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The Palos Perspective

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A Macro Market View by Hubert Marleau

What's Next?

The S&P 500 took a pause on Friday to close at 5234. It registered 3 new highs last week, notching a weekly gain of 2.2% - the best one of the year. Given that the rally isn't showing signs of exhaustion, the bull market could reach my 5450 target for 2024 well ahead of schedule. The momentum is relentless because the breath is deepening as advances continue to beat declines, and new highs are whipping new lows by wide margins even on down days. In this connection I'm tempted to believe that the market has enough staying power to resist bearish criticism and perhaps sufficient fuel to propel it to 5900 in 2025.

There is no doubt that overall financial markets are discounting the hopes of good news. According to Bloomberg data, equity, credit, bond and commodity ETFs took in nearly $375 billion since last October, the largest haul in 2 years. Nonetheless, there are a variety of reasons that support a bullish stock market thesis.

First, Fed officials neither tossed out their plan to dial down their monetary stance nor their outlook for the economy, based on 2 months of inflation data whose seriousness is questionable. Indeed, they continue to anticipate inflation falling towards 2%, even if the ride proves to be bumpy. Although Powell demurred when he was asked during the presser whether the Fed would lower rates at the coming FOMC meeting in May or June, he did say that fairly soon it will be appropriate not only to decrease interest rates, but also reduce the pace at which bonds are sold off. In other words, the message was dovish. The so-called "dot plot," which has effectively become the "de facto" monetary policy forecast, is projecting a steady decrease in the policy rate from 5.375% to 4.63% by the end of 2024, to 3.825% by the end of 2025 and 3.125% for the end of 2026.

Second, Powell might be a lot more sensitive to the concerns of the Democrats than he has led us to believe. The Democrats are particularly nervous that high rates could sap consumer sentiment, risking a downturn through fear of November's election. They are hopeful the Fed will be able to follow through on its projections of lower rates before then.

History shows that previous recessions have often occurred when real Federal Funds rates (FFR) are too high - 3% being a number. Pushing the economy into a downturn during an election year could have huge political ramifications, too. As a rule, incumbent politicians want a quick return to easier

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money, betting that higher inflation now is better for them politically than running the risk of a recession.

Third, central bankers took centre stage last week. With the exception of the Bank of Japan, which essentially ditched negative interest rates in a dovish manner, they all suggested that the

time has come to begin dialling back policy restraint. The Swiss National Bank and the Bank of Mexico surprised the world with interest rate cuts. Meanwhile, the Australian, British and Canadian policymakers have dropped their tightening bias, seeing conditions improving for rate cuts this year.

Fourth, productivity, which had a tipping point about 15 months ago, is still running relatively strong, growing at a rate of 2.6% in 2023, substantially above its 2010s average of 1.1%. Currently, full employment, combined with huge investments in innovation and technology, which are being sparked by AI, digital implementation, robotics and cloud computing, strongly suggests that the current phenomenon is not a one-hit wonder. A quick calculation of employment and economic growth is supportive of the notion that another 1.5% to 2.0% annual increase is very possible for Q1/24.

Five, valuations may not be as rich as bearish speculators suggest. S&P 500 forward earnings per share for 2024, calculated by bottom-up analysts, are $250.38 and are expected to rise to $275 in 2025. Based on Friday's close, the earning yield for stocks is 5.25%. That's 350 bps above the present 5-year real rate of 1.75%.

Keep on trucking.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.63	5.02%
Palos Equity Income Fund - RRSP	PAL101	$7.04	4.51%
Palos WP Growth Fund - RRSP	PAL213	$9.87	3.78%
Palos-Mitchell Alpha Fund [3]	PAL300	$10.65	4.36%
S&P TSX Composite (Total Return with dividends reinvested)			5.26%
S&P 500 (Total Return with dividends reinvested)			9.47%
S&P TSX Venture (Total Return with dividends reinvested)			-0.53%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.23%
Canadian Government 10-Year			3.50%
Crude Oil Spot			US $81.62
Gold Spot			US $2,177.20
US Gov't10-Year/Moody BAA Corp. Spread			153 bps
USD/CAD Exchange Rate Spot			US $0.7362

[1] *Period ending March 26th, 2024. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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