ALPINEMACRO
A Unique Mind On The Markets

GLOBAL FIXED INCOME & CURRENCY STRATEGY

November 8, 2024

A Clean Sweep?

- A Republican clean sweep will lead to easier U.S. fiscal policy, which should mean fewer rate cuts by the Fed.

- The post-election rise in Treasury yields does not reflect a loss of investor confidence. Yields are rising on stronger U.S. growth expectations.

- With a stronger economy and less easing by the Fed, the steady state for 10-year Treasuries could be near 4.25-4.5%. Investors should hold off on increasing duration.

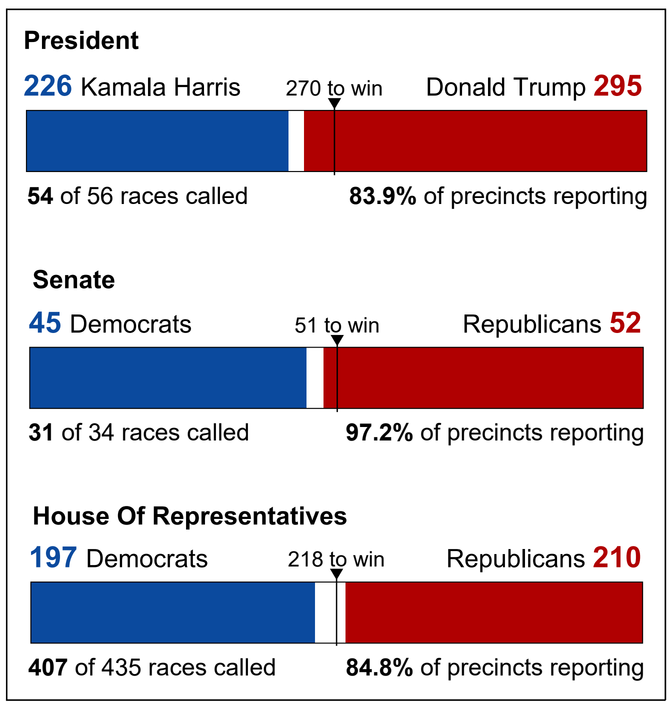
- The fiscal and monetary policy mix will become more supportive for the dollar. We are shifting our long JPY, GBP, and AUD positions from against the dollar to the euro.

Hmm very different from MRB's findings

The U.S. election results represent a significant development that will impact global fixed income and currency managers. Not only did Trump win back the White House, but the Republicans took control of the Senate and could also hold on to their majority in the House of Representatives. In other words, the Republicans are looking at a potential "clean sweep" (**Chart 1**).

Our baseline view had been a split government. For months, our *Geopolitical Strategy* service argued that the odds were tilted in favor of Trump winning the presidency. However, we felt that Congress would

Chart 1 **Will It Be A Clean Sweep?**



Source: Financial Times

be split, with the Senate flipping to the Republicans and the House to the Democrats. A split government would have checked Trump's legislative ambitions, including on fiscal policy.

If the Republicans gain full control of Congress, Trump will be in a stronger position to push his economic policies forward. At minimum, it would mean that the 2018 tax cuts that are scheduled to expire at the end of next year will be extended.

Trump campaigned on cutting taxes further. He wants to reduce the corporate tax rate from 21% to 15%. Additionally, he is offering tax breaks to individuals, such as exempting tips, overtime, and social security benefits from income tax and removing the cap on state and local tax (SALT) deductions.

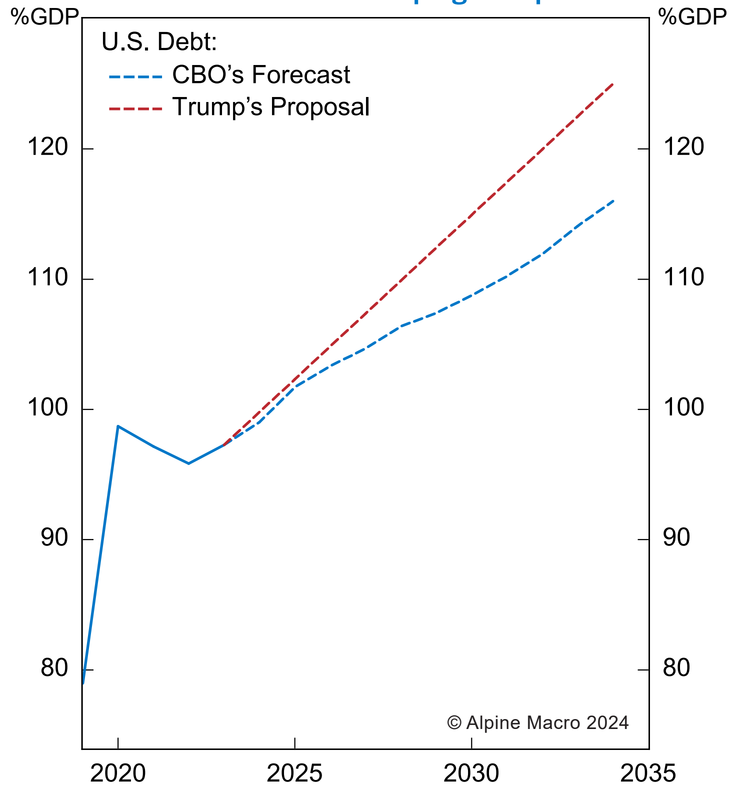
Potential spending cuts and increased government revenue from higher import tariffs will not be enough to offset the lower taxes that Trump is proposing. The Penn Wharton Budget Model suggests that Trump's campaign policy proposals would add almost 14 percentage points to the debt-to-GDP ratio over the next decade (**Chart 2**).

Our *Geopolitical Strategy* team highly doubts that Trump will be able to get *all* his proposals through Congress, even if the Republicans control both chambers.[1] Nevertheless, there will still be some easing of fiscal policy as some of Trump's policies will be adopted.

At this stage, it is impossible to quantify what the fiscal thrust could be. The final composition of Congress is still unknown and Trump still has to put together his economic team. Surely, his advisors will nix the unfeasible proposals that Trump had put forward during the campaign.

1 Alpine Macro *Geopolitical Strategy Special Report* "United States: Trump's Comeback – Brace For Headlines, Expect Policy Surprises" (November 7, 2024).

Chart 2 Will Trump Follow Through With His Campaign Proposals?

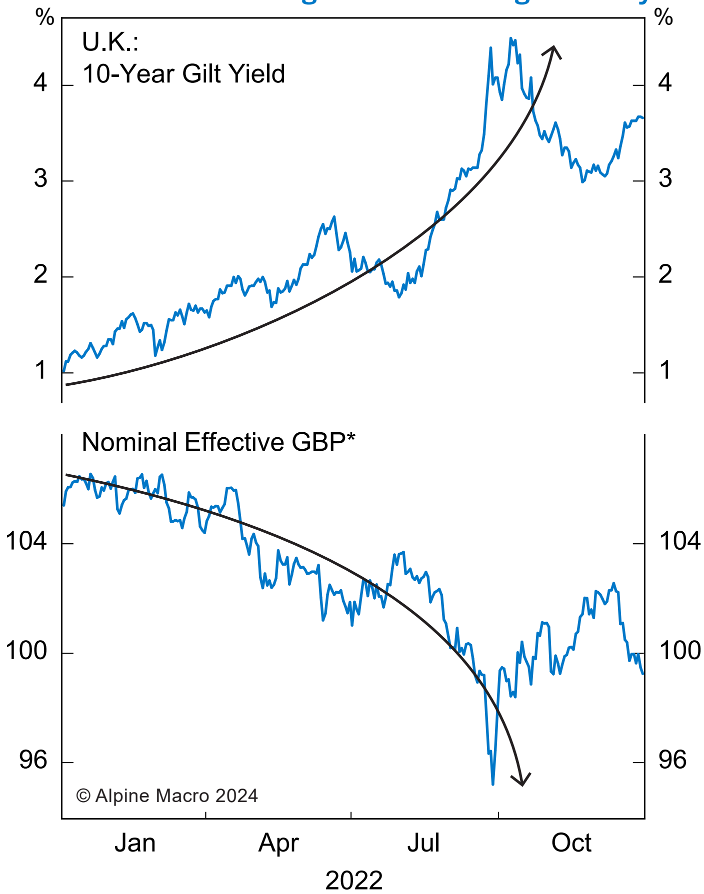


Moreover, any new fiscal stimulus may not hit the economy until 2026. It will take time to put a package together and pass it through Congress. Any tax cuts that are passed in mid-2025 will probably only come into effect in 2026.

Of course, financial markets are inherently forward-looking. Even if the new stimulus is more than a year away, investors have reacted swiftly to the U.S. election. Stocks, bond yields, and the dollar have soared. Clearly, the markets view the election results as pro-growth.

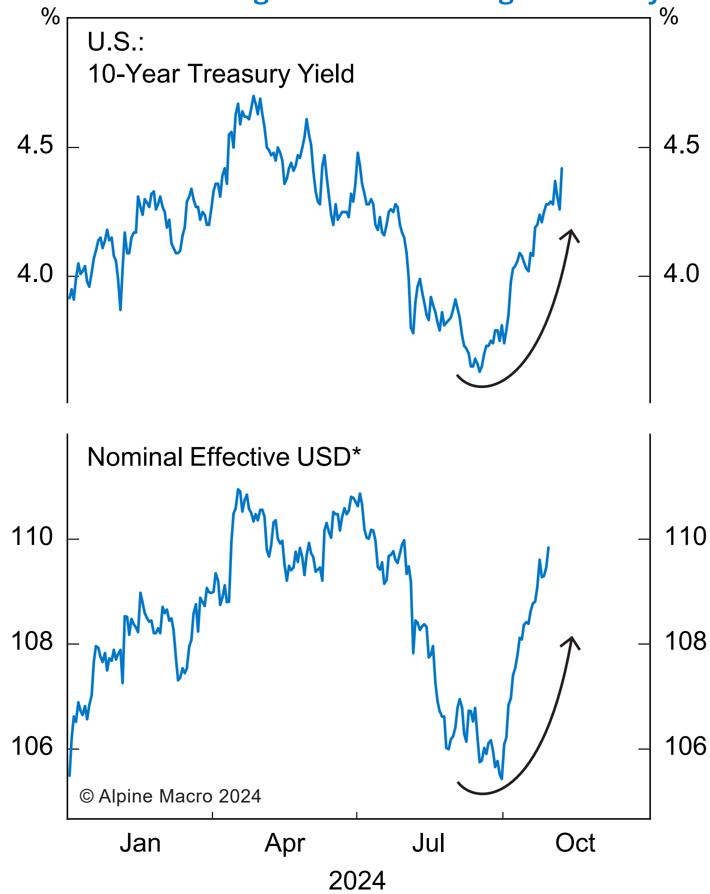
When it comes to Treasuries, we do not see the post-election rise in yields as signaling a loss of investor confidence. Comparisons with what

Chart 3 The Anatomy Of A Fiscal Crisis: Soaring Yields & Sinking Currency



*Source: BIS

Chart 4 No Signs Of A Fiscal Crisis Here: Higher Yields & Stronger Currency



*Source: BIS

happened in the U.K. in 2022 following Liz Truss' mini-budget are off the mark. As investors revolted against Truss' large unfunded tax cuts, Gilt yields snapped higher and sterling lurched lower (**Chart 3**).

In sharp contrast to the U.K.'s 2022 experience, the U.S. is witnessing higher yields and a stronger dollar (**Chart 4**). This is not a sign that foreign investors are dumping U.S. assets. Rather, higher Treasury yields are a reflection of stronger growth expectations, which are attracting *more* capital inflows and pushing up the dollar.

All this is to say that the potential for easier U.S. fiscal policy is impacting the Treasury market in a very traditional way. If fiscal policy loosens, there will be less need for the Fed to cut interest rates aggressively. Very simply, bond yields are undergoing upward pressure as rate cuts get priced out (**Chart 5**).

The dollar is also behaving in a typical textbook manner. As per the Mundell-Flemming framework, expectations of easier fiscal policy and fewer rate cuts by the Fed are giving a lift to the greenback.

In terms of investment implications, we had cut duration to neutral in early August and were looking for higher bond yields to go back to above-benchmark. Despite the 10-year yield getting up to

Chart 5 Occam's Razor: Bond Yields Are Up Because Less Fed Easing Is Expected

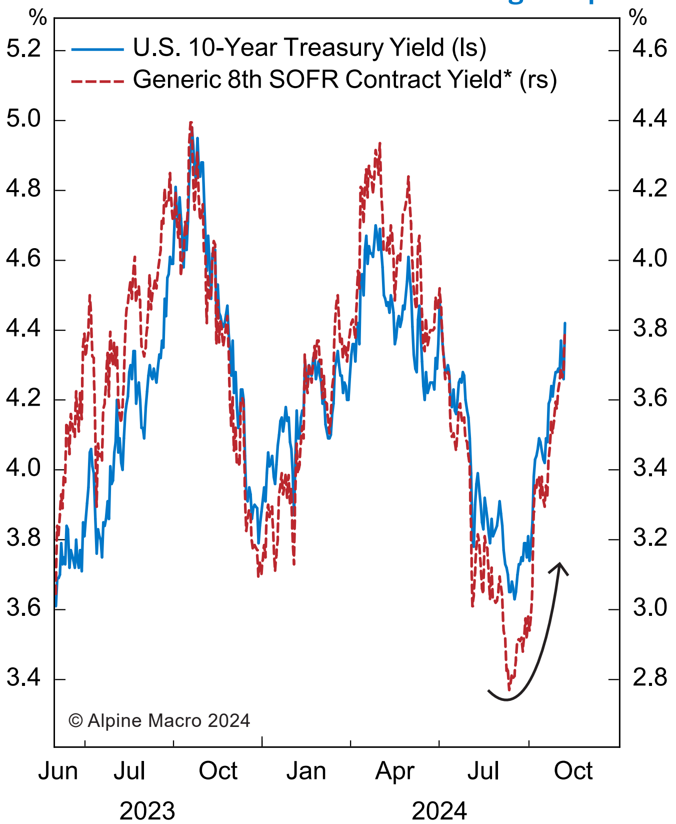
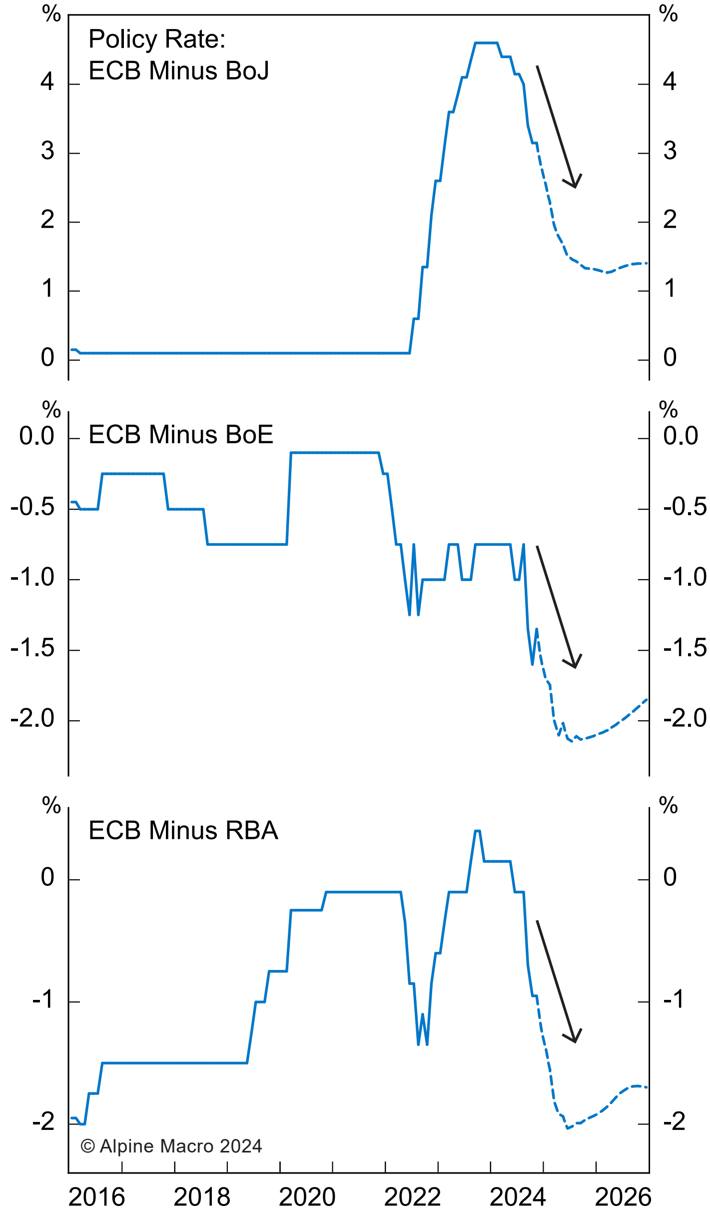


Chart 6 The ECB Will Be One Of The More Dovish Central Banks



Note: Dotted lines denote market expectations from OIS curves

4.5%, we believe it is prudent to keep duration at neutral for the time being. If fiscal policy becomes easier and supports the economy, the Fed will not need to move short-term interest rates below neutral.

Our *Global Strategy* service has argued that the nominal R-star for the U.S. economy may have risen to 3.75-4.0% after the pandemic.[2] Assuming a term premium of around 50bps, then the equilibrium for the 10-year Treasury should be 4.25-4.50%, which is roughly in line with the current yield. Therefore, while yields have risen, U.S. bonds may not be sufficiently attractive to boost duration just yet.

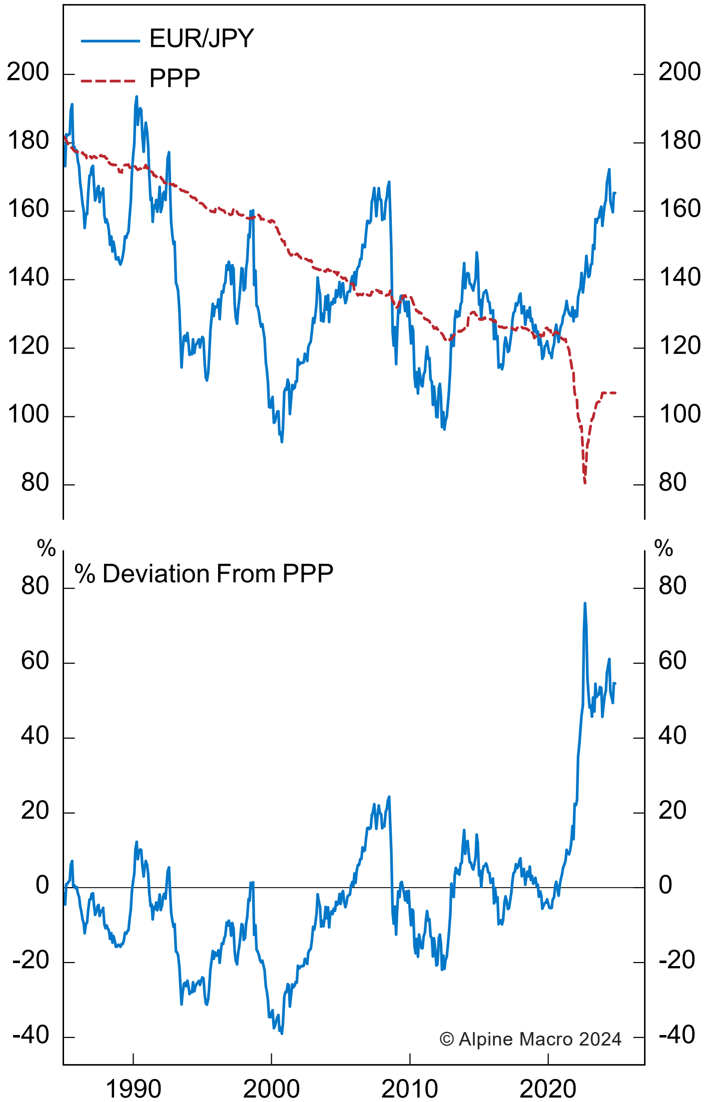
Less Fed easing should also keep the dollar supported. Most importantly, the growth gap between the U.S. and eurozone would widen if Trump eases fiscal policy. A more dovish outlook for the ECB versus the Fed should keep the euro on the defensive.

We are therefore shifting our long JPY, GBP, and AUD positions from against the dollar to the euro. All three central banks should be less dovish than the ECB (Chart 6):

We have the opposite positioning as of rn (EUR/USD). But the same long GBP/EUR positioning

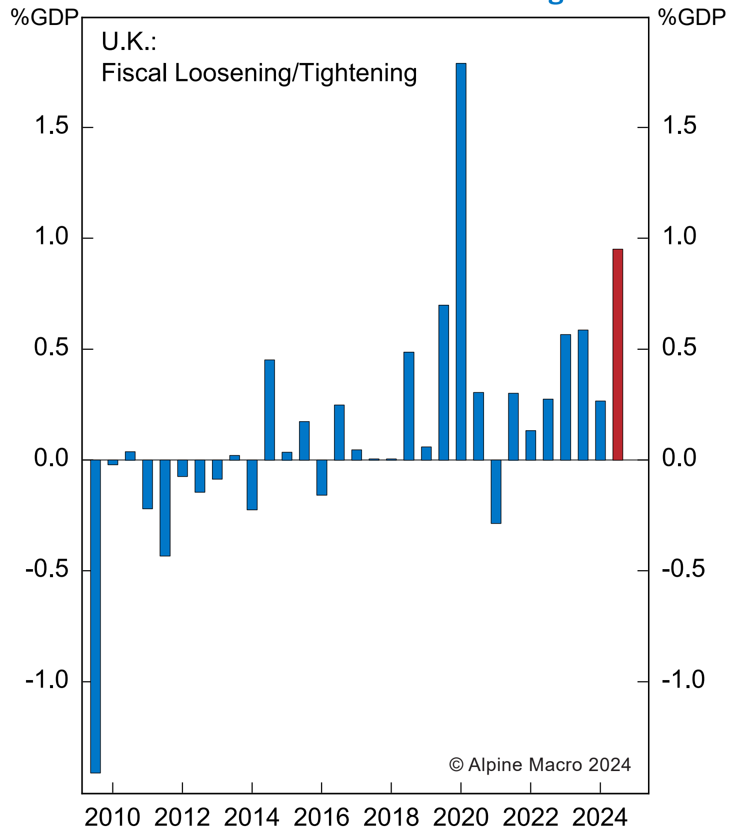
2 Alpine Macro *Global Strategy Special Report* "Why R* May Have Risen" (October 21, 2024).

Chart 7 The Yen Is Super-Cheap Versus The Euro



- At last week's policy meeting, the BoJ signaled that it will soon resume its tightening cycle. With global financial markets recovering from the volatility after its last rate hike this summer, the BoJ is no longer saying that it can *"afford to spend time"* assessing the risks. This suggests that the BoJ is moving closer to raising interest rates again. The deeply undervalued yen should recover with the BoJ being the sole G10 central bank that is hiking rates (**Chart 7**).

Chart 8 The New Labour Government Loosens The Purse Strings



Source: OBR

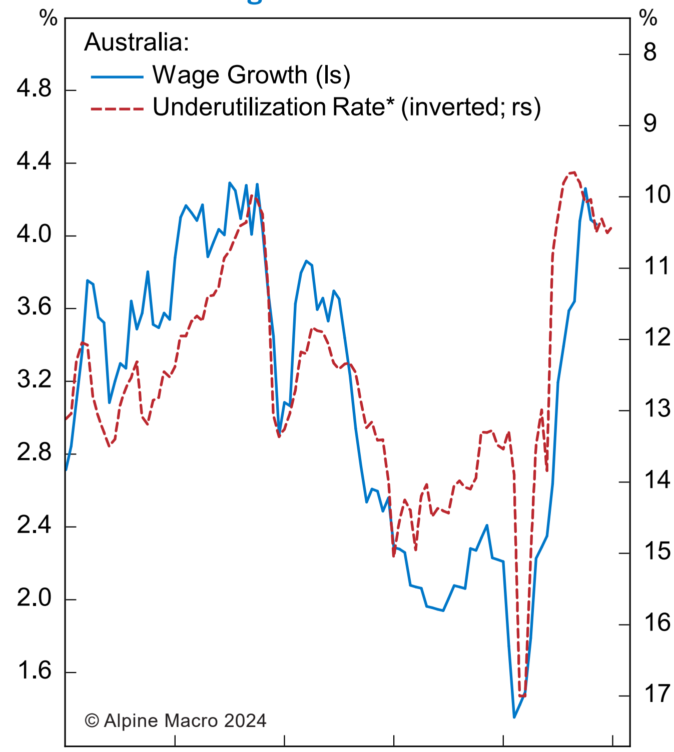
- U.K. Chancellor Reeves tabled a budget that eased fiscal policy significantly. According to the OBR, the latest budget represents *"one of the largest fiscal loosenings of any fiscal event in recent decades"* (**Chart 8**). As a result, the OBR expects GDP growth to accelerate in 2025 and keep inflation above the 2% target. At this week's policy meeting, the BoE remarked that *"domestic inflationary pressure are resolving more slowly."* Hotter inflation should mean that the BoE will be slower to ease policy than the ECB.

- The RBA kept policy unchanged this week and it is in no rush to join the other major central banks in cutting rates. The RBA noted that aggregate demand is outstripping the economy's supply-side capacity and the labor market remains tight (**Chart 9**). As a result, the RBA does not see inflation returning to the mid-point of its target band until 2026. This will require monetary policy to remain *"sufficiently restrictive"*. Stronger Chinese growth could provide further support for the Australian economy and reinforce the RBA's hawkish bias.

Bottom Line: A Republican clean sweep will lead to easier U.S. fiscal policy, which would mean fewer rate cuts by the Fed. Although U.S. bond yields are approaching 4.5%, we recommend holding off on increasing duration in fixed income portfolios. The fiscal and monetary policy mix will become more supportive for the dollar.

Harvinder Kalirai
Chief Fixed Income & FX Strategist

Chart 9 Australia's Labor Market Is Too Tight For The RBA's Comfort



*Sum of unemployment and underemployment rates; advanced by 2 quarters; truncated at 17%

Currency Outlook

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

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
Switzerland	2
Norway	2
Sweden	3
Canada	4
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	-	4.86%	-4.08%	0.78%
Long Gold	2022-03-04	1,928	-	-	40.46%	-	40.46%
Short USD/JPY (CLOSED)	2024-08-23	146.23	-	-	-3.90%	-0.97%	-4.88%
Long GBP/USD (CLOSED)	2024-08-23	1.3094	-	-	-1.50%	-0.04%	-1.54%
Long AUD/USD (CLOSED)	2024-09-27	0.6896	-	-	-4.55%	-0.03%	-4.58%
Short EUR/JPY	2024-11-08	165.17	-	Rolling -3%	-	-	-
Short EUR/GBP	2024-11-08	0.8318	-	Rolling -3%	-	-	-
Short EUR/AUD	2024-11-08	1.6172	-	Rolling -3%	-	-	-

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%	-	-	85.60 bps

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