Mark Cudmore: Around the World of Macro
January 18, 2018

Erik: Joining me next on the program is Mark Cudmore, who is a macro strategist with Bloomberg and runs Bloomberg's live blogging service.

Mark, thanks so much for joining us, I know you've got a really busy schedule.

I want to start with the US dollar because, obviously, everything is so dependent on it. But, particularly, in the last week we finally saw this resolution of a new lower low, below the 91-prior print on the dollar index. Is this just a little trade, or are we looking at a major secular trend?

I think you've actually been bearish on the dollar for quite a long time before it suddenly became in vogue recently. Give us a little bit of history of why you've had that view and what you see coming from here.

Mark: Thanks. I think this year it's kind of a mirror image of 12 months ago when I really became very structurally bearish on the dollar. Just to give some context to why that change happened then, first of all I think the market was extremely bulled up. And that's the opposite of this year where everyone's quite negative.

But they were also very bullish on a slightly suspect framework. And there was this whole narrative that there was going to be this global reflation trade led by the US. And, actually, what happened in 2017 is the US was very much middle of the pack in terms of growth amongst the G10 economies. It wasn't one of the leaders at all.

And also there was the fact that the US 12 months ago still had very negative real yields. Most of them were at the curve. Yet there was this narrative that, because hikes were coming, they were going to have this real yield support. But that just wasn't there.

Suddenly, now we've had quite a bit of a change in the US. So this year, 2018, based on consensus forecasts, not anything out of the ordinary, it is expected that the US will be one of the fastest-growing developed market economies. Amongst the G10 it will only be beaten by Australia and New Zealand, based on consensus forecasts.

So, suddenly, the US is leading developed market growth this year. And yet people are much more bearish.

On top of that, we've had like a 70 basis point climb in two-year yields in the last four months. And so, suddenly, that massive negative real yield you had in the US has kind of disappeared. So both the rates argument and the growth argument are much more supportive of the dollar this year than 12 months ago. And yet the kind of positioning and sentiment have switched massively.

Now I should say that this is kind of making me feel that the dollar is vulnerable to probably a sustainable bounce that could last several weeks, several months. But I think overall, structurally, in the much more longer term, I do kind of stick by my call from January of last year that the dollar is in a multi-year down trend.

And the background picture here is that the dollar still makes up roughly 63.5% of global reserves. And yet the US economy is a slowly shrinking part of the global economy. It's currently about 24.5%.

Now, the US is the world's reserve currency. It's always going to retain a premium in terms of large financial markets. But that premium is going to shrink more and more. So the fact that it's still 63.5% of reserves seems too high.

So I think, structurally, the world is still long dollars and will slowly start trimming that position. And that's going to be a headwind for the dollar. But for the next couple of months I think people are maybe over their skis and being bearish, and I think there's a chance of a bounce. That's the dynamic I'm looking at, at the moment.

Erik: Something we've discussed quite a bit on this program is a very interesting signal which is that we're seeing, actually, a lot of expectations of more rate hikes from the Fed. You would think in the face of increasing interest rate differentials – you know, traditional macroeconomic theory says that attracts international capital flows into the dollar. But we're seeing the dollar weakening even as rate differentials are improving.

Some of our guests have suggested that it doesn't necessarily mean the dollar loses its reserve currency status entirely, but maybe this de-dollarization trend that Russia and China have talked about is starting to gain a little bit of traction.

Do you think that there's room for that interpretation based on what we're seeing? Or is it just a case of maybe those rate differentials haven't kicked in yet and we're going to see the dollar recover as we do start to see those rate hikes come in the future?

Mark: I think it's the opposite, actually, that they haven't kicked in yet. I think the dollar benefited in advance. So the Bloomberg Dollar Index, you know, the broad trade weighted index, rallied more than 25% between mid-2014 and early 2017.

So, basically, when there were only two rate hikes we saw a 25% increase in the dollar on the trade weighted index. That's because FX markets tend to front run the expectation of the rate hiking cycle. And this rate hike cycle was very much forecast, it was expected, it was predicted. And, in fact, it kind of came through slower than expected.

So what we saw was actually the FX already made that massive appreciation. And this is why we kind of saw the dynamic last year that, even though the Euro – Europe has done very little to withdraw stimulus. They've done a small bit of tapering and some signaling, but still they've got negative yields. We've seen the Euro benefit. And that's because FX markets drive it ahead.

And I think people who get very excited about the fact that there were rate hikes in 2017 and wonder why isn't the dollar rallying – they're not really looking at history. We generally see this in US rate hiking cycles; we quite often see that the dollar trades poorly.

And that's because, when you have the US rate hiking cycle, that implies the US economy is doing well. When the US economy is doing well, because it's still the world's largest economy that means the global economy is doing well. And at that stage – we're actually in a re-leveraging period. And that means people are pouring into assets in other parts of the world.

And that generally means selling down the world's reserve currency, selling down the dollar. So this is actually quite a normal cycle. Currencies front run the expectation of the rates move. And it's not like the rate hikes last year were a surprise.

Erik: Now, you're in Asia, which gives you the benefit of actually knowing about markets. Something I've noticed is a lot of people in the United States talking about this new Shanghai Futures Exchange contract that was supposed to start trading this week. It's now been delayed by a couple of months.

A lot of people who have never been to Asia and probably don't know as much as you do about markets, are speculating about what that may mean for the US dollar. Some people think it's just a sideshow, it has absolutely no significance. Other people are saying, hey, if this thing gains traction it could seriously derail the petrodollar system and the dollar's role as the hegemonic currency in the world.

What do you think there in Asia about this new oil contract that would be yuan-denominated? Is it a serious factor? Or is it a sideshow?

Mark: I think the answer is going to be slightly nuanced. It's really a massive factor. I think it's very big. But it's not going be a sudden event. I think this is another step in the process of the dollar's dominance of world trade, world commodity pricing, being slightly eroded at the margin.

But it's not going to be a sudden thing. The dollar will remain the world's reserve currency for a number of years to come. There's just no viable alternative. It's just that its complete share of global trading will continue to be eroded. And that's another step in this process.

I think it is also important about how successful China manages to make this whole oil contract. And I think this may tie in with the – some people speculate this may tie in with the Saudi Aramco IPO, that maybe they can exchange some kind of support there, from Saudi Arabia for their pricing in terms of maybe investing in the IPO.

So there's some other kind of deals that are going to go into that. But if this is successful, yes, it will help change the narrative a little bit at the margin, but it's not going to be a sudden shift.

Erik: Let's move on to fixed income. Because there's been so much recent activity with some really big names – Jeff Gundlach, Bill Gross, making statements to the effect that the 35-year bond bull market is over, it's done. In some cases we've got people – Bill Gross is very outspoken in saying, okay, we're about to see rates seriously start to back up dramatically.

What's your view? Is the 35-year bond bull market really over? Are we about to see a big backup in rates? Or is this just a little blip we're seeing right now?

Mark: I think the 30-year bond bull market ended a year or so ago. I don't think that suddenly means we need to go into a bear market. I think that – I'm absolutely not a bond bear and I think we kind of stay in this slightly volatile range for a long time to come.

And I'll even go further and say that I don't think the long end yields in developed, functioning societies, and developed, functioning markets are rising substantially for many years to come.

So I don't think we're going to see much higher yields at the back end of the curve. We can see tickups and they'll kind of move back and forth. But, to me, there are structural disinflationary pressures which are still underestimated in the market. Particularly from technology. But also from demographics.

We're seeing a real change, like commodities – the whole extraction, production of commodities is becoming significantly cheaper. That's making things much easier. Transportation, distribution of those goods is becoming more efficient all the time. So I think we're seeing these kind of structural disinflationary pressures.

And one way you can see that is that agricultural prices globally continue to fall to the lowest level in the last 25 years. (We don't really have great data going back before then.) And that's falling to the lowest levels in dollar terms, which, as we discussed, the dollar is weakening. In local currency terms they're also plummeting.

When you look at agricultural prices, or food prices, this becomes really important for the CPI basket. Particularly in Asia – in a lot of emerging markets, in a lot of countries, but it's very much emphasized in Asia. So it's very hard to get sustained inflation, consumer price inflation, in Asia when you've got food prices that continue to get lower and lower.

And they probably will continue to get lower. Food price production is still very inefficient in many parts of the world, and it's getting much more efficient very rapidly. And as energy prices on a much more secular basis have come lower as we're seeing viable alternatives to oil come through, this is going to continue this trend.

So I think, because you can't get inflation sustainably accelerating in Asia – that's also the factory for the world, it's where 40% or more than 40% of the world's population lives, it's where all the growth is – and that means it doesn't feed through to inflation elsewhere.

So I don't think that we're going to get a sustained inflation in any country, real inflation. The only way you're going to get massive inflation is where you've got big currency devaluation – but that's not real inflation. That's FX-driven. And therefore I don't think we're going to get much higher rates in the back end.

So, to put this in some kind of perspective: Ten-year yields, can we see 2.8% at some point this year? Sure. Can we see even 3%? Maybe. But I don't think we're going to get yields staying above 3% in the ten-year basis in the US any time soon.

Unless people start genuinely doubting the US's ability to repay its debt and they start worrying about its deficit. And I really don't think we're anywhere near that crisis. So I would say that I'm definitely not a bond bear. I don't think it's an exciting time to be bullish bonds, but I think we're going to be in a range. And I would say that whenever yields spike up I don't think those spikes in yields will be sustainable.

So every time you get this excitement like we had already in January, where bond yields go up to the highs, and everyone goes, yes, it's the start of the bear market, and they wheel out all the usual names to cite this, I think that's normally a great chance that the market's probably going to reverse pretty soon.

Erik: I definitely want to come back to the energy, food, and inflation that you just mentioned, but first, before we move off bond rates – when you say a long time, help me understand what you mean by that.

Are we talking about a turning Japanese scenario where we're potentially looking at decades of stagnation and very low yields? And what's driving it? Is it the Lacy Hunt view that there's just too much private debt and that forces rates to stay low for a long time? Or is it something else?

And how long is a long time?

Mark: It's a combination of those things. First of all, I would like to challenge one perception, this idea that low inflation means stagnation. In the last few years you've had great examples of some of the fastest-growing economies in the world have had massive deflation. And Romania, Israel, Poland are three great examples in the emerging markets where they've had real proper deflation, and yet very solid growth.

And I think there is this idea that we've built from the economics framework that we all learned in university that what we need to have 2% inflation because that's good. That's an arbitrary number. It's not necessary.

And, even in Japan it's sometimes mistaken – I'm not saying that Japan economically has been a massive success, but I think sometimes its stagnation so-called is perhaps overhyped. You've got to remember that the Japanese economy is shrinking. If they maintain steady GDP and they have a shrinking economy, well then the GDP per capita is going up. So I don't think the Japanese situation has been as bad as people think.

That said, I don't actually think we're going to go to as low as Japan. I do think that this can last for a number of years.

And there's two different parts to this. I think, structurally, I cannot see in the foreseeable four- or five-year horizon much higher long-end yields in these developed markets.

But I also think there's a cyclical thing as well, in terms of that we're still in the midst of the positive part of the US economic cycle. In which case, the curve tends to continue to flatten. And this happens in every economic cycle in the last 30 years. It's quite standard. We shouldn't be worried by the flattening.

This tends to happen as we go into the latter half of the cycle. The twos/tens curve in the US still has roughly 50 basis points to flatten. But it should flatten. It should probably invert. And I expect that to happen.

It does look like the Fed is very determined to hike rates. So I think that means that we will see front-end yields go higher and we'll see the long-end yields probably stay roughly where they are, or maybe come a bit lower at some point if people are worried that the Fed has made a mistake.

So I think that, cyclically, there's also downward pressure on long-end yields as the front end is hiking and as we continue this flattening cycle. But I think, structurally, there's just no reason for those long-end yields to go that high. Unless people genuinely start challenging the whole economic situation in the US, the whole debt situation.

And that's because there's just infinite liquidity in the world. The amount of money that's been pumped into the system since the crisis is just incredibly unbelievable. And I think that people took a long time to adjust to this.

I know, myself, I took a long time to adjust to this. I was someone who was a super-bear going into the crisis. I stayed a super-bear for way too long. As someone who was extremely bearish going into the crisis in 2008, I stayed bearish until about 2010, late 2010, way after we saw the low in asset prices. I just completely failed to understand the scale of money that was being pumped into the system and what that really meant for financial assets.

And I think what that means now is that there is still this massive hangover of liquidity in the system. I think people are overly focused on the Fed slightly reducing their balance sheet. The Fed hasn't been the marginal driver of liquidity for a number of years. In fact, the Fed balance sheet peaked out in late 2014. It's been roughly stable for the last three and a bit years.

The marginal liquidity for the last few years has been coming from other central banks. The Fed doesn't even have the largest central bank in the world anymore. Three other central banks have much bigger balance sheets. The PBOC, the ECB, and the BOJ all have larger balance sheets than the Fed now. All continue to pump liquidity into the system. And therefore that completely dominates any marginal tapering from the Fed.

Now this might change at some point in the future. But, at the moment, the facts are there is so much liquidity still in the system, and so much liquidity still being pumped into the system. And that's why I think that it's very hard for yields to back up. Because this money needs to go somewhere. It needs to be parked somewhere. It needs to chase some return.

So I think anytime that you get a spike in yields then this money just wants to flow into that system. And that's why I don't think that we'll see sustainably higher yields, much higher yields, in any developed market economy for the next number of years.

Unless we completely change what central bank balance sheets are doing. Unless they massively reduce them. And I just don't see the whole world as one, all central banks reducing their balance sheets in one go. Because that would be complete carnage.

Erik: Let's move on to something that you and I have in common, Mark. You and I have both been publically somewhat outspoken saying that we think the massive rally that we've seen in crude oil is probably not sustainable. We also share in common that we've both been wrong so far about that.

Are we finally going to be proven right? Is this oil rally almost over? Or have we missed the point? And are the people who are saying $80 to $100 going to be proven right?

Mark: I'm torn on this one. Like any time where you're getting a market wrong, it lowers your conviction, your confidence. And this is definitely a call I have got wrong. I wrote a couple of years ago that I didn't think we'd see oil prices rising sustainably ever again.

I thought we'd see spikes when we saw Middle East tension. I thought there would be various reasons for supply spikes. And I thought they could be very large spikes. But I thought they'd be a thing that would last for a month or so and then we'd see prices come down. Instead we've just seen oil continue to trend higher. And definitely this has taken me by surprise.

I think, though, that it's not a permanent change of situation. One of the things that's driving the markets at the moment – and I didn't really pick up on this into December so much – is that, importantly for oil markets, speculators can actually dominate the price action for such a long period of time.

And, at the moment, we still have this backwardation in the oil curve, which means it rewards speculators for being long oil. And so a lot of people look at the market and go, oh my God, speculative positioning in oil is just completely stretched, it's crazy, it's due a massive correction. And people were saying this from a couple of months ago.

Yet it continues to motor higher. And that's because, you know what, these speculators are getting paid to hold this position. So, even if it falls back a little bit, they're not too worried. And that means it's a very comfortable position. That will change at some point.

And, also, we will start getting more and more production coming out, particularly in the US, where we have seen the rig count start to pick up again, start to accelerate again. That will start changing the game. But, on top of that, the higher oil prices go, the more incentive there is for OPEC members to cheat on their production as well.

So I don't think that this is going to continue going ad infinitum. I don't think we're in a new paradigm of $80 to $100 oil or anything like that. I do think that oil prices will come back lower from where they are now. Quite a bit lower. But I'm just not sure it's going to happen in the next couple of weeks. And I do think that the large shift we've seen is going to play into a lot of other themes we talk about in the world.

Oil, like the dollar's role, oil's role in asset prices is slowly declining at the margins. But yet at the moment it remains one of the most important assets feeding into other prices.

Erik: You mentioned food earlier, and I want to come back to the subject of commodities in general, particularly agricultural commodities, and other softs for that matter. It's been a multi-year secular decline here. It looks like maybe we've put in at bottom and stuff is starting to take off as the dollar has turned south.

Is the bottom in for commodities, particularly ags? And, in general, what do you see happening in terms of the map forward from here?

Mark: First of all, it's important to be aware of the dollar lens of looking at this. So I think, in terms of dollar prices, which is what the core pricing of all of these commodities is, I think we have seen commodities bottom out. And I think oil is driving up at the moment, metals are doing pretty well, and agriculturals are very soft.

In local currency terms or other currency terms, the picture is less clear. But I do think there's a broad base in commodities. And that's because global growth is very good and we are seeing a genuine demand pickup, a real demand pickup, for a lot of these commodities. Particularly in the metals space. And I think that's very positive.

So, metals, I think the whole picture is much more tactical. I think, even for a couple of months basis, you do see that a lot of the Asian speculation can drive really strong momentum moves. And it's hard to hold on to structural views. My views aren't too exciting in terms that I'm overall actually constructive.

But I find it hard to get excited because I'm just not close enough to the market – what is shifting when over any short-term period. And when I say short-term I mean over any one-month to three-month period.

I do think, as I said, oil prices at the moment are still doing well. And I don't think they're going to turn around on an imminent basis. But I don't think they're going to stay high. I think that will come lower, and I think that will support the global economy.

It is good for the global economy to have cheaper energy prices. It's just not good if it happens too quickly.

As for food prices, they've just fallen so far over the last couple of years. You have to believe that at some point there's going to be a correction. It's hard for assets to move in a straight line forever. So I do think there will be a corrective bounce higher.

Food prices might have a sudden shift where we get this transition wrong. But I will say that on a secular basis I do think that food prices will continue to come lower.

I think what's happening in the whole food production process – just on the science background here – is just unbelievable in terms of how much more efficient we're making our crop yields and our whole process. And also the whole dynamics around diet. And we're soon going to get into the whole world of lab-grown food.

If we start getting into a world where we have lab-grown food made cheaply enough – where it's healthier than natural meat, it tastes as good, no one can tell the difference, and it's cheaper – then it will suddenly be very hard for much of the world to justify growing billions of animals each year purely for the purposes of slaughtering them to eat them. And I say this as someone who loves my burgers. But I think this is going to be a massive shift in the years ahead which is going to change things.

And that suddenly frees up a lot of agricultural land. As we know, a lot of crops are grown specifically to feed animals, so that goes into the food production process. So I think that, at the moment, we're in a secular change in terms of crop production.

But this might last long enough to then feed into the whole process of lab-grown meat and change our whole mentality and approach towards food. And I think this is a really, really big background shift for the next ten years, which is possibly being underestimated in markets. Because there are implications for land prices, implications for pharmaceutical companies, implications for retail, implications for food processing, distribution, for everything. And it's a really big story. But it's probably a bit too slow-moving to affect markets in the next couple of years.

Erik: Moving on to equities. I should mention that we taped the interview early this week because of your location. So we're speaking Tuesday evening. And we've just had the first 1% down day in the S&P that anybody can remember. We had almost that on December 29th. But finally we're seeing some weakness. And, of course, already some people are saying, okay, finally it's here. The moment is upon us. The end is nigh. Others are saying, no, this is less than 1%. It's just a blip.

Are we seeing the beginning of something here? And what's your outlook for equities, both in the United States and globally?

Mark: I think all of us are hoping that we're seeing the beginning of some volatility, at least. Which makes it easier for people who trade in markets, who comment in markets, and makes for more interesting dynamics. And we can play different scenes rather than just sitting long equities and doing nothing else.

I will say I don't think it's the start of something new in terms of a structural trend for markets. I remain structurally very bullish. And, something I repeat on Bloomberg TV – I probably bore a lot of the viewers – a regular rant of mine is that there are three pillars behind this structural global market in equities.

That is growth, earnings, and liquidity.

And, until one of them crumbles, I think you've got to stay kind of bullish overall. This doesn't mean we can't get more volatility. And it would make sense, that we're going to get much more volatility. But this is just the structural picture, this doesn't look like this is the peak or the turn, that you should turn bearish. I think that's very important.

Global growth is very good. The simple average G10 growth rate forecast for 2018 is close to 2.2%. That was only put at around 2% in September, or below 2%. So there are broad upward revisions happening in the developed world. The US is accelerating, or expected to accelerate to 2.6% this year from 2.3% the year before.

China may be slowing, but it's still above 6%, which is really quite phenomenal given the size of the economy. Asia overall is growing exceptionally well.

As we discussed earlier, liquidity is still absolutely abundant in the system. Just because the Fed is reducing its balance sheet doesn't matter, because the rest of the world is still pumping money into the system. And that helps the margin – that trend has helped the margin by the fact that we're getting a weaker dollar. Which is emphasizing the liquidity being added by those central banks while it's also diminishing the effect of the Fed's central bank balance sheet reduction.

And, finally, earnings are still good. Global earnings were phenomenal in 2017. That's not going to be repeated everywhere in 2018, but the tax reform in the US has provided a new boost to earnings, certainly in the US.

And that makes a big – it's an important indicator because it reflects sentiment everywhere. It influences sentiment everywhere. And we can debate whether the tax reform will be brilliant for the economy or not, or whether it will be a game changer for the economy. I am in the camp that I'm slightly cynical it will be that great for growth.

But it is a game changer for equities because it will massively boost earnings. And that suddenly makes all the ratios look more attractive again.

So I think, overall, the story for earnings, liquidity, and growth remains strong. And therefore you've got to be structurally bullish. It's really, really important to emphasize this doesn't mean we can't get more volatility. Just because we've had such a sustained period of no volatility doesn't mean that's going to go on forever.

In fact it makes it more likely we get increased volatility, because traders have to take more risk to sell up var limits, value at risk limits. Which means they're more leveraged, which means they're more vulnerable to a bit of a shock. But, ultimately, the structural bull story still remains.

Erik: I want to move on to China because I know that's right in your back yard. I'm very much looking forward to getting your view since you're in Asia. A lot of people, a lot of analysts, have a lot of concern about China.

Kyle Bass in particular has been very outspoken with his view saying that the credit expansion that has occurred in China is just so massive that, when that unwinds, it potentially is going to create a credit crisis that forces the PBOC – whether they want to or not – to dramatically devalue the yuan. That could send a wave of deflation around the world.

There are concerns that if there was a major problem in China's economy there would be knock-on effects, to Australia in particular – 47% of Australian GDP, of course, is exports to China.

You're actually there. A lot of these analysts who talk about these views on Bloomberg Television have never been to China. You have. What's your take on the whole China story? Are these risks as real as people have talked about?

Mark: The risks are very real. But I would say that I'm generally very constructive on China. I'm generally very bullish on China as a broad thing. So let's address the two parts of what you said there that I think are completely valid.

The risks are real in terms of the impact. If there is a big problem in China, then the knock-on effects are going to be massive. China is the marginal consumer of many commodities in the world. It's the marginal demand consumer for most countries' exports now in the world. It's not the US. The change in demand comes from China.

So, so many economies are dependent on what China does. And if China's growth takes a big shock, it's going to be catastrophic for markets. So I think that is real.

The next bit that I also agree with is that the corporate debt bubble is massive. It is unprecedented. It is scary. And that is the end of where I agree.

I think there are so many times where this analysis of China is really poor. And it's by lots of people who have never been to China, don't understand it. And one of the things is this corporate debt bubble. It's very much looked at in isolation rather than looking at China Inc. as a whole.

Importantly, the China private savings rate is exceptionally high.

People look at the property bubble. Again, the analysis is terrible. People used to talk a few years ago about the ghost cities in China, not understanding the culture of how it was built, where people would actually buy their apartments before the infrastructure was in, because there was such a boom in property and they knew there was so much demand there.

People would buy these properties, off-plan, no infrastructure. So all these Western analysts go, oh my God, all these properties are around but no one's living there. What they didn't realize is if they went back two years later they'd suddenly go to a city with six million people there. The rate of urbanization is just incredible.

There's also a culture in China that newly-married couples tend to want to move into a new house or apartment that no one else has lived in before. And that means, if you buy an apartment and keep it empty and don't have a rental yield, it retains a massive value, a value premium above apartments where you're getting a rental yield. Which means it's not such a problem for saving money by buying property that stays empty. I think a lot of these cultural things are misunderstood in the Western world.

On top of that, the deposit-to-loan ratio in China for buying property is much higher in the West. So the property market is much less vulnerable, private savings rates are very high, banks tend to be very well capitalized.

And then, of course, you've got the government. I mean, China has more than three trillion FX reserves. Let's imagine that there's a trillion dollars in bad debt in China – they don't have a Congress, they are a single-party system. I'm not saying it would be completely smooth, but relatively easy.

They could set up a bad bank tomorrow with one trillion in bad debt, wipe out all the bad debt, and suddenly China has no more corporate bad debt left and they still have the largest FX reserves pile in the world.

China Inc. overall is exceptionally wealthy. So I think where I get really upset is a lot of these analysts who've never been to China, don't understand, they look at it through purely the Western, the US economic framework, the US economic model. Which is not what applies here. And they don't look at both the assets and the liabilities, they don't look at the whole balance sheet, which is very important.

Now, I'm slightly simplifying the situation. This is to make the bigger picture that I am not very worried about China's debt problem on a global economic basis. We all know that, if that happens, there's going to be some financial market disruption. If the corporate debt bubble does start having problems, there will be a slight delay before they can solve problems.

All I'm saying is the Chinese economic system makes it much easier for them to solve these problems quicker than it can happen in the West. And they've got much better resources. So they will be solved. It's not like the corporate debt bubble will be allowed to just collapse in some complete mess.

So I'm not really worried about China for many years to come. If the corporate debt bubble continues to grow at a faster pace that they're catching up with the economy, then it will continue to be a worry. But it's not something I'm worried about for many years to come. So overall I'm very constructive China.

And I think this is one of the reasons why, for the last number of years, I've probably been much more bullish than the average analyst out there. Part of the reason I'm super-positive financial assets, is that if China is doing much better than people think, well, then there's probably some premium on the upside that people are missing.

Erik: Let's move on to Europe next. We've had guests on the program with views ranging from Brexit was the beginning of the end, it's all over, European exit contagion is going to be the whole theme of macro for the next two decades, the European Union is toast, it's over, it's done.

And we've had at the opposite extreme people say, look, Brexit was a flash in the pan, it was a little bit of a political anomaly that you should just forget about and ignore.

What is your view on Europe, the structural problems that some people say exist there? How bad are they? Or do they exist at all? And, particularly, the Euro has been very strong recently. Is that going to continue? And where do you see the Euro headed longer term?

Mark: Over the last 15 years, I've actually been on both sides of that spectrum. I was someone who believed that the Euro currency wouldn't survive the first major crisis. So when the financial crisis came I thought that was it. It was certainly a matter of time.

And I was someone who, in 2010-2011 when we had the Greek crisis, I was convinced that it might take a couple of years but it was just a matter of time and that the Euro would not last.

Clearly, I was completely wrong on that. And I think, as part of being wrong, I realized that there are some things that I missed. And one is that the political will in Europe is probably much stronger than is realized. Again, particularly I think in the US, they underestimate the political will around this project.

And I think it's important that the Eurozone has survived not just a small recession, not just a small crisis, but a pretty massive financial crisis. And, you know, at its early stage of its creation. It has made it so much stronger. There wasn't the structure in place there to survive a lot of these problems. But they kept on sticking on more and more Band-Aids to solve these problems.

And eventually they've actually put quite a robust structure in place there that, overall, the Eurozone will continue to survive problems. It's much more resilient now as a construct that it was seven or eight years ago.

So I think I've gone from being someone who thinks the Euro was vulnerable, it was going to fall in any crisis, to – as of about two years ago – I now think that all European crises are completely overhyped. And that was very much the view I had last year in France and I've been very bullish the Euro.

I think that theme probably has a little bit more to run, but I think it's running out of steam. The reason I think it has a little bit more to run is people are getting excited about the Italian election again. But, again, for the Euro, the currency, it's irrelevant. The Italian election is not a big risk. It might be a small risk for some domestic assets, Italian bonds, but it's not a concern, it's not an existential concern for the Euro currency. And I think that's very important.

And that's the dynamic that changed probably a couple of years ago. I probably only realized it myself maybe 14 months ago. But that was going into the European elections last year.

So I think overall there is this kind of – the world is structurally underinvested in European assets. FX reserves managers have been underweight Euro as they've had this worry. And we've kind of seen that correction. So I think that, overall, the Euro story is still good, but it's running out of steam. It's kind of on its last legs.

And that's because the whole speculative market has got very excited about Europe, and I think they may be, again, a bit ahead of themselves. It's kind of like this whole situation that I discussed earlier with the dollar. The dollar having front run the Fed rate hikes.

There's a lot of the market that are front running the fact that the Euro might taper a bit earlier because growth is good. And then when it finally happens, when we start getting the change in negative rate policy in Euro, there's probably less boost left in the Euro currency.

So the overall summary is that I think the Euro is still probably on a little bit more upside, but I think we're on the last legs of that story and I'm no longer excited by the story. I think there's better, more exciting things to play in this world.

Erik: So it sounds like you think the story is a good one. It's just a little overplayed and perhaps about to run out of steam. Does that mean we're just setting up for a correction and then a resumption of a secular trend of strength in the Euro? Or is it over and done with? And time to move on to the next trade, not just in a tactical sense but in a secular sense?

Mark: That's a good question. I guess when you get to the late stage of any theme or narrative, you do tend to get more volatility. So I think that we've entered a time in the next few months where we're going to start getting a bit more tactical, a bit more volatility in the Euro.

And I think that means, for a lot of macro investors, it becomes something less interesting to trade. I think the best stories are where the long-term macro story fits the tactical story. So, for example, the dollar last year was a perfect example. To me it was one of the best ones in FX in years, in that the structural fundamental story was very negative the dollar and it had become much more negative the dollar in late 2016. And yet the tactical situation was also very negative dollar, because the whole world was so bullish.

What you've got in Europe now is that the structural fundamental story is less exciting. The Euro has appreciated so much that there's probably less upside. So, again, it's not that it's negative. But it's just a bit meh, not too exciting.

And also, tactically, people are super-bulled-up, and that means there's going to be more volatility. So I think it's probably just that there's much easier things to look at in terms of expected return rather than expected volatility.

Erik: Let's move on to emerging markets. I'm guessing, given your dollar views longer term, you're probably bullish on emerging markets. Tell us what the outlook is there.

Mark: I'm super-bullish on emerging markets on a long-term basis. First of all, I'm particularly bullish on emerging markets. I'm particularly bullish on Asia. I think when you look at where the growth is in the world, where the exciting stories are –

I mean, again, in 2018, where are all the fastest-growing countries in the world going to be? They're going to be in Asia. It's going to be India, Philippines, China, Indonesia, Malaysia. All these countries will have about 5% growth. Demographics, not just in terms of size of population – I mean, India, China, Indonesia alone, just those three countries make up 40% of the world's population. India and China make up more than 30% of that.

But also the age of the population in many of them. Not so much in China, but in many of the other countries like India, Philippines, Indonesia, it's just so much more positive demographics.

So I think that the structural story is you've got better growth, you've got better demographics, and these things essentially are cheap. Now, I say cheap in two ways. In terms of there was this massive correction in emerging markets post-crisis, and that still hasn't fully caught up. Even though we've got much better growth there, there's still kind of a big discount for emerging markets, a long-term discount for emerging markets. And I know it's played a massive part to catch up in the last year.

And I'll reiterate what I said earlier – just because there's a secular change doesn't mean we can't get more volatility in that theme. But I think overall that's got a lot to play out.

But, importantly, I think these macro stories, currencies always come back to being one of the most important. If your currency can do well, then that kind of feeds through to a lot of other assets and it kind of helps the whole story.

And a lot of these EM currencies are still massively undervalued on a PPP basis. Now I know many of your listeners will correctly say PPP (purchasing power parity) is irrelevant for trading over the short term. Absolutely, it is irrelevant over a short term. People like using rears, real effective exchange rates. but the problem with rears is they have to start on an arbitrary basis.

I prefer PPPs because they're completely objective. There's no subjectivity. And over a much longer term, macro basis, which is what I tend to look at, they are relevant and they do play into factors.

And the fact is that many of these emerging market currencies are just so undervalued. Many of these Asian ones we're talking about are 60% undervalued to the dollar on a PPP basis. Now they shouldn't be equal to the dollar. There should be a dollar premium. But it shouldn't be that large.

So these are going to continue to support their economies, and a lot of them are doing structural form at the margin at different paces, and there's awkward process. But the multi-year story here, for emerging markets, is just so positive. And particularly in Asia.

Erik: Mark, we touched on so many different macro topics all around the world. Pulling this all together, how do you think about markets going forward? How do you pull this all together into an investing framework?

Mark: I think that, very importantly, I come from quite a quant background. My degree was mathematics and economics, and I like looking at the data. But something I realized trading over the years is that markets actually trade much more off narratives.

And I think the best example of that is when you get a GDP print. So, sometime in Q1, we'll get a GDP print for Q4 in the US. And the market will react in seconds to a number that's giving data for several months ago. And I think the fact is – even ask many traders out there, when they react to a retail sales number or an industrial production number, and you go, for what month was that data from? And they won't even know. Two months previous, or one month previous, or what month it is. And that's because markets actually trade around narratives. Now where I think markets get really interesting is when you get a massive dislocation between fundamentals and narratives. The dollar last year was a great example of that. And I think this is how I look at markets. I spend my whole time looking at data, looking at fundamentals, I'm very much a spreadsheet-based person – comparing stuff.

And what I look for is when there's a sign that the narrative out there is very dislocated from markets. So that's what I continue to look at this year. And I think it's always going to be the driver of markets. And it's part of the reason why I've come to Bloomberg. Why not help shape the narrative rather than being suffered to wait until everyone else changes it?

Erik: Fantastic. Mark, I can't thank you enough for an excellent interview. Now, for listeners who would like to follow more of your work, for our professional audience that has access to the Bloomberg Terminal, you've got a huge amount of writing that's available there.

Unfortunately for our retail audience, Mark's writing is only available on the Bloomberg Terminal platform, which is institutionally priced. For the benefit of those who are fortunate to have access to it, what should they do in order to find your numerous writings there?

Mark: That's a great question. The main product that I run in Asia is the Markets Live blog (MLIV is the function on Bloomberg Terminal). And that's a 24 hours a day, 5 days a week, live market commentary.

Rather than breaking news, which Bloomberg does very well elsewhere, what we try to do is be the first people to provide analysis. We've got the massive resources of Bloomberg and we've got a dedicated team, mostly ex-traders and strategists, who are focused on trying to provide the immediate analysis with no agenda. That's probably the most exciting place to watch.

I also like to macroview and we, the team, have done some large team macro outlook pieces across a number of assets that we've discussed today.

Erik: Fantastic. I cannot thank you enough for an excellent interview. Patrick Ceresna and I will be back as MacroVoices continues right here at macrovoices.com.