

Nick: Good morning. Today is the 17th of February and another episode before President's Day Holiday. Andy, we had some very hot CPI and PPI numbers last week. Does that change anything for the Fed, do you think?

Andy: Maybe at the margin, the moving parts for the Fed are what they expect.

Inflation, PCE inflation, core PCE inflation to be at year end. And the GDP to be at year end and the terminal rate to be and starting backwards. The terminal rate has been, expectations have been two and a half for a long time. Pre-Covid in fact. And so for it to terminal rate has become a part of the discussion is, post-COVID is the terminal rate higher than it has been?

But so far there's been no sign that they're willing to move that rate up. There is no possibility that they would move it down, but. They haven't moved it up. So then you look at CorePCE at 2.4 and I don't think that one number is likely to, get them to move CorePCE up meaningfully. I. But maybe there's a little, there's no downside pressure given the numbers We saw this weekend, this week, and then GDP has been strong, and so I think there's some upside pressure on that.

But when you put it all together, no, I don't think there's a significant change to the Fed's expectation for the path of rates, except possibly not Now that the last FOMC and the 60 Minutes interview pushed March off the table, possibly pushing May off the table and starting the cutting cycle in June.

That's where they are, and I don't think the Fed, per se is I. Changing on the news, what is changing is market pricing. And since the hot employment number in late January sorry, early Feb, and the and these numbers, the cuts that were priced in to 2024 have dropped by, over 50 basis points and the cuts priced for 2024.

This week fell by twenty-five basis points. And so the market for the short end has corrected to be more in line with the FOMC's dot plot. Yeah, I

Nick: absolutely agree. I think we are now very close to the FOMC's dot plots, and I think the Fed will be happy with that. Still 75 for 2024, and another a hundred for 2025.

The danger becomes if they start reducing those dot plots in the weeks ahead. But I think I agree with you. It's just too early. For them to move those dot plots at the moment. But they are data dependent and the danger becomes that they start moving the dot plots by a little bit higher I.E. less cuts for either 2024 or

2025, but I don't think the market is going to move that much over the course of next few weeks.

That, that becomes significant. When it will become significant is if the. Excuses that we are making, that CPI and PPI were hot because of some January effect, weather related and so on. If those start falling out and then we start getting higher numbers than expected or projected for February and March, then the Fed really has a choice whether it delays, cuts.

Past June or even lowers the terminal rate for 2025. But I agree that is not something that we need to think about at the moment. I think at the moment the market is fairly priced with the danger that rates go slightly higher. It's not going to be anything significant and not something that we need to discuss today.

Andy: Yeah I just put my flag in the, I think it's been clear for the last, since two graybeards has been founded, that I think inflation is going to be stickier than Market expects, and. At the same time that I say that, which would suggest that there are going to be less cuts than the SCP and that the SCP will one day reflect less cuts, maybe as early as March at the same time.

That's my opinion and that. I don't place any comfort that, oh boy, I gotcha. I'm right based on these two warm numbers that we got this week, I need more data to show that the disinflationary path is going to fall short of reaching the Fed's target and. I look out on the calendar, I don't see any data that's gonna convince me.

I don't see any data that's gonna convince the, those that think the Fed's gonna cut more coming as well. We're, the PCE, which is the big data that comes out is widely already figured out by the release of the CPI and the PPI. So the data that comes at the end of this month, February 29th, I think is is not gonna be relevant to markets.

So that data points off all the jobs and other economic data is gonna continue to be I. Solid as it has been. There's no shift there. You got some issuance, but by and large, I don't look at any meaningful data that's gonna convince anybody of anything, including the Fed themselves between now and the FOMC, except the new, the next CPI and PPI reports and.

Powell's testimony on March 7th, so sixth and seventh in front of the house. And so what about next week?

Nick: Next week is gonna be very quiet indeed. We just have jobless claims and global PMIs, and of course the FOMC minutes. And. The only thing that is really going to be interesting about the FOMC minutes is if they're going to mention QT at all and their plans about QT, because that could move markets.

Andy: Right? And, they've pre, they've already given us some information about that. In that Powell said that the next, at the next meeting, they are going to begin talking about what to do about qt. But. Didn't place any urgency despite the January, the December FOMC minutes mentioning it, and Laurie Logan mentioning it in her speech and.

Others like Williams and Waller mentioning it the RRP, which has been the catalyst for that discussion, is stabilizing and likely to stabilize due to less bills issuance this next quarter. And so there is no urgency to cutting QT but they'll mention it in the January minutes and so we'll look at it.

Nick: No, absolutely. And pricing would change if they were aggressive in their wording about. Cutting it sooner than the market anticipates, so we'll definitely send you an email because we will want to do things if that is mentioned. But I think the odds of it being mentioned in an aggressive form, it are very low, and therefore we just went even think about it before we see it because we think the odds of seeing it are extremely

Andy: low.

Yeah, I'd place higher odds on them saying, expressing lower urgency than the market expects, than I would. Being more urgent than the market expects, but in either case I think it's nothing. So I guess the other thing is we have some twenties and tips, thirty-year tips that, are small and bespoke auctions that come off.

That could pressure the long end a little bit. But I think the most important thing is we just don't have a lot of data and the front end, as we just mentioned, is

Nick: pretty fair. Yeah. Now the front end is gonna be stuck around these levels for the next couple of weeks, so nothing to do there.

And of course, the big event for tech and the stock market could be Nvidia earnings. We absolutely have no idea what Nvidia earnings are going to be. I think if they are stellar and the market rallies a lot, we probably want to be selling calls against that.

Andy: Yeah. We've seen a lot large move in Nvidia in specifically, which is a meaningful weight in the Nasdaq and thus in QQQ, which is one of our positions, a less meaningful weight in the S&P.

It definitely will excite. Potentially disappoint or straight-out disappoint investors. And that will have implications for the rest of the AI sector. So yeah, I think it's a sell the rally, but you have to get the rally to sell it. Sort of thing. And so, preparing ahead of the earnings, we looked at the volatility of two-week options and even one week options and Nasdaq volatility.

QQ volatility is low. You don't wanna sell that ahead of this event.

Nick: 17% ahead of Nvidia earnings, if anything, is a buy. And it. What the only thing we can do is send you an email after the Nvidia earnings because we are tempted to overwrite it with calls, but just not at this level and not at this level of volatility.

Traditionally this period of late February tends to be. Statistically bad for tech and Nvidia has a habit of rallying on earnings and then doing absolutely nothing. For two or three weeks. So that pattern could well be repeated and that is why we don't want to anticipate it. We want to react to it.

And we'll send you an email if anything needs doing

Andy: that. Sounds about right. So mostly in summary, it's a slow data, macro side. It's dripping, it's short end is. Fairly priced. The long end could drip a little bit wider, but isn't likely to rally much. And equities all depend on what Nvidia is gonna bring.

Nick: Absolutely. And when we've decided to change our locations and the reasons for it, we will put in an email and send it to you of course, before we trade. Thank you very much indeed. See you next weekend. Looking at the allocations, we did swap the Dow for the Qqs. I. And we are still at around 36% in equities, which, it is defensive and we do fear what is going to happen after Nvidia earnings.

But as we mentioned, selling 17% ahead of earnings is just ridiculous. It's just very bad risk reward. So on the order entry side, this is what I've written. We think Nvidia earnings are going to be good, but we think they're also discounted by the market. So if the market does rally, we will want to override QQQs by shorting two to three week calls, probably in the money calls for QQQ.

What we can't know, of course, is what the earnings are going to be and what the market reaction is going to be. So we prefer to wait for that. It comes out Tuesday and the market will react on Wednesday morning. We will be ready for it with an email for you in either case. What we do think is that TLT has very little room to rally over the course of the next couple of weeks, so we would like to overwrite that as well, and that would hedge the VWOB and the tips part of our portfolio.

The reason why we would do TLT is because. VWOB and tips don't really have liquid options that trade. The spreads are too wide and we wouldn't want to have anyone stuck in an option in those. So TLT is much a much better alternative. In any case. As always, we will always send you an email before we trade.

And please make sure that you are signed up for the emails on our website so that you get them. We will still be sending them individually, but it'll be so much easier for us if you all signed up for the email updates on the site, and then we can be absolutely sure that you are getting the, everything else is updated.

The broker statements are here. And the monthly performance also is updated as always. Thank you very much indeed and have a lovely Presidents Day weekend.

