

PCA Monthly Commentary

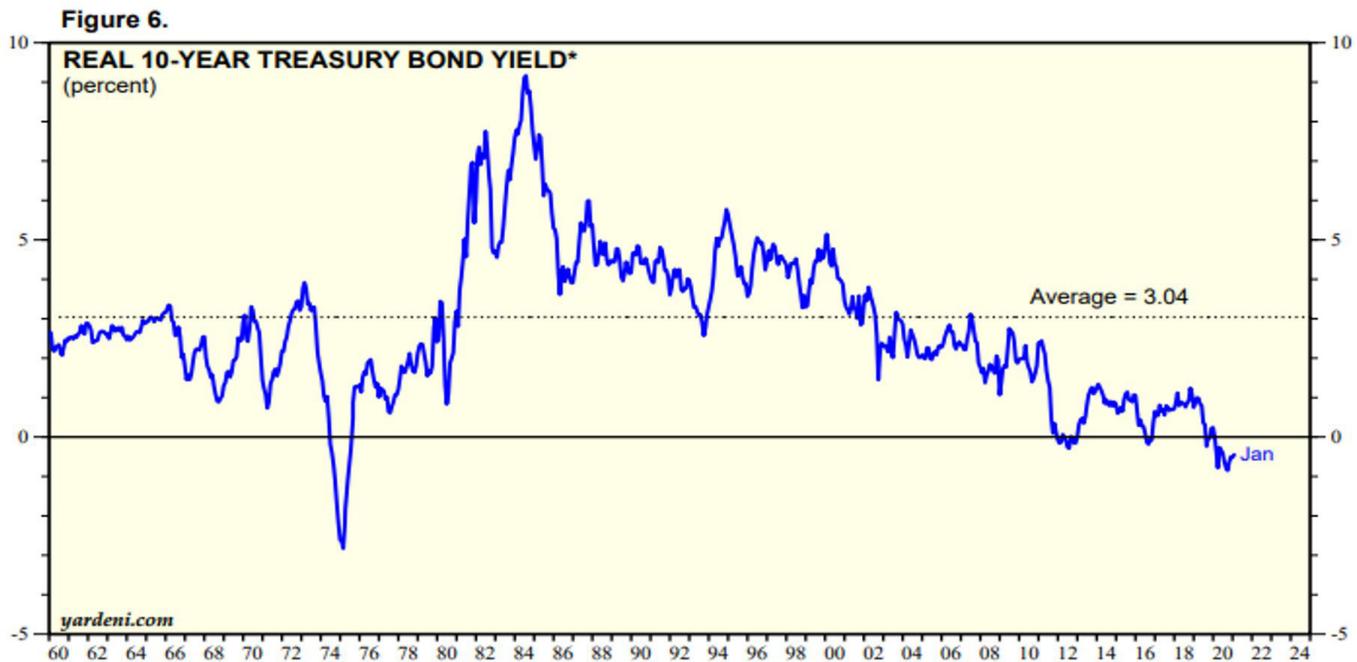
March 2021

Interest Rates Reach Inflection Point

March 2021 sees the country, government, and markets attempting to envision a world beyond the pandemic. Three coronavirus vaccines are being administered, and long-term interest rates are moving up. Global equity markets rose with the S&P 500 +2.7%, NASDAQ +1.0%, EAFE +2.2%, and Emerging Markets +0.8%. Fixed income performance was mixed with the Bloomberg Barclays US Aggregate -1.4% and US high yield +0.2%. Cyclical commodities such as oil continued to rally +18.3%, while gold fell -6.6%.

LONG-TERM US TREASURY YIELDS MOVING UP

The 10-year US Treasury yield began the year at .92% and has risen to over 1.50% at the beginning of March. Nominal bond yields are a function of real interest rates and inflation. Over the last few months, the market is reflecting higher real yields and nominal inflation. Real yields are negative but have moved up roughly 50 bps since the end of 2020.



* 10-year Treasury yield less yearly percent change in core PCED.
Source: Federal Reserve Board and Bureau of Economic Analysis.

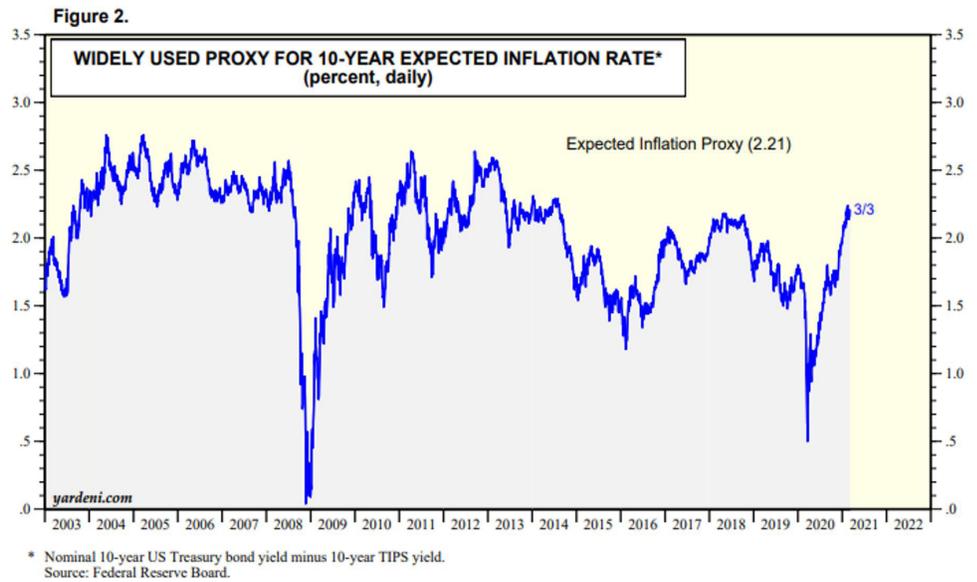
Source: <https://www.yardeni.com/pub/nomrealyield.pdf>

Rising real yields are an indication of stronger future economic growth. With three vaccines now approved and distributed in the US, the prospect for the resumption of normal activity has been rising. Stronger economic activity should be positive for job growth and company earnings power. A negative effect of rising real yields could be on the price of gold. Gold prices typically rise as real yields fall.



The second component of nominal yields is inflation. Inflation expectations cratered at the beginning of the pandemic as economic activity ground to a halt. As economic activity recovered throughout 2020 and the prospects of yet another stimulus package emerged, inflation expectations have been rising.

With real yields and inflation picking up, implications are varied throughout the market as nominal yields rise. For the bond market all else equal, bond prices fall when yields rise. A positive for bond markets could be on the credit side as better economic activity can lead to stronger creditworthiness across the economy. On the equity side, rising rates impacts sectors differently. Better economic activity and inflation benefit sectors such as financials, energy, and materials. Higher rates can negatively impact companies whose values are derived from cash flow far into the future. These are typically growth stocks where the present value of those cash flows is lower given higher rates.



Source: <https://www.yardeni.com/pub/nomrealyield.pdf>

CORONAVIRUS RELIEF IN SIGHT

The spike in daily new cases post-Thanksgiving is now declining with the average now below 80,000. Hospitalizations have also improved to under 50,000. Since vaccination efforts began in the US on December 14th, more than 78.6 million doses have been administered and more than 26.1 million people were fully vaccinated per the CDC. The US is currently administering around 1.9 million shots a day. The Johnson & Johnson vaccines received early approval by the FDA and began distribution in early March. President Biden announced on Tuesday that the US will have enough vaccines for all adults by the end of May, two months earlier than he previously expected.

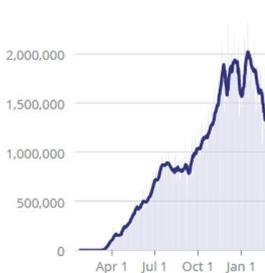
Overview of National COVID-19 Data

Last 90 days **Historical**

— Solid line represents National 7-day average

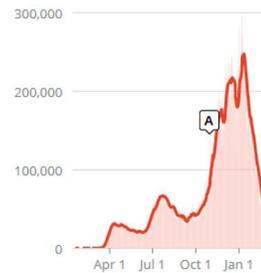
New tests

Total test results (mixed units)



[Chart information and data](#)

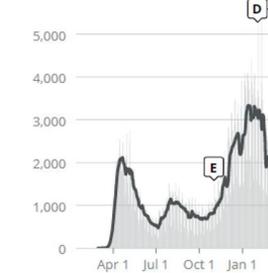
New cases (Notes)



Current hospitalizations (Notes)



New deaths (Notes)



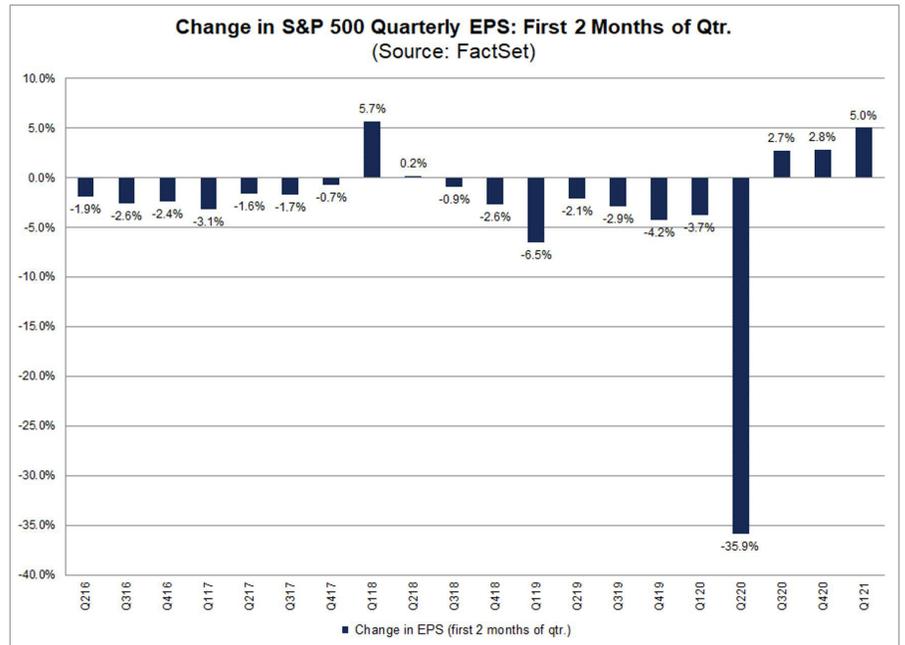
Source: <https://covidtracking.com/data>





Q4 SURPRISED TO THE UPSIDE

According to FactSet, approximately 96% of the S&P 500 has now been reported. Earnings season has been typified by another round of outsized beats. Close to 80% of reporters have exceeded consensus estimates while in aggregate, companies have reported earnings nearly 15% above expectations. However, estimates and expectations had moved up during Q4 as the market reaction did not fully reward earnings beats. This was an issue for many of the at-home winners, where concerns about sustainability have been exacerbated by the more recent improvement in coronavirus trends. At the same time, Q4 results brought more evidence of a COVID-driven acceleration of secular growth and disruption themes.



Source: Factset, Pallas Capital Advisors

CONCLUSION

2021 opens with a view towards a resumption of normal activity in the US. Coronavirus optimism improved as daily new cases dropped, and vaccinations are accelerating with an additional approved manufacturer. The positive news on the economy and prospects for another stimulus bill were catalysts for a rise in long-term bond yields impacting financial markets.

Corporate earnings surprised on the upside providing support to a recovery in earnings power. Pallas Capital will continue to monitor macroeconomic, political, and company news for impacts on markets.

Sincerely,



Mark A. Bogar, CFA[®], CAIA[®]
Chief Investment Officer
Pallas Capital Advisors

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