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Nick: Hello, good morning, and today is the 7th of March and I'm in the Rocky Mountains. Andy, you've been around all week. I haven't, I've been looking at what's been happening, but you probably can express better than I can the intricacies of what is happening at the moment. Certainly let's not get too much into the geopolitics because neither of us has got a clue about what could happen.

Anything could happen, right? And. We can't really predict it. We can play the odds and so on, but the geopolitics will leave to someone else. So tell us what you think is going on and how can we profit from this?

Andy: Sure. Obviously the thing that's happening is the geopolitics and so we have to acknowledge what is happening versus.

What I think Nick's entirely right about, no one knows about what's going to happen, including, all the players who are gonna have to adjust to changes that occur. So what is happening is we're at war in Iran. We are seeing no signs that the war is, going to end immediately though.

You never know. So what We are at war and so that has disrupted the supply chain of oil. Which has resulted in a an extreme move in oil prices, which are up from a month ago. The front month crude was \$56 a barrel. Now it's in the nineties. And that's a huge move and even the longer dated oil contracts are being lifted up by that and with some uncertainty about where the oil prices will be in the future.

You're seeing longer dated oil up. 16, 18%. Not the near doubling of the front contract, but, substantial. And so that reflects uncertainty regarding the geopolitical outcome. Asset prices broadly are lower. The sort of early read on, bonds, and to and gold were to rally a lot on the sort of Monday opening and that failed pretty spectacularly though gold is only down a little bit for the week.

The sort of risk off run to. Bonds and gold just didn't play out this week and got very, pretty worse. Much worse for bond for bonds by the end of the week, and we'll get to that in a second. Equities, they're down, certain equities are down quite a bit. So the things that we're really working like.

Semiconductors in Korea, that's probably the most fluffy thing in the world, which by the way, is a significant holding for EEM. Emerging markets are heavily impacted with the three big semiconductors. But even things like the, anything that non-dollar like RVEA was down relative to the s and p.

Some of the more everything that's working got sold. And so we come into Friday with a. An economy that is UNC to me, very unclear about where it's going. But to most very clear that we are in a re absent the war in a reaccelerating, strong job fed, never gonna cut sort of environment, we get a. The first negative NFPI can remember, maybe there was another one, but I think it's the first one and just a complete rejection of that idea in terms of the data, which to me is not worth then extrapolating to say, geez, the job market and the economy are about to roll over.

It's just to say no one really knows right now because the economy is dealing with. More uncertainty than it does most of the time. And the data is still catching up from the disruption of the shutdown. So you're seeing all these cross currents. And so bonds ended up selling off a little bit, though they rallied back by the end of the day for the month, for the week they were down, 10 year yields were up from the lows of 3 95 to four 13.

They looked, they were even higher at one point on Friday morning. Two year notes have traversed a RA wide range from three 40 to 360 3 and back. And, they're more they've been more volatile lately last week. So you're seeing all these cross currents, then you drop into US equities, US equity.

Prices of the broad index were down a little bit, 1.75%. If I did the math right on the s and p obviously other things were happening. Software stocks bounced and recovered in a major way where the rest of the market didn't. As I said, the things that everyone loved are the things that got sold. But I think the thing that's much more noticeable and much more important is the level of implied volatility really spiked along with oil.

Those are very correlated trades in this environment, and vIX Futures, which are better than using the VIX Index, but VIX Futures closed at their highs and were up six ball points during the week, and I think there. What are they, mid, late, high twenties right now? I'm short. It's so short. Yeah. 26 ish.

Nick: Yeah.

Andy: That's remarkable. It's consistent with great uncertainty. It's consistent with aggressive buying of puts. But you don't actually see the aggressive buying

of puts. What is a lack of selling, of puts. So where in past crises you see very significant flows into puts, pushing up, put prices, which tends to then resolve in a bullish way.

In this case, you're seeing some demand for puts, but. Mostly you're seeing a lack of supply. And so that to me is just an interesting dynamic. And so you have a historical situation where outta the money puts are much, more bid than stop, than outta the money calls. So then the question is, does that predict anything?

And I think now you're back into. We can talk about the Fed. Are they going to hike? No. Are they gonna cut as much as priced? Probably. No. That's where I think we need to now talk about what to do about all these things. And Nick, what are your thoughts?

Nick: My thoughts are that. If the Fed was going to, if the market was counting on the Fed, cutting aggressively over the course of this year, the market has to be disappointed by not so much the data that we've been getting, but certainly by the response of the bond market with steepening of the yield curve.

What we are seeing at the moment is certainly a very. Aggressive steepening in the curve, which is being caused by the spike in the oil price and therefore the fear that the market has, that we are going to go into a period of basically stagflation. What we have to figure out is what the Fed's response to that is going to be.

While a couple of weeks ago, we were discounting a hundred percent likelihood that the Fed was going to cut in March. Now we are discounting almost a 0% likelihood that the Fed is going to cut in March. I have absolutely no idea how the Iranian thing is going to play out, but. The odds tell me that at the end of the day, the US is going to win.

The question is it going to win nice or is it going to win ugly and is it going to take a week or is it going to take months? And I have no answers to that and I don't think anybody has any answers to that. But what we do know is that the Fed is not going to hike, and therefore every time that the two year note gets to a level whereby the funding is.

Neutral IE, you don't lose money funding it. You are supposed to buy it. And whether the, then the curve steepens via the Fed cutting aggressively because the employment situation overrides the fear of inflation and. The Fed is

supposed to look through this kind of inflation because this is a supply shock and their job is actually to look through it.

The bond market won't look through it, but the Fed is supposed to look through it and therefore they could still cut and you could still get a steeper curve while via the short end rallying while the long end does nothing more or less. So what do I want to do? Do I want to extend? No, I don't. I think that the best place to be over the course of the next several weeks or months is going to be the short end.

Anywhere between one year and four years or five years, that kind of area, exactly where we are. And I definitely do. You might lose five basis points, 10 basis points, but you're not gonna lose the 30, 40, 50 that you could easily lose at the long end. So that's where I want to be. But in terms of equities, I think that if the Fed were to cut, it will be for a very good reason.

And that reason is that the data has turned very negative for the economy. IE the employment situation, the NFP. That we got on Friday migrates into other areas because let's be fair, we haven't seen the NFP negative number into in the weekly claims, nor the A DP nor the challenger, nor in any. Other data nor the GDP now casts.

So if that starts spreading and it goes into these other numbers, I'm pretty sure that the Fed will cut. But the only part of the curve that's going to be rallying will be the very short end, zero to fives. The rest is just going to remain pretty neutral where it is now. And that actually. Stops the equities from rallying as much as they would otherwise rally.

They've got a double whammy. The long end is not rallying, and the Fed is cutting because of risk off. Am I, do you agree with where my head's at for equities? Yeah.

Andy: I we have a slight, we have a slight difference of opinion about what the future lies for the economy. I have been skeptical about what this re-acceleration idea and believe it's more than fully priced into markets.

So I love the two year because I think they're gonna cut, but at the same time, I also know they are not gonna cut. If the economy remains strong and that keeps equities at bay. So the question is, what do we do? So I agree with you completely on that. So then the question is we just disagree on the economic outlook and neither of us know.

So the question is what does that mean for equities and. Your love of the, your you're favoring the two year, as do I. We favor it for modestly different reasons, but in both re, but we agree completely that. You've taken away any sort of, in a good economy, you've taken away any sort of stimulus to equities for cutting and in a, and the cutting will only come at something that's bad for equities.

So equities fell, certain equities fell a lot not much relative to what's happening in oil, and certainly not at all relative to what's happening in vol. Are we supposed to buy equities on Monday morning?

Nick: I don't think so. But what we have to consider is that our puts expire on the 13th of March, not the 18th, on the 13th IE, next Friday.

And we have to do something with them because we don't want to take we Volatility is at 26%. I think it's much, much easier for a portfolio like ours to sell calls. Rather than roll and buy more puts, buying puts are 26% is, dreadful. Do you agree with that or do you think that buying puts or put spreads is still the way to go?

Andy: I'll start with the delta, which is, do we want to increase our delta if we let our puts expire or sell the, or sell them outright? Do that increases our exposure to long equities. It come do, we can maintain that exposure by selling calls or buying puts. I guess the first question is, do we wanna maintain our delta or do we want to increase it?

And I'm not that interested in increasing at current prices. I'm quite interested in increasing at, a few percent,

Nick: much lower prices,

Andy: three, four, 5% lower. I'm quite interested in that.

Nick: So basically what you're saying, do a str, do a strangle, sell the cools above and sell the puts below.

Andy: Yeah, so again, I'm starting with my delta, which is we're gonna replace a short delta with some, with either nothing or something.

If we, if our puts are providing us with a short delta, I want to replace that short delta. 'cause I don't want to change my e equity exposure, so I want to either sell calls or buy puts. Now I look and say puts are expensive. I wanna buy stocks

anyway if they dip a lot. So to me that favors put spread, particularly given that skew is so steep.

So to answer your question, I don't love selling upside calls because they actually are pretty darn cheap right now. They're not as cheap as they could be or else we'd be suggesting a stock replacement strategy where we sell stocks and buy calls out of the money calls. That's not what we're saying. I don't think they're cheap enough.

They're rich enough to sell. And so I'd prefer to buy puts and buy put spreads to, because the skew is so steep. But that's just a, you're gonna look at the prices, you're gonna look at the levels and come up with the best idea. But I favor put spreads over outright puts to replace our existing puts.

And I favor, and I don't favor selling calls.

Nick: I can't do that now because I'm not set up for it, but I'll do it on Tuesday when when I'm at my desk and then I'll put out a quick note via the website and tell everyone what we are gonna do. So basically we are not doing anything until Tuesday morning.

And on Tuesday morning, I'll have all the prices. I'll know where we are and I'll tell everyone,

Andy: And the urgency is not because we want to, so let's just review. We like our twos we wouldn't extend. Makes sense to me. We like equities down a lot. We don't like equities here. But we have an urgent thing to, to deal with, which is the puts that we are long.

And so that'll be a Tuesday's business. And as it relates to other things we did, we sold gold, got very good prices, we scaled out of some commodity exposure. Didn't get great prices 'cause oil's up. A tremendous amount since,

Nick: We lost very little.

Andy: Is there any any other thing to do outside in, in gold or commodities do you think, Nick?

Nick: I don't think so. I, I'm comfortable where I am thing. I don't think this is a by gold kind of thing because, you, we saw how it acted. I don't think this is an extend duration kind of thing. Before data tells you that it's spreading to other

parts of the economy. I don't think that this is cheap enough to actually start pounding the table and say bye.

Equities, I think you could easily have another big leg lower, depending on the geopolitical news of the day. That is when we want to act, when that geopolitical news is out and everyone is panicking because we have plenty of cash, we can, we can really invest at really cheap prices.

Andy: So I've seen a bunch of people talk about this, and I think it's likely true that this is a market in which people are much more concerned about missing out on the bullish headline than they are about selling here.

Agree. I think that's, I'm not, that is true. It's certainly been true, like missing out in the. May tacos, the June tacos. Any sort of taco has been, pretty painful for if you between May and. October, but since then, missing out on good news hasn't cost you anything at all.

Nick: I don't think there's that much good news that's going to come immediately.

And if you think there is, as you said, calls are quite cheap, so just buy them and forget about it. I think that we are going to get a few more bad headlines and that will be the time to actually sell out the money puts. Or do some kind of call spread to the upside. I then think that this is the time and we really don't need to do it today.

Makes sense to me. Let's wait till Tuesday, send out a note to everyone and tell them what we're doing. I think that's probably the best thing to do.

Andy: All right. Have more fun on your vacation. Thanks for joining us while you're away.

Nick: Okay, thank you and expect a note from me on Tuesday. I'm not going to do my bit now because it's too complicated, but you, I will do something for you on Tuesday.

Bye.