

PALOS

The Palos Perspective

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The State of the U.S. Economy

Release of the official estimate of the real gross national product for Q3 - a key measure of overall level of economic activity - will be delayed until December 19 because of the government shutdown. We should have had this number by now. The best estimate that we currently have is from the Atlanta Fed's GDPNow Model, which has a seasonally adjusted annual rate growth projection of 3.9% in Q3. Interestingly, the total employment increase for the comparable period was only 0.5%, suggesting that productivity gains were noticeable, while the money supply rose at an annual rate of 5.0%, an amount sufficient to meet the needs of a growing economy.

What is important to note is that growth has become exclusively dependent on AI investment and related productivity, plus the wealth effect on domestic consumption created by it. If it had not been for that, the affordability squeeze and lack of confidence among lower income masses would have plausibly caused a severe slowdown or recession. Thus, the big question as to what is in store for 2026 is how these two opposite forces - productivity versus affordability - will play out.

In my view, the prospects for easier monetary conditions; the fiscal impulse of the One Big Beautiful Bill (OB BB); better visibility on the tariff front; the continuation of the AI-related capex boom; and the upcoming flurry of AI-driven innovations and automation are tailwinds that will likely continue to counteract headwind risks like the potential for disintermediation, trade flare-ups, softer labour conditions and geopolitical tensions. Thus, I expect that economic growth will slow down in 2026 and land around 2.5% in 2026 and 2027.

A Macro Market View by Hubert Marleau

What Took Place in the Week Ended November 28?

On Sunday, global markets were mixed ahead of a short but event-filled week. Goldman Sachs sent a note over the weekend to their clients, saying that it expected a Federal Reserve rate cut on December 10, followed by two more in March and June of 2026.

On Monday, in a risk-on mood, the S&P 500 surged 1.6% to 6703, led by broad momentum across all sectors, especially AI-connected technology stocks, which followed the lead of Google.

On Tuesday, everything went wrong. Nvidia shares slumped, wholesale prices rose, consumer confidence soured, job expectations deteriorated, private payrolls weakened, and retail sales tapered off. Yet the S&P 500 rose 0.9% to 6766. Why? The CME FedWatch futures index showed an 85% probability of a quarter-percentage point rate cut on December 10, as San Francisco Fed President Mary Daly, who usually sides with Chairman Jerome Powell, announced publicly that she supports lower interest rates because a sudden deterioration in labour conditions is more likely and harder to manage than a temporary inflation blow-up.

On Wednesday, early morning futures indicated that the stock market was set to extend a 3-day rally. It did. With the help of tech stocks and a decrease in jobless claims, the momentum produced a 0.7% increase in the S&P 500 to 6813.

On Thursday, the U.S. financial markets were closed.

On Friday, stock and bond markets closed early on Black Friday, heading into a jittery session, nonetheless the S&P 500 rose 0.5% to 6849.

A Macro Market View by Hubert Marleau

The Near-Term Stock Market Outlook

Last week I wrote: “Conditions for a year-end stock rally are also present. Flat aggregate hours worked in recent months even as real GDP has been running above 4% (saar), are highly suggestive that productivity is booming. But it might be a grinding affair because investors are still nervous about the unpopularity of President Trump, the bitcoin freefall, Fed’s undecidedness, the carousel of deals with OpenAI and Softbank, and the Thiel and Burry sell-off of NVIDIA even though NVIDIA, as the world’s most important company, it had produced ostensibly a reassuring report. In this context, if the 5% pullback were to turn into a 10% correction, the 7000 year-end target would likely slip into early 2026. I’m clinging to 7000 by the end of 2025 and 7500 in 2026.”

The pullback ended as fast as it started, while the probability of a Federal Reserve rate cut rose close to certainty, while it became clearer that such a move might be the right one, with doves outnumbering hawks. In this context, the market may have started to price in the appointment of Kevin Hassett, the leading contender for Fed Chair, as an advocate of lower interest rates. As the new year approaches, top-down Wall Street strategists have started to incorporate their economic, monetary, financial and fiscal assumptions for 2026 in their stock market predictions for next year.

The strategy team at Deutsche Bank boldly predicts that strong corporate earnings and AI-driven growth will project the S&P 500 to 8000 by the end of 2026, making it the most bullish prediction on Wall Street; while JPMorgan Chase strategists, meanwhile, dropped their cautious view on US equities, joining the ranks of Wall Street firms forecasting a rally next year. They now see the S&P 500 Index rising 11% from its current level to 7500 points by the end of 2026.

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