LEVERAGED FINANCE MARKET PERSPECTIVE LETTER

A Tenuous Balancing Act

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SHENKMAN
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July was either the beginning of a market comeback or a bear market bounce following an avalanche of conflicting economic trends. Investors had to contend with the reality of higher rates, pernicious inflation, problematic liquidity, and economic uncertainty amid a better-than-feared earnings season. A political debate also erupted over the definition of a recession, although for the past several decades, two consecutive quarters of negative GDP was deemed a recession. Historically, recessions have unique characteristics, and the current circumstances could be labeled a "full-employment recession" as new jobs continue to be created despite a modest contraction in economic activity. The big question investors may be struggling with is whether inflation has now peaked. Nevertheless, the Federal Reserve must continue its fight to control the inflation they helped create. The transition from quantitative easing to quantitative tightening during a period of surging inflation presents a real balancing act for central banks around the world. Hopefully, the Fed can avoid repeating the monetary policy errors of the 1970s, which undermined economic stability for several years. The direction of the markets will likely hinge upon containing inflation without triggering a recession or a prolonged period of stagflation. It is a tenuous balancing act with numerous potential pitfalls and significant ramifications

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