

WEEK IN REVIEW

FRIDAY, NOVEMBER 4, 2022

TOP 10 TAKEAWAYS FROM PALLAS CAPITAL'S WEBCAST WITH INVESTING LEGEND BYRON WIEN

This week Pallas Capital's Chief Investment Officer Mark Bogar and Director of Planning and Client Experience Shannon Smith hosted investment legend Byron Wien. Byron did not disappoint and provided insight on the current financial, political, and social environment bringing lifelong lessons to his view about the path forward in these turbulent times.

Byron is one of Wall Street's most widely read analysts, known for his uncanny ability to forecast economic, social, and political trends and assess the direction of financial markets. In tribute to Byron's annual list of top ten surprises, we are pleased to share the top takeaways from our discussion.

1. Rates – The Federal Reserve increased the fed funds rate by 75 basis points this week and will likely do an additional 50 basis points in December. The Federal Reserve will likely keep going with raises until the fed funds rate is above inflation. Byron sees inflation coming down to 4% during 2023 which he believes supports a fed funds rate of 5%. He also intimated that it's not out of the question for inflation to come back down to 2% in 2024.

2. Recession – With the continued strength in the labor market and corporate profit resiliency, the U.S. economy is not currently in a recession, but is likely to fall into a shallow and short recession during 2023. A recession should help bring down inflation, a positive, but there is a risk that the Federal Reserve overreaches and causes a deeper recession.

3. Tactical Moves – Current investment playbook going into a recession is to hold quality stocks with staying power and ability to regenerate. Conversely one should exit stocks with marginal future potential. Yields on short duration credit and private credit and real estate with short term leases are providing an attractive opportunity. Be prepared to deploy cash during 2023 into a pullback in corporate earnings and peak in fed funds rate. Avoid the temptation to get out at any cost.

4. 60/40 portfolio – Expect lower average annual returns in the next decade as compared to the past two decades, which benefited from falling interest rates, as going forward interest rates are likely to be structurally higher. The 60/40 portfolio mix between equities and fixed income will likely come back in vogue.

5. Diversification – Portfolio diversification remains important with many sectors currently looking attractive including consumer services, technology stocks trading at reasonable valuation levels, healthcare, energy, finance companies, and REITS with short-term leases. Durable goods-based businesses may be at greater risk from a recession.

6. Housing – The housing market is caught between short supply and falling new builds and current mortgage rates and home prices that are prohibitive for many buyers. The slowdown in housing will likely contribute to a decline in the economy, although prices may not come down significantly as long as employment remains strong. Beyond housing, other high ticket durable goods purchases such as automobiles also may be at risk in the higher rate environment.

7. Crypto – Despite a lot of effort trying to understand bitcoin and crypto currencies, could not get to owning it. At the end of the day, bitcoin and crypto have proven too volatile as a haven relative to the dollar which will likely retain its status as the global reserve currency.

8. Politics – Domestic politics are likely to see a shift to the Republicans for the house, senate and ultimately the presidency. While what transpires going forward with Federal Reserve policy and the economy will likely dictate financial markets, the financial markets will likely benefit under lower fiscal deficits if pursued by Republicans.

9. Geopolitics – International geopolitics will likely see the Ukraine war drag on with no cease fire in sight as long as U.S. and European resolve does not diminish which could occur as economic pressures mount. China, on the other hand, will likely see a step down in hostile external rhetoric towards Taiwan as Xi turns to addressing internal issues such as loosening Covid policy and turning the economy around.

10. Books – An avid reader, Byron has gravitated to non-fiction and studying current events. He noted that one should try and keep up with what is going on right here and right now and recommended “The Avoidable War” by Kevin Rudd.

When asked for a preview of the top ten surprise list for 2023, the ultimate answer was that we will need to wait. Something to look forward to for 2023...



Pallas Capital's Mark Bogar and Shannon Smith, Blackstone's Byron Wien

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