2021 Market Outlook

The More Rates Stay the Same, the More Things Change…

The New Year’s celebration this year took on a different meaning, as many looked to turn the page on 2020 and put the global pandemic-induced struggles of the past year behind them. The new year holds the promise of improved economic conditions, but challenges remain for cash investors as the current course of monetary policy and short-term rates is unlikely to change.

JONAS KOLK
Chief Investment Officer
Global Liquidity

BRIAN BUCK
Executive Director

BOB LEGGETT
Executive Director
In this outlook, we will review the impact an economic recovery might have on rates and central bank policy and what steps investors can take to find opportunities—and mitigate risk—in their liquid portfolios.

**Accommodative Central Banks for the Foreseeable Future**

**KEY QUESTIONS:**
- What is the expected path of interest rates?
- What are the risks to the outlook?

Central banks across developed markets globally are running parallel accommodative monetary policies to help economies recover from the pandemic. These policies go far beyond low rates. Depending on the specific central bank, there have been asset purchase programs, liquidity facilities, lending schemes, extended forward guidance, and in some cases, all of the above. The conversation now is not about whether we will see a reversal in these policies in 2021, but rather to follow progression of policy over the next few years as it evolves from crisis to vaccine implementation to recovery.

The stimulative central bank policies are being paired with elevated levels of fiscal stimulus. Whether this comes in the form of stimulus checks or programs aimed at bolstering employment, these efforts are adding to the foundation laid by monetary policy. There is also tremendous optimism with approval of COVID-19 vaccines. The idea is that these monetary and fiscal packages will support the economy and build a bridge to the recovery when the vaccine is widely distributed.

The base case for accommodative central bank backstops are well documented. But what is the risk to the outlook? There is certainly downside risk with the spread of the virus proliferating or with delays or others issues with the vaccine. The ripple effects of this are fairly straightforward and will mean extended periods of accommodative policy. It is perhaps a more interesting exercise to investigate the opposite end of the spectrum.

With all of this stimulus in place, global growth consensus expectations in 2021 are north of 5%. Morgan Stanley Research is even more optimistic, estimating 2021 global growth at 6.4%. If this plays out and employment and inflation rebound quickly, central banks might have to reconsider their policies to keep rates at extremely low levels. All of that being said, before rates can be increased in any of these major economies, crisis-era liquidity and lending facilities will have to be rolled back and quantitative easing programs will need to be tapered. So even if growth does accelerate beyond current expectations, it will take time to peel back the accommodative central bank policies that are currently in place. This is a major reason why the market is expecting rates to be at current low and even negative levels for the next several years even in the face of a global synchronized recovery.

Faster growth in 2021 could lead to rising long-term rates, but given current central bank policy forecasts, short rates are anchored close to zero. Until rates expectations change materially, the interest rate curve for short-term fixed income securities will remain flat and investment yields will remain challenged.
Stagnant Rates Should Not Mean Stagnant Cash Investment Plans

KEY QUESTIONS:

- How do you ensure efficient cash management across deposits and traditional investments?
- What is the value of an extra basis point in yield to you?
- Have you embraced new ideas for your cash management with regard to product or technological innovations?

For many treasury professionals and cash investors, 2020 was characterized by reactionary measures to a challenging market environment. Many investor emerged from 2020 with elevated levels of cash, and that presents a unique challenge given the record low rates globally. As we move into 2021, market functioning and sentiment has largely recovered. The harsh reality for cash investors lies in the fact that major global central banks are unlikely to raise rates anytime soon. This fact, while painful, gives investors what could be a period of stable rates where they can focus on new ideas and emerging trends within the cash management space. First and foremost, evaluate your portfolio and make sure that your current investments reconcile with your goals and time horizon, especially if your cash balances increased substantially in 2020. Ask yourself if you would change anything if you knew rates were going to be on hold for the next two to three years. Some investors might stand pat with their investments but others might realize that more stable cash balances will allow them flexibility to consider a broader set of investments. Investor decisions come down to efficient cash management as well as determining the value of an extra few basis points in yield and what it might take from a duration or credit perspective to get there.

Secondly, a year of calmer interest rates could allow you to focus on some emerging investment trends. For some, these trends could come in the form of adding an element of environmental, social and governance (ESG) or socially conscious considerations to your investment portfolio. These themes have come to the forefront recently and could help in aligning cash portfolios with an organization’s mission statement or overall goals and objectives. Alternatively, emerging ideas can be realized in the technology space with the advancement of integrated investment portals that contain innovative monitoring and analytics tools that can increase treasury efficiency and transparency. While interest rates may be on hold, the cash investing landscape is very much in motion.

**Conclusion**

As we begin 2021, cash and liquidity investors should first acknowledge that accommodative monetary and fiscal stimulus. The below checklist should keep investors on track with current investing themes as they continue to evolve:

- **TAKE CARE OF THE BASICS.** Make sure your cash is managed efficiently with your goals, time horizon, and liquidity needs aligned with your investment solutions.
- **UNDERSTAND THE RISKS OF SEEKING OUT HIGHER PORTFOLIO YIELDS.** Review your current investments and maximize your banking relationships, including monitoring deposit and earnings credit rates.
- **CONSIDER THE EMERGING TRENDS IN CASH AND LIQUIDITY MANAGEMENT.** ESG or social-conscious investment themes could help align your investments with organization-wide goals. Technology enhancements could also help your treasury efficiency and transparency.
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. Market values can change daily due to economic and other events (e.g., natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g., portfolio liquidity) of events. Accordingly, you can lose money investing in these portfolios. Please be aware that these portfolios may be subject to certain additional risks and general market liquidity (market risk). 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 a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. Longer-term securities may be more sensitive to interest rate changes. ESG Strategies that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance.

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.

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) 4 709 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 114 88280964. The Netherlands: MSIM Fund Management (Ireland) Limited, Rembrandt Tower, 11th Floor Amstelplein 11096HA, Netherlands. Telephone: 31 2 0462 1200. 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. 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.

Japan: For professional investors, this document is circulated or distributed for informational purposes only. For those who are not professional investors, this document is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. (“MSIM”)’s business with respect to discretionary investment management agreements (“IMA”) and investment advisory agreements (“IAA”). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIM to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIM accepts such commission. The client shall delegate to MSIM the authorities necessary for making investment. MSIM exercises the delegated authorities based on investment decisions of MSIM, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20 percent per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIM cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This document is disseminated in Japan by MSIM, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.

U.S.: A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required. For important information about the investment manager, please refer to Form ADV Part 2.

STABLE NAV FUNDS

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Funds’ sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

FLOATING NAV FUNDS

You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the Fund’s liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or

2021 MARKET OUTLOOK
any other government agency. The Funds’ sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time. Please consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectuses contain this and other information about the funds. To obtain a prospectus please download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

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

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

Hong Kong: This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to “professional investors” as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. Singapore: This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore (“SFA”), (ii) to a “relevant person” (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. Australia: This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for “wholesale clients” within the meaning of the Australian Corporations Act.

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.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully review the strategy’s/product’s relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles. A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing.

The views and opinions are those 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 or economic conditions and may not necessarily come to pass. 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 investment teams 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, may not come to pass 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 communication is not a product of Morgan Stanley’s Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This material is a general communication, which is not impartial and 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. All investments involve risks, including the possible loss of principal. 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.

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.

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. Additionally, financial intermediaries are required to satisfy themselves that the information in this document is appropriate for any person to whom they provide this document in view of that person’s circumstances and purpose. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary.

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.

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.

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

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

Explore our site at www.morganstanley.com/im