Bianco Research L.L.C.
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Conference Call

Introducing Our Index & Our 2024 Outlook
December 21, 2023, Conference Call
(This transcript has been lightly edited)

Good morning, everybody. This is Jim Bianco. A little bit of housekeeping here. We are live streaming this call on YouTube. Hopefully, you guys can hear me. If somebody wants to drop into the question that you can hear me and as soon as I get the word that I have connected this properly, we will get started. I'm just holding on to get this thing rolling here on YouTube. Let's see here. I just want to check and then we'll get started here like only in just a few seconds. Okay, good. Now it's working on YouTube. I can see it there on YouTube as well. Thank you everybody for joining me. Thank you for your patience. This is Jim Bianco. Welcome to our year-end 2024 call.

On this year-end 2024 call, we are going to cover a couple of topics. Those couple of topics are going to be the new ETF that we rolled out, its index, and we're also going to discuss our 2024 outlook. The bulk of this call will be about our 2024 outlook.

Total Return Index & WTBN

Let me start by talking about our ETF. This is going to be two minutes because I am not in the ETF business. WisdomTree is in the ETF business. I got into the index business, and I created the Bianco Research Total Return Index, which is coming next, my explanation. And that'll take five minutes and then the rest of the call will be on the 2024 outlook.

There is an ETF, WTBN, WisdomTree, there it is in the upper left-hand corner, WisdomTree, Bianco. It is going to track our index. It is a NASDAQ-listed ETF, and so it's just like any other ETF. And what you're looking at on the screen here is the prospectus. I would encourage anybody that is interested in this to look over the prospectus. It is listed on, should be listed on most platforms that you could trade it just like anything else. And if you've got any issues regarding the ETF, you can reach out to me.

Okay, so that's the ETF. The next thing I want to talk about is our index because that's what I'm doing. We have created, and now this is the website, it's BiancoAdvisors.com. And we've created the Bianco Research Fixed Income Total Return Index.

Now, what is this? We started off with a benchmark broad-based investment grade index, covers 10,000 plus bonds. It looks very much like all of the other broad-based investment grade indexes, because when you have an index that big, they all look pretty much the same. And we are running this index as a long-only strategy. We are always long the market.

We have, if I were to jump onto the index characteristics page, or the factors page, we have identified five factors that we believe drive the total return of an index. Duration, are you long or short the index? And I'll talk about what we are in a second. The yield curve, are you bulleted or betting on a yield curve steepening or barbelled betting on a yield curve flattening? Your credit weighting. Now, remember, these are all relative to the benchmark, because we're always long. Volatility of structure, which would be mortgages. Are you long or short, or overweight or underweight, that might be the better words to use, relative to the index. And the other would be outside of the index, as far as where you think we're going to be. Those factors drive what I think is going to be total return.

A couple of words about indexes before I move on to where we are in the index currently, and then explain for the rest of the call for my 2024 outlook, why we are there. if you're thinking about, oh, you've structured an index, it's run by a committee, and if you want an analogy, S&P has an investment committee that runs the S&P 500, Bianco Research has an investment committee that runs the Bianco Research Total Return Index. S&P is not in the ETF business.

Everybody that has an ETF that tracks the S&P 500, BlackRock, Vanguard, WisdomTree, on down the line, they're in the ETF business. We are not in the ETF business. WisdomTree is in the ETF business for us. that's analogous to what we've done.

Now, we will try and position of being overweight or underweight, these factors relative to the benchmark, always long, to try and outperform. But nobody can outperform an index. Well, that's largely historically been the case in equities, 95-ish percent of strategies in active managers and discretionarily run indexes cannot beat the S&P 500. That's true. In fixed income, it's more like 50-50. It's more what you would have thought before you looked into it, shouldn't the index kind of be in the middle of where either discretionary indexes, which we are, or active management is? Yes, it is on fixed income.

And there's various reasons for why that is. One of the big ones is you tend to get most of the borrowing from over-levered countries and over-levered countries and companies that tend not to be good credits and tend to be very shaky credits. Your biggest weightings are in your problem children, where in equities, your biggest weightings are in your all-stars. You know, so your biggest weightings are in Apple, Amazon, and Google because they've run up a ton and they've increased their weightings, and that's good. You want to be long those. But in fixed income, your biggest weightings are in troubled companies and in Japan and in Italy and countries that have way over borrowed and have provided subpar returns. That's maybe why the index is somewhere around the 50th percentile.

The approach that we are looking at is that we can maybe structure this index or our weightings so that we can outperform the index a little bit better. index updates on our website, and then I'll turn to my 2024 outlook. When our investment committee meets, and I'm the chairman of the investment committee, we update on this webpage our positioning in the index.

Currently we are 90% of the benchmark, so we are a little bit short of our benchmark, being defensive on the idea that interest rates may rise. Now 90% is not, you know, a maximum short for us. We can go all the way to 50% in extreme cases and shorter if we believe so that rates are going to head up. And I will address that, all of these, why we are there in the 2024 outlook, because that's kind of, you know, the explanation of our positioning.

We are equal weighted with the benchmark on the curve. If you were to break our index in the buckets, the 1 to 3, 3 to 5, 5 to 7, 7 to 10, 10 plus, our weightings are roughly or 100% as close as we can to being similar to those weightings. Now why are those weightings very similar on the benchmark? Because the yield curve is so flat, there's not really a lot of opportunity yet, we don't think, to make money in a bulleted structure or a barbell structure. That will come, but it isn't right now.

Structure or securitized, we're 71% of the index, so we are more defensive on that. That means that we're underweighted mortgages and we're underweighted structure, and that's because of the high volatility in the bond market, and that tends to make these positions underweight. You can see we put together a chart here of the option adjusted spread of mortgages, and the Merrill, excuse me, the move index, which is the old Merrill option volatility estimates like the VIX of the bond market, and they move together. And so, if we're going to stay in an elevated period of volatility, which we've been in all year and continue to be, I've got some charts again in the twenty-four outlook, it's set next, I'll explain it, then this should be a challenge as well too.

And then on credit, I'll just start off by pointing out the chart. The blue line on the chart is the credit spreads, investment grade credit spreads, option adjusted spread, and the orange line on the chart is the S&P 500, your credit weighting is your equity weighting. We're slightly short on the credit weighting at 91%. Now remember this investment grade credit as well, high yield credit would be considered in our last section, which is an outlier of that. We don't have any high yield currently in our index. What we do have is a 20% positioning in short tips, zero-to-five-year tips. Because remember now, a tip is a Treasury Inflation Protected Security. A tip is basically you get the inflation rate plus a yield on top of that, and a yield on top of that is running at around 1.5% or so, so I get the inflation rate plus 1.5%. That is a very attractive security sector right now, and so we've got a 20% weighting. In the short end, we didn't want it to be muddled with a long duration bet, which would be whether or not rates are going up or down, we want to try and capture that yield. That's where we are in terms of our index.

The index committee meets, it meets at least monthly, sometimes inter-month if circumstances dictate it, and we adjust those weightings, and when we adjust those weightings, we will publish it on this website. BTRINDX is our index on Bloomberg. You can track our index on Bloomberg, and WTBN is the ETF that tracks our index as well. That is for that section of the handout.

2024 Outlook

Now I'm going to jump into the 2024 outlook, and now I'm going to jump into my PowerPoint presentation, and you can see I can draw on the screen, I just want to make sure it's working, and I'm going to go through my 2024 outlook, and by doing this, what I'll be doing is explaining to you why we are all of those positions.

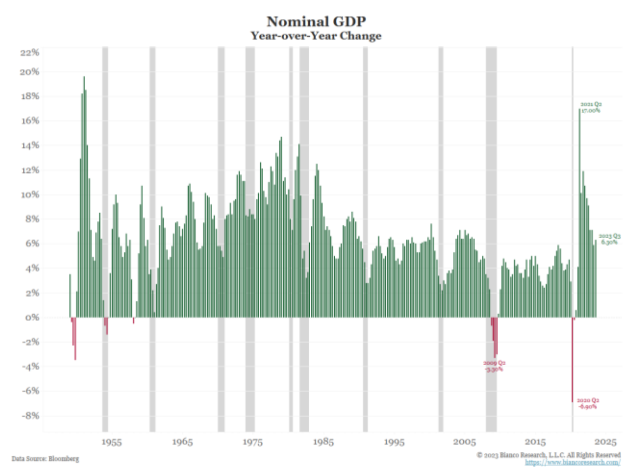
I want to start by acknowledging that a lot of people have noticed that I keep saying that yields could go to 5.5% sometime in 2024, maybe mid-year-ish or so, and that seems to be a big outlier call, get a lot of trolling on social media on it, and I understand it because it's a heterodox or it's an outside of the consensus opinion view, and if you don't understand what my bigger picture view is, it doesn't make any sense, so I want to start off by talking about the bigger picture, and then I want to try and zero in on some of these sectors and some of the viewpoints that I've got on the marketplace right now.

What is my bigger picture view? That every so often, we have a major event that changes trends in financial markets and in the economy. The Great Depression, post-World War II, guns, and butter of the sixties, the oil embargo of the seventies, the financial market boom of the 80s, 9-11, the global financial crisis. Going into that, markets and economies behaved one way. Coming out of that, they behave in a completely different way. I would argue to you, and I'm going to use these words carefully, the lockdown restart of 2020 did exactly that to the economy.

Now, I said lockdown restart, now obviously COVID was the reason, but it was the response to COVID with the lockdown restart that I think have changed trends in the economy, and I'll explain that, but I just want to point out, there's a lot of pieces coming out at the end of the year now that are talking about that this is the, it's been a very difficult year for people to forecast, at the beginning of the year, we thought that the U.S. economy was going to go into recession, and that was the consensus view or near consensus view that markets were going to struggle, that the Fed wasn't going to get a handle on inflation. I still don't think they have, but I'll talk about that in my inflation section, and that China was going to boom.

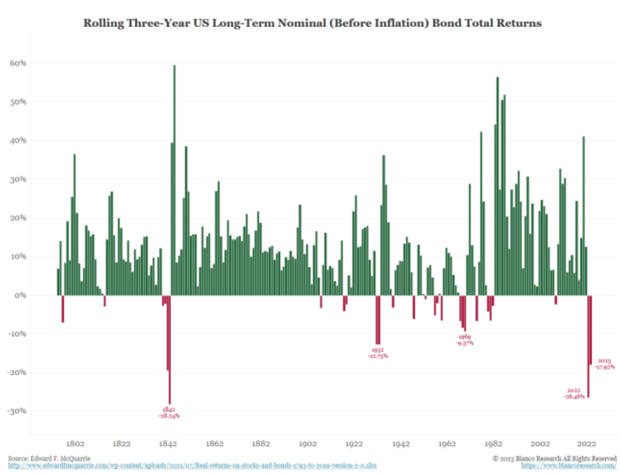
At the end of the year, we start realizing the opposite happened. The economy did well, it grew above trend pretty much the whole year. Inflation came down, still at 3% or 4%, depending on headline or core, and China really struggled. There's been a lot of introspection about why did we got it all wrong? I would argue, people are saying we have to dig deeper into the models. The models are based on relationships and understandings that I think changed in 2020.

I would argue to you that George Fox, the famous UK, or British statistician said, all models are wrong, but some models are useful. That all models, including the Fed's model, everything else is wrong, but they can be useful, and they can be useful in that they've been so wrong that instead of saying, I have to go down even granular to understand stuff, the assumptions your model is based off of might have changed. If you're going to wait for data to prove it, then check in in 2030, because you're not going to get that data right away.

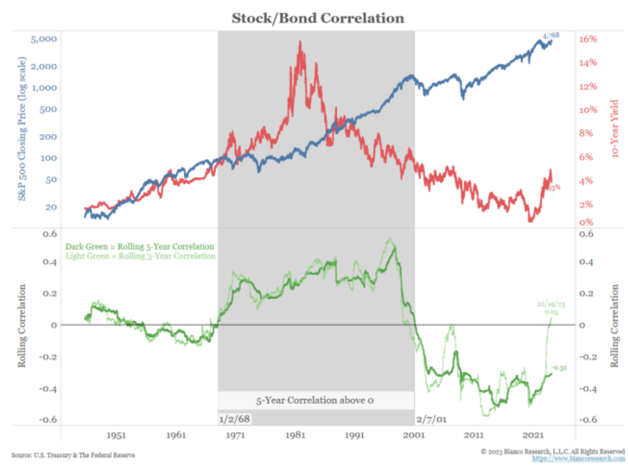


Let me start with this chart here on slide two, nominal GDP. Again, I want to explain why I think things have changed. Here is what happened when we locked down the economy, and this goes back to the end of World War II. We had the biggest contraction in nominal GDP. Nominal is the combination of inflation plus real growth, and then coming out of that, we had the biggest expansion. The biggest extremes of the last 80 years came in 2020 and 2021, obviously one year apart from each other. This, I believe, like the financial crisis and like the post-World War II era, changed things. This changed a lot of things in the economy. Change does not mean worse, does not mean dystopian. It means different. if you're using a set of rules that worked in 2019, they may not work in 2023, and that's what we learned.

Now, what's changed? A couple let's start with the financial markets. Here's a chart of over 50 years of the 10-year yield. It peaked at 15.8% in 1981. It bottomed out on August 4th of 2020 at 51 basis points or half a percent, and it has shot up and it has broken its 40-year trend. I'm starting from the premise that the 40-year bull market is over, and we are now in a multi-year bear market. And since the multi-year bear market started in August of 2020, this is year four of the multi-year bear market right now.



And what was the result of breaking that bear market? It was pretty big. here's data from Ed McQuarrie. He is a professor at, I believe, Santa Clara right now, and he put together total returns of the bond market back to 1793. No kidding, 1793. And this is a rolling three-year return, and the rolling three-year return shows you that 22 and 23 is the worst period since before the Civil War, 1842. What happened in 1842? We actually ran out of debt. We actually got down to like $30,000 of US Treasury debt in total that we basically were running surpluses and nearly paid it all up. And these numbers were like two bonds that just wildly gyrated. But let's just forget that period and just say, since the Civil War, the best time to be bearish on bonds in the last 150 years was 2020 to six weeks ago, because you had the worst return in 150 years to be on bonds. And so, this kicked off, in my mind, a multi-year bear market in bonds.



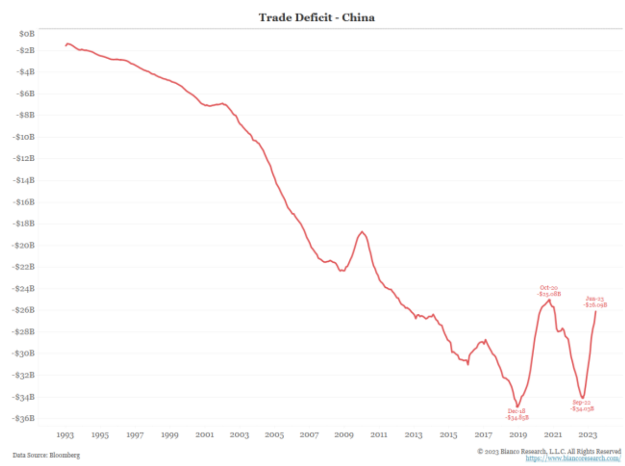
Now, the next chart here shows you the stock bond correlation, the change, or the relationship between how stocks and bonds relate. in blue, on a large scale, is the S&P back to World War II, and in red is the 10-year yield on this scale. Now, the bottom chart shows a rolling five-year and three-year correlation between prices. Now, let me explain that because I know everybody's not a statistician here. When the correlation is positive, that means stock and bond prices move up together and down together. When the correlation is negative, it means they move opposite each other. Now, for a lot of the last 20 years, as I circle here, the correlation has been negative. stocks and bonds move in opposite of each other. We have understood that that we now have created industries around it, the risk parity trade. We refer to it as risk on, risk off. The 60-40 portfolio became very popular because stocks and bonds are supposed to move opposite each other. And now what's happened with the three-year correlation is that it has gone up slightly positive, but it's moving straight up, and it’s at the highest level, it's been in 23 years. All of a sudden, stocks and bonds are moving up and down with each other. when people ask me, "What's the status of the 60-40 portfolio?" Well, it isn't what you thought it was. You used to put 60% of your money in risky markets like equities and 40% in bonds, so you participated in some of the upside. But when things got ugly, the bonds were supposed to rally and offset that. That's not the case anymore. They move together.

Now, what causes the stock-bond correlation to change? It does change. I point out here from 1968 to 2001, it was largely positive. And what was that period? That was what we've defined as the inflation mindset period. And I use that word mindset carefully. People were worried from '68 to '01 about inflation. They were worried it was going to go up. They were relieved it was going down. But stocks and bonds went down together when they were worried about inflation, and they went up together when they were relieved about inflation.

Now, around 2001, that was the tech bust. That was right after the Russian debt moratorium, LTCM blowing up. The relationship inverted here from about '98 to 2001, and it's been negative. This is the deflation mindset. The biggest concern we have is deflation. Deflation is bad for risky markets. Stocks go down. It's good for safe markets like sovereigns or treasuries. They go up. When you're relieved, there is no deflation. Risk markets like stocks go up. We don't need safe assets like bonds. They go down. I'm talking about the price now. The yields move up and down. The yields and stock prices move together, but the prices move opposite. That relationship is over. That relationship is ending, and it's going back to a positive relationship because we are returning to an inflation mindset, period.

The cycle changed in 2020. Bonds changed. They're now in a multi-year bear market, and the stock-bond relationship is suggesting that that's changed too.

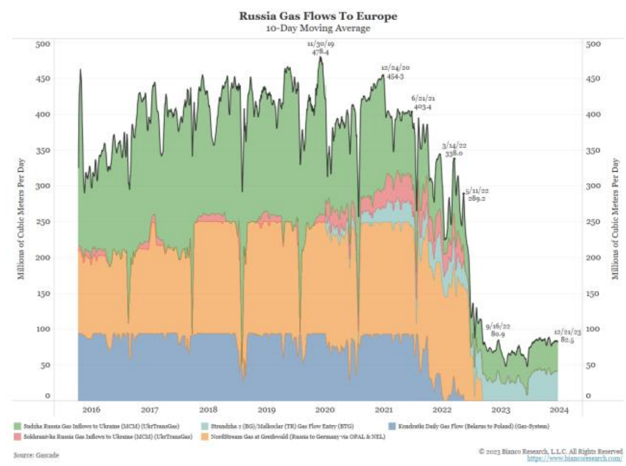
Now, what economically is causing that to happen? I think the first one is deglobalization. here's a rolling 12-month sum of the trade deficit between the US and China, and you can see that the deficit kept going down and down and down, meaning that we were importing more and more and more stuff from China relative to what we were exporting, and then around 2019, that started to change. Actually, it started to change around 2018, right around the time that Trump started the trade war with China, but it hasn't changed otherwise, but the relationship is changing. This is a signal of deglobalization in that we're moving away from just finding on the planet the lowest-cost producer, regardless of their politics, regardless of the rule of law, and just produce stuff there, put it on a boat, and send it here. Relationships are starting to change. Nearshoring, friend shoring is becoming popular phrases.



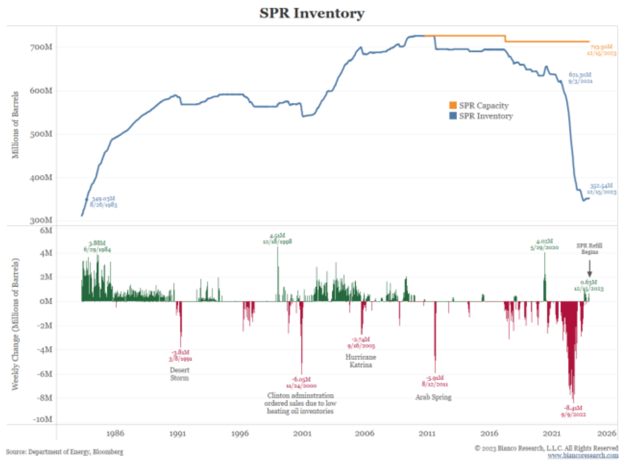
China is suffering because of that. Here's China's GDP back to the late 1970s, when interest rates peaked, Tiananmen Square, the Asian financial crisis, the global financial crisis. I think China's been a far big loser when it comes to COVID. This was COVID lockdown. This was when they reopened, and they had the zero COVID policy. Their economy is gyrated wildly all over the place, and then they reopened, and this downtrend that started after the global financial crisis in 2009 is consistent. Five percent growth for China is terrible. There's supposed to be an emerging market in the higher growth ranges, and in January, when they ended zero COVID, everybody thought, get out of the way, watch China go, and it didn't. It reopened, so it's stronger growth than last year, but this isn't what we expected. We expected animal spirits that China was going to go, and it really has been a dull thud in the way that they've gone.

You can see that in the financial markets too. The black line, this chart starts on February 11th, 2019. Now, why did I pick that date? Because between February 11th, 2019, so almost five years ago, and today, the orange line is the Chinese CSI 300 index, and the Chinese 300 index is unchanged almost for five years. The stock market has done zero for five years, and that goes back to before COVID, where the S&P, the black line, is up 74% over the same time period. Their stock market has been horrifically bad because their economy is in trouble because, I believe, of deglobalization, and this story came out last month on Bloomberg.

China bans displays of wealth. CICC, which is China International Capital Corporation, are barring from sharing negative comments about the economy or markets and post public and private discussions. CICC is a brokerage firm in China, and bankers are discouraged from showing off their wealth, that bankers don't show off your hedonistic lifestyle by driving fancy cars or wearing fancy watches. What does that tell me? When the Chinese say, no more negative reports, otherwise, you're going to be sent to the gulag and don't wear your Rolex to work, they're out of ideas. They are out of ideas. The next thing they'll do is they'll throw the short sellers in jail like they always do. That is, I have no other thing to do at this point, except just jail people that say bad things, because I can't produce a policy to make this thing go up. Again, this is all part of my thinking that the cycle has changed. Deglobalization is here, and it's real.



Energy is another part of the cycle as well, too. We're using energy as an economic and a political weapon. I'll use one example. This is natural gas flows out of the major pipeline from China to Europe. And you could see broken down by each two different colors, a different pipeline. And then you could see where Ukraine war started. And you could see how much Russia is now importing natural gas to Europe. And it's very, very little at this point. They're sending most of it to China and in other places as well. They're using gas as an economic weapon. We never thought of that. We were always so afraid of energy that we needed to have energy be freely traded and freely marketed and keep the energy flowing. But now, we have no problem seeing at least Russia has no problem using energy as an economic weapon.

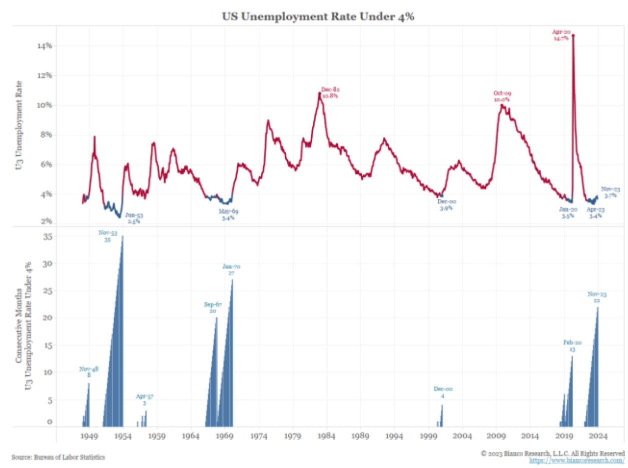


And in the United States, we use it as a political weapon. Here's the Strategic Oil Reserve, or the SPR. And this is the amount that's in the SPR. Its capacity is 713 million barrels. It is currently at 352 million barrels. You could see this was the big drawdown, which was affectionately referred to last year as the Strategic Midterm Reserve, was they flooded the system with money or excuse me, with oil to try and depress gas prices. It worked. It depressed gas prices. But it also upset OPEC Plus. OPEC Plus is OPEC Plus Russia. And they have these voluntary cuts of about a million and a half barrels because they're trying to get the price of oil back up.

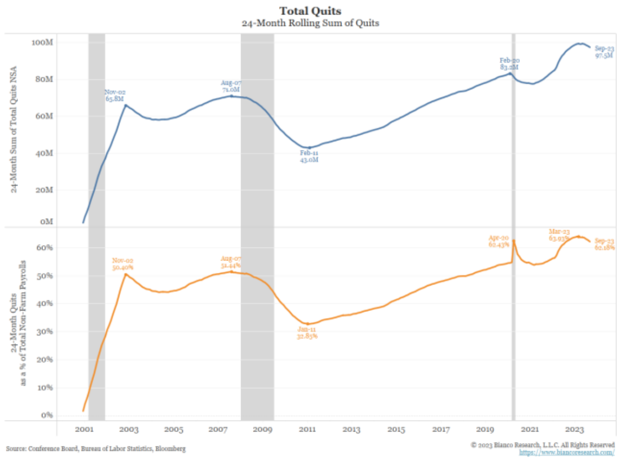
The second thing, deglobalization is the first one. The second one is the view of energy. Energy is a weapon now. It's either an economic weapon or it's a political weapon. It's no longer viewed as a freely traded economic asset or less viewed as a freely traded economic asset. These things change trends. And this is my second one.

Now, my third one on why the big trend has changed is remote work, hybrid work. Now, when I say remote work, I really mean hybrid work. If I say work from home, I really mean hybrid work. I don't mean working from home five days a week. I mean the shift away from the office. I've gone on to argue I'm in Chicago, for those of you who are not familiar with it and in Chicago, I got Haymarket Square is two miles from my house. In 1888, there was a demonstration at Haymarket Square, there was a bombing and people were killed. It turned out that the big companies put the police up to causing the bombing. This was one of the big catalysts to create the entire labor movement. Interestingly, that's what they celebrate around the world, especially in communist countries, on May Day. Yes, thank you, Chicago. We're celebrating an event that happened in Chicago in 1888.

Coming out of that event was the slogan, "eight hours of work, eight hours of play, eight hours of sleep," and the eight-hour, five-day work week came out of that event. I think what we're seeing in the market right now is as big a deal in terms of attitudes and the shifts in work as that was in 1888. A lot of things about the labor market have changed. I always joke, don't listen to any labor market economists over the age of twenty-five because they're encumbered by the way things used to work in 2019 or earlier and they're starting to change.

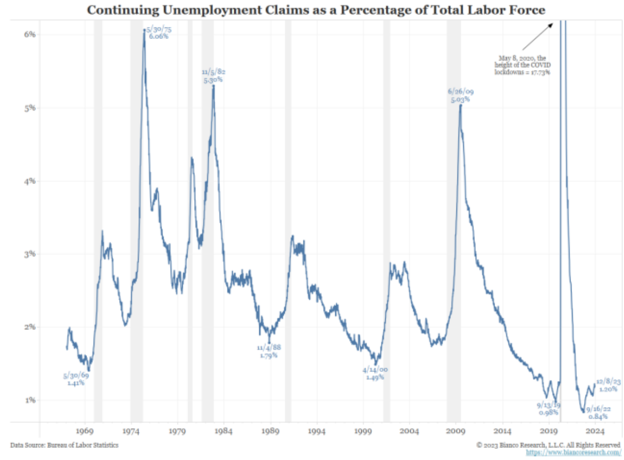


Here's a chart of the unemployment rate in the United States. You can see it went from 3.5 to 14.7 and right back down. That, if you want another metaphor, the labor market's got PTSD from this and will have PTSD from this for decades as well as that. Coming out of that, what we see now is we see 22 months of unemployment under 4%. That is the longest period we have seen in 53 years. This labor market is very different than any other.



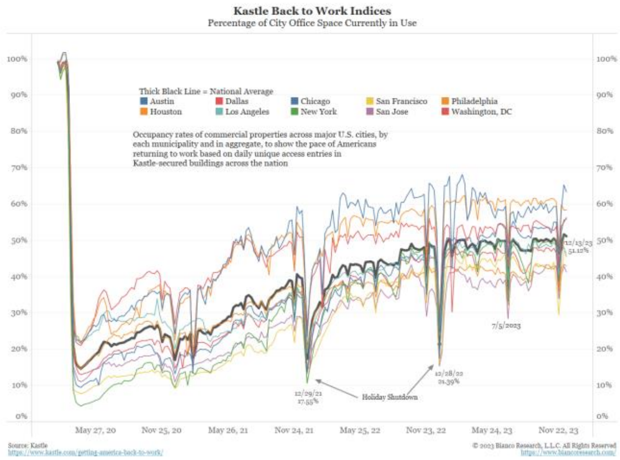
Now, how is it different? This chart shows the quits rate. We all know about the JOLTS report. We all like to look at the quits rate, but I wanted to take a step back and I wanted to point out that here's the rolling 24-month sum of the quits rate. How many people quit their job every month added up? It's ninety-seven million in the two months ending in September. That's actually still the latest data. I actually might not be, maybe October's out and I forgot to update this chart, but it's not going to change materially. Ninety-seven million people quit their jobs in the two years ending in September. That is equivalent to 62% of the workforce.

Now, the vast, vast, vast majority of people that quit a job are because you got another job, but you still have quit a job. But notice that the quit rate is higher than anything we've ever seen before. The market, the job market has become far more transactional than we've ever seen. People take a job. I've got a college friend who's a manager of a bunch of big box retailers. And he says, you know, about the phrase labor hoarding and the like, they get people coming in as stock boys and stock women, and they do a good job, and they promote them to assistant manager. And this is the example he was giving me. They've been here for seven months. This was about a month and a half ago, six weeks ago. And then they quit. They quit. Why did they quit? They quit because they want to go skiing for the winter and they'll look for another job in the spring. They're not worried about finding another job. They're not interested in maybe having a career.



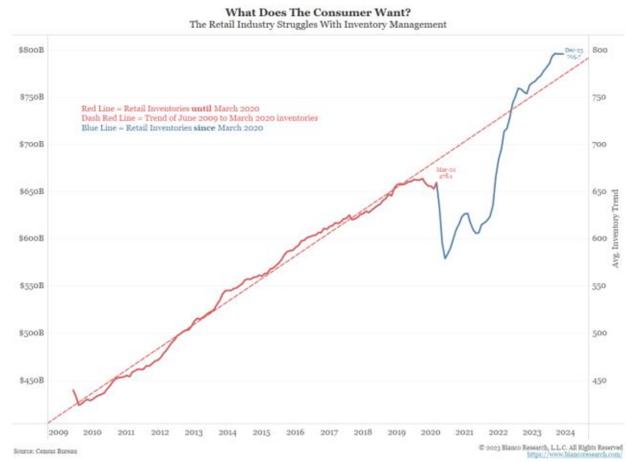
Now, maybe you and me and a lot of people on this call, we are more career oriented, and we would never do that. But a lot of people are in the trend. The turnover in the labor market is much bigger and I would argue is more transactional. If you look at continuing unemployment claims, now people make a big deal that this is at an 18-month high, but I think they're missing the bigger story here. What is it as a percentage of the labor force? It is 1.2% of the labor force. This chart goes back all the way to 1967 when they started putting out this statistic. This number here is one of the lowest we've ever seen. One percent of the workforce is on unemployment insurance. It is an extraordinarily low number. The labor market is very healthy right now.

The labor market, and because people feel comfortable about the most important thing in their decisions of continuing paycheck. And if I don't get a continuing paycheck, I can find a continuing paycheck. They are spending and they continue to spend. And I would argue when I get there, people are missing this because what they're doing is they're focused on excess savings. It isn't excess savings in my opinion. It is comfort about the labor market.



Now, comfort about the labor market extends here. here's the Kastle back to work indices. Kastle is the key card swipe system that's used in more buildings in the United States and companies than any other company. They publish statistics on what percentage use that they have of all the offices they use. The thick black line is the national average. And then here's a select number of cities. Now, the thick black line is at 51%. What does that mean? If I have one hundred employees, five days a week, I should be getting five hundred swipes into my office. I'm getting 250. Now, maybe 250, maybe one hundred people come in on Wednesday and Thursday and fifty come in on Tuesday, or maybe fifty every day. But I should be getting five hundred swipes, but I'm getting 250 on average. I'm getting half. We're going into the office about half of the time.

Now, why is that? And you can see the spread. Austin is the highest in the low sixties, and in the low forties is Silicon Valley in San Jose. But nobody's back near 80 or 90% and notices that that trend has been flat now for well over a year. What's happened is a lot of people want to push everybody back to the office, but they don't want to go back, and none other than the federal government. Fortune, December 1st, even the US president's return to office push is being ignored by workers. They aren't coming back. And this is about federal workers. They've asked the federal employees in DC, get back to the office three days a week, maybe four in some instances. They said no. And then they said, well, we'll fire you if you don't come back. And they said, fine, fire me. I'll find another job. And they're not and by the way, I'm going to the Bahamas, and then I got to go to the store and spend some money because I'm not afraid about my paycheck.

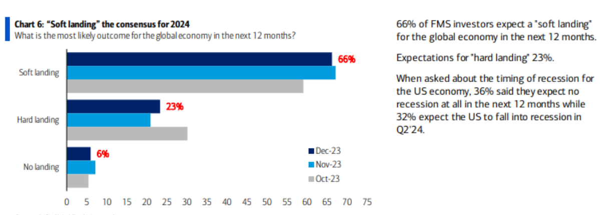


My other argument about the three big trends, globalization, energy as a political and economic weapon, and the change in the labor market, is why we're seeing these trends change in financial markets. And you can see that, at least to my mind, this is the biggest one. And this chart here shows you the inventories held at retailers. And what I show here in red, and this is a theme you're going to see in a lot of other charts on this handout is 2009 to March of 2020. March of 2020. Hopefully, my penmanship is helping and not making it worse. And then the dashed line is that trend. The blue part of this is what did retail inventories do after? They dipped down during the lockdowns. They soared up. They've been all over the place.

McKinsey and Company, the business consultants, wrote a piece in May. I'm thinking beyond the markdowns to tackle retail's inventory blood. Retail inventory management has been extraordinarily difficult. Over the past 18 months, retail supply chains have experienced an unprecedented demand and supply shift. And, you know, demand is the big word there. Retailers are struggling to understand what to put on the shelves because they're struggling to understand what we buy. Why? Because of the pre-pandemic, you were home two days a week, Saturday, and Sunday. Post-pandemic, you are home four days a week, Saturday, Sunday, and probably Monday, Friday, and you go to the office Tuesdays through Thursdays. Just to keep the example simple. You are double the amount of time you're at home. I don't know your personal circumstances, but I can say this. If you're doubling the amount of time you're at home, the things you demand, the things you want is different than what it was in 2019."Or what it was in 2019. Maybe you demand different things because you can do them yourselves. You don't need certain services. You prefer other services as well. And retailers are trying to figure out what does the 2023-2024 consumer wants because it isn't what they wanted in 2019 because something happened, the shutdown restart, de-globalization, changing in energy policies. And the big one is the change in the way that we work, especially at service sector jobs, which is half the jobs in the United States, if not more. And that is why I think we've seen these major trend changes. I'm of the opinion that we've seen some major trend changes.

Now, those major trend changes are going to lead to higher nominal growth and stickier inflation. And I'll explain that next, or not next. But what I want to explain, first of all, is where Wall Street is. Wall Street, interestingly, is the one place where everybody's being demanded back to the office five days a week and they're complying. 5.0 is what Goldman Sachs refers to as getting back to the office five days a week. Interesting, Wall Street is the place you're going to see where they're going to say, you know that thing that happened in 2020? Yes, it happened in 2020. And it's over. It's over. Dust off the playbook of 2020, 2019, 2018. Everything will be exactly the way it was back then. Nothing in the long term has changed.

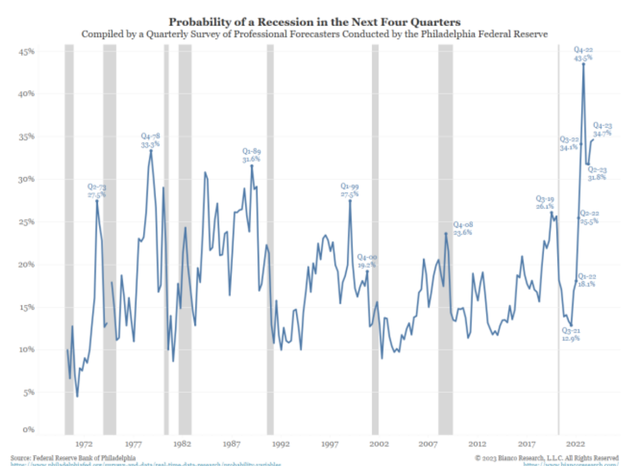
Well, if they're right, then my argument for sticky inflation, which I'll talk about in the next section, isn't going to come to pass. And if they're wrong, we're in year four of a multi-year bear market in bonds that they still haven't understood. That's not unusual. You know, by 1985, when we were in year four of a multi-year bull market in bonds, they were still bearish on bonds, still trying to think that we were going to keep going up on bonds as well.



Where are we? Bank of America's December global fund manager survey, they surveyed about three hundred fund managers globally, 66% expect a soft landing, 23% expect a hard landing, which is a recession, and 6% expect a no landing. I happen to be in the no landing camp, which is a very small camp right now. I've often quipped that Wall Street loves soft landing, because soft landing really has basically no definition. What is it? Is it slow growth? Is it a mild recession? Is it a combination of the two? And then how long is it? Do we get one quarter of 1% growth? Then what? Do we take off? Or do we hard land? Or do we continue to just print one quarter of lousy growth, but not recession growth for ten quarters in a row?

The reason I say Wall Street loves the soft landing is because it has no definition. And so therefore, I'll predict a soft landing. And then in a year, I will define it and tell you that my forecast was correct. Hard landing has a little bit more of a definition. That's a recession. And no landing has a definition. And that's what happens 90% of the time. The economy grows a trend, or maybe a little bit more, slightly less. round it off close to trend. That's what no landing means. It does what it does 90% of the time. It grows a trend.

That's what fund managers think, 66, 23, and 6. And then Bloomberg surveyed economists. Half think soft landing. A third think recession. And 20% think no landing. The no landing camp is a little bigger among economists and a little smaller among money managers. I quip that money managers forecast a soft landing because it works for their business model, the everything rally. Interest rates come down, inflation moderates, and the like.



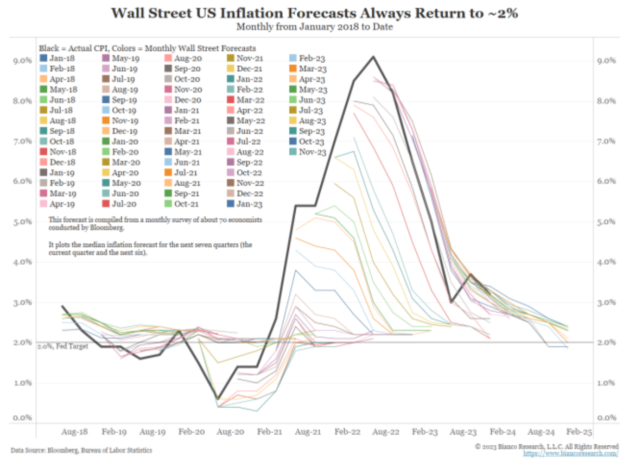
As far as a recession goes, a couple of things about a recession. The Philadelphia Federal Reserve has this thing called the Survey of

Professional Forecasters. They have a bunch of forecasters. They give them a questionnaire. I used to be part of it. I stopped many years ago. But anybody can be part of it. You could just request on their website to be part of it. And they've got several hundred people that you can fill out all these questions about where you think things are going to go. One of the questions they ask is, what percentage do you think will be a recession in the next 12 months?

Now, this survey started in 1971. We got a good fifty plus years of data. The four highest plots in the history of that survey are the last four, including the peak a year ago when everybody was pessimistic that we were going to go into recession. Now, yes, you could say, but the majority didn't think we were going to be in a recession. But here's all the recessions that we actually had. Going in or coming out of all these recessions was never as high as it is right now. A lot of people were very, very pessimistic about the economy.

Jamie Dimon was last month. I understand it. Look, he could be right. I have my opinion. He is his. We'll check back in a year and see how they work out. But I do think that I agree with Bernanke and Yellen here. In January 2019 at the American Economic Forum in Atlanta, they talked about this. And Yellen said, I don't think expansions die of old age. Two things usually end them. One is financial imbalances. That's the stock market crashes if you want to put it bluntly. And the other one is because inflation has gotten out of control and the Fed needs to tighten and bring it down. That's fancy talk for we raise interest rates too much and we choke the economy.

Then Bernanke on stage one right after it exists. But as Janet says, expansions don't die of old age. I like to think they get murdered instead. And this is true. If you look at all of these recessions, COVID, financial crisis, 9-11, the Iraq War, high inflation, 15% interest rates, oil embargo, almost all of these recessions, something comes along and breaks it. Something breaks the economy. That's what causes a recession.



We think, is the next chart, we are being not me, but the collective of everybody on Wall Street, thinks that the thing that is going to break the economy is going to be interest rates. in January of twenty-two, they went from under 2% to nearly 5% on a closing basis in October, and they backed off now. I updated this chart yesterday, 393, but we're at 387 right now on the ten-year. But they think that this is what's going to break it.

And I'm going to argue now in the next two sections, I don't agree with any of this. And that's why I have this different opinion. And that's how I've got the index structured 90% duration and underweighted on credit and really underweighted on mortgages and the like.

Let's start with inflation. The perception of inflation is that nothing's changed. It is the way it used to be. this black line on this chart is the actual inflation rate, down to 3.1% year-over-year CPI. Now, Bloomberg does a survey of about seventy economists every month. And they ask these economists, give me your inflation forecast for the next six quarters. All these colored lines are the median forecast for the next six quarters of a survey every month of 70 economists. Here's all the surveys to all these different colored lines.

What comes out of this? The six-quarter hour forecast is always at 2%. If inflation's heading up every single month, that's the peak 2%. That's the peak of 2%. That's the peak of 2%. When inflation is heading down, that's the bottom 2%. That's the bottom 2%. And what's happening now? See, I was zero for thirty-five, but now I'm looking like a genius. We're going back to 2%. In fact, we're so sure we're going back to 2%, we coined a term for it, the last mile. What does the last mile imply? Of course, we're going back to

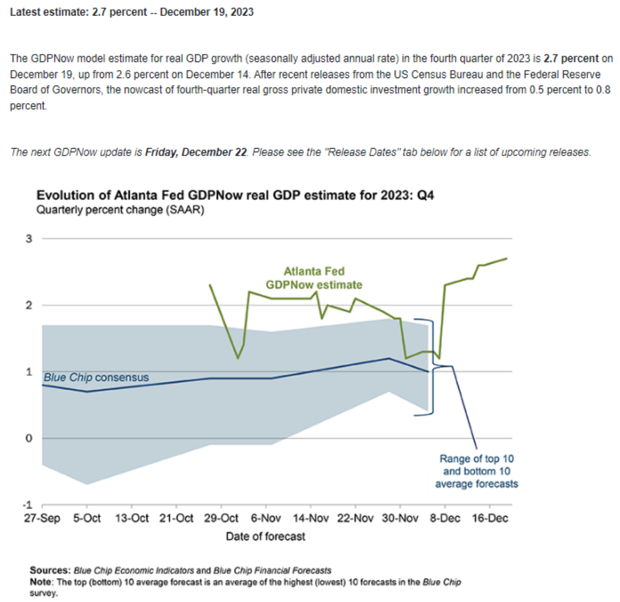
2%. Of course, that is where we're going to end up. That is a statement of fact. That is not even an opinion anymore. It's just how do we get there? And I would argue that we have played out the"Last mile already. We bottom at 3. I'll talk about that in the next coming slides. Or we bottom out at 3. Or I think that we're very close to bottoming out and that we're not going to go there. The only way we get to two is if we have a recession and depressed demand to pull it down to two. But short of that, I don't think we get there.

I often joke that the best Fed governors or Fed officials to listen to are the ones that recently leave, because then they speak their mind. Dan Tarullo was a Fed governor from 2009 to 2017. He left in the summer of seventeen. In October of seventeen, he went to the Brookings Institute, and he presented a paper and gave a speech. The Fed has no reliable theory on inflation. The standard point is that we do not at present have a theory of inflation dynamics that works sufficiently well enough to be of use to the business of real-time monetary policymaking.

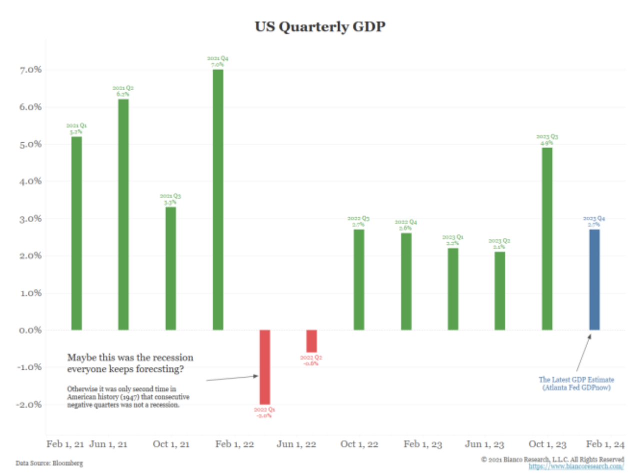
Do you know what? He's 100% right. You could tell me why inflation goes up or goes down, and I could say, let's go back to the history books, and let's look at it. Your theory's got a correlation of zero. And that's basically what he's trying to say. That's fine. That is fine. The Fed is not required to understand how inflation works. The problem is they pretend that they do, and they set monetary policy off on the pretense that they know how it works. And that's why they got in trouble at 21 when they kept talking about transitory, and it shot up to 9%.

And I'm afraid they're going to get in trouble now when they start talking about the last mile as if it is an accepted fact, not even in a forecast anymore, that we're going back to 2%. And of course, I'm talking about without a recession, organically going back to 2%. Yes, if the economy craps out, we could get it down to 2%, but only to the extent that it's crapped out. When it rebounds, then inflation would return. I'm of the opinion that inflation is going to come back.

Now, as far as the soft-landing scenario goes, I put out a piece yesterday. I also tweeted it out for those of you that are on YouTube. And I said, sometimes there's narratives that are so powerful you can't even go against them. And one of the narratives is we're not having a soft landing. We're actually having a no landing. We're actually seeing every evidence of a no landing.



The Atlanta Fed has a GDP tracker. Now, GDP tracker, GDP is an aggregate statistic. All the other numbers feed into it. I like to explain the GDP tracker as saying, you're running the marathon, just to keep the example simple, at the 10-mile mark, you're at 1 hour. You're at a 6-minute mile pace. OK, let's apply 6 minutes to the next sixteen miles. And then we can calculate that you'll finish the marathon in 2 hours and 36 minutes. Well, maybe you slow down. Maybe you will speed up. You know, things will change in the next sixteen miles. But as of the 10-mile mark in that marathon, the economy is growing at 2.7%.

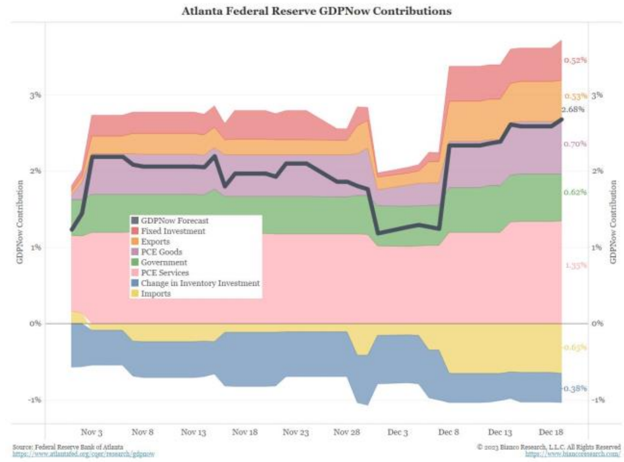


Now, there's more data to come. And some of the data will be released. And that data to come might not be at the same pace that we've seen. It might be faster because that's what we've seen recently. That's why the numbers are going up. It might slow down and go down. But right now, we're seeing that the economy is growing at 2.7%. 2 and 1 quarter to 2 and 1 half is kind of considered trend.

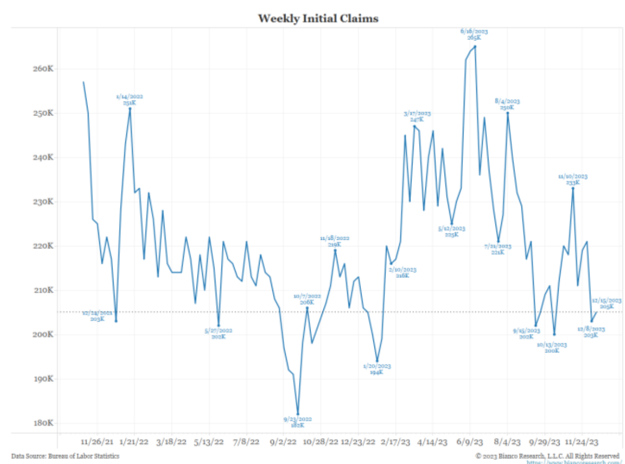
If we look at the next chart, we can see that for the last six quarters, we got 2.7, 2.6, 2.2, 2.1, 4.9. And that is a booming number in the third quarter. And 2.7 from Atlanta Fed. And again, it's as good as any other number that's out there. This is not a soft landing. This is a no landing.

I actually argue that maybe the recession and the soft landing everybody's looking for came in the first quarter of 2022, when we had two negative quarters in a row. Now, remember, the definition of a recession is whatever the National Bureau of Economic Research, the NBER, says is a recession. A committee of elders if you will. Some of them have been on the committee since the seventies. They're great economists. I know a couple of them. They're really good economists. And they're very sincere about their work. I'm not trying to denigrate them. don't misunderstand my language for that. But whatever they say is a recession.

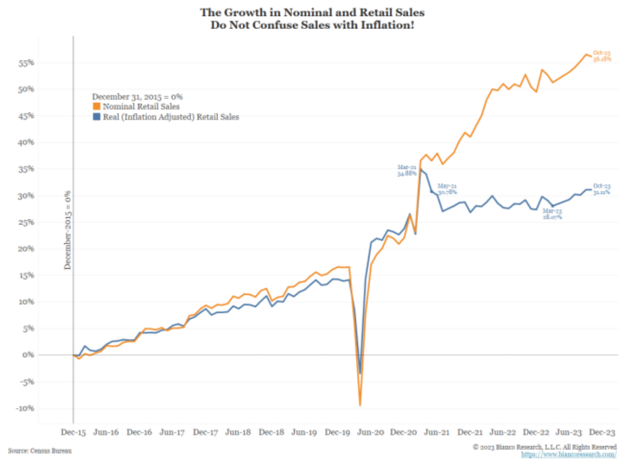
And they came out and said that these two consecutive quarters was not a recession in 2022. The only other time that happened was in the post-war period, another period of epic change in 1947, when you had two quarters in a row without a recession. The previous other fourteen instances that you had two negative quarters in a row was a recession. And do you know what? This had, you could argue, the hallmarks of recession. The stock market fell 25%. You had the worst sell-off in the bond market ever. You had all kinds of problems in both financial markets and changes in the economy. But maybe this was the soft landing.



Because what we're having now is not a soft landing. And we're still not seeing evidence of a soft landing coming. If you break down the Atlanta Fed number, they give you a contribution number. there's your 2.7. How do you get there? Well, let me just point out that the change in inventory and imports is what is the drag on it. These are the below zero numbers. All the consumption numbers are very strong. We're spending money. We are very, you know, we're going to the Bahamas. We're going to the store. We're on Amazon. We're ordering services. Why? I would argue because I feel good about my job. My boss wants me back in the office. I quit. I'll find another job. I'm going to get a paycheck next week. I'm going to get a paycheck the week after. They laid me off. I'll find another job. Let's go to the Bahamas anyway. That's why the economy continues to boom.



And evidence of that is the initial claims on unemployment insurance. 205,000 is what was reported this morning. I put a line at 205,000. You can see we are at the lower numbers that we've seen over the last couple of years. There's no evidence, at least not yet, that the labor market is struggling.

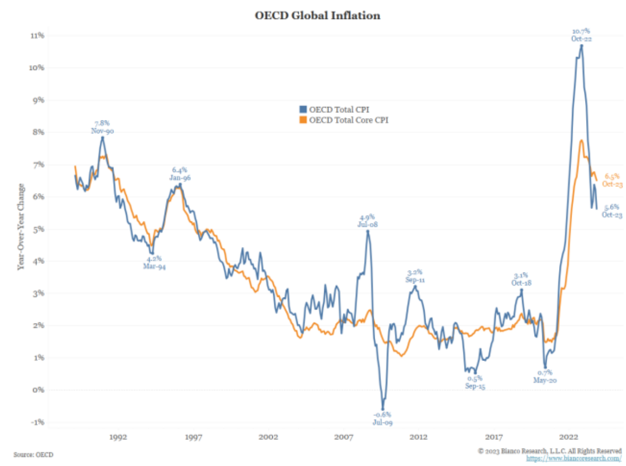


If I were to go and look at retail sales, you could see that in retail sales. Reuters, Thanksgiving weekend sales hit a record on big discounts and online. It's always that way. Everybody is looking for a sale. They always act like, well, it doesn't count because it was in the sale. Of course, we mark everything up in September. Then we could put 50% off in December and everybody thinks they got a deal. But that's the game we play. But nevertheless, record on Thanksgiving.

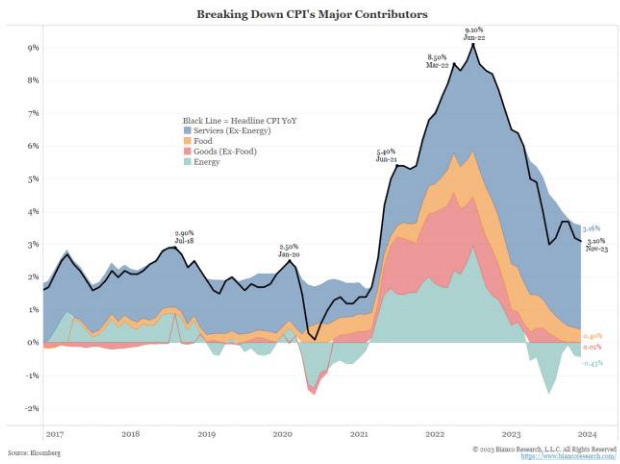
And what you'll see here in this chart is two numbers. Nominal retail. This is 2015. I just went back several years to show you that we are now buying 56% more stuff in dollar terms than we bought eight years ago. whatever you spent $100 on eight years ago at the store, you're spending $156 on at the store today. Now, 131% of that is real stuff. you're buying more things today than you bought then. You're spending more money. And this gap here is inflation as well.

But look at the inflation adjusted number in blue. That's what this is. This nominal number goes up because prices are going up and you spend more money. But even in inflation adjusted numbers, I know it isn't as dramatic on this chart, but it is starting to swing higher. And on an inflation adjusted basis, October was the highest number since May of 2021. what we're seeing is we're definitely seeing people starting to spend more money.

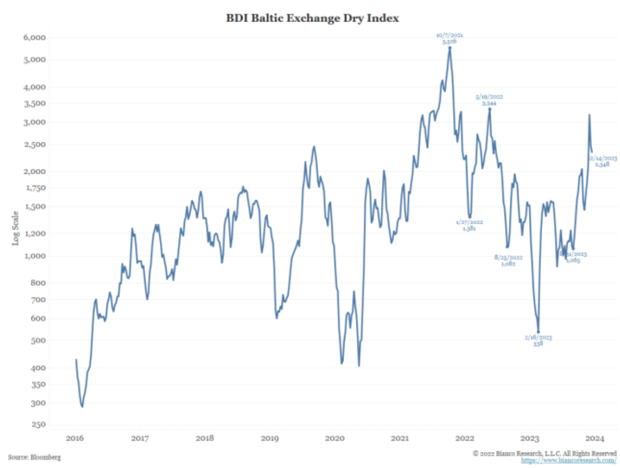
Talk about inflation next. before we talk about inflation, let me conclude. I don't think we're having a soft landing. I think we're having a no landing. And the economy is going to continue to churn around at 2.5-ish percent or thereabouts, a little bit more in some quarters, a little bit less in other quarters. But we're not going to slow down. I think that's going to put pressure on prices. let me start talking about inflation with the OECD, the Organization of Economic Cooperation and Development, the Paris organization that tracks global economic statistics. They have a global inflation measure. What is inflation for the globe? That's their measure. And I wanted to point out that the inflation spurts and come down is global. It is not happening in the United States. It is happening everywhere right now. The average inflation rate in the world right now is 6.5 percent, 5.6 on a core basis through October. That is the last set of numbers that they have.



Let's break down the United States just so we can see where the inflation numbers are. here's CPI, 3.1 percent in November. November we have for the United States. How do you arrive at 3.1 percent? Services X energy is 3.16 percent. Everything we're spending on services is more than the overall inflation rate. Everything else combined is actually at zero. And that is food is adding forty basis points to it. Goods are down around zero. I'll talk about goods in a second. And energy is negative. Energy is gasoline prices.

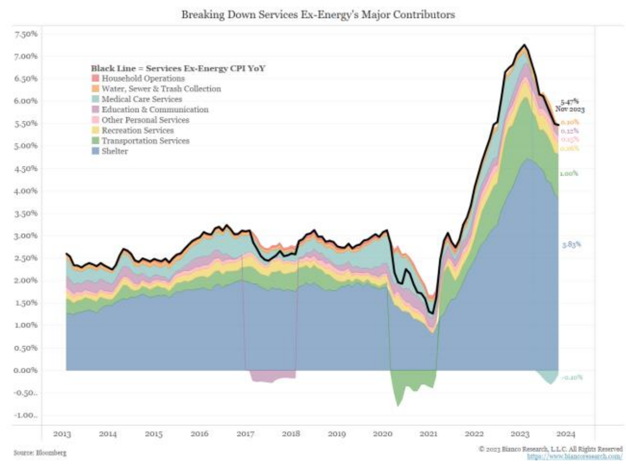


Let me start there. You know, will that stay negative? You tell me where gasoline prices are. You tell me where the oil is going to go. It has been gyrating wildly this year. It was at $65 a barrel in June. It was at 93 barrels in September. It is now under sixty barrels, $70 a barrel again in December. First half of twenty-four, where is it going to go? I'll remind you; OPEC and Russia are cutting production. They want it to go up. And so, and then you've got the administration to drain the SPR if they have to. I expect a lot of volatility in oil, but that is basically a gasoline crude oil call.

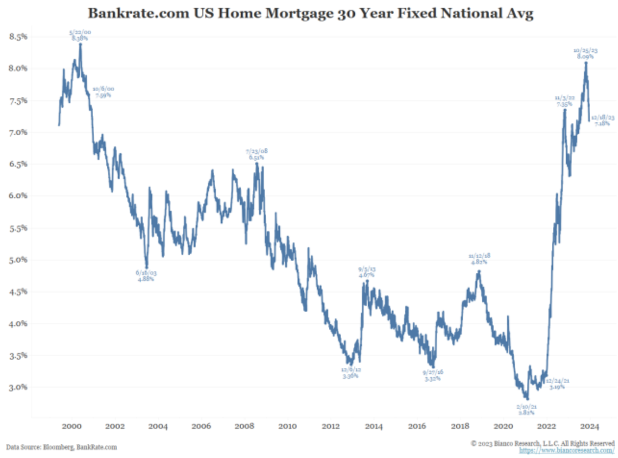


Goods. Goods are down at around zero. And yet we still have 3 percent inflation. Now, if I go to the next chart, this is the Baltic Exchange Dry Index. This is a container shipping index that shows you what's been happening with container shipping. Now, it's a large scale, and it peaked in late twenty-one when we were all talking about supply chains, and we were all experts on the number of ships in San Pedro Bay that was off where Long Beach and Los Angeles' export terminals are and shipping terminals are. And that number collapsed all the way down to February of this year, and it's now started to come back up.

What is common about shipping is it booms, and it busts. And I know what we like to say is when it booms, it's out of balance, and when it busts, we say it's back to normal. It's actually gone too far the other way. And I think what we're starting to see now is we're starting to see shipping prices start to move up. Shipping prices are a good indicator of goods prices if they continue to move up. And if the problems in the Red Sea and around Yemen continue to disrupt shipping, it's going to get worse, and that could be an upward pressure on goods prices.

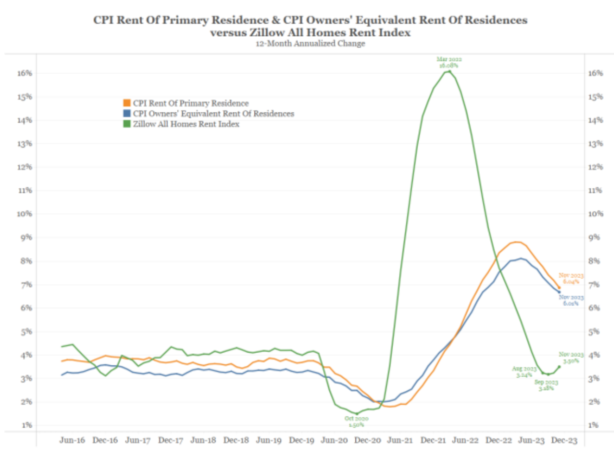


Look at services, X energy. , here's that part that was 3.16 percent of overall inflation. How does that break down? The vast majority of that that number, by the way, by itself is a 5.5 percent growth rate, but then it adds 3.16 percent to the overall inflation rate. The vast majority of this is shelter. And this gets to the big call that everybody has from this is the big call that everybody has for 2024 inflation and why they think it's the last mile.



Here's mortgage rates. Mortgage rates at the end of 2024 were 3.5 percent. They shot up to 8 percent in October, and they've now backed off to 7.2 percent. Bankrate.com's national average of a 30-year fixed rate mortgage. This is the highest levels we've seen in 23 years. 23 years. , under that auspice that everybody talks about that something has to break the economy, we're convinced it is high interest rates and we're convinced it is housing.

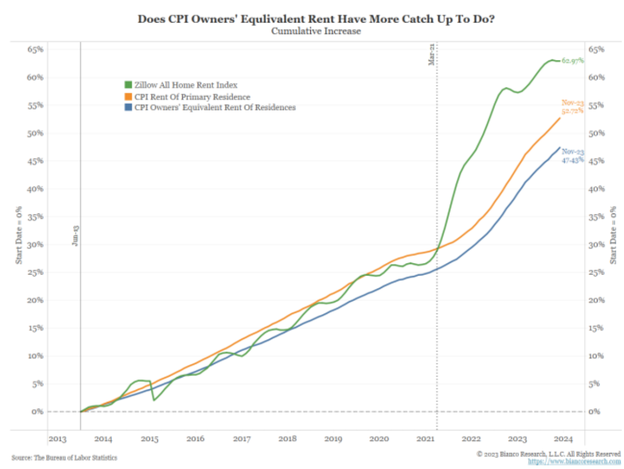
Jonathan Gray reported the Blackstone's numbers and warned of a looming hit to consumers from the surge in bond yields, and he went on to talk about that the jump in the ten-year yield would force consumers to tighten their belts when the 30-year mortgage and car loans cost you 8 percent. That will impact consumer behavior. Now, maybe it does or maybe it doesn't. I kind of quipped gently that when you're the head of a private equity firm that built its business model on free money and there's no longer free money, you see this as a disaster. And maybe it isn't.



And I want to argue that the economy or the housing market or that in shelter inflation might become stickier than people think. We like to use, when explaining shelter inflation, we like to use this chart here. , the green line shows you Zillow. Zillow has, if you've ever signed down to it, the Zillow estimates. They estimate the price of every single house and rental unit in the United States via an algorithm. And then they estimate, they give you changes in that algorithm as well. And you can see that there's been, on a year-over-year change, there was a big fall in that, and it started to bottom.

And that there, this is real time that the owner's equivalent rent and rent of primary residence, these are the big shelter components. The owner's equivalent rent is what would you get if you rented your house? Because what, a house is a funky thing. It's a financial asset and it's a physical asset. They want to try and separate the financial asset aspect of your house from the physical asset. It's just more expensive. Housing is getting more expensive or that housing has become more desirable. More desirable is not inflation. More expensive is inflation.

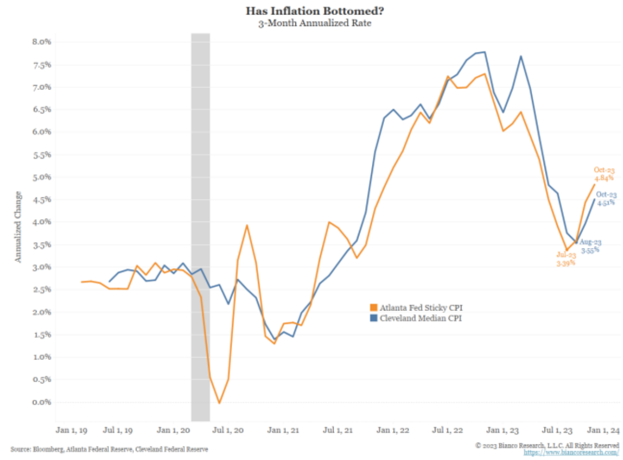
They impute this rental owner's equivalent rent and rent of primary residence is the same inputs, different model to impute rent or inflation. Well, this lags the real-time measure of Zillow by about a year. Why? Rents don't change that much. They only survey the rental population twice a year, once every six months. it's slower moving. A lot of people have looked at this year-over-year change and said, this number will continue to head lower.



Now, Adam Shapiro at the St. Louis Fed, I tweeted about this last week, and we had it a couple of days ago in our news clips for our customers. He talked about, why is year-over-year the magic number? Maybe what we should be looking at is cumulative change. I went back to 2013, the beginning of the Zillow measure, and that's in red. And I looked at the cumulative change to that, owner's equivalent rent and rent of primary residence. From 2013 to May of twenty-one, this way, these all moved right in line with each other. But since then, they have opened up a big gap between Zillow and the rent of primary residence and owner's equivalent rent.

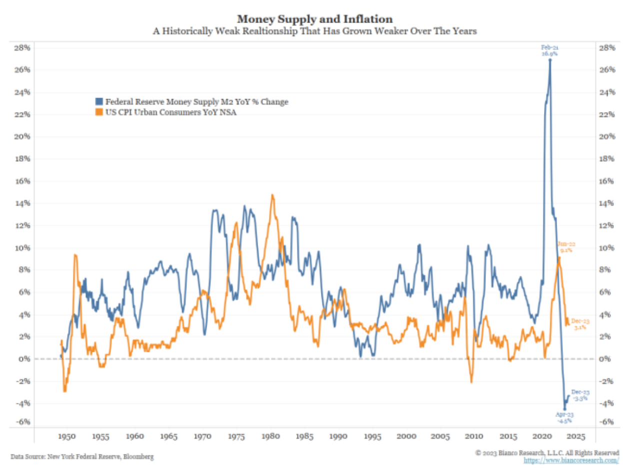
Home prices, the inflation component of home prices is up 47%. Zillow is up 63%. We got catching up to do. This is what happens when you have a change in the trend. The year-over-year rates of change like this chart work great when you don't change the trend. But when you change the trend, something happens. And what's happened is owner's equivalent rent, rent of primary residence still have more catch-up to do.

Now, what that means is if we go back to this chart, Zillow stays down here. They stay up here. And then they continue to close that gap, putting upward pressure, making that so-called last mile in inflation even harder to achieve. You see something similar. And by the way, just to finish off on inflation, here's the three-month annualized rate of inflation of two measures. The Cleveland Fed median, inflation is an average. Median is you take all the thousands of measures and what's the 50th percentile? And the Atlanta Fed breaks down the inflation, thousands of inflation measures into two categories, sticky and flexible. Flexible is stuff that gyrates around all over the place."Over the place, gasoline prices are one example of flexible. Those are the numbers that are down, they're up, they're down, they're up. Just wait a minute. Airline tickets are another one. They're up, and we all talk about them. Wait two months and we'll see what happens to them next, if there's another round of discounting or if they stay sticky, or if they stay flexible. But sticky is the kind of stuff that slowly moves and when it moves, it continues to move.



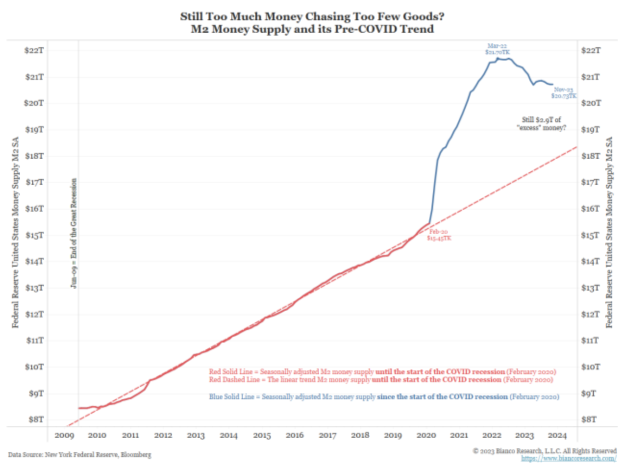
At a three-month annualized rate, the sticky inflation in the median, the midpoint, has bottomed out. And I don't want to maybe go as far to say that they're moving up, but let's just say that they've bottomed out. And that's part of my thinking that the last mile might have already been completed. And we're very, very close to 3% inflation.

Now, a lot of people like to use money supply. Oh, but the year-over-year change in money supply has collapsed, the blue line, to the most that we've ever seen. You got to go back. This chart goes back to the 1950s, but actually if you took money supply back to the 1930s, what you'd find is that this is the biggest collapse in money supply and inflation is following it lower. Okay, again, the same fallacy of using year-over-year when trend changed.

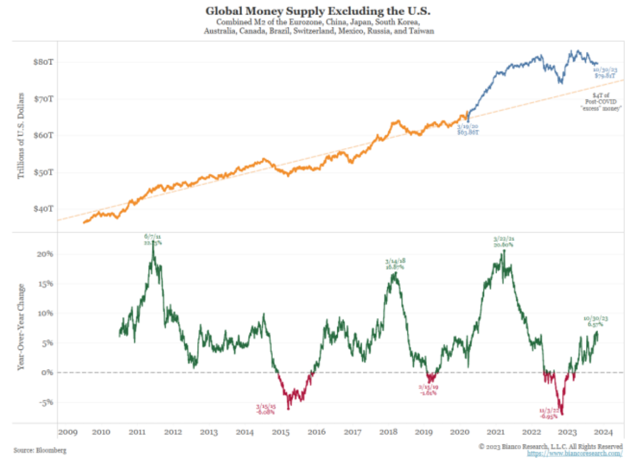


Let's look at it differently. Let's look at the growth of money supply since the end of the Great Recession. The red line is the growth of money supply. The dashed line is a trend line. Boy, we were right on that trend line all the way until COVID. That trend line continues here. This was the COVID spurt. This is what we've been doing with money declining. We still have $3 trillion of excess money that we didn't have before. Now, maybe some of that is because we've got excess inflation or something, but I don't see, this is the better measure to use in this trend-changed environment. The cumulative change, just like with Zillow, the cumulative change is better.

I think what's getting everybody mixed up is these year-over-year changes. They work when your trend hasn't changed, but when your trend has changed, if you want to look for normalization, I think you've got to look for them in the larger trends as well. You've got all that excess money.

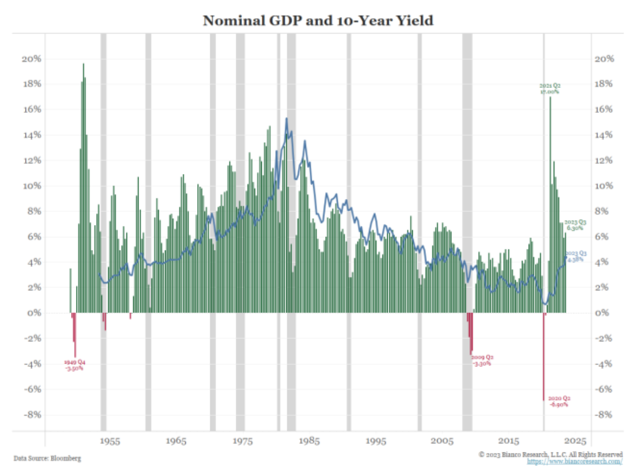


Now, in the U.S., you know, you've got contracting money. Now, remember, as I started, I showed you inflation is global. If you look at global money supply, excluding the U.S., so Eurozone, China, Japan, South Korea, Australia, Canada, Brazil, Switzerland, Mexico, Russia, and Taiwan, you'll see that their money supply is growing at six and a half percent. Too much money is chasing too few goods, and it is a global inflation. They've got pretty heady inflation. They've got money growing faster than the global inflation rate, and they're still four trillion dollars above their 2009 to 2020 trend. They've still got excess money.



What's made everybody look at that year-over-year change in money supply and say, oh my God, the deflationary collapse is coming, unless the trend changes, and you've got this big spurt that we're working off. That would be true, but we have this big spurt that's working off.

Let me sum this up, and then I'm going to turn to markets, and I'll take some questions. I see some good questions coming in here too. The best metric for looking at where an interest rate should be, should it be at a hundred and twenty percent, should it be at zero, is nominal GDP. That's real, let's see if I get, my penmanship is, and inflation combined together.

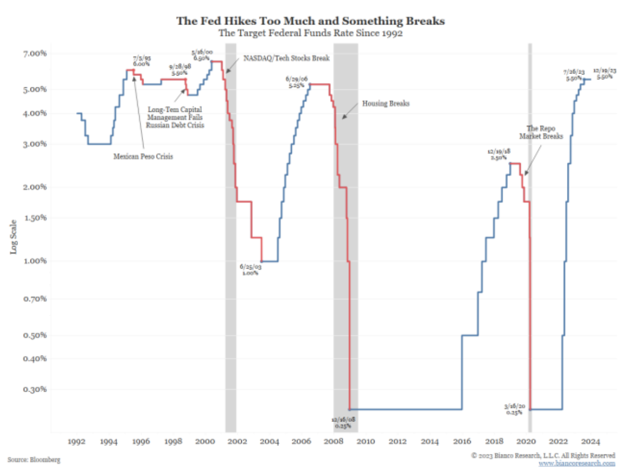


If you're Venezuela or Argentina, and you add inflation and real growth together, you're over a hundred percent, you have a hundred percent interest rates. If you worked in Japan until about a year ago, and you add inflation and real growth together, and you're at zero, your inflation rates, your interest rates are at zero.

Should our interest rates be at 20, should they be at 1, should it be five, should it be three, should it be eight? What is nominal growth? Well, currently nominal growth is 6%. Now, I'm arguing to you that we're probably going to have two and a half percent ish plus or minus 50 ish basis points of real growth, and we're going to have three to four percent inflation, not eight, ten Zimbabwean inflation. I add that together, and I get, I'll just be, I'll be a little bit imprecise, I'll get five to six percent nominal growth for 2024, that's where five and a half percent comes from.

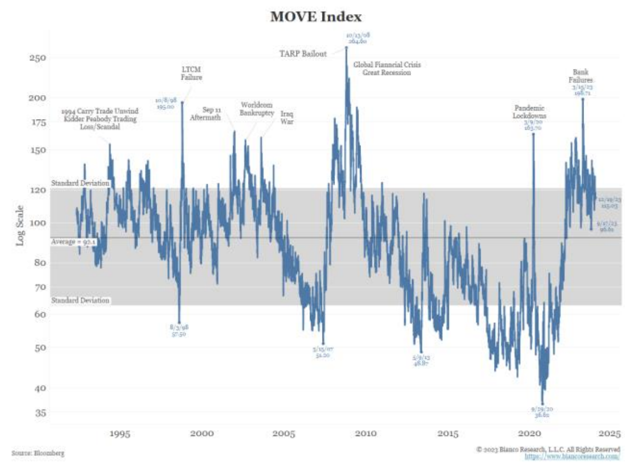
We are not going to have a landing in the, we're not going to have a soft landing, we're going to have a null landing, we're going to turn out two and a half percent for the year. Inflation is going to be around three, and that's how I produce five and a half percent, and for the year.

Now, for the index that I explained earlier, in talking about the index, what I was referring to there was that the index is looking at, when I structure the index, I'm structuring it for the next year or so. Remember, we change the index monthly, maybe, maybe twice a month if circumstances warrant, we're not trading anything, we're not in the ETF business, we're in the index business. This is why I'm short duration, it's why I'm a little bit short on credit, and this is why I'm very short on structure, because I think the volatility in interest rates is going to stay much higher.



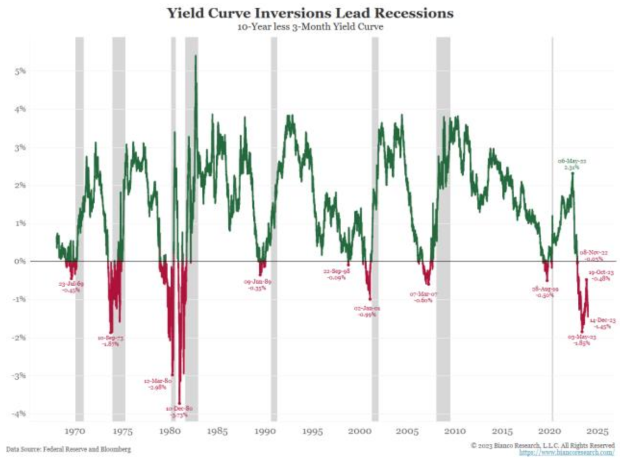
As far as the yield curve goes, here's the funds rate, and here's the big rise in interest rates that everybody has been looking at. Usually, when the yield curve inverts, is when the Fed panics and starts cutting rates hard, because a recession is coming. What un-inverts the yield curve is usually a recession, and it's referred to in the bond market as a bull steepener, bull being falling rates, and market is steepening.

But, what we've got in the market, here's the move index again, here's its entire history, ninety-two on the index is what it's averaged, we're at 115 as of Tuesday, this shaded area is plus or minus one standard deviation, and so we're near the higher end of where we are in volatility in the bond market. The VIX, by the way, is at a three-year low, but the bond market is pushing some of the highest numbers we've seen since the financial crisis right now, in this range that we've seen right here.



And so, this volatility is because of this tremendous uncertainty in the market. Now, what un-inverts the yield curve is when there's a panic, and you start cutting rates, and they cut rates on the short end faster than the long end, and it just falls below long end, and that gives you a steep yield curve. Here's the yield curve on October 19th, this is the 10-year three-month curve, was minus 48 basis points, today it's minus 145. The yield curve has been, even if you look at the two-year tenure curve, it's been getting more inverted, not less inverted.

And one of the reasons I think it's getting more inverted is because of the volatility and the uncertainty about what's coming. By the way, as far as the yield curve goes, we are 394 days inverted, the record was in the 70s, 522 days, and 473 days. Now, we use the yield curve inversion as a predictor of inflation, excuse me, as a predictor of a recession. And you can see on this chart the red areas are where the curve inverts, and the shaded areas are recessions, and it is a very good indicator of a recession.



Every time the curve inverts, we have a recession. But what we're learning now with this long period is, it might not be that it's when the curve inverts, that is, here, this, it's not the date that the curve inverts that signals a recession and inverted 13 months ago, it might be the date that it un-inverts. Because the amount of time between the inversion date and the official date of a recession is 316 days or 10 months. But the average time between the inversion date and the official date of a recession is 316 days or 10 months.Between the un-inversion date and a recession is two months.

How Long Until the Recession?

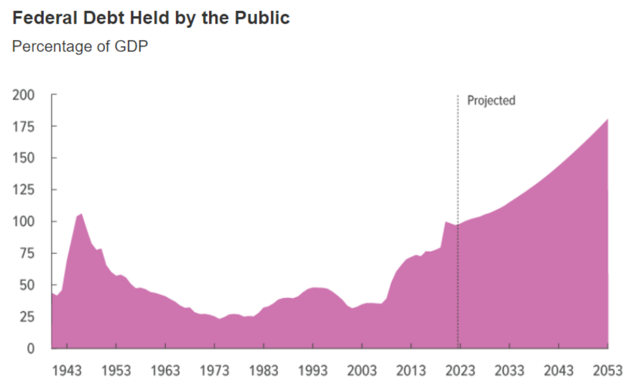
When the 3-month to 10-year yield curve uninverts for 10 consecutive days

Date of Inversion	Date of Uninversion	Days Inverted	Date of Next Recession	Calendar Days to Recession From Inversion Date	Calendar Days to Recession From Universion Date
1/10/1969	2/21/1969	42	Dec-69	325	283
6/14/1973	9/30/1974	473	Nov-73	140	-333
12/8/1978	5/13/1980	522	Jan-80	389	-133
11/7/1980	3/31/1981	144	Jul-81	236	92
6/6/1989	9/7/1989	93	Jul-90	390	297
7/31/2000	2/8/2001	192	Mar-01	213	21
8/1/2006	6/11/2007	314	Dec-07	487	173
6/6/2019	10/23/2019	139	Feb-20	268	129
11/22/2022	*????*	*394*	*????*	*394*	*????*
Average		**257**		**316**	**66**

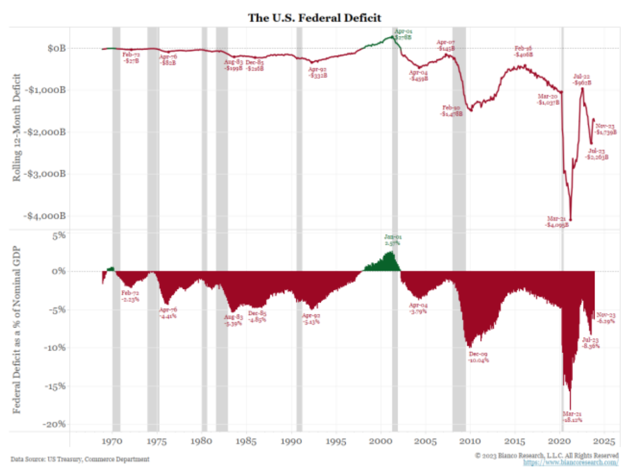
1/10/1969 = Inverted for 24 calendar days, went positive for 33 days, then inverted again for 53 days
6/6/1989 = Inverted for 30 calendar days, went postive for 9 days, inverted again for 26 days
6/6/2019 = Inverted 41 consecutive trading days, went positive for 1 day, then inverted again for 67 days

The reason that we never had to make this nuance is, other than the seventies, the inversions were not very long. When the yield curve inverted, and then when it un-inverted, they were close enough together to each other that the inversion was close enough, call a recession, and soon there we had one. But now, maybe we need to nuance this a little bit more and go back to this chart, is that when the Fed panics and starts massively cutting rates to un-invert the curve, they're usually trying to stop a recession and they can't because it's too late. But that's really when we get the recession call.

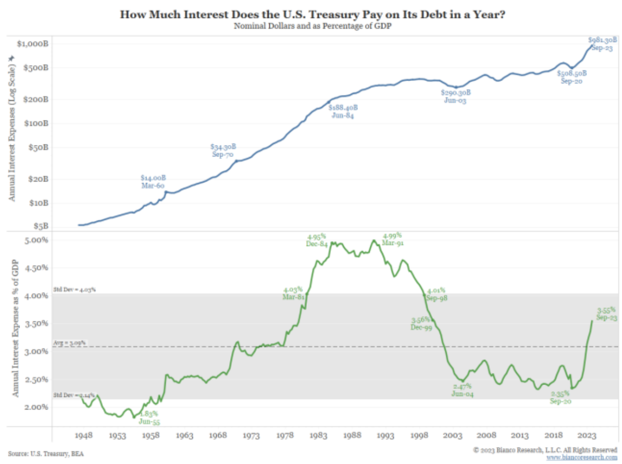
Now the Fed could cut rates, they could cut rates a couple of times next year and not un-invert the curve. But if they un-invert the curve, it can be a signal of that. Now I'm calling for the idea that rates are going to stay high. What I'm arguing is, to Jonathan Gray's argument, 8% mortgage ain't going to kill the housing market. Five and a half percent ten-year isn't going to kill anything. That has not broken anything. We can handle those level of rates.

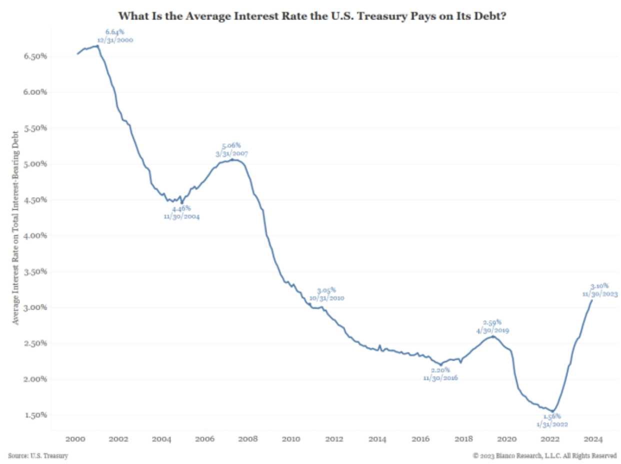


Now the first thing I get back from people when I say that is, have you seen the deficit? Here's debt to GDP. We have taken out the World War II peak and look at what we're projecting. And have you seen the deficit? This is the deficit in actual dollars. It's 1.7 trillion dollars or 6% of GDP. Look at all that red and very little green. It was two thousand last time we had a surplus. We have all this debt. We can't afford to have interest rates go up because interest payments, which are now approaching a trillion dollars, are going to swamp us and crush the federal government.

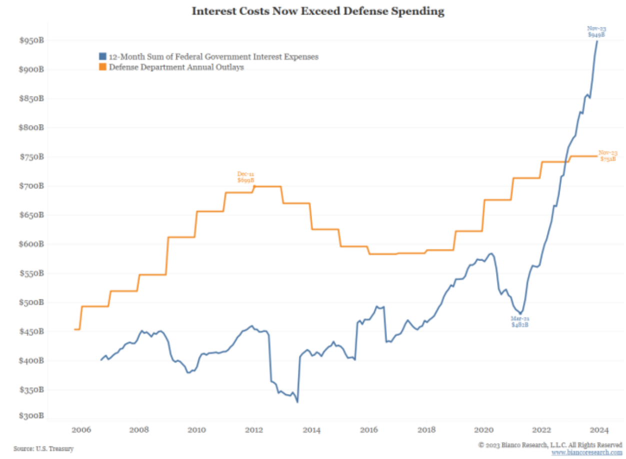


And on a percent of GDP, it's at three and a half percent of GDP. That is the highest level since ninety-nine, but it's not above this plus minus one standard deviation. It is elevated. It is above average, but it is not up at this very, very elevated level. And by the way, if you look at the average interest rate that the United States government is paying, it's 3%, up from one and a half 18 months ago or 20 months ago or so. It will continue to head up, even if the Fed raises cuts rates next year, because they'll be rolling off 2% and 3% mortgages or coupons and bringing them out on 4% coupons and maybe 5% coupons, which is still talking about bills. that number will still go up.





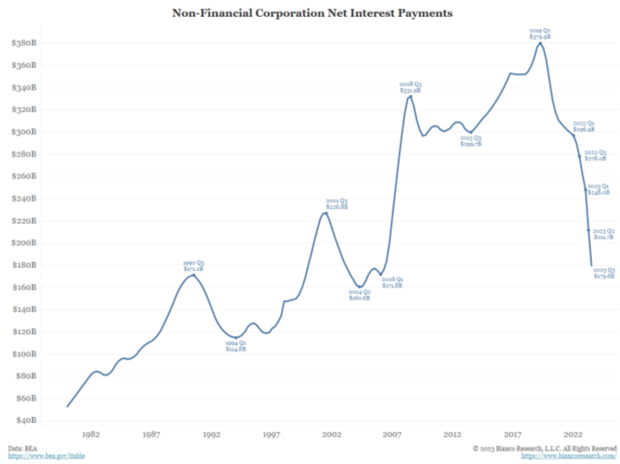
You're right that the federal government is going to have to pay higher interest costs. And here's a fun chart that we like to use. Interest costs are now higher than the Defense Department budget. And that happened about a year ago, that we're spending more. And that number is going to continue to go up. But you get it wrong if you say, so therefore we can't raise interest rates.



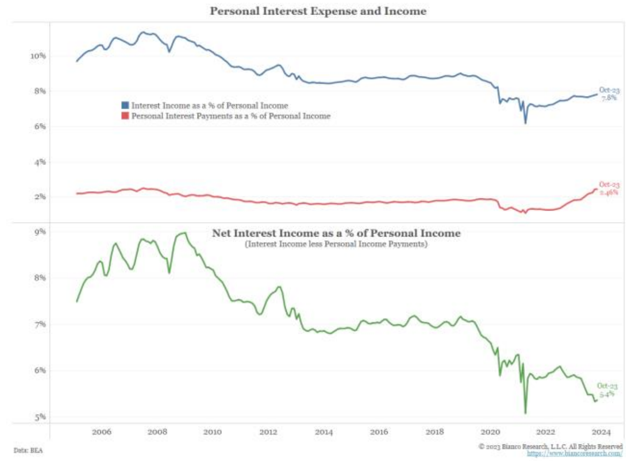
Because that's like saying, go to the bank and say, I'm over levered on my credit cards, and I'm over levered on my second mortgage and my home equity loan. Will you cut my interest rate so that I can afford to pay these so that I can continue to spend? No, rates are going up because we want you to stop doing this, is the way it goes. It's not that they can't go up because they'll bankrupt the country. It's because they want to stop this.

And an example of that is what happened in the UK last year. when Liz Truss, who was 49 days as the Prime Minister and her big thing that happened in those 49 days was the Queen died, she put out what was called the mini budget in September. She was a Tory, a conservative, and her mini budget cut taxes, raised spending, increased the deficit. Parliament was fine with it. The bond market was not fine with it. The UK gilts market was not fine with it. since Parliament wasn't gonna do anything about it, the UK gilt market did. UK gilts shot up a hundred and fifty basis points, one and a half percent in eight days. In eight days, they went up one and a half percent. One of the biggest rises that we've seen in UK gilts in several years. I'm sorry, in three hundred years of data. In three hundred years of data that the Bank of England has. The bond market was saying to Parliament and to the UK and to the Truss government, we don't want this budget. And so therefore we're gonna force this on you to make a change. That's what the bond market's gonna do with higher interest rates. Do you want this to stop and go down? You got to tell Congress to stop spending. They're not going to stop spending. The higher interest rates might do it. Now they might break things along the way, but they have not yet.

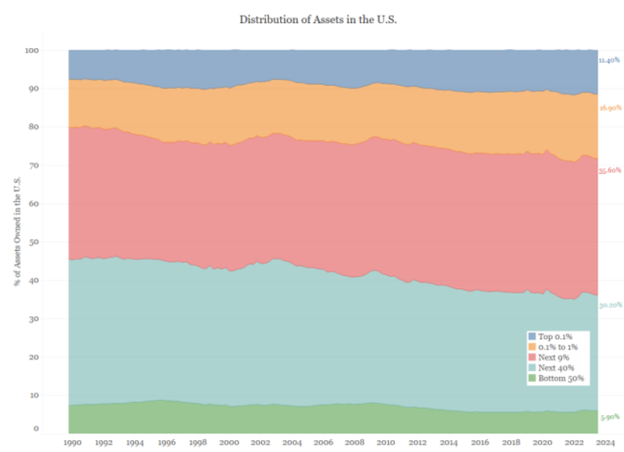
But there's something else we're missing when it comes to this number. What about the other side of the equation?



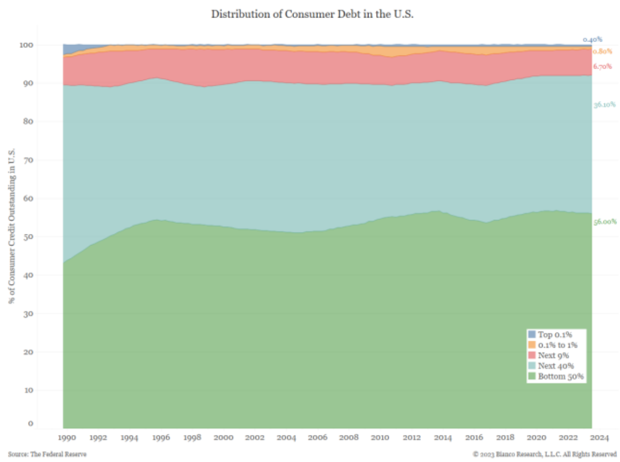
The Bureau of Economic Analysis, the BEA, puts out a number called non-financial corporate net in net interest payments. Net is interest income, less interest expenses. Because the yield curve is inverted and money market funds are going to five percent, Warren Buffett has a hundred and twenty billion dollars of cash. Warren Buffett two years ago was getting zero interest income on that cash. He's getting six billion dollars for Berkshire's bottom line now because of five percent bills. What's happened is interest income for corporations is rising faster than interest expenses. And they use the slops market and they've termed out their debt, meaning that they've locked in their borrowing costs because even if rates go up, they don't have to worry about it until maturity. This number is falling, meaning that the financial position of companies is improving. It's getting better because rates are going up. They're paying higher interest costs to borrow, but their investments are yielding them even more than their higher interest costs. They are improving their situation. And this is why we're seeing earnings coming through and labor hoarding and the attitudes that we have of companies. They're not being crushed. They're not being crushed by higher interest rates. It's not breaking.



What about the individual? Okay, so here's your interest expense and interest income. interest income as a percentage of personal income. How much money you make, how much of that is from interest income is eight percent. Interest payments are two percent. Now it's falling, meaning that these interest payments are eating up more than your interest income, but it's still positive. You're making more money. The average person is making more money on coupons and interest in their money market funds as a group people than they are paying out in mortgage debt and credit card debts and student loans and the like.



Unfortunately, the way it works too is here's the distribution of assets in the United States done by the Federal Reserve Survey of the Consumer. And what this shows you is this is the top tenth of a percent. This is the top one percent. This is one through nine. This is the top 50 percent. Ninety-five percent of all assets in the United States, stocks, bonds, pension annuities, real estate, and the like is owned by ten percent of the population. The bottom 50 percent, they have six percent of the assets. As bad as that is, the next charts worse. If you look at the distribution of debt, who owns the debt in the United States, the bottom 50 percent own over half the debt. and the bottom 62 percent of the public are living paycheck to paycheck. This holiday spending credit card rises.



Unfortunately, this is not new. This is the way it always is. It's always in the high fifties, low sixties. The reality is the rich being the top 50 percent of income, own all the assets, and they benefit from rates going up. The poor have debt. They have personal loans, mortgage debt, credit card debt, and they get hurt when rates go up. This is why when rates go up, it's a transfer of wealth from the poor to the rich.

"Unfortunately, these rich are the ones who spend money, and they're spending money, and that's going to keep the economy strong. But if inflation continues to be a problem, and Jay Powell has acknowledged this many times over, it really hits these people in the bottom 50 percent. These people are right here. And they are the ones that he's going to have to address.

What if inflation bottoms at 2.7, 2.8, 3.1, 3.2? Close enough for government work? No. They've got to do something for these people. We used to talk about this last year. You know, do your patriotic duty as a part of the upper 10 percent with assets. Lose money with dignity. Watch the stock market go down to bring inflation down and say you're doing your job to help inflation go down. We might return to that if we don't get the inflation rate down. Three percent is unacceptable for these people. They need it to come down, they need the interest rates to come down, because inflation is coming down, because they're settled with all the debt.

What about interest rates being too high? A couple of more charts, and then I'll jump into some questions. And so hopefully you're seeing why I like, you know, why I'm short, a little bit short duration. I understand we're at 3.80. Fund started trading yesterday, and I'm mentally thinking of my indexes from yesterday, that I want to go in short duration, because I think that over the next several months rates are going to go up. If I get a bigger conviction that we're going to go to five and a half, the index might become shorter.

Curve, I don't think it's going to do anything, a hundred percent. You know, the structure is down there. I'm going to talk about credit in a second. And inflation, if I think inflation's hit the last mile at 3%, a short tips will give me 3% plus whatever the tip yield is, and that's well over 1%. I could get, you know, I can get a very, very good short-term yield, and be protected from inflation going up. And that's why we've got so much of it in that one as well, too.

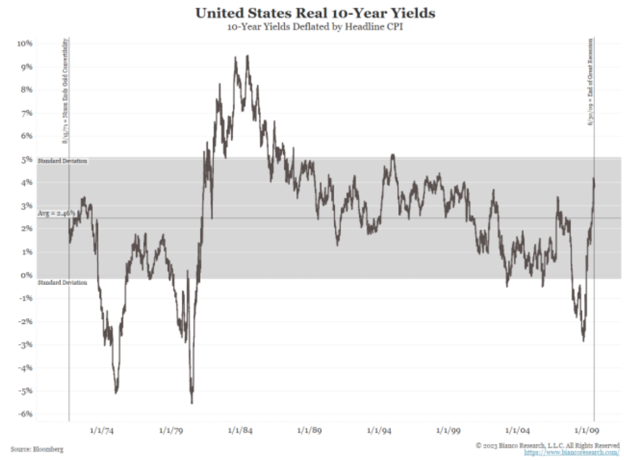
Here's the real yield. Here's TIPs yields. Again, what is a real yield? It is the yield you get on top of the inflation rate. This is a Treasury Inflation Protected Security, and it tells you that these securities issued by the government will pay you the inflation rate. They call it accretion. Basically, they give you more bonds. If you buy $100 worth of bonds, and in a year the inflation rate was 3%, you'll have $103 worth of bonds, and then you get a 1.7% yield on top of getting more bonds for the inflation rate. You get a yield above the inflation rate of 1.7%.

Now, Bill Ackman came out at the end of November in an interview with David Rubenstein on Bloomberg, and he said, what is happening is t. . al rates, which is what impacts the economy, keep increasing as inflation declines. If your real rate is here and the inflation rate goes down, real rates go up, Ackman said, and that is if the Fed keeps rates roughly at the 5.5% range when inflation trends are below 3%. It's a statement of fact. It's not a forecast. It is still a forecast. There's no reliable theory on inflation. I agree with Dan Tarullo. We got this completely wrong in twenty-one, but somehow we figured out the Rosetta Stone on inflation in twenty-three, but when inflation goes back to below 3%, it's a very high real interest rate, meaning that that high interest rate is going to hurt things.

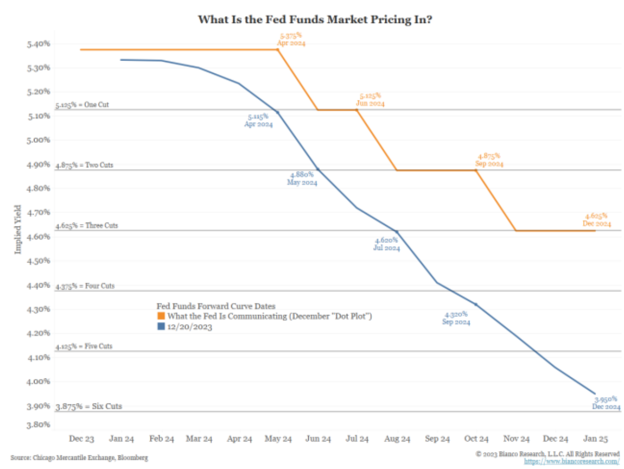
Mary Daly earlier this week said exactly the same thing. If inflation continues to steadily decline in recent months, the Fed's benchmark interest rate, it will be quite restrictive, even if we cut three times next year, meaning as inflation comes down and rates stay high, that real rate gets very large.

Okay, here's real rates back to 1997, and now I put two periods in here. This period here is 2009 to 2022. This was the QE period, as I point out right here, when the Fed was doing QE. The average real rate was 0.23% during that period. What was it before QE? It was 2.74%. What I think has happened is we've all got anchor to the QE period. We all think this was normal. This was the most abnormal period that we've ever seen in the market. To correct it, we had the biggest sell-off in the bond market in 150 years. We had negative interest rates in Japan and in Europe for the first time in 5,000 years. This was the most distorted period we've ever seen. Now we think that's normal, so when we see real rates here, we say, man, they are high relative to that. That is going to punish the economy. What were they like during the non-QE period? They were 2.74%. We're at 1.67%. We had booming economies, bull markets and stocks, growth, and everything at 2.74% real interest rates. We were fine during that period. Oh, but the government can't handle that payment. Sure, they will have a problem. They'll have to cut back on spending at some point in the future. But corporations and the public, because the public is rich, are getting income and they're spending it. And corporations' public net position is improving. They're fine with these levels of rates.

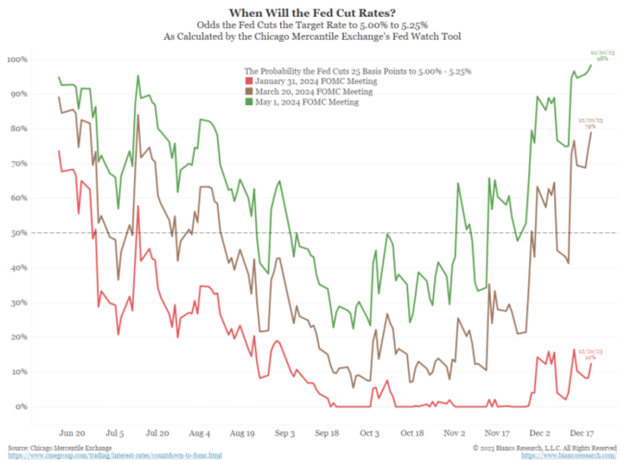
Now, 1997 is when tips started and that averaged 2.74% on real rates when you didn't have QE. Well, we've had a distorted period.



Okay, here's actual real rates where I took the 10-year yield minus the inflation rate to give you the residual, which is real yield. And I started it in 1971 when we started fiat currencies, when we entered the inflationary period. The average during that period is 2.46% versus 2.74% on tips. Close enough, thirty basis points difference. That's where normal non-QE real rates are. this Mary Daly, Bill Ackman argument that real rates are going to crush everything, I don't see it. I see it's returning back to where we were pre to a non-QE period. We've anchored ourselves down in this QE period and now we need to understand that we got to get off that QE period.

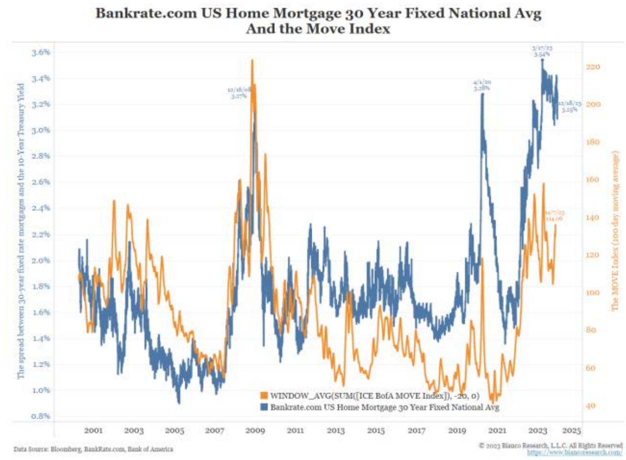


A couple of more charts to end up. Where is the market right now? Where's the market right now? The Fed is talking about three rate cuts. The market is priced in six. The market has a terrible history at predicting the Fed beyond the next meeting. the next meeting we've got, this shows you the probability in red of a cut at the January meeting. It's 12%. We're not going to cut at the January meeting. At the March meeting it's 79% and at the May meeting it's 98%. Have there been instances where two or three meetings in the future the market has been 98% and then it didn't happen? Yes.



When it gets to within a meeting, like once we get past March 20th and this thing is still at 98%, then you take it seriously. But we're on December 21st talking about what's going to happen on March 20th and there's two meetings ahead in January and March. That's the third meeting out. It's interesting. It's important to know where the market's thinking is. Doesn't necessarily mean it's going to come to pass. But the next meeting now, that's the one you want to pay attention to. There's gonna be nothing going on in the January meeting.

A couple of other quick charts to finish and then I'll look into some of your questions. I've talked about that rates are going to go up. I don't think we're going to have a soft landing. I think we've hit the last mile already with 3% inflation. That rates could go back to five and a half percent. The yield curve is going to stay roughly where it is. there's really no opportunity yet with the yield curve that the volatility in the bond market is going to stay high.



here is in orange is the 20-day average of the move index and here are mortgage rates. You can see that they move up and down with volatility in the bond market. That's what. rives mortgage spreads. Why are mortgages at seven and why is the 30-year at four? Why are there three hundred basis points difference? “Points yet? Because there's a lot of volatility built in and expected in the bond market. I expect that to be the case and I expect mortgages to stay up at those yields as well too. With that said, I think that that will continue.

What about credit? Here's the investment grade index and this is the in blue is the option adjusted spread or that's credit spreads for investment grade in blue and it's plotted inversely so tighter is a higher chart and here's the S&P 500. Credit is your stock bet in bond land. I'm slightly short of credit because I think that the biggest thing that we've learned about the stock market in the last year or so has been that it has been driven by this expectation of interest rates.

In October, we got third quarter GDP, third quarter earnings reports. They were great. They were very good, and we sold off in the stock in the S&P by October 27th was 10% off of its July high in the midst of getting all these good earnings reports. November 1st, we got the quarterly refunding announcement followed up by better-than-expected CPI number 14 in the bond market took off. I wish I had caught it, but I didn't, but it took off and so did stocks.

You could give me 280 great energy reports, or you could give me a rally in the bond market and the stock market saying you keep your earnings reports, I want to rally in the bond market. If rates stay sticky and stay high, I think the competition for stocks is going to be problematic and I'm using that word carefully problematic. Not a bear market, not the end of the work. a struggle. Just like the stock market struggled less the seven AI stocks until November 1st when bonds started to rally.

Why? Dr. Jeremy Siegel wrote an update to his book Stocks for the Long Run, a new edition out this year. I'll summarize it very quickly. What is the long run expected return in the stock market at a forward PE of 20 and everything else? Around 8%. Okay, that's what you should expect the stock market to give you over many years. Over the last two years, it's giving you zero because we're right back to where we were on December 21, in December 23.

But over the next several years, you would expect stocks to give you roughly 8% return. In 2019, when money market funds were giving you zero, we used the word TINA correctly. There was no alternative. You get out of money market funds, you get into stocks, you pick up eight hundred basis points of potential. Maybe the stock market does poorly, and you only get 5% of that, it's still better than a zero-money market fund.

But at the end of twenty-three, with all-time highs in the stock market already, you can get two-thirds or thereabouts of the stock market's return in a money market fund at 5% or in a bond fund. You can get it at 5% as well. And so, by being able to get that two-thirds number, why should I take the extra risk of going out in the stocks? Well, the reason you're doing it now is the expectation that that competition for stocks is going to fall. Those interest rates are going to fall. But if they don't, go ahead and give me three hundred good earnings reports. But if you give me rising rates, that could make struggle the stock market.

I'm using the word struggle. I don't mean we're going to have a bear market, we're going to have a full-blown disaster, but it could look a lot like what the Russell looked like, the mid-cap looked like, the S&P 493 looked like going into November. I've also posited the idea that as far as this trend changes with interest rates and everything else, we're going to go back to a stock picking environment.

No longer do you want to buy a broad-based equity ETF like the SPY or VOO, but you want to buy something narrowly based or maybe actively managed because there are opportunities. AI was an opportunity. We're going to go back. In other words, Peter Lynch can come out of retirement now. We need his skill set; the ultimate stock pickers kind of skill set. And we are transitioning back to that.

Now, maybe it comes within the structure of an ETF that we see more actively managed ETFs, actively managed fixed income ETFs have been one of the hottest sectors that we've seen in the market. Or maybe it comes in a little bit of a different kind of structure as well. But if interest rates go up, the competition for stocks is going to cause the struggle. That's why the index is at 90% as well.

Q&A

I'm going to stop there. I ran a little bit longer than I wanted to. Tried some stuff on volatility at the end, but I'll skip that for right now. And I'm going to jump into questions. First name only basis. I know who you are. That's all that matters.

let me see here. **Jay asks, "Are you aware of Daniel DiDiMartino Booth's opinion that the risk of deflation outweighs the risk of inflation? what about her position do you disagree with?"** I am aware of her opinion about the risk of deflation. It really boils down to, I think that the cycle has changed in 2020. And the biggest driver of that cycle change is that there's a different attitude about work.

Yeah, I have this job. I'm just going to give me a paycheck. I'm going to spend money. What if my boss fires me? I'll find another job. I'll get another paycheck. I will continue to spend money. I think that attitude did not exist in 2019. It did exist in 2020. It is an outgrowth of PTSD of the shutdown restart of the economy. I think that deglobalization and energy is a weapon are parts of that. And I think that that's why you've had a major turn in the bond market.

Look, I could be wrong on my position. And I got enough respect for Danielle that I take her position very seriously as well too. And so that is really what I am focused on right now is the trends changed in 2020 and we need to update it. And that's why I started at the beginning. All models are used, she doesn't use a model, but all models are useful, are wrong, but some are useful. And we're trying to understand, go back to what we thought was going to happen a year ago and none of that happened. Go back to two years ago when we thought inflation was transitory and none of that happened. Why should we believe the soft landing and all these other stories with the risk of recession outweighing the risk of a no landing when all the evidence is pointing to no landing? That's my view as well.

Preston asks, "How much do you expect, hope your index will outperform? I ask because the 54-basis point fee on your ETF leaves you a good bit behind the index." Look, if I get my calls right and I've done some testing on getting the weightings right, a couple hundred basis points if I'm right, a couple hundred basis points if I'm wrong. I'm just rolling in at 90% duration on the index now because we're in the midst of a big rally. I've got a January rebalancing coming up and I may change it to the January balancing, if not then the February rebalancing. that's what I've been shooting for in terms of where the index is going to go. And the fee was picked because that's kind of the average of like kind of ETFs that we see in our space. Hopefully, that isn't a problem for you.

John asks, "What happened to the days where Powell said the goal of inflation average of 2% over time? Shouldn't that mean that we should have let it run below 2% for some period of time after running so hot for so long?" You're a hundred percent right, John. We should. And what you're hearing people say is core PCE on a six-month annualized basis might hit 2.0% when the December number comes out next week. Core PCE might hit 2.0% for one month on a six-month annualized basis. Victory! Victory! Start cutting rates right now. No, that's one month on a, that's one of many statistics on a six-month basis, not even a yearly basis.This is part of the narrative. We desperately want the Fed to back off on interest rates because what we're afraid of is competition for everything else. As we saw from last year and into November of this year, when rates go up, they just suck the life out of everything except for theme stocks like AI. We need rates to go down so everything else can rally. That's why we don't want the US to declare victory.

Now, the other problem I have is, does this also overstimulate the economy? We have a wealth effect and lower rates. The argument you'll hear from people is, well, in the last 40 years, every time we had a bull market in stocks, it never stimulated more inflation, so why should it now? My retort is it will happen in 2021. In 2021, we had meme stocks, we had Dave Portnoy picking Scrabble letters, or picking letters out of a Scrabble bag to buy stocks. We had the craziness going on of everybody piling stimulus checks into the stock market and making money and YOLOing.

Then in 2022, by the early part of 2022, we had eight and a half percent inflation. The last time we stimulated the hell out of things and had the stock market go up, we had inflation. That's part of the new cycle. Yes, everything that happened in 2019 and earlier was part of the older cycle. I think attitudes have changed right now.

Because it gets back to the job thing. I got a paycheck. I don't worry about my job. I'm going to get a paycheck if I lose my job. Oh, my brokerage account made me more money. Let's go buy something. It's no longer, oh good, I've got that cushion in case something bad happens. It's free money. Let's go spend it. Or let's go YOLO on some zero GTE option because it's a form of entertainment or something along those lines. Yes, I also fear that this might overstimulate the economy.

Larry asks, "What would you say to a string of yield curve inversions predicting a recession has been broken?" It could be. But I would argue to you, looking at the timing of the question, that what I said earlier is I think it's an un-inversion. I think it's really the un-inversion that is what's going to drive the signal of a recession.

If I go back to this chart here again, when the Fed starts cutting rates like mad, they cut rates, short rates, long rates. They cut short rates below long rates and the curve un-inverts. That's when you get into the recession. What's different about this cycle here is the length. Again, it is the un-inversion. 66 days after the un-inversion, on average, you have a recession. We're not un-inverted. We're getting more inverted. That's what's different. I would argue, let's hold it off until the un-inversion and let's see where it goes.

You argue that inflation is going to be stickier than anticipated and that the last mile will be near impossible to achieve. Assuming you are correct, and that inflation never gets to a level of 2%, but it bottoms out at 3%, what are the implications upon hitting the 3% level? The Fed changes its neutral assumptions and declares mission accomplished.

No, I don't think they change their assumptions because of this chart here, that high rates benefit the upper 10% and high rates hurt the bottom 50%. And the only way you're going to get rates down is if you get inflation down. And they cannot say to you, all you people that shop at Dollar Tree or Dollar General, sorry, but all you people that own, you know, a bunch of bond funds and drive Teslas and own two homes, you're good. They can't do that. They have to continue to apply accommodation or apply restrictiveness to get from three to two.

Now that may not mean more rate cuts. It just might mean we're not coming anywhere near six or maybe even three rate cuts next year. That's assuming that I'm right, that, you know, we eventually see inflation bottom around 3%. Remember, core inflation is currently four. Core inflation is four right now. Headline is three, again, because energy, food, and goods are depressing it. And as I said, energy, tell me where you think gasoline prices or crude oil are going to go and I'll tell you what that part's going to do. And I think goods might be bottoming. I think we've gone too far the other way when it comes to goods.

Okay, a couple of other quick questions here. How much of a move in year-over-year CPI is from the base effect? I didn't put the base effect chart in here, but the base effect means when you look at year-over-year CPI, you say, okay, what are we expecting this month? Well, the Cleveland Fed has the CPI nowcast as expecting 3 or 4 tenths for this month, and we're dropping one tenth. What should happen is the year-over-year number should go from 3.1 to like 3.2 or 3.3 for the year-over-year number as well.

And then when you get into early 2024, when you look at the early 2023 monthly CPI numbers, they were very low. There was even a zero in there. as we print, you could see CPI still hovering around three. You could see core inflation staying in the fours or high threes at least through the second half of the year as well.

What would you say to the argument, Amy asks, "What would you say to the argument that there's a lot of housing supply, multifamily, coming online that will drive rents down?" There might be a lot of housing supply coming online that could drive rents lower, and to some extent I think that they have been driven lower, but I don't see the supply glut as being any more than a correction to what we had post-financial crisis. We way, way under built the housing market in, you know, post-2009, and I think what we're doing is we're starting to catch up, and a lot of that supply glut is already factored into the current level of prices.

Calvin asks, "Is the chart on line 24 adjusted by headline CPI or CPI goods?" let's go to twenty-four and answer your question really quickly. It is overall CPI because retail sales can, it is overall CPI. I do have a version of it that is CPI goods. It's essentially the same chart. If anything, the CPI goods chart shows that this movement here is a little steeper because CPI goods are closer to zero where headline CPI is closer to 3%. If I showed you CPI goods, this number goes up a little bit more, showing that there's more real growth in retail spending.

Next question. Jim, you make a pretty compelling argument, and yes, we could be in a secular bear in bonds, but what would you see being the catalyst for a cyclical bull market, 550 on the US Treasury? cyclical bull markets will come when you have cyclical recessions. yes, if I said to you that I think we're in a multi-year bear market in bonds and 5% of 499 was not the high and the interest rates are going to keep going up, yeah, along the way within that, just like in the 70s and the 60s, you know, and in the 50s, you had cyclical, you had recessions and you had cyclical one or two or three-year bull markets in bonds, you could do the same thing along the way as well.

By the way, a quick word about a discretionary managed index or even actively managed fixed income, now's the time to do it. Now that we've gotten the worst sell-off since the Civil War done, now that there's a yield to manage, there's a yield to manage right now, you want to manage it. And even if I'm right, just flat out, I'm right, we go to 550, flat out, the indexes will have a positive return in 2024. Stocks, how are they going to handle that kind of competition? Remains to be seen. I don't think they collapse, but they're going to have a big headway. Like I said, look at what all of them did except for AI stocks until the day we hit 5% in late October. I think now's the time to manage that.

But yes, to your larger question, when we have a recession, we will have a one or two or three-year bull market in bonds within a larger secular uptrend. Just like when we had recoveries in the 80s, 90s, and 2000s, we had a couple of year periods where bonds struggled. '94 was the worst year since 1927. 2009 was a disastrous year for bonds within a larger bull market as well. Yes, we can have those bull markets as well too.

Let's see, a couple of other questions here. What? Let's see. there's some trolling. I'm looking at the angry trollers on YouTube thing. Thank you, Don, for your angry troll. Good luck WI. your life.

Jim, great stuff as always. My biggest concern is if the ten-year Fed fund spread is minus 175 to minus two hundred, the FOMC can't ignore the bond market and seems to be forcing the rate cut. Which seems to be forcing the rate cut. What do you see? Yes, Deutsche Bank did a piece where they said that currently we are now pricing in the seventh pivot on the Fed. Maybe the seventh one turns out to be the one where the Fed pivots. But since '21, we have seen six other times where the bond market is priced in, the Fed's going to pivot, and they didn't. maybe this one did, or maybe they did a partial pivot. We get a couple of rate cuts before the end of the year, but nothing spectacular. Maybe the curve stays inverted throughout the year. Maybe, you know, the ten-year still continues to do what it's doing. But I wouldn't read into it too much more than that.

Let's see, just some other questions here. **in the equity space, this K-shaped economic background disproportionately hurts small cap companies. Should IRAs ignore the quilted chart and diversify clients, then buy market cap weight?** Yes, diversify clients. But my opinion is you don't necessarily want to diversify them by market cap weight. Maybe you want to diversify them by thematic weight or active weight. The reason that the small cap, you know, the reason that large cap worked was seven stocks were 30% of the index, the AI stocks. Now you could say, who cares? Just see, you got to be in the index. Okay, there's going to be a point where seven stocks are going to cause the index to be terrible because they're correcting. But you could have guessed any one of the other 493 stocks and gone better. what I would argue is start thinking about the idea that broad cap-based weighted ways to invest, that might have ended in 2020. ETFs are still a way to go, but there are thousands of thematic ETFs, actively managed ETFs. I don't have a recommendation in the equity side for you on those, but your thinking is right. It isn't just SPY or VOO or not SPY or VOO. Okay, I'll go IWM instead of SPY because in those big cap spaces, remember, Apple alone is larger than the entire Russell 2000. And if Apple suffers a correction, it's going to drag everything, but it's not part of the Russell 2000 and that might do better. I think maybe a more thematic approach would be a better idea for that as well too.

What do you think will happen with yields when Janet starts to buy off-the-run longer treasuries? I think she's going to do it in January. I'm not so sure she's going to start really buying off the runs directly in some kind of an operation twist or some kind of a direct measure of trying to manipulate the yield curve. I don't think it worked very well in the past. What the Treasury has done in the past is they bought high coupon discounted bonds. Bonds that had eight, nine, ten percent coupons that were trading at 80 or 90. They bought all those up and retired them, but they're all gone now. They're all gone. she would have to be buying lower coupon. Most of the off-the-run stuff is lower coupon, trades above par, paying a premium for it, and I just don't see them doing that. I understand your question, but I would just answer, I just don't see her doing that as well.

Will ask, well Janet, is Janet going to do anything to prop up the economy for Biden? The answer is yes. What do you think that may mean cutting capital requirements for banks? Whatever she does has to come within the precipice of that inflation. I'm wrong on my inflation forecast in the last mile is on its way to two percent. Because if you start stimulating in an inflationary environment, you're going to run the first half of '22 is what you're going to wind up doing. We were too stimulative, inflation was too high, stocks fell, bonds got crushed, the economy printed negative quarters, but the NBER did not call it a recession. If you try to stimulate within an environment of too much inflation, it will not go well. You can stimulate and try and help Biden if you want to if inflation is perceived to be a non-problem. And we'll have to see how that plays out in '21. The one thing you can do is I'll probably drain the SPR, try and put gas prices as low as possible. That mattered in '22 and maybe they can matter well.

Effort asks, if the sixty portfolio is no longer a good diversifying tool, what do you think should be the new split? It is no longer a good diversifying tool because they move together. The split doesn't matter. Basically, what you're doing is you're putting a low beta version of the stock market by owning some bonds, because bonds are lower beta than stocks because they don't move opposite each other. What you have to do is find some uncorrelated assets. Again, thematic, or active might be a way to find something uncorrelated along the way in order to see what's going to happen from there.

Let's see, a couple of other quick questions. Can you discuss the implications of 2024 being an election year? Yellen and Powell are political animals. What does it mean for low rates in a bull market? They'll try, but I'll remind everybody when it comes to election years, some of the biggest debacles in markets, 1980 with the high inflation and the debacle in the financial markets, especially the bond market. 1992, George HW Bush, George Bush Sr., 41, wrote in his memoirs that Greenspan kept interest rates high in '20 in 1992 and lost him the election. He blames Greenspan for that. 2008, the Fed was doing the most extraordinary things with TALF and TARP and quantitative easing and everything else, literally hours before the election. Remember famously the markets were so out of control that John McCain, who was the Republican nominee, suspended his campaign because we were having a financial crisis that turned out to be a political disaster for him, but that was an election year and 2020 was an election year.

Here's what happens in the election year. The Fed and the Treasury try to goose it for the existing president. Okay, I agree. And what usually happens, half the time the markets blow up in an influx, '80, '92, '08, 2020. They wind up blowing up because what you think is going to happen in the election year does not happen in the election year. What would my argument be? It's strong. It's strong. Inflation stays sticky, rates stay up, and why is the president's approval rating at an all-time low right now if we're not having a soft landing, we're having a no landing? Because everybody's pissed about high prices, the cumulative effect of three years of higher inflation and maybe two years of nothing returns in the stock market until several weeks ago, until the last few weeks. And if that's what we start to see, higher prices, more uneasiness, struggling markets. I didn't say bear market. I didn't say down 20% or anything like that. He's not going to win in that scenario. We’ll have to see. But half the time that you wind up '80, '92, '08, 2020 were all election years and they were bad. They were bad for the election. They will try, but there is no magic dial over at the Treasury, at the Fed, make markets go up, make everybody happy so they vote the incumbent in. They could turn that dial, and it can blow up in their face, and it does. A lot depends on the economic backdrop being consistent with turning that dial, and we'll see. Anyway, this went well for my first live simulcast for my 2024 outlook. Hopefully, things made sense to you about what I said about the ETF, the index, my outlook, and how it fits back into the index. If it did not and you have questions, I am available. I am not going on vacation this holiday, and it reminds me to wish everybody a happy holiday. Thank you for sticking along.

For regular customers, this is the format we do every three weeks. For those of you on YouTube, this is what we do every three weeks behind the paywall for regular customers too. You can go to biancoresearch.com, check out our research product, BiancoAdvisors.com to check out our index, WTBN to check out the Wisdom Tree ETF that tracks our index.

If you've got any questions or concerns or comments about anything I've said, I'm here. Thank you, happy holidays, and I'll be online for those of you on YouTube, you know, on social media expressing my opinions and stuff like that. But I got a chance now to kind of give you soup to nuts where I'm at because usually I talk about individual topics and it kind of gets lost where my bigger picture is.

Happy holidays, everybody. Thank you very much. Talk to you soon. Goodbye.

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