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The Palos Perspective

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A Macro Market View by Hubert Marleau

Tariffs, Treasuries, and Triumphs: A Breakneck Week in the Markets

The Palos Macroeconomic Commentary will be off for the next three weeks for a much-needed vacation. It will be back in your mailbox on December 21.

In the meantime, the week was highlighted by Trump's nomination of Scott Bessent to be US Treasury Secretary; his intention to impose tariffs on America's top trading partners (Mexico, Canada and China); and the BLS' report on the Fed's preferred inflation gauge.

On Monday, the bond vigilantes gave Trump full trust that Bessent will be able to deliver a "3/3/3" approach to fiscal policy, namely cutting the budget deficit to 3% of GDP, achieving 3% annual growth, and increasing domestic oil production by 3 million barrels per day. These numbers are attainable. What is needed is a $750 billion reduction in government waste, not $2.0 trillion; the maintenance of annual productivity gains at the achievable 2.0% rate; and implementation of incentives in the form of higher depletion allowances to keep on drilling.

The San Francisco Fed came out with a study conducted by INSEAD professor John Fernald, suggesting the ongoing surge in labour productivity may not fade as it so often has done in the past. He believes the U.S. may be entering a new period of breakout growth like that from 1995 to 2004 which enabled big economic gains without much inflation (this courtesy of The Macro Strategy Partnership). In this connection, a vote of confidence was given, as reflected in the 14 bps decline in the 2-year and 10-year US Treasury yields to 4.24% and 4.27% respectively. The S&P 500 increased to 5987.

On Tuesday, markets were unmoved by Trump's opening salvo that he would impose a 25% tariff on Canadian and Mexican imports, including an extra 10% surcharge on the tariff to be levied on

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Chinese goods entering the U.S. for as long as it takes for these countries to stop the inflow of illegal migrants and the deadly opiate fentanyl. Markets were unperturbed, judging that the volley was more of a bark than a bite, trying to yield the world to his will rather than upset the global supply chain. Both Canada and Mexico have expressed publicly their willingness to cooperate on these matters; the auto industry is likely to use political means to shield itself; and specific products may be excluded like oil and gas. Retaliation, however, is probable, and China could well profit from a multi-regional trade war. So it's not that simple. Justin Trudeau, the Canadian Prime Minister, said he had had a good call with Trump. The S&P 500 rose to 6024, a new record high.

On Wednesday, it was disclosed that the headline PCE price index increased 0.2% in October while the core PCE index was up 0.3%, registering a y/y increase of 2.3% and 2.8% respectively, climbing for the first time since July and moving away from the Fed's 2% goal. Given that economic growth ran at the annual rate of 2.8% in Q3 and is probably running at 2.7% in Q4, with the money supply increasing currently at an annual rate of 6.6%, inflation could be heading in the wrong direction for a while. The Fed-funds futures are still assigning a 66% chance of a December rate cut. However, the last mile to price stability is proving to be difficult, which should coerce the monetary authorities into not cutting the policy rate beyond December, trusting instead the strength of the dollar to check the course of inflation. As it is, the S&P 500 was in jeopardy, shedding 24 points by the end of the day.

P.S. My three favourite economists - Frederic Bastiat, Frank Hyneman Knight and Milton Friedman - whose Parable of the Broken Window, the Knightian Uncertainty and Free-Market Capitalism respectively remain classics of their kind are, in my opinion, the most brilliant economist journalists who ever lived, having made a lasting impact on economic thought.

Federic Bastiat developed the concept of opportunity cost, which highlights the cost of forgoing the next best alternative when making a decision, illustrating the unseen costs of economic activity when making a decision and emphasizing that destruction does not benefit the economy.

Frank Knight introduced the distinction between measurable risks and unmeasurable uncertainties, critiquing government intervention while advocating classical liberal forms of social organization and emphasizing free-market principles.

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And Milton Friedman argued that minimal government intervention in the economy leads to more efficient and prosperous outcomes, arguing consumption choices and investment decisions are determined by long term considerations.

Investors should be mindful of these 3 great men in assessing Trump's threats. The major question to figure out is whether the "Tariff Man" is trying to negotiate a ploy to wring concessions out of trade, and/or start a campaign to reshape global trade, rearrange the US economy, launch a new era of protectionism, reopen the U.S.-Mexico-Canada free trade accord, and go nuclear on Chinese trade.

Canada exports approximately 25% of its national output to the U.S., selling almost all of its oil there, while vehicles manufactured in Canada account for 7% of U.S. auto sales. On the other hand, Canada buys more from the U.S. than China, Japan, France, and the U.K. combined. I cannot emphasize enough the importance of these issues. If I were in charge, I would immediately implement supply-side economic policies: that is to decrease the corporate income tax at both the federal and provincial levels, do away with capital gains and eliminate the dividend tax.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$9.19	19.70%
Palos Equity Income Fund - RRSP	PAL101	$7.83	17.50%
Palos WP Growth Fund - RRSP	PAL213	$11.15	18.55%
Palos Global Small-Cap Equity Fund [2]	PAL251	$9.81	-1.44%
Palos-Mitchell Alpha Fund [3]	PAL300	$11.71	15.86%
S&P TSX Composite (Total Return with dividends reinvested)			24.50%
S&P 500 (Total Return with dividends reinvested)			27.81%
S&P TSX Venture (Total Return with dividends reinvested)			8.92%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.31%
Canadian Government 10-Year			3.28%
Crude Oil Spot			US $68.77
Gold Spot			US $2,621.30
US Gov't10-Year/Moody BAA Corp. Spread			142 bps
USD/CAD Exchange Rate Spot			US $0.7115

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

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