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Nick: And hello, today is the sixth. 6th of December, I'm losing days. We had a very boring week last, Andy, didn't we? But certain things are happening, like the bond market is slowly giving up the ghost. And basically what we said a few weeks ago, that duration is going to be a problem, are beginning to be realized, and they're recognizing it and they're pushing up long-term rates.

What's interesting I thought was that during a week where really no major news came out and no economic news of any sort, that was significant. Basically everything that came out for November showed absolutely no change in the economy. It's still trundling along at the same pace, but. The terminal rate went up by about 12 basis points, and you would've thought when that happens that you would've got some sort of a flattening in the yield curve.

You didn't. You got a small steepening out of it, and that is odd. Isn't it handy? It's not what you'd expect because. Everything, all the yields are going higher and equities are doing nothing. But that's removing another long-term support for them, I feel. But let's discuss what you think is going on, what the bond market is telling us and what next week is going to bring.

Because that's gonna be important,

Andy: right? I think it's, when I think about how the front end and the back end works. When the economy is strengthening, ignoring what the central bank is trying to do, when the economy is strengthening, when inflation is not coming down and staying high bond yields rise and they rise across the curve.

Part of it could just be that, that the bond market is seeing a relative economy that's not weakening yet. At least the data hasn't weakened. And a real economy that seems to be doing okay and inflation that seems to be not coming down.

Fairly stimulative fiscal upcoming, there's gonna be a 2026 positive fiscal impulse. And in the US and globally, fiscal is pretty hot. And so yeah, you'd expect yields to rise. And then you bring in the central bank. And the central bank can either be ahead, behind, or even with that outcome. And if they're ahead.

Meaning they are seeing that economic outcome and raising short and trying to convince markets that they are likely to not cut or raise short term interest

rates. That's when you get a cur reshape and put, to put it simply, if the Fed is worried that the economy is heating up and they're willing to do with that, deal with that.

The bond market curve should flatten because long-term bonds are seeing the Fed doing their job, trying to slow the economy and maintain anchored inflation expectations and not too hot growth. There isn't any sign of that in the last E, even though some of the rhetoric has gotten. More hawkish. And what I mean to say is that the committee is.

The committee is heavily divided. We know Waller, Williams, Myron and Bowman are all dovish and have been, some have had, some have dissented, but others have just spoken publicly about how they want more aggressive rate cuts. We know the administration has been very aggressive saying the Fed should cut rates.

All of those folks are. Quieter, I would just describe it, which means pound pounding the table less or not even at all. And so the very dovish group has gotten modestly less dovish, and that's all that's really gone on, but. That doesn't mean they've gotten hawkish. And so you look at that and say, is that what's going on the long end?

That the market is expecting the Fed to be dovish and the answer is not really. The neutral rate, as Nick said, is going higher.

Nick: Yeah. No and it's going to be interesting to see how the bond market deals with what is still very likely to be a cut next week, because the expectations are at 87%.

They haven't moved. It's the neutral rate, it's the terminal rate that's moved and that is. To me, very interesting because then the market is saying that we are likely to get a very hawkish cut, IE it could be that they cut the dot plots don't really move down. Even the the very, very dovish dot plots from couple of months ago, they don't move, which basically tells you that.

That's it boys. That's all you're gonna get until the data really starts getting worse and. That to me is a top inequities. It's a top in all risk assets. Really. The, because what? What do they have to look forward to? They have to look forward to the Fed easing because the economy is. Going down the pan, that's not what equities want, right?

So they are getting, they're getting a double whammy. I feel that we are very close to a top and I think that we. Should seriously consider selling equities? Should the fed cut into the spike of the Fed cutting? If there is a spike, if people, start taking equities higher on the Fed cut, and it's quite clear that it's a hawkish cut, I think that is going to be the high for this year.

Andy: And people talk about these sort of things in this way. So we've got the dot plot, which is part of what the forward guidance will look like. We've got Powell at the press conference, and then we've got all the Fed Go Governors coming out and trying to clarify their views after the FOMC. But the way we markets tend to think about this is there's the decision which is cut or no cut.

Odd of a cut are very high. It would be unusual for them to decide to surprise. And there's real it just doesn't seem likely that they're not going to cut. But I guess that's a possibility. But then there's the after effect. What does the guidance look like? And as Nick said, is that, is it very hawkish, which is the dots do not drop at all, do not project further fast rate cuts.

Or even more so are more one and done sort of rhetoric from Powell saying We're not we're on pause Now that would be what people call a hawkish cut. I guess the question, Nick and I agree on a hawkish cut, you on a cut, you probably want to sell the spike because that's all there is, except if it's dovish cut.

What do you think of the possibility of a dovish cut?

Nick: I just can't see how they can do it without abandoning, abandoning their principles, their ethics because there isn't a single piece of data that's come out that says the economy is weak. If there was, I would, wouldn't have a problem with that.

I wouldn't have a problem with then continuing to cut. If inflation was also under control and coming down. Now, is it possible that in two, three months time you're going to start getting weaker employment data? Absolutely, but, and that's the time to resume the cutting cycle. But while the employment data is as firm as it is, I just don't see how they can do a dovish cut.

I, I just can't see it. We are so close to to the front end is so close to where the the PCE, the core PCE is that to take the fed funds rate to zero real rates in this environment, to me, is just asking for trouble from the bond vigilantes. And I just can't see what they gain by doing that because all they do is they steepen the curve.

People have less and less faith that they really want to drive inflation back down to 2%. And if you don't have that conviction that the Fed is still, targeting 2%. Then why would you buy 30 year bonds? And unless you're getting a lot of yield, a lot of carry, and here you are, you getting carry?

Yes. But are you getting a huge amount of carry? Yeah. I don't know.

Andy: Yeah, that's the question, isn't it?

Nick: Yeah. So therefore, I just can't see how they can do a dovish cut. I'm waiting for just these words from Powell. We are now at neutral. If he says we are now at neutral, I think the s and ps start bleeding very quickly.

Andy: I think that's right. I think that.

And I don't know how they can get to, so the range is four to th to three and three quarters four. It's gonna be three and a half to three and three quarters on Wednesday. So is that neutral? I don't think, I don't the median is not there. The median's lower, it's closer to 3.125.

It's really one or two more cuts. But I guess the question is, does that really matter? Like when I think of asset prices, I think it really matters that the market is for broad assets to rally in monetary conditions have to ease more than expected. And not just a little bit more, particularly in this day and age when mortgage holders still are paying three, two and a half percent mortgage rates when corporations are under levered.

When. Investors are under levered when most consumers are under levered in the real economy. I think you have to cut a lot more than that to get people to act and increase consumption. So it's tricky. I just don't know whether is it neutral?

Nick: Close. It doesn't matter whether it's neutral or not, it matters.

If he says it, if he says it's neutral, I am selling everything.

Andy: But he won. But he won't know. I don't think he'll say, listen, he could do anything he wants. Oh. But if he were to say if the message is that we're within basis a cut of the end, I think you have to be very cautious with assets.

If we are, hey, we'll do whatever it takes to offset labor. We're, if so, though, there's no evidence of this. GDP growth is very strong. Inflation is elevated.

There's no evidence of anything else. The only thing that's potentially weak is labor. And if the Fed says, Hey, we will. We will cut rates until labor's no longer a risk.

That's a lot more than 25 to 50 basis points.

Nick: Yeah.

Andy: And so

Nick: that completely negates what I just said though.

Andy: That would be the dovish cut, right? Yeah, that would be the, we'll do whatever it takes. We more likely is you're gonna get, hey, the inflation is sticky. Wage growth is a little better. Jobs may be a little harder to find.

We can't do much about that. And because GDP is so strong, yeah, we're close to done. Yeah. That's the hawkish. Cut. Yeah. And that would be just very difficult to get you. I think you need that hope. You need that. Hope that the Fed is going to significantly ease to support assets, prices of all sorts at this level.

Nick: Yeah. And if he says. We are done. IE we Are it neutral then? That is ultra bearish. I it just removes What do you think about that?

Andy: The bond market? We talked a little bit in the prep man if that, if they do that, if they do something that is on the hawkish side of hawk the very hawkish side of a hawkish cut, I would think that would be okay for the long end.

Nick: It should be. Absolutely. It should be. We have a bit of a technical situation in which we have 10 year notes at one o'clock before the Fed announcement at two on Wednesday, and then we have the thirties on Thursday. So I wouldn't expect the yield curve to start flattening immediately, but if it doesn't flatten after.

The auction on Thursday of the thirties. Then you have to ask yourself what on earth is going on? Because it has to be a demand thing. There just seems to be very, not good demand for the long end, even though you are having. Hundred and what, 1,520 basis points of carry. Now, that normally is a very nice carry for banks to just put away and hold or, do basis trades for the hedge funds, et cetera, et cetera.

And if that. Doesn't come through then we are having a generalized problem with the long end, whether it's driven by Japan, whether it's driven by one reason or another. It doesn't really matter. What matters is that still even having real rates quite high and having a lot of carry, it's not enough to entice people into the long end, and that is yet another.

Support level that is taken away from equities.

Andy: Which I think the point, it's a real

Nick: problem.

Andy: The point we're trying to make is that if we get a hawkish cut of a very hawkish cut, let's say it's, it, Nick's looking for words, I'm looking for words as well. But if we get something that's perceived as, Hey, we may not cut until.

Data comes out like January, taking January off the table, taking March off the table, being very data dependent, having the dots not signal anything more in terms of further cuts. All of those things, if those things were, if you told me those things were gonna happen, and recognizing there's a bunch of supply in the tens and thirties during that period, if on Friday I look at that.

All that happens and I look at that and I see long bonds struggling, higher yields, lower price. That would be a real concern and a real concern. Not for bonds particularly. 'cause as Nick said, they're not awful. They're not awful here, they're steep. The Fed's cutting. The Fed is hawkish, so that means they're willing.

They're not going to cut a ton to. Which stimulates inflation. They're not bad here, but man, if they if nobody else sees that when the Fed steps up, you have a bigger issue. And that's the type of issue that hurts all assets. We don't own any, we're not buying any, but the implication for equities is probably pretty interesting.

So I guess the, to summarize, we're looking for. A cut where think a dovish cut is highly unlikely. So we're now in the gray area of how hawkish the cut will be, and we're watching the long end because the more hawkish it is, the more the long end needs to rally or else something. More difficult is being is likely to occur where long end yields don't go down, even though the Fed is cut, has cut, which takes a leg out of the equity.

Nick: Yeah. And of course, once we've seen what they've done, we'll send you an email straight away should we need to change our locations. I expect that's highly likely this time.

Andy: Yeah, it feels like it.

Nick: Yeah. Excellent. Andy, thanks and I'll speak to you next week.

Andy: Alright. Okay.

