

PALOS

The Palos Perspective

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CONTENTS

The Worst-Case Scenario is Off the Table, Bringing Global Relief	1
Disclaimer	4

A Macro Market View by Hubert Marleau

The Worst-Case Scenario is Off the Table, Bringing Global Relief

Under condemnation from the American people, allies, and even the Pope, and amid fears of the Iranian people facing the total elimination of their Persian civilisation, an agreement to a two-week ceasefire between Iran and the U.S. was reached, with a commitment to open the Strait of Hormuz, just as it was suggested numerically by the gold and copper futures markets, and as predicted by oil futures and the swap markets, stemming from the political realisation that the cost of the war on just about everything makes its continuance unthinkable. Indeed, it is also plausible that government officials have conveyed their warnings over the cost of the war on more “Guns and Butter” spending and the loss of “Petrodollar Flows” into U.S. Treasuries, stemming from the lack of oil revenues, given the unsustainability of the huge budget deficits and outlandish debt load of the U.S. government.

At the time of writing, even the truce appeared tentative, unstable and fragile. The players remain locked in the harsh reality that there are disagreements on the terms of the cease-fire, as Israel is still bombing targets in Lebanon and the Strait of Hormuz is still closed, suggesting that it could easily crater, thereby failing to bring a permanent settlement. While I have no idea how this will play out (as if anyone actually knows because the compromise is murky), the “left-tail risk” may nonetheless be off the table, enough to generate a 7.5 percent point S&P 500 rally from a low of 6,344 on March 30 to 6,817 on Friday.

In this regard, investors will continue to agonise over the conflict, yet are more likely to revert their focus to the state of the economy. This is best seen through the lens of the Misery Index - a metric calculated by adding the inflation rate to the unemployment rate - which shows how well the economy is doing. Since June 30, 2022, it has fallen from 12.7 to 6.5 on April 30, 2025. Since then,

A Macro Market View by Hubert Marleau

it has risen erratically to a new high of 7.6 on April 10, with an inflation content of 43.4%, resulting from the imposition of US tariffs on imports and a surge in oil prices.

Considering that the Misery Index optimum number is 6.0, with an inflation content of 33%, most of the anguish and hardship lies with the substantial 0.9% monthly leap in the level of consumer prices that took place in March, which brought inflation to an annual rate of 3.3%; while under the Sahm Rule, a recession isn't coming. According to Claudia Sahm, this is only triggered once the unemployment rate (4.3%) rises a half-percentage point from its base (4.1%). Moreover, the Atlanta Fed's economic tracker estimate for Q1/26 is 1.3%, while the N.Y. one is predicting 2.3% for Q1 and 2.6% for Q2, despite a negligible employment increase in the past 3 months, implying that productivity is holding up rather well for corporate earnings, but narrowing the path to a near-term Fed rate cut. However, investors should note that the swaps market is predicting that, one year for now, the inflation rate could be as low as 1.5% year over year, and real rates are suggesting that the unemployment rate should stay below 4.5%, taking the Misery Index to 6.0 with a favorable 25% inflation factor. This may explain why the Fed's policymakers have indicated that they may look through some of the inflationary effects from the oil shock, if they prove to be short-term as forecast by the futures contracts.

Be Greedy When Others are Fearful:

The time may have come for investors to consider Warren Buffett's famous investing maxim because many high-quality companies are relatively cheap. Equity investors are significantly underweight, especially in tech, software, financials, and energy. As an example, the Magnificents are trading at the same P/E multiple as Staples. Does this make sense?

Yet Wall Street analysts are predicting an S&P 500 first quarter annual earnings per share growth of 16.2%. Incidentally, Deutsche Bank is even flashing an earnings increase of 19%, justified by productivity, weak dollar tailwinds, cyclical drivers and a broadly favorable macro environment.

A Macro Market View by Hubert Marleau

P.S. Tom Lee, Head of Research at Fundstrat and a “par excellence” forecaster of the stock market, said on Friday that he was very comfortable with his bullish stance because the CBOE Volatility Index is back to normal levels, stock prices have risen on bad news, and higher oil prices have not been less damaging than consensus expectations, suggesting that the “war bottom” is in. Based on his technical analysis and market observations, he claims that the S&P 500 could reach 7,400 this year.

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