# Pallas Perspective

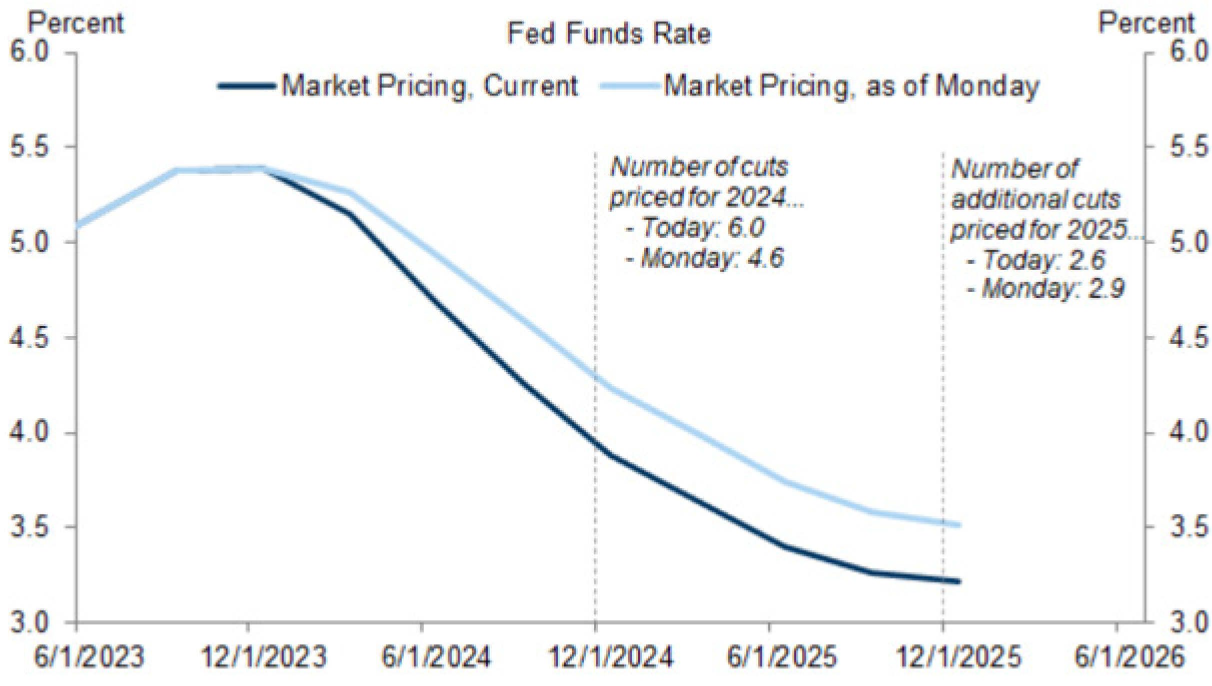
December 15, 2023

## Positive Data and a Fed Pivot - Tie the Bow on 2023

Data on inflation and the release of the Federal Reserve's (Fed's) latest rate decision fueled expectations for both lower inflation and lower interest rates as the U.S. economy moves into 2024. The soft Producers Price Index (PPI) report on Tuesday morning combined with downward revisions to prior months' data implies that core Personal Consumption Expenditures (PCE) inflation was only 0.07% month-on-month and only 3.1% year-on-year in November. The annual pace of deceleration is even more striking by some measures as core Personal Consumption Expenditures (PCE) inflation appears to have slowed from 4% annualized in the first half of 2023 to 1.9% annualized in the second half of 2023 – near the Fed's stated target.

Jerome Powell, Chairman of the Fed, noted the decline in inflation during his comments on Wednesday and pivoted from a message of "higher for longer" for interest rates to a dovish posture of peak rates being in place and an expectation for cuts in 2024. While financial markets were already anticipating lower rates for 2024 before the Fed decision and comments, expectations for rate cuts accelerated for 2024 following the meeting.

### Projected fed fund rate




Source: Goldman Sachs Global Investment Research

Financial markets reacted positively to the Fed's pivot, with both equities and fixed income seeing positive returns.  Lower rates are seen as a positive catalyst for valuation of financial assets.  However, the other side of the equation is fundamentals.  Assuming the economy remains resilient and posts growth in 2024, earnings and credit should remain in good shape.  Lower interest rates should aid as a positive catalyst for growth and credit.  Markets have adopted this viewpoint with little or no expectation now for a recession or negative credit event in 2024.

While a positive backdrop for 2024 is warranted, the risk to economic growth still exists in 2024.  Traditional economic forecasting metrics such as Leading Economic Indicators (LEI), an inverted yield curve, low consumer confidence, and rating agency credit downgrades suggest a cautious outlook for economic growth.  A pivot by the Fed to a dovish policy would be consistent with elevated concerns about future economic growth.  Uncertainties still exist as we enter 2024 but absent a severe recession – which, at this juncture, does not appear to be a high-probability scenario, financial markets are positioned to exit 2023 on a more positive stance than entering the year.  However, much of the good news near term is arguably priced into the market as well.

At Pallas Capital Advisors, we strive to remain on top of the macro investment environment but also retain a longer-term perspective in allocating across asset classes and individual investments. We believe that a well-balanced portfolio, emphasizing strong fundamentals, and quality and reasonable valuations aligned with realistic medium-term expectations, can offer appealing risk-adjusted returns to meet client's financial objections.