

Central Banks Start New Decade on Hold

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | JANUARY 2020

Federal Reserve Board¹

On January 28, 2020, the Federal Reserve (Fed) held its first policy meeting of the new decade. Although the federal funds rate was unchanged at 1.50%-1.75%, policy committee members opted to increase the interest on excess reserves (IOER) rate by 5 basis points to 1.60%. The modification was a technical adjustment done in part to move the IOER rate closer to middle of the fed funds range from the lower end where it has trended in recent months.

While most commentary was left unchanged in the accompanying press release, the Fed downgraded household spending from “strong” to “moderate.” Similarly, the press release indicated that inflation needs to “return” to its 2% target rather than stay “near” the target, which had been used in previous press releases. Overall, the first meeting was benign, as Chairman Powell views current policy as “appropriate.” He reiterated that without any material change in the data going forward, policy is likely to remain unchanged. The January Fed statement did not address the emerging coronavirus epidemic, but Chairman Powell discussed the risk to the global economy in his press conference. While it’s too early to assess the full impact, investors must keep a close eye on incoming data as policy can shift quickly and unexpectedly.

European Central Bank¹

In the European Central Bank’s (ECB) first meeting of 2020, President Lagarde and the policy

committee kept the ECB deposit rate unchanged at -0.50%. The ECB Governing Council believes current policy will likely persist for the time being, potentially becoming more accommodative if necessary. The ECB interest rates are to remain at current or lower levels until inflation rises near its 2% target. Lagarde also announced the central bank would conduct “a review of the ECB’s monetary policy strategy.” In the first strategic review in 17 years, the ECB will be examining its “quantitative formulation of price stability, monetary policy toolkit, economic and monetary analyses and communication practices.” Investors will be closely monitoring the process, as the findings could have an impact on future policy.

Bank of England¹

The Bank of England (BoE) Monetary Policy Committee (MPC) met on January 30, 2020 and voted 7-2 to maintain the Bank Rate at 0.75%. The MPC noted that global growth is starting to stabilize, reflective of accommodative policy from global central banks and a de-escalation of trade tensions. In the U.K., business and household uncertainties have declined while business activity surveys, investment intentions and housing market expectations were seeing modest improvements. Whether these indicators can establish a longer-term trends remains to be seen in the incoming data.

The Bank of England’s outlook presumes a smooth Brexit outcome. Should a free trade agreement between the U.K. and the European

¹ Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of January 2020 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 31/1/20

	SONIA (%)	EONIA (%)	OBFR (%)
Overnight	0.71	-0.45	1.58

Source: Bloomberg

Union come under fire, monetary policy will need to be reassessed. The MPC is ready to act in whatever capacity necessary to return inflation to the 2% target. With more clarity and optimism out of the BoE, policy will be under the microscope, especially coming out of a year of global accommodative policy.

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

As is typical in early January, many short-term investments the Fund received over year-end started to unwind, which meant both a drop in Fund size and lengthening of the WAM. These outflows were very much offset, however, by the large number of early January maturities, so we were able to lengthen the Fund from its year-end position, while meeting the redemption requirements of our clients. Mid-month inflows meant the WAM stayed around the 50-day mark for most of January. Investments in January were split across our investment spectrum from 1-month up to 6-month maturities, with some

strategic asset sales to fund either extension trades or top up liquidity when we saw outflows towards month end.

MSLF STERLING LIQUIDITY FUND (LVNAV)

After positioning the Fund in December to prepare for year-end, early January saw a flurry of maturities and inflows invested into longer-dated assets, moving the WAM from its year-end position of 46 days into the mid-50s, peaking at 57 days mid-month. This strategy proved to be wise, as MPC dovish rhetoric threw the sterling yield curve into a sell-off, with up to 60% of a 25 basis point rate cut at one point being priced into wholesale funding markets. The Fund did not engage with these lower yields, instead waiting for the MPC decision in late January to re-engage with investing. As such, the WAM was allowed to drift lower in the second half of January as we concentrated on shorter-dated opportunities and positioning for month-end outflows. The WAM therefore drifted back to 49 days before outflows brought it back higher to 52 days by month end.

DISPLAY 2**LIBOR Rates**

As of 31/1/20

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
Overnight	0.68	-0.57	1.57
1 week	0.68	-0.54	1.59
1 month	0.71	-0.51	1.66
2 months	0.75	-0.45	1.73
3 months	0.76	-0.42	1.75
6 months	0.82	-0.38	1.75
12 months	0.88	-0.31	1.81

Source: Bloomberg

DISPLAY 3**Yield Curves**

As of 31/1/20

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
2 year	0.50	-0.67	1.31
5 year	0.41	-0.64	1.31
10 year	0.52	-0.44	1.51
30 year	1.03	0.07	2.00

Source: Bloomberg

MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)

As widely expected, the Federal Reserve voted unanimously to leave the target for the fed funds rate unchanged at its January meeting, while reiterating the belief that current monetary policy remains appropriate amid a backdrop of sluggish economic growth abroad and muted inflation pressures. At the meeting, the Fed approved a 5 basis point increase on the rate paid on excess reserves, a technical adjustment designed to keep the main fed funds rate within its target range. As year-end stress in the wholesale funding market subsided, LIBOR tightened throughout the month, setting at 1.75% on January 31, a 16 basis point decrease compared to December 31. During the month we opportunistically added duration to the portfolios, purchasing fixed-rate and quarterly resetting floating-rate securities, locking in attractive yields in the near term. With the Fed asserting its confidence in the current monetary policy but the market pricing in an interest rate cut in 2020, 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 respond to changes to the interest rate environment.

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

At its January meeting, the Fed left rates unchanged and expressed confidence regarding U.S. economic growth and labor markets. The policy committee reaffirmed continuing its monthly Treasury bill purchases at least into the second quarter, which it started after the September 2019 repo rate increase, in order to ensure ample reserves within the financial system. The Fed made a technical adjustment by raising the interest on excess reserve rate by 5 basis points to 1.6% and the overnight reverse repo rate to 1.50% to better control its benchmark fed funds rate. This action placed upward pressure on overnight repo rates, which rose a few basis points. With Treasury yields remaining compressed, we focused on investing in overnight repos collateralized by U.S. Treasuries and longer-term Treasury floating-rate notes. We continue to manage the portfolio to be responsive to changes in market and rate conditions.

12 Month Performance Periods to Latest Month End (%)

MSLF Euro Liquidity Fund (LVNAV)	JAN '19 - JAN '20	JAN '18 - JAN '19	JAN '17 - JAN '18	JAN '16 - JAN '17	JAN '15 - JAN '16
Institutional Accumulation Share Class	-0.49	-0.50	-0.51	-0.40	-0.09
One Week Euro LIBID Index	-0.61	-0.55	-0.54	-0.50	-0.28
One Month Euro LIBID Index	-0.58	-0.52	-0.52	-0.48	-0.22
Euro Overnight Index Average (EONIA)	-0.40	-0.37	-0.36	-0.33	-0.12

MSLF Sterling Liquidity Fund (LVNAV)	JAN '19 - JAN '20	JAN '18 - JAN '19	JAN '17 - JAN '18	JAN '16 - JAN '17	JAN '15 - JAN '16
Institutional Distributing Share Class	0.68	0.53	0.22	0.38	0.44
One Week GBP LIBID Index	0.57	0.47	0.17	0.25	0.36
One Month GBP LIBID Index	0.72	0.62	0.32	0.40	0.51
SONIA	0.72	0.59	0.28	0.34	0.46

MSLF U.S. Dollar Liquidity Fund (LVNAV)	JAN '19 - JAN '20	JAN '18 - JAN '19	JAN '17 - JAN '18	JAN '16 - JAN '17	JAN '15 - JAN '16
Institutional Distributing Share Class	2.21	2.05	1.14	0.56	0.11
One Week USD LIBID Index	1.98	1.86	1.00	0.35	0.06
One Month USD LIBID Index	2.04	1.98	1.06	0.40	0.10
FED Funds	2.14	1.96	1.09	0.43	0.16

MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)	JAN '19 - JAN '20	JAN '18 - JAN '19	JAN '17 - JAN '18	JAN '16 - JAN '17	JAN '15 - JAN '16
Institutional Distributing Share Class	1.96	1.78	0.76	0.19	0.01
FTSE 1 Month Treasury Bill Index	2.12	1.92	0.87	0.24	0.03

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 to see the latest performance returns for the fund's other share classes.

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 30 September 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.

Low Volatility Net Asset Value (LVNAV) MMF – a MMF qualifying and authorised as a LVNAV MMF in accordance with MMF Regulation which

seeks to maintain a stable NAV under the condition that the stable NAV does not deviate from the NAV per Share by more than 20 basis points. In case of a deviation of more than 20 basis points between the stable NAV and the NAV per Share, the following redemption or issue of Shares shall be undertaken at a price that is equal to the NAV per Share.

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations. In particular, the Shares are not for distribution to U.S. persons.

Ireland: Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's, Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland.

United Kingdom: Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA. **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland 4th Floor Junghofstrasse 18-26, 60311 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0)44 588 1074.

IMPORTANT INFORMATION

EMEA: This communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Liquidity Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Liquidity Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December 2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

The Funds are not a guaranteed investment and are different from an investment in deposits. The Funds do not rely on external support for guaranteeing the liquidity of the Funds or stabilising the NAV per share. The value of investments and the income from them may go down as well as up and you may not get back the amount you originally invested.

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.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

The views and opinions expressed are those of the portfolio management team at the time of writing/of this presentation and are subject to change at any time due to market, economic, or other conditions, and may not necessarily come to pass. These comments are not representative of the opinions and views of the firm as a whole. Holdings, countries and sectors/region weightings are subject to change daily. All information provided is for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the sectors and regions referenced. Information regarding expected market returns and market outlook is based on the research, analysis, and opinions of the team. These conclusions are speculative in nature, may not come to pass, and are not intended to predict the future of any specific Morgan Stanley Investment Management investment. Past performance is no guarantee of future results.

The material contained herein has not been based on a consideration of any individual client 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.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable

European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM Ireland shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Liquidity Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent.

All information contained herein is proprietary and is protected under copyright law.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.

Explore our site at www.morganstanley.com/liquidity