Fed Up, Slow Down

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What made Kane Tanaka so special? As the oldest living person on the planet until her passing last month, Tanaka-san was born (January 2, 1903) almost a year before the Wright Brothers' historic first flight at Kitty Hawk. Her secret to a long life? "Being myself."

Sticking to your knitting was top of mind this week as we prepped to chair the Private Credit Investor Summit in West Palm Beach. The conference features an impressive speaker list, largely LPs and asset managers. Attendees and panelists represent a wide spectrum of strategies, belying the view that private credit is crowded with firms "doing the same thing."

The timing is also propitious. The past several weeks have witnessed an interesting market move in public assets. Equity indices have reversed course since the May 20th bottom, with the Dow up 7.6% and NASDAQ 10% higher.

In part this is due to a a change of perception regarding inflation, the economy, and interest rates. As discussed in a excellent FT commentary, the conversation has moved from 'Is the Fed too late?' to 'What happens if they catch up?' Rather than higher inflation and higher rates, markets are pricing in slowing inflation and the chances of a recession.

The bond market has shown similar leanings. If Fed hikes (or the expectation of hikes) actually accomplish their mission, interest rates might not peak as high as anticipated. Ten-year Treasurys peaked at just over 3.13% on May 6th, drifted down and below that level since.

No doubt that's contributed to fixed income sentiment becoming more bullish. According to Lipper and S&P/LCD, retail high-yield funds pulled in $4.77 billion last week, the largest in-flows since June 2020. Not to say bonds are out of the woods, but at least the fret list has changed.

All of which sets us up nicely for conference chats about relative value and risks. With the new hawkish regime in place, should investors be rethinking their views on 60/40 equities and fixed income allocations? Do lower prices in those assets make them more attractive, or is this just a moment in time that will vanish once markets stabilize?

The beauty of private credit in a volatile market is their relative lack of correlation to bonds and equities. But in an environment, such as we're in today, where leveraged loans yield 7% and high-yield bonds yield 8%, do they become more attractive than illiquid loans?

These questions become more relevant the further the Fed rate program progresses. If by mid-summer inflation shows real signs of abating, will a hike pause cause things to heat up again? In which case are we back to where conditions were a year ago?

Kane Tanaka survived two world wars, the Great Depression, the 1918 influenza epidemic, typhoid and cancer. She stuck to her routines and lasted for 119 years. We think investors could learn a thing or two from her example.