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Nick: Hello. Good morning. Today is the 2nd of August. We had a very big week last week with lots of data. Let's start off with the QRA, which was unfortunately a complete non-event, although we prepared very insidiously for it. Nothing of what we thought was a low chance of happening did indeed happen, and therefore the 90% that we said was.

Nothing did happen, but we had to be very careful because Trump did say that he had instructed his people in inverted commas not to issue anything past nine months. Obviously that didn't happen, and cooler heads at the treasury prevailed. And now we have a situation in which we are very unlikely to have.

Changes in the QRA for the next several quarters. They upped the buybacks very by very small amount, 8 billion, which is really not going to impress the market or move it in any way. So that unfortunately is the QQRA and it's unlikely that we'll see any changes in the forthcoming quarters. Then we had the FOMC, which the market took.

To be slightly hawkish because during the presser, Powell did not specifically say that. Yes, he would cut rates in September, but that was never likely, and therefore I certainly thought that he was nonsensical for the market to expect. That kind of a statement from him when there's Jackson Hole coming up and there's a whole load of data that they will receive before the September meeting that they can use to make up their minds.

Finally. And then we had NFP on Friday, which really put the cat among the pigeons, so to say, because we had. Revisions, which were absolutely awful. But not withstanding that the private payrolls are still at a level. Which does not indicate an imminent recession, although the market certainly upped the recession probabilities with a very strong risk off move.

The yield curve steepened a lot and equities fell quite hard, so Andy. What do you think is going on at the moment and what do you how can we make sense of this labor market where neither demand is rising, nor supply is rising and seems to be in balance at a very low level.

Andy: Yeah. I think from a, we've been saying, and I think we continue to believe that the economy is slowing slowly.

It is when the economy is heavily indebted and interest rates are too damn high. Economies slow rapidly as they dele and as debt problems ha occur. That's not what's happening here. The economy is slowing slowly. Is likely to continue to slow slowly as tariffs which are sizable. We did get f final ish numbers for most countries on tariffs.

And there's gonna be a, essentially a 17 to 18% import consumption tax that should have a hundred to 150 basis points per year reduction in. GDP. That's a slowing, that's not a fast slowing like recessions. That's not a debt crisis. That's a slowing. It's a slow slowing. At the same time we'll probably get some of that tariff tax paid by the consumer, which will hurt their ability to consume raise their.

Consumer prices and some will get absorbed by the importer and the supply chain on this side of the border and the exporter and its supply chain on the other side of the border. And so that's been our outlook and we think that's what's gonna happen. And so it's not surprising to us to see the Fed.

I'm not particularly certain about what to do until they actually see the data and thankfully the QRA showed that the. As you said, the cooler heads prevailed regarding what the supply and demand of issuance is going to be. And so that lever didn't get pulled, and I think it's important then to look at what occurred over the last three days.

The last three or four days as the all this news came together equities fell, oil fell. Bonds broadly rallied. All of those things crypto fell, all of those things are on the pro-growth side. Growth expectations, falling side of the ledger. And I think that's what we saw. And whether the data is the revisions go away or what, it's very hard when you look at backward looking data to really assess what's going forward economic outcomes, but.

The market doesn't pay much attention to all that nonsense. It says what's happening and what are we pricing? And this week was a pricing of negative growth. Furthermore the QRAI think was actually, it's not gonna be it, there was so much news. It's hard to associate the news with all, any one particular point, but in the combination of, so what happened?

They didn't pump. So what does that mean? That means one would expect growth expectations to fall, as I said they did. I would also expect the dollar to rally relative to gold and Bitcoin, which is what happened and is consistent with, Hey, we're actually being responsible with our issuance. We're not going to flood the market with bills.

And that's what happened. And so when I put everything together, I see pressure for risk premiums to rise because they had contracted significantly expecting some sort of pumping on the QRA, the curve to steepen because we are experiencing a slowdown and they will cut interest rates. And equities to fall.

Not a lot, but fall because of the slowdown and the rise in risk premiums. And so that's our out, that's my outlook. How does that sound to you, Nick?

Nick: Absolutely, and it's all being sped up by this resignation of Kugler that we had. Late Friday and Adriana Kugler, who was going to leave the FOMC in any case in January, brought forward her leaving and resigned on Friday, leaving Trump with a seat on the FOMC to fill, which she will try very hard to do, and therefore he is going to have a third person in favor of cutting rates.

At the September meeting, almost regardless of what the data shows between now and then, so we have Walla, we have Bowman, and this third person, which the betting markets are going for Wash at the moment, are going to be pushing Powell and the rest of the committee to cutting rates in. September. Now, the only question then becomes how much are they going to cut rates and where the terminal rate is going to be?

Because if we are to believe the employment figures and the revisions to the employment figures, then my view has always been, and I think you concur with me, that if employment starts rising. Unemployment starts rising rapidly past 4.3%. The Fed is then way behind the curve. The question then is how fast do they cut?

And I think it's likely to be fifties, not 20 fives, and I think it's likely to be at least two fifties. Back to back, in which case you could have a situation that by December this year, we have rates a hundred basis points lower than they are at the moment. So around three and a quarter percent. That would give you a two year note around three 50 or even lower three 40.

Maybe just above fed funds. Who knows? So the two year note where we are positioned effectively, that is what we own, whether it be real or nominal via SLQD or stip. We are at the right part of the curve. We are naturally unlevered. But if you wanted to have some longer duration unlevered, that's probably not a bad.

Play either, but certainly the short end is where you want to be at. Any backup in rates over the course of the next couple of weeks or couple of months even, is

an opportunity to get on board on the short end of the curve. And that tells me that we are going to continue to have not risk on. I dunno how better to put it.

I wouldn't bet on outright risk off, but I would bet that the, that we have seen the highs inequities for quite some time. But again, as you said, probably not much more than three, four, 5% on the downside. Given the data that we have at the moment, do you think there's anything more about Kler and the Fed that we need to say?

Because we have Jackson Hole coming up at the end of this month, and that will be a very important speech given by Powell, and I'm sure he'll defend Fed Independence, with gritted teeth, so let's wait for that before we do anything. To the portfolio. Significant to the portfolio.

But as far as I can see, that is the kind of environment macroenvironment that we are in at the moment.

Andy: Yeah. As it relates to Kugler, I think what happened is, I don't know why she chose to resign. Now versus waiting till January when our term ends. But it really places a specific thing that Trump wanted, but now has.

It's like the dog chasing the car. What do you get when you actually catch it? And so now Kler by her resigning has placed the. Onus squarely on Trump to make a decision instead of holding it over Powell and the marketplace. And so he'll have to make a decision. I guess it's possible he could wait till after the next meeting, but wow, that would be a huge surprise to me.

So we'll get a new person who is. May or may not be specifically assigned the role of taking over for Powell, that act, that decision doesn't actually have to be made and Waller is still a reasonable candidate for the Powell replacement in May. But we'll see. There'll now be a legitimate onus on Trump to make his decision and I expect he will.

Then we have what happens, it's September. We've got a lot of data between now and September. We know the employment number was bad. And in terms of, particularly in terms of revisions, there are some that are saying they're gonna revise the revisions back up to high. And the employment number situation is still great.

I don't think that's not our macro view that the employment should start to weaken. I think what Nick said is right. Low demand for workers and low supply of workers means, means relatively stable employment figures, but not

good, right? Low demand for workers is the key thing. You don't get enhanced wages if there's low demand for workers.

So with all that data in front of us an apolitical fed. May actually wanna cut in September, and if they do want to cut, why not make it 50? So I'm not surprised they, based on the data that the front end of the curve rallied a lot. But as Nick pointed out, it has, it's still behind the curve. Right now all that is priced for the.

Fed rates for December is two cuts. It's not three cuts or four cuts or five cuts, or, it's 50 basis points of cuts that's still behind if the economy is weakening. And so that tells me, okay, twos are really the place to be and thankfully that's where we are. Some of you might say I can't really le, this is an unlevered portfolio and I'd like some duration because that's how I make capital gains versus income.

And it speaks to where we think the risks and rewards are for bonds. I think that it's possible that you could extend duration a little bit. You could go out to five years and that would give you some capital appreciation without a lot of price volatility. So what does that mean? If we assume that two year notes gonna go to 3 40, 10 year notes at four 20, right now that's a 30 basis point.

Rally in twos, the 10 year note is probably going to rally as well. Because short rates are so low and other people are extending out the curve. But is it gonna rally 30 basis points almost? Definitely not. Is it gonna rally 10 basis points? Sure, that could happen. And your 10 year note in that case, we'll appreciate by roughly three quarters of a percent.

Okay, but what's the risk? We could be wrong. The economy could be. Smoking hot. The deficit is sizable. There's a lot of issuance of long-term bonds. Japan is struggling with its long-term bond market. The world is struggling with long-term bonds. Inflation may be higher than we expect. All of those represent very little risk to your note, but substantive risk to your tenure note.

And so while we can see a little bit extending out the curve, if what would've been a good idea in the event that we're right. The risk rewards don't make sense to us.

Nick: Absolutely. And especially since, guess what we have next week? Very little data, but we have threes, tens and thirties in the us and as you said, we also have tens and thirties in Japan.

And so the supply continues unabated. The supply of duration is there all the time and will continue to be there all the time. And unless we go into recession, duration is not gonna get bought to. Aggressively that those are just facts because they're like buses. They come every month. You keep on getting this supply and someone's gotta buy it, and it's gonna be more and more from all countries in the world and therefore.

There is just no rush to buy the duration unless we start going into recession, but that is just not what we think is likely to happen in the immediate future given what we know now. So what to do, Andy? What do you think are, even if we don't do them for the portfolio, what would be sensible trades to do to take advantage of the current situation until we get.

Over this holiday hump because Europe is going to be on holiday for the next month and really seasonality is pretty damn bad in August and September and really we don't really start ramping up trading until the middle of September again.

Andy: So the things that interest me are long twos. If you can lever levered long twos, they've moved a lot on Friday.

But they have a lot more to go. The dollar, gold and Bitcoin and things like that. Bitcoin's a risky asset, but gold and the dollar. Or any other currency are likely to be relatively stable. I'm not particularly optimistic on gold because I like the dollar, that's a few percent either way.

Equities, we're not gonna crash, but we shouldn't be going up. We should probably be going down. And so volatility picked up somewhat on. This on Friday as the equity market sold awful a lot. And so I could imagine that if we were to dip again, that we'd wanna start thinking about where we wanna buy equities, not where we wanna sell equities.

And you're the best at this. I think it's a combination of selling val and buying at a price. And so the sale of puts. To increase our relative, our very low equity allocation to increase our equity allocation at prices seems to be the sort of thing that our clients should be at least considering.

Nick: Absolutely. And I'll con I'll do that in my segment coming up. Otherwise, I think that's about it for this week. Andy, we haven't got any more words of wisdom than this. That sounds about right. I'll speak to you next week. Bye. You too. See ya.