

Morgan Stanley Institutional Liquidity Funds – Tax-Exempt Portfolio

MSILF Participant Class

Symbol: **MXPXX** CUSIP: **61747C632**

August 31, 2008

Monthly Commentary

Overview

The tone in the municipal market remained defensive during August, although municipal bonds improved modestly compared to Treasuries. The pace of new issuance slowed, but restructuring of troubled auction rate and mono-line insured debt was still a significant component of the financing calendar. In the tax-free money market, variable-rate yields fluctuated widely. Heavy cash flows into the market early in the month brought variable-rate resets to unattractive levels relative to taxable alternatives. Cash outflows later in the month coupled with quarter-end pressures for many dealers prompted variable rates to spike back upwards. With fall looming, municipal governments' budget-related pressures began to move to the forefront, with governments seeking tax hikes and belt tightening, while taxpayers resisted or sought rollbacks. The SIFMA Index of weekly variable-rate securities fell from 2.24% at the end of July to 1.84% at the end of August. The Bond Buyer One-Year-Note Index remained relatively unchanged, from 1.59% to 1.58%.

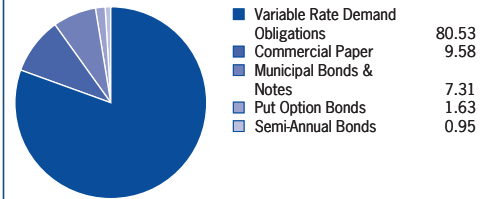
Strategy

- Protecting the safety and liquidity of the portfolio's assets remained our priority. In the recent turbulent market, we have focused on managing exposure to institutions under stress.

Outlook

- We will remain watchful for developments that may impact the portfolio.

Security Type Breakdown (%)



Historical Yields (%)

	Portfolio
7-day current	1.25
7-day effective	1.26
30-day effective	1.21
Annualized 1-month	1.22

As of August 31, 2008, the fund's nonsubsidized yields were 1.17%, 1.18%, 1.13%, and 1.14% respectively, and its simple (7-day) yield, gross of all fee waivers and expense reimbursements, was 1.86.

Yield quotations more closely reflect current earnings of the money market fund than total return quotations. Yields are subject to change.

Portfolio Characteristics

Weighted average maturity	31
Moody's rating	AAA
Fitch rating	AAA/V1+
Purchase deadline	2 PM ET
Redemption deadline	1 PM ET

Total Net Assets

All Share Classes (\$B)	5.25
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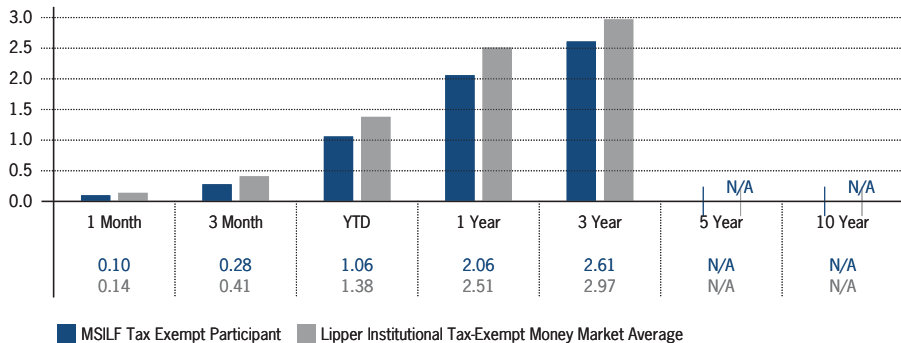
Top Holdings (%)

Southeast Alabama Gas District	3.81
Kentucky Public Energy Authority	3.27
North Carolina Medical Care Co.	3.13
Commonwealth of Massachusetts	2.88
State of Texas	2.38

The portfolio is actively managed, therefore holdings may not be current. The holdings shown are provided for informational purposes only and should not be deemed as a recommendation to purchase or sell the holdings mentioned. Morgan Stanley is a full-service securities firm engaged in securities trading and brokerage activities, investment banking, research and analysis, financing and financial advisory services.

Investment Performance (% net of fees)*

Average annual total return (Periods ending August 31, 2008)



The inception date for this performance record is November 1, 2004.

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please visit www.morganstanley.com/msim or call 1-888-378-1630. Investment returns will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.

Portfolio Profile

Objective

The Tax-Exempt Portfolio seeks to maximize current income exempt from federal income tax to the extent consistent with preservation of capital and maintenance of liquidity.

Philosophy

We believe that a conservatively managed portfolio of liquid, high-quality tax-exempt money market instruments may maximize tax-free current income while preserving capital and liquidity.

Process

The management team follows a multi-pronged investment process with respect to credit risk, interest rate risk and liquidity. Securities are reviewed on an ongoing basis taking into consideration factors such as economic developments, budgetary trends, cash flow, debt service coverage ratios and tax law changes. Exposure to guarantors and liquidity providers is monitored separately.

See reverse for important information

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Performance Definitions

Annualized 1-month yield A simple annualized net yield. It differs from the 30-day yield in that it accounts for the actual days in the month, which can be 28, 29, 30, 31, 32, 33 or 34 days depending on the number of days in the months and a fund's accounting procedure. The monthly dividend factor is converted to a monthly yield. The following formula is used:

$$\text{Annualized 1-month yield} = \frac{\text{monthly div. factor}}{\# \text{ of days in fund's month}} \times 365 \times 100$$

Nonsubsidized yield The nonsubsidized yield reflects what the yield would have been had a fee and/or expense waiver not been in place during the period shown.

Yield definitions The 7-day current yield is an annualized net yield in which it is assumed that the income earned on the principal is not reinvested in the fund. The effective 7-day and 30-day net yields are annualized net yields that describe the amount one is expected to earn over a 1-year period assuming that dividends are reinvested at the average rate of the last 7 days or 30 days, respectively.

Total return A measure of a fund's performance that encompasses all elements of return: dividends, capital gain distributions, and changes in net asset value. Total return is the change in value of an investment over a given period, assuming reinvestment of any dividends and capital gain distributions, expressed as a percentage of the initial investment.

The following formula is used:

$$[(1 + \text{monthly div. factor}) \times (1 + \text{monthly div. factor}) \text{ for past 12 months} - 1] \times 100$$

Portfolio Characteristics Definitions

Weighted average maturity Maturity measures the number of days remaining in the life of a bond. The weighted average maturity of the portfolio represents the market-weighted average of the maturities of the portfolio's individual holdings.

Credit ratings Ratings represent the opinions of the rating agency as to the quality of the securities they rate. Ratings are relative and subjective and are not absolute standards of quality. The portfolio's credit quality does not remove market risk.

Morgan Stanley Institutional Liquidity Fund (MSILF) MSILF is a high-quality institutional mutual fund offering seven different cash management portfolios.

Fund adviser The Morgan Stanley Institutional Liquidity Fund (MSILF) is managed by Morgan Stanley Investment Management, Inc.

For additional information, please call 1-888-378-1630.

Risk Considerations

An investment in the portfolio is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the portfolio seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the portfolio. The portfolio is managed to maintain its stable \$1.00 per share price.

The prices of fixed income securities respond to economic developments, including interest rate changes. Indeed, prices tend to be inversely affected by changes in interest rates. Accordingly, the portfolio is subject to interest rate risk, and in a rising interest rate environment, portfolio shares can decline in value.

In addition, the portfolio may invest a portion of its total assets in bonds that may subject certain investors to the federal Alternative Minimum Tax (AMT). You should consult your tax adviser for further information on tax implications.

Other Considerations

The Lipper Institutional Tax-Exempt Money Market Average tracks the performance of all funds in the Lipper Institutional Tax-Exempt Money Market Funds classification. The Average, which is adjusted for capital gains distributions and income dividends, is unmanaged and should not be considered an investment.

Fees The Adviser has voluntarily agreed to reduce its advisory fee and/or absorb other expenses so that the total operating expenses of each portfolio's Participant Class will not exceed 0.70%. The current total expense ratio for the portfolio's Participant Class is 0.62%.

The forecasts and opinions referenced are those of the fund's portfolio management team as of date of publication, are subject to change at any time due to changes in market or economic conditions, and are not necessarily those of Morgan Stanley Investment Management.

The MSILF portfolio returns are reported for Participant Class shares, which have an ongoing 25 basis point (0.25%) 12b-1 fee, which affects performance.

*MSILF returns are net of fees and assume the reinvestment of all dividends and income. Returns for less than one year are cumulative (unannualized). MSILF returns are reported for Participant class shares. Performance for the other classes will differ. The Adviser has voluntarily agreed to waive a portion of its fees and/or reimburse expenses if annual operating fees exceed certain levels. Absent of these waivers, if any, returns would have been lower. Fee waivers and/or reimbursements are voluntary and the Adviser reserves the right to terminate any waiver and/or reimbursement at any time.

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This material must be preceded or accompanied by a prospectus for the Morgan Stanley Institutional Liquidity Funds. The prospectus contains information about the funds, including the investment objectives, risks, charges and expenses. For an additional copy of the prospectus, please visit www.morganstanley.com. Please read the prospectus carefully before investing.

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley Institutional Liquidity Funds.

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Morgan Stanley Investment Management

Morgan Stanley