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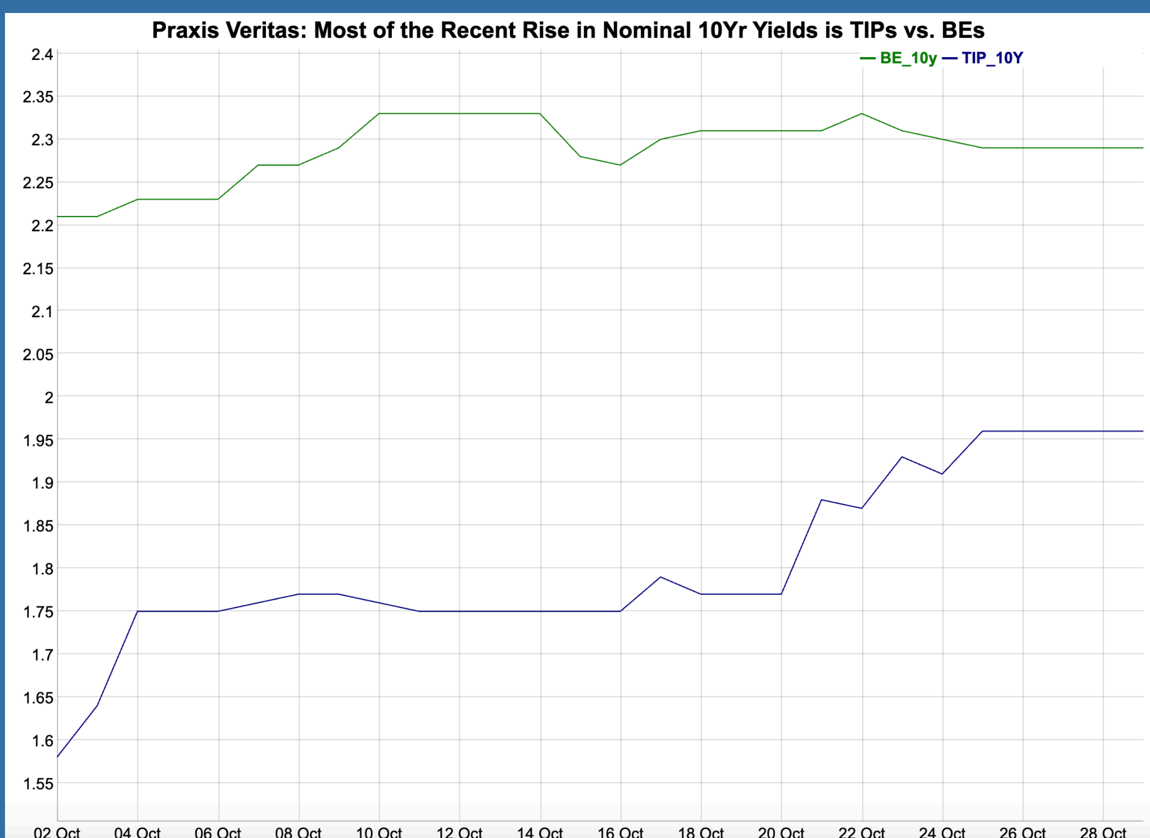
>>Price Regime Predictions Update 2024-10-29

The slow-motion hawkish policy shock which has been unfolding over the past month continues. Most of the increase in US 10Y nominal yields over this period has come from real yields rising, with breakevens little changed.



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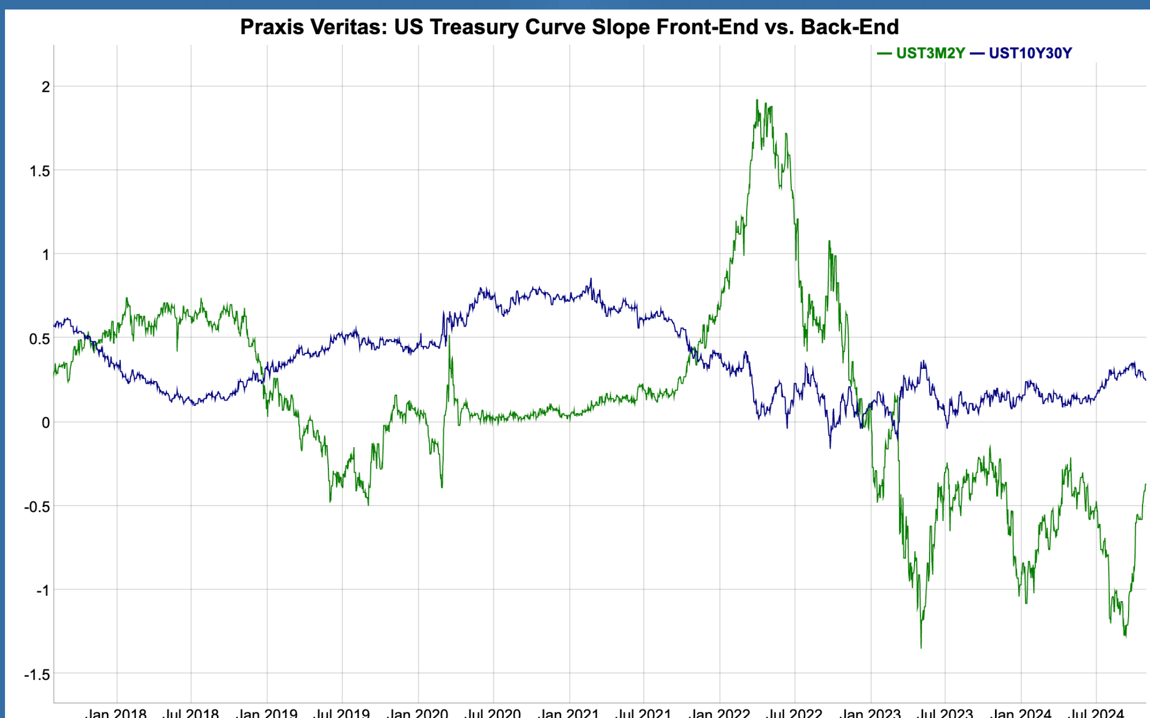
Over the past month, as the front end of the curve repriced for more hawkish policy path expectations the back end of the curve has flattened.



This repricing is more consistent with a reassessment of the FOMC's reaction function than a reaction to improving global growth and inflation data. Commodity prices remain under pressure even as Middle East geopolitical risks are at multi-year highs; breakeven yields remain rangebound; the back-end of the curve flattens even as a narrative of pro-growth and inflation policies in the years to come takes hold.

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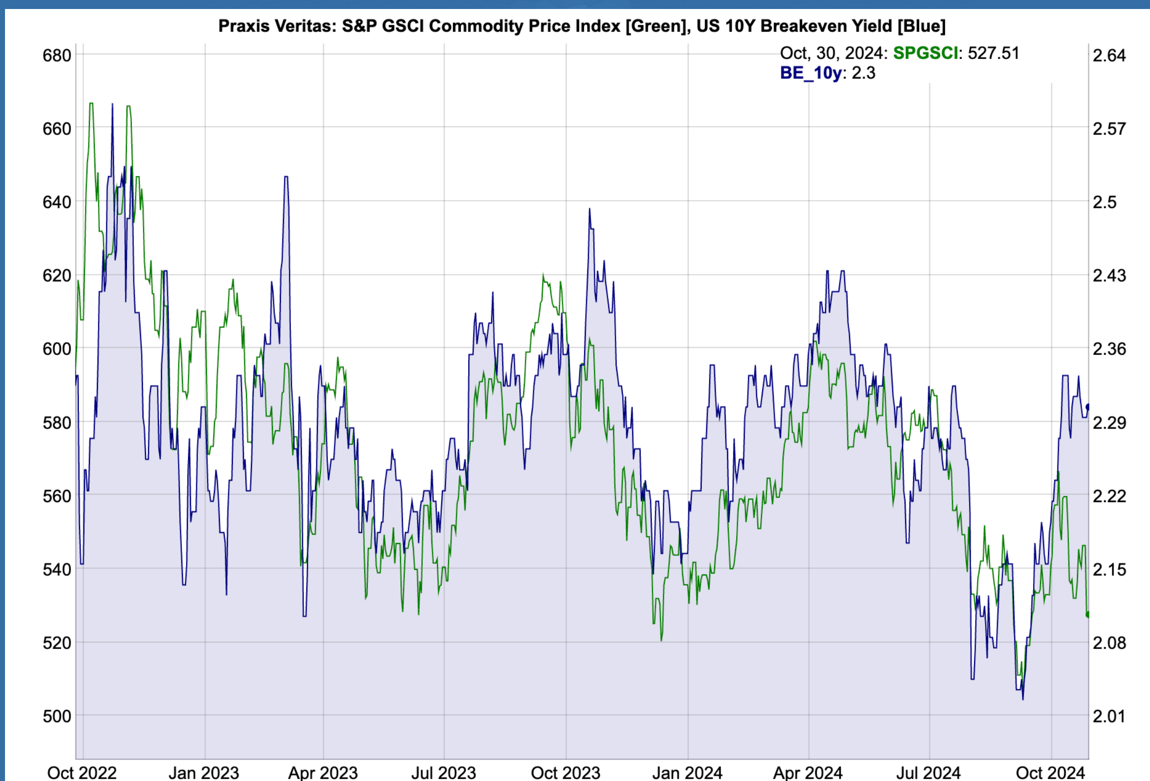

A 15-20 percentage point shift in odds in favor Donald Trump to win the US election is likely some of this hawkish policy path repricing. At around 65% on Polymarket, these odds as well as the way in which they have fluctuated over the past 6 months looks very familiar to the 2020 experience.

The first chart below shows the RealClearPolitics aggregation of prediction markets in the lead-up to the 2020 election, while the second shows a similar time period in 2024.

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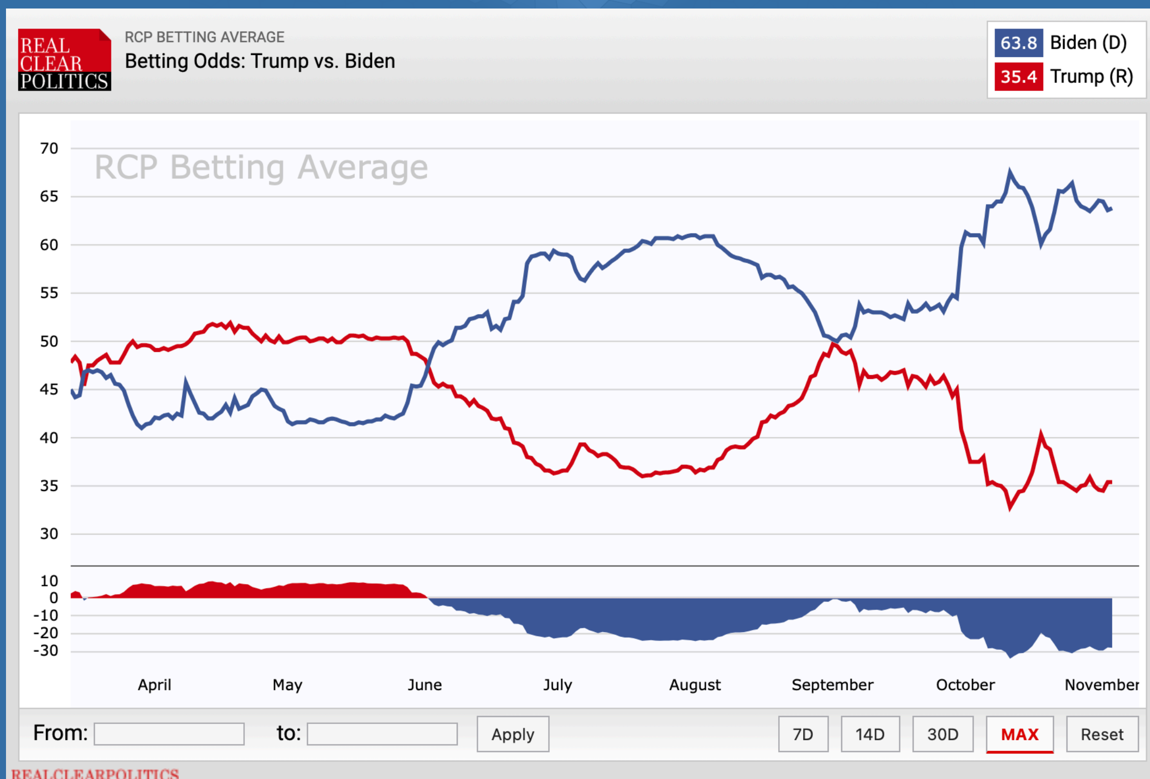

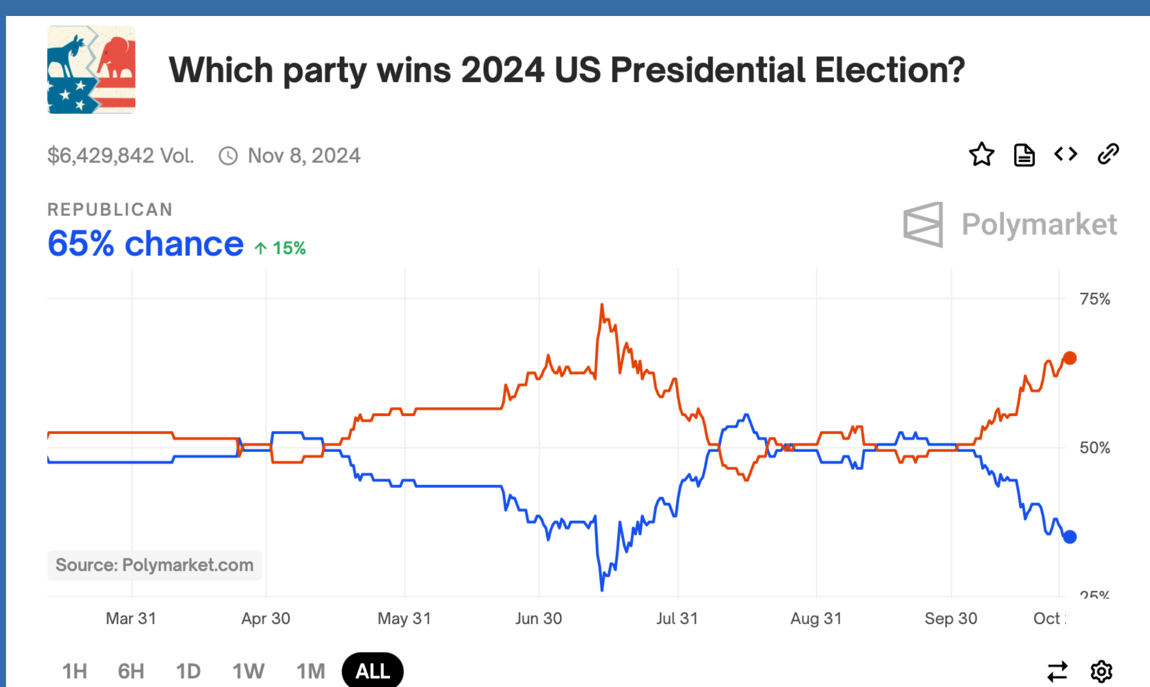

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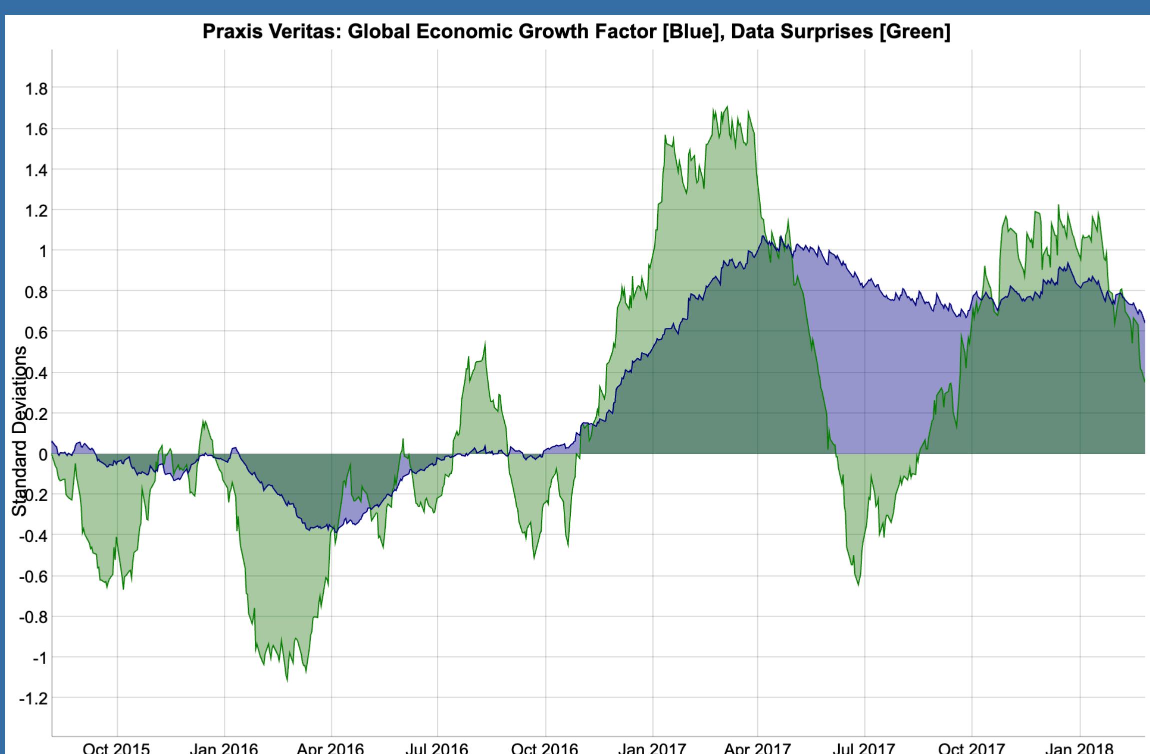
Market consensus over a Trump win is likely an analogue of the 2016 experience. After the initial bout of risk aversion around the surprise election results, markets quickly focused on the likelihood of pro-growth and inflationary policies in a Trump administration with asset prices responding accordingly.

However the 2016 election occurred in a meaningfully different context. Secular stagnation was the chief concern among policymakers, with Fed Funds still below 1% and a fiscal deficit in the 3.5-4% of GDP range. Global growth data and economic surprise indices had started improving at end-Q3 2016 and continued doing so in the post-election period.



Today, most of the positive risk backdrop that accompanied Trump's 2016 victory has inverted. Secular stagnation has given way to risks of a 1970s inflationary resurgence in terms of big ideas to consider among policymakers. Fiscal deficits in the 6% of GDP range are significantly wider compared to the norm during previous non-recessionary periods. Global growth and economic surprise index data are not consistent with a meaningful inflection point around the corner.

Even if a Republican sweep occurs (~50% odds on Polymarket) an extension of the 2017 tax cuts coupled with tariff increases and border protection appear to be the most likely new policies enacted in the foreseeable future.

Probably the most bullish case to be made for a Trump win is that China and Europe/Germany would finally enact aggressive pro-growth policies of their own. Tariff increases and contingencies to common defense agreements would no longer be risks but facts under a second Trump administration.

However, we could be months away from these sort of outcomes.

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Remain Very Cautious Risk Assets in Post-Election Period

Forward-looking probabilities of entering a declining price regime for the S&P500 continue rising to near 100% by mid-December. This is some of the most skewed readings this model has delivered in recent years. Increasingly the most salient takeaway for portfolio allocations is a shift to cash to preserve any YTD gains.