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The Palos Perspective

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The Blue Tsunami

Last week I wrote: "A Blue Wave is inevitable, but whether this expected outbreak will translate into a large Democratic majority in both the House and the Senate has raised many unanswered questions that have created some market concerns about how tax, debt, geopolitical, social and tariff issues are going to be dealt with. While these topics are important, history shows that they eventually go away in an election aftermath, especially when there is gridlock under a lame-duck President.

"If indeed dealers, volatility-control models and margin accounts directly caused the tech wreck, then I'm encouraged, from a contrarian point of view, to think that numerous retail tech lovers and traders, who have gone into cash over the past few weeks, will soon step in."

The Economic Week of November 1:

The mood was upbeat on Sunday evening because crude prices had fallen more than 3% as talks between Iranian and Qatari officials on a deal to end the war in the Middle East raised hopes that supply disruptions might ease. Even though the calm was thin, tech-heavy indices enjoyed a solid rebound after experiencing a brutal and dreadful October session.

While the above was welcome news, the fact remained that the big item on the agenda was the US mid-term elections, these being, according to investors, effectively a referendum on public trust, especially capitalism, domestic politics, and geopolitics in a jam-packed week of labour market data.

Democrats stormed to a huge House majority, won control of the Senate and made many gains in state legislatures and governorships: a remarkable feat, powered by victories in several former Republican strongholds. Unpopularity over mass deportations, unreasonable tariffs, an expensive war in Iran, abusive language, billionaire boot-licking, and the social cost of AI data centres were too much to overcome.

The blue wave will likely create a crucial check on Trump's autocratic behaviour, empowering the Dems to investigate alleged corruption, law-breaking executive orders, and perhaps enabling them

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to pass alternative legislation to counter his agenda. Indeed, the real twist isn't simply that Washington has changed hands, but it has been replaced by a Democratic regime that could use upcoming fiscal deadlines as leverage to constrain the war in Iran, press for a rollback of tariffs, contemplate roadblocks to reduce the construction of data centres and perhaps prevent Trump from picking another Supreme Court judge.

Meanwhile, Trump himself reacted quickly, choosing Stephen Miller, one of his most loyal and trusted consiglieri, as his new Chief of Staff to fight for what MAGA likes, push a maximalist approach to executive power, and combat Democratic power in Washington.

The Bond Market Tells:

The fixed income market spoke loud and clear. The 10-year benchmark fell 14 bps to 4.86%, but more importantly, the swaps firmly projected that inflation should fall to 2.0% and real growth moderate to 2.5% by the end of next year, thereby indirectly insisting that not more than two rate hikes will be enough to bring price increases to target.

What's Happening in the Economy:

The economy continues to perform well, with both productivity and employment rising in tandem. The Bureau of Labor Statistics (BLS) reported that non-farm labour productivity was up an annualised 3.6% q/q, significantly above the historical average, and a blockbuster increase in payroll employment of 165,000 had absorbed an influx of workers, thereby reducing the unemployment rate to 4.1%.

In this connection, the Atlanta Fed's GDPNow model estimate for GDP growth in Q4 of 2026 is 3.4% and the prospects for continuing expansion are reassuring, given that job openings are rising and layoffs are low while the recent fall in oil prices has lowered the energy share of GDP to 2.8% in less than a week from 3.20%.

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The Stock Market Outlook:

While I cannot be certain what will happen next, there are good chances for optimism around a quicker end to the war, a rollback of tariffs, and a stop to massive deportations. Moreover, polls show that people are not against data centres per se, but their unregulated spread. The AI buildout has not died. It will be welcomed by jurisdictions that may want the tax revenues that come with it. Indeed, they can be built elsewhere. For example, Canada could be interested on a quid pro quo basis. This is why I believe that the selloff, which pushed the Nasdaq into correction territory below its 200-day moving average, represents a buying opportunity, for I'm sticking with my 7,850 year-end S&P 500 forecast.

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