

PALLAS PERSPECTIVE

SEPTEMBER 13, 2024

SEPTEMBER STARTS WITH MARKET VOLATILITY AND WEAKER EMPLOYMENT

The start of September saw volatility increase and equity markets take a step back as markets reassessed the direction of the economy, magnitude of rate cuts, and high expectations for growth investment themes such as artificial intelligence. Fixed income moved conversely with the aggregate bond index putting in its highest close in two years.

The final event of the week was the release of job growth data for August. Here are the most salient points from the report: Job growth of 142,000¹ was weaker than market expectations of 161,000. Additionally, job growth in both June and July was revised down substantially. To put the data in perspective, the last 12-month average growth was around 200k. Manufacturing was hit particularly hard and suggests that lower end consumers are likely to face challenges. This could prompt the Federal Reserve to be more aggressive.

The impact of the latest data was to confirm that a rate cut of 25 bps is all but certain. However, given the weaker than expected labor market report, a 50 bps cut is very possible.

INVESTMENT IMPLICATIONS

- Challenging outlook for money market funds - Yields will decline by 0.25-0.5% in 2 weeks. In past fed cutting cycles, this normally accelerates money exiting money market funds. The pace is hard to predict so it would be good to be cautious and look at either safe Muni or Treasuries. While past performance doesn't guarantee future results, looking at the last 12 fed cutting cycles, bonds have outperformed cash (money market) and by an average of ~8%² annualized rate.
- Equity and growth assets get a reprieve - While we are experiencing a slowdown, we don't see worrying signs that would signal a recession. This is a good (not great) environment for equities but should allow equities to outperform bonds and generate 7-10%³ over the next 12 months. The environment could be even better for small cap stocks assuming a soft landing for the economy is achieved and a recession averted.
- Private Assets Look Attractive - A reduction in rates should make it easier for companies to finance acquisitions hence we could see some robust M&A activity along with reinvestment of cash sitting on the sidelines.
- Real Estate Activity may Increase - A reduction in mortgage rates and easier credit conditions may spur both an increase in housing construction and may help unlock a stalemate in existing housing supply and demand.

At Pallas Capital Advisors, we will continue to monitor the drivers of interest rates and economic growth with an eye towards maintaining well diversified investment portfolios to preserve and grow capital over the long term.

¹Source: Bureau of Labor Statistics release dated September 6, 2024 <https://www.bls.gov/news.release/pdf/empsit.pdf>

²Source: T Rowe Price Multi Asset Allocation teams analysis of last 12 fed cutting cycles

³Source: Pallas Capital Advisors estimates

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