Morgan Stanley

INVESTMENT MANAGEMENT

Market Insights

Rising COVID-19 Cases Prompt Central Banks to Extend Aid

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | DECEMBER 2020

Federal Reserve Board[1]

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 December meeting. Much of the meeting's focus related to forward guidance and the asset purchase program. The Federal Reserve (Fed) reiterated it will "continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals." Effectively signifying that until both maximum unemployment and consistent 2% inflation is met, the Fed will continue asset purchases.

In addition to the press release, the Fed updated its economic projections. Chairman Powell and the FOMC reinforced their 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 12 of the 17 officials expect rates to remain unchanged through 2023. The FOMC projects real gross domestic product (GDP) to contract by 2.4% in 2020, but rebound in both 2021 and 2022. The Fed estimates the unemployment rate will decrease

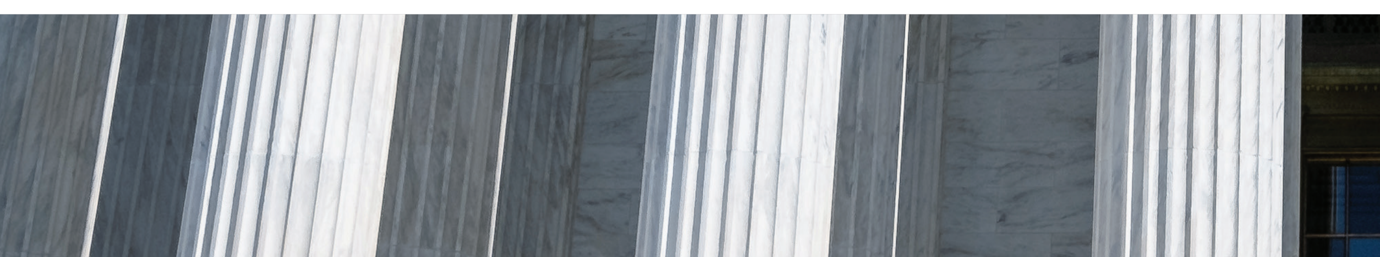
DISPLAY 1
Monthly Interest Rate Summary
As of 12/31/2020

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	0.03	(0.05)
3M UST	0.06	(0.02)
6M UST	0.08	(0.01)
12M UST	0.10	(0.01)
2Y UST	0.12	(0.03)
5Y UST	0.36	(0.00)
10Y UST	0.91	0.07
30Y UST	1.66	0.09
USD LIBOR CURVE		
O/N LIBOR	0.08	(0.01)
1M LIBOR	0.14	(0.01)
3M LIBOR	0.24	0.01

Source: Bloomberg

[1] Source: Bloomberg.

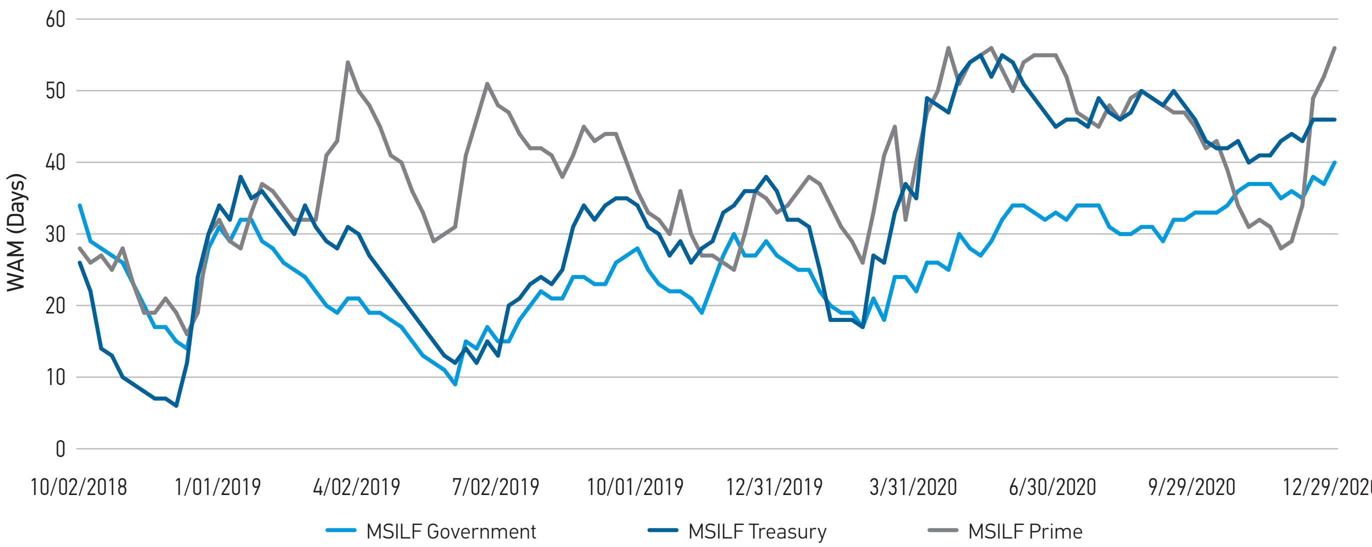
The views and opinions expressed are those of the Portfolio Management team as of December 31, 2020 and are subject to change based on market, economic and other conditions. **Past performance is not indicative of future results.**



DISPLAY 2

Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM) Summary[2]

As of 12/31/2020



Source: iMoneyNet

to 6.7% in 2020, then recover sharply in the following two years. The committee marginally increased projections for core Personal Consumption Expenditures, but does not see inflation rising to 2% until 2023. While many of these figures were positively revised since September, the FOMC plans to 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[1]

At the European Central Bank's (ECB) policy meeting on December 10, President Lagarde and the policy committee kept the ECB deposit rate unchanged at -0.50%, as expected. The Committee increased the total size of the Pandemic Emergency Purchase Program (PEPP) by €500 billion, bringing the total size of the program to €1.85 trillion, and extended the facility through March 2022, while it left the Asset Purchase Program (APP) unchanged. Market participants had expected the ECB to act, as this modification was telegraphed in prior meetings to offset the negative impacts of a second lockdown and weakening economic data. Additionally, targeted longer-term refinancing operations (TLTRO III) were extended until June 2022 and four pandemic emergency longer-term refinancing operations (PELTROs) will be offered in 2021.

Bank of England[1]

The Bank of England Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.10% and its U.K. government bond purchase program at its December meeting. The MPC noted that the second set of lockdowns and increasing COVID-19 case count would negatively weigh on economic data. The committee believes fourth quarter GDP will be slightly weaker than anticipated, but is developing a more optimistic view with the vaccine rollout in the first half 2021. The committee believes vaccine rollout procedures will "reduce the downside risks to the economic outlook." Going forward, the MPC will continue to monitor economic and inflation data while standing ready to take "whatever additional action is necessary to achieve its remit."

[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.

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Portfolio Strategy

PRIME STRATEGY[3]

As we approached year-end, technicals on the short end of the curve put slight pressure on the wholesale funding market, driving 3-month LIBOR to its highest level since August, setting at 0.25388% on December 29. In the portfolios, we continue to opportunistically purchase fixed-rate securities across the curve, locking in attractive yields and avoiding reset risk associated with floating-rate securities, as there will likely be downward pressure on LIBOR and SOFR in early 2021. Throughout December and looking ahead, we remain conservatively positioned across our funds, prioritizing elevated levels of weekly liquidity to meet any unexpected volatility.

GOVERNMENT/TREASURY STRATEGY[4]

In December, Treasury bill and agency yields remained low and in the single digits across most of the curve. Heading toward year-end, we saw higher funding needs out of several government agencies, but it barely translated into a move higher in fixed-rate yields. Overnight repo rates remained well behaved as expected over the year-end turn. At the December FOMC meeting, projections for the economy were upgraded somewhat and the Fed noted that monthly Treasury and mortgage securities purchases will continue "at least" at the current pace until substantial further progress is made toward its dual mandate goals. Toward the end of the month, Congress finally passed a $900 billion stimulus package after much debate. During December, we extended the portfolios' weighted average life as we bought Treasury floating-rate notes that offered better relative value. We added some term repos with short maturities and continued to mainly invest in Treasury bills in up to six-month maturities. We continue to ensure high levels of liquidity and manage the portfolios to be responsive to changes in market conditions and interest rate levels.

TAX-EXEMPT STRATEGY[3]

Strong demand for variable rate demand notes (VRDNs) has kept short-term tax-exempt rates steady. The SIFMA Index[5] of weekly variable rate securities dropped 2 basis points in December to 0.09% from 0.11% in November. Yields at the longer end of the municipal money market maturity range were little changed during the month as well. With the majority of state and local governments having already completed their annual financings, new issuance of municipal debt was limited. A lack of clarity around fiscal aid exacerbated broader market volatility during the month. In the period ahead, we will watch to see how monetary policy unfolds and determine what impact the election results may have on municipal yields.

[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.

[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.

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

Past performance is no guarantee of future results. This document represents the views of the portfolio management team. The authors' views are subject to change without notice to the recipients of this document. It does not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management and may not be reflected in other strategies and products that the Firm offers.

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Current and future portfolio holdings are subject to change. The forecasts in this piece are not necessarily those of Morgan Stanley, and may not actually come to pass.

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Please consider the investment objectives, risks, charges and expenses of the portfolios carefully before investing. The prospectus contains this and other information about the portfolios. To obtain a prospectus, download one at www.morganstanley.com/liquidity or call 1.800.236.0992. Please read the prospectus carefully before investing.

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events.

STABLE NAV FUNDS

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

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 the sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. 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.

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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