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Nick: Hello, good morning. Today is the 1st of February, and we've got a lot to unpack and go through because a lot of is happening in the markets, but let's just very, very quickly run through what happened last week. The FOMC did as expected and didn't do anything. Powell managed to be much more dovish than the FOMC statement and he did mention owner equivalent rents and that they were going down and therefore he expected that that would lead inflation lower in the medium term.

He is convinced that we will get to 2 percent medium term inflation and that he doesn't need to do anything because policy is already restrictive. And if he did anything, it will be a question of when to cut rather than raising rates at all. So they continue in the same vein. They're convinced that Current policy is restrictive.

We're not so sure, but we'll give him the benefit of the doubt. After that, we had what big tech earnings. Andy, would you agree that they were slightly better than expected, but within the normal range of outperformance, which they always try to achieve. So no really big news there. The ECB cut by 25 basis point as expected, and they were as dovish as expected.

But in any case, their data continues to miss on the downside in both inflation and growth. Germany. Is stagnating 0 percent growth, 0 percent growth really for the whole of the EU or within such a small margin that it really doesn't matter, it's a rounding error, whether it's 0. 10, minus 0. 1, we won't get into it, but basically there is 0 growth.

Real growth in the EU, and therefore they should remain dovish and continue easing over the course of this year. What I thought was significant was that Lagarde had zero doubt that they will achieve their 2 percent inflation medium term target, and she restated that several times. Very little to Add that the big news, of course, was on Friday, late on Friday, and that was Trump coming out with a weird statement that there was nothing at all that Mexico and Canada could do.

But because of fentanyl, whatever that means, he is going to impose 25 percent tariffs. On both Mexico and Canada as of today. Now we're recording this quite early on, so we haven't seen the announcement and therefore we have to say that things could change once the announcement comes out, but we will let you know in in an update.

He also mentioned that tariffs were on the table for the EU and that he was going to also add a 10 percent across the board tariff on China. So now we have, what we have to do is discuss what effects tariffs have and the Do you want to kick us off?

Andy: Sure. I guess I'd step back and say one thing on the FOMC.

I'm probably I think it's notable that Powell, who is always dovish and so is never going to come out as a super Hawk did aggressively, in my view, say we can, we can be patient. We can keep rates where they are essentially. And I think essentially was trying to take cut off the table for March.

Anyway, the bigger point is he does have confidence in inflation coming in. Now, tariffs. Tariffs start by being disruptive, potentially, depending on the size and where they're implemented. And we don't know, but they look, based on the news that the announcements from the president and the relatively confident announcements about what he was going to do, that they're going to be disruptive tariffs and that'll create a.

New equilibrium in prices where there'll be a one off increase in the prices of things that are tariffed that will be offset partly by changes in the currencies, which to be clear, have already happened a bit but they might happen more. And so there's going to be a one off inflationary, sort of like what the supply shocks that we've seen in the, in years past, including COVID, when all of a sudden goods were more expensive because there were Because of a change in the dynamic of supply, but that won't persist.

What will happen is the price level will jump and then stay. And that is, and further inflation will happen based on certain outcomes, in particular, retaliation. But that itself will only be a one off. So on the other hand there's a growth impact and the growth impact is that everything becomes more expensive for consumers.

Some of our producers benefit because all of a sudden they get to sell stuff that they, that they couldn't compete with in the past, but in aggregate, there's a one off anti growth shock to. Tariffs. So the bigger point is that that process of going from where we were before the election to what's been reflected in rhetoric and pricing already, and then subsequent to the actual implementation, which is what we're in the midst of right now, today maybe

Price shocks and growth shocks can be disruptive and cause further inflation and further weakening of growth. And so that's what's at play here. And so when you look at the future what we'll get is a lot of backward looking data and that backward looking data, which we think will continue to be strong in the near term.

This is our view on the economy remains that the economy has been strong and is likely the data is likely to show that it'll show. Any data in which the growth is strong is likely to be ignored by markets because they know what's coming. And so any data that shows growth weakening will be more influential.

And similarly with inflation, any data that shows inflation falling will likely be ignored because we know inflation data is going to warm up because of the tariffs. So that's the perspective I think we can all operate under. Unless, of course, Trump completely changes his mind and doesn't implement any of the things he's promised to implement.

And that would be, of course, a radical departure from where we are today. But I think what's notable is equity prices are what, 1 percent off all time highs. The anti growth of the, and disruption and volatility associated with this tariff is not reflected fully yet in equity prices if Trump goes through with what he was talking about on Friday.

Nick: He is likely to go through with it because I can't imagine that he announces something on Friday and completely changes his mind on Saturday. That would be not serious. And in any case, I think that it's quite likely that he wishes to disrupt trade, that he wants to change the current balance of things.

And if he does really want to do that going through with tariffs is a very, very powerful signal. To everyone politically and also to the markets what he also said in on friday was that He wouldn't really mind if asset prices were hit in the short term because this is his long term game so I think we have very little to look forward to.

In the very short term, I think asset prices are more likely to continue to get hit than not, and therefore a beta portfolio really isn't really going to perform all that well in the very short term because the president doesn't care. The FOMC isn't going to cut rates until they see the, the weakening of the data.

So what do you get in the meantime? In the meantime, you probably get a steepening of the yield curve. Naturally, it'll depend on the QRA and we have to talk about the QRA as well. But one topic at the time, because this is a really big one about tariffs, you'll get a higher dollar and that is deflationary.

So it'll help keep bond prices neutral, although I do think the yield curve steepens slightly, and then you have the impact on growth that I don't think the equity market is reflecting at the moment. We all know that earnings are very good and multiples are very high. Now what happens if earnings actually start going down because the tariffs are actually compensated by people.

By companies accepting lower profit margins That is a possibility. I wouldn't say it's a great probability But it's certainly a possibility and therefore, I think the equity market is particularly vulnerable at this valuation because it's very hard to see the bond market helping via an expansion of multiples.

So all the dangers at the moment in the, in this, in the equity market seem to be on the downside. Now, that would really be compounded. If we got something from the QRA as well, wouldn't it Andy?

Andy: Yeah. And before we leave that, before we leave tariffs, it is so important. I just want to reiterate, there's a lot of drama, particularly in the financial markets.

On the day to day machinations of the Trump administration and him as the megaphone for what he wants to do. I think it's critical to put the tariff discussion in perspective. The goal of this administration is to change the entire complexion international trade with the United States and the international relationships that the United States has.

And the tactics, the timing, all of that is pretty irrelevant relative to that goal. And in order to achieve that, There will be disruption. And so maybe that's happening now. And maybe if I were in the Trump, in the Trump administration, I would accept disruption now and move and in big ways, because I can just blame the prior administration.

And that brings us to the QRA and the QRA, the quarterly refunding announcement happens every quarter and it tells us how much issuance the. Treasury is going to do in the following quarter. The current quarter, quarter one, is mostly set in stone. They'll announce quarter two. And

they'll also tell us the composition of that issuance. And this is where there's been high level, the senior most people in the administration. Steve Maron, who is a friend of ours and who we know through Twitter, is the Chairman of the Council of Economic Advisors, which is the most powerful non agency cabinet member?

Cabinet member, I think? And the Secretary of the Treasury, Scott Besant, have both. Aggressively described the Yellen administration's management of the debt issuance process as being inappropriate, stimulative, political, and the reason why is over since quantitative tightening began the total issuance of the debt issuance.

Treasury bills new bills that have been issued over that time. New net bills, not the general auctions of bills. The new net versus new coupons has run at 50%. And that has muted. Quantitative tightening and muted the law and suppressed long and bond deals because they simply haven't issued much.

And this, these aren't my words. These are literally the policy makers words. Certain senators, Senator Kennedy and Senator Hagerty, have both pushed both Secretary Yellen and Chairman Powell about this issue. It is centerpiece issue for criticism of the prior administration. At this QRA, we're going to be told something market expectations are that this quarterly refunding given it's the 1st, 1 for the new administration that what's likely to happen is that the administration will walk into the meeting and be a fly on the wall for the.

Career politicians, sorry, the career civil servants that run the treasury to manage the meeting with the treasury borrowing advisory committee, which is a bunch of sell side and buy side and hedge fund participants, and they'll just be a fly on the wall and watch what happens in terms of deciding where.

New issuance happens and that's what's expected by the market. The alternative is that they take a more activist role and say, our agenda to the T back before we get to what they say to the public, say to the T back. Our agenda is to get back things back to normal, to get the financing, to rely less on volatile.

interest rates of short term bills and frequent auctions of a significant portion of the national debt. Two longer term bonds that are stable. If they were to say that, the way they would do that is increase the coupon auction sizes. They may be a fly on the wall or they may engage the TBAC in that discussion.

And then the question is, what do they do? And we'll know that on Wednesday morning at 8. 30 and be sure to tell you exactly what happens. They could increase the size of the auctions for, for Q2 of coupons, or they could say they intend to increase the size of the auctions in a relatively soon quarter.

What they, what the current language has been for months, for many quarters now, is that they do not that the treasury does not expect to increase coupon sizes for a number of quarters Now that's been the language and it's been the yellen administration language The yellen administration may or may not have had a political goal by not increasing auction sizes during the election That's in the rearview mirror.

Now the election's over strong Criticism has been leveled by the people that are deciding the issue. And so what we'll be looking for is very simple. Will there be forward guidance about increasing auction sizes or. Actually increasing the auction sizes and the, and that is not expected. The fly on the wall is what is expected with no changes.

What do you think would happen if they increase the auction sizes for the quarter Q2 or indicated that they, their objective is the thing I've described, which is that they want to increase the they want to stop relying on bills. It would be

Nick: fairly dramatic. Let's not forget that the rally in all assets really started in November of 2023 when they changed the QRA.

Yellen came out and basically said, Very little coupons or bills. And that is when the, we got it right. And we told you buy all assets now, if they were to compound the growth scare, that is likely from the tariffs with. a QRA which is hawkish because it returns to issuing more coupons, you are going to have a real meltdown in the stock market.

And I would say a correction of between 5 and 10 percent is likely. Even if we have, if we have a look at how much the stock market has gained since November of 2023. I would expect a retracement of something like a third, and that is at least 10%. The yield curve in the bond market would definitely steepen and steepen at least 25, 30, 35 basis points very, very quickly.

And that is a double kick in the teeth for, for the equity market. So I don't think there's any doubt that a QRA as you've described, where they up the size Even modestly of coupons is going to have a, an effect on both the bond markets in steepening the yield curve quite considerably and an impact on equity markets where they will go down at least at least five to 10 percent in my judgment.

Andy: Yeah, I agree. So the question that, that we're asking ourselves is what, what it appears on tariffs to me is that Trump is willing to disrupt. To get his end goal. And so the question is for me is whether the administration as an entirely wants to be disruptive. So as it applies to the treasury, for them to be disruptive, to return things to the way they should be, they would start increasing coupons or at least signal that they intend to at this QRA If at the same time, I'm sure you're seeing Elon Musk talk about the need to reduce spending by 4 trillion a day so that they can achieve a 1 trillion dollar net reduction in the deficit.

Now, to be clear, that's impossible. Can't do, but even if it were a third of that, a 300 billion reduction in spending would directly impact the GDP by 1%. You've got three fairly disruptive, now, you can, your politics or whatever they are, these, the, changing the trade to the, with the United States and the relationship, big deal, reducing the deficit, big deal.

Getting our finances back and toward normal are all a big deal. Do you stagger the issuance of all these things and disrupt for less, but for longer? Or do you kitchen sink? And I don't know what they'll do. I guess the caution might say, Let's spread these things out over time. But they're all coming.

And so the question If I were in their shoes, I'd disrupt. I'd do all the things at once, because if you do all the things at once, then you cause a bottom. And you blame the prior administration and you save the country on the, by the time the elections come around. If you stagger them and you have to do them all.

You either end up not doing something, which is a going back on one of your promises, or you extend the weakness in markets and don't have that cathartic bottom. So I don't know what they're going to do. The. Bottom line is we don't know and we will just tell you when they do. And on Wednesday at 8. 30, the second thing, which is this QRA, will be known and the expectation is they are going to be a fly on the wall and not be disruptive.

So we'll be paying attention if they're disruptive.

Nick: In any case, this is not the place to start adding to risk. If anything, it's still a place to reduce your risk. And that should be your takeaway, because these disruptions are coming. And as Andy said, either they're going to come all at once, in which case you're going to have an almighty whoosh down in equity prices.

And that is the time to then deploy the cash. Or they're going to do it over time, which basically means that equity prices are not going to appreciate for a significant period of time. The indices are just going to go sideways with 2, percent falls and then, It's just going to be a range trade, but these levels are still probably too high.

So risk reward is don't get long of equities here, if anything, lighten up, but I will go through our portfolio and give you a detailed look at what we want to do. Have a good day. Thank you. Have a wonderful week and we will contact you very soon. Bye.