To subscribe to our Newsletters **www.palos.ca/register**

PALOS

Weekly Commentary

Issue **No. 20** | **MAY 24, 2021**

CONTENTS

A Snapshot of the Market for the Week Ended May 14 1
The Altar of Economic Growth and the 2% Corrections 2
Disclaimer & Contacts 4

Macro View

By Hubert Marleau

The Altar of Economic Growth and 2% Corrections

Submitted May 23, 2021

A Snapshot of the Market for the Week Ended May 21, 2021:

The market has been particularly chaotic of late, jumping around like a chicken with its head cut off. An intense debate about whether the current inflation pace is transient, and whether the Fed will taper its bond-buying program sooner rather than later, are critical concerns for the market. Additionally, there is growing uncertainty about the path and speed of the recovery.

The economic expansion is not on hold. The Conference Board's leading indicator came in with an excellent m/m gain of 1.6%. While economic prints are still suggesting that the trajectory of business activity is very positive, they are not beating expectations or consensus anymore: Citi's macroeconomic surprises turned negative for the first time in twelve months. In other words, the rate of change is moderating. For example, job claims are on a downward trend, but they are falling as fast in numbers as they were earlier. The Atlanta Fed's GDPNow model estimate for real growth in Q/2 is now 10.1%, down from a high of 13.6% in the early days of May.

The market is also keeping a watchful eye on inflation. Inflation expectation is still running around 2.7% for the next five years. It was around 1.7% before the pandemic hit us. Cyclical and temporary factors are in full force and account for the bulk of this rise. While some structural forces are present, it is thankfully being pulled down by aging demographics, a growing debt load, a rapid diffusion of technological advancement and globalization.

Economists at Barclays argue that the exceptional lockstep world-wide increase in the demand for hard goods is directly behind the supply constraints, fanning price increases everywhere, and causing higher inflation expectations. Given that it takes time for savings to meet investments, and for demand to equal production, a short-term economic interruption and/or a rise in interest rates may become necessary to reconcile the imbalance. The performance of the commodities in the futures market this past week has given some credence that the aforementioned imbalance may indeed be temporary. Anecdotal consumer reports are telling that many

Macro View cont.

By Hubert Marleau

potential buyers of hard goods are willing to wait for sellers to catch up on production. The belief that we may indeed end up with a start-growth-stop environment has gained some momentum. It may account for the apparent rejection of bad inflation that many investors feared earlier on. Market-based probability that the Fed will raise its benchmark rate on or before its final meeting in 2021 is only 10%. It was 15% nine days ago. Range-bound bond yields and a dithering Fed caused outperformance to flip-flop between value and growth. The FOMC telegraphed an unclear message that a shift away from the easy-money policies implemented during the pandemic, and discussions about an eventual plan for reducing the Fed's massive bond-buying program are forthcoming. The message was not sufficiently convincing to satisfy either the bears or the bulls. Investors ploughed another $13 billion into global equities, but only $1.3 billion was earmarked Stateside. Consequently, the S&P 500 paused, losing a mere 17 points or 0.4% to end at 4156.

The Altar of Economic Growth and the 2% Corrections:

The GFC has fundamentally changed economic thought, which has, in turn, transformed the investment landscape and revised trading habits. On the one hand, the long-term trajectory of the stock market appears to be connected to money. On the other hand, the daily trading of stocks seems to be tied to interest rate movements. Accordingly, the investment and trading logic of the broad market looks different than how it used to.

Not so long ago, Economics 101 was about the efficient allocation of scarce resources. Now, economic growth at any expense is the new mantra. Put simply, policymakers have forsaken liberal capitalism in favour of state capitalism. Growth for the sake of growth has been put on the altar to be adored. While stock and sector selection are determinants of superior stock market returns, the long-term trajectory of aggregate stock prices is essentially connected to the quantity and velocity of money. Meanwhile, trading securities is no longer about providing pockets of liquidity for listed securities, but about taking on short or long positions for quick capital gains, which are closely related to interest rate movements.

If you are an investor and in for the long haul, it's probably a good idea to buy the dips, because there is no more recession in sight. People believe that the government has the means to prevent economic downturns. In this regard, they would be annoyed if the politicians were not to use those tools to fight them. Thus, there is no going back, because large stimulating budgets, combined with accommodating monetary policies will be used to pacify populist and polarized electorates. The next time there is a hint of a recession, rest assured the people will demand powerful monetary and fiscal policies from the politicians. Given the willingness of policy makers to acquiesce, the expectation is high that they will do what they can to reduce the probability of having severe and extensive downturns: thus, buying dips as an ongoing strategy isn't stupid.

Macro View cont.

By Hubert Marleau

If you are a speculator, however, and have to worry about everything, it may be better to tread carefully. Markets are more volatile and moving faster than they use to, because the quants have replaced the specialists and the old-fashioned traders. Quants use algorithms essentially linked to minute interest rate changes to get ahead. These mathematical trading machines have led to more corrections, whose duration and amplitude seem to be getting respectively shorter and smaller. In other words, these guys can easily create days of high volatility by changing trading liquidity at will. Quant-traders use derivatives and leverage to assault the market even when a singular piece of bad news like an undesirable economic print or a comment from an official unexpectedly arises. Thus, fast but short-term volatility eruption in everything financial has become the new trading norm.

Given that most of us tend to be an investor in our brain and a speculator in our heart, it may be a good idea to think slowly when rationality is needed and to think fast when the price is right. It is a simple investing formula that has worked well over the last ten years.

Follow us on LinkedIn:

Weekly Commentary

Issue **No. 20** | **MAY 24, 2021**

Disclaimer:

This publication is proprietary to Palos Management Inc. (along with its affiliate Palos Wealth Management Inc., “Palos”). This publication may be copied, downloaded, stored in a retrieval system, further transmitted, reproduced, disseminated, and/or transferred, in any form or by any means, but only as long as it is unaltered and attributed to Palos. This publication and its contents may not be sold or licensed without Palos’ written permission. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made or implied regarding accuracy or completeness. The information provided does not constitute investment advice and it should not be relied upon on as such. If you have received this communication in error, please notify us immediately by electronic mail or telephone. This document may contain certain forward-looking statements that are not guarantees of future performance and future results could be materially different. Past performance is not a guarantee of future performance. “S&P” is a registered trademark of Standard and Poor’s Financial Services LLC. “TSX” is a registered trademark of TSX Inc. The Bloomberg USD High Yield Corporate Bond Index is a rules-based, market value weighted index engineered to measure publicly issued noninvestment grade USD fixed rate, taxable, corporate bonds. To be included in the index a security must have a minimum par amount of 250MM.

PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca