Nick: Hello, good morning. Today is the 6th of July. Hope you all had a wonderful Independence Day. So let's immediately go and have a look at what happened last week. And really what we're doing here, Andy, is we're marking time. We're getting indications that the pace of economic expansion is moderating, which is exactly what the Fed is looking for in order to be able to cut rates.

Therefore the market and the Fed, are both happy. ISM weekly claims a DP employment and even the NFP were all slightly weaker than expectations, and therefore all the markets did well. What do you think? Do you think this can last? Because, a portfolio like ours appreciating one and a half percent per week is just not normal.

These are just not normal conditions. Yeah.

Andy: Yeah. So I agree with the data that we saw last week and indeed the jolts was a little bit better than expected in terms of job openings, which was the only counter data to the otherwise relatively weak data. And equities went to all time highs and bonds chopped they steepened over the last a little over a week, but the path is for more of the same, a fed that says they're going to cut one time, but probably really means they're either going to cut zero times or maybe as many as two times.

And bonds that are stuck in a trading range that has, ranged from call it four 20 on tens to four 70 on tens. And what has continued to happen is that the economy is continuing to deliver one thing about the numbers is the economy is continuing to deliver 5 percent annualized nominal wage growth.

We know that there's an income effect that's going on from all of the investors that own cash including us that some of that money is finding its way into the best equities in the world, and those, rustles down for the year, but, NASDAQ and S and P led by the best companies in the world are, is, are up, 18 to 20%.

And the money is finding its way that, that. Is finding its way into the things that are working that are doing well in a strong economy. And until that changes there, it's more, it's going to be more of the same. And so the question that we're wrestling with is as we head to, as we've spent basically a month with pretty weak data on the weak side certainly the weakest data we've seen since last with financial conditions as easy as they've been since the Fed began its hiking cycle, one has to ask which way the economy is going to go if anywhere at all.

Now, the rational thing is that it continues to go along as is. So that's one scenario with the Fed's pricing of hikes, what their dot of cuts, what their dot plot has said plays out. And we can talk about that. And then, there's the possibility that this weakness accelerates. And, there are lots more people extrapolating than there had been over the last year extrapolating this weak data to be recessionary.

We've not been in that camp. And there are just the same amount of people that are extrapolating what has been happening to what's going to happen, which is not much. But there's really nobody extrapolating anymore this idea that easy financial conditions could lead to a bounce in the data.

And so here we are and those are the outcomes and we have to look at what our portfolio looks like for each of those outcomes

Nick: Yeah Now I absolutely agree with you that a lot of income is being produced at 535 t bills And a lot of people have in fact, we know that what the data is. There's four trillion dollars in money markets which are dumping, income onto investors You Every month and that money seems to be finding its way to the equity market.

We are, I think, positioned to cover most probabilities. One thing that I've learned over the years is never to try and pick a top in equities because that's almost impossible. You, the market will always go far further than. Anyone thought possible and then probably retrace far more violently as well, but that's only likely to happen on data and we are data dependent here for a reason.

What we are trying to do is we are trying to. Cover with our portfolio The most likely outcomes that are out there at the moment So as you said one of the outcomes could be that this slight slowing in growth Which is a slowdown in growth it by no means. Is it anywhere near recessionary levels? Falls into recession in which case what is going to do best?

The short end of the bond curve, something like two years, three years, five years, they're going to go as the Fed cuts. They're going to go all the way down to probably two and a half, 3%. Who knows? But anyway, a long way from here, equities might go down, but. In any case, all we have are calls really, so we wouldn't be bothered.

So that outcome is covered. On the other hand, the, there is a real probability and possibility that the easy financial conditions lead to an acceleration of growth again in, say, the Fourth quarter of this year, completely possible. And if we get a Republican sweep, then people will certainly be expecting great things for equities.

Well, what do we have? We have calls in equities and we have only the short end. Of the bond market because whatever happens we are fairly convinced With reasons that the fed is unlikely to hike rates unless inflation reaccelerates Could inflation reaccelerate? The odds are lower the moment because commodity prices are really range bound, just like the long end of the bond market.

So if in, if growth reaccelerates, what is most likely to happen is that the long bonds get destroyed rather than the short end of the curve that can go up 2025 basis points. But you'll make. Up that via the dividends that we get from shy and IEI. I posted on my Twitter feed, a chart with shy making new all time highs at the moment.

With dividends reinvested because you're getting so much of a cushion through your dividends That really if 25 30 basis points of backup in the two year note is really not going to hurt us at all So we have through our portfolio positioning covered 90 percent of the outcomes that we can see at the moment, and we should be content and happy with that,

Andy: right?

And the only question that I have is the status quo outcome. And in the status quo outcome cash obviously does. Well, we've got plenty of that. Long term bonds underperform because they. They don't change in price, but they offer lower yield than our medium term and short term bonds that we have really don't have any medium term, really short term bonds.

So that underperforms because yields don't really change. So prices don't really change. And so the question then becomes. And I'm struggling this with this for the exact same reason that you have said regarding picking tops and equities, is that to me, a status quo, which is the economy slows modestly.

To me, I struggle with earnings expectations being met. And so, to me, on a status quo circumstance, I see equities as having not much upside and, 10 percent correction sort of downside. Now, how do you play that? Well, you don't want to be long actual equities, but if you're long calls, that scenario is covered too.

If I'm wrong and they make earnings, even though the market slowed down, equities are going to appreciate 10%. If they. If I'm right and they don't make earnings, we have limited exposure. So when I look at every, I think that covers the whole waterfront of scenarios. The slow down scenario where initially being in twos and threes is going to pay more than being in bonds. The speed up scenario or the bounce scenario where equities are going to do well and bond long term bonds are going to do badly. And short term bonds, they're going to do not well, but they're going to be covered by, as Nick said, the interest income. And so you won't have any negative return on those.

And this status quo scenario, I think it covers the waterfront. And I think that's what we're supposed to do. The question I have, Nick, is are we heavy enough in so I think the Our portfolio is perfectly suited for the two scenarios that are stronger. When I look at the, and you're the person that has the most experience of the two of us in this scenario.

When I look at the negative outcome scenario, the slowdown scenario, the pre-recession, ary scenario, we're gonna lose. We're gonna make money on our twos, but are we gonna miss the money on the tens and thirties and or the fives and tens? Like when should we shift?

Nick: Yeah, so basically what you're asking is when should we go up the duration curve from what we have and let's just remind everyone and I'll do that in my bit later We have some t bills not a lot We have some shy which is one to three years and we have some iei which is basically Four year duration average, let's call it.

Would it pay to go up the duration curve at some stage? I think that will we will need to do that. Certainly go out of T bills and anything which is very short end, but that will we will know that when the data comes out. I think there is no need. To prejudge the data or anticipate it when the data shows that we are hitting recessionary levels it's going to be very obvious and then we can pull the trigger.

I don't think that we need to rush and I'm struggling with this question of reinvestment risk each and every day. For my own larger portfolio and I've come to the conclusion that I'm not wise enough or Clever enough or lucky enough or whatever to be able to prejudge it I'm going to wait for the data to tell me that is a likely scenario And then pull the trigger because I always prefer to get in later, but with a much higher, with much higher odds of success.

So when that data comes out and confirms to me that the likely scenario is one of recession, which at the moment it's just absolutely not the case, then You know, then we can go and buy heavy in four years, five years, seven years. And that is the part of the curve, which always does best because the curve disinverts and gives us the way.

So we are positioned at the moment 19 for 99 percent of the likely eventualities and outcomes. And for that 1%. I don't think it's really worth thinking about right now. We will know, and we will act when it happens.

Andy: Right. And the way I'd describe that in pricing is currently the expected fed funds rate for 2027 is 3.

6%. And so if you're buying longer duration, you need that rate to come down for you to make money. And it will come down. It will, it, in the event that whatever that mythical data that will be obvious to all of us that we're heading into a recession occurs, that number will go from 360 to, I don't know, 320, 325.

On that data, and we will have missed 15 or 20 basis points in long term bond yields. But the things we own will make 100 basis points. And so for us, let's wait to own that five to 10 year duration, either at much better prices, which would require a acceleration of the economy. So we're not getting better prices until that happens, or when we're raking in money on our twos and threes and fou and fours, and we're able to then pay up whatever it is for these fives and tens.

Nick: Yeah, we will be paying up for sure, but we will have a much more certain outcome or from our investment. And therefore there is absolutely no reason to jump in with both feet now. Absolutely no reason at all. I think our portfolio is perfectly positioned for the probabilities that we can see and price at the moment.

Andy: I agree. So what's going to happen? Yeah. So we've got 109 billion of threes, tens and thirties on the calendar for Tuesday, Wednesday, Thursday, and we end the pals. I think pals on the hill. Is that correct? So if he makes news, we'll let you know. My guess is he does not pre announce a shift to one to two cuts from the current SCP.

There is significant opposition. Amongst voting members for starting the cutting cycle and whether he's going to need to control them and he's going to need to see the data to get the Hawks away from things that include saying that they'd be willing to hike again, which some of the Hawks have said so, and those are voting Hawks.

So it's unlikely they make news, but if he does, we'll let you know. As to further news, we have CPI and PPI at the end of the week, and those could be, the odds are their status quo, which shows continued softening in the economy and inflation returning to target. But, there's a little bit of oil bounce in the numbers, so it could be, it could, they could make news, and we'll let you know when they do.

Nick: Yeah, it's terribly unlikely at the moment that PPI and CPI miss by a lot, simply because, as you said, oil has bounced and commodities are firmish, they're nothing to write home about. So I don't expect a big bounce. Big miss to the upside, but it's unlikely that CPI and PPI are going to make enough waves to force the Fed to start anticipating the cuts.

At the moment, the market is pricing in almost a. And the 80, 90 percent probability of cuts starting in September, the two year note is actually pricing in 100 percent likelihood of of a cut in September and really the odds of July, if they rise. Are probably wrong. I don't unless the data, cpi and ppi thursday and friday is Abnormally weak there is absolutely no case for the fed to start cutting in July and the fmc's on the 30th and 31st So we will have had Just about all the data that they look at by the time they meet and really very little likelihood that They need to start anything in july.

Yeah,

Andy: I think that the There's basically 55 basis points of cuts priced in through december I don't know when it'll happen, but that is a little more than two cuts. If I, very short term based on the data, I would expect 55 basis points to be either 60 or 45 in the, after the CPI and PPI,

Nick: but

Andy: we'll see.

Nick: That's about it. No, and the only thing that could be of interest is the French election, the final results. That looks like it's going to be a hung parliament, which is good, actually, for French bonds and European bonds should probably start coming in. Towards the spread should start coming in towards the u.

s And therefore there's going to be very little reaction from stocks if that does happen So we're happy with what we have and we see no reason to change if anything changes the email will go out Especially after we've seen cpi on thursday. Okay. Have a good very much week Bye bye. Let's have a look at the portfolio.

Well, it's doing remarkably well. In fact, it's going it's doing ridiculously well for what is a fairly conservative portfolio. 1. 3 percent a week is not normal, but let's ride the wave. As I said, we will never get a pick the top in equities and Let's just let it go on. So where are we? Around 46 percent in equities, 52 percent in bonds, and all really short term.

SHI, SLQD, IEI. The only sort of longer term is TIP. And we are doing extremely well. We see absolutely no reason to change his portfolio. I know we're being boring, but we are covering 99 percent of the odds that we can see as outcomes as reasonable outcomes out there. Therefore, we will not change for the sake of being interesting in inverted commas, something that is working and something more importantly, that covers the eventualities that we can foresee at the moment.

If that changes, of course, we will have an email out to you, but it's only likely to change on a very big miss either way on CPI, which is Thursday, and we'll let you know immediately. Otherwise I've updated everything. You've got the the broker statements in. Here and the only other thing that I've added is the 2023 annual statement because some people asked for it so you can see every single trade that was done in 2023 when and how and that is about it.

The monthly is updated as well. We're very happy with the performance. We just don't see anything wrong with it. It's appreciating. too fast. So probably we will have some give up in the weeks ahead, but the portfolio is exactly where we think it should be. And therefore we're not going to be making any changes for the sake of making changes.

Thank you very much indeed. And speak to you next week.