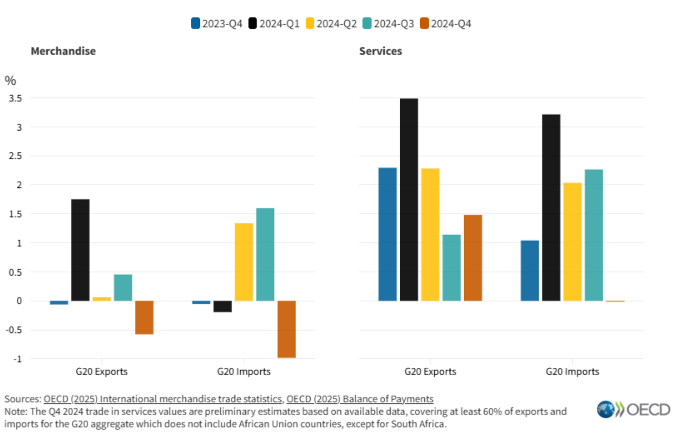
The opportunity to sit across the table from clients with a remarkable array of sophistication, needs, and goals, was a highlight of working in the asset management industry. Most likely, the PowerPoint you brought is not as relevant as you hoped it would be, so you had better come prepared to "rap markets" and make friends. That way, you might be invited back.

It is with this North Star that we write this note. Being a source of perspective and insight is the most important role we have ever had. We do not claim superior knowledge or decision-making but will hang our hats on having an open mind, long perspective and a willingness to explore concepts quite publicly and without fear of being wrong; being wrong is a learning opportunity.

It is in this context that we reiterate core views. We believe that there is a rocky adjustment coming, with elevated price pressures and resulting cost of capital. This will impact equity valuations via both multiples and margins.

The source of this is geopolitical and secular, as we transition from a global economy to a more regional one. AI is a tailwind, and a big one certainly domestically, but we have a two-track economy – AI/tech vs industry and potentially employment.

The knock-on effect of this lower, more volatile, and uneven growth regime will be continued risk of tension and conflict. Trump does not represent a new concept, rather a domestic representation of a global competitive theme that feeds upon itself.



The recent outperformance in EM, China and EU equities strikes us as a mean reversion trade. That doesn't reduce its validity, rather its potential longevity. It also could continue a relative basis; we just have a very hard time feeling like there is significant absolute upside in those areas barring an improvement in trade, a decline in the dollar, or coordinated global growth.

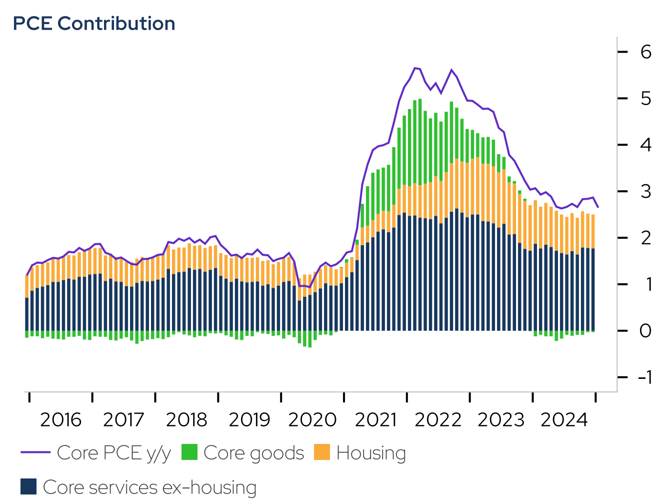
We suspect US-relative performance will be driven by a combination of global-leading productivity with an overlay of flight to quality capital flows vs high beta to risk sentiment. Good luck forecasting that.

This makes for a very tricky allocation environment, and one that few have spent a great deal of time thinking about. Income will play a larger role than it has in the past – with the demand for capital likely exceeding savings, certainly on a regional basis - and dispersion and volatility will raise opportunities for alpha for those who can structurally capitalize on it.

Onward...

Inflation

We are scratching our heads around what will be the cure for elevated and sustained price pressure. Spoiler alert, it's not eggs.

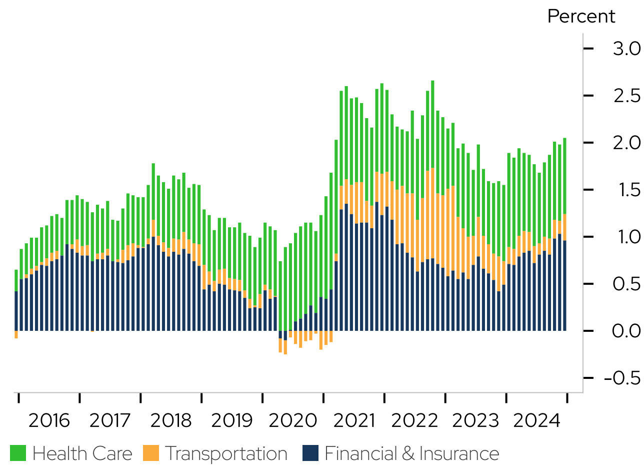


Source: Riverhead Research, San Francisco Fed, BEA

The drivers of core services are financial services and health care, neither of which exhibit the kind of price elasticity that Fed policy is designed to impact.

Insurable assets continue to rise in price and pricing is back. As for healthcare, PWC issued a report suggesting that heath care inflation should be higher in 2025 than 2024 (link), and that is before considering input costs associated with tariffs. These are the levers, barring cyclical / demand impacts to headline data.

PCE Core Services Contribution



Source: Riverhead Research, San Francisco Fed

While risking a political third rail, this is perhaps an area where deregulation can help more than the cost of overnight funds and implicit cost of debt and equity capital. We've never walked a mile in an insurer's shoes, nor put a patient on a ventilator, but to us, those are not demand driven and are industries characterized by embedded costs that have likely built up over time.

GDP Growth Nowcasts

The good folks at the Atlanta Fed sure caught everyone's attention when they adjusted their GDP forecast (not official, modeled) down by roughly 3% on Friday to negative growth, which further put a bid in bonds, with a risk off tone continued from mid-month.

To be honest, we expected an increase in durable orders, and mentioned it in a post on LinkedIn – which built on the pickup in regional surveys. But we did not connect the dots to the implication for nowcasts. Lesson learned.

The messages are: (1) business leaders are taking Trump far more seriously than many investment strategists are and (2) underlying growth, while softer, is not meaningfully so; while we are wary of the term "pro forma," we have to give credence to not only the one-time pull forward of imports/hoarding, but also on the domestic production implications after an adjustment period, and associated with these orders.

This doesn't make the murky world of tariffs any easier to navigate, for sure.

Alpha Sources

We have seen a couple of great notes on the attractiveness of hedge funds of late; especially long/short. Wellington Management put out a great piece here (link), which we happen to agree with wholeheartedly, considering short term attractiveness of beta, and relative support of income and capitalizing on dispersion. Confirmation bias? Yes, please.

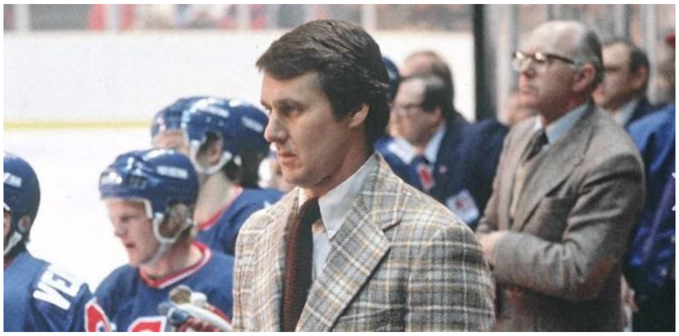
In addition, Cambridge Associates shared one here (link), which puts the evolution of L/S strategies in perspective – in particular the pressure on returns as public equity surged and private equity hit its stride. The million-dollar question is whether this will continue. We strongly doubt it, putting us very much in the camp of the bright folks at Wellington and Cambridge Associates.

A logical follow here is liquidity. With PE distributions remaining challenged and commitments still required for investors, both NEPC (link) and CA (link) have developed liquidity frameworks. We can only assume these were not planned exercises, but in response to specific needs. This issue will linger.

Miracle / PRIV ETF

Bond managers, complexes and CIOs, please look inward. You live in a big asset class and a competitive one. You have been out of favor for a long time and are only now being re-introduced to the world.

A lot has changed, and there are myriad strategies – like the 1980 Russian Olympic hockey team – who seem absolutely bullet proof, but now is your time. You can't bring the same game you brought in the past; you do something different.



Chronic overweight positions in credit are no longer a drunk uncle nobody talks about. Overweighting credit should not earn fees, especially when it implies market timing, or worse, correlation with risk (link). Competing today is going to take more than well paid research analysts opining on fundamentals that are swamped by technical factors.

The development of systematic strategies at several large asset managers, hedge funds, and feisty upstarts is wringing alpha from credit. Strategies that focus on the human element and security selection are facing an uphill battle.

This represents the low hanging fruit that harvestable alpha is not just issuer tilts. It is model driven, beta timing, duration management, among others, and we are in early days.

As a curious investor, I am very excited to watch. I would love to see a credit manager isolate idiosyncratic alpha and dynamically hedge out market beta; we believe that this is where value will be added in credit, and it can be layered on inexpensive and passive beta of an investor's choice.

Other large changes are underfoot. Apollo and SSGA launched "PRIV" – a US Agg benchmarked ETF allowing private credit, and up to 20% high yield. An open-ended, accessible vehicle with private credit is now an alternative to traditional Core and Core+ strategies.

Niche managers will have to adapt or be faced with the questioning from every single consultant they meet. It also leads to a question – is the US Agg the right benchmark anymore? In the days of only IG and HY bond markets, it made some sense.

But since the explosion of ABS/CMBS/RMBS, IG, Private IG, HY, Private Credit, and BSL to name a few, surely the credit space is ripe for a rethink, and Apollo is opening the door to private/public relative valuation.

We have spoken with other managers who aspire to lever the same dynamic to add value in Multi Asset Credit strategies. (Managers, please email us if you would like to share insight or details on strategies as we build out our understanding.)

This is one of the most exciting times we have experienced in income investing, with evolutionary change. As Herb Brooks said (link), "it's your time… Their time is done… Now, go out there and take it!"

Do your wind sprints… again… again… again… again.

To outplay, bring an advantage and catch the incumbent doing what incumbents do – nothing.

As you were…