

Central Banks Close the Year on a Quieter Note

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | DECEMBER 2019

Federal Reserve Board¹

The Federal Reserve (Fed) convened on December 10, 2019 for its last meeting of the year. Chairman Jerome Powell and the Federal Open Market Committee (FOMC) voted to keep the federal funds rate unchanged at 1.50%-1.75%. Chairman Powell signaled to the market that the Fed is comfortable with current policy and will take a “wait and see” approach going forward. The Federal Reserve press release stated,

The Committee judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee’s symmetric 2 percent objective. The Committee will continue to monitor the implications of incoming information for the economic outlook, including global developments and muted inflation pressures, as it assesses the appropriate path of the target range for the federal funds rate.

The past year was eventful for the Fed and Chairman Powell. Entering 2019, investors expected rates to rise systematically during the year, but received quite the opposite policy action.

Chairman Powell and his committee had to navigate the murky waters of global trade tension, economic uncertainty, lower than expected inflation and global economic growth deceleration. In response, the Fed cut rates three times to

help bolster the economy. Going into the new decade, market consensus expects the Fed to keep rates unchanged throughout 2020. That being said, Chairman Powell has suggested if data (i.e., inflation, employment) changes materially, the committee stands ready to act in any way necessary. In 2020, data must be monitored closely, as policy could pivot at any moment’s notice, something investors learned in 2019.

European Central Bank¹

Christine Lagarde’s first meeting as ECB president. President Lagarde and the policy committee kept ECB interest rates unchanged at -0.50%. The committee noted it expects this rate to remain at or below its current level for the foreseeable future. The committee is looking for inflation to robustly increase towards 2% before considering tightening policy. President Lagarde also mentioned that the ECB’s asset purchase program will remain in effect until it is no longer needed to support the economy.

Data that the ECB considers when making policy decisions continue to show muted inflation and weak economic growth in the region. It remains to be seen when such data will stabilize, but until then Christine Lagarde and the ECB look likely to continue accommodating all sectors of the economy.

Bank of England¹

The Bank of England (BOE) Monetary Policy Committee (MPC) met on December 19, 2019 and voted 7-2 to maintain the Bank Rate at



¹ Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of December 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 31/12/19

	SONIA (%)	EONIA (%)	OBFR (%)
Overnight	0.71	-0.45	1.55

Source: Bloomberg

0.75%. Since the MPC last gathered, economic data has been relatively in line with projections. The ratcheting down of global trade tensions, some Brexit clarity and potentially stabilizing global financial conditions have given the MPC reason to be a bit more optimistic looking forward. However, growth in job vacancies and the potential of a loosening labor market have the MPC eyeing the data carefully.

Brexit uncertainty remains elevated. The potential for a smoother Brexit outcome would allow the MPC to chart a clearer course and could potentially lead to policy actions to stave off inflation. However, that is not the base case scenario and certainly not what policy makers expect. Markets will also be watching the BOE governorship transitioning to Andrew Bailey from Mark Carney in late January. The decision was long overdue, with Brexit and other situations further delaying the announcement. The new governor steps into his role as the U.K. enters the next phase of Brexit negotiations. Investors must carefully monitor the new governor as he leads the central bank through an uncertain time. 2020 is shaping up to be a very eventful year for the MPC.

Portfolio Strategy
MSLF EURO LIQUIDITY FUND (LVNAV)

The euro market was again the most impacted by the bank balance sheet liquidity squeeze, and therefore had the largest impact on Fund trading strategies through year-end. As is typical, many clients chose the safety of a money market fund for their cash over year-end, increasing the Fund to over €300 million in the final few days of the year. Consequently, overnight maturities were reduced significantly, with a large proportion of the Fund invested into early January maturities. There is typically less opportunity to invest into government assets over this period due to the significantly poorer yields. The WAM and WAL of the Fund were broadly unchanged at 48 and 52 days respectively, as the reduction in overnight maturities was offset by a larger percentage of early January maturities.

MSLF STERLING LIQUIDITY FUND (LVNAV)

As is normal in December, Fund positioning during the month was predicated on preparing for year-end. The drop off in balance sheet availability at year-end in bank names means

DISPLAY 2
LIBOR Rates

As of 31/12/19

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
Overnight	0.68	-0.57	1.54
1 week	0.70	-0.55	1.63
1 month	0.70	-0.51	1.76
2 months	0.75	-0.45	1.83
3 months	0.79	-0.41	1.91
6 months	0.88	-0.37	1.91
12 months	0.98	-0.27	2.00

Source: Bloomberg

DISPLAY 3
Yield Curves

As of 31/12/19

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
2 year	0.53	-0.61	1.57
5 year	0.59	-0.48	1.69
10 year	0.82	-0.19	1.92
30 year	1.32	0.35	2.39

Source: Bloomberg

we typically run less overnight cash into year end, and rely on maturities and highly rated government assets to add to our weekly liquid assets. We also saw sizeable inflows into the Fund at year end, which increased the Fund size from £2.2 billion to £2.5 billion by the end of December. The WAM and WAL of the Fund were broadly unchanged, at 48 days and 60 days respectively, as the reduction in overnight maturities was offset by a larger percentage of early January maturities.

MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)

As widely expected, the Fed left interest rates unchanged at its December meeting, while signaling it would keep them on hold through 2020. The Fed indicated that “the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions and inflation near the committee’s symmetric 2% objective.” With elevated year-end stress in the wholesale funding market, 3-month LIBOR touched recent highs, peaking on December 24 at 1.96%, a 6 basis point increase compared to November 29. On the month, we opportunistically added both fixed and floating rate securities to the portfolios, predominantly in the 6- to 9-month tenors. Floating rate securities were weighted towards quarterly

resets, enabling the portfolios to lock in an elevated coupon setting for the first three months of the trade. As we look ahead to 2020, we continue to manage our portfolios from a conservative positioning standpoint, maintaining our emphasis on high levels of weekly liquidity and structuring our portfolios to respond to changes in monetary policy.

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

The repo markets were well behaved in December, with overnight repo rates only moving a touch higher on year-end, due the vast amount of liquidity provided by the Fed to primary dealers with the combination of overnight and term repos. Overnight repo rates averaged 1.55% on year-end, slightly higher than what we saw most of the month. During the month, we invested in fixed-rate Treasury bills and notes in predominately 3- to 6-month maturity tenors. At the December meeting, the FOMC remained on hold on its rate policy, as the environment remains supportive for economic expansion. We continue to maintain our emphasis on high levels of liquidity and relatively short duration as we monitor how monetary policy unfolds.

12 Month Performance Periods to Latest Month End (%)

MSLF Euro Liquidity Fund (LVNAV)	DEC '18 - DEC '19	DEC '17 - DEC '18	DEC '16 - DEC '17	DEC '15 - DEC '16	DEC '14 - DEC '15
Institutional Accumulation Share Class	-0.48	-0.51	-0.51	-0.38	-0.08
One Week Euro LIBID Index	-0.60	-0.55	-0.53	-0.49	-0.26
One Month Euro LIBID Index	-0.57	-0.53	-0.52	-0.47	-0.21
Euro Overnight Index Average (EONIA)	-0.40	-0.37	-0.36	-0.32	-0.11

MSLF Sterling Liquidity Fund (LVNAV)	DEC '18 - DEC '19	DEC '17 - DEC '18	DEC '16 - DEC '17	DEC '15 - DEC '16	DEC '14 - DEC '15
Institutional Distributing Share Class	0.68	0.50	0.21	0.40	0.44
One Week GBP LIBID Index	0.57	0.46	0.15	0.27	0.36
One Month GBP LIBID Index	0.72	0.61	0.30	0.41	0.51
SONIA	0.72	0.57	0.26	0.36	0.46

MSLF U.S. Dollar Liquidity Fund (LVNAV)	DEC '18 - DEC '19	DEC '17 - DEC '18	DEC '16 - DEC '17	DEC '15 - DEC '16	DEC '14 - DEC '15
Institutional Distributing Share Class	2.28	1.95	1.10	0.51	0.09
One Week USD LIBID Index	2.06	1.78	0.94	0.32	0.04
One Month USD LIBID Index	2.10	1.92	0.99	0.37	0.08
FED Funds	2.21	1.88	1.02	0.40	0.14

MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)	DEC '18 - DEC '19	DEC '17 - DEC '18	DEC '16 - DEC '17	DEC '15 - DEC '16	DEC '14 - DEC '15
Institutional Distributing Share Class	2.04	1.68	0.68	0.17	0.00
FTSE 1 Month Treasury Bill Index	2.20	1.82	0.80	0.21	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 to see the latest performance returns for the fund's other share classes.

Institutional Distributing and Institutional Accumulation Share Class Risk and Reward Profile



Potentially Lower Rewards

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 30 September 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

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