

2 Gray Beards Week 99

Good morning, and today is the 23rd of November. Relatively quiet week Andy? What do you make of it? We were actually quite wrong in our equity anticipation that we would see a little bit of profit taking and or stopping out. We tried a couple of times, but the bonds just didn't cooperate. And that was that.

What'd you make of it?

Andy: Yeah. I think it's premature to say that we're wrong, that we have been wrong. So far this week equity markets rallied modestly across the board with Russell and financials leading and NASDAQ lagging our view on NASDAQ was I think on point as it relates to the post NVIDIA earnings reaction with NVIDIA down and most tech down.

Equities continue to drift higher and the bond market didn't do anything literally nothing. Like I think. We tested lows, but ended the week up one basis point in twos and down two basis points in 10. So it was a very quiet week in the bond market.

And I think that the bond market got support, didn't sell off, which was not. Which was not at least my stimulus for an equity sell off, but certainly would have contributed to it. But the bond market was supported by extremely weak data in Europe. And you, European bonds rallied and the Euro fell. And that may have provided some support for bonds, we'll see.

As it relates to the equity market, the question that we're going to tackle on the show is whether. Whether there's going to be some divergence within the equity market.

Now, as you say the bond market did absolutely nothing and that supported equities, it seems obvious that unless duration starts getting hit again.

Equities in December are not the favored asset to go down simply because the momentum of the of the seasonality is there and the animal spirits can best be shown in the equity sectors where people are short or have been short all year, which is really the small caps. And the cyclicals have been doing nothing all year and now they're beginning to perform.

And that's, that has held up, the stocks, as you say, it's too early, but really different sectors are going to start diverging or could diverge over the course of next few weeks, simply because of the dollar. And as we told you last week, the dollar is very important because it constitutes something like 50 percent of the earnings of S and P companies and no way are they perfectly hedged and therefore the earnings translated back into dollars will be lower, but unless the multiplier, it looks like unless the multiplier exacerbates that via bonds.

But via bond yields going higher, it doesn't seem to be enough just now to make the broader indices like SPX go down. So that is the situation in a nutshell, but the data last week again was warm ish, I wouldn't say it was very hot, but the bond market seems to be taking it in its stride. And that probably has something to do with Besant being the new Treasury Secretary and some hopes that he's going to be the adult in the room of the Trump administration and stop his more inflationary tendencies.

Anything that you have to say about that to Andy?

Andy: Yeah, I think that at the high level the most important thing is not the secretary of the treasury, but the path of the administration and the path of the administration is going to be some sort of balance of doge waste reduction doge and administration deregulation aggressive deregulation tax cuts immigration changes and tariffs, and that's going to have some sort of balance.

And by and large, it's deficit increasing, inflation increasing, and growth decreasing, and nothing's changed in that case. But as it relates to Bessant being chosen let's start by, it's probably good for America. The, some of the other choices were that we were still dealing with. Last week included people who were not adults in the room.

So having an adult in the room is a good thing. And that certainly could have supported markets this week to create some certainty. But we have no idea how, what tactics will drive the administration's policies and what. The reaction to those will be for months from now, but they have the bias of a little bit inflationary and a little bit anti growth.

And that's where we're at. And, I look forward to seeing what Besant says now that he has the role. Most of the. Once they're announced, most of the people have gone silent, except for RFK Jr. on some things. So it'll be interesting to see what we get between now and confirmation.

Yeah, absolutely. So what more to say about last week? Anything that struck you apart from the fact that the Dow and the small caps performed and those are really dollar related. I feel financials good. Both are overweight in financials both are Have momentum on their side and the charts in them look very good As I will address later on but otherwise not really all that much I was disappointed.

I was disappointed that equities didn't try harder to To stop people out and come down But that I put down exclusively to the down to the fact that bonds did not You Did not help and it seems to me obvious that the the stock market will only go down once the bond market leads it down.

It just seems that without the leadership of the duration going higher in yield, stocks are just happy to meander about.

Andy: Yeah, that's been the way it's been. Every, the only, this is the first time in we've seen a bunch of equity drawdowns over the course of the last few years since we started two gray beards, they've always been led by bonds and this one will be too.

What's interesting is the divergence this time, bonds have led and equities have not yet followed. So it, I still think being cautious on equities makes a lot of sense and we are at the same time. The, when you look forward, there is a general there are portfolio reshuffling that happened this time of year, and I wouldn't be surprised at all if the portfolio reshuffling is that we are going to position for play out over the course of the next few months.

What do you think about next week, Nick?

Of course, it's we really have only three sessions. We have a lot of bond issuance, twos, fives, and sevens, so all the pressure is going to be at the short end. And I just can't get long of bonds at all. The short end because we still don't have positive carry.

We do have positive carry in what we own, which is SLQD, which is roughly a four year duration. With positive carry and I don't see any reason to change that allocation I can't get bullish of duration as yet Certainly not before I am told what best is going to do Certainly not because before I am told what the fed is going to do And I still firmly believe that the fed is going to be on hold in december Simply because the data next week which is the PCE and the minutes are probably going to show that the Fed can't really cut in December and is on hold until earliest January.

I don't see any other data. We have weekly claims. We, which again show no slowdown in the employment picture. And we have quarter three GDP, which is It's not going to lead it's basically a, something that happened in the past, and we know that GDP was pretty strong, so I can't see many changes there.

So in terms of changing our macro view, the data next week is very unlikely to change it, isn't it Andy?

Andy: Yeah, I agree. Thanksgiving is always let's say Thanksgiving week always squeezes a bunch of stuff into the three days before then there's the holiday. And then there's a half session on Friday, which is, by the way, there have been some crazy moves on that Friday.

So anything can happen. We're not predicting anything. Friday because I've seen some crazy moves in both directions. So hopefully everyone has a good Thanksgiving. And I'm sure we'll talk to you on Sunday after, but next week seems to be chop. The real question that I'm struggling with is this is we're set up for a continued dollar strength.

For many reasons. The administration's tariff policy is bullish dollar. The Fed not cutting is bullish dollar. The But then the question is against what? And certainly Europe is now pricing in 50 basis points of cuts as a possibility for the next ECB meeting. The data is atrocious continues to, has been and continues to be atrocious.

There's nothing good going on in Any of the other major currencies, and they all are subject to tariffs potential. So when you look at the dollar, the bull case for the dollar is clear. And if the bull case for the dollar is continues That has implications for equity constituents, which equities do well in such circumstances and it favors people who make stuff in the U.

S. and sell it elsewhere, or people who make stuff in the U. S. and sell it here and financials. Make stuff in the U. S. and sell it here. That's, and those things have been underperformers. I think of this as a January effect happening in December, more so than the classic Santa Claus rally where everything rallies.

I think it's going to be one of those things where you're going to have to pick your spots and it has a lot to do with the dollar. Yes,

absolutely. So if in the next few weeks the dollar goes down to parity, the only things really that can benefit in the US are going to be as you mentioned the financials and to some extent the the small caps.

Because the small caps, they sell stuff in the US that by definition not international enough. And also it's overweight in financials. And energy. They have some energy component. They have some some financial components. So those are the sectors that should outperform, should the dollar remain strong over the course of the next few weeks.

The stuff that won't do well are the Googles, are the Apples, are the the NVIDIAs even because their earnings translated into dollars will weaken. So those, the tech sector should really perform worse over the course of the next few weeks.

Andy: And so the question is, why dollar strength? Dollar strength, as I said, all the various policies, But it also is the other side of the pair weakness And so to get dollar further dollar strength one needs to continue to see further european in particular weakness and so that's an that'll be a very interesting development because A strong dollar is good for is what is has its implications if it's caused by strong dollar policy A weak a strong dollar caused by weak other currencies has different implication And so on this path, we'll give you the we'll hopefully help you navigate that but for now U.

S. bonds supported by weak European bonds supported by weak European data is not a reason to buy bonds in the U. S.

No, absolutely agree with you. Okay. I think we've discussed everything that's likely to happen in a holiday shortened session next week. And we'll be with you on next weekend. All we can do is wish you a very happy Thanksgiving with your families.

Andy: Indeed. Happy Thanksgiving.

Bye-Bye.