

WEEK IN REVIEW

FRIDAY, OCTOBER 22ND, 2021

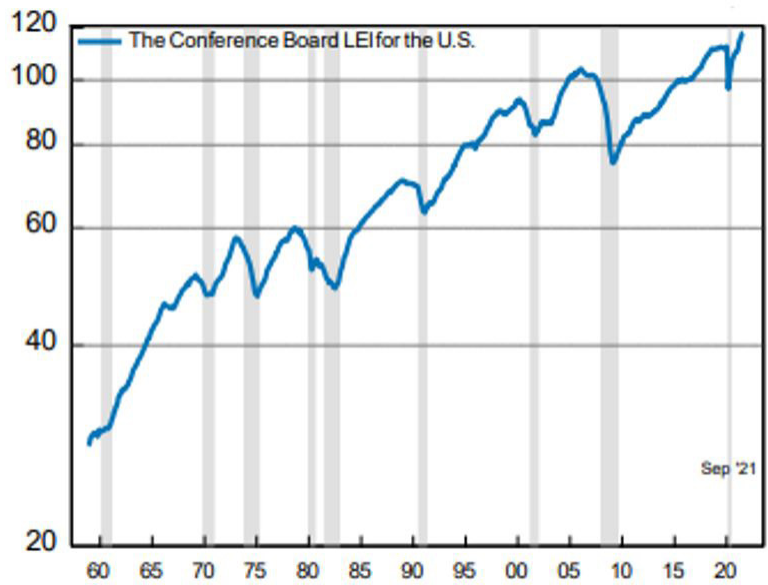
1. LEADING INDICATORS SHOWING SLOWER GROWTH BUT STILL POSITIVE

The Leading Economic Index for September was published this week by the Conference Board. The index is based on ten components including initial claims for unemployment insurance, manufacturers' new orders, residential building permits, stock prices, and consumer expectations. The index intends to signal changes in the business cycle.

After troughing in April 2020 following the initial shock of the pandemic, the index rebounded at a record rate and reached a new high for the index in September 2021.

The most recent reading saw the index rise to 117.5 in September compared to August. While a positive 0.2% increase, the reading was below expectations for 0.4% growth and well off the

0.8% increase in August and a 0.9% increase in July. The September reading suggests the economy remains on a more moderate growth trajectory compared to the firsthalf of the year.



Source: The Conference Board

LEI Index	2021		
	Jul	Aug	Sep
Leading Index	116.4 r	117.3 r	117.5 p
Percent Change	0.9 r	0.8 r	0.2 p

p Preliminary; r Revised

Source: The Conference Board

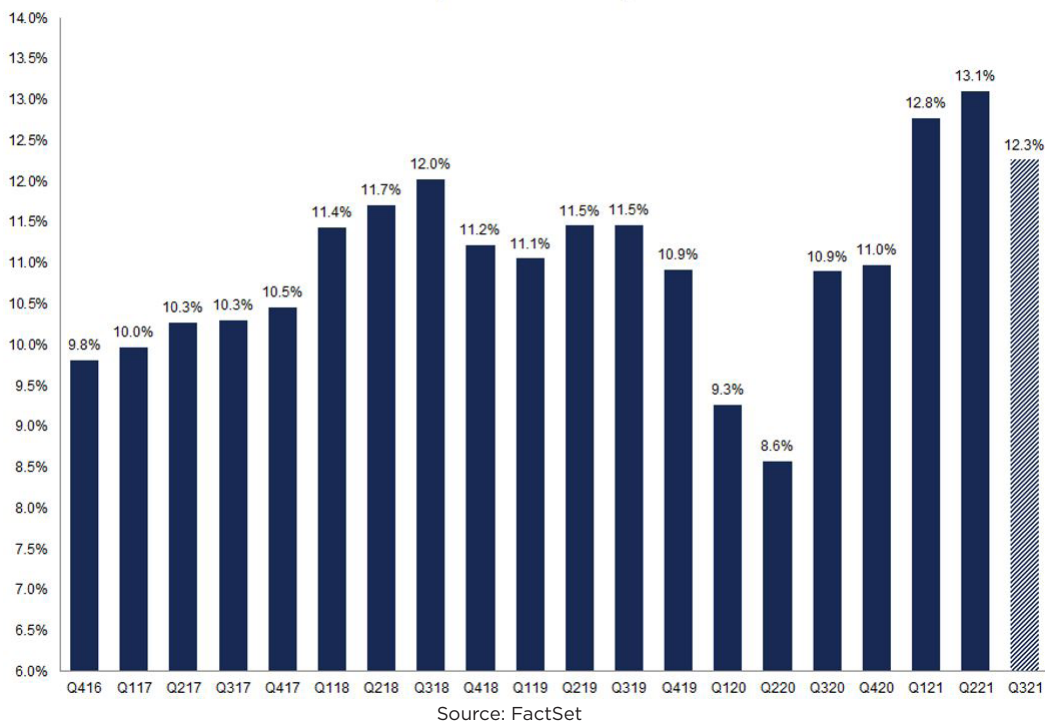
Commenting on the recent slowing of the index, a spokesman for the Conference Board indicated that the Delta variant, rising inflation fears, and supply chain disruptions were all creating headwinds for the US economy. However, the components overall remain positive, and the Conference Board continues to forecast strong growth ahead: 5.7% year-over-year for 2021 and 3.8% for 2022.

2. CORPORATE MARGINS HOLDING UP SO FAR IN THE THIRD QUARTER AND LOOK SOLID RELATIVE TO HISTORY

Going into the third-quarter earnings season, the global activity slow-down, supply disruptions, and spiking energy prices increased concern that corporate profit margins would be hurt. These concerns were clearly justified as many companies did provide warnings encapsulating these concerns prior to the release of earnings.

While it is still early in the earnings season, the level of margin pressure should perhaps be put into perspective. Utilizing data compiled and tracked by FactSet, net profit margins are coming in below the previous quarter's record level of 13.1% but the current reported level of 12.3% is still strong in historical terms, being well above the five-year average of 10.9%.

S&P 500 Net Profit Margins: Q416 - Q321
(Source: FactSet)

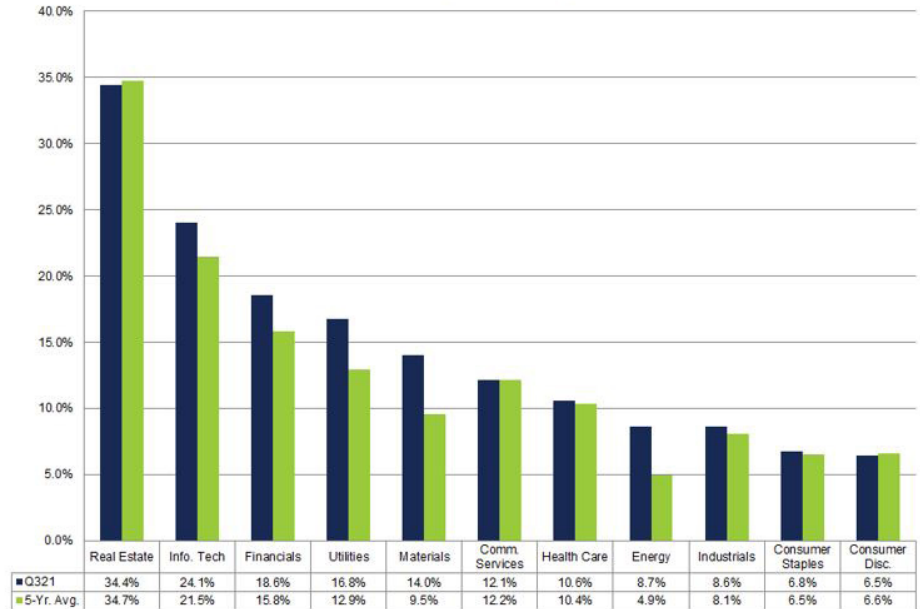


Drilling down, it is not surprising that certain sectors should be experiencing strong margins. For example, info-tech is seeing strong demand and areas such as software and the cloud have little exposure to rising commodity and labor costs. Similarly, financials are doing well and banks, in particular, have seen significant savings from lower, bad credit costs. Meanwhile, energy and commodity materials are seeing better margins driven by higher pricing.

Sectors seeing greater pressure on margins include staples, consumer discretionary, and industrials which have seen margins decline from the second quarter, but even their absolute level of margins relative to history remain competitive. One explanation of this may be that no good crisis goes to waste and many companies cut costs during the pandemic and now are operating more efficiently - at least in terms of profitability.

S&P 500 Sector-Level Net Profit Margins: Q321 vs. 5-Year Avg.
(Source: FactSet)

The maintenance of margins despite all the inherent pressures of the rapid recovery is a positive factor in looking at the prospects for companies and may suggest that companies should be able to perform just fine in an environment of higher than trend inflation.



Source: FactSet

THINKING AHEAD

Economic data and corporate earnings releases continue to provide a positive backdrop for the investment environment. Growth, albeit slower, is still positive and indications are that it should accelerate over the near term. Supply chain constraints and rising costs have so far been offset by other factors allowing the market as a whole to show resilient margins for the time being, offsetting concerns about elevated inflation.

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

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