2 GRAY BEARDS

Weekly Markets Summary · May 23, 2025

A quiet week — except for one speech that changed the tone.

FED POLICY: WALLER TURNS HAWKISH

- Waller called for removal of the easing bias — a meaningful signal shift.
- His core concern: the Fed has missed the 2% inflation target six consecutive years. Any further shock risks de-anchoring public inflation expectations.
- Market-based inflation expectations (2–4 years forward) are his explicit watchdog — if they drift, hiking is back on the table.
- Waller is a known dove. That makes this speech more significant, not less.

NEW FED LEADERSHIP: WARSH JOINS THE COMMITTEE

- Kevin Warsh was formally sworn in on Friday. His first major test will likely be the June press conference.
- Bottom line from both the speech and the minutes: every major central bank has now shifted from cutting/pausing to pause/hike. This was the final confirmation of a multi-month global pivot.
- Cuts are off the table. Hikes are possible. That's the new baseline.

RATES & BOND MARKET

- Short end (2s) continues to weaken. Long end sold off sharply, then stabilized and recovered slightly this week.
- Andy & Nick are watching 3% real rates as the threshold for significant portfolio reallocation. Current implied real yield: ~2.75%.
- What gets us to 3%? Scenarios: (1) Warsh ignores Waller's inflation-expectations trigger and refuses to hike → long end panics; (2) contagion from Japan/UK local bond stress; (3) persistent energy price pressure that Warsh looks through.
- Andy's view: no rush. A ~2.75% real yield is acceptable. A rally to 2.5% would be disappointing but manageable. Staying patient.
- Gold is weakening — starting to reconnect to real yields. Interpreted as a signal that real yields are likely to rise further, reinforcing the wait.

EQUITIES: NVIDIA, FATIGUE, AND THE AI TRADE

- Nvidia posted blowout earnings. Stock barely moved. Andy's read: it's cheap on fundamentals, but so widely held (SPY, QQQ, active funds, individual accounts) that there's no natural buyer left to push it higher — and no obvious short to squeeze.
- The AI trade remains intact, but Andy expects the economics to eventually create stress: not enough economic pie for AI companies and the rest of the market to win simultaneously.

- Equities: Andy is a dip buyer but doesn't expect much more upside. Range estimate: 5–10% more possible before meaningful resistance.
- Supply headwind: June IPO pipeline (SpaceX + AI names) represents enormous concurrent equity supply. Hard to add risk into that.

WHAT TO WATCH NEXT WEEK

- Core PCE: already implied by CPI/PPI. No surprise expected.
- Treasury auctions: 2s, 5s, 7s — ongoing supply pressure on the short end.
- War risk (Middle East): a resumption of hostilities would be immediately bearish equities, bullish oil, bearish bonds and gold, bullish USD. Andy's framework: buy assets at a materially lower price; don't chase a dip.
- Bitcoin & gold weakness: both are unusual and unexplained. Potentially a leading indicator the equity market is missing. Worth watching.

BOTTOM LINE

Portfolio stance: Hold. Don't add risk in bonds or equities. Wait for 3% real rates before reallocating significantly to duration. VWAB provides some long-end exposure in the interim.

Key trigger to watch: Market-based inflation expectations (2–4yr). If they drift and Warsh doesn't respond, the long end breaks higher and 3% becomes real.

Tone: Hawkish pivot is now global and confirmed. The Fed is no longer even pretending to lean toward cuts. Act accordingly.