Eric Peters: USD Reserve Status, Unfunded Liabilities, Inflation & more

Erik: Returning now for his second feature interview is One River Asset Management's Eric Peters.

Eric, I'm so excited to get you back on the program. There's quite a number of topics that I'm looking forward to talking to you about.

One of them we've been discussing quite a bit lately is the reserve currency status of the US dollar. And, particularly, the fact that a lot of people around the world have an incentive to change that status – even though, I think, a lot of American investors don't take this risk seriously.

The US derives a lot of benefits from having that reserve currency status. Recently, Sergei Glazyev, the Russian scholar who has been credited as the mastermind of the de-dollarization campaign that is trying to persuade the BRICs countries to abandon the dollar, had a video in English. (We've got the link to that in the Research Roundup email for listeners' benefit.)

And Mr. Glazyev is very outspoken. He is accusing the United States of financial terrorism by using and withholding access to the SWIFT [Society for Worldwide Interbank Financial Telecommunications] international payment system, which is the international wire transfer system, as a way to enforce sanctions.

Eric, I know you've done a lot of thinking and a lot of research about this. Most people I talk to, either they've never heard of this stuff or they're not concerned about it.

How do you feel? Am I crazy to think that we should be concerned about the people in the world who would like to replace the US dollar as the world's reserve currency?

Eric: For starters, thanks for having me back, Erik. I really appreciate it. I enjoyed the first interview and I'm looking forward to this one.

Should we be concerned? This is a topic that people have been talking about for quite a few decades, which is the status of the US dollar as the reserve currency. And there certainly have been episodes throughout my career where there have been concerns that we have abused the privilege of the reserve currency.

Typically, the thought process is that, by running loose monetary policy, in a sense, we are

working to undermine the value of the dollar. So those people throughout the world who hold the dollars will at some point grow tired of having their store of value degraded by our monetary policy and will eventually shift their reserves elsewhere.

The problem is there aren't a lot of good solutions. Gold is a very small market. The Euro, certainly for a period of time, or at various points in time, has seemed to be a potential alternative (although I think it's difficult to have a lot of confidence in the Euro presently).

And so there isn't really a great alternative. People aren't really putting their money into the renminbi. People don't really want to keep their money in yen. There are not a lot of great alternatives.

What's happening now is something rather different, which is that people are beginning to grow concerned about the dollar's place as the principle reserve currency because of our policies whereby we're using the dollar as a fairly blunt tool to threaten some of our trading partners and, certainly, adversaries.

So we, in a sense, have used this global payment system that you referred to called SWIFT. And we're beginning to use it in a relatively unorthodox way. What it's allowing us to do is allowing us to threaten any corporation that may be engaged in trade with a company or a country that we're unhappy with. It's allowing us to, in essence, freeze them out of this global payment system, which really reduces or eliminates their ability to transact in global commerce in a very material way. So, in a sense, we can hold companies or countries hostage using this.

And the consequence of that is that it's certainly accelerating the work that some of our adversaries – principally Russia and, to a degree, China – it's accelerating their moves to try to replace the US dollar as the reserve currency. And it's certainly in their interest to replace it. They want to get off the dollar reserve currency standard as quickly as they possibly can. It's just a very difficult thing to do.

But that process is underway. And I think the policies that we're pursuing right now, while they give us an awful lot of financial leverage currently, without question are accelerating this move away from the dollar. I don't expect it to happen any time soon. This is something that's going to take – it could happen over the next decade. But it's certainly underway.

Erik: Well, that certainly echoes a lot of my feelings. If you are the strongest kid on the block, you can beat up the other kids. But if you abuse that right the other kids start going to the gym. And it doesn't take too long before they come up with a way to fight back.

I want to move on to a slightly broader subject of politics. Particularly, whether it be the United States or Europe, we're seeing, I think, a trend where there's a lot of shift towards nationalism. We used to be – the world was focused on globalism and free trade. Now we've suddenly got President Trump really focusing a lot on what I would consider to be protectionist policies.

A lot of other countries around the world are doing the same thing – Britain, the Brexit referendum, the Italian revolt that's going on, so many things around the world.

Where do you see this all going? And what are the implications longer-term for financial markets?

Eric: That's a great question; it's a big question. Historically – and I think this is what people are concerned about – protectionism has not been a policy that's led to great growth or terrific outcomes. I think we're all familiar with it. We're familiar with the experience in the 1930s. Consequently, when you talk about anything that has to do with trade or protectionism, the inclination is to be pretty alarmist. And I think that there is some reason for alarm.

At the same time, there's no question that our trading relationships were set up for a different time in history. And it stands to reason that there are some things that probably should be updated. It's hard to update things without creating a stir until we're in that process. Whether it tips into really destructive protectionism, time will tell.

I think that it will impact the markets in quite substantial ways, irrespective of whether it's just a trade renegotiation or if it is protectionism. I just think the outcomes are more extreme if it turns into a real US isolation, US protectionist type of outcome.

And it's difficult to really handicap that, because there are so many different players at the table and it's hard to know what types of decisions they're ultimately going to make. I think that's what makes the current environment so interesting.

And this is going to run slightly astray of your question, but, for the last few decades, we've been in this world where central banks have dominated policy. And every major central bank in the world has adopted the US monetary policy. And that policy has been a very predictable policy.

Anytime there is a wobble in financial markets, anytime there is a recession, they cut rates. As the economies recover, they hike rates. And the swings have been more extreme through time because they've had to do more and more – and more and more debt has been added to the global economy.

And different countries have moved at different paces. But, that said, everyone has been on the same system.

And now what's happening is that central bank activity has led us to this destination, which – and I'm sure we'll talk about it later – for a whole host of reasons has created this populist revolt. And the thing about that is that, in a sense, if you think that the central banks have led us to this place, it's highly unlikely that they're going to be able to deliver the solution to get us out of this place.

And so what voters have done is they've said – without pointing their fingers specifically at banks – they've said *I don't like where we are. I want something different. So I'm going to vote this politician in and I expect them to do something really material to get us out of whatever place that we're in right here.*

And that's so interesting because, unlike a world where we have homogeneous central banking, we now have a world where we have all these different politicians – whether it's in the US, whether it's in the UK with Brexit, whether it's France with Macron, whether it's in Italy now with Five Star and the League. Germany appears to be undergoing a political shift. And, certainly, Poland and Hungary. So we're seeing it all over the world.

You now have this new group of politicians that, in a sense, really have a mandate. And they're different. So the policy decisions that Italy makes are going to be very different from the policy decisions that the US makes and probably that Germany makes and potentially that the UK makes.

We're moving from this world where everyone has been on the same system, which is a central-banking-dominated system, to a system where there are just a lot of politics involved. And that's why it's difficult to handicap. It's also why there should be a lot of real differentiation in markets. And, I think, more volatility in markets.

Because of that, markets will really need to reprice over the next couple of years. And not in an upward way – in kind of a downward way. But there also is going to be a lot of differentiation.

Erik: I want to stay on that topic of central banks and the era of central banking. I recently interviewed Nomi Prins on this program. In her book *Collusion*, she writes about how everybody is freaking out about $4.5 trillion on the Fed's balance sheet. That's like a quarter of the global number. It's upwards of $20 trillion that has been conjured by central banks around the world.

And, at some point, if there were a certain set of beneficial effects of creating all this money over the last ten years, it stands to reason that the unwind might not be so pretty. So it seems like we're maybe at the beginning of the end. The Fed is definitely extinguishing US dollar supply. The ECB was still creating more, as was the Bank of Japan, although it looks like maybe they're finally ready to curtail.

When do we get to the point where there is a net reduction of central bank balance sheets around the world? And what are the consequences? And what is it going to mean for markets when that happens?

Eric: Well, you can pull out your calendar, and you can look at what the central banks are telling us they're going to do, and you can run your calculations. And it looks like that real tipping point is the latter part of this year into early next year when we go into contraction of global central bank balance sheet.

That said, they all reserve the right to change their minds. So it could conceivably be faster, although I think that's highly unlikely. But it could certainly be a lot slower.

I think that, in terms of how that's going to impact markets – I take your point that central bank balance sheets have really expanded quite dramatically and, presumably, that's had a positive impact on economies. Conventional wisdom is that's the case and, as a consequence, when you remove that it's going to be negative.

And, in a lot of ways, that makes sense. I'm a real skeptic that we all understand the complexity of money and credit in the global system and how QE interacts with it.

What I mean by that is I think that people felt that they understood what QE would do to the economy and to inflation when they first introduced it – in really '08–'09. And yet, by and large, or virtually universally, people are really wrong in the sense that they expected inflation to increase in a really material way and economic activity to increase quite dramatically.

And they really didn't end up with that. They ended up with really quite static inflation and, arguably, disinflation and really muted growth.

Now, what people are assuming is that, as they exit QE, that you're going to have lower inflation and lower growth. And that may be the case. But I think it's worth considering that QE – other than the early rounds of QE which staved off a depression – but the consequent rounds of QE that really helped inflate financial asset prices, I think you could make the case that that was actually disinflationary and reduced economic growth.

And the channel by which that would have happened would have been – the obvious one is through the financialization of the US economy, where a lot of QE went into suppressing rates, resulting in corporate issuance that resulted in stock buybacks. And companies just decided to not really make big capital investments.

So it may very well be the case that, as central banks exit from these policies, that actually you see something happen in reverse where you see this financialization effect unwound somewhat. And you see the velocity of money actually increase as interest rates go higher. You see economic activity pick up as interest rates go higher. And you see inflation pick up as interest rates go higher.

That would be a really interesting dynamic. It would have the benefit of symmetry in the sense that QE seems to lead to very muted inflation and surprised people. And so the unwind could be rather unexpected.

I think that that's an environment that could be pretty good for actual economic activity, although I think it would be pretty challenging for financial asset prices.

Erik: Let's move on to labor in the United States. Because something that's gotten a lot of

headlines lately is we're moving down to unemployment levels that haven't been seen since the 1960s: Hurray for the US economy, everything is firing on eight cylinders.

And I think, wait a minute, what happened to all those stories that I read saying that a lot of these statistics were skewed because so many people had dropped out of the workforce and were not looking for employment anymore? That the number wasn't really correct?

So are we really seeing the extreme, profound low level of unemployment that the statistics are indicating? Is it really true? Or is that a statistical anomaly? And what does it mean in terms of inflation and the economy in general, if it's true?

Eric: We've all looked at the stats, and we're now at an unemployment rate in the US of sub-4% – 3.8%–3.7%. I think what a lot of people focus on is if the participation rate were back where it was pre-2008 you'd end up with an unemployment rate that had an 8 handle or something like that.

So that's what people are referring to. But making comparisons like that is difficult because a lot of things are changing. The US labor force is shrinking because people are getting older. There is the opioid issue. And this disability issue. Which are difficult to really handicap in terms of how big an impact that's having on the US labor force.

But, when I look at it, and when I think about this large pool of labor that is supposedly idle – and if I imagine that they're just a whole group of people that are eager to get back in the workforce but just haven't bothered trying at this point, or they're stuck on disability and they *don't want* to get off, or they're stuck on disability and they *can't* get off, or they're addicted to opioids, or they're just old – when I think about that, it just doesn't sound like a really robust supply of efficient labor that's ready to come back into the market.

And I think, now that we're at these levels of unemployment, if we were going to see real jumps in the participation rate I think we'd see more signs of that. If anything, it's pretty sticky.

In terms of it leading to inflation, we think that that is just inevitable. There's been a lot of talk about the Phillips curve just being flat in perpetuity. If you go back to the original work on the Phillips curve, it really shows that wages start increasing once you get below 4%. That is really where that relationship accelerates such that lower levels of unemployment lead to significantly higher wages. And that would be our expectation of what we're likely to see.

When you look at certain segments of the economy, you're absolutely seeing that. You're just not seeing it on a completely widespread basis. That said, wages are increasing. They're increasing, and they're increasing at a faster rate. And that's what we would expect to see with levels of unemployment down where we are right now.

Erik: I want to touch on liabilities as well, because this is a topic that a lot of people have stopped talking about. I'm not sure why. But the US government's debt-to-GDP is over 100%. I

think the number is 108% now.

If you add in unfunded entitlements and liabilities – it kind of depends on who you listen to because there are different ways of calculating that – I think Larry Kotlikoff [https://en.wikipedia.org/wiki/Laurence_Kotlikoff] has the record at a fiscal gap at $202 trillion. Other people have calculated differently and come up with about a $50 trillion additional debt beyond the debt that we admit is the debt.

One way or another, even if you only consider the official $21 trillion of US debt, you're still well past the 100% threshold that Reinhart and Rogoff [http://www.reinhartandrogoff.com/] in their research identified as where you get to a point of no return where countries are in real trouble if they get past that point.

So we're either just a little past that or way past it, depending on whether you consider the entitlement liabilities.

Where is all this headed? It seems like five–six years ago a lot of people were talking about this. I haven't heard so much about it lately. When does this come back and bite us?

Eric: 108% of GDP number, or some number around that, I think is accurate. Although that doesn't take into consideration that the Fed owns about $4 trillion in debt. So the numbers, as a percentage, is not quite so big. It's probably closer to around 80% in terms of US government debt held by the public.

But those are rounding errors, once you start including entitlements and those unfunded liabilities. That's just a really challenging question to answer, because no one knows exactly when these issues become really big issues.

But what we certainly can observe is that people are getting older and more and more people are beginning to draw on these entitlements. And we can also be certain that the math doesn't work. So it's a problem that will be extremely difficult to solve.

I don't have any idea what the solution is, because the difference between what people expect they will be entitled to and what they economy can deliver – that gap is just so vast that it really is unsolvable.

So, in a way, the question becomes how might we solve it? And I think one of the things the government will not do is it will not try to solve it through disinflation. I think it will ultimately attempt to try to address it. It's not going to be solved, but it will try to address it through inflation.

The question is, how do they do that? And why inflation versus deflation? I think for the simple reason that – this is the way my simple brain works – in an inflationary environment it's just easier to screw people because the numbers are moving around a lot more than in deflation.

We all know it’s a lot easier to give someone a raise than a pay cut. In an inflationary period, it’s a lot easier to increase someone’s entitlement, cost of living adjustment, by a little bit. And they feel like they’re getting bit more money. Even if on an inflation-adjusted basis, it’s not even close.

So I just don’t see how this won’t be addressed through some form of inflation. Over what time horizon? That’s awfully difficult to know.

Erik: You’ve described in a number of ways that we’re in an era of central banking. Some people have suggested maybe we’re at a turning point where the leadership of central banks is changing its mood.

In the United States you had Greenspan, Bernanke, Yellen – all very, very much accommodative – especially in the case of Bernanke and Yellen not really speaking English. Suddenly Jay Powell is a very down-to-earth guy, speaks English, and has a different attitude.

You look at Mario Draghi ending his term this year, potentially being replaced by a German with a very different attitude toward the role of what central bankers should be doing.

Are we potentially at the cusp of a change in global central bank attitude? And, if so, what are its implications for the economy and for financial markets?

Eric: Well, we don’t know about Powell yet. He’s more clear-spoken than others, for sure. I would find it highly unlikely that he is going to try to be a really hawkish central banker. And the reason for that is what I’ve just described, in terms of the government’s ultimate desire to create more inflation so that they can address some of these entitlement issues.

But, more than anything, I think the most important thing to focus on is that the era of central bankers, I really believe, has drawn to a close. And that is because if you look back post-Volcker – Greenspan came in in 1987 and the reaction function of central bankers has been really the same ever since.

And we all know where that led. It ultimately climaxed with QE and this global monetary experiment. But that destination has been one where there has been growing inequality that, certainly in the US, has reached levels really only seen back in the pre-crash era in the late 1920s.

So it would appear that – at least in our type of society – that when you hit certain natural limits of inequality that something happens. And, in this case, it appears that what’s happened is people voted for an antiestablishment president who is elected to try to listen to the forgotten man, so to say. And, ultimately, I think, try to address this issue of income and wealth inequality.

By the way, that phenomenon, obviously, is not just a US phenomenon. So let's imagine the US has led central banking activity and that central banking activity has really led governments for the course of my entire career, since the late '80s.

So we're now in this transition phase because voters have said, well, the central banks have really been the dominant policy makers. And, by and large, governments haven't mattered a whole lot. Politicians have had opportunities to address some of these entitlement issues, some of the issues that really matter to people. They haven't done a whole lot, which is why we're here.

If the central banks have been the ones who have gotten us here, they just – by definition – they're not the ones that are going to get us out of here. So I think – look, we're always going to look at what central banks are doing, they will be important. But I think that they're no longer going to be dominant. What's going to be dominant are the politicians.

You're seeing that in the US right now. I know that everyone loves to hang on every word that Powell speaks. And they look at the Fed statement. And people are still trained to look at the Fed dot plots (which are probably going to go away).

People are trained to look at all of these things because that's what they've done their whole careers. But they just are not going to matter that much anymore. Whether the Fed's terminal rate is 2.25 or 2.5 or 2.75 – we're not talking about much.

What are we going to do in terms of immigration policy? What are we going to do in terms of trade policy? How is that going to impact all of the major corporations' global supply chains? These are the things that are really going to matter.

What are we going to do about entitlements in the next recession? Are we going to borrow an enormous amount of money? Are we going to do helicopter money? Because I can assure you, the next recession is not going to be solved by the Fed cutting rates from 2.5% to zero and everything is okay.

Their toolkit has been depleted.

Erik: Eric, I want to bring in the subject of demographics, which I find absolutely fascinating. So many people are talking about how the baby boomers are reaching retirement age, and that changes everything.

Raoul Pal has been very vocal in his view that it really means a fundamental deflationary change because, suddenly, all the people who were acquiring financial assets in their retirement are going to be distributing. And cashing in. They need to move to bonds because they're too old to be holding stocks. And Raoul thinks that that creates a secular bear market scenario.

Other people have said inflation can't really happen in an aging society environment.

Meanwhile, there's still the millennial generation, and the generation behind them are getting bigger. At some point, they'll have a big impact.

How do you see these things coming together? What does it mean in terms of inflation, in terms of equity markets, and everything else?

Eric: A lot of good questions there. Maybe we can go back or we can return to the question of whether the sale of assets leads to a secular bear market – maybe we can go back to that in a minute.

Demographics are really fascinating, because they're something that you don't have to model, you can really just map out. And they're just such a powerful force in markets and economics.

But they're not that variable in the sense that you just can't all of a sudden make people. You can make money really quickly. You can issue bonds quickly. You can do lots of things in financial markets, but you can't make people really quickly. (I guess you can take them away pretty quickly in war.)

But the case is made – and I would say this is just complete consensus – it doesn't mean it's wrong, by the way – but the case is made that, in a world where people are aging and birth rates are slowing, that you simply can't have inflation.

Whenever I hear virtually everyone assume that something is a given in economics, my guard is up. Just because I think nothing is a given when it comes to economics and markets.

Markets and economics are self-reflective – as soon as you think you understand how something works, the systems themselves change. So this demographic thing has just been really interesting to me.

When I try to think through problems or issues or topics like this, what I've done my whole career is just try to create really simple models – and extreme models. And, oftentimes, you discover something a bit different than what you would have thought when you create a really simple model in the extreme.

Imagine just one society. It has a reasonable balance between old people and young people. The old people, naturally, have the wealth because the young people haven't worked for very long. And the old people probably set up the system to their benefit, just because they got to write the rules. And they care more about themselves and their children.

I'm creating a model for what the US looks like right now. So, imagine that the society really starts aging rapidly. What happens?

Well, initially, it works fine. The old people just start giving bits and pieces of the financial assets that they own – their stocks and bonds, but mostly houses – they start exchanging those for

goods and services that the young people produce, because old people are no longer working. And that works fine for a while.

But as you really start to age, what happens is the labor force shrinks dramatically (in this really simple society), the retired pool expands rapidly. All of a sudden you have a lot of demand because, while the older people may be consuming less than when they were actively working, they're still consuming. And you have very few workers left.

And, ultimately, in that society you end up with huge inflation in the price of labor, whether it's for producing goods at a factory or for services. You ultimately end up with all the old people exchanging all of their financial assets and their homes for even the most basic services. I kind of joke, the last person will exchange their house for one last diaper change. And that's – if you take it to the extreme – that's kind of what that society looks like.

But, of course, the world isn't just one country. So then I think, okay, let's just make it really simple, so now it's two countries in the world. And one is that rich country that I just described. And the second is, let's say, a less affluent or a poor country.

And imagine that you have free trade and immigration. In that world, the rich aging society, prices still go up, because what happens is the labor pool contracts. It definitely draws in a lot of immigrants. And a ton of immigrants, right? Because they are the ones that are going to have to come in and do the services and work the factories.

And, ultimately, that country just ends up consuming an awful lot and its currency declines in value. Overall labor prices go up. Inflation goes up. But it works.

But if you imagine a world of two countries where you have *no* immigration and you have free trade, then you end up with a society where – you have a rich country where you have very large inflation because domestically you have a very small labor pool because you don't want immigration. So you don't have people to work your factories.

So you have to buy a lot of goods and services from abroad, which means you are selling your financial assets. And you have to buy someone else's currency, so the value of your currency goes down a lot. Your trade deficit explodes. The domestic price of services goes up a lot because you have very few people that take care of the old people. So you also end up in this inflationary scenario.

The bottom line is, when I look at the different potential outcomes, when you think about it in the extreme, it seems to me that an aging society actually creates quite a bit of inflation (certainly in the extreme).

What's interesting is that that's completely at odds with market consensus right now, which is that, well, it's an aging society. Obviously, inflation can't go higher. I think what we're going to discover is that it's actually the opposite.

Erik: This is a really, really important point. Because if there is anything I've learned in this macro game it is: *What's the macro risk you really need to worry about?*

It's the one where, when you describe it, at least half of the people in the industry laugh in your face and tell you you're crazy to even worry about it. I don't know about you, but, from my experience meeting people in finance, I talk about the reasons why I think an eventual return to secular inflation is where the endgame starts and where things really come unglued, they literally laugh in my face and they think I'm nuts.

Your colleague Lindsay Politi did an amazingly excellent job putting an 18-page report together, which we have linked in our Research Roundup email for the benefit of our listeners. Folks, I strongly, strongly encourage you to read Lindsay's piece because it's really excellent.

But let's suppose, Eric, that Lindsay is right and that we really are seeing a return to inflation. First of all, as you said, most people don't think that's possible. Therefore, they are not positioned for it, they are not hedged for it, they are not ready for it.

Meanwhile, if I go back to the Raoul Pol argument, which says, we've been building up because of demographics the stock market for all these years. It's time to see a secular bear market as investors sell off because, due to their age, the people that are holding the assets need to move to fixed income. It doesn't make sense for them to stay invested and at risk in equities.

That's just so totally at odds with an inflation forecast, in which case you would expect equity markets to at least have a tailwind from inflation – if perhaps not in real terms, but in nominal terms. We should expect higher stock prices.

Is it possible to know who is right? And how does this conundrum of differing views get resolved?

Eric: There are a few forces at work. One has to do with symmetry, which I think about a lot when it comes to financial markets. We've now had decades of really, really muted inflation, and major decline in interest rates. And a real decline in real interest rates. And it's been amplified by central bank activity.

All of those things have been intended to pull future financial asset returns to the present. That has been what they have attempted to do. And the hope has been that, by doing that, that you would create wealth in the here and now that would lead to greater investment and greater economic activity.

And we would deal with the fact that financial asset returns have been pulled to the present – we would deal with that problem later. That's kind of where we are right now.

Then the question is, well, if you now create inflation, or if inflation appears – and we don't

really know enough about inflation to know whether it's simply something that we create or it's something that we create and it also appears and it's a bit of a social phenomenon – I think there's an element of that as well.

But, if we manage to create inflation, it stands to reason that what drove that pulling forward of financial asset price returns, what drove the pulling of that from the future to the present then goes and pushes those back out to the future.

So I think, for symmetry reasons, it makes a lot of sense to me that, in an inflationary environment, what you could do is you could – and it would be my core expectation – you would have to rewrite financial asset prices quite a bit lower. And, ultimately, that puts them back into a position where they are priced such that you could earn a reasonable return if you held them for a long period of time. But we've kind of gotten the returns, right?

So I think that's one thing to take into consideration.

When you look back at a period like the 1970s, I don't see us repeating something quite like the '70s. There were very different demographics in the '70s. And a different situation, I think, in terms of commodities. And different in terms of entitlements, too.

We didn't have the entitlement problems in the '70s, and we had a lot of population growth, and we had some issues with Middle Eastern oil, amongst others.

But now we just have a different set of problems. I think it will look different from the 1970s. But that was a period of time where stocks really just went sideways in nominal terms. But they fell a lot in real terms, with inflation.

So it's interesting, when you speak with people, they think that inflation will actually help equities in a way, because it will lift earnings and lift prices and everything. But I think history suggests the opposite.

Given that we are priced where we are right now because of low rates and muted inflation, our calculations are that if inflation increases even moderately – so let's call it from this 2-ish level to 4–5% (by the way, we were at 5.5% inflation in 2008, so I'm talking about crazy forecasts), but if we really return to that kind of inflation, we think equity markets are likely to be down 30% to even 50%, because of some of these dynamics I just was describing.

I think that the notion that inflation is going to end up being good for asset prices is really mistaken. And, furthermore, we were just talking about equities here. One of the places that people hide is in REITs [https://en.wikipedia.org/wiki/Real_estate_investment_trust]. The cap rates on these are really so low now – because the risk-free rate has been pushed down so low, and the term rates have been pushed down so low, that all of these types of assets – the prices are so high that I don't see how inflation yields a great result in REITs. I think people lose money in REITs. If people lose money in REITs, they'll lose money in equities.

Erik: Eric, one final question on this matter of equities and whether they go up with inflation and so forth. I know you've done a lot of work looking at different equity markets around the world, in terms of how they've performed both in real and in nominal terms.

Give us the overview. Unfortunately, we can't go into too much detail on that today, but give us the overview of your work in that area.

Eric: Okay, really high-level. People assume that equities always go up. And they certainly have been for an awful long time in the US. But they can go through really long periods of sideways movement.

If you look at the NIKKEI – I started my career in 1989. The NIKKEI today, in nominal terms, is where it was in 1987. It's where it was before I started my career. It's moved sideways during that period. The S&P is up over 800% in that period of time. So we've outperformed the NIKKEI from 1987 by over 800%.

Euro Stoxx, European, their big equity index, it is unchanged from where it was in 1998 – 20 years ago. We're up 130% during that period of time, the S&P 500.

And the Shanghai Composite is unchanged from where it was in 2006, at this point. So it's unchanged over the past 12 years, despite the enormous real and nominal GDP growth out of China. Their equity market is flat for 12 years. We're up 90%.

So it's just a reminder that we go through these periods of assets doing extremely well – pricing in all kinds of robust growth for the future – and then periods where they can obviously have big corrections, but even over long periods of time they can just move sideways.

Erik: Well, Eric, I can't thank you enough for a fantastic interview. I'd love to go deep on Lindsay Politi's piece on inflation. Again, I really want to recommend that our listeners read that. It was very enlightening for me, and I think it makes an excellent argument that presents the other side of the story.

We recently interviewed Russell Napier, who makes the deflationary case, and I though Lindsay's piece was really an excellent complement to that to show the other side of the argument.

In the interest of time, we're going to have to leave it there. But, before we go, just please tell us very briefly where can people follow your work? And give us a very quick summary of what you do at One River Asset Management.

Eric: We manage macro money. We have a volatility fund. And a trend fund – a systematic trend. And Lindsay is in the process of launching an inflation fund to capitalize on opportunities that we see emerging in inflation.

Erik: Fantastic. Thanks so much for a terrific interview. Kevin Muir and I will be back as MacroVoices continues, right here at macrovoices.com.