

Central Banks Remain on Hold

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | SEPTEMBER 2020

Federal Reserve Board

As expected, the Federal Open Market Committee (FOMC) kept the range for the federal funds rate unchanged at 0.00% to 0.25% at the conclusion of its September meeting. While the Federal Reserve (Fed) pledges continued support to the economy, it noted that economic and employment activity have “picked up in recent months.” Although the Fed’s tone was more optimistic, such activity is still well below pre-COVID figures. Furthermore, regarding forward guidance, the Fed clearly states that rates will remain at current levels until it is confident COVID concerns abate as well as achieving maximum employment and inflation of 2%.

The Fed continues to review policy to allow for higher inflation, which Chairman Powell publicized at the Jackson Hole Symposium in August. Updated language in the September release stated, “With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2% for some time so that inflation averages 2% over time and longer-term inflation expectations remain well anchored at 2%.” Market participants view this change as an opportunity for Chairman Powell to maintain an accommodative policy stance for longer to ensure that the Fed’s stability and employment goals are entirely realized before any policy pivot.

In addition to the press release, the Fed released its updated economic projections. Chairman Powell and the FOMC reinforced its forward guidance and accommodative policy stance with the updated dot plot which illustrates that 16 out of 17 officials expect to keep rates at current levels through 2022, while 13 of the 17 officials expect rates to

remain unchanged through 2023. The FOMC now projects real gross domestic product to contract by 3.7% in 2020, but rebound in both 2021 and 2022. The Fed estimates the unemployment rate to decrease to 7.6% in 2020, then recover sharply in the following two years. The committee revised up projections for core Personal Consumption Expenditures (PCE), but do not see inflation rising to 2% until 2023.

Despite having improved projections from June, the Fed will use “its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.”

European Central Bank

At the European Central Bank’s (ECB) policy meeting in September, President Lagarde and the policy committee kept the ECB deposit rate unchanged at -0.50%, as expected. Additionally, the committee kept the total size of the Pandemic Emergency Purchase Program at €1.35 trillion and the ECB’s Asset Purchase Program was left unchanged. Moving forward, the committee stated it will “stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.”

Bank of England

The Bank of England Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.10% at its September meeting. Subsequently, the MPC voted unanimously to maintain its U.K. government bond purchase programs. The MPC noted that the outlook for the



DISPLAY 1**Overnight Rates**

As of 30/9/20

	SONIA (%)	EONIA (%)	OBFR (%)
Overnight	0.05	-0.49	0.08

Source: Bloomberg

economy was “unusually uncertain.” It also painted a more optimistic picture, noting that economic data was a “little stronger” than expected at its August meeting. However, looking further out remains “unclear.” While the recent increase in COVID-19 cases globally and in the U.K. remain a concern to the MPC, it suggests the potential impact to be “probably on a lesser scale than seen earlier in the year.” Going forward, the committee continues to stand by the economy and remains ready to act to achieve its goals.

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

Money market yields in the euro market have continued the flattening trend seen in recent months after the ECB's pandemic response injected a huge amount of liquidity into the banking sector. With excess liquidity now over €3 trillion,¹ inevitably money market yields have fallen, with essentially a

flat curve from overnight to 3-month maturities, and again only limited improvement in longer dates. The Fund has continued its recent strategy of turning to the bond market to seek better relative value, and we have been able to add to our allocation of covered bonds, as well as senior floating-rate notes and medium-term notes. This has been complemented by money market offers which show better relative value than overnight securities. Our overnight allocation was reduced into quarter-end due to the balance sheet restraints by allocating into short-dated government-related entities. However, we would expect overnights to increase again as maturities fall due in the new quarter.

MSLF STERLING LIQUIDITY FUND (LVNAV)

Despite Bank of England MPC members' persistent reassurance that negative interest rate policy is not likely to be utilised in the short term, money market yields continue

DISPLAY 2**LIBOR Rates**

As of 30/9/20

	GBP LIBOR (%)	EUR LIBOR (%)	USD LIBOR (%)
Overnight	0.05	-0.59	0.08
1 week	0.05	-0.57	0.10
1 month	0.05	-0.57	0.15
2 months	0.06	-0.52	0.19
3 months	0.06	-0.52	0.23
6 months	0.09	-0.49	0.26
12 months	0.15	-0.44	0.36

Source: Bloomberg

DISPLAY 3**Yield Curves**

As of 30/9/20

	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS	U.S. GOVERNMENT BONDS
2 year	-0.03	-0.71	0.13
5 year	-0.06	-0.71	0.28
10 year	0.23	-0.52	0.68
30 year	0.78	-0.10	1.46

Source: Bloomberg

¹ Source: European Central Bank. As of September 30, 2020.

to price in this possibility, with an entirely flat or inverted yield curve now seemingly the norm for the sterling market. Given the low yields on offer, we have limited trading to shorter-dated money market assets to limit the amount of overnight securities being carried, and complemented this with opportunistic trading in tail-end bonds and floating-rate notes. This has seen the WAM of the Fund stay in the high 40s, with the WAL lengthened to 58 days by quarter-end. The Fund has continued its recent strong asset growth, breaking through £5 billion for the first time and peaking at £5.2 billion intra-month before cyclical outflows at month-end saw the Fund finish the quarter at €4.7 billion in assets.

MSLF U.S. DOLLAR LIQUIDITY FUND (LVNAV)

The Federal Reserve left interest rates near zero at the September FOMC meeting, while signaling it would hold them there through at least 2023 to help the economy recover from the COVID-19 pandemic. Notably, the Fed indicated that it is targeting an average inflation rate of 2% over time, reflecting the new policy framework which allows for an overshoot of its target following periods of sub-2% inflation. With a flat yield curve and spreads remaining tight on the short end of the curve, we predominantly purchased securities that mature inside of year-end, allowing the weighted average life (WAL) of our portfolios to gradually roll down to

approximately 55 days as of the close of the month. Intra-month, 3-month LIBOR touched all-time lows of 0.21788% on September 25 but were still setting well above where most banks are transacting in the wholesale commercial paper/certificates of deposit market. We remain comfortable managing the portfolio with elevated levels of liquid assets, seeking to ensure that we uphold our mandates of capital preservation and liquidity.

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

At the September meeting, the FOMC released economic forecasts that imply no change to interest rates through at least 2023. The FOMC “will aim to achieve inflation moderately above 2% for some time” and plan to keep rates low until inflation averages 2% over an unspecified period. Not unlike last month, markets continued to wait for an outcome on another fiscal stimulus package but the impasse in Washington continued. The Treasury bill curve remained very flat with only a few basis points spread between 1-month and 1-year bill tenors. We continued to invest in fixed-rate Treasuries largely up to 6-month maturities in the portfolio. 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)	SEP '19 - SEP '20	SEP '18 - SEP '19	SEP '17 - SEP '18	SEP '16 - SEP '17	SEP '15 - SEP '16
Institutional Accumulation Share Class	-0.54	-0.47	-0.51	-0.50	-0.30
MSLF Sterling Liquidity Fund (LVNAV)	SEP '19 - SEP '20	SEP '18 - SEP '19	SEP '17 - SEP '18	SEP '16 - SEP '17	SEP '15 - SEP '16
Institutional Distributing Share Class	0.37	0.68	0.39	0.22	0.45
MSLF U.S. Dollar Liquidity Fund (LVNAV)	SEP '19 - SEP '20	SEP '18 - SEP '19	SEP '17 - SEP '18	SEP '16 - SEP '17	SEP '15 - SEP '16
Institutional Distributing Share Class	0.98	2.39	1.69	0.97	0.37
MSLF U.S. Dollar Treasury Liquidity Fund (Public Debt CNAV)	SEP '19 - SEP '20	SEP '18 - SEP '19	SEP '17 - SEP '18	SEP '16 - SEP '17	SEP '15 - SEP '16
Institutional Distributing Share Class	0.70	2.17	1.40	0.50	0.12

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

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.

Weighted average life (WAL) – measures the weighted average of the maturities of the portfolio's individual holdings.

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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