Nick: Hello. Good morning. Today is the 14th of September, and let's run very briefly through what happened last week because we have a lot to talk about about what will happen next week and how we can take advantage. So this week we had PPI and CPI numbers, which were, if anything, slightly hotter than expected by the market, which the Fed shouldn't like.

But on the other hand, with oil prices down about 7 percent on the month, the market just looks straight through it because next month CPI and PPI could well be lower or take care of the excess that we had this month. The Atlanta Fed GDP. Now cast went to 2. 5 from 2. 1. So really we continue not to see any kind of bearishness, outright bearishness from those numbers.

The economy is fine the unemployment rate is stable as weekly claims keep on being within a thousand of expectations. So really nothing to see there. And all the auctions went reasonably well. The last one, the thirties was probably But that is to be expected, but otherwise no big news there. The one thing which was interesting is that we got an article from Nick Timiaraos of or however you pronounce it.

From Wall, from the Wall Street Journal, who some people consider to be Jay Powell's mouthpiece. Hinting at the possibility of a 50 basis point rate cut and that got the market excited on Friday. But really, at the end of the day, we closed very much unchanged from where we were on Wednesday. So the market is really undecided about what to do.

What the prospects for the Fed are and now let's talk about what happens next week because really what happened last week is Going to be completely unimportant come Wednesday, right?

Andy: So let me just, let me just jump in there. You know, the, the row equities rallied 4 percent from Friday, the prior Friday's low, which was a very negative.

Move ahead of that. The and Monday and Tuesday were not particularly good for equities. Either the whole thing shifted on the Timiraos article that which came out on Wednesday. And from then on, it's been nothing but a bull move in equities and strength in short term interest rates to a point where the Where prior to Tim Ross's article, there was a 15 percent chance priced in a 50 basis points cuts at next week's FOMC and by the end of the day on Friday, again, two days after Tim Ross's article the pricing went out at a 50 50 chance.

And so there's a lot of conjecture about whether it's a, a plant and that the Fed really does want to have its options open for 25 or 50. But prior to that article,

equity markets were struggling. The the bond market was expecting 25 and That changed it all and it's unclear to me whether it should have, but we're going to operate with what we know now.

And as we look into next week, it's important to note that no one knows what they're going to do. So for us, as as investors, we're trying to think of the scenarios that they are considering at the FOMC and then react to what they do.

Nick: Yes, absolutely. So let's go through the scenarios. One, the most important, the high level point to me is that whatever they do, it has to be consistent with their summary of economic projections.

They will come out with dot plots. Of what they think the fed funds rate is going to be 2026, but they also will come out with their expectations for what unemployment will be, what GDP will be, and what PCE will be over those same periods. What? To me has to happen is that whatever they do and however they move the dot blots, it has to be consistent with the summary of economic projections.

What I'm trying to say by that is the following if they keep unemployment rates steady. And if they keep the GDP steady, and if they keep the PCE steady, and then come out with a 50 basis point cut, they are going to upset the long end. Because it will seem they could correct it in the presser, but to start off with, it will seem like they want to steepen the curve.

Steepening the curve is never really good for equities. In the short term, it's never good for long bonds in the short term. It's very good for short term rates. They come down quite fast. The curve steepens and equities sell off with the long bond. So long assets, which we are long of are not going to do well.

It's very unlikely that the Fed would not know that to start off with and be that they would want that outcome. So Let's run briefly through the scenarios. The first one being a dovish 25. What do you think, Andy?

Andy: Right. So I think that's the central case. It says the economy's doing okay. We're going to begin the process of removing accommodation.

And we're, and we are going to 25 now, and we'll be cutting along with our dot plot and and along with the projections we've been making. And I would expect, you know, the 2024 dot in a 25 basis point cut scenario it's pretty unlikely to me that That would, if, and they were, and they did a dovish 25, to me, they're

going likely to have to show that there's going to be another 75 basis points cut between now and 2024, between then and 2024.

Which means at least one 50 basis point cut. So it's a little tricky when you look at the 2024 rate, how they get dovish enough to say, we're doing 25 now, but we may do 50, we will do 50 on one of the next two meetings. So it's a subtlety. But I think that's the like, the most likely outcome is that they stay on track, which is expect the unemployment rate to rise modestly, which is already their projection.

Expect the GDP to be at trend, which is already their projection and expect the PCE, the core PCE to be maybe a little lower than their 2025 projection in the past, but not dramatically lower. And that would be a, the dovish 25, which I think is the

Nick: most likely. And that actually should not really upset any market apart from possibly the very short end of the bond market, which is already discounting much more, but it certainly went upset the long end.

And if the long end is not upset, then that shouldn't upset equities either. Yeah. I mean, I think it's clear that

Andy: there's just, we'll go, we'll paint four scenarios, but it's pretty clear that the short end of the bond market. Has very little chance of not being upset. There is a massive dove, a dovish 50 that might get the short end excited.

The odds of a dovish 50 seem is, is what markets are pricing. Yeah. Now

Nick: the dovish 50 would have to. Imply to be consistent would have to have quite, quite a bit higher unemployment, lower GDP and lower PCE hundred percent. That would not upset the long end because the lower PCE is fine. The long end will price off the real rate.

That really wouldn't be too bad. It would probably be great for equities because people will be. The initial reaction will be to buy in which we would actually sell because that is a long term bearish signal for the economy, but the first reaction will probably be to go up 1 percent and then see what happens kind of thing.

There are so many scenario here and we will produce a table, which we will post as an update before the Wednesday FOMC. So, which will have our projected short and long term reactions by various asset classes to whatever they

do. The problem here is that it's very easy for them to be inconsistent with whatever they have done, with whatever they've shown in the dot plots, and The summary of economic projections so they could easily upset the short end the long end and or equities.

There are so many permutations here that we can discuss them till we are blue in the face until we've seen exactly what they've done and what they've said and why they've said it. We can't really make any decisions and therefore to start buying or selling anything before we have seen the details and the presser.

would be just silly and, but be assured we will send you out a a schematic of what we expect and why, and then we will send you an email or post on the website so you know exactly what we'll be doing as a result of whatever transpires on Wednesday. Having said that, I mean, we could go on about the FOMC forever, but to me, what, what's really going to be interesting is also retail sales, which comes out on Tuesday.

Now, we, we hear a lot about unemployment or fear of unemployment, and I think the first thing a normal person would do if he feared unemployment in the slightest is to cut back on expenditure. We have not seen any drop in retail sales at all. And that to me would start becoming some sort of a leading indicator that people are fearful of unemployment.

But if retail sales continues a pace growing without any problems, Andy, why would we Assume that there is any chance of a spike in unemployment. I just don't get it.

Andy: Yeah. I mean, you and I have been pretty consistent about this claim saying that the economy is slowing and inflation is coming to target, but the economy is pretty good.

There's no signs of the imminent recession that many of our peers and many Fed watchers who are suggesting an aggressive cutting schedule and the pricing in the stir market, which expects at a minimum significant reduction in restriction, probably to accommodation. And at a maximum, An imminent recession priced into the stir market.

We don't see that And so the real question for me is, you know on strong data We had strong listen, we had strong cpi and ppi data relative to expectations which should have been bad for the short term interest rate market and Furthermore and better for equities and worse for the long end Then you know

in terms of relative equities relative to bonds But the market was not at all interested in that strong data.

My view on strong data is the market's set for weak data. It has seen weak data for, you know, three, four months and is vulnerable to strong data. But. It needs more than just one data point to shake the, and it needs the fed not to validate the pricing in its actions and press conferences and dots for the short end to back up much.

But is it possible? You could get an extreme reaction back out to say 4 percent on two year notes in a, you know, hot, Retail sales number sure, but then the fed certainly can't be dovish. No, they always are.

Nick: Yeah, I the The two year note isn't going to move that much just on one set of retail sales Given that the next day we have the FOMC, but it would start giving me The impression that there is a chance that what is being currently priced in has any kind of possibility of being achieved in reality.

I just can't see how strong retail sales No drop in weekly claims and every you know, two and a half percent real GDP and we have a recession. I just can't, you know, I can't triangulate all those together. So I have to see some weakness in data to even start believing the possibility that we will take it.

That the fed will cut as fast as the stir market is pricing and that is why we have the barbell That's why we have abandoned the belly. We are in the very very short end hoping to Get more interest payments at the very short end as the fed cuts less aggressively And we are at the long end because we need duration and we think that over the course of time You All the people who are now in money markets and harvesting that 535 as the Fed brings down rates, they will extend duration.

And there's no point in extending duration to the one year sector or the two year sector because they're already pricing in much more than the Fed is probably going to cut. So the only place you can be in the bond market is around the 10 year area. Because the real interest rate that you're currently getting is around 65, and that could easily come down to one and a half, in my opinion.

Is it a wonderful buy? Is it the buy of the century? Absolutely not. But it's not an awful rate for the time being. And we're looking for it to slowly, slowly over time improve and we will get something out of it. In any case, high level point, we will produce a schematic, we will send it out to you, probably on Tuesday, and we will naturally, immediately after we've seen the details of the presser

and the summary of economic projections, tell you what is most likely to happen to each asset class and trade accordingly.

Sounds great. See you next week.