Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

LIQUIDITY | GLOBAL LIQUIDITY TEAM | NOVEMBER 2016

Market Overview[1]

The month of November was volatile for the U.S. Treasury and bond markets impacted by the U.S. presidential election and an inflow of strong economic data. In Europe, eurozone inflation hit a 31-month high.

Initially, markets appeared to be pricing in a Hillary Clinton presidential victory. As a result of Donald Trump being the victor, these initial moves reversed immediately following the election. Yields on U.S. Treasuries hit highs during the month as many investors believe Donald Trump's economic and fiscal policies will be inflationary.

In early November, the Federal Open Market Committee (FOMC) met and as expected, opted to not raise interest rates. The minutes from the FOMC meeting indicated that the Fed believed money market fund (MMF) reform implementation during October went smoothly, despite the massive outflows from prime MMFs into government MMFs. The minutes also showed that the Federal Reserve (Fed) has been satisfied with recent consumer price inflation (CPI) readings, despite the fact that CPI is still running below the Fed's target rate. The Fed also mentioned that quarterly gross domestic product (GDP) expanded at a faster-than-expected pace during the third quarter and that labor conditions continued to strengthen in recent months. Since the Fed did not elect to raise rates in November, the markets now look to the highly anticipated December FOMC meeting that begins on December 13.

The October employment report, which was the last employment report before the election, was very positive as the unemployment rate fell to an eight-year low of 4.9%. Hourly wages rose 2.8% year-over-year, which is the strongest reading in seven years. Many analysts believe the October jobs report gives the Fed more reason to raise rates in December, as the report showed continued strength and recovery in the labor market.

Mario Draghi, the president of the ECB, spoke at the end of November before the European Banking Congress. Draghi defended the ECB's current monetary easing program and believes that the program must continue to help increase inflation.

[1] Source: Bloomberg.

DISPLAY 1

Monthly Interest Rate Summary

As of 11/30/2016

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	0.36	0.20
3M UST	0.48	0.18
6M UST	0.61	0.11
12M UST	0.77	0.13
2Y UST	1.11	0.27
5Y UST	1.84	0.54
10Y UST	2.38	0.56
30Y UST	3.03	0.45
USD LIBOR CURVE		
O/N LIBOR	0.43	(0.00)
1M LIBOR	0.62	0.09
3M LIBOR	0.93	0.05

Source: Bloomberg

Strategy

Prime Strategy[2]

We continue to manage our portfolios focusing on high levels of liquidity as customers gain familiarity with floating net asset value transactions due to last month's implementation of SEC Rule 2a-7 money market reform. We selectively purchased fixed and floating rate paper, primarily in the one- to three-month tenor, paying close attention to the final maturity for fixed rate and reset dates for floating rate paper, due to likely FOMC rate action at their meeting on December 13-14.

Government/Treasury Strategy[3]

In November, yields across the curve increased significantly as the markets digested the results of the U.S. elections and increased likelihood of a December interest rate hike. We extended in our Portfolios as we felt money market rates were more accurately reflecting our expected outcome of a December rate hike. We primarily bought agency floating-rate notes, with 9-month to 1.5-year tenors, as issuance levels cheapened considerably post the U.S. elections, and bought fixed-rate Treasuries between 7-month and 9-month tenors. While the overall movement of investor flows from prime to government funds due to money market reform was smooth, the volume at the Federal Reserve Bank of New York's reverse repo facility remained elevated given limited short-term investment options.

Tax-Exempt Strategy[2]

Tax-exempt fund assets stabilized in November post money fund reform. Planned fund liquidations were completed in the prior month, and redemptions in November decreased. With dealer inventories consequently dropping, some stability returned to the market. The SIFMA Index[4] remained steady throughout the month finishing at 56 basis points, the same level as at the start of the month. The market is assuming the Fed will approve a 25 basis point increase in rates at its December 13-14 meeting so we anticipate SIFMA will back up soon. In response, we maintained our emphasis on high levels of liquidity and very short duration.

[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.

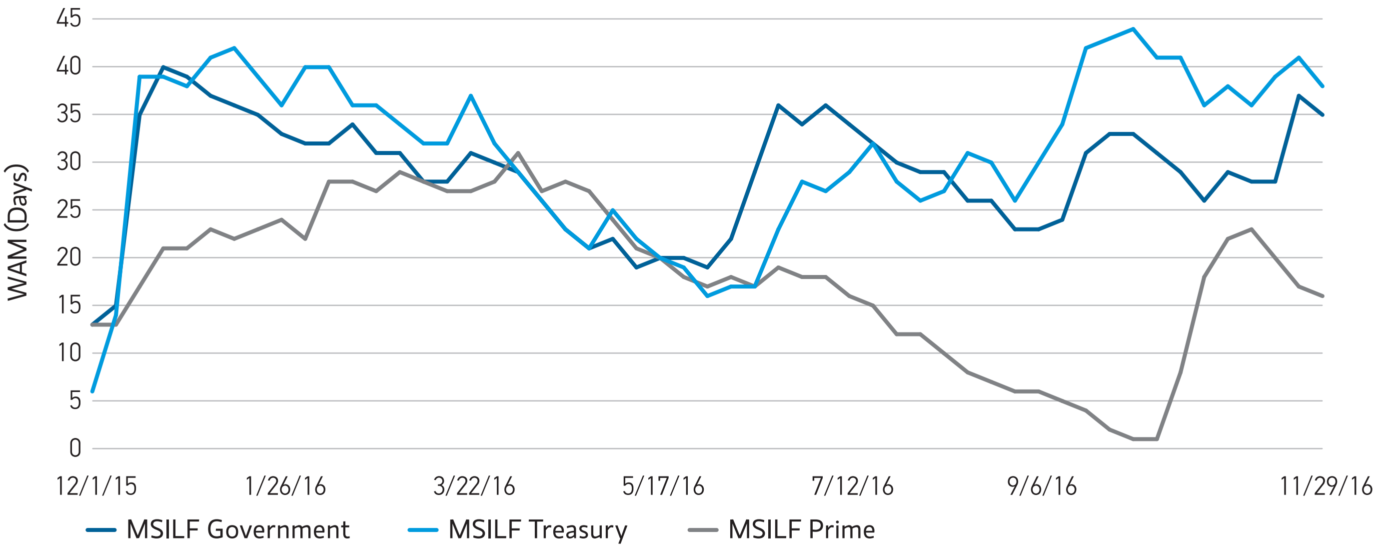
[3] Government and Treasury Funds are Stable NAV funds

[4] 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.

DISPLAY 2

Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM)[5]

12/1/2015-11/29/2016



Source: iMoneyNet

[5] **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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