Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

Central Banks Start New Decade on Hold

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | JANUARY 2020

Federal Reserve Board[1]

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.

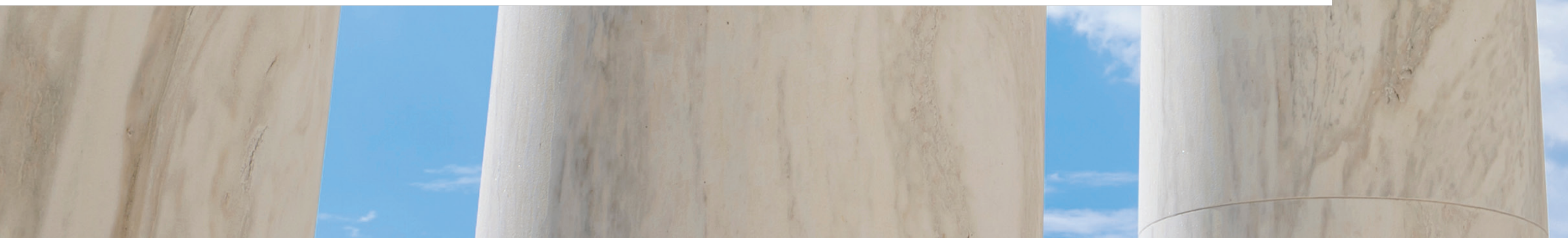
DISPLAY 1

Monthly Interest Rate Summary

As of 1/31/2020

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	1.52	0.09
3M UST	1.54	(0.01)
6M UST	1.52	(0.05)
12M UST	1.42	(0.14)
2Y UST	1.31	(0.26)
5Y UST	1.31	(0.38)
10Y UST	1.51	(0.41)
30Y UST	2.00	(0.39)
USD LIBOR CURVE		
O/N LIBOR	1.57	0.03
1M LIBOR	1.66	(0.10)
3M LIBOR	1.75	(0.16)

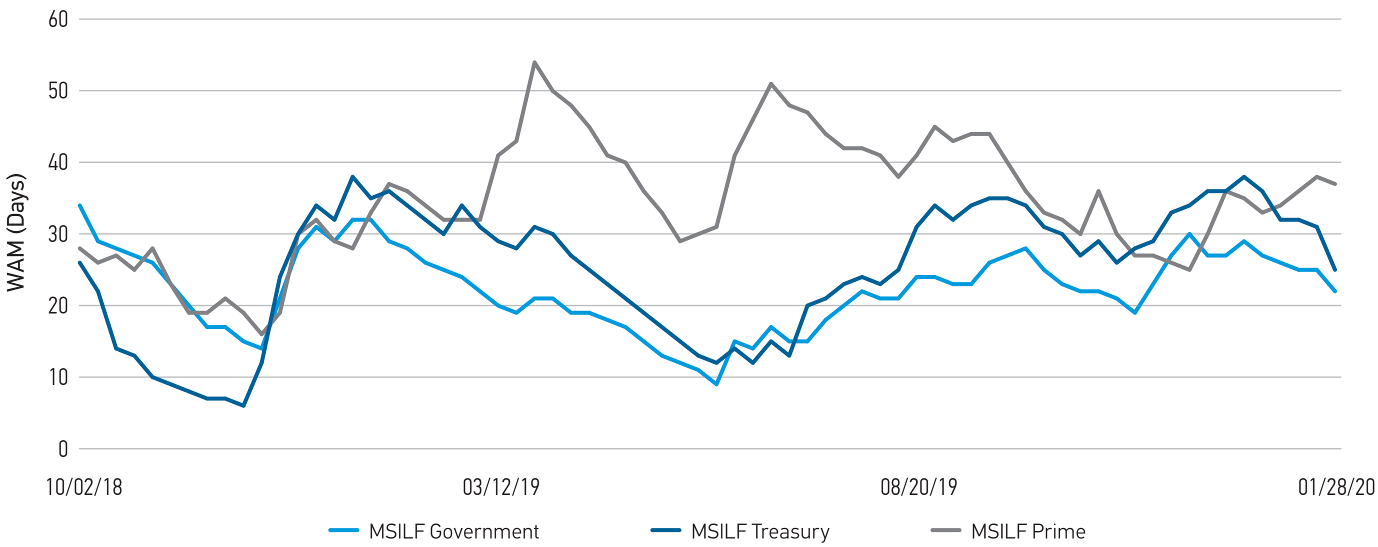
Source: Bloomberg



[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 2
Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM)[2]
As of 1/31/2020



Source: iMoneyNet

European Central Bank[1]

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 England[1]

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 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

PRIME STRATEGY[3]

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,

[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] 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.

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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.

GOVERNMENT/TREASURY STRATEGY[4]

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. Overall, with yields on Treasuries and agencies remaining compressed, we focused on investing in overnight repos and longer-term agency floating-rate notes. We continued to maintain a large portion of the portfolio in repurchase agreements and manage the portfolio to be responsive to changes in market and rate conditions.

TAX-EXEMPT STRATEGY[3]

At the short end of the curve, yields for variable rate demand obligations (VRDOs) fell during the month of January after rising during December. The SIFMA Index,[5] which measures yields for weekly VRDOs, fell from 1.61% at the end of December to finish January at 0.94%. Yields at the longer end of the municipal money market maturity range trended lower during the month as supply remained constrained. The Municipal Market Data One-Year Note Index[6] finished the month at 0.95%, down 0.19% from the prior month-end. We continue to maintain our emphasis on high levels of liquidity and relatively short duration as we monitor how monetary policy unfolds.

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[4] Government and Treasury Funds are Stable NAV funds.

[5] The **SIFMA Municipal Swap** index is a 7-day high-grade market index comprised of tax-exempt VRDOs reset rates that are reported to the Municipal Securities Rule Making Board's (MSRB's) SHORT reporting system.

[6] **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.

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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

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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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