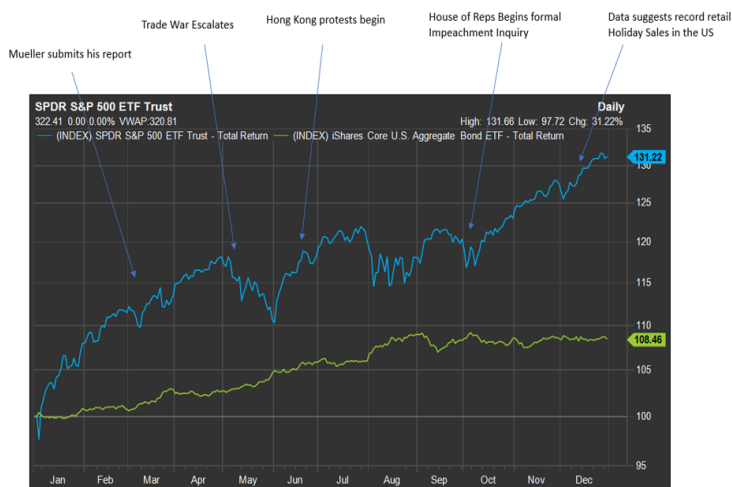


# PCA Market Commentary

January 2020

## 2019 Year In Review

While it seems that almost all asset classes put smiles on investor faces, the path there was neither simple nor straightforward. In hindsight, the collaboration from global monetary policy makers (albeit not entirely in harmony), infused liquidity into economies during a period where geopolitical uncertainty seemed to rule most days. Several positive forces, aligned with investment capital fueled by historically low borrowing cost, tempered the simmering anxiety that was threatening to boil over at certain moments in time.



Within our July commentary, we spoke of relatively positive forces that should help stabilize and potentially buoy markets. Remaining calm and disciplined despite some of the tumult in the third and fourth quarters of 2019, enabled investor portfolios to participate in a strong finish for the year.

However, the Pallas view did not come simply. Thinking back, the conversations within our investment team covered expansive topics that included US debt level, yield curve inversion, Brexit, trade wars, consumer spending, global decline of interest rates, oil volatility, dollar strength, repo markets, political uncertainty, investor risk

behavior, concentration of US equity growth, value/growth dichotomy, inflation/disinflation forces, global slowdown, and the quality vs. dividend paradox.

In our efforts to cut through the noise that characterize the past year, we reached several conclusions that supported a sanguine outlook.

- **US political upheaval** – When we examined the current instability in context of the prior precedents of presidential impeachment, we saw that the underlying fundamentals of the markets (positive or negative) supersede the headlines. In the current period of uncertainty, the fundamental underpinnings of the markets remained positive.
- **US and China stalemate** – Looking beyond the posturing, it was evident that both sides were motivated to calm the situation while maintaining a strong face. Neither country wished to face the prospects of a domestic economic slowdown resulting from a protracted trade war.
- **Monetary policy** – Historically, US policy makers have consistently worked towards stabilizing the economic landscape within presidential election years. This has remained the case regardless of incumbent party.
- **Credit markets and banking** – After examining a multitude of indicators, some in the headlines and some behind the scenes, we felt comfortable that a repeat of the credit crisis in 2008 had low odds of recurring.
- **Corporate profitability** – As indicated throughout several earnings season, corporate health remains strong. While there had been signs of slowdown in some segments of the economy, much of the news has outpaced investor expectations.
- **Consumer health** – The consumer balance sheet remains strong, much of it in response to the fresh memories of the credit crisis nearly a decade ago.

Looking forward into 2020, we are overly optimistic to expect a repeat of the 20%+ returns in equities, 8%+ in the bond markets, and 12%+ in commodities.

This ascent in 2019, while beneficial to investors, has not helped plight of active investment managers. Taking a closer view of the survey conducted by Morningstar, we see that active managers have lost further ground in recent years. While easy to attribute this to declining skills within increasingly efficient markets, we should recall how quickly sentiment (and flows) can dramatically revert, pushing active management to the forefront of conversations and outlining the potential importance of intelligent risk diversification coupled with alpha generation.

We expect that 2020 will draw more headlines for returns diversification, as positive trends begin wavering and investors seek avenues beyond equity, bonds, and credits. It's unlikely that volatility remains near record lows, corporate earnings systematically outpace investor expectations, and passive capital inflows continue unabated. This amplifies the importance of decisions relating to asset allocation, selective use of active management, and sourcing of differentiated alpha in the coming year.

At Pallas Capital Advisors, we are optimistic as we consider what the new year might bring. The global economy remains firmly interwoven despite isolationist rhetoric, technology provides forward progress, and an increasingly louder voice reminds us of our dependence on our planet and our inter-dependence to each other on the world stage.

#### 2019 Asset Class Performance (annualized)

| Asset Type  | Ticker | Name   | 2019 Returns | 5 Yr Returns | 10 Yr Returns |
|-------------|--------|--|--------------|--------------|---------------|
| Bond        | AGG    | iShares Core U.S. Aggregate Bond ETF           | 8.73         | 2.96         | 3.62          |
| Bond        | IEF    | iShares 7-10 Year Treasury Bond ETF            | 8.44         | 2.81         | 4.37          |
| Bond        | VCIT   | Vanguard Intermed-Term Corporate Bond ETF      | 14.46        | 4.65         | 5.78          |
| Bond        | HYG    | iShares iBoxx \$ High Yield Corporate Bond ETF | 14.17        | 4.96         | 6.28          |
| Bond        | TIP    | iShares TIPS Bond ETF                          | 8.43         | 2.54         | 3.20          |
| Bond        | MUB    | iShares National Muni Bond ETF                 | 7.15         | 3.09         | 3.87          |
| Alts        | QAI    | IQ Hedge Multi-Strategy Tracker ETF            | 8.46         | 1.76         | 2.39          |
| Alts        | CPI    | IQ Real Return ETF                             | 7.21         | 1.95         | 1.58          |
| Alts        | MCRO   | IQ Hedge Macro Tracker ETF                     | 8.22         | 1.57         | 0.90          |
| Commodity   | GLD    | SPDR Gold Trust                                | 18.04        | 4.40         | 2.94          |
| Commodity   | DBC    | Invesco DB Commodity Index Tracking Fund       | 12.15        | -2.45        | -4.00         |
| Commodity   | DBO    | Invesco DB Oil Fund                            | 30.34        | -6.77        | -8.75         |
| Currency    | UUP    | Invesco DB US Dollar Index Bullish Fund        | 3.88         | 2.33         | 1.52          |
| Currency    | CEW    | WisdomTree Emerging Currency Strategy Fund     | 5.02         | 0.69         | -0.36         |
| Equity      | SPY    | SPDR S&P 500 ETF Trust                         | 32.37        | 11.34        | 13.33         |
| Equity      | QQQ    | Invesco QQQ Trust                              | 40.13        | 16.39        | 17.69         |
| Equity      | VEA    | Vanguard FTSE Developed Markets ETF            | 22.89        | 6.08         | 5.63          |
| Equity      | VWO    | Vanguard FTSE Emerging Markets ETF             | 20.54        | 5.03         | 3.49          |
| Equity      | EFA    | iShares MSCI EAFE ETF                          | 22.21        | 5.59         | 5.35          |
| Equity      | IWF    | iShares Russell 1000 Growth ETF                | 37.29        | 14.20        | 14.88         |
| Equity      | IWD    | iShares Russell 1000 Value ETF                 | 27.24        | 7.86         | 11.50         |
| Equity      | VYM    | Vanguard High Dividend Yield Index ETF         | 25.15        | 9.53         | 12.75         |
| Real Estate | VNQ    | Vanguard Real Estate ETF                       | 29.22        | 6.80         | 11.75         |
| Real Estate | IYR    | iShares U.S. Real Estate ETF                   | 28.58        | 7.51         | 11.21         |
| Real Estate | RWR    | SPDR Dow Jones REIT ETF                        | 23.06        | 5.77         | 11.10         |

Source: Pallas Capital Advisors, Factset

#### Active Fund Success Rate (June 28, 2019)

| Category                     | 1-Year | 3-Year | 5-Year | 10-Year | 15-Year | 20-Year | 10-Year (Lowest Cost) | 10-Year (Highest Cost) |
|------------------------------|--------|--------|--------|---------|---------|---------|-----------------------|------------------------|
| U.S. Large Blend             | 32.3   | 29.0   | 13.6   | 8.0     | 14.5    | 18.0    | 18.7                  | 1.1                    |
| U.S. Large Value             | 34.4   | 33.3   | 15.9   | 7.0     | 20.4    | 12.1    | 18.8                  | 1.4                    |
| U.S. Large Growth            | 54.3   | 38.8   | 30.5   | 8.0     | 12.0    | —       | 14.6                  | 3.1                    |
| U.S. Mid Blend               | 46.3   | 26.5   | 14.3   | 7.7     | 8.1     | 11.6    | 13.8                  | 0.0                    |
| U.S. Mid Value               | 32.0   | 33.3   | 23.8   | 11.6    | 26.9    | —       | 16.0                  | 4.2                    |
| U.S. Mid Growth              | 79.1   | 59.5   | 54.0   | 29.8    | 26.9    | —       | 40.4                  | 24.0                   |
| U.S. Small Blend             | 45.3   | 29.3   | 26.0   | 22.1    | 19.3    | 34.0    | 39.5                  | 18.9                   |
| U.S. Small Value             | 45.1   | 44.8   | 39.3   | 39.5    | 25.7    | —       | 47.8                  | 21.7                   |
| U.S. Small Growth            | 75.8   | 61.3   | 52.8   | 35.2    | 26.3    | —       | 38.3                  | 23.4                   |
| Foreign Large Blend          | 29.8   | 29.7   | 32.6   | 32.3    | 31.2    | 37.1    | 34.2                  | 16.7                   |
| Foreign Large Value          | 8.5    | 23.4   | 44.1   | 32.6    | —       | —       | 36.8                  | 15.8                   |
| Foreign Small-Mid Blend      | 34.5   | 21.4   | 24.0   | 82.4    | —       | —       | 100.0                 | 100.0                  |
| World Large Stock            | 55.2   | 46.6   | 33.7   | 31.8    | 28.7    | —       | 41.2                  | 17.6                   |
| Diversified Emerging Markets | 33.9   | 43.4   | 55.8   | 49.0    | —       | —       | 66.7                  | 28.6                   |
| Europe Stock                 | 20.8   | 13.6   | 23.8   | 48.1    | 34.2    | —       | 83.3                  | 33.3                   |
| U.S. Real Estate             | 56.9   | 31.9   | 38.8   | 35.1    | 32.8    | 27.1    | 53.3                  | 26.7                   |
| Global Real Estate           | 76.4   | 19.7   | 51.9   | 38.6    | —       | —       | 33.3                  | 11.1                   |
| Intermediate Core Bond       | 26.8   | 52.6   | 34.9   | 31.3    | 16.6    | 9.5     | 44.4                  | 17.1                   |
| Corporate Bond               | 13.2   | 68.8   | 57.8   | 61.5    | —       | —       | 83.3                  | 60.0                   |
| High Yield Bond              | 37.7   | 57.7   | 43.1   | 57.4    | —       | —       | 67.9                  | 51.9                   |

Source: Morningstar

**May you all find peace and prosperity in the new year!**

The information contained herein is for informational purposes only, is not personalized investment advice and should not be construed as a recommendation to purchase or sell any particular security, sector or strategy to any individual person or entity.

The decision to review or consider the purchase or sell of any security, sector or strategy mentioned should not be undertaken without consideration of your personal financial information, investment objectives and risk tolerance with your financial professional.

Past performance should not be considered as an indicator of future results.

Securities offered through Triad Advisors, LLC. Member FINRA/SIPC.

Investment advice offered through Goss Advisors, a registered investment adviser. Goss Advisors and Pallas Capital Partners are separate entities from Triad Advisors, LLC.