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GARY HUTCHINGS
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Monthly Macro View

- The US forward market sees US rates at neutral in a year's time. Tariff inflation is therefore seen as temporary, growth will be at trend and all will be right with the world. Given current (limited) data showing a somewhat soft but not deteriorating economy, uncertainty over tariffs settling down and thus perhaps providing something of an uplift for business, consumers faced with higher cost of living which they can't counter well given a looser jobs market that outlook seems reasonable. The upside risks are that inflation excluding tariffs is around 2.4% and if the economy firms up a bit, then it is going to take tighter policy for longer to get it down to target; the market therefore may be too optimistic in the perfect soft landing. On the downside are well-flagged fears about the AI boom proving to be a bubble or at least not representing a smooth uninterrupted path forward. A fall in the richly valued stock market or a significant change in AI investment levels could cause the economy to weaken more than expected.

- The rest of the world isn't really adding anything else to a narrative of around target inflation and rates going to neutral. China remains burdened with real estate problems; Europe is fundamentally weak but likely supported by a fiscal boost. Emerging nations seemingly are going to struggle with competition from China and need to re-orient their economies from export driven to domestic demand as globalisation steps back. There is nothing that interrupts a broadly 'steady as she goes' theme.

- Fiscal issues remain a burden on markets. Oddly, looking at one-year short rate forward markets and current ten-year rates yield curves in most markets are quite similar at around ninety basis points (in line with the long-term average). The fiscally responsible Australia is the same as the others, calling into question the extent to which fiscal pressures are discounted in markets. In the UK positive news on the fiscal front has been seen with the government acknowledging the issue. In addition, social surveys are showing increasing public awareness of this, and the populist Reform Party is pushing for very significant spending cuts which also shows it is becoming an area of public interest. We look with interest to see if public concern is seen in other countries and the extent to which politicians take it up. If the tide has turned this would be positive for markets.

- The other significant issues remain the rise of populism/authoritarianism, the end of multilateralism and the advent of AI. Thus far populism has not caused very significant market deviations but is does raise the risks of severe outcomes if persistent policies which ignore economic good sense are indulged in. The end of multilateralism also causes economic inefficiencies and a reordering of economic resource allocation globally, but this is a long burn issue. AI is the great hope via growth but also the great concern in potential economic disruption as well as the risk of a short-term over-enthusiasm leading to a pull-back which would be growth negative.

- We think markets are likely to remain calm, with economic activity being unexciting. Steeper yield curves suggest some sense in taking longer duration to take up the increased carry available. Reinforcing this is that in our view downside risks loom larger than the upside ones. Therefore, we look to be modestly long duration. Our emphasis remains on the higher yielding markets and in particular the UK and Australia.

- On the major currencies we remain largely neutral given the political risks and possible changes abrupt changes in policies. Tariffs should push the dollar up, but other policies are poor for the economy.

- On spread we remain on the positive side of neutral. Fundamentals are robust and any softness in economies is largely down to government actions rather than excessive optimism causing distortions in either the consumer or business space. Our positioning is slight given historically tight spreads, the fiscal backdrop with populism preventing sensible policies being pursued and with the risks of populists gaining power and embarking on damaging (potentially very damaging) policies.

Portfolio Positioning

- Rates and Duration

  We maintain our strategy of underweighting long duration and dollar-related currencies versus euro-related currencies, based on the continued slowdown in the US macroeconomy. Meanwhile, as US interest rates may see only limited declines despite rate cuts due to widening risk premiums (e.g., fiscal risks), we are building long duration positions primarily in countries with scope for further rate cuts. Specifically, we believe New Zealand and Australia have significant room for further rate reductions.

  The macroeconomic situation feels somewhat stronger than anticipated, partly due to high stock prices. However, the well-known impacts of the government shutdown and deteriorating employment are likely to affect personal consumption in the near future. The equity bubble is now widely acknowledged. Historically, such recognition rarely precedes a collapse.

  We are constructing a portfolio designed to avoid carry losses even if the bubble persists. We maintain a weighting of approximately 15% in higher-quality non-government bonds. Furthermore, it is premature to conclude a recession is imminent. We maintain a longer duration stance, targeting a floor of around 3.6% for the US 10-year yield. We plan to allocate bonds to countries like New Zealand and Australia where interest rates have room to fall relative to the US. Regarding foreign exchange, we adopt an overall underweight stance on dollar-area currencies while maintaining an overweight stance on countries favoured by trade wars and geopolitics.

- Currencies

  Our core strategy involves a euro underweight, Norwegian krone, Swedish krona, and Polish zloty overweight, a Chinese yuan underweight, US dollar overweight, and Mexican peso overweight.

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