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PALOS

Weekly Commentary

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Macro View

By Hubert Marleau

Bullish On America

Submitted August 7, 2021

A Snapshot of the Market for the Week Ended August 6, 2021:

The rolling seven-day average of new U.S Covid-19 cases hit a six-month high last week as in-person events are being cancelled, major companies are delaying return-to-work plans and mothers are forced to stay home. The Delta variant is challenging, but it has neither dampened the economy or the market. Global equity funds took in another $4.8 billion, with the S&P 500 rising 42 points or 1.0%, to end at a fresh, all-time high of 4437.

Investors did not seem concerned because vaccinations have picked up, boosters are coming and the death tolls are not what they once were. Instead, they were focused on earnings reports which are outpacing expectations, on inflation which is receding, and employment which is rising. For example, the market was not negatively affected by Minneapolis Fed's President Neel Kashkari's opinion that the Delta variant could throw a "wrinkle" into the labour market.

He was wrong. The labour market recovery is booming. The BLS announced that employers had added 943,000 jobs in July, upwardly revised June's employment gains to 938,000, showing a 0.5% decline in the unemployment rate to 5.4%, and pointing to a stunning decline of 5.2 weeks in unemployment time. A separate survey stated that the number of people working or seeking work had risen. There are now 5.7 million less jobs than there were in February 2020(152.5 million). Assuming that roughly 2.3 million eligible workers are not likely to go back to work, the report unambiguously supports the argument that the economy has made "substantial further progress".

Macro View cont.

By Hubert Marleau

Richard Clarida, Vice-Chair of the Federal Reserve Bank, is now in the “hawk” camp, siding with Fed Governor Christopher Waller, Dallas Fed’s Robert Kaplan, St-Louis Fed’s James Bullard and San Francisco Fed’s Mary Daly, who are pushing for an accelerated timeline. In this regard, the dovish holdouts are definitely diminishing as momentum is building for the Fed to start the taper before the winter season.

The scaling back of monetary support will not test the strength or the durability of the economic expansion. U.S. banks are stuffed with cash reserves. Presently, total loans equal 60% of all deposits compared to 75% in February 2020. JPMorgan and Bank of America had $1.0 trillion in unused corporate credit at the end of June. In this connection, the banks have the capacity to accommodate the ramping up requests for credit lines that can be drawn quickly for spending on inventory, labour and capex. The Federal Reserve’s survey of senior loan officers in July reported that banks were getting more inquiries from commercial and industrial borrowers about new and increased credit lines. Business confidence is the highest in a decade. The bottom line is that there are enough excess reserves to provide the amount of liquidity to keep real rates below normal, and of credit to finance above trend growth in business activity. In other words, the abundance of money in the banking system assures meaningful economic growth for the foreseeable future, which will largely be based on a technology-led business revolution and revival for natural resources. A 3.5% economic growth rate is achievable.

As mentioned in last week's commentary, the stock market is entering a seasonally turbulent period. Expected volatility could offer several dip-buying opportunities because the mid-to-long term outlook is optimistic. David Kostin at Goldman Sachs increased his projection for the S&P 500 to 4700 and Edward Yardeni raised his conjecture to 5000. The journey to these new targets will not be smooth, but the explanations for their optimism are well grounded. Leuthold Group’s Jim Paulsen offered in “Market Watch” a path to 6000 for the S&P 500. He said: “Historically, a 3.5% real growth rate has been associated with 8.2% annualized profit growth. Carry that GDP growth rate forward for the next four years--which is not an outlandish proposition-- and S&P 500 earnings per share would climb above $300, if the correlation between profits and GDP holds. Over the past 30 years, the trailing P/E multiple has been 20.2. A 6,000 level at the end of 2025 would represent a roughly 10% total return between 2022 and 2025, given the current 1.3% dividend yield.”

That’s all, folks! I’m on holiday for the next two weeks.

Macro View cont.

By Hubert Marleau

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