PALLAS CAPITAL ADVISORS

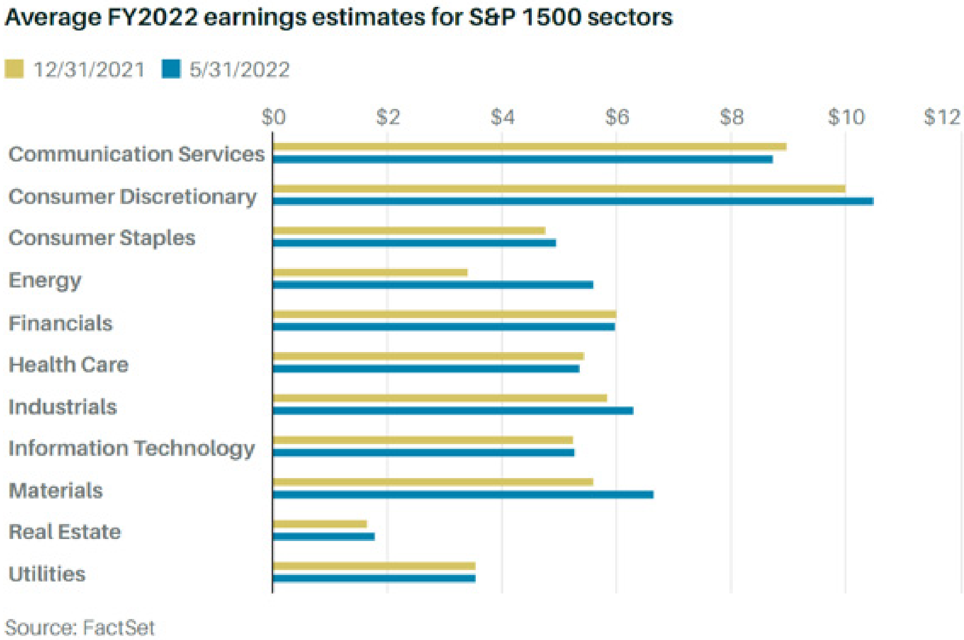
Week in Review

Friday, June 3rd, 2022

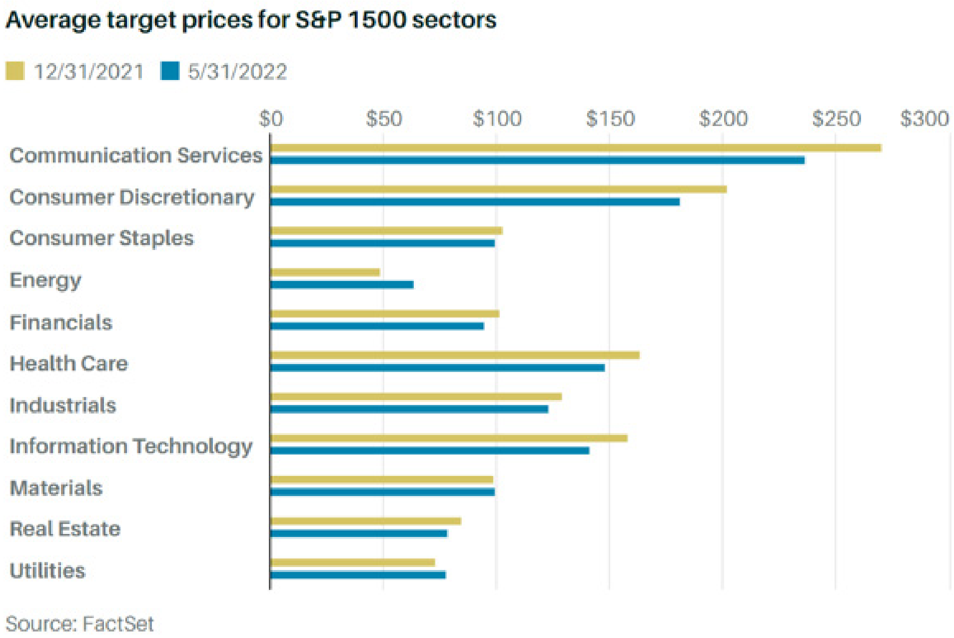
1. Earnings Estimates Holding Up for Now Despite Concerns

This past week saw several high-profile negative comments about the economic outlook, such as from Jamie Dimon of JP Morgan ("an economic hurricane is on the horizon") and Elon Musk from Tesla ("super bad feeling about the economy"). The comments are concerning, but current data released this week such as the ISM Services PMI index and the ISM Manufacturing Index seems more encouraging as both logged their 24th straight month of growth.

Corporate earnings estimates for this year and next continue to track with the recent positive economic data and in aggregate, have been revised upwards for 2022 and 2023 as this year has progressed. While higher estimates can be partly attributed to record inflation with energy and materials seeing the greatest increases in earnings projections for 2022, most other sectors have also seen estimates increase except for communications services, healthcare and financial sectors which have only seen very modest decreases.



Persistently elevated inflation remains a risk to the earnings outlook as it impacts buying power of consumers, pressures profit margins, and catalyzes the Federal Reserve to curb inflation through tightening monetary policy. These concerns have weighed on the market this year with a contraction in earnings multiples that has resulted in a broad reduction of forward-looking price targets for most sectors except for energy, materials, and utilities, which are seen as beneficiaries of inflation.

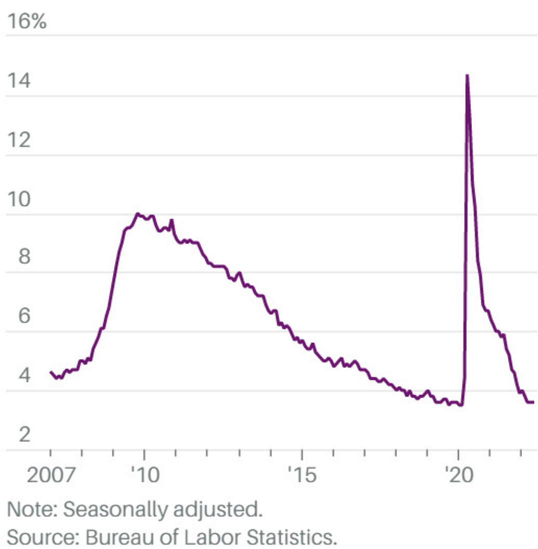


Sentiment has turned negative towards forward earnings potential and has likely in part been priced into equities during 2022 despite the continued up trend. It is reasonable to be cautious and expect that negative earnings revisions have an elevated probability, but also remain confident in the longer-term opportunity set for strong, profitable, well-capitalized businesses to navigate through this period of uncertainty.

2. Employment Data Remains Strong

Total nonfarm payroll employment rose by 390,000 in May, and the unemployment rate remained at 3.6 percent, the U.S. Bureau of Labor Statistics reported today. These measures are little different from their values in February 2020 (3.5 percent and 5.7 million, respectively), before the coronavirus pandemic. Notable job gains occurred in leisure and hospitality, professional and business services, and transportation and warehousing while employment in retail trade has declined.

U.S. Unemployment Rate



Also included in the data was wage growth. Wage growth came in at +0.3% month-over-month and at +5.2% on a year-over-year basis. The level of wage growth was in-line with expectations, but also was the fourth month in a row above 5% on a year-over-year basis. While not showing an acceleration, wage growth is still indicative of elevated inflationary pressure.

Overall, the data remains reflective of the underlying strength in the U.S. economy. The data is also supportive of the Federal Reserve continuing its plan for monetary tightening including increasing interest rates. The Fed's dual mandate is to support a strong labor market and price stability. The employment data suggest that the first part of the mandate is being met, but high inflation levels mean that the Fed should increase rates to curb demand to stabilize pricing.

Thinking Ahead

While new data this week on the economy and company earnings continue to be supportive of growth and relative strength, sentiment about the future remains cautious. Inflation, China closure policy, on-going supply chain constraints, Ukraine War, declining consumer sentiment, and Fed policy lead a long list to fuel the concerns. On the positive side, strong employment, strong corporate profit margins and balance sheets provide a buffer against these concerns.

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