Morgan Stanley

INVESTMENT MANAGEMENT

# Tidal Shifts

**MARKET INSIGHTS** | GLOBAL LIQUIDITY TEAM | September 2024

## Federal Reserve Board[1]

In September, the Federal Open Market Committee (FOMC) lowered the federal funds target rate by 50 basis points to a targeted range of 4.75% to 5%. This is the first time in four years that the Federal Reserve (Fed) has cut interest rates. The press release took a tone of cautious optimism, noting the progress made on lowering inflation while acknowledging that the "unemployment rate has moved up." The committee highlighted that inflation and unemployment risks are roughly in balance.

The September 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 decreased 70 basis points from their June projection to 4.4%. The 2024 median gross domestic product (GDP) growth projection decreased 10 basis points to 2.0% while 2025 forecasts remained unchanged at 2.0%. The 2024 unemployment rate estimate increased to 4.4% from 4.0% in June. The 2024 core Personal Consumption Expenditure (PCE) projections decreased 30 basis points to 2.3%.

DISPLAY 1

**Monthly Interest Rate Summary**

*As of 9/30/2024*

| US TREASURY RATES | YIELD (%) | MOM CHANGE (%) |
|---|---|---|
| 1M UST | 4.81 | (0.55) |
| 3M UST | 4.62 | (0.67) |
| 6M UST | 4.40 | (0.68) |
| 12M UST | 4.00 | (0.74) |
| 2Y UST | 3.64 | (0.62) |
| 5Y UST | 3.56 | (0.35) |
| 10Y UST | 3.78 | (0.25) |
| 30Y UST | 4.12 | (0.18) |

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 September. The ECB credited the cut to the "dynamics of underlying inflation and the strength of monetary policy." The Governing Council noted the inflationary impact of high wage growth was buffered by profits while financing conditions remain restrictive. Inflation forecasts were revised slightly lower considering a weaker contribution from domestic demand. 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[1]

The Bank of England (BoE) Monetary Policy Committee (MPC) voted 8-1 to maintain the Bank Rate at 5%. The one dissenting member voted to reduce the Bank Rate by 0.25 percentage points, to 4.75%. The BoE has adopted a gradual approach in removing policy restraint in the absence of material developments. The MPC forecasts inflation to rise to 2.5% near the end of the year as declines in energy

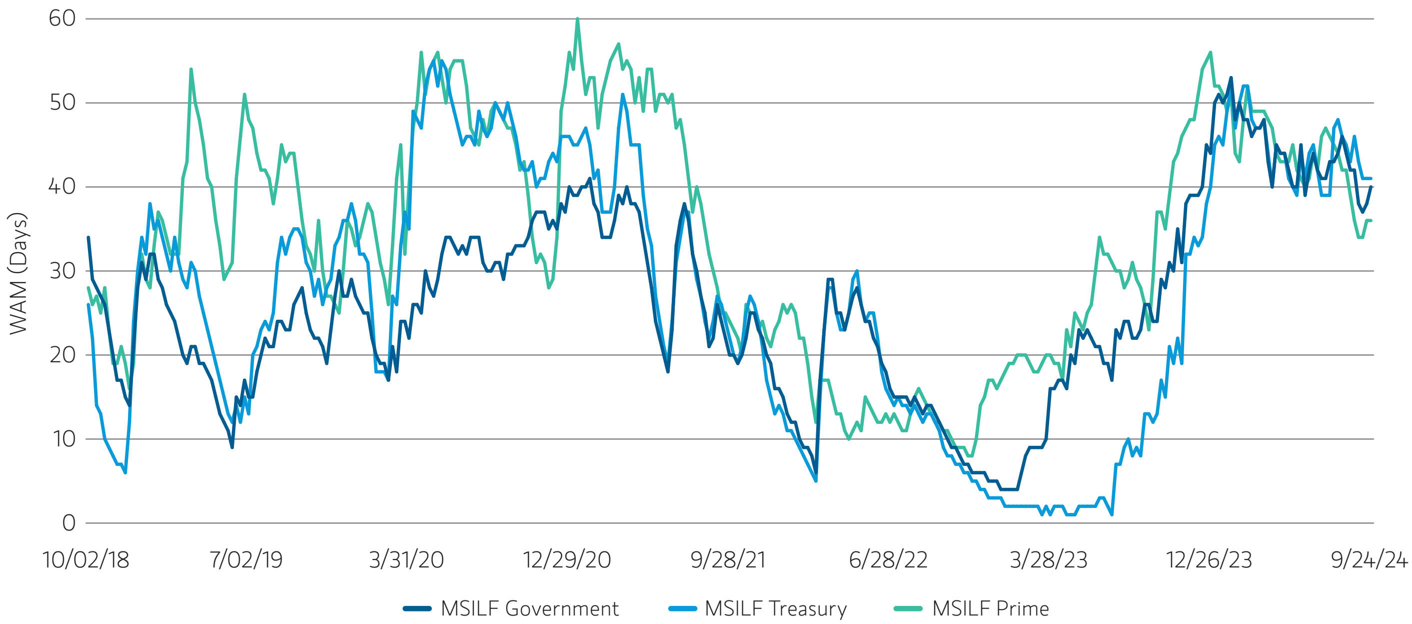
[1] Source: Bloomberg.

The views and opinions expressed are those of the Portfolio Management team as of September 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 9/30/2024*




Source: iMoneyNet

prices last year fall out of the annual comparison. Despite progress toward the 2% target for inflation, the committee remains cautious in determining the appropriate degree of monetary easing.

## Portfolio Strategy

### GOVERNMENT/TREASURY STRATEGY

Building on our themes from August, we continued to pivot our portfolio to lock in longer-term fixed-rate securities where appropriate. Specifically, we added fixed-rate Treasury and repo securities in 6-month to 1-year terms.

As the FOMC has formally acknowledged that its dual mandates of labor and Inflation are now closer in alignment, the focus has moved to reducing the outright level of restrictiveness that the Fed policy rate currently places on the economy. Additionally, committee members have indicated that they are pleased with progress on inflation so far, but the job is not done. This means, moving forward, the Fed will be extremely data dependent, but with seemingly slightly more weight put on the labor side of the equation. We continue to like extending duration when market sell-offs occur.

Treasury and agency auctions have been orderly. Treasury bill supply began to modestly increase toward the end of September, with the largest increases in bills of shorter tenors. We have no concerns or issues to raise with respect to T-bill liquidity.

The Fed has initiated its rate-cutting cycle, and the market continues to contend with the upcoming presidential election. Funding markets perked up for September month-end, providing attractive opportunities in the overnight markets for lending cash. We expect settlement dates and month/quarter-end dates to continue to be volatile in the funding space.

[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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**PRIME STRATEGY[3]**

After extending duration in the earlier part of the third quarter by adding longer-dated fixed-rate securities to the portfolios, we allowed both the weighted average maturity (WAM) and weighted average life (WAL) to organically roll down as the curve was extremely inverted and adding duration became excessively punitive. Corporate bonds continue to trade dislocated and cheap relative to wholesale funding equivalents, providing opportunities to add diversification and yield benefits further out the curve. Overall, we believe fundamentals in the wholesale funding space remain strong. Dealer balance sheets remain unconstrained and excess cash remains in the system, keeping spreads tight.

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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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