

# 2 Gray Beards Week 155 - Summary

## Key Economic & Market Themes

### Data Quality Concerns

The discussion centers on serious questions about the reliability of U.S. economic data:

- Ongoing concerns about BLS data accuracy and constant revisions
- Disruption from recent government closure affecting data collection
- Administration distrust of data leading to methodology changes
- Potential for another government shutdown in January when the continuing resolution expires
- Data may not become reliable until Q2 2025
- Republicans unable to pass ACA premium relief, adding to shutdown risk

### Current Economic Picture

Despite data concerns, the surface readings show:

- Unemployment remains stable; weekly claims surprising positively
- Inflation data coming in mild (though controversial)
- Economy appearing "okay" overall
- Fed viewing inflation as decelerating toward target, growth strong, labor as the weak component

## Bond Market Analysis

### Duration Strategy - Wait and See

Both analysts strongly recommend **avoiding duration at current levels**:

#### Current Status:

- 10-year real yields: ~180 bps ("nothing too exciting, right in the middle")
- German Bunds: within 5 bps of highest yields "since God was a boy"
- 30-year Bunds: at levels last seen in 2011
- Japanese yields: at levels last seen around WWII
- U.S. bond yields slightly lower week-over-week, but sold off immediately after low CPI print

#### What They're Waiting For:

- 10-year nominal: 4.50%+ (currently lower)

- 30-year nominal: 5%+ (possibly 5.25%)
- 10-year real yields: 225 bps (vs. current ~180 bps)
- At these levels, banks would have balance sheet capacity and incentive to buy

### Headwinds to Duration:

- Heavy upcoming issuance (corporate and government)
- Foreign bond yields rising (Europe, Japan)
- Real yields not attractive enough yet
- Uncertainty around SCOTUS decisions and new Fed chair
- U.S./Europe 10-year spread: ~124 bps (lowest in long time)

### Yield Curve Control Unlikely

- Nick and Andy dismiss concerns about U.S. yield curve control
- Market will find natural buyers at better prices (4.50%+ on 10s)
- Banks will have appetite once yield curve is steep enough and regulatory changes provide balance sheet room
- Would be able to fund at 1-1.25% over Fed funds

## Equity Market Outlook

### U.S. Equities - Cautious

- Markets at or near all-time highs (within 1.5-2%)
- Expecting either no Santa rally or very limited one over next 10 days
- Any gains likely reversed in second half of January
- Technical January buying (new money, rebalancing) may provide temporary support
- U.S. market requires further monetary/fiscal easing, which is bad for duration
- Current allocation: mid-30s percentage (comfortable with this level)

### International Equities - Preferred

Strong recommendation to favor non-U.S. equities:

#### Rationale:

- VEA (developed markets ex-U.S.) has **doubled S&P 500 returns in 2024**
- Non-U.S. markets don't require Fed easing to perform
- Japan hiked rates slightly but not on aggressive cycle
- Europe done with cutting cycle unless significant economic deterioration
- European countries planning domestic investment and growing budget deficits
- Less overinvested than U.S. market

### Dollar Weakness Theme:

- Administration appears comfortable with weaker dollar
- Helps U.S. exports and makes U.S. equities more attractive to foreigners
- U.S./Europe yield spread compression doesn't support strong dollar
- Supports gold as well as equities

## Portfolio Positioning Recommendations

### Current Strategy

Given unreliable data, dangerous duration, and equities at highs:

1. **Maintain broad global diversification** - don't concentrate in U.S.
2. **Keep equity allocation steady** - mid-30s is appropriate
3. **Avoid duration** - wait for significantly better levels
4. **Favor international over U.S. equities**
5. **Position for potential dollar weakness** - benefits foreign equities and gold

### Future Scenarios (2026 Outlook)

#### When Real Yields Reach Target Levels (225 bps):

*Scenario 1 - Equities Don't Decline:*

- Swap from equity exposure to duration
- Take profits in equities, rotate to bonds

*Scenario 2 - Equities Decline with Yields:*

- Buy both equities and duration
- Banks likely to outperform when duration becomes attractive

**Key Insight:** Once markets anticipate real yields heading down from peaks, that creates buying opportunity in both asset classes.

## Inflation Outlook

- Don't expect re-acceleration
- Likely in 2.25-2.75% range "for a long time"
- This range supports 4.50% 10-year yields as reasonable, not excessive

## Timing

The analysts view the duration opportunity and portfolio repositioning as a **2026 story**, not imminent. They recommend patience and maintaining current positioning through year-end and early 2025.

