PALLAS CAPITAL ADVISORS

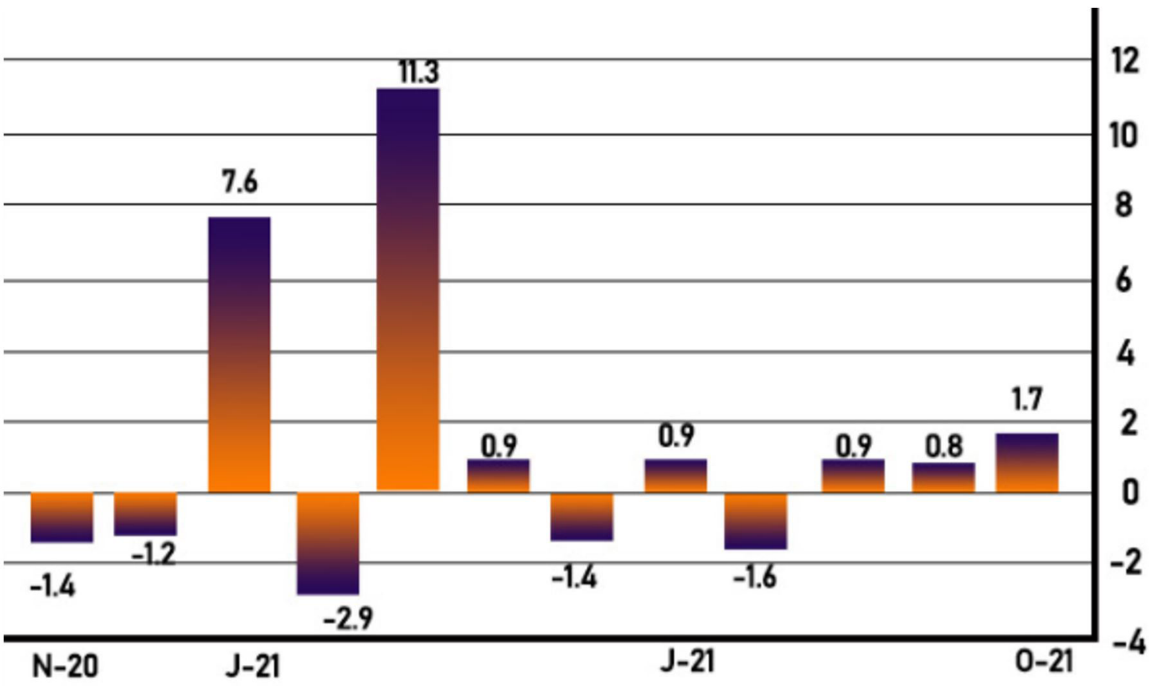
Week in Review

Friday, November 19th, 2021

1. Retail Sales Surprise to the Upside

Retail sales increased 1.7% in October, topping economists' expectations for a 1.4% increase. On a year-on-year basis, sales surged 16.3% and are running well above their pre-pandemic level.

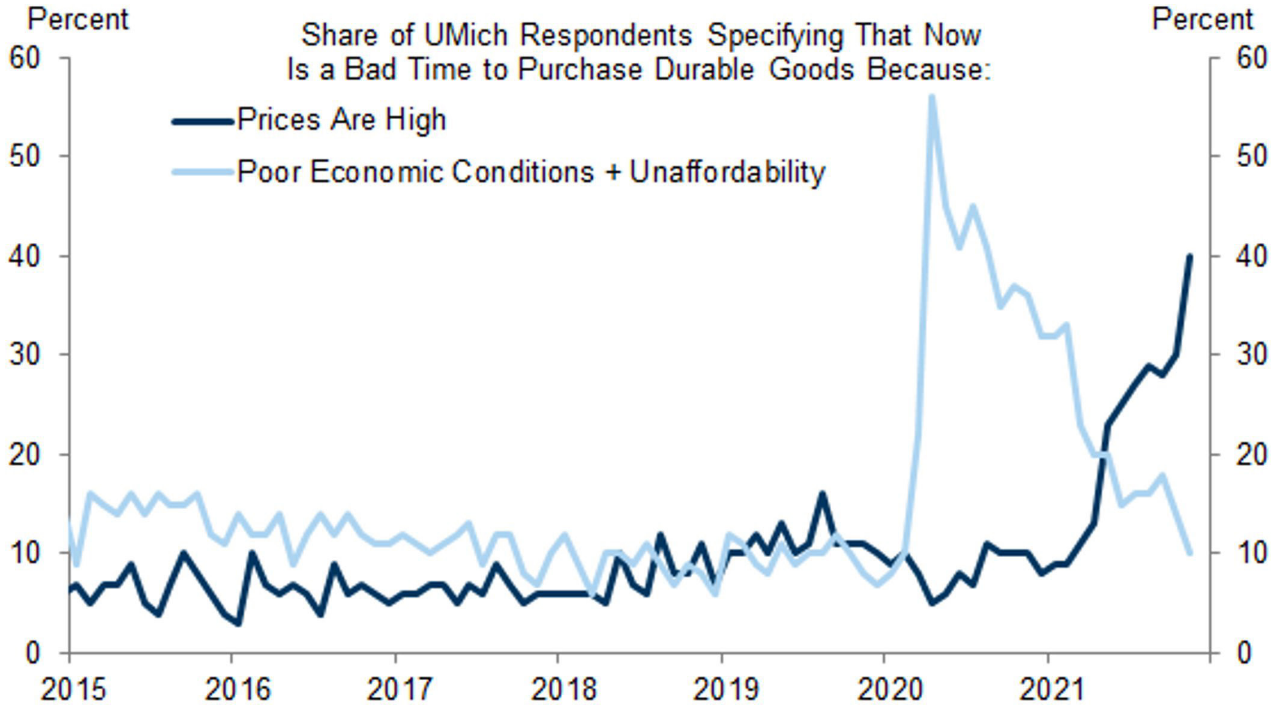
US Retail Sales – Percent Change from Previous Month



Source: US Department of Commerce; RTT News

The retail sales data suggests that the consumer remains strong. Several retailers reported this past week, including Walmart, Home Depot, Target, and Lowes. All reported sales growth that was above expectations and indicated that positive trends are continuing. One factor possibly driving the better-than-expected sales pace is a movement forward in holiday shopping due to concerns about supply shortages, a reasonable concern as retailers are also reporting lower inventories than typical at this time in the year.

Another factor impacting the US retail sales figures is inflation. Prices of goods have risen at their quickest rate in nearly 30 years. This is increasing the ticket price for a variety of goods and increasing consumer concerns of even higher pricing in the near future. This has resulted in offsetting drivers of consumer sentiment in terms of current purchases as captured in the University of Michigan's recent consumer sentiment survey.



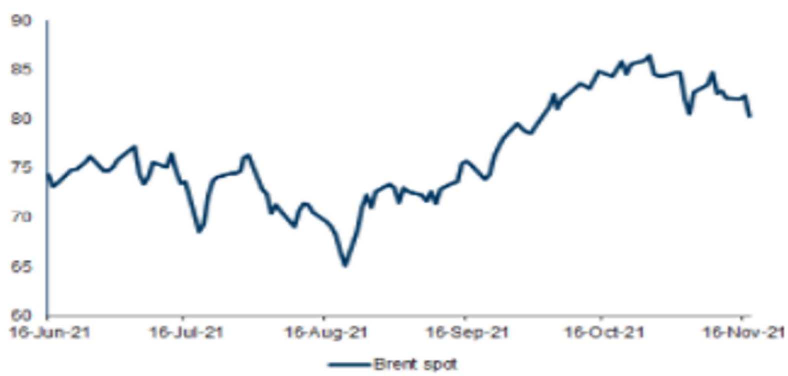
Source: University of Michigan, Goldman Sachs Global Investment Research

The survey indicates that consumers feel confident in the current economic conditions but also believe prices are high. So far, inflation and concerns about higher prices have not dissuaded consumers, perhaps in part due to the ongoing pandemic recovery. However, the specter of inflation is a growing concern on consumer sentiment as we move into 2022.

2. Oil prices have Come Down, at Least for the Near-Term

A significant area of inflation in 2021 has been the rise in oil prices, impacting many costs including raw materials, transport costs, gasoline, and heating fuels. Recognizing the potential negative impact on individuals and the economy broadly, politics has come into play with calls to release more supply from the strategic petroleum reserve and even investigate possible criminality within the energy supply chain.

Price of Brent Oil

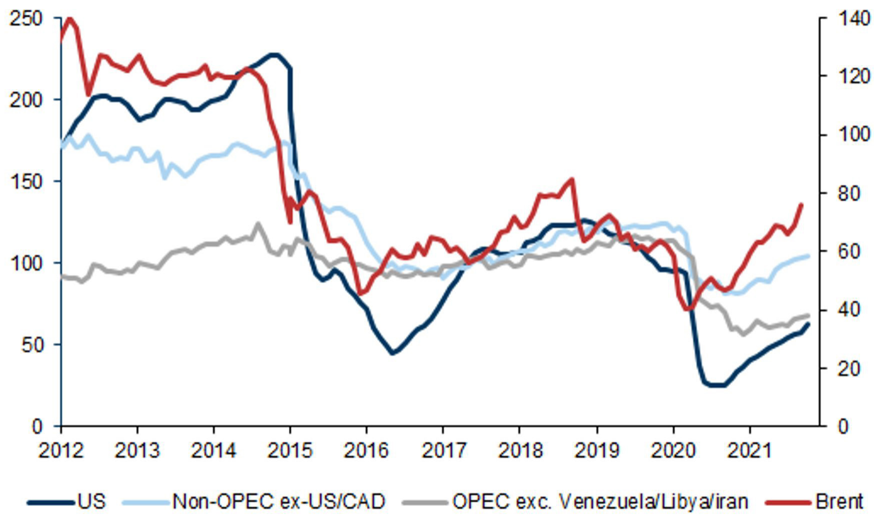


Source: ICE, Goldman Sachs Global Investment Research

While oil prices are coming off peak levels, the government actions may not be addressing some of the underlying causes of the rise in prices. Key drivers of energy supply and pricing include a recent period of lower CAPEX for US domestic production, severe shortages outside of the United States, and OPEC policy.

In terms of CAPEX, rig count activity is a good proxy. The current activity level, while off the lows of 2020, still remains below both recent and long-term averages. The significant drop in 2020 is likely to have an ongoing impact as production tends to lag rig activity by 12-18 months.

Global Rig Counts (Indexed to 2017 Average)



Source: Baker Hughes, ICE, Goldman Sachs Global Investment Research

Higher oil prices and various pandemic disruptions are likely contributing to the recent increase in rig counts. However, further increase may be limited as many large US public operators look to cap growth investment in lieu of returning capital to investors. Such policies if held would likely limit supply growth longer term.

While the US has the capability to increase production, other countries including Europe and China are more limited in their options and are currently facing severe energy shortages. These countries are more dependent upon other oil producers such as OPEC. OPEC has its own agenda though, as its interest is served in maintaining stable but higher oil prices.

For now, oil prices are coming off peak levels and year-on-year price increase comparisons should moderate in 2022, but longer-term the low oil and natural gas prices the consumer enjoyed during the pandemic are not likely to return.

Thinking Ahead

Concerns are growing about inflation. Consumers continue to spend, despite their concerns about rising prices and potentially even trying to get in front of it. The government is also taking notice and taking actions such as releases from the strategic petroleum reserve to dampen oil prices by getting supply and demand back in balance - at least for the short term.

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