POXONO CAPITAL

INVESTMENT STRATEGY NOTE

The Bond Market Won the Election - like in '92

DECEMBER 2024

TLDR: Clinton's rhetoric surrounding his 1992 electoral campaign amid a precarious market environment is not dissimilar to that of Trump in 2024. Although Clinton had originally promised policies such as a multi-billion-dollar stimulus package, two years into his presidency, he had to take a more centrist stance after the bond market priced his policies in and the feared recession appeared mild. We believe Trump will need to do the same to thread the needle between a potentially mild recession and a Federal Reserve cutting cycle. Trump is already starting to do this (e.g. DOGE), much like Clinton did early in his presidency, which then resulted in a mid-90s soft landing. We remain hedged as interest rates increase at a rapid pace and until we see the outcomes of Trump's policy agenda, but we prepare our clients for a similar soft landing with asset allocations that will attempt to take advantage of price appreciation.

I was born in 1991. Bill Clinton's 1992 election is a history lesson – not a memory. For most of his presidency, I was more interested in collecting NFL pencils from the Oak Park Elementary school store than I was interested in politics (or economics, trading, eating vegetables, etc.). In this note, we will walk through how Clinton changed his policy based on US Treasury market reactions. I like to look to history to help inform my opinions. Bill Clinton ran for president in 1992 versus George H.W. Bush after Bush's first term. Bush was a very popular president at times but lost the election because people feared a recession (sounds similar to 2024 to me). Clinton was a centrist democrat when he ran for President but his platform – Putting People First – and his eventual policies, in our opinion, were shaped by the bond market.

The LA Times did a wonderful job chronicling the Clinton transformation. We will briefly walk through 2 articles – one from just after the election in 1992 and one from 1994.

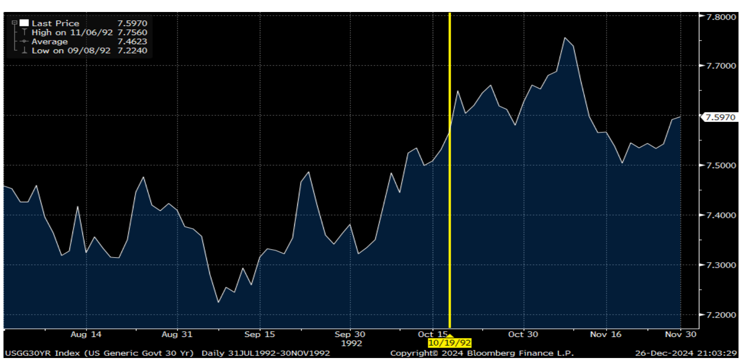

Chart 1: The top chart is the US 30y Treasury Rate in 1992. The yellow line is the date of the October debate between Clinton and Bush where Clinton began mentioning changes to his platform2. Chart 2: The bottom chart is the US 30y Treasury Rate in 2024 leading up to the election. The yellow line is the date of the DOGE announcement from Trump's team. Bloomberg Professional Ticker USGG30YR Index. Source: Bloomberg Professional, Poxono Capital

The November 1992 LA Times article, “Bond Market Packs a Punch Clinton Is Already Feeling: Policy: Foreign influence will grow as investors help finance U.S. debt, impacting nation’s interest rates”1 by Victor Zonana sounds like it was written in 2024 with the wrong president’s name. I recommend reading the entire article, but below are some of my favorite quotes:

“It was that fear that prompted rates on 30-year Treasury bonds to climb about half a percentage point, to about 7.7%, since just before the November election when a Clinton victory became widely anticipated. The rates shot up after newspaper stories appeared suggesting that Clinton planned to embrace a broad stimulative fiscal package. Clinton and his advisers immediately said that such action was not planned, calming the bond markets.” Check out the 30y price action around ‘92 and ‘24 elections to the right.

“‘There will be serious constraints on the policy options of the President of the United States in 1993—and it doesn’t matter what his name is,’ said Richard B. Hoey, a bond portfolio manager and the chief economist for the Dreyfus Corp., a purveyor of mutual funds.”

“No one is more keenly aware of the influence of the bond market than Clinton, whose economic advisory team is liberally sprinkled with Wall Street-types.”

“He’s saying all the right things, but the markets still see an inflationary bias in the coming Clinton Administration,” said David Jones, chief economist of Aubrey G. Lanston & Co., a New York securities firm.

The first quote highlighted from the ’92 article is the one I want to focus on most. The quote mentions that Clinton proposed a stimulus package—one that, as we describe later in this paper, he would eventually back away from. Bush and Clinton sparred back and forth in September and October about how their party platforms would stimulate the economy. Given Clinton’s lead in the polls, his stimulus package started to become priced in by the bond markets. Unlike Trump in ’24, Clinton held a high-single-digit lead going into the ’92 election.

Speculation around Trump and Powell conflicts is another similarity to Clinton. Clinton was also tied to potential conflicts with Federal Reserve Chairman Alan Greenspan[3].

The market has sold off in the second half of December so far (Chart 3) but remains within reach of all-time highs. The treasury market has also seen rates move higher after Powell’s press conference post the Federal Reserve’s December meeting (Chart 4). We think the Trump administration is beginning to react to bond market changes and economic data much like Clinton did during his first term. In our previous portfolio summaries, we thought both parties would be big spenders. In our opinion, Trump is pulling back on some spending measures as rates have jumped on his election win. The biggest measure so far was announced on 11/12/2024— DOGE, or Department of Government Efficiency. DOGE is expected to cut trillions in spending. We think Trump will announce more policies like DOGE after inauguration, and we believe the bond market will continue to inform us whether Trump can implement the policies he promised, such as a possible extension of the tax bill from his first term.

Chart 3: This is the 1-year chart of the S&P 500 (SPX Index) return. Source: Bloomberg Professional

Chart 4: This is the current 5-year chart of the 30y US Treasury Rate (USGG30YR Index). Source: Bloomberg Professional

The second LA Times article titled “Clinton’s Economic Ordeal: Promises Doomed by Math”4 written in 1994 walks through Clinton’s attempt to deliver on promises and the problems with his platform’s budget or deficit math issues. Chart 5 shows that Clinton and the US economy were able to calm down treasury markets in 1993 as his administration took office and the feared recession proved to be mild. Then, the 30Y Treasury rose ~2% from late 1993 to early 1994 as Clinton’s spending agenda became a concern and the Federal Reserve hiked/rose interest rates. Clinton’s main problem was that the savings from cutting costs weren’t big enough to fund his promises of a balanced budget. Clinton had to abandon stimulus measures because “bond vigilantes” aka US Treasury bond investors and the Federal Reserve wouldn’t allow stimulus packages to be priced in without increases in inflation expectations. Billions in stimulus were scrapped and his policies moved towards the center. Like those of Clinton, Trump’s policies will be shaped by the Federal Reserve and US Treasury markets, in our opinion. The deficit math behind Trump’s campaign promises will not add up, while at the same time, the (potential) recession will turn out to be milder than expected because of strong household balance sheets – most obviously seen by the amount of money in money market accounts. Together, the deficit math and mild recession will force Trump to focus on decreasing the deficit to fight stubborn inflation fears. We believe the casualties within his platform will be policies related to key platform topics such as taxes, tariffs, energy, and healthcare.

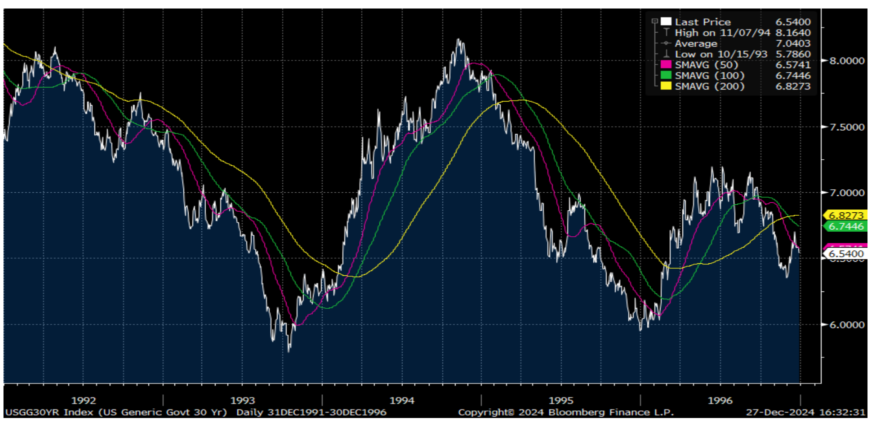

Chart 5: This is the 5-year chart of the 30y US Treasury Rate (USGG30YR Index) ending at the end of 1996. Source: Bloomberg Professional

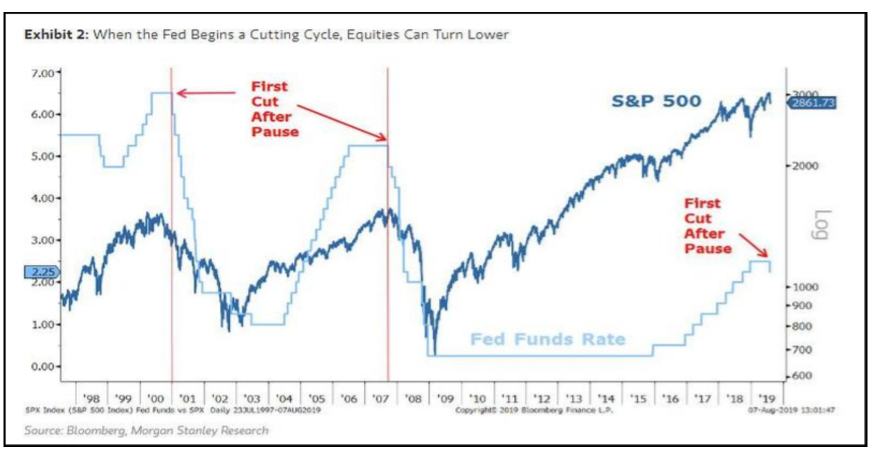

Chart 6: Chart created by Morgan Stanley using Bloomberg Professional source data.

Chart 7: This is the current 50-year chart of the S&P 500 Index (SPX Index). The red lines indicate Federal Reserve cutting cycles that were followed by S&P 500 drawdowns. The green line indicates a Federal Reserve cutting cycle that was followed by a strong market performance. The yellow line indicates the current Federal Reserve cutting cycle. Source: Bloomberg Professional, Poxono Capital

If Trump can thread the needle created by the rate-cutting Federal Reserve and rising US Treasury rate environment, the outcome can be quite favorable for stocks. In our opinion, however, threading the needle is difficult. In Chart 6, you can see that cutting cycles can lead to a drawdown shortly after the cutting cycle begins. Morgan Stanley (and presumably other strategists) have included Chart 6 in research notes. We bring this up because if you only look at Chart 6, it appears to show that every outcome of a cutting cycle is a market drawdown.

We want to highlight a time when the beginning of a cutting cycle was not followed by a drawdown. The US economy's "soft landing" in the mid '90s included a rate-cutting Federal Reserve, a mild recession, and a technological revolution (the internet). In Chart 7, we highlight the beginning of major cutting cycles going back 50 years. In most cases, the Federal Reserve is cutting to stimulate growth in a slowing economy. Like in the mid-90s under Clinton, Trump can create the rate-cutting Federal Reserve, mild recession (inflation coming down with solid GDP growth), and a technological revolution (AI) scenario. We additionally think the "Wall Street types" described in the '92 article about Clinton applies to Trump. Trump and his cabinet will be very focused on market prices. We believe the Trump administration will properly react to market turbulence and mold policies to fit what is best for the market.

The Trade

When appropriate, we prepare our clients for the mid-90s soft landing with asset allocations that will attempt to take advantage of price appreciation, but until we see the outcomes of Trump's policy agenda, we remain hedged. We will remain hedged as we monitor how the new administration reacts to the rising interest rate environment highlighted in Chart 4. Additionally, we remain cautious about the December sell-off. According to our view of Goldman Sachs' prime brokerage data, the sell-off was driven by short selling. If the sell-off continues in January with retail long selling driving the market lower, we will look to roll down hedges and build cash positioning for new long buys while retail long selling is exhausted.

Please feel free to reach out to discuss how positioning is changing and how it fits into your long-term plans.

Disclaimer

[1]https://www.latimes.com/archives/la-xpm-1992-11-21-mn-734-story.html
[2]https://www.nytimes.com/1992/10/17/us/1992-campaign-democrats-budget-deficit-thorn-clinton-s-economic-plan.html
[3]https://www.nytimes.com/1992/11/02/business/would-clinton-have-to-fight-greenspan-over-a-stimulus.html
[4]https://www.latimes.com/archives/la-xpm-1994-05-01-fi-52635-story.html