

Think Wealth Visionaries – Richard Clarida

Frederic Neumann:

It's a great pleasure to be with Dr. Richard Clarida today.

Welcome, Richard. It's good to see you today.

So, Richard, over the last six months, we've seen tremendous volatility in global financial markets. We had the tariff issues. We had other geopolitical events, of course, much to keep investors on their toes.

But let's start with tariffs. How should we think about the risk of tariffs going forward? How high will this be? What will be the impact on the U.S. economy? How can investors prepare themselves in terms of their portfolio construction for the uncertainty related to tariffs?

Richard Clarida:

Well, it certainly looks like the new normal for tariffs are going to be at a very elevated level compared to the experience of the last 75 years. I think at minimum, we're going to see something like 10% across the board tariff that every country will pay. And then on top of that, additional tariffs. The risk is that tariffs could set to a level of 20% or above. In terms of the implications for the outlook, it will be a stagflationary hit to the economy. It'll tend to push up prices, and to slow growth. And the ultimate destination for the economy is going to depend on the ultimate destination for tariffs. In terms of markets, markets and risk assets recovered quite impressively, coming out of "Liberation Day". My sense is that markets do think that tariffs will settle down somewhere in that 10% to 15% range. But the risk is obviously, if they settle at a higher level, that could be an issue for markets.

Frederic Neumann:

Now moving on from tariffs. What about the U.S. dollar?

We've seen a tremendous depreciation of the U.S. dollar first half of this year. Partly related to the policy uncertainty emanating out of the U.S. Do you view this as a structural change in global currency markets? Is this foreign investors selling out permanently out of U.S. assets or is this more of a temporary setback for the U.S. dollar?

And do you expect some stabilisation to come back in?

Richard Clarida:

So, at PIMCO, we would distinguish between the dollar as a dominant

reserve currency and the related but distinct issue of whether the dollar is going to strengthen or depreciate over the next several years. On the first, we think the dollar will continue over the next several years to be the dominant currency in global financial markets reserve holdings, FX trading trade invoicing and international financial derivatives markets. That said, the dollar came into the year at a very elevated and lofty valuation. So, on a valuation basis alone we've not been surprised that we've seen some depreciation of the dollar especially against advanced economies. And that could well continue especially at some point when the Fed re-engages and starts cutting rates.

Frederic Neumann:

You mentioned the Fed cutting rates again. Now the Fed faces a tough path ahead. On one hand, you mentioned higher inflation risks from tariffs. On the other hand, the Fed has a dual mandate it needs to look at employment as well. How do you weigh these two factors: Employment risk and Inflation risk? And where do you think the Fed will ultimately settle in the coming quarters and months?

Richard Clarida:

Well right now, inflation, even before the hit from tariffs, inflation is still running a little bit hot relative to the 2% target. Whereas, the labour market is right in line with the Fed's view of full or maximum employment with the unemployment rate around 4% to 4.2%. So, by that metric, the Fed is further away from its inflation objective than it is from its employment objective, which is why they're content to have policy at the current setting, which they judge to be moderately restrictive.

Frederic Neumann:

Now, moving on to market implications of this. U.S. yields, relatively high at the moment, we saw them rise a little bit in recent months. Is this a good time to invest in the fixed income markets with 10-year yields where they are currently? Or do you expect more volatility? Should investors be a bit more cautious about going into fixed income markets?

Richard Clarida:

We think this is a very good time for investors to not only hold fixed income, but potentially to increase their allocation, because again it comes down to valuation.

Both historical experience and research have shown that the best single predictor of the total return on a quality fixed income portfolio is its starting yield. So, starting Treasury yields now, in both real and nominal terms are at levels that we haven't seen in 15 years. There is going to be some volatility in markets. But interestingly enough the index of implied fixed income volatility, the so-called MOVE index has been actually declining in recent months. And so, we do think this is a good entry point for investors either to allocate to fixed income or to add to fixed income on that basis.

Frederic Neumann:

Thank you very much.

Richard Clarida:

Thank you.