

PALOS

The Palos Perspective

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Back to Basic Economics? Perhaps

Although Trump failed to eradicate Iranian worries and warned of longer involvement in the war, the S&P 500 nonetheless closed at 6,583 on Thursday, registering a powerful weekly peace-rally gain of 3.4% on optimism of a de-escalation down the line in the Middle East conflict. Goldman Sachs reported that traders rapidly unwound their hedges and speculators exited their bearish bets.

President Trump, declaring victory and mission accomplished, signalled that the U.S. could end its military attacks on Iran in 2-3 weeks without a deal with Tehran to wind down hostilities, even though Iran was still firing missiles at industries and US companies in the Persian Gulf and Israel and the U.S. were still bombing Iranian military and infrastructure installations. Meanwhile, the UAE manifested willingness to help the US and its allies open the Strait of Hormuz by force, seeking a UN Security Council resolution for action, suggesting that the US should occupy Iranian strategic islands. This puts a lot of pressure on Iran's Revolutionary Guard to yield toward a peace resolution.

Meanwhile, Benjamin Netanyahu shifted his own rhetoric, describing Iran as something less than an existential threat, and suggesting that the IDF would follow the US lead in dialling down the intensity of direct attacks and revert to diplomatic engagement rather than confrontation. Keir Starmer, in a speech outlining a 5-point plan to stave off an energy crisis, announced that a 35-nation meeting would take place to assess all viable diplomatic and political avenues to restore freedom of navigation and that the UK would spearhead an international effort through a united front of military strength and diplomatic activity to guarantee the safety of trapped ships and resume the movement of vital commodities.

On Wednesday evening during prime time, President Trump sought to reassure Americans in a direct 19-minute sales pitch that the conflict in the Middle East is in the national interest, military objectives would be completed very soon, and economic pains would be short-lived. He vowed that he would

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hit Iran hard in the coming days to bring it to the negotiating table to end the war with a diplomatic agreement.

Thus, if indeed there is truth to the notion that the hostility in the Middle East will wind up soon, the improved performance of North American stock markets of the past week could stick, as the narrative would then revert back to basic economics. Nonetheless the market has the right to change its mind as often as Trump does and it will therefore continue to be volatile because we are at a multi-year low in sentiment readings and high in “vibecession” mood.

However, the belief found in the swap and futures markets that there is an end to this conflict is sufficiently strong and widespread, encourages me to maintain my view that the S&P 500 will touch 7500 sometime in 2026 based on ongoing strength in corporate earnings expectation. Indeed, 52-week forward earnings per share as of March 26, 2026 were \$336.33, 15.5% higher than the quarterly annualised Q4 2025 earnings per share of \$292.48. Oil prices above \$100 a barrel will not last either, creating opportunities for bargain-hunting. Futures contracts are pricing crude oil in the 80s by July, drifting in the 70s for the rest of the year and the swap market is predicting that inflation will fall below 2.0% in 2027. Indeed, a resumption of the bull run in the foreseeable future is a palatable outcome for the following additional reasons:

First, the S&P 500 earning yield is currently 5.10%, attractively more than 375 bps above 5-year real rates.

Second, the economy is not falling apart: on the contrary it is positive. Recession odds range tolerably around 25% and the Atlanta Fed GDPNow real growth estimate for Q1/2026 is 1.6%, which incorporates recent improvement in consumer confidence; the current neutral state of the labour market as the private sector added jobs; a February rebound in retail sales, and stronger growth in factory activity in March. Moreover, the U.S. added a bigger-than-expected 178,000 jobs in March and unemployment fell a tick to 4.3%, a sign that the labour market is holding firm. In this regard, economic trackers are bound to raise their real growth predictions for both Q1 and Q2.

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Third, the Cleveland Fed's Inflation NowCasting model shows that headline CPI probably jumped 0.84% in March, creating a sharp step up in the year-over-year increase to 3.25% from 2.5% in February, flashing an early resurgence of inflation. However, this inflationary prospect may not hurt corporate profit margins because a lot of it is coming from prices paid to businesses, which are reacting quickly to input costs and adjusting expeditiously to international prices.

Fourth, assuming that the length and depth of the current correction will match the average of all S&P 500 corrections since 1928, Mark Hulbert, a reliable market statistician, has calculated that the benchmark should bottom in May, then rebound by October, surpassing its January 27, 2026, all-time high of 6978.

It should nonetheless be noted that there are considerable variations on either side of this historical average. If you are a long-term investor who seeks to participate in the stock market's long-term uptrend, it is better to view these corrections as the cost of doing business, says Mark. Keeping in mind that bear markets are rare and less frequent than corrections, it is better to be a dipper than a loser of opportunity.

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