# WEEKLY DIGEST

"YOU'RE FIRED! OR NOT…"
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**Investors have to cope with the flurry of announcements and changeable policy of the second Trump era. In particular, they're pondering the increased pressure on the Fed to keep rates low.**

I'm an assiduous reader, but there are only so many hours in a day and not enough of them to consume everything that comes my way. I have to resort to making various reading piles, both real and virtual.

Luckily, I only subscribe to one physical newspaper, the *Financial Times*. Much as I like the online edition and the app, I always find interesting stories or opinions in the print version that I would have missed online. This all adds up to quite a lot of newsprint. But you don't have to worry about me turning into an old man surrounded by teetering barricades of newsprint. Mrs. W-E has a black belt in Marie Kondo-style domestic order and there are occasional purges!

In my recent catch-up reading, I came across an FT article by Simon Kuper extolling the virtues of the *Annales d'Histoire Economique et Sociale*. It's a famous French journal that eschews the daily noise in favour of the long sweep of lasting forces.

The journal's founders suggested that history operates on three levels of time: geographical, social and individual. The first has the longest cycle as it relates to changes in the planet and nature; the second refers to factors such as demographics and culture; individual time has the shortest cycle. Not only is it limited to a human lifespan; people also tend to think more about the here and now rather than the experience of many years, when making decisions. This behavioural bias of thinking only about issues that readily spring to mind – often recent – is known as the 'availability heuristic'.

The French historians concluded, with some justification, that we should spend more time focusing on the long cycles, but that human nature tends to lead us to focus on the short-term stuff, which might offer quick fixes but often fails to address the underlying malaise. Does this sound worryingly familiar when we put it into the context of politics or investing? (If you'd like to read more about how insights from behavioural science are helping us refine our investment process, click here to read our latest *Investment Insights*.)

## Diversionary tactics

The king of the short news cycle is President Trump. Mr Kuper even suggests that he's operating on his own fourth level of time: the daily news cycle. It certainly feels that way. The reasons behind it are in the realms of speculation. There's little doubt that he has a very short attention span; this makes him jump from one topic to another with alacrity. He's also prone to influence by the most recent opinion he's heard. Then there are what one might describe as 'diversionary tactics', where he churns out social media comments and press releases with the deliberate intention of deflecting attention from news that reflects badly on him. In a similar vein, he can rattle things off purely with the intent to destabilise or confuse his opponents – or even his supposed allies!

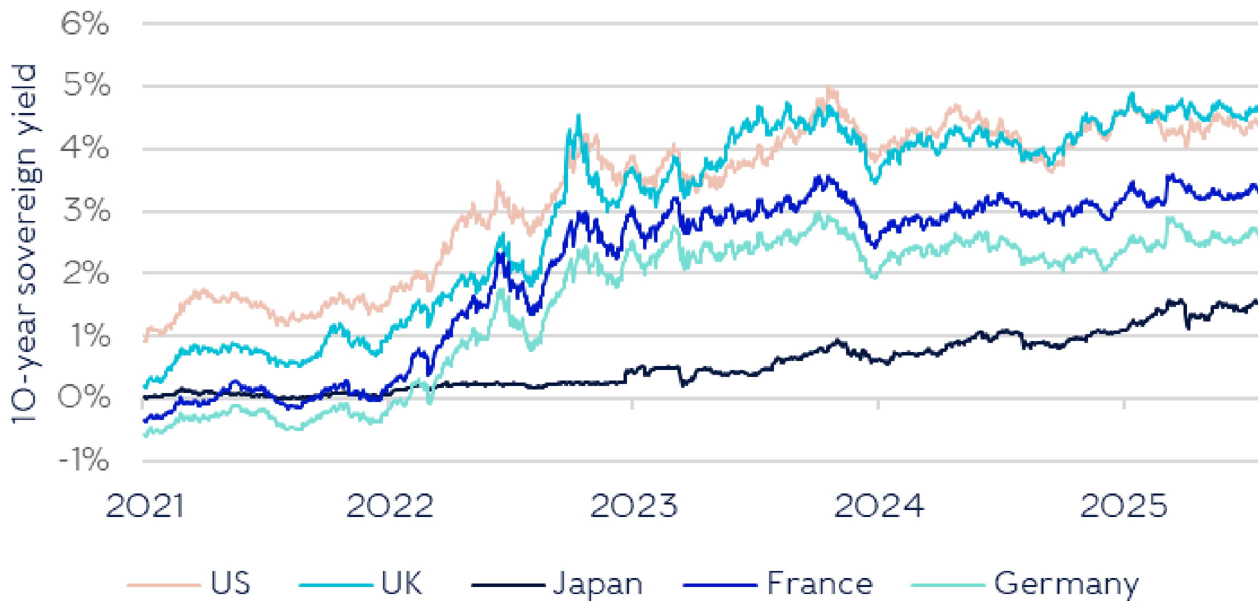
One of the recent cycles of daily noise concerned the fate of Jerome Powell, the Chair of the Federal Reserve (Fed), the US central bank. His term as Chair ends in May, but the President is constantly haranguing him to cut interest rates with a view to reducing the interest burden of the US government. This a burden that, I might add, has just been increased by the recently passed, deficit-expanding One Big Beautiful Bill Act. Trump also keeps threatening to fire Mr Powell. The latest leak to that effect came last Wednesday but was quickly denied after a brief, but noticeable, sell-off of US equities, bonds and the dollar – the same nasty cocktail that greeted the 'liberation day' tariff announcements.

In the short term, this episode illustrates that the White House is willing to keep sending test missiles into the market to gauge opinion on certain matters. The market reaction on this occasion was negative, forcing the disavowal of his comments. This all adds to the background volatility, but for now, the impact is relatively limited.

## Heading towards fiscal dominance

More pertinent to the long term, though, is the fact that the President is paying so much attention to interest rates. In the West, we've recently lived through several decades when monetary policy was the dominant force. Interest rates were used both to damp down the economy when required and to boost it. Following the bailouts to alleviate the financial crisis and then the pandemic spending, fiscal interventions have become more prevalent, in the form of cheques. Populist forces are reinforcing that trend.

The value of investments and the income generated by them can go down as well as up.




Source: FactSet

The debt and interest rate burden is now becoming onerous enough to make politicians wish for greater influence over monetary policy. This is the economic condition known as 'fiscal dominance'. I predict we're going to hear that phrase a lot more, because debt burdens are unlikely to fall in the absence of some sort of productivity growth miracle (which is the great hope for AI).

Investors are understandably nervous about politicians wresting greater control of monetary policy from central bankers. Economic historians and Fed governors are still haunted by the ghost of Arthur Burns, the Fed chair in the 1970s who was at least partially responsible for that era's high inflation owing to his subservience to President Nixon, who demanded lower interest rates.

When we approach portfolio construction, we're acutely conscious that government debts are both rising globally and much less affordable now that interest rates are higher. The US is far from alone, with the UK, Japan and several European countries in the same predicament. We could be on the edge of a slippery slope. That's one reason why, in portfolios that include bonds, we're only investing in government bonds with shorter maturities. They might benefit from lower rates if central banks are persuaded to cut rates sooner, faster and further, but will be less at risk from increased inflation if monetary policy is inappropriately loose.

*For this week's economic highlights, see below on page 3.*

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## ECONOMIC HIGHLIGHTS

**UK –** We continue to observe that both the Governor of the Bank of England and the Chancellor are stuck between rocks and hard places. Growth is anaemic, but inflation is too lofty to permit aggressive interest rate cuts. The government needs to raise taxes into a slowing economy to balance the books. Last week’s data offered no relief. Inflation came in higher than expected for June, with the headline rate at 3.6% and the core at 3.7%. Services inflation was stuck at 4.7%. This may be a sign that businesses are passing on more of the rises in employer National Insurance Contributions and the national minimum wage. The latter is also a potential factor in rising unemployment. Even though previous months’ data was revised up, there are fewer people in jobs than three months ago, and the unemployment rate crept up again to 4.7% on a rolling three-month basis. Futures prices suggest that the Bank of England will lean towards supporting employment at August’s meeting with a 0.25% cut to 4%, but will remain cautious about cutting too quickly thereafter.

**US –** Core inflation rose slightly less than forecast to 2.9%. Both industrial production (in May) and retail sales (in June) increased by more than expected, illustrating the durability of this economic cycle. Polymarket betting odds now show just a 19% probability of a recession this year. We’re inclined to agree, given the successful passage of President Trump’s One Big Beautiful Bill Act through Congress. The market sees no rate cuts till October.

**Europe –** Further tentative signs of improvement in the Eurozone included a 1.7% month-on-month increase in industrial production, or +3.7% on a year earlier. The next hurdle for the EU is to agree some sort of trade deal with the US ahead of the (current) 1 August deadline. Otherwise, it faces a base 30% tariff rate.

**Japan –** The ruling coalition, dominated by the Liberal Democratic Party (LDP), lost its majority in the Upper House. It now has control of neither house of Japan’s parliament for the first time since the LDP was formed in 1955. As in many countries, voters are dissatisfied with the combination of slow growth and higher inflation – and voted to reflect that. Notably, opposition parties have pushed for more fiscal easing. However, Prime Minister Shigeru Ishiba intends to carry on since the LDP still has the most seats.

**China –** Q2 GDP growth hit its expected level of 5.2%, but the composition was weak, with consumption still struggling to gain traction. Retail sales growth of 4.8% year-on-year was below the expected 5.3% and down from 6.4% in May. We still await more concrete stimulus proposals, potentially from the forthcoming Politburo meeting at which the next 5-year policy plan will be set.

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