# 2 Gray Beards Week 139

**Nick:** Hello. Good morning. A bit of a shock to me because we only have one gray beard now and it's still the 30th of August. So let's discuss what we went through last week, which was not really very much right, Andy? All the data keeps on coming in. As expected the economy keeps on chugging along the employment situation is weirdly, I balance and I think everyone is beginning to recognize that, including Walla, where when he spoke about it in his very long speech in Miami.

They don't know what to do any more than we do. The everything's in balance, but they're afraid that something will go outta balance at some stage, and they're more worried that it'll be employment rather than the inflation picture. So that's where we are. Right. And really not very much to say.

Asset prices were very steady all last week. The s and p closed within 10 ticks of the week before. It's the height of summer, so it's not really that surprising. We can discuss what we think might happen next week and how we'll react to it. What are your thoughts, Andy?

**Andy:** Yeah, just looking at last week I agree the data was not, indicative of some sea change. But also it was largely expected, particularly the PCE data, GDP is warming up which is a bit surprising to me at least. While her speech was more consistent with my view which showed more, significantly more concern about the employment picture and more certain that rate cuts need to come, but also not.

Aggressive saying, he made the statement that they situa he wanted 25 in July and dissented on that. And the case is stronger now, which makes you wonder why he isn't saying 50, but 25 makes sense to me. And I think that's what they do in September. And the question becomes will it be enough?

Will the economy actually weaken? I think so, again, there's nothing that's showing that is going to happen yet. Auctions went very relatively well in the twos, fives and sevens. As Nick said. S and p was like 25 basis points lower. Russell was unchanged. The only thing that was interesting was the yield curve got somewhat steeper.

With two years rallying seven and a half basis points and 30 years. Falling rising in yield 5.1 basis points. So that's a bit of a steepening. So, I think that's last week. This week is well firstly it's the Labor Day holiday, so it's a shortened week. And secondly. It's a everything you could possibly want regarding labor.

And at the same time, it'll be closely watched because of the firing of the BLS head. And what may come of that. Are we gonna get a job weakening? If so, 25 is, which is already locked in the books for September, will potentially extend out driving two year yields lower. And that gets to a point where you say, why own two years anymore?

**Nick:** Absolutely. I find it very difficult to see a terminal rate below 3% at the moment, unless the economy goes into a full blown recession, of which there are absolutely zero signs. The GDP now. Increased into the threes. So I really can't see how anybody can start arguing that we're going to go into some sort of a recession.

The mere fact that the Fed has so much room to cut, if the growth picture weakens, that tells me that even. If we do go slightly lower in terms of growth, it's going to be shallow and not long lasting because, so much monetary stimulus can be put to work, in which case, it's very difficult to see.

The short end going through 3%, especially since we all expect PCE to be at 3% or even slightly higher by December, and that is what everyone is expecting, probably including the Fed, if they're, if they want to be honest. So why would they take. Real rates negative at the front end. It just doesn't make any sense.

And therefore, if we see another 15 to 20 basis point fall in the two year note, it's really time to get rid of everything we own at the short end and extend. The only question is where can we extend? Where can we pick up some yield and clip the coupon as we say. And I just don't know. You have to go up the risk curve and you have to go up the duration curve.

That's the only options you are left with.

**Andy:** Right. And the duration curve is, as we've said, has gotten a lot steeper and in particular you've seen a pretty significant route, outperformance of five-year point on the curve. Both in a real sense and a nominal sense. And so that part of the curve just doesn't represent significant value.

So then the question is, do you go out to tens to thirties, do you size up in terms of credit? And I don't think we're talking about doing anything radical, but at some level we're gonna have to start looking at long-term duration as the curve steepens and as long as the economy stays, okay. Though it's already priced as with that assumption, credit has to be something that you consider at least for to keep your yield that you've had.

And so that's gonna be a natural move. And, do we expect a ice cold employment? Picture this week. I expect a cold one, but ice cold enough to drive twos to three 40 or so. It's unclear if it happens. I think we do end up getting out of our shorter term paper, and the question is at what levels do we get into longer assets?

Which I think brings to bear the last thing that happened on Friday, which was after the close the. Appeals court upheld the lower court ruling on the illegality of the new Trump tariffs. That was a hundred percent expected. There was just nobody that expected the, including Trump, frankly, that expected that to get through.

And so. It happened on the early side, but not ridiculously early. Regarding the court process, could the, and importantly as part of the decision, they said that recognizing it was gonna get appealed, that tariffs were still in place. We're left in place. And so off to the Supreme Court we go, and I could imagine a circumstance where the plaintiff in the case wants to expedite the case in front of the Supreme Court, but it's unlikely the Trump administration wants to expedite it because.

The longer it lasts, the longer they collect tariffs, even if they have to pay them back, they're still collecting the tariffs today, so I don't think it's gonna be a rush to judgment at the Supreme Court. So odds are it's a 2020 early 2026, mid 2026 issue, not a late 2025 issue. So, got it all up. Nothing really should happen.

On the other hand, Trump has sent two email tweets, one right before the right after the decision yesterday that says that this decision, if it was upheld, would destroy the country and cause the stock market to crash and there to be a great depression. Probably not, probably none of those things are gonna happen but, we, the way we kick things around less tariffs or less taxes, which is good to for real growth. So it's arguable, and I think most would argue that removing the tariffs could short term be good for the country. Not bad. There's a portion of the country and the president of the United States that thinks differently than we do, and, maybe we're the wrong ones.

Nonetheless, the bottom line is nothing happened. Everything was expected. And so now the question is there a knee jerk reaction? And what would we do about it?

**Nick:** I think that if equities were to fall on some sort of a knee jerk, we buy them even before NFP. I really have no problem with that. I don't think that's going to happen.

I think the likelihood is that, we opened very much unchanged and nobody really cares if long bonds were going were to fall though. That's the more interesting side of things. If yields were to go over 5%. The twenties and thirties, would we buy them? That's the question.

**Andy:** Certainly if it was with a 3 42 year note, you'd have to do, well,

**Nick:** you're not gonna get that.

**Andy:** So I guess the question about buying them there is, listen, the economy, you've got some, there's a lot of people out there, a lot of analysts that are seeing economic momentum. We're not, I'm not one of them but there are people that are seeing economic momentum in a hot number. Could you get.

You're not gonna get the 25 basis points of cuts coming out no matter what happens. So are you gonna get a steepening with a big sell off in bonds?

**Nick:** I actually meant on Tuesday morning before. No, I know.

**Andy:** Yeah. But before all that numbers come, if you get a knee jerk. To above five.

Is that enough insurance that you can survive a, that you're getting good value, even if the data comes in super hot this week, maybe.

**Nick:** Yeah, I certainly think that people are going to be looking for carry trades. They're going to be looking for things where they can just keep on clipping that coupon and VWOB has the right amount of duration, and also it has the spread.

So I would have no problem at all if Vwb falls together with TLT. Adding some even on Tuesday morning before the numbers for the week and deciding that it's worth a gamble into the Friday payroll I have absolutely no problem doubling the allocation to VWOB if that were to happen and selling some of the short end.

I know it's taking a little bit of risk, but there again, we don't have a huge amount of risk in any case. What can we do? We will see if it were to happen, I think personally, that it's very unlikely, but if it does happen, we'll send you an email and we'll go for it. In any case, we'll send you an email after Friday because once we've seen all the employment numbers, we should have a much clearer picture.

As to Fed Timing, which is only in what, two and a half weeks, right Andy?

**Andy:** Yeah. I mean we still have CPI and PPI, but this isn't an inflation story. No, the next Fed cut, the next Fed meeting is gonna be about employment.

**Nick:** Yeah. Excellent. All we can do is wish you a very pleasant Labor Day weekend and we'll speak to you next week.

Enjoy everyone. See you. Bye.