

Remarkable Events

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To turn around a blog for a Monday we are usually asked to deliver the final version on the preceding Friday, so that the relevant teams can perform the required reviews ahead of Monday's publication. So, with England on the cusp of football glory, I asked my colleagues "Can I wait until Monday and deliver it then?" knowing that a few days' grace would provide me the opportunity to champion our (inevitable) sporting success. "Why don't you write two blogs for Friday?" came the response. "One for if England win the Euros; one for if we lose." This sounded like a bad deal. And it was, because had I done that, I'd then need to deliver a third to cover the bigger talking point this weekend.

Around 4,000 miles west of Berlin is Butler, Pennsylvania, where on Saturday an unassuming 20-year-old Thomas Matthew Crooks opened fire at a Trump rally, injuring several people including the former president and Republican frontrunner, and tragically killing one rally attendee. The picture of Donald Trump with his fist pumped, blood on his face, surrounded by the Secret Service, will become an historic image. That the shooting even happened is itself remarkable and the lapses in security will be scrutinised in the coming days. Trump literally dodged a bullet – 'God alone' saved him – and the looming US election took another twist.

Whilst an assassination attempt is never in reality a zero percent probability, markets assign it as such because it cannot be forecast and would be such a left field event as to be deemed an unrealistic scenario. The effect of the attempted assassin's actions has, ironically, been to increase Donald Trump's chances of winning November's election with as much as a 10ppt swing higher over the weekend to a 67% probability today¹. What could have gone to zero in an instant, moves closer to 100. Despite his election success now seeming almost inevitable, we have to recognise that other outcomes do still exist, and this event serves to demonstrate how there will always be alternative scenarios not previously considered. If markets moved to fully discount a Trump win – 100% – then they are failing to price the 'unknown unknowns'. What exactly 100% looks like however is another matter, and where ultimately Mr Market plays the arbiter.

been a somewhat binary outcome (Trump wins; Trump loses) fails to recognise the alternative scenario that he never even runs as the Republican Presidential nominee (because he died, in which case you could say that he loses, badly). As investors, we are faced with seemingly binary outcomes quite regularly, particularly in financial markets. More specifically though, it's not the markets that appear binary; it's the data and decision flow behind them. Trump wins the US election (or not); the Federal Reserve (Fed) cuts the Fed Fund rate (or not). These events will either happen or they won't, which is true, but as we've demonstrated above, they fail to fully appraise the alternative scenarios which may play out.

Just a month ago the probability of a 25bps rate cut at the September Federal Open Market Committee (FOMC) meeting was around 50%² – an evenly balanced and seemingly 50/50 binary outcome. At last Friday's market open – after Thursday's US inflation downside surprise – that 25bps cut was 99% priced in. As close as you can get to a 'dead cert' wouldn't you think? Well, in January of this year the outcome was 100% priced, before that 'dead cert' retraced all the way back to 30% at the end of April, and then back up into the 90s where it is again today. The danger here is thinking that there are just two outcomes – which would indeed be binary: that the Fed cuts by 25bps, or they do not. In reality though, they could cut by 50bps in September. They could raise by 25bps. Neither of these alternative outcomes have a zero percent probability. Unlikely? Yes. Impossible? No. [There are options contracts protecting a notional – \$250bn against a rate rise in September³.]

What this weekend's remarkable events means for us is that yes, we need to recognise the high and increased probability of Trump being the next President, and what that means for markets (yield curves are today steepening on fiscally expansive expectations), but not be so blinkered as to disregard all and every alternative scenario. If anyone can surprise us, (God alone) it's 'The Donald'!

Source: ¹⁻³ Bloomberg Finance L.P.



Global Matters Weekly

15 July 2024

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