Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

Central Banks Remain On Hold But Prepared for Accommodative Policy

LIQUIDITY | GLOBAL LIQUIDITY TEAM | MACRO INSIGHT | JUNE 2019

Federal Reserve Board

As expected, the Federal Open Market Committee (FOMC) kept the range for the federal funds rate unchanged at 2.25% to 2.50% at the conclusion of its June 18-19 meeting. While it kept rates unchanged, the FOMC removed the word "patient" in describing its approach to monetary policy and reiterated it remains ready to take appropriate action should economic uncertainties, such as international trade tensions, have a negative impact on global growth and inflation.

In its updated dot plot, the FOMC showed that 8 out of 17 officials expected lower rates by the end of 2019—with 7 members anticipating 50 basis points of easing. As a result, the average federal funds forecast for 2019 fell to 2.17% (down from 2.49% during the March FOMC meeting) while the median remained unchanged at 2.38%. Looking ahead, the median federal funds forecast for 2020 was lowered to 2.13% (down from 2.63%) and the median forecast for 2021 was lowered to 2.38% (down from 2.63%).

While reconfirming its 2% inflation target, the Federal Reserve (Fed) acknowledged a decline in near-term inflation expectations and cut its median Personal Consumption Expenditures (PCE) and core PCE inflation forecasts for 2019 to 1.5% and 1.8%, respectively. Gross domestic product (GDP) growth projections for 2019 remained unchanged while the unemployment rate was revised lower to 3.6% from 3.7%.

Subsequent to the June FOMC meeting, Fed Chairman Powell spoke on June 25 at the Council on Foreign Relations, where he reiterated economic crosscurrents have reemerged and risks to the baseline economic outlook have grown.

European Central Bank

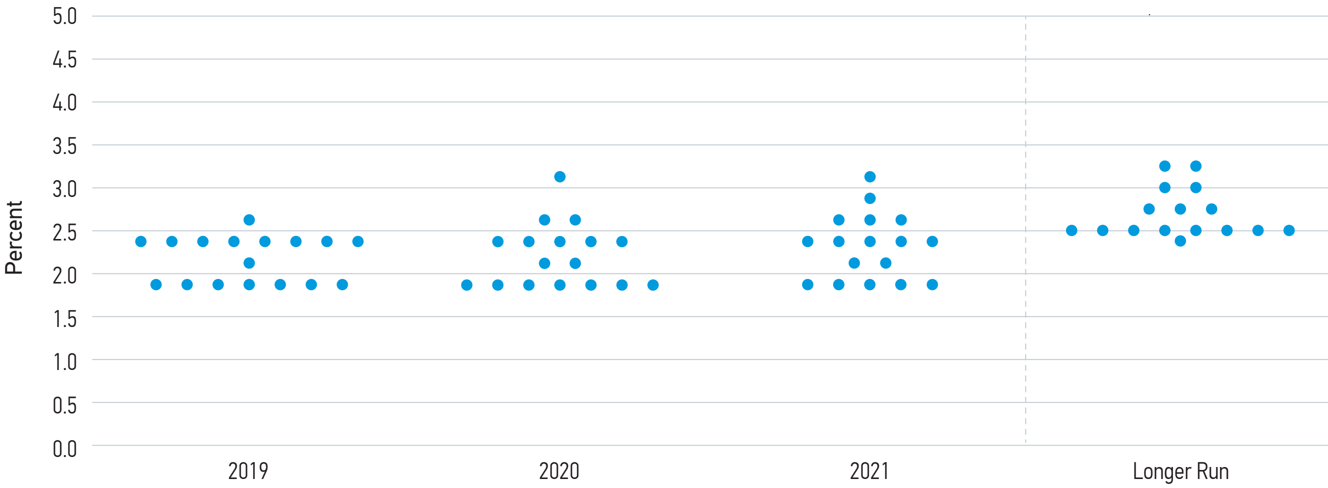
The European Central Bank (ECB) kept its policy rates unchanged during its meeting ending on June 6 with its main refinancing rate, marginal lending financing rate and deposit rate remaining at 0.00%, 0.25% and -0.40%, respectively. In its policy statement, the Governing Council noted it does not expect rates to be adjusted until at least the summer of 2020. However, during his press conference, ECB President Mario Draghi softened this statement, reiterating the ECB stands ready to cut rates if necessary.

In terms of the recently announced targeted longer-term refinancing operations (TLTRO III), the ECB set the terms such that banks meeting their net lending benchmark could receive the TLTRO III as low as the average deposit rate over the life of the program plus 10 basis points (slightly better than the markets anticipated). However, the banks which use the facility would not be able to repay the TLTRO III prior to maturity.

DISPLAY 1

Federal Reserve Dot Plot

As of 06/30/19



Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

Source: Federal Reserve

Bank of England

Given continued uncertainty around Brexit and weaker economic data, the Monetary Policy Committee (MPC) voted unanimously to maintain its bank rate at 0.75% during its meeting ending on June 20. While it did not adjust its bank rate, the MPC lowered its second quarter 2019 GDP growth expectations to be flat year-over-year (down from 0.2% previously) and noted it would act appropriately if economic conditions deteriorated.

In addition, during a subsequent speech to the U.K. Parliament's Treasury Select Committee on June 26, Bank of England (BOE) Governor Mark Carney highlighted the BOE would be more likely to provide stimulus to the economy via interest rate cuts in the event of a no-deal Brexit.

Looking at economic data, U.K. retail sales fell at their fastest pace since 2009 in June (down to -42% from -27% in May). This data supported the notion that the strong growth seen in the beginning of the year was driven by firms stockpiling ahead of the original March Brexit deadline. As such, the pound continued to weaken versus the euro throughout the month of June.

DISPLAY 2

Monthly Interest Rate Summary

As of 06/28/2019

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	2.13	(0.19)
3M UST	2.09	(0.25)
6M UST	2.09	(0.25)
12M UST	1.93	(0.27)
2Y UST	1.75	(0.17)
5Y UST	1.77	(0.14)
10Y UST	2.01	(0.12)
30Y UST	2.53	(0.04)
USD LIBOR CURVE		
O/N LIBOR	2.37	0.02
1M LIBOR	2.40	(0.03)
3M LIBOR	2.32	(0.18)

Source: Bloomberg

Portfolio Strategy

PRIME STRATEGY[1]

In line with market expectations, FOMC members voted 9-1 to leave the federal funds rate unchanged at 2.25% to 2.5% at the conclusion of their June meeting, while updating their dot plots to show a committee split between no hikes and two cuts for the remainder of the year. Recent dovish sentiment from the Fed can be attributed to uncertainty surrounding trade negotiations

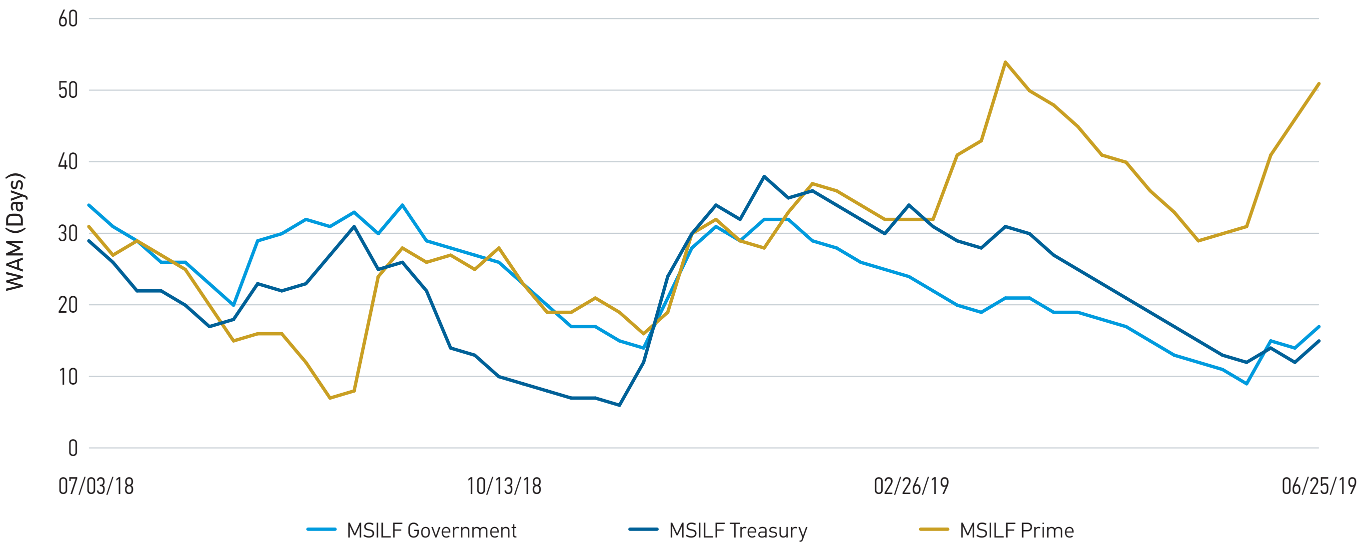
[1] The Portfolio will be required to price and transact in their shares at a floating net asset value ("NAV") and will be permitted to impose a liquidity fee on redemptions or temporarily restrict redemptions in the event that the Portfolio's weekly liquid assets fall below certain thresholds.

The views and opinions expressed are those of the Portfolio Management team as of June 2019 and are subject to change based on market, economic and other conditions. **Past performance is not indicative of future results.**

DISPLAY 3

Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM)[2]

07/03/18-06/25/19



Source: iMoneyNet

and a potential slowdown in global growth. With the Fed indicating that it will "act as appropriate," and a market pricing in an upcoming rate cut at the July FOMC meeting, Treasuries rallied, highlighted by the 10-year note ending the reporting period 12 basis points lower at 2%. Throughout the month, we opportunistically added duration to our funds, purchasing fixed rate securities in the 6- and 9-month tenors, helping insulate the portfolios from potential interest rate cuts in the near-term.

GOVERNMENT/TREASURY STRATEGY[3]

During the month, the market continued to anticipate an interest rate ease from the FOMC in the near term, with Treasury rates rallying throughout the month. We bought fixed-rate Treasury debt with 3- through 6-month maturity tenors. We also continued to buy agency floating-rate notes, with rate resets indexed off SOFR and 1-month LIBOR. We continue to manage the portfolios to be responsive to changing market conditions and to invest a significant portion of most portfolios in overnight repurchase agreements.

TAX-EXEMPT STRATEGY[1]

At the short end of the curve, yields for variable rate demand obligations (VRDOs) rose throughout the month of June as tax-exempt money fund assets saw outflows during the first half of the month. The SIFMA Index,[4] which measures yields for weekly VRDOs, increased 0.48% over the course of the month to 1.90%. At the same time, yields for fixed-rate one-year municipal notes saw good demand in June. The Municipal Market Data (MMD) One-Year Note Index[5] tightened 19 basis points in June to 1.30%. June 30 marked the end of most state and local governments' fiscal years. Almost all state and local governments are required by their constitutions or charters to pass balanced budgets. We maintain our emphasis on high levels of liquidity and relatively short duration as we watch how monetary policy unfolds.

[2] **Weighted Average Maturity (WAM):** Measures the weighted average of the maturities of the portfolio's individual holdings, taking into account reset dates for floating rate securities.

[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.

[5] Thomson Reuters Municipal Market Data (MMD) AAA Curve is a proprietary yield curve that provides the offer-side of "AAA" rated state general obligation bonds, as determined by the MMD analyst team. The "AAA" scale (MMD Scale), is published by Municipal Market Data every day at 3:00 p.m. eastern standard time with earlier indications of market movement provided throughout the trading day. The MMD AAA curve represents the MMD analyst team's opinion of AAA valuation, based on institutional block size ($2 million+) market activity in both the primary and secondary municipal bond market. In the interest of transparency, MMD publishes extensive yield curve assumptions relating to various structural criteria which are used in filtering market information for the purpose of benchmark yield curve creation. MMD yield curves are available on a subscription basis from Thomson Reuters TM3.

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.

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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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