Nick: Hello. Today is the 12th of October. We had a semi interesting week, didn't we, Andy? Not a lot of data, but the market response to it was very interesting, I found. What did you find telling about last week?

Andy: Yeah, to me, it was you know, mostly it was on the CPI and PPI data and the market reaction all week was prominent in the bond market and it really showed the the, there's been a rapid shift since the Fed cut 50 basis points from An expectation of a rapid, deep cutting cycle to one where now markets are considering whether the Fed is going to pause in November, and that's had meaningful impact.

And in particular, it's had meaningful impact on the long end of the bond market.

Nick: Yes, what is the big danger here? And we have to, as investors, avoid big dangers. The danger here is a rapid steepening of the yield curve for whatever reason it might be. At the moment, we're in the middle of a steepening of the yield curve.

The market is concentrating on a, the fact that the Fed might cut slower, that's not so much a problem for the long end, but also it's concentrating on the upcoming election and what the budget deficit might look like, and also the possibility of the Yellen twist, i. e. the issuance of Much more in the bill area or the short end of the curve being reversed.

And going back to what it should be, i. e. Much more at the longer end to re, to increase the duration of the of the debt, but also to make it more sustainable in the long term. So that is the big danger that the market is looking at at the moment. It's not something that is suiting us, of course, but as investors, we have to recognize that that is the big danger.

If the economy is not about to go in a pre recessionary phase, and none of the data that we're getting is really suggesting that the economy is weak in any way, then we have to recognize that the next big danger is, is a big steepening of the yield curve to Front run. What is the potential additional budget deficit that any new administration would run?

And also the possibility of this untwisting of the issuance side, which would really increase the issuance at the long end, which would definitely be a problem for the yield curve. Do you see the same danger, Andy?

Andy: Yeah, I mean, that's, I wanted to recap what was happening in the In the in last week, but I think when you look forward, this is something that Nick and I have been on for a long time.

And we were surprised how well the bond market had done ahead of this type of of. Experience and I think where we come from is that we've been very strong on the economy expecting the economy, seeing no signs of the economy weakening and expecting it to continue to be strong. And now we see we had a slight disagreement on inflation last week, but no big deal.

We see nothing turning down. And so that's bad enough for bonds. A Supply and demand imbalance. Which could come from the Fed slowing its purchase of the long end as they re evaluate what they want their permanent balance sheet to look like. The quarterly refunding announcement that comes in October, which will be Yellen's last, and we'll be scheduling debt issuance for the next administration could be a catalyst.

The budget busting Of either candidate, but the odds seem to be moving toward a Trump presidency over the last few weeks of a budget busting increase, which would not only create supply, but also create growth and inflation from the spending are all bad things that we've been pointing to for the long end.

The economic data that we saw in the past and the potential outcomes in the future that are short term, that'll be begin to be resolved during the election. It's a danger that markets can sort of begin to front run. And we don't think the, the curve flattened sorry, the curve since the Fed met really moved up in a parallel way.

The two year note, And the 30 year note both went up. And so at this stage, the two year note doesn't have much room to go, go up in yield because it's right on what the Fed is telling us they're going to do. While the 30 year has the possibility of doing a lot because it's for all intents and purposes when you look, I know we've been in a very strong inverted curve environment, but when you've traded bonds for 30, 35 to 40 years, a, the level of steepness in the 30 year bond is laughable.

It's just not at all normal. So. With all of those factors, the risk now, I'm not saying it's, we're not that tomorrow, the bonds are going to sell off in a major way, but the risk is of in all markets of all the ones we look at, the biggest risk is for a meaningful steepening. And so, yes, we're on exactly the same page that that's the potential risk given what's ahead of us.

Nick: And markets, as you said, tend to front run and they tend to front run exactly when there is no data and no one knows why it's happening. Next week, we have very little data. We just have retail sales and some more weekly claims on Thursday. which are going to be distorted still by the various hurricanes we've all been suffering through.

And we have also the ECB in Europe, where a cut in rates, a hawkish cut, is discounted by the markets and looks like it's almost a given. So it really would not be. Surprised me if next week we saw the beginning of a significant steepening Simply because no one is expecting it as it were But we shall see we are not changing our view about the economy Are we andy the economy is strong none of the data that's coming out slow shows any Sign that the economy is in a pre recessionary phase so What should we do with our portfolio?

What changes should we make do you think?

Andy: Yeah, I mean, I think the important thing on our view is that we think the fed's going to do what they said and We never thought they were going to do what the market said which was cut a lot very quickly to a low level And so now that basically the front end of the yield curve is pretty safe place to be And things that are economically sensitive like equities Like corporates, like corporate bonds.

Are in pretty good shape. You saw earnings on Friday from the major banks. They are in great shape. We'll see a lot of earnings this week, this next couple of weeks. And you know, the market is pretty well valued for both expectations of those earnings and multiples on those earnings. So it doesn't seem like.

Equities are a big risk unless the thing that we think is a big risk occurs. And at that point, you're going to get a whoosh down in equities. So I think the most important thing we do is address our, we had a bad trade. We bought some TLT as a barbell along with getting out of all of the middle of the curve and all of the real yields we had.

That didn't work. So that's the big risk. So I would think we'd want to dump that and look to something that is, the front end's pretty safe. Is it great value? No, but it's safe. And maybe we can enhance that.

Nick: Yeah, certainly in front of the election, I think, and I've been saying this for a while, this is precisely the wrong time to carry a lot of risk.

My view is very simple. The curve will steepen for no reason other than it can and those and the from and the market will front run it because after the election, it's too late. So the big risk here and as investors, we want to avoid the big risk. The big risk is that Tuesday and Tuesday steepen out of sight and they can go 2030 basis points in in a day.

So what we want to do is we want to dump the long end and we want to hide in corporates at the short end. And I will be going through that in my segment in just next. Sounds great. Thank you very much indeed. Bye Andy. Have a good week everyone.