Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

GLOBAL LIQUIDITY | GLOBAL LIQUIDITY TEAM | OCTOBER 2016

Market Overview[1]

U.S. money market reform came into effect on October 14, marking the transition of institutional prime and tax-exempt money market funds from stable net asset value (NAV) to floating NAV. Money market funds will also now have the ability to impose liquidity fees and redemption gates, although government money market funds can elect to opt out of this. There have been $1 trillion of outflows in prime money market funds year-to-date, with $130 billion in outflows during the month of October alone. Most of the prime money market fund assets have flowed into government funds—which will continue to have a stable NAV—and other prime fund alternatives. Leading up to the reform deadline, a large supply/demand imbalance developed in the markets for securities maturing beyond October 14, which caused a substantial spike in 3-month Libor.

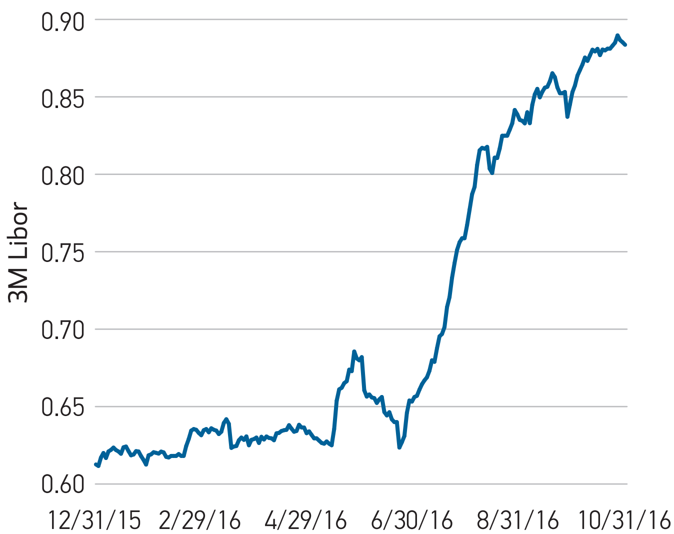
Following the Federal Open Market Committee's (FOMC) decision to keep rates on hold at its September meeting, the minutes from the meeting were released in mid-October and showed that the FOMC was relatively divided over an interest rate hike. While the Federal Reserve (Fed) will hold a meeting in November, investors will look to the December meeting for a potential increase in the federal funds rate. The Fed appears to be positioning itself to increase rates in December as it continues to watch data closely. Economic data has been relatively strong during the second half of this year. The market believes there is about a 71% chance there will be an increase in rates, according to federal funds futures.

With regard to economic data during the month of October, the employment report was slightly weaker than forecasted, with nonfarm payrolls increasing 156,000, missing expectations of 172,000. Additionally, July and August payroll net revisions were lowered by 7,000. Aside from the September employment report, economic data coming out of the United States during October was generally strong. U.S. gross domestic product (GDP) for the third quarter of 2016 rose by 2.6% year-over-year, which is the largest quarterly increase in two years. The boost in GDP growth was caused mainly by increases in exports and inventories.

Outside of the United States, the European Central Bank (ECB) held its October meeting and decided to leave monetary policy unchanged, with its refinancing rate at 0% and the deposit rate at -0.4%. In its statement, the ECB said it expects interest rates to remain at present or lower levels for an extended period of time. The ECB also stated that the corporate bond buying program would be continued until at least March 2017.

[1] Source: Bloomberg.

DISPLAY 1
3M Libor
12/31/2015-10/31/2016



Source: Bloomberg

DISPLAY 2
Monthly Interest Rate Summary
As of 10/31/2016

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	0.16	(0.02)
3M UST	0.30	0.03
6M UST	0.49	0.06
12M UST	0.64	0.06
2Y UST	0.84	0.08
5Y UST	1.31	0.16
10Y UST	1.83	0.23
30Y UST	2.58	0.26
USD LIBOR CURVE		
O/N LIBOR	0.43	0.01
1M LIBOR	0.53	0.00
3M LIBOR	0.88	0.03

Source: Bloomberg

Strategy

Prime Strategy[2]

In conjunction with the October 14 conversion date for SEC Rule 2a-7 money market reform, over $1 trillion year-to-date moved out of prime funds, predominately into government funds. As we transition to the new regulatory regime, we remain cautious with our investment approach, allowing clients to become comfortable with the operational aspects of floating NAV (FNAV) transactions. We are focusing on short duration and elevated levels of liquidity. We selectively purchased fixed and floating rate paper, primarily in the two- to four-month tenor, paying close attention to final maturity for fixed rate and reset dates for floating rate paper due to potential FOMC rate action at the meeting on December 14.

Government/Treasury Strategy[3]

As a result of money market reform further prime fund outflows moved into government funds, leaving these funds with large investment needs. This shift helped drive strong agency floating-rate note volume over the last few weeks, with new issuance coming in at tight nominal levels. While the U.S. Treasury increased the 1-month bill auction size by $15 billion, the additional supply was easily absorbed by the market and, despite more supply, short yields trended lower during the month. Volume at the Federal Reserve Bank of New York reverse repo facility remained higher than normal after quarter-end given current market dynamics. We invested in longer fixed-rate Treasuries and agency floating-rate notes with 1-year and 18-month maturity tenors. We continued to maintain a significant portion of certain Portfolios in short-term repurchase agreements.

Tax-Exempt Strategy[2]

The October 14 money market reform deadline led to further outflows from tax-exempt funds in October as money market fund complexes restructured product lineups in advance of money fund reform. As planned fund liquidations continued, redemptions increased, doubling the pace of outflows to almost $5 billion per week in the third quarter.[4] As of October 11, tax-exempt money fund assets had fallen by $127 billion (50%) year-to-date.[5] With dealer inventories consequently on the rise, volatility returned to the market as dealers sought to recruit additional

[2] The Portfolio will be required to price and transact in their shares at a floating net asset value ("NAV") and will be permitted to impose a liquidity fee on redemptions or temporarily restrict redemptions in the event that the Portfolio's weekly liquid assets fall below certain thresholds.

[3] Government and Treasury Funds are Stable NAV funds

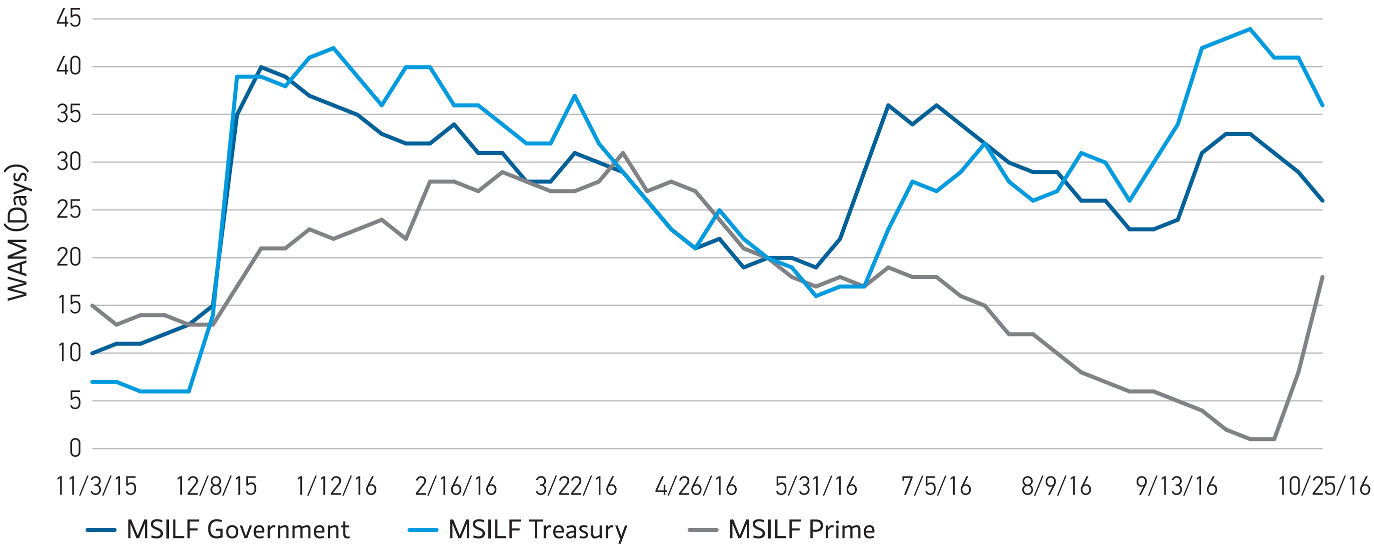
[4] Source: iMoneyNet

[5] Source: iMoneyNet

DISPLAY 3

Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM)[7]

10/30/2015-10/31/2016



Source: iMoneyNet

crossover, separately managed accounts, and short-bond fund investors. The SIFMA Index[6] subsequently backed up nine consecutive weeks for a total of 43 basis points—a 98% increase over the quarter to 0.87%, its highest level since December 31, 2008. We will maintain our emphasis on high levels of liquidity and very short duration in the period immediately ahead.

[6] The **SIFMA Index** is issued weekly and is compiled from the weekly interest rate resets of tax-exempt variable rate issues included in a database maintained by Municipal Market Data which meet specific criteria established from time to time by The Bond Market Association. The index is unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

[7] **Weighted Average Maturity (WAM):** The weighted dollar average maturities of all securities held within a 2a-7 fund. WAM is used as a measure of sensitivity to interest rate risk (the longer the maturity the greater the sensitivity). WAM is calculated by using the asset weighted days until maturity of securities in the portfolio calculated by using the lower of the stated maturity date or the next interest rate reset date.

Past performance is no guarantee of future results. This document represents the views of the portfolio management team. The authors' views are subject to change without notice to the recipients of this document. It does not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management and may not be reflected in other strategies and products that the Firm offers. The document has been prepared as information for investors and it is not a recommendation to buy or sell any particular security or to adopt any investment strategy. Current and future portfolio holdings are subject to change. The forecasts in this piece are not necessarily those of Morgan Stanley, and may not actually come to pass.

Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund and can be obtained by contacting your financial professional, or by downloading a copy at www.morganstanley.com/liquidity. Please read the prospectus carefully before investing.

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 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.

The Tax-Exempt Portfolio may invest a portion of its total assets in bonds that may subject certain investors to the federal Alternative Minimum Tax (AMT). Investors should consult their tax adviser for further information on tax implications.

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