Meeting summary for Jonathan Petersen - TDI Podcast Guest (#897)

Quick recap

Andrew and Jonathan discussed various economic topics, including time zones, career paths, and market trends. They explored the potential impacts of leadership changes, sector performance, and economic factors on the stock market and investment strategies. The conversation also covered global economic conditions, particularly in the US and China, as well as the role of central banks and fiscal policies in shaping market dynamics.

Summary

Jonathan's Career Path and Motivations

In the meeting, Andrew and Jonathan discussed Jonathan's career path, which started as a strategy consultant at Deloitte before he became a chief markets economist at Variant Perception. Jonathan shared his motivation for studying economics, which was driven by intellectual curiosity and a desire to understand the interactions between different markets. He also mentioned his experience working at Vanguard and Capital Economics, and his interest in keeping up with various global factors. The conversation ended with Andrew asking Jonathan about his experiences at Vanguard and his thoughts on his current work.

Leadership Change and Stock Market Impact

Andrew and Jonathan discussed the potential impact of a change in leadership on the stock market. Jonathan explained that a change in leadership often leads to a reversal of sector leadership, with previously underperforming sectors like energy, staples, and utilities potentially outperforming in the coming years. He cited historical patterns since 1970 to support this observation. Andrew acknowledged the discussion and expressed interest in how this might play out, particularly in relation to the energy sector.

Sector Performance and Presidential Term

Andrew and Jonathan discussed the potential performance of various sectors over a two-year period, particularly in relation to a presidential term. They considered the impact of midterm elections and the continuity of policy during this time. Andrew suggested that the sectors they were discussing, including energy and utilities, were more likely to outperform due to their essential nature, such as providing heat, electricity, and gasoline. Jonathan agreed with this assessment.

Capital Cycle and Sector Allocation

Andrew and Jonathan discussed the economic implications of slower growth, value orientation, and risk off trading. Jonathan emphasized the importance of considering sector-specific allocations, using a proprietary indicator called the capital cycle to identify industries with capital scarcity. He used the energy sector as an example, noting that its capital scarcity could lead to outperformance over a 2 to 3 year horizon. Andrew then connected this to the 2016 US election, noting that the market's response favored small cap value stocks, particularly those in the energy and financial sectors. Jonathan agreed, highlighting the need for lower interest rates and deregulation for these companies to thrive.

US Election Impact on Economy

Andrew and Jonathan discussed the impact of the US election on the economy and markets. They noted that the market had initially reacted positively to the election of Trump, with small-cap value stocks rising 5-6% on the day of the election, but then fell 4% the following week. They suggested that this volatility was due to election uncertainty, which had been weighing on businesses and sectors of the economy. However, they hypothesized that once this uncertainty was resolved, the economy could reaccelerate, particularly in manufacturing. They also touched on the importance of stability and the potential for no change in the current situation.

Federal Reserve's Role in Economic Shift

Andrew and Jonathan discussed the potential impact of a Republican sweep on the economy and the role of the Federal Reserve in this context. Jonathan explained that the Fed had raised rates aggressively to address inflation and was now looking at the balance of its mandate, shifting more towards growth concerns. He suggested that the Fed might aim to get back to neutral rates, which he estimated to be around 4% nominal. Andrew questioned the feasibility of this in a world with significant stimulus and debt, and Jonathan agreed, stating that they would have to wait and see how much of the proposed deregulation and tax cuts would come to fruition. They also discussed the potential for government spending reductions and the concept of a "fiscal Sisyphus," where government spending supports the economy during slowdowns.

Market Conditions and Investment Implications

Andrew and Jonathan discussed the current market conditions and their implications for equity and fixed income investments. They noted that the market has seen significant growth over the past six months, with the S&P 500 continuing to rise. Jonathan highlighted the supportive monetary policy environment, with synchronized easing from central banks like the Fed, ECB, and PBOC. However, he also acknowledged that the good news is already largely priced in. Andrew pointed out that the market's limited upside and potential for a soft landing are concerns. Jonathan concluded that the current environment is fairly neutral for equities, with no strong buy or sell signals. They also touched on the topic of fixed income positioning, but no specific decisions or next steps were mentioned.

Stock Market Dynamics and Fixed Income

Andrew and Jonathan discussed the current state of the stock market and the role of fixed income in investment portfolios. They noted that the market is currently highly valued, with equity market cap as a percentage of total equities and total debt at a high level. Jonathan suggested that this high valuation could lead to pressure for rebalancing flows to go into bond markets. They also touched on the recent sell-off in fixed income markets and the potential for more fiscal measures to impact bond prices. Andrew expressed interest in seeing how these dynamics play out.

Chinese Economy and Equity Markets

Andrew and Jonathan discussed the Chinese economy and its equity markets. Jonathan explained that China's surprise stimulus package in September led to a rapid equity market rally, but they remained skeptical about its impact on the ground economy. They suggested that Chinese equities are a buying opportunity, particularly during dips. Jonathan also mentioned that they are seeing some improvements in macroeconomic measures, but these are still from a very bad to less bad situation. They cautioned against expecting a real turnaround in the economy. Andrew thanked Jonathan for his insights and expressed interest in having him on the show again.