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Amadeus Wealth Alternatives
Your Compass to Alternative Investments

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In this week's recap: A Fed taper may loom; economic data mixed.

Weekly Economic Update

Presented by Ed Papier, August 23, 2021

THE WEEK ON WALL STREET

Stocks turned lower last week amid the increasing probability of a Fed tapering, mixed economic data, and growing concerns about the economic impact of the Delta variant.

The Dow Jones Industrial Average slumped 1.11%, while the Standard & Poor's 500 lost 0.59%. The Nasdaq Composite index slipped 0.73%. The MSCI EAFE index, which tracks developed overseas stock markets, surrendered 2.94%.[1,2,3]

UNSETTLING NEWS

After the Dow Industrials and S&P 500 index climbed to new record highs to begin the week, stocks pulled back amid weaker-than-expected retail sales, festering concerns about the Delta variant, and slowing growth in China.

The stock market retreat accelerated mid-week with the release of the FOMC (Federal Open Market Committee) meeting minutes, which signaled that Fed officials may be ready to begin reducing its monthly bond purchases before the end of the year. Stocks managed to stabilize on Friday, paring some of the week's losses. Consumer staples, health care, real estate, and utilities were the top-performing groups.[4]

TAPER BY YEAR END?

Two weeks ago, multiple regional Federal Reserve Bank presidents suggested that the economy was strong enough to justify tapering the Fed's monthly bond purchases.

Last week, that chorus grew a bit louder with the release of minutes from July's FOMC (Federal Open Market Committee) meeting. The precise timing was left undecided, with some officials believing it should begin before year-end, while others thought waiting until the start of the new year was the better choice.[5]

THE WEEK AHEAD: KEY ECONOMIC DATA

Monday: Existing Home Sales.PMI (Purchasing Managers' Index) Composite Flash.

Tuesday: New Home Sales.

Wednesday: Durable Goods Orders.

Thursday: Jobless Claims. Gross Domestic Product (GDP).

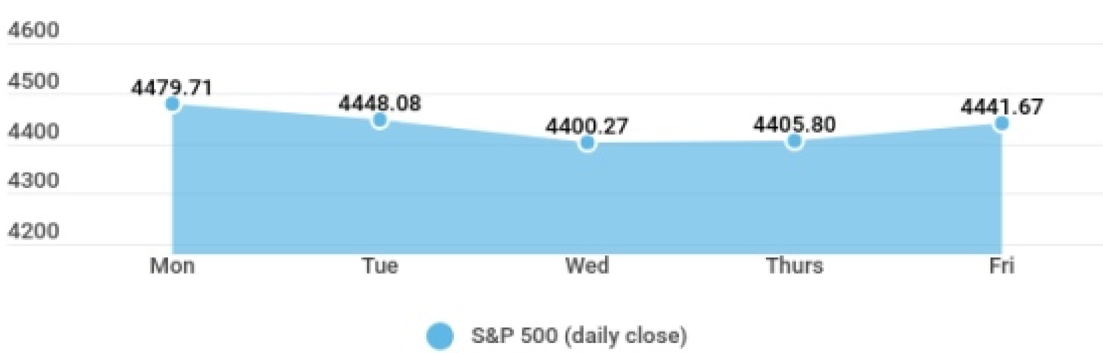
Friday: Consumer Sentiment.

QUOTE OF THE WEEK

"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market back up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates"

From a Cartoon

Market Index	Close	Week	Y-T-D
DJIA	35,120.08	-1.11%	+14.75%
NASDAQ	14,714.66	-0.73%	+14.17%
MSCI-EAFE	2,309.06	-2.94%	+7.52%
S&P 500	4,441.67	-0.59%	+18.25%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.26%	-0.03%	+0.33%

Sources: The Wall Street Journal, August 20, 2021; Treasury.gov, August 20, 2021
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, August 13, to Friday, August 20, close. Weekly performance for the MSCI-EAFE is measured from Friday, August 13, open to Thursday, August 19, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

An interval fund is a type of closed-end fund with shares that do not trade on the secondary market. Instead, the fund periodically offers to buy back a percentage of outstanding shares at net asset value. Credit interval funds have become increasingly popular among investors looking to increase the yield on their fixed-income allocations.

Since the great financial crisis, there has been a fundamental shift in the fixed income landscape. Banking regulations implemented in 2008 limited the ability of traditional banks to make loans to U.S. middle-market businesses (generally defined as companies with EBITDA of $10 million to $100 million, which are those too small to access capital in broadly syndicated markets). The result was that non-bank lending, led by institutionally funded independent asset managers, emerged as a growing lending channel.

Private credit exposure can be a viable option for some investors seeking income in the current low interest rate environment. For example, as of July 16, 2021, while Vanguard's High-Yield Corporate Fund with a duration of about 2.7 years, was yielding about 4.3%, the largest private credit interval fund, PIMCO's Flexible Credit Income Fund, with floating rate loans, was yielding about 3.5 percentage points more.

Unfortunately, not all credit interval funds offer the same value. Therefore, investors should look beyond a shiny exterior to assess true value. Credit interval funds can have significant variability in both asset mix and expense ratios, resulting in some funds offering more value to investors. When examining credit interval fund fees, it is important to look beyond published expense ratios, which include the interest costs of leverage but not the interest income, to get a "true" picture of the ownership cost of these funds. It is also important to analyze the makeup of the lending portfolio to determine the amount allocated between public and private credit exposure, as the cost for private credit exposure should be less than that of managing public credit.

Studies of credit internal funds have shown a wide range of expenses including major differences in private asset exposure ranging from 2% to 95%, with an average of 40%. There is substantial variability between the true ownership cost and the amount of private credit for the 10 largest private credit funds.

Not all private credit interval funds are alike. The differences can be not only in their exposures to private versus public debt and their expense ratios but also in their credit quality. Some fund portfolios will consist of senior secured debt of companies backed by private equity firms, whereas others have high exposures to debt that is further down the capital stack and thus are riskier.

Some funds offer diversification away from credit only, including direct real estate, real estate debt including senior mortgage loans, subordinated debt, mezzanine loans, commercial mortgage-backed securities and structured credit including investments in debt and equity tranches of collateralized loan obligations. Private asset exposure through credit interval funds can be a good option for income in the current low-rate environment. However, investors should do more than look for low management fees when choosing a fund.[6]

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Know someone who could use information like this?

Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:

1. The Wall Street Journal, August 20, 2021
2. The Wall Street Journal, August 20, 2021
3. The Wall Street Journal, August 20, 2021
4. ALPS Portfolio Solutions, August 20, 2021
5. Reuters.com, August 19, 2021
6. advisorperspectives.com/articles/2021/08/09/the-hidden-fees-in-credit-interval-funds?topic=alternative-investments