What if the Fed turned 'MAGA dovish'?

As the Fed continues to cut rates, corporates are becoming more enamoured with swapping from paying fixed to paying floating rates, to get exposure to the rate-cutting process. Should the Fed morph ultra-dovish, all the better, it seems. But how could that outcome evolve? And what then? Let's push some extremes and see how they look

The US administration is invoking Section 122 of the 1974 Trade Act, which allows tariffs of up to 15% for as long as 150 days

Here's how the Fed could theoretically swing super super dovish

Not our central view, but here's how we could get to a 'MAGA dovish' Federal Reserve:

- Lisa Cook is forced out and replaced by a dove (actually looking less likely now, but to be seen).
- Chair Powell steps away from the Fed completely (not just step down as Chair, but actually leave the Fed – probable, but not certain).
- Then there is a majority of Fed governors down as outright doves (Stephen Miran, Lisa Cook's replacement, the new Fed Chair, and one more existing dove; that's then four out of the seven Fed Governors).
- At that point, the majority of dovish governors could have had the power to reject Fed Presidents they don't like as they get rotated in 2026. But there will be no rotation (already

decided), so that route is cut off.
- One FOMC voting member is due to retire, and he would no doubt be replaced with a MAGA dove.
- That leaves us potentially with four MAGA doves out of 12 voting members.

Then the outcome could depend on who the new Chair is. If it's Kevin Hassett, we're of the opinion that he won't have a material impact beyond his own vote. If it were, for example, an outside shot like Rick Rieder (or even Scott Bessent!), we'd expect a potentially bigger impact on the wider votes on the committee, partly as they'd better represent the outside voice of business. But basically, to swing the Fed, the MAGA doves would need to swing three of the remaining eight FOMC members to have a material and definite swing effect on rate decisions.

A Fed cutting 'without justification' scenario sees the US 10yr yield heading higher

While unlikely, let's explore its implications for a moment, if only to frame an extreme.

A Fed-cutting-without-justification-scenario is where a Trump-administration-impacted Fed swings super dovish, and executes rate cuts far in excess of what's required, partly, some would say, in an attempt to juice the economy ahead of the mid-term elections. With risk assets starting the year off in a good mood, the impact effect of even lower funds rates is likely very positive, at least to begin with.

And for Treasuries? They typically love rate cuts, but the longer end won't like them so much in this scenario. An elevation of inflation risks plus a tarnishing of the perception of the Federal Reserve poses a toxic cocktail. In the extreme (e.g. should the 10yr yield shoot above 5%), the notion of yield curve control could be brought into the conversation. But that would not control the likelihood for material US dollar weakness, hurting externally held front-end Treasury exposures (more than wiping out the bond price gains coming from Fed rate cuts).

This cumulative set of circumstances should *not* be good for risk assets. But they could hold off on making that judgement, at least until, or unless, it manifested in a material negative outcome for corporate America. Again, we're probing the extremes here, to see how it could look. And our conclusion is it would not look good. It's partly why it's not our base view.

Here’s how SOFR fixed rate receivers shape up if set today

So first, let's focus on our base view, where the Fed cuts by 50bp, and stops there.

The chart below illustrates the current 10yr SOFR rate at 3.8% (fixed), versus the 3mth SOFR rate (gets cut by 50bp) and the per annum positive carry outcome (on a swap to floating).

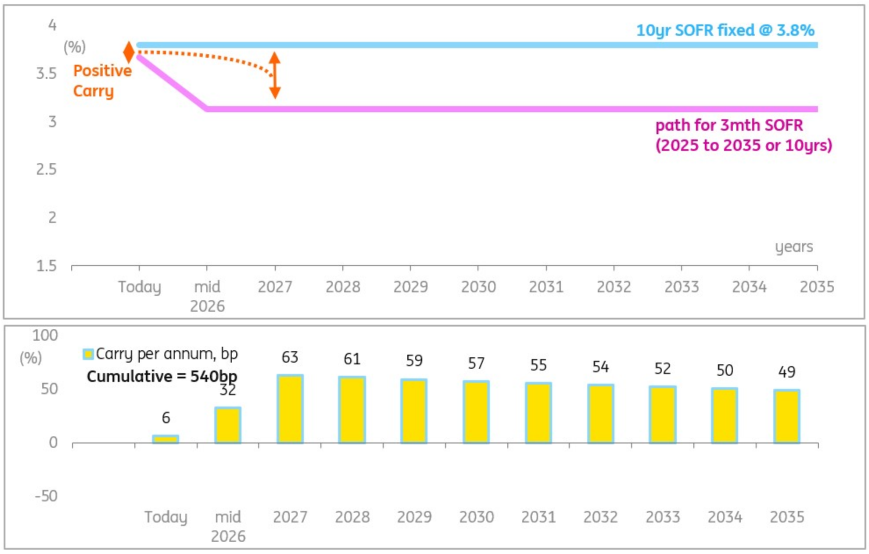
Base View: Technical Explanation

Swapping to floating in the 10yr tenor comes with impact carry of some 6bp. Should the 10yr SOFR rate remain at 3.8%, and the Fed cuts by 50bp (2*25bp), positive carry expands to around 60bp per annum. If we further assume that the funds rate averages at 3.25% into the medium term, we achieve a cumulative positive carry outcome of some 540bp.

Note: It is of course unlikely that the Funds rate will *remain* at 3.25% for the next decade. But it is a fair assumption that it *averages* at 3.25% in the next decade (as that's what it's averaged at historically).

Baseline view where the Fed cuts towards 3%

The lower chart shows the carry implications from swapping from the 10yr fixed rate to floating



Source: ING estimates, Macrobond

Is there a better entry point? Maybe.

We think the 10yr rate could edge up to a 4% handle (now 3.8%). A risk-on environment together with sticky inflation (and some tariff-related upside in the coming months) are drivers. If we're right, receiving at a 4% handle is clearly better than 3.8%. But that's no more than an educated guess, and stuff can happen along the way.

If hitting a 4% handle on the 10yr fixed rate receiver is important, then consider a 2yr forward start – that's well into 4% handle territory, and something that can be locked down now. The big downside to such a forward start strategy is it misses the growing positive carry in the coming couple of years from a vanilla cash start receiver.

It depends on how greedy we want to be, but all things considered, we like current entry levels.

What if the Fed swings super dovish?

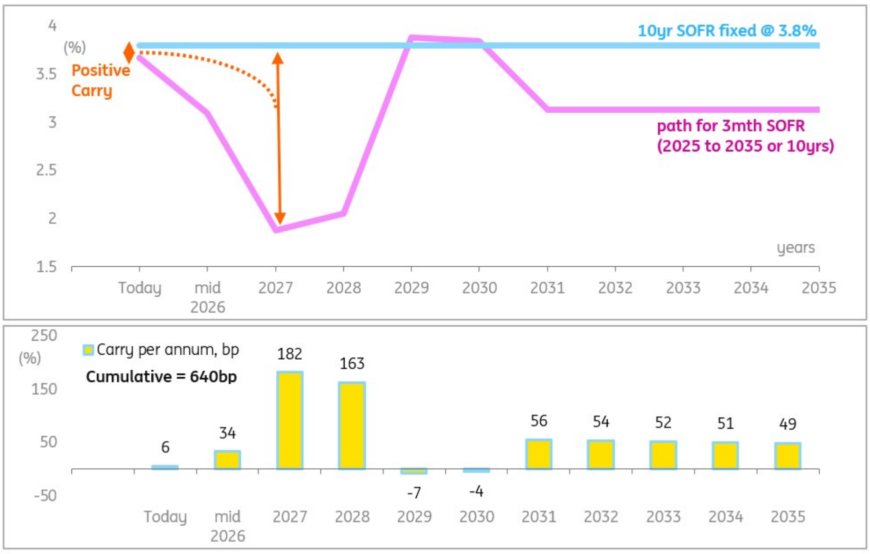
What if the Fed cuts by more? Much more! Say down to 2%, on the theory that the Fed turns, as aforementioned, ultra 'MAGA dovish' through various appointments in the coming months. If that *did* happen, and the cuts were 'unjustified' by fundamentals, then we'd assume that the Fed could have to compensate after a couple of years through a subsequent overshoot to the upside, say to 4% (before then settling back down to the 3.25% neutral area).

Dovish View: Technical Explanation

Here, as the Fed cuts to 2%, the 10yr receiver moves into significant positive carry; in the area of 160-180bp per annum (through 2027 and 2028). Then, the kick-back up to 4% sees carry turn moderately negative, while the final few years are back in neutral territory (circa 50bp in positive carry per annum). This cumulates to around 640bp in positive carry, over this full crazy 10yr period.

Scenario where the Fed cuts to 2%

The lower chart shows the carry implications from swapping from the 10yr fixed rate to floating



Source: ING estimates, Macrobond

And, it's not improbable that a 'traditional macro bust and subsequent boom' could see a not too dissimilar profile. So we won't complicate by attempting to paint an alternative picture.

Bottom line, we like the carry characteristics on swapping to floating here. Fed hikes remain a low probability outcome, while more Fed cuts are much higher in probability. Deeper cuts than discounted also have an elevated probability, but are not our base view. A fake dovish Fed is not likely. The cleaner way to get the funds rate much lower is through sustained macro weakness. Again, not our central view.

Swapping to floating here is not huge in terms of carry per annum, but over 10yrs it cumulates to over 5% – not at all bad!

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