

2 Gray Beards Week 169

Nick: Hello. Good morning, and today is the 28th of March. The war goes on. Andy, shall we give them our views as to what we think is going to happen here? Not that it,

Andy: sure.

Nick: Not that it sort of, uh, our views are going to change anything, but my personal view is that we're going to have. Another escalation at some point because the gap between the two sides is just too wide at the moment for them to reach any kind of stable agreement.

And I watched President Trump in Miami last night and he was very, very hawkish. He basically said that. They're going to resolve Iran once and for all, and I can't see how that's gonna happen without some kind of major escalation. So my view is there will be an escalation, but the US wins as normal.

What's your view? What, how do you think we are gonna progress from.

Andy: Yeah, so I've went through the gap fairly, you know, we have, for one, we have uh, multiple, uh, we have one foe, one one plus some splinter group foes. And we have who are backed by Russia at least, but probably China as well. So there's, you know, that's the opponent.

And then you've got this. The, the, the team and the team is the United States, the Gulf States and Israel, and, you know, they have different some substantially different issue in interests. And then of course there's the, the spectators on the sidelines like all of Europe. And, um.

You know, those interests are gonna be hard to align in agreement. So to me, the first, the is to think about what the agreement would be and frankly, you know, we know what we want the United States wants, it wants to essentially end Iran's influence and prevent them from ever having influence again.

That's a, I support that ask. That sounds like a good ask. They seem to have been a bad actor for it,

Nick: but it's a big ask

Andy: a long time. But, you know, it's also a 90 million person country with some heavy backing from some fairly, uh, from some superpowers. I, so from their point of view, the Iranians seem to think this is a war of aggression on us.

We've doing nothing wrong, we're just. Doing our thing and protecting our nation. And you killed all our leaders. And yeah, you've gotta pay for all the damage you've done. You've gotta, uh, let us control the straight of hormones, you know. Forget reducing our ability to wage war, forget our ability to, you know, there's just no way we're giving up on that sort of stuff.

And so the gap is just really super wide, like super wide. And so there's, now that's of course also. It's also reasonable to think of why gap exists before a negotiation occurs, but I don't see any motivation to come to the table. So, you know, they could surprise me and certainly, you know, the fact that they are at least putting out their anchors and saying, here's where I am.

You can think of as a positive, and I think it's just a delay tactic before further escalation. So I expect further escalation. I've expected further escalation. I don't listen to anybody that tells me there's. A so a solve to this and a solve to this to me is either, is something in which the worlds can go back to something like normal and.

I don't see that happening in the near term. Yeah. So that's where I'm at. And so that, I

Nick: think we're in agreement in that case,

Andy: right? And so I, but at the same time, do I think we're gonna, the, so then you say, well, who's gonna cave? And to me the answer is Iran will cave if they are destroyed and not before, and the US will cave if they if the, a global economy and the US economy in particular is devastated or we lose lots of lives. Now we don't have lots of lives at risk right now, so that one's off the table. But, you know, the markets could force things. I don't happen to believe that the midterms or the markets, which are the common thing for why Trump will, leave without lose, lose the war. I don't see those as on his agenda. But you know, people do. So, you know, when he looks like he's concerned about the market, people get, uh, get enthusiastic. Alright? Um, but in the end you just, it's just gonna take some time. And that means oil's gonna be high for a long time.

Nick: So let's discuss actually things that we purport to know about, and that is what? Happened last week. First of all, we had some very, very bo uh, bad bond

auctions with massive tails. Which is not all that surprising given the, uh, the background that we are in, but real yields, you know, close that all time.

Well, I mean, not all time highs, but since the GFC, let's say. Around the 2 78, 2 80 mark in the 30 year real rates, they're going towards that 3% where we said that we are very, very interested. And for the first time on Friday, the markets started pricing in the possibility of recession being the outcome.

And by that I mean that equities were down hard. Gold was up. And the short end started getting a bid, although the long end didn't. So it's not really pricing in a recession. It's more pricing in the possibility of thinking about one kind of thing. Do we think that this is going to be enough to put the world economy or any economy in particular into recession?

I think it's so hard to tell at this stage, and it's far too early to draw that conclusion. What's your view?

Andy: So I don't, I think it's very easy to draw a very simple conclusion, which is. We're gonna, the world is gonna pay 20 to \$40 more per barrel of oil than they did for the last year, next this coming year.

We're already paying \$50 a barrel. More gasoline prices are through the roof heating oil prices, which I actually am a consumer of immediately corrected 20%. You know, that's gonna hit the pocketbook and it's gonna hit the global pocketbook at roughly 50 to a hundred basis points of GDP, which, when you're talking about a 2% real GDP sort of level.

Two 3% is a 50% change in GDP. That's a slowdown and that's, that's coming, that's has to be your base case. Unless somehow you think the oil price is never not gonna be 20 to \$30 a barrel above for the course of the next year. So it's that pressure on GDP because people have to consume and literally burn.

Money on oil that they now can't use to buy other stuff. By the way, food and fertilizer that cause that creates food are heavily influenced by the price of oil and those prices are going up. And as far as I can tell, food is a necessity. And so you just have to think that there is a real economic slowdown occurring.

Add to that. You've got hundreds of billions of new issuance needed by the US government to finance the war by foreigner, uh, the Gulf States to replenish. They're not selling oil, so they need to issue or sell assets to. Anybody that eventually rebuilds, that's getting piled on to a 6% debt to GDP, growing debt to GDP deficits, to GDP everywhere else.

That's recognizing that they need to arm up. And this massive set of promises made by the world to spend on CapEx. That's gonna tighten financial conditions and make it difficult to make money owning assets with all that supply on top. So, yeah. You know, we've been saying this for six months, at least, maybe nine months, that this is that the macroeconomic conditions are primed for some disappointment.

And now with O Oil as a catalyst, that disappointment is fairly certain, but markets have moved. Markets are 600 points off their all time highs. That's a correction. Bond yields are, as you said, pricing higher real yields. And so as an investor, listen, if you have been prepared for this event by being underweight risk, now's your time to shine.

And now it's just a question of timing.

Nick: But what we are saying is that the timing is A, not yet, and B is going to be a hard slog because you don't recover from this kind of a macro background in a V kind of way. You, it's going to be false starts, it's going to be all sorts of things at the bottom to scare you out.

By, causing you to sell the bottom rather than buy the bottom. So it's going to be a process,

Andy: right? I mean, the question is, is there a v possibility if tomorrow Iran agrees to all the United States terms?

Nick: Sure. But we are saying the odds of that are very, very tiny.

Andy: But that's what you have to be prepared for.

Absolutely. I guess you have to be prepared for. So we, I think we said that the US doesn't. Capitulate without the thing that we're saying is likely to happen happening, right? So they don't capitulate the other side, could capitulate for any reason whatsoever. And if they were to capitulate and deliver the United States' terms.

That's a extremely low on outcome. But if it were to happen then, then we act.

Nick: Absolutely. Absolutely. So what we are saying is that we still need to hedge the immediate short timeframe risk, but we are heading towards prices that we think are going to be attractive. Even if we have a slowdown but not a recession, we are thinking that recession is a lower odds risk than a slowdown.

Right. So slow down. Yes. Recession, no. And therefore the pricing is getting to attractive levels. Might not be there yet. In fact it certainly isn't there yet, but we are heading in the right direction and pretty soon should prices be a few percentage point lower, it's probably time to. Buy some equities, buy some risk, and certainly start buying at 3% or so.

Some real. Rates in the longer end? Is that what we are saying?

Andy: I, I mean, I think so. I mean, I just this weekend for me and most of the commentators I read are either an analyst that I read are either focused on um, what to do given that they've been massively overlevered long for a long time or.

Following price and expecting this to extend, or some are calling a recession now and saying, now's the time to short stocks and. For that group, I have to say, what's the downside? And so, you know, I think you just have to look at it. We s and p made \$278 of earnings last year in a normal sort of recession.

That could fall. That could fall. Now is it gonna, are, is the hyper or the hyperscalers gonna stop spending? They might, but they're not scheduled to, and so. These earnings for next year and the year forwards are pretty baked in the cake, but maybe they could have a negative earnings. So I've seen people say, well, you know, we'll see a 10% earnings drop.

Well, that's two 50. Call it 18 pe. Yeah, you could make a case for a 4,500 s and p. Now, that's a joke. That's a joke. Could it happen? Of course it could happen. There's a lot. Yeah. But

Nick: what are the odds,

Andy: right? There's, just so you understand pricing right now. Equity options, pricing for year end has a probability of 25% that we hit 5,000.

That seems like, geez, two heads in a row and we're at 5,000. That's the odds that seems extreme to me. That's a possibility, but you have to recognize it is a possibility. And by the way, that's earnings flat and an 18 pe. Realistically, just realistically, like what would sort of my sort of bear case be about the same bear cases it's been for six months, which is three 10 earnings, which is a 10% earnings growth year over year.

Remember? The, these are huge companies that are just going to keep earning, uh, at an 18 PE takes you to 5,600. We're at 6363 75. What do you do? I don't

think you sell to cov If you, if you, if you weren't selling at 6,900, if you weren't scaling out of risk at 6,900. Scaling out at 63 70, you have to ask yourself, what am I even doing?

Nick: Right?

Andy: On the other hand, if you were prepared to at 6,900 and preparing at 6,900, at 60 106,000, with a downside, of course it could go a lot lower, but a downside realistic downside of 5,600, you're supposed to be buying.

Nick: Yeah, certainly not selling. Okay. But what we are saying is that we are headed towards that 6,000 6,100, maybe 6,200 level, and that we are going to have very, very nasty corrections in the meantime upwards.

But they're not going to stick. They're unlikely to stick to higher prices, A, because of the earnings, and B, because of the higher real rates. For all the reasons that you enunciated amongst, which are the enormous, enormous issuance needs by companies and the federal government.

Andy: So yeah, I want, I want to say I rarely do this, but it's worth doing.

Next week has a, is a quarter end with a tremendous amount of options expiry. And this is something I've spent many, many, many years and very publicly on Twitter describing. I think it's likely without positive news from the war that we open pretty weak on Mon Sunday night into Monday morning, and I think we closed Tuesday at 64 75.

Because of month end and very technically oriented options expire. It's not a pin, but there is some significant likelihood that we have a pretty sharp recovery from Monday night into Tuesday afternoon and. I'm just watching for now. I'm probably, I mean, if we get a massive dip on Monday morning, I'm likely to add equities long, but until Tuesday plays out, I think it's crazy to be anything but a buyer.

Nick: Gotcha. Okay. Anything else that we think is important? What's happening next week? Because really everything is going to be overshadowed by the Iranian situation, and we do have some data, including NFP on Good Friday, which is a ridiculous time to release it because the markets will be. Either closed or non-existence in term in terms of liquidity.

Andy: Wait, are they, uh, releasing NFP on Good Friday?

Nick: They're releasing the NFP next Friday.

Andy: Wow.

Nick: Isn't that ridiculous?

Andy: Yeah. Yeah. Okay. Yeah. So, um, bonds are closed. Good Friday, typically.

Nick: Well, yeah. I mean, it, it, some markets like the futures will be open, but the, the liquidity is going to be. Like zero.

Andy: Alright, well that's something to look at.

I was hoping to have a day off on Friday.

Nick: Yeah, well I think you might need to, you know, because things will be very volatile anyway. So, um, let's think about what we need to do to the portfolio because our options are of course, expiring on the 31st. So let's think about that and I'll do that in my next, next segment.

But I think you've got the idea from us that we think that things are going to be very volatile. But the rallies aren't likely to stick for all the reasons that we gave you, and the path of least resistance for now is still with a lot of volatility down towards lower prices, but not hugely lower prices and that we, those lower prices is worth buying.

Andy: Sounds good.

Nick: Great, Andy, speak to you next week.