Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

FOMC Increases Interest Rates by 0.25%

LIQUIDITY | GLOBAL LIQUIDITY TEAM | JUNE 2018

Overview[1]

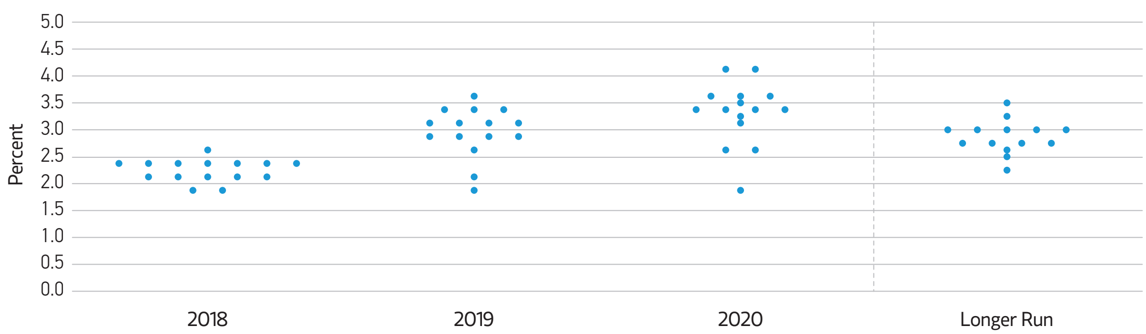
In June, the markets were largely driven by the Federal Open Market Committee's (FOMC) meeting. The FOMC unanimously voted to increase interest rates by 25 basis points to a target range of 1.75% to 2.00%. The summary of economic projections (SEP) showed that the FOMC expects two additional rate hikes this year, up one rate hike from the December meeting. Additionally, the Federal Reserve (Fed) believes there will be three rate hikes in 2019. No changes were made to the balance sheet normalization program, and the fed funds rate remains the main monetary policy tool for the FOMC.

The tone of the FOMC meeting was generally optimistic, as Chairman Jerome Powell stated that the economy is doing "very well." Inflation has picked up and has moved closer to the Fed's 2% target, and the Fed believes inflation will be symmetric around its target range in the coming months. With regards to employment, job gains have continued to be strong and the unemployment rate has decreased further. Unemployment forecasts for the fourth quarter of 2018 decreased to 3.6% from 3.8%. With additional Fed rate hikes, economic activity is expected to expand at a solid rate. The gross domestic product (GDP) forecast for the fourth quarter of 2018 modestly increased to 2.8%, while the forecasts for 2019 and 2020 remained largely unchanged.

DISPLAY 1

Federal Reserve Dot Plot

As of 03/21/2018



Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.
Source: Federal Reserve

[1] Source: Source: Bloomberg L.P.

DISPLAY 2

Monthly Interest Rate Summary

As of 6/30/2018

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	1.74	0.01
3M UST	1.91	0.02
6M UST	2.10	0.03
12M UST	2.31	0.09
2Y UST	2.53	0.10
5Y UST	2.74	0.04
10Y UST	2.86	0.00
30Y UST	2.99	(0.04)
USD LIBOR CURVE		
O/N LIBOR	1.94	0.22
1M LIBOR	2.09	0.09
3M LIBOR	2.34	0.01

Source: Bloomberg

The European Central Bank (ECB) also met in June and announced its plan to end its quantitative easing (QE) program in December of this year. From now until the program ends, the ECB will purchase bonds at a slower pace of 15 billion euros. It was previously expected that the bond purchase program would last until September, with monthly bond purchases of 30 billion euros. The ECB also stated it anticipates that interest rates will remain at its current levels for over a year. With that being said, interest rates on the main refinancing operations remained unchanged at 0.00%, the marginal lending facility was unchanged at 0.25% and the deposit facility was unchanged at -0.40%. ECB President Mario Draghi emphasized that the QE exit and interest rate levels were dependent on incoming data and are subject to change if data readings change relative to the forecasts.

In the U.K., the Bank of England (BoE) voted to leave rates unchanged at 0.5%, as expected. In the minutes from its June meeting, the Monetary Policy Committee (MPC) stated it believes GDP will grow at 0.4% in the second quarter, consistent with its May projections. The MPC also addressed recent weakness in data such as household spending and GDP, calling the readings "temporary, with momentum recovering in the second quarter." Regarding a potential rate hike in the second half of 2018, markets remain mixed on whether the MPC will opt to raise rates.

PRIME STRATEGY[2]

One-month London Interbank Offered Rate (LIBOR) rose to recent highs post-FOMC meeting, opening at 2.09% on June 14, while three-month LIBOR retraced some of the pullback experienced through May, to open at 2.33% as of June 14. With the FOMC expecting further gradual increases in the target for the federal funds rate, we continued to manage our portfolios from a conservative positioning standpoint, focusing on high levels of weekly liquidity and structuring our portfolios to help minimize interest rate risk that could arise from future interest rate hikes.

GOVERNMENT/TREASURY STRATEGY[3]

Agency and Treasury bill yields continued to increase leading up to the FOMC meeting and leveled off as typical quarter-end investor demand picked up. During the month, we primarily invested in fixed-rate Treasury and agency debt within 3-month and 6-month tenors. The maturity dates of these debt securities line up well with our expectations of quarterly FOMC rate hikes for the remainder of the year. Lower quarter-end repo capacity by dealers was evident by the higher usage of the Fed's overnight reverse repo facility ($96.97 billion) at month-end. However, compared to the prior year's usage, volume was on the low end. We continued to maintain a significant portion of certain portfolios in short-term repurchase agreements.

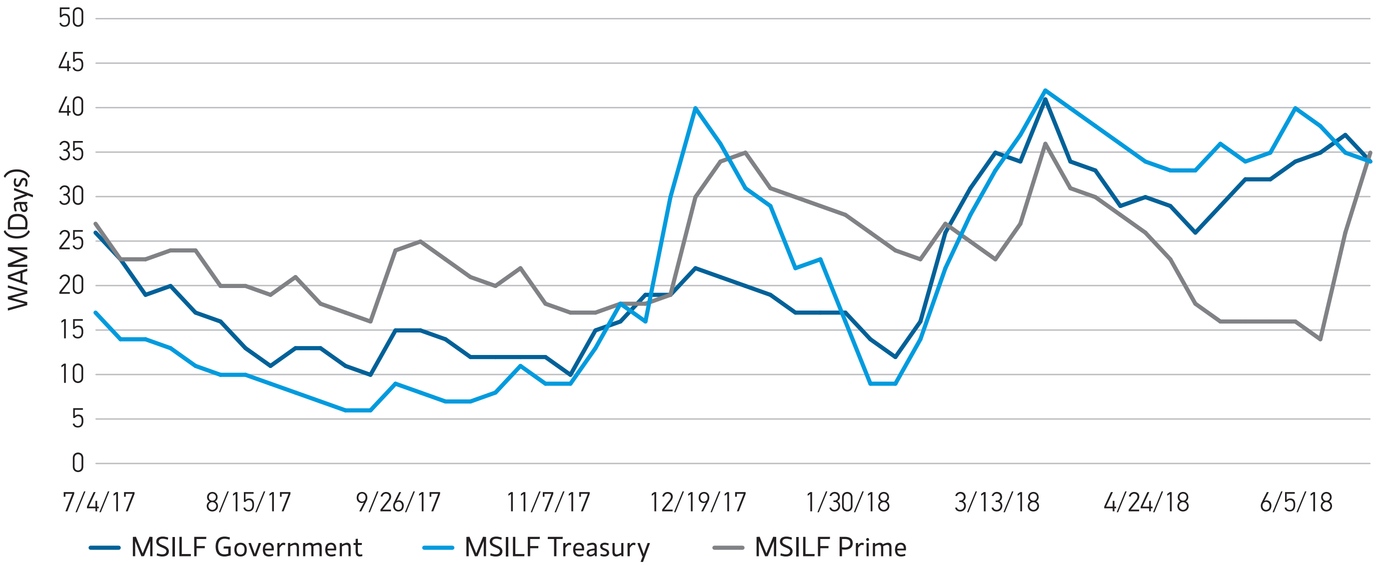
[2] The Portfolio will be required to price and transact in their shares at a floating net asset value ("NAV") and will be permitted to impose a liquidity fee on redemptions or temporarily restrict redemptions in the event that the Portfolio's weekly liquid assets fall below certain thresholds.

[3] Government and Treasury Funds are Stable NAV funds.

DISPLAY 3

Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM)[6]

6/30/17-6/30/18



Source: iMoneyNet

TAX-EXEMPT STRATEGY[2]

At the short end of the curve, yields for variable rate demand obligations (VRDOs) rose throughout the month of June as tax-exempt money fund assets saw outflows. The SIFMA Index,[4] which measures yields for weekly VRDOs, increased 0.45% over the course of the month to 1.51%. At the same time, yields for fixed-rate one-year municipal notes saw good demand in June. The Municipal Market Data (MMD) One-Year Note Index[5] tightened 12 basis points in June to 1.58%. June 30 marked the end of most state and local governments' fiscal years. We maintained our emphasis on high levels of liquidity and relatively short duration as we continued to watch how monetary policy unfolds and what impact the final tax reform changes may have on municipal yields.

[4] The **SIFMA Index** is issued weekly and is compiled from the weekly interest rate resets of tax-exempt variable rate issues included in a database maintained by Municipal Market Data which meet specific criteria established from time to time by The Bond Market Association. The index is unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

[5] Thomson Reuters Municipal Market Data (MMD) AAA Curve is a proprietary yield curve that provides the offer-side of "AAA" rated state general obligation bonds, as determined by the MMD analyst team. The "AAA" scale (MMD Scale), is published by Municipal Market Data every day at 3:00 p.m. eastern standard time with earlier indications of market movement provided throughout the trading day. The MMD AAA curve represents the MMD analyst team's opinion of AAA valuation, based on institutional block size ($2 million+) market activity in both the primary and secondary municipal bond market. In the interest of transparency, MMD publishes extensive yield curve assumptions relating to various structural criteria which are used in filtering market information for the purpose of benchmark yield curve creation. MMD yield curves are available on a subscription basis from Thomson Reuters TM3.

[6] Weighted average maturity (WAM) measures the weighted average of the maturities of the portfolio's individual holdings, taking into account reset dates for floating rate securities

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Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund and can be obtained by contacting your financial professional, or by downloading a copy at www.morganstanley.com/liquidity. Please read the prospectus carefully before investing.

STABLE NAV FUNDS

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Funds' sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

FLOATING NAV FUNDS

You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Funds' sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

The Tax-Exempt Portfolio may invest a portion of its total assets in bonds that may subject certain investors to the federal Alternative Minimum Tax (AMT). Investors should consult their tax adviser for further information on tax implications.

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