

PALOS

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The Palos Perspective

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The Fed's Economic Narrative is Positive - or Not Far Off

Sessions of geopolitical turmoil or domestic political strife usually do not derail the path of the economy or upset the flow of investment money, unless these sort of events disrupt supply chains, trade or the global energy complex. While I'm reading up on these risks, I don't allow them to change my view of the stock market - until it becomes a must. Speculators hedged these haphazard issues with purchases of Bitcoins and Gold, which explains their mysterious and spectacular price performance over the past several weeks, rather than walk away from the financial markets. Bond yields are down and stock prices are up.

The week ended on March 10 was jam-packed with employment data that suggests the inner dynamics of the labour market are settling down, productivity is still rising and inflation is cooling. Job openings fell only 26,000 to 8.86 million in January, while the quit rate - the number of workers leaving their jobs - dropped to 2.1%, the lowest since August of 2020 - an occurrence which should help moderate wage inflation and boost productivity. On Friday, the BLS reported that the Non Farm Payroll (NFP) rose a healthy 275,000, but not enough to contradict the ISM release that said employment was not rising as fast as the 2.5 % increase that the Atlanta Fed NowCasting model is projecting for Q1/24, suggesting that the trend in productivity is moving in the right direction. Why? The January and December employment gains were revised to a much lower amount than previously printed.

The Business Roundtable's quarterly gauge of CEO sentiment is strikingly confident about the economy. As a rule, CEOs are planning to increase capital spending in robotics, factories and digital equipment, a sign that the rip-roaring hiring rates are being replaced with more modest employment plans. Meanwhile, average hourly earnings rose only 0.1% in February, suggesting that inflation pressures were subdued.

In this respect, the Federal Reserve Chair Jerome Powell was tenacious in reinforcing his message, under a barrage of questioning from lawmakers in Congress, that the central bank is in no rush to cut interest rates, but adding that it will likely be appropriate to lower borrowing costs at some point this year. Raphael Bostic, President of the Atlanta Fed, thinks that the economy will need 2 rate cuts

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this year. The point here is that the comeback in productivity is making it feasible for the economy to grow even though the policy rate (5.38%) is above the neutral one (4.00%).

Given that there's no evidence or no reason to think that the economy is about to fall into a recession, the market has embraced a new bullish narrative. Indeed, it's better to have one that is strong even with higher interest rates than one that is weak with lower interest rates. Thus, the rally is broadening because it has become easier for investors to focus on company fundamentals and earnings growth. Wall Street analysts' bottom-up forecast is for 11% S&P 500 earnings per share growth in 2024 and 13% in 2025. This comes to \$282 a share in 2025 with a P/E ratio of 18.0x with no recession in sight.

Two weeks ago, I raised my forecast for the S&P 500 to 5500. There are, for sure, a few signs of madness. However, for now the usual accompaniments to a genuine bubble are missing. It closed at 5124 on Friday, March 10, 2024, amid profit taking from traders.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.59	4.51%
Palos Equity Income Fund - RRSP	PAL101	\$7.02	4.16%
Palos WP Growth Fund - RRSP	PAL213	\$9.37	-1.49%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.70	4.83%
S&P TSX Composite (Total Return with dividends reinvested)			4.72%
S&P 500 (Total Return with dividends reinvested)			8.82%
S&P TSX Venture (Total Return with dividends reinvested)			0.15%
Chart 2: Market Data ¹			Value
US Government 10-Year			4.15%
Canadian Government 10-Year			3.39%
Crude Oil Spot			US \$77.56
Gold Spot			US \$2,166.10
US Gov't10-Year/Moody BAA Corp. Spread			159 bps
USD/CAD Exchange Rate Spot			US \$0.7412

¹ Period ending March 12th, 2024. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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