PCA Monthly Commentary

December 2021

'Tis the Season for Tax-Loss Harvesting

Calendar year-end is the perfect time to mine client portfolios for tax-loss opportunities to reduce 2021's tax bill. In the broader economy, November 2021 brought mixed capital markets results as the Omicron coronavirus variant emerged, and the Federal Reserve moved to a more hawkish tone. Macroeconomic data signaled more short-term inflationary pressures. Equity markets generally fell, led down by international and small-cap stocks with EAFE -4.7%, Emerging Markets -4.1%, Russell 2000 -4.2%, S&P 500 -0.7%, and NASDAQ up marginally +0.3%. Fixed income performance was mixed with investment-grade up, Bloomberg Barclays US Aggregate +0.3%, and US high yield down -0.9%. Cyclical commodities sold off with WTI crude oil plunging -20.8% on the month.

PALLAS CAPITAL ADVISORS TAX-LOSS HARVESTING PROCESS

Tax-loss harvesting typically occurs at the end of the year to help mitigate the coming tax bill due early in the next year. Pallas Capital sells securities at loss and replaces them with reasonably similar assets so that clients maintain their portfolio's asset allocation and expected risk and return levels while realizing the loss at the same time. Many clients are aware that the security sold cannot be bought back for 30 days. If the security is repurchased within 30 days, a wash sale is created, nullifying the deductibility of the loss. Many clients are also unaware that one cannot buy a security 30 days before the sale, or else a wash sale is created. One important detail to note is that if the stock is sold at a loss in a taxable account, that stock cannot be purchased in the client's IRA for 30 days either, as the wash sale rule still applies.

Pallas sets ourselves apart on the implementation front. Some advisors may only find positions that are fully at a loss, and sell that full position for tax-loss harvesting. Pallas, on the other hand, has the technology to drill down to the individual lots to find losses even if the position as a whole is at a gain. This process ensures that we maximize potential tax loss opportunities, bringing greater value to our clients. We then systematically swap the positions at a loss with the identified replacements. Pallas trading technology then helps us ensure over the next 30 days that no wash sales are created across the accounts.

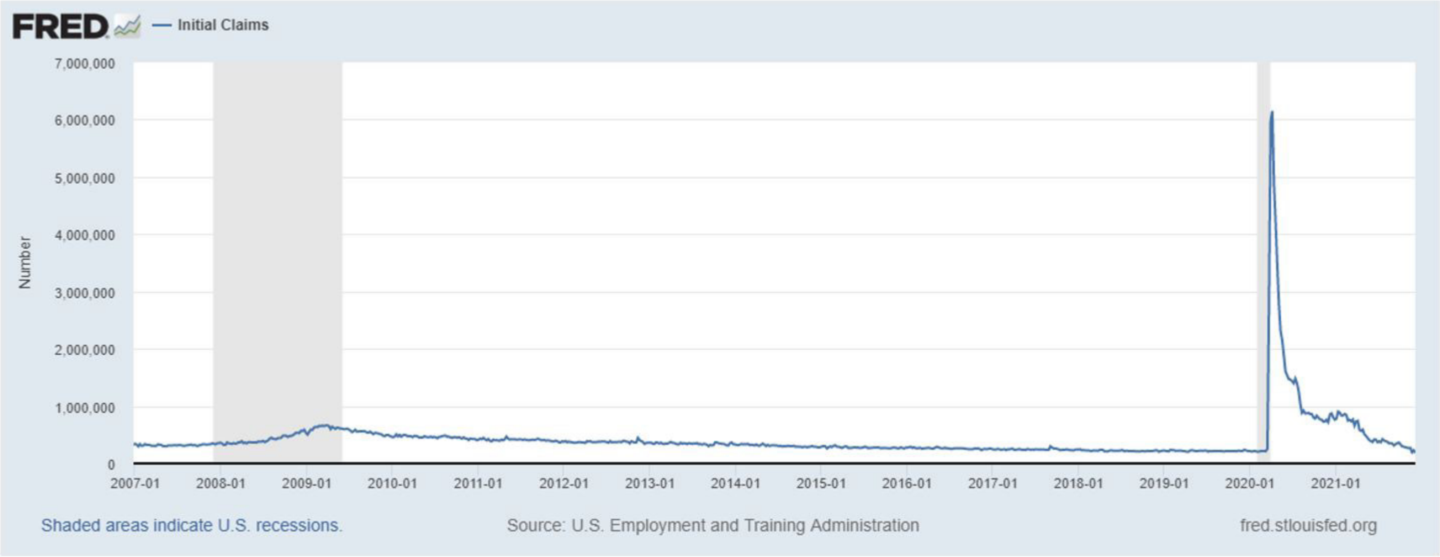
OMICRON, THE FEDERAL RESERVE, AND INFLATIONARY DATA

The Friday after Thanksgiving brought news of a new coronavirus variant – Omicron – discovered in South Africa. Markets reacted very negatively at first with equity markets selling off. As the scientific community studied this variant, the conclusion appears to be that Omicron may be more contagious but less virulent than other variants. Bloomberg noted that South Africa's hospitals not being overwhelmed despite approximately 20,000 new cases a day supports the thesis that Omicron cases may be generally mild. Equity markets rebounded following the initial sell-off as the risk from Omicron appears to be no greater than current expectations for society moving forward with coronavirus.

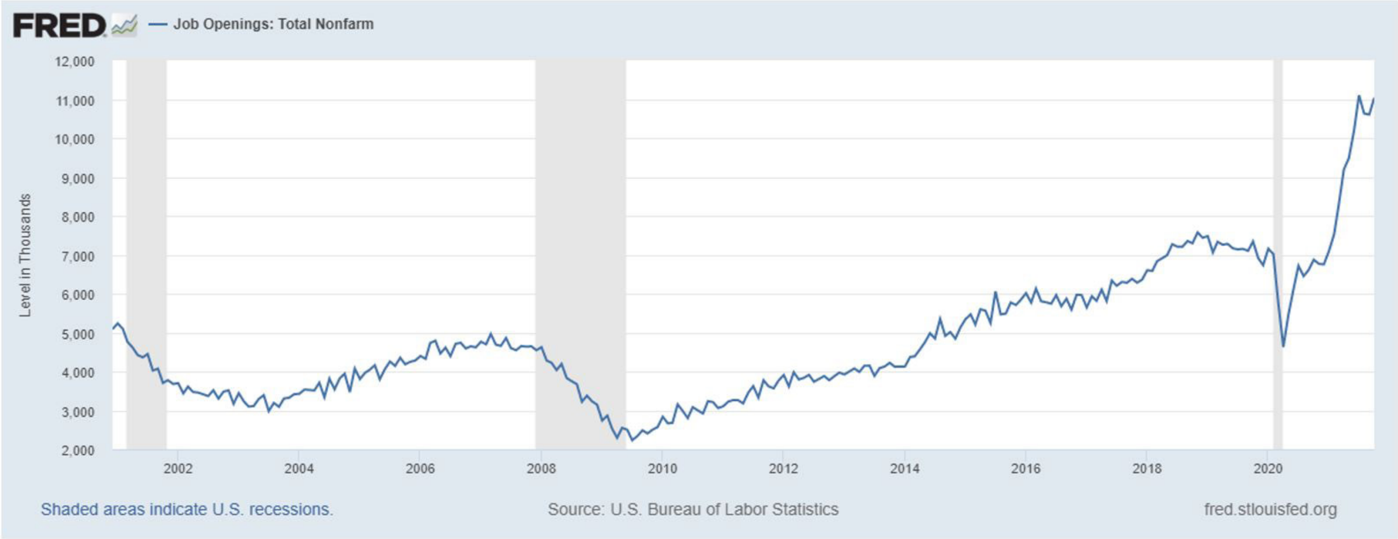
Around the same time as Omicron emerged, Federal Reserve Chairman, Jerome Powell, signaled that he expects policymakers to discuss accelerating the timetable for the tapering of monthly bond purchases. Per CNBC, the central bank could step up the removal of its efforts to boost the economy as it battles escalating inflation pressures. In an appearance before a Senate committee, the Fed chief said he thinks reducing the pace of monthly bond buys can move more quickly than the $15 billion-a-month schedule announced earlier this month. "At this point, the economy is very strong and inflationary pressures are higher, and it is therefore appropriate in my view to consider wrapping up the taper of our asset purchases, which we actually announced at the November meeting, perhaps a few months sooner," he said. "I expect that we will discuss that at our upcoming meeting."

INFLATION RUNNING HOT

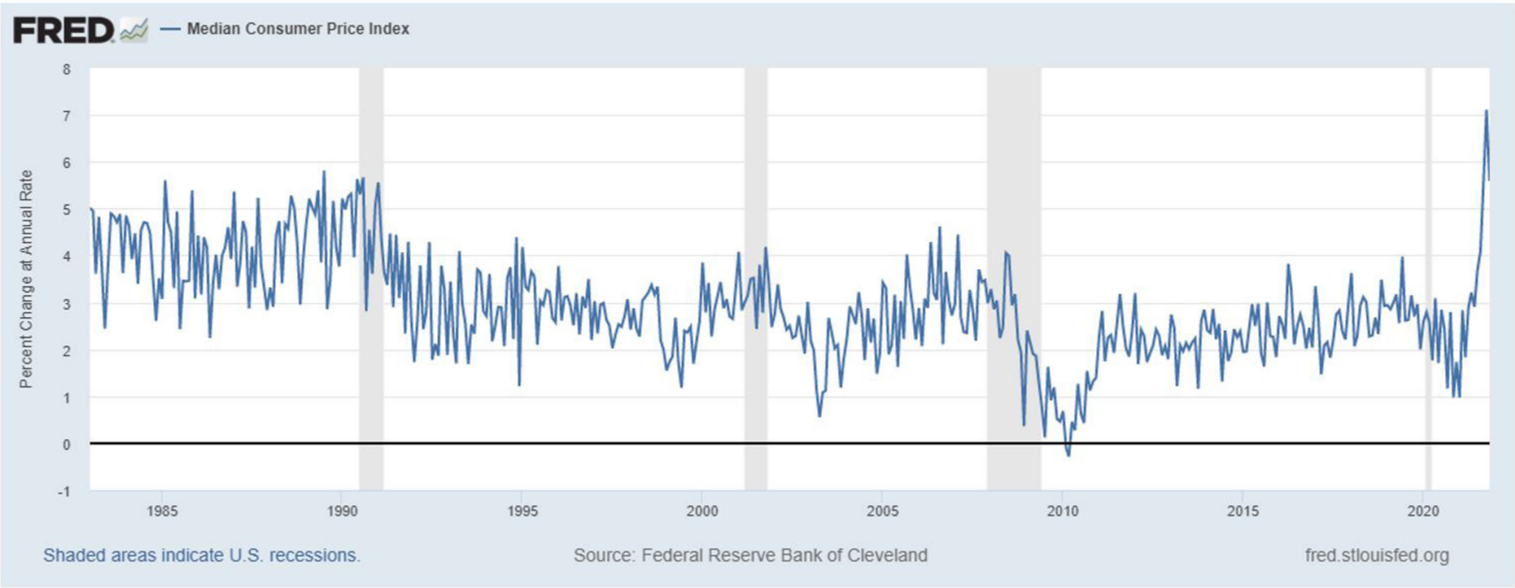
Some of the data points signaling near-term inflationary pressures include initial jobless claims coming in at 184,000 last week, a new pandemic low, and actually lower than the pre-pandemic run rate which was in the low 200,000's.



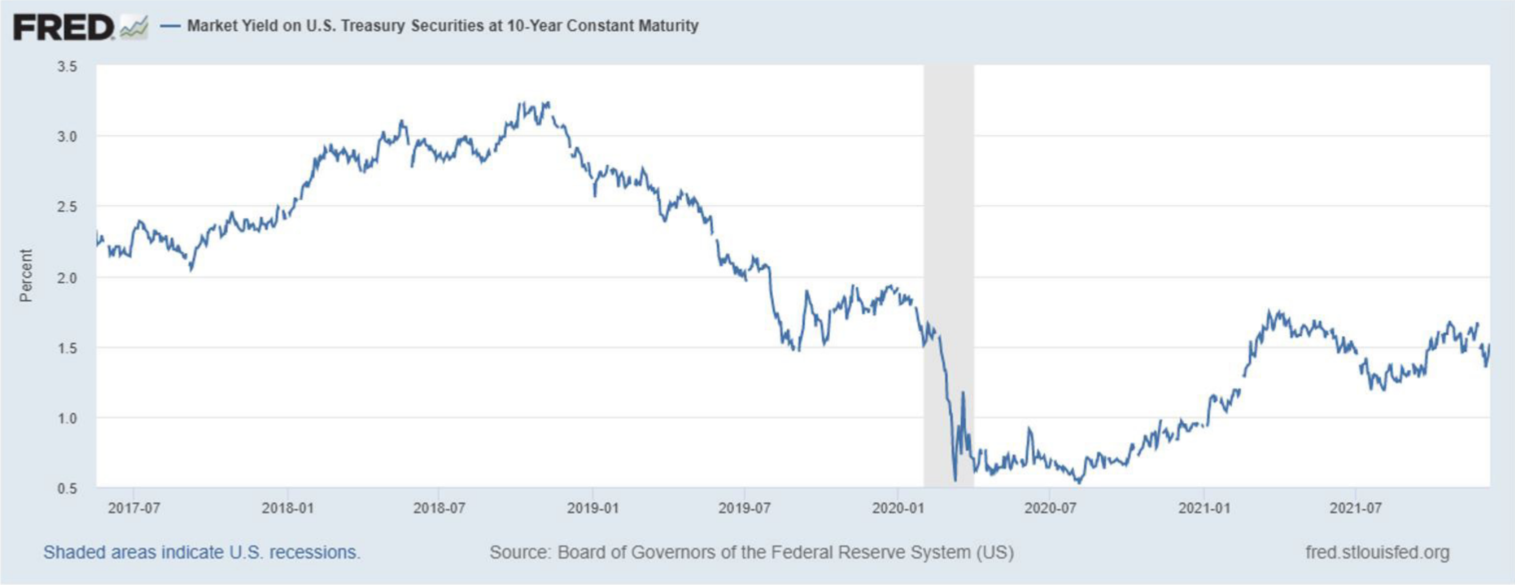
Total job openings have remained stubbornly high, exceeding 11 million on the JOLTS report. The coronavirus appears to be impacting people's willingness and ability to return to work in terms of fear of the virus and the need for childcare services for working parents.



The direct inflation measures like November CPI are generally in line with expectations, but reaching the highest annualized rate in 40 years. Per Factset, November headline CPI of 0.8% was above consensus estimates of 0.7%, though down from October 0.9% print. Annualized CPI of 6.8% was above consensus estimates of 6.7%, up from last month's 6.2% - the highest annualized rate since Jun-1982, also fifth-straight month above 5%. Core CPI (ex. food and energy) of 0.5% in line with consensus estimates of 0.5%, down from October 0.6%.



Interestingly, the 10-year Treasury has remained around 1.5% despite the inflation pressures.



CONCLUSION

Markets have generally taken the inflation, coronavirus, and Fed news in stride in that equity markets have rallied and the 10-year Treasury has remained around 1.5%. The implication seems to be that corporate earnings will continue to grow supporting equities, and inflation will be temporary. Regardless of the macro environment, PCA will execute a tax- loss harvesting strategy this month to save clients' money where applicable. Pallas Capital will monitor macroeconomic, political, and company news for impacts on markets.

Sincerely,

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Pallas Capital Advisors