

## Money Market Update: Implications of European Sovereign Debt Crisis

JUNE 23, 2011

### Morgan Stanley Investment Management U.S. Institutional Liquidity Funds

#### Market Update

On June 15, 2011, Moody's Investors Service, Inc. placed on review for possible downgrade several ratings of three major French banks: BNP Paribas, Crédit Agricole S.A. and Société Générale. Moody's placed the following ratings on review: financial strength, long-term debt and deposit. The reviews will focus on the banks' exposures to Greek sovereign debt and domestic Greek loans and the possible impact on the banks in the event of a Greek default or restructuring.

Moody's did *not* place the banks' short-term ratings on review. Furthermore, Moody's said that the reviews were "unlikely" to lead to downgrades of more than one notch for BNP Paribas or Crédit Agricole S.A., while Société Générale's ratings might be downgraded by two notches. Moody's action and press commentary have raised some concerns among market participants regarding U.S. money market funds' exposures to European banks.

#### Fund Commentary

##### Overview

Our investment process continues to focus on robust credit research and risk management. Our dedicated credit analysts based in London and New York conduct independent analysis of the money market securities universe. Our money market "approved list" is continually monitored so names may be added or suspended as warranted. Although we follow the rating agencies' views closely, we base our investment decisions on our in-depth analysis.

**Morgan Stanley Investment Management liquidity funds do not have any direct exposures to either sovereign debt or to bank debt in Portugal, Ireland, Italy, Greece or Spain.** We are comfortable with the European banks, French and others, in which we invest based on our analysis of their financial strength and their ability to absorb losses (if any) in the event of a default or restructuring by Greece.

We believe BNP Paribas, Crédit Agricole S.A., and Société Générale are strong financial institutions. They are well-capitalized, profitable and have broadly diversified business models. Based on our analysis these three banks have ample "core capital" and earnings to absorb potential losses in the event of a Greek default (which we consider unlikely).

In addition, the French economy is growing and the three banks' domestic retail operations have performed well. If Moody's reviews did result in downgrades for the three French banks they would still be highly rated based upon Moody's initial comment:

- BNP Paribas, would be rated Aa3 rather than Aa2
- Crédit Agricole S.A would be rated Aa2 rather than Aa1
- Société Générale could be rated A1 rather than Aa2

### U.S. Taxable Money Market Funds

Consistent with our investment philosophy, we continue to manage our portfolios defensively with respect to liquidity and duration.

#### WAM Comparison - MSILF Prime and Money Market vs. iMoneyNet Prime Inst. Fund Category Average

Data from December 31, 2009 through May 31, 2011



Source: iMoneyNet

As of June 17, 2011 our MSILF Prime Portfolio had 62.2% in one-week liquidity with a weighted average maturity (WAM) of 18 days and a weighted average life (WAL) of 39 days . While our MSILF Money Market Portfolio had 57.9% in one-week liquidity with a WAM of 20 days and a WAL of 47 days.

We are sensitive to the changing market conditions and sentiment, and we will continue to take a defensive approach in managing the portfolios. We will continue to monitor the situation closely.

### U.S. Tax-Free Money Market Funds

In our U.S. tax-exempt fund, we have exposure to municipal securities enhanced with either a liquidity demand feature or letter of credit (“LOC”) provided by BNP Paribas and Société Générale.

As part of our investment process, we conduct risk and credit analysis at multiple levels. Morgan Stanley municipal credit analysts draw upon the research of Morgan Stanley credit analysts globally for their ratings, views and approval of the financial institution providing the liquidity demand feature or LOC.

- Morgan Stanley analysts review the legal documentation provided with the liquidity demand feature or LOC to ensure security measures are in place to protect our tax-exempt money market fund in the event either of these features are terminated.
- In the case that the financial institution is downgraded below a certain level, a mandatory tender of the bond would go in to effect.

### **Summary**

At the cornerstone of our liquidity funds complex is an investment process focused on extensive credit research and risk management. In the recent uncertain markets, protecting the safety and liquidity of the portfolio's assets remains our first priority.

Morgan Stanley has managed liquidity solutions since 1975 and is dedicated to offering money funds. The team has \$73.9 billion<sup>1</sup> in assets under management across a variety of money funds and manages money in three currencies, U.S. Dollar, Euro and Sterling.

For information about MSIM's liquidity product offerings and the team's market views, please visit [morganstanley.com/liquidity](http://morganstanley.com/liquidity) or contact:

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There is no assurance that a money market portfolio will achieve its investment objective.

**An investment in a money market portfolio is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the portfolios seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the portfolios. Shareholders should consult their individual tax advisor to determine whether the portfolios' distributions derived from interest on the U.S. Treasury obligations and U.S. Government securities are exempt from state taxation in their own state.**

The Tax-Exempt Portfolio may invest a portion of its total assets in bonds that may subject certain investors to the federal Alternative Minimum Tax (AMT). Investors should consult their tax adviser for further information on tax implications.

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 [morganstanley.com/im](http://morganstanley.com/im) or call 1.800.236.0992. Please read the prospectus carefully before investing.

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<sup>1</sup>As of May 31, 2011.

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MSILF Exposure to BNP Paribas, Société Générale and Crédit Agricole S.A. as of June 23, 2011 (excludes repurchase agreements). Prime Portfolio: BNP 2.64%, Soc Gen: 0.47%, Crédit Ag 2.18%, Money Market Portfolio: BNP 2.41%, Soc Gen: 3.43%, Crédit Ag 2.35%, Tax-Exempt Portfolio: BNP 0.00%, Soc Gen: 0.00%, Crédit Ag 0.00%. The portfolio is actively managed, therefore holdings may not be current. The holdings shown are provided for informational purposes only and should not be deemed as a recommendation to purchase or sell the holdings mentioned. Morgan Stanley is a full-service securities firm engaged in securities trading and brokerage activities, investment banking, research and analysis, financing and financial advisory services.

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