2 Gray Beards Week 115

Nick: Good morning, ladies and gentlemen, another episode of Two Great Beards today on the 15th of March. Time is marching on and we are still in risk off, aren't we, Andy? Not a lot of love for equities at the moment. And what happened last week? Well, we had CPI and PPI and they were more or less as expected in terms of components.

Although the Headline was slightly cold for both, but PC is going to be exactly as expected by the Fed, and therefore the Fed is unlikely to take any solace from the current numbers. Otherwise, the economy continues. Very much as we expect, i. e. this is going to be a slowdown as opposed to any kind of a recession, certainly from the numbers that we have seen so far.

Weekly claims keep on being in line. It looks like all the people who are being fired by the federal government are either finding jobs immediately or they're not yet reporting. That they're unemployed. So, not much change for the economy. Bond auctions went very well as you would expect during a period of risk off, but bonds really on the week did absolutely nothing.

And as we've been saying for a couple of weeks now, if you have a portfolio of 50 50 bonds and equities, whatever you lose in equities is unlikely to be made up by gains in bonds. Bonds have found an equilibrium level and until and unless we find That the current pricing is completely incorrect because we are in a recession and the Fed can move.

Bonds are unlikely to make up the losses in equities and therefore we are at an impasse. What do you think, Andy? What has struck you over the course of the past week?

Andy: Yeah, I'm a little bit more. I took the readings from the components of CPI and PPI a bit more warm than not warm.

Most of the forecasters, there are some extreme forecasters, but most of the. Big forecasters of PCE place it in the 0. 29 to 0. 33 rounded level, which makes it roughly 0. 3%. And you annualize that, and it's 3. 7%. And you using any of the moving averages of three months, six months, even a year, there's no sign of inflation returning to target.

So I think it will but it may take a long time. And the Fed is very much on hold. It's on hold for that reason. It's on hold for no data yet. And admit it admittedly.

All of this data, we'll get retail sales, we'll talk about that, but almost all of this data, certainly the employment data, it's very lagging.

And so they won't know that the the slowdown is that we have forecasted and we continue to forecast turns into a a more severe slowdown looking in their rear view mirror. So. They have no reason to cut. They won't cut in next week. They have a small reason to well, anyway, they have no reason to cut.

We'll talk about what they do in the next segment, but they won't cut and that will keep you up to date. Financial conditions tight ish and likely further the potential for a slowdown, which gives, as Nick said, very little upside for bonds until we actually become, it becomes an actual slowdown. And, not much upside in equities. And I guess the other thing we have to think about is policymakers. And we had some fairly meaningful news on the policy. At the end of the week we got, and since the, this broadcast was, is on Saturday it appears that the continuing resolution has passed, which means that the government will not shut down.

It was scheduled to shut down last night. Midnight. And so, that won't happen. But the budget is still not even close to being resolved. We still have a debt ceiling in place, which will restrict the amount of issuance and that can be done. We have no budget reconciliation and I'm sure you've been listening to past The reconciliation is a very large expenditure cut to finance the TCGA extension, which is the tax cut for corporations that's and wealthy individuals that's already in place.

And so, that is an anti growth policy, but it is yet to pass. And based on what Besson said in a recent interview, it's not likely to pass until the summer. So we're going to be in this uncertainty regarding how much deficit will be cut. Doge applies to 2026 and beyond. So that is yet to be negotiated with Congress, and the Congress is not aligned to the Policy agenda.

So we have a lot of uncertainty on growth while inflation remains sticky. And that's a difficult place for the Fed to be. We, the last thing, we also got a significant amount of news on tariffs back and forth with Canada very consistent threats from the Trump, from Trump's mouth regarding European, Tariffs the so called reciprocal tariffs and active use of the steel and aluminum tariffs.

So there's, again, a lot of policy uncertainty, and that'll have be anti growth and mostly Short term inflationary. And we saw that in some of the very politicized survey data, which showed even Republicans thinking the economy is slowing and inflation is rising while Democrats put out numbers of inflation and And growth expectations that were frankly wild.

And so there's just no need for the Fed to do anything but pause and so they will.

Nick: That could be the first indicator that there is some slowing. And after that we have three central banks, the BOJ, the Fed, and the BOV. So the Bank of England and all three are forecast to do absolutely nothing. What will be interesting is to see what the new dot plots look like. But our guess is that they will look much like the old dot plots.

Right, Andy? Do you foresee much? Difference there.

Andy: Yeah, I'm working on through my dot plot forecast, which I will post sometime this before the FOMC here. But the dot plot in December was fairly hawkish. It showed inflation expectations falling and growth relatively robust, but still coming in a bit and a.

Path of two cuts between now and year end and a terminal rate that was a bit more dovish. The terminal rate stayed low at just above three percent. I don't expect that to change much. I don't expect all of a sudden into a slowdown that the terminal rate is increased. Nor do I expect dovishness, which would be hawkish, or nor do I expect dovishness where all of a sudden three cuts are priced relative to current two cuts in the SCP.

So it's likely the SCP is going to be a nothing burger. On the other hand, There are two other aspects of the FOMC that are going to get a fair amount of attention because of what happened in the minutes last week last meeting, where we were told they Fed is considering how to manage its balance sheet on an ongoing basis in terms of how it What it invests in to when it receives runoff and perhaps more importantly, at least for us from a sentiment standpoint, because when the minutes were announced, we got the last bit.

Gas rally and equity markets on the end or pause of quantitative tightening. And so we're going to pay attention to that language that is, there could be an announcement where QT is put on pause. To deal with the debt ceiling, really, and there could be an announcement regarding future refund reinvestment policy, which would be market moving, but I would expect they'll wait till May for both of those announcements.

Nick: Right. So apart from that, what do we have? We have OPEX and the quarterly expiry next week, and we have a couple of small auctions, 20 year and 10 year tips. So nothing really market moving. What are we saying for the portfolio? What are the implications of everything we've just said? Is it that? Equities in the US are the least likely to rally, certainly compared to their international equivalents.

Andy: Yeah, I think that you look at market pricing, the equity market in the United States has led on the downside and is likely to pause and consolidate before it makes its next move. Is that 150, 200? Is it 2 to 3 percent higher or 2 to 3 percent lower? Probably neither. It's somewhere in the middle.

Is it and it could be anything given the FOMC and how that's all perceived, it's likely to not rally a lot. And so that seems to be the biggest takeaway. It's also not rally likely to. Crater like it has for a month. The bond market to me is very not interesting. It's not interesting regarding the FOMC on the front end because basically the projected SEP is priced already.

And so they're going to have to really surprise to get a big change in the front end. And the long end still has all the factors that for one, it doesn't offer much real yield. It doesn't offer much term premium and it doesn't have a favorable supply and demand unless the budget deficit is significantly cut and we go into a real slowdown.

And so the. The things that to me are aberrations to me are gold, which broke 3, 000 which there's lots of sensible reasons to have gold in the portfolio and for our unlevered long only portfolio, we Advocate having gold in it and have gold in it at a fairly high allocation. There's no real sense for why it's taken off quite the way it has.

So those are the things that I observe. I think there's still more downside risk to European bonds, which should be another factor keeping pressure on us bonds and. We'll see, but those are the things that come to mind. It could be a fairly slow week, and yet, and I think this is where Nickel deal with this in his portfolio updates, and yet, volatility is very high.

Nick: Right. So, what we're basically saying is that If there is a rally in equities, you are likely to get more bang for your buck from international equities because you have a reflationary policy going on in Europe, you certainly have one in China, you have a bit of a Private re leveraging in Japan. So those are all positives in international equities.

It's very interesting to see that emerging markets, EEM, ETF, actually was up on the week and it's the only equity market which was up on the week. All the other markets were shades of down with the U. S. being the worst. So we're basically unwinding the excesses of the past couple of years, certainly since November of 2023, and you're getting a rotation into international equities out of U.

S. equities, which makes perfect sense. And if you're an investor in bonds, you're actually buying U. S. bonds, and you're buying Things like VWOB, which have the extra spread on top of treasuries and you're selling European bonds and you're selling Japanese bonds because of the reflationary policies. So you're getting this dichotomy that it's probably best to be in international equities.

Rather than U. S. and is best to be in U. S. denominated bonds Rather than in international, they're not denominated bonds So that seems to be The situation at the moment gold. I agree with you. It makes no sense to me at 3000 and I will address that we have to change something there But that's about it really I think the highest level point is that Besant has told us that he's concentrated On the 10 year note and that really means that he's not concentrating on the equity market And even trump has told us that really he's not looking at the equity market in the short term So these are all negatives or At least it says that any move higher in U.

S. equities is going to be limited and can be call overwritten. Would you agree with that, Andy?

Andy: Absolutely. It, we could easily rally next week and, every Friday, the last three Fridays in a row, we've had a late day or mid starting midday, but often by the, in the last half hour, 45 minutes, we've had a hundred point rally in the S& P to.

but ended lower for the week. And so that pattern wouldn't surprise me at all. Great. I'll do my bit and I'll speak to you next week. Sounds good.