Fed Rates - It would be a good idea if Trump listens to Powell and the FOMC

Trump and Powell have never been on great terms; not even during Trump's first term. However, his threat to get rid of Powell from the top job at the Fed misses out on the key monetary point.

What Donald Trump wants?

Trump has protested that Powell had been too slow when it came to cutting rates. There are already fears that the reciprocal tariffs imposed by the Trump government could derail US growth as well as global growth. It is not just the global trade, but even global GDP would grow much slower. It is this slowdown that Trump wants Powell to pre-empt by cutting rates aggressively. He believes that if rate cuts are delayed further, it risks hard landing for the US economy.

A lot at stake for Donald Trump

For Trump there is just too much that is at stake. He has pushed through tariffs, despite stiff opposition from the EU, and the rest of the world. He can tolerate inflation, as that is a logical corollary of any tariff hike. However, he must prove that the tariff hikes are in the interests of the American people. For that, it is key that growth is sustained and jobs are protected. Trump's plan is to hold the growth story, even if that means higher inflation. They can address that later. However, if Powell does not relent on aggressive rate cuts, then the plan to present a positive US growth story will fail. That is Donald Trump's dilemma!

Why is Jerome Powell cautious?

However, there are reasons why Jerome Powell is overly careful on the inflation front. Trump is not the first to criticize Powell on going slow on rate cuts. Other economists have also said that Powell was late on rate hikes and also on rate cuts. However, Powell is apprehensive that the steep tariffs could create shock stagflation in the US economy. That is a case of low growth, weak jobs, and high inflation. This creates a policy dilemma for the Fed. Rate cuts can temporarily solve the growth problem, but inflation at higher levels would still hit purchasing power deeply. For now, the US Fed can afford to wait and that is exactly what Powell is doing. As Powell says, “Fed’s job is to respond to data flows, not to predict data flows. That is justified!

Trump should listen to Powell

In the US, the Fed chair job has a constitutional sanctity; is not something that can be changed at the whims of the head of state. The logic is to separate monetary policy from political thinking. That is not something Trump wants. Ideally, Trump should let the Fed have its way on monetary policy, a model that has worked perfectly in the past. US Fed governors have been larger than life personalities, and there is a logic to that. They have to stamp their authority on monetary policy, irrespective of what politicians believe. That is something, Trump must not attempt to change!

Indian IT sector - Facing tough times; but it is ripe to put cash stash to good use

Week after week, we get to see Indian IT sector underperforming the indices. It is the frontlines biggies like TCS, Infy, and Wipro that are being hit. What does this really mean for the Indian IT space?

Closer to its yearly lows

IT is the only heavyweight sector that is trading closer to its yearly lows. One has to only look at this comparison. Nifty 50 is just about 9.2% from 52-week high, and the Nifty Bank is just about 0.5% off its 52-week highs. However, the IT index is a full 27.6% away from its 52-week highs and is actually trading closer to its yearly lows. That is not normal for a sector that still contributes a sizable chunk of the Nifty 50 profits each and every quarter. This dichotomy has also reflected in the weight of the IT index.

How the mighty have fallen

In the recent week, the weight of the IT sector in the Nifty has slipped to 10.2% and, remember, this is the lowest in the last 17 years. At its peak the weight of the IT index was around 17.7% in the Nifty 50 index. Even if you leave out the peak, the average weight of IT sector in the Nifty has rarely fallen below 13.84% and this is the first time that the weight of the IT index has fallen to such a low. That surely reduces the clout of the IT index in influencing the Nifty as other sectors like financials, FMCG, oil, and autos are likely to see a rise in weight. But, why is IT losing prominence now?

Several factors have conspired

The signals have been around for some time and the factors are fundamental and also momentum driven. One reason the IT sector has been under pressure is the global client preference shift from IT service providers to IT solutions. That is what the big consultancy firms are adopting and that trend is here to stay. Secondly, onslaught of AI is a double whammy. It makes scores of workers in IT firms redundant and also these IT companies find themselves unprepared for the shift. The more immediate factor has been Trump tariffs. It threatens to slow global growth and one big casualty will be the IT spending by businesses globally. That pressure is translating into finer pricing and thinner OPMs for IT.

IT needs change in mindset

The need of the hour is just a change in mindset. IT companies can no longer be a source for labour arbitrage. Indian IT companies have made billions out of this pricing inefficiency. It is now time to use that money to prepare for the new IT order. IT companies have to train their workers in AI, ML, big data; and even the sales team needs training on how to make the big consolidated pitch. Indian IT companies cannot survive just on IT services. They must now offer solutions and they have the cash flows to do that. It is enough of generous dividends and big buybacks. Time to put the cash in the balance sheet to productive use!

Gold Prices - The real risk is not for gold buyers, but for gold loan borrowers

Gold prices are rallying like there is no tomorrow. Retail gold demand has been subdued due to household budget stress, but Indians have not given up on their obsession for gold. There is a bigger risk.

Gold prices at multi-year high

This is not just a gold price rally driven by weak dollar or by Jewellery demand. This is a rally that has been driven by central bank buying and by investment buying, as evidenced by ETF demand. Global spot gold prices at $3,327/oz is now even higher than the inflated price of the January 1980 peak. Even at such lofty gold prices, central banks continue to accumulate gold as a viable option to holding dollars. It is not just China and Russia, but even countries like India and the rest of the EU are splurging on gold. It is the only asset that truly glitters!

Panic buying at multiple levels

There is panic buying in gold at multiple levels. Countries like Russia and China are buying gold as a means of reducing their dollar exposure. Then there are the likes of EU, where most of the countries already have large reserves of gold. They are not only adding gold, but also getting their gold stashed in other countries, back to the home country. Then there are the ETFs that are buying gold as a hedge to sell to institutional investors. Gold is not just the best performer last year, but also in the last 10 years. It is rare that gold has outshone equity consistently!

What should be gold strategy?

If you had advised your clients not to buy gold like equity, you would have been proven wrong in the last 10 years. Gold is traditionally seen as a hedge and not as a return generating asset. However, in the last 10 years it has belied that very definition. One good thing is that buying gold at higher prices may not be such a big risk at this juncture. For now, it does look like political uncertainty and macro risks are here to stay. Hence, it may not really matter at what price you buy gold. The best strategy would still be to limit your gold exposure in the portfolio to

10% to 15% of portfolio value. Even if gold looks too exciting, it is best to limit to 15% and look to spread across other asset classes so you do not lose out on the fundamental merits of diversification!

Real worry is gold loans

The real worry today is not about gold buying at higher prices. The real worry is about the proliferation of gold loans in India. The organized gold loan market is about ₹7.1 trillion, which is less than 6% of total gold holdings. However, the gold loans from unorganized lenders is nearly twice the organized segment. So, actual gold loan size may be closer to ₹21 trillion and that is huge. Most people are paying usurious rates and have used top-ups to the hilt. Even a 10-12% correction in gold prices can trigger a mix of margin calls and panic selling in gold. That is the real risk in gold to be watching out for!