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The Palos Perspective

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The Misery Index Eases Pressure on the Fed

Last week I wrote: "As predicted, the summer lull for stocks clearly ended on Tuesday when the S&P 500 broke out to a new record high of 7,737 on its way to 8,000, after being stuck around 7,500 since May 14. Interestingly, July employment supports this view. Put simply, US businesses shed 23,000 jobs in July, a surprising print that is likely to ease some pressure on the Fed to raise the policy rate and the unexpected tick-down in the unemployment rate to 4.1% is proof under the "Sahm Rule" that there is no recession on the horizon for now. In other words, the jobless rate is still in the range of full employment and the market-based odds of a September rate hike have fallen to 44% from 55%. In this regard, speculators could not ask for better conditions to make bullish bets. Incidentally, Societe Generale also expects the benchmark to reach 8,000, while Yardeni Research has a higher target of 8,250, urging investors to 'buy the momentum dip'. The S&P 500 closed at 7757, registering a weekly gain of 3.5%, with only 3.0% to go to reach my target. I might need to revise it sooner than expected. We'll see."

The Week of August 9:

At the start of the week, stock futures were flat amid an impasse over the war in the Middle East as Iran had stiff demands that must come first, like seeking billions of dollars from the U.S. to pay for war reparations, wanting removal of US troops in the area, ending the US naval blockade, unfreezing of Iranian assets, and elimination of sanctions for permitting the free flow of traffic in the Strait of Hormuz. Given the tenacious temerity of the Iranian government and its insistence to play a waiting game, with its "survival economy" it defies Trump's stubborn refusal to admit defeat, in his misguided belief that the Iranian economy is about to collapse under the pressure of absorbing job destruction and intolerable inflation. Unfortunately, the war is even more mired in a stalemate since Iran has figured out that its military presence abroad is very aggressive, suggesting a protracted era of regional conflict.

As a result of the toughness of their opposite positions in their long-deal-locked negotiations, the odds of reaching a permanent peace deal have diminished considerably, making an off-ramp exit to

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end the war almost impossible. In this connection, the war in Iran spurred international Brent prices for a barrel of oil, hurting the operational cost of the Japanese economy and raising the risk of financing of U.S. Treasuries. As important as oil prices are, speculators were, nonetheless, much more focused on forthcoming inflation numbers (CPI and PPI), acknowledging that they would be the real test, because they were bound to be crucial in the Fed's decision-making process scheduled for the September FOMC meeting.

On Wednesday morning, the BLS reported that inflation in July was in line with expectations. Headline and core CPI had increased 3.4% and 2.5% respectively - not enough to guarantee a Fed rate hike at the upcoming FOMC in September, in part because the Misery Index, which is the addition of inflation to the unemployment rates, a closely observed measure by the Fed, ticked down as did its inflation content. Moreover, the CPI, less the essentials like food, energy and shelter, is right on target, running at an annual rate of 1.9%, while the Trueflation CPI, which utilizes modern cutting edge technology methods to calculate consumer and spending data sets in real time, is now only 2.3% higher than a year ago. Thus, in spite of elevated oil prices, financial markets were happy: bond yields were flatish and stock futures rose as the CME Fed watch tool showed that the chance of a rate hike had plunged to 33%.

On Thursday, the Producer Price Index (PPI) confirmed the pull-back in consumer inflation is a real downward inflation trend.

The Stock Market Outlook:

There are several cross-currents at play like crude prices and the Iranian war, monetary policy and the yield curve, doubts about the AI trade, the huge funding needs stemming from large fiscal deficits and heavy corporate financing, and real yields that could change the stock market's speed limit. On the other hand, there are many encouraging signs that make me believe that the market has much more room to run. It is true that the AI boom is getting bigger, but it's no longer doing all the work: its impact is spreading into all sectors of the economy, widening the market's profit base, and making earnings a bigger story than originally thought.

In this connection, S&P 500 forward earnings per share, which are currently at $400, should progress toward $415 by the end of 2026 and then to $484 by the end of 2027. Assuming that 10-year Treasury yields will range between 4.50% and 5.00%, I think that by the end of this year it is highly probable that the benchmark could touch 8,300 as a minimum; and possibly, as a low probability, 9,000 as maximum.

JPMorgan Chase equity strategists have raised their S&P 500 forecast for a second time in two months to 8,000, citing strong corporate earnings and monetization of AI spending by hyperscalers through increased backlogs stemming from customer demand. Strategists at Citigroup Inc., Deutsche Bank AG and Goldman Sachs Group Inc are the bullish voices on US stocks this year.

Denis DeBussschere, the reputable chief strategist at 22V Research, believes that the chances for the S&P 500 reaching 8,500 on a roughly 12-month horizon are good, arguing that the economy is hot without generating wage pressures under cooler labour conditions; and that businesses are enjoying higher revenues and profit provided by the use of artificial intelligence, while stocks are benefiting from lower equity risk premium and steady 10-year Treasury yields.

Yardeni Research has raised its year-end 2026 forecast for the S&P 500 to 8,400 on the key assumption that the economy will remain resilient, and so will corporate profits, on the basis of a subjective 80% probability that the “Roaring 2020s” will continue, thinking that any pullback or meltdown would represent a buying opportunity because there is no recession in sight.

Michael Burry, the investor who correctly predicted the financial crisis, warned the street of a potential one-day crash resembling the 1987 Black Monday because of the prevalence of volatility-targeting funds, but said that investors should ignore the advice of permabears for they are usually wrong. Indeed, Peter Lynch, one of the most successful money managers of all time said: “Far more money has been lost by investors trying to anticipate corrections than has been loss in all corrections combined.”

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