Morgan Stanley

INVESTMENT MANAGEMENT

Money Market Funds

2025 Outlook

OUTLOOK | GLOBAL LIQUIDITY | 2025

AUTHOR

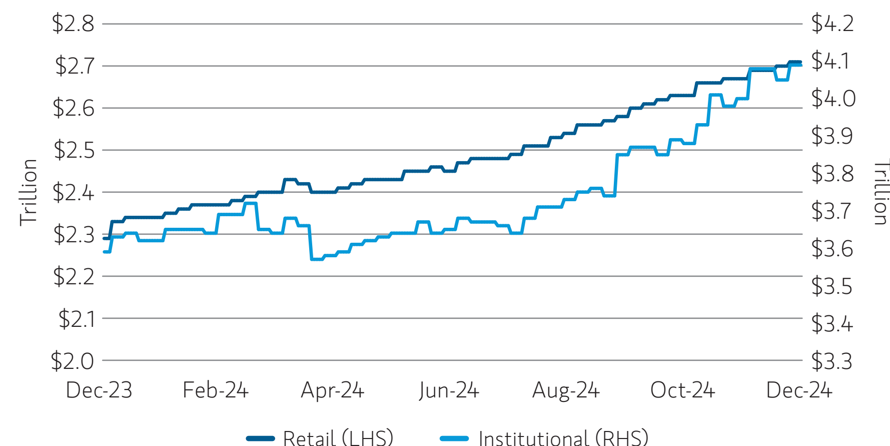
GLOBAL LIQUIDITY TEAM

Money market funds (MMFs) defied prognosticators in 2024 as strong inflows, attractive interest rates and shifting winds created opportunities and obstacles for the industry. While the year began with expectations that investors might allocate away from MMFs into other asset classes, an inverted yield curve, economic uncertainty and enhanced awareness of the product features led to increased demand. In the U.S., MMF assets reached $7 trillion as both retail and institutional investors helped drive growth forward. Retail MMFs took center stage in the first half of the year as attractive yields, relative to alternatives, became more appealing to investors. In the second half of the year, government funds led the march higher in industry assets under management (AUM) as regulatory changes and shifting deposit betas led to increased demand.

DISPLAY 1

Institutional and Retail Money Market Fund Assets

Data as of December 31, 2024



Source: Bloomberg, ICI

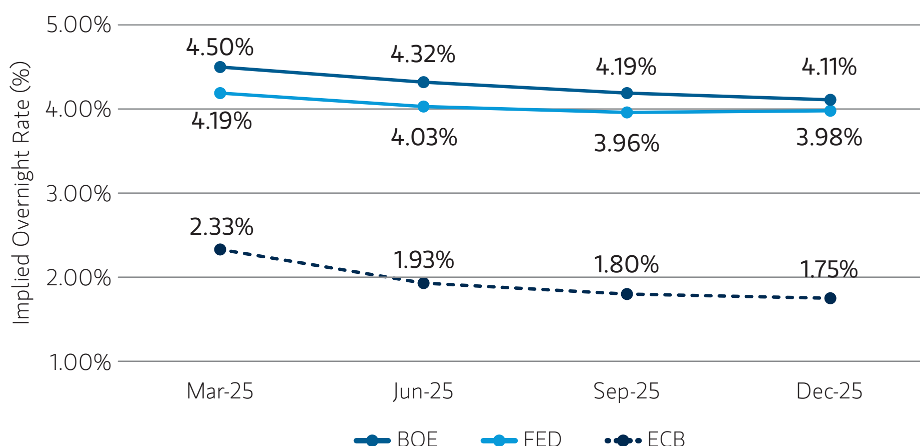
In the United States, Donald Trump's reelection set expectations for renewed fiscal expansion, deregulation, dollar strength and supply-side policies. In the U.K., economic stagflation dominated political discussions, as the Conservative Party confronted weak growth and a more fragmented electorate in the face of upcoming elections.

Following a period of aggressive tightening in 2022-23, most central banks shifted toward a slightly dovish stance in 2024 as softening inflationary pressures and expectations of slowing economic growth shaped monetary policy decisions. The U.S. economy showed mixed signals throughout last year with views vacillating between whether the Federal Reserve (Fed) would engineer a hard or soft landing. As we move into 2025, uncertainty remains as investors seek clarity on how changing fiscal policies will influence economies and the path central bankers will follow.

DISPLAY 2

Market Expectations for Implied Overnight Bank Rates

Data as of December 31, 2024



Source: Bloomberg

The Federal Reserve

Fed Chairman Powell conveyed a cautious tone during his December Federal Open Market Committee (FOMC) press meeting, as lingering inflationary pressures and the possible risk of its resurgence under the Trump administration could skew the direction towards fewer rate cuts. While the markets remain focused on Trump's policy changes, namely tariffs, taxes, immigration and regulation, the sequencing and severity of these changes is less certain. Morgan Stanley's economic strategists believe that while announcements have been made relatively fast, the actual implementation will be slower due to practical and political constraints. The fast announcement/slow implementation tactic is likely to benefit risk assets in the first half of the year, but could become a headwind in the second half as implementation leads to higher volatility, one potential tailwind for MMFs.

Expected economic headwinds this year include the recurring debt ceiling debate and the potential political jockeying that comes with discussions about budgetary priorities, spending cuts and fiscal policy. While a bill was passed to fund the government through January 15, 2025, and to suspend the debt ceiling until February 7, investors will need to weigh any uncertainty that may arise. As in prior instances, market participants will draw their attention to the "X-Date"[1] and the possibility of treasury defaults once extraordinary measures and borrowing capacity is exhausted.

Potential effects on short-term treasury valuations and supply and demand factors will also be tangentially impacted from a debt ceiling impasse. Prolonged negotiations surrounding the ceiling could limit the issuance of new treasury bills in the first half of the year, requiring investors to assess the relative attractiveness of alternatives. Treasury bills nearest the "X-Date" may experience greater price volatility as investors demand compensation from the possible technical default risk. Additionally, demand for other treasury bills may increase as investor favor treasuries with a lower likelihood of falling near the "X-Date."

The FOMC's December forecast now predicts slower growth and firmer inflation after some participants included trade and immigration policy assumptions into their baseline forecasts. This was somewhat surprising after Powell's comments at his prior meeting, suggesting the committee would not speculate regarding policy changes. Monetary policy is less restrictive today, however, there is still room for future rate cuts as the FOMC now anticipates two rate cuts in 2025, half its prior estimate of four. We believe the Fed will take a careful approach to monetary policy decisions, ultimately lowering rates gradually until more clarity is gleaned on the economy, employment and full impact of prior easing.

[1] "X-Date": The date when the U.S. government hits the debt limit and could technically default on its debt payments and/or other payment obligations.

European Central Bank

With inflation pressures now receding, the ECB began the process of removing the restrictiveness of monetary policy gradually through 2024, reducing its key deposit rate 100 basis points (bps) from 4% to 3%. However, indicators around growth suggest a weakening of the wider Eurozone economy, coupled with the threat of increased trade frictions due to the threat of increased tariffs by the new U.S. administration. As such, the ECB now appears to be willing to cut rates at every meeting to quicken the pace of reaching a neutral rate, which is expected to be around 2%. If growth worries continue, a number of ECB Governing Council members have suggested that interest rates may be cut below neutral, a more accommodative position in order to support Eurozone growth. Markets however are currently only pricing in four consecutive 25 bp cuts, reaching the target neutral rate of 2% by June 2025. But risks around this path are mainly for more cuts than are priced in currently.

Bank of England

Views on the Monetary Policy Committee (MPC) have continued to be split on the risks around persistent inflation and the potential for a sharp growth shock by leaving interest rates at a restrictive level for too long. While MPC members have reduced interest rates from their peak of 5.25% to 4.75% over the last two quarters, markets remain unconvinced that the pace of these reductions will be maintained, particularly after the new Labor government's first budget, which includes potential short-term inflationary impacts. With services inflation still printing uncomfortably high for many MPC members, and labor market data suggesting upticks in wage growth towards around end of the year, the market has only two 25 bp cuts fully priced for 2025. This would still leave interest rates firmly in restrictive territory by the end of 2025. While the December 2024 MPC vote was a slightly more dovish split than markets anticipated, it suggests that there are risks that we see a larger number of cuts though the year, particularly if labor market wage data is proven to be a one-off, and inflationary pressures continue to subside.

The path for inflation and forward-looking inflationary expectations will remain a key risk and remain forefront for central bankers in the coming year. Given the interconnectedness of developed market economies, any divergence in inflation prints could prompt other central banks to alter monetary policy plans. This risk bears observing, particularly as populist fiscal policies are implemented which may lead to higher inflation and might force central banks to implement policies to maintain currency stability and capital flight prevention.

Last year, general sentiment across Wall Street expected sharper and faster rate cuts through 2024, the possibility of an economic rebound was associated with U and V shapes, and wishful optimism ran afire. As we reconcile the events of 2024 and look ahead at 2025, we are optimistic on the attractiveness of cash and the role MMFs provide for investors.

The views and opinions and/or analysis expressed are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively the Firm") or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors or investment team. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific strategy or product the Firm offers. Future results may differ significantly depending on factors such as changes in securities or financial markets or general economic conditions. This material has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information and the Firm has not sought to independently verify information taken from public and third-party sources.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Charts and graphs provided herein are for illustrative purposes only. **Past performance is no guarantee of future results.**

The indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

This material is not a product of Morgan Stanley's Research Department and should not be regarded as a research material or a recommendation.

Current and future portfolio holdings are subject to change. The forecasts in this piece are not necessarily those of Morgan Stanley, and may not actually come to pass. morganstanley.com/liquidity

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

Please consider the investment objectives, risks, charges and expenses of the portfolios carefully before investing. The prospectus contains this and other information about the portfolios. To obtain a prospectus, download one at www.morganstanley.com/liquidity or call 1.800.236.0992. Please read the prospectus carefully before investing.

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events.

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

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.

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.

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

NOT FDIC INSURED. OFFER NO GUARANTEE. MAY LOSE VALUE NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY. NOT A BANK DEPOSIT.

morganstanley.com/im

© 2025 Morgan Stanley. All rights reserved.

RO 4212366 Exp. 02/29/2026 25Q10182_KC_0125 LTR