

PALOS

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The Palos Perspective

Issue No. 1 | January 6, 2025

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A Macro Market View by Hubert Marleau

AI Mania, Trade Uncertainty, and Political Drama: What's Next for the S&P 500?

Throughout last year, I maintained all along that the S&P 500 would attain 5950 sometime in 2024. It did even better, touching 6090 on December 6, registering a year-to-date raw gain of 27.7%. I didn't think that the election of Donald Trump as President of the U.S., albeit bullish, would have catapulted the market to 9 all-time highs since Election Day to reach a record high of 6090.

Year over year, total return, which includes dividends reinvested, amounted to 25.2%; 1.5% was attributable to dividends, 10.8% to higher valuations, 5% to revenue growth, and 8% to margin expansions. This exceptional performance followed a 26.1% gain in 2023. Three consecutive years of double-digit growth are very rare. Yardeni Research thinks the year will be bumpy with possibly a significant pullback in January, given uncertainty about trade, immigration and fiscal policies. Indeed, it's been disappointing for the bulls since December 5, as reflected in the significant increase in the term premium content of bond yields, which reflects the extra yield demanded by bond traders to compensate for rising uncertainties. The weakness of the Magnificent Seven Group, except Nvidia, exposed these, as did the lack of market breadth.

On Friday, the S&P 500 closed at 5943, down 2.4% from its all-time high of 6090. The benchmark may have dipped below its 50-day moving average but remains well above its long-term uptrend.

Nonetheless, Yardeni is looking forward to a 20% increase in 2025 to around 7000. Such an optimistic forecast of course assumes that the tariffs are not going to be harsh, the cost of money will not rise, immigration will be allowed, and the productivity boom will last. Enthusiasm surrounding AI and the prospect of further economic growth also accounts for Yardeni's bullish forecast, yet I'm a bit more reserved because my target for 2025 is lower at 6650.

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P.S. What Just Happened?

President Biden decided to block the \$14.1 billion Nippon Steel acquisition of US Steel. The excuse for the refusal is national security but the real reason for the objection is totally political. There is no national security here. The Treasury Department, the State Department and the Pentagon found no security issues. Indeed, Japan is the closest ally the Americans have in Asia. Meanwhile, as a final irony, the US approved the sale of \$3.6 billion worth of air-to-air missiles to Japan. Based on job security, onshoring policy, capital inflow, and modernization, this was an investment that should have been allowed. The decision will impose an onerous cost on the industry. In fact, management, the municipal government, investors, steelworkers and members of the president's own cabinet all favored the acquisition. I therefore see no justification for such a decision and find it risky, being against the US culture of open investment. The US Chamber of Commerce was appalled. In my opinion, the decision will be reversed either by the courts or by Trump. The stock itself may be a good buy.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.81	17.37%
Palos Equity Income Fund - RRSP	PAL101	\$7.50	16.24%
Palos WP Growth Fund - RRSP	PAL213	\$11.78	25.64%
Palos Global Small-Cap Equity Fund ²	PAL251	\$9.81	3.50%
Palos-Mitchell Alpha Fund ³	PAL300	\$11.32	17.05%
S&P TSX Composite (Total Return with dividends reinvested)			21.65%
S&P 500 (Total Return with dividends reinvested)			25.00%
S&P TSX Venture (Total Return with dividends reinvested)			8.60%
Chart 2: Market Data ¹			Value
US Government 10-Year			4.57%
Canadian Government 10-Year			3.23%
Crude Oil Spot			US \$71.72
Gold Spot			US \$2,624.50
US Gov't10-Year/Moody BAA Corp. Spread			145 bps
USD/CAD Exchange Rate Spot			US \$0.6952

¹ Period ending December 31st, 2024. Data extracted from Bloomberg

² Fund is priced monthly

³ Fund is priced weekly on Tuesdays

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