2 Gray Beards Week 116

Nick: Good morning. Hello, and today is the 22nd of March. So last week we had the Fed and let's discuss what the Fed did and didn't do. So Andy, what are your thoughts about what the Fed did? Because they lowered the growth projections and they increased unemployment and they increased inflation higher for longer.

The market response wasn't great, but we need to discuss what they did and what they are saying. And also we need to discuss the QT issue. Sure. So do you want to kick us off?

Andy: Sure. Yeah. So Nick said it right. The dot plot, which is their cons, median economic projections was shifted a little bit and in fact was shifted a little bit more than current Wall Street.

Regional bank and so on. Consensus toward a higher inflation projection for 2025 and a lower GDP projection for 2025. And, looking in the rear view mirror though, there are some signs that there is a little bit of. Growth slowdown going on. By and large, the data doesn't support that shift. And so what you have to take from that is that the Fed has its median forecast, has projected policy.

I. That the Trump agenda, the policies of the Trump agenda have begun leaking into the Fed's projections. Now, they could be completely wrong. Trump may change his agenda and the implementation of the agenda may have less certain impact than what is being projected. But the projections shifted, and that is to lower growth and higher.

Inflation for longer. Now in the press conference, they were chairman Powell was indicating that he had great uncertainty, as did most of the members larger uncertainty than in the past regarding their economic projections. And even still, he said that their economic projections are always uncertain.

So not only did they start uncertain. They're increased in their uncertainty. So he couldn't be more, I don't think, could have been more clear that he is without a clue. And so he paused and projected the exact same dot plot in terms of the Fed funds, despite lowering growth and. Increasing inflation expectations and use the faded word transitory for the potential for the primary impact of tariffs.

So I don't know that you really should take much from that except the uncertainty bit. But the economists. Those who listen to the economists are projecting a certain thing. And to be honest, it makes mostly sense to me that we are likely to see an inflationary impact of the trade war regardless of the level of tariffs and that there is a.

Growth slowdown underway that we may see in data soon, or it may take months for that data to shift. But I think the big takeaway is, whenever the Fed talks, there's a equal amount of focus. From the media, from the f, from us, from the financial, like we don't take a holiday on any particular Fed meeting, but if we were to have taken a holiday, this would've been the one they really tried to make as little news po as possible.

And people are squinting to look at the real, the news from this fed meeting. They did make one legitimate change to their, actions, and that is they hald the amount of quantitative tightening that they were doing, and we expected that to happen. I expected that to happen at the next meeting, but I thought there was, they had told us in the minutes that we mentioned in past episodes that they were going to pause.

The fact that they paused this month versus next meeting to me is not a big deal. It doesn't have much impact to begin with. And so they paused sorry. What they did is taper. They didn't pause, they kept going, but just at a slower, for longer level. And that's the rhetoric that we're hearing slower for longer so that they don't break anything along the way to.

Withdrawing reserves from the financial system, which is their goal. And so I projected now instead of QT ending in 2025, I think it'll end sometime in 2026, unless, of course the economy requires some different ch shift. But they can continue at this level, which is roughly 25 billion of mortgages plus treasury runoff per month.

Really for quite some time, at least a year if they wanted to, without really threatening, breaking anything. So the question, the last thing I'll say on that is market participants are, most market participants from since that have been around AF started their career 2007, 2008, or, soon around that time, are used to a Fed that does quantitative easing.

Quantitative easing has been the policy for a large majority of those years. So there's always hope from those who understand that quantitative easing is bullish for risky assets. To think that anything, anything that reduces quantitative tightening is just a imminent step to quantitative easing.

Again, and I can't be more. Certain that is a false idea, that quantitative easing would require a massive sell off in risky assets before it would even, and a significant reduction to zero of the fed funds rate before it were to happen. So any animal spirits that were created by this quantitative tightening pause, sorry taper.

Slower for longer is misguided in my view. Right.

Nick: No I think the high level takeaway is that the Fed and all the market participants could not be more uncertain about the projections for the next few months. Powell was at pain to tell us that they had to write down something in their dot plots and they had to expect something for interest rates, but their level of confidence in their expectations has never been lower.

So. Really, there is not a lot to take away from what they did and what they said. And I absolutely agree with you that the qt taper really makes no difference at all to risk assets, and it is nowhere near an indication that they're anywhere near to doing qe because qe, as you rightly said, would first require.

Zero level of interest rates before they did it, and they've been at pain to explain that. And I just don't understand why some people insist on not listening to them. The how it goes is very simple. They first end qt, then they ease to zero and they only employ QE when zero interest rates are too high.

So it just takes a, a, an inordinate amount of time to go from qt. Taper of qt, ending of QT zero interest rates, qe. It's, possibly years away should it ever be needed. And we are nowhere near in a situation that we need it. After all, real data. Still coming in pretty strong. The only thing that we are having that we are lowering is expectations of what that growth will be going forward.

Now, does the Fed have any better idea than we do? What is going to happen? On the 2nd of April when tariffs are introduced or they've been announced that they will be introduced? Probably not because there are so many variables that we don't know. We don't know what the other administration policies are regarding deregulation of both the financial sector, the banks, and the real economy.

It's entirely possible. Those deregulations matter more for inflation than any trade war entirely possible. The normal reaction from economists when they hear trade war is higher inflation, lower growth, and that is what the Fed is. It's a bunch of economists. Or people who listen to the staff projections of economists, do we know that this is going to happen?

For sure. No, we don't. We just know that the probabilities of this happening are increasing and that is what the market is reflecting. We are. 10% off all time highs. We fed our correction and now we wait to see what the data shows. So for the time being is steady as she goes. The market response to the Fed was very muted.

In fact, that is what I personally expected. Volatility came off some that was a mechanical response to an event being passed. And going forward it doesn't mean very much because once more, their confidence, their level of confidence in what they wrote down in the dot plots could not be lower. And Powell told us that.

So we are past that event and now we look for real data. What else happened last week, Andy, that you thought was significant? I thought what is significant is that both houses of Parliament in Germany passed the new measures for their budget increases. The debt break in Germany is now history. The debt break for the whole of Europe is now history because it's unbelievable that the that other countries seeing what Germany's doing to their own debt break are not going to follow suit because you can't have one rule for Germany and another rule for Italy, a third rule for France.

So it's, it seems very likely that going forward at some stage you will have much higher. Deficits in all the European Union countries, and therefore probably higher growth and probably higher inflation than otherwise there as well. So we are in a in very much. A dis equilibrium situation because we don't know what will happen and how the various countries are going to react.

It's going to be a very interesting year from the macro standpoint as a result. Anything else that you would like to add there?

Andy: Not really. Growth was the various economic data was mixed, but nothing to be particularly concerned about. We markets were basically flat on, we had some volatility, but natural volatility given the options, expiration large options expiration during the week.

By and large markets were, volatile because of the Fed, but really didn't move much.

Nick: No, absolutely. What about next week? We don't really have all that much data for next week. We have some interesting technical positions with a lot of options rolling off and being reset, but otherwise, as far as real data is concerned.

I guess the biggest one is PC on Friday, but we already know what PC is going to be, so how important is that? Yeah, Q4 GDP is Q4 and really, it's not gonna matter much for markets because it's, behind us we have some global PMI and we have some consumer confidence and some durable goods, but as long as the data, the real economic data keeps on coming in.

As expected, it's very unlikely that we start another leg lower in equities. It's far more likely that we stay in a range or even try to do a little bit better ahead of what is going to be a very important. Event on April the second when these tariffs finally go into effect. And also we see what the response is from other countries because you need two for a trade war, right?

Just because the US does something, it's more important what the other count, how the other countries react to those tariffs. And we won't know that until, early April. And therefore the likelihood of us. Having much movement next week are not that great. Would you agree?

Andy: Yeah I'm not quite as optimistic as you and I'm looking for any possible rally to sell.

And I think we agree that given the elevated level of volatility that writing calls against long equity positions into any rally makes sense. I'm targeting the 55 65 level for a very technical reason due to some month end options exposures which is about a hundred points down on the SPX.

I could see us drifting down there during the, this week. But there's no catalyst. I think we certainly agree that the cattle, the known news is not likely to create a catalyst on the other hand. While I'm suggesting selling volatility calls on a rally April 2nd is a period, a point of known uncertainty.

And I think you're gonna see some stickiness in volatility, which will create its own dynamic and possibly cause. Whipsaws chop, more chop than you would expect leading into April 2nd. So I think next week can be more choppy and drifting down, but who knows? We do have a bunch of auctions, 180 billion of twos, fives, and sevens comes for auction.

The front end of the curve has been very bid. And so it's po it's likely those auctions go quite. We'll go quite fine. But we're gonna continue to be buffeted with the fiscal side, the po, the Trump administration making comments during the week. And we're likely to also see fed speakers continue to extend the rhetoric on, slower for longer impact of qt. Governor Waller wrote a, an unusual dissent to the decision to slow qt. I think you'll get more of that to try to suggest that no, this is not qe. And continued caution and pause language from most central bankers because the banks are on the sidelines until further notice.

Nick: Yeah. And clarity emerges via real economic data. Absolutely agree with you. Again, highest level point. This is precisely the wrong time to really go overboard on risk and not something that you want to be levered. At this point, you want to wait because there's gonna be plenty of time once clarity emerges.

To be able to do something much more sensible sensibly than we can do at the moment with the data that we have. Absolutely. Great. Thank you very much Andy, and I'll see you next week. I'll do my bit now and have a look at the portfolio.

Andy: Have a great weekend everyone. Bye.