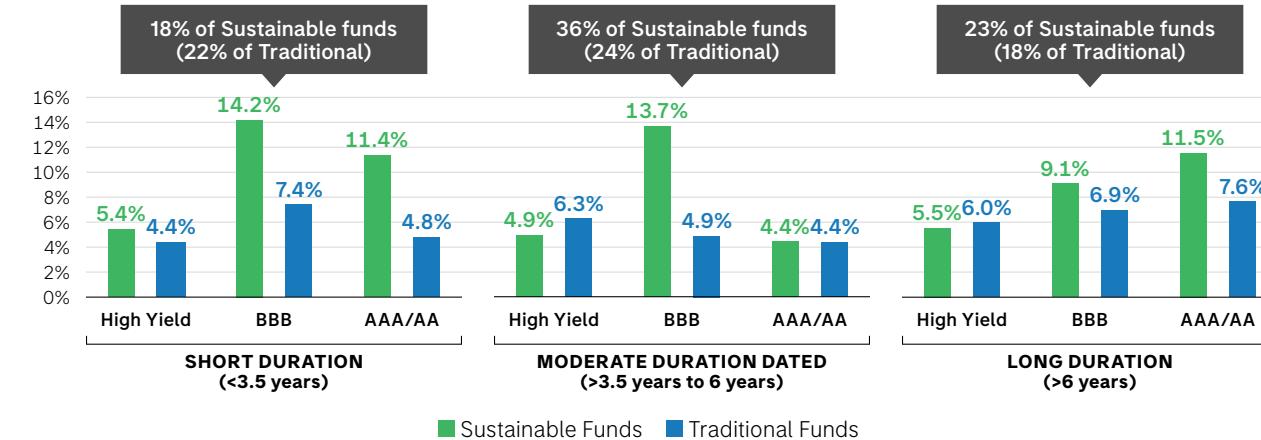
78% of Sustainable funds,  
and 69% of Traditional  
funds, focus on large cap



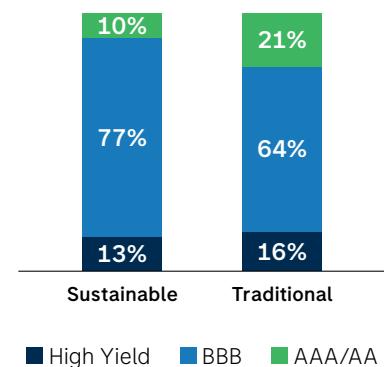
Split of equity funds count by style



## 1H 25 Median Fixed Income Return by Style



Fixed income fund count by credit quality, 1H 25



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025. Morningstar classifies bond funds by the average credit rating of the portfolio.

# Regional focus: impact of new ESMA fund name guidelines

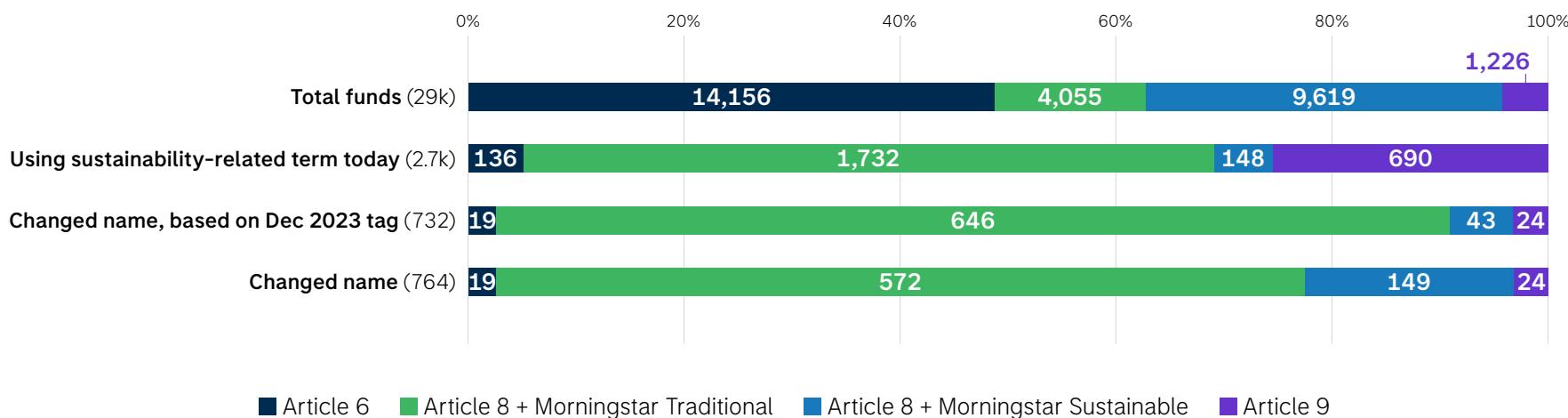
In May 2024, ESMA<sup>1</sup> released guidelines on sustainability terms in fund names, requiring funds to exclude certain investments if using terms like “ESG” or “Sustainable” by May 2025.

- Today, more than 2,700 funds reporting under SFDR use sustainability-related terms in their name, down from <3,500 in February 2025. More than half of Article 9 funds use these terms, at 56%; 43% of Article 8/Sustainable<sup>2</sup> funds, just 2% of Article 8/Traditional funds; and 1% of Article 6 funds.

Since April 2024, 764 funds have changed name. Over 90% removed a sustainability-related term altogether, with a few changing terms.

Almost all of the funds changing name were Article 8 funds. Based on current Morningstar classifications, 572 were Article 8/Sustainable and 149 Article 8/Traditional, although based on December 2023 classifications, this was 646 and 43 respectively. While there are other variables, such as fund launches or closures, this suggests that around 100 Article 8 funds may have changed investment strategy as well as name, and therefore been reclassified by Morningstar.

## Funds reporting under SFDR



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

<sup>1</sup> European Securities and Markets Authority, see their final Guidelines. Funds had until May 2025 to comply.

<sup>2</sup> Sustainable/Traditional classifications from Morningstar

# Restriction screening

Morningstar data on how funds are using restriction screening shows that the proportion of AUM subject to most exclusions continues to move modestly higher. Controversial weapons, thermal coal and tobacco are the most common exclusions.

RESTRICTION SCREENING AT JUNE 2025	GLOBAL AUM, \$bn	% Global AUM	EUROPE- DOMICILED AUM, \$bn	% Europe AUM	NORTH AMERICA- DOMICILED AUM, \$bn	% North America AUM	ASIA- DOMICILED AUM, \$bn	% Asia AUM
<b>Controversial Weapons</b>	<b>13,047</b>	<b>19.1%</b>	<b>12,368</b>	<b>68.2%</b>	<b>391</b>	<b>1.0%</b>	<b>288</b>	<b>3.4%</b>
<b>Thermal Coal</b>	<b>10,151</b>	<b>14.8%</b>	<b>9,854</b>	<b>54.4%</b>	<b>218</b>	<b>0.6%</b>	<b>79</b>	<b>0.9%</b>
<b>Tobacco</b>	<b>9,562</b>	<b>14.0%</b>	<b>8,864</b>	<b>48.9%</b>	<b>382</b>	<b>1.0%</b>	<b>316</b>	<b>3.7%</b>
Other*	8,284	12.1%	7,815	43.1%	315	0.8%	150	1.8%
Fossil Fuel	7,858	11.5%	7,555	41.7%	234	0.6%	69	0.8%
Small Arms	6,532	9.5%	6,077	33.5%	307	0.8%	148	1.7%
Gambling	3,626	5.3%	3,302	18.2%	221	0.6%	99	1.2%
Adult Entertainment	3,501	5.1%	3,263	18.0%	144	0.4%	94	1.1%
Military Contracting	3,355	4.9%	3,147	17.4%	151	0.4%	58	0.7%
Alcohol	2,001	2.9%	1,706	9.4%	215	0.5%	77	0.9%
Nuclear Power	1,652	2.4%	1,518	8.4%	102	0.3%	32	0.4%
Palm Oil	1,380	2.0%	1,343	7.4%	24	0.1%	12	0.1%
Genetically Modified Organisms	690	1.0%	671	3.7%	16	0.0%	3	0.0%
Pesticides	570	0.8%	567	3.1%	4	0.0%	0	0.0%
Animal Testing	301	0.4%	244	1.3%	40	0.1%	17	0.2%
Fur and Specialty Leather	228	0.3%	224	1.2%	2	0.0%	1	0.0%
Abortion	155	0.2%	90	0.5%	64	0.2%	2	0.0%

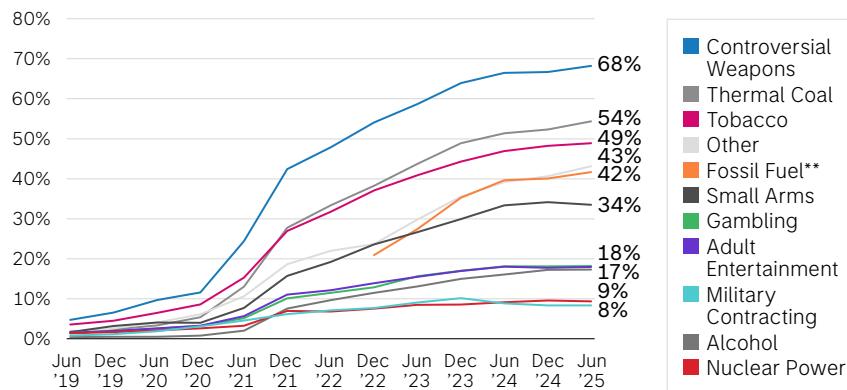
Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

Other\* includes any factors not covered by the named exclusions, for example companies with operations in countries whose governments pose human rights concerns.

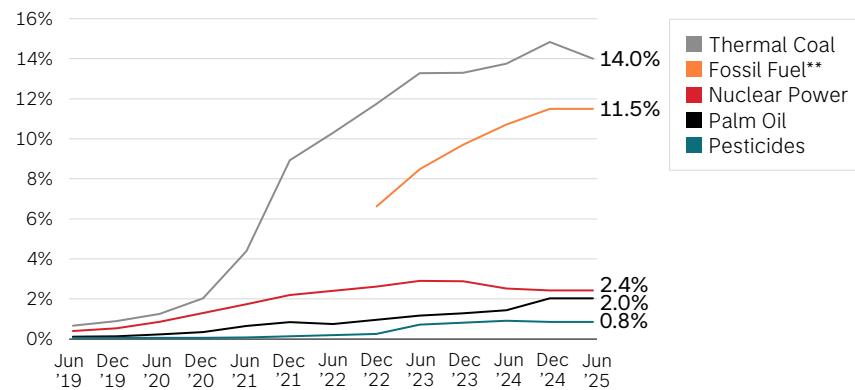
# Restriction screening over time

Europe-domiciled funds account for most of the AUM using restriction screening

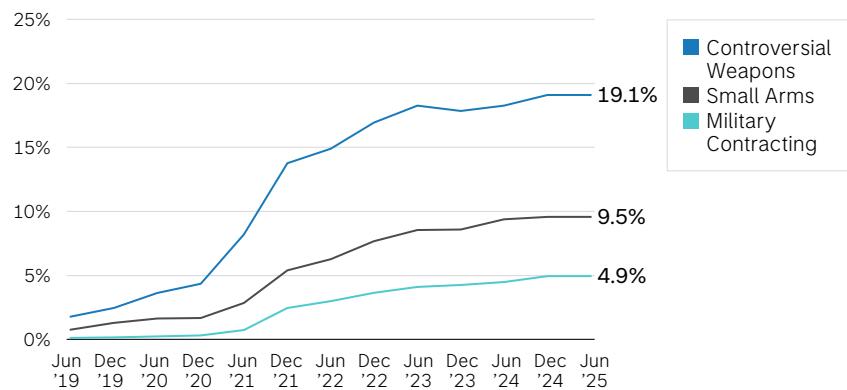
Europe Restriction Screening, as % of Europe AUM



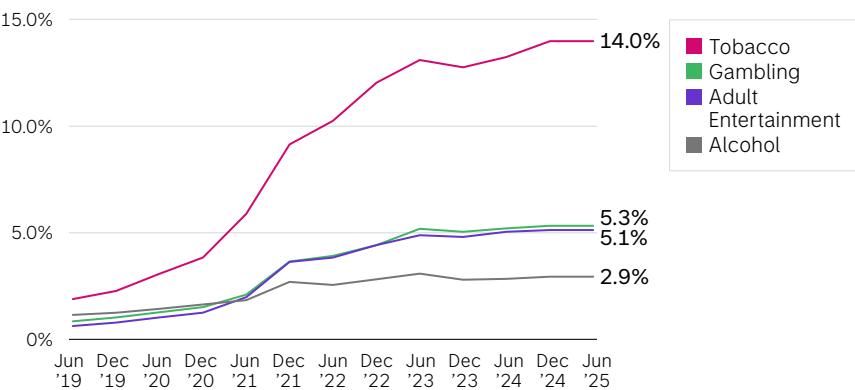
Environmental Restriction Screening, as % of Global AUM



Defense Restriction Screening, as % of Global AUM



Values-Based Restriction Screening, as % of Global AUM



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 6, 2025.

\*\*Fossil fuel was introduced as a separate category starting in December 2022.

# Methodology

This report is part of the Morgan Stanley Institute for Sustainable Investing's 'Sustainable Reality' series, which assesses the historical performance of Sustainable funds against Traditional funds over a specific timeframe using Morningstar data. This report analyzes performance for January 1, 2025 – June 30, 2025.

The fund universe for this analysis includes closed-end funds, exchange-traded funds and open-end funds, taking the oldest share class, and excludes feeder funds, funds of funds and money market funds. In total, this analysis covered approximately 99,000 funds globally. This analysis takes each fund's sustainability classification as of June 30 (for 1H editions) or December 31 (for full year editions). While the parameters for including a fund do not change, taking the fund's classification at the most recent date means that universe of funds can change for each edition. All historical datapoints are restated based on the current period classification.

Morningstar classifies a fund as Sustainable if "...in the prospectus or other regulatory filings it is described as focusing on sustainability, impact investing, or environmental, social or governance (ESG) factors. Funds must claim to have a sustainability objective, and/or use binding ESG criteria for their investment selection. Funds that employ only limited exclusions or only consider ESG factors in a non-binding way are not considered to be a Sustainable investment product."

Sustainable funds are those classified 'Sustainable' by Morningstar, which can differ from the newer, and still broad, European Sustainable Finance Disclosure Regulation (SFDR) Article 8 and Article 9 definitions. Over 99% of Article 9 funds are also classified as Sustainable by Morningstar, while this only applies for around 30% of Article 8 funds. Traditional funds are those classified as 'Not Sustainable' by Morningstar.

Morningstar's calculation of total return is expressed in percentage terms and is determined each month by taking the change in monthly net asset value, reinvesting all income and capital-gains distributions during that month and dividing by the starting net asset value (NAV). All returns figures refer to median returns, as in prior Sustainable Reality iterations.

There can be a time lag of weeks or months in funds reporting data to Morningstar, notably for Asia-domiciled funds. Some figures from prior periods are revised to reflect the latest disclosures. Where this is material to prior analysis, the impact is noted in the text. Prior period figures could also be subject to modest revisions in the future. Data in this report were collected on August 6th, 2025. Older editions of Sustainable Reality have looked at regional data based on the fund's domicile. As with the February 2024 edition, this report retains this breakdown and separately adds data based on a fund's investment area. For example, a fund could be domiciled in Europe but invest in global assets.

# Disclosures

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Certain portfolios may include investment holdings deemed Environmental, Social and Governance (“ESG”) investments. For reference, environmental (“E”) factors can include, but are not limited to, climate change, pollution, waste, and how an issuer protects and/ or conserves natural resources. Social (“S”) factors can include, but not are not limited to, how an issuer manages its relationships with individuals, such as its employees, shareholders, and customers as well as its community. Governance (“G”) factors can include, but are not limited to, how an issuer operates, such as its leadership composition, pay and incentive structures, internal controls, and the rights of equity and debt holders. You should carefully review an investment product’s prospectus or other offering documents, disclosures and/or marketing material to learn more about how it incorporates ESG factors into its investment strategy.

ESG investments may also be referred to as Sustainable investments, impact aware investments, socially responsible investments or diversity, equity, and inclusion (“DEI”) investments. It is important to understand there are inconsistent ESG definitions and criteria within the industry, as well as multiple ESG ratings providers that provide ESG ratings of the same subject companies and/or securities that vary among the providers. This is due to a current lack of consistent global reporting and auditing standards as well as differences in definitions, methodologies, processes, data sources and subjectivity among ESG rating providers when determining a rating. Certain issuers of investments including, but not limited to, separately managed accounts (SMAs), mutual funds and exchange traded-funds (ETFs) may have differing and inconsistent views concerning ESG criteria where the ESG claims made in offering documents or other literature may overstate ESG impact. Further, socially responsible norms vary by region, and an issuer’s ESG practices or Morgan Stanley’s assessment of an issuer’s ESG practices can change over time.

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The appropriateness of a particular ESG investment or strategy will depend on an investor's individual circumstances and objectives. Principal value and return of an investment will fluctuate with changes in market conditions.

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