# First Fed Rate Hike in Nine Years – What does it mean for you?

At the much-anticipated December Federal Open Market Committee (FOMC) meeting, interest rates were increased for the first time since 2006. FOMC members acknowledged progress in the labor market but noted that inflation remains below their target. They also commented on monetary policy action, policy messaging, and interest rate projections. These major takeaways are discussed in greater depth below.

## Monetary Policy Actions and Messaging[1]

- The FOMC raised the target range for the federal funds rate by 25 bps to a range of 0.25%-0.50%
- They note that the stance of policy remains accommodative after this increase
- Conditions were satisfied for a rate hike – "The Committee judges that there has been considerable improvement in labor market conditions this year, and it is reasonably confident that inflation will rise, over the medium term, to its 2% objective."
- "The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run."
- "Gradual" is used in this statement instead of "measured" – this conveys more flexibility and a slower path of rate hikes, rather than mechanically increasing rates at every meeting
- Inflation
  - The committee expects inflation to rise to 2% over the medium term as transitory factors dissipate
  - FOMC projections were revised lower very slightly – this was primarily due to the stronger dollar
  - The committee added that it will monitor "actual" progress in addition to expected progress toward the inflation goal

[1] **SOURCE:** Federal Reserve, December 2015.

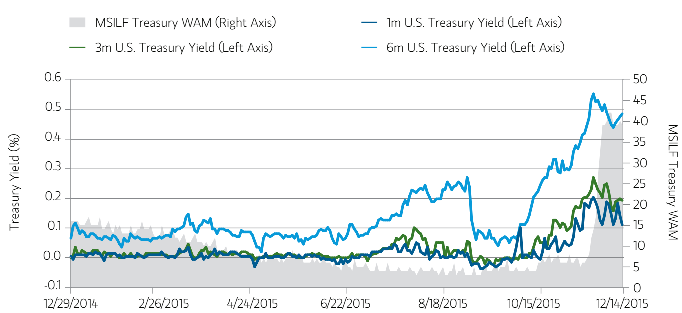
## Morgan Stanley Fund Positioning and Market Reaction

In volatile rate markets, active management of interest rate risk plays an increased role in money market fund performance. Leading up to this point, the Morgan Stanley U.S. Dollar-denominated money market funds had been managed with shorter duration profiles and higher levels of liquidity than the industry averages. Our strategic portfolio positioning was influenced by our belief that we were not being properly compensated to extend our maturity structure and invest further out the curve. As yields adjusted higher in anticipation of the impending rate hike, we began to feel comfortable that interest rates properly reflected our market expectations. As a result, we shifted the portfolios' maturity structures and extended durations by purchasing Agency and Treasury securities maturing in the belly of the money market curve.

As the graph below depicts, our positioning entering this tightening cycle allowed us to be opportunistic and take advantage of higher yields, something that would not be possible to the same extent in funds with less liquidity or longer duration profiles. These actions resulted in strong performance, while still operating within the spirit of our overall defensive portfolio management framework. Despite these adjustments in portfolio positioning, we still maintain much higher levels of daily and weekly liquidity than required.

### Morgan Stanley Treasury Portfolio WAM and Treasury Bill Yields[2]

*December 29, 2014 – December 29, 2015*




[2] **SOURCE:** Bloomberg, iMoneyNet.

## What does this mean for our investors?

Prudent and opportunistic portfolio management has allowed us to take advantage of the higher yield environment and potentially provide higher net yields to our clients very quickly. Please see below for fund information:

### U.S. Domiciled Institutional Liquidity Funds

*As of December 28, 2015*

| Portfolio Name | Ticker[3] | Rating[4] | Description | 1-day Yield | 7-day Yield | Assets (MM) | WAM | WAL |
|---|---|---|---|---|---|---|---|---|
| Prime | MPFXX | AAAm, Aaa-mf, AAAmmf, NAIC Rated | Invests in commercial paper, CDs, repos, government securities, and VRDNs | 0.30% | 0.29% | $18,868.14 | 22 | 46 |
| Money Market[5] | MPUXX | AAAm, AAAmmf | Invests in commercial paper, CDs, repos, government securities and VRDNs | 0.37% | 0.36% | $4,764.83 | 26 | 40 |
| Government | MVRXX | AAAm, Aaa-mf, NAIC Rated | Invests in Treasury, government and agency securities and repos | 0.17% | 0.16% | $42,642.88 | 39 | 112 |
| Treasury | MISXX | AAAm, Aaa-mf, NAIC Rated | Invests in U.S. Treasury securities and repos | 0.17% | 0.16% | $18,125.96 | 39 | 100 |
| Treasury Securities | MSUXX | AAAm, Aaa-mf, NAIC Rated | Invests in U.S. Treasury securities | 0.05% | 0.04% | $16,257.45 | 40 | 98 |
| Tax Exempt | MTXXX | Aaa-mf, AAAmmf, NAIC Rated | Invests in short-term municipal obligations and VRDNs | 0.01% | 0.01% | $130.18 | 5 | 5 |

*Performance data quoted represents past performance, which is no guarantee of future results and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please visit* ***www.morganstanley.com/liquidity.***

*Investment returns will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.*

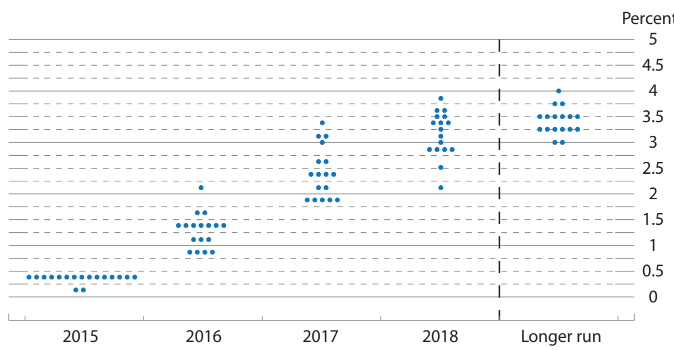
## Outlook

#### FOMC INTEREST RATE PROJECTIONS

- The FOMC interest rate forecasts show rates rising gradually over the next several years. The median rate projections (and change since the last meeting) were as follows: 2016: 1.375% (unchanged from September); 2017: 2.375% (down 25 bps); 2018: 3.25% (down 12.5 bps)
- This prices in four rate hikes next year – quite different from current market expectations
- The range of these projections for each year has compressed – there seems to be more consensus in the FOMC than in September

### FOMC Participants' Assessment of Appropriate Monetary Policy[6]:

*Midpoint of target range or target level for the federal funds rate*




[3] Tickers shown are for the institutional share class.

[4] S&P rating, Moody's rating, Fitch rating and NAIC rated respectively. Ratings source is that of each respective agency shown and as of October 31,2014. Ratings rate the investment quality of the fund's shares.

[5] Minimum Investment and ongoing balance requirement of $150MM.

[6] **SOURCE:** Federal Reserve, December 2015.

## About Morgan Stanley Investment Management

Morgan Stanley Investment Management has managed money market assets since 1975 and is dedicated to offering clients unique investment solutions through institutional money market funds and highly customized solutions. The Global Liquidity Solutions team, which has more than $151 billion[7] in assets under management, is comprised of highly experienced professionals across the U.S. and Europe and welcomes the opportunity to advise on the issues impacting short-term markets both broadly and with respect to our portfolio management strategy. If you have further questions or require additional assistance, please contact your Morgan Stanley Relationship Manager.

---

[7] **SOURCE:** Morgan Stanley Investment Management, as of September 30, 2015

---

**There is no assurance that a money market portfolio will achieve its investment objective.**

**An investment in a money market portfolio is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the portfolios seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the portfolios. Shareholders should consult their individual tax advisor to determine whether the portfolios' distributions derived from interest on the U.S. Treasury obligations and U.S. Government securities are exempt from state taxation in their own state.**

**Past performance is no guarantee of future results.**

**This material must be preceded or accompanied by a prospectus for the Morgan Stanley Institutional Liquidity Funds. The prospectus contains information about the fund, including the investment objectives, risks, charges and expenses. For an additional copy of the prospectus please visit www.morganstanley.com/liquidity. Please read the prospectus carefully before investing.**

This material has been prepared using sources of information generally believed to be reliable but no representation can be made as to its accuracy. This document represents the views of the portfolio management team. 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. The document has been prepared as information for investors and it is not a recommendation to buy or sell any particular security or to adopt any investment strategy. Current and future portfolio holdings are subject to risk. The authors' views are subject to change without notice to the recipients of this document. The forecasts in this piece are not necessarily those of Morgan Stanley, and may not actually come to pass.

Morgan Stanley Distribution, Inc. serves as distributor for the Morgan Stanley Institutional Liquidity Funds.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

Morgan Stanley Investment Management

Morgan Stanley's printed materials use recycled paper from sustainable forests



CRC 1378329 Exp 12/23/16 8456312_CH_1215