Episode 17

Research Roundtable: Q4 market and economic outlooks

In the home stretch! The Investment Research team gathers to discuss their predictions for Q4.

Kara O'Halloran (00:05):

Welcome back to FireSide, a podcast from FS Investments. My name is Kara O'Halloran and I'm a director on our investment research team here and today is our last Research Roundtable outlook episode for 2021. We brought my whole team back together to talk about the home stretch of the year, where we've been so far, how we think things will wrap up in the fourth quarter and we'll take a sneak peek into 2022. In the room we have Andrew Korz, another director on the team, Laura Rhame, our chief US economist, and Rob Hoffman, the head of our research team. Welcome, everyone.

Lara Rhame (00:36):

Hey, Kara.

Andrew Korz (00:37):

Hey, Kara.

Robert Hoffman (00:37):

Thanks for having us.

Kara O'Halloran (00:39):

As always, I want to set the stage a little bit. We are recording on Wednesday, September 29th. When we recorded our Q3 outlook episode back in late June, it really felt like that sweet spot where mass vaccinations were available, everything had, for the most part, just reopened. I think it was our first ever in-person podcast recording. We all talked about the trips and vacations and plane rides we were excited to take. And turning to the economy and markets, that's when we really saw some of our strongest growth forecasts and solid returns throughout markets with not a whole lot of volatility, but a lot can change in three months. I am excited to dig into all of that. Lara, I want to start with you as we always do to just bring us up to speed on what has happened in the economy in the third quarter.

Lara Rhame (01:24):

Kara, I feel like your summary really hit on a lot of my points because I also remember that glorious moment in mid July where we had peak GDP forecasts, reopening felt like it was really almost as close as back to normal as I think I felt since February 2020. It was all driven, I think, by the tailwind of vaccines.

Lara Rhame (01:52):

Going into the third quarter, really, nobody was focused on growth. The focus was really inflation and we saw CPI as high as 5.3% in the third quarter, core CPI hit its highest in 1991. That in the third quarter was really the big focus. I think something that surprised us and continues to surprise is the fact that inflation continues to bubble up from a lot of different areas. We saw high inflation coming from commodity prices. We saw it from supply shortages, but right now, and as the third quarter progressed, I think we've realized that those year-on-year numbers are going to come down somewhat, and against that backdrop while inflation may remain a challenge, we're still, I think, thinking that the Fed is going to be able to address that. Markets have really settled down and gotten comfortable with the challenge of inflation, and we've kind of moved back into growth because, of course, the Delta variant, I think, was a huge dark cloud on that incredibly amazing period of positive growth outlook.

Lara Rhame (03:02):

And now looking ahead, I think we've seen for the first time GDP forecast be revised down. I wrote down a couple, we haven't gotten GDP for the third quarter yet even though we're almost at the end of it, but we started with GDP growth forecast of 7% and that got, right now, the consensus for the third quarter's 5%. And then you have other sort of high-frequency now casting measures like the Atlanta Fed forecast, which is at only 3.2% for the third quarter. These are some of the first GDP forecasts being revised down that we've seen, so that's kind of where we are today.

Kara O'Halloran (03:38):

Actually, in prepping for this podcast, I looked at what we talked about in our Q3 outlook and I literally went to the transcript and did a search for the word Delta and it was not in there, so really just goes to show how quickly things can change with this.

Lara Rhame (03:52):

Still in a pandemic.

Kara O'Halloran (03:53):

Yeah, absolutely. Rob, I want to talk about credit now. As we just said, we talked about some of the things that have changed in the economy in the third quarter, but credit really continues to feel very steady. Catch us up, what happened in that market?

Robert Hoffman (04:10):

When we think about credit, one of the things that I think really defines credit markets today and in particular, high yield bonds and senior secured loans is just the solid economic foundation that the market finds itself on.

Robert Hoffman (04:25):

As I'm sure we'll talk about, there is a lot going on. There's some pockets of volatility as it relates to equities, and the economy, and rates, but when we think about distilling it down to corporate credit, default rates are extremely low. That outlook hasn't changed at all. Companies for the last available data basically posted record year-over-year growth in revenue, in EBITDA and cashflow, and that just really sets a very solid base for credit.

Robert Hoffman (04:56):

When we look at what happened in the third quarter, our outlook was for returns that were predominantly all income-based and that's really what happened. The loan market returned about 1%. Spreads today from the beginning of the quarter are almost exactly flat. High yield had a little bit of spread widening, basically all of that has come in the past week or so, but otherwise generated a very consistent income with what we thought would happen.

Robert Hoffman (05:26):

There were some changing dynamics. I think as risk premiums increased a little bit earlier in the year, lower rated CCC credits had been outperforming, that reversed itself somewhat in Q3, where we saw higher quality BBs outperform CCCs, but not a lot, I think, in the big picture as it relates to credit has changed, and I think that's going to be a theme for the foreseeable future. I don't know what really knocks the base of growth that the market finds itself on to continue generating relatively stable returns, albeit one's predominantly coming from income because spreads are relatively tight across credit markets.

Lara Rhame (06:10):

Enjoying the ride.

Robert Hoffman (06:11):

Yeah.

Kara O'Halloran (06:13):

We did enjoy the ride last quarter.

Robert Hoffman (06:16):

We still are.

Lara Rhame (06:16):

That's such a great title.

Kara O'Halloran (06:17):

I know. I will try to roll it forward.

Lara Rhame (06:20):

I think yeah, we still are.

Kara O'Halloran (06:20):

But that didn't catch. All right, Andrew. On this podcast, we had episodes focused on housing and the office sector, but I want to talk more broadly about commercial real estate in the third quarter. What happened there?

Andrew Korz (06:34):

If you recall in our Q3 outlook, we talked about the fact that economic fundamentals had improved pretty quickly and that had fed through to market sentiment. Investors were showing some pretty strong sentiment about the direction of the market, but we hadn't quite seen it yet channeled into a robust recovery in actual sales activity. There was this gap between what sellers were looking to sell for and what buyers were looking to buy at. That has really changed during the past three months.

Andrew Korz (07:08):

The market is back to pre COVID run rates for sales volumes, 2021 is actually on pace to set a new record in that regard potentially surpassing the level from 2019. Obviously, the Delta variant has been one of the major topics as we spoke about over the past three months. And while it hasn't necessarily weighed heavily on property values, which continue to soar or overall sales of properties, it has, I think, further extended the dominance of the apartment and industrial sectors in particular.

Andrew Korz (07:41):

They've accounted for nearly 60% of transaction volume this year compared to about 47% in full year 2018. It's been a pretty drastic re-composition I'd say of the market in terms of investor preferences that has followed the change in consumer preferences from e-commerce to remote work to preference for more space in suburbs. And, of course, this has fed through to price growth where the two sectors are seeing property values increase at a 13 to 15% annualized rate. Obviously, that trend was already in place pre COVID, but I would say COVID has accelerated it and Delta in particular has extended it. Despite Delta, I think we're seeing budding signs that we're entering into a new market expansion period.

Andrew Korz (08:32):

Typically, what we look for is rising transaction volumes. Check, we have that. An uptrend and strong property fundamentals, we are seeing that particularly in apartments. We're seeing sort of an uptrend in retail and in hotels as well, but that's obviously a little tricky with the Delta variant.

Andrew Korz (08:53):

Finally, we're looking for a broadening out of the lender base. Some of the traditional lender types like CMBS, like banks step back new originations during COVID and we're seeing some of them come back gradually. The Fed does some surveys of the banks that show growth in demand for new loans as well as willingness of banks to loosen standards. We're also seeing CMBS volumes rising consistently over the past few quarters.

Andrew Korz (09:21):

I would say it appears to us that lenders are out of that sort of hunker down mode and getting back into the game in terms of originating new loans. This cycle has been really unique. Property prices never fell for most property types, so it's a bit less obvious when a recovery ends and when an expansion begins, but I think Q3 sort of represented a bit of a transition period in terms of getting us into that next expansion.

Kara O'Halloran (09:51):

Great. I'm sure we'll expand upon that.

Andrew Korz (09:53):

Indeed.

Kara O'Halloran (09:53):

When we talk about the fourth quarter. Lara, one thing that you mentioned is that the first half of the year, we really had tailwind upon tailwind in the economy. We had stimulus measures, super accommodative fed, mass vaccinations, this economic reopening. And now, it seems like we have mounting headwinds. I think there's always something you can find to worry about, but it seems like there's kind of a lot of some things right now. Maybe you could talk us through some of those and what that means for our economy in the next quarter.

Lara Rhame (10:23):

Absolutely. That's well paraphrased, because I feel like there were so many tailwinds now that balance has shifted a little bit. Something that continues to really be a tailwind is just the solid financial health of the household. We know our economy, household spending is such a large part of that, and that is one thing that continues to really go well. I think that really now, it's a question of traction because when I think about household spending, I think about the spending that we do on goods. Boy, that came just roaring back not only a strong rebound, but has still now so far exceeded good spending that we saw prior to the pandemic. That's something that I think we're seeing across the board from businesses as well. We're seeing the strong good spending but you start caveat in these things, supply chain disruptions. We're hearing that more and more.

Lara Rhame (11:23):

Services spending is still challenged. That recovery is still incomplete. That's something that we're really watching as we enter the fourth quarter as far as traction for growth goes. And I think something that enters the conversation really quickly is the labor market. That to me in the fourth quarter is going to be almost synonymous with the growth outlook, because while we've seen this employment recovery, that's been really remarkable. I remember we had 25 million people out of work. The shock to the labor market was just so unprecedented and this has come back. So far, the unemployment rate now at 5.2% is really on its surface, a very healthy unemployment rate for our economy, but underneath that, you're still seeing millions of people out of work. In fact, it's interesting that right now, we still have 5 million people out of work from our peak. That is worse than the worst part of the last recession.

Lara Rhame (12:29):

In other words, the total number of unemployed that we had in the last recession is actually about where we are still right now. The employment recovery, even though it's been so strong, still has room to go, and the labor force recovery has been quite weak. These are dynamics that are, to me, really are going to dominate growth in the fourth quarter because at the end of the day, our economy in many respects can only grow as fast as we are growing bodies to create that economic activity, especially when you look at sectors like leisure and hospitality, transportation, retail. These are the largest sectors of our employment picture and there's some of the lower productivity jobs. That's just by way of saying, there are only so many beers that a bartender can dispense at one time sadly. I've been in that experience. That has been a challenge for me. I'm speaking of experiences this last weekend, but it's something that we really will, I think, focus on more and more as the fourth quarter continues.

Kara O'Halloran (13:36):

And especially as a lot of the unemployment or supplemental unemployment insurance rolled off, I'm curious how that'll play out in the next months.

Lara Rhame (13:44):

This is, I think, a key feature, to me, top of the list of how this expansion continues to just really break the mold. We cannot look at prior episodes when we're forecasting right now. And I think that's something that policymakers are having to contend with too and something that I know we're going to speak about next, but at the end of the day, when we think about growth in our economy, we've seen a big productivity surge over the last quarter. I don't think that that is going to continue. And as we think about growth, labor market dynamics, the expiring unemployment benefits, we're seeing consumer confidence start to wane a little bit, part of that's Delta and part of that may be because some aspects of the labor market, people who've been unemployed for a long time, those numbers are very high. Despite some numbers that are really strong about the labor market, we have other numbers that remain weak.

Robert Hoffman (14:44):

How much of the uncertainty in some of these issues and not to talk about 2022, because I think we'll do that a little bit later, but how much uncertainty does that create for the fourth quarter, which we're just getting ready to start versus issues that take longer to materialize and could be big deals for next year, but we carry the Q3 momentum into Q4. And so, Q4 is kind of well-baked, which is probably not, but what was your perspective on that?

Lara Rhame (15:11):

I think that's a really important question because one of the primary, I think, focus for the end of Q3 was the expiration of all these unemployment insurance benefits, the supplemental unemployment insurance benefits. And we've seen sporadic pockets of states that ended those benefits early, people haven't returned to the labor force as we were hoping, but schools are back open again. The household savings rate is still high.

Lara Rhame (15:38):

It could be just a matter of months before we see some further erosion in the sort of cash stockpile that households have enough of an erosion for people to finally start to kind of get more serious about re-engaging with the labor market. I think there is actually some expectation that the factors, which people have kind of been kicking the can down the road three months and saying, "Oh, it'll re-normalize soon. It'll re-normalize soon." The fourth quarter is when that should happen and I think that is something that is really going to be a focus versus longer term, maybe geographic shifts that Andrew's talked about or work from home dynamics. Those may be longer term issues that are really going to impact 2022.

Kara O'Halloran (16:20):

Definitely talk about those in the coming months. Rob, I am curious your thoughts on how some of these headwinds that we've talked about could impact credit. We called our Q4 outlook's still on solid footing, but maybe you could elaborate a little bit on what that means.

Robert Hoffman (16:36):

It's hard from the macro side to think about credit in the fourth quarter from a fundamental basis, because I think that the foundation is solid enough that credit should remain fairly steady. I mean, I think there are interest rate concerns and things that the fed might do. We've seen a little bit of that induced volatility recently. That potentially poses some challenges. It's one of the things that we listed as what we're watching for the fourth quarter, but I think one place to start is just thinking about the low spread environment that we're in. And a little bit of a reminder that we have low spreads, but we have defaults that are sub one and a half percent and the expectation that those numbers are going to stay there for a while.

Robert Hoffman (17:24):

And we do have previous periods of time in the market '95 to '98, '04 to '07, where you were in very low default environments with relatively steady economies and you maintained tight spreads for almost the full duration of that period of time, little things causing volatility here and there, but nothing really upsetting the larger path that the market was on.

Robert Hoffman (17:51):

And so, for the fourth quarter, I have a hard time really coming up with what's going to derail credit markets in Q4. I think we're watching the Fed talk and taper talk and what happens with rates. We saw a little bit of a rate spike. The five-year treasury is something that more closely matches the duration of the high yield market and the five-year is up by 25 basis points over the past few weeks or so. That definitely has an impact on the market.

Robert Hoffman (18:25):

We've seen spreads tighten that have offset some of that rising rate on the treasury side. And so, I think the question is, do we get further spikes that really start to spook people or do you get a gradual increase in rates that's kind of absorbed by the spread side of the market and it ends up not really being that big of a deal and the market continues to generate largely income-based returns for index investors.

Robert Hoffman (18:52):

I think we're also watching supply. That's one thing that's been very interesting about this year overall. Similar to what's gone on, I think Andrew maybe in the real estate market, different drivers, but you've really had record issuance of high yield bonds and senior secured loans, significant investor demand coming from a multitude of different places that has absorbed all of that paper, which has been great. It's led to balance supply and demand, but I do think you see these little inflection points in previous market, not necessarily cycles, but times where you've got all the supply that's coming to market. And if something upsets the applecart quick enough, the market kind of gets caught with an abundance of supply and suddenly your demand dries up.

Robert Hoffman (19:37):

Historically, high supply correlates with good markets, because when you're in a good market, you tend to have a lot of supply, but I think when things change very quickly, that can cause some volatility and cause things to switch around a little bit. But overall, it's hard to see some of these headwinds bubbling up to create true headwinds at the corporate level to really cause a material move in spreads that would severely impact credit. I have a hard time seeing that. Now, sometimes when you have a hard time seeing it is when it comes, so we'll see, but that really forms the basis of kind of the solid foundation that we expect for Q4 and where it's going.

Kara O'Halloran (20:20):

All right. Andrew, you said that we, in the third quarter, kind of crossed over from recovery to expansion. What are you thinking about for the fourth quarter? Do these headwinds that we've been talking about, do they risk throwing off that expansion? What are you thinking?

Andrew Korz (20:37):

Generally speaking, the early part of an expansion is probably the strongest time for the commercial real estate market, which intuitively makes sense. I think the stars are aligning for a pretty strong Q4. I'm going to inject some positivity into this podcast here.

Lara Rhame (20:56):

You always accuse me of being too negative.

Andrew Korz (20:57):

No, never.

Robert Hoffman (21:00):

Looks like credit's going to do well.

Kara O'Halloran (21:01):

Yeah.

Lara Rhame (21:03):

Just tailwinds of the economy, still a strong economy.

Andrew Korz (21:07):

No, I'm just messing.

Lara Rhame (21:08):

Just headwinds.

Andrew Korz (21:10):

I really think the stars are aligning for a pretty strong Q4. As I said, you've got lenders coming back, which I think should keep borrowing costs contained even if rates do rise somewhat. You've got good seasonality where Q4 is typically the strongest quarter of the year as investors try to get deals done prior to year end. You've got hopefully a peak in cases. Most models are showing daily case counts declining over the next couple of months. Famous last words, it's dangerous to project COVID a week in advance, let alone a couple of months, but I think given all that, I think we're set up for a nice couple of months here and what does that look like? I think what I'm looking for is progress in these so-called non-COVID beneficiary sectors.

Andrew Korz (22:01):

You've got retail. It'll be really interesting I think to see what this holiday season looks like in terms of revenue, in terms of composition of revenue, in-store versus e-commerce. We all know Lara's talked at length about supply chain challenges. I think investors are really going to be watching the holiday season and what goes on with retail fundamentals. Hotel is obviously extremely sensitive to the COVID backdrop. As Delta hopefully wanes a bit, we're going to see an uptick in occupancy and hopefully in holiday travel. And then office, especially central business district, it's all really regional right now. You hear anecdotally about New York City being more crowded. The subway station being slowly but surely coming back in terms of passengers. Are we going to see that uptick in office space utilization in cities like New York, like San Francisco, where they've been persistently low. Personally, I expect to see a modest improvement in activity in these sectors.

Andrew Korz (23:07):

You're beginning to see wider gaps in terms of relative cap rates across sectors. Apartment has, over the past five years, traded about 100 basis points tight to office. That gap is about 150 right now. Industrial has, in the past five years, traded on average with a cap rate about equal to retail. That gap is now a full 100 basis points, which is the widest it's been.

Andrew Korz (23:32):

I think investors will start to see some relative value there, especially in certain markets, for example, in some of these Sun Belt markets where office space utilization is stronger. As property yields and the differential between property yields increases, investors might look to dip their toes more so into these out of favor sectors, especially as fundamentals become more certain.

Andrew Korz (24:01):

With all that said, dispersion, as we all know is the name of the game with COVID. We see it in all different sectors of the economy and all different sectors of the market. I think we could see a little bit of right-sizing in these retail office, hotel sectors, but ultimately, make no mistake. We are in a bit of a new normal for CRE right now where apartment and industrial are really the dominant sectors right now and everything else is just sort of playing catch up.

Kara O'Halloran (24:30):

All right. Each quarter, we try to pick a theme to kind of hone in on that we really think is going to dominate conversations for the next few months. It was a little more challenging this quarter just to pick one. There are a lot of things that we could talk about. As we said, there are some rising uncertainties out there. You're right, I'm sounding super negative on this podcast, but today, I want to focus in on the Fed.

Kara O'Halloran (24:51):

Last week, we had the Fed announce that they were likely to start tapering their asset purchases in the coming quarter. This announcement, I think, was very expected and we seem to avoid another taper tantrum, at least at this point, but this pivot away from ultra accommodative policy is going to have wide-ranging impacts across our economy and markets. Lara, what are you watching when it comes to the Fed right now?

Lara Rhame (25:15):

Clearly, messaging around the taper, just again, so unique, so different this time around. We don't have a lot of examples of tapering, but this time around, the Fed not only signal they were going to start tapering in Q4, but that it would probably end by mid 2022, really notable that they gave us a schedule pretty much.

Lara Rhame (25:38):

Markets are now focusing very quickly on when they're going to start raising rates. And the expectation seems to be that pretty quickly after they are done tapering, they're going to start rate hikes. This, I think, fits with the theme that we've had all along throughout this incredible recession and expansion, just this cycle is moving so fast. Normally, the Fed doesn't start raising rates until three years after a recession has ended. And last time around, given the depth of the last downturn, it was six years.

Lara Rhame (26:13):

If they do actually raise rates by the end of next year, that'll be two years after the recession ended. This is just a theme that keeps coming up again and again in our quarterly outlooks and as we discuss all of this. And, of course, I think it's appropriate right now to just talk about the fact that Fed Chair Powell is up for renomination at the beginning of next year, that given some of the recent controversies about the trades and financial market activities of regional Fed presidents, the recent resignation of, of course, Rosengren and Kaplan, has I think drawn fresh uncertainty as to whether or not he will be renominated. And we should watch very closely in the fourth quarter to see if he actually will be replaced and how that renomination process is going to go, because that, suddenly, I think is pretty important and would probably signal a dovish pivot if he is replaced.

Lara Rhame (27:08):

We may actually not get the aggressive rate high trajectory. Is aggressive too strong? And the Fed tends to be aggressive when they forecast their own rate high trajectory and they can be pretty wrong. That's maybe another thing to bring up at this point. A lot of people, one of the graphs I have in the outlook is they're wrong often when they think that they're going to be able to manage more rate hikes, a higher terminal rate hike than they actually achieve.

Kara O'Halloran (27:39):

And we saw them have to backtrack on their most recent rate hiking cycle. I'm going to change the order. Andrew, let's go to you next.

Andrew Korz (27:47):

Oh, okay, a little crazy.

Kara O'Halloran (27:48):

I know. I'm feeling loose today.

Andrew Korz (27:52):

I'm flustered.

Kara O'Halloran (27:53):

What are you watching for when it comes to real estate with this Fed talk?

Andrew Korz (27:59):

Certainly, and as we know, real estate tends to be a very sensitive sector when it comes to interest rates, so we shall be watching Fed policy really closely. I thought it would be interesting to take a quick look at past monetary tightening cycles to see if there are trends we can glean in terms of impacts on commercial real estate market. Investors right now are prepping for imminent tapering of Fed asset purchases. And I was just looking at my Bloomberg at the OIS curve. The market is currently expecting a little more than one full rate hike in the next 12 months and almost four in the next 24 months, so as Lara said, a fairly aggressive rate hike cycle.

Andrew Korz (28:41):

In terms of taper, obviously, we only have one historical data point from 2013. What we saw were mortgage rates going up alongside benchmark yields, but transaction volumes and price growth really didn't flinch and they kept improving along with the expansion. We have two examples of rate hike cycles in our dataset, the '04 to '06 cycle and the '15 to 2018 cycle. And there are certainly some trends that we can take from analyzing them together.

Andrew Korz (29:08):

Price growth in both cases peaked in the 18 months following the first rate hike. It peaked closer to 18 months after in the '04 to '06 cycle and more like six months in the '15 to '18 cycle. Borrowing rates, mortgage rates have bottomed about a year after the first hike and have gone on to rise roughly 80 basis points in the pursuant couple years in both cycles. Transaction volumes, there's really not much to glean here. Sales continued to surge pre global financial crisis as we know. That was more of a real estate led downturn. While last cycle, they sort of leveled off later in the cycle.

Andrew Korz (29:53):

The most interesting one I think is dispersion. Typically, we see dispersion between sectors decline during a rebound and early expansion and then begin to rise as the Fed raises rates and the sort of differences in fundamentals between sectors start to become more clear. This to me is really interesting because we are already seeing record dispersion right now between sectors, which is highly uncommon for this part of the cycle.

Andrew Korz (30:21):

If and when the Fed begins tightening, will it drive a further wedge between performance in different sectors or will we see more of a mean reversion from these "lagging sectors" right now? For me, the broad takeaway here is that the taper is less likely to be impactful than a rate hike cycle. And in the case of a rate hike cycle, we've traditionally seen mortgage rates rise, property price growth moderate, and ultimately, you see NOI or income become the primary driver of returns rather than continue to see cap rates come down, driving valuation increases. That's really what I'm looking for.

Kara O'Halloran (31:04):

All right, thanks. Rob, as I said, we seem to have, at this point avoided another tantrum and we've talked in the past about how rising interest rates don't impact credit as much as investors may think that they do. I am curious your thoughts and what you're watching when it comes to the Fed making this pivot.

Robert Hoffman (31:22):

I think that's well said, your final comment. Historically, you think of markets like the loan market, it's a floating rate market. It tends to really not have that correlation to duration risk because it's floating rate. In addition, 70% of loan buyers are CLOs, they are spread buyers. The CLO market is very strong. When rates go up on the asset side, they go up on the liability side, things are still matched and it doesn't create a problem. It doesn't create for selling of loans. And so, for a variety of reasons, the loan market is fairly resistant to changes in rates.

Robert Hoffman (32:01):

Similarly, on the high yield side, just because fundamentals are such a larger driver of return in that market, you get some little pockets of volatility sometimes with rates. And like we saw very recently, just with this move higher in rates, BBs, which are a little bit more rate sensitive underperformed against CCCs, but by and large, the market does okay. And especially over the intermediate to longer term, high yield doesn't trade with a correlation to changes in rates and going back to a piece that we authored looking at effective duration, the effective duration for high yield is negative, meaning it tends to do well also in rising rate environments.

Robert Hoffman (32:43):

I think the issue becomes with taper talk and positioning by the Fed, does something shock the market and by market, it's probably equity market to such a large degree that equities think they really got something wrong and equities trade off some 5, 10%, some large number that causes risk sentiment to change in markets, which flows into credit. Even though the underlying fundamentals of credit are still solid, it's not immune from that type of larger risk-off change in the equity markets. And so, that's what I think we'll be watching in terms of the Fed. Is there anything that causes that large of a shock, because if there's not, it's hard to see this repositioning and moderate changes, a little bit more hawkishness from the Fed doesn't really have a major impact on bonds alone.

Kara O'Halloran (33:40):

I wanted to call our outlook, but we're not going to start the fire, but I didn't think that was... I thought that might send the wrong messages. I'm not implying that there will be fires. All right. I want to wrap us up with our lightning round and I'm going to hold you guys to it this time. We're going to be rapid. Andrew, I think you probably can relate to this, but one of my favorite things to do in early April is look at the way too early top 25 college basketball rankings. We are Villanova basketball fans, so we usually see our name pretty high up on that list, so it's always really fun. Lara, I know you're a huge college sports fan, so you're also a...

Lara Rhame (34:16):

Only by proxy for you too.

Kara O'Halloran (34:21):

Anyway, I want to do our way too early top one or two things for 2022. What are you guys going to be paying attention to at this point, what do you think? Lara, we'll start with you.

Lara Rhame (34:31):

All right. I got to tell us who goes first with the lightning round.

Kara O'Halloran (34:33):

I forgot. All right. Make it snappy.

Lara Rhame (34:36):

All right. We haven't talked about China. I think the US, largest economy in the world, we're used to getting our forecast organically, but increasingly, I think risks, we're going to start looking externally either because of shutdown, supply chains or because of regulatory changes or growth scares in other parts of the world. Strong US economic outlook, certainly very solid, but the global factors could be a larger influence than we are used to seeing.

Kara O'Halloran (35:06):

All right, Andrew.

Andrew Korz (35:07):

Aside from college basketball, in 2022, I'll be watching. This cycle is moving rapidly, much more quickly than certainly previous cycles. As I said, I expect to start to see fundamentals catch up to valuations and income really become a larger contributor to returns than sort of this is cap rate contraction that we've seen. I also expect to see these "alt sectors" like life sciences, cold storage, self storage, data centers, further enter the mainstream. They're already around half of the public equity REIT market. I expect more private managers as cap rates continue to kind of get smaller and smaller in the in-favor sectors like industrial and apartment to start looking for yield elsewhere. And those sectors are certainly fundamentally attractive places to be.

Kara O'Halloran (35:56):

We're cheating a little bit. We're just speeding up our... We're talking really fast to get the... All right, Rob, take us home.

Robert Hoffman (36:04):

You forget I was a high school debater.

Kara O'Halloran (36:05):

I didn't know that.

Robert Hoffman (36:07):

I can talk really, really fast.

Lara Rhame (36:09):

God, that explains so much.

Robert Hoffman (36:12):

Five pages into 30 seconds. I'll pick fundamentals as something that we're watching and it's something that's different than what we listed in the outlook is what we're watching in Q4. I think there's a question out there, not that Lara, you necessarily expect this, but it's something worth monitoring, which is, does persistently high inflation start really making its way into the economy, start hitting bottom lines, cause deteriorating fundamentals for companies and ultimately impacting revenue and EBITDA stats from a situation today that we think the economy is on relatively solid footing, especially solid footing enough for credit markets, but does something cause that to change and do we start to see companies not reporting steady enough type of financials that they really need to be able to continue to pay down debt that was taken on during COVID and really change that solid foundation that today, we feel that we see for credit.

Kara O'Halloran (37:13):

All right, thank you all. We will be back to wrap up the year and do a full 2022 outlook in the next couple of months. Thanks everyone.

Robert Hoffman (37:23):

Thank you.

Lara Rhame (37:23):

Thanks.

Andrew Korz (37:27):

Thanks, Kara.

Kara O'Halloran (37:31):

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