

Central Banks Hold the Line on Accommodation

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | FEBRUARY 2021

Federal Reserve Board¹

While no formal policy meeting occurred in February, Chairman Jerome Powell presented the Federal Reserve's (Fed) semiannual monetary policy report to Congress. The chairman kept his prepared remarks very consistent with recent Fed language and Federal Open Market Committee (FOMC) press releases. He reiterated that the Fed is committed to maximum employment and price stability in addition to its current monetary policy stance. The next FOMC meeting will be held on March 16-17 and will feature an updated summary of economic projections.

European Central Bank¹

The European Central Bank (ECB) also did not hold a formal policy meeting in February. In the upcoming March meeting, analysts expect the ECB to leave policy unchanged. Outside of policy, the ECB's commentary on the ongoing impact of national lockdowns on economic data will be highly sought. Additionally, investors are paying close attention to any insight the ECB can offer on the European Union's vaccine rollout and the path of the Eurozone's economic recovery.

Bank of England¹

The Bank of England Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.10% and leave its U.K. government bond purchase program unchanged at its February meeting. The press release noted that fourth quarter gross domestic product (GDP) growth softened as the U.K. reintroduced lockdowns to contain the spread of COVID-19 but markets

have remained "resilient." The committee expects inflation to increase in the spring, although the labor market remains "difficult to interpret." Consistent with its prior meeting, the MPC projects GDP to increase "rapidly" as the vaccine rollout continues and restrictions are lifted. Looking ahead, the MPC believes current policy is appropriate; however, if the inflation outlook deteriorates the committee "stands ready to take whatever additional action is necessary to achieve its remit."

Portfolio Strategy

MSLF EURO LIQUIDITY FUND (LVNAV)

While the Fund's asset size and its weighted average maturity (WAM) and weighted average life (WAL) stayed broadly unchanged through the month, there was significant trading activity given the scale of flows and maturities. While our weekly liquidity was maintained at a high level, we were able to trade a number of term assets in some high quality and rare issuers at attractive levels. While we were able to replace some maturing bond assets, much of the term trading was in money market instruments, as we attempted to maintain a WAM in the high 40 days given the potential for increased excess liquidity reducing the term funding needs for European banks and putting pressure on the money market yield curve. However, with higher yields appearing in both U.S. dollar and sterling markets, we believe opportunities in euro market may still be possible, so some of the Fund's WAM scope has been left to take advantage of these opportunities.

¹ Source: Bloomberg



DISPLAY 1

Overnight Rates

As of 28/2/21

	SONIA (%)	EONIA (%)	OBFR (%)
Overnight	0.05	-0.48	0.07

Source: Bloomberg

MSLF STERLING LIQUIDITY FUND (LVNAV)

Given the Bank of England MPC meeting in February implying that negative interest rates were highly unlikely in the U.K. for the foreseeable future, and the stronger-than-expected outlook, we anticipated that money market yield curves would soon start to steepen. As such, the Fund was managed through the month to take advantage of some longer-dated levels to keep the WAM around 50 days, but also increasing the amount of shorter-dated liquidity before it was reduced by typical month-end flows. The Fund's asset size dropped slightly on the month due to these outflows, ending the month at just over £3 billion, which also increased the WAM to 55 days. As yield curves continue to steepen, we expect to be able to continue our strategy of maintaining good levels of liquidity whilst trading some of the higher term levels to maintain our Fund positioning.

MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)

On the short end of the curve, an abundance of cash and an increase in reserves pushed three-month LIBOR to all-time lows, setting at 0.17525% on February 19, while clearing

levels in the wholesale funding market continue to go through 3 to 5 basis points tighter. With spreads remaining tight and LIBOR and SOFR continuing to grind lower, we maintained our strategy of adding fixed rate investments to the portfolio, seeking to avoid reset risk associated with floating rate notes. Weekly liquidity in our portfolio remains elevated, in excess of 50% throughout the month.

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

During February, yields continued to be under pressure across the curve with one-year Treasury bill yields hitting a new low of 0.07% and SOFR also marking a new low of 0.01%. This contrasts with the long end of the curve where yields pushed much higher during the month. The U.S. Treasury cut bill supply after its quarterly refunding meeting, eliminating two cash management bills from its auction schedule. We expect the continued decline of the Treasury's cash balances and bill cuts will only pressure short rates further. While a new stimulus package is working its way through Congress, it is uncertain if bill supply will increase in the near term.

DISPLAY 2

LIBOR Rates

As of 28/2/21

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
Overnight	0.04	-0.59	0.08
1 week	0.04	-0.58	0.09
1 month	0.05	-0.58	0.12
2 months	0.06	-0.55	0.15
3 months	0.07	-0.55	0.19
6 months	0.08	-0.51	0.20
12 months	0.15	-0.48	0.28

Source: Bloomberg

DISPLAY 3

Yield Curves

As of 28/2/21

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
2 year	0.12	-0.67	0.13
5 year	0.39	-0.57	0.73
10 year	0.82	-0.26	1.40
30 year	1.38	0.19	2.15

Source: Bloomberg

We continued to buy U.S. Treasury bills and coupons while keeping a fair amount in overnight repos collateralized by U.S. Treasuries. We continue to ensure high levels of liquidity

and manage the portfolio to be responsive to changes in market conditions and interest rate levels.

12 Month Performance Periods to Latest Month End (%)

MSLF Euro Liquidity Fund (LVNAV)	FEB '20 - FEB '21	FEB '19 - FEB '20	FEB '18 - FEB '19	FEB '17 - FEB '18	FEB '16 - FEB '17
Institutional Accumulation Share Class	-0.58	-0.49	-0.50	-0.51	-0.42
MSLF Sterling Liquidity Fund (LVNAV)	FEB '20 - FEB '21	FEB '19 - FEB '20	FEB '18 - FEB '19	FEB '17 - FEB '18	FEB '16 - FEB '17
Institutional Distributing Share Class	0.11	0.67	0.56	0.23	0.36
MSLF U.S. Dollar Liquidity Fund (LVNAV)	FEB '20 - FEB '21	FEB '19 - FEB '20	FEB '18 - FEB '19	FEB '17 - FEB '18	FEB '16 - FEB '17
Institutional Distributing Share Class	0.25	2.15	2.13	1.19	0.60
MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)	FEB '20 - FEB '21	FEB '19 - FEB '20	FEB '18 - FEB '19	FEB '17 - FEB '18	FEB '16 - FEB '17
Institutional Distributing Share Class	0.08	1.91	1.86	0.82	0.20

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 to see the latest performance returns for the fund's other share classes.

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.
- 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 28 February 2021 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

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.

Weighted average life (WAL) – measures the weighted average of the maturities of the portfolio's individual holdings.

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.

For Professional Clients use only

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations. In particular, the Shares are not for distribution to US persons.

Ireland: MSIM Fund Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. Registered in Ireland as a private company limited by shares under company number 616661. MSIM Fund Management (Ireland) Limited is regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** MSIM Fund Management (Ireland) Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** MSIM Fund Management (Ireland) Limited, Milan Branch (Sede Secondaria di Milano) is a branch of MSIM Fund Management (Ireland) Limited, a company registered in Ireland, regulated by the Central Bank of Ireland and whose registered office is at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM Fund Management (Ireland) Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 11488280964. **The Netherlands:** MSIM Fund Management (Ireland) Limited, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of MSIM Fund Management (Ireland) Limited. MSIM Fund Management (Ireland) Limited is regulated by the Central Bank of Ireland. **France:** MSIM Fund Management (Ireland) Limited, Paris Branch is a branch of MSIM Fund Management (Ireland) Limited, a company registered in Ireland, regulated by the Central Bank of Ireland and whose registered office is at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM Fund Management (Ireland) Limited Paris Branch with seat at 61 rue de Monceau 75008 Paris, France, is registered in France with company number 890 071 863 RCS. **Spain:** MSIM Fund Management (Ireland) Limited, Sucursal en España is a branch of MSIM Fund Management (Ireland) Limited, a company registered in Ireland, regulated by the Central Bank of Ireland and whose registered office is at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM Fund Management (Ireland) Limited, Sucursal en España with seat in Calle Serrano 55, 28006, Madrid, Spain, is registered in Spain with tax identification number W0058820B. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0) 44 588 1074.

IMPORTANT INFORMATION

EMEA: This marketing communication has been issued by MSIM Fund Management (Ireland) Limited. MSIM Fund Management (Ireland) Limited is regulated by the Central Bank of Ireland. MSIM Fund Management (Ireland) Limited is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland.

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Liquidity Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Liquidity Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December 2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

The Funds are not a guaranteed investment and are different from an investment in deposits. The Funds do not rely on external support for guaranteeing the liquidity of the Funds or stabilising the NAV per share. The value of investments and the income from them may go down as well as up and you may not get back the amount you originally invested.

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 Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxembourg B 29 192.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

The views and opinions expressed are those of the portfolio management team at the time of writing/of this presentation and are subject to change at any time due to market, economic, or other conditions, and may not necessarily come to pass. These comments are not representative of the opinions and views of the firm as a whole. Holdings, countries and sectors/region weightings are subject to change daily. All information provided is for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the sectors and regions referenced. Information regarding expected market returns and market outlook is based on the research, analysis, and opinions of the team. These conclusions are speculative in nature, may not come to pass, and are not intended to predict the future of any specific Morgan Stanley Investment Management investment. Past performance is no guarantee of future results.

The material contained herein has not been based on a consideration of any individual client 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.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM Ireland shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Liquidity Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent.

All information contained herein is proprietary and is protected under copyright law.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.