

WEEK IN REVIEW

FRIDAY, AUGUST 20TH, 2021

1. PRICES OF CORE GOODS PROJECTED TO MODERATE RELATIVE TO CORE SERVICES

The core personal consumption expenditures index (PCE) measures the prices paid by consumers for goods and services excluding food and energy. The PCE can be further divided into core goods and core services.

In the first half of 2021, core goods rose by 4.2% while core services grew by 3.3%. The combination of the two saw the core PCE grow by 3.54%. In the second half of 2021, both goods and services are expected to post growth year over year, but goods are expected to slow driven primarily by a lower increase in used car prices while services are expected to accelerate slightly driven by housing and airfares.

Comparisons change materially looking forward to 2022. In 2022, core goods are expected to see a net decline in price versus 2021. Categories projected to have the most significant price decrease are used vehicles, household appliances, and video/computers. The only category within core goods expected to contribute positively to growth year over year is pharma and medical products. Core services on the other hand are expected to see net growth and keep the overall growth for the PCE index at 2.0%. All the categories for core services are expected to grow in excess of the PCE index with housing being the biggest contributor overall.

	June 2021		End 2021		End 2022	
	Weight	YoY	YoY	Contribution to Change	YoY	Contribution to Change
Core PCE	100.0	3.54	3.75	0.21	2.00	-1.54
Core Goods	27.4	4.2	3.7	-0.14	-1.9	-1.68
New Vehicles	2.8	5.4	7.1	0.05	-1.8	-0.20
Used Vehicles	1.7	39.2	23.1	-0.28	-17.1	-0.97
Household Appliances	0.5	11.7	7.3	-0.02	-8.4	-0.10
Video, Audio, Computers	2.3	0.0	-0.1	0.00	-9.2	-0.21
Recreational Vehicles	0.6	6.3	5.7	0.00	-1.1	-0.05
Jewelry, Watches	0.8	11.5	9.3	-0.02	-0.5	-0.10
Clothing & Footwear	3.4	4.7	3.8	-0.03	2.3	-0.08
Pharma & Medical	4.1	-2.3	-0.5	0.08	2.0	0.18
Pets Products	0.6	1.1	2.0	0.01	1.5	0.00
Expenditures Abroad	0.1	9.6	3.7	0.00	4.9	0.00
Residual Core Goods	10.4	1.8	1.8	0.00	-1.0	-0.29
Core Services	72.6	3.3	3.8	0.36	3.4	0.10
Housing	17.0	2.2	3.4	0.19	4.3	0.35
Ground Transportation	0.3	8.8	6.3	-0.01	2.3	-0.02
Air Transportation	0.7	-3.0	23.3	0.20	4.6	0.06
Food Services & Accommodation	7.8	4.5	6.5	0.16	3.8	-0.05
Financial Services & Insurance	9.2	3.9	3.5	-0.03	3.1	-0.07
Medical Services	18.3	2.7	2.7	0.00	2.4	-0.06
Foreign Travel	0.8	3.3	2.9	0.00	4.6	0.01
Residual Core Services	18.5	4.0	3.7	-0.06	3.5	-0.10
Mix Shift Impact (Across Categories)				-0.01		0.04

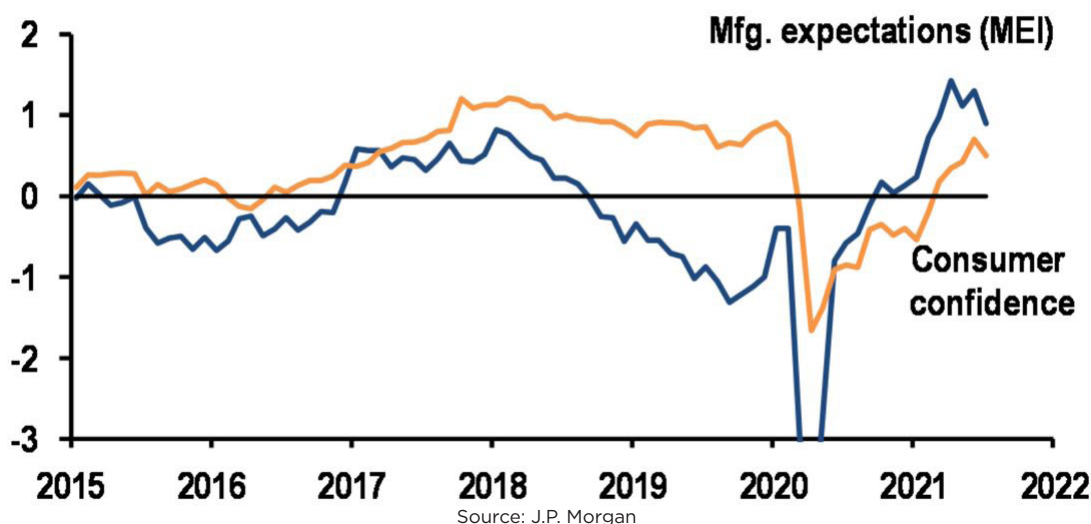
Source: Department of Commerce, Goldman Sachs Global Investment Research

In the big picture, this analysis would suggest consumers will see a greater percentage of their spending going towards services rather than goods in 2022. However, factors such as ongoing supply chain constraints, high raw material costs, and low inventories may keep upward pressure on the cost of goods. Uncertainty about the path of COVID may influence the ongoing recovery in core services.

2. DELTA VARIANT DAMPENING RECOVERY EXPECTATIONS

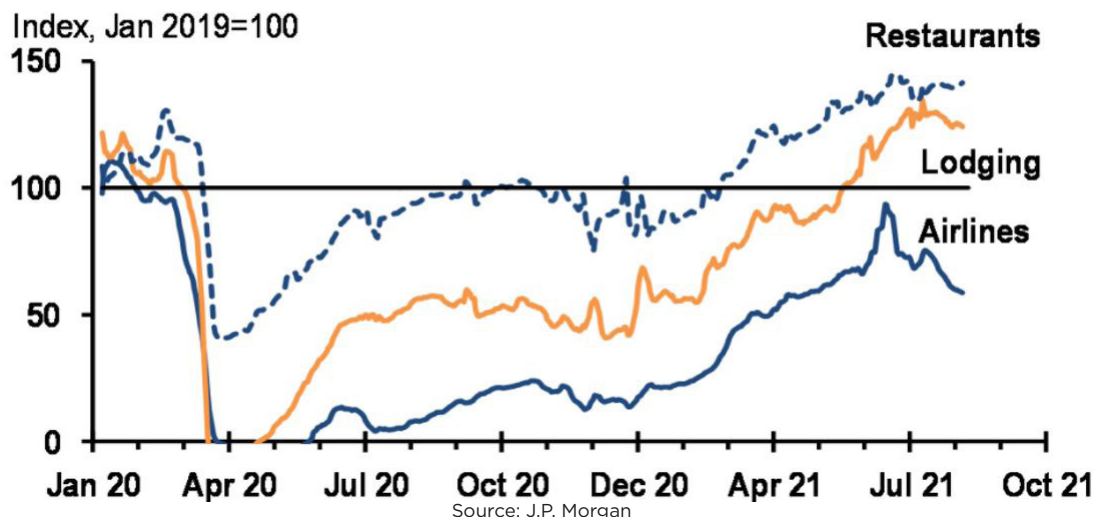
As COVID cases have risen in the US and globally, expectations for both manufacturers and consumers have inflected downward this summer.

Global Sentiment Indices



Not surprisingly, in tandem with the downward inflection in sentiment, spending in areas such as air travel, lodging, and restaurants has plateaued and turned down to some extent.

US Chase Credit Card Spending



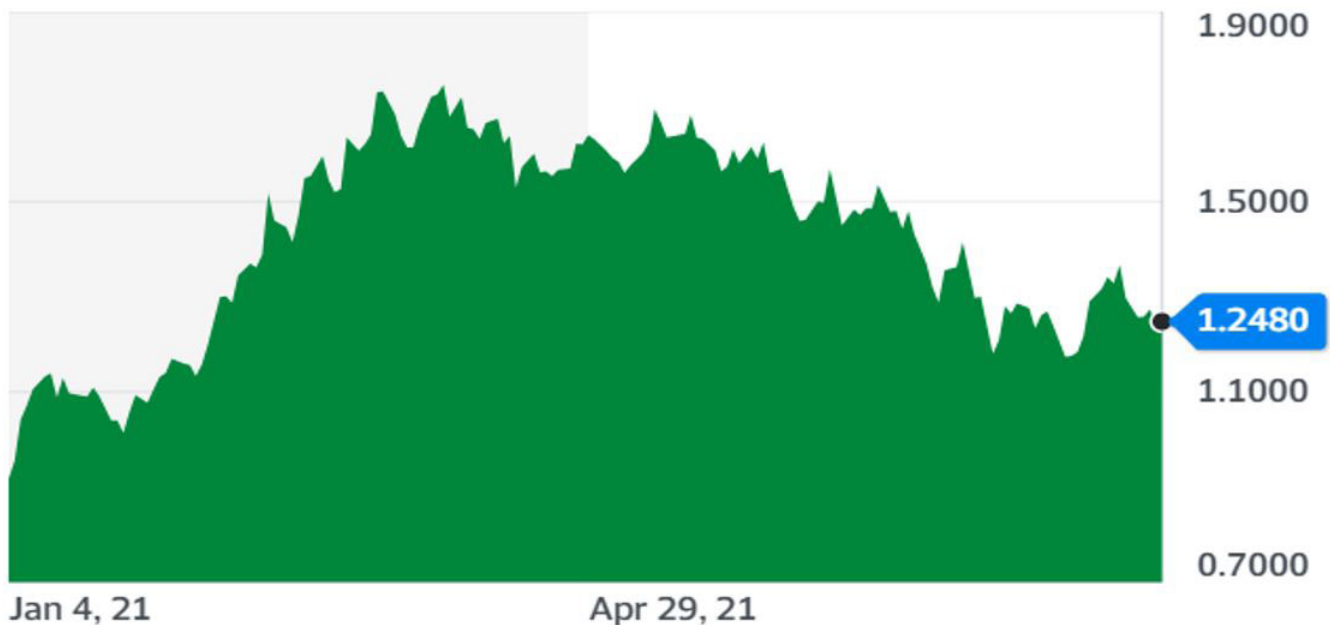
In addition, there is substantial news flow that the Delta variant is impacting office reopening, school protocols, and inside gatherings. This has potentially elevated anxiety about the pace of the broader economic recovery.

Given declining sentiment, observed spending patterns, and general anxiety, some projections for economic growth are being reduced. Goldman Sachs released a report this week lowering its estimate for the current quarter's growth (Q3 2021) to 5.5% from 9.0% and lowered its outlook for the full year to 6.0% versus 6.4% previously. On the positive side, the Goldman report surmises that the impact of the Delta variant may be brief and growth for Q4 2021 is raised as is growth for 2022 slightly.

3. FEDERAL RESERVE MINUTES FOR JULY RELEASED

The minutes from the Federal Reserve (Fed) meeting in July were released this week. A number of the committee members expressed that the economy was on track and had reached its goal on inflation which warranted a reduction, or tapering, of asset purchases. However, it was also expressed that further progress on employment would be necessary before considering raising interest rates. In terms of the market reaction, the closely-watched 10-year treasury rate remained relatively unimpacted, and the broader equity markets saw some downward pressure.

10-Year Treasury Yield Year-To-Date 2021



Source: Yahoo Finance

The 10-year treasury reaction suggests that while the market is expecting tapering to commence soon, there is no significant immediate fear about rising rates that could prompt a taper tantrum in the equity markets.

THINKING AHEAD

Corporate and economic data this past week took a back seat to the news on Afghanistan, an earthquake in Haiti, and anxiety about the Delta variant as schools and businesses were scheduled to reopen in person. Overall, the markets appear to be adapting to incremental changes in the economic outlook in a measured manner.

Pallas Capital Advisors will continue to monitor economic, political, and corporate data for implications to markets.

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