2 Gray Beards Week 107

Nick: Hello, today is January the 18th. Hello, and welcome to another episode of two gray beards. So Andy, we had an interesting week last week, CPI and PPI came in slightly weaker than the ramped up expectations that we saw towards the end of last week that several houses made. So at the end of the day, PC is going to come in.

Almost unchanged relative to the previous months, and therefore the market breathed a sigh of relief. The Fed doesn't need to be any tighter than they have been so far. What did you make of what the Fed did? Numbers where is the U. S. Economy weakening at all in your view?

Andy: Yeah, no, I think the data was supportive of the same thing that we've been saying for a long time, which is that the U. S. Economy is strong and that there is no sign of weakening in the overall economy. While, of course, there's always weakening individual sectors of the economy in aggregate. The data is all at the macro level is all strong. And. Conditions still remain fairly accommodative to future growth of the United States economy and inflation that stays above target away from the data.

I took the information that we got this week as being more about people and, in particular, we saw three meaningful voices in the the financial markets speak. We had the testimony of the Secretary of Treasury appointment Scott Besant, we had a influential dove on the central bank.

Chris Waller speak, and we had a person who was, was considered for secretary of treasury was on the short list for that. And certainly is In the conversation for Powell's job speak in an op ed in the Wall Street Journal, Kevin Warsh, and, you know, I took more from those three speakers than anything and What did you think?

You know, Besson spoke on the Hill for his confirmation hearing. I didn't get much from that.

Nick: I got nothing at all from Scott Besson. It was more of a coronation than anything else. The questions were very much softball. And you know, that, that he didn't mention any of his intentions of what he was going to do while in the job.

So that remains to be seen. Waller as usual was dovish, but he did qualify his statements. He basically said that he can see a path towards cutting three or four times this year, i. e. another 1 percent towards his mythical. Star that he sees at around 3. 5 percent or, you know, thereabouts, but he qualified that very, very heavily with if data allows.

Well, that to me is a tautology. If data allows, of course, they should cut, but we haven't seen a single piece of data that suggests that he is right. If the data develops in that direction, I am sure that the bond market will love it and therefore will rally a lot, but we are seeing absolutely no signs of it.

And until we see those signs as investors, we really shouldn't chase the market just because someone says that if data changes, he will change policy. That, to me, is a tautology.

Andy: And Kevin Warsh who is oddly claiming he would do a better job as suc as Fed Chair basically said that the cuts all the cuts have been a mistake, and that they should aggressively reduce their balance sheet and suck Both add duration to the market and suck reserves from the banking system.

I don't see how that really is going to get him the job unless inflation kicks back up and Trump. Feels like you know, completely changes his tune in terms of rate cuts. So I don't think that's interesting, but he did make those statements. Coming back to Besson, there were two little things that I noticed.

Well, one big thing tax cuts are coming. Well, let me rephrase, rephrase that the t. C. J. A. Cuts in 2017 are being maintained. There is that, you know I thought that Warnock, Senator Warnock led him down an interesting path where he said, you know, do you think tax cuts for people who make over 400, 000 should happen?

And he said, yes. And then Warnock moved him up to a million and he said, yes. And then Warnock moved him up to a billion and he said, yes. He was just not playing ball. He wants the tax cuts for the rich and for corporations to stay in place and made a. By the way, a totally reasonable point that if the tax cuts were allowed to lapse, which is really the only option, it's not like new tax cuts.

These are just existing tax cuts that stay in place, but that has to be voted on or else they sunset, they fall off. The fiscal cliff associated with The government all of a sudden, and the budget deficit reduction, by the way, but the fiscal cliff of massive tax inflows that would have to be paid from the private sector to the real, from the real from the private sector to the government would be A massive anti growth pulse.

So when I, and that was the dominant theme for everything tariffs really didn't get discussed much though they were mentioned. And, you know, we'll see what the tariff policy is. But those are really the areas that were mentioned. Nothing about the debt, the debt ceiling, the debt limit, except to say it obviously has to be raised and nothing about Terming out the debt.

What the one little thing, which really confused me and I'll be interested to see how it develops is he was asked about in the context of the the, social entitlement, Social Security, Medicare, et cetera, Medicaid, Medicare, et cetera, et cetera. Whether a sovereign wealth fund would be a good idea for the country in which they inve in which the country, the government, invests in assets, presumably stocks, but maybe crypto, maybe something else.

Now they'd have to fund it with issuing debt and or printing currency. So that has a different thing But that wasn't didn't get the constant the negatives didn't get brought up Besson said he was excited about discussing that idea which blew me away to be honest because it's just awful policy But that's one that I thought was interesting

Nick: Again, these are all things that we know nothing about at the moment.

Let's wait and see and judge the consequences when something gets announced. You know, we, there's very little that we can do to anticipate the complete unknown, I think on Monday, you are likely to get a whole load of executive orders from Trump. And we have absolutely no idea how many there will be, what they will address, what he will address first, and what can we do until we have seen it and we have decided what the economic effect will be.

We've been saying for quite some time that we would like to see the market reach a certain level of real rates. very much. At which point we would know what we want to do i. e. invest much more heavily in bonds. We are not there and all we can do is see what the result of the announced policies might be.

Before he announces the policies, I feel very uncomfortable with changing any of our allocations because that would be just guessing and we shouldn't be. Be doing that what policy has he announced that would be really beneficial for the bond market? I don't see any that he has announced where where he wants to aggressively cut the budget deficit I think the bond market cares most about the size of the budget deficit And how it's going to be managed now that's going to be best job and somebody who is Might say that he, he actually got Besson into the job simply because he doesn't intend on cutting the budget deficit and thinks that a market professional who's respected by the bond market might be able to manage the bond market disappointment better than anyone else.

Maybe, but the bond market will be disappointed if all he talks about is cuts, tax cuts and nothing to balance that increase in the budget deficit with decreases elsewhere. I don't know how you feel, but I certainly haven't heard anything from Trump and don't expect anything on Monday that he's going to.

Decrease the budget deficit or slow down growth? You know Do you see anything or do you expect anything?

Andy: Well, I guess that to put simply I see really for policy Issues. One is spending and taxes, which is the direct change in laws that reallocate the spending and increase and decrease it. I don't know.

It sounds like they want to cut spending while also cutting taxes. Hard to do. I mean, you can do that, but you won't have any impact on what matters, which is the budget deficit. Who knows? We'll see. I agree. We should wait and see. Tariffs are anti growth. It create, they create frictions that reduce trade which reduces growth.

The big thing I think is for particularly for the financial sector, the energy sector, but not for the health care sector, given Kennedy's position is deregulation. Banks have been on a tear ever since the deregulation was ever since the election and energy has been as well.

So, you know, that's a sort of sector level thing. That's not something we get into much here, but it is. Worthy of recognizing that deregulation is short term, very, very positive for growth and disinflationary. And then I guess the last thing is immigration, which that's anti growth. So we'll see how aggressive he does and what expectations are already.

I think. I want to just step back and say one very important thing that is worth paying attention to. All the other stuff is going to be hard to implement and take time to have effect. Everything that we hear on Monday and then the day soon the days that to come have a very good chance of not happening and being noise.

However, one thing that absolutely must happen Is that the, the dominant thing that will either make or break the next 100 days is the debt ceiling this government, which is now instituting extraordinary measures to be able to continue to fund the government and then we'll have to spend its savings account over the next 6 months has to raise its debt ceiling and the drama of that is Around that will create market volatility.

I expect, and this is a guess, but given that the, this is an infighting between Republicans and Republicans, all, all of whom are in control and can be resolved entirely without any, not a, not a wit of democratic support. I expect that to be his highest priority, whether he's, whether he says it on the, during the inauguration or soon after, or whether he makes any sort of executive order is irrelevant, but that will be the big deal for markets in the near term.

And so that's the thing I'm paying attention to most, and I expect it to be resolved relatively quickly. And that's not bullish bonds.

Nick: Absolutely. I agree with you. So apart from the unknown, which is what Trump will do in terms of executive orders on Monday or Tuesday or Wednesday, it hardly matters.

We've got a very light. Week of data next week Just more unemployment claims and more pmis And very little issuance as well. Just a 20 year auction and a 10 year tips So we're not going to get much information about the real economy or Have much pressure in the bond market from the auctions All we can do is wait and see what he will do and then decide whether we can afford to wait to see real rates back up to the levels that we've been discussing, i.

e. new highs above 255 percent, some around the 275 area, which we think will be enough to slow down this economy. All we have to chase, but we won't know until we see what the policies announced are. Anything else that you'd like to add there, Andy?

Andy: Nothing more about the, the week ahead the Fed is in blackout.

We're going to start, we're going to get, receive more earnings, which are undoubtedly going to be good. And it'll be about the outlook. And then the following week is a Big, big week FOMC, lots of earnings and leading into the QRA the following week. So this might be a week of a pause, but we're going to get a lot coming the following week.

Great. I'll run through the portfolio and I'll speak to you next week. All right. Have a good day,

Nick: Nick. Bye.