Pallas Perspective

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A Strong Earnings Season is Providing Underlying Support to Equity Markets

At Pallas Capital Advisors, we believe that price trends in equity markets are highly correlated with corporate earnings growth, both in absolute terms and relative to expectations.

As we move through August, approximately 80% of the companies in the S&P 500 have reported second-quarter results , and the outcomes have been strong on both an absolute and relative basis. The percentage of S&P 500 companies reporting positive earnings surprises, as well as the magnitude of those surprises, is above the 10-year averages.

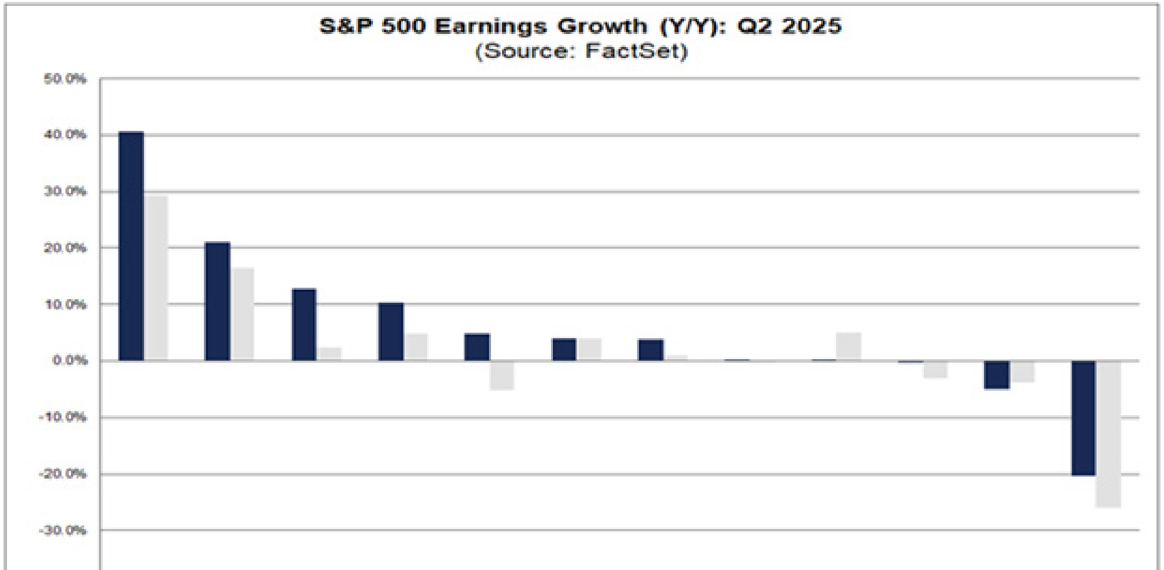
As a result, the index is reporting higher earnings for the second quarter relative to expectations at the end of the quarter (June 30). On a year-over-year basis, the S&P 500 is reporting double-digit earnings growth for the third consecutive quarter.

Of the approximately 80% of companies in the S&P 500 that have reported actual results for Q2 2025 to date, 82% have reported earnings per share (EPS) above estimates — exceeding the 5-year average of 78% and the 10-year average of 75%. If 82% is the final number for the quarter, it will mark the largest percentage of S&P 500 companies reporting a positive EPS surprise since Q3 2021 (also 82%).

In aggregate, companies are reporting earnings that are 8.0% above estimates. While this is below the 5-year average of 9.1%, it is above the 10-year average of 6.9%. As a result of these strong reports, the index is currently showing higher second-quarter earnings than were expected at the end of the quarter. The blended earnings growth rate for Q2 now stands at 10.3%, compared to a 4.9% growth rate expected as of June 30.

Since June 30, positive EPS surprises from companies in the Financials sector and from five of the “Magnificent Seven” in the Communication Services, Information Technology, and Consumer Discretionary sectors have been the largest contributors to the overall increase in the index’s earnings growth rate.

Eight of the eleven sectors are reporting year-over-year earnings growth, led by Communication Services, Information Technology, and Financials. Conversely, three sectors are reporting a year-over-year decline in earnings, led by the Energy sector.



	Comm. Services	Info. Technology	Financials	S&P 500	Consumer Disc.	Health Care	Real Estate	Industrials	Utilities	Consumer Staples	Materials	Energy
Today	40.7%	21.1%	12.8%	10.3%	4.8%	3.9%	3.7%	0.3%	0.3%	-0.1%	-5.0%	-20.3%
30-Jun	29.4%	16.4%	2.3%	4.9%	-5.3%	4.0%	1.1%	-0.3%	5.0%	-3.0%	-3.8%	-26.0%

Looking ahead to the third and fourth quarters of 2025, analysts are forecasting earnings growth rates of 7.6% and 7.0%, respectively. For the full calendar year 2025, year-over-year earnings growth is projected at 9.9%. While these figures are below the pace observed over the past three quarters, they still suggest a relatively robust outlook—especially considering ongoing uncertainties related to tariffs, interest rates, geopolitical tensions, and more challenging year-over-year comparisons.

Although earnings growth has been a notable strength for the market, current valuations appear to already reflect much of the positive news. The forward 12-month price-to-earnings (P/E) ratio stands at 22.2—above both the 5-year average of 19.9 and the 10-year average of 18.5. This also slightly exceeds the forward P/E ratio of 22.1 recorded at the end of the second quarter (June 30).

While valuation levels alone do not typically indicate a market downturn, a period of consolidation or digestion may be warranted, as expectations for corporate performance have now risen.

At Pallas Capital Advisors, we will continue to closely monitor the key drivers and trajectory of earnings growth, with a focus on maintaining well-diversified investment portfolios aimed at preserving and growing capital over the long term.