

2 Gray Beards Week 125

Nick: Hello. Today is the 26th. We have a holiday shortened session next week thanks to Memorial Day. Now, what happened this week? I. A couple of things of note. First of all, we had the passage of the one big beautiful bill in the house, and we'll talk more about that later because it is slightly fiscally expansionary.

What the Senate will do with it is an unknown at the moment, but probably not very much so a net positive for equities. And despite that, they gave up. Well close to 3% this week. It's obvious that the market had. Being over ambitious in what it expected to happen from that bill, but also tariffs are not over by any stretch of the imagination, as Trump reminded us on Friday with his tweet about threatening a 50% tax on the eu, which the market really took.

Not too bad. I mean, we ended up slightly down, but it wasn't really a disaster because I think the market is beginning to recognize that these are negotiating tactics and the likelihood of the EU ending up at 50% while Chinese are 30 is really not all that high. So the market is worried, but it's not hugely worried otherwise, what is going on is exactly what we.

Have been saying consistently over the past several weeks is that the window of opportunity for weakness from the Liberation Day tariff episode is now open. And if we are going to get some weak economic data, and if the economy is to weaken, it's going to happen in the next four to six weeks maximum.

So that is probably another reason why equities are slightly cautious, because they recognize that that is a significant possibility, not a, not a hundred percent probability, but nothing in life is. But it, there's a significant possibility that the economic data, the real economic data, starts catching up to the soft economic data over the course of the next month.

Otherwise, even next week, we have very little data. But let's discuss what we are doing, what we are thinking of doing and why. Andy, did you want to give us an idea of where you think we are? Because we are getting to some interesting levels in real yields that we might want take an opportunity of buying, but we are really not quite there yet in anything.

Are we?

Andy: Yeah. So let's review, um, where we are. So Nick talked about this window, which we've been sort of targeting for really since January of when the combination of the Fed being on pause and higher long-term bond yields and the Trump administration's policies of that were relatively anti-growth, were likely to show up in data.

Because data always lags these types of things. And six months, call it on the election six months ago, animal spirits were fairly high and so the economy wasn't going to weaken with the new Trump administration being elected and a frankly, relatively stimulative fed that was in the midst of cutting.

But that all played out by January, and now the animal spirits are at least. Chastened, if not gone. And so that's gonna start showing up in data. And so what Nick was saying is we've been targeting this next four to six week window as when the reported hard data would start to weaken. That's a little different than saying that somehow we think the economy will strengthen in a sort of longer term horizon while.

We expect the data to weaken in the next four to six weeks. If it doesn't weaken, that doesn't mean, gosh, we're about to go on to some strong economic run. The pressures remain. The Fed is on pause, probably more so than ever. The fiscal policies are developing into anti-growth policies, though they can be subverted, and I'll mention that briefly when I finish, and yields are high, and so.

The economy is likely not to accelerate even if this data window passes. So I just want to make sure you recognize that we're not saying, gosh, once this window closes, it's off to the races for the economy and for assets though, what it does mean is that there's a fair amount given what's priced, there's a fair amount of opportunity if the data does surprise on the weak side, which we expect.

So I mentioned one thing that I think is left there is the possibility that. Certainly the promise of the Trump administration to enact some very serious deregulation, and while the easy deregulation pushes, cap potentially pushes capital onto industry and investors. That's called bank regulation Deregulation.

What the hard deregulation is the poll deregulation, which encourages real economy investment by companies and individuals because they don't have to pay the costs of regulating themselves as high a cost as regulating themselves. And so we haven't really seen any of the second form of deregulation, and we have seen and saw again this week a fair amount of.

Of rumors about not just rumors, we're going to change bank regulation, so that has a possible upside for stocks over bonds. I just wanted to mention that in that it's a developing story. Alternatively, all the rest of the stuff is still bonds over stocks, and so here we are looking at bonds and saying.

Real yields have become much more attractive. They haven't reached the targets that Nick and I have mentioned to you a number of times. Something like 3% of, uh, on long-term real yields, but they're getting close. And so you have to ask yourself, you know, here we are, we've been very conservative our in, in our investments for many, many months, both in stocks and in duration.

When do you buy some. And I think we might have an opportunity this week to buy some duration or buy some equities, but probably not both. And so that'll depend on the developments this week. And

Nick: how do you see this development this week? Because it's going to be binary. Either Trump is going to enact some threats or he's not.

And we won't know that until June the first, most probably. Um, but you never know with him, he could tweet at any time. Yeah, June 1st. June 1st just happens to be a Saturday, so we won't know anything until the next Monday. So it, it really is. He's making it as difficult for, for investors as he possibly can, isn't he?

Andy: Yeah. I mean, um, what do we got? We got, uh, June the first. I have it as a Sunday next. Yeah, whatever. You know, it's the weekend, a week tomorrow, a week from tomorrow. So we've got 50% on tariffs on Europe coming a week from tomorrow. Okay, but what are the odds of that? They, they've gotta be minute, that's pretty heavily anti, um, yeah.

Growth and pretty disastrous. So what, what's happened? I mean, just let's talk about what's happened. I. Liberation Day, we were heading toward a slowdown before Liberation Day because tariffs were gonna be high. The fed was on hold, the budget was going, doge was going to cut massively, the budget was going to be hawkish.

Um, fed was on pause and interest rates were high, and we went into Liberation Day. And holy moly, all those things caused an overreaction. And boom, we went down to 4,800 on the s and p, and then a week later, anybody who sold. An idiot. And so why? Because he paused the tariffs He. Didn't do Doge cuts. He as of now has a house bill that is modestly expansionary in 2026.

Does make some cuts, but gives all of that away with tax revenue, tax cuts. Well, where is Doc Mr. Hyde? Mr. Hyde was, took people panicked at 4,800 and now. He doesn't exist anymore. And so we were at 59 70 or whatever it was, a few week, a few a week ago. Anybody who sold looks like an idiot. So are they gonna sell next week, sell aggressively based on a 50% tariff?

That isn't possible. Of course not. Nobody's gonna be stupid. But what will the tariff be? It won't be. UK great deal. It may be a, it won't be a deal at all. Let's be clear. There will be no deal between now and June 1st no matter what. You put a 50% tariff on the eu. The EU does not say, Hey, what, what will it take?

Let's come to the middle. We wanna, we wanna, they say we're leaving the table. This is ridiculous. So. What's gonna happen? Either Trump softens his tweet, there's just nothing that's gonna happen. We're gonna end up on June 1st and there will be no deal and there will likely not be a 50% tariff. But you know, there could be.

So, I don't know. I look at this sort of thing and say, no one's gonna get duped in listening at Trump. Use his what is now clearly to everyone on the planet, a negotiating strategy. No one's gonna get duped to extrapolating 50% tariffs on Europe and take down the global equity markets. No one's gonna get duped like that.

So at the same time, no one's gonna buy equities ahead of whatever happens because it's not, you know, what's the upside? So I look at this sort of thing and say, what's gonna happen? We're either gonna get some Trump tweet that is going to be softer or some or nothing between now and the weekend. This come the next weekend.

So if we get nothing, equities are gonna be down. Bonds are gonna be up if we get something. Equities are gonna be up a little bit. Bonds are gonna be down a lot. And so when I look at those things, I say, oh, by the way, when I say equity, in the first case, we get nothing and we walk into the weekend with 50% tariffs still hanging over and no caving.

Equities are gonna be lower than where they are today. They could be modest, a fair amount, lower enough that it might be worth a shot to buy some and get back to what is, you know, just a low allocation to equities. Similarly, I. If he caves next week and bonds, bonds are gonna sell off, and if bonds sell off, we're getting to a yield that becomes interesting.

Yeah.

Nick: And, and that is what I was waiting for because if bonds do sell off again, you are getting to that five, uh, 3 85. Real yield that is beginning to interest me on this because I just think it's very unlikely to hold that for a long time. Either we're gonna go massively higher and I then see what is going to cause that.

Or that kind of real yield really does start hurting the economy. And the economy really does then keel over and die kind of thing. Right? 2

Andy: 85 is a, is a, is the first level that you wanna start adding to duration. Um. 2 85. 2

Nick: 85 is, is, is a wonderful level to start putting some real yield on at the long end.

Andy: I said, and you said, um, the, you know, could real yields go a lot higher? Yes. Real yields could go a lot higher if the deregulation and or ai and some of both is massively. Productive in that case, real yields are going higher or, and if the government budget deficit expands more than expected, which is either a killing of the complete cave of tariffs or more stimulative fiscal, and the fiscal's mostly stuck.

Now, you know, the Senate may tweak it, but the fiscal's mostly stuck now, and so. Cut tariffs, increase productivity. You could see us being too early, buying real yields at 2 85, but it's time to get started.

Nick: And the easiest way to do that is actually probably selling puts and just waiting to get hit on those.

You know? And especially if next week is bad because the data, the real economic economic data next week, again, is very sparse. We have. The only thing that is not in the rear view mirror is durable goods. And also the weekly claims and weekly claims have been stuck for such a long time. It's hard to see them moving.

So durable goods are still going to be influenced by all sorts of front running of tariffs. So there will be justification. Whatever the number is, there will be justification as to why it is what it is. So I don't expect next week. For the data to actually be definitive and tell us which way the economy is heading.

So all we have really is Trump, and we want to basically play whichever way the market ends. We want to go against it, don't we? Because if, um, if stocks fall a lot, that will mean that we miss the bond market, but. On the other hand,

if, as you said, if Trump softens his stance, then we have an opportunity to buy bonds, and I think we should definitely take it.

Equities again, you know, what is a fair range for equities now, what, what do you think is a fair price for the s and p at the moment?

Andy: Right? So, and that question is, it's gotta be around

Nick: 5K, doesn't it? Still? Yeah,

Andy: I mean, 19 pe um, we're at 21 now. 65 ish. Um, you think 2

Nick: 65?

Andy: We can get there. That's high. Yeah.

Well, I mean, 19 PE partly puts into that 'cause we're at 21 now. I don't know. I, I, listen, I think, I think the, I idea that after all we could be wrong. The idea after all this. Hundred and 20 days in the administration or whatever it is. Um, and the policies that are trying to be enacted and the financial conditions and.

Monetary conditions where they are, we're gonna have a slowdown. And if we're gonna have a slowdown, equities are still rich anywhere above with a 5,000 handle on it. But at the same time, there's not a catalyst because there's not that fear. And so a slow grind down to that sort of level is more my thinking.

And so for me. Along that path, your job is to sell, puts on equities equal to what you would otherwise want to own. To increase what is for us a very low allocation in equities over time. And so, you know, scaling, using puts to sell on any downturn, meaningful downturn, and then collecting that premium, not ending up buying stocks because it's not a waterfall down to this level, letting the market bounce, sell some more puts that seems to be the way to, and if you end up, if.

We waterfall down great. We're way under invested in equities and in long-term bonds and this will provide us a way of getting invested. Well,

Nick: great. Thank you very much indeed, Andy. Have a wonderful memorial day and I'll speak to you next week. You too, Nick.