Morgan Stanley
INVESTMENT MANAGEMENT

Wading Waters

MARKET INSIGHTS | GLOBAL LIQUIDITY TEAM | December 2024

Federal Reserve Board[1]

In December, the Federal Open Market Committee (FOMC) lowered the federal funds target rate by 25 basis points to a targeted range of 4.25% to 4.50%. This is the Federal Reserve's (Fed) third consecutive interest rate cut this year. The press release remained relatively unchanged from last month, noting that "inflation has made progress" toward the 2% target while acknowledging that "labor market conditions have generally eased." The committee highlighted that inflation and unemployment risks are roughly in balance.

The Summary of Economic Projections (SEP) shifted to only two cuts next year instead of four, with inflation not reaching the 2.0% target until 2027. The Fed's dot plot showed officials' median projection for the benchmark rate at the end of 2024 remained unchanged from their September projection at 4.4%. The 2024 median gross domestic product (GDP) growth projection increased 50 basis points to 2.5% while the 2025 forecasts increased marginally to 2.1%. The 2024 unemployment rate estimate decreased 20 basis points to 4.2% from 4.4% in September. The 2024 core personal consumption expenditure (PCE) projections increased 20 basis points to 2.8%.

DISPLAY 1
Monthly Interest Rate Summary
As of 12/31/2024

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)	PRIOR MONTH
1M UST	4.27	(0.34)	4.61
3M UST	4.31	(0.17)	4.49
6M UST	4.27	(0.17)	4.44
12M UST	4.14	(0.14)	4.28
2Y UST	4.24	0.09	4.15
5Y UST	4.38	0.33	4.05
10Y UST	4.57	0.40	4.17
30Y UST	4.78	0.42	4.36

Source: Bloomberg

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 December. The ECB credited the cut to the "disinflation process" being "well on track." The ECB removed the reference to the need for restrictive policy from its statement, putting it en route to neutral. On inflation, the forecast of wage growth in 2025-26 was revised down meaningfully (-30 basis points). Most measures of underlying inflation suggest that inflation will settle near 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 6-3 to maintain the Bank Rate at 4.75% at the conclusion of its December meeting. Three members

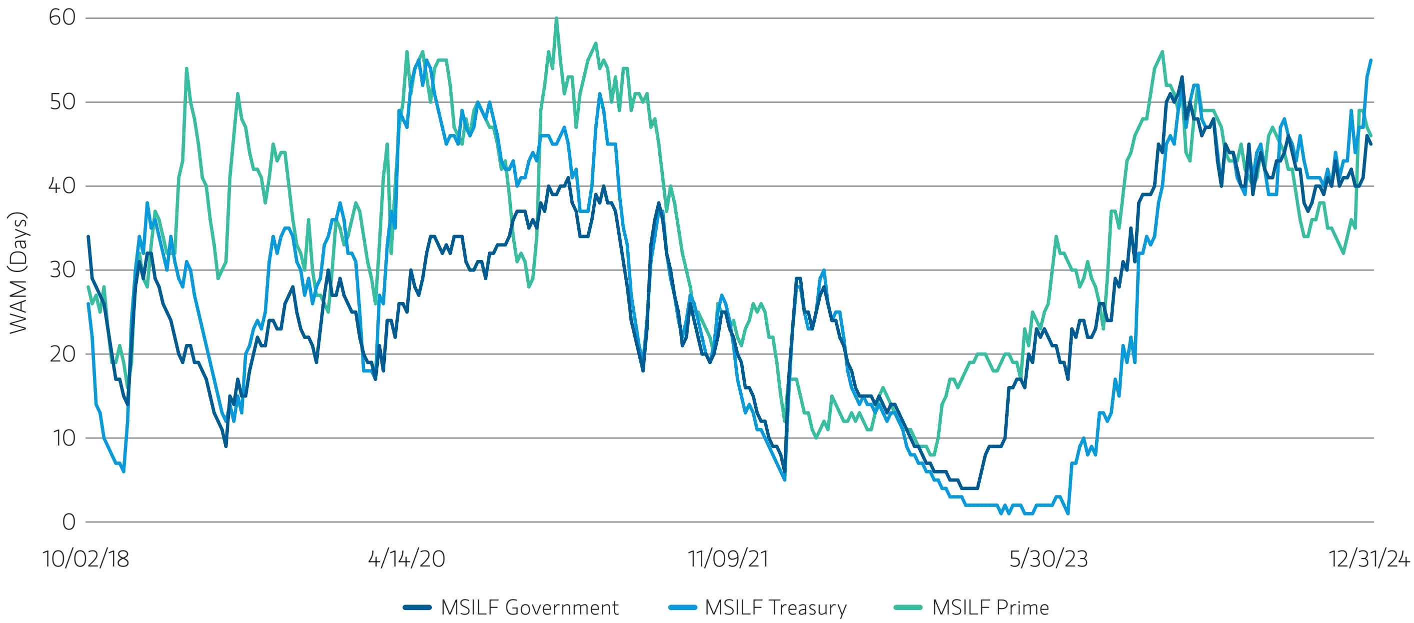
[1] Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of December 31, 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 12/31/2024



Source: iMoneyNet

preferred to reduce the Bank Rate by 0.25 percentage points, to 4.5%. The BoE has adopted a gradual approach in removing policy restraint in the absence of material developments. Since the MPC's previous meeting, 12-month consumer price index inflation increased to 2.6% in November from 1.7% in September. The committee remains cautious in determining the appropriate degree of monetary easing.

Portfolio Strategy

GOVERNMENT/TREASURY STRATEGY

Both the weighted average maturity (WAM) and weighed average life (WAL) of the Funds extended throughout the month as we continued to opportunistically lock in both fixed- and floating-rate securities on the back of the recent sell-off in rates. We believe adding fixed-rate exposure further out the curve is an attractive proposition given the minimal concession to overnight funding levels, which wasn't the case only a few months ago. In the floating-rate space, a slower pace of expected rate cuts in 2025 caused us to upsize our exposure to Treasury floating-rate notes, while tailwinds for SOFR (secured overnight financing rate)—including active funding markets and year-end pressure—caused us to also add SOFR-based exposure.

As the FOMC has formally acknowledged that its mandates of labor and inflation are now closer in alignment, the focus has moved to reducing the outright level of restrictiveness that its policy rate currently places on the economy. The Fed has now delivered 100 basis points of rate cuts, and we expect the Fed to become a bit more patient and deliberate with cuts in 2025, but still believe there is room to cut rates back closer to neutral. Market pricing anticipating less than two full rate cuts through 2025 seems reasonable, in our view.

Despite year-end pressures, auction results in the Treasury market were quite orderly and provided some attractive entry points for our Funds near year-end. Looking forward in 2025, the path of the debt ceiling will be paramount. Specifically, should the debt ceiling issue not be resolved promptly by the new administration, there will likely be a need for Treasury bill supply to be cut substantially heading into the middle of the year, before ramping back up quickly after any resolution/changes are made. Currently we have no concerns or issues to raise with respect to T-bill liquidity.

[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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PRIME STRATEGY[3]

Both the WAM and WAL of the Funds extended throughout the month as we continued to opportunistically lock in both fixed- and floating-rate securities on the back of the recent sell-off in rates and the technical spread widening that occurred on the front end of the curve. We believe adding fixed-rate exposure further out the curve is an attractive proposition given the positive carry compared to overnight funding levels, which wasn't the case only a few months ago.

Credit spreads in the money market space widened materially throughout the final month of the year due to various known technical factors. On the back of the widening, we find value across the curve in both fixed- and floating-rate formats, but this opportunity will likely remain short-lived as spreads tend to tighten back to a more normalized level once we pass the year-end turn.

From a liquidity standpoint, we note that dealer balance sheets have become constrained heading into year-end, but we anticipate that trend reversing next month.

[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%

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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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