

# PALOS

## The Palos Perspective

Issue No. 16 | May 8, 2026

### CONTENTS

The Middle East Saga Versus the Economic Narrative	1
Disclaimer	5

*A Macro Market View by Hubert Marleau*

## The Middle East Saga Versus the Economic Narrative

Last week, I wrote: “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’m anticipating a consolidation phase in the near term.”

Stocks started the week on the upside, and continued to march upward throughout the week, refusing to submit to the barrage of critics who claim that the market is overvalued and due for a sharp fall. Instead, the S&P 500 roared upward, registering a few new all-time highs, ending the week on a strong note. While I still expect that the market needs to take a short break to inhale all the stuff that is going on, not for lack of fundamentals but for technical momentum reasons, the recent rally was not due to valuation expansion but to earnings growth. In fact, the PEG ratio, which is the forward P/E divided by long-term earnings growth, supports the aforementioned argument. It currently stands at 1.03x - a historic low as it rarely falls below 1.00x - down from 1.45x a year ago. Perhaps the reason why RBC raised its 12-month forward S&P 500 price target to 7900. In the words of Michael

## *A Macro Market View by Hubert Marleau*

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Wilson, the main strategist at Morgan Stanley, corporate earnings led by a buoyant tech sector and a resilient economy are overshadowing the Middle East conflict.

### **S&P 500 Earnings are Rich:**

Industry analysts' consensus forecast for S&P 500 companies' aggregate earnings growth has climbed to 21.4%, with the fewest earnings misses in 25 years, well above the 11.7% and 13.6% figures posted in 2024 and 2025. Indeed, this double-digit marathon should continue in 2027, with analysts collectively forecasting a 16.9% gain, in sync with Yardeni's Roaring 2020 narrative. While a few large technology companies are expected to be the major contributors, finance, utilities, industrials, minerals and energy are also playing in that expected performance.

On earnings calls, companies are downplaying the impact of \$4-plus gasoline price, suggesting that business is holding well. The reason why they are sanguine is because oil no longer has the same importance it used to. Interestingly, the inflation-adjusted price of gas is presently \$3.51 versus a 35-year average of \$3.30 and has been flat for the past 22 years. In this regard, the North American oil grid is helping the case: Canada supplies U.S. refineries with heavy sour crude to create road fuels while US producers export light sweet oil to feed Asian and European refineries.

### **The Middle East Saga:**

Stock futures started the week on the upside in response to Trump's announcement of a plan named "Project Freedom" to partially reopen the Strait of Hormuz to help neutral countries navigate it, coupled with OPEC+'s declaration that it would modestly increase oil production in June while the overall ceasefire agreement held. There was also hope that Iran was approaching a painful tipping point as oil storage was reaching capacity and oil infrastructure had deteriorated enough, thereby forcing a shutdown of oil wells that may have riled up the IRGC. Indeed, it may have. On Wednesday, President Trump, seeking a way out of the Hormuz impasse, paused the military mission to guide commercial ships through the Strait of Hormuz, in a U-turn on "Project Freedom," a day after the

## *A Macro Market View by Hubert Marleau*

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operation began, to see whether a diplomatic solution could be reached with Iran, citing a lot of progress had been made toward a signed agreement - a one-page memorandum - with representatives of Iran at the request of Pakistan, the mediator. The bottom line is that Iran needs to suppress economic pain to avoid regime change as much as the U.S. needs to keep the economy stable to escape the political price. On Wednesday morning, WTI oil price plunged 12% to below \$90 a barrel, but ending the week near \$95.

### **The Economy Keeps on Rolling Up:**

The Atlanta Fed GDPNow growth estimate for Q2 is 3.7% as mentions of “recession” in the press have collapsed since their 2022 peak. There are 3 reasons why this is happening.

First, consumer spending, the single biggest driver of growth is showing remarkable resilience, defying economic gravity. Redbook showed that same-store real sales excluding gas station sales were up 7.8% y/y in the week ended May 1.

Second, key indicators are suggesting a reversal in the labour market for the better. The private sector added 106,000 jobs, according to the March ADP report; and the JOLTS report for March confirms that businesses have both retained and hired workers with stunning numbers. The BLS showed that the labour market. Employers created 115,000 new jobs, beating Wall Street expectations for the second straight month.

Third, the Institute of Supply Management showed that both manufacturing and services remained firmly in expansionary territory in spite of experiencing some inflationary pressure for the rapid increase in energy prices.

Fourth, it's no secret that the \$1.0 trillion capital expenditure on the supply side is underpinning the economy and having an outsized role on growth, a situation that will likely persist in the trillions of dollars for years to come.

## *A Macro Market View by Hubert Marleau*

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### **The AI Boom is no Ordinary Cycle:**

The economy is in the midst of a data revolution because the collection, process and analysis of data has become relatively inexpensive and fast, a boosting factor to production that increases incessantly the demand for more compute, more memory and more storage, ad infinitum. BlackRock's Tony Kim says that AI trade has the power to totally rewire the global economy, which is equivalent to 10 Manhattan Projects going off at the same time with 2 layers: the bottom one being physical - compute, chips, data centers, and power - and the top one being the intelligent model - SpaceX, Bing, Anthropic, OpenAI, and others.

**P.S. Global Oil Intensity:** The amount of oil necessary to produce a certain amount of economic output has improved dramatically over the decades. The FT calculated from industry sources that in 1973, the year of the first oil price shock, about 80% of one barrel was consumed per \$1,000 of global GDP in 2025 prices - 131 litres, to be precise. In 1980, the year after the Iranian revolution, this was down to 116 litres. Last year it was 52 litres.

Thus, the average oil burden is 60% less than 50 years ago, suggesting that real prices would have to escalate much higher before they cause serious economic damage associated with previous disruption. The FT added that today's diminished oil cost burden to the global economy is to adjust the nominal price of oil not only for inflation but also for efficiency improvements. If one does, a hypothetical price of \$115 per barrel today compares with an average price of \$339 in 1980 in today's dollars. By this measure, prices have plenty of runway before the oil burden resembles 1980.

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