

2 Gray Beards Week 152 Summary - November 29, 2024

Market Overview

The week following Thanksgiving saw significant asset rallies across the board:

- Equities up 3-5%
- Crypto up 6-7%
- Bonds strengthening
- Short end rates declining, suggesting anticipated Fed cuts

The rally occurred despite thin trading and quiet news flow, driven primarily by expectations that the Fed will cut rates in December and speculation that Kevin Hassett may replace the Fed chair.

Key Market Drivers & Concerns

Supreme Court Tariff Decision

Nick identifies an impending SCOTUS decision on tariff legality as the most significant market risk factor:

- Expected within the next four Mondays (December)
- Nick estimates 75% probability the Court rules tariffs illegal
- If struck down, tariffs would need Congressional approval and specific trade deals to be reimplemented
- Potential market impact: significant yield curve steepening and volatility for both equities and bonds

Recent Rally Dynamics

The market briefly touched 6,500 before participants began chasing it higher. Nick characterizes this as a "knee jerk reaction" ahead of the SCOTUS decision, with investors unwilling to let the market go lower. He views chasing this rally as the wrong move.

Federal Reserve Outlook

December FOMC Meeting

Nick presents a nuanced view on the potential December rate cut:

FOMC composition: Nearly equal split among governors on cutting vs. holding, with Powell's decision likely determining the outcome

Current positioning: The Fed is very close to what most governors (except two) consider the neutral rate, with disagreement only about whether neutral is 25-50 basis points lower

The "hawkish cut" scenario: If the Fed cuts in December, Nick expects highly hawkish guidance indicating they've reached neutral and won't move again until data dictates otherwise. This would likely remain in effect until the new Fed chair takes over.

Terminal rate implications: If rates reach 3.50-3.75% and economic data doesn't decelerate, the market's expected terminal rate could begin "wobbling"

Data Considerations

The only current, reliable data available:

- Weekly jobless claims
- Continuing claims
- ADP report for November (coming next week)

Other data (including PCE) reflects September, which both hosts consider outdated and irrelevant for forward-looking decisions.

Nick's Counterintuitive Preference

Nick argues he's "far more bullish of equities and bonds if they don't cut in December":

- **If they cut in December:** Nothing to look forward to until May (after new Fed chair is installed)
- **If they skip December and cut in January:** Market has a near-term catalyst to anticipate

Powell Speech

Powell speaks Monday evening, but both hosts expect no meaningful hints given the Fed is in blackout period. Given market expectations are at 80% for a December cut and the Fed's aversion to disappointing markets, Nick concludes a December cut is very likely.

Equity Market Analysis

Current Market Structure

Andy highlights several concerns about the equity market:

- **Valuation:** Multiples at 23-24x earnings
- **Rate environment:** Interest rates already low with limited room to fall further
- **Earnings expectations:** Extremely high
- **Institutional participation:** Notably absent

The Ownership Question

Andy raises a critical point about market dynamics: Markets have been "relatively propped up by holders that are not institutional" who have successfully bought every dip. However, he notes that eventually these holders must sell to realize profits, which requires institutional buyers. He sees no evidence of institutional FOMO to buy at current valuations.

Technology Sector Uncertainty

The hosts note significant undercurrents in the tech sector:

- Leadership has experienced significant issues
- Nvidia and Google dynamics shifting
- Questions about AI productivity and who the ultimate winners/losers will be
- Recent flip: Google went from expected "most destroyed by AI" to "new leadership of AI"

Despite these undercurrents, there's been "really not much action" in the market overall.

Portfolio Positioning

Current Positions

The hosts describe their portfolio as being in a "fantastic position" for potential volatility:

Fixed Income:

- Positioned in the short end
- Protected against curve steepening

Equities:

- Long equities
- Long put options for downside protection
- Can't get hurt if market goes down
- Can sell equities and remain long puts if market rallies on SCOTUS decision

Credit:

- Previously sold credit exposure

- No plans to re-enter as original reasons for selling still apply

Strategic Rationale

The positioning allows them to benefit from multiple scenarios:

1. If SCOTUS rules tariffs illegal and market initially rallies (expected first reaction: "buy equity, sell bonds"), they can sell equities and hold puts
2. Protected from downside if market falls
3. No exposure to curve steepening risk

No Changes Planned

Both hosts agree there's no reason to adjust positions currently:

- Don't want to buy duration here
- Credit exposure still unattractive
- Equity position optimal given uncertainty
- Will wait for SCOTUS decision to react

Economic Data Outlook

For November and December, limited relevant data:

- Weekly claims
- ADP report
- PMI and ISM (will likely confirm economy is "still chugging along")

The hosts see no upcoming data that would change their current views or positioning.

Overall Market Assessment

The market has "gone nowhere in three months" since the September Fed meeting, chopping around with significant uncertainty looming. Andy expects the market will eventually "break in one way or the other, up or down" depending on how data plays out, but currently "the data's not obvious."

Both hosts maintain a cautious stance, comfortable with their defensive positioning while awaiting the SCOTUS decision that could create substantial volatility in December.