Morgan Stanley

INVESTMENT MANAGEMENT

Policy Paddling

MARKET INSIGHTS | GLOBAL LIQUIDITY TEAM | January 2025

Federal Reserve Board[1]

In January, the Federal Open Market Committee (FOMC) decided to maintain the federal funds target rate at 4.25% to 4.50%. The press release remained relatively unchanged, reflecting less downside risk to the economy. The release noted that "inflation has made progress" toward the 2% target while acknowledging that "labor market conditions have stabilized at a low level." The committee highlighted that inflation and unemployment risks are roughly in balance. The path ahead remains uncertain as the Federal Reserve (Fed) remains data dependent in considering further policy decisions.

European Central Bank[1]

The European Central Bank (ECB) Governing Council lowered the key deposit rate by 25 basis points at the conclusion of its policy meeting in January to 2.75%. The ECB credited the cut to the "disinflation process" being "well on track." Inflation and wage growth were elevated as prices in certain sectors continue to adjust on a delayed basis due to inflation spikes. Most measures of underlying inflation suggest that inflation will likely settle around the Governing Council's 2% medium-term target on a sustained basis. The path ahead remains uncertain as the Governing Council is not pre-committing to a particular rate path and remains data dependent.

Bank of England

The Bank of England (BoE) Monetary Policy Committee (MPC) voted 7-2 to cut the Bank Rate to 4.50% at the conclusion of its February meeting. The two dissenting members preferred to reduce Bank Rate by 0.50 percentage points, to 4.25%.

DISPLAY 1

Monthly Interest Rate Summary

As of 1/31/2025

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	4.28	0.01
3M UST	4.28	(0.03)
6M UST	4.30	0.03
12M UST	4.15	0.01
2Y UST	4.20	(0.04)
5Y UST	4.33	(0.05)
10Y UST	4.54	(0.03)
30Y UST	4.79	0.01

Source: Bloomberg

The BoE has adopted a gradual approach in removing policy restraint in the absence of material developments. Consumer price index inflation in the fourth quarter of 2024 was 2.5%. Domestic inflationary pressures are moderating, but remain somewhat elevated with some indicators easing more slowly than expected. The committee remains cautious in determining the appropriate degree of monetary policy easing.

Portfolio Strategy

GOVERNMENT/TREASURY STRATEGY

We continued to opportunistically lock in both fixed- and floating-rate securities as the money market curve remained very flat. Adding fixed-rate exposure further out the yield curve

[1] Source: Bloomberg.

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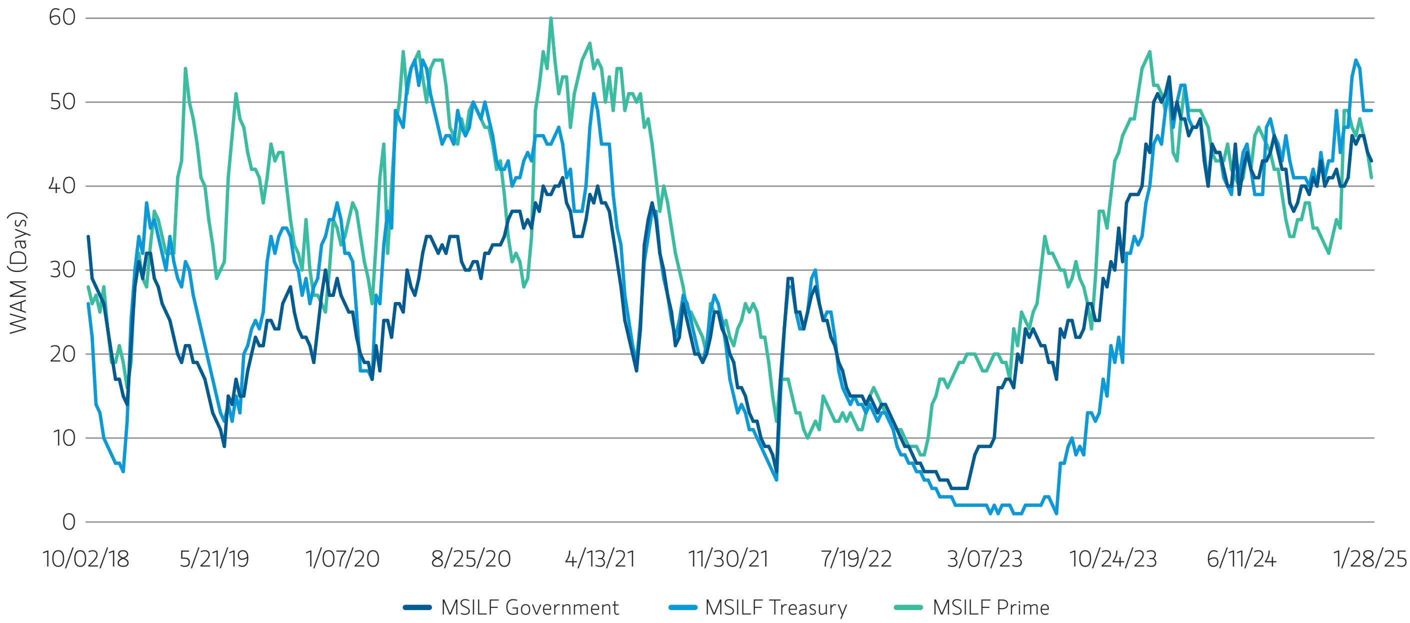
DISPLAY 2

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

As of 1/31/2025



Source: iMoneyNet

remains an attractive proposition, in our view, given the minimal concession to overnight funding levels. In the floating-rate space, a slower pace of expected rate cuts in 2025 caused us to increase our exposure to Treasury floating-rate notes, while tailwinds for SOFR (secured overnight financing rate) continue.

In the January FOMC meeting, the theme was patience—with the Fed signaling that they are still in a restrictive posture but are in no rush to change that. Specifically, the Fed would like to see further progress on inflation without weakness popping up in the labor market while they wait. Given the ever-changing political and geopolitical landscape, the market is understandably confused about what to price and on what timeline to do so. Currently the market is pricing in approximately one and a half rate cuts in 2025. But the path of outcomes feels wider across the board, with some expectations still focused on cuts while others believe the rate-cutting cycle may be on hold for the year.

Looking ahead in 2025, the path of the debt ceiling is paramount. Specifically, should the debt ceiling issue not be resolved promptly by the new administration, there is a likely need for Treasury bill supply to be cut substantially heading toward the middle of the year, before quickly ramping back up after any resolution/changes are made. Currently we have no concerns to note about T-bill liquidity.

PRIME STRATEGY[3]

Both the weighted average maturity (WAM) and weighed average life (WAL) of the portfolios organically rolled down as we remain patient in deploying capital given material spread tightening following the year-end turn.

With credit spreads returning to a more normalized level following the year-end turn, we believe secondary market rolled-down corporate bonds continue to provide the most value and are trading dislocated, priced cheaply relative to their wholesale equivalents. We looked to add exposure mostly around month-end during index selling.

From a liquidity standpoint, we note that dealer balance sheets appear unconstrained, which is one of the main reasons for the spread tightening experienced over the past month.

[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").

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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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