2 Gray Beards Week 156 Summary

Market Overview

The week after Christmas saw minimal macroeconomic data releases, with stable unemployment and steady weekly jobless claims. However, gold and silver experienced significant price surges despite the absence of corresponding moves in equities or Bitcoin.

Gold & Silver Rally Analysis

Andy's Interpretation: The precious metals rally is primarily driven by **year-end flows and window dressing** rather than fundamental debasement concerns:

- **Tax-loss harvesting**: Investors avoiding taxable gains on winners while harvesting losses (particularly visible in Bitcoin and MicroStrategy)
- **Performance chasing**: Portfolio managers who underweighted gold (which gained ~60% in 2024) are buying at year-end to improve their annual statements
- **Speculative frenzy**: Year-end dynamics have ignited momentum trading beyond fundamental justification

Portfolio Impact:

- With a 5% gold allocation that returned 60%, even benchmark-allocated portfolios gained 3% from gold alone
- Most portfolios lacking precious metals exposure massively underperformed in 2024

Debasement Thesis

While acknowledging some legitimate debasement concerns, both analysts agree the current rally exceeds fundamental justification:

Supporting factors:

- Fed purchasing $40 billion in Treasury bills monthly through April
- Administration prioritizing jobs and growth over inflation control
- Dollar weakening policy to stimulate growth

However: Bitcoin's underperformance suggests this isn't purely a debasement trade, reinforcing the year-end flows explanation.

Portfolio Strategy for Gold

Recommended approach for benchmark-allocated portfolios:

1. **Maintain core gold position** - No reason to abandon the 5% benchmark allocation given the overall macro outlook
2. **Monetize elevated volatility** through options:
    - Sell out-of-the-money calls to capture premium if prices don't rise further
    - Sell out-of-the-money puts to collect premium and potentially add on dips
3. **Rationale**: High speculation has inflated options premiums on both sides, creating opportunities to profit from volatility without taking directional bets

Andy notes he's already implementing this strategy in his Alpha book with March-dated options.

Major Upcoming Catalysts

Two critical events could significantly impact markets:

1. SCOTUS Tariff Decision

If SCOTUS rules for the administration:

- Unleashes aggressive tariff policy
- Reduces budget deficit through tariff revenues
- Likely inflationary → **negative for duration**

If SCOTUS rules against the administration:

- Increases budget deficit expectations
- Unlocks consumer spending from tax refunds requiring debt issuance
- Stimulative effect → **also negative for duration**

Conclusion: Either outcome appears bearish for longer-dated bonds.

2. Fed Chair Appointment

Even a dovish appointment (like Hassett) faces constraints:

- The 2-year market prices rates based on current short-term levels
- Market skepticism limits potential yield compression to perhaps 10-50 basis points
- Any dovish surprise unlikely to meaningfully benefit longer duration

Fixed Income Positioning

Strong consensus to avoid longer duration:

- **Stay short**: 2-year and 3-year Treasuries acceptable
- **Avoid 5-10-30 year bonds**: Risk/reward highly unfavorable
    - Buying 10-year real yields below 2% offers "no risk reward"

    - If yields fall to 1.5%, it signals economic problems that hurt equities more
    - Duration becomes a "terrible diversifier" in this scenario

Key insight: If economic conditions warrant buying long bonds, you'd be better off reducing equity exposure instead.

Equity Outlook

Current positioning:

- Equities appear fully priced at current levels
- Difficult to justify adding above benchmark allocation
- Possible year-end rally to S&P 7,000 (up ~1% from discussion date) due to seasonal flows

2025 outlook:

- At some point, reducing US equity exposure may be warranted
- **Non-US equities** look attractive due to:
    - Much cheaper valuations than US
    - Expected continued dollar weakness
    - Better relative value

US market dynamics:

- AI trade is the primary driver of US outperformance
- Expected to reignite in 2025, potentially favoring tech-heavy exposure (QQQ)
- No urgency to chase markets into year-end

Overall Strategic Positioning

Current stance:

- Comfortable with existing allocations
- No major adjustments needed before year-end
- Patient approach until major catalysts (SCOTUS, Fed Chair) resolve

Thematic views:

- Administration prioritizing growth over inflation → bullish for gold, non-US equities, bearish for Treasuries and USD
- Markets will provide sufficient time to react to major policy decisions
- Focus on capturing volatility premiums in overheated markets (precious metals)

The analysts close by wishing subscribers a Happy New Year, indicating this was their final update for 2024.