5 January 2026

Why We Worry – Part III

Dear Investors

In the first two parts of this series, we explored the shaky economics of the AI boom and the growing fragility in the US labour market. In Part III, we turn to the final pressure point: the political and policy environment underpinning what many call the “Trump Bubble”.

The administration’s economic narrative has relied heavily on promises of revitalised industry, reshored jobs, and a stronger middle class. Yet the policies designed to deliver this vision – tariffs, immigration restrictions, and a sharp pivot toward populist fiscal strategy – are now generating unintended consequences. Rising costs, slowing job creation, and growing political backlash suggest that the foundations of the Trump Bubble are beginning to crack.

Understanding the risks of this political cycle unwinding is essential, because it has direct implications for markets, corporate behaviour, and the sustainability of the broader economic environment. In this final part of the series, we examine why these dynamics matter, what could come next, and how we are positioning in anticipation.

The Political Architecture of the Trump Bubble

None of the forces outlined in the previous two articles operate in isolation. A layoff-induced recession could slow AI adoption and capex, just as a natural slowing in AI adoption could itself trigger a layoff cycle. The relationships run both ways.

These economic risks are also deeply intertwined with the political landscape. Trump returned to office on a platform of populist restoration: a promise to make the flyover states “great again” by reversing decades of industrial decline. He framed China as the principal culprit behind the erosion of America’s manufacturing base, and he offered voters who had missed out on the American dream a return to a past defined by well-paid factory jobs, strong growth, booming markets, low inflation and a more affordable cost of living.

The administration’s strategy for turning back the clock rested on three pillars: the “One Big Beautiful Bill,” shutting down immigration flows, and aggressive tariff policy. However the White House failed to recognise how these very policies would undercut its own political standing. The Trump Bubble is now beginning to deflate.

Immigration and Customs Enforcement (ICE) crackdowns have damaged support among Latino voters, who swung sharply toward Democrats in recent off-year gubernatorial elections. Tariff policy – whether or not it deserves the blame – has fuelled a widespread perception of rising cost-of-living pressures. Politically, tariffs suffer from a familiar flaw: many more people feel the pain of higher prices than feel the eventual gains in industries that have long since been hollowed out. The cost is immediate; the benefits are distant and diffuse. This is rarely a winning formula in a democratic system.

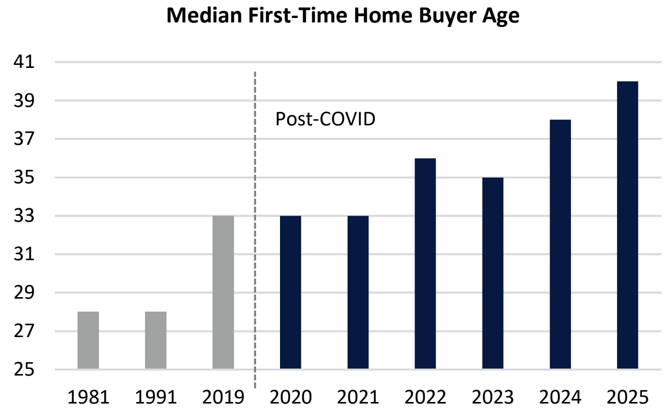
Meanwhile, efforts to reduce Medicare and Medicaid enrolment are unlikely to resonate with the populist MAGA base. And unlike his first term, Trump did not enjoy the tailwind of massive fiscal stimulus to bolster the economy and stock market. The budgetary damage from Covid spending constrained any such support.

In many respects, the administration’s policies contained the seeds of their own political undoing. Measures that were once sold as populist became, upon implementation, deeply unpopular – their practical consequences stripping away the very attributes that made them politically attractive in the first place.

Populism Meets Economic Reality

With fiscal and trade policy backfiring, it was left to the AI boom to carry the economy. But AI-driven investment is not labour intensive. Massive datacentre capex may boost GDP on paper, but it does little to create broad-based employment. The result has been a weak combination of mediocre growth, worsening cost-of-living pressures and limited job creation. Prosperity has accrued mainly to the asset-owning minority, while the majority – once again – have been left behind. Unsurprisingly, this sense of betrayal has already begun to hurt Republicans at the polls.

What the administration has also failed to recognise is the extent to which deeper structural forces are eroding the living standards of middle America. Younger generations increasingly believe they will be worse off than their parents – a break from a century of upward mobility. One stark macro indicator of how far the American dream has drifted out of reach is the rapid post-Covid rise in the median age of first-time homebuyers:



Source: National Association of Realtors, Fawkes Capital Management

The promise of America was built on a simple meritocratic ideal: if you worked hard, lived decently, and contributed to your community, the country would reward you with a home, a family life, and a dignified retirement. For most of the post-war era, the American "dream" was not a dream at all – it was attainable. But over time, that promise has slowly slipped out of reach. The rise in the median first-time homebuyer age illustrates this poignantly. It increased more in the past five years than in the previous forty combined, a sign that an essential marker of middle-class prosperity has become increasingly unattainable.

One of the forces that has destroyed many of the livelihoods in the flyover states is the oligopolisation of America. The process started in the 1980s but has gathered steam. Deregulation meant that companies could conduct business across state lines. With scale providing an advantage in cost, insurance companies, banks, brokerages, medical service providers, car dealerships and retailers spread like weeds across the country. Walmart displaced the local grocery store, JP Morgan Chase replaced the local bank. Technology then amplified these disparities, concentrating power and wealth among a small number of firms while extracting from the many. AI now appears poised to extend this trend rather than reverse it.

When basic health insurance consumes around 10% of the average wage-earner's post-tax income and continues to compound at supernormal rates, the situation becomes untenable with time. This measure doesn't even include any actual incurred medical costs. When telecom plans cost more than the phones they service, the pressures compound. Over time, such an extractive corporate structure inevitably produces a populist political reaction. The oligopolisation of the economy is beginning to have visible and measurable political consequences. It feels increasingly like an era where populism begets more populism.

In this environment, the Republican Party has become fiscally conservative in name only. When even the Freedom Caucus – the beating heart of Republican austerity politics – waves through Trump's reconciliation bill despite its heavy addition to the national debt, it is clear that populism has taken root. The party now blends tax cuts, protectionism, a quasi-Monroe Doctrine foreign policy, and social conservatism into a political cocktail that tastes good in the moment, promises a better tomorrow, but ultimately risks leaving the nation with a severe hangover.

At present, however, the Republicans offer more hope than the Democratic Party. Their policy proposals are simple, novel, and shovel-ready. The Democrats, by contrast, are skilled at diagnosing problems but far less adept at articulating practical, coherent solutions. They are worse still at marketing any plan they do produce. In a populist era, doing nothing is often a losing strategy. History shows that when populism feeds upon itself, electorates tend to oscillate between the far left and far right in search of something that feels like an answer.

A New Era of Debt-Driven Populism

What distinguishes today's populism from earlier waves is the starting point. In past episodes, the national "credit card" had not been used nearly as heavily. Today, however, the card is close to maxed out. If the nation's income – its tax base and economic growth – were to experience a negative shock, the sustainability of that debt load could quickly come into question.

America's saving grace is that it issues the world's reserve currency. It is akin to holding the one credit card a bank must continue to extend, because there is no alternative borrower of similar scale or safety. For decades, this has allowed the US to absorb far more fiscal strain than other nations could withstand. Under normal circumstances, the bond and currency markets are the ultimate disciplinarians. They toppled Liz Truss in the UK and constrained President Clinton in the 1990s. But the pressure today has not yet reached a level that forces a political reckoning.

Still, the trajectory is clear. We are moving closer to a point where the debt burden becomes unsustainable – a topic we may explore in detail in a future note. Historically, when populist governments face such fiscal constraint, they choose inflation over stagnation. The political calculus tends to favour eroding the real value of debt rather than confronting the painful structural trade-offs that stagnation would require.

The fiscal stimulus deployed during Covid delivered its intended short-term boost, but the longer-term consequence was clear: inflation surged well above target. Interest rates had to rise sharply in response, and now they cannot fall meaningfully without triggering a recession. This removes a traditional engine of growth. At the same time, the scale of government spending and the already-stretched fiscal position leave little room for policymakers to stimulate their way out of stagnation. Once private-sector savings fall below a certain threshold – as appears to be the case for lower-income households – the likely outcome is a period of weak growth coupled with persistent, above-target inflation.

AI cannot solve the stagnation problem, though it may provide some modest help against inflation. These are difficult inferences to make, given the absence of historical base rates for a technological shift of this nature. AI can drive capex and productivity improvements for businesses, but it cannot repair household balance sheets or materially raise consumer earning power in the short run.

The Trump administration is not blind to the economic pressures building beneath the surface. Their proposed solution, however, is not structural reform but more populism. The latest idea is to distribute tariff revenues directly to citizens – an amount currently floated at around US$2,000 per person. This would provide temporary relief, but it does nothing to address the drivers of stagnant real incomes or a weakening labour market. It is a political response to economic anxiety, rather than an economic one.

History suggests that any political party promising a return to the fiscal restraint of the mid-2010s is unlikely to retain power. The incentives point in the opposite direction. If we were offered fair odds, we would wager that the next administration is even more populist than the current one.

A Potential Shock Absorber: The Supreme Court and Tariff Reversal

If there is a genuine bright spot in the economic outlook, it may come from the growing likelihood that the Supreme Court strikes down Trump's tariffs. Recent oral arguments suggest that even several conservative justices view these tariffs as constitutionally indistinguishable from taxes — and under the Constitution, only Congress can levy a tax, not the Executive. What remains uncertain is the remedy. The Court may or may not require the government to refund the duties already collected. If it does, the return of roughly 1% of GDP to importing businesses could provide a meaningful offset to the layoff trend now emerging. Even without refunds, the removal of tariffs would ease pressure on margins and supply chains. This possibility complicates the picture further.

Portfolio Implications

What does this all mean for our portfolio? In short, our crystal ball is foggier than it was even a couple of months ago. The current risk-reward trade-off for equities feels, to us, uncomfortably close to a spin of the Roulette wheel. We remain open-minded – markets may continue rising simply due to the structural imbalance between asset demand and supply – but timing is now a far more critical determinant of success.

Given this, we believe we can afford to step aside and wait for the next fat pitch rather than force exposure into an increasingly uncertain environment. Our recent reduction in equity length, and focused concentration on only our absolute highest conviction equity ideas, is reflective of a meaningful shift in stance. At present, we suspect that the next attractive opportunity set is more likely to emerge in bonds, commodities or currencies than in stocks. For now, we continue to watch developments closely and stand ready to adjust our posture as the facts evolve.

Kind Regards,
Fawkes Capital Management

Please click *here* to subscribe to receive future Fund or market updates.