THE MACROECONOMIC GUESSING GAME

Jeremy Schwartz — Global Chief Investment Officer
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On last week's episode of the "Behind the Markets" podcast, we were joined by two guests. The first: Peter Boockvar, the chief investment officer and portfolio manager for Bleakley Advisory Group, a $4.5 billion wealth management firm. He is also the editor of "The Boock Report," a macroeconomic and market newsletter.

The second guest was Jim Bianco, president and CEO of Bianco Research, which provides wide-ranging commentaries on monetary policy, the intersection of financial markets and politics, the role of government in the economy, fund flows and positioning in financial markets.

Our conversation was broad, touching on the Federal Reserve (Fed), European Central Bank (ECB), the challenges of negative interest rates for Europe and Japan, and a bullish outlook for gold and silver. We also discussed the potential end of the bond bull market and the possibility that we may be nearing the end of the growth-led equity market rally.

Thoughts on the Fed

- Bianco said that the inversion of the curve is a market signal that the Fed is too tight and has to lower rates. He added that the Fed will move too slowly in its cuts to bring rates down.
- He also noted this is the first time in 40 years that the Federal Funds Rate at 2% is the highest policy rate in the developed world. It is the only interest rate of any tenor still above 2%.
- Boockvar is worried that another Fed cutting cycle "drags us into the mud" of near-zero rates as in Europe and Japan, which would impede our banks. Boockvar would prefer to not lower rates dramatically. Rather, he said the ECB should raise rates out of negative territory.
- Boockvar also sees cutting rates to be partially self-fulfilling by affecting consumer confidence because consumers believe it's a negative signal when central banks lower rates.

The Endgame for Fed Policy and Yield?

If central banks decide they cannot go any more negative with interest rates, Boockvar believes we are likely to see a sharp move higher in rates.

Boockvar noted the spike higher in interest rates last week may foreshadow a continued spike in rates in the near future. The 2015 move in yields saw German 10-year bunds go from 7 basis points to over 1% in just two months, and he would not see any adjustment higher to occur slowly.

It's Not Time to Be a Hero

Boockvar is cautious on equities given higher valuations and keeps bond portfolios at very short duration levels.

Gold and Silver Bull

Boockvar sees the gold rally as the new phase of a bull market. Because fundamentals are stronger than they were during the 1970s bull market, he ultimately expects that the rally will have to surpass levels of past bull-market highs. Offline in Maine, Boockvar and I discussed levels as high as $2,500 being possible during this rally. Boockvar also likes silver and mentioned a potential $45 to $50 price level, which would be considerably higher than where we are today.

The Gold Carry Trade

Bianco pointed out that a challenge for gold over many millennia was that bonds provided income and were thus a good alternative to gold, which provides no income stream. With the large percentage of global bonds in negative-yield territory, gold provides a “positive carry trade” and is a strange but actual high-yield alternative at 0 yield when compared with German bunds or Japanese JGBs in negative territory.

Value Cycle Turning Point

Both Bianco and Boockvar discussed the traditional growth stocks being in late phases and that value is poised for a run higher. Boockvar was cautious on traditional value indexes that are heavy on financials and banks, which he considers a value trap, but he also pointed to many of the low-volatility global business franchises with multiples near 30 that are overextended.

This was an interesting conversation with two great macro thinkers. Please listen to the full episode below:

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Bullish : a position that benefits when asset prices rise.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

German 10-year bund : a debt instrument issued by the German government with an original maturity of 10 years.

Basis point : 1/100th of 1 percent.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Japanese Government Bond (JGB) : A bond issued by the government of Japan. The government pays interest on the bond until the maturity date. At the maturity date, the full price of the bond is returned to the bondholder. Japanese government bonds play a key role in the financial securities market in Japan.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

Volatility : A measure of the dispersion of actual returns around a particular average level. .