

2 Gray Beards Week 155

Nick: Good morning. Today is December the 20th, and that's a notable day because it's my birthday. Hey, there you go. Old man. Nearly an old age pensioner. Anyway, another year, and we are there. So Andy, welcome. What happened last week? Not a lot. All the data keeps on coming in. As the economy is doing okay.

There's, the unemployment rate is not rising. In fact, weekly claims keep on surprising to the upside, a less unemployment, if anything. And the inflation data that we got, although controversial was. Very mild. Is this data real? Are we getting bum data that is being revised constantly by the BLS and what is going on with the data?

[00:01:00] Can we trust it? That is the question.

Andy: Yeah. And I think that's, I think unfortunately that's gonna be the question for, many months to come, possibly. Maybe as maybe we get lucky. But the data disruption due to the closure is, was significant. It was a long closure relative to most, but it also seems like there's.

The methods, the, for one, the administration never really trusted the data and is spending time and resources trying to improve the process. So I think we're gonna get data that is. Just not the same. Not the same in quality, that there may be an adjustment to the way it's delivered, the way it's collected.

And then we have some basic problems to face, which is. The continuing resolution in November that opened, reopened the [00:02:00] government ends in January and when it ends, there was a promise from the, to extend the continuing resolution or actually to negotiate the continuing resolution. There was a promise by the Republicans to address the a CA premiums going up, which are gonna go up a lot for a lot of Americans.

Assuming there's nothing done and the Republicans have not been able to get that passed, so there's a very decent chance, I don't know what number, but a very decent chance that the government gets shut down again in January and we once again go on a data holiday, even if that doesn't happen. There's a New York Times, a Wall Street Journal article Today I'll f I'll forward to you guys.

That shows that the data may not become reliable. And what I mean by reliable, like it used to be until Q2. So I think it's very tricky nowadays and the market is.

Acting as [00:03:00] if it's tricky to use either for current condition assessment or projected assessment of the economy to use the data that we're getting.

And Nick's w it's showing what. The Fed thinks it's showing, which is inflation no longer accelerating and coming down toward target slowly and growth strong and labor the weak part of the data. So it says, and so I think it's gonna be just very tricky to make any sort of, large conclusions about where the economy is going given the data, and I think that also implies. The, at least the Fed, at least the Powell Fed is not gonna make large shifts. And that's what you look at. And then tying that back to what markets are doing, it continues to be our, probably our [00:04:00] strongest belief that long-term bond yields are just not attractive enough to buy.

Nick: Yeah, no, last week we, although the US bond yields were slightly lower than the close the previous Friday it just showed that the market doesn't really trust the data because as soon as the low print came out in CPI, that was the high for prices that, that second and.

Everything sold off from then and in in Europe and in Japan, yields keep on going higher. So duration is something that we are still not attracted by. Is it Andy? It's just too dangerous, especially in the US until we get the SCOTUS decision and also that we know who the new Fed chair is and what his policies are going to be.

It's we are in, [00:05:00] we are stuck in this, scenario whereby foreign markets keep on doing worse in terms of duration. And let's face it, buns are now within five basis points of the highest yield we've seen since God was a boy and the B. The 30 year is actually now at levels last seen in 2011. The Japanese market is at levels last seen probably during the second World War kind of thing.

And yeah, so we are in a situation that the issuance that we are going to face, both from the corporate side and the government side. The fact that real yields are, you know me, nothing too exciting, 180 on the 10 year. It's neither in the twos nor at one and a half where you'd say, [00:06:00] I'm just not interested.

It's right in the middle of the range, and therefore all these negatives out there at some stage are going to weigh. On the on duration. And when that happens, that is a headwind to equities. So really what I'm expecting is either a no Santa rally or a very limited Santa rally in the next 10 days before the close of the year.

And probably anything that we gain over the next 10 days is going to be reversed in, in the sec, in the second part of January because you always get. A

little bit of buying in the early part of January because new money comes to work and rebalancing and all sorts of technical reasons, but it's just unattractive.

So what do you do in this kind of situation where you have. Data, which you can't trust. Not for a while. [00:07:00] You have duration, which is dangerous. It really is dangerous to buy duration right here and right now. And you have equities at all time highs or within. One and a half, 2% of them. What do you do? How do you position yourself to have the least amount of risk and most amount of reward?

What's your thought, Sandy?

Andy: Like we said last week the US market depends a lot on further easing of both of monetary policy and potentially. Fiscal policy pumping the economy. And both of those are bad for duration but they also require fed actions. And the Fed actions may or may not come in the next few months, but that's what the US market requires.

The non-US markets don't require that. You saw Japan hiked a little bit fine, [00:08:00] whatever. They're not on a hiking cycle, but they're not on an easing cycle. And Europe and the rest of the globe, basically that is not us, is done with their cut by and large, done with their cutting cycle unless you see a significant reduction in the economies and all of those countries have.

Plans to, while they've made pro, some have made promises to invest in the US all have plans to invest domestically and grow their in particular Europe, grow their budget deficits. And so that to me continues to favor non dollar. Equities. You look at the VEA, which we have some of, and that's in, is it for US dollar investments that has doubled the s and p return this year.

I don't think there's any reason to think that won't continue. [00:09:00] That while the dollar is not going to lose its reserve status, it isn't likely to rally a lot. Other countries have more attractive bond markets, still not very attractive, not duration's, not attractive anywhere yet, but more attractive bond markets and fairly attractive and well performing equity markets.

I think you wanna be on that trend and off of what is an Overinvested US market.

Nick: Yeah, no, I agree. I think we should remain well diversified across the globe. I don't think that we should be upping significantly our equity allocations. We are more or less where we want to be in the mid thirties. I.

Certainly wait to buy duration. I think there will be a time to buy duration, but that is saying that things are gonna get worse. It's, if we don't like 180 1 90 [00:10:00] real yields, we like 2 25 real yields. And if you know that for the market to get there. Nominal bonds have to get significantly worse.

You have to get something in the four fifties in tens, and even above 5% in the thirties. Significant, maybe even five and a quarter. That probably is an attractive place, and that is when probably the banks will start performing. So you really need to be diversified across a broad range of assets to be able to take advantage of those scenarios.

Andy: And those, and. While I agree with those levels and so on, it'll be also interesting to see what real yields, which are always gonna be lower for Japan and Europe, the primary other bond markets. But where real yields are then for those countries is [00:11:00] gonna dictate whether the opportunity in duration is.

Suddenly in the US or more likely in another country. It's not like there's a great deal in duration anywhere right now. And so it'll be very interesting to see how that plays out. Nick, what do you think of this idea that, cent at least, is going to do everything he can to protect bond yields.

I don't think the Fed has any interest in growing its duration balance sheet, but they are willing to increase the size of their balance sheet. Does this all get saved by. Action by policymakers to put a floor a cap on long-term bond yields through whatever means they have. What do you think about that?

Nick: I don't know. It's unlikely that they introduce some effective. Yield con, yield curve control [00:12:00] measures. I don't think the US duration is particularly in trouble once it gets to a level where it's attractive. I think as soon as the yield curve is steep enough and the banks have the balance sheet room through the feds.

Change in regulations, which gives them more room to buy us treasuries that will jump at the chance to to buy stuff that they can fund at 1% or one and a quarter percent over fed funds.

Andy: Yeah, I think that's one of, and we're not there. That's one of the big misunderstandings that you get from lots of people who think that yield curve control is coming.

Yielded curve control, will the US bond market will be fine at a better price.

Nick: Yeah, no, absolutely. And I don't, I certainly don't think that inflation is likely to re-accelerate. And while you know how [00:13:00] much it moderates is a, it's open to. A lot of questions. I think that we are in a 2.2 5, 2 7 5 world for a long time.

But that means that if you see four fifties in tens, it's not excessive. And you will find lots of buyers at those levels. Lots of buyers,

Andy: right?

Nick: So we,

Andy: So the question is, if they don't want price to do that, because. They don't accept that idea that there is a strong bid for duration at a price, or for whatever reason.

They feel like they need to have lower long-term interest rates for purposes of increasing economic activity, keeping mortgages, mortgage rates low, all those sort of things. And they act. They act regardless of what we think they're gonna do, but they do act to me. That's just saying that they're [00:14:00] favoring.

A weaker dollar. Yes. And that just says to me that once again, you need to be outside the US for some portion of your assets.

Nick: Now it's very difficult to see how this. Increase of how these bond spreads coming in to just about, they're the lowest now against Europe, around 1 24 in tens.

They haven't been that low for a long time. How is that going to support the dollar? And I think that the administration is perfectly all right with a weakening dollar. They don't have that much interest in supporting it, that actually supports foreign equities, as you said. But it also supports US equities because you can export more.

The the value of the e the absolute value of the equities for foreigners is more attractive. So I think that is the way they are [00:15:00] slowly, making the dollar less attractive, which supports gold, right? And it also supports. All equity markets, but once we see that we are at yields that make sense and real yields that make sense, that are attractive, then we can switch into duration as well.

And that should be when equities perform well.

Andy: Sounds good if they can handle the high real yields.

Nick: Correct. But once they get to the high real yields, the market will start anticipating that they're gonna head down again.

Andy: Depends on where equity prices are. They become viable if they, if real yield.

I think the point is, if real yields go to where we think they may go, equities has to trade down or that for them to become viable. But if they don't, they're still not viable at those high real.

Nick: Correct, but I just assumed that the real yields would, will make them come down slightly [00:16:00] and then you buy them.

Andy: So the point being, if equities don't come down, when real yields become buyable, then you swap from your equity exposure to your to real yields. If they do come down, you buy both.

Nick: Correct. That's a story for 2026, so all we can do is wish everyone a very happy Christmas. Thank you for following us, and we'll be with you on the 27th and all the best

Andy: and for 2026.

Thanks everyone.

Nick: Bye.

Andy: Great Christmas.