

### Market Insights

# Yields Decline As Investors Prepare For Lower Rates

**LIQUIDITY** | GLOBAL LIQUIDITY TEAM | MACRO INSIGHT | AUGUST 2019

### Federal Reserve Board<sup>1</sup>

After the Federal Open Market Committee (FOMC) decided to lower the range for the federal funds rate by 0.25% to 2.00%-2.25% on July 31, investors sought additional clarity as to whether the policy adjustment would be a mid-cycle rate cut or the start of a longer cycle of easing by the Federal Reserve. Unfortunately, weakening economic data in Europe and a number of negative news headlines about the U.S.-China trade war in August raised concerns that the Federal Reserve might need to take additional policy measures to “sustain the economic expansion.”

During his subsequent press conference, Powell On August 21, the Federal Reserve released the minutes from the July FOMC meeting, which noted the U.S.-China trade war and global growth concerns continued “to weigh on business confidence and firms’ capital expenditure plans.” A reduction in U.S.-China trade tensions could promote a more supportive global economic backdrop and an increase in business confidence.

However, trade tensions continued to escalate in August with China announcing on August 23 that the country would impose tariffs ranging from 5%-10% on \$75 billion of U.S. goods in two stages, effective on September 1 and December 15. In addition, China announced it would resume tariffs on U.S. autos, imposing a 25% tariff on U.S. cars and 5% on automobile parts and components, starting December 15.

In response to these additional Chinese tariffs, President Trump announced the U.S. would increase tariffs on \$250 billion of Chinese goods to 30% from 25% on October 1 and would tax an additional \$300 billion of Chinese goods on September 1 and December 15 at the rate of 15%, rather than the original 10% rate as planned. In addition, President Trump called for U.S. companies to stop doing business with China.

Against this backdrop of escalating U.S.-China trade tensions, investors continued their flight to U.S. Treasuries in August, with the 2-, 5- and 10-year yields falling 37 basis points (bps), 44 bps and 52 bps, respectively, throughout the month. As of August 31, the 10-year Treasury bond was yielding 48 bps less than the 3-month Treasury bill. The 5-year Treasury bond was yielding 59 bps less than the 3-month Treasury bill as of the same date.

### European Central Bank<sup>1</sup>

While the European Central Bank (ECB) kept its policy rates unchanged during its July 25 meeting, the Governing Council acknowledged muted inflation pressures and slowing economic growth in the eurozone could lead the ECB to take additional accommodative policy measures, including the potential of lowering rates, during future meetings.

Even though the ECB’s next monetary policy meeting would not be until September, there were a number of economic data releases in August

<sup>1</sup> Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of August 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 31/8/19

	SONIA (%)	EONIA (%)	OBFR (%)
<b>Overnight</b>	0.71	-0.36	2.11

Source: Bloomberg

which led many investors to believe additional rate cuts would be necessary. In particular, the eurozone's August inflation was only 1.0% and its August composite PMI was 51.8, one of the lowest readings during the last six years.

**Bank of England<sup>1</sup>**

As expected, the Bank of England's (BOE) Monetary Policy Committee (MPC) kept rates unchanged at 0.75% during its meeting on August 1. While the MPC did not adjust rates, the BOE lowered U.K. growth forecasts to 1.3% in 2019 and 2020, down from 1.5% and 1.6%, respectively, in its previous forecast. However, the BOE noted that these revised growth forecasts assumed the U.K. would leave the European Union smoothly and that growth could be much lower in the event of a no deal Brexit.

**Portfolio Strategy****MSLF EURO LIQUIDITY FUND (LVNAV)**

August saw markets adjust term euro rates for the probability of a rate cut in the ECB September meeting. Swap markets quickly fell to price a rate cut between 15 and 20 bps in September, with additional cuts priced in to future ECB meetings. The Fund therefore positioned itself for the lower

yield curve by lengthening WAM to around 50 days, while month-end outflows took the Fund slightly longer towards 55 days. The WAL has again been traded very close to the WAM due to the lack of available floating rate options in short-term markets.

**MSLF STERLING LIQUIDITY FUND (LVNAV)**

With continuing political uncertainty being offset by resilient data, we continue to position the Fund in a broadly neutral position, maintaining a WAM in the mid-40s. Markets have been pricing in rate cuts in sterling rates for a number of months. However, without a conclusive Brexit outcome it is unlikely to be seen in the short term. Credit markets continue to under-price risk, so the WAL of the Fund has again been allowed to drift shorter, from 58 to 53 days. The Fund size stayed broadly stable through the month around £2.5 billion.

**MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)**

Minutes from the Federal Reserve's July FOMC meeting indicated that officials viewed their 25 bps interest rate cut on July 31 as "insurance against too-low inflation and the risk of a deeper slump in business investment stemming from uncertainty" due to global trade concerns. With the market

**DISPLAY 2****LIBOR Rates**

31/8/19

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
<b>Overnight</b>	0.68	-0.47	2.09
<b>1 week</b>	0.69	-0.47	2.14
<b>1 month</b>	0.71	-0.49	2.09
<b>2 months</b>	0.74	-0.49	2.15
<b>3 months</b>	0.76	-0.47	2.14
<b>6 months</b>	0.78	-0.46	2.04
<b>12 months</b>	0.84	-0.40	1.97

Source: Bloomberg

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## DISPLAY 3

## Yield Curves

As of 31/8/19

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
<b>2 year</b>	0.38	-0.93	1.50
<b>5 year</b>	0.33	-0.93	1.39
<b>10 year</b>	0.48	-0.70	1.50
<b>30 year</b>	1.02	-0.18	1.96

Source: Bloomberg

pricing in approximately 60 bps worth of rate cuts for the remainder of 2019, Treasuries continued to rally in August, with both the 10- and 30-year note ending the month at recent lows of 1.50% and 1.96%, respectively. As yields continued to move lower in August ahead of the September FOMC meeting, we remained comfortable adding duration to the portfolio, predominantly purchasing fixed rate securities in the 6- and 9-month tenors. We continue to manage our portfolio from a conservative positioning standpoint, maintaining our emphasis on high levels of weekly liquidity and structuring our portfolio to respond to changes in monetary policy.

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

During the month of August, more Treasury bill supply hit the market, helping to invert the bill curve further. Treasury bills in general continued to rally on solid investor demand, with the 1-year bill yield falling by about 15 bps during August. We continued to invest in fixed-rate Treasuries, favoring 3-month to 7-month tenors and added longer Treasury floating-rate notes, to a lesser extent. We continued to maintain a large portion of the portfolio in overnight repurchase agreements and manage the portfolio to be responsive to changes in market conditions and interest rate levels.

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**12 Month Performance Periods to Latest Month End (%)****MSLF Euro Liquidity Fund (LVNAV)**

	<b>AUG '18 - AUG '19</b>	<b>AUG '17 - AUG '18</b>	<b>AUG '16 - AUG '17</b>	<b>AUG '15 - AUG '16</b>	<b>AUG '14 - AUG '15</b>
Institutional Accumulation Share Class	-0.46	-0.52	-0.49	-0.27	-0.03
One Week Euro LIBID Index	-0.57	-0.55	-0.52	-0.42	-0.21
One Month Euro LIBID Index	-0.53	-0.53	-0.51	-0.39	-0.16
Euro Overnight Index Average (EONIA)	-0.37	-0.36	-0.36	-0.26	-0.06

**MSLF Sterling Liquidity Fund (LVNAV)**

	<b>AUG '18 - AUG '19</b>	<b>AUG '17 - AUG '18</b>	<b>AUG '16 - AUG '17</b>	<b>AUG '15 - AUG '16</b>	<b>AUG '14 - AUG '15</b>
Institutional Distributing Share Class	0.68	0.35	0.23	0.46	0.43
One Week GBP LIBID Index	0.58	0.34	0.12	0.35	0.36
One Month GBP LIBID Index	0.73	0.50	0.26	0.50	0.51
SONIA	0.72	0.44	0.21	0.45	0.45

**MSLF U.S. Dollar Liquidity Fund (LVNAV)**

	<b>AUG '18 - AUG '19</b>	<b>AUG '17 - AUG '18</b>	<b>AUG '16 - AUG '17</b>	<b>AUG '15 - AUG '16</b>	<b>AUG '14 - AUG '15</b>
Institutional Distributing Share Class	2.39	1.61	0.92	0.33	0.05
One Week USD LIBID Index	2.21	1.46	0.69	0.21	0.01
One Month USD LIBID Index	2.25	1.58	0.75	0.26	0.05
FED Funds	2.35	1.55	0.76	0.31	0.12

**MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)**

	<b>AUG '18 - AUG '19</b>	<b>AUG '17 - AUG '18</b>	<b>AUG '16 - AUG '17</b>	<b>AUG '15 - AUG '16</b>	<b>AUG '14 - AUG '15</b>
Institutional Distributing Share Class	2.16	1.31	0.44	0.11	0.00
FTSE 1 Month Treasury Bill Index	2.32	1.43	0.55	0.13	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](http://www.morganstanley.com/im) to see the latest performance returns for the fund's other share classes.

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## Institutional Distributing and Institutional Accumulation Share Class Risk and Reward Profile



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 31 August 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.

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The Funds are authorised to invest up to 100% of their assets in Money Market Instruments issued or guaranteed separately or jointly by a Sovereign Entity and by any other member states of the OECD and their central authorities or central banks subject to certain conditions. Please see Prospectus for further details.

Applications for shares in the Funds should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxembourg B 29 192.

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