July 7th, 2025

FESC Asset Management

MACRO VIEW

Snapshot

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MacroView *Snapshot*:

A Fed Blink and a Soaring Deficit Mark the End of Cheap Money

The initial half of 2025 has witnessed the emergence of a scenario we previously identified as a key concern: "The Fed Blinks." Our fear centered on the Federal Reserve prematurely initiating interest rate cuts before compelling evidence of inflation sustainably converging towards its 2% target materialized. This constituted a policy misstep, in our assessment, as core inflation (2.8% YoY) and services inflation (3.7% YoY) in May remained above the levels needed for the Fed to reach its target. **This premature action has supported a stubborn return to a higher average rate of inflation, cementing it for the long term and marking the definitive end of cheap money.**

Key U.S. Macroeconomic Dynamics

Inflation's Second Act: The Fed's removal of counter-pressure to price growth could prove costly in the face of rising trade tariffs. While the latest inflation data doesn't yet show a spike from tariffs, this is likely due to an inventory "front-loading" effect. If tariffs remain, the risk of higher goods inflation is significant and could establish a floor for the decline in services inflation. We assess that inflation is unlikely to remain close to 2% over the long term and will likely stabilize in the 3-3.5% range.

Fiscal and Trade Challenges: The administration's efforts to reduce the trade deficit via tariffs are unlikely to yield significant results, and the fiscal deficit is projected to further exacerbate given the approved budget and the simultaneous extension of tax cuts. We believe attracting financial capital is paramount to redressing the deficit problem by enhancing the global competitiveness of U.S. services—the industries of the future—instead of focusing on a 20th-century growth model based on manufacturing.

Economic Resilience: In the short and mid-term, we do not anticipate a recession in the United States. While the pace of job creation has moderated, employment figures and consumer spending remain robust. This lack of a convincing deceleration in growth means there is no counter force to rising rates, reinforcing pressure on short- and long-term interest rates.

Global Dynamics and Vulnerabilities

Japan's Yield Curve Shift: The Bank of Japan's backtracking on its Yield Curve Control policy has caused long-term Japanese bonds to experience significant price declines and yield increases. We believe this dynamic is fundamental for the global bond market and could reinforce a worldwide environment of increasing interest rates.

China's Silent Crisis: The economic outlook in China presents an even more challenging picture. The persistent real estate crisis and massive public and private debt keep the economy mired in a worrying deflationary environment. Despite official growth targets, the growth model appears unsustainable in the long term, and monetary stimuli have proven insufficient to reactivate investment or consumption.

Final Thoughts and Investment Opportunities

On this landscape, the crucial question for investors is what would be more important for markets: **an attractive interest rate environment in the U.S. or the attractiveness of other markets as we enter a multi-polar world**. We expect capital to flow in waves, and surfing those waves will be crucial for success. Portfolios are probably better diversifying.

Investment Opportunities:

Alternatives to the USD and US T-Bills: We recommend reducing U.S. Dollar exposure in favor of other liquid currencies like the Euro and the Yen.

Precious Metals: We advise maintaining a position in Gold as a classic safe haven asset and see excellent opportunities in Silver and Platinum.

Semiconductors and chip components: Recent market volatility offers a chance to invest in semiconductor and chip component firms. These are essential for all electronics, and higher-risk opportunities exist in companies focused on AI, 5G, IoT, and EV technologies due to their growth potential. Quantum computing stocks are also an option, but they are more speculative.

China and India Equity: We maintain a strongly positive outlook on the Chinese equity market and are highly supportive of India's outlook, noting its robust domestic market and strong signs of industrialization.

Emerging Equity Markets: We are actively scouting for opportunities in solid Emerging Markets or those recovering from periods of high stress, including the equity markets of Argentina, Brazil, Indonesia, Taiwan, Vietnam, or Poland.

Short U.S. Sovereign Long-Term Debt: Our conviction trade remains unchanged: we expect yields on long-term U.S. government bonds (those with maturities of 10 years or more) to continue their ascent. We therefore recommend favoring short-term fixed-income investments and building positions that benefit from rising long-term yields.

For any questions or any further information in the outlook, please feel free to Contact us at: info@fesc-am.com . We will be glad to be in contact with you and discuss.

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