Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

Fed Cuts Rates by 0.25% at September Meeting

LIQUIDITY | GLOBAL LIQUIDITY TEAM | MARKET INSIGHT | September 18, 2019

The Federal Open Market Committee (FOMC) lowered the range for the federal funds rate by 0.25% to 1.75%-2.00% during its September meeting. The Fed noted that this policy action is appropriate given global developments and muted inflation pressures. That being said, Fed members are divided on the outlook and appropriate policy path going forward.

FOMC Meeting Summary[1]

Monetary Policy Decision

- The FOMC voted to lower the target range for the fed funds rate by 0.25% to 1.75%-2.00%
- The interest on excess reserves rate was lowered by 0.30% to 1.80%
- The Fed statement retained prior language that it would “act as appropriate to sustain the expansion”
- Three FOMC members dissented to the rate cut, with two preferring no rate cut and one voting for a rate cut of 50bps

Fed Interest Rate Projections

- In the Summary of Economic Projections, interest rate expectations were shifted lower:
  - The median federal funds forecast for 2019 shifted down by 50bps to 1.88% from 2.38% in June, marking to market the two rate cuts that have happened since then. This median forecasts no further change in the federal funds rate in 2019
- The Fed members seem divided on the policy path forward in 2019: five members advocate for higher rates, five support no more movements in rates, and seven suggest that rates should be lower by year-end
- Looking into future years, the median federal funds forecast for 2020 was lowered to 1.88% from 2.13% in June and median forecast for 2021 was lowered to 2.13% from 2.38% in June
- The median of the longer-run neutral rate remained unchanged at 2.50%

Assessment of Economic Conditions

- The assessment of the U.S. economy was very similar to the June statement and remained generally upbeat
  - The labor market remains strong and economic activity has been rising at a moderate rate. Job gains have been solid and the unemployment rate has remained low
  - Although household spending has been rising at a strong pace, business fixed investment and exports have weakened
  - Core inflation remains modestly below the Fed’s 2% target, with Core PCE expectations of 1.8% in 2019 and 1.9% in 2020
- FOMC Economic Forecasts
  - GDP – Slightly upgraded to 2.2% for 2019 (up from 2.1% in June)
  - Inflation – Expectations for 2019, 2020, and 2021 were unchanged from the June forecasts
  - Unemployment – Slightly downgraded to 3.7% for 2019 (up from 3.6% in June)

Portfolio Strategy

MSIFT Ultra-Short Income Portfolio:
Leading up to the September FOMC meeting, where a 25 basis point interest rate cut was widely expected by the market and telegraphed by Federal Reserve officials, both one-month and three-month London Interbank Offered Rate (Libor) declined throughout the month, setting at 2.04 and 2.16 percent respectively as of September 18. As yields moved lower in recent months, we opportunistically added duration to the portfolio, purchasing fixed rate securities predominantly in the 9 and 12 month tenors. As Fed Chair Powell reiterated the FOMC's willingness to "act as appropriate to sustain the expansion," we remain comfortable maintaining an elevated duration of the portfolio. We continue to structure the portfolio from a positioning standpoint, aiming to minimize interest rate risk that could arise from future changes to monetary policy.

MSIFT Ultra-Short Municipal Income Portfolio:
The municipal-bond market has recently diverged from its usual correlation with Treasuries, while Treasuries rallied this week, municipal bonds have slumped as investors prepare for a pickup in the pace of new debt sales. As yields moved lower in recent months, we have opportunistically added duration to the portfolio, purchasing fixed-rate municipal notes and tax-exempt commercial paper. There continues to be an inversion in the municipal yield curve between short-term Variable Rate issues and fixed rates. We believe that this inversion will continue thru year-end. We believe the portfolio is well positioned to optimize the inversion in short-term municipal rates with over 50% of the fund invested in Variable Rate Securities and Floating Rate Notes.

Please reach out to your Morgan Stanley Investment Management Relationship Manager with any questions, or visit www.morganstanley.com/liquidity for more information.

---

[1] Source: FOMC September 18, 2019 Statement.

FOR FINANCIAL PROFESSIONAL USE ONLY AND MAY NOT BE USED WITH THE GENERAL PUBLIC

IMPORTANT INFORMATION
Fund information is subject to change daily and is provided for informational purposes only, and should not be deemed as a recommendation to buy or sell any securities in the sectors presented.

The views, opinions, forecasts and estimates expressed of the author or the investment team as of the date of preparation of this material and are subject to change at any time due to market, economic or other conditions. 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 portfolio managers at Morgan Stanley Investment Management (MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors. These conclusions are speculative in nature and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

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. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks.

Ultra-Short Income: Fixed-income securities. Financial services industry. Asset-backed securities. U.S. Government securities. Repurchase agreements. Municipal obligations. Foreign securities. Restricted and illiquid securities. Liquidity risk.

Ultra-Short Municipal Income: Fixed-income securities. U.S. Government securities. Repurchase agreements. Restricted and illiquid securities. Liquidity risk. Tender Option Bonds. Taxability Risk. Municipal securities. Investment company securities.

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 the current rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. The Portfolio is more susceptible to any economic, business, political, regulatory or other developments that adversely affect issuers in the **financial services industry** than a fund that does not concentrate its investments in the financial services industry. **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. 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. Repurchase agreements are subject to default and credit risks. By investing in **municipal obligations,** the Fund may be susceptible to political, economic, regulatory or other factors affecting their issuers. **Foreign securities** are subject to currency, political, economic and market risks. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities **(liquidity risk)**. Municipal securities are subject to early redemption risk and sensitive to tax, legislative and political changes. **Tender Option Bonds**. The risks of tender option bonds include the risk that the owner of such instrument may not be considered the owner for federal income tax purposes and thus will not be entitled to treat such interest as exempt from federal income tax. The Fund's investments in tender option bonds may expose the Fund to risks associated with leverage and may reduce the Fund's returns and/or increase volatility**. Taxability Risk.** Changes in tax laws or adverse determinations by the Internal Revenue Service ("IRS") may make the income from some municipal obligations taxable. By investing in **investment company securities,** the portfolio is subject to the underlying risks of that investment company's portfolio securities. In addition to the Portfolio's fees and expenses, the Portfolio generally would bear its share of the investment company's fees and expenses.

Please ask your clients to consider the investment objective, risks, charges and expenses of the funds carefully before investing. The prospectus contains this and other information about the funds and can be obtained by contacting you the financial professional, or by downloading one at morganstanley.com/im. Encourage your clients to read the prospectus carefully before investing.

The Ultra-Short Municipal Income 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.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

NOT FDIC INSURED | MAY LOSE VALUE | OFFER NO BANK GUARANTEE | NOT A DEPOSIT | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY