

PALOS

The Palos Perspective

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Inflation's Siren Call and the IPO Market Weighs

Last week, I wrote: "Unfortunately, mounting inflation, stemming from higher tariff rates and energy prices, has tilted the misery index—which is the addition of the yearly increase in the consumer price to 3.8% and the current unemployment rate to 4.3%—to an inflation content of 47%. That is too much for any responsible central banker to accept, if the growth path of the economy is to remain intact. In this connection, the likelihood of a Fed rate hike rose significantly, which in turn finally brought about the widely anticipated valuation adjustment. The S&P 500 booked a plummet for the week of 3.0% to 7,485.

However, investors should not despair because economic conditions are still promising. First, the True Inflation index, a measure of price changes in real time, is below the annual rate of 2.0% and trending down. Second, Fed's NowCasting economic models (New York and Atlanta) are pointing toward more than a 2.5% annual growth rate for both Q1 and Q2. Third, commercial energy producers are betting robustly that contract oil prices are heading to \$75 a barrel. Fourth, the profit picture is appealing, consumer spending is holding up, business capital formation is booming and energy export is growing. Fifth, the recent increase in bond yields has been caused mostly by higher real growth rather than inflation expectations. Sixth, the surge in initial public offerings (IPOs) has forced a reallocation of portfolio positions to the detriment of chipmakers; and seventh, the non-tech sector is doing reasonably well.

Put simply, the market will continue to be choppy as it always is, but it should travel north to 8,000 by year-end given that the US government may take equity stakes in forthcoming giant IPOs: OpenAI, Anthropic, SpaceX and others. In the meantime, in light of this week's sell-off, investors should have some perspective: nothing keeps going up every single day, as Bernstein analyst Stacy Rasgon rightly says."

A Macro Market View by Hubert Marleau

In the week ended June 12, the market faced a key inflection point, as tensions in the fragile truce between the USA and Iran once again mounted, even as inflation jitters crept in and as the hyperscalers and new AI giants were either raising huge amounts of capital, or planning to do so to fund their data centres. Thus, in turn, brought about concerns at three of the trading, speculative and investor levels, resulting in a series of wild and dreadful sessions. By the end of the week, the S&P 500 opened at 7,400, near the close of last Friday.

In my judgement, however, the drawdown will be short-lived as the above three altercations should wane, returning excitement to the AI ecosystem. First, new issue buyers—mostly retail investors—sold some big winners like chipmaking and hardware technology companies, en masse, to raise cash to buy big tech IPOs that were on deck. For example, the SpaceX IPO, touting a \$25 trillion market opportunity, was an outstanding four times oversubscribed, generating \$300 billion of buying interest, following big stock and bond issuance, totalling \$255 billion by Alphabet, Amazon, Meta, Microsoft and Oracle. Meanwhile, Anthropic and OpenAI are themselves planning stock debuts in 2026 that will bleed billions of dollars from the stock market. Although those billions of dollars in new shares have or will hit the street, forcing investors to make room to absorb them, the market can comfortably do so because there's a lot of dormant cash floating on the sidelines: roughly \$8 trillion parked in U.S. money market funds alone. (Interestingly, in the shadow markets, SpaceX jumped to \$184 from an IPO price of \$135 at the open.)

History shows that after short adjustments, equity-issuance waves don't create market stress for long periods of time because companies tend to issue stock when earnings momentum is healthy and risk appetite exists, as is currently the case. Indeed, according to Deutsche Bank, the unusually large volume of IPOs expected this year will collectively represent only 0.1% of the S&P 500's total market capitalization.

Secondly, speculators apprehensive of elevated inflation, fearing that the Fed might pivot its monetary stance toward tightness, rearranged their portfolio with short-term protective tactics that can easily unwind: a process that may have already started. Faced with tariffs, an AI boom and higher

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energy prices, year-over-year inflation reached a 3-year high of 4.2% in May. Fortunately, that part of the bond market sensitive to changes in inflation hardly budged because general price increases appeared to be cooling while gas prices seemed to have peaked and not spread to the broader economy. Core prices, which exclude food and energy prices—a more reliable predictor of future inflation—rose 2.9% from a year earlier, while True Inflation, a real-time composite of price changes, is currently only 1.8% higher than a year ago and “supercore” inflation that excludes housing revealed a sharp deceleration. Moreover, the current inflation blowout stems from external factors and not from an excessive increase in the money supply or from a tight labour market: continuing unemployment claims, which scale with the total size of the unemployed population, have risen. In this connection, a rate hike does not seem warranted. The Fed will highlight the risks, but it will opt for a neutral monetary decision.

Thirdly, traders with algorithmic robots defended their risky bets through hedging strategies tied to events in the Middle East, where there is one retaliation after another. The Iranians struck down an Apache helicopter, the Americans retaliated, bombing sites in the Strait of Hormuz; Iran retaliated with attacks on a US base in Jordan, Jordanian forces shot down Iranian missiles in turn; and so on and so forth. On Wednesday, Trump ratcheted up his rhetoric against Tehran, saying that the US was about to hit Iran hard and assume control of its key oil hub on Kharg Island unless an acceptable interim peace deal were concluded.

As to that, the real question is how far Trump is willing to go to end the conflict. At this point, it's all the way: he holds all the cards. On Thursday afternoon, however, he backtracked on fresh attacks, suggesting that “discussions and final points” on a peace deal with Iran had been approved by all parties involved, with signing expected next weekend.

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