Morgan Stanley

INVESTMENT MANAGEMENT

Central Banks Continue to Pledge Support to the Economy

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | MAY 2020

Federal Reserve Board

The Federal Open Market Committee (FOMC) decided to keep the target range for the federal funds rate unchanged at 0.00% - 0.25% at its scheduled meeting on April 29, 2020. This was the first meeting since tangible economic data had been collected on the coronavirus impact. The committee noted that the virus had catalyzed significant job losses and steep drawdowns in both consumer spending and consumer confidence. In March, the Federal Reserve (Fed) acted swiftly to respond to the potential impacts of COVID-19 by lowering rates to the lower bound while also implementing quantitative easing (QE) programs, among other facilities aimed at increasing liquidity in short-term debt markets.

In April, fears of potential coronavirus impacts were realized. First quarter gross domestic product (GDP) growth came in at -4.8% and initial jobless claims surged to around 30 million. While extraordinarily weak readings were anticipated as a result of the temporary pause across many parts of the economy, both data points underperformed expectations. Chairman Powell noted in his press conference that the current policy was appropriate while acknowledging that "the ongoing public health crisis will weigh heavily on economic activity, employment and inflation in the near term, and poses considerable risks to the economic outlook over the medium term." The chairman also noted that the committee will "maintain this target range until it is confident that the economy has weathered recent events."

Going forward, the Fed plans to consider health data along with traditional economic data to develop future policy actions. The committee remains committed to acting as needed to ensure the economy's eventual recovery, as it intends to "closely monitor market conditions and is prepared to adjust its plans as appropriate."

European Central Bank

At the European Central Bank's (ECB) policy meeting on April 30, 2020, President Lagarde and the policy committee kept the ECB deposit rate unchanged at -0.50%. However, the ECB eased conditions on its targeted longer-term refinancing operations (TLTRO III) by lowering the rate to "50 basis points below the average interest rate of the Eurosystem's main refinancing operations." The ECB will continue to conduct stimulus by maintaining its Pandemic Emergency Purchase Program (PEPP) as announced in March. The ECB noted in its press release that "these purchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions. The Governing Council will conduct net asset purchases under the PEPP until it judges that the coronavirus crisis phase is over, but in any case until the end of this year." At the press conference, President Lagarde said the ECB expects euro area GDP to contract between 5% and 12% in 2020.

Bank of England

Although no formal policy meeting was held in April, market participants and analysts expect the Bank of England (BOE) to further ease and/or increase stimulative policy. The BOE's next meeting on May 7, 2020 is highly anticipated, considering the unprecedented policy actions taken by other central banks around the world.

DISPLAY 1
Overnight Rates

As of 30/4/20

	SONIA (%)	EONIA (%)	OBFR (%)
Overnight	0.07	-0.45	0.04

Source: Bloomberg

Portfolio Strategy

MSLF EURO LIQUIDITY FUND (LVNAV)

With the ECB pandemic response firmly entrenched in the "more of the same" medicine it has been using to stimulate the European economy since the sovereign debt crisis in 2014, the markets became a little uneasy about the adequacy of the ECB's response, particularly given the limited fiscal response from some European governments. As such, risk in euro money markets continued to reprice higher in April, with 3-month Euribor climbing from -0.36% to -0.16% in the first three weeks of the month. This rise in wholesale funding rates caused the ECB to respond with further monetary stimulus, both in the form of a more attractive rate for its third version of the targeted long-term refinancing operations (TLTRO) and also an introduction of a new pandemic-specific LTRO which would not be limited in its use, meaning banks would have freedom to use the proceeds for any purpose. This should serve as a backstop to money market funding rates, and its introduction has since seen Euribor rates start to fall again. With market rates continuing to show volatility, the Fund has been defensive, continuing to build liquidity buffers and reduce its WAM, from 43 days to 33 days intra-month, before lengthening again to 37 days by month end.

MSLF STERLING LIQUIDITY FUND (LVNAV)

Following the comprehensive central bank action in March to offset the impending economic impact of the lockdown measures implemented to combat the spread of COVID-19, sterling money markets recovered gradually through April. As investor flows out of the wider money market fund sector eased in early April and funds were able to build liquidity buffers, maturities gradually started to be re-invested back into longer dates than the overnight to one week maturities that had dominated trading through most of March. The WAM of the Fund was lowered from 38 days at the end of March to as low as 30 days in middle of April, before slightly lengthening back out to 34 days by month end. The Fund also continued to see strong inflows throughout the month, increasing its asset size from £2.8 billion to £3.2 billion in April.

DISPLAY 2
LIBOR Rates

As of 30/4/20

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
Overnight	0.05	-0.57	0.06
1 week	0.10	-0.51	0.13
1 month	0.20	-0.43	0.33
2 months	0.40	-0.27	0.59
3 months	0.59	-0.19	0.56
6 months	0.68	-0.06	0.76
12 months	0.83	-0.02	0.86

Source: Bloomberg

DISPLAY 3
Yield Curves

As of 30/4/20

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
2 year	0.01	-0.78	0.20
5 year	0.09	-0.77	0.36
10 year	0.23	-0.59	0.64
30 year	0.57	-0.18	1.28

Source: Bloomberg

MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)

Funding conditions improved throughout the month of April, with 3-month LIBOR rallying from 1.45% on March 31 to 0.56% on April 30. With the Fed indicating that it is "committed to using its full range of tools to support the U.S. economy," while also pledging to keep rates near zero in the near term, the market is pricing in no changes to the benchmark policy rate until 2022. As assets return to Prime funds, we opportunistically extended the duration of the portfolio by purchasing longer-dated fixed-rate securities, ending the month with the weighted average maturities (WAMs) of the Fund in excess of 50 days. Going forward, we remain comfortable managing the portfolio with elevated levels of liquid assets, seeking to ensuring that we uphold our mandates of capital preservation and liquidity.

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

In April, a massive issuance of Treasury bills hit the market to help the U.S. government fund ongoing stimulus and other aid packages. The record supply moved front-end Treasury yields higher, where the bill supply was concentrated. However, strong investor demand for short bills tempered some of the yield increase and flattened the short Treasury curve. While fund inflows moderated from the prior month, we continued to have strong industry inflows to government and Treasury money market funds, which contributed to this demand. We bought Treasury bills across our portfolio, reducing the amount of overnight repo as repo rates remain pegged at low single digits. We continue to seek to ensure high levels of liquidity and manage the portfolio to be responsive to changes in market conditions and interest rate levels.

12 Month Performance Periods to Latest Month End (%)

MSLF Euro Liquidity Fund (LVNAV)	APR '19 - APR '20	APR '18 - APR '19	APR '17 - APR '18	APR '16 - APR '17	APR '15 - APR '16
Institutional Accumulation Share Class	-0.52	-0.49	-0.52	-0.46	-0.16

MSLF Sterling Liquidity Fund (LVNAV)	APR '19 - APR '20	APR '18 - APR '19	APR '17 - APR '18	APR '16 - APR '17	APR '15 - APR '16
Institutional Distributing Share Class	0.61	0.61	0.25	0.32	0.45

MSLF U.S. Dollar Liquidity Fund (LVNAV)	APR '19 - APR '20	APR '18 - APR '19	APR '17 - APR '18	APR '16 - APR '17	APR '15 - APR '16
Institutional Distributing Share Class	1.87	2.27	1.31	0.69	0.20

MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)	APR '19 - APR '20	APR '18 - APR '19	APR '17 - APR '18	APR '16 - APR '17	APR '15 - APR '16
Institutional Distributing Share Class	1.58	2.00	0.98	0.25	0.06

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

Lower Risk **Higher Risk**

1	2	3	4	5	6	7

Potentially Lower Rewards **Potentially Higher Rewards**

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.

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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.

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