

# Sterling Liquidity Fund

Morgan Stanley Funds p.l.c.

**Launch date:**  
June 2003

**Portfolio manager:**  
Corinne Lewis-Reynier

**Location:**  
London

**Base currency:**  
Sterling

**Benchmark:**  
1 Week GBP LIBID

## MARKET REVIEW

Crisis conditions continued in October. Equity prices plunged as investors began to recognise the magnitude of the recession touched off by the dysfunction in credit markets. Credit markets remained under severe pressure and yield spreads widened massively. Government bond yields plunged, especially at shorter maturities. The Bank of England joined a coordinated global policy easing early in October and reduced rates further, to 3% in early November.

While markets remain turbulent, there was evidence last month that EU economic policies were beginning to get a grip on problems in the financial system. While each country's approach has differed, the general strategy has featured a massive provision of liquidity through central banks and powerful support to commercial banks through capital injections and asset purchases. The total amount of public resources deployed in these operations – estimated at more than \$4 trillion by the Bank of England – became comparable to the scale of the problem, as shown by declines in money market rates and credit spreads on the debt of large financial institutions.

The good news in money markets was not enough to spare credit markets a second straight month of historic underperformance. Despite credit spreads already being near the highest levels of the past 50 years, the collapse in equity prices and recognition that deep recession may lie ahead forced them wider still. The spread move was proportionately more severe for non-financial issuers, as government injections of capital and guarantees of at least some liabilities provided support for bank debt. Despite lower yields on government debt, the magnitude of the spread widening has forced corporate borrowing costs sharply higher, posing yet another risk to economic activity.

Markets priced in a sharply lower path of monetary policy rates through next year following poor economic reports. The Bank of England participated in a coordinated rate cut of 50 basis points on 8 October and cut again by an unprecedented 150 basis points, to a 3% base rate, early in November.

October was the first full month following the September freeze in money and credit markets and data began to reveal the extent of the damage to economies.

In the UK, economic news was the gloomiest since 1992. The three months to the end of September saw the first quarter of negative growth for more than 16 years. Gordon Brown admitted on 22 October that Britain was almost certainly heading into recession. A day before the prime minister spoke, Mervyn King offered his grimmest take on the economy in his five-year-stint as governor of the Bank of England, warning of "a sharp and prolonged slowdown in domestic demand." The pound promptly fell to its lowest level against the dollar since 2003.

Mr. King's emphasis on recession, together with notes from the previous meeting of the Monetary Policy Committee showing that its members voted unanimously for the half-point cut in the base rate announced on 8 October, suggests enough worry to prompt another rate cut, perhaps as early as November. Companies would welcome it: the latest survey by the Confederation of British Industry, the main employers' body, recorded the steepest single-quarter fall in manufacturing confidence since 1980.

Other data was equally morose, with retail sales on a clear downward trend and the number of homes sold during 2008 at their lowest level since 1974, after a record 14.6% decline in annual house prices in October.

## STRATEGY AND OUTLOOK

Given the uncertain outlook and market volatility, the investment strategy in the fund continued to be prudent and defensive in nature. We remain conservative in our approach to both credit, duration and liquidity management.

During the month, the Sterling money market yields declined sharply on the back of Central Bank liquidity injection and interest rates easing: the one-month Libor rate was down 42 bps at 5.65%, the three-month rate was lower by 46 bps to 5.84%, while the 12-month rate decreased by 49 bps to 6.01%.

At the end of the month, the 30-day gross yield to maturity on the fund was 5.38% with a weighted average maturity (WAM) of 31 days. Asset allocation at the end of the period was as follows: Commercial Paper 30%, Floating Rate Notes 20%, Certificates of Deposit 20%, Short dated Government Bills 2% and Time Deposits 28%.

**For further information, please contact your Morgan Stanley representative:  
Email: [Institutional-Liquidity@morganstanley.com](mailto:Institutional-Liquidity@morganstanley.com)  
Tel: +44 (0) 207 425 7220**

# Commentary

### Important Information

#### **FOR BUSINESS AND PROFESSIONAL INVESTORS ONLY AND NOT TO BE USED WITH THE GENERAL PUBLIC**

Applications for shares in any Morgan Stanley Funds p.l.c., should not be made without first consulting the current Prospectus, Annual Report and Semi-Annual Report ("Offering Documents"), which are available free of charge at the below address.

#### **[www.morganstanley.com/liquidity](http://www.morganstanley.com/liquidity)**

The Morgan Stanley liquidity web site is directed only to persons in Ireland and UK only.

Past performance is not a guide to future results. The value of investments and the income from them can go down as well as up and an investor may not get back the amount invested. Changes in rates of exchange between currencies may cause the value of investments to decrease or increase. The source of all data is Morgan Stanley Investment Management, based on Institutional Share Class performance.

This Financial Promotion has been issued and approved for use in the UK to those persons who are Professional Clients or Eligible Counterparties (as defined in the UK Financial Services Authority's rules) by Morgan Stanley Investment Management Limited, 25 Cabot Square, Canary Wharf, London E14 4QA, authorized and regulated by the Financial Services Authority.

This communication is only intended for and will be only distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.