MACRO Voices
with hedge fund manager Erik Townsend

Louis-Vincent Gave: Breakdown in Historical Norms between Emerging Markets and USTs

October 4th

Erik: Joining me next on the program is Louis Vincent Gave, cofounder of GaveKal Research.

Louis, thanks so much. It's great to have you back on the program. Your dad wrote an interesting piece called "The Recession of 2019." We've got a link in our Research Roundup email to that piece. Some of the things that he touched on I want to discuss with you briefly.

Generally speaking, emerging markets – it seems like we've had some really tough times. Is that driven by the rally in the US dollar? And how do you relate it to the situation in Treasuries? Because we've got everybody thinking that the Treasury yield is about to explode here.

What's going on?

Louis: There's a lot of the pieces in the puzzle that don't quite fit together. The one you just highlighted – I've been doing emerging markets for 20 years – and for the first time in my career, we have a situation where over the course of the summer you have a complete meltdown in emerging markets.

Argentina down 50%, Turkey down 50%, South Africa, India, Indonesia etc., you name it. It was a very ugly summer for emerging markets. And, against that, you also had US Treasury yields that, instead of falling, actually rose. And we're above 3% now on the 10-year.

And here I'll be dead honest. If you told me at the beginning of this year China will be down 20%, Argentina down 50%, etc., I would have said, hey, you can't own enough US Treasuries. But here we are where, actually, year-to-date you're losing money on US Treasuries. You're losing money on US corporate bonds. So it's not your typical setup.

When you look at this disappointing performance from emerging markets, I think the consensus view has generally been, oh, well, I think it's because of the strong dollar. That's the natural reaction: Strong dollar equals weak emerging markets.

And, frankly, I don't buy it. I don't buy it because the dollar, first, hasn't been that strong. Basically, you look at the DXY, it's roughly where it was a year ago. And, yes, you've had it move higher in the past six months. But it hasn't been a massive move higher, number one.

Number two, I think really it wasn't as much a case of dollar strength as RMB weakness – I've written a few pieces about this. For me, the big shock of the past three to four months was the

renminbi falling 10% against the US dollar in a matter of a few weeks in late May, early June, early July, because this had never happened before. You had never seen China let the renminbi go down so quickly against the US dollar, basically, since 1995.

And so I think this raises a whole number of questions as to what is China doing? Is China changing the way it's running its currency? Is China signaling to the US that, look, if you want to make this tariff, this trade war, worse, we've got lots of ammunition? Many potential scenarios, none of which, of course, might be that exciting for emerging markets.

So, for me, when I look at the EM meltdown it's probably less to do with what's happening in the US and a whole lot more to do with what's happening in China. Because the general media view is emerging markets are a leveraged play on the US dollar. The reality is that, today, emerging markets are a leveraged play on China.

Look at the past 10, 12 years. Emerging markets have only had short periods of outperformance. They had massive outperformance in 2009–2010 and big outperformance in 2016–2017. And both of these periods of outperformance basically followed massive easing of monetary and fiscal policy by China.

Today, I think emerging markets are really a levered play not on the dollar but a levered play on what China is doing.

The reality today is of course that China is slowing. And the other reality is that the Chinese government is doing fairly little to re-stimulate the economy. The government feels pretty confident that, yes, the economy is slowing but it's not the end of the world. It's a slowdown that we can stomach.

Against this background of RMB devaluation, against China's slowdown, against emerging market slowdown, the real quandary is indeed US Treasury yields. Why are US Treasury yields going up against a background that should be fundamentally more inflationary for the world?

I think, for me, the only answer that makes sense is the US Treasury market is responding not as much to the slowdown that's unfolding in emerging markets but to the fact that US debt, US budget deficits, are really starting to go through the roof. And that debt issuance in the US is going to be enormous for years to come.

Erik: So much of financial reporting is focused on US markets and the S&P and so forth. Everybody is obsessed, it seems, with is the S&P popping? Is it going to come down? And so forth. And it's really not clear what's going to happen next.

But something I've noticed in a lot of the research that you guys do is maybe it's not clear what's going on with the US, but it's much clearer between emerging markets and Europe. Most other equity markets around the world are really showing signs that they have rolled over. They're not necessarily crashing, but they're not breaking out to new highs.

Does that mean potentially that what we're seeing is a global topping of equity markets but some of that flight capital that's going out of other markets is pushing the S&P to maybe one last final high? Is that the phenomenon here? Or why is it that the US market seems to be out of whack with the rest of the world?

Louis: I think that is what is happening. One of the charts in my presentation pack right now is a performance review of every major asset class since January 31. So we start the year, everything goes up, as sometimes happens in January all the capital gets put to work. You've got a big rally. Everybody's happy.

But since January 31 every single asset class has underperformed US dollar cash, apart from US equities. So, basically, if you owned anything but US equities since late January – so the past seven or eight months – you've lost money.

And that's true of European equities, it's true of Asian equities, it's true of corporate debt, it's true of emerging market debt, it's true of commodities, and so on and so forth. So, yes, an environment where you're losing money on every single asset class, I think, is an environment that tells you – except for one – that indeed tells you that liquidity is getting tighter.

We know that we have several liquidity drains today in the system. We have, of course, the Fed, which is shrinking its balance sheets. Then we have oil. And oil by continuing to rise is a liquidity drain on the system. Just those two facts alone mean that there is less money floating around the system to push up asset prices, to push up valuations.

And, yes, amongst this you have US equities that are increasingly the only beacon of light in an otherwise tough environment for everybody else, but a beacon of light that is also getting more and more concentrated. If you look at August, August was almost a parody in that respect in that the world MSCI as down 3%. The US MSCI was up 2%.

But amongst that, Apple was up 20% and Amazon was up 13.5%. So the two biggest stocks contributed $350 billion in additional market cap for the US.

So you've had within the US, I think, a fairly concentrated rise. Within global markets, it's been concentrated on the US. And within the US it's been concentrated on a few mega-cap, large-cap tech stocks and health care and, basically, growth stocks.

Growth stocks I think have done well, thanks in part to the flattening of the yield curves that you've seen everywhere around the world. Because, as you get flat yield curves, you can project yourself further and further away so you don't mind buying stocks like Amazon that might be trading at 45 times EV/EBITDA.

So, yes, this has unfolded, and it's made the life, I think, of most active managers fairly miserable.

Erik: If that mechanism is in action, as you said, where what's going on here is global markets are rolling over, people are starting to lose confidence, and they're going into US equities as a safety trade away from other markets, how long can that last?

Or what would you expect? Does it necessarily mean that the US markets are likely to top after other markets? And is there a lag or a guideline as to what people should expect?

Louis: I wouldn't say that, actually. You have many potential avenues of exit here. The first one, of course, is that the enormous divergence we've seen since mid-May between the US equity markets and global equity markets gets resolved, not through US equity markets collapsing but through European markets rallying, the Japanese market rallying, Asian markets rallying.

Of course you could say, well, in Europe we have a lot of uncertainties. Italy, upcoming European elections which should lead a lot of Eurosceptic parties to perhaps be a majority in the European parliament for the first time etc. So, there are uncertainties around Europe, no doubt.

But, meanwhile, Japan has now started to break out to new post-1991 highs. So that's another beacon of light that is emerging out there.

China also seems, frankly, to be bottoming.

And, now that we basically have a NAFTA agreement, that removes a lot of uncertainty surrounding Mexico, surrounding Canada, both of which are cheap markets trading pretty much at historical discounts against the US. So I think you can make the argument, okay, all these cheap markets in Asia, cheap markets in the Americas outside of the US, will start to suck up the relative underperformance that got put in in mid-May.

For this to happen, of course, you need probably a fairly benign global macro environment. You need growth to be decent and you need the US dollar to not shoot up.

As it turns out, the US dollar has been under a little more pressure in recent weeks. It tried to break out, failed, and the reality is in spite of a decently hawkish Fed – a Fed that basically confirmed they've got four more tightening's over the coming 12 months – even in spite of that, the US dollar didn't really break out to new highs.

So I look at this and I think, okay, maybe the environment for some of the beaten-up emerging markets – also for Japanese equities and also for Canada and Mexico – maybe that's where the returns are going to be for the next six months.

Erik: With that in mind, does that change your view? Or how does it affect your view if you think that maybe things are bottoming?

Let's come back to US Treasuries. Should we expect this breakout that everybody's sort of waiting for – past 3.10% on the 10-year and all uphill in yields from here? Or could it be that the bond market is bottoming and that maybe Treasuries are about to rally and we'll come back down in yields?

Louis: Well, I don't want to answer your question with another question and do like a Jesuit priest, but here is the shocking thing for me. A couple of weeks ago Larry Kudlow came out to give his review of the US economy and very rightly highlighted how great the US economy was doing. You know, all-time record consumer confidence, strong ISMs, industrial production, etc.

So, there was a lot to report that was extremely positive. Very strong GDP prints.

Then, amidst all this, he was asked, okay, this is great, where do you see the budget deficits? And his answer was the budget deficit is going to be between 4–5% basically for as far as the eye can see, but we shouldn't worry about it.

The reality is if you have a US economy that is booming, that is really growing on all cylinders, and even with that your budget deficit is 4 or 5% of GDP, I think the question then becomes, what happens if and when there's a recession?

Now why should there be a recession in the US? Well, the simplest answer to that is you have to look at the things that are already starting to roll over and break, simply because of the rise in oil and the rise in interest rates.

We know, historically, higher oil prices, higher interest rates, are typically what breaks the back of any economic expansion. And today we do have higher oil and we do have higher interest rates. And we are starting to see US housing roll over. And we are starting to see the US auto sector roll over. So, basically, the most interest–rate–sensitive parts of the economy are starting to feel the pain.

You mentioned my dad's piece "The Recession of 2019." If you project yourself 12 months and you think, okay, in 12 months' time if the Fed really has gone through its four rate increases, where is housing? Where is autos? Where is overall growth?

Now, you can say it's fine, everything is great because animal spirits have been rekindled because we're deregulating at the same time. So, yes, you have this increase in costs but you have the lower costs of deregulation, so everything is fine. But even in this "everything is fine environment" you're still ending up with 4 or 5% of budget deficits.

So your first option is: The economy will be fine because of deregulation. Yes, you'll have higher interest rates, but the higher interest rates get compensated by a bunch of other factors. So, roughly, your yields probably end up more or less where we are today.

The second option, the one with a whole lot more uncertainty, is you get your four interest rate increases from the Fed, the higher interest rates combined with higher oil price really start to take a bite out of the US economy, and the US economy starts to move towards a recession.

And this is – it goes back to my dad's piece, "The Recession of 2019" – if you get there, the big question is then historically of course you say, oh, recession, I buy US Treasuries. But, of course, here the uncertainty is recession at a time where if you enter into a recession with your budget deficit already at 4 or 5% of GDP, by the time you get into recession your budget deficit is at 10% of GDP.

And the numbers get so big that the question then becomes, who is going to be the big buyer of these US Treasuries?

And this gets me into the odd policy mix that you have in the US today where, on the one hand, you have massive funding needs and, on the other hand, you have policy makers that are, in essence (excuse my French), telling the rest of the world to bugger off and showing them the middle finger.

So, in essence, today the US is increasingly dependent on the kindness of foreigners to fund our debt. But the US isn't really treating the rest of the world with much kindness. If tomorrow there is a recession, are China, Japan, Indonesia, India, etc. going to rush and buy US Treasuries as perhaps was done in the past?

Or will China be using this opportunity to perhaps make the point, as they've been trying to do for the past few years, to say this is now our window of opportunity to de-dollarization trade, de-dollarize the commodity trade, and start moving away from, in essence, this dollar world – where the dollar dominates everything – towards a more multi-currency world?

So, again, I didn't really answer your question. I said I'm sorry to answer your question with another question. But, in essence, the question on US Treasuries, it comes down to whether you fundamentally believe that the US running budget deficits of 4 or 5% in boom times and 10% in bad times is a stable situation or not.

I tend to believe it's not. I tend to believe that US Treasuries are actually a dangerous asset class because the risk/reward is just not a very attractive one. If maybe bond yields can go back down to 2%, but all of a sudden the debt situation starts becoming alarming for investors, bond yields could easily rise to 6% or 7%.

With that in mind, the risk/reward, for me, in US Treasuries is not particularly attractive.

Erik: I want to stay on that de-dollarization topic for a few minutes. Last week we had the European Union's foreign policy chief standing shoulder-to-shoulder with the Iranian foreign minister. Basically pledging solidarity, the two of them standing at the United Nations in New York City, saying that the European Union intends to create a workaround payment system to

bypass the SWIFT payment network so that European companies' right to legally conduct trade with Iran, notwithstanding sanctions from the United States imposed unilaterally without UN support, can be effective.

So you're in New York City at the United Nations. You've got the foreign policy chief of the EU speaking out against US foreign policy, which they perceive as being completely inappropriate, and trying to tell the rest of the world what to do. And they're fighting back with another payment scheme.

Clearly that shows that there's some great frustration in Europe with the US attitude toward unilaterally imposing sanctions on a nation like Iran. My question is, do you think that translates to European investors not buying US Treasuries because of that same frustration? Or are they stuck in the no alternatives situation where, yeah, they don't like it but there's really no viable alternative to the US Treasury as a safe reserve asset?

Louis: I think it all depends on your timeline. Over the past 10 years – but really the past two years – I think the US government has been weaponizing the US dollar like never before. For me, the sort of breaking point moment was when the US government imposed an $8 billion fine on BNP for doing a deal in Sudan.

Basically, the logic was the loan you made in Sudan was priced in US dollars. And if it's priced in US dollars, we, the US government, have a right to look into it. So I think, with that BNP deal of a fine of a few years ago, the US basically said anything that happens in US dollars, wherever it might be in the world – you and I do a US dollar transaction in between Canada and China, the US says we're allowed to look into that transaction and if we don't like it we'll fine it.

And I think for me that was a massive game changer because, indeed, it does mean for a number of countries that you then have two choices. You have to build a workaround, or you really can't have a foreign policy of your own because whatever the US dollar dictates will have to go.

I think there's a number of countries for which this latter option simply doesn't work. Let's face it, the European Union and the US are good friends. And the fact that even the European Union is now saying this really doesn't work for us tells you if that's the case at the European Union, guess what they're thinking in Moscow or what they're thinking in Beijing or what they're thinking in Deli or in Jakarta or etc., where they are a lot less sure that the US and themselves are friends.

For me, on this de-dollarization of the world, one of the most interesting developments this year – I don't know if you've looked at this chart – has been the flatlining of the renminbi against gold, which is kind of odd. Because the Chinese government has a pretty good track record of saying what they do and doing what they say.

For years, they managed their currency against the US dollar. Then in 2015 they told us, oh,

we're not managing this against the US dollar anymore. We're managing it against the baskets. And they even gave us the baskets. And you look at 2015, 2016, early 2017, there is fairly little volatility in the renminbi against its baskets.

Fast forward to the past 12 months and, all of a sudden, you have a whole lot more volatility against the baskets. But at the same time you're completely flatlining against gold. So it's almost as if all of a sudden China is no longer managing the renminbi against the baskets but managing the renminbi against gold.

Now what would be the interest in that? Well, if China's long-term goal is to de-dollarization trade (we know that's their goal), if China's long-term goal is to de-dollarize the commodity trade (and we know that's the goal) – they've launched the RMB oil future in Shanghai, they're already cutting deals with the likes of Russia, with the likes of Qatar, with the likes of Iran to buy energy in renminbi – then fundamentally, over time, for this strategy to work, China really has two options.

The first is to completely open up capital controls and let foreigners buy and sell whatever assets they want in China, just like foreigners can buy whatever assets they want in the US. That's option one.

Option two – when you turn to Russia and you say, okay, let's sign a 20-year deal of oil for renminbi, the first question Russia is going to ask is, okay, that's great, but what am I going to do with these renminbi? China's answer – buy renminbi bonds – perhaps doesn't satisfy Russia. So China turns around and says, well, instead of buying renminbi bonds you can trade your renminbi for gold and I'll make a market there and I'll ensure a certain level of stability.

Now I'm not saying that this has happened. But if you're China and if your strategic goal is to de-dollarization trade and de-dollarize commodity trade, doing this through gold would be a very easy way to achieve that goal. And, providing a certain stability in the RMB/gold price would take you a long way towards there.

And, sure enough, were are we today? Into a complete flattening of the RMB/gold price, which I find very odd.

Erik: I have one more question on de-dollarization, then I want to come back to China. I talk to a lot of investors in the United States and I take this de-dollarization thing seriously. It seems to me that China and Russia are both pretty darned serious about doing whatever they can to try and persuade the rest of the world to abandon the dollar.

I'm shocked that most people don't take it seriously. I take it very seriously.

What are you seeing? Because you deal mostly outside of the US. Nobody in the US thinks this is a real issue: "Ahh, whatever, it's just China talking. Ignore it." I don't think we should be ignoring it.

What are you hearing around the world outside the US?

Louis: I want to first start with the US because I think if you spend any time in Washington, whether you talk to journalists or policy makers or bureaucrats, there is a uniformity of views that really I haven't seen since really October 2016 when everybody was dead convinced that Hilary Clinton was going to win.

Today, everybody is dead convinced that China is on the verge of imploding, that basically all the US needs to do is push a little bit and China's economically will implode. It's a house of cards built on debt, not creating enough value, etc. You know the whole story.

I think part of the problem is that everything that's happened in the past five months will have reinforced that view, and that's the US starts talking tough against China, the Chinese stock market goes down 20%, the US stock market goes up 12%, and this will have reinforced the view of everybody in Washington that China is really in deep economic trouble.

Now, of course, a 20% drop in the Chinese stock market is neither here nor there. It's especially neither here nor there for Chinese policy makers. That kind of thing happens all the time. But, most importantly, it doesn't really matter because very few Chinese corporates actually fund themselves or fund their growth through equities. They basically fund themselves through bank credit.

So the view in the US is China is about to implode.

Meanwhile, if you go to Beijing, the view is that the US is more politically divided than it's ever been and that, as such, the US is really incapable of taking any kind of economic pain. That if and when the next recession comes, the political bickering that will unfold in the US will basically tear society apart. I'm not saying that this is true. I'm saying that this is, I think, the prevalent view in China.

Now, the first point I'd make is this is the worst possible setup for any kind of negotiations. If you and I need to strike a deal on whatever, and if we're both convinced that each one of us has all the cards and that the other guy has none of the cards, then we're very unlikely to compromise on anything.

So the view in China today, I think, is we don't need to compromise on the US because we can wear economic pain. If and when the next global recession comes, we'll wear it. As the Chinese say, we'll chīkǔ, which means "eat bitterness." Because we're used to that.

Meanwhile, the view in the US is, if and when the next recession comes, China is going to completely implode.

Of these two things, and perhaps because I spend more time there, I'm more inclined to the

Chinese view. I'm more inclined to the view that China can wear pain and the US can't. And I'm not inclined to the view that China is about to implode.

So, to the points you were making, I do think that the likelihood that China is going to continue being very aggressive with this de-dollarization push is going to continue for months, quarters, and years to come, if only for the simple reason that for China de-dollarizing Asian trade, de-dollarizing the commodity trade, has now become a national security imperative.

Today, what is the US doing? They're basically telling China we don't want to run a trade deficit with you anymore. And that's fine. But that basically means we don't want to give you dollars anymore.

Now, if you're China, you think, well, hold on, I need dollars to buy my oil. I need dollars to buy soybeans. I need dollars to buy copper. And if you don't want to give them to me anymore, how am I going to buy those things? Well, the only possible answer, of course, is I've got to change the way those things are priced.

Hence the launch of the RMB oil futures in Shanghai last March. Now this RMB oil futures, which came out of nowhere, launched in March of this year, already accounts for 14% – that's one four – 14% of the oil futures traded volumes from nowhere six months ago. It's a very impressive launch. To capture 14% of one of the biggest commodity markets in the world in the space of six months tells you, I think, how deeply, deeply serious China is about all this.

Erik: Let's stay on the subject of China. You recently wrote a piece – we have a link in the Research Roundup email for our listeners – this is normally a research piece only available to your clients, but you were kind enough to share it with our listeners. It's titled "The Dissolution of Chimerica."

Give us an overview of what our listeners can expect from that piece. And how does it fit into this conversation?

Louis: For most of my career and, in fact, for most of my life – I was born in the early 1970s – I think the policy of the Western world has been really to embrace Chinas since, basically, Nixon flew over to Beijing to meet with Mao. The policy has been to embrace China and, in essence, bring it from the cold.

The view was that the more trade we do with China, the more we integrate our supply chains, then China will evolve and, just like South Korea, move from being a dictatorship to a democracy. Just like Taiwan moved from being a dictatorship to a democracy, China will evolve in the same way and at some point it will become a member of the club.

I think this was very much the Western policy probably until this year's 19th People's Congress. Because at this year's 19th People's Congress Xi Jinping came out with two very forceful policies.

The first was the One Belt, One Road, which is very much an imperialist view of China's role in the world. One Belt, One Road is we're basically going to tie up all of the Asian economies all the way to Africa, all the way to Western Europe and Central Asia. We're going to tie all these economies into our own.

Fundamentally, the history of every empire boils down to a road-building exercise. Empires want to build roads to bring in commodities cheaper to the heart of the empire and push out finished goods to the outer realms. That's why in Europe we say "all roads lead to Rome."

Well, for Xi Jinping in the 21st century, all roads lead to Beijing. So the first thing that happened in the 19th People's Congress was Xi Jinping came out and said we're going to basically tie in all these economies into our own.

And the second thing he said, having done that, we're going to move up the value chain in terms of the goods that we sell. So by 2025 – and this was a made-in-China 2025 policy – by 2025 we're going to be a world leader in CMI conductors, we're going to be a world leader in artificial intelligence and in fintech and in satellites and in building airplanes etc.

Five years ago, if China had come out and said, by 2025 we're going to be leaders in artificial intelligence and fintech, people would have laughed. But now, of course, nobody is laughing because they might already be there.

And I think it was these two policies that all of a sudden triggered a shift of thinking in Washington about China in general. What you've had in Washington now, I think, is a sort of union of different people who look at China no longer as a big opportunity or as a big market, but potentially as a threat.

Not least of which, of course, are America's big corporates themselves. For decades, the biggest pro-China lobbyists in Washington were all the big corporates. As soon as somebody started to bash China, you could count on Boeing or John Deere or Caterpillar or Walmart to pick up the phone and say, hey, maybe you tone down a little. You know, we do make a lot of money there.

But, of course, if China comes out and says, hey, by 2025 we're going to be producing our own jet planes, if you're Boeing you think, hold on, you're supposed to be my customer. You're not supposed to be my competitor. So all of a sudden I think there was a paradigm shift, a big shift in the way people perceive China.

Combine that with all the national defense types, the John Boltons, the CIA, the Department of Defense, etc., who are not so keen on China's imperialist ambitions, all of a sudden the view has become instead of integrating our supply chains with China we need to disintegrate our supply chains.

So that's why I think that, behind all of this rhetoric of the trade war, the real threat is really a

new economic cold war, where after 20, 30 years of integration we now look to, basically, break apart all the supply chains that were established for so many years.

Erik: Now, Louis, I'm just a small businessman, maybe I don't understand high finance. But in my line of work we usually look for an alternative before we burn any bridges to suppliers.

Who are we going to buy all the cheap stuff from if we disintegrate our supply lines with China? This is a serious question. What is the United States going to do as an alternative for all of the cheap goods and services that it sources from China? Which is a lot.

Louis: Well, this goes back to what I was saying earlier about how, on the one hand, there is US foreign policy and, on the other, there is the economic reality underlying in the United States.

Today, I think the US foreign policy is fundamentally inflationary. You start tearing apart all of these supply chains – to your point – it's going to be very hard to reproduce elsewhere. You can't really reproduce them in the US. In the US you already have a very tight labor market.

You will be able to do some in Mexico, perhaps some in Canada as well, which is why signing this NAFTA thing was especially important. And, by the way, to me, I look at the fact that NAFTA has now been signed as a way for the US to now be tougher on China instead of kinder to China.

So some of it can move to Canada, some of it can move to Mexico, some of it can move to the US. But, beyond that, I think we have to accept that the foreign policy, this economic cold war with China, would be inflationary. If it does unfold it will be inflationary.

And if it is inflationary, that should lead to higher yields. Higher yields at a time when government debt is already going through the roof.

Here just a little factoid for you: In August of this year, for the first time ever US tax receipts were not enough to pay for interest payments plus all your social entitlements. So forget infrastructure, forget military spending, forget the government payroll, forget all these things. The US is now at a point where tax receipts cover interest payments plus entitlement spending and that's it.

If you follow a policy that is fundamentally inflationary at the back end, then you can probably assume that your interest payments are going to go up. So I think that's where, for me, there is a sort of dislocation between the foreign policy and the underlying economic reality in the US.

Erik: Louis, I want to come back to gold. You mentioned something that we've certainly observed for many weeks on this program, that there has been an uncanny correlation – as you put it, a flatlining – where gold is trading in sympathy with the Chinese RMB. You talked a little bit about why that might be happening.

But let's talk about the outlook for gold itself. Because we've had some radically different views. On one hand, dollar bullish, you ought to be gold bearish. On the other hand, a lot of people are thinking with this de-dollarization stuff, maybe that's a catalyst that really says that flight capital is going to start to move into gold and not into US Treasuries.

What is your outlook for gold and precious metals generally?

Louis: Well, let me preface this by saying that I came into this year with the view that if ever there was an accident on the markets, then the Fed would ease up policy and thus the best hedge on any potential market meltdown was probably to own some gold and some gold miners.

Now, as you well know, gold miners got absolutely smoked this summer in spite of the fact that we did have a financial accident. But the financial accident was in emerging markets. It wasn't on the US.

I think, for now, gold is still trading on the view that, as the Fed tightens, what's really the point of owning gold? You can say the point of owning gold is when the market changes its mind about the Fed tightening, then the US dollar will collapse, gold will shoot up, and gold remains a decent hedge against a financial accident. But really only a financial accident in the US, because, as the Fed has shown, if the financial accident happens elsewhere then the Fed doesn't care.

So I think that the first thing is you can own gold as a hedge against a financial market accident in the US, a market accident that would be big enough to lead to a shift in thinking at the Fed.

The second reason you own gold today is if, like me, you believe that China is on the path to de-dollarize and if you think there are some odds that China will be successful in this course. If you think, okay, well, I think it's pretty obvious that China wants to de-dollarize Asian trade, that it wants to de-dollarize commodity trade.

For me there's at least a 50% chance that they are successful. And the fact that US fiscal policy today is so loose only helps China in that quest over time.

So these are the two good reasons to own gold. Right now, of course, as US equity markets make new highs, neither of these reasons seems to be making a case for gold immediately today. But, again, these things can change quickly. So I own some gold, even if it has been extremely disappointing, no doubt, this year to date.

Erik: Louis, I can't thank you enough for a fantastic interview. Before we go, I want to talk a little bit about what you do at GaveKal Research. More than half of our listener audience is institutional. I know you are an institutional research firm.

We've got a sample of one of your daily research notes, which was the Chimerica piece. You'll find the link, folks, in your Research Roundup email. Beyond that sample, tell us a little bit more

about what you do and what services you offer at GaveKal.

Louis: We provide independent research for institutional investors. We have a global macro product. We have a China macro product. We have a China corporate due diligence product for people who do a lot of deals in China.

The best way to find out about what we do is probably to go to our website which is gavekal.com, and there should be plenty of info there. And if there is not enough, you can contact us through the website.

Erik: Well, Louis, thanks so much for a fantastic interview. Patrick Ceresna and I will be back as MacroVoices continues, right here at macrovoices.com.