Morgan Stanley

INVESTMENT MANAGEMENT

Cruising Altitude

MARKET INSIGHTS | GLOBAL LIQUIDITY TEAM | November 2023

Federal Reserve Board[1]

The Federal Open Market Committee (FOMC) held the federal funds target rate at its current range of 5.25% to 5.50% in November. The press release was relatively unchanged aside from a minor adjustment in characterizing the economic expansion as "strong," from "solid" previously. The release also noted that job growth has "moderated" compared to earlier in the year. Chairman Powell's press conference was viewed as more dovish than expected, which has led to a strong rally in longer-term bonds and shifted market forecasts toward projecting a sooner initial rate cut in 2024. The Fed continues to analyze incoming data, and the current mantra surrounding rates is "higher for longer." But for how long remains the outstanding question.

DISPLAY 1

Monthly Interest Rate Summary

As of 10/31/2023

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	5.38	0.04
3M UST	5.46	0.02
6M UST	5.57	0.03
12M UST	5.45	0.00
2Y UST	5.09	0.04
5Y UST	4.85	0.24
10Y UST	4.93	0.36
30Y UST	5.09	0.39

Source: Bloomberg

European Central Bank[1]

At the European Central Bank's (ECB) policy meeting on October 26, President Lagarde and the policy committee decided to leave the ECB deposit rate unchanged at 4.00%. The ECB repeated messaging from its prior meeting that policy rates are "sufficiently restrictive" and that if rates are held at current levels for "sufficiently long duration" it will continue to make a material impact on inflation, which remains "too high." While the press release noted September inflation data was dropping "markedly," committee members believe this trend can continue with rates at current levels and they reiterated their "data-dependent" stance.

Bank of England[1]

The Bank of England (BoE) Monetary Policy Committee (MPC) voted 6-3 to hold the Bank Rate steady at 5.25% at the conclusion of its November meeting. Three dissenting members preferred to increase the rate 0.25% to 5.50%. MPC members anticipate third and fourth quarter U.K. gross domestic product (GDP) growth will be "weaker" than previously thought. Labor market indicators show a more uncertain landscape and signs of "loosening" compared to earlier in the year. Headline 12-month inflation data came in below expectations for the third quarter at 6.7%. In light of a deteriorating economic outlook, the MPC noted that policy rates will "likely to need to be restrictive for an extended period of time."

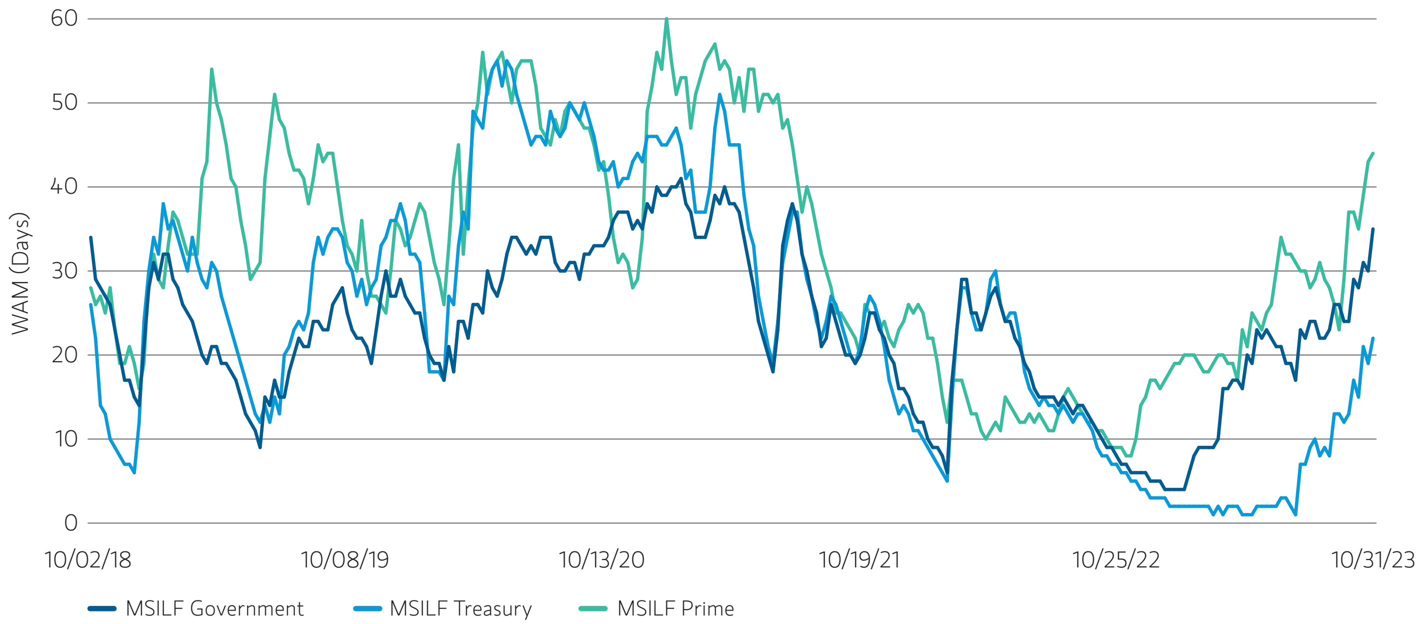
[1] Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of October 31, 2023 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 10/31/2023



Source: iMoneyNet

Portfolio Strategy

GOVERNMENT/TREASURY STRATEGY

With the broader Treasury market testing yield highs in October, we took the opportunity to add allocations to 4-month, 6-month and 1-year Treasury bills, while yields approached the 5.40% to 5.50% range. While these purchases were outright, we used the market volatility to reduce some less-attractive, "off-the-run" bills in the portfolios, balancing out some of the purchases while still extending. In floating-rate securities, we were active in adding Secured Overnight Financing Rate (SOFR)-based agency floating-rate notes (FRNs) as supply picked up from the Federal Home Loan Bank. Lastly, when it made sense, we rotated some of our Treasury FRN positions, taking gains on aged positions to rebalance into some newer securities with attractive yield pickups.

As October progressed, FOMC officials alluded to their intention to hold rates steady at the November 1 meeting while taking a slightly more cautious stance to wait and see how the long and variable lags of this hiking cycle truly impact the economy. Clearly this cycle is no longer in the "pace of hikes" stage but rather the "calibration" stage, where the FOMC try to fine tune their level of restrictiveness with limited material impact to the economy. We do feel the balance is shifting toward the Fed likely being done or very close to done, with a calibration hike possibly occurring next year. We also believe that the FOMC has no desire to cut any time soon. In our view, rate cuts would only be on the table in a material "something breaks" event until we are much more firmly into 2024. Therefore, we expect rates to remain elevated for a material period of time.

[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") 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.

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Supply remains elevated, and once again the market was tasked with taking down larger T-bill auctions. However, given such large reverse repo (RRP) balances in the system, this supply continues to be taken down well—with investors eager to add bills even with minimal pickups to RRP. Over the longer term, as excess RRP cash winds down, it will be interesting to see how the market looks to price this new supply.

PRIME STRATEGY[3]

Due to the move in longer-end rates and subsequent tightening of financial conditions, throughout October Fed officials indicated that their preference is to keep rates static and allow the lagged effects of monetary policy to continue working its way through the system. With December the next "live" FOMC meeting, we continue to opportunistically add duration in 6- to 9-month tenors, locking in attractive carry while also looking to be compensated in the event that there is an additional rate hike later this year. We continue to hold floating-rate note exposure through the remainder of 2023 and into early 2024, diminishing the portfolio's sensitivity to interest rate risk if the Fed hikes again or needs to reach a higher-than-expected terminal rate. The portfolios' maturity profile, weighted average maturity (WAM) and weighted average life (WAL), ended the month toward the median of the peer group.

Liquidity remains strong, and dealer balance sheets remain unconstrained as spreads have held mostly static over the past couple months. As we likely enter the final stages of this tightening cycle, we remain thoughtful about security selection, seeking to ensure we are purchasing the most liquid securities in the appropriate formats, while opportunistically adding duration when there is a dislocation in market pricing.

TAX-EXEMPT STRATEGY

The Bloomberg Municipal Short-Term Index[4] posted a +0.30% return for the month of October 2023, continuing its outperformance versus the broader municipal market. The Bloomberg U.S. Municipal Index[5] returned -0.85% for the month.

With fiscal deficits widening, rising geopolitical risks and Fed Chair Powell's comments at the Economic Club of New York stating the FOMC is "proceeding carefully" as it considers "the extent of additional policy firming and how long policy will remain restrictive based on the totality of the incoming data," we continued to favor shorter WAM/WAL in anticipation of higher municipal money market rates.

The SIFMA Index,[6] which measures yields for weekly variable rate demand obligations (VRDOs), averaged 3.71% for the month of October 2023, continuing its outperformance versus the broader ICE U.S. Municipal AMT-Free VRDO Index.[7]

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[4] **Bloomberg U.S. Municipal Short-Term Index** is an index that covers the U.S. dollar denominated short-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

[5] The **Bloomberg U.S. Municipal Bond Index** is an index that covers the USD-denominated long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds. It is composed of approximately 1,100 bonds.

[6] 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.

[7] The **ICE U.S. Municipal AMT-Free VRDO Index** measures performance of variable rate demand obligation (VRDO) securities which are issued by municipalities exempt from U.S. federal income tax in addition to the Alternative Minimum Tax (AMT).

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 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. 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.

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