We woke up this morning to a nation without TikTok, or at least so I am told. Interesting, the world still spins on its axis, and we have an inauguration tomorrow. The price of eggs has almost tripled since 2020, the average duration of unemployment is up 3-4 weeks and is higher than any point before the GFC, lower income consumers are buckling under loan payments, and we are trying to refinance $7T in Treasury debt this year. We've got bigger fish to fry.

On Monday we will have a new President of the United States, and as much as we as an investment community have prognosticated around tariffs and trade and potential impacts on inflation and policy, none of us really know the answer.

The WSJ carried an article this weekend (link) highlighting the near immediate efforts to deport illegal immigrants from Chicago. If one thing is clear, Trump is willing to push boundaries on trade, immigration, and his brand of nationalist populism.

But the mainstream media misses the mark when putting as much emphasis on this point and instead focuses on his persona in the context of The Georgetown Set and mainstream political environment. That is the wrong lens.

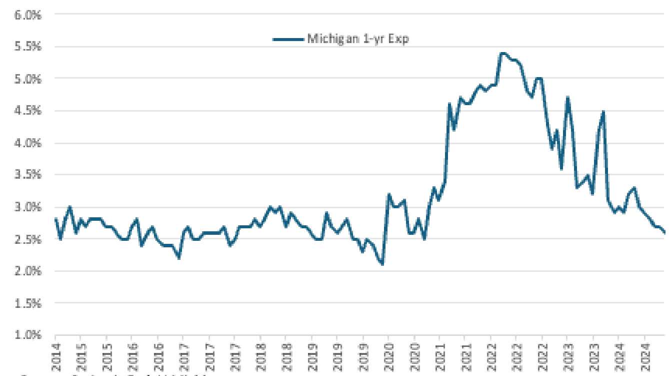
For this reason – more apathy and shock by some – the audaciousness of his policies may come as a surprise. "You mean he was serious?" Yes. This collective mainstream gasp at what is likely to come should dominate headlines for the foreseeable future. No judgement here. Investing is apolitical. But is also radically objective. It is my job to attempt to uncover what is not appreciated by markets or asset prices and consider how that could impact portfolios.

Between a new oligarchy class, technology policy, trade policy, industrial/neo-capitalist policy, we have a lot to work through and decipher in the coming months. Throw in a stubbornly high inflation rate and cost of capital and we're entering "adult swim" markets.

Upcoming Data

What won't get a ton of attention outside the data wonks will be important, nonetheless. I will be focusing on the German ZEW index on (manufacturing sentiment), The US Leading Index, Initial Claims, and a whole host of PMI and Michigan data to close out the week. Sprinkled among here are a couple of US Treasury auctions that are always fodder, and with the red headed stepchild (20-year maturity) coming, there could be fireworks.

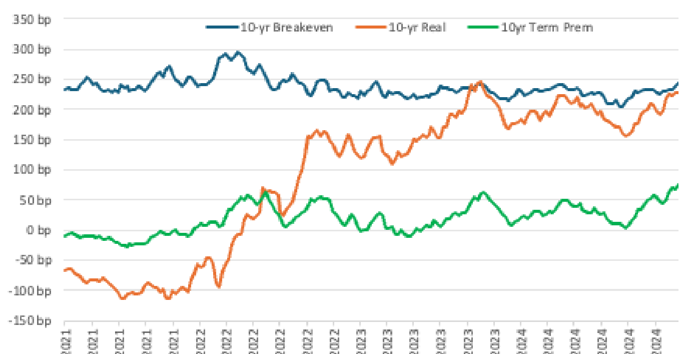
Figure 1: Michigan Inflation, expected 3.3%



Source: St. Louis Fed, U Michigan

I'll be paying close attention to the Michigan 1- and 5-yr inflation expectations very closely, as it does feel a little as thought we are approaching an inflection point here. With social media just abuzz with conflicting views on inflation expectations maintaining or coming loose off their anchors, this will be a great data point. it is not showing up substantially in markets. A divergence to watch.

Figure 2: Breakevens not showing concern



Source: St. Louis Fed

Long Rates / Positioning

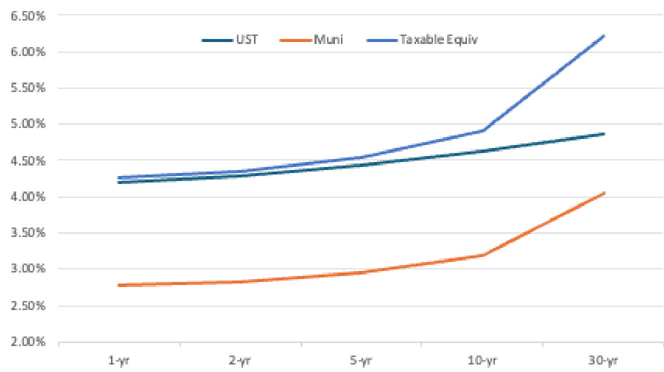
The long bond bounced off 5% like a bad check, which to many signals both psychological and technical support. However, it is important to consider that the investing in the long end without a stated purpose and use in a portfolio context is like playing the Squid Game. It's treacherous. Professionals own it, or futures representing it, to plug risk characteristics in their portfolio and for those of us who used them in credit portfolios when correlations shifted, it was painful. I doubt I will ever own the long end outright again.

Perhaps the only exception might be the long end of the generic municipal curve, which sticks out on a taxable equivalent basis. This data is likely substantially skewed by CA yields, and perhaps other stressed credits, so if you are contemplating this, do your work and do not blindly buy anything.

As a data point, 30-yr MA GOs are roughly 4% on a YTW basis and 4.5% on YTM, so its not wildly off.

Unlike US Treasury long end buyers, the municipal ecosystem is often viewed as a buy and hold space and income generator, compared with US Treasuries, which I personally view as more of a building block, a risk factor, in a more diversified portfolio.

Figure 3: Long end of muni curve

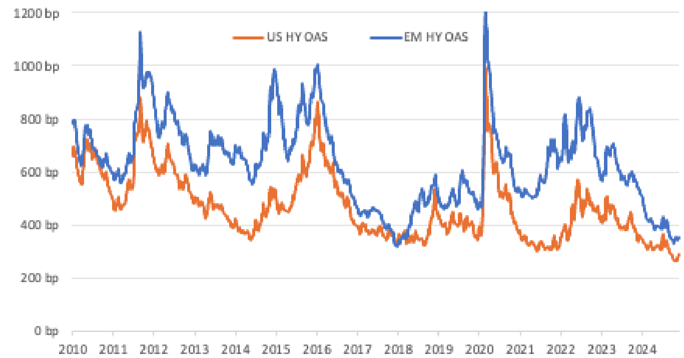


Source: Bloomberg

<u>Spread Compression</u>

Within spread sectors, it's quite challenging to find something to get excited about, which has philosophically driven me to generally fade riskier and higher beta portions of all markets, and the case is here as well, with EM HY trading on top of US HY in the context of both a geopolitical environment and currency dynamic that is not agreeable. Yes, historical comparisons in these markets are challenging, considering the evolution of both, but for like spreads, I am holding US HY and feeling just fine about it. There is a tendency on the part of managers to reach for incremental yield outside their benchmark, often when it is inappropriate, because they view out yielding their peers as a temporary fix. It is until it is not. Eyeballing underperformance in the mid-teens (current account, FX crisis), and 2022 (correlation crisis), patience is rewarded.

Figure 4: EM looks rich to US HY



Source: St. Louis Fed, BaML

For now, my risk exposure in HY is active, as many non-opportunistic active managers do not overweight CCCs, and I pair a more traditional strategy (Blue Bay High Yield) with a smaller, more nimble strategy (Intrepid Income) that focuses more on idiosyncratic risk and is less tied to the benchmark. I also happen to know the manager personally, and respect him greatly as a person, thinker, and investor, and he has strength of process. Many lack this. The highest praise I can give an investor is that they have earned my trust, and that is the case here. (remember, no recommendations here, just personal views).

Stay humble my friends,
Henry