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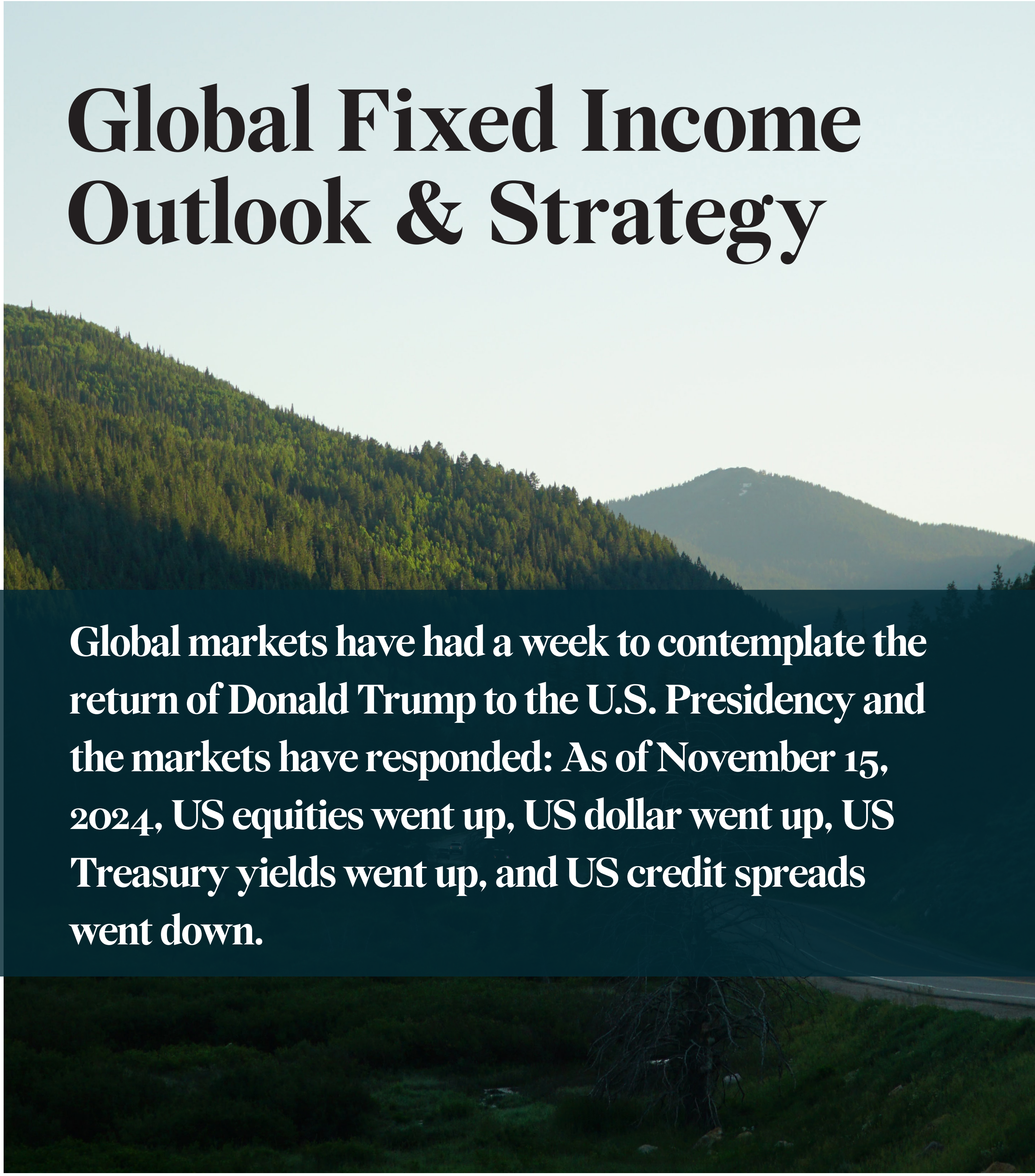
Global Fixed Income Outlook & Strategy



Global markets have had a week to contemplate the return of Donald Trump to the U.S. Presidency and the markets have responded: As of November 15, 2024, US equities went up, US dollar went up, US Treasury yields went up, and US credit spreads went down.

Market Recap & Outlook

We have spent the week collecting the opinions of from investment banks and consultants as to the likely thrust of White House policies and now have a few opinions of our own.

We believe fiscal policy expectations have replaced monetary policy expectations as the proximate factor in the markets for now. Our univariate model of the trade-weighted dollar and the 10-year Treasury that we wrote about in previous outlooks we now view as now obsolete. We argued that most of the 2024 variation in U.S. Dollar Index (DXY) and the 10-yr note was explained by shifting market sentiment towards future Federal Reserve policy. We believe the correlation were impressive, but in October DXY began trading more strongly than future Fed funds would have previously implied. We believe that DXY strength is a US tariff risk premium.

During the first Trump administration (2016-2020), we first experienced tax cuts for which the markets liked. This followed later with a Trump trade war that the markets did not like. China-targeted tariffs announced in the opening days of the administration early next year. The CNY has shifted gears. The September CSI 300 equity rally stalled, limiting the need to purchase CNY. We believe the likelihood of even more tariffs than during the first Trump administration, has undermined sentiment in the Renminbi.

The President can do a lot by executive decree, but a potential universal tariff hike of approximately 10 % would require an act of Congress subject to Senate filibuster. It would not go through Reconciliation as a revenue bill. We view this as a judgment call. We believe there is a potential for more tariffs that could increase costs and decrease output. As a result, we believe that the net effect will be to increase prices. Immigration spiked in 2022-23, from a prior ten-year average of about 1mn per year to about 3mn per year. This added some 4-5 million total migrants over 2022-2024. We believe this will likely have an impact on agriculture and the food industry. We believe that there will be an increase in wage expenses and as a result, the net effect will be to increase prices.

From our perspective, there is a potential for regulatory change in the oil, gas and financial industries. We believe the outcome as deflationary with the net effect reducing costs, at least in the short term. We believe the prospect of a minimal regulatory environment has boosted sentiment across the private equity, venture capital, and investment banking, with potential acceleration of M&A activity. As a result, we believe that this may result in a negative credit spread. Historically, many private equity transactions have included additional leverage. One theory is that excess private equity returns partly capture value from pre-existing creditors, whose debts are traditionally lower in more aggressive capital structures with weaker collateral.

We believe that for the incoming administration, the tax policy will likely consist of an extension of President Trump's first administration tax package, for which there seems little fiscal room for added tax cuts. Current headlines about the US deficits state an approximate 7% of GDP in 2025 with the possibility of more to come later.

Our Strategy

In summary, we support the market's belief for potential of a higher dollar and higher treasury yield, but we disagree with the market view on the possibility of higher credit spreads.

Source: Loomis Sayles and Bloomberg.

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Important Disclosures

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