Morgan Stanley

INVESTMENT MANAGEMENT


# Growing Divergence

**MARKET INSIGHTS** | GLOBAL LIQUIDITY TEAM | December 2025

## Federal Reserve Board[1]

On December 10, the Federal Open Market Committee (FOMC) lowered the federal funds rate by 25 basis points to a target range of 3.50%–3.75%. Most members agreed with the decision, however three disagreed—one favored a larger 50 basis point cut, while two preferred leaving rates unchanged. The move was made amidst moderate economic expansion, slower job growth, a slight rise in unemployment and inflation that remains somewhat elevated. The Committee highlighted ongoing uncertainty in the economic outlook and noted that risks to employment have increased recently. The FOMC reaffirmed its commitment to maximum employment and reducing inflation to 2%, emphasizing that future policy decisions will depend on incoming data, the evolving outlook and risk assessments.

## European Central Bank[1]

On December 18, the European Central Bank (ECB) Governing Council left its key interest rates unchanged, reaffirming its view that inflation is on track to stabilize at the 2% medium-term target. The latest forecasts point to a gradual decline in inflation over the coming years, while economic growth has been revised slightly upward, driven mainly by stronger domestic demand. Although the inflation outlook for 2026 was adjusted higher due to persistent services inflation, the ECB stressed that overall inflation is expected to ease over time. The Governing Council reiterated its commitment to price stability and underscored that future policy decisions will remain data-dependent and taken on a meeting-by-meeting basis, without pre-committing to a specific interest rate path.

## Bank of England

At its December meeting, the Bank of England's Monetary Policy Committee (MPC) voted 5–4 to cut the Bank Rate by 25 basis points to 3.75%, while four members preferred to keep it unchanged at 4.00%. The MPC noted that disinflation has advanced, with inflation falling to 3.2% and projected to return toward the 2% target more quickly in the near term. Easing pay growth, softer services inflation, subdued economic activity and a loosening labor market were cited as signs that underlying inflationary pressures are diminishing, though wage growth and inflation expectations remain elevated. Economic growth continues to be weak, with gross domestic product growth near stagnation and unemployment rising, increasing the risk that weak demand could weigh on inflation over the medium term. The Committee reiterated that any further policy easing will be gradual and data-driven, emphasizing that monetary policy is not on a preset path and future decisions will depend on evolving inflation risks.

**DISPLAY 1**

**Monthly Interest Rate Summary**

*As of 12/31/25*

| US TREASURY RATES | YIELD (%) | MOM CHANGE (%) |
|---|---|---|
| 1M UST | 3.5904 | (0.31) |
| 3M UST | 3.6264 | (0.17) |
| 6M UST | 3.6017 | (0.20) |
| 12M UST | 3.4700 | (0.21) |
| 2Y UST | 3.4730 | (0.10) |
| 5Y UST | 3.7252 | 0.04 |
| 10Y UST | 4.1670 | 0.09 |
| 30Y UST | 4.8436 | 0.19 |

Source: Bloomberg

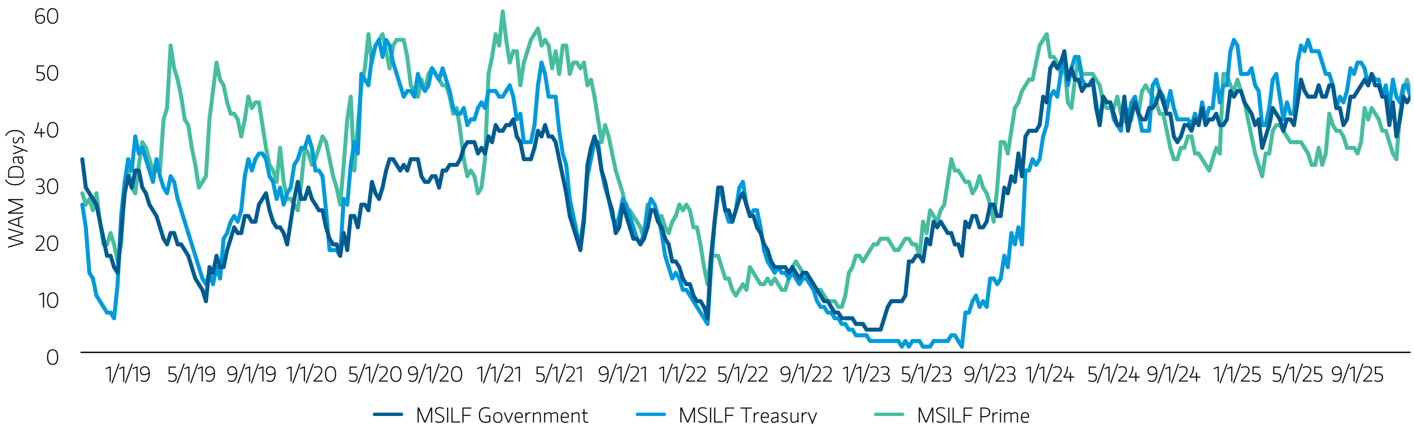
[1] Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of December 31, 2025 and are subject to change based on market, economic and other conditions. **Past performance is not indicative of future results.**

**DISPLAY 2**

**MSILF Weighted Average Maturities (WAM) Summary[2]**

*As of 12/31/25*




Source: iMoneyNet

## Portfolio Strategy

### GOVERNMENT/TREASURY STRATEGY

Our portfolios were well positioned heading into year-end and on the longer end compared to our peers. We remained patient and added duration opportunistically in term repo and Treasury securities. We also added longer-dated agency SOFR (secured overnight financing rate) floating-rate securities to take advantage of elevated funding pressures heading into year-end.

The government shutdown has delayed the release of key economic data. As data releases get back on track, the market will need to digest important releases to assess the future path of monetary policy. At the December FOMC press conference, Chair Jerome Powell conveyed that rates are closer to neutral and that the Fed can be patient in determining when the next move in rates may be appropriate. Until more concrete economic data arrives in January and beyond, we believe there is a chance for a rate cut to occur as early as the March FOMC meeting.

Although auction sizes have decreased, issuance remains robust. Large auction sizes continue to spark funding volatility in repo markets around major statement dates. The implementation of buybacks by the Federal Reserve has added more cash into the system, allowing funding markets to normalize faster after large statement dates.

Currently we have no concerns on liquidity in the markets.

### PRIME STRATEGY[3]

Following the Fed's third and final 25 basis point cut in 2025 at the December FOMC meeting, the market reset lower, which slightly inverted the front-end of the yield curve, particularly after the updated Summary of Economic Projections pushed 2026 easing to the second half of the year. As spreads widened in the wholesale funding market due to expected year-end technicals, we took the opportunity to extend both weighted average maturity (WAM) and weighted average life (WAL) near their maximums to take advantage of attractive spreads before the anticipated spread tightening in the first month of the new year.

Credit spreads widened and buying opportunities were ample in the last month of 2025 before entering a trend of seasonal tightening into January. We deployed capital across fixed- and floating-rate structures while opportunities presented themselves. Corporate bonds continue to be an attractive asset class, in our view, offering a yield pickup to wholesale funding equivalents with diversification benefits away from programs that don't offer commercial paper/certificates of deposit programs.*

Liquidity remains healthy as dealers continue to competitively bid paper when liquidity needs arise.

* Diversification neither assures a profit nor guarantees against loss in a declining market.

[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"). The views and opinions expressed are those of the Portfolio Management team as of December 31, 2025 and are subject to change based on market, economic and other conditions. **Past performance is not indicative of future results.**

One basis point = 0.01%

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment.

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**STABLE NAV**

**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 a bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor is not required to reimburse the Fund for losses, and you should not expect that the sponsor will provide financial support to the Fund at any time, including during periods of market stress.**

**FLOATING NAV**

**You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon sale of your shares. The Fund generally must impose a fee when net sales of Fund shares exceed certain levels. An investment in the Fund is not a bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor is not required to reimburse the Fund for losses, and you should not expect that the sponsor will provide financial support to the Fund at any time, including during periods of market stress. The Portfolio will be required to price and transact in their shares at a floating Net asset value ("NAV"). The Portfolio will be required to impose a mandatory liquidity fee when the Fund experiences daily net redemptions that exceed 5% of net assets, unless the Fund's liquidity costs are de minimis.**

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