

## 2 Gray Beards Week 114

**Nick:** Hello, and today is the 8th of March. What an interesting week we had, Andy, right? Just about everything moved. What are your first impressions? And then I'll give you mine.

**Andy:** Yeah, I think I really am very interested to hear about your outlook for global defense spending as In particular, your expertise in German buns, et cetera, but I think what you saw is an extension of what we've been saying, which is we're in the midst of a growth slowdown that for now, people are uncertain whether it's simply a growth scare or a actual slowdown.

And. I think the highest level point we have to take away is from the policymakers the ignoring the nonsense around Trump and Lutnick in particular and their and that impact and what tariffs are doing and so on. I think the biggest takeaway that you have to have is that Treasury Secretary Besant has seemed to have successfully convinced the president that and continues to reiterate without correction from the president the idea that we are.

In for a detox period. He used that word. And what that means is that it's a, that Trump administration is trying to reduce the size of the government. And stimulate the private sector both the banks and the private sector companies and for that matter, well, manufacturing companies in particular to build to grow the economy and depend on private sector instead of public sector, but.

And that detox period, which will lead to what the administration believes is healthier growth for all Americans has a sequence. And that sequence starts with a hit to growth as the public sector gets reduced in size. While around the globe, And the most notable and the biggest market action was in Germany this year this week, and it was quite notable is fiscal spending increasing and into a economy into economies that were have been weak including Europe, including China, and.

Even in Japan, where the economy is being, is still has relatively easy fiscal sorry relatively easy monetary policy, though they are hawkish, still relatively easy policy, the economy is performing extremely well, so you have three economies, three major economies outside the U. S. that are being financed.

Thank you. being stimulated fiscally and monetarily or simply monetarily. And that just makes US assets a lot less attractive.

**Nick:** Absolutely. Now, the big news actually this week was from Europe and the Europeans have decided that they can no longer rely on just the defense spending of the US. To safeguard their interests, but they have to re-arm themselves.

And you saw both Britain say, so you saw the EU say so and Germany act. So what what we are getting at the moment is the removal of the debt break in Germany. We are getting the EU creating exceptions. Under their rules for the GDP ratios to debt for defense spending, and therefore we are getting diametrically opposed I wouldn't say policies, but results between the U.

S. And especially Germany, but the EU in general. So the budget deficits are going to increase in in Europe while the aim is for the budget deficits in the U S to decrease, but that's going to take a long time. What is happening at the moment is that the global demand for funding is actually increasing.

And that has. Certain repercussions, especially on German debt. We saw bonds move from the two fifties to the two eighties very quickly. The yield curve steepen very sharply, even though the ECB cut rates. And my high level point now is that it really doesn't matter what the ECB does. Because they're very close to being at neutral in terms of policy, while the the long end is going to keep on going.

It's when these kinds of shocks happen in Germany market rates go a long way. 1994 when they went from 5 to 8 percent, and I would expect much the same thing to start happening now. We were at 250. I think that we are on our way to 350. Now, what does that mean for assets? It means that equities in Europe are going to perform better than bonds.

That's for sure. But how much better I'm they can do from these levels. I am not sure the the market has priced in a hell of a lot now in, in European equities and probably rightly so, but I think that the odds of them being able to go another 10 percent say, while the boom goes from two 80 to three 50.

Are relatively low and much the same actually in the US. We've priced in a Quite a lot in terms of faith in what Besant is doing And we you know, we certainly take notice that his aim is to get the 10 year note down but given the global situation and the fact that overall The demand for funding deficits is going up globally I would have thought that's what is most likely to happen is that the U.

S. rates stay pretty constant and the only thing that's really going to help them is a precipitous drop in CPI. Now we do have CPI next week. But the likelihood that we immediately see this precipitous drop in CPI, that they need to come down and to have lower real rates, I think it's unrealistic that we're going to get it at the moment.

So what I'm saying is that you are likely to have a period in which rates between Germany and the U S converge, they came in. A lot last week, but I think they can come in a hell of a lot more. They can probably end this year in below one percent and that is going to put an enormous pressure on the euro to appreciate. And also the yen to appreciate and the dollar to depreciate. So those are the big macro headwinds that we are facing at the moment.

**Andy:** Yeah, that makes sense to me.

The issue around the U. S. Treasury market, the way I look at it is and we got, once again, we got reaffirmation by Chris Waller who was interviewed by Nick Temeros. And, he basically 100 percent removed March from the table. The Powell spoke on Friday and he couldn't be more clear.

He basically, I'm paraphrasing. He basically said, why do we need to do anything? And so the answer to that is they don't need to do anything until things really turn. They've done a hundred basis points and they're on pause. And so we're going to get information, obviously the data, and then we're going to get information around the SCP in March, which is what now, two weeks, two and a half weeks from now, and so the path is for possibly slow rate cuts in the next few in the next 18 months with a slow rate. A coin flip on whether it happens or not and priced that way. And I think that's the important part. Expectations are now for a very shallow cutting cycle in the U.

S. A very shallow cutting cycle in Europe and likely not so much of a hiking cycle, but possibly a hiking cycle in continuing in Japan. And so. That doesn't leave much opportunity, but it also doesn't leave much risk for keeping your money in your long bond money in relatively short duration stuff, which is where we've been for a while in the short end of the yield curve.

I don't see a reason why that pause would be. Great for bonds. Obviously, if we get some, we've gotten some fairly negative signs of weakness in the survey data, and we've gotten no sign of. Inflation coming in but if actual data starts coming in cool and the CPI starts coming in cool, obviously the long ends going to rally, but how much it's there's just not much left, given the what we've just described, which is a global increase in.

Supply of treasuries and boons, et cetera, to finance a growing budget deficit for the world in that world, bonds just don't look that interesting to me.

**Nick:** Yes, no, I completely agree

**Andy:** extending duration. Doesn't look that interesting.

**Nick:** I was racking my brain for reasons to extend duration here.

I don't think that we are going to get anything but a. Relatively flat yield curve at best and a steeper yield curve at worse. So extending duration here makes no sense to me. We saw last week with all the weakness in the equity market that you would have thought would cause a bond bid that the long end just could not rally at all.

And in fact, we finished the week Lower than we started it

**Andy:** same with the rest of the curve, frankly,

**Nick:** right? So we've done absolutely nothing. And I think that is the way of things to come. If you can buy things, which yield more, i. e. VWOB countries that are not increasing their budget deficit and have a widespread to US Treasuries.

So that to me makes sense, but unfortunately VWB has quite a bit of duration, but otherwise staying in instruments, which yield more than us treasuries, which we believe are going to remain stable. Over the course of the next couple of months. And in fact, the only reason why I would think that us bonds can really rally is if inflation falls precipitously.

I don't think that is high odds. I really don't see that we have. Much of a probability that is going to happen short term Certainly not until all these supply chains That have been threatened by the trump tariffs have sorted themselves out and that is going to take many months So in the short term and we're talking about two three months at least The likelihood of bonds being able to make up for losses in equities is very low What does that mean?

That means that every time that equities rally, I think that we should be a seller of calls. We are in a period of retrenchment, as Besson said, privately and publicly. They're going, they're trying to get the U. S. economy to not rely on the public purse anymore, but to grow itself via Bank borrowing and other factors, but private factors, not a public factor anymore.

That takes time. And while that happens, although it's very bullish longer term, it's actually bearish for all assets. In the short term. That's why I think that the likelihood of equities making new Heinz in the next two or three months is very low, and they're more likely, unfortunately, to probe the downside and stop people out.

That is what they're trying to do. They keep on holding the 200 day moving average. But one day they won't and that's the day that everyone will panic and that's probably close to a bottom But it's going to take time. That's a high level point Do not chase rallies rather sell calls against them for the next several months

**Andy:** right and in particular, global volatility, but in particular u.

s equity volatility is really high in a period of time in which what appeared to be a bottom on Friday to many we all bought some stocks on Friday, covered some shorts in all the things we look at have all stayed high.

**Nick:** Yeah, and quite and that is a sign that the market is nowhere near comfortable yet and that every rip Is a sell and we will be selling calls against our portfolio at any opportunity we get absolutely Great andy speak to you next week.

Yep. See you, nick

