MacroResearchBoard
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Independent Investment Strategy
WEEKLY
MACRO STRATEGY
October 18, 2024

Policy Rates Rose, But Financial Conditions Stayed Positive

- A pause in the recent rise in G7 bond yields and a dovish ECB this week have helped to sustain risk-on. Remain positioned for a higher global stock/bond ratio.
- Risk appetite is also benefitting from the ongoing strength in global corporate profits. Strong profits, in turn, are supporting solid DM employment growth.
- Of the major economies, the U.S. is the most at risk of rising inflation. Nevertheless, underlying DM inflation will prove sticky, especially as better global growth looms.

Monetary Policy *p.7*

- U.S. financial conditions have diverged meaningfully from the policy rate since the Fed began hiking in 2022, which has been supportive of growth.

Fixed Income *p.11*

- Upgrade the euro area to neutral and downgrade Japan to underweight within a global (currency hedged) government bond portfolio.

MRB *TradeBook Update* *p.12*

- We closed one profitable currency position and opened a new equity pair trade this week.

The recent pause in the uptrend in U.S.-led government bond yields is supporting risk-on, because the pause is not related to economic worries. Dovish DM central banks, with the ECB cutting rates again this week (more below), and benign global CPI readings are limiting the upward pressure on bond yields, for now.

We expect that the main beneficiaries of capped DM bond yields will be equity and credit markets, given the positive backdrop for corporate profits and overall global economic activity. In contrast, bond yields have limited downside despite lower

This Week's Research

MRB *Asset Class Indicators* click here

MRB's *Investment Recommendations* click here

DM policy rates, given this positive growth backdrop and likelihood of sticky underlying DM inflation.

There are some soft economic areas, primarily the industrial side of the global economy, which has contributed to weak goods prices. However, the overall picture is one of solid growth and ***increasing prospects for better economic activity ahead as monetary conditions ease and financial conditions remain supportive***.

Our investment strategy remains mildly pro-growth, and positioned for a higher global stock/bond ratio over the next 6-12 months, or at least until fears of much higher bond yields return. The latter will take time to develop, as economic growth is not likely to rocket higher, but rather undergo a slow and steady improvement. Until then, asset price inflation will persist.

Oil and natural gas prices are at the low end of their ranges and are supportive of global growth

There is always the chance that the risk-on phase might be cut short by some major geopolitical or possibly U.S. political development. The main and immediate conduit for current geopolitical threats to undermine the global economic expansion would be via a spike in energy prices. This has not happened despite a chaotic geopolitical backdrop; rather, oil and natural gas prices are at the low end of their ranges and are supportive of growth[1].

While protectionist actions in the late-2010s almost derailed the global economy, former-president Trump pulled back before too much damage occurred, although it did produce a downcycle in global trade. It is premature to bet that a possible Trump victory next month would create an even larger global economic roadblock, because in addition to the claim that he likes tariffs, Trump also prefers a strong economy and stock market.

The impact from rising policy rates is transmitted to the economy via tightening financial conditions; this did not happen for a variety of reasons

Thus, he has little incentive to risk an escalating trade war. To be sure, if elected, he would threaten draconian trade actions, but probably more as a negotiating tactic rather than an intended policy direction. The eventual outcome may well be less than feared (and less than he currently claims he might enact).

Below we examine the bizarre behavior of U.S. financial condition indexes during this decade's rate-hiking cycle (page 7). Normally, the impact from rising policy rates is transmitted to the real economy via tightening financial conditions. This did not happen for a variety of reasons.

[1] See **chart 4** in the **MRB*:*** "***Weekly Macro Strategy: Extending The Cycle***", September 27, 2024

The net result is that liquidity conditions remained robust, as is evident in the strong performance of many risk asset markets, including zero-yielding instruments (**chart 1**, panels 4 and 5). And conditions are now being relaxed further.

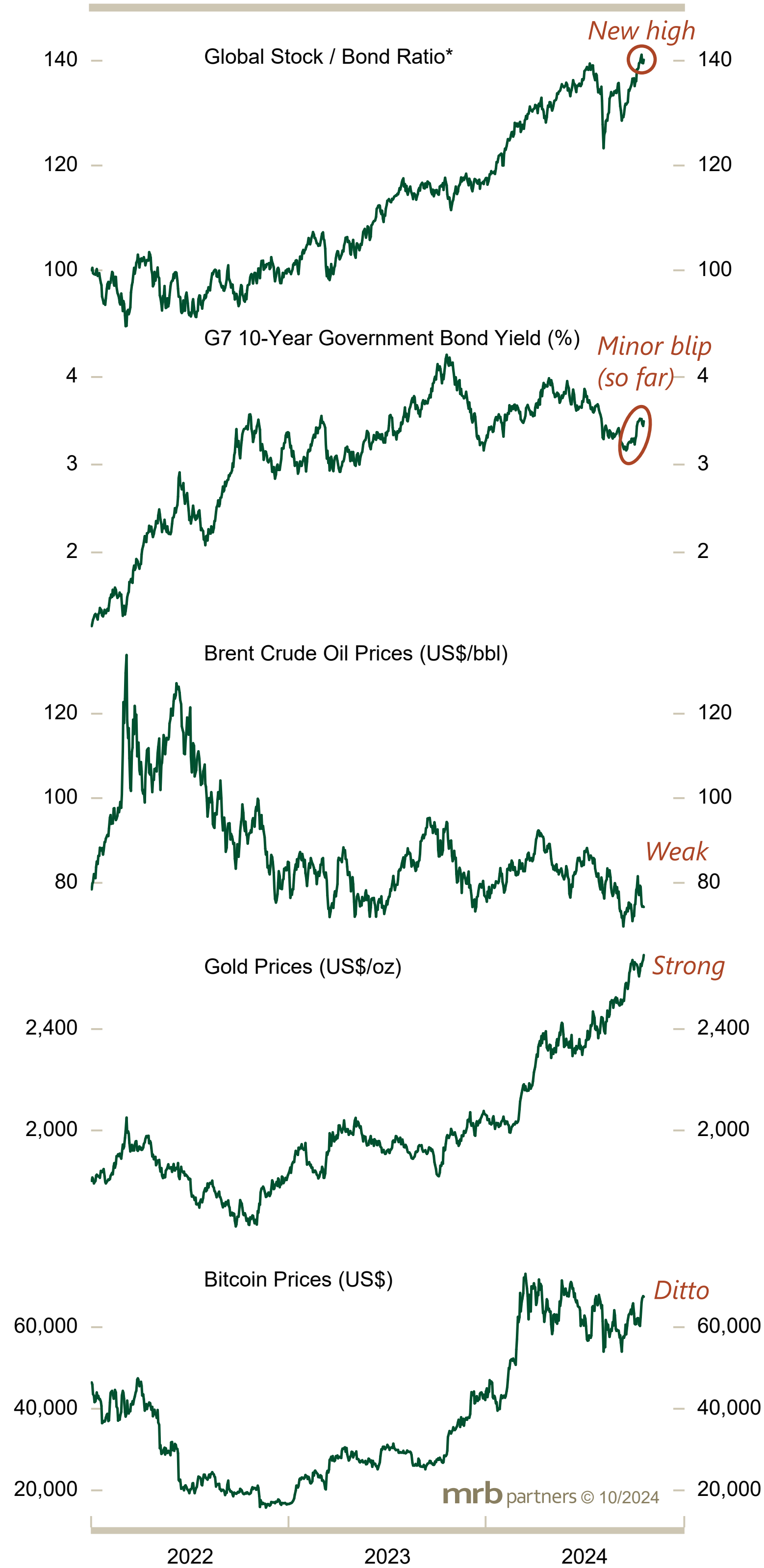
The U.S. economy did not deteriorate over the past two years and is not likely to weaken markedly going forward (the economic data, however, will be temporarily volatile due to the recent massive hurricanes). Ongoing economic vigor undermines the claim by Fed Chair Powell *et al* that monetary conditions had become highly restrictive. Inflation has fallen significantly from the brief, pandemic-influenced spike earlier this decade. However, this had little to do with monetary tightening.

While some weak link economies and sectors have slowed, the overall picture is one of good global growth and still-elevated hiring intentions driven by historically strong profits and high margins (more below). And the odds favor improved economic activity as global trade gradually firms, which is already apparent in the EM world (see page 15). Meanwhile, DM inflation will remain sticky, holding above levels recorded last decade.

Yet another rate cut by the ECB this week was supportive of the risk-on backdrop (**chart 2**). As we have noted, the ECB has more latitude to cut rates even though the forces holding back the regional economy are not related to tight monetary conditions or high borrowing rates.

The overall euro area business sector is enjoying solid profits, even taking into account the weakness in the manufacturing sector. Consumers are sitting on a mountain of excess savings and are benefitting from solid nominal and real income growth. The gradual firming in consumer confidence bodes well for better consumption ahead.

Chart 1 Risk-On Continues



* Global MSCI stock market total return index divided by G7 10-year government bond total return index; local currency; rebased; source: MSCI

Euro area bond yields have mildly diverged from U.S. trends this autumn, and the euro has softened anew. We upgraded euro area bonds to neutral within a global (currency hedged) fixed-income portfolio, as we expect a modest divergence between the region and the U.S. in the coming months (see page 11).

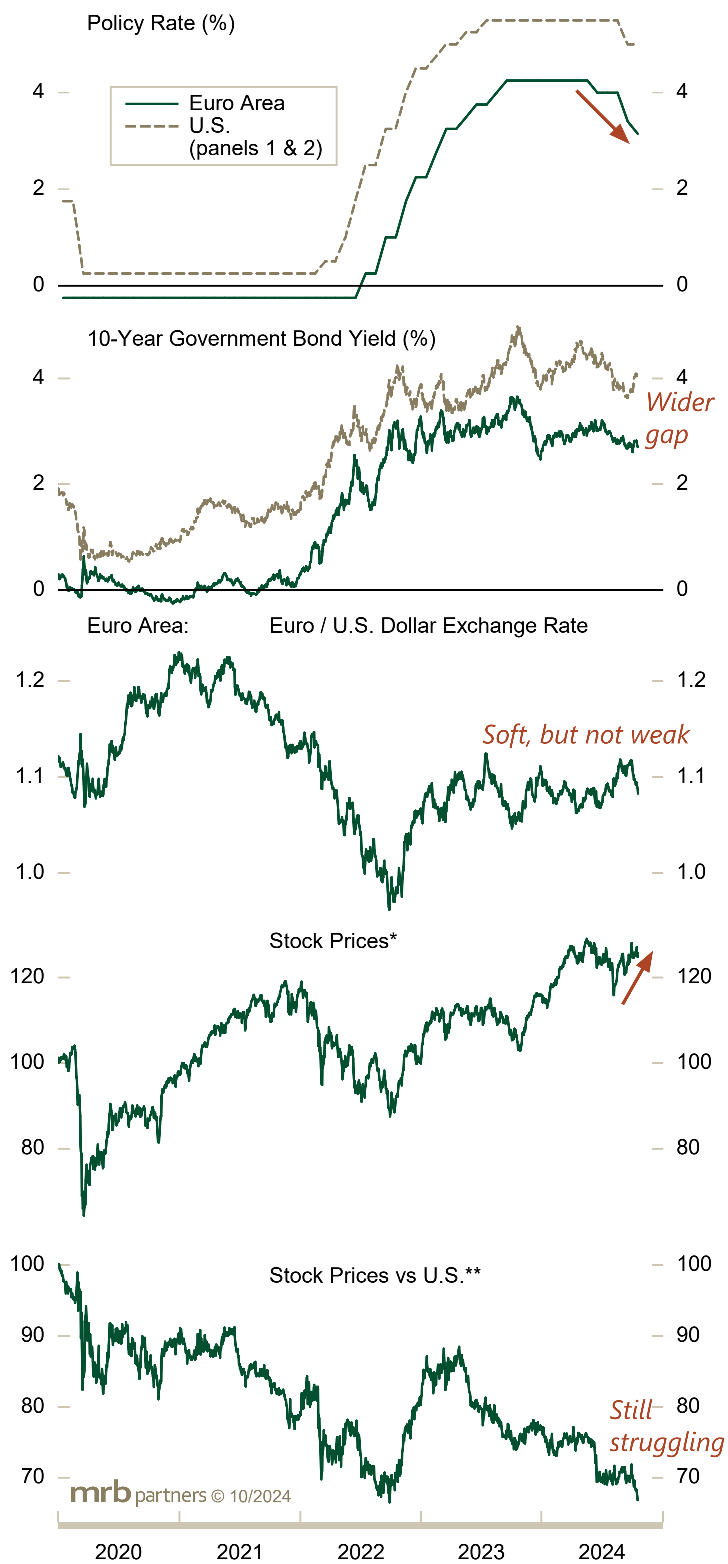
Despite some high-profile hits to a few major stocks, the overall euro area market is flirting with new highs. Still, the regional market has continued to struggle versus the U.S. in common-currency terms (**chart 2**, panel 5). A period of better absolute economic growth is likely needed to spark better sentiment.

While the euro area faces significant fiscal deficits and high debt burdens, these are not unique from a DM perspective, as all countries have witnessed massive debt/deficit increases this decade and lack the will to take meaningful action. However, the deterioration in all government's balance sheets will not be a headwind for growth for as long as bond vigilantes stay in hibernation.

Adding it up, we expect further ECB rate cuts ahead (and indeed the ECB President's tone was dovish this week), with the economy in a position of modest slack (more below) and inflation much lower than a few years ago. It should be noted though that service sector (and wage) inflation is proving sticky (as is the case elsewhere), and we expect euro area inflation to hold above the low levels of last decade. This, plus better growth, will force the ECB to the sidelines in 2025, which should also coincide with better relative performance of both the euro and regional stocks. → respectfully, i disagree

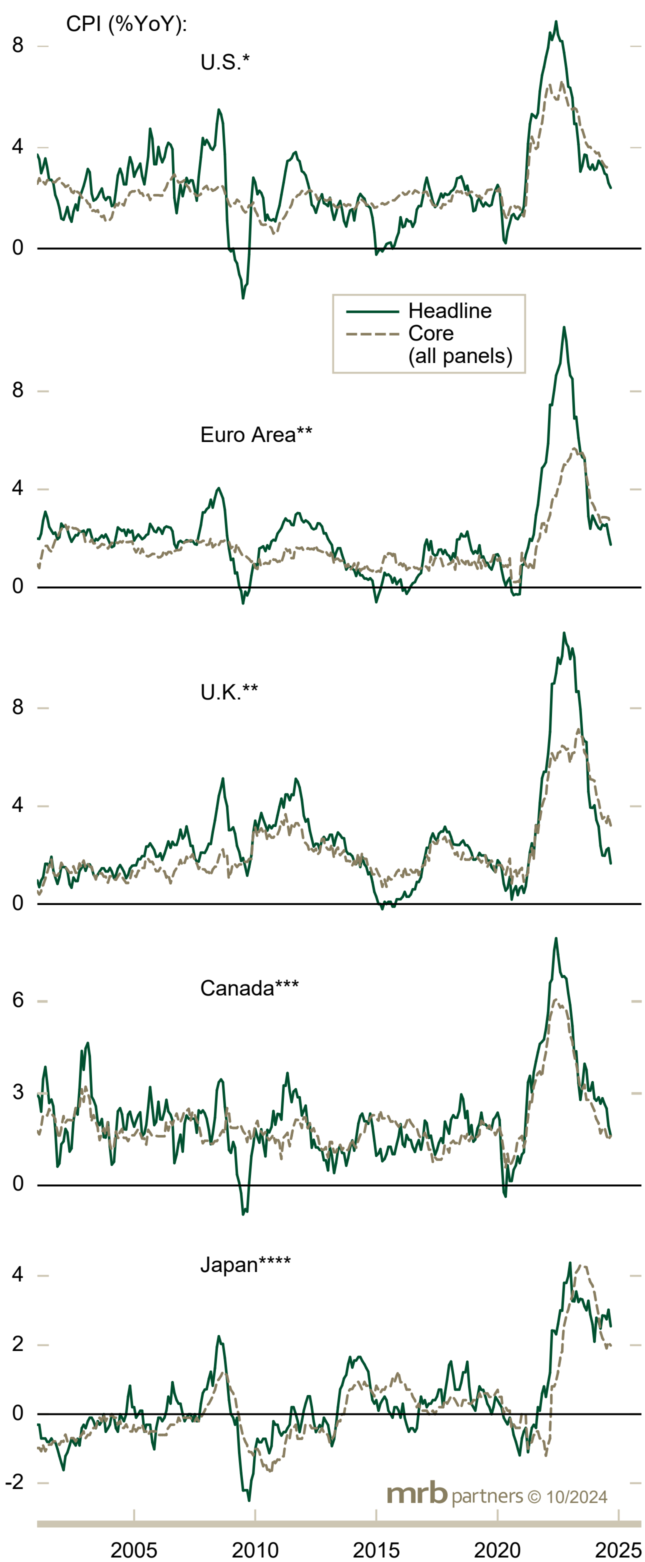
The divergence theme between a stronger economy and more inflationary backdrop in the U.S. versus

Chart 2 **ECB Rate Cuts Are Positive For Growth And Risk-On**



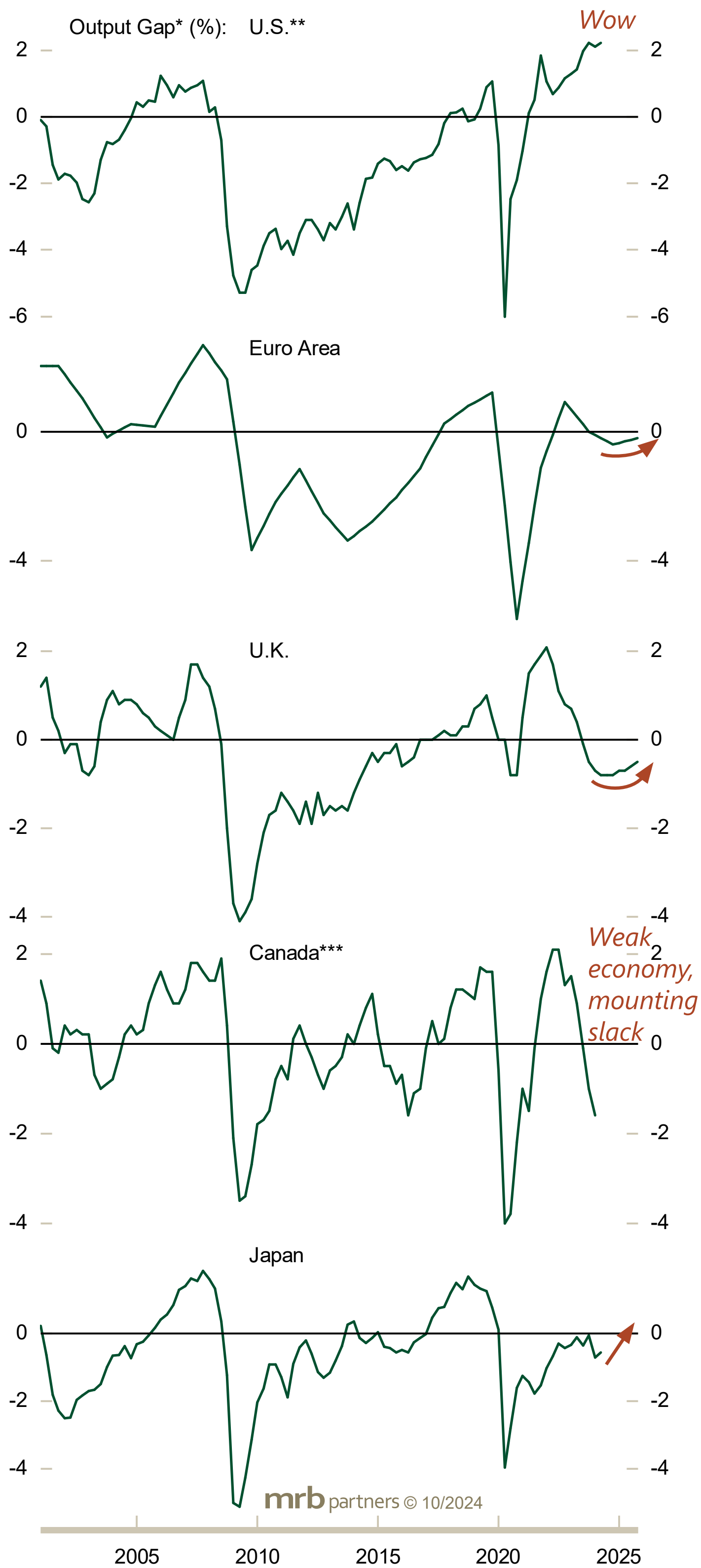
* Local currency; rebased; source: MSCI
** U.S. dollars; rebased; source: MSCI

Chart 3 Global Inflation: Down, But Not Out



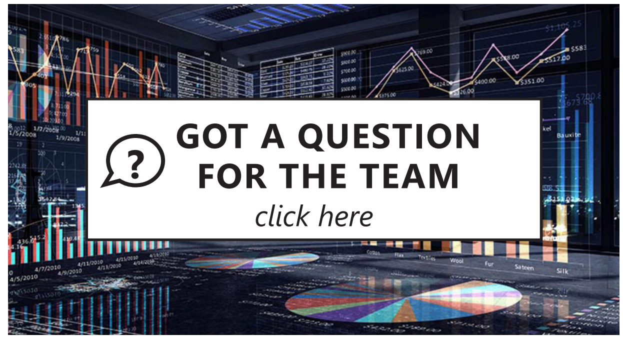
* Core excludes energy and food
** Truncated above 60; core excludes alcohol, energy, food and tobacco
*** Truncated above 60; core excludes energy and food
**** Excludes tax effects; core excludes fresh food and energy

Chart 4 Output Gaps Vary In The DM World



* Current GDP relative to potential GDP; sources: U.S. Congressional Budget Office, European Commission, U.K. Office for Budget Responsibility, Bank of Canada, Bank of Japan
** Truncated below -6
*** Truncated below -4
Note: Panels 2 and 3 include 2024 and 2025 estimates

most of the rest of the DM world is expected to prop up the U.S. dollar for a while longer, while sustaining the relative underperformance of U.S. Treasurys[2]. **Charts 3** and **4**, previous page, highlight that the U.S. output gap is by far the most positive within the major DM economies and, thus, the economy will be more inflation prone.



We expect the output gap to gradually close in the euro area and possibly the U.K., as both regions should see better growth ahead. Meanwhile, Japan is on its own path, in that it significantly lagged the global economic expansion earlier this decade, but is now firming. The BoJ is the only major DM central bank likely to continue ***lifting*** its policy rate in the months ahead.

The BoC will continue its steady easing cycle, with another rate cut next week

At the other end of the cyclical inflation-risk spectrum, the weak Canadian economy has caused its output gap to turn negative, which heralds a less threatening inflation backdrop. The BoC will continue its steady easing cycle, with another rate cut next week.

It is important to note that economic growth relative to its potential rate (and thus changes in the output gap) plays a crucial role in the cyclical ebb and flow of inflationary pressures, even though this link is surprisingly downplayed by some major central banks. Moreover, there is also a strong case that the secular global disinflationary forces that existed up until the late-2010s have also dissipated. →

what about AI? it is inherently disinflationary

There is a strong case that the secular disinflationary forces that existed up until the late-2010s have dissipated

These forces included the greatest advancement in globalization in modern history, the widespread implementation technological advancements stemming from the tech revolution, and the massive deleveraging drags in the U.S. and euro area economies (which are two major sources of global demand and tend to set global prices). While difficult to estimate, these secular disinflationary forces may have dragged core CPI inflation rates down by a percentage point during the 2000s and 2010s in most developed economies[3].

If so, then all developed countries will now experience higher and stickier ***underlying*** inflation than is generally appreciated by their central banks and bond investors.

We close with a candidate for "chart of the year", which shows the strong link between the trend in U.S. corporate profitability and margins, relative to capital spending and employment (as was discussed in a report earlier this week, see page 13, **chart 5**). Historically, it takes a downturn in margins to undermine economic activity. However,

[2] **MRB**: "*Divergence Re-Emergence: Opportunities In Regional Bond Markets*", October 1, 2024

[3] **MRB**: "*U.S. Inflation: What Will Be The Underlying Run Rate?*", June 5, 2024

profit margins have actually recently risen to heights rarely seen in the post-war period.

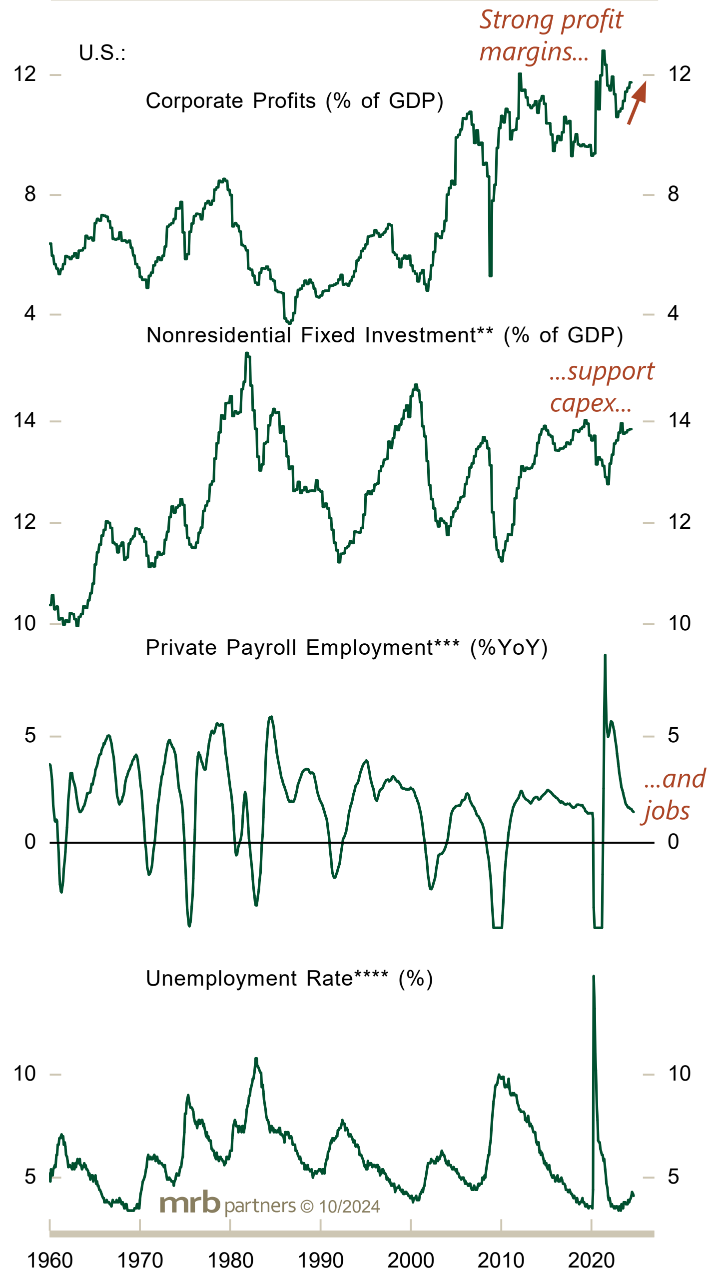
U.S. economic ***growth*** indicators have come down substantially from the unprecedented levels reached earlier this decade, and many analysts have claimed that this deceleration is a sign of fundamental deterioration and impending economic weakness. However, aside from housing and manufacturing, the overall U.S. economy is still historically in solid shape, and is not on track for a recession.

And now with the Fed *et al* easing policy it will provide ***a further boost to the U.S. and global economy***. As we have consistently noted in recent years, it is premature to position for a recession. Perhaps some geopolitical development(s) may trigger an end to the cycle, but so far this has not been the case.

Final Word: *A pause in the recent rise in G7 bond yields and a dovish ECB this week have helped to sustain risk-on. Remain positioned for a higher global stock/bond ratio. Risk appetite is also benefitting from the ongoing strength in global corporate profits. Strong profits, in turn, are supporting solid DM employment growth.*

Of the major economies, the U.S. is the most at risk of rising inflation. Nevertheless, underlying DM inflation will prove sticky, especially as better global growth looms.

Chart 5 **U.S. Profit Margins Peak Before Unemployment Rises**



* Shown in log scale; source: U.S. Bureau of Economic Analysis
** Source: U.S. Bureau of Economic Analysis
*** 6-month moving average of 1-month changes; truncated below -4; source: U.S. Bureau Of Labor Statistics
**** Source: U.S. Bureau Of Labor Statistics

Monetary Policy

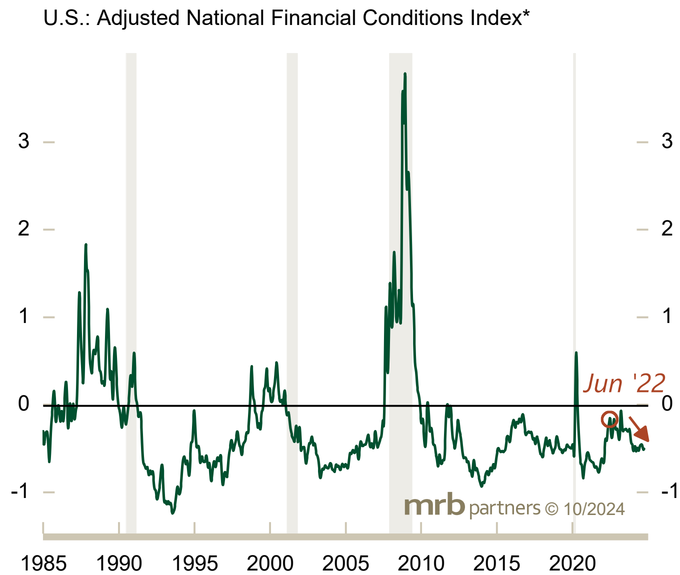
What Do U.S. Financial Conditions Imply?

Financial conditions (the current state of key financial variables that affect the economy in the future[4]) have diverged meaningfully from the policy rate since the Fed began raising rates in 2022 (**chart 6**). A rising policy rate would have normally underpinned

[4] ***Financial Conditions Indexes: A Fresh Look after the Financial Crisis***, 2010

tightening financial conditions; instead, and contrary to expectations, ***financial conditions became slightly easier between 2022-2024***.

Chart 6 Financial Conditions Have Eased Since 2022



* High values denote tight conditions; source: Federal Reserve Bank of Chicago
Note: Shaded for NBER-designated U.S. recessions

Financial conditions are the conduit for monetary policy, through which the Fed influences employment and prices (see below). Monitoring financial conditions is important because they need to evolve consistently with changes in monetary policy, in order for the latter to have its intended effect.

The relationship between changes in monetary policy and financial conditions is neither steady nor always predictable, and financial conditions may also be affected by non-policy factors. Moreover, the relationship between financial conditions and the economy also may change over time. Still, all else being equal, the divergence of financial conditions from policy changes implies a possible "leakage" in the chain of transmission of monetary policy to the economy.

The Chicago Fed's Adjusted National Financial Conditions Index indicates that its credit subindex which had a 42% correlation with the lagged fed funds rate from

Financial Conditions Indexes

Financial conditions indexes (FCIs) concisely summarize the trends of multiple relevant financial variables into a single indicator.

There are two types of FCI. The first type of FCI is designed to describe whether financial conditions are loosening or tightening compared to their own history. This type of FCI comprises a statistical average of underlying indicators. Examples include the Bloomberg FCI and the Kansas City Fed's Financial Stress Index.

The second type is designed to gauge the influence of financial market variables on economic growth (and may therefore contain present as well as lagged values of financial indicators). The weights on the underlying indicators are derived based on their historical relationship with GDP growth. Examples include the Federal Reserve's FCI and the Chicago Fed's FCI, and the Goldman Sachs FCI.

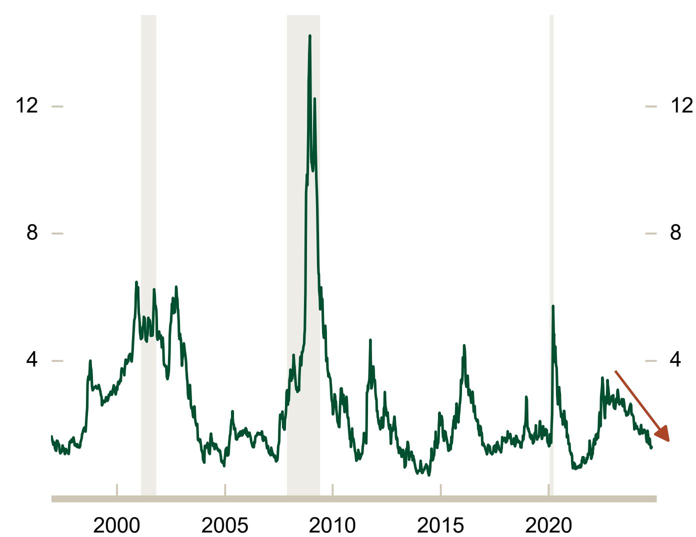
The Chicago Fed's FCI is the broadest of all gauges, based on 105 indicators of financial activity, which are classified as risk, leverage and credit related indicators.

1990 to 2022 became negatively correlated with the policy rate after 2022. This divergence of credit conditions from their historical relationship with the rising policy rate was led by the corporate credit indicators, namely the High Yield 5-yr Senior CDS Index, the Investment Grade 5-yr Senior CDS Index, the 1-month nonfinancial commercial paper A2P2/AA credit spread, the High Yield/Baa corporate bond yield spread, and the Baa corporate bond/10-yr Treasury yield spread **(chart 7)**.

Only a few credit components behaved somewhat "normally" vis-à-vis the rising fed funds rate, i.e. they contributed to some tightening of credit conditions since Q4 2022. These largely included survey-based indicators, such as consumers' survey responses regarding credit conditions for autos, durables and mortgages, and consumers' self reports on non-current loans as well as credit managers' assessment of the credit cycle **(chart 8)**. Only a couple of non-survey indicators turned more restrictive alongside policy rate hikes: the 30-yr jumbo mortgage spread, and the municipal Swap/State & Local Government 20-yr GO bond spread.

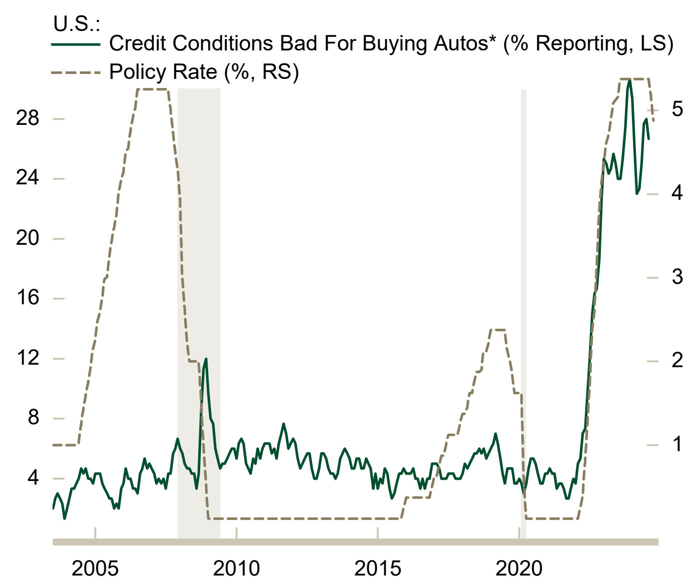
In short, while the rising policy rate seems to have led to a marginal decline in the capacity and prospective willingness of some market participants to borrow and lend, the effect was overwhelmed by the strong underlying economic fundamentals and solid health of the corporate sector (see page 13). The economy's interest rate sensitivity has simply been much lower this cycle.

Chart 7 **Tighter Credit Spreads Underpin Easing Financial Conditions**



* Source: Ice Data Indices and Moody's
Note: Shaded for NBER-designated U.S. recessions

Chart 8 **Selective Borrowers' Sentiment Soured Alongside Rate Hikes**



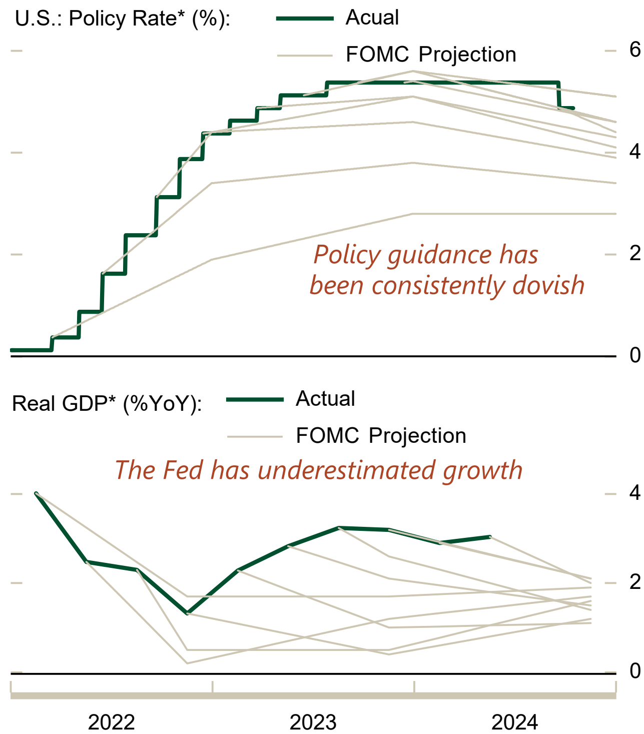
* Source: University of Michigan
Note: Shaded for NBER-designated U.S. recessions

The Fed's dovish forward guidance is another factor that may have contributed to financial conditions diverging from the policy rate. Financial conditions depend on not just the short-term rate, but also the overall stance of Fed policy, which includes guidance on the future path of the policy rate and the neutral, or long-run, policy rate.

The latter two matter for longer-term borrowing rates, which is important given that more borrowing in the economy depends on longer-term rates rather than the short-term rate.

Although the Fed rapidly lifted the policy rate after 2022, its forward guidance on rates was consistently below the eventual path of the policy rate through most of the hiking cycle **(chart 9)**. This dovish forward guidance may have blunted the impact of higher policy rates on the financial markets. The bizarre inversion of the yield curve in 2022-2024 was another reflection of this dovish guidance, and was supportive of economic growth by lowering the aggregate cost of capital.

Chart 9 **Forward Guidance And Growth Expectations Have Been Off The Mark**



* Source: Federal Reserve & U.S. Bureau Of Economic Analysis

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Moreover, the Fed's estimate of the longer-run policy rate remained fixed at 2.5% throughout the hiking cycle. It is only this year that the Fed has slowly begun acknowledging that the policy rate might average higher in the future than they had previously estimated. Even with the Fed's gradual lifting of the longer-run policy rate estimate, the latter remains far too low[5], and thus likely is ***still*** contributing to easier-than-usual credit conditions by capping long-term bond yields.

That financial conditions have remained relatively easy since 2022 underscores MRB's view that the fed funds rate never became truly restrictive, even at its highest level of 5.25-5.5%. Benign financial conditions are consistent with the fact that economic activity has remained above its potential rate throughout the rate-hiking cycle, to the Fed's surprise **(chart 9)**. By ignoring or downplaying the signal (and implications) of benign financial conditions, we think that the Fed has raised the odds of a policy mistake by way of its recent dovish policy pivot[6].

That financial conditions have remained relatively easy since 2022 underscores MRB's view that the fed funds rate never became truly restrictive

The Fed believes that the cooling of inflation this year justifies cutting the policy rate. The reality is that the Fed's prior policy tightening has had relatively less to do with the stepdown in inflation than most people believe (restrictive Fed policy would have impacted inflation via the demand channel, and growth has maintained an above-potential rate).

[5] **MRB*:*** "*R-Starring The U.S. Economy*", September 6, 2023

[6] **MRB*:*** "*U.S. Fed: The Makings Of Another Dovish Error*", September 19, 2024

Final Word: *Unlike the Fed and the bond market consensus, we believe that economic growth matters greatly for the underlying trend of inflation. Benign financial conditions will help to sustain continued above potential economic growth ahead, implying that the cyclical contribution to inflation will remain above the Fed's desired level for the foreseeable future. This, in turn, will ultimately prove bearish for Treasurys.*

Table 1 Changes To Our Fixed-Income Positions

DM Government Bonds* (Currency Hedged)

Australia			■
Canada			■
Euro Area	→	→	
Japan	←	←	
New Zealand			■
Norway			■
Sweden			■
Switzerland		■	
U.K.			■
U.S.	■		

* Relative to hedged global fixed income benchmark mrb partners © 10/2024

Note: Apart from the Asset Allocation section, recommendations are within asset classes; + = overweight, N = neutral and – = underweight

Fixed Income

Government Bonds: Upgrade The Euro Area & Downgrade Japan

We are making some modest shifts to our regional government bond allocation to be consistent with our latest research on the euro area and Japanese economies, and the diverging outlook for their central bank policies (**table 1**).

- **Euro Area:** Upgrade euro area from underweight to neutral within a global (currency hedged) government bond portfolio. MRB's research has shown that the euro area economy is more durable than widely perceived, with limited imbalances and sizable household savings which will serve as a firewall against contractionary forces (unlike many of the "weak-link" economies where we are overweight government bonds[7]). Nonetheless, the euro area economy has struggled over the past two years, primarily due to weakness in the region's industrial economy (and especially Germany), which has weighed on the overall economy, despite solid growth among Southern member nations[8]. Problems within Germany are not due to restrictive monetary conditions, but rather a weak global manufacturing/trade cycle and the struggle to compete with Chinese autos and machinery companies. Still, we expect the ECB will bring forward rate cuts in an attempt to provide offsetting support by stimulating other areas of the economy (most notably encouraging greater consumer spending). This comes at a point when deep Fed rate cuts for 2025 are likely to be pared back steadily further[9] (note that we are underweight U.S. Treasurys). Unlike the U.S., the euro area has modest economic slack which should create less near-term inflationary pressures and provide the ECB with greater flexibility to cut rates.

The ECB will bring forward rate cuts to stimulate other areas of the regional economy (most notably encouraging greater consumer spending)

[7] **MRB*:*** "*Global Fixed Income – Rate Cuts: Not Needed, But Coming In Any Case*", August 1, 2024 and **MRB*:*** "*Weak Links (Household Imbalances)*" October 2024

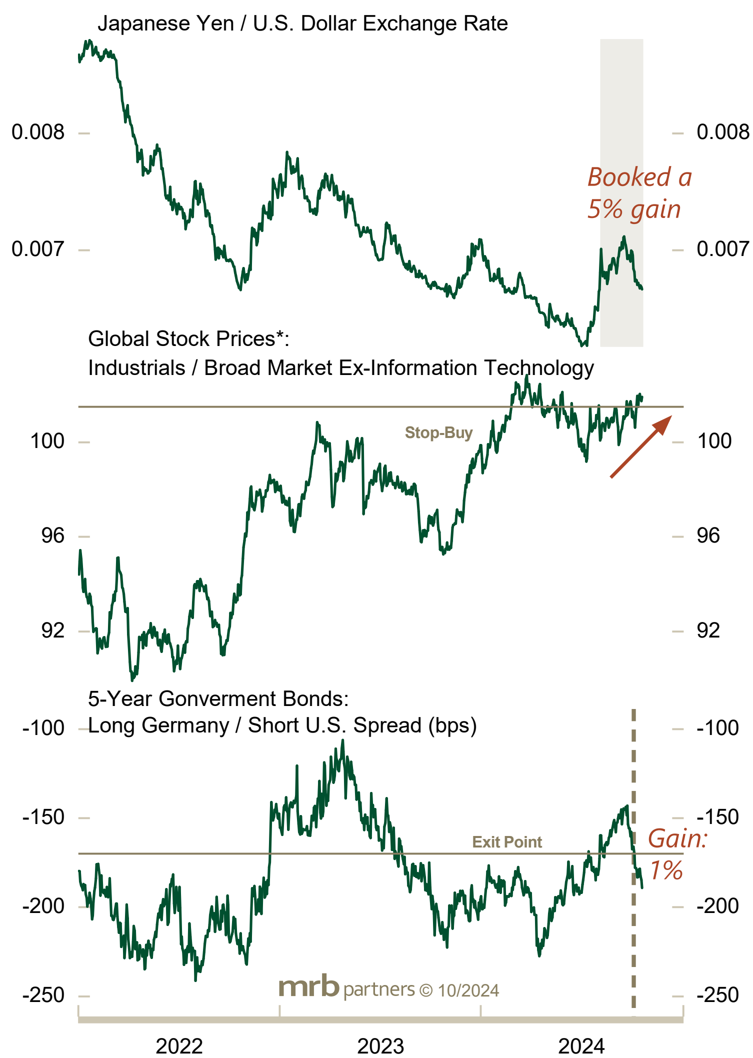
[8] Note that we will publish a report next week highlighting the dramatic divergences in cyclical economic conditions among euro area member nations.

[9] **MRB*:*** "*Divergence Re-Emergence: Opportunities In Regional Bond Markets*", October 1, 2024

❍ **Japan:** Downgrade Japan from neutral to underweight within a global (currency hedged) government bond portfolio. Japan has sustainably exited a prolonged period of secular stagnation and, thus, its extremely accommodative monetary policy is no longer appropriate[10]. The BoJ is concerned about triggering too much currency strength but will continue to steadily normalize policy rates over the next two years, and by more than the forward market is currently anticipating. In turn, this should put further relative upward pressure on JGB yields.

Final Word: *Upgrade the euro area to neutral and downgrade Japan to underweight within a global (currency hedged) government bond portfolio. Note that we remain underweight government bonds within a global fixed-income portfolio and within a global multi-asset portfolio (i.e. continue to favor equities and spread products).*

Chart 10 MRB *TradeBook*: Positioning Changes



* Rebased; source: MSCI
Note: Shading denotes when MRB previously held trade

MRB *TradeBook Update*

Positioning Update

There are three changes to positioning in the ***MRB TradeBook*** this week (**chart 10**):

Closed Position:

❍ **Long JPY/USD:** The Japanese yen has given back some of this year's gains versus the U.S. dollar, triggering our stop and causing us to book a 5% profit earlier this week. While we had been expecting a consolidation in the yen's advance since mid-September, this does not alter our positive bias on the currency[11]. The Japanese economy has sustainably escaped its long-term stagnation and deflationary funk, and can withstand gradually higher interest rates and a firmer currency. The yen is still extremely undervalued from a longer-term perspective based on the real effective exchange rate and the *MRB Purchasing Power Parity Measure*. The yen is at its cheapest levels in 50 years and, thus, offers an attractive risk/reward trade-off given the improvement in underlying economic fundamentals. We will set a 3% trailing stop-buy to capture the next upleg.

The yen is at its cheapest levels in 50 years and offers an attractive risk/reward trade-off given the improvement in economic fundamentals

[10] **MRB***:* "*Global Fixed Income – The Last Yield Anchor Lifts*", March 26, 2024

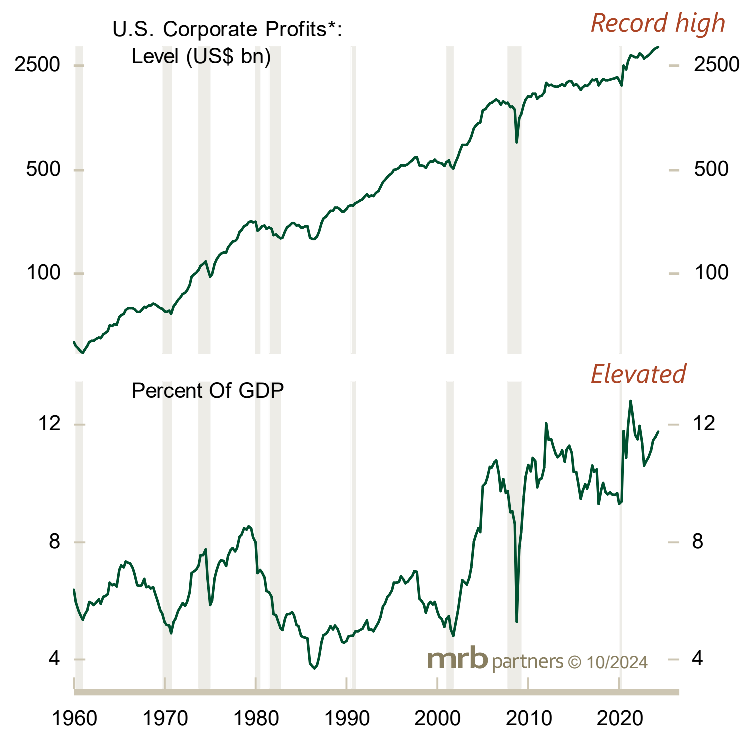
[11] **MRB***:* "*Global Foreign Exchange – Fed-Induced U.S. Dollar Weakness For Now*", September 5, 2024

New Position:

- **Global Stocks: Long Industrials/Short Broad Market Ex-Technology:** The stop-buy on this equity pair trade was triggered earlier this week in response to the recent outperformance of global industrials (up 1%). This equity position was introduced this summer[12] and has been designed to benefit from resilient global growth, the easing in global monetary policy conditions, as well as the gradual recovery in global trade. For now, we will set the exit point on this position to only allow for a 4% loss.

- **Long 5-Year German Bonds Vs. US Treasurys:** We are tightening stops on this spread trade to 170 bps to protect profits in this position (initial entry 156 bps). We initiated this trade last month as part of our "Divergence Re-emergence" theme following the Fed's 50 bp cut. We argued that the Fed would not be able to continue deep rate cuts given the strength of the U.S. economy, while other central banks would be compelled to frontload easing. This has occurred, but we see additional room for this position to run following the ECB's explicit move to signal sequential rate cuts.

Chart 11 Corporate Profits Are Very Strong



* Source: U.S. Bureau of Economic Analysis
Note: Shaded for NBER-designated U.S. recessions; panel 1 shown in log scale

This Week's Research

Corporate Profits Provide Ballast For The U.S. Economy

Strong U.S. corporate sector finances point to healthy ongoing hiring and capital spending levels. The corporate sector will remain a bulwark for the overall U.S. economy.

Companies are looking to hire, not fire

Highlights of Tuesday's report included:

- A robust corporate sector should help sustain a healthy job market and rising private non-residential fixed investment.

- Corporate profits remain strong (**chart 11**), profit margins are high, and surveys indicate that companies are looking to hire, not fire. Job growth should remain solid.

- Capital spending is elevated relative to GDP but there has been no sign of overinvestment that will need to unwind anytime soon.
- Moreover, capex relative to corporate profits and cash flows is low by historical standards, highlighting that corporate financial conditions are favorable for ongoing investment growth.
- Continued growth in private non-residential fixed investment will help sustain solid overall U.S. economic growth.

Capex relative to corporate profits and cash flows is historically low, highlighting that conditions are favorable for investment

U.S. Election 2024: Biden's Energy/Climate Policies At A Crossroads

Table 2 **Summary Of Energy/Climate Policy Proposals And Their Impact On The Energy Sector And Other Associated Groups**

Proposal/Policy Stance	Candidate	Impact On Energy Sector And Related Groups	Comments
Implement the provisions of the IRA in a manner that is consistent with fighting climate change	Harris	Positive for renewable energy companies, EVs, and industrials leveraged to the buildout of renewable energy infrastructure and grid modernization; long-term positive for utilities	Subsidies for renewable energy and EVs could be modestly expanded in a Democratic-sweep scenario
Keep restrictions on oil and gas drilling on public lands and waters	Harris	Negative for the broad energy sector at first, but may be positive in the longer term if decreased supply levels contribute to higher oil and gas prices	Oil production grew rapidly under Biden, underscoring that lower lease approvals do not spur an immediate drop in output
Continue efforts to reduce greenhouse gas emissions through the actions of the EPA	Harris	Negative for oil and gas producers, chemical companies, ICE vehicle manufacturers, and utilities with coal-fired plants	The overturn of the Chevron Doctrine will expose the EPA to more court challenges
Boost domestic oil and gas production by reducing the regulatory burden on fossil fuel industries	Trump	Positive for the broad energy sector in the near run, but may be negative over the longer term if increased supplies pressure oil and gas prices	Not clear that oil and gas producers will follow Trump's directive to produce more given their embrace of greater capital discipline in recent years
Rescind the unspent funds under the IRA and repeal certain tax credits and subsidies for renewable energy and EVs	Trump	Negative for renewable energy companies, EVs, and industrials leveraged to the buildout of renewable energy infrastructure and grid modernization; long-term negative for utilities	Easier to accomplish with Republican control of Congress; even so, a full repeal of the IRA is unlikely given that several Republican states are benefiting from the law's climate investments
Weaken the power of the EPA and roll back environmental regulations	Trump	Positive for oil and gas producers, chemical companies, ICE vehicle manufacturers, and utilities with large carbon footprints	Mostly achievable through executive actions, but it could still take time to roll back environmental regulations given the rulemaking process and likely legal challenges

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Energy and climate policy are near the top of the list of issues that could face changes depending on the election outcomes. The two presidential candidates differ on how to address climate change and energy security. Vice President Kamala Harris is an anti-pollution advocate, who cast the tiebreaking vote that resulted in the passage of the Inflation Reduction Act (IRA), President Joe Biden's signature climate legislation. Former President Donald Trump, on the other hand, is a climate skeptic who supports the development of fossil fuels, extensive rollbacks of environmental regulations, and a scaling back of renewable energy policies.

Efforts to decarbonize would slow under Trump and there would be an easier regulatory environment for fossil fuels

Wednesday's report analyzed the contrasting energy/climate policy agendas of the two presidential candidates and their potential impacts on the energy sector and other associated groups (**table 2**, previous page). Highlights included:

- A Harris victory would mean a continuation of the Biden Administration's climate and energy policies, which would favor renewable/green energy stocks and industrial sub-groups leveraged to the buildout of clean energy infrastructure and grid modernization at the expense of the conventional energy sector.
- Under Trump, efforts to decarbonize would slow, and there would be an easier regulatory environment for fossil fuels, with conventional energy companies and automakers benefiting, while the share prices of renewable/green energy and industrial firms linked to clean energy investments would weaken on fears that some of the government subsidies supporting these investments will be at risk.
- However, a full-scale repeal of the climate provisions of the IRA is unlikely, even in a Republican-sweep scenario.
- The actions of either candidate will have a limited impact on oil prices, which are determined in international markets and are influenced by other factors including global economic prospects, geopolitical events, and the behavior of producers.

The actions of either candidate will have a limited impact on oil prices

Emerging Markets Foreign Exchange: The Stars Are Aligning For EM Currencies

Domestic and global growth conditions are supportive of EM currencies

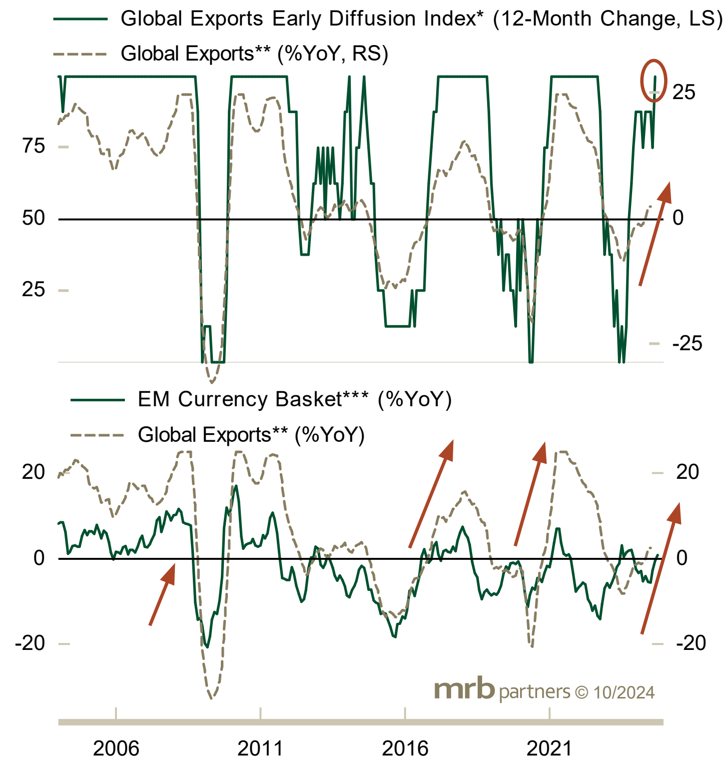
EM currencies had a decent broad-based recovery versus the U.S. dollar (DXY) between July and September, driven in large part by downward revisions to fed funds rate forecasts and a softer dollar. The subsequent modest rebound in the DXY has led to some underperformance for an equal-weighted EM currency basket, underlining yet again that for now the primary impulse for EM currencies remains changes in the U.S. dollar.

However, looking beyond the short-term noise, the ongoing global economic expansion and broad-based monetary easing in the DM world will ensure that EM relative growth momentum remains strong and global risk appetite improves further. This, in turn, should ***eventually*** trigger a rotation into EM assets and ensure that an equal-weighted EM currency basket resumes its modest outperformance versus the greenback and other major DM currencies over the next 6-12 months.

Highlights of Thursday's report included:

- Domestic and global growth conditions are supportive of EM currencies (**chart 12**).
- The Fed's easing cycle, in the context of relatively less dovish EM central banks, is positive for EM capital inflows.
- Brazil's rate-hiking cycle is not a precursor to broader EM tightening pressures.
- Stay overweight Brazil, India, Indonesia, Korea, Malaysia, Taiwan and Turkey within an EM currency portfolio, and underweight China and Poland.

Chart 12 EM Currencies Outperform When Global Trade Recovers



* Includes Brazil, China, Indonesia, India, Korea, Taiwan, Turkey, and Vietnam
** Truncated above 25; source: Netherlands Bureau for Economic Policy Analysis
*** Equal-weighted aggregate

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