Pallas Perspective

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PALLAS CAPITAL ADVISORS

FOMC Released Rate Decision on Wednesday this Week

Key Insights and Implications of the Latest Federal Reserve Decision

Reading the press release and listening to the conference call following the release we were pleased to see Chairman Powell strike a calm note. Amidst the policy driven volatility he exuded confidence that the Fed would be able to structure a "soft landing". This is the main reason markets rallied across the board.

- **Rates on Hold and Fed in No Rush to Cut** - The Fed kept rates steady at 4.25%-4.50% and signaled patience on easing, maintaining its outlook for two rate cuts by year-end 2025. Powell emphasized a "high bar" for early cuts, with data dependency remaining key. This is the right approach to take as we still don't know how Tariff's will impact growth/inflation etc. until we see it in real numbers.
- **Inflation Still Above Target But Easing:** Inflation is trending lower but remains sticky, with the Fed now forecasting 2.7% by year-end, slightly above prior projections. Powell downplayed the risk of a 1970s-style inflation spiral and said tariffs are a one-time price shock rather than a sustained inflationary force.
- **Slower Balance Sheet Runoff = Dovish Tilt:** The Fed reduced the pace of Quantitative Tightening (QT), cutting monthly Treasury runoff from $25B to $5B starting in April. Powell described this as a "soft landing" approach to liquidity management, indirectly easing financial conditions without rate cuts. While this had been talked about it was good to see as it demonstrated once again that the Fed has other tools to manage the economy.
- **Fed Sees Slower Growth, But No Recession Base Case:** GDP growth was revised down to 1.7% (from 2.1%), and unemployment is expected to tick up to 4.4%. We were encouraged that Powell noted cooling consumer spending and elevated uncertainty but maintained that the Fed's base case remains a soft landing, not a deep slowdown.
- **Markets React Positively – Stocks & Bonds Rally:** Equities rallied across the board, led by tech (+1.4%) and discretionary stocks (+2%), as Powell removed worst-case recession fears. The 10-year Treasury yield dropped to ~4.25%, and consistent with our expectations at the beginning of the year, Fed Funds futures fully priced in two cuts by December, with rising odds of a first cut by June.

Where we See Opportunities?

1. **Enhancing yield of FI portfolios with Credit/ Structured Credit** - Treasury bonds have rallied significantly across the board with longer maturity assets rallying more strongly. As we continue to see, low single digit returns from equities for the rest of the year amidst high volatility we see value in biasing investor portfolios towards income generating assets. This may be best achieved by reducing duration and wading deeper into both high-quality credit and structured credit (CLO/ MBS).
2. **Adding to international and diversifying with some active funds -** International assets have rallied strongly this year. However, there may be room for assets to still run up as Europe unleashes more fiscal spending and could benefit from a potential ceasefire in the Russia-Ukraine crisis.
3. **Inflation Hedging** – The outlook for inflation has incrementally worsened. Against that backdrop investors should consider real return generating assets. We view Infrastructure assets as best positioned for this trend especially against a backdrop of continued strong spending globally on upgrades to roads/airports/energy infrastructure.

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