

The Bull Case is Largely Based on Hope

The stock market is on an absolute tear, with the Nasdaq up 5% last week and nearly 13% year-to-date. The proximate causes include a cease-fire somewhat holding with Iran, a 28% surge in S&P 500 corporate profits in the first quarter, and some consensus-beating economic reports, like Friday's payroll numbers.

We have been cautious on this market...and overly pessimistic up to this point. So, should we rethink that? Should we become more optimistic about stocks?

The optimistic case was summed up in an X post by James E. Thorne at Wellington Altus who said there is a “systematic underestimation of an AI-driven productivity revolution...a Cap Ex Super Cycle, [an administration that is] letting the economy run hot, and multiple expansion [due to] a Peace Dividend. History suggests that when productivity waves coincide with supply-side policy and geopolitical de-escalation, as in the 1990s, both earnings and multiples expand beyond historical norms.”

Let's go through this list one item at a time. 1) Is AI really driving a productivity boom? According to McKinsey, 88% of companies say they use AI in at least one business function, but just 7% say they have expanded its use enterprise wide. As far as we know, there are little data showing a direct correlation between AI and profitability. While many could surmise this, it remains a forecast. And, while, capex is growing, it is concentrated in (or related to) data centers. Excluding that, investment is weak. A Super Cycle is an exaggeration.

Events in the Middle East are certainly promising. Having the UAE exit OPEC is a big deal. It suggests a more “go it your own way” free market world, not one divided into factions. However, Iran seems a long way from being willing to accept

this reality and we are not convinced a “peace dividend” is really in the cards. We hope and pray that it is, but we haven't seen a Peace Dividend or full-blown geopolitical de-escalation yet, just hope.

Finally, are we really in a Supply Side revolution? Well, Reagan cut the top income tax rate from 70% to 28%. Other than tax cuts for tips, social security, and overtime, the top tax rate is the same today as it was last year, and will be next year. Overall government spending has been flat, which means it is declining as a share of GDP, but Congress has yet to pass a budget that promises continued spending restraint in the future.

Regulation has been reduced, but could be expanded again if a more pro-regulation president gets elected in 2028. Virginia is a perfect example...the new governor is trying to reverse the direction of policy put in place under the previous governor. Recent spending and regulatory restraint don't pre-commit future presidents and congresses to the same policies.

So, while many positive developments are taking place, the idea that we are entering into a long-term secular bull market seems a stretch. The PE ratio on trailing earnings of the S&P 500 is currently near 29. When Reagan entered office and cut both tax rates and spending, and broke the back of inflation, the PE ratio was 8. Even if policies today were equally as good, the same kind of boom should not be expected.

We aren't pessimistic even though it might sound that way. The US (as it has done for 250 years) is pushing back against feudalism in all its forms. At the same time, AI is a transformative technology. But it will take time for these things to fully play out, and we think markets are underestimating the time, energy, and volatility it will take.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-11 / 9:00 am	Existing Home Sales – Apr	4.050 Mil	4.070 Mil	4.020 Mil	4.010 Mil
5-12 / 7:30 am	CPI – Apr	+0.6%	+0.6%		+0.9%
7:30 am	“Core” CPI – Apr	+0.3%	+0.3%		+0.2%
5-13 / 7:30 am	PPI – Apr	+0.5%	+0.7%		+0.5%
7:30 am	“Core” PPI – Apr	+0.3%	+0.4%		+0.1%
5-14 / 7:30 am	Initial Claims – May 9	205K	202K		200K
7:30 am	Retail Sales – Apr	+0.5%	+0.7%		+1.7%
7:30 am	Retail Sales (Ex-Auto) – Apr	+0.7%	+1.0%		+1.9%
7:30 am	Import Prices – Apr	+1.0%	+1.2%		+0.8%
7:30 am	Export Prices – Apr	+1.1%	+1.0%		+1.6%
9:00 am	Business Inventories – Mar	+0.9%	+0.9%		+0.4%
5-15 / 7:30 am	Empire State Mfg Survey – May	7.5	5.9		11.0
8:15 am	Industrial Production – Apr	+0.3%	+0.4%		-0.5%
8:15 am	Capacity Utilization – Apr	75.8%	76.0%		75.7%