For this week's video, I'm going to put Nick's update video below the main video. If this is unpopular, I will go back to having it at the end of the episode. Thank you. Good morning. Today is the 31st of August and a happy Labor Day weekend to everyone. The summer's coming to a close and lots of exciting things are going to happen next week, Randy, right?

That's what everyone tells me. Yeah, well, so let's have a look at what happened this week. And really nothing different from what we expected in so far as all the data that keeps on coming out, although it is secondary admittedly. Just shows an economy, which is nowhere near a, a tipping point of going into a recession.

The data is nice and steady. The weekly claims are nice and steady. There's absolutely no panic out there whatsoever, right? I mean, stuff is just where it should be for a Goldilocks soft landing. Really, we don't know what Powell was so worried about last week at Jackson Hull. It all seems to be very nicely progressing, which is a favor equities over bond scenario still.

But this week, I guess we will get confirmation of that theory with NFP, and that is the important one. What, what, what are your thoughts, Andy? Right. So just dropping back to what happened last week, we saw three auctions of 180 billion that went fairly well some, you know, not great, not, not tremendous, but okay.

And GDP figures came in warmer. The revisions came in warmer on the actual GDP and a little cooler on inflation. So, you know, that's an economy that's growing, slowing and disinflationary and is exactly what the Fed wants. And so the question becomes why the, Concern why, why do markets which ended the week with weak bonds and strong stocks, but for the week was, were relatively unchanged.

Why are markets pricing in 50 basis points of cuts as a 30 to 40 percent chance that's simply not what one would do with given the economic data we've seen to date. Yeah. So next week, what do we think about next week? Well, next week is the important one because although we do have PMIs and jolts and ADP, the important.

Data will be on Friday. Everything else can more or less be disregarded. And it's NFP, which either is going to confirm the previous weakness in NFP, which a lot of people consider to be weather related and all sorts of other statistical errors included. Or we don't get confirmation, in which case the scenario become quite much, much easier to actually game forward, don't they?

So let's try and do that. I mean, I'm going to attempt to game the scenario. First scenario, which is the most probable, is that the NFP is actually completely in line with expectations, i. e. it does not confirm the weakness from the previous months. In that case, I think it's fairly easy to say that we need to price out any probability of a 50 basis point cut by the Fed, we need to price in the absolute certainty of a 25 basis point cut from the Fed at their FOMC in, in mid.

September, I forget now the exact date, but the that seems to be the easiest probability. So what does that mean for the curve? It basically means more or less a parallel shift, but probably towards the front end of a 15 basis point backup, which is the probability that we have priced in. As Andy said, of about 30, 35 percent of a 50 basis point move.

So that is the baseline scenario, i. e. completely in line. Now, if we get a shock number like, I don't know, let's guess, 50, 000 or more. Or something like that, which is then much weaker than expectations that really should favor bonds over equities, right? Andy, do you have? Yeah, I mean, Yeah, I mean, I think the, the issue here is that the bond market is pricing a fairly weak number with the 30 percent ish possibility of a 50 basis point cut and the rest of the curve being fairly steep in terms of the cutting pace.

The equity market is priced for two things, which is it's multiple is on the high side. So valuations are. On the high side, particularly if earnings growth is still phenomenal, but decelerating amongst the tech, which is obviously a very heavy component of the S and P, but at a 21 multiple the equity multiple is at risk to tightening of financial conditions and also doesn't have a ton of upside.

On the other hand, Equities also depend on their earnings growth and earnings growth are very straightforward. You need strong economy for the earnings growth to be realized. So when I look at the relative value of equities versus bonds, it comes down to what could hurt bonds. Equities will play out based on what could hurt bonds and what could help bonds.

And as Nick said, the thing that can help bonds the most is a very weak economy. So if we get 50, 000 jobs, which is a low number confirming another low number. From June, July, I would expect bonds to do quite well. Again, 50 basis points. I don't know necessarily the fed will do 50 basis points.

But 50 basis points would become the higher probability in markets, and so markets would rally, bond markets would rally, call it 8 to 10 basis points on, in the front end on, and possibly, possibly a panic toward more as if they do 50,

they're doing 50 next month, the next month, and they're doing 50 the next month.

So if they do 50, there's going to be 150 basis points of cuts in 2024. And currently they're only priced for 107. So we could see a real move in bonds. If they were to do 50. Now, we're talking about the market reaction to a negative NFP print. We're not talking about the actual cuts. So it'll approximate that.

Now, the problem is for equities, this is pretty bad for equities. If the Fed is behind the curve and needs to cut aggressively. And the economy is weakening. Those two things are both bad for bond, multiple equity multiples and stocks. So I think that's the bad case for stocks. The rest of, but the more not likely case is better for stocks than bonds.

Yes, absolutely. So the, the only scenario we haven't gamed is a very strong number. So, let's say that it's, I don't know, 200, 250, it's strong, it completely denies the July number. Again, we don't think that that is going to be very bad for bonds. It's going to be bad, but it's not going to be very bad, because we already know they're going to do 25 in any case.

So, what we're really saying, Is from a inline number to a very hot number. There isn't all that much difference for bonds. They, they back up, but they only back up to the 25. The marginal difference is going to be at the speed of cuts and probably to the terminal rate, the market might be. Take out a little bit of terminal rate and say the terminal rate is going to be 3 percent or something like that at the end of 2025.

So not a huge difference. The difference probably will be in equities because the spike on equities is probably going to be higher. Then otherwise would be, but we still think that equities are going to struggle at the higher valuations. Don't we, Andy? Because if the bond market is not supportive, I just don't see that the earnings growth is going to be strong enough without tech and tech has moderated very substantially as we saw this week.

You know, we, we did well to get out of XLK and, and. Distribute elsewhere. I just can't see much upside that is sustained in equities. What do you think, Andy? So the way I think about it is again multiples and valuation, which is another name for multiples and earnings and earnings are growing expected to grow at 12%.

So if they achieve their expectation, you should earn a 12 percent return on equities. Otherwise. Any other return you would receive, either less or more,

would be based on multiple expansion or contraction. And so, 12 percent is not bad, don't get me wrong, that's a nice return over cash. And so, it's not a terrible thing to see the economy strong enough to support the earnings.

The question for equities in terms of, okay, you know, should I be in equities versus cash is whether you expect higher returns than the earnings priced in, which would require multiple expansion. And so the big problem with a hot number or even a not so an inline number for equities is it's not necessarily going to generate multiple expansion because the expectation is the Fed is going to have to keep rates higher for longer.

Now they're going to cut, don't get me wrong. When I say higher for longer, they're not hiking. They're cutting. They're cutting 25 on, on Friday. Sorry, on the 16th, they're cutting. But the slope of the cuts would flatten out and the terminal rate of the cuts would rise. So. That's not good for multiples, but it is good for earnings.

So I think the knee jerk is going to be on a, on an hot number, or maybe even an inline number is drift down for bonds because they should drift down and spike for equities on both multiple expansion, expansion, and The view that the earnings is that are actually going to be realized less concern about earnings growth.

The question is how long it will sustain. And based on all those things I just said, not very long. So we are basically in agreement. We've gamed out the three scenarios. All that remains for us to do is have a look at how the portfolio are doing and what to do about, you know, do we want to do anything right now?

I think we wait and see what the NFP number is. Things are going to be much, much easier to determine after that confirmation, aren't they, Andy? Yeah, I mean, there's no, no sense in making big investment decisions as long as you're well positioned to take advantage of them. Obviously our new effort Two Greybeards Squared is in cash.

And our Standard portfolio to gray beards is well positioned to manage through that time. But, you know, I, I think doing certain, certain tweaky trades as we approach the numbers based on price makes sense. And to get started possibly with some things in two gray beard squared makes sense. Yeah, no we will, I will discuss that in my.

Segments subsequently, but that's about it. That's all we have for you. Have a wonderful Labor Day holiday and speak to you next week after the numbers. And of course, we will most probably send you an email straight after NFP, if it's significant. Bye bye.