

Market Insights

FOMC Increases Interest Rates by 0.25%

LIQUIDITY | GLOBAL LIQUIDITY TEAM | JUNE 2018

Overview¹

In June, the markets were largely driven by the Federal Open Market Committee's (FOMC) meeting. The FOMC unanimously voted to increase interest rates by 25 basis points to a target range of 1.75% to 2.00%. The summary of economic projections (SEP) showed that the FOMC expects two additional rate hikes this year, up one rate hike from the December meeting. Additionally, the Federal Reserve (Fed) believes there will be three rate hikes in 2019. No changes were made to the balance sheet normalization program, and the fed funds rate remains the main monetary policy tool for the FOMC.

The tone of the FOMC meeting was generally optimistic, as Fed Chairman Jerome Powell stated that the economy is doing "very well." Inflation has picked up and has moved closer to the Fed's 2% target, and the Fed believes inflation will be symmetric around its target range in the coming months. With regards to employment, job gains have continued to be strong and the unemployment rate has decreased further. Unemployment forecasts for the fourth quarter of 2018 decreased to 3.6% from 3.8%. With additional Fed rate hikes, economic activity is expected to expand at a solid rate. The gross domestic product (GDP) forecast for the fourth quarter of 2018 modestly increased to 2.8%, while the forecasts for 2019 and 2020 remained largely unchanged.

The European Central Bank (ECB) also met in June and announced its plan to end its quantitative easing (QE) program in December of this year. From now until the program ends, the ECB will purchase bonds at a slower pace of 15 billion euros. It was previously expected that the bond purchase program would last until September, with monthly bond purchases of 30 billion euros. The ECB also stated it anticipates that interest rates will remain at its current levels for over a year. With that being said, interest rates on the main refinancing operations remained unchanged at 0.00%, the marginal lending facility was unchanged at 0.25% and the deposit facility was unchanged at -0.40%. ECB President Mario Draghi emphasized that the QE exit and interest rate levels were dependent on incoming data and are subject to change if data readings change relative to the forecasts.

In the U.K., the Bank of England (BoE) voted to leave rates unchanged at 0.5%, as expected. In the minutes from its June meeting, the Monetary Policy Committee (MPC) stated it believes GDP will grow at 0.4% in the second quarter, consistent with its May projections. The MPC also addressed recent weakness in data such as household spending and GDP, calling the readings "temporary, with momentum recovering in the second quarter." Regarding a potential rate hike in the second half of 2018, markets remain mixed on whether the MPC will opt to raise rates.

Overnight Rates

As of 06/30/2018

	OBFR (%)	SONIA (%)	EONIA (%)
Overnight	1.90	0.44	-0.36

Source: Bloomberg

¹ Source: Bloomberg

LIBOR Rates

As of 06/30/2018

	USD LIBOR (%)	GBP LIBOR (%)	EUR LIBOR (%)
Overnight	1.94	0.47	-0.44
1 week	1.98	0.48	-0.42
1 month	2.09	0.50	-0.39
2 months	2.17	0.58	-0.37
3 months	2.34	0.67	-0.36
6 months	2.50	0.79	-0.32
12 months	2.76	0.96	-0.23

Source: Bloomberg

MSLF EURO LIQUIDITY FUND

Following confirmation of the Asset Purchase Programme to end in December 2018 and the dovish comments from Mario Draghi about the timing of the first rate hike, the market curve has flattened slightly in the longer end with expectations of a rate hike not until the fourth quarter of 2019. The Fund is currently running a longer WAM with little prospect of the curve steepening over the rest of the year.

MSLF STERLING LIQUIDITY FUND

With the stronger economic data signalling a likely BoE rate hike in August, the Fund is again being positioned to take advantage of the higher yields expected following the MPC decision. With no MPC meeting in July, eyes will be focussed on both

consumer price index and GDP data, looking for an improvement from the disappointing first quarter print.

MSLF U.S. DOLLAR LIQUIDITY FUND

One-month London Interbank Offered Rate (LIBOR) rose to recent highs post-FOMC meeting, opening at 2.09% on June 14, while three-month LIBOR retraced some of the pullback experienced through May, to open at 2.33% as of June 14. With the FOMC expecting further gradual increases in the target for the federal funds rate, we continued to manage our portfolios from a conservative positioning standpoint, focusing on high levels of weekly liquidity and structuring our portfolios to help minimize interest rate risk that could arise from future interest rate hikes.

MSLF U.S. DOLLAR TREASURY LIQUIDITY FUND

Agency and Treasury bill yields continued to increase leading up to the FOMC meeting and leveled off as typical quarter-end investor demand picked up. During the month, we primarily invested in fixed-rate Treasury and agency debt within 3-month and 6-month tenors. The maturity dates of these debt securities line up well with our expectations of quarterly FOMC rate hikes for the remainder of the year. Lower quarter-end repo capacity by dealers was evident by the higher usage of the Fed's overnight reverse repo facility (\$96.97 billion) at month-end. However, compared to the prior year's usage, volume was on the low end. We continued to maintain a significant portion of certain portfolios in short-term repurchase agreements.

Yield Curves

As of 06/30/2018

	U.S. GOVERNMENT BONDS	U.K. GOVERNMENT BONDS	GERMAN GOVERNMENT BONDS
2 year	2.53	0.72	-0.67
5 year	2.74	1.02	-0.31
10 year	2.86	1.28	0.30
30 year	2.99	1.73	1.02

Source: Bloomberg

12 Month Performance Periods to Latest Month End (%)

MSLF Euro Liquidity Fund

	JUN '17 - JUN '18	JUN '16 - JUN '17	JUN '15 - JUN '16	JUN '14 - JUN '15	JUN '13 - JUN '14
Institutional Share Class	(0.52)	(0.48)	(0.21)	0.00	0.11
One Week Euro LIBID Index	(0.54)	(0.52)	(0.38)	(0.18)	(0.01)
One Month Euro LIBID Index	(0.53)	(0.51)	(0.34)	(0.13)	0.03
Euro Overnight Index Average (EONIA)	(0.36)	(0.35)	(0.22)	(0.03)	0.15

MSLF Sterling Liquidity Fund

	JUN '17 - JUN '18	JUN '16 - JUN '17	JUN '15 - JUN '16	JUN '14 - JUN '15	JUN '13 - JUN '14
Institutional Share Class	0.30	0.28	0.46	0.42	0.39
One Week GBP LIBID Index	0.28	0.14	0.37	0.36	0.35
One Month GBP LIBID Index	0.43	0.28	0.52	0.51	0.50
SONIA	0.38	0.24	0.46	0.44	0.43

MSLF U.S. Dollar Liquidity Fund

	JUN '17 - JUN '18	JUN '16 - JUN '17	JUN '15 - JUN '16	JUN '14 - JUN '15	JUN '13 - JUN '14
Institutional Share Class	1.47	0.79	0.26	0.04	0.04
One Week USD LIBID Index	3.33	0.56	0.17	0.01	0.01
One Month USD LIBID Index	1.43	0.62	0.21	0.04	0.04
FED Funds	1.41	0.63	0.26	0.11	0.08

MSLF U.S. Dollar Treasury Liquidity Fund

	JUN '17 - JUN '18	JUN '16 - JUN '17	JUN '15 - JUN '16	JUN '14 - JUN '15	JUN '13 - JUN '14
Institutional Share Class	1.15	0.33	0.08	0.00	0.01
Citigroup One-Month Treasury Bill Index	1.27	0.42	0.11	0.02	0.03

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 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 not a reliable indicator of future results. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the Fund will achieve its investment objectives.

Please refer to the Prospectus for full risk disclosures. All data as of 30 June 2018 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.

Citigroup One-Month Treasury Bill Index - index calculated by Citigroup 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.

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