Nick: Good morning. Today is the 24th of February and another episode of Two Grey Beards. We had a fairly quiet week, haven't we, Andy?

Andy: Yeah, except for the enjoyment of watching nvidia move about and some of the tech stocks it It was quiet on the macro front.

Nick: Yeah, I don't know. Well, what do you feel? I feel that like the market went up less than I thought it would on stellar nvidia earnings I think the these macro stocks are getting a bit tired at these levels

Andy: Yeah I think so.

The aftermarket for most of the stocks that are peripheral to, the mag six and those stocks definitely faded as NVIDIA continued to rally. There was a lot of options activity in NVIDIA and the related stocks, but, some, I think cooler heads are prevailing.

Outside of NVIDIA, which, by the way, were fantastic earnings, obviously and the stock is, if it, if, it's possible it's a fairly priced or cheap stock, but at the same time it's interesting that, they're selling to the mag six. The CapEx of the Mag6 is being spent on GPUs, and so the question that you have to ask is is that a good investment by the Mag6?

Are they going to earn money by that? Are they going to have to continue to provide, buy it? Significant amount of GPUs, et cetera, and I think the market's starting to say, what pie are we all eating from? And is there enough room for each of us? So overall, I think the price action was also.

Heavy to me.

Nick: Yeah. No, I definitely agree. And the other thing that I've noticed last week, and we've got to talk about the price action as opposed to any macro because there wasn't any is the just overall weakness in the in the commodity space. It just continues to be very heavy price action.

Any kind of bounce is sold into and that just doesn't chime in with what everybody's talking about. And that is an economy which is on fire. And everything being wonderful and big reflation in in, in, in equities, it just doesn't triangulate with what the price action actually is showing and I've, I'm going to talk about some indicators that I particularly.

Got worried about on Friday in the price action later on in my segment But it just doesn't feel like a market which is ready to continue higher It just feels like a market which wants to go sideways at best And down at worst

Andy: Yeah, I think you're right. As it relates to, I focus on oil and I focus and I've been writing a lot about China lately.

I do think there is a case for energy, but the rest of the commodity sector is particularly weak. You have all the aggs are in China. Thank you. The particularly the grains are very weak. And, it's clear to me there's some doubt on the path of growth that isn't reflected in the equity market.

So, yeah, I think that's worth paying attention to, I'm long a little bit of oil at damp spring and I'm long a little bit of China at damp spring. So I don't think it's a throw out, we're heading toward a weak growth environment, but there is some question about it. Yeah,

Nick: and certainly the prices that we've attained discounts so much that it's probably only natural for the market to hesitate at these levels.

So, as we've sold calls against our QQQ position, and I'm very happy with that. Maybe we could have been even more aggressive and lowered the strike by a couple of points, but I think that we are in the right position for the time being, and I don't feel that we need to make. Too many changes.

What about next week? What do you think big auctions? 170 odd billion worth of twos fives and sevens the market is You know, fairly priced for them. We have given up a lot of the cuts that we had priced in. Now we are on top of three cuts for 2024, which is exactly where the feds dot plots are. And after, apart from that, all we have are durable goods or, and the Q4 GDP, which nobody's going to pay any attention to because it's all in the rear view mirror.

And finally we have the PCEE. On Friday, which we all know that every Fed governor will look at, but we already know what it is because it's a derivative of the two data points that we've already had the PPI and the CPI. So, very unlikely we get any kind of surprise from PCE. That would be news if we had a surprise from PCE.

And definitely what we need to talk about. Really is the feds doc plots, which will come at the FOMC meeting in March and what the likelihood for those is.

Andy: Yeah, for sure. And we got a little bit of a hint of at least the tone. Now, as Nick mentioned, we get no data this week, so this is relatively irrelevant for the week ahead.

But the following week, we get Powell in front of the Senate and House, and he could make news. The week after that, we get inflation data, and the week after that, we get the FOMC. So it's something for next episode, but at the same time, the market is set up for basically, as Nick said, in the short end, trading at fair, assuming the dot plot stays basically the same, and the Fed continues to expect three cuts in 2024.

We've got some evidence that at least there's a slight movement toward. Maybe not two cuts, but at least a movement toward two cuts that came from FedSpeak but in particularly a speech by someone who we think is particularly influential, and that's Waller, when he said in an extended speech, which is worth reading, what's the rush?

And he was referring to Cuts. And so we think he's at three cuts. And we think Powell is probably at three cuts as is the median fed governor, which is what shows up on the dot plot. The question will be is, either in the press in the the Hill testimony or based on the data that we get in the CPI, what will the FOMC do?

Will there be a shift of the median? It'll only take two voters going from three cuts to two cuts, but that might be hard to do. Will the median jump to 4. 9 from 4. 6? If so, that'll be a market moving event, and the market will predict it based on whether Powell says I'm moving in front of Congress, or some hints at moving, or the CPI, PPI data comes in line or hot, or we'll just have to wait till the FOMC and see.

But for now, two years are stuck with waiting for that type of information with a tremendous amount of

Nick: supply. Yeah.

No I completely agree with you. I think the two year is completely stuck at these levels for the foreseeable future. And We will only get a 30 basis point move in the dot plots after we have seen or the likelihood will increase after we have seen the CPI and PPI numbers for February, which we get in mid March.

Those I think are pivotal because you can make excuses for the January number. You can say that it's seasonal, you can say it's a one off, you can do all sorts of things, but if two on the trot come out, then the probabilities decrease. And I really can't see that three cuts becomes the base case anymore, simply because we're going to be running out of time.

If they need to see several more months this year, then even June starts becoming dodgy. And as we all know, we have then the elections and I think that they will loathe the, they will be loathe to start cutting in front of the election because that will be seen as political and that only leaves. Two meetings after the election, which is November and December, and really the odds that they will move, start moving 50 basis points unless the economy really weakens are very low.

So we could end up with two cuts this year quite easily. And then the market will be certainly at the short end will be 25 basis points. Lower than it is at the moment and that must impinge on equities and their valuation. And that's why I think that the likelihood of them just ripping higher from here is very low.

Andy: Yeah. So that sort of covers our macro outlook and what to expect for next week. We'd like to also mention to our viewers how to think about. Our portfolio and what matters nick. Do you want to start?

Nick: Yeah, we've had a lot of questions about why are we at a certain level of allocation? In equities and not higher or lower or whatever What we would like to stress to you is that this portfolio needs to be a balanced portfolio for wealthy individuals who only want to make changes relatively relatively few changes per year and want to be able to talk to their wealth advisor and discuss with him when changes should be made.

Personally, I think that what you need to disregard And let's do an analogy here with driving a car. To me, it doesn't really matter whether I'm driving the car at 50 miles per hour or 75 miles per hour. What matters is when I brake and when I accelerate. And why I do those things. If you think that we're driving this car too slowly, there is absolutely no reason for you not to be driving it faster.

What you should be concerned with is when we break and why we break. And if you agree with that, then you lower the allocation to equities now the other thing that Is important to understand is that cash returns are particularly good at the moment You're getting five and a quarter percent on your cash Unless you think that there is a very good reason to go riskier than that, then a 35 to 40 percent allocation to equities is not ridiculous at all.

And I think that you have to understand A, where cash is, and B, what a balanced portfolio seeks to do. Would you think Andy?

Andy: Yeah, exactly. We think a balanced portfolio does well when there's a recession and does well when there's a growth growing robust economy. And you can't own just equities.

You can't own just bonds to have a balanced portfolio. So what we do is we seek balance and then we have a certain risk tolerance. And let's, let's say we drive, we're old gray beards and we drive at 55 and we drive at the speed limit. That doesn't mean that you have to, you drive at the speed you want.

Your own personal circumstance, the way you talk to your broker. Now that said. Just because I'm saying you should drive at your own speed doesn't necessarily mean that means you should have a higher equity allocation and no bond allocation, because that means that you've decided that you're going to be unbalanced to future outcomes, and you would, you're going to be exposed to recessions.

So the best way to use our work is to say, okay, I like balance. That makes sense to me. I don't like the speed you're traveling. I want more return for the amount of risk I'm willing to take because I'm more risk seeking than you two old guys. And in that case, your job is to lever your portfolio, reduce your cash, increase the holdings you have, but in a balanced way, then.

And so that's the lever, that's your accelerator, is the leverage you use, the amount of cash you have on the sidelines. But it doesn't mean that you should be unbalanced. Now you can be, that's up to you. Bet on what you want, but we like balance. And so the next step is what really matters from week to week, what the signal we're giving.

Forget our allocation and that we're traveling at 55. We're saying, that's our speed, we like balance. And then We change. We either accelerate in a particular asset class, decelerate in a particular asset class, or accelerate or decelerate on overall assets through time. Now you can push the accelerator harder or softer than we do.

That's up to you. But the chain, the overarching concept, and then the change in our allocations are the signal you get from us.

Nick: Excellent. I hope we've cleared that up for you. Now, let's talk about what allocation changes we want to do for next week, if any.

Andy: Sounds good. So, I've been looking at the bond market.

I know there's a ton of supply on the front end. I know that there is also a ton of the, as we said, the front end is stuck because we don't know what the dot plot is going to be and no one's going to take big swings until after the CPI. And yet. The long term bond market seems to be seasonal set up in a way that favors the potential for upside in the next week, in particular month end flows that might be pro bond and anti stock.

But I like our bond exposure. I don't think we need to mess with that.

Nick: No, I think we are, fairly balanced there. We have VWOB for We have the longer exposure. We have tips for the longer exposure. We have the belly, which is really not moving here at the moment. I think that's stuck as well. We've got rid of the the two year because that was dead money and we've got it in cash now returning five and a quarter.

So, we have plenty of cash. We can allocate it whenever we see something that is, that needs to be done. What I would like to do, and I think the commodity space is vulnerable. And especially if we agree that the potential for a squeeze is there for the bonds is get rid of some of the exposure in commodities and buy gold instead, because gold would benefit from the.

From the bonds going up as well.

Andy: Yeah, I always like gold and we haven't had it in a while. I don't, I don't think it's going to be running away, but as a, as an enhanced way of owning sort of duration bond I like it better than commodities at this stage. Oil's had a big bounce. And I think it probably, as I said, I'm long it and damp spring, but I think it probably can, and I think it probably can go higher, but I think gold is going to actually outperform in that environment as well.

So I agree. So you're thinking to sell two thirds of our,

Nick: yeah, something like two thirds, but I'll mention that in my segment later on.

Andy: Okay.

Nick: Sounds great. Yeah, I think that's all we have for you this week. It's going to be another relatively quiet week, but we feel somehow in our water that the equity market is going to stabilize or even give back some of the gains of the past week.

Thank you very much indeed. See you next week, Andy. Let's start with the allocations. Naturally, all we did is we sold the QQQ 442 calls, which I haven't put in here because they're not in the money, but naturally they are in the broker statements. All you've got to do is download them. So what orders are we putting in for next week?

Well, as 600 shares of GSG and buying the equivalent amount of GLD. If we have a look at that is approximately two thirds of what we have in GSG. And we are unbalanced at the moment because we really need to have some gold. As we mentioned, we think the odds are that the commodity space is a bit sickly, and I'll show you a couple of charts in a moment.

And we feel that risk is well, I wouldn't say that we think that risk off is going to happen. We just think that we're in a period that is likely to balance risk. This idea that we need to go up one or two percent per week in equities is silly. And it's plain wrong. Periods of retracement and stability will happen, and I think that we are in front of one right now.

This is one of the primary risk indicators that I look at. And it's actually the SOX index against the Japanese Yen. And as you can see, it did a key reversal on Friday. So we think that has room to come down and therefore rebalance things. And if we look at ITOT over government. That's the totality of the bond market against the totality of the stock market.

We see that it's very overstretched. We think a period of sideways would do equities a lot of good. And especially if we have a look at things like GLD over TLT, it indicates to me some more stability. So gold as opposed to. going into commodities which are especially weak at the moment makes a lot of sense and that is why we are switching and that is why we are happy to remain short of those calls in QQQ.

I think that if you wanted to be more aggressive than we are you would probably Lower that strike down to 440 or even 438 as opposed to 442 and you know that way you become more aggressive than we are, but we certainly feel that over the next week or so we're going to have a period of re tracement in the stock market and that QQQ has probably done as much as it is going to do in the short term.

Anyway, thank you very much indeed and speak to you next week.