

### Market Insights

# Trade Tensions Lead to Market Volatility

LIQUIDITY | GLOBAL LIQUIDITY TEAM | MACRO INSIGHT | MAY 2019

## Federal Reserve Board<sup>1</sup>

As expected, the Federal Open Market Committee (FOMC) kept the range for the federal funds rate unchanged at 2.25% to 2.50% at the conclusion of its May 1 meeting. The Federal Reserve (Fed) noted that in light of global economic and financial developments and muted inflation pressures, the Committee will continue to be “patient” as it decides what future adjustments to the fed funds rate are appropriate. FOMC participants believed the most likely outcome for the U.S. economy would be sustained expansion of economic activity, with strong labor market conditions and inflation nearing its 2% target.

However, the Trump administration’s decision on May 10 to raise tariffs to 25% on \$200 billion of Chinese goods and its threat to levy tariffs on another \$300 billion of Chinese goods following the next G20 meeting in June stoked concerns that the U.S.-China trade war could be longer and more pronounced than expected. The Trump administration’s decision on May 29 to threaten Mexico with a 5% tariff only exacerbated these concerns and raised the specter of additional U.S. trade wars with other countries.

Fearing continued trade tensions could weaken economic growth, investors fled to U.S. Treasuries in May. The Treasury yield curve flattened significantly, with the 2-, 5- and 10-year yields

falling 34 basis points (bps), 37 bps and 38 bps, respectively, throughout the month and the belly of the curve becoming inverted. As of May 31, the 10-year Treasury bond was yielding 22 bps less than the 3-month Treasury bill. The 5-year Treasury bond was yielding 43 bps less than the 3-month Treasury bill as of the same date. Given this shift in sentiment, the market was pricing in at least two rate cuts by the Fed by the end of 2019.

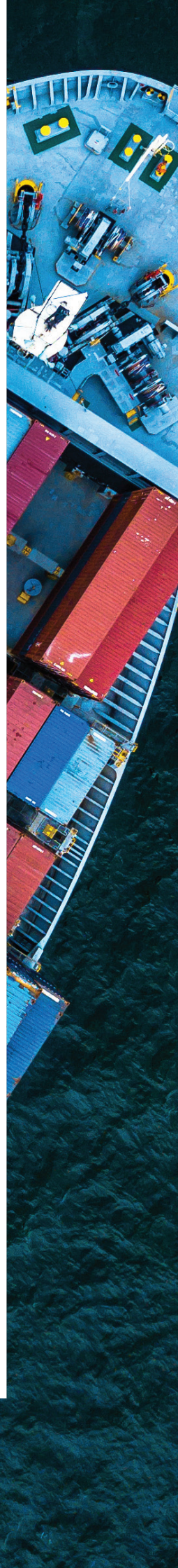
## European Central Bank<sup>1</sup>

While the European Central Bank (ECB) did not hold a policy meeting in May, the ECB released the results of its semi-annual Financial Stability Review on May 29, highlighting the potential economic risks to the euro zone. The report noted that asset prices could move substantially lower if the U.S.-China trade war continues to escalate and weaker gross domestic product (GDP) growth persists. The report also warned that global leveraged loans could be significantly impacted by weaker corporate earnings and European banks would continue to struggle to meet their return on equity targets.

On the economic data front, consumer prices in May were only 1.2% higher than a year earlier (down from 1.7% in April 2019 and the lowest level since April 2018), putting increased pressure on the ECB to take additional action in order to meet its 2% inflation target.

<sup>1</sup> Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of May 2019 and are subject to change based on market, economic and other conditions. **Past performance is not indicative of future results.**



**DISPLAY 1****Overnight Rates**

As of 31/05/2019

	SONIA (%)	EONIA (%)	OBFR (%)
Overnight	0.71	-0.36	2.38

Source: Bloomberg

**Bank of England<sup>1</sup>**

In the U.K., the pound continued to weaken versus the euro following the announcements of a delayed Brexit and Theresa May's resignation as prime minister. Given continued uncertainty around Brexit, the Monetary Policy Committee (MPC) voted unanimously to maintain its bank rate at 0.75% during its meeting ending on May 1. While the MPC kept rates on hold, it revised up its 2019 growth forecasts to 1.5% from 1.2%, noting better-than-expected GDP growth to start the year.

**Portfolio Strategy****MSLF EURO LIQUIDITY FUND (LVNAV)**

May saw the weighted average maturity (WAM) of the Fund drop slightly, as we experienced a number of sizeable inflows, which added significantly to the Fund size. This contributed to a drop in WAM from 49 days at the start of month to 36 days intra-month, before month-end flows re-balanced us back to 41 days. We continue to expect a degree of volatility in the WAM due to fund size fluctuations in the coming weeks. With the ECB considering additional monetary policy easing via TLRO III and lowering growth and inflation forecasts, we expect the WAM to adjust back towards the high 40s as the Fund lengthens where possible, whilst continuing to provide sufficient liquidity to investors.

**MSLF STERLING LIQUIDITY FUND (LVNAV)**

The strategy was kept unchanged during May with our WAM maintained around the high 40s throughout the month. With the U.S. curve continuing to flatten swap levels are not as attractive in sterling and consequently sterling money market rates have continued to fall, despite attempts by the MPC to talk up the possibility of rate hikes in a smooth exit scenario for the U.K. to leave the European Union. The Fund WAL was also maintained in mid-60s with few opportunities for new issues in floating rate notes given the recent spread tightening.

**MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)**

As widely expected, the Fed voted unanimously to maintain the target range for the federal funds rate at 2.25% to 2.50% at the conclusion of its April 30/May 1 FOMC meeting. The Committee repeated language from its previous meeting, saying it "will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate." With mixed economic data and increased geopolitical headlines throughout the month, Treasuries rallied, with the 10-year yield ending the reporting period at 2.12%, a 17-month low. Three-month LIBOR also ended the reporting period at a recent low, setting at 2.5% on May 31, down 8 bps month-over-month. With the Fed indicating that it would be on hold in the near term, and LIBOR continuing to grind tighter, we opportunistically added duration to the portfolio, purchasing fixed-rate securities in the 6- and 9-month tenors.

**DISPLAY 2****LIBOR Rates**

31/05/2019

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
Overnight	0.68	-0.47	2.35
1 week	0.70	-0.45	2.39
1 month	0.73	-0.42	2.43
2 months	0.77	-0.38	2.47
3 months	0.80	-0.34	2.50
6 months	0.87	-0.32	2.52
12 months	1.00	-0.23	2.51

Source: Bloomberg

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**DISPLAY 3****Yield Curves**

As of 31/05/2019

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
2 year	0.60	-0.67	1.92
5 year	0.64	-0.58	1.91
10 year	0.89	-0.20	2.12
30 year	1.47	0.43	2.57

Source: Bloomberg

**MSLF U.S. DOLLAR TREASURY LIQUIDITY FUND  
(PUBLIC DEBT CNAV)**

With the Fed indicating during its April 30/May 1 meeting that it would be on hold in the near term, we added duration to the portfolio, investing into longer-term, floating-rate agencies and Treasuries up to 2 years in maturity. We also

invested into shorter fixed-rate Treasuries and agencies up to 6 months in maturity. We continue to manage the portfolios to be responsive to changing market conditions and to invest a significant portion of most portfolios in overnight repurchase agreements.

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**12 Month Performance Periods to Latest Month End (%)****MSLF Euro Liquidity Fund (LVNAV)**

	<b>MAY '18 - MAY '19</b>	<b>MAY '17 - MAY '18</b>	<b>MAY '16 - MAY '17</b>	<b>MAY '15 - MAY '16</b>	<b>MAY '14 - MAY '15</b>
Institutional Accumulation Share Class	-0.49	-0.52	-0.47	-0.19	0.02
One Week Euro LIBID Index	-0.56	-0.54	-0.52	-0.37	-0.16
One Month Euro LIBID Index	-0.53	-0.53	-0.50	-0.32	-0.11
Euro Overnight Index Average (EONIA)	-0.37	-0.36	-0.35	-0.20	-0.02

**MSLF Sterling Liquidity Fund (LVNAV)**

	<b>MAY '18 - MAY '19</b>	<b>MAY '17 - MAY '18</b>	<b>MAY '16 - MAY '17</b>	<b>MAY '15 - MAY '16</b>	<b>MAY '14 - MAY '15</b>
Institutional Distributing Share Class	0.58	0.27	0.30	0.46	0.41
One Week GBP LIBID Index	0.54	0.26	0.16	0.37	0.36
One Month GBP LIBID Index	0.70	0.41	0.31	0.52	0.51
SONIA	0.67	0.36	0.26	0.46	0.44

**MSLF U.S. Dollar Liquidity Fund (LVNAV)**

	<b>MAY '18 - MAY '19</b>	<b>MAY '17 - MAY '18</b>	<b>MAY '16 - MAY '17</b>	<b>MAY '15 - MAY '16</b>	<b>MAY '14 - MAY '15</b>
Institutional Distributing Share Class	2.10	1.39	0.74	0.23	0.04
One Week USD LIBID Index	2.12	1.26	0.50	0.14	0.01
One Month USD LIBID Index	2.20	1.36	0.56	0.18	0.04
FED Funds	2.24	1.35	0.58	0.24	0.11

**MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)**

	<b>MAY '18 - MAY '19</b>	<b>MAY '17 - MAY '18</b>	<b>MAY '16 - MAY '17</b>	<b>MAY '15 - MAY '16</b>	<b>MAY '14 - MAY '15</b>
Institutional Distributing Share Class	1.87	1.07	0.28	0.07	0.00
FTSE 1 Month Treasury Bill Index	2.22	1.20	0.36	0.09	0.02

Past performance is not a reliable indicator of future results. The net performance data shown is calculated net of annual fees. The sources for all performance and Index data is Morgan Stanley Investment Management. Please visit our website [www.morganstanley.com/im](http://www.morganstanley.com/im) to see the latest performance returns for the fund's other share classes.

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## Institutional Distributing and Institutional Accumulation Share Class Risk and Reward Profile



The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- The fund is in this category because it invests in money market securities and the fund's simulated and/or realised return has experienced low rises and falls historically.

This rating does not take into account other risk factors which should be considered before investing, these include:

- The value of bonds are likely to decrease if interest rates rise and vice versa.
- Issuers may not be able to repay their debts, if this happens the value of your investment will decrease. This risk is higher where the fund invests in a bond with a lower credit rating.
- The fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the fund to financial loss.
- US Dollar Liquidity Fund, Sterling Liquidity Fund, and US Dollar Treasury Liquidity Fund: While it is intended that the distributing share classes will maintain a share price of €1/\$1/£1, this may not be achieved due to the creditworthiness of the issuers of investments held or changes in interest rates.

Past performance is no guarantee of future results.

Please refer to the Prospectus for full risk disclosures. All data as of 31 May 2019 and subject to change daily.

### INDEX INFORMATION

**One week Euro LIBID Index** – One week London Interbank Bid Rate - The average interest rate which major London banks borrow Eurocurrency deposits from other banks.

**One Month Euro LIBID Index** – One month London Interbank Bid Rate - The average interest rate which major London banks borrow Eurocurrency deposits from other banks.

**Euro Overnight Index Average (EONIA)** – the standard interest rate at which banks provide loans to each other with a duration of 1 day within the Eurozone.

**FTSE 1 Month Treasury Bill Index** – index calculated by FTSE that is an average of the last one month Treasury bill month-end rates.

**One Week USD LIBID Index** – 1 week London Interbank Bid Rate - The average interest rate which major London banks borrow deposits from other banks.

**One Month USD LIBID** – 1 month London Interbank Bid Rate - The average interest rate which major London banks borrow deposits from other banks.

**FED Funds** – excess cash reserves that commercial banks and other financial institutions deposit at regional Federal Reserve banks; these funds can be onward lent to other market participants with insufficient cash on hand to meet their lending and reserve needs.

**One Week GBP LIBID Index** – 1 week London Interbank Bid Rate - The average interest rate which major London banks borrow deposits from other banks.

**One Month GBP LIBID** – 1 month London Interbank Bid Rate - The average interest rate which major London banks borrow deposits from other banks.

**SONIA** - the standard interest rate at which banks provide loans to each other with a duration of 1 day within the Sterling market.

### DEFINITIONS

**Public Debt Constant Net Asset Value (CNAV) MMF** – a MMF qualifying and authorised as a Public Debt CNAV MMF in accordance with MMF Regulation which seeks to maintain a stable NAV and invests 99.5% of its assets in money market instruments issued or guaranteed by sovereign

entities, reverse repurchase agreements secured with government debt and cash.

**Low Volatility Net Asset Value (LVNAV) MMF** – a MMF qualifying and authorised as a LVNAV MMF in accordance with MMF Regulation which seeks to maintain a stable NAV under the condition that the stable NAV does not deviate from the NAV per Share by more than 20 basis points. In case of a deviation of more than 20 basis points between the stable NAV and the NAV per Share, the following redemption or issue of Shares shall be undertaken at a price that is equal to the NAV per Share.

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The Funds are authorised to invest up to 100% of their assets in Money Market Instruments issued or guaranteed separately or jointly by a Sovereign Entity and by any other member states of the OECD and their central authorities or central banks subject to certain conditions. Please see Prospectus for further details.

Applications for shares in the Funds should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering

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