

[00:00:00] Andy Constan: The reason why the Fed, in all cases, increases short term interest rates is not because that's where the marginal borrower is at, but because that pulls up the interest rate on long-term borrowing, which is where the marginal borrower is at. And so by increasing long-term borrowing rates, that's how the Fed has historically slowed the economy. Now, we all know about the multi-year inversion that was supposed to lead to a recession. And that's because, and that's what's happened typically. Even that small increase in long-term yields that was driven by the inversion, was enough to slow the economy. In this economy, it has not been enough. It hasn't come close to slowing the economy. So that's what the Fed has done, and that was the first act.

[00:01:04] Adam Butler: Yeah. Okay, cool. Yeah. So we've got Andy Constan here. He's a recurring guest. We're very lucky to have him. You'll all know for sure, Andy, from [Damped Spring](#), and I know you've got a few other ventures like [2 Gray Beards](#) that you continue to grow as well. So, actually might be fun to kind of start there. What is this [2 Gray Beards](#) project and how has it evolved?

[00:01:32] Andy Constan: Sure. So I met Nick Giovanni on Twitter, like I've met you guys, and, uh, he and I overlapped at Solomon. He was a European rates trader, though we didn't know each other, and through the magic of Twitter, we began talking back and forth, and Nick had a great idea to try to help, sort of broker the people that have enough assets on that they are trying to invest, that they are covered by a high net worth broker/financial advisor. And we thought at the time that the high, and this was a little over a year, two years ago, we thought that that area was poorly served because most people were in a 60/40 portfolio, and we thought that investors who are, fit that bill have earned their money in non-finance related careers, or have been in finance related careers and have gone on to do something else with their lives. And so they offer, you know, they get their money managed by professionals and those professionals charge, you know, 80 basis points.

So, a 10 million account is paying, what is it, \$80,000, yeah, \$80,000 a year for financial advice, and the investor tends to have calls when they are down, or when they're nervous, or when, or just once, or episodically, based on a schedule, maybe once a year or once every six months, or whatever it might be. And so they walk into that environment, often nervous and upset because of performance. And so that's one problem, but almost always not fully informed about what's going on. And they're given the typical market rundown that comes from professional investment advisors, which, I get that what they try to do. And they're pitched a variety of things they could do to their portfolio, blah, blah, blah. So what we thought is, these people are just unable to have a quality conversation with their financial advisor, and more importantly, they're unable to get a short synthesized weekly drop of news and information that can compound their understanding of their

own portfolios and the world that we live in, in a way that can at least have them, have good, informed conversations with their financial advisors.

And so that's why we launched [2 Gray Beards](#). We record a 10 to 20 minute video once a week and release it with a, and we have a portfolio that we think is a good portfolio to invest. and we ask our clients to look at our portfolio, understand why we are doing what we're doing in that portfolio, which is long-only, and passive, by and large passive, but we do change it based on the conditions, modestly, and so that you can have a good conversation with your financial advisor about what is the difference between these guy's, the [2 Gray Beards](#) portfolio and their own portfolio. And so that's been fairly successful.

[00:05:12] Rodrigo Gordillo: So Andy, you know, in the financial industry, we have this group of professionals, the financial advisors that get paid to give financial advice and create thoughtful portfolios. I often get, when I talk to my doctors, I'm well informed in a lot of the latest and greatest things that are happening in longevity and health.

And I'm constantly challenging my physician to push his level of knowledge and understanding to the latest and greatest elements of what could help my health in the future. And they're always kind of upset that I'm forcing them to do homework. And I've had a friend who equates me bothering my physician to an investment in, an investor bothering their investment advisor.

But I've, in my discussion with this friend of mine this weekend. We actually had, we delineated that it was two different things. In the one case, things are changing quite a bit in the medical profession, or at least what we know about the human body. But you have a very interesting framework for both passive and active. And I think the difference here is that there is a playbook that doesn't really change that much in the world of investing. And I'm, this is where I came to, I'd be curious to hear your thoughts.

[00:06:34] Andy Constan: Yeah. So...

[00:06:35] Rodrigo Gordillo: Follow a framework. If you follow that passive framework, and the active like playbook that you have, you should have enough knowledge to be able to challenge your advisor as to where you stand in your portfolio now, and how you should think about it going forward. So, can you talk us through the passive and active playbook quickly before we get into...

[00:06:53] Andy Constan: ... your example, where knowing you, I know you have a deep interest in the topic of longevity. And so that is not our target audience. We're going in there to the person, the more average person, or the less extreme person, who has no capability of pressing their financial advisor for more information.

They just, they don't know what net present value is. They don't know, they are not educated about why various assets behave in the way they do at all. So that's our target audience. And so, yes, it is *frameworked* in that way. And it starts with the idea that every investor should own assets, and that assets have free money called beta, or called risk premium that, simply by loaning money to corporations, the government, the private sector broadly, by savers, gives them a positive expected return, versus keeping that money in the bank earning interest. Even if they're earning T-bill interest, they're going to outperform over the long period of time, and so we strongly believe that most investors need to have a sizable allocation to long-only strategy that is relatively passive.

And when I say relatively, that's where we add value. So then there's this other thing called alpha, in which you have a strategy that has no exposure to the direction of that other strategy I just described, which is long assets, meaning it's uncorrelated to that. And that gives you an, sorry, I'll fix that.

That gives you an opportunity to get added diversification. And I know you guys are experts in that particular topic. And so, what I like to think of is that once you have this basic investment portfolio that offers free money, if you are then well enough educated to understand how to generate alpha in, either to find managers who have alpha, or to generate alpha yourselves by timing markets, that's a nice diversifier that you can add on top of your long-only portfolio. And then the question is how much? And so, I'm pretty conservative as it relates to what I would say to investors. I'm quite a bit more aggressive when it comes to my own account, but, because I literally try to generate alpha for a living. But the average investor has no capability of generating alpha.

It's just extremely hard. Market timing is extremely hard. Unfortunately, that also means if they're unable to generate alpha, they probably don't know who has alpha. So when they try to allocate to alpha providers, that's a sort of an alpha thing. So both of those circumstances, both, it's difficult to allocate, to find advisors who, and money managers, who can generate alpha for you. And it's even harder to generate it on your own, speaks to having a low fraction of your allocation toward alpha. The alternative is, even if you're not so good at that and you can generate a very small amount of alpha, it is a diversifier. And so you want to have some, you don't want to have none. You don't want to have, and you don't want to have a ton unless you have alpha.

[00:10:43] Adam Butler: So, it seems to me that the kind of passive portfolio even, that you would probably advocate for, would create a fair amount of cognitive dissonance between what the typical advisor might be suggesting and what you have sort of come up with, from your experience in markets, first principles, your understanding of diversification and balancing risk, et cetera. When you have conversations with [Gray Beard](#) clients about that, how did those conversations go? And what do you say?

[00:11:21] Andy Constan: Well, it's a lot of education primarily. I think the status quo for the last 40 years, which has worked very well, is still the 60/40 portfolio. There's some diversification added because of the large growth of easy to access for high net worth clients, hedge fund investments, PE investments, VC investments, private credit and things of that nature, which have, so those are hard things to see if you can do well, as well. But, they are pitched fairly heavily by financial advisors who I think have an economic incentive to decide, even though they're potent, likely a fiduciary, they have some still sideline economic incentive to pitch these other products.

But you end up with a portfolio that's heavily tilted toward growth, and that portfolio just doesn't work when you have anti-growth. And if you have anti-growth with inflation, it really doesn't work. And we saw that obviously in most of 2023, 2022, and so the portfolio I like has an excess of bonds, relative to the 60/40. It has commodities and gold, and if you were so inclined, it could have, and believe this, it could have crypto in it as part of the allocation for gold, but it is designed similar to [risk parity](#), to [all weather](#), to Harry Browne's [Permanent Portfolio](#) that was written about during the ..., that he wrote the book on this type of stuff back in the seventies. And, I had the good fortune of working at Bridgewater and working with the people who, and helped redesign that product, and tweak that product. So that's where my background comes from, and, so that's what I do, that. And then we sprinkle a little bit in market timing, generating alpha also, partly for education, for the client to say, here's what we see, and here's why we see it, and here's how we would change, and here's what we are doing in our own portfolio. Here's the trade, literal trades, but you do what you want. But what you need to do is take back from that why, the why that's going on. So when somebody tells you they expect the Fed to cut interest rates, what that would mean to your portfolio. And we explain that by saying, well, here's what it means.

[00:14:09] Rodrigo Gordillo: Right. And so, a lot of people hear [alpha](#) historically when they think about investing, and what they're thinking about is stock selection, right? That's almost exclusively what anybody thinks about, but really when you say market timing, and I, at least, you can correct me if I'm wrong, a lot of your focus first on the passive portfolio is about asset allocation. And even more so in the active side, you're looking at market timing, both long and short asset classes for the

most part, rather than just equities, right? So I think that's an important distinction. Now, maybe tell us a little bit about how you try to capture alpha, through what asset classes.

[00:14:43] Andy Constan: Sure. You know, I spent the first 18 years of my career at Solomon in the equity department, and I saw the way equities are, how investors choose their equities, how they are then mechanically transacted, how the derivatives come into play, how convertible bonds come into play, the whole gamut of an experienced individual stock. And that's what most people know when they think about buying and selling and changing their portfolios - what stocks should I buy?

And I found that that area is an area that is extremely over-covered by investors. And all that means is a lot of stocks are getting a lot of attention from a lot of people with a lot of money. And so, you know, you look at that even in the very short term, with high frequency traders like [RenTech](#) who are, you know, give you no shot of trading an individual stock and coming back with edge. But even longer-term investors, the only time I've seen great long-term investors, I think choosing stocks is, it's very hard to say that they really outperform.

They may have taken more risk. They may have been, had an undiversified portfolio. They may have used leverage that their insurance company is able to provide them, using tax efficient leverage, lots of different things that have created edge, that aren't picking stocks. I just find it very, very difficult, and so what I do is I focus on macro and asset allocation. By the way, that's not that much easier, but I think it's a little less covered, and has room for innovation still. I hope it does. I think it does. So that's what I focus on. And so [2 Gray Beards](#) is about asset allocation. It isn't about stock picking.

[00:16:48] Adam Butler: We always say that in the neighborhood of 99.9 percent of all cognitive and computational energy and capital in markets is focused on security selection, like equity selection, picking the right stocks, emphasizing the right stocks or emphasizing the right bonds and vice versa. And so very little attention is being paid to what percentage of different global equity markets you should have in your portfolio, different levels of credit, in terms of rating or duration or what have you, right? And so there's just a lot more opportunity sets in that area, maybe than there are in style, the way you call it, sort of over-cover. Individual equities are profoundly over-covered, whereas there's much less discussion at the asset class level, but then there's very few segments of the market that have any flexibility to do much at the asset class level, right?

Pensions, endowments, they have fairly narrow asset allocation guidelines within those organizations. You've got the guys who focus on equities, both individual equities and picking equity managers. And there's a whole other separate group that's focused on picking bonds and picking

credit managers, and ne're the two shall meet, and then there's, the only group that's focused on how much equity versus bonds should we have, versus commodities, international versus domestic, is that sort of investment committee, and they're overseen by the board. And so they also are very constrained, right?

[00:18:28] Andy Constan: And I think that last bit is why, what I've spent my entire career doing, which is what I've seen is that silos, investment silos create opportunity. And so the problem that, in the thing you just described, is you have all those experts in their asset class, picking the things they pick without any context regarding the overall macro environment. And then you have an investment committee who sits atop that, who is not deep enough. They may have a tremendous amount of experience. They may be *gray bearded*. They may be in whatever, they may have had fantastic siloed experience in their career. They probably rose to a point in which they no longer have subject matter expertise in the silo that they brought up to, and all they have is what I would call experiential learning, and they don't have depth in any of the other silos they have to look over. So, the strength that, the only edge I think I have is breadth and depth, that I can talk about the very edge, tip of the spear in a particular silo, but also place context across silos, across investment asset classes and so on.

And part of that is I, part of that is systemizing things, but also having a 36 year, 38 year now, career on Wall Street, I've seen some things, and also not just sat on top of anything for an extended period of time and lost my depth.

[00:20:17] Rodrigo Gordillo: Right.

[00:20:18] Adam Butler: The channel for that is your [Damped Spring](#) newsletter and service, right, and you've been kind enough to share that with me and with us, on occasion over the past many quarters. And I know that your current framework, you've laid out almost as a play that is likely to have several acts, right? So I wonder if you can just lay the groundwork in terms of why do you think this is a useful construct to use, to think about where we are in the market cycle, and then what is Act One, Act Two, Act Three, and where do you think we are? But maybe like why did you choose this structure?

[00:20:59] Andy Constan: Sure. In July, I wrote about this and it was, the reason why I wrote about it is because I think none of us have lived, most of us in our careers, none of us have lived... I've been doing this for a long time as you guys have, through a cycle in which something didn't break, caused a recession, and that makes this cycle very different.

And so I needed a way to think through how a cycle, that isn't exposed to something breaking, would play out through time. And so what do I mean by that? I mean, like prior, since inflation has not been a problem, which '85 to 2019, call it 2020, even maybe earlier, inflation was coming down globally, and there were de-globalization headwinds that every investor faced and knew and was comfortable with, that they would be disinflationary, and the central banks, of course, saw that as well. And they said, okay, we can make mistakes by cutting early. Faced with their dual mandate, they knew if they cut too early and the economy ran a little bit hot that the de-globalization would reduce inflation, even if they didn't, and so they cut early. Now they cut early, often because something broke in a classic business cycle of all sorts. As the economy heats up, people take on additional leverage to buy new factories, to consume more, et cetera. And, the Fed tries to slow that down by increasing interest rates. And when they do, what that means is that last factory that was built with rates at 10 percent, can't afford to make its goods at a profit, with that interest carry.

And so they default, and the bank then has a loss, and those accumulate and the banks withdraw credit from the market, or in 2007, collapse. And so what that does, is it means that, and when that happens, the Fed can cut early because they don't have to worry about inflation. They're confident that inflation is not going to be a problem. And by cutting early, we create the sort of V recovery in both the economy and markets that have been shown for as long as I've been doing this, every year, even in COVID. And so now we have an environment in which inflation is taking a long time to come into control. Now it's been, it was transitory.

There were two transitory features of the COVID inflationary period that were truly transitory. One was supply chain disruptions. Once the boat started sailing and the goods started being made, that became less of an issue. The other was a pent up demand that got spent with, now there's the monetary and fiscal thing, but the pent up demand would have been there, even if the financing wasn't there, such that when people got back out, they spent, because they had been stuck at home. And so those two things were one-off and transitory and they became stuck that way.

But what we're left with is an economy that still has tremendous savings and is fueling relatively fast velocity of money. Even though M2 and things, measures of money are not expanding. The economy continues to expand because of wage growth. And how do you stop that? Well, you have to change the orientation of those who have jobs, to fear for their jobs, or else they're going to demand higher wages, or else they're going to jump to another firm that pays them higher wages. And so the only way to get that fear, change that cycle back to where wages are not growing in a real sense, not growing, and the economy can slow, and inflation can come down, is by creating layoffs, increasing unemployment.

And so the script really is, we're not going to crack the banks. They're extremely well capitalized. We're not going to crack a systemic sector of the credit market in which, you know, with high yield and high grade being the dominant corporate credits. But also mortgages, we're not going to crack any of those. Maybe CRE is a little weak, but there it's a small factor relative to total consumer, total credit. And so the only way we can, so we're not going to break anything. So the only thing we can do is break employment. And so my view for now, since really, since the COVID crisis, the summer of the COVID crisis, has been the economy was going to go extremely well. And inflation was going to be transitory, but stay at a higher level for longer. And so I was on *Higher for Longer Island*. And so that's where the first Act begins. It begins in an environment where the Fed increases interest rates and doesn't cause anything to break, nor does it actually slow the economy.

Why doesn't it slow the economy? Because it doesn't cause job loss? Why doesn't it cause job loss? Because the economy is not particularly, has never really been particularly sensitive to short rates. It is modestly sensitive to short rates, but our economy, and particularly when so much of the debt was financed at extremely low rates and has long terms to run, is just not sensitive to short-term interest rate changes. The reason why the Fed, in all cases, increases short-term interest rates is not because that's where the marginal borrower is at, but because that pulls up the interest rate on long-term borrowing, which is where the marginal borrower is at. And so by increasing long term borrowing rates, that's how the Fed has historically slowed the economy. Now, we all know about the multi-year inversion that was supposed to lead to a recession. And that's because, and that's what's happened typically. Even that small increase in long-term yields that was driven by the inversion, was enough to slow the economy. In this economy, it has not been enough. It hasn't come close to slowing the economy. So that's what the Fed has done. And that was the first Act.

[00:28:48] Rodrigo Gordillo: Did that surprise you that it didn't do it, that it wasn't enough?

[00:28:52] Andy Constan: No, that was my expectation.

[00:28:54] Rodrigo Gordillo: So, what about it, is it, why didn't the long-term, or why hasn't the long-term rate gone up and created a traditional yield curve environment at this point? Is everybody just waiting for the Fed to cut so that it, you know, is that the only reason that's kept things...

[00:29:13] Andy Constan: Let, so let's talk through how that has played out. So, December 21st, '21, and December of '21. And then soon after, in the minutes, on January 3rd, the Fed announced quantitative tightening, and the market began to sell off long-term bond yields, significantly. They were at, they were below two when that announcement was made, and now they're, they sort of

ended up in the mid threes, high, to just below four, and that slowed the economy, and it also, asset prices and was heading all in the right direction to hit.

So the second Act is bond yields rising. And so we were doing that, and then equities followed, which is the third Act. And then the economy should have weakened, but, and this is the important thing, one year later, all that had been playing out, and the Fed had increased its quantitative tightening in September of '22, and then the market started rallying in early October, and rallied, peaked late October, but December, early December, and then ended up being a little bit off by 2022, but sorry, 2023, but what had happened was the transmission mechanism of quantitative tightening is very different than it is in England, for instance. The BOE, when they want to reduce their balance sheet, sells the bonds they own, and that directly impacts the private sector. They've got to buy the bonds that the Fed owns.

But in the U.S. version, we do something called runoff. And in that case, whenever a bond matures, the Fed takes the proceeds, up to 60 billion dollars, and says to the Treasury, we want our money back. We're not going to reinvest it. We want our money back. And then the Treasury goes out and issues, and that's the transmission mechanism. The private sector now has to not buy what the Fed is selling. They have to buy what the Treasury is selling. And so what happened as we started 2020, as we led into 2023, there was a debt ceiling, and so the Treasury couldn't issue, and because they couldn't issue, the pressure was not transmitted anymore of, on quantitative tightening.

What then happened? They also spent down their bank account. They had run up a bank account called the Treasury General Account through normal issuance, as part of their normal business. But then they had to spend it because they couldn't issue more debt. And so for the first half of 2023, we saw no transmission of quantitative tightening. And so, besides the hiccup of the banking crisis, which is a small topic we can come back to, but besides that hiccup, markets did very well through the first half of 2023.

[00:32:43] Rodrigo Gordillo: Which is not what the Fed wanted.

[00:32:45] Andy Constan: Which was not what, well, I mean, the Fed wants things to go perfectly and has, would like the inflation to come down as well. We all want a soft landing, the increase in equity prices, the low, low cost of credit for corporations, the low mortgage rate for borrowers relative to, obviously still very high relative to it was, but still lower than it could have been, let's the economy run hot, and doesn't require it, doesn't cause anybody to lose their jobs. And so the wage pressures stay high, and that was what happened through the first half of 2023. And lo and behold,

by September, we printed 4.9 percent real GDP for that summer. The economy was on fire because long-term interest rates stayed very low, because the Treasury couldn't issue.

[00:33:44] Rodrigo Gordillo: Sorry to interrupt, but I did want to take a quick second to remind listeners that while we do absolutely love providing our audience with world class guests and weekly investment insights, we wanted to remind you that we actually do our best work outside of this podcast. And we try to do this by providing cutting edge, globally diversified, and systematic investment strategies that are designed to be broadly non-correlated to traditional equity and bond portfolios.

So we actually manage private and public funds, as well as bespoke, separately managed accounts for investors that seek the potential to smooth out portfolio returns in the long run. So if you do want to see that theory that we've been talking about put into practice, please do go ahead and check us out at www.investresolve.com. Now back to the podcast.

[00:34:26] Adam Butler: So Andy, just kind of help us out. Can I chime in here for a quick second, because I think, I just want to make sure that we connect all the dots that we can. So the Treasury wasn't able to issue any more debt because of the debt ceiling. Meanwhile, the Fed was requiring the Treasury to continue to pay off the debt that they held on behalf of the Treasury to the tune of about 60 billion a month. That ended up getting drained from the Treasury General Account instead of the Treasury issuing new bonds, right? So as a result, there was no new issuance. The TGA was drawn down instead. But then once we went forward, overcame the debt ceiling issue, then the Fed, the Treasury needed to refill the TGA, right? So what transpired after?

[00:35:20] Andy Constan: And so, we're coming into, when I wrote this script, and what I noticed at the time was that, again, highly inverted yield curve, very low yield on long-term bond yields, not restrictive. How would that change? What would cause long-term bond yields to rise, which is Act two, then equity multiples to fall, because long-term bond yields have risen and they are an attractive alternative. Then a combination of equities falling and bonds falling creates a wealth effect that reduces demand. The reducing of demand results in overcapacity and increased unemployment, which results in demand destruction adequate to cause inflation to end. And so those are the five acts of the script. And that's what I observed.

That's what it's going to take to kill inflation. And then out of the blue, in the second half, in the second quarter, sorry, the third quarter of 2023, the Treasury issued \$178 billion of coupon bonds, net coupon bonds. That's the supply, the transmission of quantitative tightening. They also issued

\$1.1 trillion of T-bills, which reduced the money market fund investment called the RRP. And so it was able to fund the buildup of the Treasury General Account without tapping any investors. Just the money market funds were happy to move from the Fed to the bills market.

[00:37:16] Adam Butler: That was unexpected, right? The market was expecting a lot more coupons and...

[00:37:20] Andy Constan: Well, this was announced in May. So this, we're coming to July. They had been issuing very few coupons and had been issuing a ton of bills. And then on July 31st, they announced that they were going to increase the coupon amount by, essentially double up to \$348 billion, and reduce the bills amount, still substantial amount of bills issued because the deficit was large and they still had more TGA to fill. But that soured the bond market and yields started at around 3.9 percent and by two months later, they were trading at 5.1 percent on tens and thirties,

[00:38:03] Rodrigo Gordillo: Right. That was a big hit to both bonds and equities. I remember that in July.

[00:38:09] Andy Constan: Right. Equities followed. They did okay for a few more months, a few, a month. And Powell was not hawkish in Jackson Hole, and so they did okay into, but by September 5th they started following bonds down aggressively. And, you know, they made that low on October 31st, a low that was caused in both bonds and stocks. A low that was caused when Janet decided to not further increase the coupon bond issuance on Halloween.

[00:38:41] Rodrigo Gordillo: Which seemed to be unexpected by most of the people that I know.

[00:38:45] Andy Constan: Yeah, no, it was the expectation that she was going to continue to increase. She increased by \$10 billion coupons and the market... And then we, now this is important because it plays into the script at the same time that these higher yields were happening. The market, the economy slowed down. The transmission... you know, we talk about the variable and variable lags of raising short-term interest rates. You know why it's variable lags? Because it depends on when long-term interest rates go up. What doesn't lag is when long-term interest rates go up? The economy cools very rapidly. And so not surprising in...

November, we got a very soft CPI report. In December, we got another soft CPI report. All the data started coming in consistent with what was a large tightening of financial conditions because stocks and bonds, long-term bonds, were both down substantially. And the Fed pivoted! The Fed said, you

know, Waller got on this, got on and said real rates are restrictive, inflation is going in a good place, and we're going to have to cut because, just to keep the same level of restriction. And immediately, seven cuts were priced in for 2024. The pivot had occurred. And so, you know, we've been playing that, that's been coming out ever since, but for at least all of December and much of January, and all of January, equities at least have rallied a lot. Bonds peaked at the end of the year, and they've been on the way down ever since, because they then said, wait a second, the economy might be a little hot here, and they've been proven right by that two months of extremely low interest rates. We got down to 3.9 again on 10. Became stimulative. And so, not surprisingly, January data, March data, February data, and March data have been warm.

[00:41:01] Rodrigo Gordillo: And nominal income never changed though, which is, I thought that was amazing that they're making this pivot, but they're not seeing the wage growth succumb to anything. Like it's still strong as it ever, as it has been the last 18, 24 months.

[00:41:18] Andy Constan: I'd like to say, and I think it's true, the Fed does its best it can, and it used a classic, I think somewhat myopic, but classic view of real interest rates, and told the market what to expect. At the same time that they said all these things, they said, we expect to cut rates three times in 2024. That was in December. That was what the dot plot said. Why did the market price seven?

[00:41:51] Rodrigo Gordillo: That was crazy.

[00:41:52] Andy Constan: That's not, it's hard to make that the Fed's fault, but...

[00:41:58] Rodrigo Gordillo: No, no. The mispricing was clearly market led and still baffling to me. Now what, did it have anything to do with trying to read what Yellen was up to? I mean, I still don't understand why Yellen issued bills instead of rates. Do you have any.

[00:42:15] Andy Constan: Yes. So my view is that as just, the debt ceiling, she didn't choose to stop issuing coupons. The Congress told her she couldn't. So for two months, for six months, she couldn't issue enough paper. And then she decided that the TGA is a really important thing to have full, because it's designed to protect the citizens and the country from a default in the event that we had, God forbid, something like 9/11, where the Treasury's unable to issue bills for five days. That account is really important to be full at all times. And thankfully it is now, and probably will stay that way through the year end. But she needed to get that rapidly built, and the best way to do that is sell bills.

And but then, but the question is, why did she decide on Halloween to slow the pace of increase? And I have a view, and I think it's like, we've all managed large orders in our lives probably. And when you have a large order and you are trying to sell a bunch of stuff and the thing you're trying to sell goes from 390 yield to 5 percent yield in two months, and by the way, the TBAC, which is a bunch of your brokers and some clients and all those guys say, what the hell's going on, you got to take a break. And by the way, I'd say, yeah, I probably should take a break. And so she did. It makes total sense to me. I didn't ...

[00:43:50] Rodrigo Gordillo: From a practitioner, you can see why that played out.

[00:43:54] Andy Constan: Like, you know, what is she trying to do? She's not trying to crush the market and she hadn't been so, and I am certain that she did not expect in two months for yields to have fully retraced all the way from where they started in July. If she had thought that, she probably would have sold more. And so February 2nd, February 1st, she sold more. She increased from \$338 billion to \$538 billion. And ever since, bonds have been in serious decline and equities are catching down at this stage.

[00:44:39] Rodrigo Gordillo: ...

[00:44:39] Andy Constan: Which by the way, when she decided to do that, that's when I said Act two had begun. It's no more, the cuts were higher for longer, is about cuts coming out. That had happened. It's gone to seven higher for longer. It came out to three or four. And then the bond supply catalyst came on February 1st and that's when Act two started.

[00:45:02] Rodrigo Gordillo: ...of this year. So you didn't think that Act two was in play in July of 2023?

[00:45:08] Andy Constan: No, no. Act two. So July of 2023, Act two started on July 31st, when they in doubled the amount of coupons. Act three started in September as equities started to catch down to bonds,

[00:45:23] Rodrigo Gordillo: Then we're back to Act one.

[00:45:24] Andy Constan: And then Janet pivoted and we're back. And not only are we back to Act one, we're not even in higher for longer yet. Because now we're soft landing, 100 percent soft

landing. The Fed's going to pivot. There's no bills supply. Let's ramp every asset in the world. And that lasted through year end.

[00:45:43] Rodrigo Gordillo: Well, this goes to show, right? When I remember reading your Act process, I remember articulating that to clients. And one thing is to understand how things work, the order of operations of how things need to go in order to get to a place. And then there's just another way to get, what's the path to get there could be very, very different, right?

[00:46:02] Andy Constan: The policy makers...

[00:46:04] Rodrigo Gordillo: ... doesn't happen exactly as you expect it. And as a trader is trying to create alpha, you're constantly taking one step forward, two steps forward, one step back, if you're good.

[00:46:14] Andy Constan: Yeah, the policy makers changed their minds, and the Fed doesn't believe necessarily in the way I think that it's going to work. Inflation will be killed. A significant portion of them believe, and Powell says at every meeting, that conditions are tight. Now, what I find interesting is that in October, the many Fed members, Lori Logan, Waller, Powell, all said that higher long-term interest rates were doing some of the work, the Fed's work, and that's why they didn't have to hike that one last time that they planned on hiking. So they knew it worked. But they haven't reacted to the recovery in long-term bonds. And so now they're stuck. Now they're stuck with having to take June off the table, and warming up data that may cause them to delay hiking for, cutting for an extended period of time.

[00:47:20] Adam Butler: So are we back to into Act two now, Andy, with where we've got rates rising and equities beginning to acknowledge this rise in rates?

[00:47:32] Andy Constan: Right. I think Act three started at quarter end. I think the top in equities was put in, assuming Janet doesn't pivot again, the top in equities have put in until we have inflation killed, which will probably take some form of recession.

[00:47:53] Adam Butler: TGA is currently well funded, there's no sign of another shutdown threat over the next 6 to 12 months, right? So, Janet now has the flexibility to rebalance the debt outstanding back towards coupons or back towards the long-term target. Actually, on that note, where are we currently, in terms of coupon versus bill issuance, relative to the long-term target? Do you have that?

[00:48:28] Andy Constan: I think the last time I looked at it, which was at month end, we were at, and I, just remembering the number, it's some number like 22.7, it may be 22.3 or 22.9, but it's 20, between 22 and 23%. And that's high. It's not as high as it is during recessions. But it's high, based on any history. But I think what's important is also interest rates. Long-term interest rates are a bargain for the Treasury because they still are significantly below bills rates.

[00:49:09] Adam Butler: Right. Okay.

[00:49:10] Andy Constan: And where the Treasury had been, market observers, the thought, the Treasury had been delaying coupon issuance because they wanted to issue coupons after the Fed cut. And so U.S. bills and now they're not market timers. You can't issue what we issue and be a market timer. They know you're coming a mile away. So that was just not working.

But now, with interest rates like bills rates now, no cuts expected. Only a hundred basis points of cuts expected between now and the end of 2025. Coupons look like a good bargain. And so I expect them to issue unless they try to do something political. And at 5,100 on the S&P 500, an unemployment rate which was at last 3.8%, GDP growth in the three, in two and a half plus, and credit spreads great, I don't see any reason why she can't take some risk and continue to load up coupons, but she might not, and we'll find out on May 1st.

[00:50:26] Rodrigo Gordillo: Now, to be clear, what you mean is, it's a bargain for her at these levels.

[00:50:31] Andy Constan: Yeah, it's a terrible...

[00:50:32] Rodrigo Gordillo: But you're not saying, is it a bargain for investors to start piling...

[00:50:37] Andy Constan: Long-term bonds are a terrible deal for investors.

[00:50:40] Rodrigo Gordillo: So what is the order of operations there, right? We got, most investors are in equities and bonds. What do we expect in terms of bonds over the next, let's assume that Act two continues to play out accordingly. What is the lag between equities and bonds and what can we expect?

[00:50:55] Andy Constan: Yeah, I think that, so I look at a risk premium framework, and I think that another 25 basis points of increase in term premium on 10 year bonds would be adequate to attract both buyers and also to slow the economy out so that inflation is killed. And so, I don't know, just

shy of 5%. The problem is it needs to subsist for at that level for less than two weeks, more than the two weeks it did in October. It needs a couple of months there and then the economy's...

[00:51:31] Rodrigo Gordillo: Why 25 basis points? If at 25, are you assuming that the rate cuts priced in are accurate, plus a 25 basis points will give us a term premium of 1%, and that's kind of historically...

[00:51:44] Andy Constan: You know, I'm not so, I'm much more bearish on term premium than that, and I could give you a much more bearish case, but that's farther out. What I think is that the economy will slow with term premiums between 40 and 50 basis points, and 40 and 50 basis points is still an awful deal.

It's like a 0.1 Sharpe ratio for bond investors, but, and they're used to a 0.25, but we haven't had a 0.25 for, since QE started in 2008. So, maybe expected returns are just going to be much, much lower. Risk adjusted returns are going to be much, much lower unless the Fed says no more QE, and tolerates pain in the economy. A full re-rating of bonds to old term premiums seems it's the direction, I think we're going to travel, but it seems, I don't know. It doesn't seem like an immediate, it doesn't think, nothing I would forecast in the near-term.

So yeah, I think a 5 percent bond yield, that'll probably, you'll have both a combination of multiple hit and because of the higher bond yield and earnings hit, which are currently, I think the 12 month forward earnings is, expectation is 250. You know, I would be surprised if the script played out and we ended up generating 240. And you know, you take an 18 PE on that, which is down from 21 where it is now, and you're talking about 4,300 on the S&P for the full script.

Now, you can tell a much more bearish story if we don't have a shallow recession, and 240 is a very optimistic earnings expectation, for any sort of recession. But then the multiple probably increases if the Fed is able to cut rates. That means if inflation is dead, and you get earnings that are worse, but you know, a similar downside, probably another 10 percent lower. And so that's the way I'd see it playing out, if the script was allowed to play out fully and policymakers didn't interfere.

[00:54:10] Rodrigo Gordillo: The order is bonds down, equities down, then the Fed can cut.

[00:54:15] Andy Constan: Well, then demand down, inflation down, firings occur, further demand decline, now inflation is dead, then the Fed can cut.

[00:54:26] Adam Butler: But that's a multi-quarter process, right? That's, there's a grinding process for multiple quarters in there. It's, this is not something that'll sort of transpire overnight.

[00:54:41] Andy Constan: That's the problem with targets. I don't know why these guys, everyone needs a target. I want to be short equities and short bonds here. I don't care where they're going. I just want them to go, you know, a position for them to go down. When conditions change, then I will change my position.

[00:55:00] Adam Butler: Now, what about the right tail of the asset allocation? So, I mean, on the inflation front, where, what do you think about commodities here? What do you see is going on with the gold market? What about TIPS, you know, any comments on that side of the...

[00:55:19] Andy Constan: So, at the same time I decided to say that we had topped in equities and call Act three, I shifted my beta portfolio from a normal, sort of [all weather](#) allocation with a bit more cash than I would normally want because of elevated asset prices, to one that is, has no nominal bonds in it. And for all the reasons I just said, and particularly because all of the, this was soon after the Fed meeting and Powell was once again dovish, and just refuses to acknowledge that financial conditions matter to inflation paths. And so at that point, I said to myself that there is a fair chance that the Fed has increased its inflation target, either explicit, implicitly, if not explicitly, and I know how that goes.

And increasing inflation targets lead to further increases of inflation targets, lead to further inflation, and so on. And so, in that environment, you want to own commodities, gold, a healthy allocation to stocks, because sometimes those also accompany rapid growth, which, and then you also want to own TIPS, because those protect your purchasing power, but also protect your overall portfolio for stagflation. What you don't want to own is nominal bonds. And I'm still positioned in that way in my beta portfolio, no nominal bonds, and over-allocated, versus my normal portfolio in gold and commodities.

[00:57:20] Adam Butler: And do you expect those inflationary assets to continue to outperform over that sort of multi-quarter period as the market digests these higher rates ?

[00:57:31] Andy Constan: What I hope and believe is that the events of May FOMC and QRA and the June meeting will result in a restoration of the Fed's commitment to kill inflation through not hiking, not cutting in in May, hope that in June, hopefully they actually telegraph that June is off the table. That would be my, for the economy, that would be my greatest hope, that they say we're

back, serious, and in that case, not, and then I would be, I get out of commodities, out of gold, back to my normal allocation and buy nominal bonds.

[00:58:18] Rodrigo Gordillo: So Andy, can we just talk about some practical trading here? This is what we're hoping, where it's really tough to make money and create alpha in this space, when it doesn't go your way. I'm curious to know how you pivot. Do you pivot based on [stop losses](#) and then kind of try to figure out what the next Act, what Act we're going to be in for the next few months, or are you just looking at the narrative and saying, okay, I got to get my, I got to get out of these positions because now we're back to Act one.

[00:58:48] Andy Constan: Yeah, so you're talking about the [Alpha Portfolio](#). In the [Alpha Portfolio](#), I'm not a believer in [stops](#). I use a different tool to manage my risk and that is I never, I only buy [call options](#) or [put options](#) or [one by one call spreads](#) or [one by one put spreads](#), or sell [one by one call spreads](#) or [put spreads](#). Every one of those formulations has a max loss that. no matter what happens, you can't lose any more. And I size that accordingly at the asset level and at the portfolio level so that I'm, it is impossible for me to have a drawdown of greater than 10%, no matter what happens, literally, no matter what happens with my existing inventory, and so that's the way I manage the portfolio.

My risk? Now you're asking a different question. When do I change my mind? And I changed my mind when like my, I've had two sort of mind blowing mind changes in the last 12 months. The first was on July 31st, where I was short coming in, because I thought asset prices were elevated, but then pressed hard on July 31st when I saw the QRA and then...

[01:00:03] Adam Butler: Credit, you pivoted instantly. Yeah.

[01:00:05] Andy Constan: Right. And I think I did okay. So I came into Halloween, same thing, expecting her to increase and in, and was positioned expecting her to increase. And at 8:31, when that was announced, I said to my clients, and actually publicly at Twitter, that Janet had saved Christmas, and hold your nose and buy everything you can. Unfortunately, about a month later, I said, it's gone too far, too fast and said, sell them. But you know, it was a nice pivot at the time. And so sometimes I'm wrong and when...

[01:00:45] Rodrigo Gordillo: Bonds went down at the end of December, at least.

[01:00:48] Andy Constan: Yeah.

[01:00:49] Adam Butler: So we talked about, we talked about Act one, Act two, Act three. Andy, is there an Act four, Act five?

[01:00:54] Andy Constan: Yes. Act four is when a combination of lower equity prices and lower bond prices begin to end, I think very importantly, higher cost of financing by borrowers. I say lower equity prices and lower bond prices and people are like, well you know, people are still wealthy. They'll still spend. That's not what I mean. Lower equity prices and lower bond prices mean higher yields for borrowers, both who use equity because they're not getting as high a price as they were used to, and bonds because they're paying a higher interest rate and higher credit spreads to...

[01:01:34] Rodrigo Gordillo: You mean they're not able to issue equity at the same valuations that they did.

[01:01:38] Andy Constan: Yeah, you go into the more, you're, when, as a private citizen, you go get a mortgage, your mortgage, both your mortgage spread and your mortgage and your Treasury risk free rate that's appended onto, are higher. When you're a corporation and you try to issue a corporate bond, your corporate, your interest rate and your credit spread are higher, whatever, and if you're a private equity company and are trying to do, IPO your company, all of a sudden the multiple that you are, the growth of your company, and your ability to reinvest in new opportunities in the private equity space, depend on you being able to issue the old company that you're bringing public at an attractive rate that tightens.

So everything tightens, including people's individual wealth and people's ability to borrow against their individual wealth to invest and consume. And so that, that's what broadly I'm talking about. Financial conditions are now tight and because financial conditions are tight, which they're not today, the economy slows, the economy slows.

That means that people begin losing their jobs and their income goes away, and their income is somebody else's, their spending is somebody else's income. And so that person's income goes away and you have a cascading of tight financial conditions and job loss, which crushes demand and kills inflation for sure. And that's how it typically plays out. Usually it plays out, not in the way I've described, but in the way that has happened for the last 40 years. Just, the increase in interest rates causes something to break, and all those things I just described happen.

[01:03:33] Adam Butler: What role does the Treasury and the government in general play in this? You know, if Trump comes in and he upends the fiscal situation in Washington, or Biden wins a new

strong mandate, what are the potential areas that government spending could shift around some of your expected trajectories?

[01:04:06] Andy Constan: Sure. Lots of things. So let's just start with what we are dealing with now. What we're dealing with now can't change. We're at gridlock next nine months. Who the hell knows? Just can't change. So, the economy is strong. Tax receipts are strong. That might reduce issuance a little bit. If Janet decides to cut coupons because she's getting more tax revenues that will undo some of Act two and could undo Act three, at the same time the, when you get to the election, assuming there's a undivided government, my basic assumption is that, like all undivided governments, they grow the pie by creating increased deficits, and they spend all their energy splitting the pie.

And, you know, if it's the Democrats, they're going to split the pie by saying, corporations and wealthy people have to pay more taxes, higher taxes. They won't cut spending. And if it's a Republican, classic Republican economy, administration, they'll say let's cut taxes on those same people, and that will create a deficit, increased deficit. Either way, it'll increase the deficit, if the country, if the fiscal side is not divided. And so, yeah, that's a big deal. If you're, if you are, you have to choose your assets well, but if you're a, if you think it falls on one side or the other divide, not divided, your job is to buy assets. But that's a tough play to make because, you know, if you get the Senate that, or the House, that means gridlock again. And then there's the question which I think is just ...

[01:06:14] Adam Butler: So.

[01:06:15] Andy Constan: ... at least from my standpoint having watched this for my whole life, it's possible that a platform, by the summer when we get all the alleged platforms, campaign promises slate, you know, their economic plans, it's possible that austerity is at least discussed. Certainly, the most recent administration is going to be vulnerable for profligate spending. And by the way, every incumbent is, except Clinton in '96, has been a profligate spender, but this one happens to be a Democrat. And so if I was a Republican, I might talk about austerity, but austerity kills growth and is great for bonds and terrible for stocks. And so I'll be interested to notice that, but...

[01:07:22] Adam Butler: There's certainly no hints or breadcrumbs that might lead one to believe that there's any serious austerity program in the works by either party. So, they might talk about it, but it's unlikely to come to fruition in any way more likely that they...

[01:07:41] Andy Constan: And what can they get through anyway? You know, once, if it's a divided Congress, austerity is a natural thing that never happens, so I would tend to fade austerity if that was the root cause for a market reaction. But I tend to, I almost never invest based on election outcomes or alleged promises by politicians.

[01:08:10] Adam Butler: There's also some geopolitical, degrees of freedom in the mix here that would no doubt shift your thinking on which Act we're in, and how one should position.

[01:08:22] Andy Constan: Yeah, so the thing for me is, generally wars are inflationary. They consume resources with no productive result, meaning stuff blows up, and then they need to be rebuilt, and that tends to be inflationary. And it tends to be inflationary if a country that can print money prints money to fund that sort of thing. And so, we'll have to see how that all plays out. And then there's the aspect of oil, which to me, looks not as vulnerable as it has in that there is a, it's just different with Iran being the participant, versus everyone can be against Israel, but they're not like, buddying up with Iran.

There's some buddies in the Arab nations, but you know, these are not Arabs and they don't have necessarily the same allegiances. And so, who knows? I don't. It's not my skill set. But if for some reason oil were to rise, that would be a demand destroyer for other goods and services. It would create supply side inflation, which the Fed can't do anything about, so shouldn't change its policies because of that type of inflation. And it would reduce demand for other goods because it's not substitutable in many of its applications. And so that just means a tax on the wallet of the world. And so, that's how I'll look at it as I see things go play out. But, you know, I've drawn no conclusion right now. I think people are claiming expertise and things, that they have no business claiming expertise in that, and I certainly am not going to do that.

[01:10:24] Adam Butler: But energy prices could do some of the work for the Fed, in the event that we get sustained higher prices, for myriad reasons.

[01:10:35] Andy Constan: Right. But then you have to wonder what happens when the, when that comes back.

[01:10:42] Adam Butler: Hmm.

[01:10:43] Andy Constan: You know, you don't, it's a temporary supply driven inflation. It may temporarily reduce demand, but again, if it doesn't follow with firings...

[01:10:57] Rodrigo Gordillo: Yeah.

[01:10:58] Andy Constan: ...it doesn't last.

[01:10:59] Rodrigo Gordillo: I like what you said in the beginning, when it's fear of asking for a raise. When that starts to happen, that's when inflation gets, stabilized in a more perpetual manner. But one of the things that I'm curious to hear your thoughts on is, the general performance between global equities and U.S. equities. We used to publish kind of the cyclical nature of domestic versus foreign, and how we've talked to seven years, it would be a period of outperformance or one or the other. We're now, I think at the 10 years of U.S. drastically outperforming. What do you, what are the drivers of, that could change the relative performance of global equities versus U.S.?

[01:11:44] Andy Constan: I'm going to give you something to think about, which I'm not sure is the root cause of this, and it comes back to the framework, investment framework that I operate on. Which would you rather own, the stocks and bonds of a country that may have, that has positive, that has meaningful positive interest rates or the country that has negative interest rates.

[01:12:13] Rodrigo Gordillo: Positive.

[01:12:15] Andy Constan: Right. And the reason is, is because you can take more risk if you have a bond that you can buy that's anti-growth that will actually respond when your equity portfolio is getting hit.

[01:12:28] Adam Butler: Um...

[01:12:29] Andy Constan: And so for, since 2008, most of the world, except for the United States, has had zero or negative interest rates, and so, their asset market was essentially un-investable. And so, now people invested in it, of course, and you know, if you look at Japan and you know that buying equities in Japan, which once, because they were the only easy place on the planet relative to, in a relative sense with a currency that was going to depreciate, turned out to be a pretty good investment if you hedged the currency. Not so great if you didn't. But was an excellent investment.

That country you can't buy bonds, and because you can't buy bonds, how can you lever up an equity portfolio? It's just, there's no diversification opportunity, and the same thing applied to everywhere, but, everywhere across Europe. Italy might've had positive interest rates, but that's because the

credit spread, not the risk free rate. The German bond market, you couldn't buy both. Germany, and so you're going to have an extended period of underperformance in environments like that.

And I think that the normalization of interest rates globally will make for attractive portfolio investments in each country. And so that's what I would say to that question. Just think about it. It's not, there's all the other stuff that people talk about, like the composition, but if you look at composition and then you say, well, this composition is in the U.S., and this same company is in this other country and it, the U.S. outperforms, it's something else.

[01:14:19] Rodrigo Gordillo: Right. Right. The relative performance has to be some structural reason for underperformance, not based on cash flows.

[01:14:27] Adam Butler: Something that we've been following too, Andy, I don't know if this has been on your radar at all, but many of the large pensions in Canada, in the U.K., in Australia, have started to make a lot of noise about directing investment into domestic companies, domestic infrastructure, domestic projects, et cetera, and so we've been sort of digging into this thesis that if non U.S. countries are sort of looking at the U.S., every dollar that goes in on a market cap weighted basis, 60 cents of that goes to the U.S., and 40 percent goes to the rest of the world. There may be an opportunity to just sort of mandate at the margin, higher investment in domestic equities and bonds by these extremely large domestic pension plans and sovereign wealth funds, et cetera, and at the margin, that might be a catalyst for foreign markets.

[01:15:30] Andy Constan: Right. So I would answer that in the same way I answer most things, which is, when does the flow start, how big is it going to be, and when does it end? Because I want to know if it's been front run already, if there's enough room to front run it, and when do I get out? Because I do know that these things don't last forever. So the question is, when will they start? I see no signs of that yet, so maybe it's early, but it also has the trappings of inefficient distribution of capital, which I think is a global problem, including in the U.S. where we're building chip factories and doing Inflation Reduction Act type investment.

That is, and you know, a lot of people are buying AI servers, anything you might pick. Is there a deglobalization phenomena that is deploying capital in the wrong place to build capacity that we don't need in a world which should be more global over time? And so, that's a fascinating conversation and worthy of understanding those flows for sure.

It reminds me a little bit of Harvard announcing that they are going to exit fossil fuels at the bottom, for reasons other than economic self interest, and reminds me of Texas leaving BlackRock, I guess, because they ESG for them, and investing in things that are less ESG at higher levels, much, much higher levels, when Harvard sold, Texas is buying. And so I always look at those things as being phases, not things to go long. That those types of policies are, may be large enough to ride, but you better be damn sure because politics can change quickly.

[01:17:42] Rodrigo Gordillo: Yeah.

[01:17:43] Adam Butler: And the fact is, if they're, if, if those dynamics do play out, it'll show up in the price, right, and you'll have the confirmation of strangers on...

[01:17:54] Andy Constan: Right.

[01:17:55] Adam Butler: So.

[01:17:57] Rodrigo Gordillo: So, one of the other last things I want to chat about when it comes to actually placing bets, is this idea of understanding what's going on, and then understanding what's priced in. The fact that you might be writing a narrative, you understand it, and it's exactly what is priced in, doesn't mean you can make money off of it. How do you discern what is priced in and what isn't?

[01:18:22] Andy Constan: Well, there's some things that are easy and you start with the easy things and then you build on to them. And the things that are easy are Fed rate cuts. So, you know, we know that, uh, prior to, at quarter end, there was a 50 percent chance of a June hike, cut, sorry, an 80 percent chance of a June hike, cut, and now there's a 10 percent chance. And so if you had a view that a June cut was less, lower chance than 80%, you had a trade to do.

So let's start with that. And then everything else just gets complex from there. Oh, well, not even that. Let's just hit on the single use drug company that has it's, that's in clinical trials, third phase clinical trials that decide that either is a yay or a nay, and the stock's either zero or a hundred. Well, you know, what's the odds? If it's trading at \$99, the odds better be damn certain that they're going to get approval. If it's trading at \$1, that's a better buy to me, and so, each of those, that's how I think about gambling, that it's simply, what are the odds on the dice, and what are the probabilities the dice show up in the way you want them?

And what it says is that you think that the dice are mispriced. That there are, somehow, the actual odds are not reflected in the price. And I think that's a bold thing to say, generally. So when, let's talk about what's priced in. So I start with things like term premium. And right now, term premium on assets is, has gone up a lot. After Janet pivoted, it collapsed down to, bond term premium collapsed down to about minus 30 basis points, and it's now resting at around plus 10. So assets are more attractive than they were at the end of Feb, at the beginning of February.

Okay, what about equities? All we can look at for equities is consensus earnings and valuation, and there are a million different valuation models. I tend to use about, I think I have about 18 different models and I triangulate each of them and blah, blah, blah. They, none of them work. You can't trade off any of them. You know, you've got, they all depend on earnings expectations and discount rate, and so earnings expectations are for an 11 percent year-over-year growth. That happens fairly often, usually coming out of a recession, and it also happens during periods of time when there's high nominal GDP.

Okay is that the environment to be in, where we're going to see high nominal GDP? I think so, unless the Fed tightens financial conditions. So I'm going to posit that the earnings expectation is high, but achievable. So I'm not going to dump all over equities based on earnings expectations, though they are high. And my expectation is the Fed will do what it takes to cut inflation, which will lower those earnings.

But, you know, I'll just use that as a price. And then the question is, what's the right discount rate. And I know that the discount rate has gone up by a hundred basis points in the last six or eight weeks, and so I know the discount rates gone up, so the price should have fallen, but it didn't. So that makes me think equities are a little rich. And so I shorted them.

[01:22:12] Adam Butler: What about...

[01:22:13] Rodrigo Gordillo: ... it really is that.

[01:22:15] Adam Butler: What about the QRA? How do you, you knew instantaneously when the QRA was announced that it was extremely dovish, that the coupon issuance was way below what the market expected. Is there a consensus estimate of QRA mix?

[01:22:32] Andy Constan: A little bit. Yeah, I mean, there's some of that. I haven't seen anybody's yet and I haven't written my own yet, so I can't give you that. I'll tell you what to look for. There's

probably, well, you certainly have the amount of debt that is going to be issued, which will be large, and the amount of coupons of that debt. That's going to be important.

And then you should also look at the announcement of the Treasury buyback program, which will be, my estimates, \$10 billion a month. And we'll be, in my view, strong view, having strong and I think informed view, is that the Treasury will fund the purchase of secondary securities with matching maturity, new issuance. That's their objective, which should be duration neutral and not require the private sector to either lose bonds at once or end up with more bonds than it wants.

But you know, how that's communicated will be an important factor. And so those are the things that I would look for in the QRA. And then the FOMC, I'd look for whether they've reached, I don't think they have, but it's possible that they'll announce how they're going to taper. I think they will taper, it's just a question of when. And I think it's probably, though it's for the, it's business for the June meeting, but it could be business for the May meeting. And so I'd be focused on that.

[01:24:08] Adam Butler: Well, we've almost kept you for an hour and a half, as usual. You've shared a tremendous amount of wisdom for which we are immensely grateful. Andy, let's tell everyone where they can find you on Twitter, how they can get access to your newsletter, how they can find you at [2 Grey Beards](#), etc.

[01:24:28] Andy Constan: Sure. So I have, my main handle is [DampedSpring](#). Nick and I share the [2GrayBeards](#) handle on Twitter, so you can get us either of those places. And then, my service is available at, for both institutional and anybody else at [dampedspring.com](#). and [2graybeards.com](#), and I would also like to say we started a collaboration with Jimmy Jude, who's been a partner with me for a while, and most recently with chAI Girl, who's a well-known person, does great pods by the way, to deal with commodities, a commodities only service. And you can find that on our main website at [dampedspring.com](#).

[01:25:20] Rodrigo Gordillo: Excellent.

[01:25:21] Adam Butler: Yeah, I've been following chAI Girl for many years as well, and just extremely great analysis in the energy commodity sector.

[01:25:29] Andy Constan: Yep. She's been killing it so far and just three months in.

[01:25:33] Rodrigo Gordillo: Great. Andy, thank you.

[01:25:35] Adam Butler: All right. Well, we'll, I'm sure we'll have you back at some point, if you can make some time for us in the coming months. And until then, we look forward to following your prodigious commentary on Twitter.

[01:25:49] Andy Constan: Glad to be here and we'll talk again.

[01:25:52] Adam Butler: All right. Thank you.

[01:25:54] Rodrigo Gordillo: Sorry to interrupt, but I did want to take a quick second to remind our listeners that the team works really hard on these podcasts. We spend a lot of hours trying to get the right guests and we do a lot of prep work to make sure that we're asking the right questions. So if you do have a second, just do hit that Subscribe button, hit that Like button, and Share with friends if you find what we're doing useful.