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Nick: And good morning. It's today, the 8th of November. Not a very exciting week, was it? We expected more. Andy, tell us about the QRA

Andy: it was going to be a nothing event where the. Treasury told us that they were going to maintain coupon auctions at the same exact size as they have been and keep the Treasury General account their checking account static at 850 billion, and that's what they did.

Down a level. They also have language about what they expect to do in the future, and they didn't change that language. They left the, the, the major portion of the language the same, which says they don't expect to change auction coupon sizes. For several quarters what they did do, and it's super small, but still came a little bit, the tiniest of surprise if you wanna make something out of nothing.

The tiniest of surprise was that they said that they are now considering when they are going to increase auction sizes, which just tells me that in February when they do this again, they may. Reduce several quarters to a few quarters, and then in May when they do it again, they may say reduce that and say they are now contemplating when to increase auction sizes.

And then maybe by July they start increasing auction sizes. But more likely they do it next year for the, at the end of the year. So what it basically says is that treasury auction coupon volumes are gonna remain the same and for the, for which has been the case for the last year and will likely be the case for the next year.

Nick: But they also said that coupon sizes are likely to start going up, and they mentioned where they might increase the issuance. So it seems to me that we are. A hundred percent sure now that at some stage over the course of the next, call it 14, 16 months, they will start increasing coupon sizes and they will probably start doing it.

At the belly of the curve. Yeah. Do you have any thoughts about that?

Andy: Yeah, so they plan, so they, they don't like the 20 year, the seven year. They like the twos, threes, fives, even tens. They don't love the 30, but it's an

important benchmark. So my guess is that any increase will happen on the stuff they really love to sell.

But as Nick said, they did indicate that they are going to increase auction sizes, which. A small part of the market of market observers. People who focus on this sort of stuff did think that Treasury, treasury Secretary Besson might reduce coupon auction sizes due to the fed ending q. Qt the high income from tariffs and generally a reduction.

Hi, in his expectation of the budget deficit, which would've been a bullish sign. And so I guess at some level, some market participants may have been disappointed. The bond market sold off on that, but has since recovered a little bit. One thing we didn't mention it to me, it was a more exciting week than for Nick.

Next week seems very unexciting, but last week we did have the first the the Supreme Court oral arguments, and those went very, very per were perceived. I didn't listen to 'em, them myself, but I've since read them were perceived as being very negative for the administration. The administration was going to have to deal with the Supreme Court, overruling them on tariffs and declaring them illegal.

And that was reflected in all manner of betting markets and to some extent bond markets where the, as that happened, bonds sold off a bit because that would mean a larger deficit with less tax revenues. People forget that that happened. What it says to me is that we won't know this could, it could all just be the, it still could end up with a favorable ruling for the government for the Trump administration, but we won't know probably.

The absolute earliest would be a week from Monday. That seems extremely unlikely. That would mean a rapid decision but very likely happens before year end. And that'll have an implication. But for now that did happen. And the only comment I'm making is that it went badly for the administration.

Nick: Yeah, I actually listened to it and I was watching the betting market as each judge asked a question and it did move against the administration for sure. But it did recover by the end of the day. And as you said, the bond market took it in its stride. It, it really, I mean, the yield curve steepened, which is what you would expect as a result of tariffs being ruled illegal.

But also I get the feeling that they're going to do some kind of a fudge and give plenty of room. To the administration to reimpose them under some other

heading. We will see. It's not something that's gonna happen next week, so let's not think about it until we have to. What do you think of the employment picture?

Because it's rather mixed. If you look at the compilation of the state's data, which is still being produced for the weekly claims, we seem to be. Nowhere. We are not going up. We're not going down. If you look at some private surveys, like the Challenger report that we got on Thursday, that seems to show an acceleration of people being let go, but it's so tough without official data to actually decide what is going on.

And certainly that is beginning to weigh on all the markets, both bonds and equities a lot of uncertainty about, and that uncertainty is being reflected in the lower prices that we are seeing. Do you have any words of wisdom there? Because I certainly don't.

Andy: Yeah, I wish I did. My view is employment is week-ish.

Continues to be weak ish. We'll get a little bounce when potentially when the government gets brought back and consumption occurs again. But by and large, the job market remains the weakest part of the economy, where the, inflation and GDP remain much more robust. And so I think, you know, we'll see when the data comes in, but to be honest I don't make much of the most recent data.

The synthesis is the Fed thinks the job market is more of a risk though. They are definitely talking hawkish lately, so they're still trying to keep their options open, hoping that the government will reopen and they'll get the actual data.

Nick: Well, it looks like the government might reopen next week.

They're, they're talking positively or at least they're talking. So with the assumption that they do reopen next week, do you think there's any odds that we get the CPI that we are due to get on Thursday, or is it just too soon for them to. Produce the survey data and release it?

Andy: Yeah, that's a good question.

I mean, basically they can release a number with whatever they want, you know, that they, they, they won't be able to do their entire process in that period of time. So they'd have to, they can, at the same time, they can make shortcuts and release a number and then revise it later. My guess is that the odds of us reopening are fairly low though. Because, and basically every day people seem

to have a reasonably high expectation that tomorrow the government will reopen. And so far they've called it wrong for 38 days. I don't know. One day the government will reopen.

Nick: Well, the betting market is at 45, so they're saying next week,

Andy: and I think they've been at 45 every week for. Five weeks.

Nick: They're being very accurate,

Andy: accurately. Right, exactly. Or consistent. We'll see. But I mean, the point remains, it's a very simple thing. We don't know when they're gonna reopen, but at the same time, what we do care about is when they release data once they reopen.

And I think the CPI is just a bridge too far. Yeah.

Nick: Let's talk about something that I noticed last week the corporate spreads have blown out a little bit, and that's weighed on equities and especially on the big, you know, max seven, the big tech companies.

What is going on there? Yeah, tell us. It's pretty straight. I

Andy: think it's pretty straightforward what we know. That there is a tremendous amount of Promised CapEx being done. Most of it's been in building data centers, building energy infrastructure around data centers building chip fabrication cap capacity.

But some of it has been promised around building general factories. For industry coming from potential FDI by foreigners foreign direct investment you know, all the promises we've been given about all of these financings and here to four, most of the CapEx, most of the chip buying has been able to be done in by, within earnings, cash flows from the major chip buyers. You know, Microsoft wants a chip. They sell us a piece of Windows software and or office software, and boom, they have a dollar for a chip. They buy the chip, but they're running out, they're using all their cash flow to buy chips. So the next thing they have to do is issue debt.

And over the last few weeks, Oracle. Google, I think Amazon and Microsoft have all and meta have all issued significant amounts of corporate debt. You know, 50 billion ish, like per guy. And that even doesn't come close. Not even

close to funding all the promises of CapEx for the year, which are, you know, people are talking about a trillion a year for the next two years.

So the corporate bond market says, wait a second. You guys wanna sell a trillion of corporate bonds to me? I'm gonna back up the prices. And so they have Oracle issued its 10 year note at 120 basis points spread to treasuries, I believe, and it's now trading 150 basis points. Microsoft. Its 10 year bond is up eight or nine basis points.

Metas is up 12 or 13 basis points. Every hyperscaler debt, CapEx funding issuance is wider. And so if the major, and by the way, these are great credits that are definitely gonna pay their, their bonds back. And so it's possible that the selling is a opportunity. This increase in yields is opportunity.

The issue is whether the market closes temporarily, and it does. This happens all the time. The corporate bond market absorbs a tremendous amount of supply and then says no MAs, and during that period of no MAs, that means no issuance, which means no CapEx, which means no chip sales, which means no data center sales, which means.

A retrace in terms of what is a very strong AI trend.

Nick: And that's why we got the QQQ Rera, the X the XLK, basically the tech market was under pressure. The big seven were all under pressure all of last week.

Andy: That's despite excellent. That actually weighed

Nick: on SPX,

Andy: right? Despite excellent earnings, frankly, I mean, these companies killed it.

Absolutely. And NVIDIA's gonna kill it too. But the bottom line is, if you can't. Raise debt to buy to, to do this CapEx and you've exhausted your working cash flow and you've spent most of your cash hoard on all these things. Your only choice is to issue. And if that market's closed, you can't do the CapEx temporarily.

And that temporary thing could, you know, take a little bit of, of the zoom out of some of these large scale,

Nick: Absolutely. And it, and it weighs on the equity price, because they start anticipating the next, they might start issuing equity and you know, who knows, right? And so the whole thing is a vicious circle,

Andy: right?

And when does, ultimately the corporate bond market, these are great credits. The investment in AI is probably going to pay off. But you know, a corporate bond guy is like saying. Hmm. I can buy this corporate bond for 150 basis points spread to treasuries, and that's the best I get. Like AI can work and I get 150 basis points.

Yeah. If AI doesn't work, I get nothing. I lose 10 points.

Nick: Yeah.

Andy: Right. Or 20 points. Not now. These are great credits. You're not gonna lose a lot, but there's just no upside for this. So the corporate bond market can just. You know, just a period of time, once it stops, accommodating issuance, the question isn't be, isn't.

Will it ever accommodate? Of course it will. It's just when will it start? And as long as there's an uncertainty on when it's gonna start, you got issues. And so that's where my head is going. And it's just the only observation we're making at all. N none of this has happened. The only thing that's happened is they issued a bunch of bonds.

And those bonds are now trading badly, right? That's all the only observation we're making

Nick: and the high level point here is that it's too early to really jump into corporate bonds because the odds of the market. Getting indigestion and closing for a while are pretty high, and where that happens, yield back up even more.

And that weighs even more on the equity side of things. And we are hedged and we should remain hedged for a while until this plays out and then take off the hedge. So that is the high level point. As far as next week, again, we don't know what data we are gonna get, if any, but it looks like, as you said, that we are not gonna get it.

Get CPI for sure. All we have are some auctions, threes, tens, and thirties, which are gonna continue to weigh on the bond market. And let's not forget the

way the corporate people hedge their corporate bonds is, they sell more treasuries. And that's why the 30 year especially, or the 20 and 30, the long end really couldn't get any traction at all last week.

Certainly not compared to the short end and the yield curve steeper.

Andy: The other piece of news is whether the government will reopen or not. I wanna be clear. There's a sentiment thing, like the government being closed can be negative to sentiment and the government being open can be positive to sentiment.

There's a but and, and that's a big, can be modestly can create some noise, but. From an economic standpoint, only if only if there's a extended slow cut like months, not days should we wor be worried about the economy. And from a liquidity standpoint though, there's many on there that out there that are making a big deal about how it's the, the shutdown has.

Reduced liquidity in the market and that suddenly when it's reopened, liquidity will become plentiful. Crypto will rally meme. Stocks will rally on that, though that stuff's mostly nonsense. Now from a sentiment standpoint, sure, it might have a small effect when the government reopens positive effect, but that's not a reason to chase stocks right now.

Nick: Absolutely no good. So we are happy where we are, and I'll go through the portfolio and give some levels where we might be taking off our hedges and looking forward to the year end rally if it happens. Thanks, Sandy. See you next week.