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Nick: [00:00:00] Hello, and good morning to you. Today is the 30th of May. Another month rolls by. Let's try and be practical in this, uh, episode and tell you what we think about where assets are and why they would move from these current levels. First of all, I'll tell you my candid view, and I'm sure that Andy is going to chirp in and tell me where I'm [00:00:30] wrong, if I'm wrong, and if he agrees or disagrees.

The problem at the moment is that bonds are in no man's land. That I think is the ultimate problem. We've been looking forever for real yields to get to 3% and to jump all over real yields. They are not getting there. They've gone back down this week. They're around the 217 on the [00:01:00] 30-year, and they keep on trading in this range trying to break higher, but not actually achieving the break higher.

We can all argue about why that is, but I personally, I think the most important reason is because we just don't know or have not be-- it's hasn't been confirmed to us what Warsh's policies are going to be at the Fed. I might suspect what he wants to [00:01:30] do, but that doesn't mean that the market agrees with me or that Warsh agrees with me because he hasn't told me.

Until Warsh tells us what he intends to do, I think bonds are going to remain in a very tight range. Why? Because at the moment we have a lot of positive carry. It's very difficult to remain short of bonds when you're paying away on the 30-year, you're paying away something [00:02:00] like 120 basis points per day because you have Fed funds at 365 and you have the bond trading at 490 or 5%, whatever it is.

And unless you see, uh, a big tightening coming up, you just cannot afford to remain long, uh, to remain short of bonds for very long. And that's why you keep on getting this seesaw [00:02:30] with prices going, uh, lower prices of bonds, i.e. yields higher, and then they come back and mean revert. While that is happening and while bonds are undecided, it's very, very difficult for equities to go down and remain down.

The only thing that is going to kill this equity rally is bond prices. And until they get high enough, that's just not going to happen. [00:03:00] The other thing that I believe is muting the bond response is that we just don't know where oil prices are going to settle. If they settle back down into the 50 to 60 range or even lower, bonds are going to scream, equities are going to scream.

It's only gonna be a question of what goes up more in terms of asset prices. If, on the other hand, you get a situation where, uh, the price after [00:03:30] this war settles in the 70-plus range, 70, 80, 90 range, then you are going to have, I believe, a response from bonds naturally depending on what Warsh says and does and how the market interprets it.

That I think is the situation, and if that is the situation, then all we can do is recognize [00:04:00] that it is what it is and wait for Warsh to tell us and get the bond response. That's my current position and where my head is at, uh, relative to the pricing that is indicated by the various asset classes. What do you think, Andy?

Andy: Yeah, I mean, I think equities are, um, globally. This is not, by the way, just a US thing. Equities globally are [00:04:30] in s- some sort of bubbly-like behavior over the last month and a half. Um, I think we've been trading equities in a reasonable range, uh, that, uh, over time rises. Um, and then we blew out to unsustainable levels.

But at the same time, um You need something to change for the market to change. Psychology is pretty [00:05:00] bullish, pretty, uh, positioning is, it's all-- In the end, everybody owns exactly the amount of equities they want, and tomorrow they may want more or less. And most of every day, people have wanted more the next day than they had.

And so there's a chase going on in equities. Um, but they've sort of disconnected from the rest of the markets. And by the way, this is global. Like, uh, and I'm not talking about Kor- Nor- [00:05:30] Korea, where you see two semiconductor stocks leading the market. Broad, boring, global ex-- without emerging markets, without Korea, without China, without any...

Like just, you know, the normal sort of developed market equities are up 15% this year, outperforming the S&P by 4% in dollars. And the dollar isn't really moving much. So the rest of the world [00:06:00] equities are also going up. Um, it's not just a US story. It's global equities rallying. Now, that should be based on higher growth, um, easy monetary policy, f- easy, you know, fiscal stimulus, um, and, um

And a, you know, a decline in volatility and a lowering of risk. [00:06:30] I don't think any of those things are happening, so it's probably an unsustainable move, but for now it's not worth fighting. You know, uh, when, when you're in a bubble, there's two choices. You can chase or you can fa-- Three choices. Fight it, chase it, or sit on the sidelines.

Fighting it is just never the right thing to do. Chasing it, man, you've gotta be a [00:07:00] fast and nimble trader to do that. And so standing on the sidelines and letting it work is fine, and that's where we sort of find ourselves. But Nick's point was on the bond market, and I agree completely. Central banks have, over the last-- since the war, have moved from the dovish side of neutral, depending on which country, more dovish than less dovish, to the hawkish side of neutral.

And [00:07:30] they aren't likely... I mean, Warsh could make some sort of, I don't think there's any chance he's acts dovish. I think he needs to build his credibility. We'll know this and we'll talk to you about it before the 17th, which is in two weeks when he actually meets. But he's probably also not going to be aggressively hawkish.

And so that's just gonna be more of the same pause, which is keeping global bond markets in the middle of a range. Sometimes they get [00:08:00] a little rich, sometimes they get a little cheap. That tends to be perfectly correlated with what's happening to oil. And so we don't know what's happening to oil. So, we'll jump into the war briefly.

We don't know what's gonna happen. What appears to be happening based on market pricing and what appears to be happening based on some sort of stepping back objective view is neither side wants hostilities [00:08:30] Which means There's no deal, and both sides benefit from kicking the can down the road and suggesting that there is an ongoing talk.

And so we've had every day it seems like there's a deal announced, and every day no deal actually happens. And that's because the sides are still widely apart, and there's no-- and no one's interested in [00:09:00] escalating. And so that's where we sit. And so I could imagine that happening for a long time, and then that speaks to where-- what happens to oil.

Listen, if we had a true deal where Iran became a trusted partner in the Gulf, to whatever extent they can be, such that oil flowed freely, there's a chance we have an oil glut in the next six months, and that could drive oil prices dramatically lower, which would drive [00:09:30] bond prices dramatically higher.

But that doesn't seem to be what the oil market expects. The oil is still well above its war-- longer-term oil is still well above its longer-term price. And so there's not an expectation of a, of a sudden resolution that resolves the whole oil supply. That would be what-- So it looks like what we're gonna get is a drip, a trickle of oil, a [00:10:00] constant ongoing uncertainty that leads to oil not being fully restored in terms of supply.

Okay. That's actually fine for bonds to do nothing. It's not a rally. It's not a cut. It's not a drop. And so we're in this period where we could just be going sideways in bond prices and oil prices for an [00:10:30] extended period of time. Now that tomorrow maybe there's a deal or tomorrow maybe there's an escalation.

But for now, markets are Just trolling sideways. And if that's the case, it's hard to be short equities.

Nick: Yeah. But do you agree that the only thing that's gonna kill this equity bubble, rally, whatever you like to call it, are bond prices?

Andy: Uh, in the, in the short term, yes. In the short [00:11:00] term, there is-- I- in the end of the day, the on- what'll determine whether equities are worth what they're worth today is almost entirely at this stage the success of A- AI to return investors, um, a reasonable rate of return, which means a whole bunch of tokens are going to be sold at a profitable price to the rest of the economy, and the rest of the economy is going to [00:11:30] find those tokens so valuable and yet not cut anybody's job because of it.

If that world happens, equities are well supported at current levels. If there's any glitch to that, they can't deliver the tokens. The tokens aren't that valuable. Mm-hmm. The tokens cost too much. The tokens that are worthwhile cause employment to explode. All of those things, that's h- what long term [00:12:00] kills current equity prices.

But that doesn't play out. That won't-- I don't know if, I don't think that'll play out in 2026. Yeah. Talk to me in a year, we'll know. But short term, without bonds selling off, all you're gonna get is buyable dips in equities.

Nick: And what do you think about the SpaceX IPO, which is coming up on the 12th, I believe?

Andy: So- Right. That, so that, I don't know when the d- deal's gonna get priced, but to me, I saw they were lowering the price talk. I don't, I, you know, [00:12:30] let's wait till that plays out. It's big. It's a lot of supply. And all of this CapEx that is being done by, that is accruing to the chip makers at the expense of the hyperscalers and, um, frontier model developers, has to get funded.

And it'll be an interesting test. I suspect it'll go fine. But again, it's one of those things where... And I think it'll go fine for one [00:13:00] very simple reason. Everybody on the planet who thinks that if it doesn't go fine is gonna crush the market, are gonna hedge in front of it.

Nick: Yeah, no, that, that makes perfect sense.

So what about next week in particular? Because we have NFP and stuff like that, but nobody's looking at the data in this market. I mean, basically data can be anything and nobody seems to care.

Andy: Um, so the, the, to me the most, the, the signal on the data is gonna be, um, [00:13:30] th- potential Fed policy implications.

And I guess it's possible-- So I don't, uh, let me tell you this. Weak data, no one's gonna care. Absolutely. And no one should Because inflation is the problem On the other hand, extremely hot data, I guess I could see a reaction. Yeah. And if so, that would be bad for [00:14:00] bonds.

Nick: Yeah, indeed. You know, I agree with that.

The risks are still for higher bond prices, uh, for higher bond yields, I apologize, and lower prices. Those are, especially at the long end, because I, I still get the feeling I don't know, but that is why I want to wait for the 17th and to hear it from Warsh himself. But I still get the, uh, the distinct feeling that Warsh is going to try and deliver what he promised to [00:14:30] Trump at some stage, which is lower front-end Fed funds.

Why he-- W- why Trump is so enamored with lower Fed funds is beyond me, because, you know, I'm sure he understands that you could actually have lower Fed funds at and higher 30-year bonds, uh, yields. Why, why do you-- Do you get any sense that Warsh is going to be actually [00:15:00] hawkish and try to build up his credibility?

What do you think those odds are?

Andy: Like actually hawkish, um, where he forecasts the potential for rate hikes?

Nick: Yeah.

Andy: Zero.

Nick: Ah.

Andy: Um, I think he'll come in with Yeah. I think zero because, uh, the, his-

Nick: So you reckon he's gonna be a Waller basically? Yeah. Uh, he's [00:15:30] going to say, you know, we-

Andy: We don't need to, we don't need to hike, but we certainly can be on pause to cut.

Nick: We are mildly restrictive as it is. Let's see how the war plays out. Let's see where oil prices are. Well, that to me, if he says that-

Andy: I think he'll step even farther back and say oil will be-- He will ma- make declarative statements that are consistent with what the administration is saying, which is the war will end, oil will be low, [00:16:00] much lower- The war will end, yeah

in the future. Oil is transitory, and AI is going to be a large disinfla- inflation area. That is

Nick: dovish. That is dovish talk.

Andy: Well, and at the same time say For that reason, I have no reason to think that we need to hike.

Nick: The, and that, that makes the curve steeper. That makes the short end say this guy's not [00:16:30] hiking ever."

Two years go down to 385, 390. The long bond doesn't really like it. It makes the curve steeper. Equities shouldn't r- you know, they're gonna go meh. You know, you've got a steeper curve. You haven't really moved anything. It's not really an equity problem, it's a bond market problem. And, you know,

Andy: kick

Nick: the can.

Andy: No, I think that's, I think that's, I, I think, put it that way. I think that's the most dovish you'll get from him, which is reiterating things he's [00:17:00] already said before about the future of oil prices and the disinflationary impact of... Now, again, he's already said all these things. Disinflationary impact of, of AI, but that we don't know.

And given that we don't know, inflation is our problem. I'm not worried about the job market. And so while I don't think hikes are necessary, we're certainly not in any rush to cut.

Nick: [00:17:30] Gotcha. All we can do is wait. We've told you what we really think about current asset pricing and what is likely to move it.

I think that before we make any drastic changes to the portfolio, we need to wait for Walsh, and we need to hear, his policy from his own mouth. Because it's one thing to tell you something while you're out of office, it's another thing completely to say what he's going to say from the pulpit there, [00:18:00] you know, after the FOMC meeting, after he's spoken to his colleagues, after- And it'll-

you know.

Andy: And it'll be a challenge- It's

Nick: a completely different thing.

Andy: It'll be a challenge for him because he's gonna be, uh, the gauntlet is gonna be the reporters who are going to try to get him to misspeak.

Nick: And then after that is going to be- And who knows if he's any good ... the bond market reaction, because the bond market reaction could be very extreme if he misspeaks.

Andy: Yeah. One, [00:18:30] um, one thing also, uh, you know, I've written a bunch of things. You can look at my Substack at dampspring.com uh, at Damp Spring Substack. It's free. I've written a lot about how to manage a beta portfolio through a bubble. Feel free to look at that if you have questions on what's going on, o- just in terms of at least my framework.

I think Nick shares it, which is don't chase unless you're a very nimble [00:19:00] trader.

Nick: Well, yeah, and that's me. Stick with what- I mean, I just trade it ...

Andy: stick with what you got, and don't lever up at the wrong time. But if you have m- if you want more details, feel free to look at that as well. It's a difficult environment, guys.

Nick: Yeah. No, and, and let's just, um, say what, because we follow a lot of hedge funds at a lot of institutions, let's just say what they're doing. Andy, you probably have a better idea. I [00:19:30] know through following all the people that I'm invested in, and they're all underweight against their benchmark in equities.

Every single one. There isn't one that's overweight in my case. What do you see?

Andy: So most of my clients don't care about an S&P benchmark, and so an overweight or underweight stocks is just not a thing. Most of them are long-small. They are not taking big risk on [00:20:00] equities. They're trading equities, but long small.

Now, does that mean they are gonna get long big? No, that means they don't wanna have a big position in equities in either direction. No one's fighting it. Um, on the other hand, the, the, um, positioning for, in other asset markets is very boring right now. Like, there's just not a lot to do in things outside of equities.

So what I would [00:20:30] describe is the absolute return funds that are not S&P benchmarked are on the sidelines and willing to watch. Will they-- On, on the other hand, there are a number of other funds, including my high net worth client, um, RIAs, that feel like they ha- have to ma- match the benchmark.

And so they are finding every possible way they can to try to equal or outperform the benchmark, and that means they have to make a [00:21:00] decision on whether to chase semiconductors in particular. And I would say most are saying, "Forget it. I missed it. I'm looking for other stuff."

Nick: Yeah. Waiting is, um, very rarely wrong.

Okay. Thank you very much indeed. I'll go through the portfolio, and we'll speak next week.

Andy: Thanks, Nick. See ya.