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Nick: Hello, ladies and gentlemen. Today is the 15th of February. We had a semi exciting week last week, didn't we, Andy? We had CPI, which was much stronger than expected, and the market certainly didn't like it. But then on what was it on Wednesday, we had PPI, which was actually in its components. Weaker, and therefore the PCE is going to remain very roughly unchanged.

People are actually looking for it to be slightly lower than the month before. But in any case, it's something that the Fed is not going to be terribly excited about. And therefore, the market's all recovered. What do you think is a standout for last week?

Andy: Yeah, I think the thing that I'm focused on is as Our view is that the economy is strong, that inflation is sticky, that the Fed is on pause, and that as yet, we haven't seen anything that would indicate a slowdown, despite a fair amount of investment.

Of policy uncertainty, which may or may not lead to a slowdown including expenditure cuts, including tariffs, including immigration policies and offset by by deregulation and we saw some deregulation last week comments by Powell at his Senate and House testimony, indicating that the SLR, the supplementary leverage ratio, which Would be looked at and addressed so that banks could hold additional U.

S. treasuries was news in my view though it was, to me, somewhat inevitable. And then it's, so that, that's our view, which is Supportive of assets, supportive of equity, supportive of basically things staying around here, but at the same time retail sales was pretty weak and it's possible that was the first of data that could start looking at a turn changing our view, my view, for instance, has changed toward a forthcoming slow, relatively small slowdown in the economy based on the policy implications of.

That I just mentioned, but for now, our view remains that there is no slowdown in sight. So it'll depend on the actual implementation of the policies and then how that will show up in data. And then, of course, it'll depend on whether the Fed actually sees the same thing and wants to ease. And so next week.

You're not going to get much information on that. So what do you think about next week? Well, let's talk about asset markets. What happened is bond markets rallied led by really across the curve. Two year yields fell to four 25 ish and priced in cuts of for the next 18 months or so fell by 15 basis points, so there's more cuts expected, but still not many.

Equity prices led, interestingly enough, by significant strength in global markets. Rallied to what is essentially all time highs in most indices. Still remain, in the U. S. at least, very fully priced. What do you think happens next week, Nick?

Nick: Yeah, it's going to be a slow week. I, one has to look back at really what is happening at the moment.

You're getting a a bond market which might be pricing in that there are some further cuts to come, but certainly they're not going to be quick and they're not certain. So the bond market is in a period of stability whereby Everything around from twos to fives is on top of general collateral So if you buy it now, you have to get a fairly speedy cut from the fed To make for it to make sense to own them because you're losing money on a funding basis day to day And that is slowly pushing up people up the duration curve Because that is the only way they can get some positive carry.

So 10s and 30s at the moment are Don't give you a huge cushion against Fed funds, but at least they give you some positive carry and that is why people are buying them. Also, Doge is doing its work. It looks like 250, 000 government employees will be let go. Over the course of the next few months, they will naturally get a very nice severance package of around eight, nine months, and therefore that shouldn't be a real problem for them.

The fact that retail sales were as weak as they were could mean that they are starting to cut back on expenditure. But I think it's too early to absolutely say that is what's happening. And therefore, it's very difficult to say that equities should start going down immediately. But our longer term view is still that it's likely that equities are fully priced.

And if we start getting a slowdown on top of that, then equity prices should actually come down. And there should be a little bit of a risk off move. Whereby people buy duration in bonds because it's got positive carry and they start discounting a little bit of a slowdown of growth not a recession, but a slowdown in growth And therefore possibly a slightly lower environment for equities Are we going to get any data next week with changes or confirms anything that we've been saying?

No, a very light data week. We. We, we keep on getting weekly claims being absolutely in line with expectations and therefore employment is not moving, not yet. And what else do we have? We have a holiday on Monday. We have the FOMC minutes, which we already know what they're going to contain because basically Powell was on the Hill and last week.

Said the same thing as in the presser. So it would be a real shock if the FOMC minutes contained anything, but we already know. And then apart from that, we only have some housing starts and we have some global PMIs, which are really not going to move the needle as it's all secondary data. Very little bond issues as well, just some 30 year.

Tips and some twenties. So, nothing that's going to upset either the bond market or the stock market. But what we do have next Friday is expiry, option expiry. And that's always good for some excitement. But nothing that really is going to change our idea of allocations and what the right allocation is.

We added some VWOB last week. Simply because we both feel that if the Fed is stuck for the next several months, while it examines the inflation data, because don't forget the CPI on Tuesday was a bit of a shock for the Fed as well, certainly should have been a bit of a shock for Waller, who thinks that conditions are tight, they might not be as tight as the Fed thought, in which case the Fed is just going to hang around For longer.

I, it's not going to be one meeting. It might not be two meetings. It might be three meetings. It might be four meetings. And if that is the case, why collect 450 on a 10 year note when you can collect 7 percent on VWB. And that is our thinking at the moment. My own thinking is that if I had nothing on, no positions, I really wouldn't know what to do that is better than collecting 7 percent right now.

That will change. The data will change and confirm our view or deny our view, in which case we probably need to ramp up our equity holdings. But for the time being, I really can't see anything that's better than collecting a 7 percent coupon. And sitting around and waiting for developments, what do you think?

Andy?

Andy: Yeah, so we have a equity allocation that is hedged through friday. We'll address that by friday. If something requires doing the equity allocation is full in my view, given pricing. But at the same time, we'll see where we're at. When the hedge expires and you know that the 10 year note that vwab is going to be the same duration Again, is it attractive?

It's not it's rallied. It's not as attractive as it was before the Cpi number well after the cpi number or and it's certainly not the highest yields, but it's also Dealing with a Fed that is as on pause as we've seen in a long time, you can bet on a couple of months of a couple of meetings of no change and a economic climate that is, likely to change, but there's no clear direction yet.

And so that's where you want to what I like to call pick up theta collect yield. And one way of doing that is to buy higher yielding bonds. Which have limited price change in our outlook, but excess yield other ways would be to be selling options but options premiums have come in quite a bit in both equities, but really in bonds.

Which makes sense because there's nothing going to be happening in bonds in the near term. And so, yeah, I'm all for collecting yield. The only question for me is whether we should buy more.

Nick: Yeah. Again, I think we both feel, and correct me if I'm wrong, that the odds of the bond market doing significantly better in the short term without data confirming a major slowdown are probably not that great.

I think that the odds of a bull steepening such that. You get a rather a bull flattening. So you get 10 years below general collateral are really not all that great in the U. S. Right. So if that is the case, we are what 20 basis points or even less than 20 basis points from that level. So, where's VWOB going to go?

Is it going to go another 10, 15 basis points on the upside? Well, on the other hand, we might get some strong data, which knocks it back. And I would definitely look to add on the knockback, but I certainly wouldn't chase it here. Not a lot of sense.

Andy: I agree. And given our equity allocation, I think we're fine if equities rally next week.

And we'll just address whether we want to hedge some of that by the end of the week.

Nick: Yeah, I think that's about it. There's, it's steady as she goes and our ship is sailing nicely. And when he does you just add a little bit from from cash when the opportunity arises as it did last week But otherwise you leave things alone and you just

Andy: Sail on.

Yeah, let me just make one final comment. The one thing that I think is pressing Is the budget deficit and there was some significant announcements regarding what the budget deficit would be the big key thing, the major platform priority is to extend the tax cuts for individuals and for corporations called the T.

C. J. A. And that was in the budget proposal, but at the same time, it requires a 4 trillion increase in the debt ceiling. And so. How that goes could have an implication to the market. We'll pay attention to that, but passing that budget is a big priority and will lift some uncertainty from the market when it, when and if it happens, but that may linger through a March when you actually have a threat that the government would close down or whatever.

Potentially all the way to August where the Budget where we literally run out of money, so it's going to be an ongoing thing But there was news this week last week about that in that there is a budget being floated And so we'll keep you up on that as that plays out, but it could be a lingering Overhang

Nick: great.

I'll go through the Portfolio and we'll see you next

Andy: week. Have

Nick: a good week