



**Lara Rhame**  
Chief U.S. Economist  
FS Investments

# Navigating inflation, policy and global growth

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FS INVESTMENTS®

## Leading alternative asset manager

FS Investments strives to solve investor needs by creating access to alternative ideas and institutional-quality managers to achieve a higher probability of investment success. We never settle on behalf of investors by providing best-in-class management, customized structures and investment education.

### Key facts Data as of September 30, 2021.

**2007**

Year founded

**\$29+ billion**

Total assets under management<sup>1</sup>

**10+**

Years of experience managing alternative assets

**300+**

Professionals nationwide

### Partnering with industry leaders



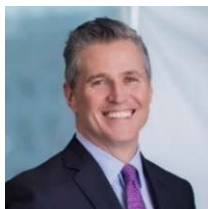
**KKR**



**Wilshire**



### Meet some of our in-house experts



**Mike Kelly**  
Co-President +  
Chief Investment Officer

Prior to FS, was CEO of ORIX Asset Management and FrontPoint Partners.



**Lara Rhame**  
Chief U.S. Economist

Frequent contributor to financial television, print, radio and podcasts to discuss trends in finance and the economy.



**Ryan Caldwell**  
Chief Investment Officer,  
Chiron Investment Management

Named to Institutional Investor magazine's "Rising Stars of Mutual Funds" in 2009.



**Brian Cho**  
Head of Quantitative Research

Named to Institutional Investor magazine's All-American Research Team every year from 2003 to 2014.



**Troy Gayeski, CFA**  
Chief Market Strategist

Has spent over a decade as a contributor on Bloomberg, Fox, Yahoo Finance and CNBC. Prior to FS, was Co-CIO at Skybridge Capital.

### Capitalizing on in-house portfolio management expertise

#### Private credit

Credit of private U.S. middle market companies

#### Liquid alternatives

Hedge fund and alternative beta strategies

#### Cryptocurrency

Access to Bitcoin and crypto-related investments

#### Real estate

Focus on commercial real estate debt

#### Dynamic, global multi-asset

Chiron Investment Management

#### Special situations credit

Stressed, distressed, event-driven and opportunistic performing credit

#### Investment research

Insights and analytics for alternatives and broader economic trends

1. Assets under management as of September 30, 2021.

1

Economy:  
Strong economic tailwinds

2

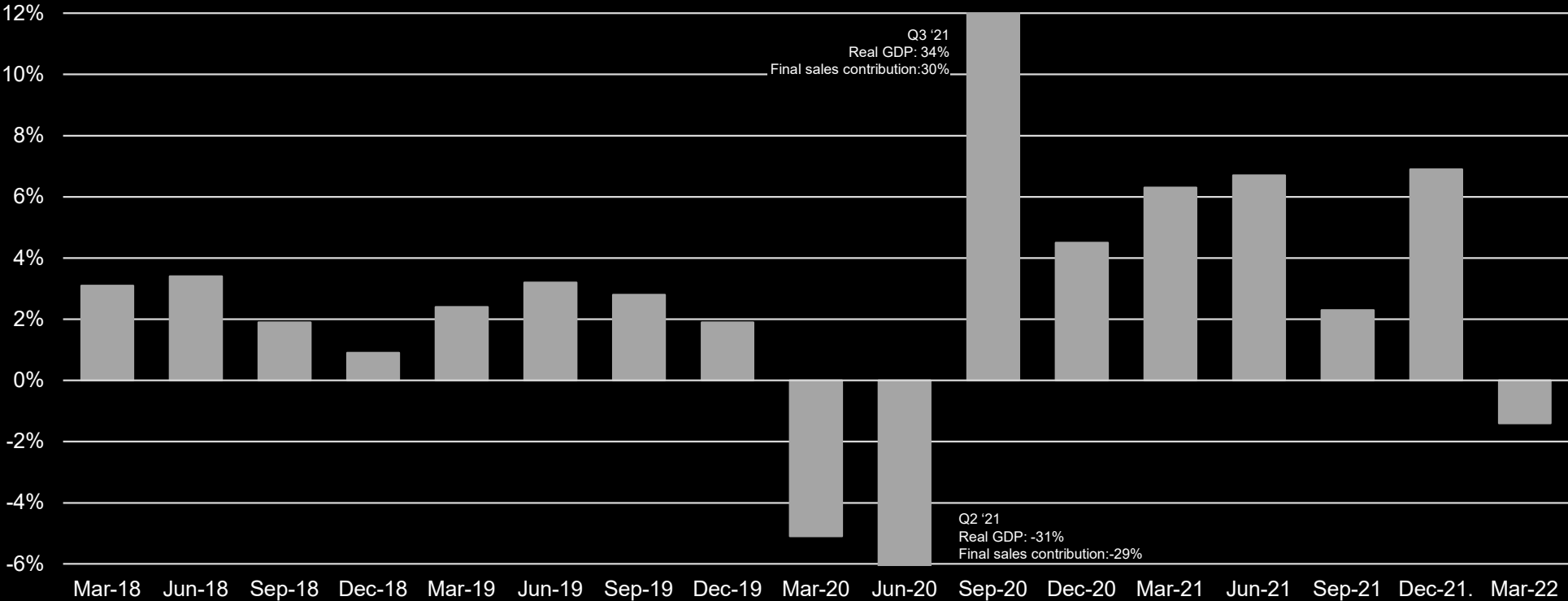
Policy:  
Fed rate hike cycle playbook

3

Markets:  
Flying through turbulence

# U.S. economy still on track for strong growth in 2022

Positive momentum is supporting growth above pre-pandemic rates (for now)

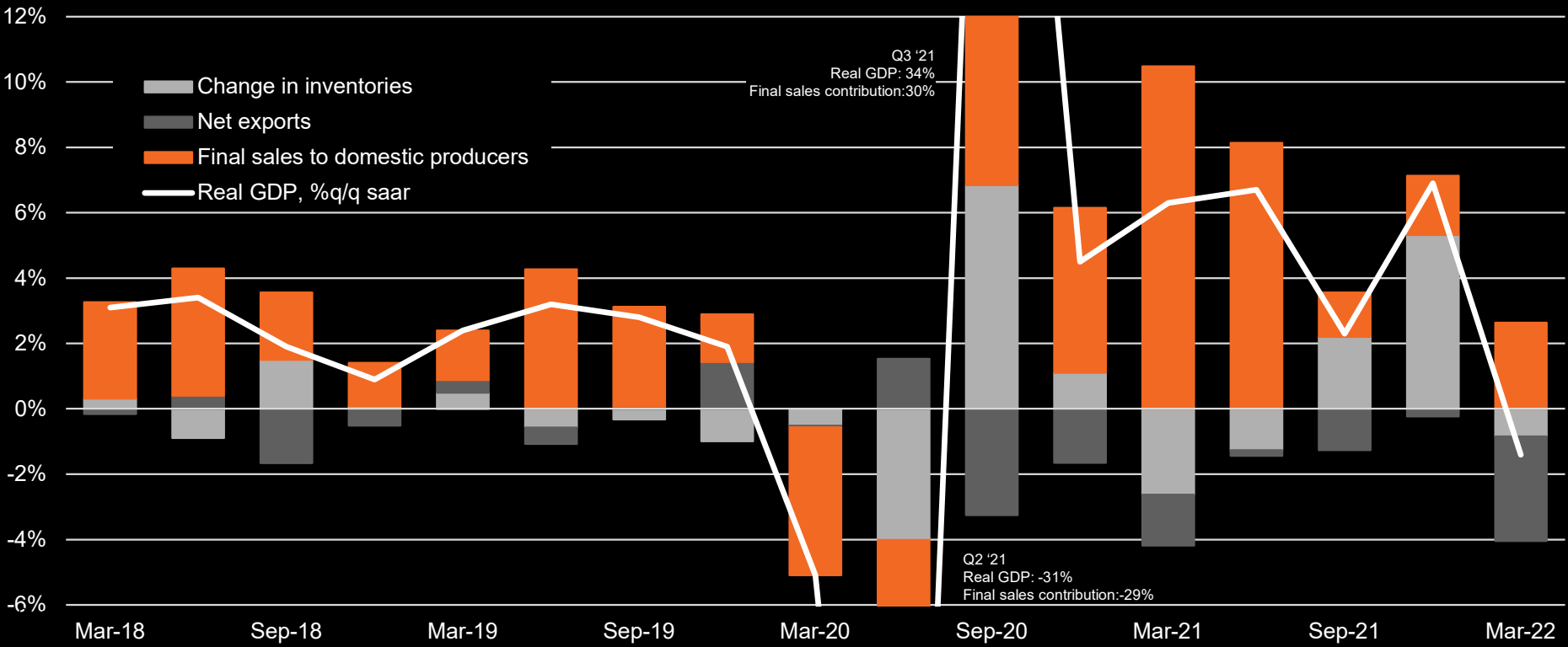


Source: U.S. Bureau of Economic Analysis, as of March 31, 2022

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# The composition of growth is changing

Inventory contributions will fuel GDP growth

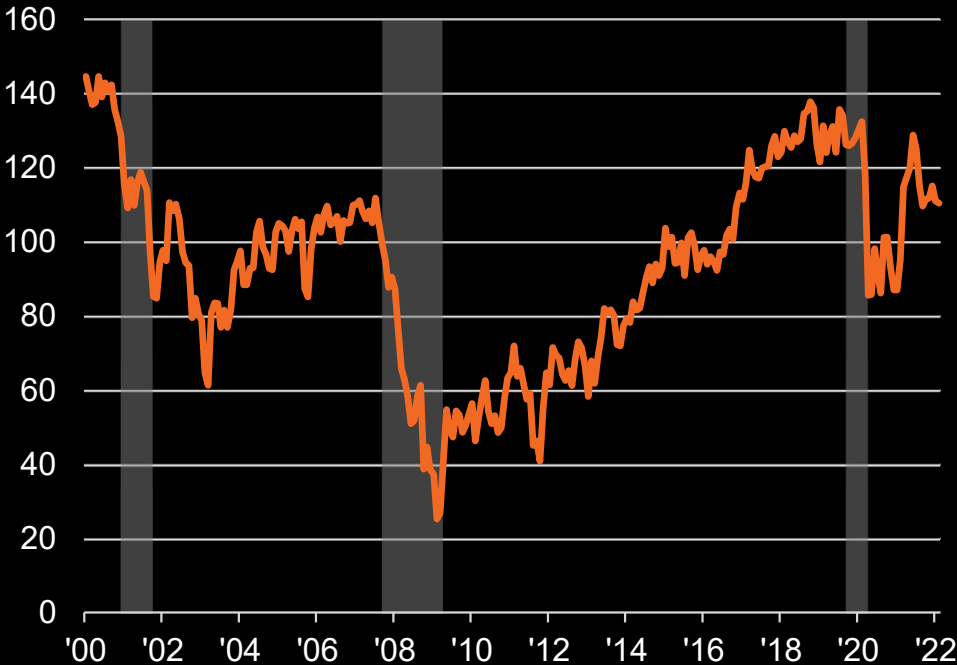


Source: U.S. Bureau of Economic Analysis, as of March 31, 2022

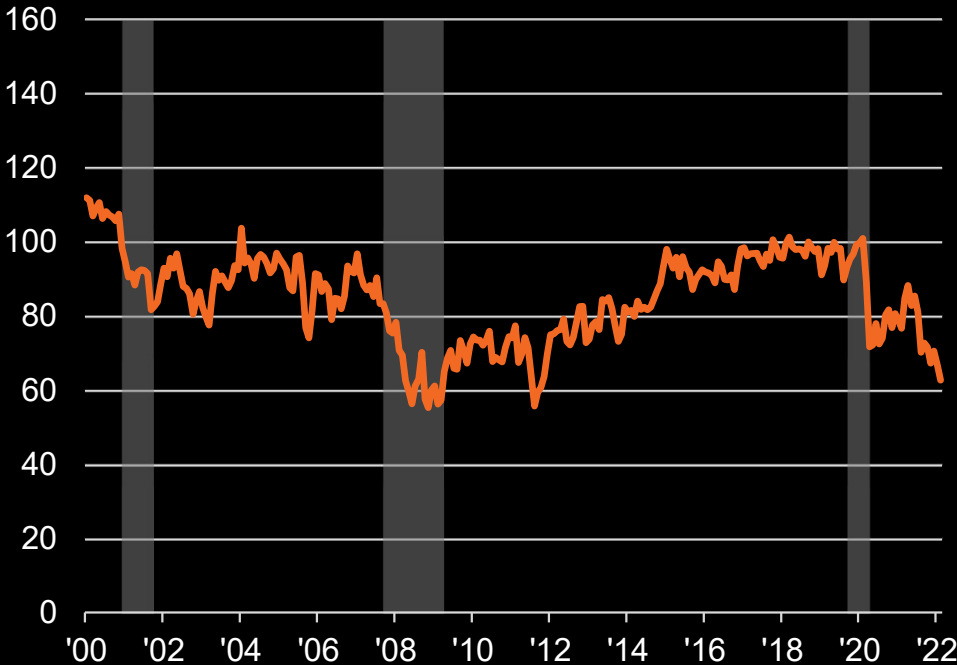
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# Consumer confidence: It depends on what you ask

Conference Board consumer confidence index



University of Michigan consumer sentiment

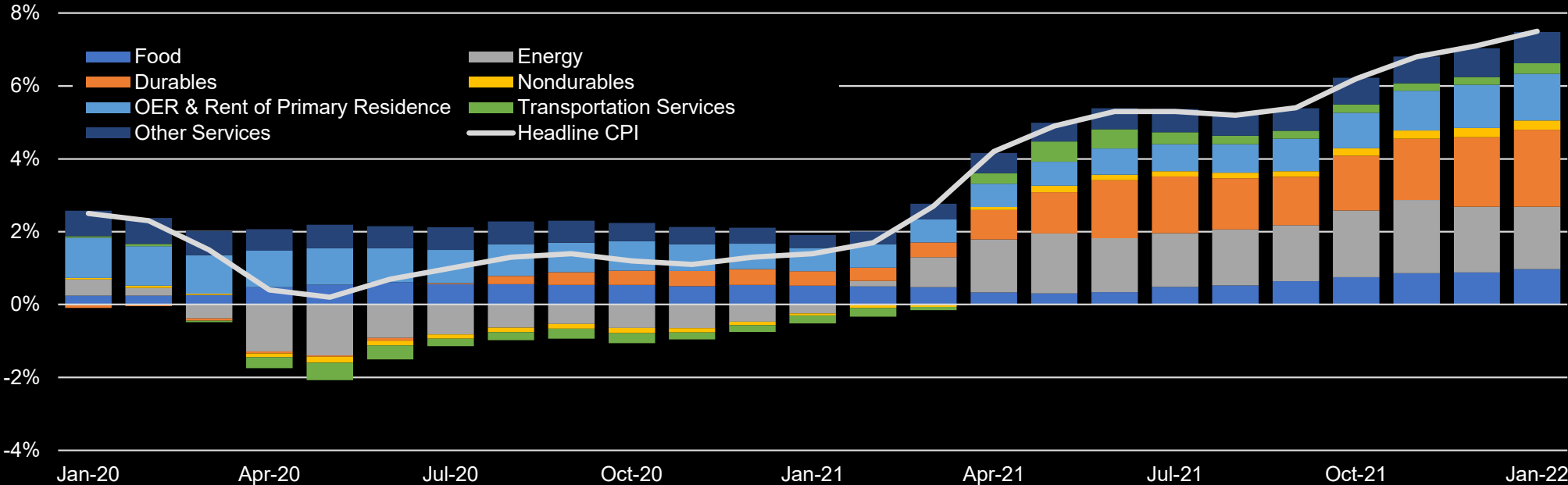


Source left chart: NBER, Conference Board, as of March 8, 2022.  
Source right chart: NBER, University of Michigan, as of March 8, 2022.  
Shaded areas represent NBER dated recessions.

# Inflation: A peak without much descent

## Broad-based price gains

### CPI contributions

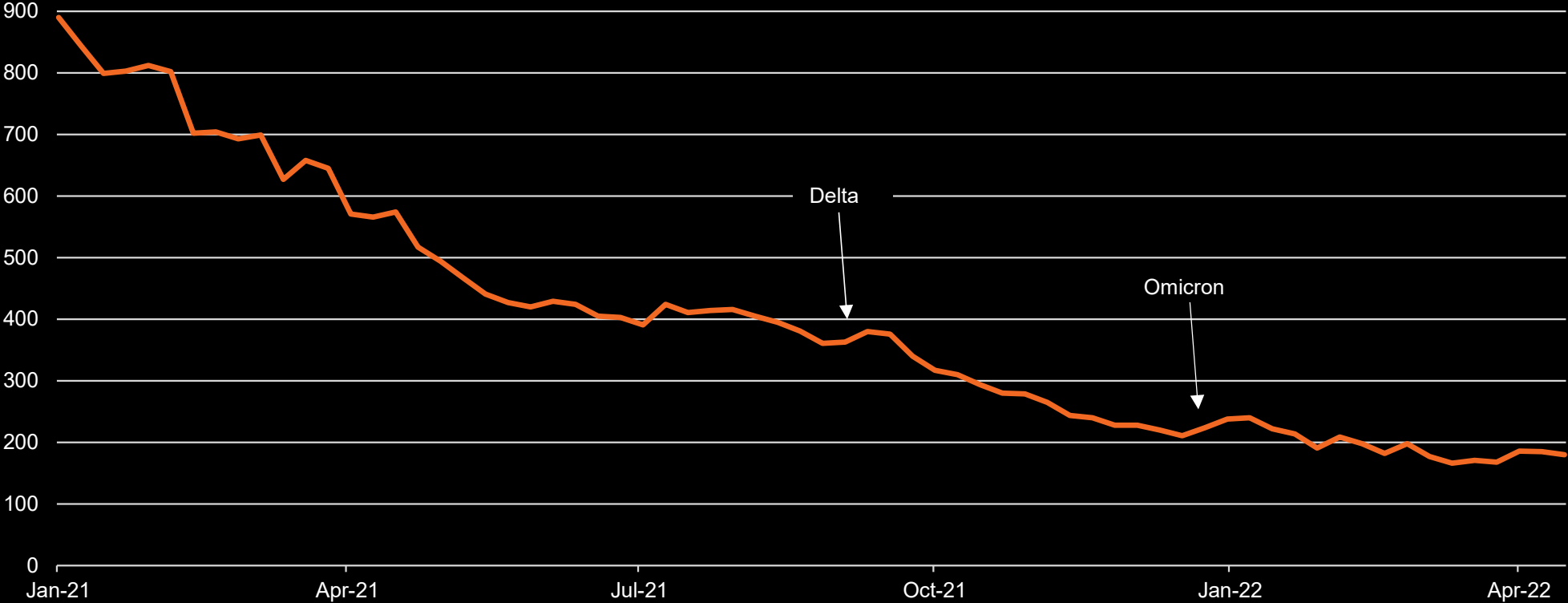


Source: Bureau of Labor Statistics, FS Investments, as of February 10, 2022.

Note on categories: Energy, food, owners' equivalent rent and transportation services categories are all represented by their CPI defined subindices. Other categories combine subindices and apply CPI designated weights. Durable goods: Household furnishings, recreation, education & communication, transportation. Non-durable goods: Apparel, medical goods, alcoholic beverages, other goods. Other Services: Lodging away from home, tenants' & household insurance, water & sewer collection, household operations, medical care services, recreation services, education & communication, other personal services. Categories are meant for illustrative purposes.

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# Initial jobless claims reflect labor market resilience

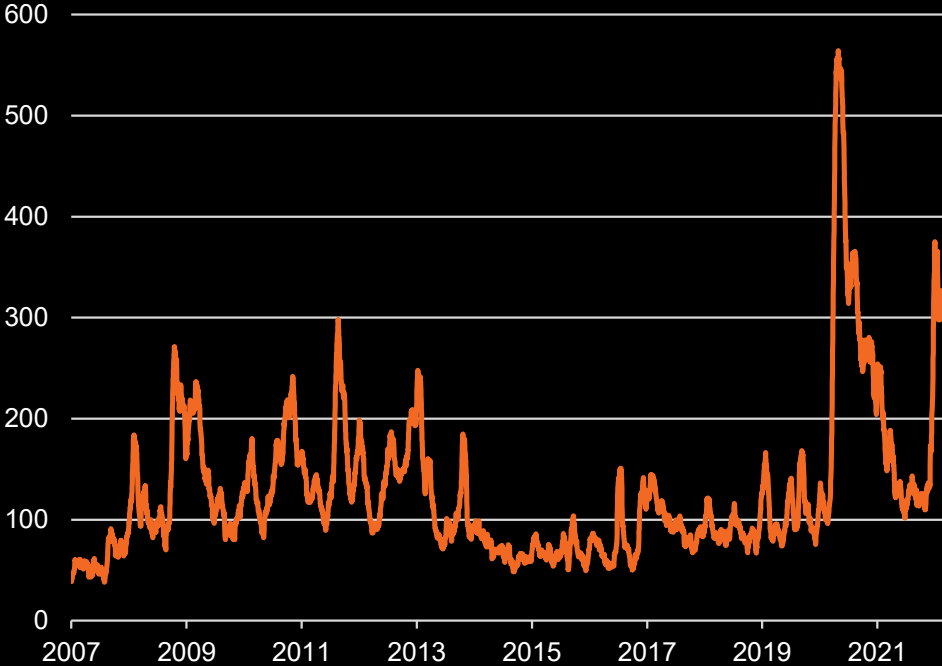


Source: Department of Labor, Bloomberg News & Johns Hopkins, as of April 25, 2022  
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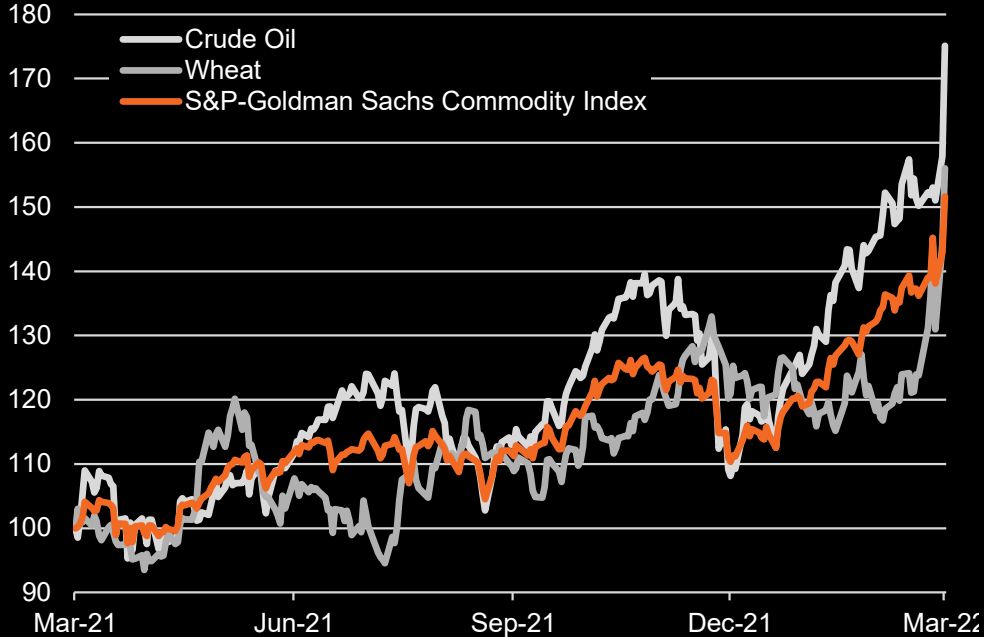
# Conflict in Ukraine is an uncertainty shock wave

### Economic policy uncertainty has skyrocketed



### Chaos in commodities

3/1/2021 indexed to 100

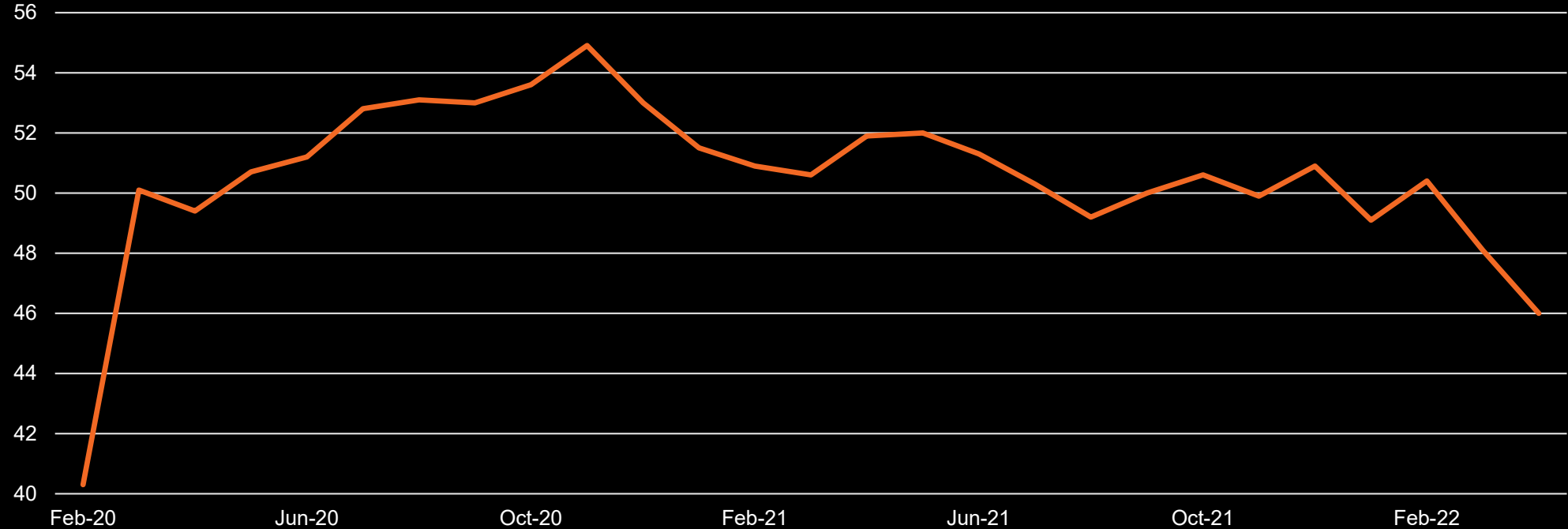


Source left chart: Economic Policy Uncertainty Index, Federal Reserve Bank of St. Louis, as of February 18, 2022. See Baker, Scott, Nicholas Bloom and Steven Davis (2012), "Measuring Economic Policy Uncertainty."

Source right chart: Bloomberg Finance L.P, as of March 1, 2022.

# Production declines as lockdowns in China persist

Caixin Manufacturing PMI

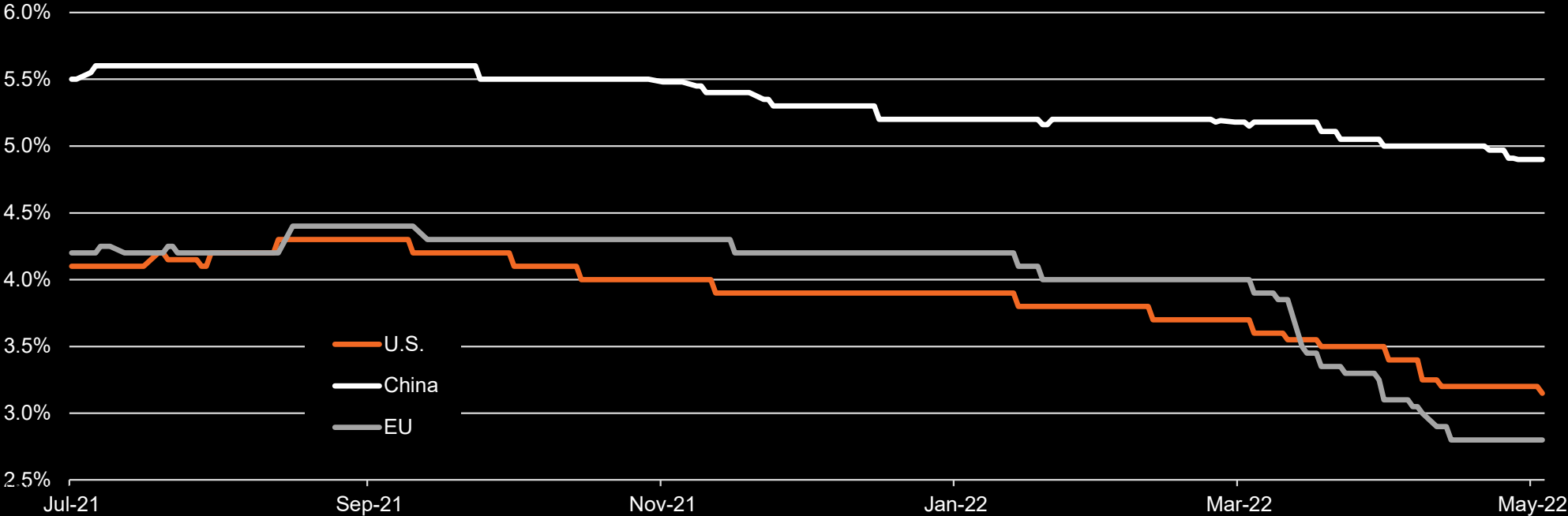


Source: Macrobond, HIS Markit, as of April 30, 2022

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# Global growth expectations fade

2022 real GDP consensus estimate



Source left chart: Bloomberg Finance, L.P., as of May 3, 2022

Source right chart:

1

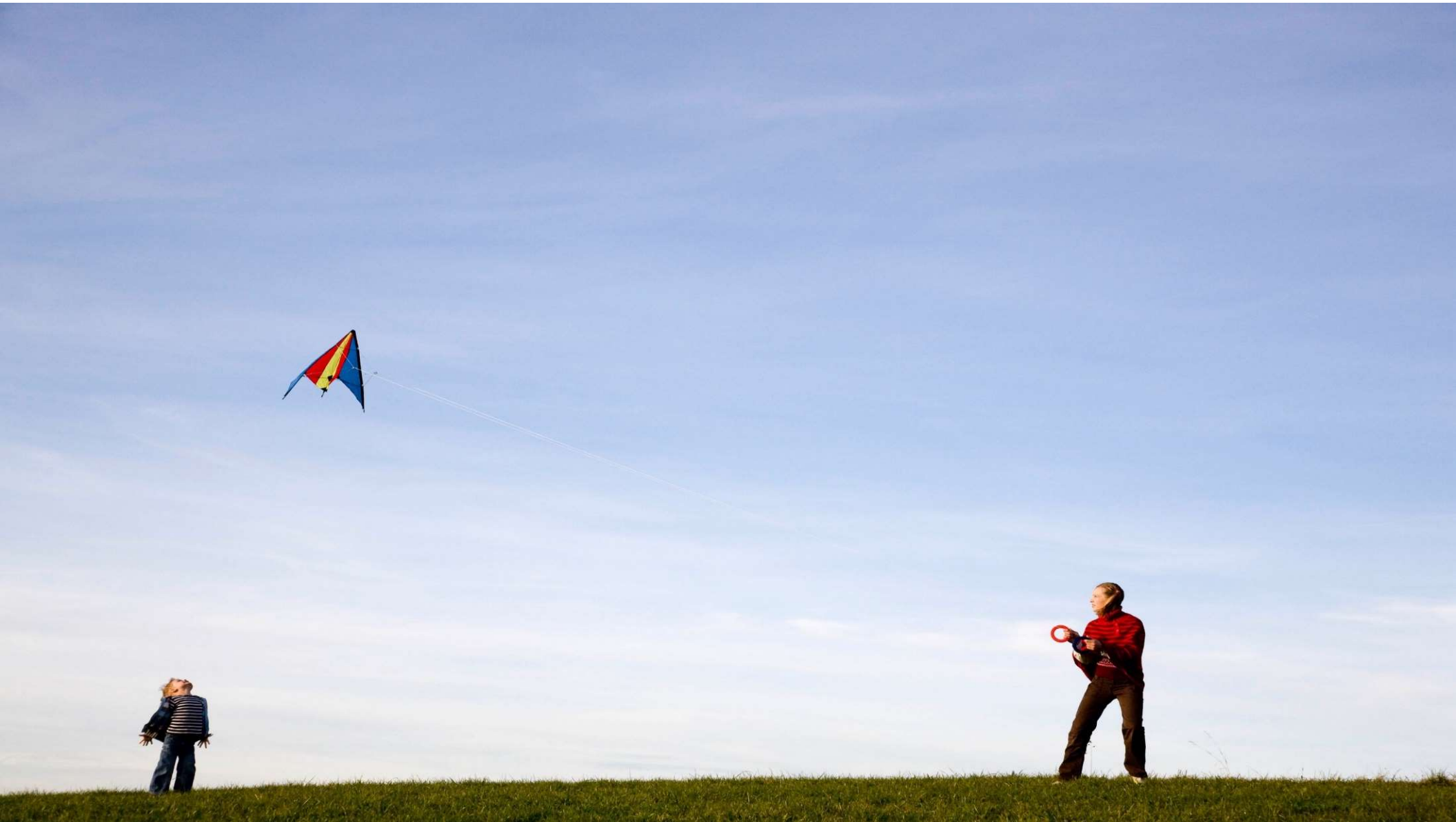
Economy:  
Strong economic tailwinds

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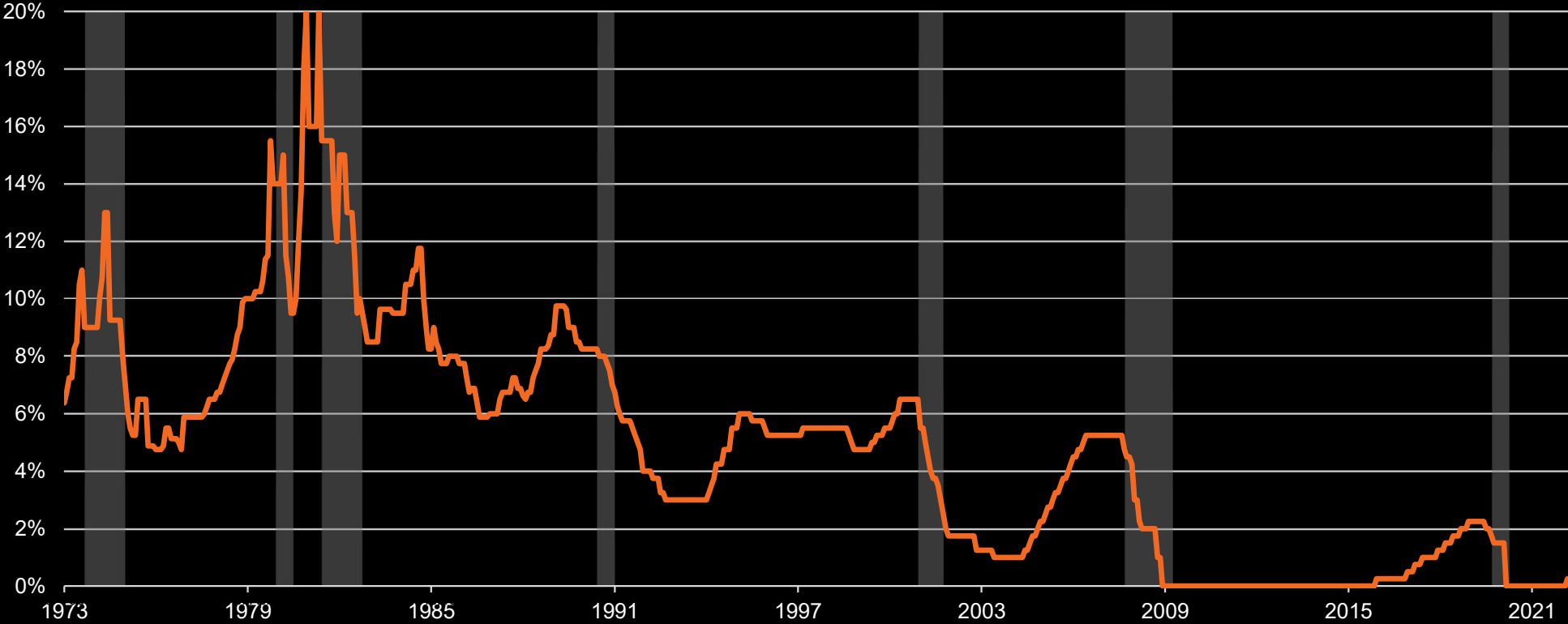
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Markets:  
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# This Fed rate hike cycle is going to be a doozy

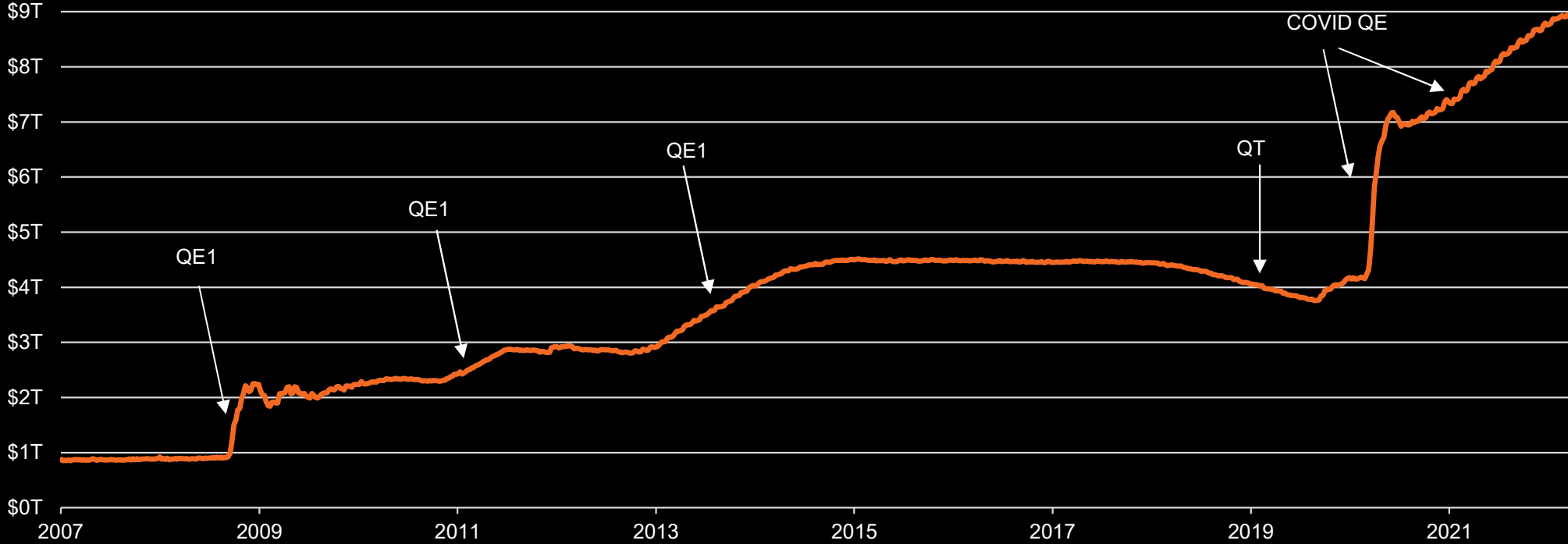


Source: Federal Reserve, NBER, as of April 30, 2022. Shaded areas represent NBER recessions.

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# Quantitative tightening is coming

Federal reserve balance sheet

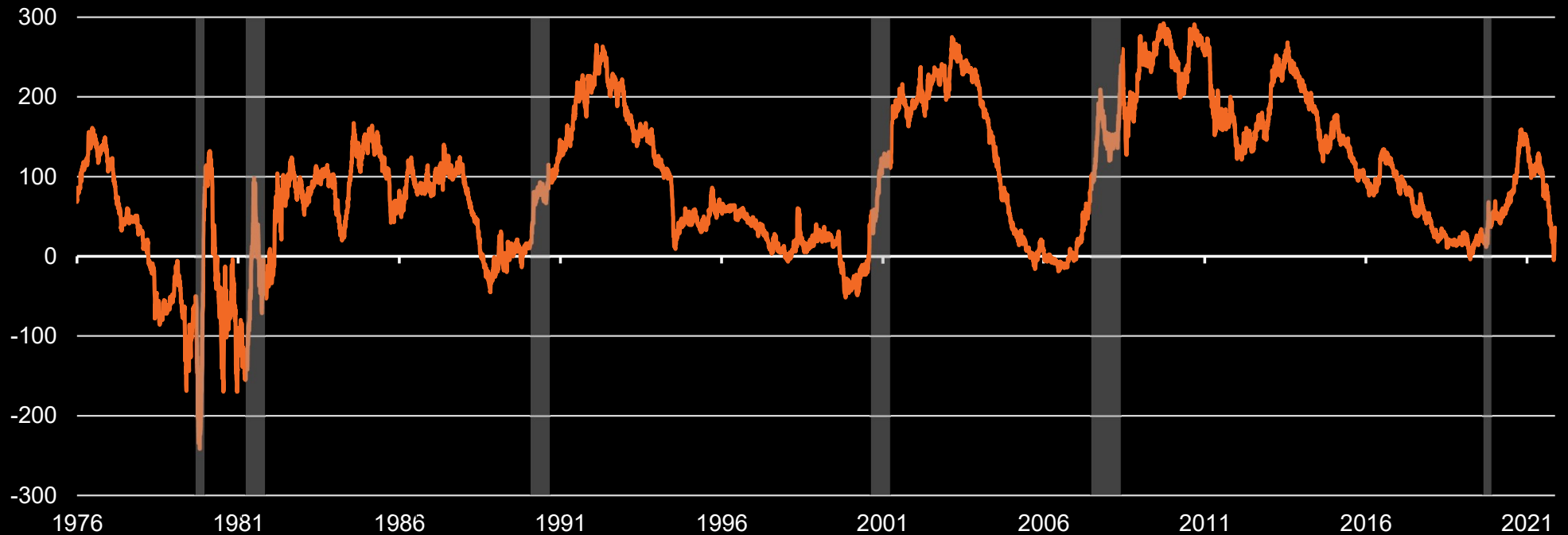


Source: Federal Reserve Bank, as of March 16, 2022.

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# Yield curve inversion check-in

Spread between 2-year and 10-year Treasury yields

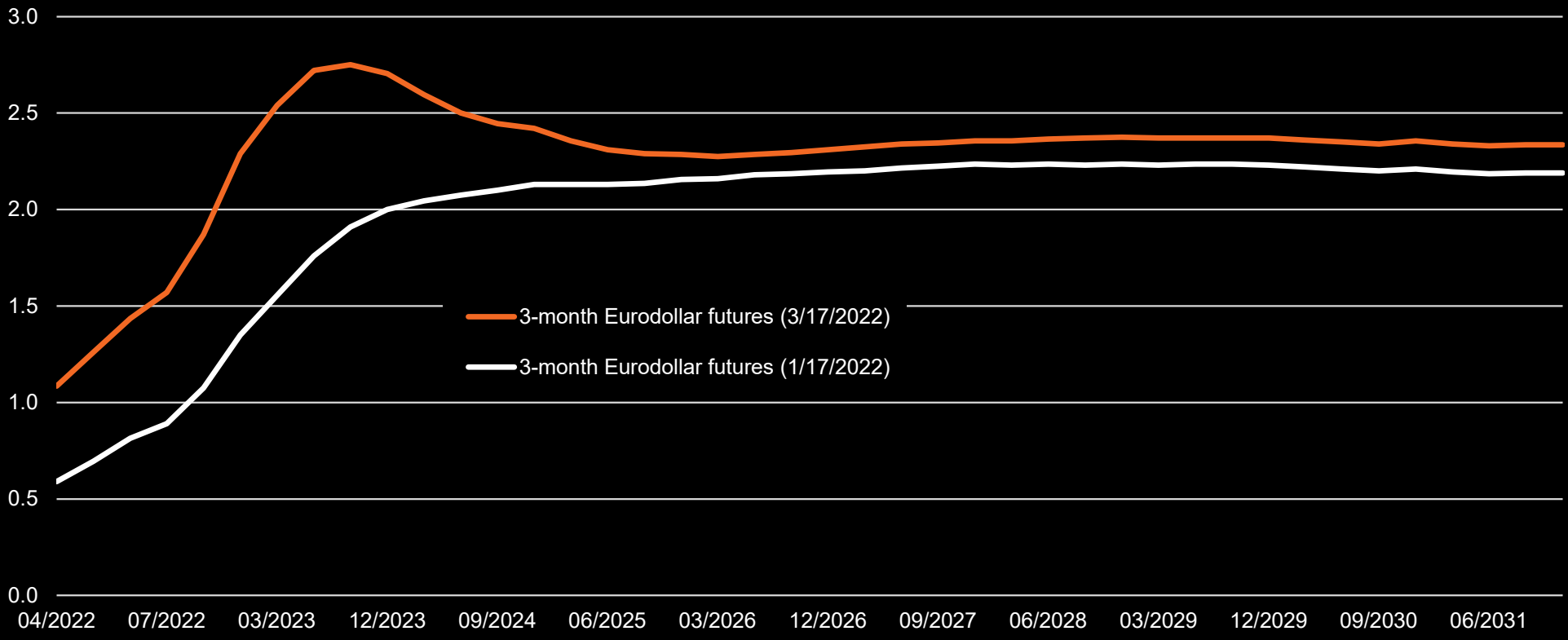


Source: Federal Reserve, NBER, as of March 9, 2022

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# Eurodollar futures are pricing a policy “mistake”

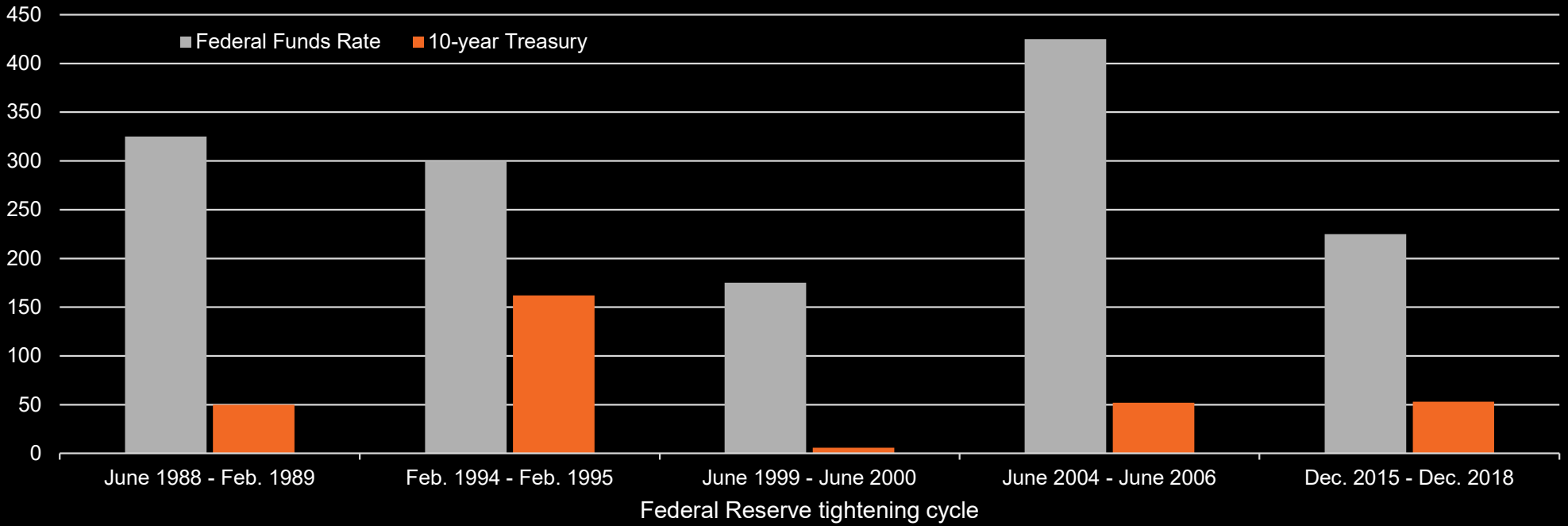


Source: Bloomberg Finance, L.P., as of March 17, 2022.

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# Rate hikes have muted impact on long-term yields

Basis point increase from start of tightening cycle to end



Source: Federal Reserve, FS Investments, U.S. Department of Treasury as of March 9, 2022.

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# Real yields remain deeply negative

10-year nominal and real interest rates



Source: Bureau of Labor Statistics, Federal Reserve, Bloomberg Finance, L.P., FS Investments, as of March 17, 2022.

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1

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# Higher inflation spells trouble for the 60/40

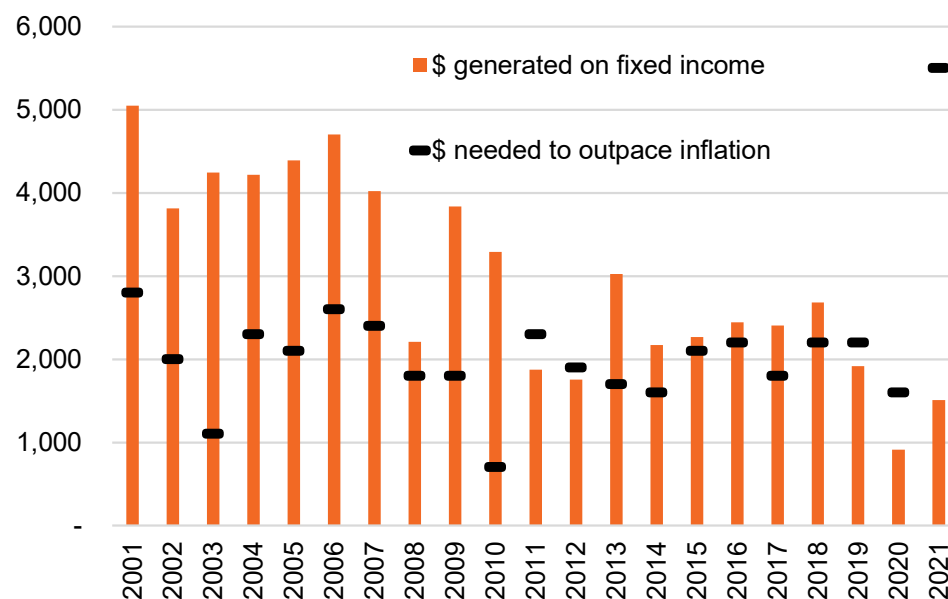
Historically, inflation has mattered for equities

## Nominal Total Return (Forward 12M)

CPI Level	Trailing 12M CPI Level Change		
	Increase	Neutral	Decrease
High	-1.70%	7.21%	10.26%
Neutral	13.67%	15.16%	9.14%
Low	18.16%	19.65%	13.31%

“... stock investors fail to properly account for inflation in their present value calculations.”(1)

Fixed income investors also face challenges



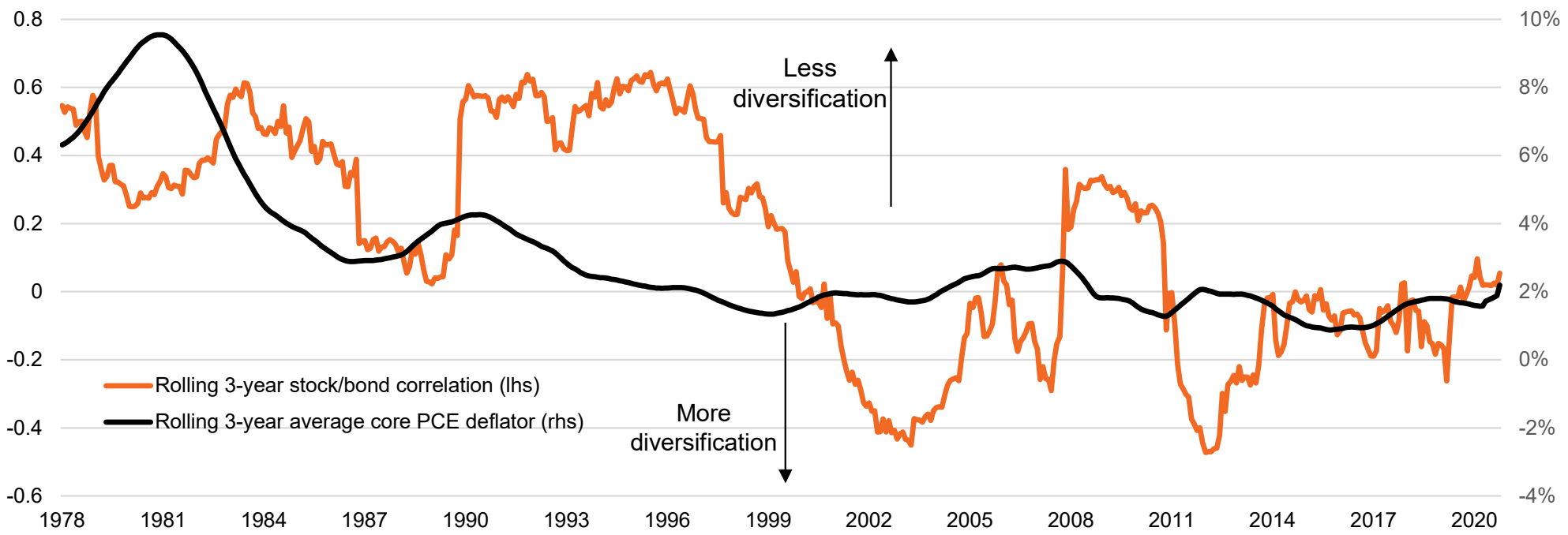
Source: LHS Table based on CPI data from January 1988 to September 2021. Defines a “high” inflation level over 3.2% y/y (top quartile), “low” inflation of below 1.7% y/y (bottom quartile), and all other cases are “neutral.” An “increasing” environment reflects a greater than 0.9% level change in trailing 12-month CPI, a “decreasing” environment reflects a -0.8% decline in level CPI in the trailing 12-months. A “neutral” environment is all other cases. Nominal Total Return forward 12 months is the following 12-month performance of the S&P 500. As of October 21, 2021. LHS chart source: Bloomberg Finance, LP. Bond income based on annual yields for 10-Year U.S. Treasury Bonds assuming \$100,000 investment. Inflation based on core Consumer Price Index (CPI). Data as of December 31, 2021.

(1) “Stock Market Valuation and the Macroeconomy,” Lansing, Kevin J., Federal Reserve Bank of San Francisco, November 13, 2017.

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# Implications for portfolio construction

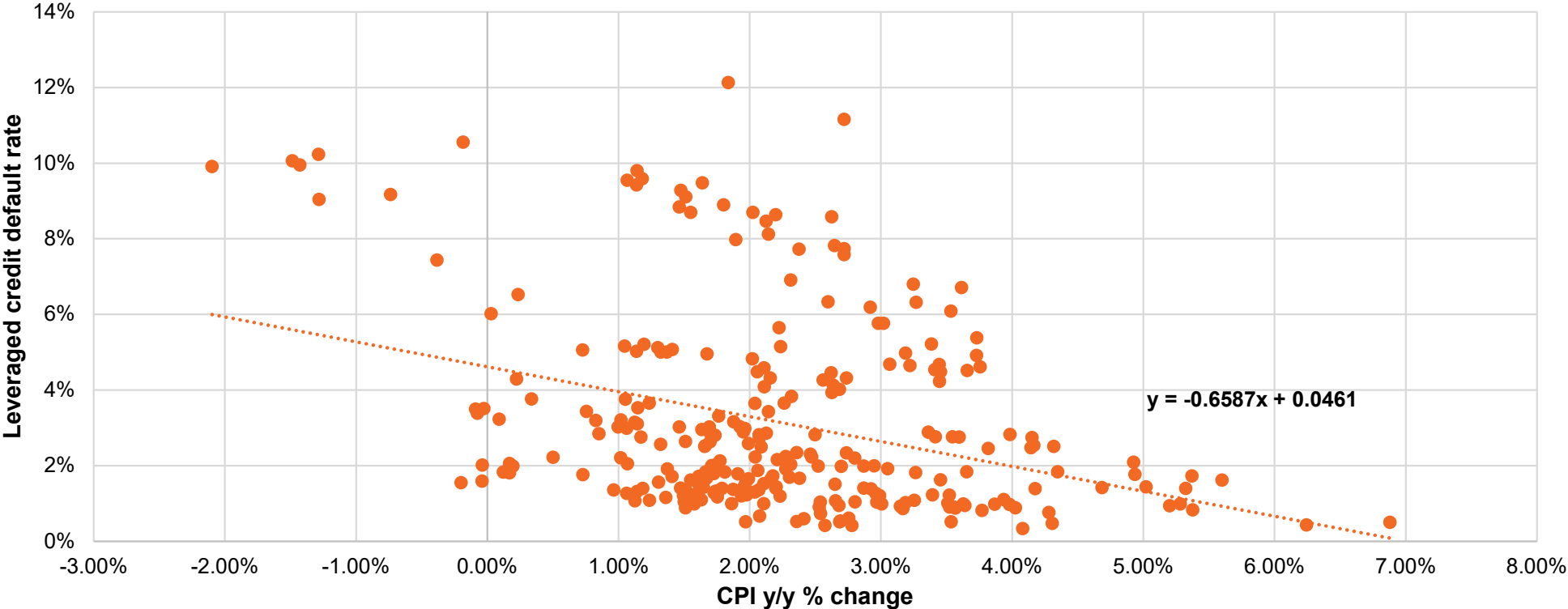
Stock/bond correlation rises during periods of elevated inflation



Source: Bureau of Economic Analysis, Bloomberg Finance, L.P., FS Investments, as of December 31, 2021.

# Credit remains fundamentally sound

Higher inflation has historically coincided with low default rates

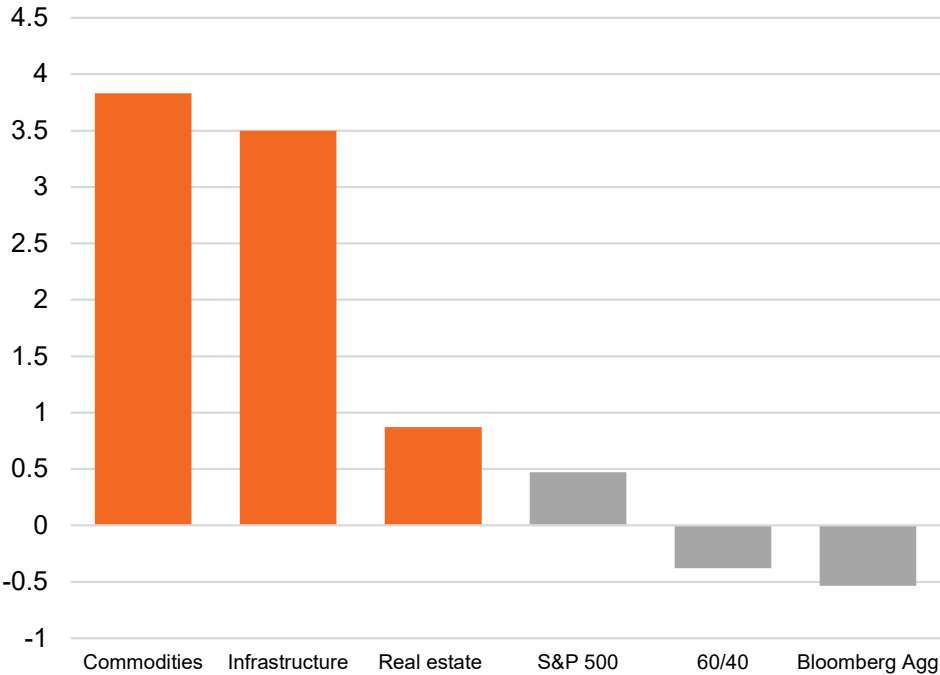


Source JP Morgan, Bureau of Labor Statistics, FS Investments. December 1998–December 2021.

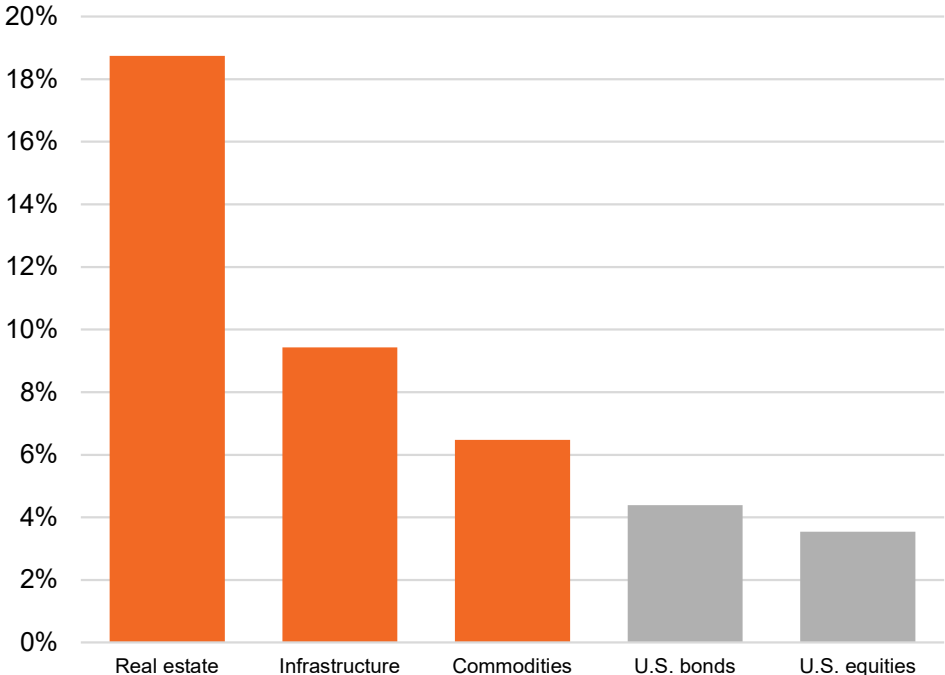
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# Real assets: The tried & true inflation hedge

Real assets have high beta to inflation



Which has led to outperformance vs traditional stocks & bonds during periods of rising inflation



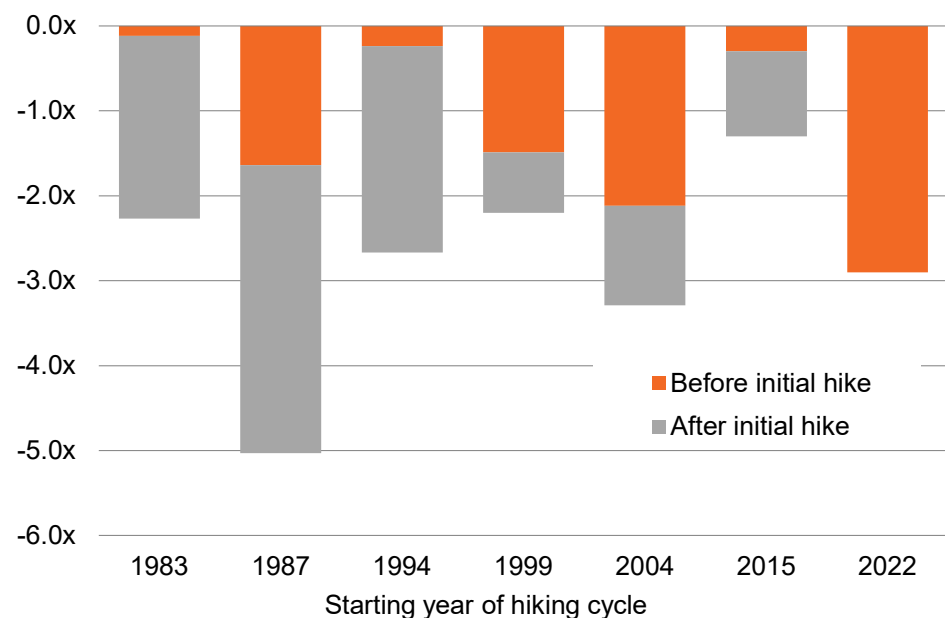
Source: Bloomberg Finance, LP, FS Investments. December 31, 1978–December 31, 2021. Beta of index returns to change in Consumer Price Index (CPI). Rising periods of inflation include all periods when CPI rose above the mean by one standard deviation or more.  
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# Earnings can take a hike

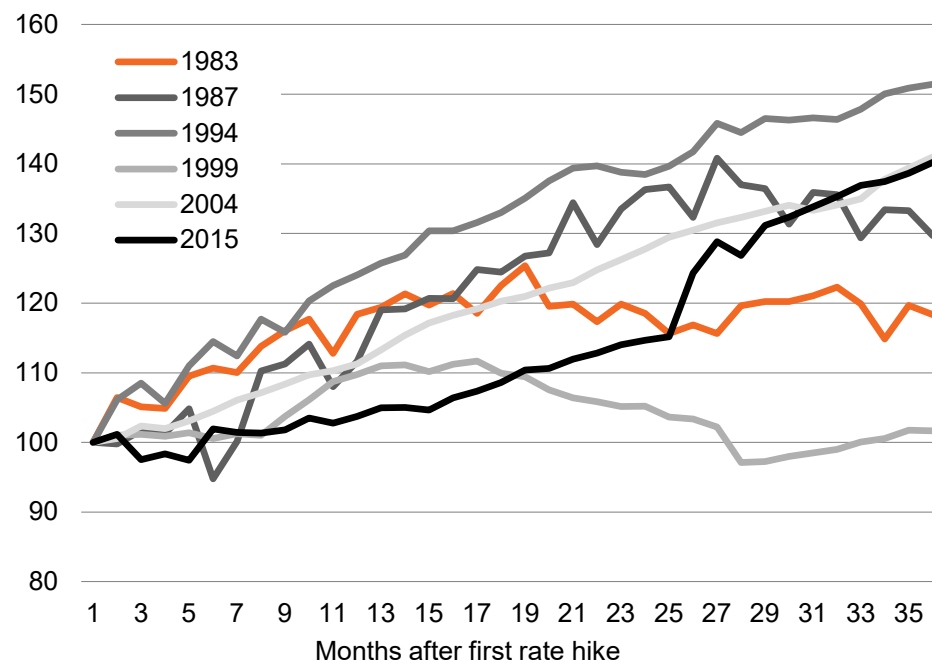
## Changes in S&P 500 P/E in rate hike cycles

Max decline in fwd P/E ratio during the period from 1 year before the first hike to 1 year after



## Earnings can take a hike

S&P 500 EPS following the first-rate hike

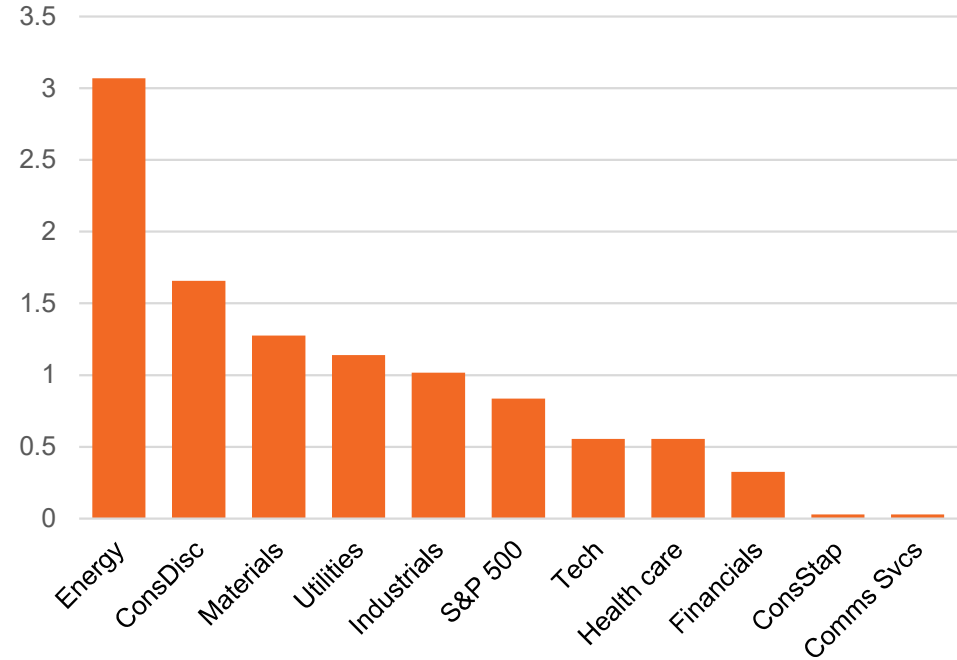


Source: Bloomberg Finance L.P., FS Investments, as of February 18, 2022. Right graph: Bloomberg Finance, L.P., FS Investments, as of February 18, 2022. Indexed to 100 = month of first rate hike.

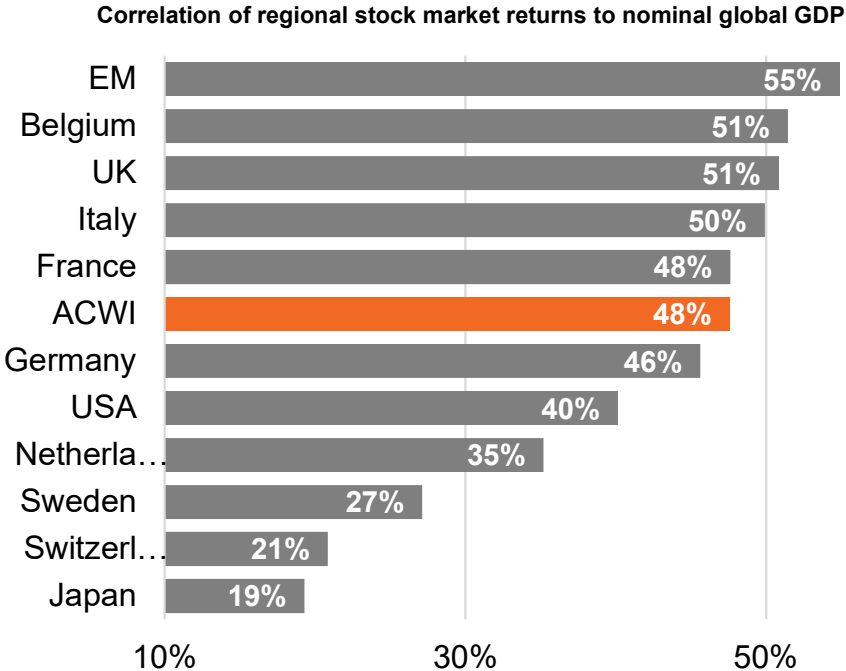
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# But accessing earnings becomes a challenge

S&P 500 sector beta to nominal GDP



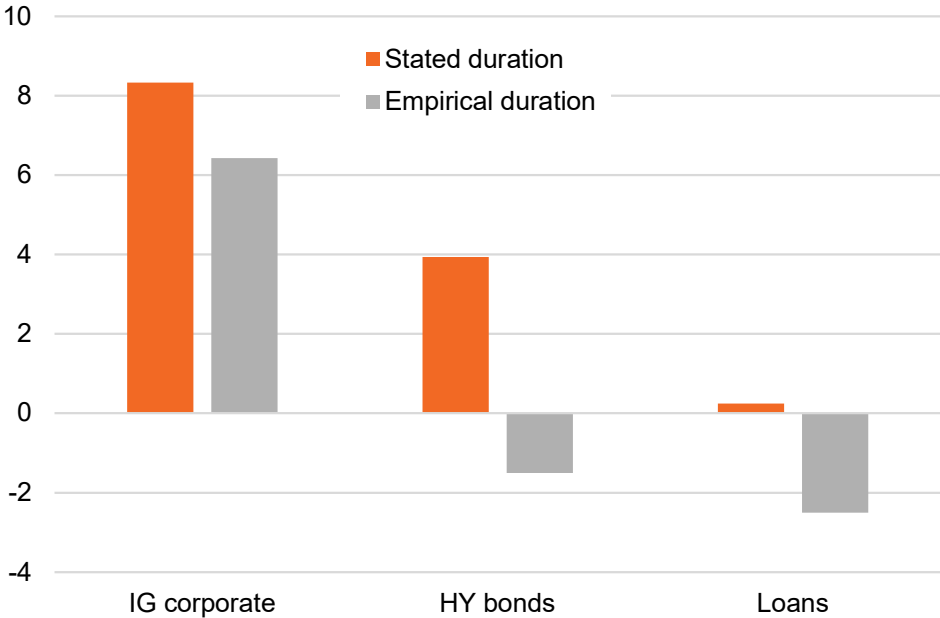
EM & Non-U.S. may benefit amid strong growth



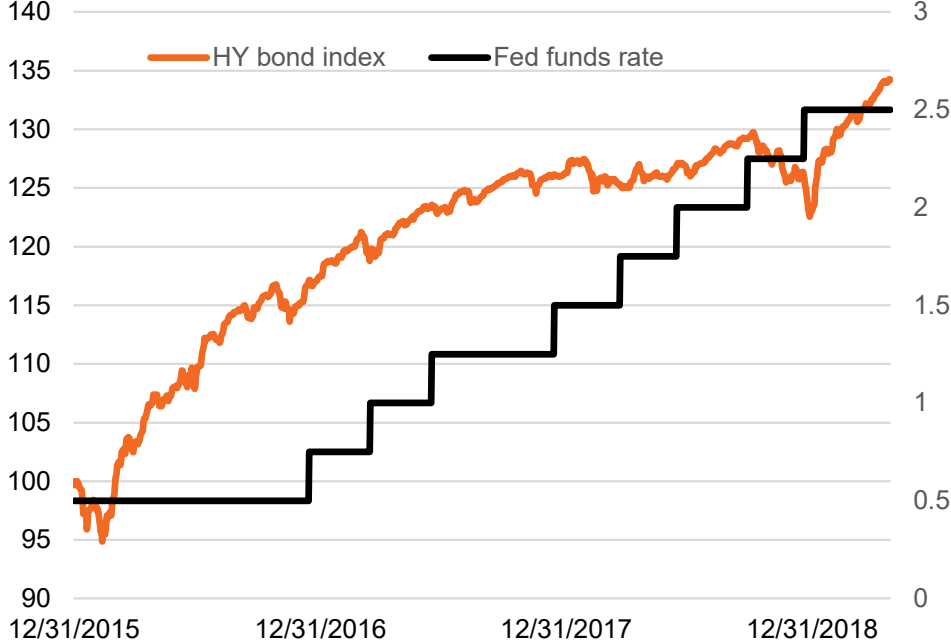
Source: Bloomberg Finance, LP, FS Investments, as of December 31, 2021. Beta to GDP is the beta of % y/y sector revenue growth to % y/y U.S. nominal GDP growth. Bloomberg Finance L.P., World Bank, as of December 31, 2021.

# Credit well positioned for Fed hike cycle

Bond performance during periods of rising rates



High yield bonds weather last rate hike cycle well

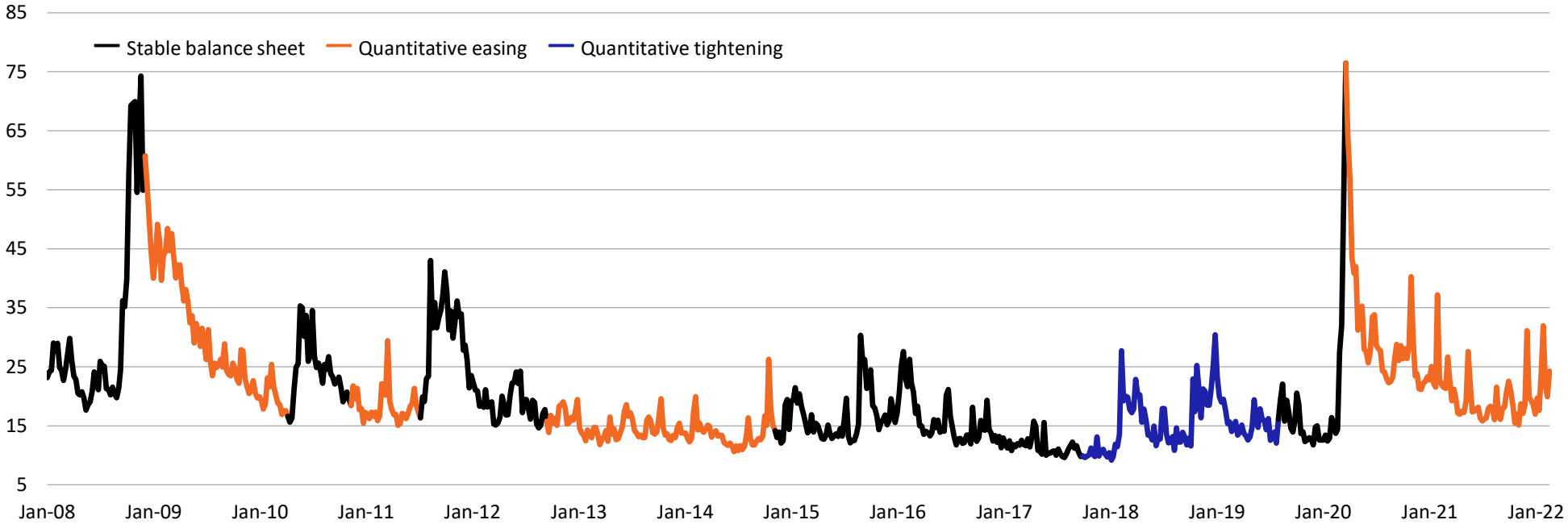


Source LHS: Bloomberg Finance, LP, FS Investments, ICE BofAML U.S. High Yield Bond Index, ICE BofAML U.S. Corporate Bond Index, S&P LSTA Leveraged Loan Index. As of February 28, 2022. RHS: Bloomberg Finance LP, FS Investments. December 31, 2015- March 31, 2019.

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# Into the unknown?

## VIX Index: QE has suppressed market volatility for much of the past 14 years



Source: Bloomberg Finance LP, FS Investments. Line shows VIX Index while colors indicate Fed policy. Measured from December 31, 2007-January 31, 2022.

# Questions?

**For more insights, visit**  
[fsinvestments.com](https://fsinvestments.com)

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