A Unique Mind On The Markets

GLOBAL FIXED INCOME & CURRENCY STRATEGY

November 15, 2024

Bond Models & FX Indicators

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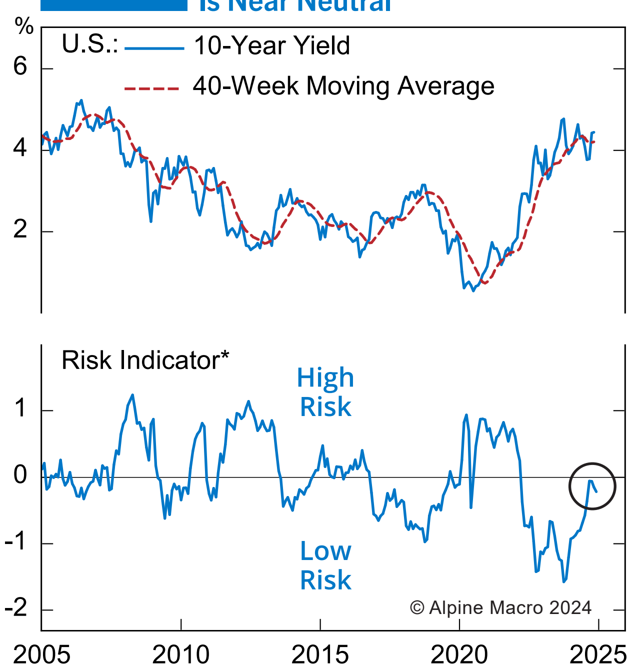
This week, we are publishing a full review of our fixed income and currency indicators, along with an update from our Global Bond Allocation Model.

As a recap, our bond models are summarized by a Risk Indicator (Chart 1). This consists of three subcomponents: cycle, value, and momentum. A high risk reading is bearish for bonds, and vice versa. The models are an important input to our call on duration and global fixed income country allocations.

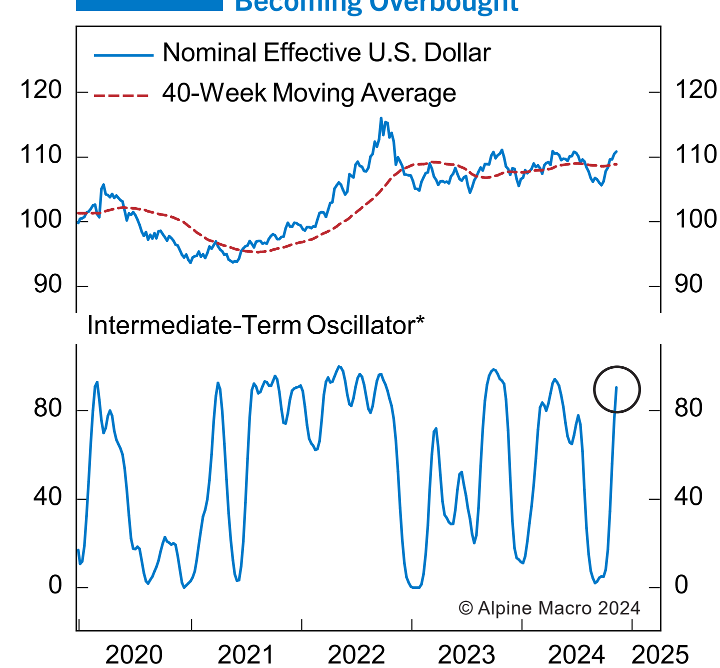
For FX, we focus on technical indicators as currencies are prone to momentum trading. Our intermediate-term oscillator helps to gauge how nascent or advanced a trend may be (Chart 2). We also provide measures on speculative positioning and sentiment, which can be useful contrarian indicators.

Chart 1 The Risk Indicator For U.S. Treasuries Is Near Neutral



*Alpine Macro proprietary indicator

Chart 2 The U.S. Dollar Is Becoming Overbought



*Alpine Macro proprietary indicator

Chart 3 Most Bond Risk Indicators Are Close To Neutral

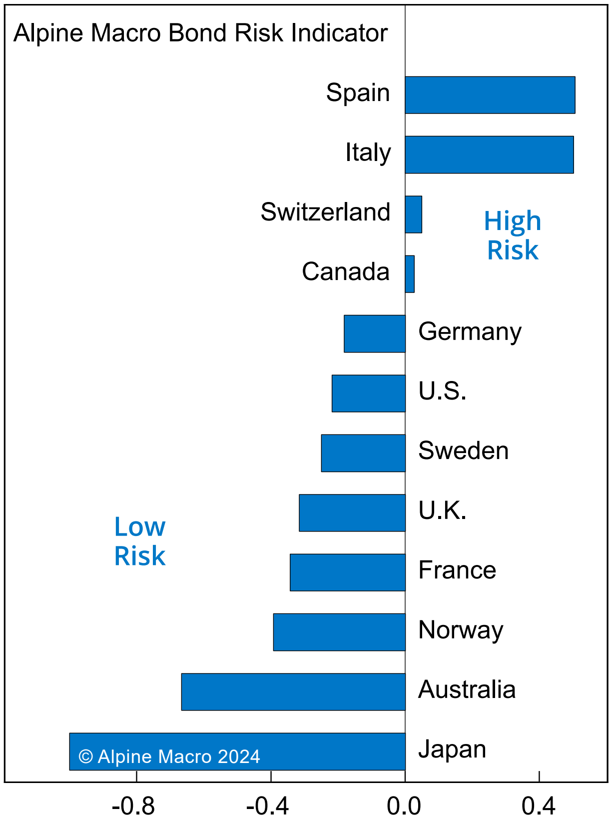
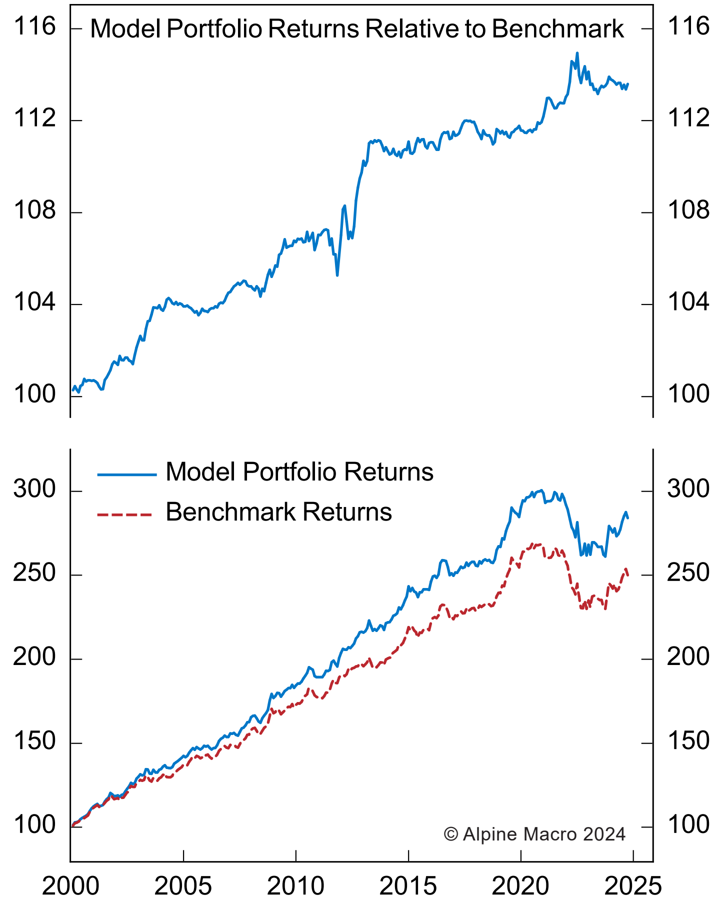


Chart 4 Global Bond Allocation Model's Performance



Note: Series are rebased to Jan 2000 = 100

Bond Risk Indicators Remain Near Neutral

Most of the Risk Indicators for the markets that we track are holding close to neutral levels (Chart 3). With a few exceptions, most bond markets are near fair value and no longer oversold. Economic cycles are generally sluggish, but some markets are showing signs of an improvement. This supports our recommendation to be at benchmark on duration.

Our Global Bond Allocation Model (GBAM) utilizes our sovereign Risk Indicators to derive the country allocations.[1] The objective of the GBAM is to outperform a custom benchmark of global sovereign bonds by strategically overweighting and underweighting different countries (Chart 4).

We do not follow the allocation model blindly as a "black box", but we use it as an input to our investment process and as a cross-check to our fundamental analysis. Table 1 presents the GBAM's latest country allocations compared to our custom benchmark.

Since we last ran the model in early October, the most significant change has been an upgrade to U.S. Treasuries. Last month, the model had cut

1 Alpine Macro *Global Fixed Income & FX Strategy* "Introducing Our Global Bond Asset Allocation Model" (July 7, 2023).

Table 1 Global Bond Model's Country Allocations

	Portfolio (%)	Benchmark (%)	Deviation (%)
Japan	23.9	14.1	9.7
France	11.4	7.3	4.1
Australia	7.4	4.9	2.4
Sweden	5.9	4.2	1.6
U.S.	29.8	28.7	1.0
Germany	7.1	6.7	0.4
Norway	4.7	4.2	0.4
Switzerland	2.3	4.3	-2.0
Canada	2.8	5.1	-2.3
U.K.	3.7	7.2	-3.5
Spain	0.8	6.1	-5.3
Italy	0.3	7.0	-6.7

U.S. bonds to the second largest underweight position. It has now moved Treasuries to slightly above-benchmark. The back-up in yields has made U.S. bonds more attractive from a valuation perspective.

Of course, the model cannot account for potential changes in fiscal policy following the U.S. election. Our *Geopolitical Strategy* team is arguing that Trump will govern more moderately than his campaign rhetoric would suggest:

- First, the Trump administration will want to maintain market and economic stability. For Trump, market performance has long been a measure of his own governing success. Therefore, he is unlikely to enact policies that would significantly disrupt the economy and financial markets.

- Second, Trump's economic team will include Wall Street veterans. Trump's economic advisors include figures like Scott Bessent, John Paulson, Howard Lutnick, Kevin Hassett, David Malpass, Jay Clayton, and Stephen Moore. These advisors are likely to dominate Trump's economic team and will tend to be market-friendly.

- Third, even with the GOP winning both the Senate and the House, the majorities are slim. The Republicans do not have a filibuster-proof majority in the Senate. In the House, a few fiscal hawks could stonewall new legislation.

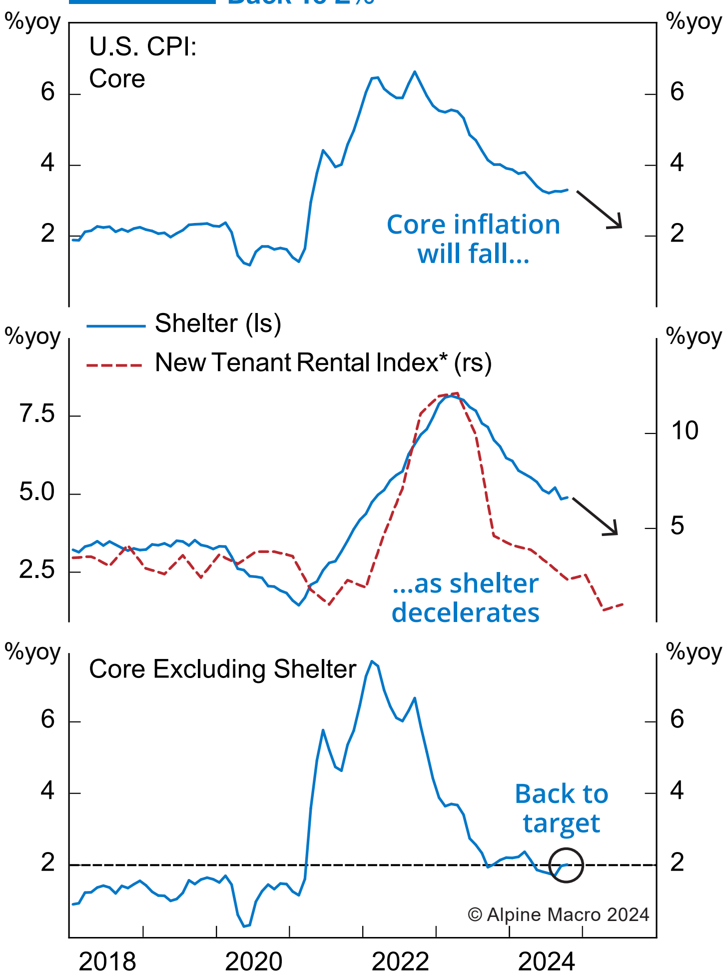
- Fourth, in addition to lowering taxes, Trump is looking for ways to cut spending. Elon Musk and Vivek Ramaswamy have been nominated to reduce government waste. To some degree, spending cuts will dampen the fiscal thrust.

- Fifth, Trump should understand that higher inflation courts political defeat. Inflation spikes have been a blow to incumbent governments in the U.K., France, Japan, and the U.S. Higher inflation would spell trouble for the Republicans in the mid-term elections in two years, leaving Trump as a "lame duck" president.

On balance, we expect Trump to be moderate on fiscal policy to prevent a renewed upturn in inflation. This week's CPI report shows that core inflation excluding shelter has returned to 2% (**Chart 5**). Although it is still elevated, shelter inflation is on a downtrend that should continue. This will pull the overall core inflation down to the Fed's target.

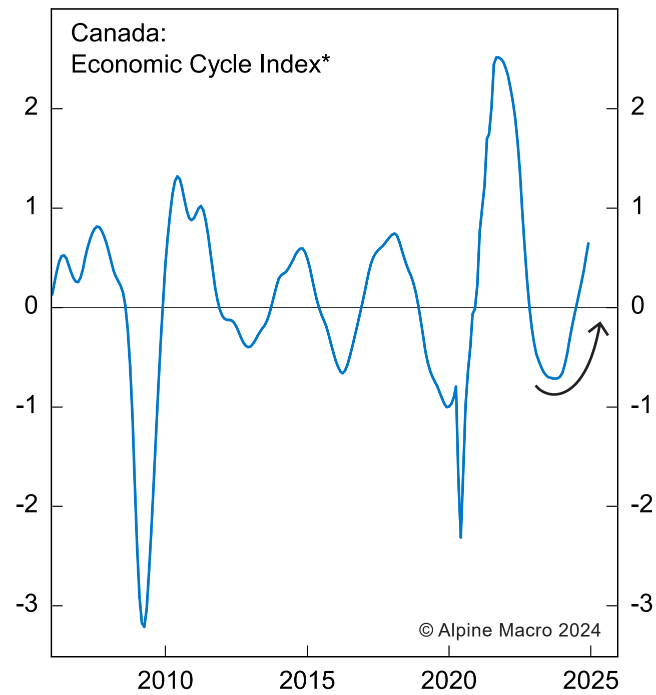
As U.S. inflation returns to 2%, the Fed should continue to lower short-term interest rates. Of course, the Fed will not have to move policy to a stimulative level if fiscal policy turns more growth supportive. Our baseline view is that the Fed could

Chart 5 U.S. Inflation Is Heading Back To 2%



*Advanced by 10 months; source: BLS

Chart 6 Better Days Ahead For The Canadian Economy?



*Alpine Macro Calculation

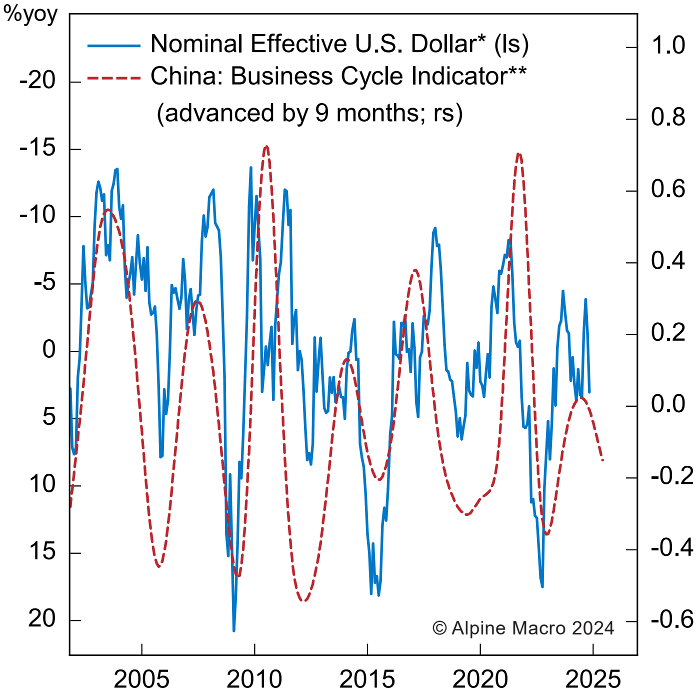
take rates down to 3.75-4.0%. This would put the 10-year yield at 4.25-4.50% and warrants a neutral allocation to Treasuries.

Offsetting the upgrade to Treasuries, our bond model lowered its allocation to several markets:

- The U.K. got downgraded from close to neutral to the third largest underweight position. We agree with this qualitatively. Chancellor Reeves' budget loosened fiscal policy that will push up GDP growth and keep core inflation sticky above the BoE's 2% target.
- Canadian bonds also fell out of favor. Our models show that the cyclical outlook for the economy is improving (Chart 6). The BoC's interest rate cuts and the weaker currency could be the reasons for the better cyclical profile.
- Germany was downgraded from a large overweight to close to neutral. However, the bond model continues to favor a heavy weighting to French OATs.

In line with the model's recommendations, we are trimming our allocation to Gilts and Canadian bonds. Despite the model's lower weighting to Germany, we are maintaining core eurozone bonds as a large overweight. With growth already weak, the European economy faces potential trade wars against the U.S. and China. We are also upgrading Norwegian bonds. Disappointing stimulus measures from China could weigh on commodities, including crude oil.

Chart 7 Weak Chinese Growth Is Bullish For The U.S. Dollar



*Shown inverted; source: BIS
**Alpine Macro proprietary indicator

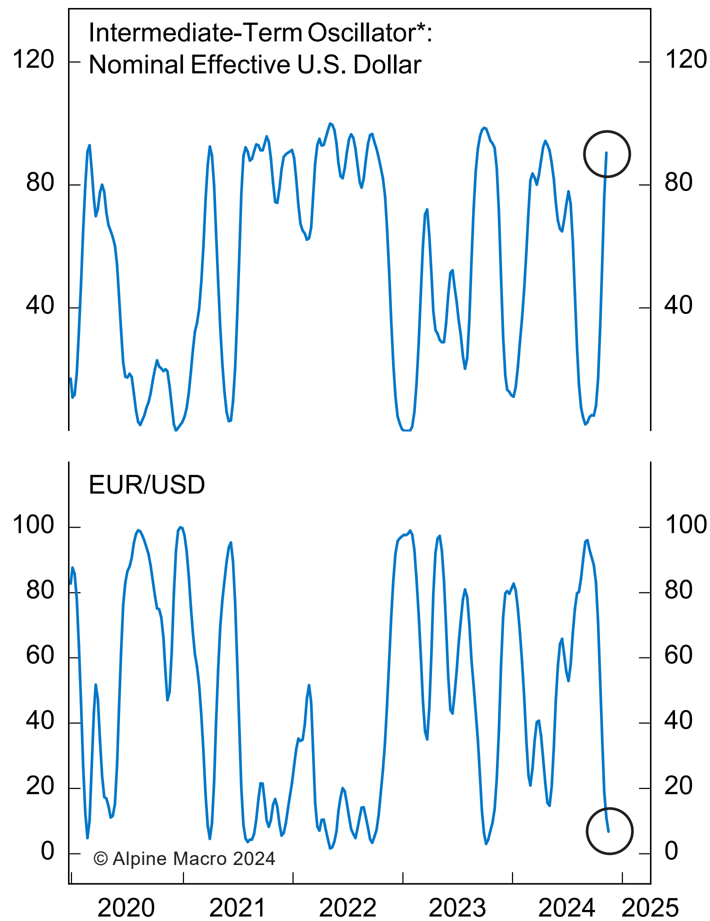
Finally, Japan is the major bond market where we are overriding our country allocation model. In sharp contrast to the model that has JGBs as its most favored bond market, we recommend maintaining an underweight position in Japanese bonds.

The BoJ will not follow the other G10 central banks in easing policy. With the Japanese yen coming under pressure again, the BoJ could be compelled to hike rates sooner rather than later. JGBs offer low yields and have limited scope for capital appreciation.

The Dollar Is Becoming Overbought

From a cyclical perspective, the outlook for the U.S. dollar is bullish. Easier fiscal policy, fewer rate cuts by the Fed, and higher tariffs should support the greenback. Moreover, China's latest policy announcement was disappointing. This will keep non-U.S. global growth sluggish and increase the attractiveness of the dollar (Chart 7).

Chart 8 Two Sides Of The Same Coin: Overbought USD & Oversold EUR

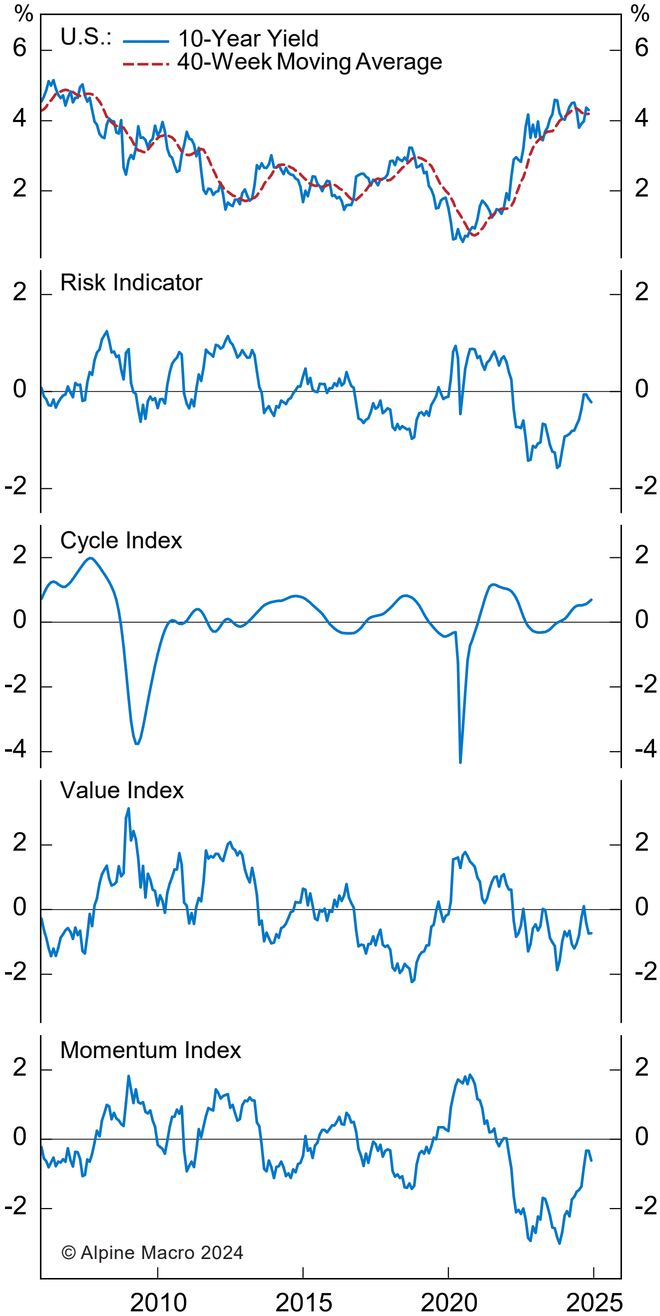


*Alpine Macro proprietary indicator

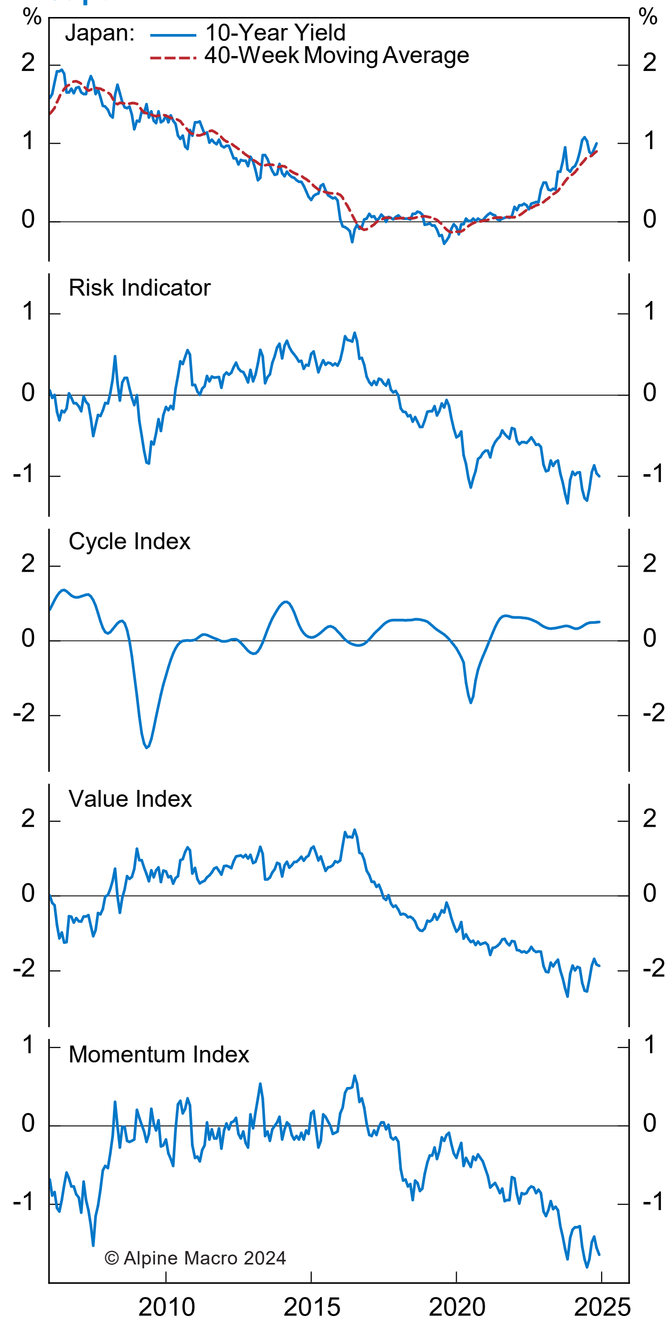
However, our intermediate-term oscillator warns that the dollar is becoming overbought (Chart 8, top panel). On the flip side, the euro is reaching oversold levels (Chart 8, bottom panel). Therefore, investors should be braced for a period of consolidation or retracement before the dollar's cyclical bull market resumes.

Harvinder Kalirai
Chief Fixed Income & FX Strategist

U.S.

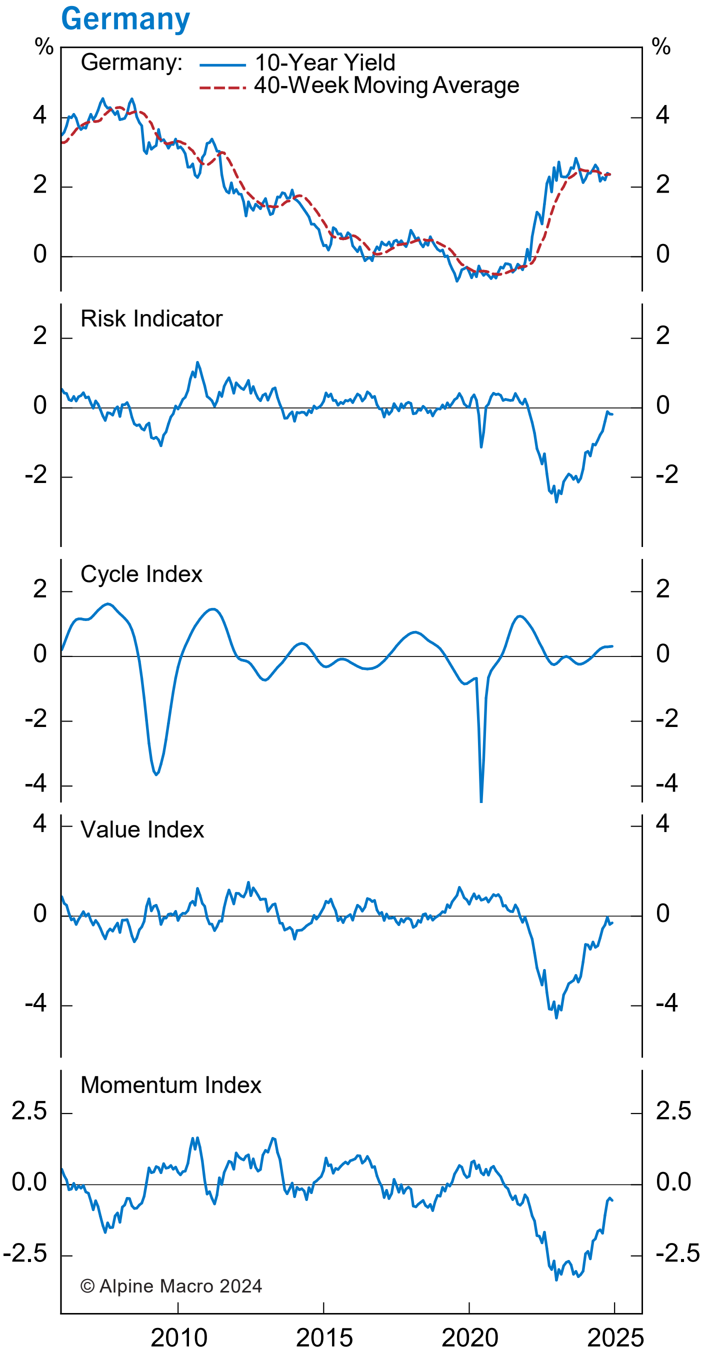


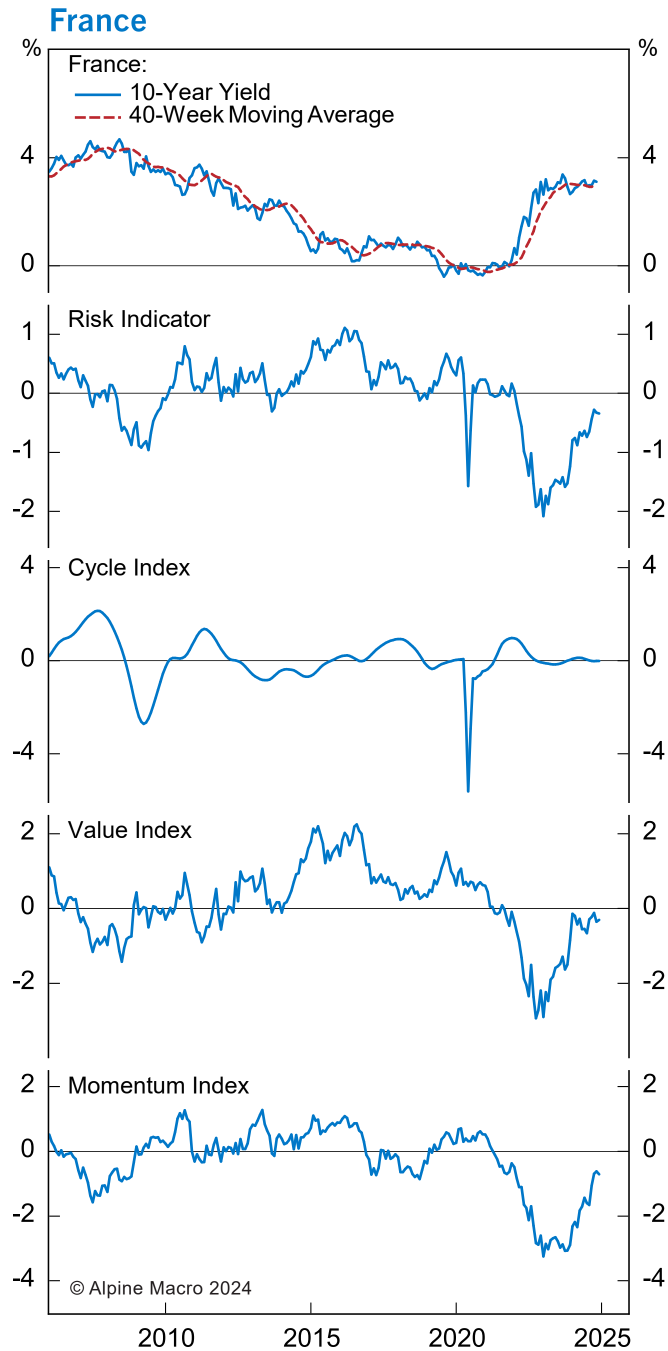
Japan



The Risk Indicator for Treasuries is close to neutral. U.S. bonds are only slightly cheap and oversold momentum has been mostly worked off. The cycle index is pointing to moderate economic growth.

According to our indicators, the risk profile of JGBs is attractive. Japanese bonds are cheap and oversold. The cycle index is consistent with modest GDP growth.

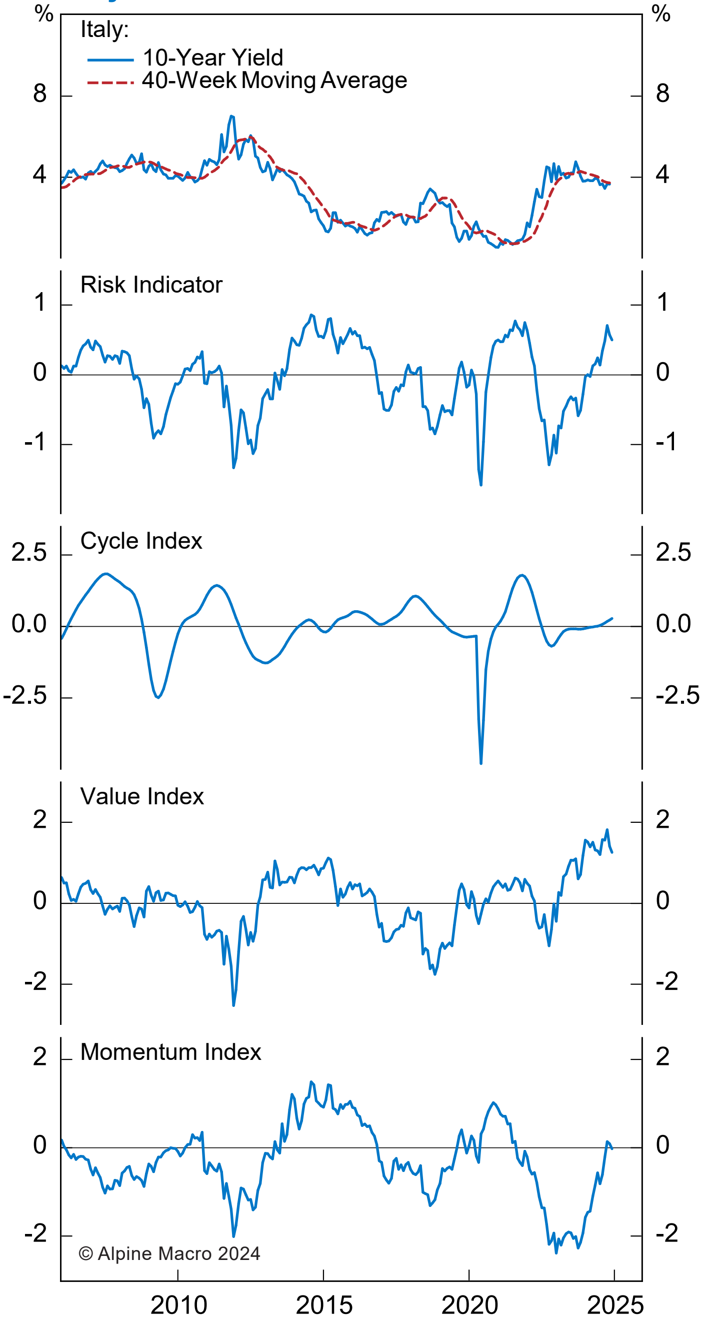




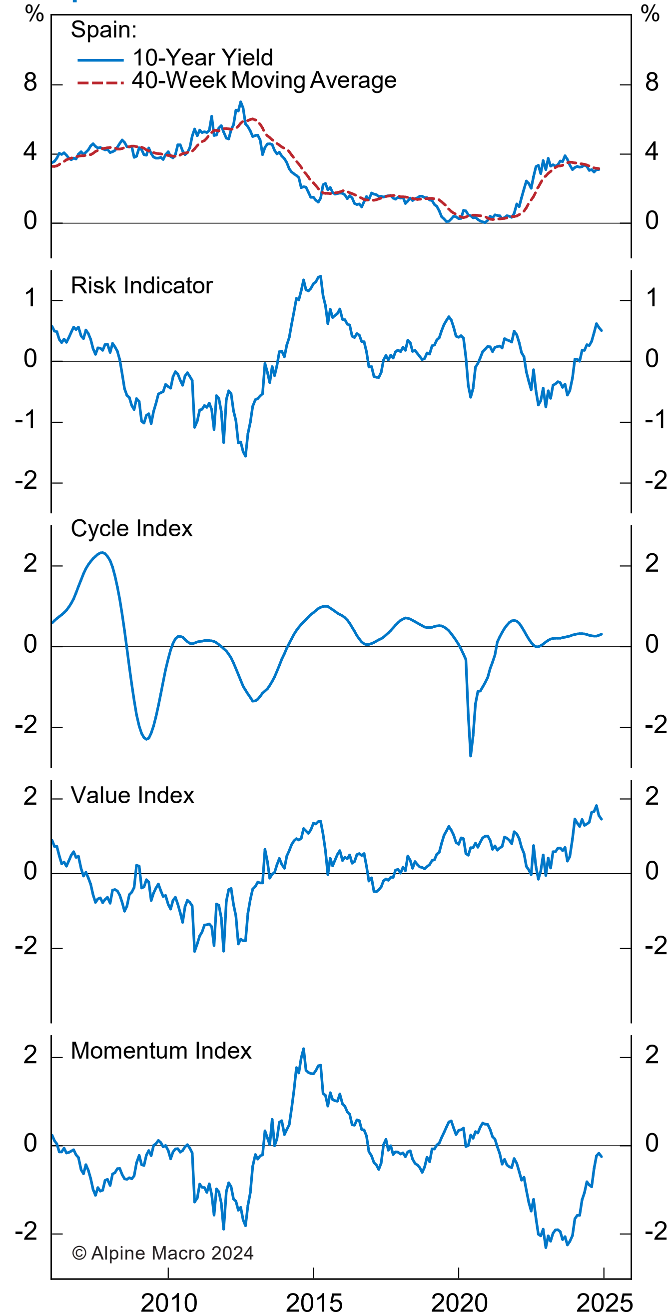
The Risk Indicator has risen to near neutral. German Bunds are no longer undervalued or deeply oversold. The cycle index points to sluggish growth.

The risk profile of French OATs is slightly better than German Bunds.

Italy



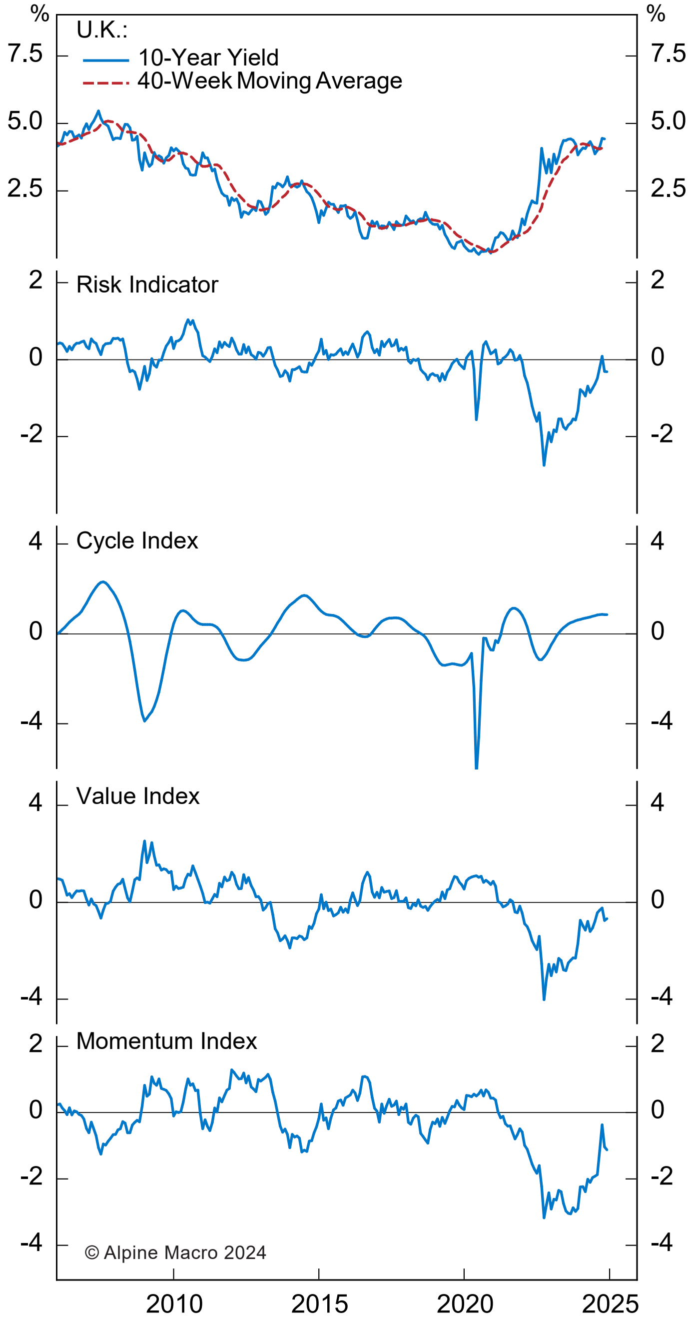
Spain



The Risk Indicator for BTPs is among the highest of all the bond markets we track. While the economy is sluggish, Italian bonds are overvalued and momentum is no longer oversold.

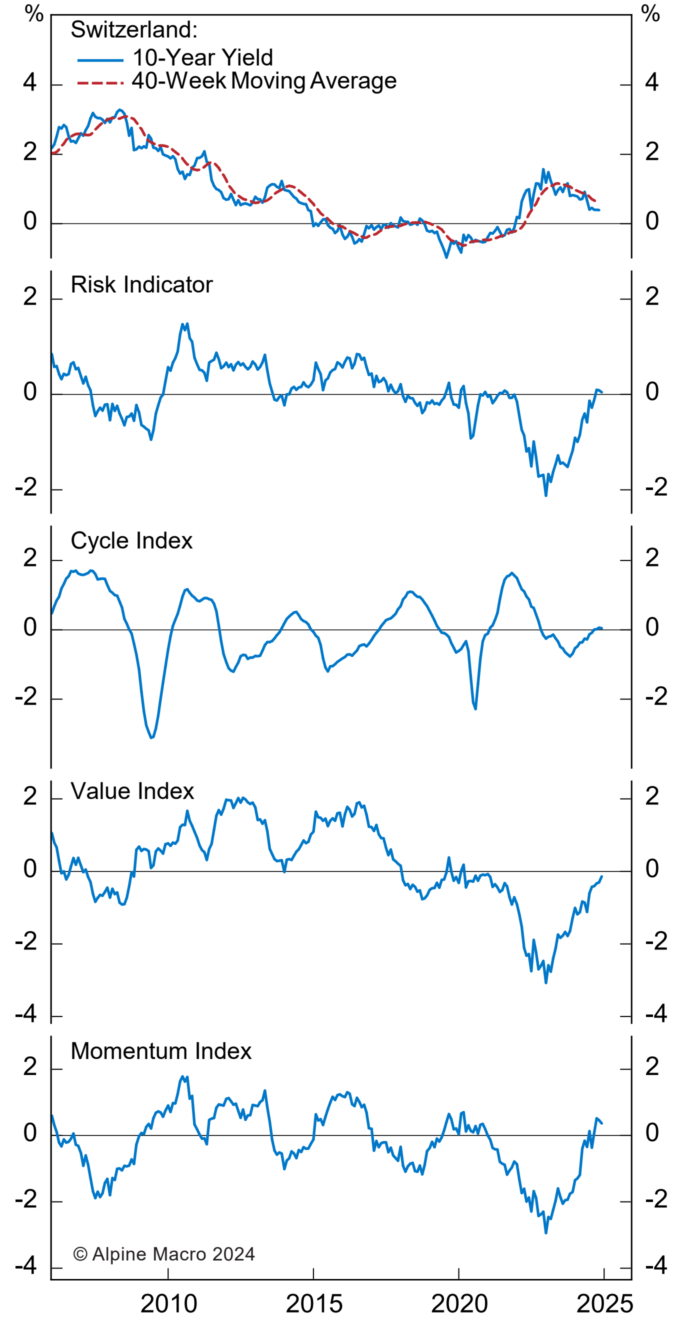
Similar to Italy, the Risk Indicator for Spanish Bonos is elevated. Our models continue to warn that investors should underweight Bonos and BTPs versus core eurozone bonds.

U.K.



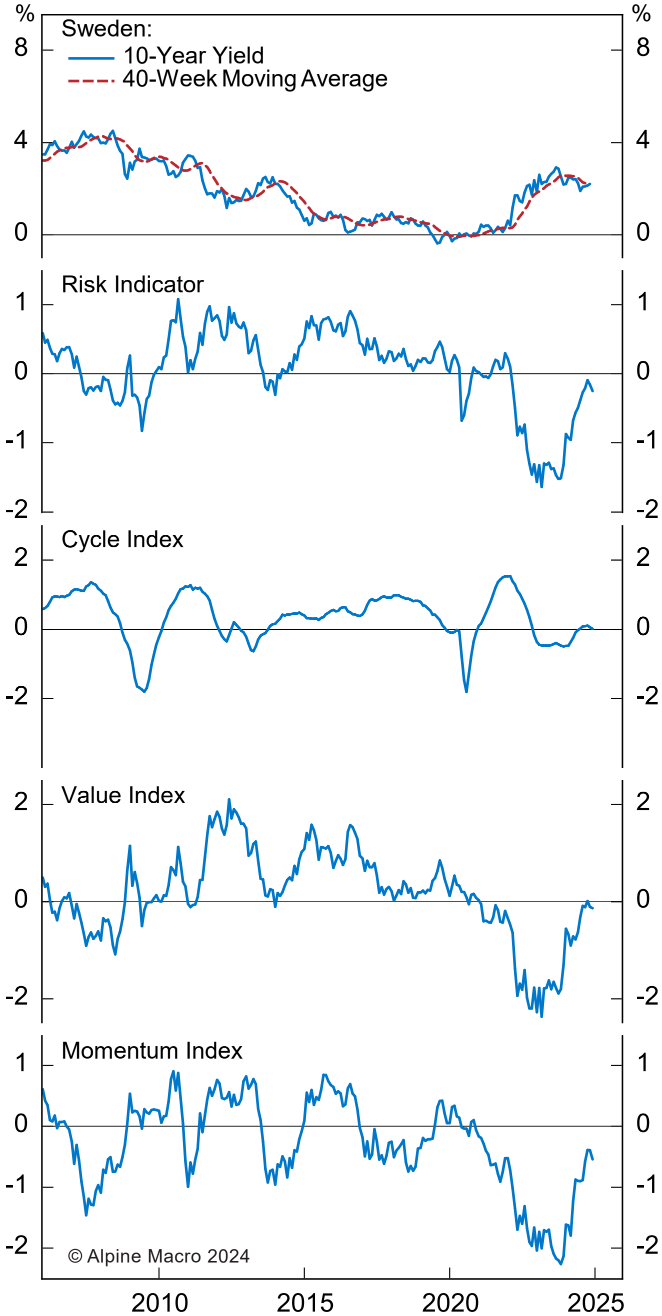
The Risk Indicator is close to neutral. Gilts are no longer undervalued or oversold, while the cycle index is firming.

Switzerland

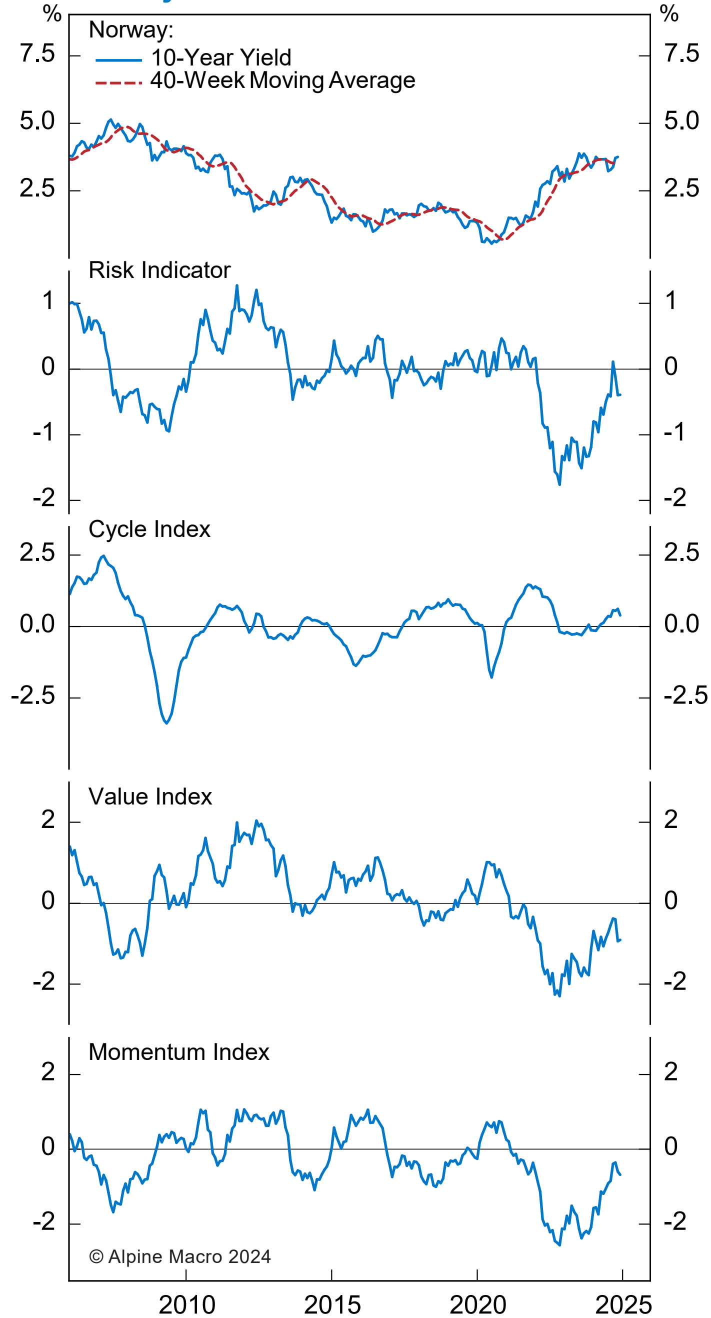


The Risk Indicator is back to neutral. The rally in Swiss bonds has eliminated the undervaluation and the oversold technical conditions. The cycle is weak, but it is on the mend.

Sweden



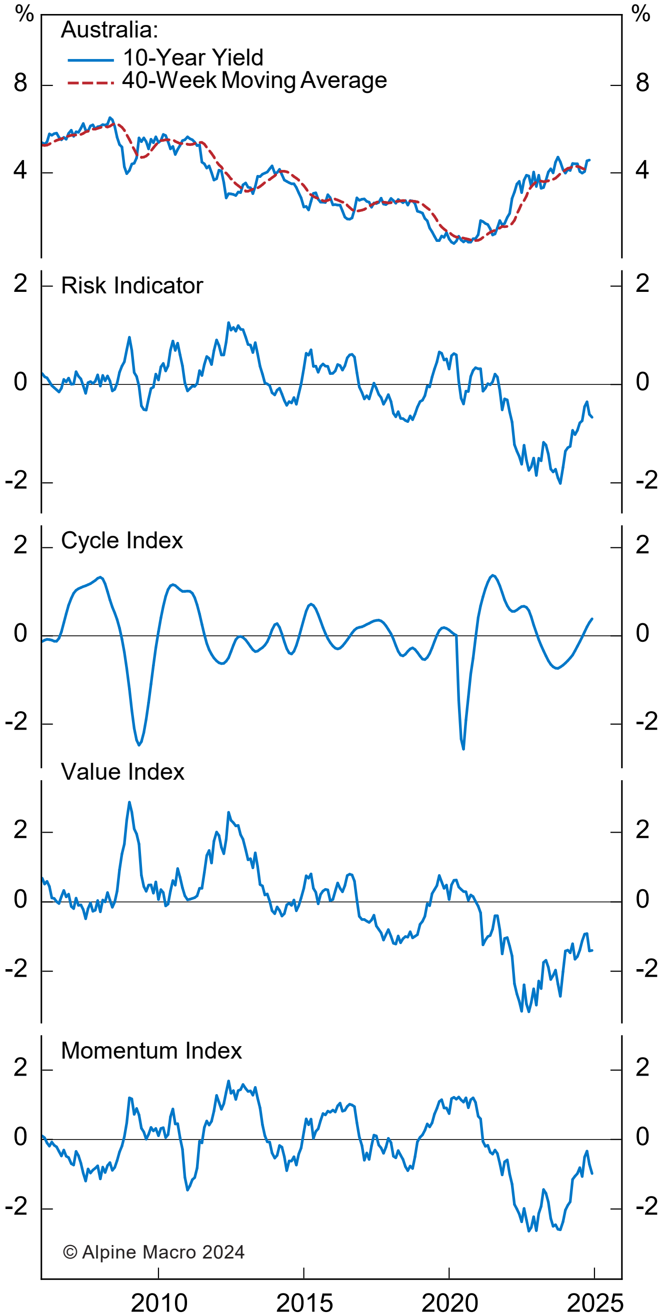
Norway



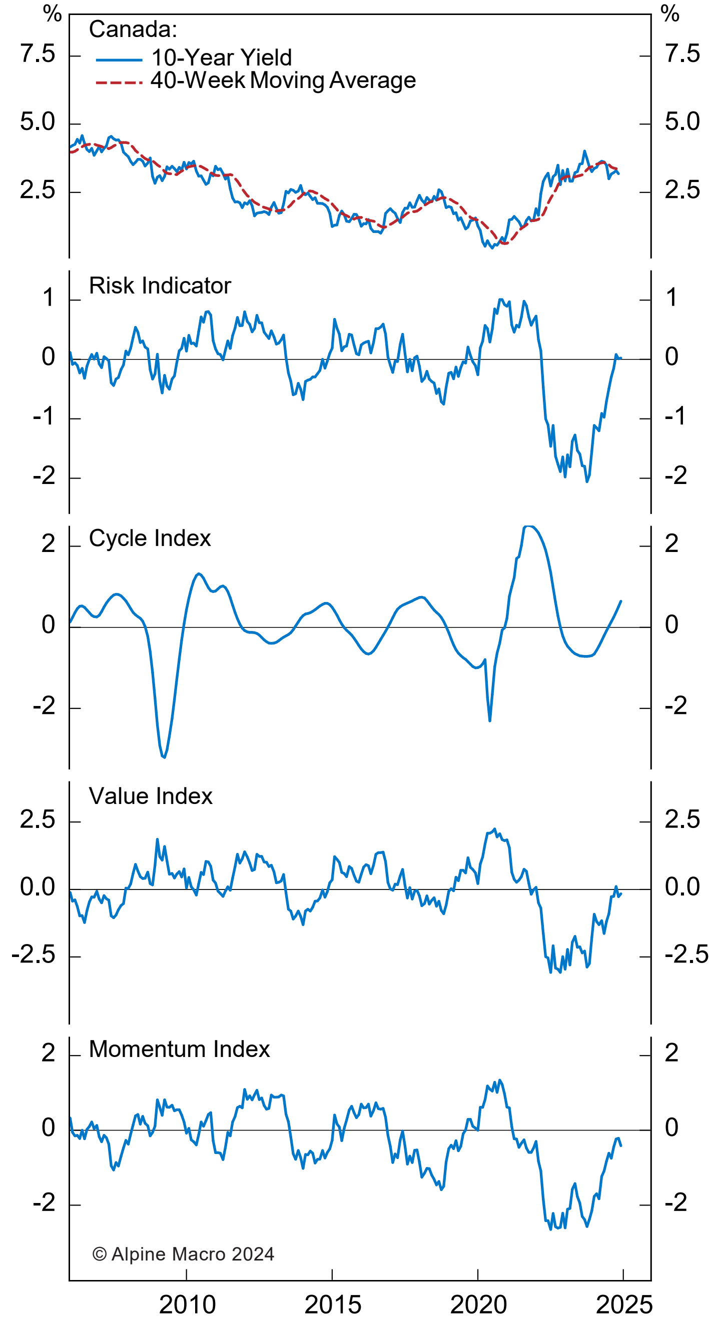
The Risk Indicator is near neutral. Swedish bonds are no longer cheap or deeply oversold. The cycle is soft, but it looks to have bottomed.

Norway's risk profile is somewhat better than Sweden's. The cycle is slightly stronger, but Norwegian bonds offer better value than Swedish counterparts.

Australia



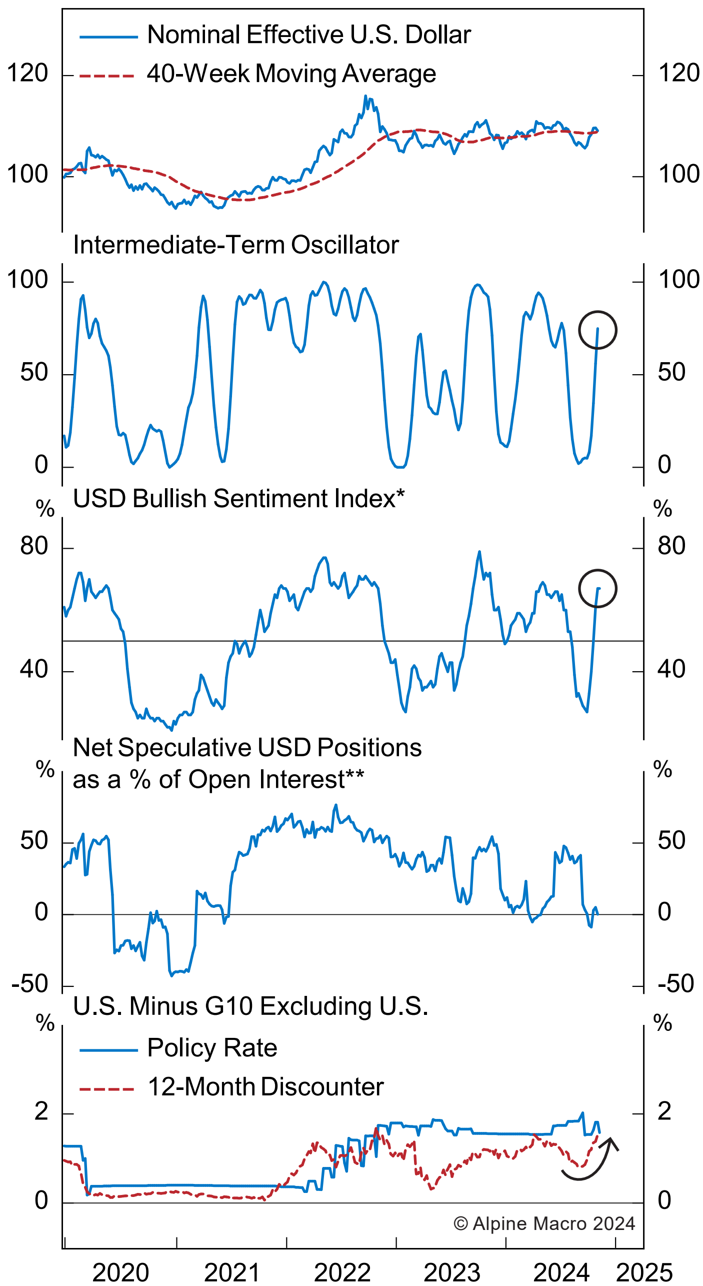
Canada



The Risk Indicator has recovered from record low levels, but it remains below neutral. Australian bonds are modestly cheap. The cycle index is inflecting higher, but it is still soft.

The Risk Indicator has risen to neutral. Canadian bonds are fairly valued and no longer oversold. The cycle index has bottomed and signals an improving growth profile.

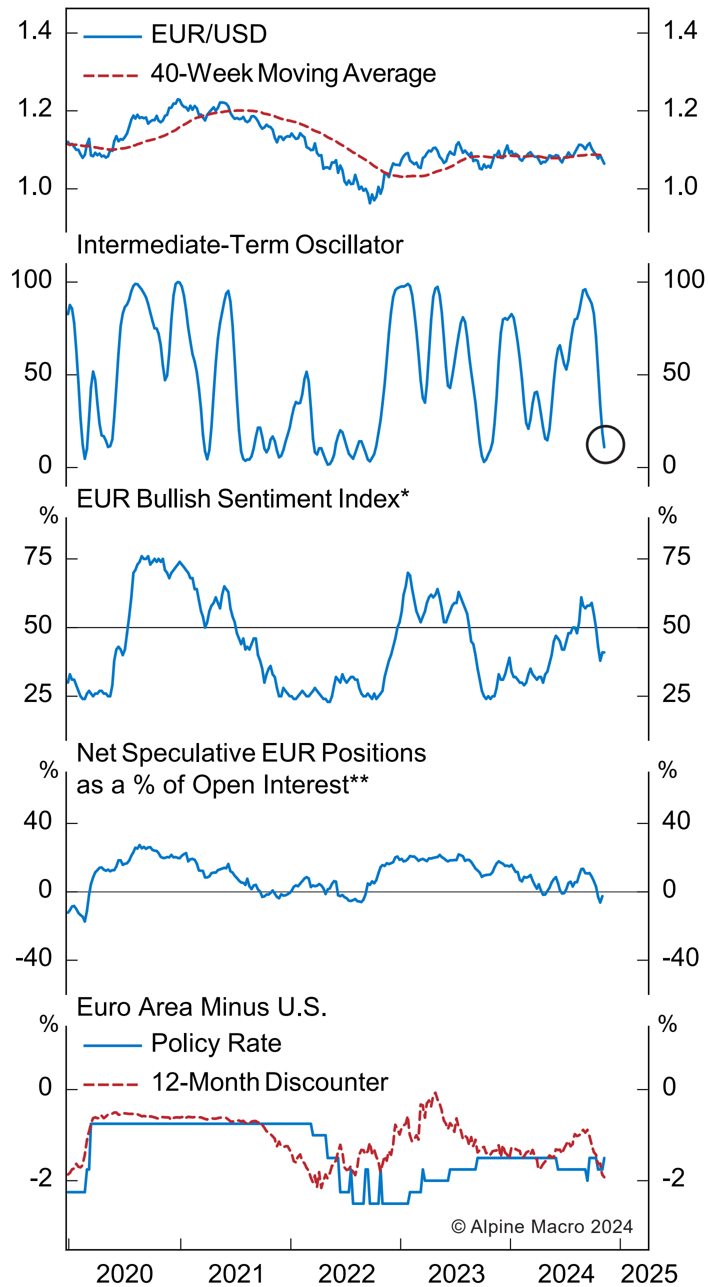
U.S. Dollar



*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

The recent rally in the dollar is getting mature. Our intermediate-term oscillator is becoming overbought and sentiment is turning very bullish. While the dollar is due for a breather, expected yield differentials have turned up and are pointing to a cyclical bull market.

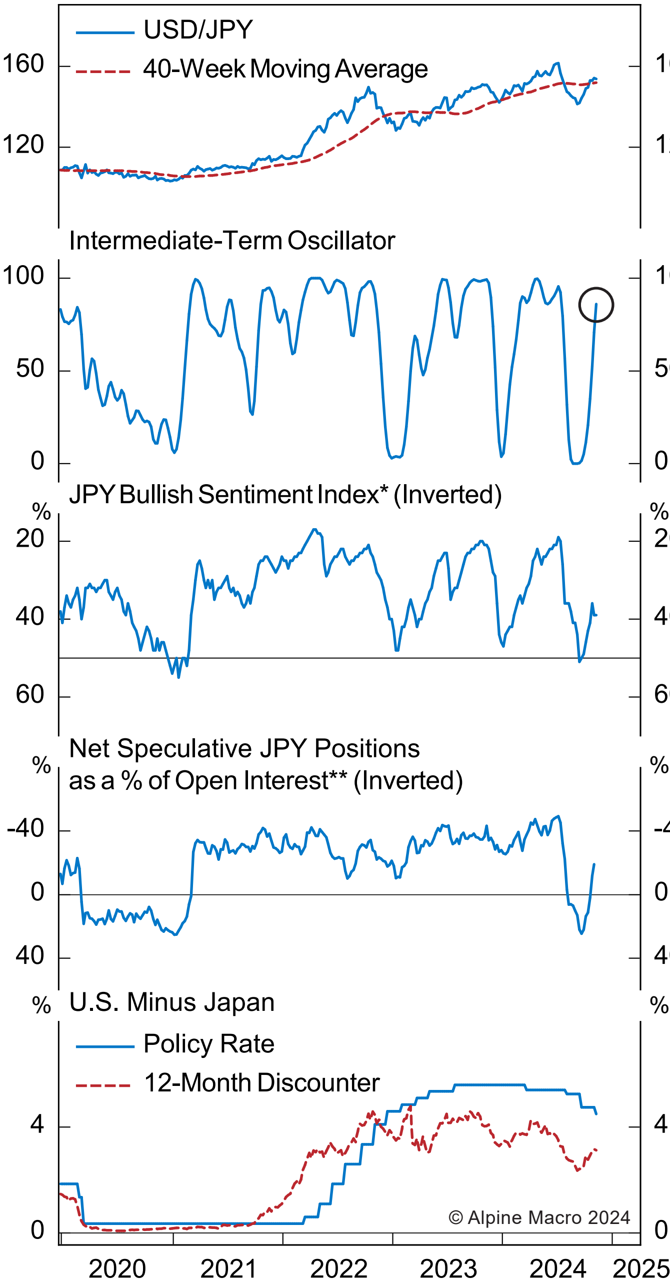
EUR/USD



*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

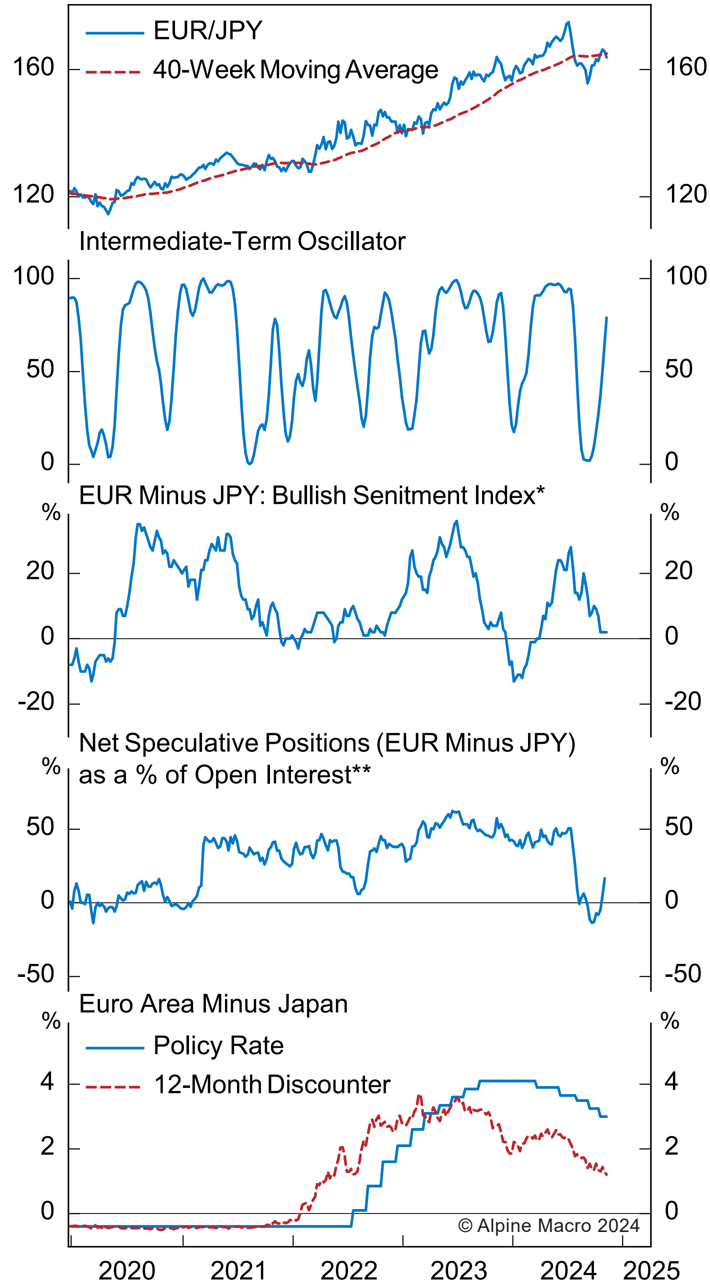
With momentum nearing oversold levels, the euro's downtrend could soon be due for a pause. If the euro holds below the 40-week moving average, it would signal that a new cyclical bear market is underway.

USD/JPY



*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

EUR/JPY

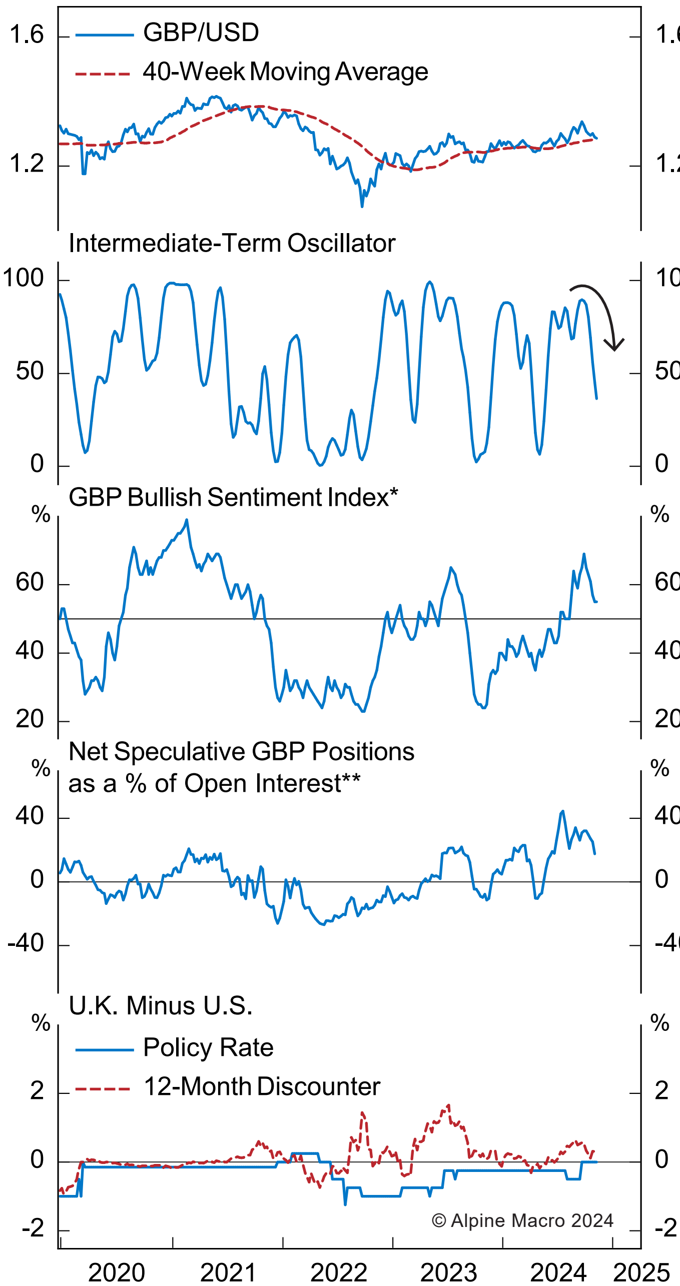


*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

USD/JPY has retraced to the 40-week moving average and our intermediate-term oscillator is becoming overbought. A failure to break above this key long-term average would be a bearish sign.

EUR/JPY is also testing the important 40-week moving average. The cross needs to hold below this technical level to signal that a cyclical downtrend is underway.

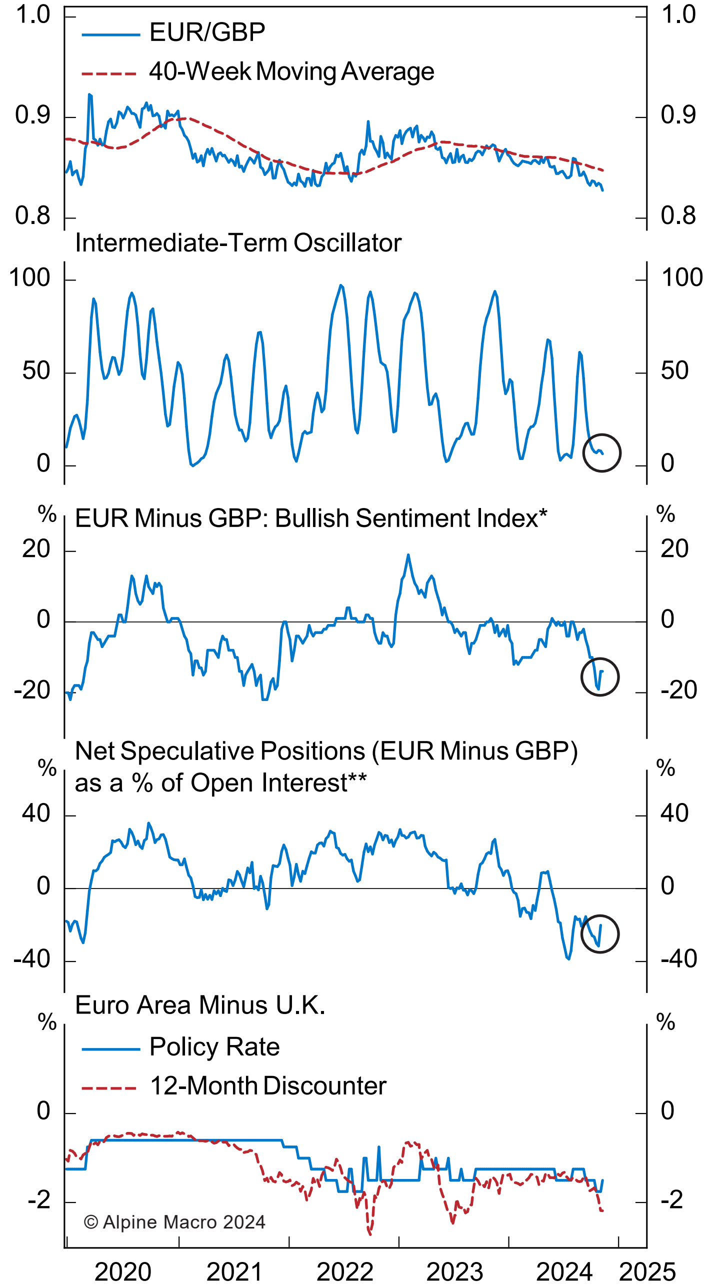
GBP/USD



*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

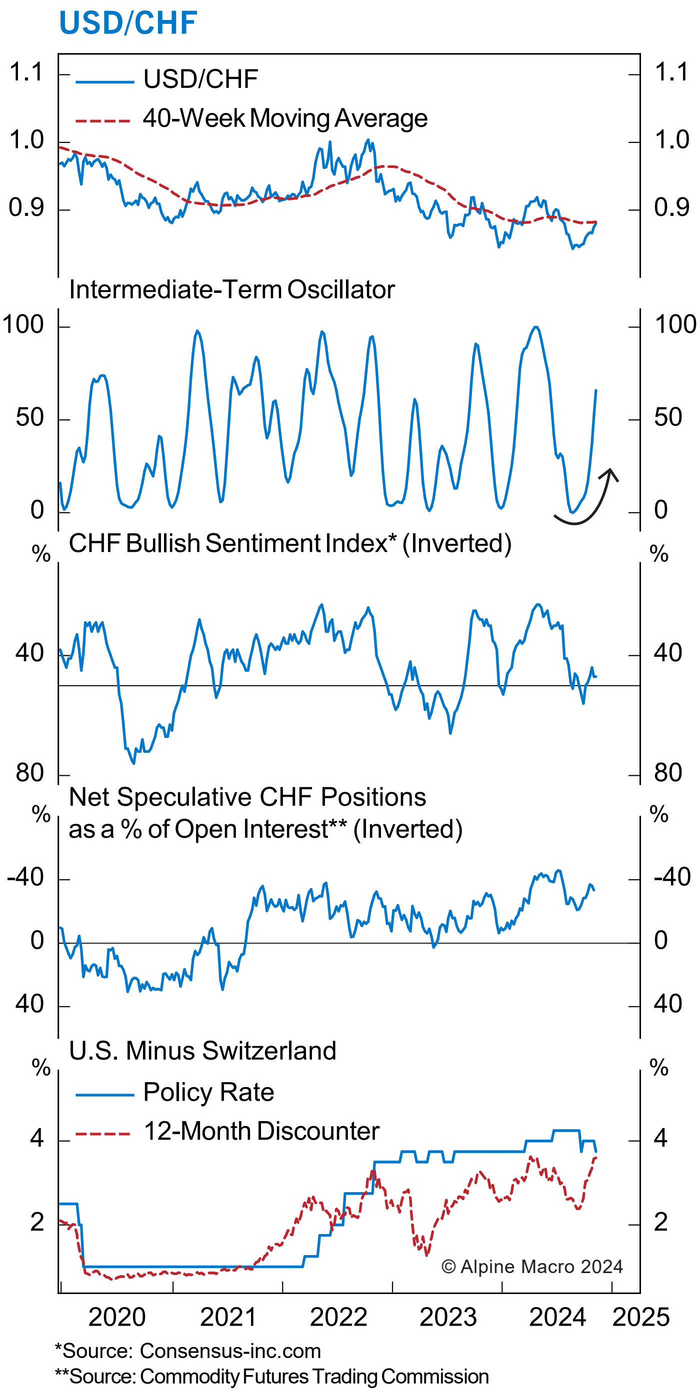
Cable has retraced to the 40-week moving average. However, our intermediate-term oscillator is only slightly below neutral, which warns of more downside potential for sterling.

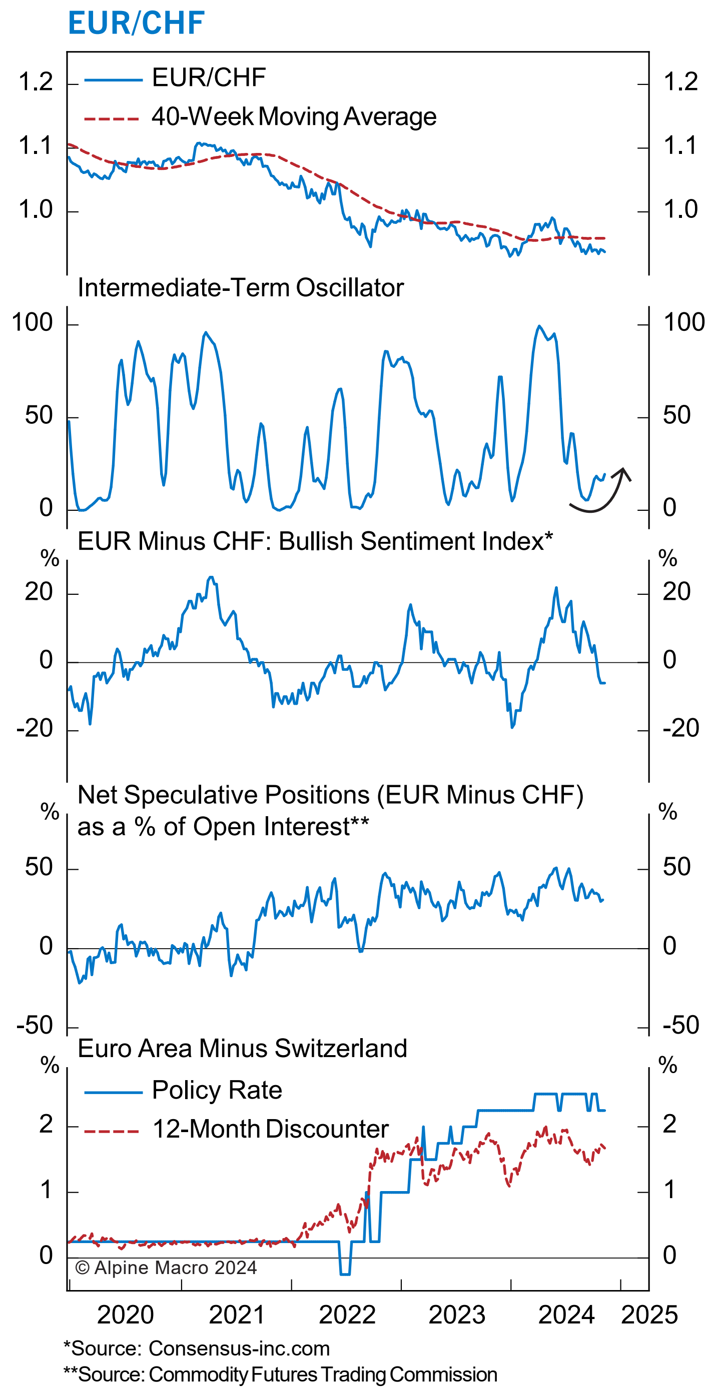
EUR/GBP



*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

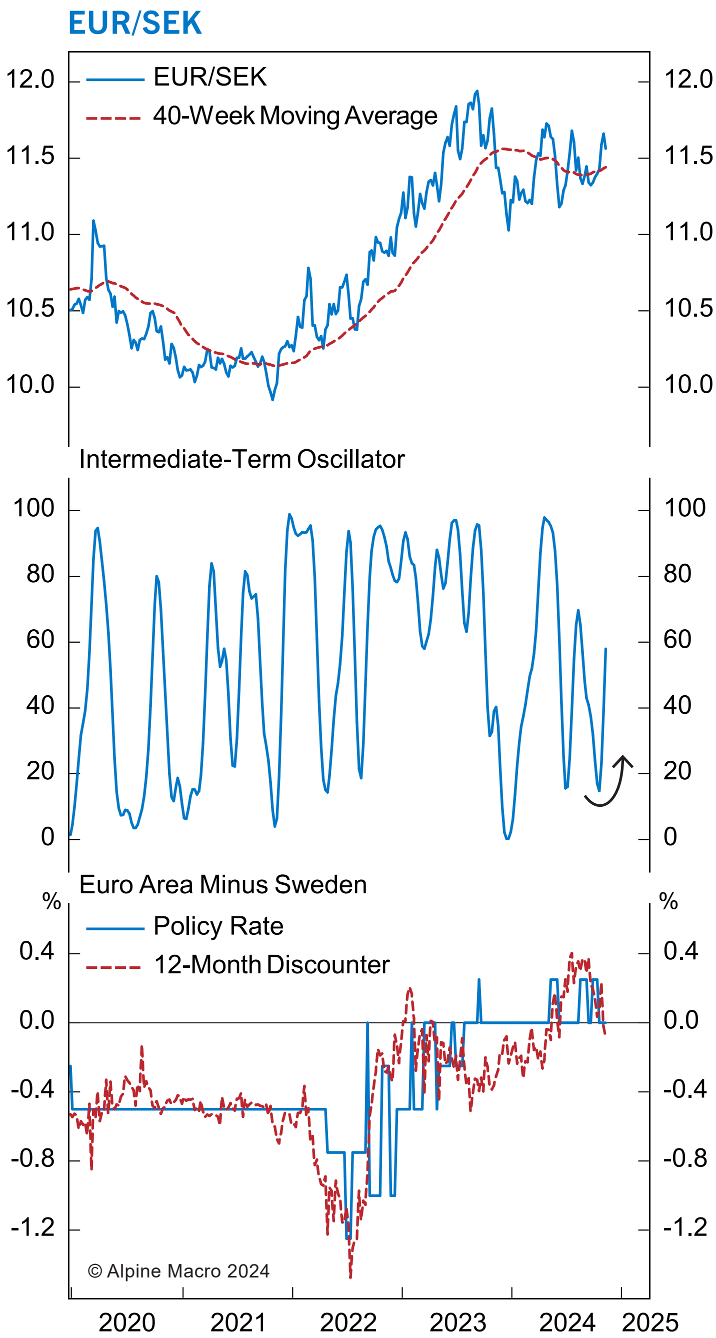
The primary bear market remains in place with EUR/GBP holding below the falling 40-week moving average. But some type of consolidation or retracement should be expected with our intermediate-term oscillator becoming oversold. Relative sentiment and positioning are also extremely depressed.

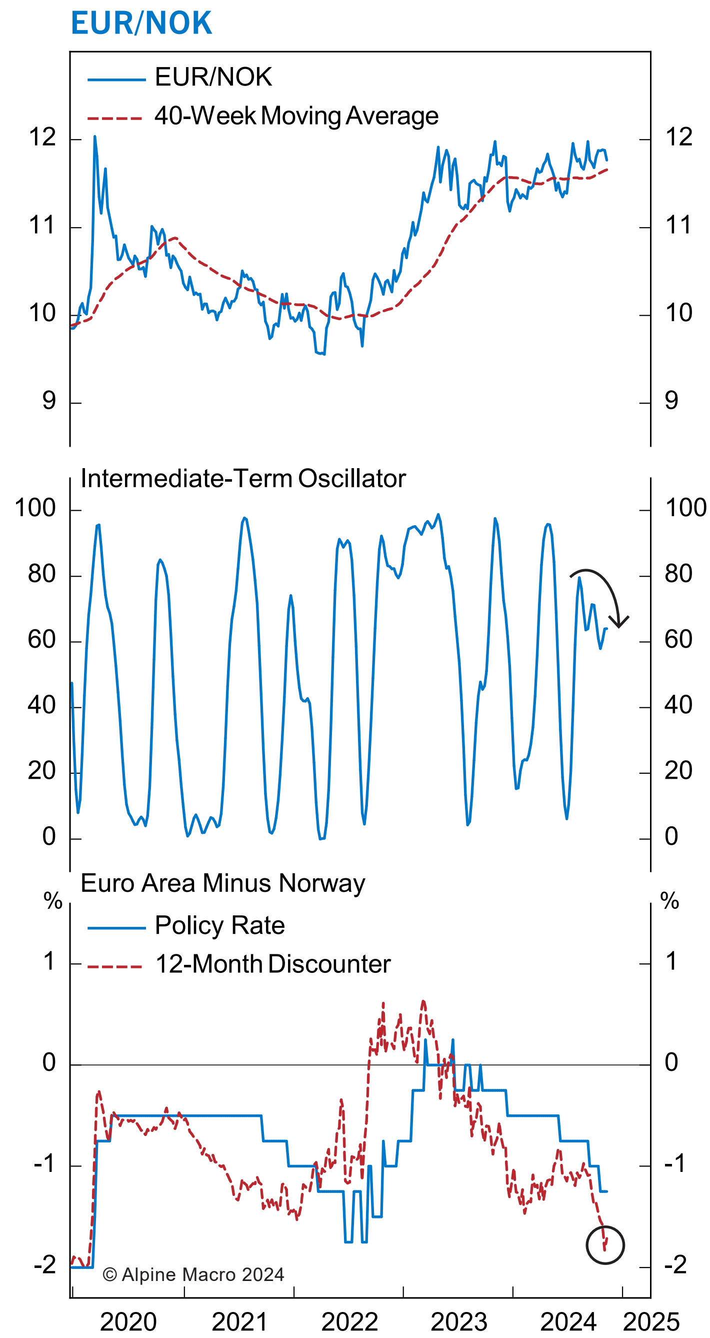




USD/CHF has bounced to the 40-week moving average, but our intermediate-term oscillator has more upside potential before becoming overbought.

EUR/CHF could experience a technical bounce as our intermediate-term oscillator is turning up from oversold levels. However, with the cross below the 40-week moving average, the primary trend is downward.

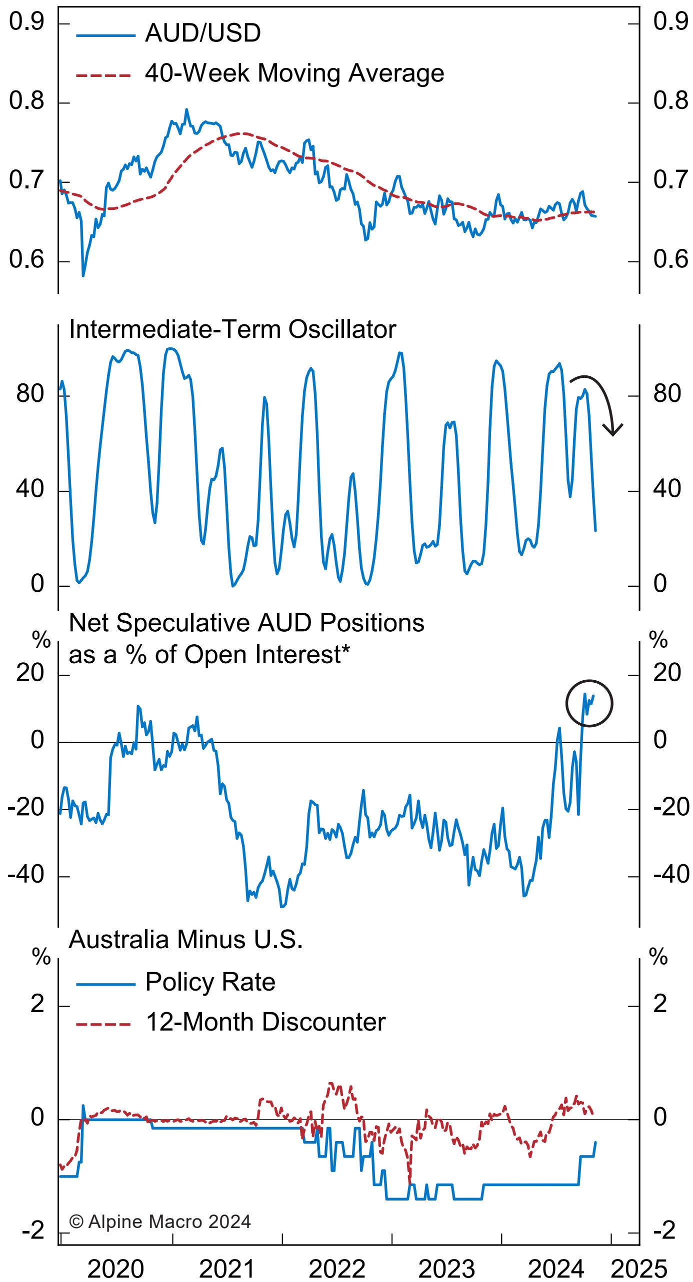




Our indicators point to upside risks. The intermediate-term oscillator is only near neutral and heading higher. Additionally, EUR/SEK is back above the 40-week moving average, which is also turning up.

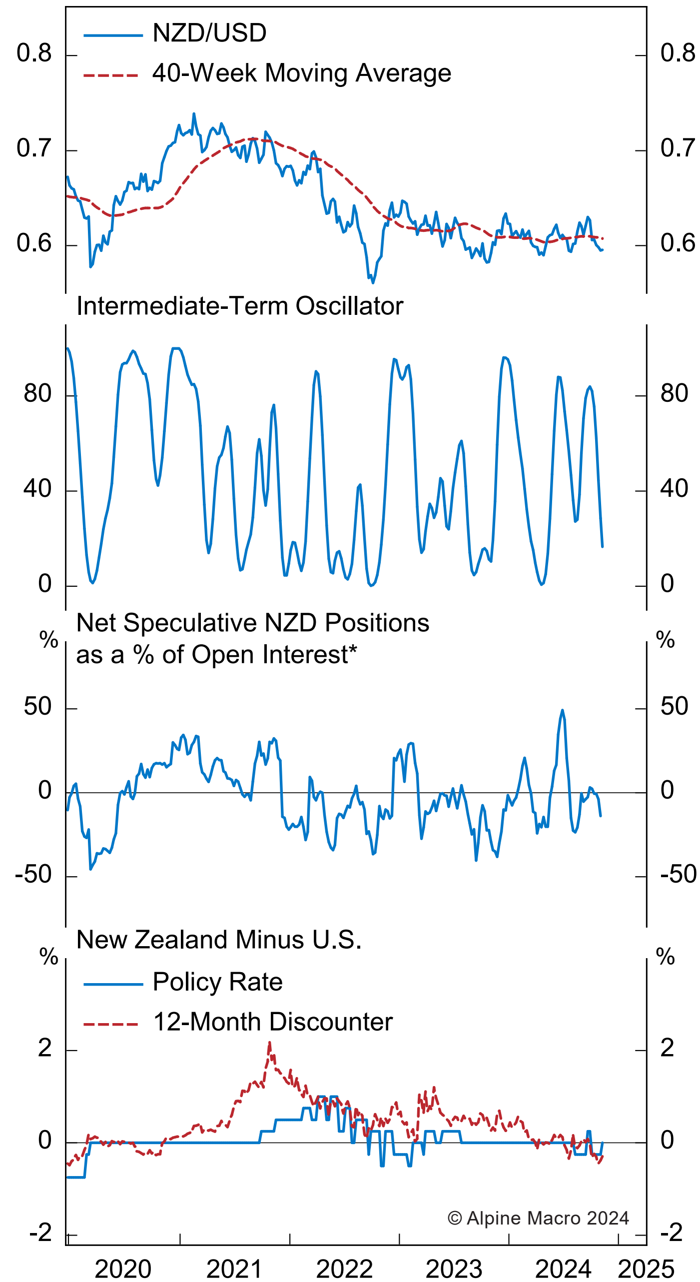
EUR/NOK has been gyrating around the flat 40-week moving average for the past year. Our intermediate-term oscillator is near neutral and trending lower. Expected yield differentials are bearish for the cross.

AUD/USD



*Source: Commodity Futures Trading Commission

NZD/USD

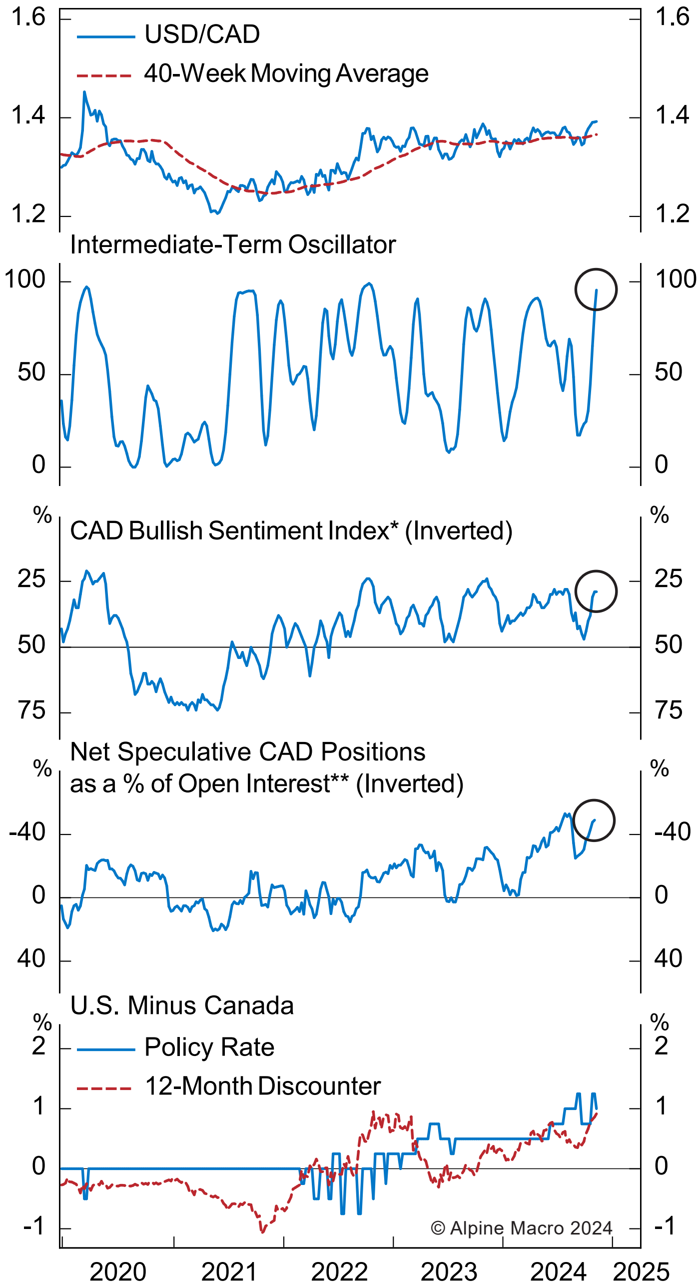


*Source: Commodity Futures Trading Commission

AUD/USD is breaking back below the 40-week moving average. Momentum is not deeply oversold yet and specs have been caught "long and wrong".

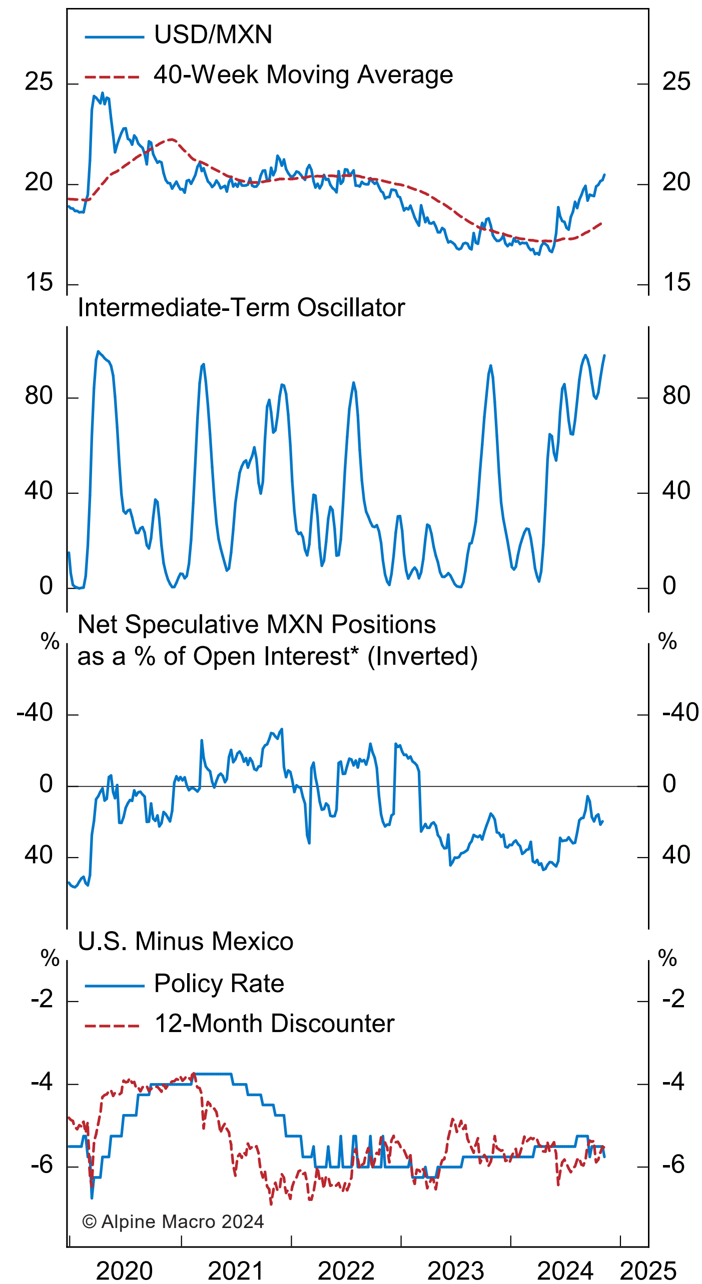
The Kiwi has failed to hold above the 40-week moving average, but our intermediate-term oscillator is close to becoming oversold.

USD/CAD



*Source: Consensus-inc.com
**Source: Commodity Futures Trading Commission

USD/MXN



*Source: Commodity Futures Trading Commission

USD/CAD is ripe for a downside retracement. Momentum is overbought, while sentiment and positioning are excessively negative towards the CAD.

The intermediate-term oscillator is overbought and indicates that USD/MXN's sharp rally is due for a pause. But from a cyclical perspective, the powerful break above the 40-week moving average suggests that a primary uptrend is underway.

Currency Outlook

Vs THE DOLLAR	1-3 Months	9-12 Months
EUR	FLAT	~~FLAT~~ DOWN
JPY	FLAT	UP
GBP	FLAT	~~FLAT~~ DOWN
CHF	FLAT	FLAT
CAD	~~DOWN~~ FLAT	~~FLAT~~ DOWN
AUD	FLAT	~~FLAT~~ DOWN
NZD	FLAT	~~FLAT~~ DOWN

Vs THE EURO	1-3 Months	9-12 Months
JPY	UP	UP
GBP	UP	UP
CHF	UP	UP
SEK	FLAT	UP
NOK	FLAT	UP

Fixed-Income Outlook

OVERALL PORTFOLIO DURATION

AT BENCHMARK

COUNTRY ALLOCATION*

U.S.	3
Japan	1
Eurozone	4
Core	5
Periphery	2
U.K.	~~3~~ 2
Switzerland	2
Norway	~~2~~ 4
Sweden	3
Canada	~~4~~ 3
Australia	4

* Numbers denote allocation where 1 = maximum underweight and 5 = maximum overweight

Currency Positions

Recommendations	Open Date	Open Level	Target	Stop	P&L Spot	P&L Carry	P&L Total
Long AUD/NZD	2019-04-29	1.0574	1.2000	-	4.27%	-4.08%	0.18%
Long Gold	2022-03-04	1,928	-	-	33.57%	-	33.57%
Short EUR/JPY	2024-11-08	165.17	-	Rolling -3%	0.44%	-0.06%	0.38%
Short EUR/GBP	2024-11-08	0.8318	-	Rolling -3%	0.05%	0.03%	0.08%
Short EUR/AUD	2024-11-08	1.6172	-	Rolling -3%	-0.79%	0.03%	-0.76%

Fixed Income Positions

Recommendations	Open Date	Open Level	Target	Stop	P&L
Long 2-Year/Short 10-Year U.S. Treasuries	2022-12-02	4.24%/3.51%	-	-	85.76 bps

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