

**Nick:** Good morning, and today is the 4th of May, and we've got a lot to unpack, don't we, Andy? We had the QRA, followed by the Fed, followed by big tech earnings, so let's get into it. QRA, exactly as we expected. What do you have to say about that?

The high level point is exactly as we expected because the only thing that really matters is the amount of coupons they issued which was exactly in line with our expectation of.

**Andy:** 1 trillion and 84 billion. And that's exactly what it was. There were expectations away from us that the fed would, the treasury would cut coupons, but that didn't happen, but I think there were a couple of interesting things that came from it in particular. The Treasury general account, which is the Treasury's checking account, which some believed the Janet Yellen would use as a way of pumping the economy by spending from that completely blew up in that.

Narratives face as she now has increased it by a hundred billion Which will create about a hundred billion more t bills than expected which is not a monetary thing, but it is interesting that She isn't she's following the rules and not violating the rules and maintaining the tga based on the rules that's one thing and then The second thing was the projection for how coupon bond auctions will happen in the future.

And, they retained the statement that they would keep auction sizes the same for next quarter. But they also mentioned in the TBAC notes, lower in the statement, that they saw pressure because of the budget deficit to increase coupons in the future. So when you take those two things those unexpected things, it seems clear to us that the odds that at the next QRA in July that Janet Yellen will in some way reduce coupons, which they've said they won't.

In fact, they said they might increase not next quarter, but in future quarters and that she's kept the TGA high Means she's not going to pump in the next qra and the election outcome is not going to be impacted by these sort of You know, easings. So I think that's the big takeaway. Yeah from I think you're

**Nick:** absolutely right The high level takeaway is that she is not going to be political She's not going to pump and even if she wanted to the next qra is probably far too late So that is the, high point take away that it's business as usual at the Treasury no shenanigans and therefore, what do you think about term premia?

The odds that term premia are going to go down over time has to be almost as close to zero as makes no difference and therefore, term premia over time as a result of this QRA, Are almost bound to go higher

**Andy:** Yeah, the Yeah, always have to start with where term premium is before you make that statement and term premium is very low It's not as low as it was in december, but it's very low and makes long term bonds and long term assets generally, but particularly long term bonds Unattractive at around 20 basis points, we expect over the course of this significant It For years, issuance of duration that is now clearly projected with no political shenanigans in the near term to generate a, probably 100 basis points of higher.

Term premium over the next couple of years and basically probably pressure to go up 10 or 20 in the next couple of months With no downside.

**Nick:** Yeah, so that is quite clear and then after that immediately after that we had pal and his presser at the fmc Where he basically kept rates unchanged, which was completely expected and the slightly unexpected thing You Because it's slightly earlier is the QT taper and slightly larger than we thought.

Well, we. We're guessing 30 billion and in fact, it's reduced down to 25 billion So an extra 5 billion per month now My personal view is that makes absolutely no difference to anything. Let's have a look at how the qt taper Works, so basically they're going to be reinvesting 35 billion more Then they would have been reinvesting without the QT taper.

And what does that do? They've already said what they're going to invest in. They're going to invest in bills and they're going to invest in some coupons. Now, bills, the supply of bills is absolutely astronomical. And this extra that they're going to be buying is going to make a I don't think even a basis points worth of difference to the yield of T bills.

The coupons they're going to be buying are add ons, i. e. what the treasury has said they will issue to the private sector remains. They just issue a little bit extra for whatever the Fed's bond needs are. So the as I've just said the pressure on the term premier remains constant.

It's exactly the amount. That the private sector has to buy that the treasury said they will issue to the private sector that changes Not at all. What do you think of that? Andy?

**Andy:** Yeah, I think that's totally right our expectation was they'd wait another meeting before they taper and that it would be 30 billion So, you know it was it a coin flip?

We thought the odds were a little higher than a coin flip that they would wait, but they didn't. And I think that when you take what Nick just said, it has no monetary impact. What it does do is reduce the financing needs of the government of the treasury by 35 billion because the Fed reinvests 35 billion instead of demanding its money back.

And so aggregate per quarter issuance is down 105 billion. But importantly, all that did was reduce the coupon. Sorry, the bills issuance, the coupon issuance, which is the thing that affects markets. Is constant. So a switch from bills or not is really no has no monetary impact. What has monetary and asset market impact is the issuance of coupons.

And as we said, they're, they came in at exactly what they were last quarter and are Only going to rise even with taper going on. So, I think that's the big takeaway on taper. I think the last thing, and you probably want to comment on this given where we're, our heads at the last thing to take away from the, um, FOMC was that Powell was, really raised the bar to fairly high levels that rate hikes are not coming.

**Nick:** Yeah, I think he was very clear. He believes now rightly or wrongly, but he believes that current Fed policy is restrictive, so he believes that it's only a matter of time before monetary policy has a real effect on the real economy. He also believes, and this I would argue with him, that the infl, the inflation rate will come down because the rent component.

Is somehow lagged and given that current rents are not rising, he says, therefore, that will affect the inflation rate going forward. Now, that is slightly more dubious because the latest data has shown that rents are actually currently rising, so I don't know what data he's looking at or what he's hoping to get from future data.

But that is his stance and we have to take him at his word that this is what he truly believes. In which case the bar to hikes is almost impossibly high at the moment. And that is what we have to believe in which case buying a little bit of duration around the the two's area is actually a very good Insurance policy to reinvestment risk in the future and to a weak economy.

What the other thing that he said and that slightly surprised me is that he is worried about unemployment ticking higher. And he mentioned it a couple of times, and he said that if it goes higher than about 4.1%, and we had the 3.9 percent print in the NFP, that the committee might get more worried. So certainly he's paying far more attention, that probably is warranted, to the second part of the Fed's mandate, To the inflation mandate, and that is another thing that the bond market, the long term bond market might not be really liking here or will not like in the future, and that is why I think that term premier is far more likely to rise than to fall with a combination of everything that we've heard this week.

What do you think, Andy?

**Andy:** Yeah, so, I agree with everything you said there. The in terms of the stance of Powell in his press conference, which was much more balanced to his dual mandate and with a fair amount of confidence, though he claims he doesn't have adequate confidence to cut with a fair amount of confidence that he will be able to cut in the future.

And that really caps the yield on two year notes. It just is unlikely that if the Current fed funds at five and a quarter, five and a half range is restrictive and it's not going to go up. It would be almost impossible for Five, two year notes to have yields that are above or even close to the current rate of money, which is 5.

33%. So that gives us investors an opportunity to buy a two year notes at any yield close to 5%. Because. You're not really paying away much. You're paying away 33 basis points of current yield if you buy that versus keep your money in cash. And if we have a slowdown, you're going to Experience capital appreciation far in excess of 33 basis points a year.

In the two year, you might experience 100 basis points of price appreciation fairly rapidly if we had a slowdown. And if we have a weakening, yeah, you would have been better off in cash. Sorry, a strengthening, you would have been better off in cash. But, You're only giving 30 basis points and you make that up in coupon relatively quickly.

**Nick:** Correct. And, at the long end, it's exactly the opposite because, if you lose 30, 40 basis points at the long end, it's going to take you years to make that up in, in coupons. So there's a disbalance there of risk reward, which we should definitely take advantage of. And I'll talk about that later in my segment.

And after all this, we had the NFP, which let's admit it, it was slightly weaker than expectations. No way was it a recessionary print, like some are making out, but the good part, apart from the fact that it was slightly lower than expectations, was that wages. The wages component did not accelerate. In fact, he was 0.

1 lower than expectations, which, makes Powell probably have more confidence that he is correct and that inflation will moderate in time. Is that a fair summary? Do you think Andy?

**Andy:** Versus what we've been seeing in the last couple of months where inflation has been a little bit hotter than expected.

And, um, growth has been a little hotter than expected, which looks like a no landing scenario. This is was much more Goldilocks in which and markets responded in that way to the number by rallying equities and bonds because It's possible that, they nail the landing and we have a Goldilocks economy where inflation returns to target without significant labor weakness.

And if so, equities and bonds are, okay in value. Not great, certainly not great, but At that point, you still get two years rallying meaningfully if we have this Goldilocks environment because of the pricing at such high interest rates right now. So, Goldilocks is Goldilocks. The question is, as you approach any runway when you're trying to land an economy every approach looks like a soft landing until it's not.

And so, that's what we're looking out for. And It's possible we do achieve that soft landing, but if the landing ends up being hard that's gonna be seen by an accelerating weakness of the data which as yet we have not seen.

**Nick:** Yeah. And there's absolutely no reason to expect at the moment that we will be seeing it anytime soon.

What do we have next week? Very little in terms of real data, just weekly unemployment claims, which have been as steady as a rock for a very long time. And that's it. So we are all now waiting for CPI. Which is the week after next and Powell did say that they want to see more data. Central banks are, they have a huge amount of inertia behind them.

It's always easier to punt into the next meeting and to gather data in the meantime. The only urgency that the FOMC is ever going to have Is if the data turns and turns very rapidly and very hard and that we're not going to see next

week And therefore there really is no urgency in the markets to do very much over the course of the next week

**Andy:** Yeah Market sentiment can bounce around and yesterday on friday.

Certainly there was a lot of bullish sentiment for this goldilocks idea But there's nothing that'll support Any case next week in terms of data, the only thing that really exists in terms of information for next week is 125 billion of auctions of threes, tens, and thirties, which should keep some pressure on bond markets in the coming week and probably will keep a lid on, serious optimism earnings are in the rear view window.

There were some In the mag seven space, there were some good earnings with weak reactions. There were some good earnings with strong reactions. There were some pretty bad earnings apple in particular with a very strong reaction. So, that dispersion is going to happen, but we don't have much of that next week.

And then weeks from now we'll have Nvidia. So in the very short term supply of bonds and no news, there's not much to do.

**Nick:** Yeah, certainly no reason to go overboard on risk at the moment. I just don't see the risk reward of having too many equities on board or thinking that Goldilocks is stuck and that landing is a 10 out of 10.

I think it's far too early to say that. And I think that the only smart play is to buy some duration insurance and reinvestment risk insurance Around the two year area and that's about it and keep on selling volatility

**Andy:** Yeah, exactly and equities if they dip that's probably a short term buy and if they rally it's probably a short term sell But you know We're long only.

So at 25 percent equities, we can probably afford to sell some puts in the short term ahead of CPI.

**Nick:** Yeah, absolutely. So we are looking for steady as she goes with the auctions next week, pressuring the long end of the curve and not allowing term premia to dip. And therefore equities should do very little to the upside.

That's the summary of what we are looking for next week. And thank you very much indeed and speak to you next week. See you next week. Before I go into the allocations, just a very quick public service announcement. A lot of you

have emailed us saying that you're not getting emails and that is because you have not joined the mailing list.

Please go to the website and click on join the waiting list and then insert your email address here and press sign up. Thank you.

So let's have a look at the allocations. I've updated everything. This is where we are. 25 percent equities we feel is about right. We really do believe that the odds are very high that over the medium term you will see a rise in term premia and that has to reflect upon equity appreciation. The odds of equities now making a new leg higher are very low simply because bond yields will not allow it to do that.

We are very heavy in USFR. We didn't get filled on our orders in the two year note equivalents, and therefore, we have to move those up. And in order entry, I have written the following. We will sell two 501 puts and buy one of the 494 puts to Tuesday, the 14th of May expiry, which is the day before CPI.

That is a modest yield enhancer play because as we told you, we don't think that next week equities will be able to do very much. And even if they go down to 501, we will probably like to buy them and resell them higher. In SLQD, we will bid 48 93 limit for 50% of the USFR holdings that we have. So we'll swap 50% of USFR for SLQD at that limit price.

Very unlikely that it happens next week. You never know it could, but if it doesn't happen next week, and the print of the, the weekly unemployment claims is low again like NFP was that might give more incentive to up that bid from 4893. But if we And if you decide that is what we want to do, we will give you we will send you an email and tell you what we are doing.

We certainly won't trade without telling you. Again, going back to the allocations, we feel that there is a little bit of risk of reinvestment risk of holding everything now in USFR. Given how high the bar is to hikes. that PAL has expressed in the FOMC and therefore we feel that transferring some of that risk into SLQD or maybe even in SHY if you prefer is not such a bad idea.

Otherwise, everything is updated, the broker statements for the dailies and even the monthly broker statement for the month of April. The monthly performance is updated, as are the weekly performance charts. It's all updated for you. That's all we have for you this week. Have a great weekend and we will speak to you next Saturday.

**Andy:** Hey there, we'd like to let you know about a special offer we're going to release soon. We'd like to, we're very happy about your participation in Two Grey Beards and we hope you think it's worthwhile and we'd like to offer to your friends and family, to your referrals, a special discount.

**Nick:** Yeah, well, so what we're going to do is send you an email very soon, probably even today.

And if you enjoy two great beers and you think it's useful, It'd be great if you could forward it to anyone you think might be interested and they get a free month worth of two great beers. They can sign up, they don't have to pay anything at all or insert a credit card. They watch and if they think that it's useful to them, they can sign up and therefore have a month free.

