Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

Key Takeaways From the Fed's September Rate Hike

LIQUIDITY | GLOBAL LIQUIDITY TEAM | MARKET INSIGHT | September 26, 2018

In a move expected by the markets, the Federal Open Market Committee (FOMC) increased the federal (fed) funds rate by 0.25% at its September meeting.

FOMC Meeting Summary[1]

- Monetary policy decisions
  - The FOMC unanimously voted to increase the target range for the fed funds rate by 0.25% to 2.00-2.25%.
  - No changes were made to the balance sheet normalization program. The fed funds rate remains the main monetary policy tool for the FOMC.
- Rates outlook
  - 12 of 16 FOMC members believe there will be one additional rate hike this year, likely taking place in December. The median fed funds rate forecast for 2018 remains at 2.4%.
  - Median rate forecasts indicate the Fed believes there will be three rate hikes in 2019, one in 2020, and none in 2021. This brings median fed funds rate projections to 3.1%, 3.4%, and 3.4%, respectively.
- Assessment of economic conditions
  - One notable change in the statement was the removal of the reference to "accommodative" monetary policy.
  - GDP projections were revised upwards from the FOMC's June meeting, with 2018 projections now at 3.1% and 2019 at 2.5%. Chair Powell indicated that further rate hikes will help support a strengthening economy.
  - Core inflation remains around the FOMC's 2% target.
  - Job gains have continued to be strong and the unemployment rate is expected to decrease further in 2019. Unemployment forecasts for the remainder of 2018 is 3.7% and drops to 3.5% in 2019 and 2020.
  - Chair Powell stated that the FOMC continues to watch trade developments very closely, but that economic conditions do not currently appear to be impacted by the recent trade developments.

In summary, the tone of today's meeting was overall very positive. In particular, the Fed's rate hike and removal of the word "accommodative" from the statement are indicative of a strengthening economy and the continued normalization of monetary policy.

[1] Source: FOMC September 26, 2018 Statement.

Morgan Stanley Global Liquidity Solutions Fund Positioning

As monetary policy continues to tighten, we believe that active management of interest rate risk is critically important. We believe there is a high likelihood of continued gradual rate hikes for the remainder of 2018 and into 2019. Our conservative, yet opportunistic portfolio management strategy will position us to help capitalize on opportunities that present themselves in the market.

Prime Portfolio Strategy

Leading up to the September FOMC meeting, both one-month and three-month London Interbank Offered Rate (Libor) rose to recent highs, with a September 26 setting of 2.24 and 2.39 percent respectively.[2] As we approached the FOMC meeting, fixed rate credit securities had not yet priced in expectations of an upcoming rate hike, so we opportunistically purchased both 1 and 3 month Libor floating rate notes, with a reset date immediately following the FOMC meeting, allowing the securities to reset in the new higher interest rate environment. The weighted average maturity (WAM) of the portfolio touched a three month low, as fixed rate maturities approached their final maturity date and floating rate notes approached their reset date. 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 help minimize interest rate risk that could arise from future interest rate hikes.

Government and Treasury Portfolio Strategy

We continue to manage the portfolios conservatively, positioning the funds for continued interest rate hikes while maintaining high levels of liquidity. Over the last few weeks, we purchased 3-month fixed-rate agency and treasury debt as the market priced in the September FOMC rate hike. We also invested in treasury floating-rate notes which reset daily off the most recently issued 3-month Treasury bill. This type of positioning in the Portfolios allows for interest rates to reset immediately following future FOMC meetings and is consistent with our strategy to help minimize interest rate risk.

Please reach out to your Morgan Stanley relationship manager with any questions, or visit www.morganstanley.com/im for more information.

[2] Bloomberg. As of September 26, 2018.

IMPORTANT INFORMATION

This material is a general communication, which is not impartial and all information provided 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. 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.

Government and Treasury Portfolio
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.

Prime Portfolio
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.

Please consider the investment objectives, risks, charges and expenses of the portfolios carefully before investing. The prospectus contains this and other information about the portfolios. To obtain a prospectus, download one at morganstanley.com/liquidity or call 1.800.236.0992. Please read the prospectus carefully before investing.

The views and opinions are those of the author as of the date of publication 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 portfolio managers 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.

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.

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.

Morgan Stanley Distribution, Inc. serves as the distributor for the Morgan Stanley Institutional Liquidity Funds and the Morgan Stanley Investment Adviser Funds.

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

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