Nick: Good morning, and we're back from our thanksgiving break. It's today is the 2nd of december and we're in december already andy

Andy: It's amazing Got my christmas shopping mostly done which is a rare thing for me

Nick: Yeah, and we've got a lot to talk about because a lot happened last week, although we didn't really expect it, but it's gone our way So I really think the big news is europe Where inflation is falling far faster than people anticipated.

And then Christopher Waller came out in agreement with what Powell said, I don't know, two or three meetings ago, in answer to a journalist's question, as to why they had lower dot plots in 2024 and 2025. When he basically said, well, that is simply because we think inflation is going to fall towards target in 2025.

And if we kept rates, where they are now, then real interest rates would become higher and higher. So I think this is all a real interest rate debate. And with Europe coming down where inflation is coming down at the speed that it is. Real rates are beginning to become high in both Europe and in the U. S. and the market is anticipating. Something that will, the Fed moving and the ECB moving at some stage in the early part of next year. Would you agree with that, Andy?

Andy: Yeah, That's the Fed rhetoric and the reality around Europe regarding real rates. And that is one factor of a, what I think is a multi faceted analysis of, You know what it is for the Fed to be restrictive or not, but it's certainly the one that they focused on and reiterated this week and have been speaking about for many months, along with the other factor, which has completely reversed, which is In Q3 with interest rates much higher, long term interest rates much higher.

They, the Fed was happy to slow hikes based on the high interest rates, long term interest rates doing their work for them. And that was very much part of the rhetoric and they haven't yet. Pulled back on that rhetoric. So absent a change in that rhetoric the real rate rhetoric is dominating the conversation sensibly.

And so the question that, that You look around is firstly what happened like last week? What exactly happened equities? There was a lot of what I would describe as rotation in equities we sold some nasdaq at the beginning of the week qqq's at the beginning of the week and they're actually a little lower I think nick than where we sold them so nasdaq didn't do much but russell really ran up sizably during the week. And was the biggest Performer well Dow Jones and some of the other more defensive sectors were also very strong performers S& P pretty neutral, but what was the action that was the most interesting by far is what happened to the interest rate curve since october 31st the when interest rates peaked long term interest rates are down 70 to 80 basis points and to your note, based on all of this Rhetoric around real interest rates and the slowing economic data fell.

45 50 basis points and most of that was this last week so there was a big move in short term interest rates.

Nick: Yes, The belly of the curve is is the one that's doing all the big moves rather than talk about what happened And we all know that in December markets tend to go crazy and they, volatility tends to increase in terms of rate movements.

What is interesting to me is how the market is going to price in what we're going to get in two weeks time. And that is the dot plots from the Fed, because I think that might be a little bit of a cold shower for the market. Because I can't really see the Fed producing a set of dot plots which anywhere near justify the levels that we are discounting in terms of cuts for 2024, especially the very early part of 2024.

I completely agree with you that the economic numbers The real economic numbers are beginning to cool instead of having a 6 percent GDP growth like we had in Q3. We are now anticipating something like 1. 2 percent on GDP now. So that is market, markedly slowing down. Employment situation is not looking nearly as rosy.

It's still strong. NFP is going to be very important this next week, I think. But what I think is far more likely to happen is that the market gets a cold shower from the Fed. Not next week, but the week after and that I think might be our opportunity to actually change the portfolio around And put on some longer term trades, which makes sense

Andy: Yeah I think the I think the data that we've seen which was data reported in november that refers to October the cpi and the ppi for instance and even the pce which we got just at the end of this week All were showing weakness the jobs data, which is lags a little bit in terms of the economic cycle definitely benefited or benefited got slightly worse, meaning more jobless claims than expected.

And I think that's. Right, because that data refers to a period of time before Halloween, when interest rates were very high, and as the Fed said, they were doing the work of the Fed. And so the real question is now, for us, is that we've now priced in a very aggressive cutting outlook for the Fed, and We've seen financial conditions ease massively in a month and that is by long term bonds prices rising equity prices rising significantly ten percent in, TLT and in spy and then QQQ and now Russell's joining the party It's been a real easing of financial conditions and that will itself lag and possibly support the economy, but Running into NFP at the end of this week, I would expect it to be on the weak side, which the market may continue to extend what it's been doing, or look to the following week and, come to, do actually the work which we will show you on the physical SEP chart next week about what likely the Fed will do when they repencil in their estimations.

This is what the SEP is. The Fed writes down what their estimations for Fed funds rates is going to be and the broader economic numbers. And I think Nick's right. I think it's very unlikely that the numbers that are priced in the market, which is for December of next year. is a 3. 9 percent Fed funds rate is there's any chance that the Fed is going to actually support that.

And so that is going to be a pull to that, to the current market prices when that number is released. And even with a very bad NFP print, we've And we'll show this next week. We've projected the SCP and it still doesn't justify current pricing. So, chasing the short end right now seems not sensible.

Now, in the belly, that's a different story. So why don't we talk about what the actual data is and then we'll go into the portfolio.

Nick: Yeah, we've got very little stuff next week. We've got PMIs, jolts, ADP employment, but the big one is NFP on Friday, which is going to be a summation of all of them, really.

And as you said, I think the the analysts are going to fall over themselves to NFP. For next week. anD I think the high of the market in terms of prices and lower yields is going to be right on the NFP print or just before the NFP print. I would basically like to sell everything I have in bonds.

Before the nfp or and maybe leave some and have them take me out on the nfp print I completely agree that the week after is going to be the week that matters I don't think that the fed is going to justify The levels that we are at and that will be our Opportunity to get into trades on the belly or anywhere else

Andy: Right.

Yeah. I think the key point is that cash. Based on the potential that is now priced and the dot plots that will soon be announced is going to be less attractive than other points in the curve, which makes you think, should we be buying the long end? Now we have TLT, but long term bonds are very dependent on supply.

And we know that supply is going to be coming in the next six months. And so the question will be at what place should we buy? We love where what we own, that we own tips there at six and a half duration and five year tip real rates are still attractive at 2%, not as attractive as they were when we plowed into them, but attractive.

And so we love that area. The question will be, at what rate does the five year bond, the four year bond, the three year bond make sense for us to own and replace our barbell of cash and TLT with that and head to the belly?

Nick: Yeah I think that is something for after the Fed. The disappointment from the Fed dot plots should cause a 30 to 40 basis point.

Retracement in the belly in threes, fours, fives, sixes, and that will be our opportunity. But I think that is something that I will have ready for next week. I will, I really would like to buy some individual bonds and ride the curve next year. Because my anticipation is that at some stage next year, the curve will actually disinvert.

And you will be able to ride the curve again and that is when the belly performs best why do I think the curve disinverts and it's important for people to understand that if we believe that fed funds Are going to be held at a spread to real rates Then if inflation falls to near target of two percent, and I think that is quite likely that to me indicates a fed funds rate which is going to be between 375 and 410 That is my guess Because they will still want to keep conditions slightly restrictive ie around one and a half percent real Or maybe slightly higher than one and a half percent real in terms of fed funds and if that happens coupled with the supply in the Duration that we will have next year, which is going to be humongous Is going to give us some kind of a flat to positive yield curve between fed funds and 30 years so holding tlt at these levels to me is Silly, it's much better to lower your duration and go to the belly of the curve when it yields something like 425 430 435 And the ride the curve down next year, towards the 4%, 375, depending on what the economy is going to do, because we are very much data dependent now, whatever the fed might want to do, you can only do it when the data allows it to do it.

And I think the data might not be as cooperative as they would like, but what do I know? We will play week by week. There's no point in guessing, but if you look at what the odds here are, the odds are for an outperformance of the belly from any retracement that we might have in yields.

Andy: Right. Yep. So, I guess the point is, you mentioned that the in that, in your the conversation a few minutes ago, that you'd like to sell the TLT ahead of the NFP.

Is that a real thing? Or we think

Nick: No, absolutely. I think the it, NFP is the market is going to anticipate A good NFP as far as prices are concerned. So I think the high is going to be either just before NFP or just on the NFP print, within five minutes of it. So you wanna at, so definitely like to get rid of both shy and TLT on the NFP print or just before, and I'll talk about that later in my piece.

And then have a load of cash to be able to reassign. After the fed dot plots have come out four or five days later

Andy: in real bonds real physical bonds So that's something that our clients should think about how they can access, Physical bond physical treasury bonds that can be done through treasury direct or most brokerage things.

Nick will describe that next week ahead of that if we decide to buy bonds, physical bonds. Otherwise, and what I'm talking about is threes, fours, fives, notes, not bonds otherwise we'll give you an ETF alternative, but it's not quite the same in that we really want to be able to ride the curve and only bonds with a fixed maturity allow you to do that.

So more details on

Nick: that in the future. Yeah, and I think as far as you know what we want to do this week Nothing much apart from sell those bonds if we can at higher prices and then wait for the Wait for the FED to produce its dot plots and then we can really talk about What is likely to happen with a much higher probability of being correct?

Sounds good. Thanks very much indeed See you soon. Bye So let's put some flesh on the bones of what we just discussed. This is our current allocation. As you can see, we're about 32 percent in equities, having lightened up in the SPYs and the QQQs. Our Dow Jones, we like. It's doing brilliantly and we think it continues.

Bonds, we are at 39%. The bulk is tip M-V-W-O-B, which I think are both going to do incredibly well next year. So I want to keep them. What we want to sell is here is the TLT and the Shy. We want to get rid of those sometime next week, and let's talk about some levels where that might be best achieved at.

If we look at the shite chart, this happened because it was a dividend day and it still rallied. We think 81. 85 is a very good level and we're going to leave our offer there and TLT. We think the best level is here, 94, 91. What we're trying to do is we're trying to catch a quick spurt either on NFP itself or anticipation of an NFP number, which is good for the market.

We really think that twos and. What did TLT 17 year duration, whatever it is, are not the places to be. What do we want to achieve? Well, this is now a chart of the three year note and what we are trying to achieve is a return back up towards 445, 448, 450. After the after the Fed dot plots and the outcome of the FMC meeting, when the market should realize that it's really putting the cart before the horse.

And once that happens, that is where we want to get into the belly of the curve, basically threes, fours, and fives. And if we look at the five year note, this is the kind of level we want to get in. 430 440 and then next year ride the curve all the way down now back to the excel sheet if we achieve that we will have raised as you can see another eight percent that will add to cash will be at 30 percent in cash And after the Fed, what we want to do is allocate all that cash to something like a 3, 4, 5 year note.

I'll have those ready for you next week so you can anticipate putting in the orders. but we also want to increase our allocation to VWOB. We think this is by far the best bond because it's yielding you seven and a half percent and we think that those spreads are going to continue coming in. So I've updated the chart pack.

I've updated the broker statements where you can see exactly where we are and the order entry is speaks for itself. We want to get rid of SHITE and TLT. If we don't get filled after NFP we will most probably send you an email and tell you what our decision is as what to do in that case. I hope you understand our strategy.

We think we're going to make a very good return on this if it works out over the course of the next year or so and that is what we are here for. If you look at the investing rules and objectives, we are here to make money in the long term in the safest possible way. Thank you very much indeed and speak to you next week.