
Hello and welcome back to Conversations. It's been a wild ride for financial markets, and it seemed timely to bring GSFM's investment strategist Stephen Miller back to the microphone. Steve has been penning opinion pieces for the AFR and speaking to media far and wide about 'Liberation Day', the turmoil unleashed by the Trump administration's tariffs policy and potential outcomes. Joining Steve is GSFM's CEO Damien McIntyre.

Before I hand over, I need to read this important notice:

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Damo and Steve, over to you.

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Damien McIntyre

Thank you, Tracy, and welcome everyone to our Conversations podcast. It's timely that we chat to Steve Miller today on the back of the election, which in many senses is yet to be concluded. But for the most part, it was a resounding victory to the Labor Party. And whilst most pundits expected the ALP to retain power, I don't think any pundits were forecasting a victory as strong as what we saw on Saturday night and indeed the control that the ALP now has over the parliament.

So, with that, Steve, what do you think is most pressing in the Labor Party's agenda? And how do you think that will impact bonds?

Stephen Miller

Oh, look, Damien, I don't think the election has much by way of implications for bonds. I mean, there's probably a couple of ways you can look at it. One is you can say the resounding victory is given the Labor Party a strong mandate to implement its policies. The reason I hesitate is we really don't know much about the nature of policies. You know, I don't think the policy ambition in the first term was vast. I'm not sure that the policy ambition we faced within the second term is considerable. It's certainly a long, long, long way from the sort of the Hawke Keating reform agenda that we saw through the 80s.

I would hope that, you know, the government can address some structural issues, in particular around microeconomic reform, if I can put it that way. But that's sort of in the more in the realm of hope, then I'm confident that they'll do that. I sort of think it'll be a little bit more of the same. So, the election itself won't have any implications for bonds. But I do think it's worth noting that both the government and the opposition have done actually is they've sort of not retaliated to the Trump threat of tariffs. And I think that's actually a wise strategy, because what it does do is it gives the Reserve Bank more flexibility to respond to any global growth downdraft that will flow from the Trump tariff agenda. And in that sense, it means that, you know, the Reserve Bank can cut interest rates aggressively if it needs to, which should actually be beneficial for bonds.

Now, not every central bank is in that boat. The US Federal Reserve has sort of been quite circumspect about its ability to cut rates. The Canadian Central Bank governor has also issued concerns about the impact of retaliation on inflation in Canada. So, I will say this. I think whilst the election itself has not got much by way of implications for bonds, that Australia hasn't gone down the retaliation path, will give the Reserve Bank more flexibility to cut rates in the event of a global growth downdraft. And I do believe there will be one. And that should mean that Australian bonds actually should do reasonably well, given that a stool of the retaliating against the Trump tariffs.

Damien McIntyre

Well, given Trump's pension to retaliation, and he seems to a champion, a global isolationist policy, I think it was pretty wise on the part of both Albert easy and done not to take him on in a public forum.

Stephen Miller

Oh, no, I agree. I agree entirely. It was lose-lose had they gone down there. No, retaliation is circular firing squad stuff, you know, it might make the Canadians feel good if they retaliate or it might make the Europeans feel good if they retaliate or the Chinese. But what they're doing is compounding the problem for their own citizenry rather than mitigating it. Retaliation doesn't help. And, you know, sometimes back-channel negotiation can be more helpful.

And I think the fact is that Australia has actually been treated quite lightly, at least in a relative sense, probably helped Australia sort of adopt that less aggressive, I think, more sensible non-retaliatory approach.

Damien McIntyre

So you've been sort of reasonably vocal in the domestic press. I refer to articles in the Financial Review where you were very confident that the RBA would have a platform to cut interest rates in Australia based on. I know the economic data we're looking at today is from March, and that's for all the chaos of Liberation Day and the events pre and post. thoughts, do you still have the same conviction that the RBA will be forced to cut rates?

Stephen Miller

I think the RBA will cut rates, yes. There's not much that stands in their way and if you think the risks are loaded towards a global downturn, a global recession, or I certainly think they're loaded that way, the RBA will cut rates. It'll have a disinflationary effect on Australia and that will mean the RBA is able to cut rates. So, we got the CPI last week. That showed the trim mean inflation rates running at about 2.7%. So that's within the RBA's 2 to 3% band. The RBA think the monetary policy settings currently are restricted.

So, if you put those two things together, when they meet on May the 19th and 20th, I expect they'll cut rates. I think it'll be 25 basis points. And I think they probably will overachieve on their inflation projection. So, in that context, I think we could even have the cash rate with a two handle by the end of the year. I mean, I'm not saying that's likely necessarily, but it's certainly not implausible. And I do think we'll see at least 100 basis points of rate cuts from here this year. And we only need one more and that'll take us, as I say, the cash rate to a two handle.

And I think the reasons for that is growth is tepid. The outlook is for a weaker global growth, for a medium sized economy that's quite leveraged to international trade like Australia. That means we get caught in a crossfire. That means it'll be disinflationary here. Inflation is already within the band.

So, I think the RBA will cut and cut quite substantially in 2025.

Damien McIntyre

Well, that's encouraging news for borrowers at least in Australia.

Stephen Miller

Look, it might sound like encouraging news. I'm a little bit surprised at some of the discourse around interest rate cuts. I mean, the reason I think the Reserve Bank will cut aggressively is because the global economy is in recession. That has an impact on Australia and that's not good news. So, it might be good news. The interest rates are coming down by borrowers. The bad news is they'll need those interest rate cuts.

Damien McIntyre

Coming back to Trump's tariff policy. It was interesting to observe that the bond markets were quite influential in one of his many step changes. Much like what happened to Theresa May in the UK a few years ago.

Stephen Miller

Not Theresa May, Liz Truss.

Damien McIntyre

Liz Truss, my apologies. Talk me through that.

Stephen Miller

Look, I think the bond markets are probably excited by the Fed commentary. So, you know, the Fed's been very, very circumspect and Chairman Powell has been quite vocal in saying that he's worried about the impact of tariffs, not just on prices, but more importantly price expectations or inflation expectations. Because if higher inflation expectations get embedded, that tends to be self-fulfilling and notwithstanding the likelihood of, as I say, a downdraft in US and global growth, it might sort of take place in a sort of a stagflation light type environment.

So, we might have the worst of both worlds. We might have sticky inflation, and we might have, you know, anaemic growth. Now, the last time we, I'm not saying we're going back to the 70s where we had high, even double-digit inflation, very, very, very weak growth as a consequence of two quite large oil price shocks. But we're going back, could be going back to a stagflation light environment.

And the lesson from the 70s is this, is that you need to vanquish inflation and keep on top of inflation expectations. Because if you don't do that and you don't do that early, the costs in terms of dislocation, in terms of growth and unemployment are much, much greater, the more you delay concrete and strong action. And so, I think the bond market eventually focused on the inflation and inflation expectations consequences of tariffs, realised the Fed was worried about that, started to recalibrate their own inflation expectations, and that led to those sort of rising bond yields.

You know, there was a higher inflation risk premium that was captured by those rising bond yields. And once you've got sort of higher bond yields, the head wins to equity markets, which are already be quite substantial, just got bigger. And I think in the end, that means that some of the adults in the room, in the White House, and I'm not convinced that's a big population. But anyway, some of the adults in the room pointed out to Donald Trump that he might sort of want to reassess or recalibrate the sorts of measures that he'd been countenancing.

And that's why we sort of got the sort of backdowns from Trump. You know, we got backdowns on tariffs, we got backdowns on his threat to sector own power. And I think the bond markets then sort of relaxed a little, although it's quite remarkable, I think, that the US 10-year bond yield still has a four-handle traveling around 10-year bond yields around 430 as we speak today. Even after we've had a first quarter, a negative first quarter GDP growth, and as I see in my view, at least, the likelihood is that we will have a recession at some stage in 2025, if we're not already in one.

And it's not just me saying that, you know, I looked up the betting markets just before we commenced this podcast, and Poly Market has the betting markets saying that there's a 57% chance of a recession in the US this year. And let me say there's a recession in the US, there'll be a global recession.

I've been saying that I think the odds are around two thirds, the betting markets say it's around 57%. So, it's not that different. That's the real fear is that we do get a recession in 2025.

Damien McIntyre

So, the chaos and the animosity that Trump's created with this tariffs policy? Yeah. How does he walk that back? Is there time to walk it back to avoid a recession?

Stephen Miller

I don't think so. No, I think the damage is being done. I think post liberation day, and as I say, you know, we did get some walking back of the magnitude of threats. I think that sort of mitigated the damage but not eradicated the damage. I'll be very surprised if we don't have a recession this year. And I think all this talk about doing deals, I think that sort of misses the point a little. The only way a deal is helpful is if it agrees to zero tariffs everywhere. If it's a deal that involves, you know, some protected access to US goods to domestic markets, you know, domestic markets outside of the US, you know, that's the same as protection. It's an inhibitor on economic growth. And I think all we've seen post liberation day is a mitigation of the likely damage, not an eradication of the likely damage. And I think we may be beyond the point of no return when it comes to, you know, avoiding a recession. I mean, I look at things like the Michigan consumer sentiment, and we've never had a falling consumer sentiment of this order of magnitude in 2025 so far. And that's not been followed by a recession. And that's in the 40 odd years since that data's been collected. Yeah, we can sort of maybe mitigate the damage, but I don't think we can eradicate the damage as I say.

Damien McIntyre

Yeah, it's interesting. I was framing my thoughts on this in terms of what it's got to now is effectively a standoff between China and the U.S. and I was thinking of how does this unwind and my mind sort of rested with China being the first to concede because Trump seems to think that the Chinese obligation to negotiate with on the basis that he's the one that's initiated the tariffs, which is curious. But the Chinese have got more to lose if they don't negotiate, haven't they? Because ultimately, they're the ones selling the goods.

Stephen Miller

Yes and no. I think the US is just as much to lose. I'm sure there'll be some form of settlement. I'm just not thinking it'll be a good one. That's all. But the US has got a lot to lose too. China's a big buyer. It's a big funder of the US fiscal deficit. And I suspect that part of what you saw in the bond market was the fact that the Chinese are not adding to their holdings of US Treasuries and looking to diversify their foreign exchange reserves into things like European-denominated or Euro-denominated bonds, maybe gold. That's probably part of the gold price rise.

There is a dependency there of the US on China as much as there is a dependency from China on the US. So, I don't think it's China loses most. I think they both lose. It's lose-lose. I think it's lose-lose for the world. That's what happens with protection. That's what happens when you abandon free trade. That's what happens when you have you eschew a rules-based order to open markets. They both lose, not just China loses or China loses the most.

I think China too will find alternative markets. I think that's true. It'll find alternative markets in Europe. And I think as you phrased it earlier, the US might find itself increasingly isolated in all of this because what else is bubbling away in the background is a pretty dismal treatment on the US part of its traditional allies. And I think that will mean that there's a greater disposition on part of the Europeans to look at maybe developing a more constructive relationship economically with China, which might, as I say, lead the US out of it as much as there's going to be damage for China.

So, I'm not sure I buy that that's a big part of the narrative. Now, hopefully there will be a settlement and hopefully it can be a good one. I'm just not that optimistic. No, never mind. In the last month I've been to Europe and the US. I talk frequently to friends and colleagues in Asia. They're more hoping, particularly those in Hong Kong, are more hopeful of a negotiated settlement. Neither of them will like, but they'll live with it.

Damien McIntyre

But the Europeans, in particular, are really quite insulted. And one fellow was moved to remark to me that now Trump wants to buddy up with El Salvador and distance himself from Europe. Now this fellow is a prominent person in financial markets within Europe. So, I thought that was a startling observation. And then when I travelled to the United States, it was quite interesting speaking to some of our partners who were concerned about the reputational damage that they would wear down the line through Trump's actions. The questions were, do you think ultimately our mandates are at risk because public perception of Trump and his tax on our partners will become intolerable?

Stephen Miller

It's a good question. I've probably been sounding quite a glass half empty so far. So, I'm going to sort of switch the narrative a little. I do think that I'll say this. I think Donald Trump has a point when he says the Europeans aren't pulling their weight in terms of defence expenditure. And I think that's probably true for US allies generally.

I think if he wanted to change that, he's gone about it the wrong way. But I do think he has a point there. So that's one thing. The second thing is, if you look at what's driven the outperformance of the US equity market, if you take out the magnificent seven stocks, and so you're left with the S&P 493, over the last few years, the S&P 493 has generally performed in line with the MSCI ex-US index. So, the source of outperformance has been in that technology space. Now that may still persist because we know that there are structural things happening that they could be just as important as what we're seeing in terms of the business cycle.

Now technology has been a big loser from the Trump administration's policy so far. But I don't think this sort of mega trend of AI technology and US leadership in that is going to dissipate quickly the Trump effect notwithstanding. I think if you still want exposure to technology, you're going to have to have exposure to the US. And I think if you want exposure to global equities, you're still going to have to have exposure to the US. And while I recognise that there are sort of some substantial wins for those growth stocks, don't discount that structural mega trend relating to technology and AI is still ongoing, and that people will still need to invest in the US. I just sort of think the US is going to come back to the pack. I don't think it's going to underperform Europe, but I think it's going to come back to the pack and that I hope you sort of calm down some of your partners about the fact that their mandates might have a little more durability.

I mean, I noticed too, and again, this is just anecdotally, but I noticed the big industry fund CIOs are being quite vocal too about that they're not abandoning their listed investments in the US at this point in time. There might be some slight rebalancing, but you know, I don't think it'll be huge, and that the US equity market will remain a destination for investment because of that technology attribute, which is so much more prominent in the US than it is elsewhere, if that makes sense.

Damien McIntyre

Yeah. Well, I mean, look at it stock by stock. Microsoft is tariff light or tariff agnostic. And furthermore, Microsoft hasn't got a European or Asian software rival that can dent its market share. Meta the same. So there's three of the top seven.

Stephen Miller

Sure. Tesla's going to struggle with tariffs, remain fierce on what he's important is Tesla, Apple and Nvidia, you know, they have challenges, but they're overcomeable challenges, if you know what I mean. Europe doesn't have a tech sector to speak of. And let's not forget in all of this, the European Union has been a bit of a protectionist club for a long, long, long, long time. And what's so what's so funny about what Donald Trump's done, he's sort of more or less aping what the European Union have done in some ways.

And what the European Union have done is consign themselves to a sort of a low growth stagnating ageing economy. And why Donald Trump would want to hate that? I mean, I don't know why. So that's what I mean. You know, the US might come back to the pack. I certainly don't think it will underperform European stocks. It might just match them. But matching them is not a great outcome given where it's come from.

Damien McIntyre

So, where we are now, and I think if you're a betting man, you would say that there'll be a negotiated outcome on tariffs with the US 10 year at 4.3, as you mentioned a minute ago, the trajectory for US bonds in particular, a US debt has to be south, hasn't it? Sorry, rates have to fall.

Stephen Miller

Eventually, yeah. But you know, there's other things happening on the structural front on inflation that causes me some pause. So, it's not just tariffs that are going on, you know, if you look at what happened after the fall of the Berlin Wall, you had this mass migration of skilled labour from what was then the Eastern Bloc. At the same time, you had mass migration of relatively skilled migration from China and India. That's all coming to an end. You know, that's finished.

What that mass migration in the 30 years post the fall of the Berlin Wall did was keep wage growth suppressed, and that kept inflation suppressed. That's now reversing will remove that quiescence of inflation. Migration will also move that quiescence of inflation.

You've got de-globalisation of goods markets that are occurring anyway, even if there is some form of negotiated settlement, that will keep prices high. You've got Western governments embarking on strong regulatory agendas, which they might, it might be well intentioned, but it will have the consequence of keeping business costs high. You've got baby boomers exiting the workforce, labour's becoming scarcer, and so all those things will push wages up and make inflation harder to get down.

So yeah, you might be right. You know, yields will ultimately fall, but they won't fall in a manner that we've become used to in the period since the fall of the Berlin Wall. So going back to the GFC or the tech wreck or whatever, you know, rates fell, and they fell hard and they fell fast. I'm not sure that we're going to see that this time around. You know, rates will fall, but it'll only be a grudging fall, and it'll take longer than it has in the past. You know, I expect US bond yields will fall this year, but I think it'll be a grudging grinding type fall in yields rather than the rapid ones that we've got used to in prior episodes of stress in the period post 1990.

Damien McIntyre

Just on that, and when you go to the previous crises, you know, in the last 18 years, the global financial crisis and COVID, there's two standouts. Central banks globally worked in a unified way.

Stephen Miller

They all did the same thing, but I'm not sure it was all coordinated, if you know what I mean.

Damien McIntyre

Okay, so I suppose my question is, self-interest aside, do you think we've reached the point where central banks will be less willing to work with the Fed?

Stephen Miller

No, I don't think so, because I don't think they've ever really actually worked closely with them before. So, I don't think that'll change. I think it was just because of the nature of those crises that you mentioned. It was a global financial crisis. It was a global pandemic. And that meant that wherever you were as a central bank, you had to cut rates and cut rates quickly.

Now, you know, as I said, I think there are some central banks like the Reserve Bank of Australia that can actually be a lot more aggressive than say the Fed. I think the ECB can probably be a bit more aggressive, but that's because it started this position in a weak spot. And it started this position with inflation already low.

I'm not sure, for example, that the Fed can be as aggressive as it was in 2008 and through COVID and going back to the tech rate. I think it'll cut rates, but not as aggressive as perhaps will occur in Australia or as perhaps has occurred in Europe. And I think that'll be the difference.

It's not so much that central banks won't work with the Fed. It's just that they have for perhaps idiosyncratic reasons, different agendas, which will mean that there's going to be a different pace of monetary easing in various jurisdictions, unlike that which we saw during COVID and which we saw during the global financial crisis.

Damien McIntyre

So let's look at, I mean, you know, Trump seems to set markets on a new trajectory on a daily basis. So making any sort of bold prediction is cavalier…

Stephen Miller

Well predict early and predict often, that's what I say.

Damien McIntyre

The information changes by the hour, by the tweet. But coming back to that, let's look three to six months down the road for a year. What do you think happens with markets moving forward?

Stephen Miller

Look, I'm a bong guy. I'm a bond guy. So, you know, I'm always, I'm preternaturally pessimistic. I mentioned stagflation light. I think inflation will be sticky and growth will be weak, anaemic, recessionary even. And I think in that way, and that will mean that the Fed, as I say, it might cut rates, do so only grudgingly. The Fed meets this week. It's had a negative Q1 growth figure. I expect the Fed won't cut rates when it meets this week, which is different to what's happened in the past. So, we might, you know, the meeting after that, we might get a cut, we might get a fall in yields, but it won't be quickly.

It means that unlike in episodes prior, like the GFC or COVID, that the central bank put is no longer there, or certainly the Fed put, let's say, is no longer there. And, you know, that means, like I say, you get a grudging rally in bond yields, and they're still considerable headwinds to equity markets. Notwithstanding it, as I said before, my thought that, you know, you don't want to sort of forget the sort of the structural megatrends that might go the other way. So, if you're asking me over the next three to six months, I'm thinking some modest fall in bond yields and continued headwinds for equity markets. I don't think at a macro level, you're going to get great returns from, you might get your running yield in bonds, and you might get flat to maybe up marginally from global equities.

That's my central case outcome. Now, there are some quite fat tails around that, because there's, as you say, when you're dealing with a mercurial administration, anything can happen.

In saying that I expect flat equity markets and maybe a small decline in bond yields and a global recession, I can countenance that there are plausible outcomes, either side of that, which might make that different. So, what's that mean for investors? It always gets back to this lesson. The lesson is diversification, and the lesson is to try and look for things that are uncorrelated with equity beta and bond beta. Now, that's easy to say. It's not as easy to do. You might be looking for non-directional, long-short bond strategies, long-short equity strategies, maybe gold, macro hedge funds, quant hedge funds, things that have an allocation. I don't think that the 60/40 portfolio is, and I think its efficiency has always been overrated, but it's not a 60/40 portfolio anymore. I don't know what the numbers are, but it might be something like 50, 25, 25, 50 equity betas, 25 bond beta, and 25 other stuff. That's how I think multi-asset portfolios and builders of multi-asset portfolios should think about things. But that's, as I say, that's conditioned on my somewhat negative view of what the world's going to look like in the next three to six months.

If I'm wrong, then things turn out to be a little more positive. It's back to where we were, not maybe through most of 2024, but back to a more benign environment. Let's put it that way.

Damien McIntyre

Now, without wanting sound ageist, you've been investing for quite a while. Have you seen a set of circumstances like this?

Stephen Miller

Well, I was at a conference the other day and I said it's not the same but it's redolent of the 70s. You know, I use the term stagflation light. I mean, we had meaningful stagflation in the 70s, you know, as I said, double digit inflation and I think we sort of finished it almost with double digit unemployment, not in Australia, but you know, it was very, very high. It was high inflation and weak growth. Now, it's nowhere, nothing like that.

By the way, some people say if you remember the 70s, you can live them properly!

But anyway, it's sort of like a very light version of what happened in the 70s where equity markets struggled and bond yields were sticky. They were sticky higher. And I sort of wonder if we're sort of going to have, as I say, a lighter LITE version of what we saw in the in the 70s. Not as damaging. Inflation is not stuck at 10. It'll be stuck at maybe three or three and a bit. And growth's not continually negative but flat lines. It's that sort of world that I think we're entering at the moment rather than the great disinflation which sort of kicked off throughout the 80s a bit later here in Australia.

And that great disinflation allowed, except for a couple of bumps in the road, a strong performance of equity markets. And as I said, because inflation was structurally quiescent, those bumps in the road were all just that, just bumps in the road, even if some of them at some stages looked quite serious.

Damien McIntyre

Now, to your credit, you've been talking favourably about gold for quite some time now, years, I must say. Do you think investors have missed gold?

Stephen Miller

I'm not sure you're going to make a lot of money out of gold if you invest in it at, you know, $3,300 US dollars per ounce. But I get back to, so the reason I started investing in gold, I started investing in gold about maybe around 2016, 2017. And I first did it as a bond alternative because I sort of thought, well, why do I want, why do I want to have bonds in my portfolio that are going to yield 2%? They're not going to give me a lot of protection in a pretty ugly world. And so, I sort of looked at gold as an alternative, safe harbour, if you like, to bonds, and it's morphed into more or less an alternative to bonds and equities.

But it gets back to the point I was sort of saying is it's all, I don't think you're going to make a lot of money in gold, but it's going to have some insurance attributes that if things get really weird and really horrible, I think gold will do quite well. Now, I hope that doesn't happen. It's a good diversifier in a portfolio, even if there's some reasonable chance that you're not going to make a lot of money by buying gold at $3,300. So, it gets back to what I was sort of saying, you know, if you want to build a portfolio, don't think 60, 40, think 50, 25, 25.

And part of that 25 should be a fair part of that 25. You should think about allocating to gold.

Damien McIntyre

All right, Steve, interesting as always. Thanks very much for your time. And to the listeners, thank you very much for listening to our podcast today.