

PALOS

The Palos Perspective

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A Maelstrom of Factors in the Midst of a "Drôle de Guerre"

Last week, I wrote: "It is plausible that the record-breaking rally might enter a short-term consolidation phase because investors may need a supportive background. There is some froth in specific areas like semiconductors, and above all, the US-Iran peace talks remain in limbo as the two countries concerned are engaged in a high-stakes game of chicken. In this regard, investors may want to make sure that the new consensus estimates for earnings do pan out and that their upward revisions, which have been entirely concentrated in the energy and technology sectors, broaden to other ones without negating the re-distributional impact of crude price fluctuations in a new higher range between \$80 and \$100 a barrel, along with the powerful tailwind of AI spending."

Over the past month, the price for 1-year oil futures rose alarmingly by 8.5% to \$76.50 per barrel, pricing a prolonged supply shock and by ricochet raising longer-term and higher inflation risks. Although it looked like stocks would start the week of April 26 on a cautious note, the blasting upward movement in the price of oil topping \$125 per barrel, which led to a surge in bond yields, did not jolt the stock market for a change, because this time may be different. By the end of the week, the S&P 500 was up to a new all-time high, because Big Tech still had its magic market mojo; and when combined with a resilience of the economy and record earnings reports, there were sufficient reasons to shake off the oil shock. According to Julian Emanuel, strategist at Evercore ISI, the superlative rally that started since the pivotal March 30 low is historic, conjuring up memories of 1982. If the current rally were to replicate what took place back then, it would take the S&P 500 to 10,675 by June 2027. This is not my forecast, it's much less bullish, but just the same, my bet is 7,500-plus in 2026 because I am anticipating a consolidation phase in the near term.

First, the global supply chain disruptions may be less severe this time around because the future of energy is rapidly changing for the better:

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- 1) Before the war, more than 50% of the oil that passed through the Strait of Hormuz was going to India and China. They are now both getting a lot more oil from Russia. As for the other 50%, much of it is being rerouted by trucks and pipelines.
- 2) Thanks to the US shale revolution, America has become a dominant supplier of cheap natural gas to produce petrochemicals, which are used in nearly every industry from plastics to fertilizers.
- 3) World dependence on crude oil to generate the energy needed to fuel economy output is significantly lower today than it was during the oil crisis of the 1970s. Crude oil production as a share of global output, at about 2.0%, is about a quarter of what it was during the Iranian revolution in 1979.
- 4) The UAE exit from OPEC signals a potential cracking of the cartel to an eventual shift toward competitive supply that could reshape oil pricing dynamics.
- 5) Oil giants that shunned Venezuela are now having a second look and reconsidering their stance.
- 6) Based on cost, clean power growth will exceed the rise in global electricity demand, keeping fossil generation close to flat. More than 90% of all new electricity worldwide has come from renewable sources in recent years, with solar, wind, geothermal, nuclear and kinetic dominating new power capacity. With crude oil at \$100 per barrel, the impact of the Iran war will likely drive even faster adoption of cheaper and greener energy sources.

Second, five of the Magnificent Seven - Tesla, Alphabet, Amazon, Meta and Microsoft - have reported revenue and earnings that beat expectations and revealed higher capital expenditure plans for 2026 than anticipated. The promise of AI is that it will bring a sudden increase in productivity that will boost enough real growth to pay for the cost of overwhelming government debt and replace a shrinking labour force troubled by an aging demographic and lack of immigration. In this context, investors should take note that applications to start new businesses are climbing to record highs because AI has lowered the barriers to entrepreneurship and drawn both skilled and brainy workers.

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Third, despite objections by three members of the FOMC, it remains that the committee's official statement was that the next move in the policy rate will be down, because inflation expectations are still at moderate levels even though the policy rate at 3.625% is roughly 45 bps lower than the neutral rate (4.075%) and the money supply has been cruising at an annual rate of 7.5% for the past three months.

Fourth, there are no signs that there is a growth problem. Real GDP increased at an annual rate of 2.0% in Q1 of 2026 with real final sales to private domestic purchasers, which is the sum of consumer spending and gross private fixed investment that excludes government spending, trade and inventory swings, rising 2.5%. Put simply, the economy was on a solid footing as the Iran war began and the spate of economic prints produced by the ISM, University of Michigan, the Conference Board and the Bureau of Labor Statistics show that the economy will continue to be in an expansionary mode in Q2. As a matter of fact, the initial Atlanta Fed growth estimate is 3.7%.

Fifth, the economy may very well be in an inflationary recovery mode in the short term, but the prospects are highly probable that it will be heading toward a deflationary growth mode over the mid-term rather than sliding into a stagflation one. Demand is slowing because the population is declining, while supply is rising because capital expenditure is increasing, especially in productivity enhancement categories like AI-related equipment, software, and intellectual property as payback from the AI infrastructure boom is coming into view with the growing use of AI agents.

P.S. Canada is in a unique situation:

The global energy crisis may have reawakened inflation and fears - the arch-enemies of investors - but on the other hand it may eventually highlight a huge opportunity for North American energy companies to expand at speed. Importers' awkward dependency on Middle East crude and natural gas makes them not only vulnerable to current turbulence in the Strait of Hormuz, but also to the potential lack of long-term supply availability. A modern economy cannot function well or grow profitably without them. Additionally, applications of selfish economic policies like the general

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imposition of tariffs on imports, implementations of coercion to lure foreign industrial investments, restrictions on certain strategic exports and the relentless quest to hoard critical minerals makes the matter worse with serious long-term consequences against globalisation, affecting in turn the free flow of international trade.

As a result of the advent of these abusive controls on energy, strategic components like chips and critical minerals, electrification and essential digital services, will affect world trade in a cold-blooded, callous equilibrium, where leverage and advantage will predominate. These are bound to have profound effects beyond the transitory ones of the current geopolitical crises. In the view of the editorial board of the Financial Times, the law of one price is and will continue to be in retreat as a less reliable America means more wars, more crises and more trade disruption. Thus, markets will become less fungible, creating big differences in inflation and import prices among importing countries. In this connection, no nations will want to be in a spot where they're stuck. They will seek supplies that are easy to get, reliance is assured and prices are affordable.

Thus it's all about the electrification megatrend, and this is where Canada fits in: a large country with a relatively small population but with a huge amount of fossil, nuclear and renewable energy, and of metals (copper and aluminium especially) and critical minerals that could feed the world's transition to electrification, which, according to Anaconda Invest, could double by 2035.

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