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The Palos Perspective

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A Macro Market View by Hubert Marleau

It's About the Economy

Last week I wrote: "The summer swoon ended. A negative reaction from bond and stock operators to the Fed's refusal to raise interest rates, and Warsh's refusal to answer questions, reverberated. Regardless of his credibility as an inflation fighter, the S&P 500 registered a weekly gain of 78 points to close at 7,490, up 1.0%. Over the past week, a wave of hedge funds have de-grossed their speculative positions, including "Situational Awareness," in high-flying tech stocks, putting the market on a much better footing to appreciate the profitable, if ironic, benefits of the ongoing inflationary growth regime of the US economy, stemming from rising productivity gains and increases in the money supply, with no recession in sight."

The Week of August 2:

The week started with calls for a US planned attack on Iran that would have reached levels of military terror, strength and power not seen since World War II. Middle Eastern countries, including Saudi Arabia, then asked Trump to cool it. Why?

First, Iran had warned all the Gulf states that any new attack on its territory would trigger serious retaliation against energy infrastructure across the region, which would increase the cost of confrontation.

Second, there were concerns that Iran was willing to gamble that it could outlast the U.S. by raising the cost of military action.

And third, the "perimeters of a deal had been agreed to that would open the Strait of Hormuz to commercial traffic and end the Persian nuclear threat."

While Iran denied talks with the U.S., it admitted that it was in the final stages of an agreement with Oman on defining a new route through the Strait of Hormuz without tolls, while OPEC and its allies will raise oil output in September for the sixth consecutive month by 188,000 barrels a day. Oil traders subsequently traded the international price for crude down to $82.50, $5.50 less than it was last Friday.

Without that oil overhang, investors concentrated their attention on a week jam-packed with reports, confirming that productivity was broadening across all industries. Productivity, which is nonfarm business output per hour worked, rose 1.4% in Q2/2026, and a further increase is visible as businesses continue investing heavily in AI, robotics, and other enhancing technologies. Indeed, even without the help of new job creation in July, the Atlanta Fed's GDPNow model, a running mathematical estimate of real GDP growth, is suggesting that the US economy is currently increasing at an annual rate of about 5.0% in the third quarter of 2026.

The Short-Term Stock Market Outlook:

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 bringing the 8,000 level into closer view , after being stuck around 7,500 since May 14. Interestingly, the 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, while the unexpected tick down in the unemployment rate to 4.1% is an indication 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 8000, while Yardeni Research has a higher target of 8250, urging investors to "buy the momentum dip". The S&P 500 closed at 7,775, registering a weekly gain of 3.5%, with only 3.0% to go to reach my tag. Perhaps I might need to revise my target sooner than expected. We'll see.

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