

1 page Summary: 2 Gray Beards Week 153

Key Discussion: Fed Rate Cut Expectations and Market Implications

Nick and Andy analyze the upcoming Federal Reserve decision, where a 25 basis point rate cut is priced in at 87% probability. Their central concern is not whether the Fed will cut, but how hawkish that cut will be—and what it signals for equity valuations.

The Bond Market Paradox

Despite no significant economic news and stable November data, the terminal rate rose 12 basis points while long-term yields steepened rather than flattened—an unexpected market reaction. This suggests bond markets are pricing in persistent inflation and questioning the Fed's commitment to returning inflation to 2%. The lack of demand for long-end bonds, despite attractive 1,500+ basis points of carry, signals a deeper structural problem.

The Hawkish Cut Scenario (Most Likely)

Nick and Andy believe a dovish cut is unlikely given strong GDP growth, elevated inflation, and firm employment data. Instead, they anticipate a hawkish cut where the Fed signals it's near neutral rates with limited future cuts. Critical language to watch: if Powell says "we are now at neutral," Nick views this as ultra-bearish for equities.

The Equity Trap

Equities face a "double whammy." Without Fed easing hopes grounded in economic weakness, equities lose a key support pillar. If the Fed cuts into a strong economy while signaling near-term pause, equity rallies on the cut announcement could represent the market's high point for the year. The pair suggest selling any spike higher if the cut is perceived as hawkish.

The Bond Market Test

If the Fed delivers a very hawkish cut, the 10-year auction (Wednesday) and 30-year auction (Thursday) must rally, or risk signals a generalized demand problem for long-end bonds. Long yields refusing to decline despite Fed cuts would remove crucial support from all risk assets.

Bottom Line: A hawkish cut likely marks an inflection point for markets, with equity positioning requiring reassessment based on Fed forward guidance and bond market response.