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CONTENTS

U.S. Monetary Policy Pushing Stock Prices Higher	1
Sectors of the S&P 500 By the Numbers	2
Disclaimer & Contacts	3

Palos Weekly Commentary

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Macro View

By Hubert Marleau

U.S. Monetary Policy Pushing Stock Prices Higher

Submitted November 18, 2019

U.S. stocks rose for a sixth straight week. The S&P 500 touched 3120 last Friday. In the two months, record amounts of money have flown into the U.S. equity markets—about $50 billion.

Many strategists attribute the latest move to the fact that the current earnings season surprises investors to the upside. The S&P 500 companies are on track to post a 0.3% year-over-year decline in third quarter EPS, much better than the expected drop of 4.0% at the beginning of the season. Other strategists who try to explain what is going on, point to official reports that the trade negotiations between China and U.S. are close to a "phase one" deal and, in turn, suggesting an improved economic prognosis. I wonder whether this level of bullish sentiment can be justified at this time. In this connection, High Frequency Models have reduced considerably their estimates for Q/3 growth. For example, the Atlanta Fed is predicting a growth factor of only 0.3% while Moody's model is suggesting 0.6%. A week ago, the same models were showing growth possibility as high as1.5%.

In my view, the bullish shift in the stock market over the past year can be explained mainly by the huge changes in the availability of cheap money. There has been a dramatic turning point in the liquidity produced by the Fed, stoking an inflationary reassessment. As a result of a steepening yield curve, lower policy rates and a repurchasing program of T-Bills to feed the repo-market, the new monetary stance has brought about a significant acceleration in the money supply. The money supply with zero maturity (MZM) is up 8.0% from a year ago—-that is 5.0% higher than the yearly annual rate of increase in N-GDP. Interestingly, the performance of the DXY has been essentially flat since the end of July, further reflecting

Macro View cont.

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that monetary stance has eased. If the creation of all this new money is not going into the bond market nor in demand for more goods and services, then it is buying stocks or leaving the country. It means that investors should keep a close eye on evaluations and search for value in the form of low p/e and peg ratios. (peg is p/e divided by earning growth)

Looking at the 11 Sectors of the S&P 500 by the Numbers:

Name	Index Weight	10-Yr Annualized Total Return	Current Dividend Yield	P/E	P/B	P/S	Comment	Dependency
S&P 500 INFO TECH INDEX	22.7%	17.58%	1.4%	24.58	7.37	4.82	Growth	Future
S&P 500 HEALTH CARE IDX	14.0%	15.03%	1.7%	20.87	4.39	1.75	Growth	Age
S&P 500 FINANCIALS INDEX	13.1%	11.68%	2.1%	13.99	1.47	2.42	Neutral	Interest Rates
S&P 500 COMM SVC	10.5%	10.21%	1.3%	21.66	3.42	3.07	Growth	Innovation
S&P 500 CONS DISCRET IDX	9.7%	17.99%	1.4%	23.70	7.88	1.69	Growth	Inequality
S&P 500 INDUSTRIALS IDX	9.4%	14.06%	1.9%	19.15	4.97	1.83	Cyclical	Exports
S&P 500 CONS STAPLES IDX	7.3%	12.12%	2.8%	21.19	6.11	1.56	Defensive	Population
S&P 500 ENERGY INDEX	4.3%	2.75%	4.0%	18.19	1.54	1.10	Cyclical	Gas & Oil
S&P 500 UTILITIES INDEX	3.3%	12.76%	3.2%	20.58	2.23	2.67	Defensive	Bond Yields
S&P 500 REAL ESTATE IDX	3.0%	12.57%	3.1%	49.56	3.78	6.97	Defensive	Population
S&P 500 MATERIALS INDEX	2.7%	9.82%	2.1%	19.43	2.41	1.75	Cyclical	Global

Source: Bloomberg

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