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Nick: Hello. Today is the 16th of August. Interesting week last week, wasn't it, Andy? We had a lot of data and basically it confirms the Fed's view that inflation is not dead at all. CPI was within the limits of expectations, but PPI. Was definitely a lot hotter than expected, and certainly import prices were hotter than expected, so it fully justifies the Fed's view that we are seeing some tariff related inflation, but also that it's spreading to the service sector and therefore, PCE has been revised up.

Two 20 basis points for this upcoming release. And the Fed seems to be right that there will be a pickup in inflation going into year end, which is what most analysts have predicted, including ourselves. But the Fed currently is saying that they're going to look through it. Because it's likely to be a one-off.

So what does that do for markets? It and the economy is just absolutely refuses to keel over weekly claims. Absolutely in line. Continuing claims, absolutely in line retail sales stronger, but inflation adjusted, they're not that brilliant. So all in all, it's an economy which is just going sideways, we would say.

Would that be fair, Andy?

Andy: Yeah, I think the important data that we got that was out of line was import prices and producer prices. Producer prices is a bit wonky. It's not what it used to be in terms of being some, the difference between CPI and PPI being about corporate margin. But those numbers were visible.

And so what's happening is the rest of the world is not paying for the tariffs and, at the margin corporations are paying for the tariffs by this P-P-I-C-P-I measure again, which is not what it used to be, but still relevant. And import prices are not getting passed onto consumers through CPI.

So that tells me a simple thing, which is. Tariffs are inflationary to the us side of the border. Now that shouldn't be, that shouldn't surprise anybody. Prices go up when you tear off the, your imports. But it's completely different than the rhetoric from the Trump administration and the Besant and Moran in particular.

Navarro said it's actually deflationary, but that's another matter. The rhetoric is completely different. Inflation is going to be sticky and high and what it's doing, and retail sales confirm that is, it is impacting demand real demand. While

nominal demand was fine, a little bit warm. Real demand by definition, when the prices increase, nominal demand is per, it goes higher, but fewer people buy stuff.

So real demand goes down. And so the way I look at the numbers is it's not what the Fed wants and what the Fed doesn't want. Is inflation catching fire while real demand falls, but Nick's w right? It's not showing up in labor. Statistics though, the revisions and the BLS stuff from the earlier this month were clearly very weak.

The more current data and a DP data is not showing that weakness yet. So I'm still fairly confident that we're in the midst of a real slowdown and. That tariffs will be paid by some combination of consumers, which will hit their demand, and corporations which will eat the tariffs. And that's, that's not a good place to be if you're the Fed.

And more likely what you do is stay on pause. That's not how the market's pricing. The market has a 85% chance of a cut. In September, a cut that many of us don't see any validity for without an actual slowdown. And the data is yet to confirm an

Nick: actual slowdown. Yeah, absolutely agree. The other thing that we can talk about last week is this Alaska meeting between Trump and Putin, which looks like it's benefiting European stocks because it looks like it will lead to some kind of cessation of hostilities.

Whether it's a wonderful piece or not is really immaterial as far as that's concerned. European stocks definitely outperformed US stocks last week, and I think that is likely to continue. Gold was bid less, all weak. Oil was bid less, all weak as were other commodities, which is exactly what the kind of reaction from the market that we expected.

Those are pricing in that something will be done on in the, on the Ukraine war and. It would give us an opportunity to buy gold and commodities, hopefully at a cheaper price, because we definitely want to increase that allocation. That's really what happened last week. Next week is interesting because we have Powell's last speech, Jackson Hole, so let's examine what he could say.

The probabilities are different to what he could say. He could. One just abjectly surrender, which is almost impossible, and I can't see why he would do that. And basically say that yes, they are restrictive and that they, irrespective of what the data shows, they will now go to at least neutral, if not stimulative,

because they're more afraid that the job market could break as opposed to inflation go much higher.

That I think. Following the data this week is a very small likelihood, and the market is nearly there in its pricing, isn't it, Andy? That's the thing that surprised me about the price action this week, that the market didn't back up. More the yield curve, definitely steepened, but all that means is that the twos were absolutely constant.

They didn't move at all, not even a basis point. That tells me that people are still favoring that the Fed at some stage will succumb to the political pressure, and that's why the curve steepened, as opposed to doing a parallel shift upwards after the data. What is the neutral? I don't know. Neutral could be so many things.

I think what is most likely is that Powell acknowledges that they are slightly restrictive at the moment, but also acknowledges that stance is appropriate for the time being until they get more data, which shows that inflation. Even though it's accelerating slightly, it will not accelerate too much so that they can continue looking through it and that they can maintain the possibility or probability of cuts in both September and let's say December, the two cuts that they had penciled in at the last S ps for 2025.

That to me is a neutral outcome. Still one that the bond market isn't going to like particularly, and nor should the equity market really. And finally, there is a hawkish outcome in which Powell comes out and says that the Fed has been right all along and all they can do in this situation is look through the increase in inflation and not hike.

That really is almost taking off a cut in September off the table, which I think he will be loathed to do simply because why get rid of the optionality that they now have, because they're going to see another NFP and another CPI before the meeting in September. So I think that is. Probably less likely, but certainly more likely than the abject surrender that I espoused as option one.

I think option two is probably, the neutral ish is the most likely. But what do you think? And. Because I know that you think that he really has to look after his legacy, this being his last Jackson Hole speech.

Andy: Yeah. I think the issue on Legacy is about, pushing back on the attacks on Fed independence installing clearly political governors that are that, that are

not necessarily going to be even open to data, but are just going to follow orders attacking Powell personally, professionally, et cetera, installing some.

Final, finally installing a permanent chair that's that's a lap dog at some level. Those def pushing back on that is, and the level of degree I lean toward more so than less. I have some faith that. Powell is gonna use this as some sort of fed independence, litmus test, legacy mic drop sort of speech.

But we'll hear, and he may not, he may just duck the political I guess it's possible he could also say, you know what? Forget it, I'm resigning. That seems very low. As a sort of mic drop I guess he could do the exact opposite, saying not only am I not resigning, I'm not and I'm defending the independence of the Fed in this speech, but I'm going to ongoing, in an ongoing way, defend the independence of the Fed by sticking in as governor.

Which would be a very interesting personal decision for him. Very difficult personal decision to him given his alternatives to reenter the private sector and be able to speak from the bleachers instead of having to speak, having to fight the political battles of Washington, particularly with a new chair who we will disagree with.

So I think mostly that legacy will just be a pretty hard. Fed independence. We were right to cut in September of last year. It would be wrong to cut. Now. It has nothing to do with politics. So that sort of level, but let me just restate Nick's points on the outcomes and I'll have a diff a slightly different ranking.

There's the surrender. Outcome, the abject surrender in that case, September will be put on will go from 85% certainty to possibly even higher than a hundred percent certainty. And long, the whole stir curve, the whole short-term interest rate curve will

go even lower in yield so the terminal yield will fall. There's no chance he goes that way, but. That's what would happen. There's also the, what I would call the dovish case, which is really the one that Nick described as the surrender case in which he validates the September cut, which is currently, as I said, 85%.

Probability but doesn't go super dovish, remains open to the data about further cuts. Doesn't really start a big cutting cycle. But so mostly really affects short term interest rate markets. Then there's the hawkish case, and in the hawkish case, the, which I think is the high probability case, it, he basically says, Hey, we don't know still.

September is a coin flip. We're balancing everything. We've got more data and 85%, you won't say this, of course, 85% is too certain. And in that case, short term interest rate markets will probably drop, starting with the September hike by half, and you go down to a 50% probability of a cut in September.

Then the last thing. We had some really hot inflation data and he could say, listen, we're right. We're right. We would be if we saw this inflation data, we would hike. In that case, he would be explicitly or maybe just implicitly taking September off the table as a possible cut, and that would take it to a zero probability or close to zero probability of a cut.

The last two are the likely ones, and they're hawkish relative to pricing. And so when I look at the week and then I look at the following week, what does that mean? A hawkish relative to pricing? There's gonna be some tweaks to the bond market, short term interest rates not much very actionable.

We're still gonna be data dependent. And there's probably going to be softness in the equity market, but. Softness in the equity market in the face of Nvidia earnings. The following week probably will be

Nick: limited, but if I can summarize, we are both thinking that the current pricing at the short end. Is too good.

Let's say relative to the expected outcome or the probabilities of the expected outcome from the Powell speech at Jackson Hole. So really, we are both saying that we think that at least the short end of the bond market will be higher renewed this next Friday and. That equities will be lower. So should we be selling on Monday morning our holdings of the short end of say, SLQD or something like that, and then holding the cash to buy it after the Jackson Hole speech?

That's the only question that I have. What are your thoughts on that?

Andy: Yeah, I think it's tweaking. We're not levered in the short end really it's in actual return, it's a tweak. That said, we also have other things going on. If the Ukraine, if Zelensky showing up at the White House on Monday, if he agrees to see Donbas we may have peace.

And peace will have some implication regarding just about everything we've been talking about. So I would probably look at this and say, odds are twos are slightly higher, it's tweaky to change the allocation, and I don't know what to put it in cash

Nick: and wait for equities to drop. That's a possibility.

Yeah something to think about.

Andy: Anyway, that's, no I'm comfortable lightning in the front. Mostly because I'm comfortable adding in the front too. Like it just doesn't move the needle for me. Feel free. I, feel free at prices to do that. I think it makes some sense. It just to me is just more moving cash, more so than it is, and we're plenty prepared. If we get a big equity sell off that we want to add. Our twos are actually gonna have rallied.

Nick: Yeah. I think the equities would fall because the two would fall. But anything maybe we splitting has, maybe we're splitting has, and I'll see what we can do.

But that's the sort of thing that I would like to do for next week. Anything else that we can think of? Changes to the portfolio because, it's I think we

Andy: have to be prepared to buy gold in the event of peace. Yeah, I think we have to, you mentioned that at the get go. I think we have to consider buying commodities as we enter peace, just because the prices are improved to get some balance.

And then the question becomes should we be deploying cash at this stage? We have plenty of cash. You'd want to deploy cash if you saw something that was really great for assets. But when I add things up, volatility is down a lot, which. Is good for assets retro, coincidentally, but only is good for asset further returns if vol continues to fall.

And I think it's at low enough levels where, yeah, it could go a little bit lower and drive a little bit of E of asset outperformance, but I don't think it's gonna run away from us. So I'm patient for new prices. I agree.

Nick: Let's send out an email as soon as we've heard what Powell has to say, right?

Yeah. It's early Friday morning, right? Yeah, 10 o'clock, Friday o'clock, 10 o'clock in the morning. Great. Speak to you next week, Andy. Bye-bye. See you next.