# 2 Gray Beards Week 118

**Nick:** Good morning. We've been liberated. Today is the 5th of April and we had one of the most exciting weeks we've had in many years. So, Andy, do you want to kick us off? What do you think Trump has done? And more importantly, is there a reason behind it? Is there something that can be. I dunno, how should I put it?

Something that in the long term is going to benefit the US IE. Is this a reason policy that will produce results in the long term or is this something that just reduces the prospects of growth over the short term or medium term even?

**Andy:** Yeah, I guess that's the big question, which is, whether, firstly, what's the goal? What are they trying to accomplish? And then secondly, will they achieve it? And then lastly, what are the consequences in the short term for the economy, for jobs, for inflation, and for the markets? And so I think you have to start with the goal, which he's been pretty clear about, even in Trump 1.0 where he didn't.

Actually have the horsepower in his administration or the will given. He wanted to be reelected to cause this. But he's been pretty consistent. And I think the message appeals to. A large swath of America that for many decades we've manu, we've outsourced our manufacturing to the rest of the world, and we saw.

The consequences of that when we cho, when we shut the economy down and due to co due to Covid and the global economy was shut down and we saw a scarce supply of manufactured products that we needed. And so. Both administrations and I think the common view is that we've gone from a just in time globalized supply chain to one that people want to be to ensure against supplied disruptions, which could come from geopolitical consequences.

Covid like consequences or, wars, et cetera. And so that trend has been around for five years or so, and it is something that the Trump administration really wants to occur. And to do that you need to onshore production. And the best way to onshore production is make it as a a attractive place for.

Domestic and international investors corporations to invest their capital in building manufacturing capacity. And in order to do that, you need to reshape the global trading system. And has it been. Unclear, has it been chaotic has the path since the election and then subsequently since the administration has put in p in power?

Absolutely. We've got multiple voices, some with credibility, some without trying to articulate this vision. And it's confused a lot of people. To a point where some never believed that it was going to happen. Others believed it was just a short term get a deal, just get a quick win on some sort of irrelevant to the goal accomplishment like fentanyl or a slight change in the trade balance.

The goal seems clear to reshape global trade and onshore domestic mode manufacturing, and I think markets which have doubted it realize that is the goal and that it's going to be a long, possibly farther almost certainly farther than the Trump administrations. Runway over the next two or four years, depending on whether you're focused on midterms or his entire term to achieve.

And so there's short term pain when you try to do that for, I don't know if it'll be successful. There's lots of reasons why I would doubt it would be successful because the US is not the place to be global leaders in manufacturing. But that's another matter, the short term. But what we're really

**Nick:** saying, Andy then, is that this is permanent.

There is no point looking for an off ramp. There is no point in hoping that he's gonna do a quick deal over the weekend and this will all go away. This is intentional. This is permanent. This is not something that he is going to reverse himself. Certainly not in the short term, and therefore the consequences he is willing to.

Just take them. So what are the consequences in the short term? It has to be lower growth or even a mild recession. As far as the eye can see. I can't see what else the consequences can be because world trade without a doubt, is going to s suffer a pretty. A pretty sizable hit here, certainly over the course of the, next three to six months because supply chains don't get rebuilt very quickly.

It's going to take many years for things to return to a situation that Trump would want them to be in. IE this. Onshoring that you're talking about. So in the meantime, you're talking about corporations suffering lower profits, as as their margins get squeezed by the tariffs, possibly higher prices, higher price levels for everyone in the us and therefore that over the course of time is going to actually shrink consumption.

The US economy runs in consum consumption. Therefore, the odds of recession, I think have sizably increased last week. Would you agree with that?

**Andy:** Well, yes and no. Yes, in that people have begun to consider recession more, but know in that this was the. Expected outcome of the Trump administration if you listen to them.

So there's a level of panic and catching up that's occurring versus the in expectations. But expectations have certainly shifted toward a meaningful slowdown. And I think it's important to just mention this, A slowdown happens because. All goods that are imported are now going up in price. All domestic manufactured goods are likely to see upward pressure because California wines or American cars are going to get bid because European cars have gotten, and wine has gotten a lot more expensive, so all goods prices go up.

You have a shift to the price level. The consumer can't afford it, so they buy less. Of the total amount of goods than they used to, and that reduces corporate profits, reduces GDP in terms of the consumption, expenditure and causes job loss. And so that's the direction, that's the immediate consequence of the tariff policy.

A shift in the price level and a downward shift in growth. The question now of course is is there any other factors or that could offset a downshift in growth? Are there any. Monetary factors, private sector factors, other non tariff Trump administration agenda factors that could cause a offset to this negative pressure.

What do you think about that?

**Nick:** Well, on Friday we had Powell. So what do we have? We could have a monetary lever. We could have a fiscal lever, or we have, or we can have a private sector lever that can offset what you were talking about. So let's go back to Powell because he's the guy in charge of the monetary leader.

He told us very clearly that they are on pause because they need to assess. Through data what the effects are going to be. They think they know what the effects are going to be, that I'm sure they're reasoning much the same way as you and I are, but they need to have proof. What does that mean? That means that by the time they have proof, they are probably behind the curve and he.

Almost admitted that is likely to be the case. So the problem that he has is that the. Price level is almost certainly likely to go up, which means that the inflation expectations could become de anchored even if the price level just moves up and it's not inflation, it's a one time hit. You could still have secondary effects of de anchoring of inflation expectations.

I think that isn't very likely. We saw what oil did on Friday and we saw that, the five-year forward, forward inflation expectations actually took a huge dive on Friday. So that is not likely. What does that I. Mean, it means that the Fed is likely on hold and throughout May when the next FOMC meeting is.

But then as soon as they see the higher unemployment data. They don't see that inflation expectations are de anchoring. They're likely to move more than 25 basic points at a time, should the data prove that we are indeed going into a significant slowdown. So to me, from now on, 25 becomes the least likely move and 50 to a hundred.

Becomes the most likely, depending on how acute the slowdown is, and the data will show it. There is always the possibility that actually inflation expectations do the anchor, but I think the odds are quite low there, and therefore there might even have to hike rates. I think that those. That likelihood is quite low.

So, but you, the monetary lever will be employed at some stage, just not

**Andy:** yet. Right? Right. So the monetary lever is not short term likely to have an impact on markets. What about the fiscal.

**Nick:** Well, I certainly don't see the the administration being able to do anything short term. Doge is going to do what Doge is going to do.

The inflation, the expectations of what Doge can accomplish, I think, are exaggerated and have been from day one. They will do some good. We are talking about 1%, 2%, 3%. We are not talking about cutting the government expenditure by 10, 20, 30%. That is extremely unlikely. So if we're talking single figures there, is it going to help?

Yeah. It's not, it's gonna help lower government expenditure, but that is actually a contraction of the fiscal, right? So we are talking about how much they take away. The only way that the administration can add to the fiscal, and let's not take into consideration now how they can cut regulation, which certainly would help and will help, but is it going to help more than the the, what they have done?

I don't think so. But where, what can they possibly do on the fiscal side? In the short term I just don't see that this Congress is ready to do that. I don't see that the Senate is ready to do that. I don't see that this can happen this year,

**Andy:** most probably. Right. So what you're saying really is that immigration policy.

I. W the way it would help is if you allowed a bunch of immigrants to, that's not gonna

**Nick:** happen.

**Andy:** Then you have expenditure cuts. Doge has always been a dud because of its implementation, so I guess they could cut even less doge than already expected. And then you have the actual budget, which, currently has a fairly meaningful expenditure cut for for Medicaid food stamps and income assistance. That's not likely to go away, but I guess it could, you could have a sudden you decision by a Republican majority Congress with a Republican president to. Increase spending relative to what's currently budgeted.

That seems extraordinarily unlikely. I guess you could also have the monetary, the fiscal lever significantly reduce taxes. Which they already plan on doing with the extension of the TCJA, but that's just an extension. They're talking about increasing tax on millionaires income and they're also talking, which is a, which would be a tax increase.

And then you're talking about small, relatively small tax cuts. I guess it's possible they could blow up the deficit, but again, what congress and what president are going to do that, given the current. Trump administration agenda, it seems very unlikely. So monetary isn't gonna save us fiscal, which is contracting and causing this.

Isn't going to reverse. What about the private sector?

**Nick:** I think the private sector is so uncertain and Powell basically told us that if he's uncertain and every report he's getting from the private sector is that they are uncertain, that certainly doesn't mean that they're about to step in front of a moving train Entrenching.

They're going to be, let's wait and see and therefore, it's very important to understand that the private sector's balance sheet is in excellent shape. So if they wanted to step in front of this train, they could, but I don't think they're gonna do that for the next several months until they get more clarity which CFO is going to.

Really put his career on the line and do something next week. Hardly any of them, right? They're going to wait. And also they're going to throw the kitchen sink of bad news at their balance sheet for the next set of earnings. Like we said last week, this now is almost certain. So earning expectations are going to be reduced, and I don't really see anything.

On the horizon that's gonna change that. So really it's only quarter three and quarter four that you can hope for the private sector to do something

**Andy:** meaningful, right? So let's bring this around. We've got a pretty doom like scenario in terms of the direction. Something we've been calling for a few months now, a slowdown.

Now the slowdowns on top of us and all the things we just said. People are finally accepting that as the direction of travel. And like many people, they extrapolate that to a disastrous situation. And market prices extrapolate that to a different situation. So let's bring this all home. We see the direction.

Everybody's with us on this direction. It's now, it's unlikely to change because the ver the three levers are not, I love how you say levers. Levers are not in that sa likely to be polled, but what about market pricing?

**Nick:** Right. Well, market pricing is a, just adjusted very considerably. If you the problem, I think at the moment more than market pricing is.

Positioning. We have people still very overweight, US equities and that still needs to adjust by various methods. Either the price comes down and they don't need to sell and therefore they rebalance their worth or they need to continue to sell. I think there's gonna be a combination of both and.

Normally what tends to happen is that in a contraction or bear market phase, prices go back to the long term average, which is 18 times. Forward earnings, even though forward earnings come down slightly, you'll, I will show you later a curve of the blue angels and what they are and how it works. So we are likely over the course of the next few weeks and months to have a downward trajectory for equities.

Towards the times 1718 multiple, and that is somewhere around 4,500 to 47 50 in SPX. That is the natural flaw for this market, unless we're in a complete crash scenario. Which really should not happen because as I said earlier, the balance sheet of private corporations is in wonderful shape and they have plenty of ammunition to come in when prices get too cheap and, buy back their shares.

Not only that, but also invest for the future. What do you think, Andy? Do you

**Andy:** agree with me? Yeah. You have so I agree. Prices have corrected a lot. Positioning has. Changed. There's, institutional money managers that I follow are have reduced their exposure to equities, equity futures in particular by about 35%.

And they still have another 70% to go if they really want to go to zero, which they have in certain circumstances. They've made a significant repositioning, and I think it's important to note the idea of investor positioning as dependent on price Rebalancing is necessary from global equities to from US equities to global assets, but that can happen in price as well as in flow.

And it's happening in price, so. The pressure to sell is still remains, and you also see a very significant. Technical impact of levered ETFs every day. When markets are moving a lot, they tend to move in the last hour, a significant amount in the same direction as the day, and that's caused some extension.

Volatility is now implied. Volatility as measured by the VIX is now 45. And expects a D daily price change of 145 s and p points and a weekly price change of 320 s and p points. So markets, and that's just what's expected. So that is. Pretty darn high and can take us in ranges from, we could see 4547 50.

We could see 52 50, we could see 5,500. All of those prices are like. Expected to be within the distribution of the coming week. So the question becomes, is it time to sell and get short or to get your equity allocation down to zero, not at 47 50. Is it time to be cautious and sell rallies? Sure, but not at 47 50 at that time.

It's time to sell. At 52, it's time to buy. At 52 50 at 5,500, that's when you can pair back.

**Nick:** Yeah, absolutely. What we haven't discussed is bonds and I continue to believe that bonds are not going to make up equity losses. IE bond gains are just not going to make up. Equity losses, so bonds are in an area where I just can't buy them.

I just don't see any value. I understand the panic flows out of equities into fixed income, especially the short end. I can completely understand that, and I think that the likelihood of the two year note, or even the five year note backing up considerably here is very low. But the longer end, the tens and the thirties, we saw the tens thirties spread, expand quite a lot, and that's a sign of term premier expanding because the curve steepens.

So the long end, I would just leave alone. I, do not invest in tens or thirties at these yields. You might make a little, you might lose more than you make. It's a, 40, 60 play to me. Stay in the short end. There's nothing wrong with a short end. You won't lose much money even if you lose any at all.

So that is the place to be. Twos to fives, stay, continue staying there, reduce equity allocations as the market rallies, especially at the end of the day, because as Andy said, of these ETF levered plays, if you see 5300, 5400, you want to reduce 47 50 to 4,500. I completely agree with Andy. That is where I want to start building up a significant long position because equities will have priced in just about everything there is to price in.

I don't think it's gonna happen next week, but certainly over the course of the next month, I expect it to happen. What would you think?

**Andy:** Yeah, like if you told me what's I. I feel as neutral as I've felt for a while on the equity markets. Fairly bearish on the bond markets with not seeing much upside in the long-term bond market.

Not short, but not positive for the equity, just no value, right For the equity market. I just would absolutely expect to be right here a month from now. Excellent. Thank you very much, Andy. I'll speak to you next week. You too, Nick. Bye bye.