Episode 102

Election 2024—100 days before the vote: Market and policy impact

[00:00:05] Lara Rhame: Welcome back to FireSide, a podcast from FS Investments. I'm Lara Rhame, Chief U.S. Economist, and I could not be more excited to bring today's guests back to discuss two prime issues impacting all of us at a rapid pace: The election and investing. I'm joined by Jason Cole, our Head of Public Policy, who has had a 25-year career on the Hill and has been sharing his insights with us as these election news rapidly evolves. Jason, welcome.

[00:00:37] Jason Cole: Thanks, Lara. Great to be here.

[00:00:38] Lara Rhame: The other star of our show is Ryan Caldwell, the CIO of the Chiron Funds. Ryan, welcome.

[00:00:46] Ryan Caldwell: How are you doing, Lara? How are you doing, Jason? Thank you.

[00:00:49] Jason Cole: Great, Ryan. Good to see you.

[00:00:50] Lara Rhame: Ryan, I love, I love podcasting with you because I don't think anyone puts together the puzzle pieces of quantitative analysis, fundamentals, global asset allocation, policy together better than you do. And at the end of the day, Jason and I can opine on the economy and the elections as much as we want to.

But you really will tell us how to play this in markets. That's really where the rubber meets the road. And I think that's why I'm so excited to get our conversation going today. Jason and I recorded a podcast on the 2024 election. It was Market and Investing Impact, which has gotten over 250,000 impressions on Spotify.

And our podcasts, in general, are getting 1,500 downloads a month. So, it was really a no-brainer to bring Ryan into this conversation. It is really, I think, top of mind for everybody. There's earnings news, there's economic news, but this, I think, is the shadow of uncertainty that has its tentacles into everything, so that's why I'm so excited for today.

Jason, let me start off with you because I know that you have been almost recording now with us every week as events evolve. Time-stamp today, July 26. You know, it's been five days now that Biden has been off of the top of the Democratic ticket. Harris has been on and Obama has just come out and endorsed her. Nancy Pelosi's endorsed her. Is that a done deal?

[00:02:35] Jason Cole: It's a done deal. Okay. It's a done deal. And the process at this point, my understanding is that the delegates, the 3,900 or so delegates are going to convene in a virtual session on or around August 7 to officially nominate Kamala Harris as the presidential nominee for the Democratic Party.

[00:02:57] Lara Rhame: Okay.

[00:02:57] Jason Cole: And that's all taking place due to some state technicalities in a handful of states to try to get the nominee done before a date certain and will happen before the convention, which begins, I believe, on August 19.

[00:03:10] Lara Rhame: Okay. All right. So zoom out and just put this election in perspective, if you can.

[00:03:19] Jason Cole: Yeah, we're going to have to zoom way out. I'm going back to 1892. That was the last time that we had a presidential candidate vie for a second nonconsecutive term. So this thing started out.

[00:03:37] Lara Rhame: Who was that?

[00:03:38] Jason Cole: That was Grover Cleveland back in 1892. And Donald Trump is now only the second person in history ever to attempt this.

[00:03:46] Lara Rhame: So these things aren't unprecedented, but for all of us, they're unprecedented.

[00:03:50] Jason Cole: I recorded on Monday with Andrew and when we started out the podcast with unprecedented, and I said, at that point, this is an overused word, given where we are, right. We've had that 1892 data point. You have the two oldest, or did have the two oldest candidates, ever to run for president since May.

We've had a major party presidential nominee convicted 34 times. In the last 13 days, you had a gunman nearly kill that same nominee. And then the other party's major nominee drop out of the race, nominating his vice president and so we've never seen any of this. We're in totally uncharted territory and uncharted waters and it's been...exciting may be the right word, but it has certainly been interesting.

[00:04:37] Lara Rhame: And I think maybe another way to frame that is there's still—given how much has happened in such a short period of time—actually months away from the election in early November, and I can't imagine what's going to happen between now and then if this...I hope this pace of shift doesn't continue, but it seems like...

[00:04:57] Jason Cole: You and me both. Today marks 101 days until the election, and so we're almost at that famous hundred-day mark. That's an, in U.S. politics anyway, that's an incredibly short period of time, to wage a campaign, and sort of the mountain that Kamala Harris has in trying to put together a campaign in a very short period of time.

Now, the Brits do this all the time. They just did it. The French pulled together a campaign, two of them really, in a matter of weeks. But, in the United States, we have these interminable campaigns and 101 days is a very short period of time. I expect this race is going to settle in and become more familiar post-Labor Day. That's sort of the historical starting gun for an election. I think over the next few weeks, polls are going to be pretty volatile. The issue environment is going to be very volatile. But I think this will settle in sometime post-Labor Day.

[00:05:52] Lara Rhame: If the conclusion of this is that we are turning into Britain or France, that is a sorry conclusion indeed. All right, Ryan, talk to us about what's priced into markets. And I think you are going to give us so much good insight and information into how to trade all of this. I want to start with what's expected, what's priced in, because we all know that for markets, what happens relative to what's priced in is almost as important as what happens. So what are the markets expecting today?

[00:06:25] Ryan Caldwell: Look, Lara, it's great to have Jason here actually, because we really are—I think from a market's perspective—a bit in the fog of war, right. If I think about the geopolitics, I think about the local domestic politics, where we're at seasonally in the calendar; Lara, this is not in the bottom of the calendar, just from a market's perspective. And then, the Fed is now back in play, right. So you add it back in all these kinds of things and go, okay, how much of this is, you know, betting odds versus sort of the fog of war. But look, I think to Jason's point, post the RNC and maybe post the debates, right.

The betting odds in the market for a Trump win just exploded, right. And then, obviously, the market's been playing with President Biden would get replaced at some point. I think that was pretty consensus by the time it happened. And so if you think about just some really quick, basic market expressions of the Trump trade—and Lara, you and I've talked about this offline—but I'll just start the conversation here. You know, the market loves to go back to playbooks, right. So what it did was it kind of quickly went back to the 2016 playbook with a little bit of a twist, right. So again, thinking things like more domestic stimulus, things like more tariffs, right. And again, some of the very easy things that Trump has talked about, more energy exploration and drilling.

So right again, relative to the Biden administration that has at the moment, like LNG export restrictions. So what did the market do? LNG ripped, right. Energy was better all under this guy. So, under a Trump administration, we would drill baby drill. Some of the domestic construction companies all picked up the Caterpillars, the URIs, again, under this vein that we're going to just do more here, right.

We're going to near source more here. The other thing that happens, sort of post the betting odds, things like EV, the EV tax credit mandates going away. Now, that also got priced out. Again, Lara, fast-forwarding two weeks, like the big OEMs have all reported, Tesla, Ford and GM, and they were disastrous anyway, right.

So, I'm not sure how much of this is the credits are going away relative to nobody really wanted the cars anyway. So, if the credits go away, I'm not sure how much of an impact that really makes given that nobody was buying them with the credits. So, again, like this fog of war point, I just want to kind of reiterate in the sense that the market likes to go to these very easy, what it knows, mean reverting playbooks and like position.

And so where I think you could point to as the repositioning was less tech and global companies that have benefited from more globalization and more small cap, mid cap, domestic-oriented companies all played catch-up. And again, there's been some other things around that earnings. The other place I would point to—which both administrations quite honestly seem to be geared at—there was just talk right after the RNC about the Biden administration putting more semiconductor restrictions on companies like ASML and Tokyo Electron in Japan. And that had a profound impact on the semiconductor sector immediately. And again, that's the Biden administration, and I think the market thinks the Trump administration will be even harder there than maybe the Biden administration's been. So, there's been a lot moving around.

But I would say, Lara, there's probably a little bit, in my opinion, too much of the 2016 playbook that's being repriced by the market. Because it's at least—my opinion and reading the tea leaves and talking to some of the people that are likely to be in the Trump administration—that this isn't going to feel like the 2016 Trump administration and the starting points aren't anywhere close to where they were in 2016, which of course we can get into.

I'm not so sure I would solidify what the market priced in the last two weeks, and I think Jason brings up a really good point. This thing feels to me like it's all getting tightened in post-Labor Day, and this kind of Republican sweep that was maybe in the market is very quickly coming out, and something that looks tighter or more divided government is likely maybe to migrate its way back into markets as we get post-Labor Day. So, let's wait right here and see what this looks like, as Jason said, as we really gear into this last hundred days running into November.

[00:11:07] Lara Rhame: I think, as always, you're leading me right to where I wanted to go, which is that from an economic standpoint, from a sort of a macro market standpoint, this is absolutely not the backdrop that we were facing in the 2016 election. At that time, the Fed funds rate was zero. The 10-year was 1.8? Incredibly low. GDP growth in the five years leading up to the 2016 election had been lackluster; the year prior, it averaged 2%. That's fine. But today we're averaging 2.6%. And during Trump's tenure, it averaged 2.7%. So stronger economy, significantly higher interest rates. What were price-to-earnings ratios going into 2015, going into the 2016 election?

[00:12:11] Ryan Caldwell: You were sort of mid 16s to 17 maybe…

[00:12:15] Lara Rhame: Maybe after the correction, we're down to only 20—PE—but that is also incredibly high from any kind of historic lens. So, when I think about the fact that Trump 1.0 teased tariffs that felt radical…we've talked about how Biden did not roll back a single tariff that Trump put in place. In fact, he added more on. And now I feel like that is bipartisan. It is accepted. It is language that we've all almost become immune to. And so the prospect for moving deeper into that deglobalization trade, I feel like that door is wide open. Both candidates are going to walk through it. And, you know, you've mentioned that some of the, you know, policies that Trump is, you know, candidate Trump is discussing, take that quite a bit further in sort of Trump 2.0.

[00:13:13] Ryan Caldwell: No question, Lara. I mean, the other thing we didn't touch on is the deficit position is in a wildly different position.

[00:13:20] Lara Rhame: Yes. Another, another great example as well.

[00:13:23] Ryan Caldwell: Right. So even when you think about the tax cuts, starting point of the Trump tax cuts and where we're at in 2024, we're nowhere close to that starting point.

[00:13:34] Lara Rhame: I think that the deficit as a share of GDP at that point was like 2.5% as a share of GDP. Today it's almost seven. It's almost seven. so that's extraordinary. Very high.

[00:13:49] Ryan Caldwell: So…

[00:13:50] Lara Rhame: …a healthy economy.

[00:13:51] Ryan Caldwell: You can't really reasonably even think about running Trump 1.0 with that starting point of backdrop of interest rates, deficit, and then to your point, Lara, when you just start to talk about tariffing, right. And again, to your point, it's just become part of the nomenclature to a degree that we don't really even question whether we're going to get more of it. I think the expectation is regardless of outcome of administration, they're likely to stay in pop. And again, obviously, in the Trump administration, get worse. So your point to me is exactly right, we're going to push further. Particularly in a candidate Trump win. Now, again, if he doesn't have a full sweep, this is going to be tougher and sloggier and uglier, but more into this deglobalization trade, pulling the world apart at a time, as you just pointed out, the multiples are really high and the margins are really high and the margins are really benefiting still from globalization.

[00:14:51] Lara Rhame: And of course, yeah, I'm sorry to interrupt you Ryan. I was going to say I even forgot one of the biggest changes of all between now and back then, which is that leading up to the 2016 election, inflation had been low, it had been lower than target. It had been low for 10 years and today we're in the completely opposite situation So, this is something I'm eager to get everyone's opinion on because I want to take the conversation back to Jason because what can Trump do?

I think helping people understand what Trump can unilaterally impact, and Ryan teased it up perfectly. We need to think about the down ballot races and what Congress and the House look like. What can Trump do unilaterally at a time when inflation is high? And I think tariffs are bipartisan, but how much power does the White House have there?

[00:15:45] Jason Cole: A lot of power on the tariff side, as a practical matter. As a technical matter, not a lot, but as a practical matter, they do. I mean, the Trade Act is pretty clear, and the Constitution is pretty clear that Congress has the authority to impose tariffs. But the Trade Act creates exemptions around national security and those exemptions were used pretty broadly in Trump 1.0, with pretty de minimis pushback from the Congress. And so you've seen over years, Congress ceding their authority around tariffs in particular, to the executive branch. And it got us pretty high tariffs in the Trump administration. And to your point, Lara, none of which were removed in the Biden administration; in fact, added upon.

And so there is some bipartisan support for this, particularly vis-à-vis China, around tariffs. I'm not so sure the support exists when you start talking—as Trump has 10 percent on all nations—but on the China piece, there's a lot of bipartisan support around trying to—their word, not mine—contain China and restrict some of their economic activity, and that's certainly a corner. Now, what's interesting is I've been in rooms on Capitol Hill, in different think tanks over the last month or so. And I'm starting to feel, and hear from representatives like me from multinationals and other places, beginning to express some concern around where trade policy may be heading.

And whether or not that has an impact in a new administration, whoever it is, and among members on the Hill, will be something interesting to watch. But there's beginning to be some rumblings around, wait a minute, maybe we're pushing this trade piece a little bit too hard, but at this time, the momentum certainly around trade restriction, not trade promotion.

[00:17:49] Lara Rhame: Yeah. And Ryan, I love how you say pulling the world apart, knowing the power of the Mag 7 equities in that still hyper concentration, the S&P 500. Give us a little breakdown of the Mag 7 and how you think they're going to trade throughout this.

[00:18:09] Ryan Caldwell: Lara, two things. I think Mag 7 and the rest of the S&P 500 and the rest of the S&P…I want to loop back to Jason's comment later, but let me come to the Mag 7 first. And I think, one of the things that's very clear, and you saw this, how the donors are lining up right to each side, right.

Silicon Valley on the Trump side, global multinationals maybe on the Harris side, right. And at the heart of that matter, again, when you look at the Mag 7, is there is a clear dislike, I might say in the Trump administration for the Facebooks and the Googles. Maybe even the Amazons of the world, right, in this sort of social media, how it was used, as they feel maybe against them and weaponized. And maybe the outcome that they become too dominant in the economy, right. So again, you would think, if our listeners listen to the RNC, one of the takeaways I had was, boy, that was not my Dad's RNC, right. That was a little bit more of a mix of libertarian populism, as opposed to sort of dyed-in-the-wool kind of conservative Republican. And so one of the things again, back to Trump 1.0, that maybe 2.0 is going to feel different is, some of the antitrust sentiment that has come out of this potential Trump administration is very different, right. I think when you look at companies like Meta and Google, and again, this whole TikTok argument inside of the Trump flip-flop and why is Trump flip-flopping on banning TikTok. Now he wants TikTok not banned and reconfigured. But the argument is that these companies have just become too dominant, right. And that there should be some antitrust litigation. That's something the Biden administration has been going after, right. You want to talk about a weird cross section, different reasons as to why it's happening.

[00:20:12] Lara Rhame: Right. But again, the crosscurrents are weird because Meta and Google were never allowed in China in the first place, right?

[00:20:19] Ryan Caldwell: Correct. Right. Then you would actually go, well, those should be beneficiaries of a Trump administration because they don't have a Chinese presence. But again, in this vein, they're seen as anti-competitive. And so Silicon Valley is saying, look, we need more competitors to Meta and Google, not less.

[00:20:34] Lara Rhame: Right.

[00:20:34] Ryan Caldwell: Right, so we let TikTok stay. So I would actually argue that's starting to bleed into the multiples of the Metas and the Googles and some of these companies. And then on the other side, this race to AI, right. And the lining up of, if you look at it, obviously Elon Musk is now sitting on the Trump side of the ledger; although maybe not at $45 million a month, like he promised a couple weeks ago, but again, getting closer with AI for enterprise is probably the safer bet, weirdly, than AI for social media, if that makes sense.

So even the delineation between a Tesla and a Microsoft relative to Google and Meta is starting to become more pronounced. And again, we saw yesterday in the market service now, software company, lots of AI, but enterprise AI, in this big sell-off, has done fantastic because it's not sort of in these crosshairs.

So, what I would say, Lara, just in general for the Mag 7 and then sweeping back to the S&P 500, I want to reiterate what Jason said because I think it's the most important thing. What the S&P 500 has benefited from in global multinationals, and we've talked about this, Lara, on our podcast repeatedly with you, is that the margins of the S&P 500 in 2000, the free cash flow margins were 5%. Today, they're 15%. There's been a massive benefit to multinational companies from globalization that's translated in through profitability. And if we're going to pull this apart, and we're going to get into more tariffing and more populism. And we're going to come after that model of globalization that you don't have a good view into the profitability of the S&P 500 at all, whether it's the Mag 7—when you think about semiconductor restrictions and AI restrictions—or whether it's something like a Caterpillar that's just benefited from being a global company that could diversify its supply chain globally, push down costs and drive up margins, this is a really big deal. And that's why I think like you need to slow down on the Trump 2.0 trade is just great for the S&P. It might be really good for segments of the U.S. economy and segments of the S&P, but I would argue from an index perspective, this is not bullish, if you will, because again, I'm starting at a point where the margins are so high from globalization.

And now you're telling me we're going to do a lot less of that possibly. And particularly as we decouple from China. And I think Jason made a great point. I don't think there's much of an appetite either to go after Europe and some of these other companies on the tariff front, but there's a lot of appetite to decouple from China and contain China. And China's saying the same things reciprocally, right.

They don't want to be contained and they're going to fight back. And so when you layer all that in, you go, I don't think the margins can probably keep going up in this construct. And so the starting point at a high multiple might make you a little bit queasy. And again, Jason's point, look, and we saw this right after the RNC. Which was if you listen to some of the commentary, even coming out of the RNC and now what is vice president, what could be potentially vice president Vance, this whole argument about a strong dollar, weak dollar and production over consumption, you're talking about 15% of the S&P in production relative to 85% of the S&P in consumption and flipping that model on its head. So again, I think you've really got to slow down with where you think this is going until we see the results because to Jason's point, a sweep is going to look really different than a slog down divided government as to how much of this you can do and not do. And then again, Lara, who's sitting in Treasury, right? That will matter a lot in sort of dollar policy and what we really think there and big deficits and potential more war. So I think this is all much, much harder than just whipping out the Trump 1.0 playbook.

[00:24:44] Lara Rhame: Yeah. I think that this is one of the primary overarching investment conclusions of today. Please do not go reorganizing your entire portfolio on the back of the news of the latest week. It's going to take time for executive orders to come through and to see what's actually implemented, and retaliation, and that's a long process that takes time.

So, it's not a knee jerk response. Jason, give us some of your views. I know, leading into this, one of the things that obviously—while the presidential election takes up so much of the airspace—Congress, the House, there are other elections that will have tremendous impact on the ability of the White House to enact policy.

Tell us what your strongest conviction view is and how the new Kamala Harris at the top of the ticket against Trump changes down ballot races and expectations.

[00:25:45] Jason Cole: Yeah, look, and I think it's a threshold question here and an important one given what we've been talking about.

I mean, the presidency is not an imperial presidency in this country. The presidency has a lot of power and it's growing and has been growing for decades, but it's still, for most things, takes legislation, to have lasting effect, and policy effect and policy change in this country.

And in a world where there's a Republican trifecta, which, a week ago, I would have put pretty high odds on that...I think ultimately that's why Biden is out of this race, that folks in Congress, leader Jeffries, leader Schumer, former Speaker Pelosi, saw the polling down ballot and said, it's going to be a wipeout in the House and the Senate for us, and you're not helping.

Can we make a change? And I think ultimately that's what happened. That's been reset since Sunday at 1:46 PM. Now we've talked about this for almost a year now, and I still have a pretty strong conviction view that the Senate will flip from Democrat to Republican control.

The map and the math just does not favor Democrats whatsoever. And I think it's going to be extremely difficult for Democrats, even in this new makeup, to hold on to the Senate. I'm back to the House, however, being a pure toss-up. I think this reset and getting Biden off the ticket, reset some of those down ballot House races, particularly in California and New York.

That's where the House is going to be won or lost for Republicans. There's nine, 10 races in those two states, by the way, which are not presidential battlegrounds, where there are Republicans sitting in districts that President Biden won. I suspect, and this is just a gut right now, because there's no polling to back any of this up, but I suspect that with Kamala Harris on the top of the ticket, there's going to be an infusion of enthusiasm in depressed Democrats in Blue states like California and New York. And that may pull Democratic challengers to those Republican incumbents sitting in Blue-ish Biden districts across the finish line. The Democrats need four seats there so it could flip. And so I think we're looking at maybe a 50-50 shot of having divided government heading into 2025, which means a ton for things like tax policy.

That's number one, two and three on the menu for the new Congress and the new president with the expiration of the TCJA at the end of 2025. And having a Republican sweep and unlocking reconciliation and the ability to avert the filibuster, and to really hotline tax policy versus divided government where you have to have a negotiation is a huge difference maker.

[00:28:54] Lara Rhame: And I think that, to me, is something we are going to see play out because as you've said, it's going to have to be negotiated. And even in a world where we get a Republican sweep of all three, you know, corners of government where they're still probably going to have a very thin margin in the House. Obviously, if that's aligned with the White House, there will be probably a little bit more ability to control, sort of corral everybody into the same view.

[00:29:26] Jason Cole: That's right. With a Trump sitting in the White House, you can move some recalcitrant House members and shape them up and move them into line with Republican House members.

[00:29:36] Lara Rhame: Yeah.

[00:29:37] Jason Cole: Unlike Kevin McCarthy earlier this year and now Speaker Johnson, they've had tremendous difficulty with the narrow House majority. That shifts, I think, a little bit if there's a Trump White House and rewriting the tax code is on the line. Not, that, that said, a narrow House majority is going to be difficult to navigate.

[00:29:56] Lara Rhame: Full stop.

[00:29:57] Jason Cole: Full stop, period. I mean, I'm sitting in Philadelphia right now because the House said, we can't pass appropriations bills, let's go home. And so they're done until September 9 and that is 100% a function of a narrow House majority and the inability to get a majority of Republican votes to pass anything.

And so, that changes a little bit in a Trump dynamic, but it's still going to be very difficult. I was sitting yesterday at lunch with the senior Republican on the House Ways and Means Committee, who made the comment that they couldn't pass the TCJA today, and in today's Congress.

And so tax reform, even in a Republican sweep, isn't a slam dunk. There's going to need to be changes to that bill. At least that's what this member was projecting, and so it's going to be interesting to watch next year.

[00:30:52] Lara Rhame: Well, their dysfunction is our benefit in this instance. We have you in person for the podcast.

I want to take that conversation back to areas where that have already come up and we've already teased it out, but I want to talk about the dollar because that is something that has a huge impact on investments, investment performance on the economy, on inflation, and the U.S. has had a strong dollar policy for decades now.

We can get into what that actually means because that has been the playbook during periods of dollar strength and dollar weakness. And I think the punchline is going to be that in reality, there's not a ton the U.S. can actually do about the value of its currency. But I think the rhetoric we've heard, early rhetoric out of the Trump administration, has been a desire for a weaker dollar.

And what are the investment implications of that, Ryan? What are you looking ahead at? Because obviously, you know, the U.S. economy is more closed off. The S&P 500 is incredibly open, and so much of that revenue comes from abroad. What impact does a stronger dollar have on prospects for multinational profitability?

[00:32:22] Ryan Caldwell: You know, look, Lara, I think there's weirdly a bunch of inconsistencies actually in the potential Trump administration around this whole argument, right, of weak dollar, and can you do some of the things they want to do if the dollar weakens as significantly as some of them would like it to.

[00:32:42] Lara Rhame: And again, we should level set that. The Biden administration's technically maintained that strong dollar policy, but they've done nothing to actually elevate the level of the value of the dollar. It's the most passive policy you can have since my brother-in-law said I have an exercise policy. Well, great. What are you actually doing? It's sitting on the couch all day. So there's the policy and the action.

[00:33:10] Ryan Caldwell: But I think even vis-à-vis a Mnuchin Treasury Secretary, Secretary and Trump 1.0 right out of the Goldman School, that was still a pretty strong dollar sort of thought process in Trump 1.0. And, what we're hearing out of 2.0 is that the very simple argument is, look, the strong dollar has been great for consumption to buy trinkets from China, but it's really hurt U.S. manufacturing's ability to export. Therefore, is it really strategically, and I think this is the important word, because China's using it a lot. And you can hear it in some of the Trump administration, potential Trump administration rhetoric, about the dollar being used strategically. Right. As you start to think about strategically lining up to confront China. And I think, from a profits perspective, Lara, the very simple thing in the market did this immediately, right. A weak dollar would be great for Cat, but it'd probably be bad for Apple, right. So the market did some of that already.

And it's sort of expressing that. And there's some truth to that, obviously. Boeing would do better relative to Airbus if the dollar were weaker relative to the euro. Cat would do better relative to Komatsu if the dollar's weaker relative to the Japanese yen. I think there's some of those things that are already expressing.

I think the big 50,000-foot discussion, though, is back to deglobalization. If the Trump administration is going to actively pursue a weaker dollar, and I agree with you, Lara, I don't even know what that means.

Other than saying it, right. What are you going to do to facilitate it? I'm not sure. But let's say they're actively pursuing it, or they change this strong dollar policy the Treasury seems to have had forever. The one place I think the market has been highly focused is in the currency market, particularly in precious metals, because the BRICS countries have already said, we want to de-dollarize, right. They seem to be anticipating some move in the dollar or the administration moving away from a strong dollar policy. It would also have a very big effect, obviously, in the Middle East. There's a very big debate, obviously, inside of Saudi Arabia about a petrodollar. And moving away from the petrodollar and having diversified currencies pegged possibly in gold.

And obviously, we saw the Russians effectively bail out their economy by pegging to gold. The Chinese have been accumulating gold. A lot of the BRICS companies have. Countries have, excuse me, as a way to maybe think about an alternative currency to the dollar to facilitate trade away from a dollar-based system. Now again, Lara, you must be careful with this stuff because this is where people take an inch and have an inch and take it a mile and say, the dollar is going to collapse and gold's going to triple. And you've got to have your Bitcoin and this is where people really jump into the fray. But I would say there probably is, on the margin, this debate about a Trump administration's likely not going to endorse this very strong dollar policy. At the same time, these BRICS countries are reorganizing and thinking about trade in a different way. And so it probably could put market force pressure on the dollar. And then, oh, by the way, we have this really big deficit that we need to fund, right, with a lot of current premium in the long end of the curve that's got to get recycled out into the world. And so I don't know how you do all that. That's why I said, I don't know how you facilitate all this, right. How do you issue all the debt you need to issue to maintain…back to maybe the geopolitics for a minute.

And in this China-U.S. confrontation, I have a very good friend who just wrote a book about confronting China over Taiwan, and they're talking about jumping defense spending—and I'm glad I have Jason on the podcast—from something like 3% of GDP to seven. I don't know how you do that. Right. Given the fiscal position. And again, if the BRICS countries don't want to recycle dollars, who absorbs all these dollars to be able to do these…

[00:37:19] Lara Rhame: …things?

Right. And I think here's where, you and I have discussed this before, if not dollars, what? You know, there isn't enough gold on the planet. You know, the Bitcoin, I think, is still highly experimental. And…

[00:37:31] Ryan Caldwell: …euro?

[00:37:32] Lara Rhame: Yeah, you're right. There isn't enough euro debt out there to buy…German retirement funds are having trouble buying enough euro-denominated debt.

I think when you look at something that was making the rounds, several years ago, about China trying to put forward the renminbi as a global currency and selling oil-denominated renminbi, there has been really no broad-based effort to elevate the renminbi as a global reserve currency at all.

So, I think these issues are really important and are difficult to sift through, to your point. I mean, as somebody who's a student of foreign exchange, it's highly volatile. And I think at the end of the day, when you think about what can the U.S. do to weaken its currency?

Sterilized intervention from the Fed, unsterilized intervention. These are things that, at the margin, worked temporarily in concert with a lot of other developed country coordination. And it's not something the U.S. has a good prospect to wade into unilaterally. Especially when the rest of the world holds so much of our debt and really can pull that market-related lever so quickly.

[00:38:55] Ryan Caldwell: And Lara, the other thing you and I have talked about previously on podcasts, I'll just reiterate here, and you've made this call and it's been a brilliant call for two years now, but I think you need to stick it again, which is real rates are just going to be higher. Right. We are not going back to the real rate environment we were in. They are going to be higher. And, it's an inflation point. It's a currency point. It's a deficit point. And so if I had one takeaway to this dollar debate is you're going to need higher real rates to do all of this. And so you've got to think about that in portfolio construction, because we're just not going back.

[00:39:31] Lara Rhame: Yeah. Jason, any thoughts on deficit spending or the dollar?

[00:39:35] Jason Cole: Yeah, I want to put a pin in the point Ryan just made in the call that you've made for a couple of years now, and that real rates are higher, right. In a higher for longer or higher forever, that means your debt service goes up for longer or forever. And we are approaching a world where debt service is going to be around $1 trillion.

[00:39:56] Lara Rhame: I think you and I have talked about this tipping point. We're on the other side of the tipping point.

[00:40:00] Jason Cole: We are on the other side of the mountain and on a downhill. And I still don't sense there's beginning to be conversations among politicians, among the think-tank crowd and all of that about the need to address the debt and deficit. But if you watch this political campaign, we're not touching Social Security. We're not touching Medicare. From either party. Yeah, right. No. And those are the two fundamental drivers of our debt.

We can talk all day about cutting spending, but the reality is that non-defense discretionary spending, the amount of money that Congress has to fiddle with, defense is around $850 billion, non-defense discretionary spending. All other spending is about $850 billion. Debt service is a trillion dollars. So it is higher than the two categories that Congress is able to pull levers on in terms of cutting spending.

[00:41:01] Lara Rhame: And that happened this year. Last year, debt service was like 690...

[00:41:05] Jason Cole: ...670, 680, something like that.

[00:41:08] Lara Rhame: A pittance compared to the trillion.

[00:41:10] Jason Cole: Correct. Correct. And this is going to begin taking on hockey stick...

[00:41:14] Lara Rhame: Yes.

[00:41:15] Jason Cole: ...proportions. And so this is, this is rapidly becoming a very serious problem.

[00:41:20] Lara Rhame: Yeah.

[00:41:20] Jason Cole: All around the conversation that's going to be forced, in 2025, we need to raise the debt limit, right. That expires on January 1, 2025. And I view that as a good thing, right.

We don't need to get back into debt limit hostage taking. But hopefully it can force a conversation around debt and deficits where we can bring some fiscal sanity to Washington. I'm not totally optimistic on this, but there are some triggering events coming up that may force that conversation in a meaningful way.

[00:41:58] Lara Rhame: Yeah, and this is something that I hammer all the time in my research, in my written work, in the Q3 Outlook that I just wrote called the Summer Before the Election, because I think that's honestly what everyone's thinking about. It's the fact that the deficit is a disaster. Everybody's responsible. Both parties caused it. That's right. We are going to need both parties to fix it. And I'm hoping that's the message of hope and optimism; that's the only way…

[00:42:27] Jason Cole: …that's the only way it gets fixed. I mean, because the decisions that have to be made around entitlements are really difficult ones, and they're super politically unpopular. And in order to get them done, it's going to require the will of both parties to lock arms and jump off the proverbial cliff together. Yeah. And that's the only way this gets done. And in my view, probably the only way that happens is in a divided governance scenario.

Lara Rhame: Yeah. All right. Ryan, talk more about internationally how you're playing all of this. As we wind down our discussion, I wanted to hear your thoughts because you run a global asset allocation portfolio. Where are you shifting to or away from, emerging markets, Europe? Talk to us about how you play this for the rest of the world.

[00:43:17] Ryan Caldwell: No, look, Lara, I mean, it's getting harder because I think there's no question in a candidate Trump led world, that a lot of the fiscal burden is going to shift back, right. So again, I agree with Jason. I think tariffing Europe is going to be hard, but pouring a bunch of money to defending Europe is much easier, right.

And Trump will go back and make that case that, and again, I understand that even in the Republican Party, given this alignment between China and, for our listeners that haven't watched this, the alignment between China and Russia and China's rearmament of Russia is really the catalyst that flipped the Republican Party to continue to fund Ukraine, right.

If we put all our cards on the table, right, the red lines that were crossed by China and Iran actually in rearming Russia through this conflict with Ukraine has really put the spotlight on how fragile this has become and why we need to be at least—the hawkish argument—as to why we need to be confrontational, right, with both of these entities. Because again, they are seemingly coordinated together and those were Biden's red lines. So, you would assume Trump's red lines are going to be harder than maybe, you know, Biden's, but some sort of NATO red line. And we said to China, don't rearm Russia.

And they absolutely rearmed Russia. So it's tough. And so I think you've also had some election issues in Europe, right?

France is in a very different spot than it was two or three years ago. Germany, by next year, may be in a very different spot, right, when their elections come up. The U.K. is in a different spot given again, what went on in their election. So again, the fiscal burden, I just think in those countries, is going up, right. They're going to have to do more…

[00:45:19] Lara Rhame: …tremendously, I would agree.

[00:45:21] Ryan Caldwell: …to what they've done. And so that looks different. Right. So I think there's been this little renaissance, there's been a renaissance in European markets. I don't know how much longer that lasts, right. Because the fiscal situations are going to change. And the monetary situations are going to change. And then when we get to Asia, what I would say is, let's start with Japan and then move to China and head down, right?

Japan is in a really, really tough spot, right. And even this week where we saw all sorts of currency movement, that's really disruptive to the globe. And I believe the Fed and the BOJ are trying to calm it all down because it has really big implications for the rest of the monetary system. But Japan…I don't buy some massive reflationary Japan story that is great economic growth. They need global trade. And again, I think global trade is going to get much harder, not easier, right, for that economy to really go. There's not a great domestic story in Japan. We've kind of convinced ourselves there is, but that's not really showing up, if you will, in the numbers. And so I think Japan's tough. When you move to China, I would say I'm really concerned, not so much about the Chinese economy. And again, we've talked a lot about this on our podcast, Lara, the truth of the matter is the Chinese own all their own debt, right. They're not defaulting to anyone but themselves.

So, there's no global crisis that's likely to come out of China's debt load because they own all the debt and bank deposits are really high. And if they want to wipe it out in the name of the party, they will. And my guess is, if President Xi decides to mobilize, he will, right. Again, they can move that.

But again, that doesn't mean it's a great investment environment. As a matter of fact, I don't think it's a great investment environment. And even coming out of the third plenum that we just had in July, if you read the rhetoric out of the party, it's not about bailing out the economy. It's about gearing up to confront the U.S. strategically in these sectors, right. These advanced sectors where we're looking to repress them and they want to grow. And it's also even more confrontational…into this might be the time to confront the U.S. because we are so divided. And to Jason's point, the fiscal situation's a mess and we really can't raise defense spending and maybe do the things that you would like to do just given the constraints on spending. So, when I look at the global map, I do think it's likely to get harder, not easier, almost regardless of what administration is in power, whether it's Harris or it's Trump. The way we confront the world will be different for sure.

There's very different policies as to how we do it between the two administrations. I think when you think about this realignment, and China wants to lead this realignment, it's got really big implications for us and investment implications that again, I don't think the market's highly focused on outside of China's economy's weak. When you get, you get India, that's…

[00:48:24] Lara Rhame: What I hear you saying is that the easy environment of 2009–2019 is…

[00:48:27] Ryan Caldwell: …it's all over, is all over…

[00:48:29] Lara Rhame: …is in the rearview mirror. It's over.

[00:48:32] Ryan Caldwell: Yeah, look, Lara, I think you've made this point repeatedly, and I think it's absolutely right. For as much as we complained about nominal GDP from 2009 to 2019, the global environment was phenomenal for corporate profits, one of the best we've ever seen, maybe the best we'll ever see. Back to Jason's point. And so that does look over to me. So that all just means harder.

[00:49:00] Lara Rhame: All right. Harder. I think one of the conclusions that I drew when I went back to try to find patterns and markets around U.S. elections, it's very hard to find, over time, a clear pattern in equities, a clear pattern in bonds. Because, remember that while we can feel like we're in a rabbit hole of politics in the background, we've got a $26 trillion economy, the largest economy in the world, that's still chugging and doing what it's doing.

And at the end of the day, it looks really healthy right now. And I think that is something that both parties, both candidates, have a strong wish and strong incentive to have a strong economy. They're just coming at it from very different directions. So the main market conclusion I was able to find was that volatility, both in stocks and in bonds, really tends to pick up in the two months prior to an election.

And when you overlay the 2020 election onto that, it was much higher, even much higher volatility than we normally see going into the election. So, given how rapidly things are shifting, I think that is something we really need to prepare for. We've gotten complacent because the first half of the year, returns have just been good, headline returns have looked great and the last two weeks have been a challenge, I think, against the backdrop of this rapidly changing election news. We could see volatility really rearing its ugly head even more substantially as we close in on the election. I just have a couple of final bows to put on our discussion. And then I wanted to give you guys each one last minute to sort of give us key takeaways.

I think another one, and we've said it before, these are going to be ongoing topics of discussion. These are not going to be reasons to radically go in and tear the guts out of your portfolio. However, I think you do need to consider the ballast that is really diversifying your portfolio because traditional stocks and bonds are not working anymore.

We've written a lot about that in the past and in the show notes, we have our stock-bond correlation chart book, which, really I think is an important headline for anybody who's really thinking about how to manage and lower volatility in their portfolio at a time when it is likely to only go up heading into the election.

And I think the second thing to recognize is that the U.S. economy today is looking healthy. It is firing on all cylinders. A lot of the global concerns, geopolitical concerns, policy concerns that we have, I think, are important to counterweight against the opportunity in the middle market sphere of the economy—200,000 companies that are more domestically focused and maybe less exposed to gyrations in the dollar, less exposed to supply chain problems, international supply chain problems, less reliant on what we're seeing, I think, even for tariffs around the world.

So those are my key takeaways today. And knowing that we're going to be back here, with you, Jason, what are your last thoughts today, given our discussion?

[00:52:43] Jason Cole: Look, I think you nailed it with volatility and election year volatility. You're absolutely right that, that you see that in the markets.

There are sectors that will do well under Democratic control, other sectors will do well under Republican control. And so trying to navigate your portfolio on politics, in my view, is a mistake. One. Two, this is going to be an extremely unstable race for about a month.

And I'm going to go back to my post-Labor Day prediction. That's the official starting gun of the election. You'll be two weeks or so out of the Democratic Convention and, depending on how well that goes for the Democrats, does Kamala get a bounce, those sorts of things. Things will stabilize post-Labor Day.

We should come back then and talk in terms of what the election outlook looks like, at the presidential level. Third, and coming from the guy who used to work for Congress, and most important, Congress still matters in all of this process. And so everybody getting hung up on the presidential election, take a step back, watch Congress.

It's going to matter how government is situated in January 2025 in terms of levers of control and who's in charge of what.

[00:54:01] Lara Rhame: So that's why you're the best, Jason. Those are really important points. Ryan, take us home.

[00:54:07] Ryan Caldwell: Yeah. Look, I mean, I'll piggyback a little bit of your comment, Lara, just to make this point is that you've had a 20-year margin story and it's coming to an end.

And so I think being able to be long and passive is probably behind you now, which means being more active and more diversified in a way you just haven't had to be in a very long time. And I think I'd just leave it there. It's all harder.

[00:54:32] Lara Rhame: Yeah. So, I think the good news is that we have both of you as resources. We have both of you to walk us through this from the policy side, from the investment side. I'm just along for the ride. Happy to have facilitated the conversation. Thank you both so much for joining us today. Really appreciate it. Great conversation. Thanks.

[00:54:51] Ryan Caldwell: Thank you, Lara.

[00:54:51] Jason Cole: Thanks.

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