PALLAS CAPITAL ADVISORS

PCA Monthly Commentary

September 2021

Job Openings Exceeding The Unemployed?

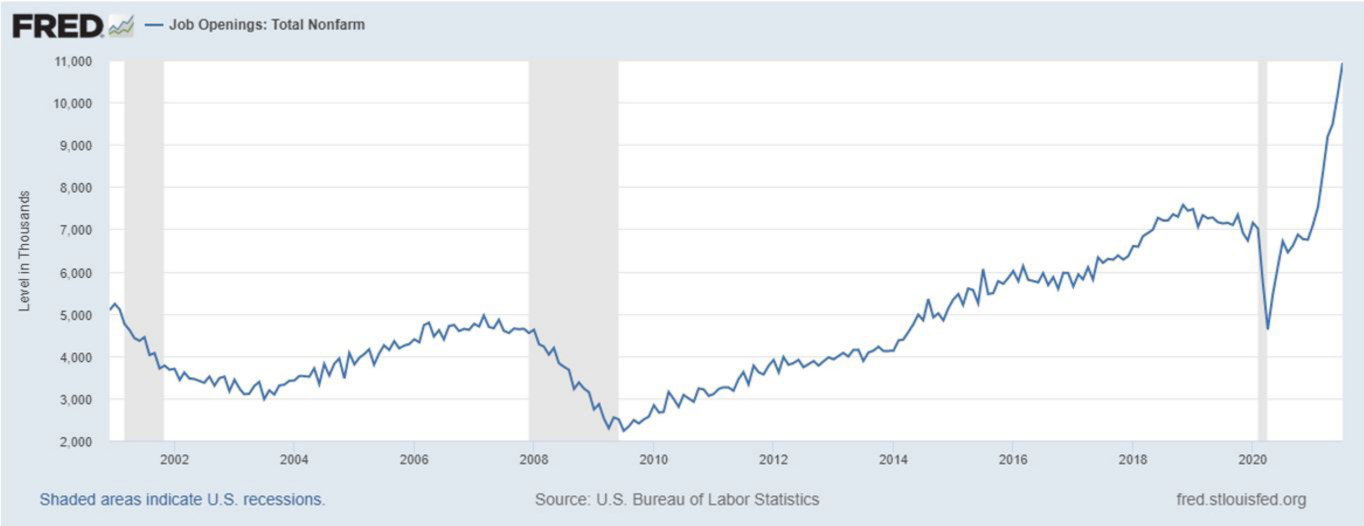
Equity markets moved higher in August 2021, led by the technology and utility sectors. A resurgent Delta variant, weak payroll numbers, and dovish Federal Reserve comments drove returns higher in the less cyclical areas of the market. All major equity markets rose led by the NASDAQ +4.1%, with other positive returns from the S&P 500 +3.0%, Russell 2000 +2.2%, EAFE +1.8%, and Emerging Markets +2.2%. Fixed income performance was mixed as interest rates rose slightly, driving the Bloomberg Barclays US Aggregate -0.2%, while US high yield rallied +0.5%. On the commodity front, oil fell 4.7% and gold was flat.

CONFLICTING JOB MARKET STATISTICS

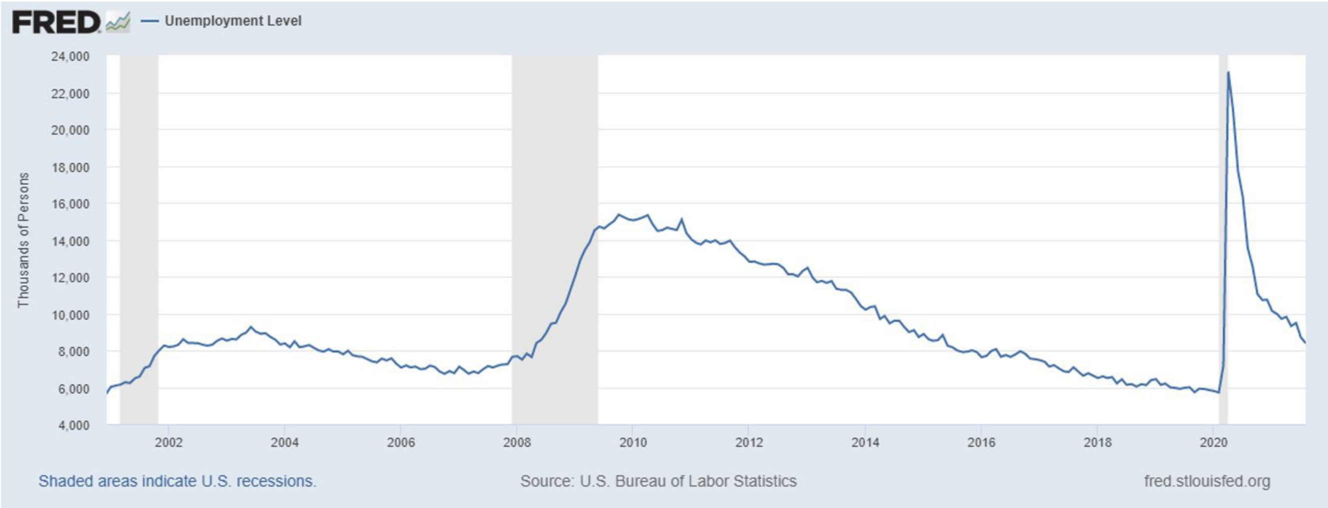
Tracking the job market recovery is key for judging the ultimate recovery from the pandemic. The Federal Reserve Chairman, Jerome Powell, has explicitly targeted a dual mandate for the Fed of long-run inflation at 2.0% and the economy at full employment. Powell reiterated in August that the US economy is far from full employment. The market interpreted these remarks as the tapering of quantitative easing and the eventual rising of interest rates will be delayed until further improvements in the job market.

On the positive side for the job market, the unemployment rate is down to 5.2% - a post-pandemic low. However, the pre-pandemic rate stood at 3.5%. Payroll data also disappointed last month as the US economy added 235,000 jobs, which was far short of expectations of 720,000. The rise of the Delta variant may be a factor in the recent slowdown in employment additions.

An interesting dynamic now exists where US job openings at 10.9 million actually EXCEED the unemployment level of 8.4 million people actively searching for work.



SOURCE: https://fred.stlouisfed.org/series/JTSJOL



SOURCE: https://fred.stlouisfed.org/series/UNEMPLOY

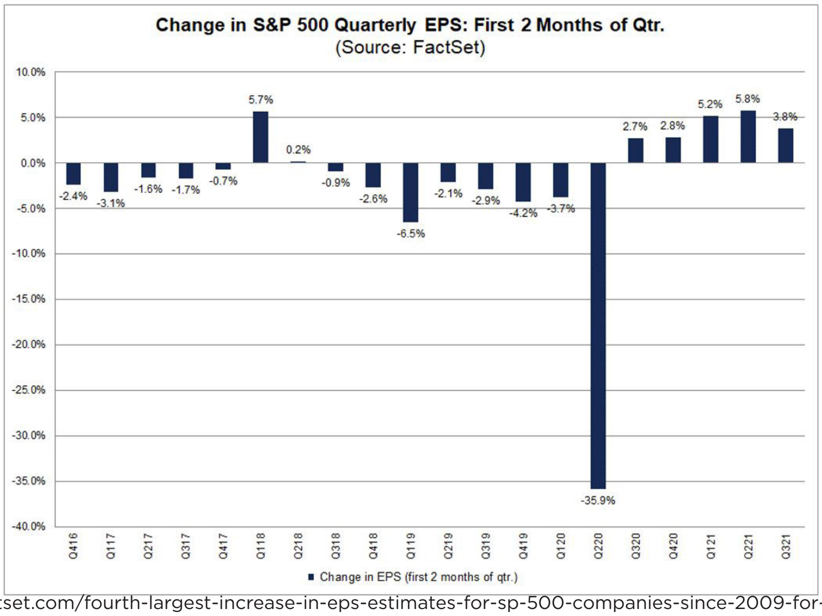
Clearly, the US economy is still dealing with the effects of the coronavirus from a multitude of levels. With respect to employment, the supplemental Federal benefits have just ended in early September. Schools are finally open again, but the Delta variant may impact the schools remaining open, which has the knock-on effect for working parents who have childcare issues without school. Some hesitancy still exists for people to get back to work as the coronavirus is still evident in society. Time will tell how the job market incongruities will resolve themselves. The Federal Reserve is positioned to be supportive until full employment is being approached.

The measure includes a nonbinding commitment to vote on the infrastructure bill by September 27, which aims to appease nine centrist Democrats who pushed the House to consider the bipartisan plan before it took up the Democratic budget resolution. In a statement last month, House Speaker Nancy Pelosi, D-Calif., said she is "committing to pass the bipartisan infrastructure bill by September 27" and would "rally" her caucus to pass it. She also stressed that she aims to pass a budget reconciliation bill that could get through the Senate — meaning it may prove smaller than House progressives want.

The Biden plan to fund the bills contains many proposed tax increases from increasing corporate rates, increasing capital gains rates, eliminating the step-up in cost basis, among others. The consensus view is that the entire tax package will not be passed as opponents exist in both the Republican and Democratic parties. This debate will heat up throughout the fall, and the market can evaluate the implications if and when final bills are passed.

MARKET OUTLOOK

Equity market reaction followed through on positive earnings surprises in July and August. In the S&P 500, technology stocks led the way again +5.4%, while energy lagged down -2.0%. The overall market trend continued of earnings growth and earnings surprise driving the market higher – S&P 500 +3.0% in August. Per Factset, during the first two months of the third quarter, analysts increased earnings estimates for companies in the S&P 500 for the quarter. The Q3 bottom-up EPS estimate (which is an aggregation of the median EPS estimates for Q3 for all the companies in the index) increased by 3.8%.



SOURCE: https://insight.factset.com/fourth-largest-increase-in-eps-estimates-for-sp-500-companies-since-2009-for-q3

Pallas Capital's equity portfolios are positioned with a balance of quality, secular growing companies such as those found in the technology sector, paired with quality cyclicals, such as industrial companies. Given the strong appreciation in equities year to date, Pallas model portfolios have been rebalanced back to long-run targets. A strong earnings outlook is tempered by risks of a Delta variant slowdown and potential tax increase affecting the consumer and companies.

With persistently lower risk-free interest rates, Pallas Capital has positioned our fixed income portfolios in a barbell of high-quality, shorter-term debt paired with private credit and real estate for higher yields. The macro drivers to monitor relative to this position would include more fiscal stimulus from the Federal government, the Federal Reserve's stance on accommodative monetary policy, and potential tax increases at the Federal level.

CONCLUSION

The job market is displaying conflicting signals with the latest disappointing payroll data. The Federal Reserve is maintaining its accommodative stance to monetary policy as the economy is far from full employment. At the time of this writing, the Federal government is debating yet another fiscal stimulus package, which would be paid for by increased taxes. Corporate earnings were a bright spot as the positive surprises versus consensus estimates continued. 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

The information contained herein is for informational purposes only, is not personalized investment advice and should not be construed as a recommendation to purchase or sell any particular security, sector or strategy to any individual person or entity. The decision to review or consider the purchase or sale of any security, sector or strategy mentioned should not be undertaken without consideration of your personal financial information, investment objectives and risk tolerance with your financial professional. Past performance should not be considered as an indicator of future results.

Investment Advice offered through Pallas Capital Advisors, LLC, a registered investment advisor.