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Good morning, ladies and, and gentlemen. Today is the 1st of August, a new month, and we had quite an exciting week because of the FOMC. So they did nothing, but that nothing was actually quite eventful because the yield curve steepened a hell of a lot. Let me read to you a passage from his prepared statement, uh, Walsh's prepared statement that I think is very significant, and I quote, "Prices reacted in real time," and now he's talking about what happened in the intervening period between the last FOMC and this.

"Reacted to incoming information, and the reduction in forward guidance may have been a factor. Market participants are learning to play the ball, i.e., the data, and not the referee, i.e., the guidance from the, uh, FOMC. And mic-market prices will continue to respond in the direction and magnitude they see fit.

This, in my view, is a change for the better, and we are just getting started." To me, the significant words were, "and magnitude." Direction is fine, but and magnitude basically means that the training wheels are off. If the market thinks that inflation is too high, it knows precisely how to kill it. Take prices much lower, i.e.,

bond yields much higher, and kill inflation yourselves. Don't wait for us to move our rates. This is a big change. We are basically going back to the days of Volcker and early Greenspan when the FOMC meeting wasn't that important. What was more important was what the market and the yield curve were doing, and then the Fed nudged it in a certain direction.

So I think that we are in a new period, that's for sure, and we saw that real rates responded very quickly with nominals. Nominals went up much more than reals, but reals went up as well. We are in a period that we haven't been in for several years Andy? This is something completely new to people who haven't been in the markets for a long time.

Yeah, the way I think about it so I agree completely with every word you just said. The way I think about it is slightly different, but it's the, again, the same issue, which is I think it is well understood by pretty much everyone with any sort of conception of reality that since 2008, the central bank and to s- la- s- since COVID, the fiscal side, have done everything they can to support the economy whi- by doing one very specific thing, and that's suppressing long-term interest rates.

Now, you might say, well, okay, obviously they suppressed them during ze-ZIRP, zero interest rate policy. But since COVID, they've done a pretty darn good job of suppressing interest rates. And that's supported asset prices, which has made borrowing for real economic participants cheaper, both by literally those who are borrowing using suppressed interest rates, but also those who are borrowing by selling equity, by dissaving, by borrowing against appreciated equity.

Those things have really supported the economy and supported demand And so, you know, there's lots of people that blame the income unequal- or the wealth inequality on this sort of thing. Well, let's not get into that. But what has been the case now running on 18 years is interest rates have been suppressed by policymakers.

And we've gotten the outcome that you would expect: stronger growth, stable employment but also a weak dollar and stronger inflation, stronger fiat inflation, uh, fiat, uh, alternative fiat inflation, stronger inflation in gold prices, stronger inflation in asset prices, but mostly stronger inflation in goods and services.

And to kill inflation, you gotta relieve... i've been, we've been saying this, I've been saying this in particular for years now, that to kill inflation, you have to kill demand. To kill demand, you have to kill asset prices or, and increase yields. You can't keep suppressing and expect to suf- su- succeed in your job of combating inflation.

And so W- what I'm hearing, what Nick's hearing is hints. Hints, not confirmation. Hints that this Fed is going to focus to is going not to take action, but to remove action. In order to suppress interest rates, you have to do something If you are willing to let the market react to prices, magnitude, all you're doing is removing things that are suppressing interest rates.

It's a taking a passive approach versus like really trying to control the economy and everything you do without any consequences to anyone. But of course, there have been consequences, and inflation is the biggest one. So I hear-- I heard those drumbeats. P- Warsh has, even six, eight months ago, has been focusing on, "Hey, we can lower short-term interest rates if we tighten with balance sheet policy."

Which just means if long-term interest rates are not suppressed. He repeated, not only did he say it in the statement, but then when ta- w- asked questions in the press conference four to six times, I haven't done the actual count, he said

he's pleased with interest rates doing the work of the Fed for them because interest rates are rising, which is slow- which is a tightening.

He likes that. That's has been said before, and the important thing is to say, "Well, it's happening again." But he's not ser- he's not serious intent, meaning he'll just go back and do the same thing all these other guys do and suppress interest rates on the h- on a hint of weakness. And listen, that's the bet.

That's the ri- the right bet. That's what they typically do. But the market's not gonna react to our view that Warsh has decided to no longer suppress long-term interest rates. The market's gonna need further confirmation. Next week, this week, this coming week, we have the quarterly refunding announcement The d- budget deficit, since the last time they increased the size of the long-term treasury issuance that they planned on making, the budget-- the national debt has gone up by \$4 trillion, and they've not adjusted their coupon issuance

They're-- That's a pressure to increase their coupon interest issuance. But still, the most likely outcome is they once again, they leave auction sizes the same and do not add supply to the treasury market. That's counteracting everything we're saying Warsh is now saying. That's a suppression of interest rates.

So we're gonna look at the quarterly refunding announcement. Our expectation is no change and also no change in the language, which has said over the last few years now that we expect auction sizes to remain the same for several quarters. Several quarters is running out. It's not gon- it, it could be that they remove the several quarters language.

I think it's a coin flip. If they do, that would be, to me, a louder drumbeat. But we don't know. Pow- um, Warsh has a Jackson Hole speech. He has another Fed speech. He has the task force on the balance sheet to deal with. We have tremendous supply coming from corporate issuers to fund AI in long-term treasuries.

Uh, it's, I don't know what you know, there's the camel and the back story, which is I don't know what thing is gonna cause it, but I'm convinced today that a, there is sizable risk, not certainty, sizable risk that we have a real bond market puke in the coming weeks and months as this momentum of this idea that we're going to return to normal curve steepness and risk premium plays out.

So it's really a risk premium expansion story, isn't it? Yes. And if risk- So that's the tightening. Yeah. And if risk premia expand, then gold can't go up. In fact, it's more likely to go down. And equities are at best going to spin their wheels

because however much earnings are excellent and can even be projected to be improving, they will be projected to be improving at a decreasing rate.

But the multiple that those earnings have to be valued at has to be lower, and there is no amount of earnings, I mean, no amount, just it would need an incredible amount of increased earnings expectations to make up for a, even a 1X multiple reduction. Term premia have to reduce the multiple of equity valuations, and every 1X is worth what?

You know, 5%? Yeah. Every multiple point is, you know, at a 20 multiple, every multiple point is 5%. You know, to me, when I add all this stuff up, listen, again, this is out of consensus, so don't expect to read this on your Substack or see it on some other podcast or in, on your Twitter feed. This is out of consensus.

We think there's a decent chance we have a significant term premium expansion based on the Fed policy shift that we see and other factors that are coming to market. What's that good for? It's good for 50 basis points on the long end. Will it overshoot? I think so, if we actually get 50. But- Always ... for the moment, we could rally- bonds could rally, stocks could rally.

All these things are just, we're out of consensus. It takes time for... Un- by the time we are at consensus and the market's moved, we're gonna have moved on. Yeah. Well, I mean, I just saw the way the nominal, uh, bonds traded last week, and we are, I think, nowhere near a, a bottom. W- what do I think is going to happen?

You tell me if you agree or disagree. Nominal rates are gonna go up more than real rates, but real rates will still go higher. So we could easily see 30-year reals at three and a quarter, even 340, while... So that's another let's call it 30, 35 higher, while the long bond, the nominals actually go 50 higher, 55, 60 higher.

So in any case, nominals go up more than reals. And that eventually, even though... W- I mean, let's, let's go back slightly and see what happened last week. We had a real dump into just before the earnings of, uh, what do we have? We had Apple and Amazon, and then before Microsoft and, uh, whatever. And We only rallied on the news that Citadel had bought out the book of that poor AI guy who got buried, and then we had the earnings which just sort of pushed it higher.

I am convinced that we go back to the levels that we were on at the close of Wednesday within the next, I don't know, two weeks. I would even say one

week. And I think that now not taking advantage of options is silly because we are at a l- at, at, at a point whereby we are either right or we are wrong.

But if we are wrong by very little, and if we are right by a lot. So this is precisely the time that one should be playing options. I'm already doing it for my alpha book, but I, I intend to talk about it for this beta book for both original and squared, uh, later on in, in my part.

Do you agree that this is really the time to spend some premium and insure the book against an o- m- I wouldn't say a catastrophic outcome, but one that could really ruin the rest of the year? I mean, I think the question is ver- is simple, which is what's the catalyst for higher equity prices?

There's the end of the war- Earnings ... and there's earnings. Yeah. And earnings are behind us. You know, of course, we're gonna get some of the smaller, less important ship and shovel companies, and then we're gonna get Nvidia toward the middle of the month, late middle of the month. But there's not a lot of single name risk coming our way.

And so, yeah, I think it's a good window to buy some protection in case the macro starts playing out the way we're talking about. Yeah. No, uh, absolutely. I, I, I'm getting that feeling that things are going to start escalating. I think s- far too many people have become far too confident that the Fed has their back.

When a Fed chair tells me that he doesn't care about the magnitude of moves that the market could make, that to me says, "You're on your own, boys. There is no Fed put, there is no Fed call, there is no... There, th- we are not going to save your bacon." That to me says increased volatility, and increased volatility to me says lower prices.

I think it's going to be as simple as that. If you get this term premium expansion that we've been talking about, then lower prices in equities are almost guaranteed, I think. That's what I think. Andy, I don't know if you agree. I agree. I think it's time to circle the wagons until we see a...

We've got a tr- a Fed chairman that's talking tough. Just for that reason alone, buy stocks when he blinks. Don't buy stocks when he's talking tough. Makes a lot of sense. I'll now go through the portfolio, what we've started doing, and how we intend to go forward. Thank you very much indeed. Speak to you next week.