RUBRICS

Macro Overview

End of the Soft Landing?

Fixed Income Macro View

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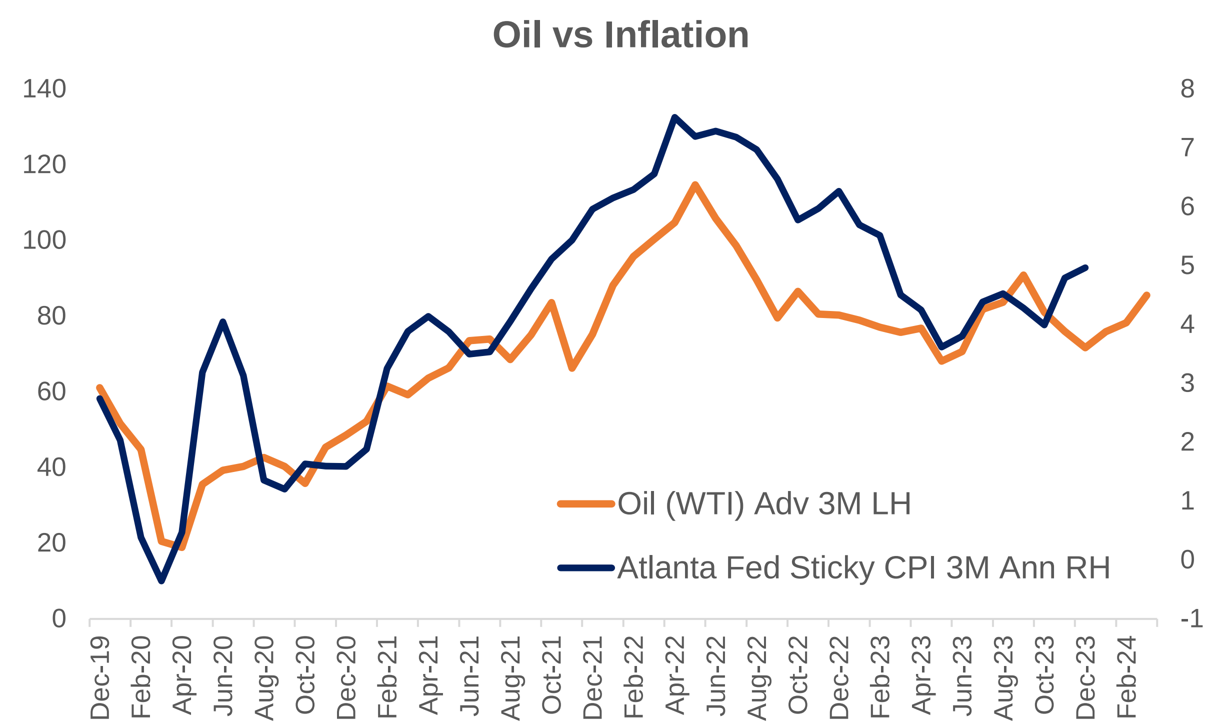
Rubrics Fixed Income Macro View

4th April 2024

Fly in the Ointment

Have recent geo-political events made the magical soft-landing even more unlikely? Once again unrest in the middle east has set off another round of oil price volatility that presents real challenges to the easy disinflation narrative that the Federal Reserve so desperately seeks in order to drop rates this summer.

Oil Price and Short-Term Inflation Momentum



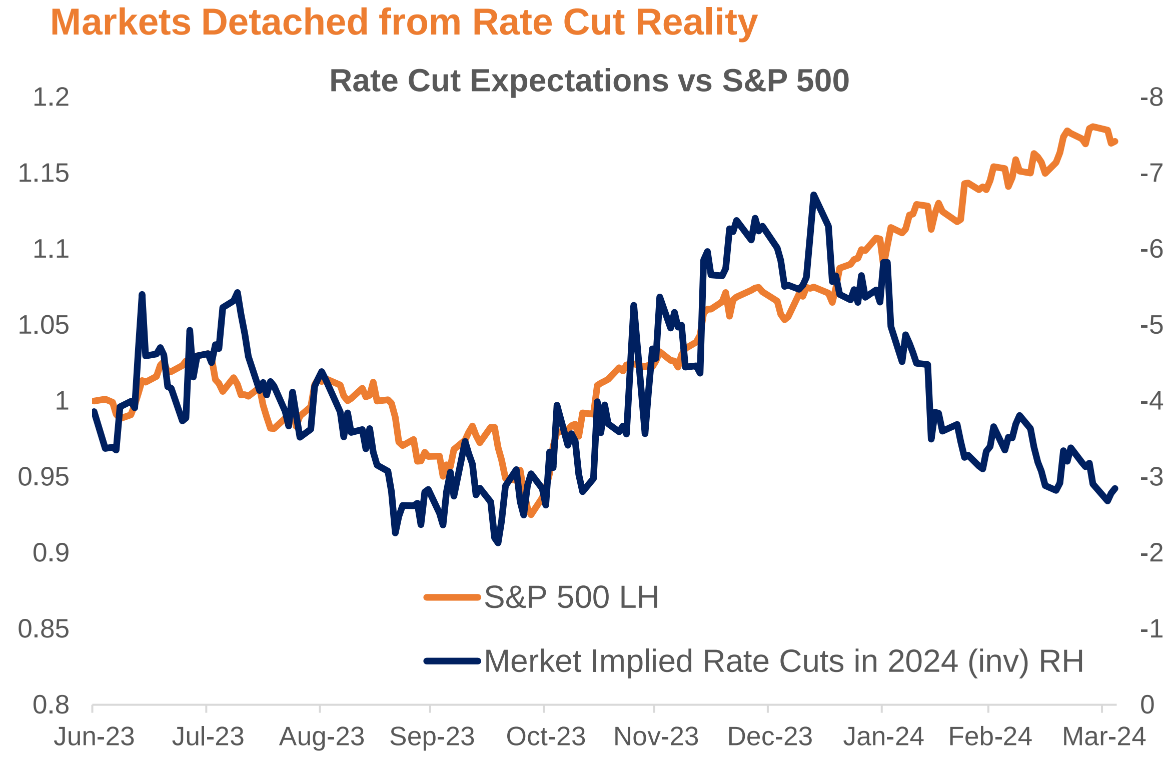
Source: Bloomberg as at 03/03/24

Elevated oil price can keep inflation hanging around for longer than the Fed would like

The outsized US fiscal stimulus programmes of 2023 and early Fed pivot (which allowed the market to price in exceptionally loose financial conditions) marked the end of the easy disinflationary story. If we now add another oil price spike, the likelihood of a smooth and uneventful decline to 2% looks overly optimistic. What the markets are now having to contend with is the potential of a 'higher for longer' rate pause after all. While the Fed are unlikely to raise rates again, even in the face of potentially rising inflation, their ability to unleash a pre-emptive rate cut to support the easy financial conditions they have already set in motion is now looking seriously curtailed. The cold reality of 'higher for longer' is likely to cut into the Fed's economic projections, just as the fiscal impulse and Fed liquidity programmes start to wane later this year. This is not the outlook that is currently reflected in financial asset prices. While US Treasury yields are having to contend with heightened inflation volatility in the short term, longer term the probability of lower inflation increases – a positive for the bond market

Rate cuts seemingly no longer matter for risk assets

Markets Detached from Rate Cut Reality



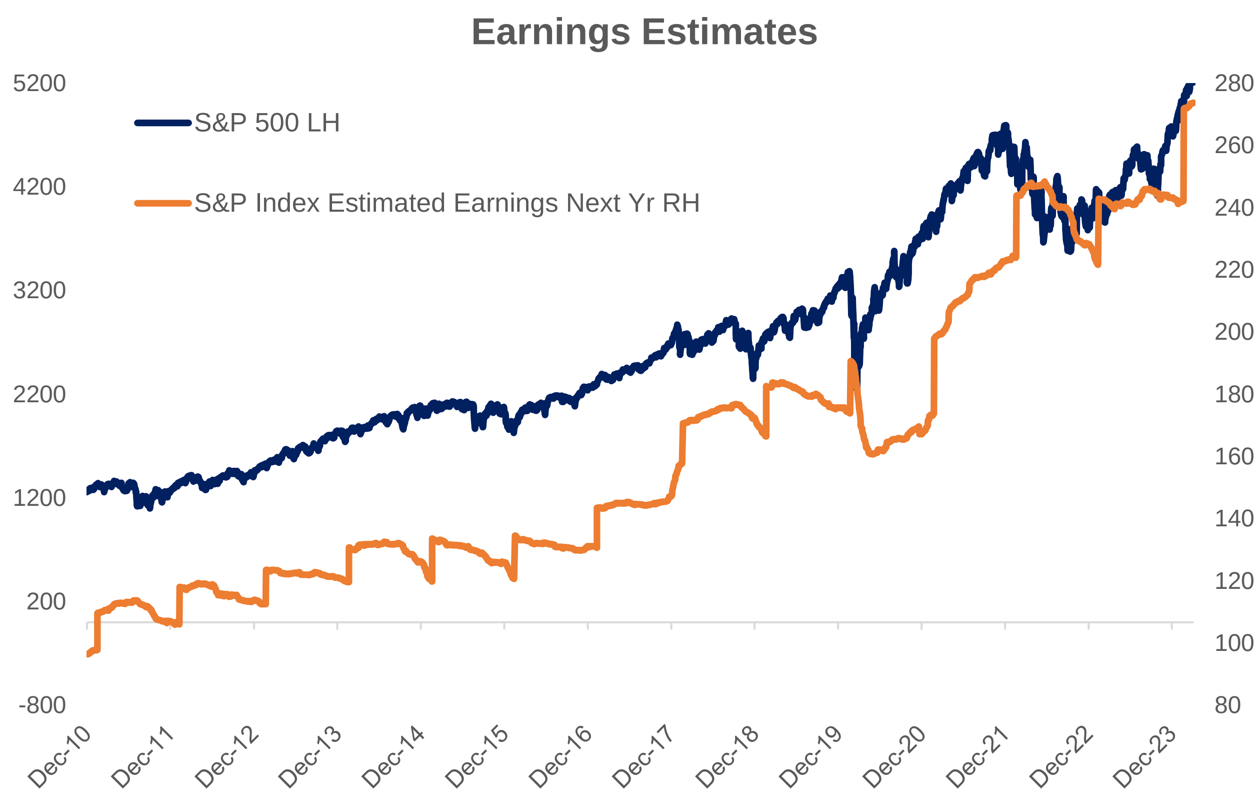
Source: Bloomberg as at 03/03/24

Monetary Lag

Global geopolitics and vulnerable supply chains are continuing to play a significant impact in the real world, while in the financial markets loose financial conditions allow investors to dismiss it as noise. While all of the excess liquidity from Covid is not yet used up, the amount is dwindling. Biden will be scrambling to get the oil price down again, but global events in Russia and the Middle East may be beyond his immediate sphere of influence. The outlook for growth in the US is staying the course so far, but even the Fed sees a fall-off in the second half of this year – the latest median projection for GDP is 2.1% for 2024 which incorporates the strong Q1 print of 3.4%. The markets might agree today with the Fed on the 3 rates cuts this year but they certainly don’t agree with the outlook for growth – not when we look at earnings projections. Higher year-end Fed Funds rates and lower growth may once again prove that the *monetary lag* from interest rate hikes is real, as it almost always is.

Optimistic earnings estimates reflective of bullish economic growth projections

Continued Optimism around Earnings



Source: Bloomberg as at 03/03/24

Risk assets are currently pricing in an outcome which always had a low probability of playing out, with plenty of help from the Fed we might add. The miraculous drop in OER inflation might not materialize quickly enough to allow the Fed to cut rates 3 times this year. This means a bigger hit to growth further down the road – what is truly required to slay the inflationary beast. The volatility in many asset classes will, in all likelihood, jump this summer. With equity markets at record highs and credit spreads within touching distance of post-GFC tights, investors can benefit from the downside protection in the safest areas of the fixed income market. Things might start to get interesting.

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4th April 2024

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