COOLABAH CAPITAL INVESTMENTS™
THE INTELLECTUAL EDGE: MAKING EVERY BASIS POINT COUNT

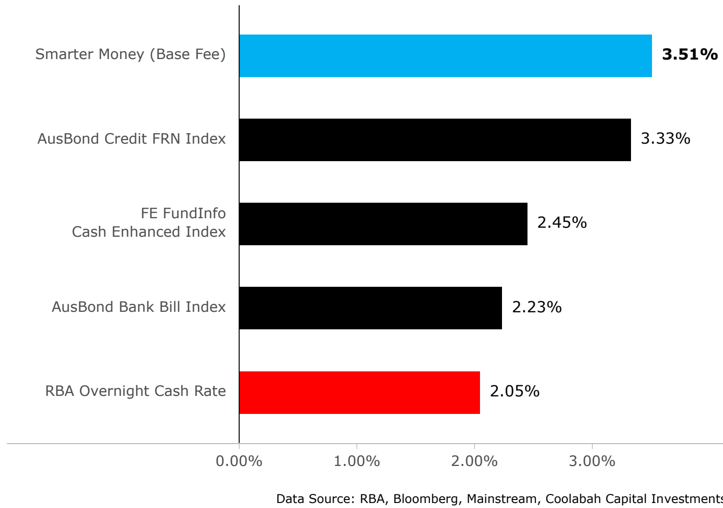
Fund: **Smarter Money Fund - Base Fee Class**
Strategy: **Smarter Money/Short-Term Fixed-Interest**
Return (since Feb. 2012): **4.33% pa gross (3.51% pa net)**
Net return volatility (since Feb. 2012): **0.59% pa**

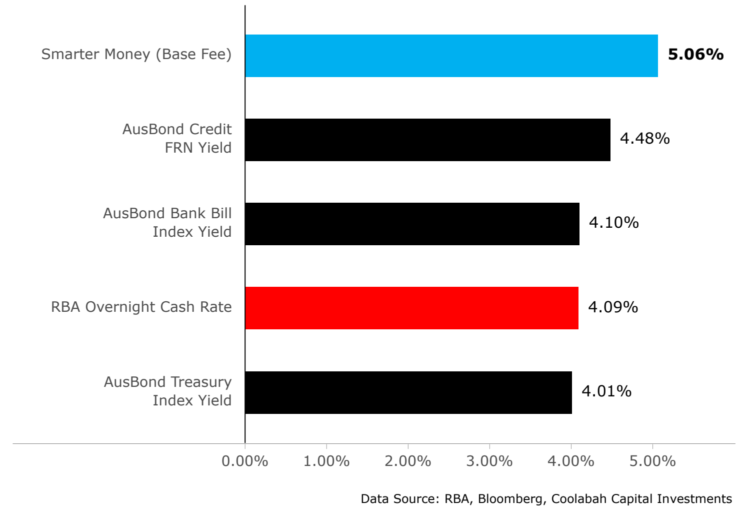
February 2025

Objective: An independently-rated/recommended strategy targeting low-risk cash and fixed-income returns that exceed the RBA's cash rate by 1%-2% pa after fees, over rolling 12 month periods.

Strategy: We actively invest in a diversified portfolio of Australian deposits and investment grade floating-rate notes with a weighted-average "A" credit rating. We do not invest in fixed-rate bonds (unless interest rate risk is hedged), sub-investment grade bonds, direct loans, equities, capital notes, preference shares (eg, hybrids), use leverage, or take currency risk. We add value via active asset-selection using a range of valuation models with the aim of (1) delivering lower portfolio volatility than traditional bond funds and (2) providing superior risk-adjusted returns, or alpha, without explicitly seeking interest rate risk, credit risk or liquidity risk. The strategy is managed by Coolabah Capital Investments, which is a specialist active credit manager.

Period Ending 2025-02-28	Gross Return (Base)	Net Return (Base)†	RBA Cash Rate	Gross Excess Return‡	Net Excess Return (Assist.)†‡
1 month	0.49%	0.43%	0.32%	0.17%	0.11%
3 months	1.58%	1.39%	1.06%	0.53%	0.33%
6 months	3.41%	3.00%	2.13%	1.27%	0.87%
1 year	**6.71%**	**5.87%**	**4.33%**	**2.38%**	**1.55%**
3 years pa	5.36%	4.54%	3.36%	2.00%	1.18%
5 years pa	3.87%	3.06%	2.04%	1.84%	1.02%
10 years pa	3.69%	2.88%	1.79%	1.90%	1.09%
Inception pa Feb. 2012	**4.33%**	**3.51%**	**2.05%**	**2.28%**	**1.46%**



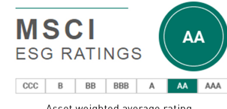


† Net returns are calculated from the historic gross returns using the current fee structure as displayed in the Product Disclosure Statement. ‡ The Excess Return columns represent the gross and net return above the RBA cash rate.

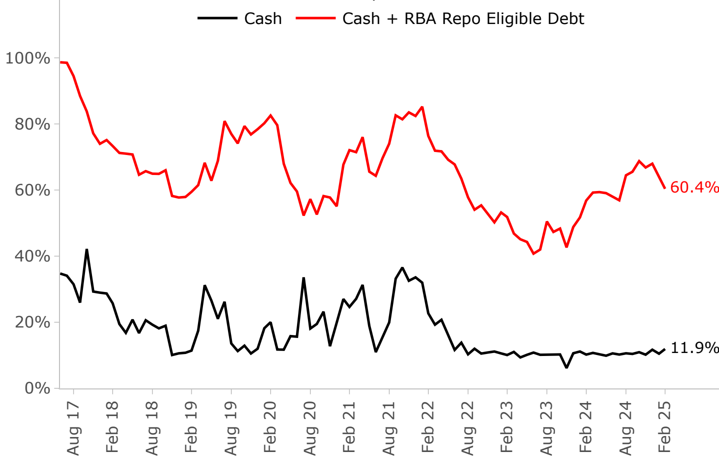
Disclaimer: Past performance does not assure future returns. Returns are shown net of management fees and costs unless otherwise stated. All investments carry risks, including that the value of investments may vary, future returns may differ from past returns, and that your capital is not guaranteed. To understand Fund's risks better, please refer to the Product Disclosure Statement available at Coolabah Capital Investments' website.

Net Monthly Returns > RBA Overnight Cash Rate	76%	Av. Interest Rate (Gross Running Yield)	5.06%
Portfolio Weight to Cash Accounts	11.9%	Modified Interest Rate Duration	0.14 years
Portfolio Weight to Bonds	88.2%	Gearing Permitted?	No
Av. Portfolio Credit Rating	A+	1 Year Av. Portfolio Weight to Cash	10.6%
Portfolio MSCI ESG Rating	AA	Cash Accounts + RBA Repo-Eligible Debt	60.4%
No. Cash Accounts	9	Net Annual Volatility (since incep.)	0.59%
No. Notes and Bonds	141	Net Sharpe Ratio (since incep.)	2.48x

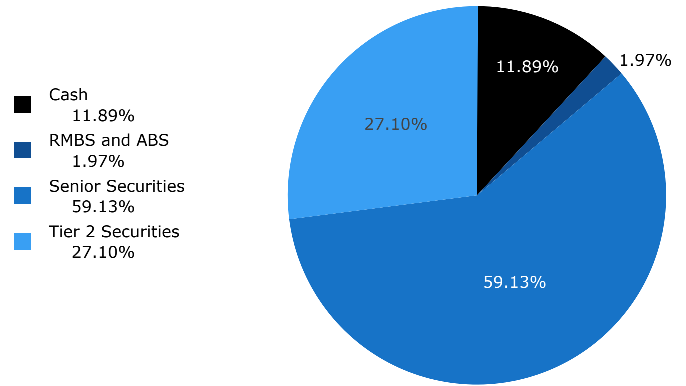
Ratings: Recommended (Zenith); Superior - Relatively Simple (Foresight Analytics)



Portfolio Weights: Cash + RBA Repo Eligible Debt
28 February 2025

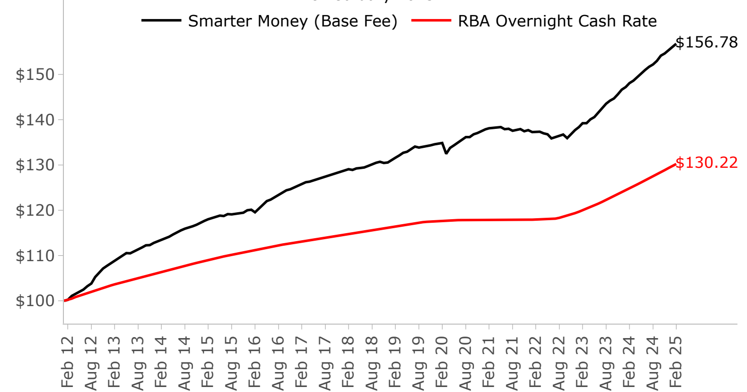


Smarter Money Fund Portfolio Composition (NAV)
28 February 2025



Data Source: Coolabah Capital Investments

Value of $100 Invested Since Inception
28 February 2025



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The since inception gross (net) return of 4.33% pa gross (3.51% pa net) is the total annual return earned by the fund since Feb. 2012, including interest income and movements in the price of the bond portfolio after all fund fees (assuming net returns are calculated from the historic gross returns using the current fee structure as displayed in the Product Disclosure Statement). The net return quoted applies to the Smarter Money Fund - Base Fee Class, with quarterly distributions reinvested. Investment return will vary depending upon investment date and any additional investments and withdrawals made. **The annualised volatility estimate of 0.59% pa** is based on the standard deviation of net daily returns since inception, which are then annualised, attributable to the Smarter Money Fund - Base Fee Class.

Portfolio Managers	Christopher Joye, Ashley Kabel, Roger Douglas, Fionn O'Leary (Coolabah Capital Investments)		
APIR Code	ETL6313AU	Fund Inception	17-Feb-12
mFund Code	-	Distributions	Quarterly
Asset-Class	Smarter Money/Short-Term Fixed-Interest	Unit Pricing	Daily (earnings accrue daily)
Target Return	Net 1-2% pa over RBA cash rate	Min. Investment	$1,000
Investment Manager	Coolabah Capital Investments (Retail)	Withdrawals	Daily Requests (funds normally in 3 days)
Responsible Entity	Equity Trustees	Buy/Sell Spread	0.00%/0.025%
Custodian	Citigroup	Mgt. & Admin Fee	0.79% pa

Signatory of: PRI Principles for Responsible Investment

Zenith RECOMMENDED

SUPERIOR RELATIVELY SIMPLE Foresight Analytics

MSCI ESG RATINGS AA
CCC B BB BBB A AA AAA
Asset weighted average rating

Portfolio commentary: In February, the zero-duration daily liquidity Smarter Money Fund (SMF) returned 0.49% gross (0.43% net), outperforming the FE Cash Enhanced Index (0.30%), the RBA Overnight Cash Rate (0.32%), the BetaShares High Interest Cash (AAA) ETF (0.33%), and the AusBond Bank Bill Index (0.34%). Over the previous 12 months, SMF returned 6.71% gross (5.87% net), outperforming the RBA Overnight Cash Rate (4.33%), the AusBond Bank Bill Index (4.48%), the BetaShares High Interest Cash (AAA) ETF (4.53%), and the FE Cash Enhanced Index (4.91%). SMF ended February with a running yield of 5.06% pa, a weighted-average credit rating of A+, and a portfolio weighted average MSCI ESG rating of AA.

Since the inception of SMF 13 years ago in February 2012, it has returned 4.33% pa gross (3.51% pa net), outperforming the RBA Overnight Cash Rate (2.05% pa), the AusBond Bank Bill Index (2.23% pa), the BetaShares High Interest Cash (AAA) ETF (2.42% pa), and the FE Cash Enhanced Index (2.45% pa). Since inception, SMF's Sharpe Ratio, which measures risk-adjusted returns, has been 3.86x gross (2.48x net). While SMF's return volatility since inception has been low at around 0.59% pa (measured using daily returns), as a daily liquidity product with assets that are marked-to-market using executable prices, volatility does exist. This contrasts with illiquid credit (eg, loans and high yield bonds) wherein assets that have very high risk can appear to have remarkably low volatility, which is, in fact, just a mirage explained by the inability to properly value these assets using executable prices.

Strategy commentary: The month of February was punctuated by a strong rally in fixed-rate bond prices as US government bond yields slumped, which powered the performance of so-called "duration" (or fixed-rate, as opposed to floating-rate, debt). This was evident in the results delivered by Coolabah's long duration strategies, like the recently launched Global Active Bond Fund, which returned 1.59% to 1.60% net in February (its benchmark, the Bloomberg Global Aggregate Corporate Index, rose 1.57%) and Coolabah's Active Composite Bond Fund (ETF: FIXD), which returned 1.10% net relative to the Composite Bond Index's 0.93%.

The US 10-year government bond yield fell by 33 basis points (bps) from 4.54% to 4.21% in February as markets reassessed the growth outlook in the face of the Fed's policy rate remaining on hold while timely data on economic activity and spending hinted at the possibility of weaker times ahead.

There are nevertheless extreme cross-currents in play. All-important household inflation expectations in the US have spiked (again) at the same time as the consumer price index appears to be reaccelerating on the back of a resurgence in global goods inflation.

Trump's trade war could be one driver of a temporary increase in prices, amongst other things. Deporting very cheap migrant labour and boosting wage growth is another source of latent inflation pressure. And then there is the potential damage done to the Fed's inflation fighting credibility with consumers by Trump's efforts to undermine its policy primacy.

The disinflationary hope is almost entirely predicated on Elon Musk's valiant attempts to eviscerate government waste. Trump's tax cuts cost US$8.1 trillion over 10 years while his tariffs only raise US$1.8 trillion over the same period. Yet if Musk can slash total government spending by 15%, the budget deficit will more than halve. This will save US$1 trillion annually, more than paying for Trump's tax cuts. Crucially, the reduction in public spending and increase in unemployment could reduce inflation and interest rates. Of course, it requires Musk and his acolytes to execute a truly herculean feat. And this will necessitate the ongoing support and imprimatur of the Trump administration, which is no sure thing. As the equity market wilts, Trump will come under pressure to soften Musk's relentless blows against the "deep state".

Nobody knows what will in practice transpire. If Musk fails, US government debt issuance could surge, pushing to the debt to GDP ratio to 133% – a level not seen since World War Two. Coupled with the prospect of sharp increases in European and UK government bond issuance to pay for higher defence spending, this could trigger a secular rise in long-term interest rates as investors demand more attractive term premia for taking down this additional debt.

February ended up being a more challenging month for many equity markets, which extended into early March. Aussie and NZ stocks led the way, plunging 3.79% and 3.03%, followed by the S&P500 (down 1.42%) and Nasdaq (off 2.76%). The UK and Europe bucked this trend, climbing 1.57% and 3.34%, respectively.

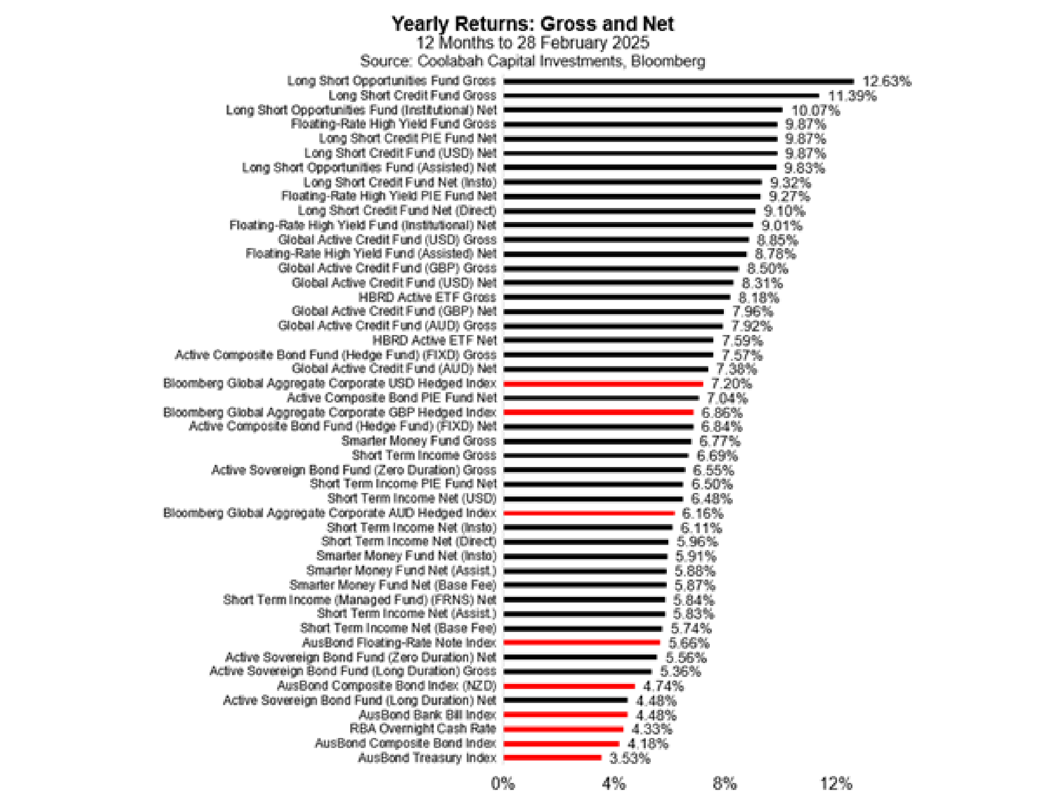
Strategy commentary cont'd: The unusually robust performance of UK and European equities was explained by banks and defence companies. The European bank index appreciated 14% on the month and has climbed 26% in the year-to-date. This was driven by the steepening of European yield curves, which is considered positive for banks as they lend money at higher rates while funding themselves via deposits at short term (and lower) policy rates.

Yield curves have steepened in anticipation of heightened government borrowing to finance military expenditure. European defence stocks were up 15% in February and have jumped 27% in the year-to-date.

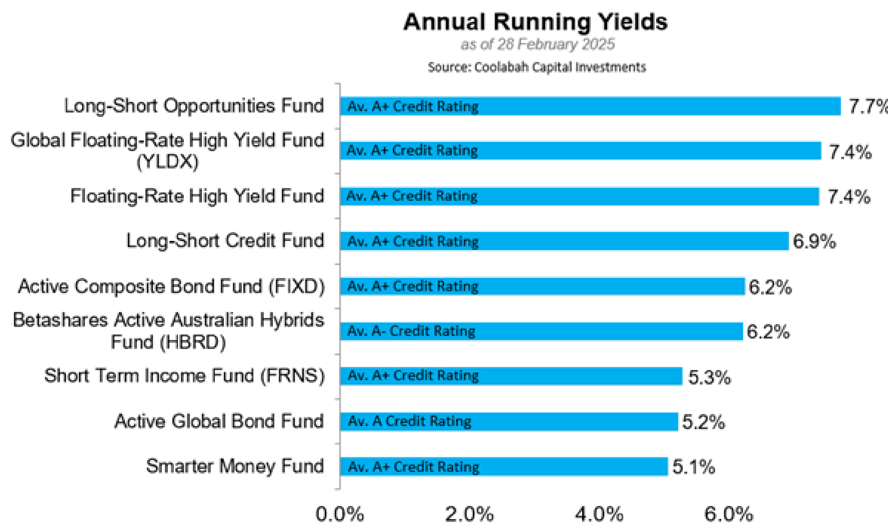
This could also shed light on divergences across government and corporate bond markets. Whereas US 10-year government bond yields plunged 33bps in February, there were much more modest declines in Germany (5bps), the UK (6pbs), France (6bps), and Italy (7bps). This could help explain differentials in the performance of credit: while US physical credit spreads gapped 8bps wider, European spreads were unchanged. Higher outright yields tend to support spreads, all else being equal. In flightier synthetic credit default swap markets, spreads on the major CDS indices drifted wider.

One interesting tell regarding the degradation of risk appetite was the substantial decline in the price Bitcoin (plummeting 17.53%) while gold prices continued their march higher (up 2.12%). Oil prices also fell 4.66%, which brought the cumulative decline since their 2024 peak to around 22%. Following the end of February, crypto was temporarily bailed-out by President Donald Trump himself, who announced that he "loved" Bitcoin and planned on establishing a strategic crypto reserve to hold these assets. The devil in the detail was, however, that this simply involved not selling crypto that US law enforcement agencies had confiscated rather than actively acquiring additional assets.

The charts below show Coolabah's 12 month returns and current yields. Past performance is no guide to future returns. Please read the product PDS to better understand its risks and consult and independent adviser on your circumstances.



Strategy commentary cont'd:



Government spending highest since World War II

Trump is going uber-hard on tariffs, as we have long warned he would. And there is probably much more to come. Those weak-willed, yellow-bellied equity investors are not enjoying this difficult dose of Trumpian reality, which is crucial to his broader economic and geopolitical strategy.

The S&P500 has fallen 4.6% while the Nasdaq has slumped 7.3%. And there is a great deal of latent downside risk that lies in wait if our central case of a stagflationary future comes to pass.

The US has upgraded its estimate of annualised core inflation in the fourth quarter from 2.5% to 2.7%, which is materially above the Federal Reserve's target of 2%. And this is all before the impact of Trump's tariffs and the mass deportation of America's largest source of cheap labour, namely illegal immigrants.

While the tariffs do result in a temporary pop in inflation, the aggressive exfiltration of illegal workers has a more powerful impact by boosting wage pressures. Undermining the Fed's commitment to its inflation target has an even greater influence.

Recall that the last time the S&P500 experienced two consecutive years of 20% plus returns – as it did in 2023 and 2024 – was back in 1998 and 1999 following which this index promptly slumped 19% over the next two years. The peak-to-trough loss in 2000 and 2001 was much deeper at a staggering 36%.

Trump has announced 25% tariffs on Canada and Mexico, which he is now implementing on March 4 after a short-lived delay. He is further whacking China with a 10% tariff on top of the existing Chinese levies introduced during his first term. Cumulative Chinese charges will add up to 27.5% after March 4.

Yet Trump has now announced another 10% tariff on China, which would bring the total to a stunning 37.5%.

On our numbers, these tariffs combined would be equivalent to a global tariff on all US trading partners of 10% or an effective tariff rate of 12% (accounting for existing levies).

This would raise $US1.8 trillion ($2.9 trillion) in extra revenue for Trump over 10 years, which he desperately needs because his tax cuts will cost $US8.1 trillion over the same period.

The only way of bridging the budget gap is through Elon Musk's cost-cutting initiatives. As we have previously explained, Musk wants to slash government spending by 15%, which would halve the annual $US2 trillion budget deficit.

Strategy commentary cont'd: Whether Musk is around long enough to do so naturally remains an important open question. An enormous amount hinges on the durability of his relationship with Trump and whether Musk can continue to win the public relations war. In this context, Musk's hyperactive leveraging of his personal communications platform, X, is a huge competitive advantage against his opponents in the "legacy media".

One thing to keep in mind is that the US does not trade much with the rest of the world – its trade intensity, or exports and imports as a share of GDP, is much lower than developed country peers.

The strategic mission for Trump is to block his adversary China from the US market and win back America's manufacturing capacity, which would radically reduce its recent reliance on external supply chains.

A potentially significant distinguishing feature of Australia is our world-beating population growth, which remains north of 2% annually on the latest data. The massive increase in skilled workers coming into this country has improved the pool of available labour supply, which is putting downward pressure on wage growth.

While there is a tendency during elections for politicians to engage in xenophobia, it is unlikely that this dynamic will change suddenly. Our extraordinary amenities make us the destination of choice for many hoping to find a better life, notwithstanding the punitive personal tax burden relative to many alternatives.

The normalisation of wages growth is making the Reserve Bank of Australia's policy challenge easier. Financial markets expect the central bank to continue lowering interest rates this year, cutting them by another circa 60 basis points by December, which would put the cash rate at 3.5%.

The unresolved question is where the normal or neutral interest rate rests. Markets have thus far dismissed the RBA's latest research findings that the neutral rate has dropped from 3.5% to 3.0%, almost certainly because the RBA's leadership has encouraged them to do precisely that. Bond traders are pricing in a terminal cash rate for this monetary policy cycle that sits around the old neutral estimate.

The RBA's signalling that folks should dismiss its research seems to be motivated by political considerations. If the RBA did embrace a much lower neutral rate, markets would not hesitate to price in steeper cuts. But that would then make the RBA the barbecue-stopper of the next election campaign, which the Martin Place mandarins are understandably keen to avoid.

For the time being, borrowers can expect another two or three rate cuts this year if current market pricing is to be believed. If the new neutral estimate of 3% is right, and the inflation data continues to play ball, the RBA could easily cut four more times, or 100 basis points in total, just to get its cash rate to a normal setting.

A couple of rate cuts are not, however, going to do much to remove the blowtorch being applied to the sub-prime lenders operating in the private credit domain. Slowly but surely investors are forcing opaque private credit funds to lift the lid on their portfolio problems. And the news appears grim with chunky write-downs as lenders get wiped out and/or are compelled to swap their risky debt for equity.

In late 2021, Coolabah argued that we would see the worst bankruptcy cycle since the global financial crisis, which would hammer non-bank lenders that are financing borrowers who cannot get money from banks due to their inherent default risks. And that is what has happened in Australia, New Zealand, the UK and the US.

If global inflation accelerates, which we think is plausible, this situation could get a lot worse. And it is particularly problematic for the "wonder Down Under" because our non-bank lenders have no history of dealing with defaults given we have not had a decent recession since 1991.

There is a broader concern that Australia is encumbered by moral hazard bequeathed by never-ending prosperity that is itself a function of completely providential natural resource endowments and a public policy paradigm predicated on running perpetually strong population growth.

Strategy commentary cont'd: We did not have a recession during the global financial crisis and were quickly bailed out of the pandemic by unprecedented government handouts, near-zero rates, massive money printing, and the mother-of-all public investment programs. Since the early 1990s, Australia has always seemed to win the economic lottery.

Yet we have arrived today with parlous productivity, high living costs, and a government sector that accounts for the highest share of the economy since World War II (aside from a temporary spike during the pandemic).

Total government spending as a share of GDP is at its loftiest level since 1959, which is as far as our records go. This includes all levels of government.

It is like we have suddenly jumped back in time to the period before the deregulatory reforms and the advent of the idea that private enterprise should be the principal driver of progress. In the post-GFC world, governments try to pour cash on all problems. With enormous amounts of pork-barrelling already being unveiled ahead of the election, this direction of travel is unlikely to change any time soon.

And it is now showing up in the federal government budget, which on our numbers lurched into a deficit late last year. Smoothing through the volatility in the data, we estimate that the federal budget deficit has grown to $2 billion a month, or $24 billion annually. Absent a cathartic economic crisis, there is no collective appetite in Australia for engaging in fundamental reform. Riven by poverty, crime and de facto failed states such as California, the impetus for change is much more acute in America. Back home, we are simply betting on the hope that we will remain the lucky country.

Wishful thinking: the Trump administration's "3-3-3" economic plan

The Trump administration's economic plan of aiming for a 3% budget deficit, 3% economic growth, and a 3 million barrels per day increase in oil production appears unrealistic. The budget deficit will likely widen as tariff revenue falls short of the cost of Trump's policies. A stronger economy is unlikely to fill the gap because 3% GDP growth hinges on a record surge in productivity given that deportations will depress weak growth in the workforce. A large increase in oil output seems unlikely because the US is already producing the most oil of any country in history. If the plan fails, record public debt is likely to underpin a further increase in the US neutral policy rate.

Scott Bessent, the newly-appointed US treasury secretary, recently set out a "3-3-3" economic plan for the second Trump administration, comprising:

- 3% of GDP budget deficit – more than halve the federal budget deficit as a share of GDP from about 6½% in 2024 to 3% by the end of Trump's term in 2028 (or c$US1.9 trillion in 2024 to c$US1trillion in 2028 in dollars);
- 3% GDP growth – 3% economic growth to reduce the budget deficit given tariff revenue falls short; and
- 3 million extra barrels of oil per day – increased supply to reduce oil prices, lower inflation expectations and keep interest rates low.

All three goals appear unrealistic, so that Trump tax cuts should lead to significantly larger budget deficits and much higher public debt, even allowing for much-needed revenue from new tariffs, with higher debt placing upward pressure on interest rates.

In terms of the first goal, Trump's tax cuts seem likely to substantially increase both the budget deficit and public debt, even allowing for revenue from Trump tariffs.

As a pre-Trump starting point, the Congressional Budget Office had forecast a relatively modest improvement in the federal budget deficit over the next ten years, estimating a still-historically large average deficit of 5¾% of GDP over the period (or $US22 trillion in total).

Strategy commentary cont'd: In this baseline scenario, continued large deficits increase federal debt held by the public from 98% of GDP last year to a new record high of 118% at the end of the ten years, eclipsing the previous all-time high of 106% of GDP reached at the end of the second world war.

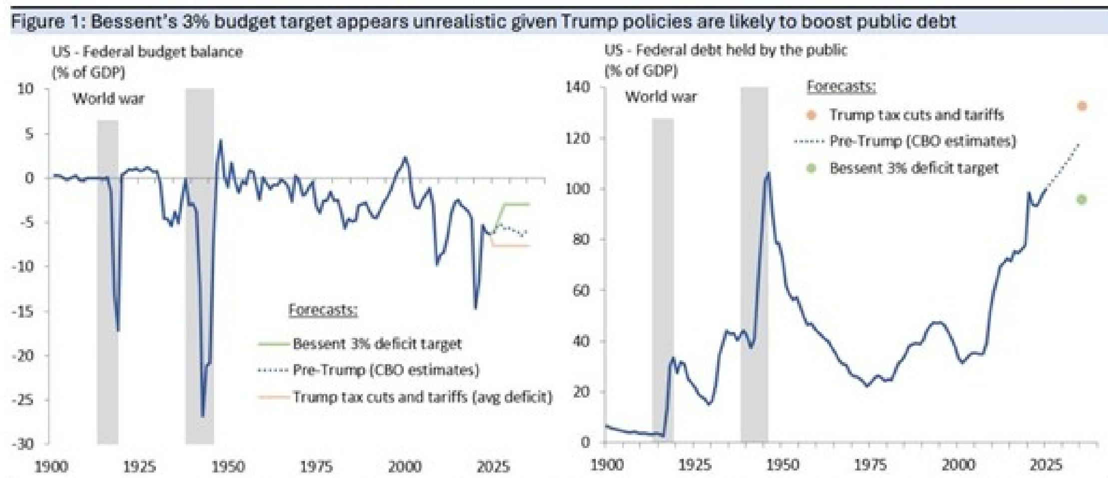
Adjusting this starting point by adding the estimated cost of Trump tax cuts and subtracting the revenue expected to be raised by tariffs significantly worsens the budget position and leads to much higher public debt.

This is because the tax cuts cost more than the money raised by tariffs, with the midpoint of thinktank estimates putting the cost of the tax cuts at about $US8 trillion over ten years, with recently-announced tariffs – i.e., 25% on both Canada and Mexico and 10% on China, broadly equating to a 10% universal tariff – calculated to raise about $US1½ trillion.

On this basis, the average budget deficit over the next ten years would increase from around 5¾% of GDP to 7½% of GDP, lifting federal debt held by the public to an even more alarming 133% of GDP.

Budget estimates spanning ten years are inherently uncertain, as reflected in a wide range of calculations, but the fundamental problem for the Trump administration is that tariff revenue looks likely to fall short of paying for generous tax cuts.

Figure 1: Bessent's 3% budget target appears unrealistic given Trump policies are likely to boost public debt



Source: Bureau of Economic Analysis, Committee for a Responsible Federal Budget, Congressional Budget Office, Federal Reserve Bank of St Louis, Coolabah Capital Investments

Figure 2: Some simple math on the budget outlook

		2024 $US	2025 $US	Next 10 years $US	2024 % of GDP	2025 % of GDP	Next 10 years % of GDP
(1) US Federal budget balance				(average of next 10 years)			(average of next 10 years)
Pre-Trump starting point (Congressional Budget Office)		-$1.8 trillion	-$1.9 trillion	-$22 trillion	-6.4%	-6.2%	-5.8%
plus	Cost of Trump tax cuts etc (Committee for a Responsible Budget)	..	..	-$8.1 trillion	..	..	-2.2%
minus	Revenue from Trump tariffs* (Committee for a Responsible Budget)	..	..	$1.5 trillion	..	..	0.4%
equals	Trump starting point (hybrid estimate)	..	..	-$28 trillion	..	..	-7.6%
VERSUS	Bessent 3% deficit target	..	..	-$12 trillion	..	..	-3.3%
(2) Federal debt held by the public				(end of next 10 years)			(end of next 10 years)
Pre-Trump starting point (Congressional Budget Office)		$28 trillion	$30 trillion	$52 trillion	98%	100%	118%
plus	Cost of Trump tax cuts etc (Committee for a Responsible Budget)	..	..	$8.1 trillion	..	..	18%
minus	Revenue from Trump tariffs* (Committee for a Responsible Budget)	..	..	-$1.5 trillion	..	..	3%
equals	Trump starting point (hybrid estimate)	..	..	$58.6 trillion	..	..	133%
VERSUS	Bessent 3% deficit target	..	..	$42 trillion	..	..	96%

Source: Bureau of Economic Analysis, Committee for a Responsible Federal Budget, Congressional Budget Office, Federal Reserve Bank of St Louis, Coolabah Capital Investments

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SUPERIOR RELATIVELY SIMPLE Foresight Analytics
MSCI ESG RATINGS AA
CCC B BB BBB A AA AAA
Asset weighted average rating

Strategy commentary cont'd: Further tariff increases, such as the threatened "very substantial" tariff on imports from the European Union and additional penalties on China, would reduce the funding shortfall, but Bessent's plan explicitly depends on 3% economic growth to fill the gap required to achieve his 3% of GDP target for the deficit.

Bessent's growth target involves raising not only actual economic growth to 3%, but growth in potential output. This is because GDP cannot sustainably grow at a 3% rate without a concurrent improvement in the supply side of the economy, otherwise the Fed would have to raise interest rates to stop the economy from overheating and lifting inflation.

This growth target also seems unrealistic, with the Federal Reserve and the Congressional Budget Office both placing potential growth at about 1¾%.

Illustrating the difficulty in achieving Bessent's 3% target by breaking economic growth into its drivers, the working-age population was originally forecast to barely grow over the next ten years and Trump's planned large-scale deportations would result in a weaker outcome.

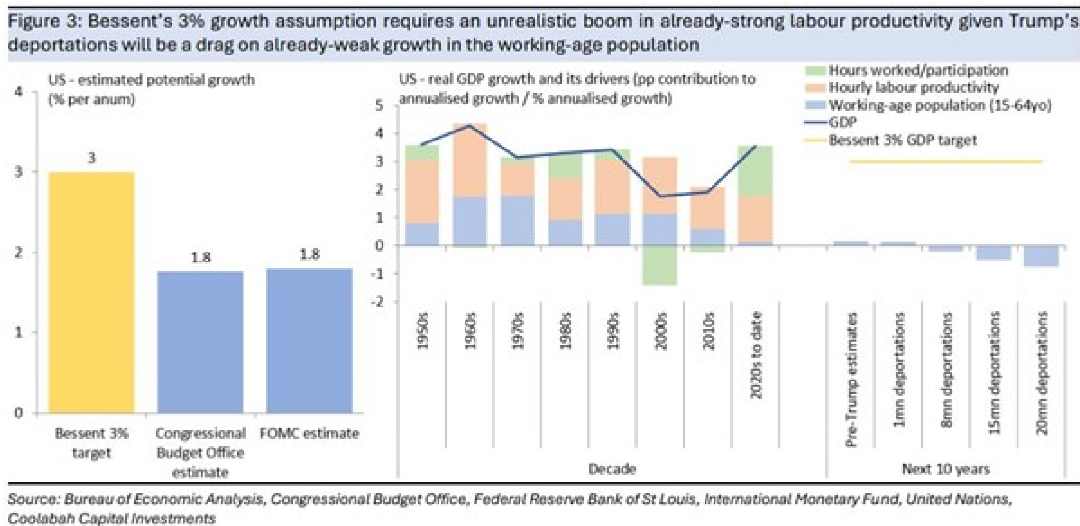
During the election campaign, Trump talked about deporting 15-20 million people, or about 4-6% of the total population, a seemingly impossible aim given the most deportations over a four-year presidential span totalled about 2½% of the population under Clinton.

Arbitrarily assuming Trump deports about 8 million people of working age, or about 2% of the total population, the working age population would contract over the next ten years.

If this happened, annual growth in labour productivity would have to accelerate from about 1¾-2% over recent years to just over 3% to hit Bessent's target of 3% economic growth.

This appears unachievable given that the strongest productivity growth in the post-war period was the roughly 2½% average annual increase in the 1960s.

Figure 3: Bessent's 3% growth assumption requires an unrealistic boom in already-strong labour productivity given Trump's deportations will be a drag on already-weak growth in the working-age population



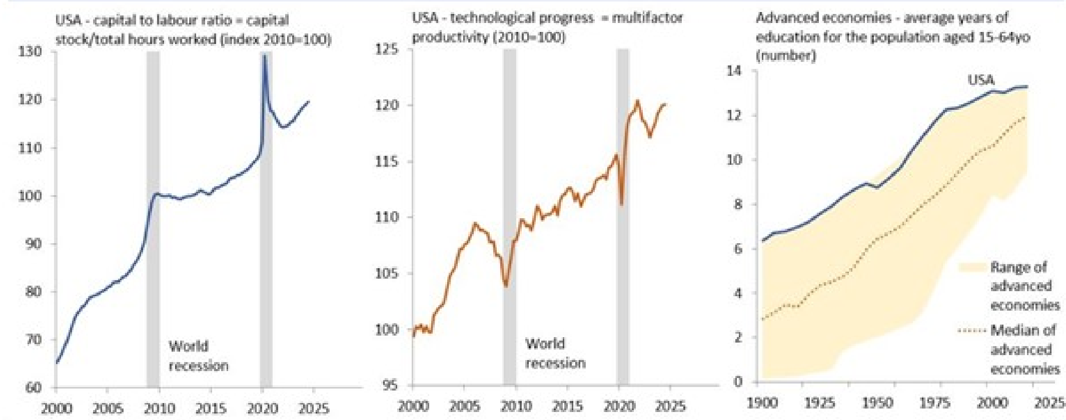
Source: Bureau of Economic Analysis, Congressional Budget Office, Federal Reserve Bank of St Louis, International Monetary Fund, United Nations, Coolabah Capital Investments

Also, in terms of the drivers of strong labour productivity, most of them are already highly favourable.

That is, while educational attainment has broadly plateaued over recent years in the US, the ratio of the capital stock to the number of workers and measured technological progress are already both trending higher, albeit where reduced investment in renewables and infrastructure could curb growth in the capital stock.

Strategy commentary cont'd: Failing to lift potential growth to 3% means that there will be no economic dividend to help pay for Trump's tax cuts, reinforcing the risk that the budget deficit is more likely to widen rather than more than halve to reach Bessent's 3% of GDP target.

Figure 4: US labour productivity is already growing strongly, driven by businesses investing more in capital per worker and technological progress, even as educational attainment has plateaued

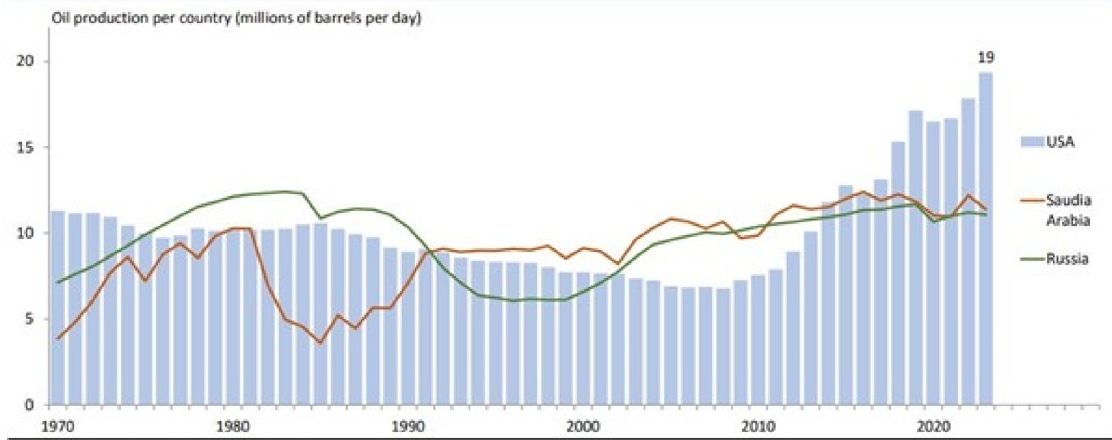


Source: Barro and Lee (2021), Federal Reserve Bank of St Louis, Federal Reserve Bank of San Francisco, The Conference Board, Coolabah Capital Investments

As for the final plank of the "3-3-3" plan, the US is already producing a record 19 million barrels per day of oil, more than any country at any point in history.

It is not clear why producers would want to sell more oil at a lower price by increasing production by 3 million barrels per day, which equals more than 15% of current record US output or 3% of world production.

Figure 5: Regarding Bessent aim of a substantial increase in oil production, the US is already producing the most oil of any country in history



Source: BP, Coolabah Capital Investments

This leaves the possibility that Musk helps Bessent out, in that Musk has claimed he can cut $US1 trillion from the budget (previously he said $US2 trillion), which is about 3½% of GDP or around 15% of annual outlays.

About two-thirds of federal government spending relates to welfare, health, education, and veterans, with the rest almost equally dominated by defence and interest payments.

Strategy commentary cont'd: Almost half of the budget is nominally exempt from cuts – Trump said he would not touch social security and Medicare, while interest payments will continue – limiting the scope for Musk to reduce spending.

Figure 6: Musk talks about cutting $US1 trillion from the federal budget, or c15% of outlays

Categories of federal govt spending	% of total	Exempt from cuts?
(1) Social assistance and education		
- Social security	21	Trump
- Health	14	
- Medicare	13	Trump
- Income security	9	
- Veterans benefits/services	6	
- Education	3	
Sub-total	66	
(2) Other		
- Defence	15	
- Net interest	13	Unavoidable
- Natural resources	2	
- Transportation	2	
- Other	2	
Sub-total	34	
Exempt from cuts		47

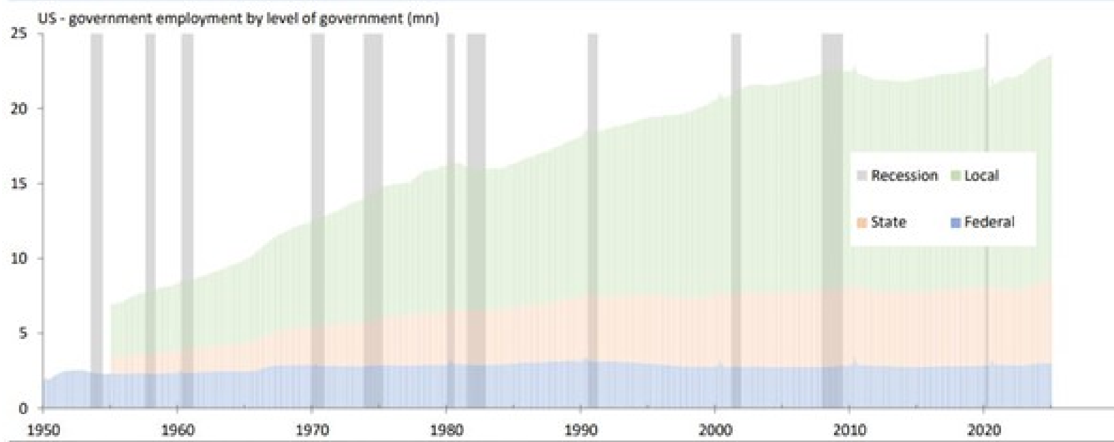
Source: Treasury, Coolabah Capital Investments

So far, budget cuts have been negligible. For example, USAID has only a $US40 billion budget, with 40% of food aid bought from US farmers, while only 2% of federal workers reportedly took voluntary redundancies versus 6% annual attrition.

More recently, though, Trump has signalled large-scale cuts to the federal workforce, with the US press citing an unattributed reduction of 25%. This figure – which seems highly unrealistic given most federal workers are employed by defence, the postal service, homeland security, and veterans affairs – would reduce outlays by about 1½%.

The potential saving is small because the number of federal employees has been stagnant for decades, with most public servants employed by local government and, to a much lesser extent, state government.

Figure 7: Cutting the federal workforce would not save much money because most public servants work for state and local government



Source: Federal Reserve Bank of St Louis, Coolabah Capital Investments

There is also the issue of illegality when it comes to cutting outlays that the administration is currently ignoring, as the president cannot unilaterally stop congress-authorised spending or dismantle or redesign a congress-established agency.

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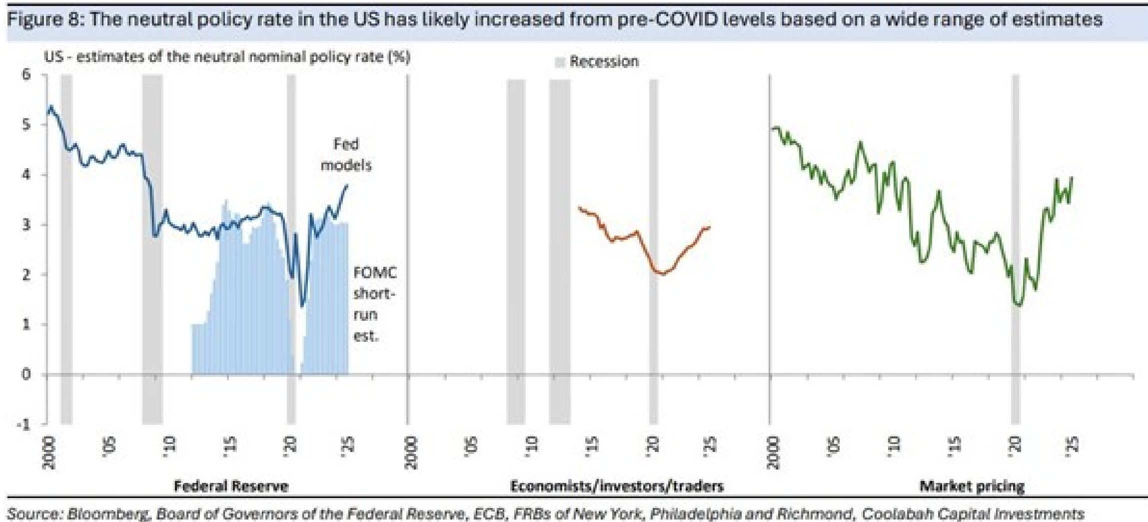
Strategy commentary cont'd: With Bessent's "3-3-3" plan unlikely to succeed, higher public debt should place upward pressure on the neutral policy rate, which is an important anchor for the financial system.

The neutral rate is unobservable and varies over time, but a range of estimates suggest that it has increased from low pre-COVID levels.

For example, the average of estimates derived from market pricing has increased from about 2¼% prior to the pandemic to about 4% now. Over the same period, the average of Fed model estimates has increased from 3% to around 3¾%, while both surveyed economist/investor/trader estimates and a proxy for the FOMC's estimate of the short-run neutral rate have risen from about 2½% to around 3%.

Figure 8: The neutral policy rate in the US has likely increased from pre-COVID levels based on a wide range of estimates



Source: Bloomberg, Board of Governors of the Federal Reserve, ECB, FRBs of New York, Philadelphia and Richmond, Coolabah Capital Investments

Most investors and traders believe that a material increase in public debt would raise the neutral policy rate further, with the median calculation from the New York Fed's survey of market participants suggesting that a 10pp increase in federal debt as a share of GDP increases the neutral policy rate by 25bp.

This means that if the Bessent plan fails and the estimates of the cost of Trump policies prove reasonable, then a 15pp increase in federal debt held by the public would increase the neutral rate by about 40bp over time. Given that the US neutral rate is a major influence on the neutral rates of most advanced economies, this would place pressure on world short-term interest rates.

This is separate to more general risks to the bond market, such as a potential asymmetric reaction to Trump adopting unrealistic budget assumptions that mask a worse fiscal position, as well as the usual array of possible shocks, including the fact that the US has experienced at least one recession per decade since the second world war and the danger of the US being involved in a war.

Figure 9: Assuming the costings of Trump policies are reasonable, the failure of the Bessent plan points to a c40bp increase in the US neutral rate over time based on surveyed rules-of-thumb and a large rise in public debt

Surveyed impact of Trump policies on the neutral policy rate	Effect of Trump policies on eco. indicator: (1) Bessent plan succeeds	(2) Bessent plan fails	Estimated impact on the neutral policy rate (bp): (1) Bessent plan succeeds	(2) Bessent plan fails
NY Fed survey of market participant estimates				
(1) labour productivity growth - 0.5pp increase in growth boosts neutral by 40bp	1.2	..	96	..
(2) public debt as a % of GDP - 10pp increase in debt boosts neutral by 25bp	-22	15	-55	38
(3) population growth - 0.2pp increase in growth boosts neutral by 20bp (assume 8 million deportations)	-0.4	..	-40	..
Total			1	38

Source: Federal Reserve Bank of New York, Coolabah Capital Investments

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