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What to Watch for in 2025: Productivity, Immigration and the Dollar

At this time of the year, predictions about the future performance of the S&P 500 are a dime a dozen. Interestingly, there seem to be only three things that are of concern to investors over the coming 12 months. First, will de-globalisation accelerate? It will if Trump throws up trade barriers like tariffs that would severely affect the global supply chain, leaving companies prone to bottlenecks and to absorb higher input costs. Second, will the last mile in getting inflation to target prove to be exceptionally hard? If it does, the Fed's monetary stance may not not ease as much as investors would like. Third, will the deportation of 11 million illegal immigrants ever happen? If it does, an administrative nightmare could easily flare up with detention centres, stiff control agents, family disruptions, civil conflicts, etc. For the most part, such immigrants work in health care, agriculture and construction - the very jobs that Americans do not want to do themselves. That is why businesses are not only afraid of what this could bring, but generally not in favour.

While the aforementioned questions may be the most obvious apprehensions for 2025, they may not be useful. There are three other big things, hiding in plain sight, which are seemingly overlooked, yet crucial because they could contest what investors believe in the most: productivity, immigration, and liquidity.

The Productivity Boom:

Worker productivity is the most important driver of a better economy. Officially, it is the total output of the economy divided by the number of hours worked, aided by investments in technology and capital. It allows an economy to expand faster - without triggering inflation - than it otherwise would if growth were confined strictly to population. Curiously, productivity booms come in sudden bursts with their own drivers. Since the end of WW11, there have been three such booms, according to

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Yardeni Research: the interstate highway buildout and rapid suburbanization of the 1950s: mainframe computers and jet engines of the 1960s: and personal computers and the internet of the 1990s.

It's becoming more and more evident that we are in the midst of the fourth one, which began toward the end of 2022. Labour productivity grew at an annual rate of 2.2% in Q3 and perhaps as fast as 2.5% in Q4. Productivity growth has averaged an impressive quarterly increase of 2.7% in the past 7 quarters compared to only 1.5% for the five years before the pandemic. This current boom involves a major step-up investment in labour-saving technologies and a smart reallocation of labour. When one looks on the horizon with all the billions of dollars worth of investment in AI and the wave of creative startups it's not hard to imagine that this boom in efficiency and innovations is bound to continue for many more years, pushing productivity increases to 3.5% to 4.0% as it did in previous ones.

The Immigration Boom:

The U.S. has become subjected to a falling birthrate and a high death rate, seeing more deaths than births in many states, because of the graying population. In this regard, population growth has become clearly dependent on immigration, in which both legal and illegal immigration has been allowed to supplement the labour force. In the 2 decades before the pandemic, immigrants accounted for less than half of U.S. population growth. In the year ended June 30, 2024 newcomers totalled 2.7 million, representing 85% of the U.S. population growth and, in turn, business activity.

Given that proposals to limit immigration and boost deportations are headwinds to growth and that demography is destiny, a large body of technology moguls are favouring more immigrants, not less. Elon Musk, himself an immigrant, is of the opinion that if America wants to keep on winning it is essential to fill the demand for high-skill occupations with high-value foreigners, while many other billionaire technologists and industrialists think that the “shit jobs” in health care, cleaning services, agriculture and construction should be left to low skilled migrants, keeping domestic human capital occupied with better-paying jobs. A recent PEW poll found that an overwhelming majority, almost 70%, place a priority on letting in both skilled workers and common workers to fill labour shortages.

Nonpartisan forecasters have expressed the positive impact that immigration has had on economic growth, labour markets and the fiscal deficit. Indeed, expect support for immigration by the powerful U.S. Chamber of Commerce in the year to come. Mass deportation would cost billions of dollars and help is wanted vigorously by factories seeking workers for the nearshoring rush.

In the meantime, I expect that the administration will embark on a policy focused on selecting the very best, yet allowing enough immigration to meet the very low level jobs that Americans don't want to do. According to Musk, the smartest and richest man on planet earth, “it comes down to this: do you want America to WIN or do you want America to LOSE? If you force the world’s best talent to play for the other side, America will LOSE.” Indeed, studies show that rejected foreigners end up in China, India, or Canada, while companies prevented from hiring them start to invest abroad. Anti-immigrant freakouts don’t last long. Past political uproars against the Irish, Polish, German, Italian, East European Catholic immigrants and Jews did not serve the racists. Look at where they are today: half of the members of Trump’s administration are Catholic. Nowadays, the same is happening with Indians and Chinese. My bet is with Musk and company and not with the far-right activist Laura Loomer, whose view is in opposition to Trump’s team. On this basis, the U.S. will be allowed to continue to absorb, without too much political backlash, over 2 million foreigners in 2025.

The Foreign Liquidity Boom:

Although the current productivity and immigration booms augur well for the S&P 500, liquidity will need to cooperate for the equity market to resume in smooth fashion in the new year if we are to keep It’s what will keep the momentum going.

This, however, is a tall order. On its own, the US economy does not generate sufficient amounts of domestic savings to fund the investment plans of the private sector, because the federal spending deficit is too large. Without the assistance of the Fed, which is, on the contrary, siphoning money away from the financial system through a process known as quantitative tightening, the economy relies on the savings of foreigners to keep prosperity going.

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Luckily, foreign inflows of capital from the rest of the world remain huge and are more than enough to service the stock of debt, fund budget deficits, feed the thirst for investment capital, sustain economic growth and, in turn, power the stock market forward. Foreign central banks dollar demands for official reserves are perhaps declining, but it's absolutely not the case in the private sector.

The U.S. may no longer be the banker to the world, but it remains the global innovator. Thus foreign appetite for claims on the US is seen all over the place - equity, debt and direct investment (FDI) - and from everywhere: Europe, Japan, Canada, UK, Ireland and the Cayman Islands. According to MacroStrategy Partnership, the U.S. net international investment position (NIIP) - the difference between U.S. overseas assets and those held by foreigners in the U.S., including stocks, bonds, FDI, and other investments - has collapsed from -USD1.66 trillion at the end of 2005, when BEA records began, to -USD22.52 trillion at the of Q1/2024, or about 79% of the N-GDP. There is plenty of evidence that this movement is still going on. Just watch the DXY: it is a measure on the value of the U.S. dollar relative to a basket of 6 major currencies. This index is holding well at 108.25, up 8.0% since the end of September.

The Stock Market Outlook:

With valuations skyrocketing and concentration accelerating in 2024, many investors are uneasy about putting more money into the market. The truth is, predictions are just guesses, no matter how sophisticated the analysis is. Too many "ifs and buts." And, yet most market strategists are predicting a continuation of the rally in 2025. Of the 20 firms who are bold enough to enter year-end price targets, only Cantor Fitzgerald is looking for a loss and it's only 90 points below the all-time high of 6090. The target range is still 6300 to 7100.

When all the experts agree, something else usually happens. Indeed, there are better ways to play the game. I think that the best counsel I can give at this time is to buy stocks whose PEG ratio is below 2.0x. The PEG ratio is the price-earning multiple divided by the 3-year growth outlook for earnings per share. Let's look at a few examples:

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GOOG: Price is $194; P/E is 25.5; EPS-GR is 15.1%; PEG is 1.69. BUY

MSFT: Price is $430; P/E is 35.5; EPS-GR is 18.4%; PEG is 1.93. HOLD

APPL: Price is $255; P/E is 41.9; EPS-GR is 11.0%; PEG is 3.81. SELL
SLB: Price is $38.8; P/E is 11.3; EPS-GR is 11.1%; PEG is 1.02. STRONG BUY
FDX: Price is $280; P/E is 16.5; EPS-GR is 18.0%; PEG is 0,92. STRONG BUY
NVDA: Price is $137; P/E is 52.3; EPS-GR is 40.6%; PEG is 1.29. STRONG BUY
PFE: Price is $26.5; P/E is 10.3; EPS-GR is 10.0%; PEG is 1.03. STRONG BUY

While I enjoy the PEG idea as a selector of potential investment opportunities, my emphasis for 2025 will be the beaten-down sectors that offer big dividend yields. There are a lot of those in Canada - utilities, REITs, telcos, energy companies, and consumer staples.

P.S. Canada may soon offer a lucrative investment opportunity in the new year. Assuming that it will not be subjected to Trump's tariff threats, the cheap Canadian dollar could bring extra profits to many publicly traded Canadian businesses that have big investments in the US and/or sell a lot of goods and services there. They could benefit handsomely from foreign exchange translations on assets and higher revenues on sales.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.98	17.04%
Palos Equity Income Fund - RRSP	PAL101	$7.66	14.94%
Palos WP Growth Fund - RRSP	PAL213	$11.22	19.23%
Palos Global Small-Cap Equity Fund[2]	PAL251	$9.81	3.50%
Palos-Mitchell Alpha Fund[3]	PAL300	$11.87	17.45%
S&P TSX Composite (Total Return with dividends reinvested)			22.08%
S&P 500 (Total Return with dividends reinvested)			26.63%
S&P TSX Venture (Total Return with dividends reinvested)			8.30%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.59%
Canadian Government 10-Year			3.30%
Crude Oil Spot			US $70.10
Gold Spot			US $2,616.87
US Gov't10-Year/Moody BAA Corp. Spread			142 bps
USD/CAD Exchange Rate Spot			US $0.6965

[1] *Period ending December 24th, 2024. Data extracted from Bloomberg*

[2] *Fund is priced monthly*

[3] *Fund is priced weekly on Tuesdays*

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