Morgan Stanley
INVESTMENT MANAGEMENT

Shift in the Tides

MARKET INSIGHTS | GLOBAL LIQUIDITY TEAM | June 2024

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 June. The press release was effectively unchanged aside from a slight modification suggesting that progress reducing inflation has been “modest,” compared to the prior meeting characterization noting “a lack of” further progress. Federal Reserve (Fed) Chair Powell mentioned inflation remains too high, but it has eased over the past 12 months.

The June FOMC meeting included an update of the Fed’s summary of economic projections. The Fed’s dot plot showed officials’ median projection for the benchmark rate at the end of 2024 increased 50 basis points to 5.1% from March. The 2024 median gross domestic product (GDP) growth projection was unchanged at 2.1%. The 2025 GDP growth forecast was also left unchanged. 2024 unemployment rate estimates remained static from March at 4.0%. The 2024 core personal consumption expenditures (PCE) inflation projection increased 20 basis points from the March forecast to 2.8%.

DISPLAY 1
Monthly Interest Rate Summary
As of 6/30/2024

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	5.31	(0.04)
3M UST	5.35	(0.05)
6M UST	5.32	(0.06)
12M UST	5.11	(0.07)
2Y UST	4.75	(0.12)
5Y UST	4.38	(0.13)
10Y UST	4.40	(0.10)
30Y UST	4.56	(0.09)

Source: Bloomberg

European Central Bank[1]

The European Central Bank’s (ECB) Governing Council reduced the deposit rate 0.25% to 3.75% at the conclusion of its policy meeting on June 6. The Governing Council noted that based on its outlook for inflation and restrictiveness of policy rates, June was a suitable time to tweak policy after nine months of maintaining peak policy rates. The committee noted price pressures are starting to abate and inflation expectations are falling. Despite this, officials increased inflation forecasts slightly, now anticipating inflation to average 2.5% in 2024 then subsequently declining to 2.2% in 2025.

Bank of England[1]

The Bank of England (BoE) Monetary Policy Committee (MPC) voted 7-2 to hold the Bank Rate steady at 5.25% at the conclusion of its June meeting. Two dissenting members favored decreasing the rate 0.25% to 5.00%. May 12-month headline inflation data declined to 2.0%, which was below March’s 3.2% print, and the MPC noted inflation expectations have continued to “moderate” in the short term. The BoE referenced U.K. GDP growing “more strongly than expected” in the first half of the year, but forecasts indicate a slowing in the second half. Progress

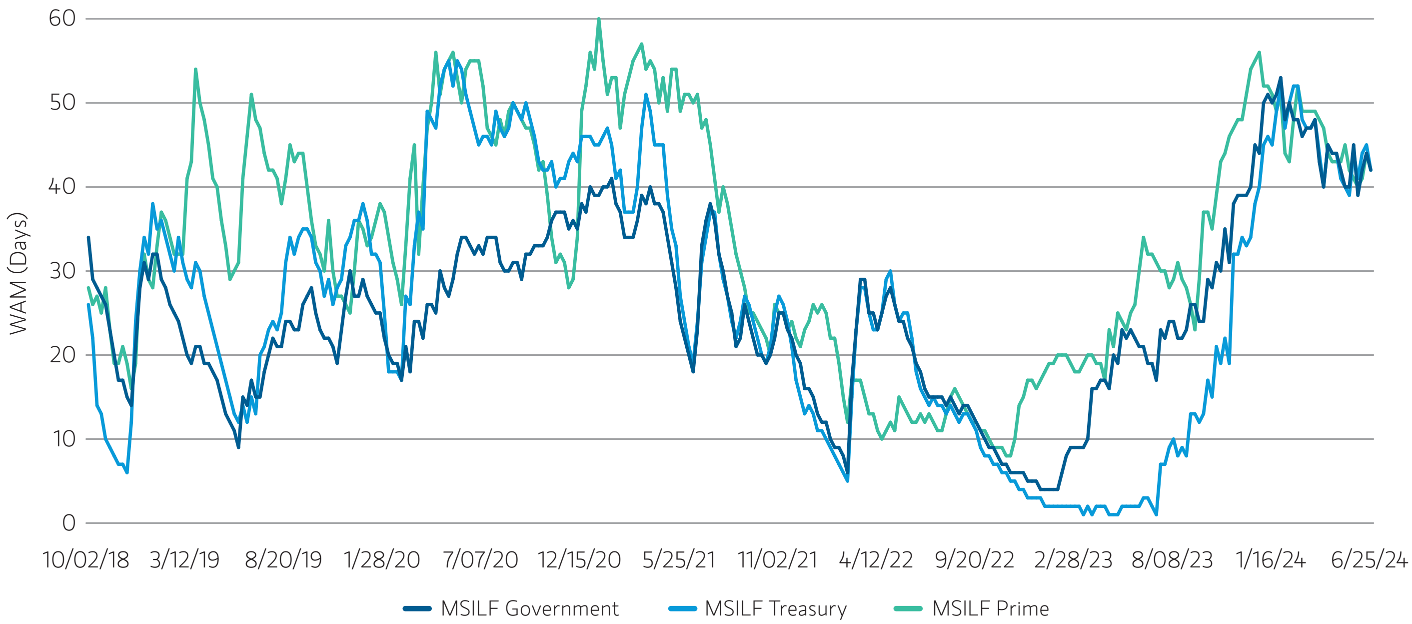
[1] Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of June 30, 2024 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 6/30/2024



Source: iMoneyNet

has been made on the back of restrictive policy, although BoE members suggested further evidence is needed. The committee remains attentive to incoming data and is prepared to adjust policy "as warranted" to ensure inflation returns sustainably to its 2% target.

Portfolio Strategy

GOVERNMENT/TREASURY STRATEGY

In June, weighted average maturity (WAM) and weighted average life (WAL) figures fell slightly month-over-month in the portfolios, as we continue to barbell a conservative approach to floating rate securities along with the laddering in of longer-dated, fixed-rate bonds at attractive yields. Specifically, as June maintained a signal of patience from the Fed, the 1-year end of the yield curve remained attractive, and less punitive from a carry standpoint than it had been earlier in the year. We feel these positions offer attractive value once the Fed starts to cut interest rates, with the added benefit of potentially outperforming if we see a deeper rate-cutting cycle.

Similar to last month, we believe the portfolios must harvest the current carry of elevated rates, but not be overly exposed to long-dated, floating-rate securities given the likelihood of Fed cuts within the next year. We remain deliberate on the floating-rate exposure we own and prefer secured overnight financing rate (SOFR) floating-rate securities overall. We believe that when/if data turns, it will turn quickly, and attractive fixed-rate options will likely disappear. Therefore, we have incrementally bought into fixed-rate positions. As the month progressed, there were more signs of the economy and labor market beginning to cool. The Fed, however, was quick to reassure the market that patience is warranted before cutting rates.

Treasury and agency auctions have been orderly. Auction sizes in the shortest tenors started to increase toward the end of June. We expect further increases in July. We see no

[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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reason to have concerns or issues with respect to Treasury bill liquidity.

PRIME STRATEGY[3]

While data over the past month continues to show progress towards the Fed's inflation objectives, officials reiterate that they will remain patient and data dependent before easing policy rates. With the Fed likely on the sidelines for the next couple months, rates remain at elevated levels and the futures curve appears to be priced appropriately with one full rate cut by the November FOMC meeting and fewer than two cuts for the remainder of the year. With unconstrained dealer balance sheets and no supply or credit shocks taking place, spreads remain tight in the wholesale funding market. We continue to prefer fixed-rate over floating-rate (or "floaters") securities, bypassing the higher current yield of floaters to lock in coupons through mid-2025, which can benefit the portfolio when the Fed eventually eases rates. WAM continues to remain elevated versus the peer group due to increased exposure to fixed-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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