ALPINEMACRO
A Unique Mind On The Markets

# U.S. THEMES & STRATEGY

December 16, 2024

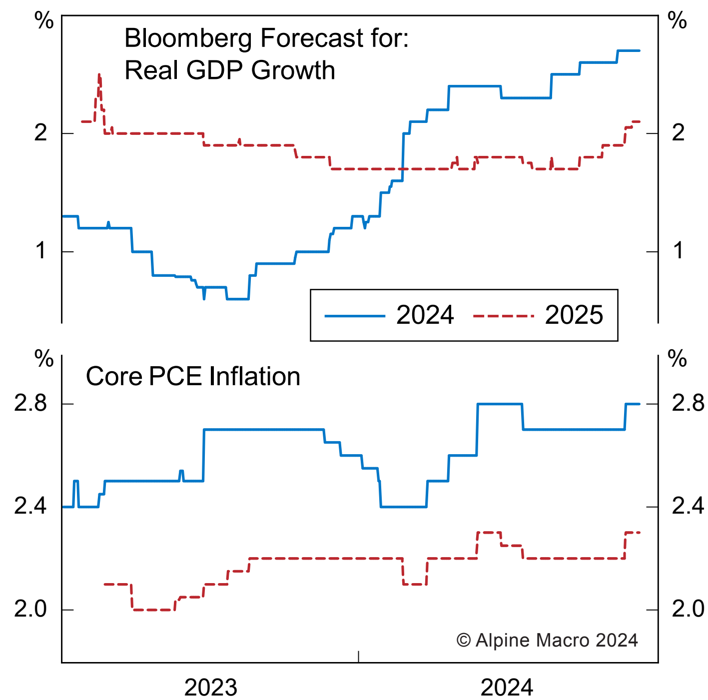
# Asymmetric Risks

- For more than a year, our baseline outlook has been for “macro calm”. The difference now is that consensus forecasts and capital market prices increasingly reflect this scenario.
- Upside growth surprises are more likely than a recession in 2025.
- Risk assets could spend much of 2025 H1 consolidating earlier gains. Equity volatility has bottomed. Big Tech remains a mania candidate. Banks, domestic cyclicals and small caps will play catchup.
- Underlying trend in 10-year government bond yields is flat. Increase duration if yields approach 5% and reduce duration if yields drop below 4%.
- The buying frenzy in corporate bonds has left both IG and HY unattractive, even though they normally benefit from “macro calm”.

For quite some time, Alpine Macro has had the view that the U.S. economy would have a perfect macro landing, consisting of 1-2% growth, 1-2% inflation and Fed rate cuts. Looking backward, this backdrop has been favorable for risk assets.

The dilemma for investors right now is that this view is increasingly reflected in forecasts and capital market prices. **Chart 1** shows that the Bloomberg consensus 2025 forecasts for economic growth and inflation are both slightly above 2%.

**Chart 1** "Macro Calm" Consensus




Consistent with expected “macro calm”, risky assets have gotten steadily more expensive and government bond volatility has dropped to a 3-year low (**Chart 2**). More ominously, the 12-month ahead policy rate and 10-year Treasury yield have bounced sharply from their lows as economic expectations improve and the inflation downtrend has been thrown into question by recent CPI data releases.

**Chart 2** Priced For Macro Perfection?

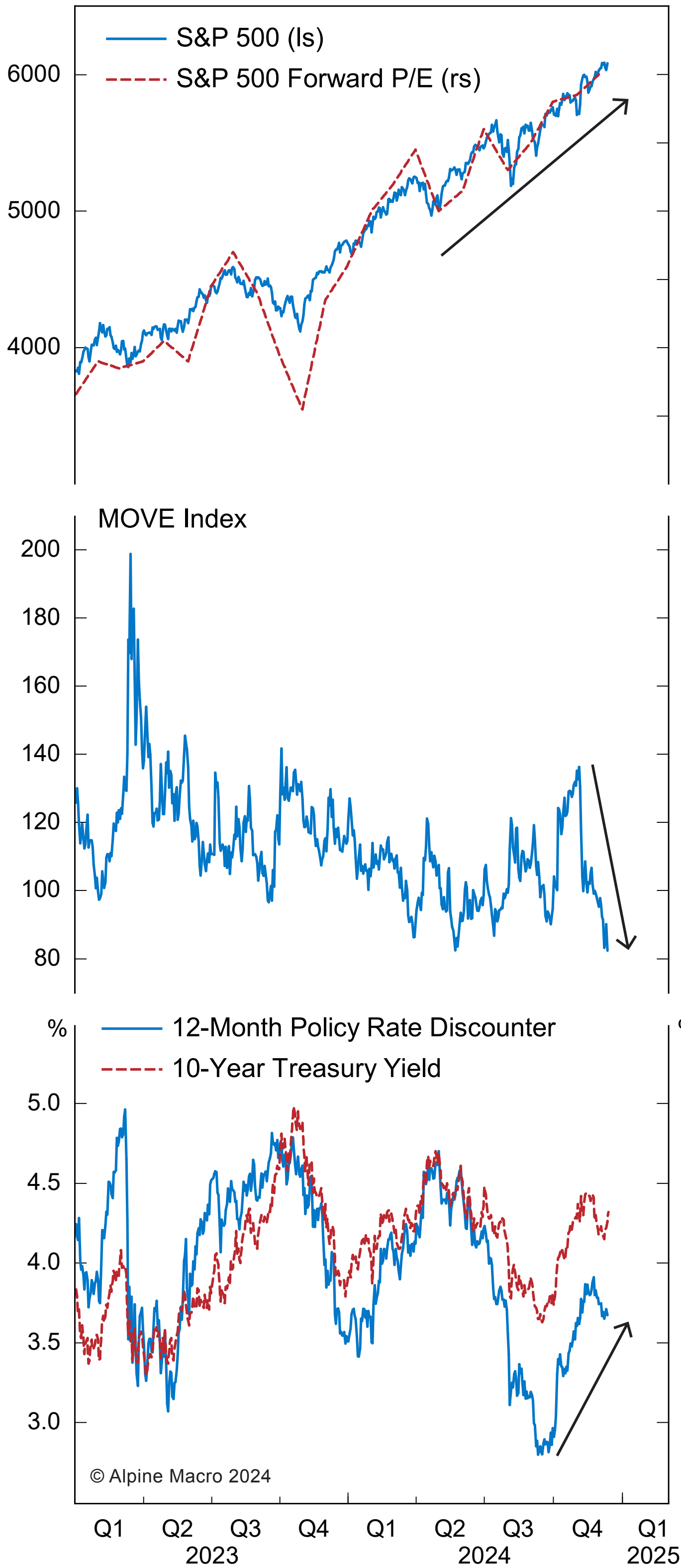
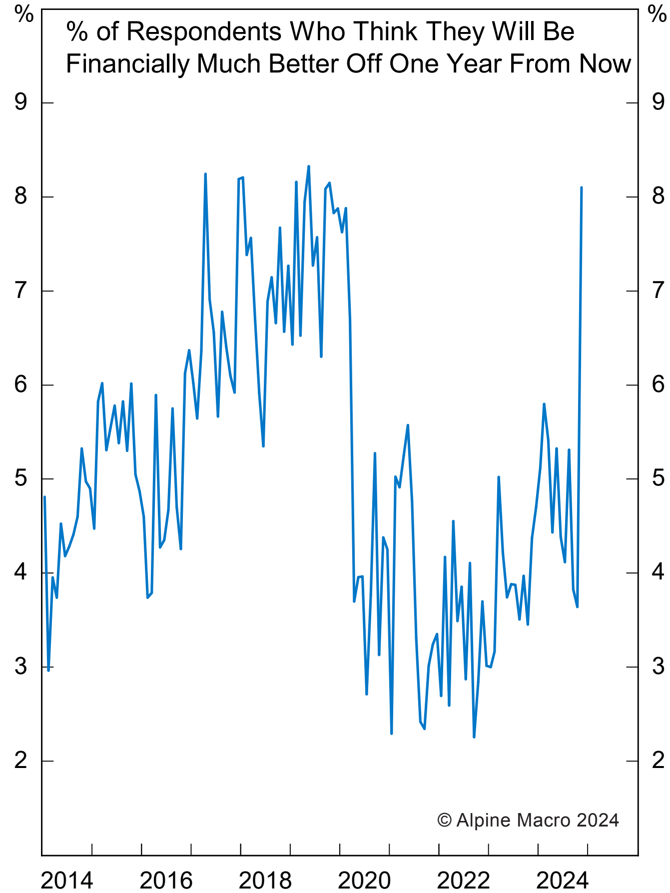



**Chart 3** Trump Bump For Consumers




Source: New York Fed

What does this mean for strategy? Risk assets will benefit further if our baseline scenario plays out. But a digestion phase is probable given investor complacency and the late stage of the Fed easing cycle.

We also believe that the risks to "macro calm" are on the side of too much, rather than too little, growth. Moreover, the Republican sweep and "Trump bump" to confidence further reduce the odds of economic contraction in 2025. That warrants an underlying bias towards overweighting equities versus bonds and cash.

## Theme 1
## Asymmetric Risks

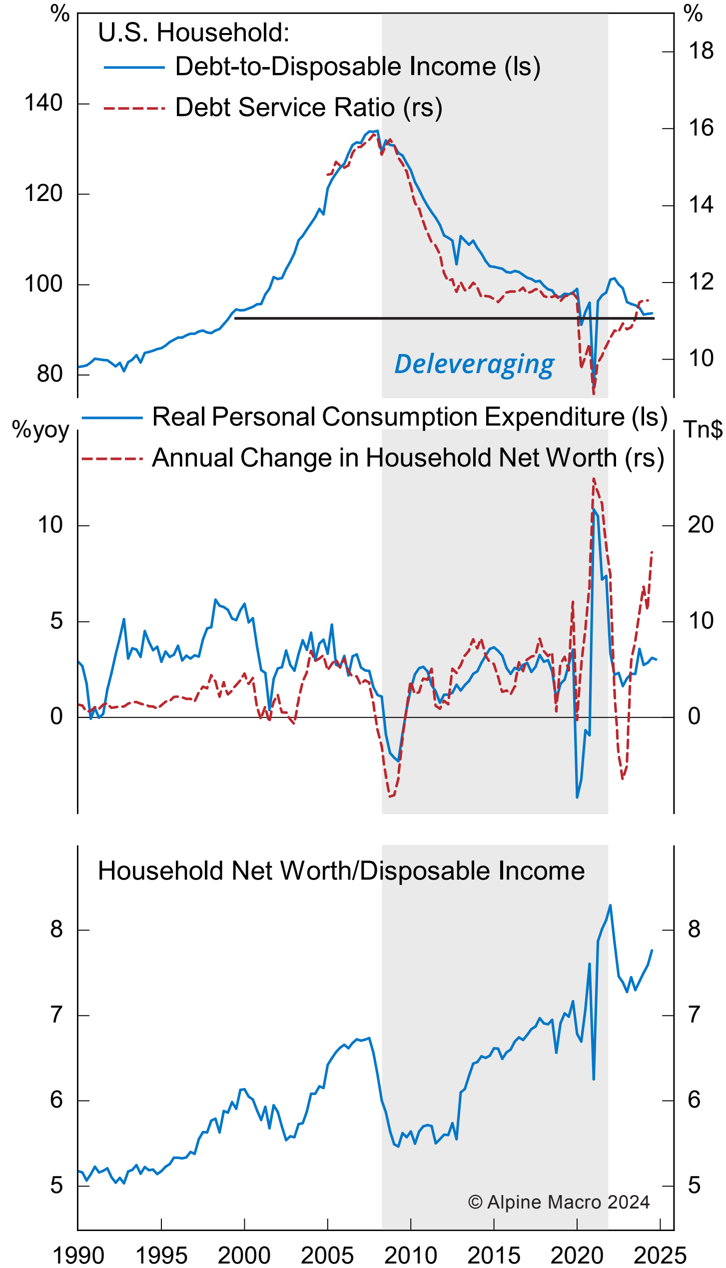
As argued in recent *U.S. Themes & Strategy* reports, most of our indicators are consistent with roughly 2% economic growth over the next 6-12 months, including leading macro variables, capital market trends and the financial aggregates. However, the risks are not equally balanced on either side of this outlook. Rather, five factors warn that growth is more likely to surprise to the upside rather than the downside:

- **"Trump bump" and consumer health:** Chart 3 shows that consumer expectations of their financial situation had another upleg after the November elections. Survey responses massively diverge between Republican and Democrat voters, but the overall backdrop is clean household balance sheets and rising net worth relative to incomes (Chart 4). Consumers have room to take on debt, although they have chosen not to, with memories of the subprime and Global Financial crises still fresh.

- **Moderate fiscal stimulus:** Our *Geopolitical Strategy* service has argued that budget plans are much less clear than would be expected given the election result, owing to the fiscal conservatism of many Congressional Republicans and incoming Treasury Secretary Scott Bessent.[1] What we can say is that President Trump's proposals call for a steeper public debt increase than the CBO forecast (Chart 5). Moderate fiscal stimulus on the order of 0.5% of GDP in 2025 is a reasonable starting point that would benefit the economy without unnerving the bond market.

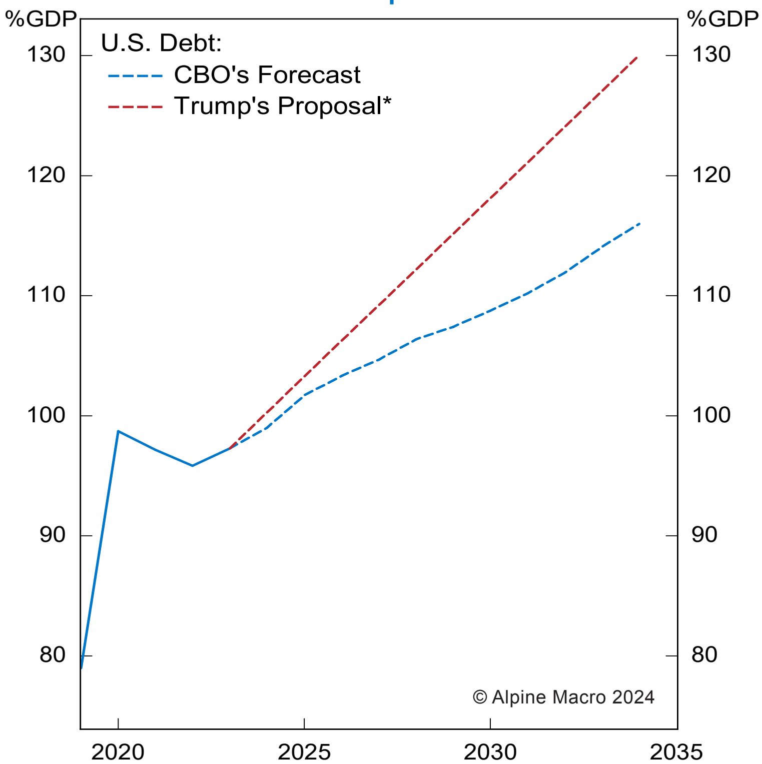
1 Alpine Macro *Geopolitical Strategy* "Geopolitical Outlook 2025: Risks, Opportunities, And Surprises" (December 12, 2024).

**Chart 4** Consumer: Rising Wealth And Clean Balance Sheets



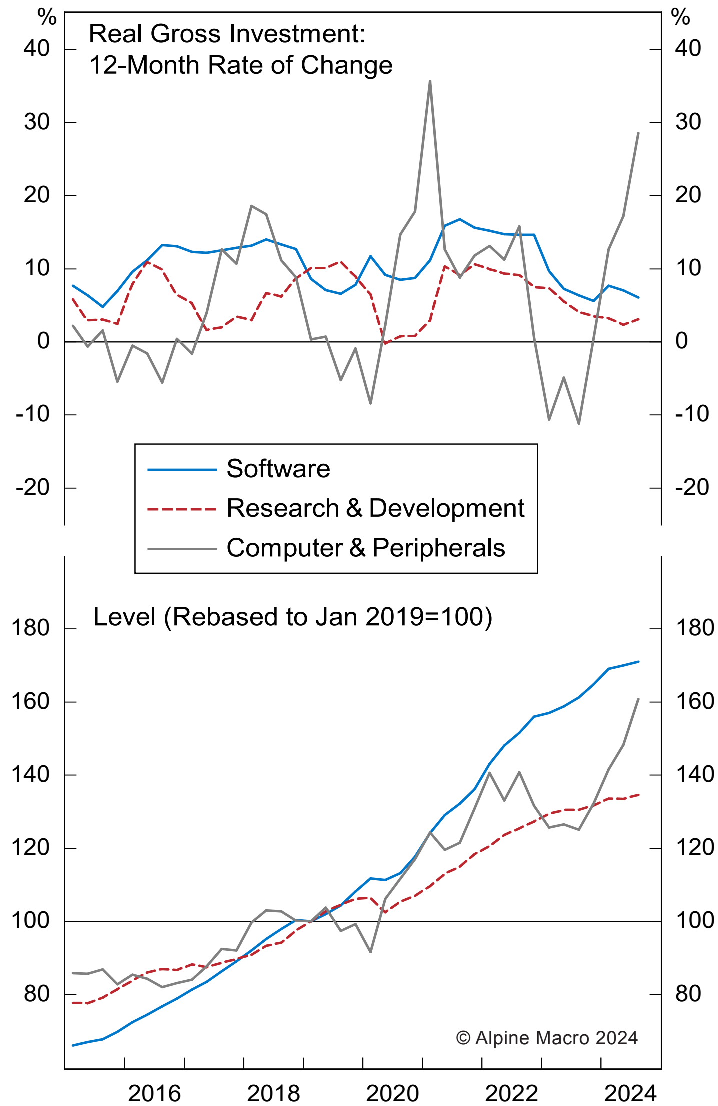

- **Rotating recession:** Information technology and manufacturing already went into recession in 2022/23, driven by Fed tightening and a burst of unanticipated inflation when the Covid-19

**Chart 5** Moderate Fiscal Stimulus Likely Under Trump



*Penn Wharton Budget Model estimate

**Chart 6** AI And Data Center Tech Spending Boom



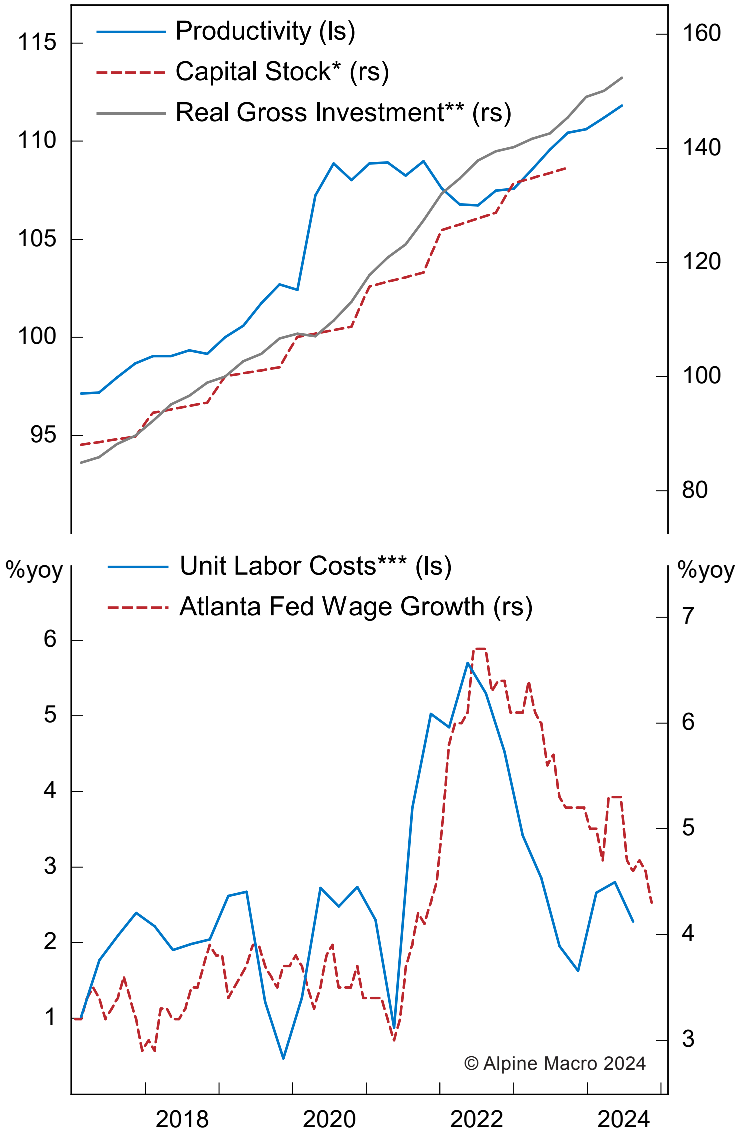

pandemic abated. Renewed contraction in either of these sectors is unlikely in 2025, barring a shock "out of nowhere", especially given that the Fed has been easing.

- **Supply-side reforms:** Trump agenda initiatives to cut corporate taxes, deregulate and eliminate government waste all have the potential to boost the ability of the private sector to produce more without generating inflation pressures. The magnitude of the benefit is much less certain but the direction is positive.

- **Tech-driven productivity rebound:** Capex related to AI and data centres is surging (**Chart 6**). Even if the benefits are smaller than Big Tech firms anticipate, it will sustain underlying productivity at a steeper rate than prior to the pandemic (**Chart 7**, top panel). Some of the gains will be labor-saving, while others will improve the performance of existing workers. Either way, the corporate sector will benefit.

Even if economic growth surprises to the upside, inflation is much more likely to stay subdued than surge *à-la*-2021/22. Productivity gains will sustain the wedge between wage growth and unit labor

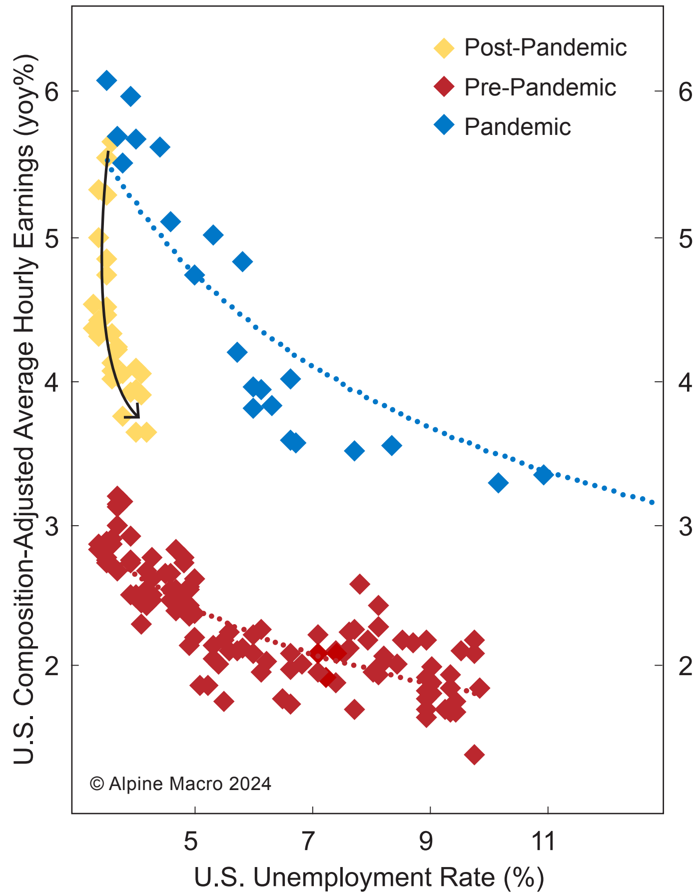
**Chart 7** **Productivity Up, ULC Growth Down**




*Average capital stock level of software, computer & peripherals, communication equipment, semiconductor
**Investment in software, R&D, computers & peripherals
Note: All series in top panel are rebased to Q1 2019=100
***Shown as 2-quarter moving average

costs (**Chart 7**, bottom panel). That increases the chances that the Phillips Curve will fully mean revert to the pre-pandemic tradeoff between wages and unemployment, especially with the prime-age labor force participation rate above its pre-pandemic high (**Chart 8**).

**Chart 8** **Will Phillips Curve Fully Mean Revert?**

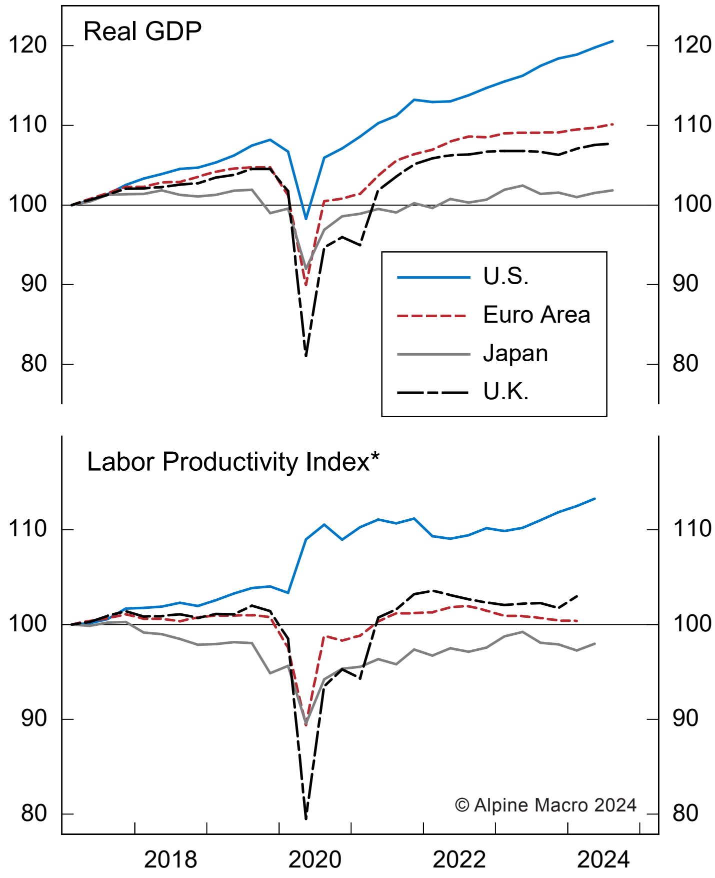



Note: Red data = 2010 Jan - 2020 March, Blue data = 2020 April = 2022 March, Yellow data = 2022 April - Now

In addition, self-regulating markets reduce U.S. domestic inflation risks.[2] Put another way, the flipside of U.S. economic exceptionalism is a lack of demand in the rest of the world. **Chart 9** shows that relative GDP trends since 2020 have tracked relative labor productivity, as would be expected. The U.S. is far outperforming the euro area, Japan and U.K. over this period. Moreover, upward pressure on China's current account and private savings also increases the role of the U.S.

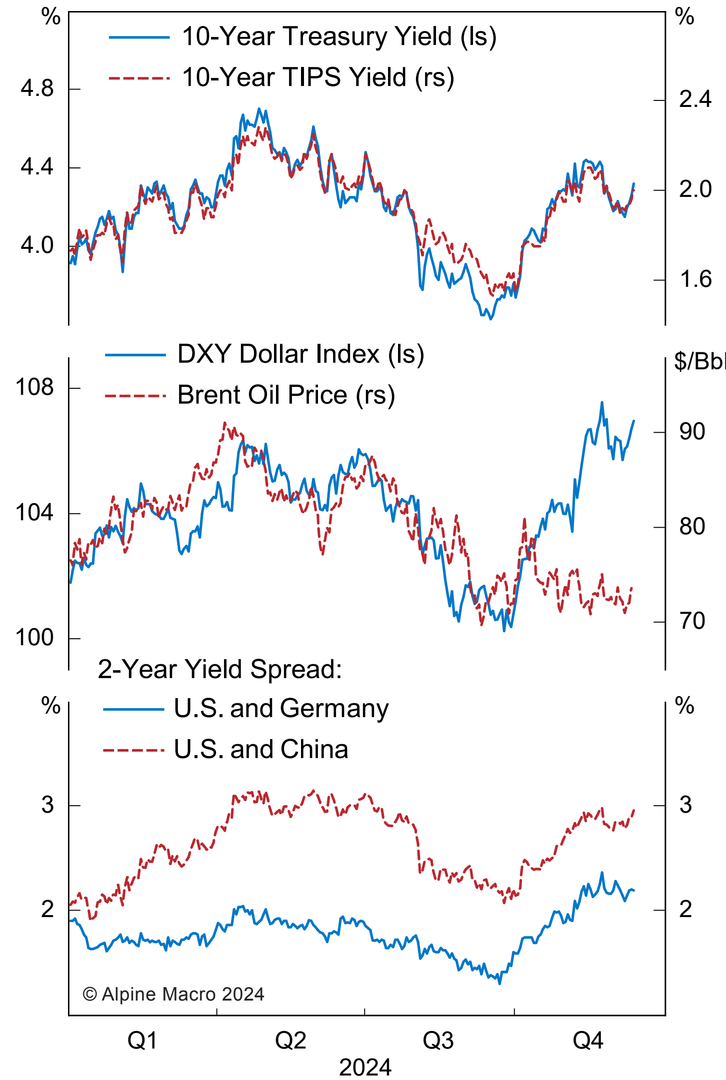
2 Alpine Macro *U.S. Themes & Strategy* "Self-Regulating Markets And The Trump Factor" (November 25, 2024).

**Chart 9** U.S. Exceptionalism...




*Source: OECD
Note: All series are rebased to Q1 2017=100

**Chart 10** ...Is Self-Regulating




consumer as "spender of last resort". Until this changes, any increase in U.S. economic strength (or tariffs) will boost the dollar, but not commodity prices, including oil (**Chart 10**). The latter are sensitive to Chinese demand, which is soft, and U.S. output, which is hitting new highs.

**Bottom line:** 2% growth and 2% inflation remain a reasonable forecast for 2025. But risks are skewed on the side of stronger-than-expected growth and away from recession. Even if growth surprises to the upside, inflation will not rebound sufficiently to force the Fed to take back earlier rate cuts.

## Theme 2

### Play The Treasury Range, Avoid Corporates

Low macro volatility points to a continuation of low fixed income volatility, because there is no need for major Fed action in either direction. "Play the range" is a compelling strategy for Treasurys. Corporate bonds are a different story altogether.[3]

3 Alpine Macro *U.S. Bond Strategy* "U.S. Bond Strategy For 2025 (Part II)" (December 12, 2024).

**Chart 11** Flat Bond Trend Without Major Drivers

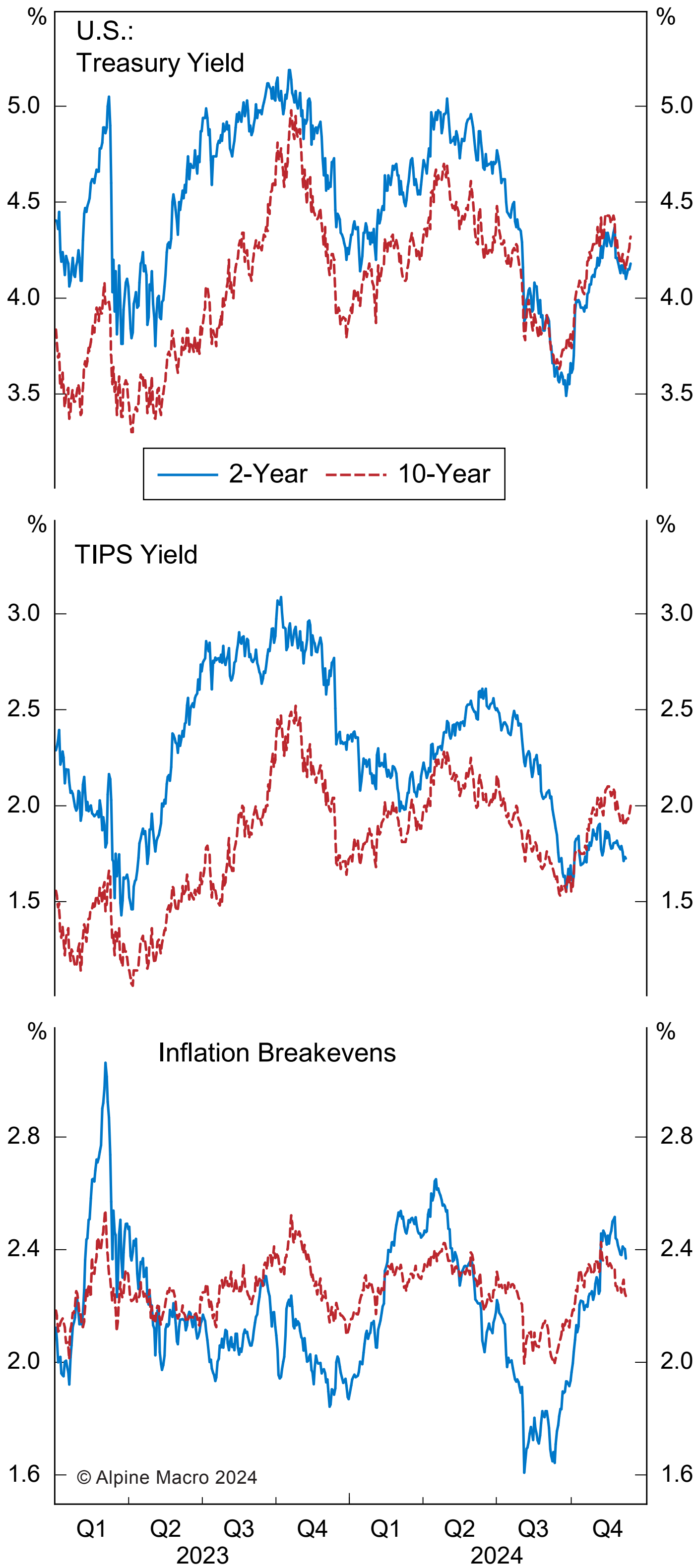



**Chart 12** Real Yields Only Have Upside If Economy Accelerates

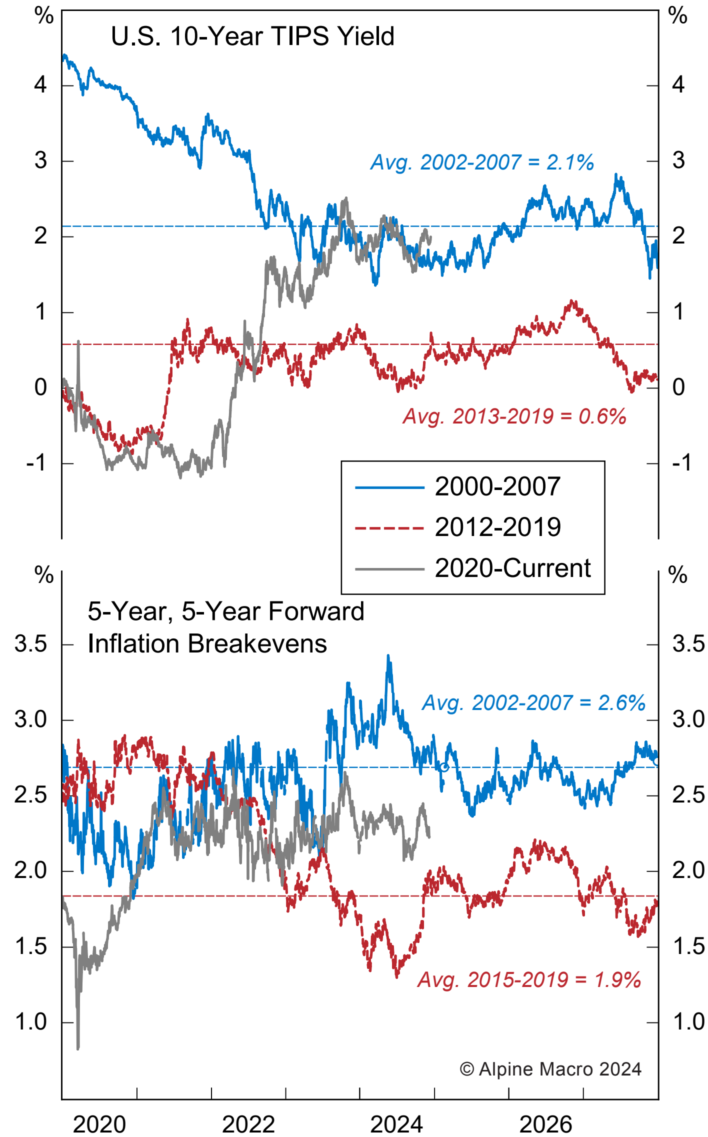
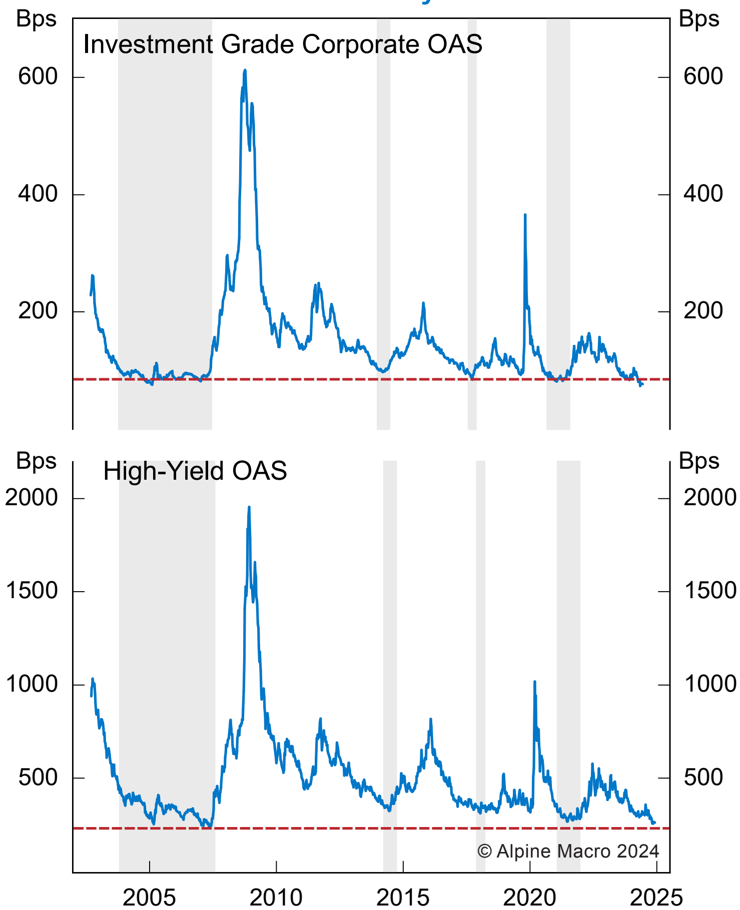


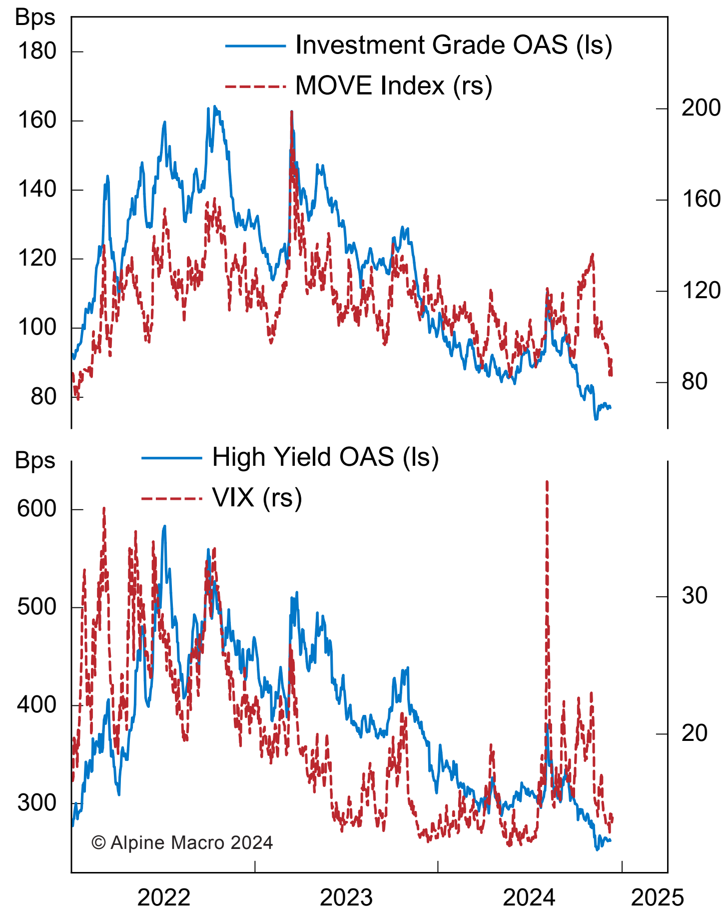

**Chart 11** shows a risk-free interest rate market without major drivers, as would be expected in a perfect macro landing environment. The yield curve is roughly flat, with the current 10-year/2-year spread only 14 basis points. Both the real and inflation breakeven components of 10-year and 2-year yields are within the well-defined ranges of the past two years, following the "technical recession" and transitory inflation surge of 2022. The

**Chart 13** Corporate Bonds Entering Bubble Territory




Note: Shaded area denotes periods of secular low corporate spreads; source: Bloomberg Finance L.P.

**Chart 14** Corporate Bond Buying Frenzy




Source: Bloomberg Finance L.P.

rise in TIPS yields has accounted for slightly more of the recent selloff than inflation breakevens. That would continue to be the case under our "upside growth surprise" asymmetric risk that could push 10-year Treasurys as high as 5%.

Still, a sizable shock would be necessary to push TIPS yields and/or inflation breakevens outside their recent ranges. **Chart 12** shows that 10-year TIPS yields already are close to the 2.1% average that prevailed in the five years before the Global Financial Crisis (GFC). They are 140 bps above the post-GFC/pre-pandemic average of 0.6%, but that period was marked by sustained consumer deleveraging that has run its course. Meanwhile, 5-year/5-year forward inflation breakevens of 2.2% are exactly between the pre- and post-GFC experiences.

As for corporate bonds, the good news is that we do not expect a recession, which has traditionally been the trigger for violent spread widening by an average of 370 bps and 1,082 bps, for investment grade (IG) and high-yield (HY) corporates, respectively (**Chart 13**). The bad news is that corporate bond spreads leave no room for negative surprises, and may be too tight to benefit further from low macro volatility.

Another perspective that yields the same conclusion involves comparing IG and HY spreads with the implied volatilities that correlate most closely with them (Chart 14). Less risky IG spreads correlate with government bond volatility, which has been falling, but IG spreads have tightened by more than the correlation would predict. Likewise, riskier HY spreads correlate with equity volatility, which also has fallen. However, HY spreads have tightened by even more and we believe the VIX has bottomed.

**Bottom line:** Underlying trend in long-term government bonds is flat. Buy towards 5% and sell towards 4% for 10-year yields. All the macro good news already is reflected in corporate bond spreads, with no margin for negative surprises.

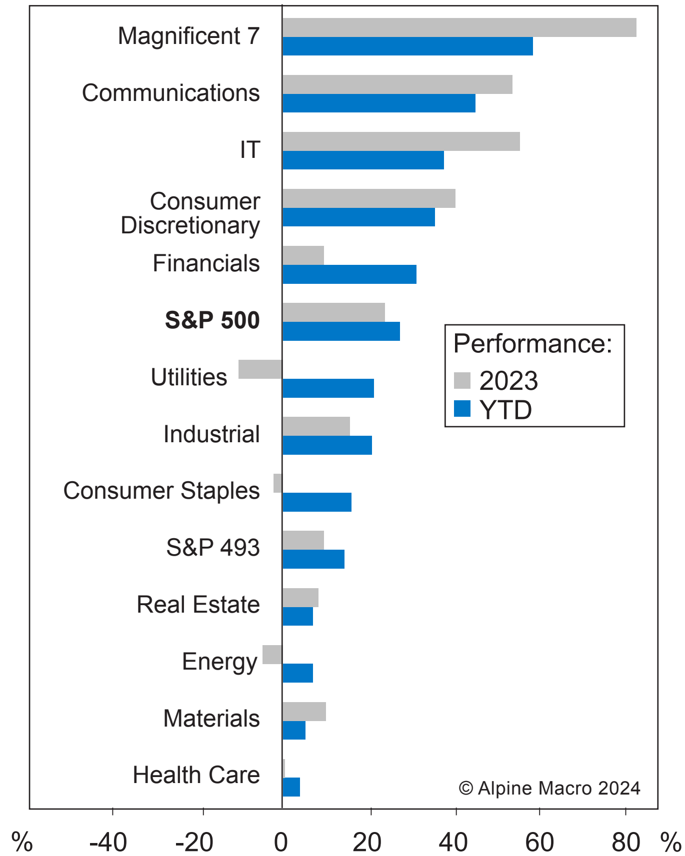
## Theme 3

### Generating Equity Alpha

In contrast with government bonds, equity volatility likely has bottomed, despite the outlook for "macro calm", given rich valuations. At a minimum, a consolidation phase is probable after recent outsized gains in anticipation of the Trump agenda, even before his inauguration next month. Numerous market-positioning and sentiment indicators are at overbought extremes. Under the surface, however, intra-equity shifts are taking shape that should generate alpha in 2025.

There have been significant cycles within the equity market in 2024, but it is helpful to step back and compare performance of various equity components with 2023. Chart 15 shows that the Mag 7 stocks have outperformed every S&P 500 equity sector in both years. Overall, the Mag 7

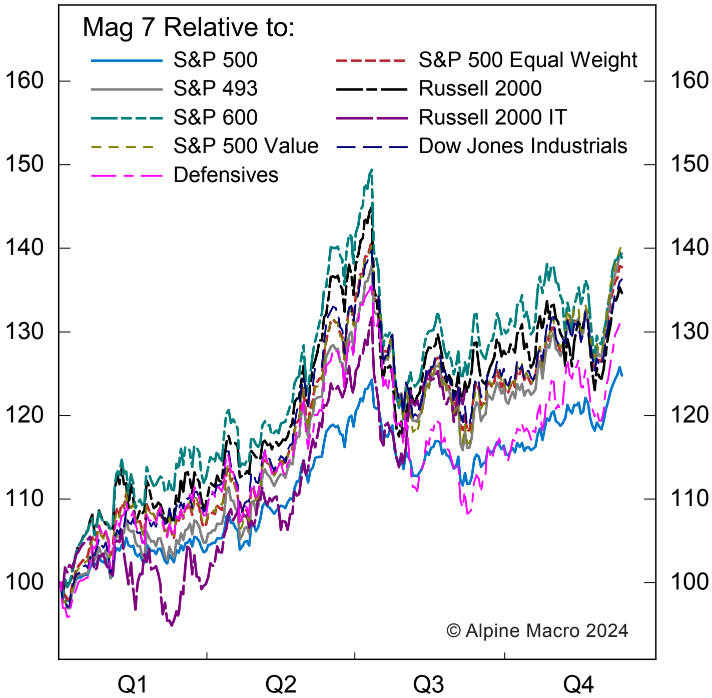
**Chart 15** Alpha And Timing Will Be At Least As Important As Beta For Equity Strategy




have outperformed the rest of the S&P 500 ("S&P 493") by 75 and 45 percentage points in 2023 and 2024, respectively. Chart 16 shows that the Mag 7 still have not reached the "panic buying" relative performance peaks of July versus a wide range of equity segments. However, the outperformance has started to accelerate since U.S. elections as fears of tech regulation abate.

We continue to believe that these Big Tech stocks satisfy all the classic conditions for a mania-like overshoot, but the extent and ultimate top in bubbles are by their nature impossible to predict. On a risk/reward basis, there are better places to put fresh money to work.

**Chart 16** Big Tech Still Has Mania Potential




Note: All series are rebased to Jan 2024=100

At the top of our list are domestic cyclicals, regional banks and small caps, all of which should benefit from a buoyant U.S. economy that does not require Fed rate hikes.[4] **Chart 17** shows that these three segments have formed major bottoms relative to the S&P 500 at different times in the past two years. Moreover, they are in clear uptrends versus the S&P 493. All three remain relatively cheap *vis-à-vis* the broad market.

**Bottom line:** Equity volatility is forming a broad bottom in the face of rich valuations and excessive optimism. Big Tech remains a mania candidate, but the risk/reward tradeoff is more compelling in domestic cyclicals, regional banks and small caps.

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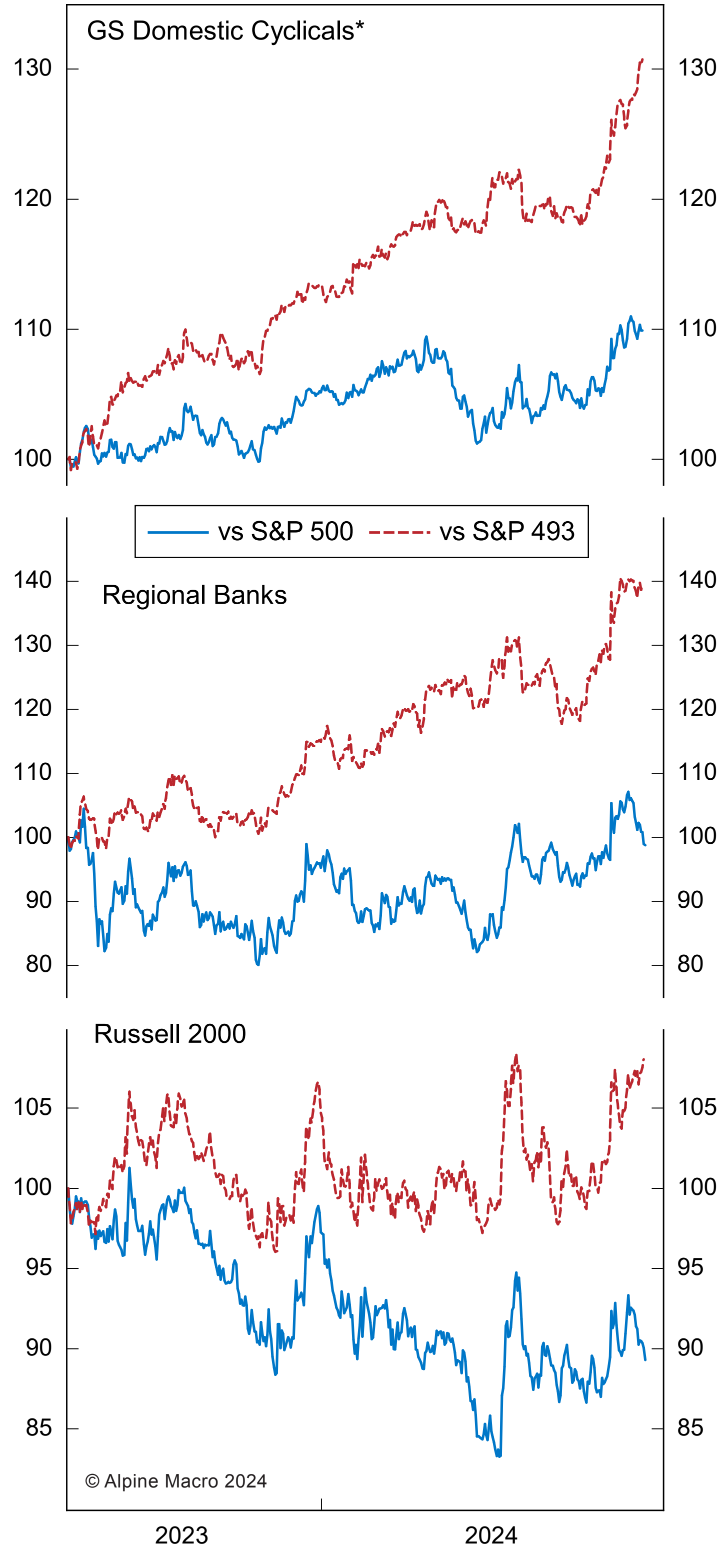
4 Alpine Macro *Equity Strategy* "Four For '25: Equity Outlook Positioning" (December 11, 2024).

**Chart 17** Selected Equity Winners




*Source: Bloomberg Finance L.P., Goldman Sachs
Note: All series are rebased to April 2023=100

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