

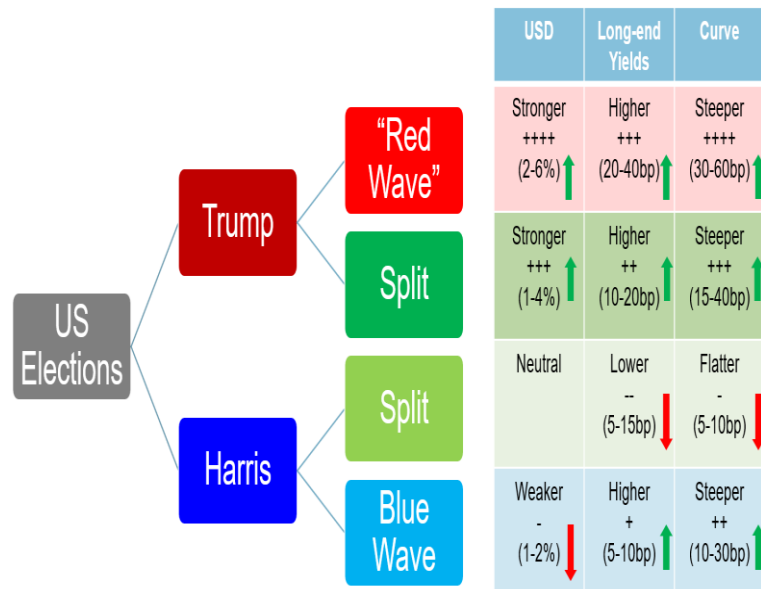
Binary Outcomes, Not risks

In a Nutshell

- With US elections around the corner (5th Nov), the tendency for higher long-end yields, a steeper curve and stronger USD are being asserted.
- This partly reflects the growing probability of a rump 2.0 outcome in what is still a tight race (with margin of error accounted for).
- But equally, **market risks are not strictly binary, even if the election outcome is.**
- Instead, **an entire continuum** of *fiscal*, *inflation* and *geo-political* risks will influence markets.
- To that end, a **steeper curve amid sharpening fiscal deterioration** is **broadly consistent** outcome with either Republican or Democrat victory.
- Specifically, as the **more pronounced drag on front-end yields** resulting from of *Fed easing* accentuates the steepening effects (as relatively lower front-end).
- A notable nuance is that a split Harris victory may square with softer yields as Republican are likely to block Democrat spending plans.
- The **Greenback** is also **inclined to stronger**, in the Trump 2.0 scenario.
- But **in any case**, at the USD will be **broadly resilient** given a conspiracy of *geo-political risks/uncertainty (including trade conflict)*,

relative US exceptionalism and *steeper UST curve*.

- **Flow-through volatility** from CNY (due to Trump 2.0 trade antagonism) and **downside risks to AXJ**, led by *THB* and *MYR*, is significant.
- Especially given the step-up in sensitivities (“CNY-beta”). But equally, this is not a static relationship.
- So, **AUD and KRW vulnerabilities should not be underestimated** given longer-run sensitivities.
- On the other hand, **MYR may be better placed on strategic investment-driven CNY beta lift.**

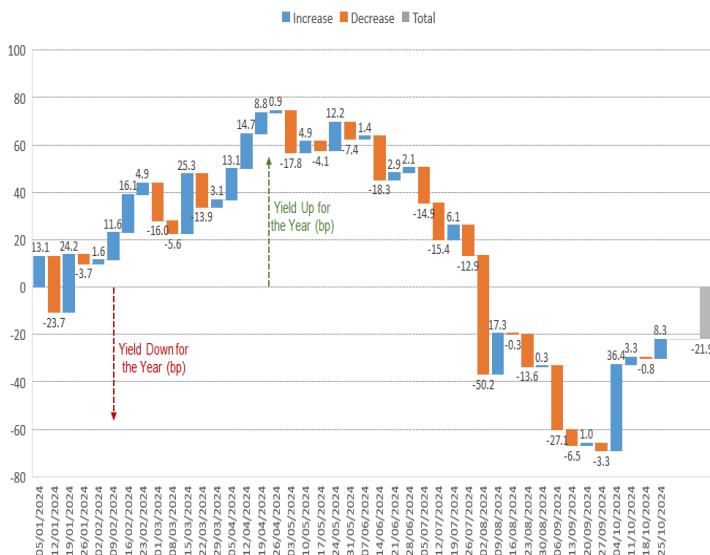


Note: These outcomes are expected to last 4-8 weeks, reflecting perceptions and “announcement effects”. Whereas our view is that Trump 2.0 may be less adverse for China than feared given Trump’s transactional tendencies, inclined to water down trade actions.

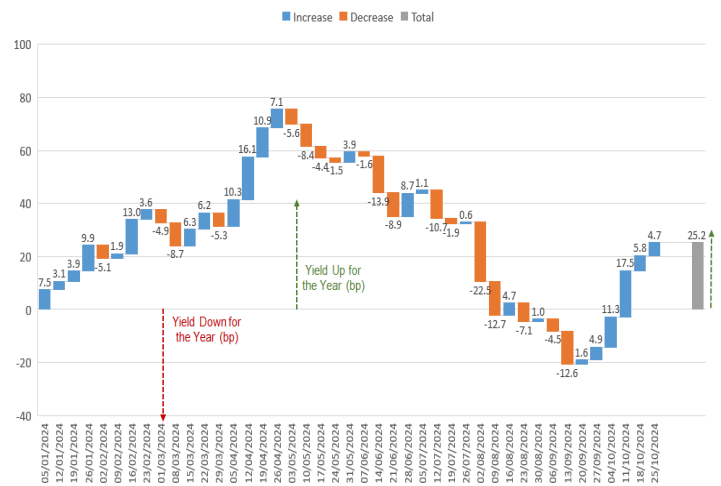
Splitting Fiscal Hairs

- **Medium-term fiscal/debt outcomes** are, to us, a key example of where the risk between Harris and Trump is **not binary**.
- To be sure, the **Democrat spending plans** and the **Republican/Trump tax cut plans** arguably have **significant distributional differences**.
- Nonetheless, (and without trivializing the distributional shifts) the **bottom-line of worrying fiscal and debt deterioration is not materially alleviated under either**.
- Especially as the debt servicing burden of the future budgets increase precariously to account for some two thirds of the estimated 6-6.5% fiscal deficit.
- What this means is **that absent a dramatic fiscal austerity drive**, the **ability of any US government (Republican or Democrat) to extricate itself from a worsening debt spiral is compromised**.
- Hence, the **knee-jerk for higher long-end yields**, reflecting worsening fiscal-debt dynamics further out is wholly expected.

2Y UST Yields (2-week Avg Chg since end-2023; bp): **Policy-Sensitive 2Y UST Yields**, which Fell Distinctly Since mid-2023, has **Partially Retraced "Pivot" Drop in October** amid Upside Data Surprises. **But Front-end Yields are Still Down YTD (~22bp at 4.02% from ~4.25% at end-2023)**. Reflects **Easing Cycle Dampened, Not Derailed**.



10Y UST Yields (2-week Avg Chg since end-2023; bp): **In Contrast to Softer Front-end Yields YTD, 10Y Yields are Up ~25bp, near -4.2% (from 3.88% at end-2023)**. This partly reflects **fiscal/debt woes as well as (structural) inflation risks associated with US Elections**. Notably, a **Trump 2.0 outcome**.



But Unflinching Fed

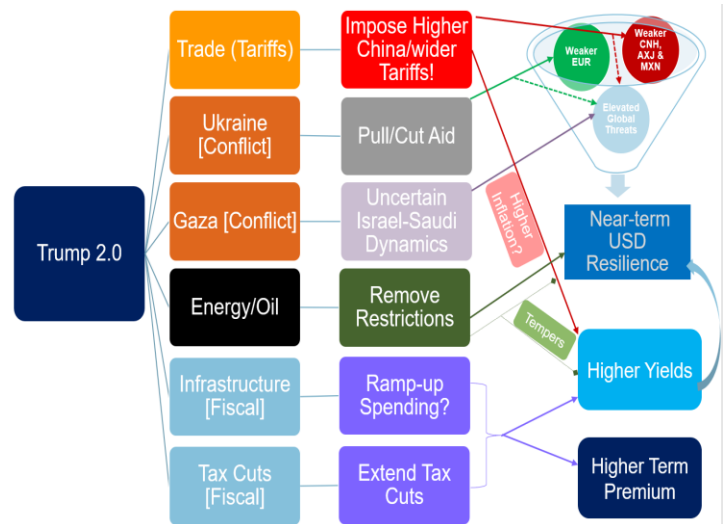
- This **swing up in yields into the elections** is however likely to have been **exaggerated by recent run of US data out-performance**.
- Whereas insofar that this merely **dampens, but does not derail, further Fed easing**, US elections may only trigger a **temporary detour higher in yields**.
- A more **enduring inclination for softer yields, especially at the policy-sensitive front-end**, is set to be underpinned by further Fed rate cut expectations.
- In turn, this should reinforce the dynamic for a distinctly steeper yield curve, with the 10Y-2Y UST spread set to rise to 50-100bp.

Trump 2.0 & Fat Tails

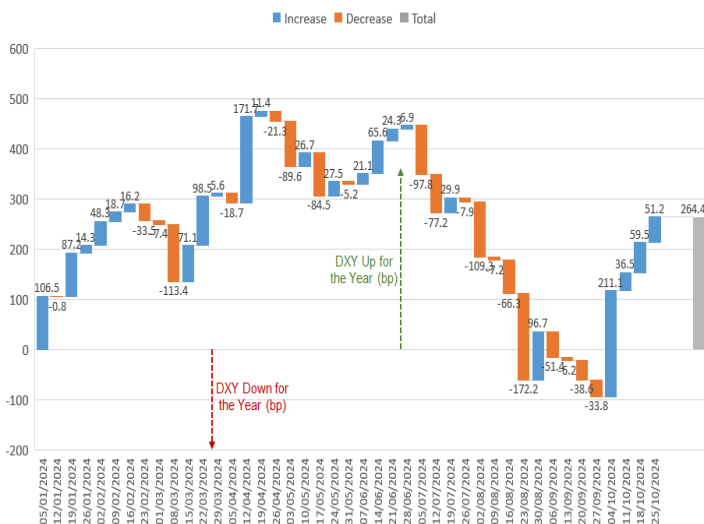
- Notably, part of the sharp pick-up in yields suggest **markets are reanimated by fatter tail risks ascribed to the rising chances of Trump 2.0**.
- This “fatter tail” stems from the prospects for a **more brutal assault on global trade exacerbated by a higher degree of policy uncertainty** associated with Trump.

- On global trade, the fear is that **sweeping tariffs on Chinese-made goods**, will be accompanied by a **fairly large spill-over to other trading partners via supply-chain linkages and/or Chinese manufacturing base**.
- This throws up far greater uncertainty around the scope of potential tariffs, accentuating a greater degree of stagflation-type outcomes.
- Consequently, **structural inflation expectations/uncertainty will be perceived to be higher under Trump**, lending itself to a comparatively **more acute squeeze in yields**.
- Moreover, **Republicans’ may be more effective in blocking Harris’ spending plans than Democrats be in thwarting Trump’s tax cuts**.
- Coupled with the bias to overestimate offsetting, positive (taxable) growth impact from tax cuts means Republican fiscal deterioration could worsen further out, underscoring more emphatic curve steepening.

- For one, *haven demand* amid **uncertainty** and **fraught geopolitics** point to an underpinned USD given that the lack of depth in Gold.
- What’s more, *adverse global trade dynamics* effects undermining major trading partner currencies (CNY, EUR, MXN etc.) lends themselves to a propensity for **stronger USD**.



DXY Index (Weekly Chg from end-2023; bp): After a Sharp Downswing in Q3 (on Fed Pivot), USD Index has Rebounded in Oct, up ~265bp at 104 (from 101.33 at end-2023). USD is Presumably Reflecting Strength Associated with Relative US Exceptionalism & Election Risks.



Dollar Trump

- What’s more, *in defiance of the dismal fiscal outlook*, **USD may be even more bullish on Trump 2.0**.

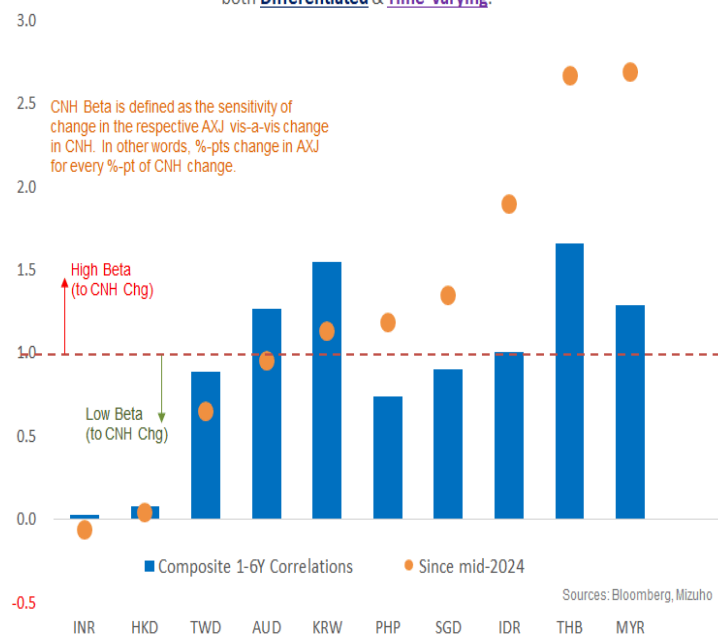
- Furthermore, the **Fed easing cycle is likely to be matched by other Major central banks** given *relative US exceptionalism* (things being worse elsewhere).
- This in turn *diminishes USD drag* from Fed cuts (as the *allure of Majors are limited* by mostly steady relative spreads).
- In addition, a *steeper UST yield curve* (as term premium being is restored) *compromises higher-beta/risk currencies*. The **risk re-pricing** involved squares with a preference for USD.
- Finally, *US energy resilience* from its crude (and natural gas) production (both conventional and shale) **translates to greater USD resilience** (especially vs. EUR and JPY) in a geo-politically charged world.

The China-RMB Risks

- The **biggest risk swing factor** may be channeled via *China trade risks* and attendant **RMB effects**.
- For one, the **transmission via supply-chains and financial linkages** will be **sweeping**. And **especially pronounced for AXJ**.
- So much so that ironically, CNY (and CNH) may actually be lower-beta than some other AXJ despite the trade assault being trained on Beijing.
- This is not merely due to amplifying supply-linkages, but also derives from CNY having the benefit of quasi-capital controls and deep FX reserves to engineer stability.
- In contrast, the RMB impact on other AXJ may be amplified by higher-beta commodity (AUD), investments (MYR) and tourism (THB) channels.
- What’s useful is that recently **heightened sensitivity (beta)** of **MYR** and **THB to CNY** moves suggests that **volatility from US elections will also transmit** accordingly.

- But the **challenge is that the “CNY beta” of most APAC currencies is not static, but time-varying**.
- So, longer-term sensitivities warn that AUD and KRW could also be highly sensitive.
- More specifically, the nature of trade antagonism, consequent supply-chain impact and Beijing’s response (both offsetting (stimulus) as well as retaliatory counter-tariffs) will determine precise reactions.
- For now though, the *MYR appears to be best placed* given the lift in CNY beta is driven by strategic investments flows (from China) that is not as proximately trade related.

CNH Beta*: There is Notable Variation in **CNH-Beta of AXJ**, which are both **Differentiated & Time-Varying**.



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