Trinity Student Managed Fund
Research Team

Bi-Weekly Markets Update

OCTOBER 14TH, 2024

TRINITY SMF
STUDENT MANAGED FUND

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Past Weeks in Review

- RBNZ cut interest rate by 0.5%
- US added 254,000 jobs
- US PMI at 47.3

The Next Two Weeks

- ECB interest rate decision
- US retail sales data (MoM)
- China GDP data (YoY)

Reaction of Shanghai Index to Stimulus Package

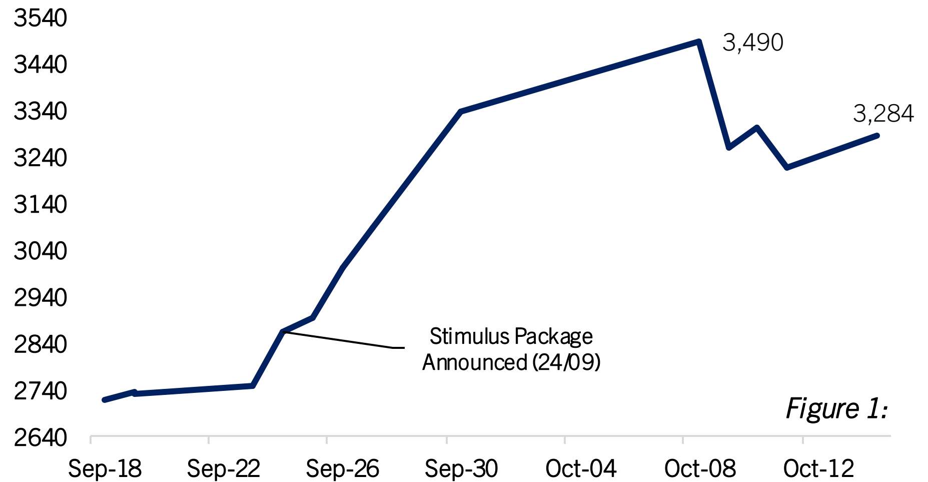
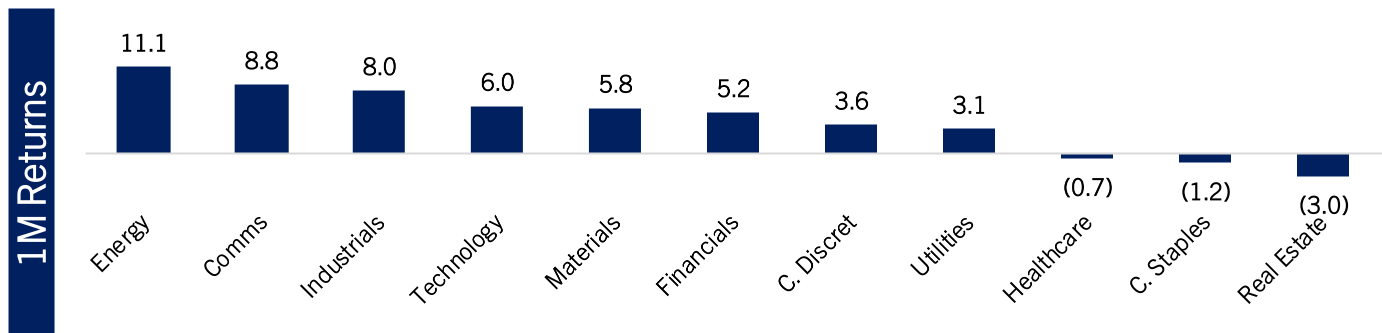
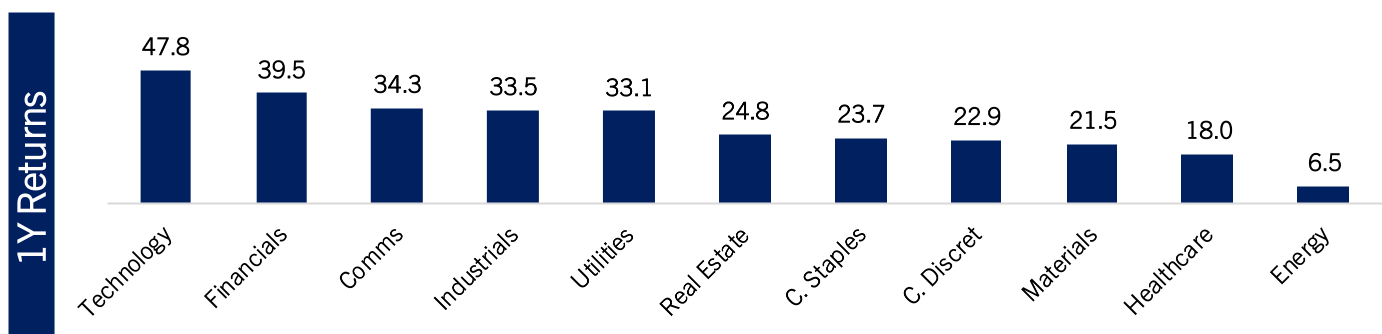


Figure 1:

Index Returns (%)						
Equities	Level	1 M	YTD	1 Year	3 Year	5 Year
MSCI	3,732	2.5	17.8	29.3	21	71.6
S&P 500	5,815	3.2	22.6	33	31	96
Dow Jones 30	42,864	3	13.7	26.1	22.8	60
Russell 2000	2,234	2.1	11	27.9	(1.8)	48.4
Russell 1000 Growth	3,828	4.1	27.3	38.1	34.4	137.1
Russell 1000 Value	1,885	2.5	15.3	26	18.3	51.1
NASDAQ	18,343	4.3	24.2	35.2	23.7	127.9

Levels (%)						
Key Rates	14/10/24	30/9/24	31/7/24	30/4/24	31/1/24	30/9/23
2Y U.S. Treasuries	4.0	3.6	4.3	5.1	4.2	5.1
10Y U.S. Treasuries	4.1	3.8	4.0	4.7	3.9	4.6
30Y U.S. Treasuries	4.4	4.1	4.3	4.8	4.2	4.7
10Y German Bund	2.3	2.1	2.3	2.6	2.2	2.9
10Y Japanese Gov Bond	1.0	0.9	1.1	0.9	0.7	0.8
10Y U.K. Gilt	4.2	4.0	4.0	4.4	3.8	4.5
SOFR	4.8	5.0	5.4	5.3	5.3	5.3





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Mario Draghi's Report on EU Competition: A Call To Action

EUROPE'S DESPERATELY NEEDED ANTITRUST POLICY REVISION

Former ECB President Mario Draghi has called for reforms to the European Union's competition policies in a report aimed at revitalising the EU's global competitiveness. Draghi's report states that Europe needs to invest around €800 billion annually to close the widening economic gap between the bloc and the U.S. and China. (1) Draghi placed a particular emphasis on the need for investment in critical sectors such as technology, energy and defence, where European companies face fierce competition from U.S. and Chinese competitors. Aside from increased investment, the bloc must do more to foster innovation, simplify regulation, and ensure greater market flexibility to strengthen its industrial foundation.

According to Draghi, this entails updating competition laws to allow for more strategic mergers. In particular, he emphasises the importance of doing so in sectors where European firms are unable to scale and compete effectively against global tech giants like Apple, Google and Amazon. Fragmented EU markets prevent European companies from growing to a size that could rival American and Chinese competitors. Draghi believes that more lenient competition laws are a fundamental part of the solution to this problem. Additionally, Draghi suggests easing the restriction on state aid to encourage investment in key technological sectors such as artificial intelligence and renewable energy.

CHALLENGES POSED BY U.S. AND CHINESE COMPETITORS

As previously stated, European firms continue to struggle to compete in terms of scale due to a fragmented internal market and more stringent regulations. The global scale of U.S. and Chinese companies such as Huawei and Tencent allows them to leverage their customer bases, benefit from relaxed domestic regulations, and, in the case of Chinese firms, receive strong state support. This results in a substantial imbalance from relaxed domestic regulations, and, in the case of Chinese firms, receive strong state support. This results in a substantial imbalance which leaves European firms trailing behind. Anu Bradford's "Brussels Effect" sheds light on a strategic paradox. (2) While the EU has been successful in exporting its regulatory standards globally – particularly in areas such as privacy with the GDPR – these high standards often make it difficult for European companies to innovate at the same pace as their global competitors. Notably, smaller firms face high compliance costs and administrative burdens which can limit their ability to scale quickly and effectively in rapidly evolving sectors.

Draghi's call for streamlining regulations under the Digital Markets Act (DMA) and the AI Act reflects this concern. While these regulations are necessary to protect consumers and ensure market fairness, their complexities risk hampering the competitiveness of European firms. To counteract these challenges, Draghi proposes reforms that would make the process of consolidation much easier for European firms. This would help to bridge the gap between European firms and American and Chinese giants. Bradford's emphasis on promoting open access and interoperability within the EU complements this strategy.

MARGRETHE VESTAGER'S PUSHBACK

While both Draghi and Bradford advocate for greater flexibility regarding antitrust rules, European Commissioner Margrethe Vestager has presented a contrasting perspective. Vestager has been a prominent figure in her efforts to prevent the creation of monopolistic market conditions. Her primary concern states that loosening antitrust regulations would undermine consumer welfare by reducing market competition and increasing prices with the European Union.

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Vestager's stance is rooted in the belief that market dominance by a few larger firms does not stifle innovation and consumer choice. This is evident in recent cases like the new antitrust action against Visa and the proposed Siemens-Alstom merger, where it was argued that such consolidations would greatly diminish competition within the EU and stifle innovation over time. (3) The decision highlights the Commissioner's view that large-scale mergers, while potentially beneficial for corporate growth, could create "European champions". Such champions would dominate industries to the detriment of smaller players and market dynamism. In essence, while Draghi calls for easing restrictions to enhance competitiveness, Vestager emphasises the importance of a more cautious, targeted approach to antitrust policy reform. This debate reflects the broader challenges the EU faces: how to foster growth and innovation while maintaining high regulatory standards that ensure fairness and consumer protection.

The U.S.' Soaring Debt Pile

According to the Congressional Budget Office's (CBO) updated "Budget and Economic Outlook: 2024 to 2034" report, the U.S. debt-to-GDP ratio is projected to reach 99% in 2024. The budget deficit for the year is estimated at $1.9 trillion, representing 7% of GDP. (4) As of April 2024, International Monetary Fund (IMF) data ranks the United States as the economy with the eighth-highest net debt-to-GDP ratio globally, placing it below other advanced economies such as France, Italy, and Japan. However, the rate of debt accumulation in the U.S. is much faster, with its budget deficit identified as the second-highest among advanced economies. (5) U.S. government borrowing has increased significantly in recent years, averaging a 9% budget deficit over the past five years, compared to an average 3.7% deficit over the past 50 years. (6)

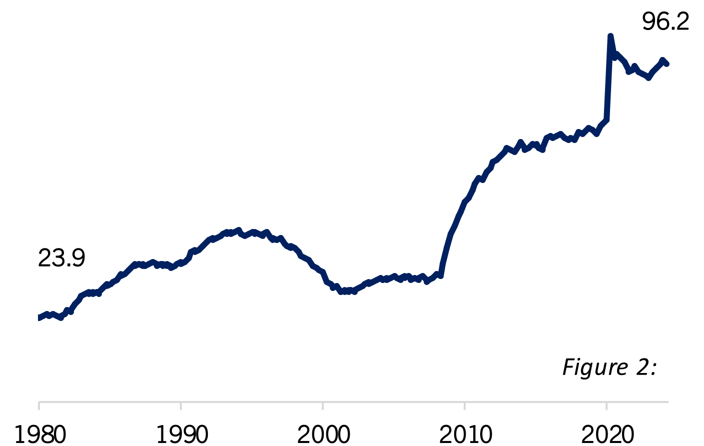

Figure 2:

ACCELERATED BORROWING

Over the past several years, U.S. government debt has been rapidly expanding due to a series of fiscal policy decisions that have increased budget deficits. Legislation introduced by both the Biden and Trump administrations—including the 2017 tax cuts, COVID-19 economic stimulus spending, the Infrastructure Investment and Jobs Act, the CHIPS and Science Act, and the Inflation Reduction Act—has contributed to a national debt that currently stands at $35.3 trillion. (7)

While increased government spending has significantly boosted the U.S. economy—making it 8.2% larger than in the fourth quarter of 2019, compared to the Eurozone's 3.5% and the UK's 1.1% —it has also resulted in budget deficits that are significantly higher than average. (8) Government revenue is 33% of GDP, lower than that of most other advanced economies, yet the U.S.'s projected 7% deficit for 2024 is more than three times the 2% average among advanced economies. (9) Based on the current spending trajectory, the Congressional Budget Office (CBO) predicts that the debt-to-GDP ratio will rise to 172% over the next 30 years, surpassing the previous high of 106% following World War II by 2029. (10) Additionally, budget deficits are expected to range from 5.2% to 6.3% over the next decade. (9)

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IMPACT OF THE 2024 ELECTION

While U.S. national debt and budget deficits are expected to continue their upward trends, the outcome of the upcoming 2024 U.S. Presidential election in November will significantly impact their trajectories. The Penn Wharton Budget Model (PWBM), released on August 26, 2024, compares the potential effects of an incoming Harris or Trump administration on the national debt. According to the PWBM, a Harris victory would see the federal deficit rise by $1.2 trillion, compared to Trump's $5.8 trillion increase. (11) However, due to higher projected economic growth under Trump's policy agenda, the budget deficits under both candidates would be similar. Harris's fiscal policies would increase the deficit to 7%, whereas Trump's policies would lead to an increase to 8%, both compared to the current baseline projection of 6%. (11)

Constructing accurate projections in both cases is challenging, given the unusually vague policy platforms presented by both candidates ahead of the election. The PWBM considers official policies unveiled by the Harris campaign, including her commitment to a larger child tax credit and an increase in the corporate income tax to 28%. The model does not account for her support to increase taxes only on Americans earning above $400,000 per year, which would require an extension of most of Trump's 2017 tax cuts, set to expire next year (11). Trump's agenda also includes extending the 2017 tax cuts, along with reducing the corporate income tax to 15% or 20%, which together would add between $4 trillion and $5 trillion to budget deficits over the next decade due to forgone revenue. (12)

OUTLOOK

As U.S. borrowing has rapidly increased, a greater proportion of federal spending has been

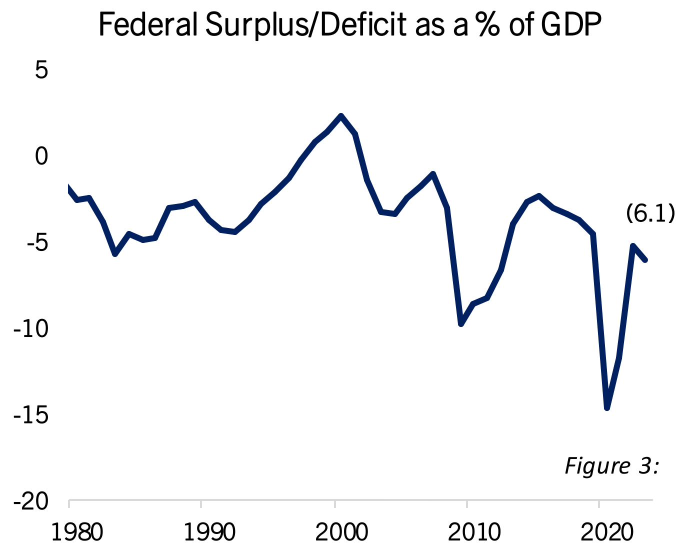

Figure 3:

allocated toward servicing the debt, requiring $728 billion in 2024, which represents 16% of government revenues. (5) This figure is expected to rise in the coming years regardless of any changes in borrowing. With an average debt maturity of six years, some existing debts carry low pre-pandemic interest rates. (5) Given the high-interest-rate environment of recent years, the cost of servicing the debt will thus increase. The International Monetary Fund (IMF) projects that a primary deficit reduction—before considering interest payments—of 4% would be required to stabilize the debt-to-GDP ratio by 2029. (6) This appears unlikely given current spending projections and the policy platforms of both presidential candidates in the upcoming election. Ultimately, neither candidate is likely to take action to reduce the national debt, given the need for both campaigns to appeal to voters through generous spending agendas.

The prospect of continued unfavourable debt dynamics has led to increased perceptions of risk and higher expected long-term interest rates. (11) The IMF believes that fiscal policy has been a bigger contributor to recent inflation than other supply and demand factors; thus, a continuation of the current borrowing trajectory may lead to

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sustained higher interest rates. (6) This would further increase the cost to the U.S. government of servicing the debt, reducing funds available for investment in projects and public services that yield long-term benefits. Combined with higher financing costs for individuals and companies, this may impact economic growth. (6) Despite a debt-to-GDP ratio projected to reach 172% by 2054, it is unlikely that the U.S. would default on its debt. (11) However, the impact of continued borrowing has long-term effects that could undermine the strength of the U.S. economy and public finances.

What's Next for the Fed Following the 50-Bps Cut?

On Wednesday the 18th of September, the Federal Open Markets Committee (FOMC) voted to lower the target range for the federal funds rate by 50-bps to 4.75% - 5.0% , marking the end of the most aggressive tightening cycle in 40 years.

JUSTIFICATION FOR THE 50-BPS CUT

In the lead-up to Wednesday, September 18th, investors debated whether the Federal Reserve would favour a 25 or 50-basis point reduction in interest rates. Ultimately, all members of the FOMC, except Michelle Bowman, voted for a 50-basis point cut. (13) Throughout the tightening cycle, Fed Chair Jerome Powell remained firm in his commitment to a 2% inflation target. For a fifth consecutive month, the annual headline inflation rate slowed, dropping from 2.9% in July to 2.5% in August, surprising analysts who had forecasted a 2.6% year-over-year increase. To date, significant disinflation progress has been made, considering that headline CPI inflation peaked at 9.1% year-over-year in June 2022. (14) Despite the decline in headline CPI, core CPI (which excludes more volatile items like fuel and food) edged up by 0.3% from July to August, faster than the estimated 0.2% increase. This uptick reduced expectations for a 50-basis point rate cut from 33% to 15% in the weeks before the announcement. (15)

However, in the days leading up to the decision, slowing job growth and rising unemployment figures led the market to price in nearly equal probabilities of a 25 and 50 basis points cut. (16) The Fed cautiously balances a 'dual mandate'. Had the FOMC opted to cut rates by 25 bps, taking a more gradual approach, they may have reduced market volatility. However, the consensus was that the Fed was attempting to pre-empt a slowdown in the U.S. economy and a weakening labour market, so a 25-basis point cut would likely have been insufficient.

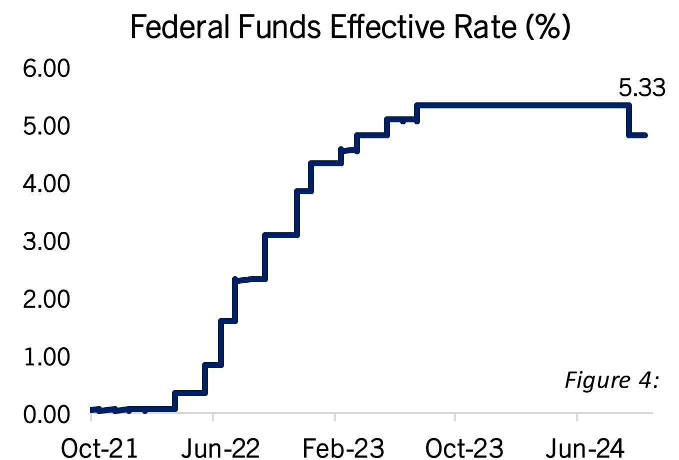

Figure 4:

LABOUR MARKET CONCERNS

In August, the unemployment rate rose from 3.8% to 4.2% year-over-year, reaching its highest level since October 2021. (17) Although the U.S. non-farm payroll added 142,000 jobs during the month, this figure was below the 12-month average monthly gain of 202,000 jobs. (18) Additionally, combined downward revisions for July and August revealed 86,000 fewer jobs than previously reported. Crucially, U.S.-based employers announced approximately 76,000 job

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cuts in August, tripling the number from July. (19) Given the Fed's dual mandate and these growing concerns within the labour market, a 50-basis-point rate cut appeared justified and was not expected to compromise the incremental progress toward the 2% inflation target.
Jerome Powell stated that the FOMC does not 'seek or welcome further cooling in labour market conditions.' (20) Echoing this sentiment, Chicago Fed President Austan Goolsbee pointed to the decades-high 'level of tightness,' measured as the difference between the Fed Funds rate and inflation. He noted that this level of tightness is required for 'an overheating economy,' but that 'this economy is not overheating.' (21) The Fed's dual mandate balancing act is now prioritising the risks of labour market softening over marginal disinflation improvements.

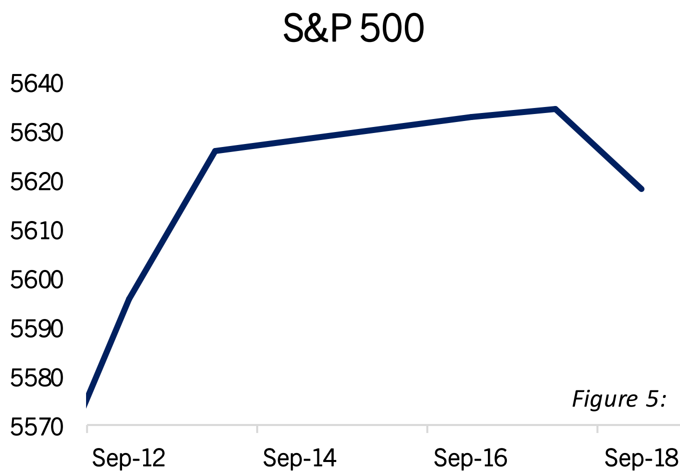

Figure 5:

HOW DID MARKETS REACT?

Given the probability of a 25 or 50-basis point cut was almost identical in advance of the decision, the market's initial response to the announcement was somewhat muted. A lot of the upside had already been priced in the week leading up to the decision, with the S&P 500 up 1.5% between the 11th and the 17th of September. (22) In the immediate aftermath of the announcement, stocks soared, with major indices setting all-time highs just minutes after. (23) The optimism was short-lived, however, as investors were left unsatisfied by Powell's attempt to dispel rumours that the Fed was behind the curve. Following the press conference, markets experienced high volatility before all three major U.S. indices ended Wednesday lower. (24)

Figure 6:

Muted Initial Reaction to Fed's Decision			
	S&P 500	Dow Jones 30	NASDAQ
Opening	5642	41629	17663
Closing	5618	41503	17573
Change (%)	(0.43)	(0.30)	(0.51)

WHAT'S NEXT FOR THE FED?

At their September meeting, the FOMC hinted at two more rate cuts to come in 2024. Powell pointed to the Fed's Summary of Economic Projections as a good indicator of the Fed's next moves. The summary suggested the Fed will lower rates twice more this year. (25) As the Fed places greater emphasis on the employment side of its mandate, labour market data is playing an increasingly significant role in influencing its monetary policy decisions. The Fed's approach over the next few months will be very data-driven. If inflation proves more stubborn than anticipated, the Fed will be a lot more cautious about the extent to which they cut rates. If the job market cools more than originally expected, the FOMC may be forced to take a more aggressive approach. The September jobs report, released

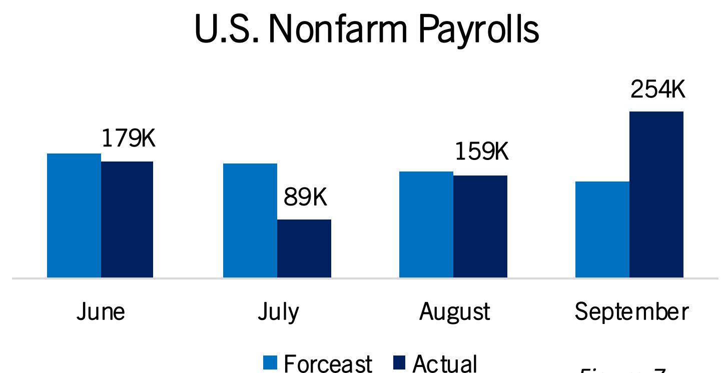

Figure 7:

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on October 6th, painted a compelling picture of the U.S. labour market and demonstrated the resilience of the American economy. Businesses added 254,000 jobs in September, far surpassing a forecasted figure of 147,000, whilst the unemployment rate fell from 4.2% to 4.1%. (26) Officials will welcome this healthy data but may take a more gradual approach for the next rate cut. October's job report is scheduled to be released just before the Fed's November meeting. Outlier events such as the Boeing Strike and Hurricane Helene are expected to disproportionately negatively impact the data, providing a muddled picture of recent developments in the labour market. Christopher Waller, a Fed Governor, has said he expects these factors to "reduce employment growth by more than 100,000 this month." (27) As a result, it is likely Fed officials will pay less attention to October's report. Regardless of these developments, the Fed's number one priority remains bringing inflation down to its target of 2%. If they continue to make good progress doing so, two more cuts this year is very much still on the cards.

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Jonathan is a third-year Joint Honours Economics and Mathematics student and is Head of Research for the 2024/2025 session. He has previously held the roles of Senior Research Analyst on the Research team and Junior Analyst in the Software sector. Jonathan has completed spring weeks at Lazard, BNP Paribas, and Morgan Stanley, and will be returning to Morgan Stanley next summer. He loves travelling, rugby and sailing.

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Sofia is a third-year Business & Economics student and is a Senior Research Analyst in the SMF for the 2024/25 session. She began as a Junior Analyst and the following year as a Macro Analyst. Outside of the fund, Sofia has recently completed an Internship at Deloitte. Sofia has been involved in music her whole life and is a fluent German speaker. This year, she will be attending McGill University as part of her Undergraduate studies. Her hobbies include listening to podcasts, playing and listening to music, and participating in sports.

MATTHEW THORNTON – Senior Research Analyst

Contributing Article: "What's Next for the Fed Following the 50-Bps Cut?

Matthew is a 3rd year Global Business student and Senior Research Analyst for the 2024/25 session. He was formerly a Junior Analyst in Basic Materials. Matthew has interned previously in KPMG Corporate Finance. Outside of college, he enjoys coaching tennis and holds qualifications in Ireland and Canada.

CONOR GRADY – Research Analyst

Contributing Article: "The U.S.' Soaring Debt Pile"

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Figure 1:

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