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关键词:
bond market、market power、commodity markets、Treasury market、capital markets、market crisis、market consequences、market context、market equities、Market volatility、major conflicts、major war、financial market、market neutral、market tremors、markets perspective、market implications、other major wars

文字记录:
说话人 1 00:02
So this slide here is oriented towards oil. The left side puts the extreme events in the Middle East into a market context. They're in a holding pattern factually speaking. And it's easy to interpret this as capital markets expect, expecting and important for global stock, bond, currency or commodity markets. And that could be right, but it also means they're not even worrying much about tail risk.

说话人 1 00:30
So think about it, even if the baseline scenario for oil both before and after, these two scenarios, of course, in reality it's more complicated. It's point one times two, fees for some time. I'm sure all of you know that the underlying, a shortage of oil supply in the coming years at current prices. Second is, but the oil companies are doing them, then, using it for capital spending and the shareholders are very happy about that, which presumably is less price sensitive than the developed world. It keeps rising.

说话人 1 02:34
Now, of course, there's potential headwinds. There are things going on in Venezuela right now about a potential lifting of sanctions. There's the possibility of US recession. But the point I want you to remember is that the path of least resistance is up. And if you're interested in energy, we have 2, in my view, excellent, timely, certainly well researched reports. One was published yesterday. It's a feature report from Goring and Rosenspig. That's their seventh for Alpine. So many of you are familiar with their views. What this report talks about is what has changed this year and it also makes it the case for uranium, by the way, even after the latest surge in prices, there's lots of reasons to be bullish. Other report on energy is from my colleague Basamna Fall, and it's gonna be published next week. It makes the case, lots of research here too, that US shale output is peaking with implications for oil prices and the market power of OPEC. There's a lot of dynamics there, but it's supports our bullishness. So I get that out of the way. Let's turn to geopolitics. And Dan, I'm gonna put you on the spot and start with a difficult question cuz that's what the listeners want. Don't wanna beat around the bush with all different scenarios flying around. Let's start off with what you think is going to happen, then we can get to the risks. Go ahead, Dan.

说话人 2 03:57
Thank you, David. To understand how the war may volve and market implications, it is useful to use the scenarios given the complexity. The next slide three, outlines ways we see this war potentially developing. The baseline to get to the point of what we think is most likely to happen is that the war will not morph into a major regional conflict. We think there is about a 70% chance the war remains generally localized as it is now. That is the good. The bad news however, is that there is a non trivial, I would say about 30% chance that this becomes a major regional conflict drawing in Israel against Hezbollah in a sustained war and potentially, involving the United States. This would very possibly lead to a direct Israeli Iranian confrontation. From a geopolitical and markets perspective, this risk would be a very high impact event and one with a rather high probability. The war becoming an Israel Iran conflict on this slight scenario to be would entail an Israeli attempt to destroy Iran's nuclear program. This would lead to a major regional conflict and major disruptions to oil ports from the Persian Gulf. Think economic and market tremors possibly on par with the 1970s oil shocks. Again, this risk alone we put at about 20% overall. So it's not that small.

说话人 2 05:27
Following the October 7th Hamas attack and is shocking civilian casualties and hostage taking, Israel declared war. It is currently retaliating with air strikes rates blockading the Gaza Strip while Hamas continues to love missiles at Israel and Israeli encouraging into Gaza appears quite likely in the next few days. Fundamentally though, this is conflict of the proxy battle between Israel and Iran. Hamas likely didn't act alone was backed by Ron. Its attack had two rationales. First, disrupt Israeli Saudi Arabian peace stocks and this has been successful. The stocks are frozen for now.

说话人 2 06:05
Second, to explode Israel's internal political divisions. As of now, Israel war aims are to eliminate Hamas dominance in the Gaza Strip or at least to establish deterrence against Hamas, Hezbollah and their main sponsor, Iran. Israel cannot afford to have these kind of attacks become precedent and regularly happen. Israel, however, will have trouble achieving this given military difficulties of urban fighting in the Gaza Strip and increasing global criticism over mounting civilian casualties in the same place in the Gaza Strip.

说话人 2 06:39
How long can this war be sustained? Regarding duration, based on similar conflicts involving Israel, we estimate that a high intensity conflict likely less last less than three months. So again, this is a low confidence call. These wars can be unpredictable, can go longer, can go shorter.

说话人 2 07:00
Back to our baseline scenario, we think there is a 70% chance the war does not become broader regional conflict. Despite fight Iranian threats to escalate, most other regional want to keep the work contained and short. The US move significant naval assets the eastern Mediterranean hinting at intervention if Hezbollah and Iranian proxy from Lebanon goes into full war mode. Most Arab states do back the Palestinian cause and are greatly upset over mounting Palestinian civilian casualties. However, neither Egypt nor the Gulf Cooperation Council states such as Saudi Arabia won the war to be a win for Hamas, Hezbolan, Iran, which are their strategic rivals. The Palestinian Authority, Hamas main rival in the Palestinian territories has also condemned Hamas initial attack. Consequently, the conflict will probably remain in Gaza with sporadic fighting in the region. We already have skirmishes in Lebanon and and in Syria between Israel and Iranian proxies. The most probable outcome would be a weaken Hamas, possibly a brief partial Israeli occupation of the Gaza Strip or a stalemate, the latter favoring Hamas.

说话人 2 08:08
This baseline scenario is broadly market neutral. So headline risk would lead to sporadic asset movements as the war continues. We have already seen an increase in the price of gold, crude oil and aerospace and defense shock stocks all gain on conflict driven news.

说话人 2 08:24
If you turn to the next slide, slide four. This slide shows a few signposts to watch if the con, if this scenario actually plays out. One additional one which we don't mention on this slide, does it run now accelerate its nuclear proliferation over the next few weeks? It could do so fearing again the conflicts getting out of hand. If this happens or if there is evidence of that, this would significantly increase the chance of an Israel attack on Iran's new clear facilities.

说话人 2 08:57
The other thing I would point out from the slide is that from a market's perspective, any US pushes to impose sanc, to reimpose sanctions on Iran, which the US Congress wants to do, would lead to lower Iranian oil supply and markets, a reduction to pre Biden levels would be possible. As the chart to the right shows, we think this is still premature, more plausible in their high risk scenarios.

说话人 1 09:23
That's great. Thanks very much, Dan. A lot to think about there, especially to do with Iran and oil supply. Great signposts to watch now I'd like to focus on what could go wrong. When I talk about I'm saying negative surprises with the outcome that you've laid out. And what should we watch to tell if the risks of those negative surprises are rising.

说话人 2 09:47
Sure. So to start with that, those would be our risk scenarios. If you turn to slide five, we see a non trivial chances we mention of significant geopolitical shocks, either an Israel Hezbollah war, possibly with US intervention or the worst case scenario, Iran Israel direct war.

说话人 2 10:07
This slide focuses on the first I would say subset of those two scenarios. So that's basically a major regional or Hezbollah, Iran Hezbollah Israel, I'm sorry, but no sustained Iran Israel fighting. This would happen most likely if Hamas is overwhelmed and Hezbollah may strike Israel then to help its ally Israel to respond, possibly extended the fight to Lebanon and Syria against Iranian allies and assets. Hezbollah aggression could draw the US than into the war. Alternatively, the one other way this could start is Israel

may preemptively strike at hezbolla scenario outcomes could range from a material weakening of Hezbollah in Lebanon to a deadlock that favors the organization.

说话人 2 10:50
A larger conflict would lead to a global to global risk of sentiment. Oil prices may jump based on previous similar events between 10 and 30 dollars, primarily on growing worries over an Israeli run direct conflict and also from probable sanctions only run by the United States. If this actually occurs, safe assets like develop market sovereign bonds will appreciate. Develop market equities and assets from non Middle East oil producing states as for example the Norwegian currencies stand to gain as the chart on the slide indicates. Other thing that may happen especially if the US decides to act against sexualized the US equities could see a short term boost. The chart to the right shows that historically US equities have increased after US entered wars that were well telegraphed in advance. At the same time, Treasury eels typically drop beforehand. Again, as this chart shows looking at conflicts between US and different entities between 1980 and 2014.

说话人 2 11:59
Now if you turn to the next slide, slide six, moving on to the next scenario. This is the worst case scenario even before the conflict, you peg the chance of an Israeli strike on Iran's nuclear sites at about one in five, 20%, which is well above the general analytic consensus.

说话人 2 12:19
Why? So three reasons. First, this Israel's overarching strategic objective is halting Iran's nuclear proliferation. So we could strike at Iran despite US opposition given the current conflict environment. 2Nd, Israel might prefer taking the war to Iran directly rather than continuously and possibly thanklessly battling its proxies in Gaza, Lebanon and Syria. And third, Israel's window to act is shrinking, especially with Iran acquiring advanced Russian jets and weaponry.

说话人 2 12:49
And again, there is this possibility I just mentioned that if Iran starts to, again, to move towards nuclear breakout, that would make this more likely. In the current conflict context, an Israeli strike would provide, would provoke Iranian retaliation, including missile attacks on Israel, land attacks from Syria and Lebanon, and very likely, and this is problematic from a market perspective.

说话人 2 13:11
Effective Iran blocking the Straits of hormone Persian Gulf shipping. This would heighten US tensions and impact the Arab Gulf states. While conflicts contained to the Middle East to the eastern Mediterranean don't usually affect oil prices, any conflicts that the Persian Gulf and create disruptions there do result in significant oil price spikes. Significant disturbances in the Persian Gulf might increase oil prices by 60,80% based on past events beyond $150 per barrel in the current context. Stack flation risks in developed markets will be significant. Call this the back to the 70s scenario.

说话人 2 13:53
The US dollar may strengthen initially given it's safe and have an appeal in such a scenario. But staggeration concerns with act as a headwind to that and could complicate that proposition. Market volatility would be very high. Volatility would be at least comparable to other major wars like the 2022 Russian Ukraine conflict. As the chart on the slide shows, besides oil, gold and assets from non Middle East soil nations can probably gain under such circumstances. If you turn to the next slide, the same point on a broader basis. So this slide, what it shows major conflicts and as well as recession and the price of oil over time. Since 1975, if you see the largest jumps in the oil price associated with geopolitical events, those red arrows, they all indicate conflicts that again, that impacted the Persian Gulf. And again, we have the Arab boiling bar, which of course, was about more than that, but it had a Persian Gulf oil being caught was part of it. So again, worry about the scenario where a conflict impacts the Persian goal that would have significant market impacts.

说话人 1 15:03
Thanks very much, Dan. I must say that at least personally, I think many of my colleagues agree that my baseline view for some time next year is 120,25 dollar oil, kind of a retest to that February 2022, even without geopolitical risk. So lots of disturbing things to consider and to monitor. Let's end on a positive note before we turn to Chen. Very few people are thinking about what could go right in terms of positive surprises from the Middle East or, or Eastern Mediterranean, whatever you want to call it. And again, in addition to that, Dan, what's on your checklist to watch for good news?

说话人 2 15:39
Sure. If you turn to two slides from here to slide nine. What's the most positive thing that can happen? Realistically, that would be our baseline holding. So basically, war being localized in short duration. Honestly, they're probably the best outcome in the current environment. Very difficult and complex.

说话人 2 15:58
However, there are a few speculative things that potentially get right from a market perspective, although they're all, I would say, rather low likelihood, the best outcome, if you want to start from there would be the conflict ends quickly with Hamas disabled militarily and politically with limited civilian casualties. And then some entity such as the Palestinian Authority assumes control in Gaza. This is however unlikely because Hamas will be very hard, impossible to dislodge militarily from the Gaza Strip and the Palestinian Authority is not that popular the Palestinian population. The other second best outcome may be if Israel manages to disable quickly Hamas military capabilities, calls this emission accomplished and the conflict ends in about let's say two to three weeks, maybe a month. This would however, need to involve, it must involve the return of Hamas held Israeli hostages. Israel would not call for a truth otherwise if this happens, however, return to the status call anti, if Israel thinks it has managed to restore deterrence visa by Hamas, Hezbollah and Iran, which is a subjective call would be possible. This basically would be Israel getting his hostages back, going home and calling it a victory.

说话人 2 17:11
The best outcome is, again, we see a major war, if we see Israel and Iran going to war would be if Iran's nuclear program is disabled militarily and Iran is preventive from blocking Bush of shipping. Thus Iran powers in Middle East would be effectively contained in the Middle East to become potentially a safer region. This is again, really unlikely or rather deeply uncertain. We don't know again, if Iran's nuclear facilities are attacked by Israel or even by United States, if they can be actually fully disabled. So again, this is deeply uncertain. In terms of the post or outcome, the best outcome would be is Israel would resume diplomatic negotiations of the Arab states which are frozen well, again, while the conflict is ongoing. And if there is an eventual agreement on Palestinian statehood, again, this is possible but not very likely then years.

说话人 2 18:01
That said, war sometimes can spur peace efforts and successful ones in the Middle East. And the prime example of that is the Cam David Accords in the Israeli Egyptian peace in 1979 that followed the, and was to some extent spurred by the 1970 three young people war.

说话人 2 18:17
In terms of short term positive outcomes, again, I will repeat this. It's basically if the worst is localized, no material impacts on global, all the markets. That's I think the best we can hope of from the situation. The other one is if the United States would, especially given the risks to the oil price, if the US moves to allow greater domestic fossil energy production, which is unlikely, or if it cuts in oil, deal with them as well. And this is actually happening. But again, the effects of this could be possibly quite limited. Could the Gulf Cooperation Council increase the oil supply? This is unlikely during the war. In fact, the opposite is possible if the conflict intensifies you have more Palestinian casualties and it drags on and the GCC starts to blame the United States and its allies for for Israel however, if the war ends quickly and if the United States repair styles with Saudi Arabia maybe this is possible bottom line again short term we do not see a major upside avoiding escalating conflict and attendant risks would be the best thing that could go.

说话人 1 19:19
Right. Okay, that's great. Thanks very much Dan. Those very provocative thoughts including on GCC supply definitely to watch for let's turn to Chen now and we can get to big picture later on Dan and the Q&A. Let's turn to Chen for some comments on strategy, both how to incorporate the geopolitical stresses and the underlying macro and policy drivers following up on what Dan said. Go.

说话人 3 19:44
Ahead. Thanks, Dave. I think it's extremely difficult to incorporate geopolitical risk into investment strategy as itself. A lot there are a lot of tail risk as very hard to formulate this strategy based on tail risk.

说话人 3 20:02
Beside, I think I agree with Dan that usually wars are good for stocks, usually bad for bond because it is

basically stimulate excessively stimulate demand and then run also stress your budget. But I mean, the these words have to be large enough to make a huge difference in terms of financial market. But anyway, on the markets right now, I think the, we're at a very confusing moment.

说话人 3 20:29
What I'm saying that, well, if you look at the chart here, it speaks basically the chart speak for yourself. If you look at the chart here on your left hand side, we're going through the most dramatic monetary tightening cycle in recent history. If you look at the red dotting line on your left hand side, that's the Fed fund rates, the speed of a Fed fund rate going up. It's quite, is quite aggressive. And not only that the Fed is tightening, is pushing up rates, but also you have monetary contraction, which is a blue line can see that it's actually contracting. Usually you don't have that. So I keep telling our clients anyways, and by normal standard today, we should have had some kind of economic trouble, either a major slump or contraction. But we have never seen anything like this before.

说话人 3 21:27
What I'm talking about here is if you look at chart here on your right hand side, if you look at history this is Cincinnati. Actually, you can extend that history to post war period. Every time you got a rate hike of this magnitude, you always have earnings contraction. But now this time around, you can see that we had a little blip downwards in terms of earnings. Now profit seem to be expanding again. And we also know in last week, we had a very strong labor market report. This week we had a very strong retail sale. So the, it looks to me that the economy is beginning to accelerating again on the background of the most aggressive monetary tightening of all, I'm not saying so of all time, but in recent decades.

说话人 3 22:19
So here, if you look at this chart, that tells you a very interesting story too. If you look at chart here on your left hand side, side top panel is detrended Fed fund rate. The reason I detrended is because you, I just want to show the cyclical fluctuation. The Fed fund rate, you can see that the speed of the speed and magnitude of rate hikes are quite aggressive. And if you look at the bottom panel, second panel here on the left hand side, that is a forward PE. So basically saying it's almost written, it's almost like written in the US Constitution.

说话人 3 22:56
If every time you have rate hikes like this, always have multiple contraction, always. You can see the shaded area that's basically describe the rate hike cycles. Not this time around. You can see that you can see the last circle there. Yes, multiple came down very briefly, not expanding again. The forward P is expanding again. So I just don't want to go on. You can see the economic growth. You can see the chart here on your right hand side, you can see the blue line, which is GDP is ticking, taking up again. So the bottom line is we have never seen anything like that. You got a very aggressive monetary tightening. At the same time, the economy will slow down a little bit and now spring red back.

说话人 3 23:47
I mean, we're dealing with reaccelerating growth. So this is something we have never seen. So the question here is this, why? What happened? What has caused this very unusual economic performance?

说话人 3 24:07
I think there are broadly speaking three reasons. We we have to understand that better because otherwise you cannot formulate any reasonable investment strategy without understanding what the hell is going on in the economy.

说话人 3 24:21
The three broad reason we believe that if the top one, number one reason is physical expansion. But four months ago, we publish a piece called be aware of physical expansion. At the time nobody actually paid attention to it. Now the rest of the world has caught up to the view, but that is still very important. If you look at this chart here, we have had very powerful physical stimulus starting from October 2022. Okay, pretty much in third quarter last year. But by the way, Dave, coincidentally, that was one the stock market bottom. I don't know whether there's any correlation or not, but hey, I thought it was an interesting fact. But anyway, the physical expansion, this is the first time the fiscal policy become procyclical in peacetime history. It has never becoming something like that.

说话人 3 25:22
So if you want to understand the magnitude of this physical expansion, if you look at the chart here on

your right hand side, the physical, the size of the physical thrust, the thrust basically is the physical deficit net change. The net change of physical deficits over GDP is about 6%. Actually if you calculate the multiplier he probably has added about 1 point of GDP growth where's very significant, very big and it's very unprecedented. So that's the first thing I think explain this economic strength in the wake of very aggressive monetary tightening.

说话人 3 26:05
The second reason go very quickly. If you wrote a chart here on your left hand side, we had a colossal collapse in labor productivity during the pandemic. Of course, everybody is sitting home, sitting at home doing nothing and I've you hand out a whole bunch of money, you basically don't have any productivity. So I think the at the trough, you can see the productivity gain was minus two and a half percent. That was that is the absolute record low in the recorded history in the United States. If you look at this data theory, it has never been this slow. Okay, so we understand that this is very artificial depression in terms of productivity gains. But we also do know one simple fact which is a productivity growth in the US on average it's about one and a half percent. This is a very mean reverting series. So if you had a colossal collapse, the natural tendency is for that year to go back. So actually we're having a mean reversion in terms of productivity.

说话人 3 27:10
You can see that chart here on your left hand side basically have added about 3 to four points of GDP growth. Hey, be careful here why this is important. A way to look at the GDP growth is basically think about GDP growth consists of two part labor force growth plus labor productivity growth. So the productivity growth itself actually has added a lot of GDP. Good thing here is if you look at the inflation on the second panel, that actually is falling. I keep making that point many times. So far, this inflation has nothing to do with the Fed policy because a lot of variable lags. I think the productivity growth, the recovery of that series has a lot to do with the lower inflation. Of course, easing supply disruption is another big factor. So bottom line here is this is the second reason I think explaining the economic strength.

说话人 3 28:05
The final thing here is if you look at chart here on your right hand side, very interesting, you have a yes, it have a very clear reduction in savings rate, personal savings rate. You can see that pre pandemic, post GFC, the US personal savings rate was about 6 to 7%. Actually just before the pandemic was about 8, a slightly over 8%. Now after the pandemic, the savings rate basically dropped to about 3%. We thought that after the economy was renormalized, the savings revenue was about to go up. Well, it did. But look at the recent tick, it came down again. So the bottom line here is we have and average savings rate now post pandemic of anywhere between 3 to 4%. Just call that three and a half, 4% in that range is about a half of what we had pre pandemic. So 3 points decline in savings rate translated into $600 billion of new spending, which is about 2% of US GDP. Okay, so I think the US consumers probably has delivery enough so that they probably feel a little bit more confident to spend more. I don't know. But anyway, these are the three things I can think of that why, why the hell the US economy economy has done so well instead of the fact that the Fed is engaging in the most aggressive monetary tightening. Again, three reasons, physical expansion, the reversion of productivity gains, plus much reduced saving 3. These three things give you this very unusual unprecedent economic performance. Back to you, Dave.

说话人 1 30:03
Thanks, Chen. Those are really good. Three clear forces that have made this cycle different from past. One of the questions I'd like to ask you, I'm sure it's on the minds of the listeners based on the questions that we're getting, but how, what does this translate to strategy? That's a nice explanation. Does it mean for the strategy, cuz the markets are moving all over the place, especially fixed income.

说话人 3 30:25
That's a very fair question. I think that let's, before we deal with the strategy, I think let's deal with the consequence, the market consequences. What exactly that, does that mean as far as market is concerned? I think the first thing means, to my mind is very simple.

说话人 3 30:58
So that basically saying rates have to be lifted to a level that is are higher than they would otherwise. That's why if you look at the chart here on your left hand side, the tip seal, you can see the tip seal actually uses three Sigma overshot and still the economy doesn't matter. The reason for that is of course the physical is pumping up growth. Of course there is no problem. So that is very unusual. That's the first

thing. That's the first consequence.

说话人 3 31:30
Another thing here is I just want to mention that I was fall into believe into believing the that the bond market rally was inevitable at the beginning of the year. Why is that?

说话人 3 31:41
Well, if you look at chart here on the right hand side, the red dotted line is a very reliable bond market indicator for the past. You can see the gold, copper, a copper gold ratio. Copper usually is a proxy for growth. Gold is a proxy for monetary inflation. Whenever this ratio coming off usually it tells you the bond yields are gonna go down. So that's why in the beginning of the year I saw the year the red you can see the blue line came down to help that's it the economy is showing a set has done has done his job and then the bonds are is Bonia's gonna go down well the whole thing got screwed up by physical expansion I got screwed up by the physical side you can see and then the whole thing but spiked up again because of the physical side so that's again I want people to remember the first consequence of that is rates are lift are lifted high much higher than they would otherwise and the first consequence the second consequence is this bond market equity market divergence if you look at a chart here on your left hand side the blue line is SNP five hundred. The red dotted lines inverted yield curve of inverted 10 year Treasury yield. Think about that as bond prices. You can see that usually these two things are positive recorded. But since the summer of this year, since the summer of this year, these two markets basically diverge. Stock prices keep going up. You can see multiples are expanding whereas bond prices just keep melting. Why that? I think it's the reason is reasonable. Is it simple?

说话人 3 33:27
Right now in handset everything become clear. If you have a physical expansion, the physical expansion support growth, support profits and support multiples. That's why stock prices went up. And then if you think about the red dotting line here fiscal expansion support growth and deprices bond prices, that's why you have this divergence. So I think the the consequences that I can think of is a, rates are lifted much higher than they would otherwise B divergence of bond and equities and see higher for longer Jerom power today emphasize that point again, higher or longer.

说话人 1 34:13
Back to you. Dave, thanks Chen that's a good framework to think about the markets, but what do you think is gonna happen? Maybe give us a forecast and then what investors should do about it.

说话人 3 34:24
That's a tough call but anyway, let me give you my ₵2 that's precisely how my advice is gonna be worse 2 cents only. Anyway, I think since since July, mid July, we publish peace. The title of that piece is a defensive shift. So we basically took down our bullishness on equities mid July. And the reason of course are is precisely because that we did not understand what the hell is going on in the economy. You cannot cuz at the time everybody was talking about soft landing, perfect landing, immaculate diff, disinflation, things like that. We don't feel comfortable anymore. So that's why that's the first reason we think.

说话人 3 35:12
But importantly, the issue here is this. If you think about the higher for longer, if the Fed stick to higher for longer, you're almost guaranteed a period of stalemate think about it if even if you have a best case scenario of soft landing you will have a stalemate between or standoff between a probably growing economy and rising rates think about what we learn from school every time you have a rising rates your profit is gonna be worth less so you have this constant battle between the two okay, so that's why we took down the bullishness that's first thing the second thing of course there are some short term headwind too if you look at the chart here on your right hand side you can see the blue line here is what we call growth tax what are they? Well based what are the growth tax? What is the growth tax? The gross tax basis is weighted average of three things, interest rates, the dollar and oil prices. These three things act as if you're imposing taxes on economic growth.

说话人 3 36:29
Be careful here. The blue line here is growth tax inverted. So every time this grow, the blue line is collapsing, it means that the growth tax is going through the roof. Historically, that is very bad for growth. Historically, that is also negative for equity. So this is sort of near term, another near term headwind. That's why we're, we wanna be a little bit careful. But most importantly at this point, we want to look at historical precedency. Hey, what happened in history if you have a longer hire for longer?

Unfortunately, we don't have a lot of experience of that. We don't have a lot of historical presence of that because in the history every time the Fed checked up rates usually provoke some problem and then immediately just they drop it. The only period that we can think about it was it like from 94 all the way to 99. That's a that is a period where the Fed health rates high. Of course, it's a plateau during that period of time, but it was a complex plateau because it was involved a few made more rate hikes a few more rate easing but because of the bunch of emerging market crisis standing in the way but anyway, I thought that was an interesting experience did you look at the chart here on your on your right hand side? UH90 three 90 four that was the bond market blew up US Treasury market blew up the reason for that is the Fed was raising rate from 3% all over to six during that period of time the US economy was not in recession but stock prices didn't do anything you can see that the the the this share price is basically flat to down okay, so what changed the stalemate what changes still made was the Mexican peso crisis when the crisis happened all of a sudden the market understood that the Fed had to ease that's when the stock prices start to take off in other words, if you s if you something happened here some crisis happen I think that is the first signal you wanna take and buy stocks but unfortunately we don't unfortunately or unfortunately I don't know how you're gonna make that judgment but anyway right now we don't have any evidence evidence suggesting we have some kind of crisis happen but anyway that's 94 if you look at this episode the same thing you can see the Fed basically raises rate and then the you can see the blue line is equal weighted SMB 500 is basically flat and if you look at Russell 2K is a flat.

说话人 3 39:36
I do believe that next year there will be a period you want to buy stocks and bond to the sleeping point because I do believe that the physical stimulus is gonna die next year and I do believe that the monetary constraint, the impact of monitor tightening is gonna intensify. I don't know exactly when, but I think the first half next year, some point there, there will be a slowdown in the US economy, even probably a mild recession, but I think slow down or mild recession, they're all bullish stuff. I think that's gonna put an end to the Fed tightening and you want to buy at that. For now, we're overwind cash or on a way stocks or on a way a duration capital preservation. That's the top priority. Back to you, Dave.

说话人 1 40:30
Thanks a lot, Chen. Dan, we're gonna get a, we're gonna get back to you on a number of question, but what I'd like to do start out on fiscal policy in the bond market and then Dan, I wanna talk, wanna get a question, wanna get your answer on the Inflation Reduction Act and what it might mean broader questions of fiscal policy. But let's start off with the whole idea of deficits. There's a bunch of questions here that are related to this. And the argument goes kind of like this chain in the bond market. There's an unprecedented fiscal deficit. You've already talked about this bond collapse, how it's gonna reverse if the economy slows. But what about this supply and demand argument that I keep hearing? China stop buying US Treasuries. The budget deficit has this avid lanch of supply. Nobody wants to buy. The wars are probably gonna ink increase the deficit, not decrease it. What do you do about that argument and how do you use that to decide when to buy bonds.

说话人 3 41:26
So that, that argument basically, I deal with that argument all the time because lots of clients actually have expressed serious concern about that, essentially saying yes, US deficits create a avalanche of supply, bond supply, whereas there's nobody want to buy them. So essentially, we're talking about a creditor strike.

说话人 3 41:47
Two points here. I don't think that is, that is the issue today. The reason for that is if you look at the dollar is being very strong. If foreign creditors don't wanna own US bonds, they stop buying and the dollar is gonna collapse. It's not, it's strength, it's strong. It basically tell me that it's, that there's no lack of foreign buying. That's number one. Number two, you have to think about bond sort of equilibrium what would be the equilibrium? But equilibrium is basically if you think about bond yields basically consists of three parts inflation expectation plus your economic growth and then term premium. So what are they? You have to ask yourself that I think the Fed is gonna be successful in bringing down inflation to 2%. I my own guess is that next year inflation is gonna be way way lower than 2%. But anyway, let's say the Fez is gonna be successful 2% inflation break even is more or less in a ballpark right? US economic growth maybe two be generous. Why are be generous? It has not been to the pre pandemic at all. The pandemic gonna change the world, but it's gonna do, better fine. Top it up by two. That's the four inflation, let's call that 50 basis point. So the loss of estimate saying is a 50 basis wasn't that 50 basis point? So 2+50 basis point, that's a four and a/2, half percent. So we are 5 not the yields today in

the marketplace. It's not completed out of whack with what you would think sort of equilibrium yield. That's another sign that's saying this argument doesn't hold much of water.

说话人 1 43:56
That's great. Very helpful. Dan, maybe I can bring you in that this specific question has to do with industrial policy, the Inflation Reduction Act, what does it mean for, is it meaningful for the economy is it a problem for fiscal discipline? Any comments about that, Dan?

说话人 2 44:19
So industrial policy, again, is something, it's a part of a broader, of the broader US China strategic competition. The United States is undertaking that as a part of this sort of economic rivalry, which will be a major trend in the future. Europeans are doing, are moving the same direction as well. In terms of what it means for the United States, if you look at the Inflation Reduction Act and also the infrastructure spending Bill, the chips act it, it did. I mean, overall, they're not supposed to have, and the way they're basically scored, they're not supposed to have an impact on inflation fiscally. They're also supposed to be neutral, although those numbers are never quite, they never quite, as projections never quite pan out. So I think over time, it, it will, again, it will add to the fiscal deficit. What extent, of course, depends on other conditions, on the way it's implemented, the way the, of revenue raising within the Bill actually happens or doesn't happen. A lot of it is contingent on, for instance, better the revenue collection by the IRS.

说话人 2 45:27
However, what it speaks to is the fact that, again, the US deficit is again on a problematic trajectory. The US fiscal position, in fact, overall is, and a lot of that has to do both with this, but specifically with unfunded liabilities. Those can't really be corrected in the short term. We have elections in 2024. So fiscal, sort of the fiscal deficit, the imbalances, the that to GDP ratio, those are things that probably the next administration will have to address. And if you look at the Social Security and Medicare trust, those start running out in the 2030. So really between 5 and I would say 2030, the political system in the US is going to start to address them.

说话人 2 46:13
The interesting thing about how US politics works when it comes to fiscal policy is that for a major change to happen, whether fiscal spending or fiscal consolidation, what you need is a crisis. So if you look in since 2011 or I had the Budget Control Act or if you look at this spending during a pandemic, which is the opposite way, in both cases, there had to be a massive action forcing event. The US political system is gridlock. But again, if you do have a crisis or if you induce a political crisis, then you can get to some sort of compromise. One thing to watch in the short term is this November 17 date when government funding runs out again. Probably we're gonna have a government shut down. Demo Republicans are quite divided. It's hard to see how that can be avoided. If it goes for months or more, it can hits growth in the fourth quarter. I don't think this is the action forcing event. That's why I mentioned again, I don't think this is the thing that gets the US government to, to try to rein in spending. I think you may have sort of hand waving a list, maybe the appointment of a fiscal mission to address it. But really with a divided Congress, with the Republicans, holding, only holding the house continuously with a razor thin majority and Democrats generally not interested in controlling spending at the moment, I think really this is a post twenty.

说话人 1 47:41
Super. I should mention to our listeners that our colleague Henry Wu has done some fantastic work on the nuts and bolts of fiscal. And what he has shown is even though, as Chen's chart makes very clear, we've had a widening in the primary deficit, extremely rare when the economy is robust, that those packages, including that specific package, the Inflation Reduction Act, really haven't kicked in terms of government. Many, it's other stuff like military. Maybe I can switch now to, I guess it's monetary policy.

说话人 1 48:14
Chan, a question about could we see quantitative tightening? How asymmetric is the Fed? Could we see quantitative tightening over the next year? And what do you think is gonna happen with the yield curve?

说话人 3 48:25
I don't know what, it's a tightening. It's a quantitatively tightening already. I've been tightening for a while. It will continue to be.

说话人 1 48:32

Tightened. A shrinkage of the Fed's balance sheet.

说话人 3 48:34
Yes. It's not happening. It's happened. It's happening. It hasn't been happening. And it will continue to happen until some kind of trouble spot being. The problem here is this the chart 1 here, M2, you can see this is contracting is reason that M2 is contracting is monetary basis contracting, period. Lots of people made the point saying, hey, they injected so much liquidity in the system, so this contraction doesn't really matter. I think that's the way to look at that is that's a very superficial way of looking at it.

说话人 3 49:13
The reason I'm saying that is that every quantitative easing, the flip side of quantitative easing is that if you are expanding commercial banking systems liabilities, okay, if you take money away, if you shrink money supply, if you shrink your balance sheet of a Federal Reserve, you are inevitably shrinking the liability side of the banking, commercial banking system. That's when the trouble start happen. The regional banking crisis, we have a shrinkage of deposits. Why? Well, you got a quantitative tightening going on. That's why the bank that overall deposits are going down because deposit is a big chunk of money supply, big chunk of M2. So when you have a deposit shrinking, then some banks are getting hurt happen to be regional banks. So all I'm saying here is the question is not a question is a, or is something that is already happening at. I think it will probably continue to happen.

说话人 3 50:21
Bottom line, I don't understand why the hell they shrink money supply. Think about the 1920,19, twenty, 1930s, the Fed balance sheet also expanded about 3,4 times. Six times, sorry, six times and never shrunk. You just stay there. If it's accounting Ledger doesn't mean anything. That's all I'm trying to say.

说话人 1 50:45
That's great. Any comment about the yield curve chain? I guess I, maybe I'll start things off. The time historically. I'm not talking about this cycle, just the data says the best time to get into stocks is when you're early in a recession. You're starting to get that recessionary data and the yield curve is bull steepening or bull disinverting if you want, whereas basically the two year is pushing everything down. And then you get this, the movement into early cyclical stocks. It's a liquidity plays. But we haven't had that. We've had a bare disinversion where things going up, it's led by the two year, but the tenure is going up even more because that term premium is rising. So any comments about how that yield curve, I'm just describing the FA, the past, how it might evolve over the next year? I think.

说话人 3 51:34
The market is basically systematically misjudged the Fed intention. We have like a over 100 basis point of curve inversion because the lawn of the curve is way lower then shorten the curve.

说话人 3 51:47
Now Fed keep telling people now they're reasserting that saying, hey, I'm gonna hold here for longer. That's why the long term of curve start to converge to the short end of the curve. Mathematically speaking, if the Fed hold shorten the curve at this current level forever, the long end curve has to converge and maybe even exceed at the short of the curve because they have to allow for term premium.

说话人 3 52:12
So this is a very difficult and there's a client's asking me the same questions. Hey, every time the curve is disinverting, you would want to buy. Hey, you gotta be careful.

说话人 3 52:23
What has been the story for this inverting? Sometimes it very rare that we're going through what we're going through now. So like long of the curve is backing backing up short and the curve stays steady. Whereas this inverting usually happens in history when the shorten the curve is coming down and when the face start to ease. This is different. So I think we're still in the stalemate where you have a pretty decent economy but high and rising borrowing cost discount factor again, just refresh your basic economics. Oh, asset pricing model. The, the even if your earnings are going up, your discount factor is going higher. You base and end up with somewhere you gonna go nowhere in market. That's, that's what I have in mind. That's what we have in mind basically is a flat profile if you don't have recession in terms of stock prices. If you do have a mild recession, most likely bonds are going to outperform stocks.

说话人 1 53:25
Absolutely. I'm just got a quick question here. I'll take care of it. If you wanna s comment, Chen, it's just the outlook for the Australian dollar. Obviously, there's a cloud over currencies like the Australian dollar right now. But I think if you wanna tell a bulky case, it might be easy based on what Chen has laid out for next year first is that if you're gonna get some weakness, it's probably gonna be focused more on the US China's already had all this terrible data.

说话人 1 53:51
There's starting to ease. Of course, they've made big mistakes. But this rotation in favor of Asian growth and out of US growth would not only be beneficial obviously for Australia, but indirectly by having a weaker dollar, stronger commodity prices and Fed easing. Anything you wanna say about DRC?

说话人 3 54:10
No, I think you said it well. I mean, it's a, it's the whole thing is about a commodities. I don't think the commodity prices, the commodity currency is gonna do much this year, especially when the Fed is so aggressive when the wars going on. That's as the headwinds for commodity currencies. Think about Canadian dollar. Our Canadian dollar cropped out even though the oil prices is high is terrible why? Well, I think that's part of them. Of course, we have our own problem. I don't wanna go into that. That's a Tangent, but probably next year.

说话人 1 54:52
Okay, that's great. Gonna get to Dan kind of last words, but first a great que really interesting question here. I hadn't really thought of it, but potential winners from the growth tax. So oil, the dollar interest rates of course were bullish on oil. That's the one that comes to mind for me. I'm talking my book, but can you think of any winners from this tightening of.

说话人 3 55:11
The gross tax? You know, of course, oil is one thing, the dollar is another thing. And I think a t Bill 5%, that's your interest rates, right, without duration.

说话人 1 55:24
Could do worse. Okay, let me shift over to Dan. Boy, two questions here. Not the, you only got a couple of minutes, Dan, I'm sorry, but great question here. The current conflict in the eastern Mediterranean spill over to Syria slash Turkey and how could it affect the Ukraine Russia conflict? And then we'll kind of close off with a kind of bigger picture. But just very quickly, your thoughts on Syria, Turkey and Ukraine Russia.

说话人 2 55:52
Sure. Syria, I mean, could come in play from the Israel conflict. I mean, there, it's a, it's an Iranian ally, of course, a very complex country. I have a number of different insurgencies and turkeys involved as well. I think that the issues around turkeys are slightly separate and I think that's a different issue I think I'll mention in a minute. But there's also the potential brewing conflict in the caucuses between Azerbaijan and Armenia. So it's a complex situation in the context of the current war should expands Syria as a likely candidate along with Lebanon. So definitely the war could expand to Syria. I mean, Israel is already bombing, doing bombing runs on the airports in Damascus and I think was Aleppo recently since October 7th. So again, the political situation in Syria's volatile. Obviously, it's a fragile country. Their Iranian proxies and military assets there, the US has troops there as a tripwire. There are Turkish troops, there are the curse Kurdish insurgencies. So it's a very complex issue and something that again, that could see significant volatility.

说话人 2 56:58
When it comes to Ukraine, of course, the war in the Middle East eggs western and native attention away from Russia. Ukraine, I see that conflict is stalemated. I think that will continue at least for this year. The way I look at it from a market perspective is priced in. The risk there is if the conflict becomes fluid. So if Ukrainians advance or the Russians for the amount of bliss likely advance and you see a massive change in territory, I think at that point, there is a risk that Russia lashes out, which would have negative market implications.

说话人 1 57:30
That's great. Dan, I'm gonna give you the last word. Just got a very quick question here about the positive correlation between the US dollar and oil prices. This has happened in the past. The main drivers

are supply. So if the dollar was to weaken next year, I think it would help oil prices. But the rising dollar right now, there's so many things going on the supply front there. These reports, if you're interested, we have two reports on that all, both of them within a couple of days of right now. So let me give you the last word here, Dan, about the kind of bigger picture about it's less urgent, but what have we Learned from this latest war about the big picture? They give us some themes to think about just in a couple the minutes.

说话人 2 58:15
Sure. So to keep it very quick, if you turn to slide 8, I actually have a slide on that. So one question that we got, and I think it's a very important question is, could things get even worse? We had the Russia Ukraine war last year. We have these Israel Hamas where that's likely to expand. Another booming conflict as I mentioned is Armenia Zarba, John. And there is also the always the discussion and potential of a US China conflict, specifically worrisome over Taiwan. So we think that one is particularly unlikely. But if you take US the back it seems that conflicts, and I'm talking about interstate war, they tend to move in way. So on this slide, if you look on the left chart, it shows kind of or one 1930s,1940s where there were a series of conflicts, not just 12 or two. And then of course, in the fifth these and then in the to the 70s, you have this waves of conflict. With this in the current environment, the question is, are we moving to another wave of conflicts, right? And the question is, what does that mean for markets? What does it mean again, for the global economy? And where could this be? Even two conflicts in Ukraine, Russia now and the Middle East are serious enough. And the one thing that conflicts tend to do, they tend to be generally speak king inflationary, worse, drive inflation. And the chart on the right, what it shows is that generally speaking, the high, some of the highest speaks, not all, but some of the highest speaks in US inflation since World War 2 have been associated with war or post war or peak war conditions. So this is something to keep in mind, the fact that again, that if we, wars can sort of spur inflation. And of course, in the current environment, the question then becomes, does this hinder major central bank's ability to cut interest rates?

说话人 1 01:00:09
Well, that's a cheery note on which to finish the discussion. I want to thank all of our listeners, especially those that sent these very provocative questions. I hope that that investment Strat, this has helped your investment strategy. I wanna thank my colleagues, Dan and Chen for their input and we look forward to talking in future. And good luck at very uncertain times. Chan, you want the last word?

说话人 3 01:00:36
No, thank you very much. Thank you for your time. Thank you for your patience.

说话人 1 01:00:40
That's great. Good night, everybody. Good morning, everybody.