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What will it take for the Fed to become more dovish? Macquarie weighs in

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Investing.com - The Federal Reserve may need to see signs of U.S. private credit market instability before it is in a state of "fear" that could prompt action from the central bank, according to analysts at Macquarie.

Policymakers have recently suggested that they are waiting for more clarity around the broader economic situation in the wake of erratic tariff measures from U.S. President Donald Trump.

Earlier this month, Trump moved to slap steep reciprocal tariffs on a host of countries, arguing that it was necessary to correct longstanding trade imbalances and increase federal revenues. However, he later announced a partial 90-day pause to the elevated levies on most of these nations, in an apparent response to deep turmoil in both stock and bond markets.

The White House then temporarily halted duties on a range of tech-related products, such as smartphones and computers, largely coming from China. Trump has also floated potentially granting exemptions to car-related imports.

Still, universal 10% tariffs on many countries remain in place, as well as trade taxes on items like steel, aluminum, autos and auto parts.

China was also left out of Trump’s reciprocal tariff delay, ratcheting up a trade spat between the world’s two largest economies. The president has placed a 145% tariff on imports from China, sparking a retaliatory 125% levy from Beijing.

Media reports, meanwhile, have suggested that sector-specific duties on electronic products, semiconductors and pharmaceuticals could soon be implemented. Commerce Secretary Howard Lutnick has said an investigation into these industries that may be a precursor to future tariffs could wrap up "in the next month or two."

Fed Chair Jerome Powell has said there has been a lot "waiting and seeing going on," including by the Fed, against this backdrop.

Powell added that this tactic seemed "like the right thing to do at a time of elevated uncertainty" -- a statement that was interpreted as an indication that the central bank may not rush to slash interest rates should the tariffs spark a broader economic crisis, an action known by many investors as a "Fed put."

Fed Governor Christopher Waller said earlier this month that although the tariffs represent a major shock to the U.S. economy, he expects the duties will have a "transitory" effect on inflation.

In a note to clients, the Macquarie strategists led by Thierry Wizman and Gareth Berry said the Fed may adopt a more dovish policy stance should more indications emerge of private credit market ructions.

"We would expect that these cracks might emerge first among the highly-levered markets, such as the leveraged loan market," they wrote.

How overweight is the world American assets?

https://www.investing.com/news/economy-news/how-overweight-is-the-world-american-assets-3988208

Investing.com -- Foreign ownership of U.S. assets has surged over the past decade, but the scale and implications of that exposure are only now coming into sharper focus.

Deutsche Bank analysts digs into the numbers and warns that the rest of the world, especially Europe, may be sitting on outsized, and potentially risky, positions in American markets.

Foreigners currently hold $7 trillion in U.S. fixed income and $18 trillion in equities. Since 2010, that's an increase of $3 trillion and $15 trillion respectively.

But the key point, according to Deutsche Bank, is that "a remarkable 90% can be accounted for by the appreciation in underlying US asset values rather than fresh flows."

In other words, foreign portfolios have become increasingly weighted toward the U.S. largely because U.S. markets have boomed, not because investors have been consciously reallocating.

To get a clearer sense of exposure, Deutsche Bank turns to relative portfolio size. In Europe, U.S. assets made up about 5% of total portfolios in 2010.

By 2024, that share had climbed to 20%. In Japan, the rise was from 8% to 16%. "The share of total US portfolio holdings has quadrupled in Europe," the analysts said, with most of the shift concentrated in equities.

This rise has broadly tracked the growing weight of U.S. markets globally. As the U.S. share of global equities and bonds increased, foreign holdings followed suit, in many cases passively.

The brokerage offers two interpretations: "The more benign interpretation is that foreigners have merely passively tracked rising aggregate valuations... The more worrying interpretation is that this has left foreigners - especially Europeans - with a huge overweight in their portfolios relative to history, especially in US equity markets which tend to be currency unhedged."

That unhedged exposure, particularly in equities, is what Deutsche Bank flags as a key vulnerability.

Data on currency hedging is sparse, but the report points to available figures from Japan, Sweden, and the euro area that suggest "outright unhedged FX exposure to the stock of US assets is very high."

The risk is not theoretical. "A sustained shift in foreign investor USD allocation closer to historical norms has the potential to generate huge negative dollar flows," the brokerage said.

That kind of rebalancing, if it materializes, could have broad consequences for the dollar and global markets.

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