Mark Cudmore: Bearish global growth and equity markets, excepting an imminent decline in stock prices

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Erik: Joining me now is Mark Cudmore, the Global Managing Editor for Bloomberg's Markets Live blog.

Mark, it's great to have you back on. I'm going to have to apologize to you because the last time we had you on we recorded your interview on an FOMC week, before the FOMC meeting, so we didn't have the benefit of knowing the outcome. We learned a lesson and we promised ourselves we would never do that again. And it's you that we did it to again. So I apologize. And I'll ask our listeners to understand that Mark and don't know, because we taped this ahead of time, what the outcome will be from the FOMC.

But let's go ahead and dive in and start with the global growth outlook for the global economy. My view is that we're seeing awfully strong slowing signs. But a lot of people have different views.

What's the big picture? How do you see this economy?

Mark: I'm completely with you. And I think actually what's important to emphasize is that I'm not really sure that it matters too much that we're recording this before the Fed this week.

I think that I do share your slightly more worried picture around the global growth outlook. I think that this is already set to be – well we know it's already set to be the slowest growth in three years. But I think that the growth outlook will actually turn much worse towards the second half of the year. And I don't think that the Fed – no matter what they do – is going to change the story that much.

Ultimately, we know from history that the Fed has a very poor ability to change the economic cycle. They can change the timing, alter it, but they can't stop recession when it comes.

And I think it's important to emphasize that the last two recessions that we saw in this century we did see rate cuts come before the recession but they didn't stop the recession coming.

So in September 2007 they cut by 25 basis points. Recession still started in December of that year. And in January of 2001, the Fed cut by 50 basis points. The recession still came starting in March that year.

And I think in both of those cycles the Fed had more than 500 basis points to cut. In fact, they did cut at least 500 basis points in both economic cycles, both easing cycles. And yet it didn't stop the recession.

Honestly, the Fed doesn't have that kind of ammo this time. And the transmission mechanism is even more impaired after years of QE. So the Fed was already poor at turning the economic cycle around, even before QE, even when it had lots of ammo. Now it has neither the ammo – and the transmission mechanism is broken.

So I think that the global growth outlook is looking quite worrying. We last spoke in April 2018, so 17 months ago. It's actually interesting to note that J.P. Morgan's global manufacturing index has declined in every single month since then, which is quite a good track record.

And preliminary PMIs from July, almost guaranteed, will be in contraction for the third consecutive month when those numbers are released, I think the day this podcast will be published.

So the collapse in global trade is really impairing things and I think that's very important at the moment. The summary of the situation, there are so many different metrics to look at with collapse in global trade. I don't think anyone disputes it. You can do clever things like look at FedEx earnings or any number of indicators.

I like looking at two of the world's best broad indicators, and that's Germany, which accounts for roughly 12% of global trade, and Singapore the trade hub for Asia.

So Germany, 2019 GDP forecast has collapsed from 1.9% this day a year ago to 0.7% now, so it's quite an extraordinary downgrade. And all of the risks remain to the downside.

The most recent business expectation index has dropped to the worst level in a decade. And at least a decade ago it was on the way back up. Now it's actually on the way back down. It was on the way back up in the crisis back then.

And we're going back into another crisis I think, but a more minor crisis.

The most recent manufacturing PMI, at 43.1, in Germany suggests a recession is likely coming there, or it's certainly a high risk. And the manufacturing PMI has actually been in contraction territory all year.

Germany is not only the most important economy in Europe, but it's also so dependent on trade. So it's a great, broad measure. And it looks like it's heading for recession. So I struggle to overlook that signal.

And especially when that's combined with what's happening in Singapore, where I live. Electronic exports most recent reading have seen a more than 30% annualized decline. And that's for two consecutive months. We've not actually seen that kind of drawdown since the crisis. Again, that's quite incredible.

And you know Singapore is such an open economy, it really captures what's going on in Asia. So I think that both the trade hub in Asia and the trade hub in Europe are kind of showing this collapse.

Now, there's not the same kind of trade hub which matches up quite so well in North America, because the US is a little bit more closed economy. But Mexico is the closest. And as we know, the Mexican economy is in absolute dire straits as well. So I think we're getting a very consistent message there.

You know, just to emphasize this – the high-frequency data is showing that this kind of slowdown that we've seen is ongoing. So the advance estimate, for example, for 2Q GDP in Singapore came in at minus 3.4% versus plus 0.5% expected. That's the worst quarterly reading since 2012.

But all the high-frequency data like retail sales, industrial output, and PMIs suggest that contraction is ongoing.

So there are clear problems for all the big trade indicators. I'm very worried about global growth. That's primarily based on a manufacturing and trade situation. And so the outlook is definitely more negative than it's been for many, many years – for me.

Erik: Mark, I think the story on global growth – I mean it's undeniable, it blows my mind that anybody could disagree. But in the case of US growth, I'm also thinking the US is not immune. Some people seem to think the US is not going to be subject to all the same forces that everybody else is feeling.

What's your take on US growth?

Mark: Obviously there are these scary signs that are the world's best trade indicators. And then you combine that with the message that we're getting from manufacturing. And I think that the optimism around the US is actually particularly misplaced.

It's not that suddenly the US is going to have the worst growth in the world. It's that it's there that people are most in denial about what's happening. And I think not looking, possibly, ahead of how some of these indicators are going to play out. And they are taking a very optimistic kind of outlook.

I like applying Occam's Razor which is make the lowest number of assumptions as possible. And I think many people's optimism is based on a number of things which don't look like – one is, of course, the US-China trade war being resolved. And I think that is particularly misplaced.

So, as I mentioned, the trade, the manufacturing is a problem for the US. But particularly the decline in the CapEx in the US will accelerate by the end of the third quarter, just as the lag impact of May's time hits.

So you saw last year that the tariffs came in in the summer. But we really saw the economic impact towards the fourth quarter. And I think this year we've again seen the tariffs about a month or so earlier. And we'll probably see them – towards the end of the third quarter is when we'll start seeing the economic impact.

Because there's a little bit of front loading and there's just delay in adjusting business supply chains, etc. Also, the guidance from US corporates in the past two weeks has made it clear that the third quarter is likely to see earnings shrink for the first time probably since December 2015, which we seem to be ignoring because 2Q earnings are holding up okay, even though most of them came before the tariffs were in place.

So the companies are going to get hit directly on the profit side just as the economy is getting hit. And that's going to be a double whammy on CapEx to kind of help accelerate the end of the cycle.

And I do think – this is very much contingent, I will say – my bearish outlook I don't think matters too much on the Fed meeting this week – and the guidance, as I mentioned – but it does matter a lot on the US-China trade war. I don't see a resolution coming any time soon in that.

And I think, unless I'm very wrong on that, if we do get a resolution which removes all tariffs – and I think it's important to emphasize the resolution needs to remove tariffs, not just call a peace. If we don't get something that removes tariffs, then I think the situation will be much worse.

And I think it's important to emphasize that the view on the trade war – well, I was in New York a few weeks ago talking to a lot of investors – and the view on the trade war in Asia is very divergent. In the US, it's very much seen that it's entirely Trump's decision and that Trump will want a deal with China before the election in 2020 to boost the economy. And therefore, because that will suit him, ultimately there will be a deal.

I think the view in Asia is that since May that's massively changed. Up until May, that was true. China wanted a deal as well. They were really downplaying the trade war domestically and they were kind of happy to make some kind of peace with Trump, especially since they are going through their domestic deleveraging campaign.

But what's actually happened since May is that the narrative onshore is completely changed. So rather than ignoring the trade war, downplaying it, they've actually hyped it up quite a bit in the domestic press. And they now no longer can be seen to not get a win out of this.

I mean, there's been reference back to the opium war treaties of the mid-19th century. So going back 150 years, which kind of shows the time scale they're thinking of. They're not thinking in election cycles. They don't need to think of election cycles.

Xi Jinping seems to have been given the message quite clearly from the Standing Committee, the Politburo, you must get a win out of this in some way.

So obviously there are many ways that both sides can sell whatever agreement as a win. And I realize that's a situation that can be fudged. But it's not that neither side can be seen to concede completely.

Certainly Trump has bipartisan support for a hard line on China and the US, even if maybe not his exact tactics. And he's made it such a big part of his campaign that he's taking a hard line there. It's not something that he's going to concede, probably, completely on.

And I think, likewise, China, while they might be able to convey the message in a certain way domestically, again, they cannot concede completely. So I think a deal is going to be very hard on US-China. And Trump even said this recently, that China may want to wait until after the election.

I do think that there's been some slightly better data in the US recently. But I do think that the focus is on the wrong things.

People keep on pointing to unemployment as proof that the US economy is doing wonderfully and the Fed shouldn't be cutting rates. I find this completely bizarre, because one of the things you learn very early on in economics is that unemployment is a lagging indicator. And I think it's worth pointing to what happened in the last three recessions as an example.

In 2007 unemployment had only risen from the 4.4% cycle low to 5% before the recession started. Unemployment, obviously, peaked at 10% in that cycle. So most of the pain came after the recession.

Again, in 2001 unemployment had only risen from 3.8% to 4.2% before the recession started. It peaked at 6.3%.

In 1990, unemployment had risen from 5% to 5.5% pre-recession. It peaked at 7.8%.

So, generally, there's been about a 0.5% climb in unemployment from cycle low before the recession officially starts. Of course, we don't get confirmation that the recession has started until many months later.

So that will tally with the recession starting around when unemployment hits 4.1% in this cycle. That's easily possible by the end of this year or early next, which is when I think that we may get close enough to a recession starting in the US – probably maybe [the] December-January period. Obviously these things are very hard to predict very exactly, but that's my rough base case.

And I should emphasize that there's a chance we might avoid a technical recession of two quarters of negative growth. But I do think it will be close enough to recession in terms of a severe impact on markets, which is what I care about most.

Erik: Well, let's move on to what you care about most then and talk about markets. Why don't we start specifically with US equities?

Mark: I think this is probably where I've got the most interesting view. I think when I've been on with you before I've been on in a good period for markets and a bad period, and both times I really emphasized that I've been a deep structural bull for many, many years. I can't actually remember the last time I was a structural bear in US equities, but it was at least 2011.

I did stay too bearish after the last cycle. I can't remember when I finally learned my lesson of what QE was doing to the system. But now, for the first time since at least 2011, I'm a structural bear on US equities.

I think the timing of that decline is hard, but I guess I'd phrase it that up until now, for the last many years I've had periods of being tactically bullish/tactically bearish. But I've always been in the mindset of ultimately you're buying the dip. It's just a change of how low you buy the dip.

And I think it's now the mindset of – I think that ultimately you're kind of selling the rally. But exactly where you sell the rally I don't know. And that's what I'm trying to work out.

I do think that the selloff starts imminently. But I would have said that to you a month ago and obviously been wrong, sort of at record highs. But I think it starts by September [at the] latest. Maybe October at the very latest.

But I really I'd be surprised if it hasn't started by September. Because by then we've had the bad data from August, which is when the tariff impact will really start to hit properly. And it would also, in my theory, be likely clear by then that the US and China aren't removing tariffs soon.

And then what happens is we'll see economic forecasts get slashed. And then we'll see earnings forecasts get slashed. We've seen the earnings guidance come a lot lower over this earnings season already. But I think we'll see Wall Street really react to the fact that the economic forecasts are getting slashed everywhere.

The S&P 500 is trading at 17.2 times blended forward earnings, 12-month forward earnings. That's versus the 10-year average of 15. Now, that's very expensive. There is a massive premium.

Now, we all know that these things can stay expensive for a long period of time. But it just means that it's vulnerable if the narrative changes. Corporates are healthy; they've got a good profit margin. And that makes it particularly hard to call a top.

But I just will emphasize that the narrative can turn very quickly. If just one part of that jigsaw changes, people will go, whoa, suddenly that price looks weird.

And I think that if you look at that forward "P" of 17.2, if the denominator gets cut there, earnings get cut, which we're seeing, we're starting to see. And we'll see that happen more from Wall Street in the next couple of months. Then, even without a price change, they start looking more and more expensive.

So, ultimately, we're probably going to need price to come down a lot to make that "P" look normal. And then it will probably overshoot as it always does in these situations.

Importantly, that impressive margin story is starting to be unwound at the margins (excuse the pun). We're seeing estimates revised down for the third quarter, fourth quarter, and first quarter of 2020.

But, bizarrely, we still expect an impressive rebound in 2020. Why is that? Well, the index estimates for 2020 are based on steady revenue gains and strong improvement in cyclical sectors such as technology and industrials.

I find that very bizarre, given what we're seeing on the trade front and the economy front. It could be true, but it does look like, at the moment, that those index estimates for 2020 of double digits gains in earnings again are just wildly optimistic. And I just don't see what narrative to base it on.

Actually, I can probably tell you what narrative they're based on. They're based on that US and China will definitely have a grand deal which kind of accelerates trade by early next year. That is the narrative they're based on. And the Fed's expected easing, however much they do in the next few months, will successfully re-stimulate the economy like the late '90s insurance cycles in '96-'98.

I think it's bizarre that everyone seems to have convinced themselves that the Fed cut this time will be just like the insurance cut in '96-'98. It's clearly possible. I find it bizarre that's the base case, given that the two most recent easing cycles of the Fed didn't stop deep recessions and didn't stop – both coordinating with the recession in the early 2000s and the one in 2007-2008 – both times the S&P lost more than 50%.

I'm not sure we're going to get quite that big a dip this time, but it's something to be aware of.

Erik: Well, Mark, I couldn't possibly agree with you more that US equities are overvalued here, overpriced at these levels. But I have thought that for more than a year. And that hasn't caused the market to give up.

So I'd like to play devil's advocate and run a couple of thoughts by you.

One of the reasons is I struggle to figure out how the heck we got back to all-time highs. Okay, if you look at just the mechanics of what's been driving this market, it seems that corporate buybacks have played a huge role. And, hey, if we're going to see Treasury yields continue to move lower – meaning cheaper, easier money for buying back your stock – that potentially propels the market higher.

There is also the view that a couple of our guests – Brent Johnson in particular has expressed – which is things are going to get so bad for Europe and other parts of the world and they're already at negative-yielding Treasuries, so their safety trade can't really be into Treasuries as is the usual deal.

They've got to look for something else. And maybe US equities end up benefiting from an international safety trade and that propels the market higher.

Now, I don't mean to suggest that I think the market should go higher, but since it hasn't been what I think it should be doing for a quite a while now, what do you think about those scenarios as potentially frustrating our mutual view that the market ought to be moving lower?

Mark: Great question. I love these kinds of questions because, obviously, all the time what I want to do is find out what I'm missing. So I think I'll just say the context – I'm not trying to be annoying to you – in that I was staunchly a structural bull until May this year.

And I think, for me, I always believed that we'd keep on going back to record highs and I was very dismissive of previous concerns. And I think it's important to emphasize that backdrop just because I'm going to explain what's changed.

For me, what kind of drove the rally before then were three pillars I used to refer to. And that was growth, earnings, and liquidity – economic growth, good earnings, and liquidity in the system.

Now you've talked about the corporate buybacks as being a really important part of the story. And I think that comes into the liquidity thing. I'm probably going to come to that last because that's probably most nuanced.

So I think, first of all, one of the pillars is that global growth has been kind of subdued but absolutely fine for years.

And, as I explained in the first part, I do think that global growth picture is going to get severely downgraded, largely because of this trade war and just because we're at the end of the economic cycle and then that CapEx deceleration.

So I think that growth is one pillar that's about to be taken out by the end of this year.

The second pillar is earnings.

Now we've come off an incredible earnings period. Both internally in [that] companies were making a lot of structural changes and then just technology helped. But then, of course, we had the stimulus that came to the US, the tax cuts. So we've had a massive boost in earnings.

And, again, the earnings picture is changing very drastically. It turned out we didn't quite get negative earnings in the first quarter and I think the second quarter we're going to be again slightly positive. But they're still massively down in the last couple of years. So already the earnings outlook is less positive, but it's not been taken out yet.

Now the estimates show that the third quarter is likely to be, as I said, the first negative earnings quarter for the S&P 500 since December 2015. So, suddenly, that's the second pillar taken out.

So two of the pillars have been taken out.

Now the third one is liquidity.

There is clearly abundant liquidity in the system. And central banks are still overall pumping a lot of cash into the system. One of the favorite things I like pointing out – it doesn't matter too much about quantitative tightening – we discussed this, actually, a year and a half ago – the Fed is only the fourth most relevant central bank in the world when it comes to providing liquidity.

The ECB, the PBOC, and the BoJ all have balance sheets around $5.3 trillion roughly, whereas the Fed balance sheet is now around $3.8 trillion. So they are nearly 30% bigger than the Fed. Each of them is nearly 30% bigger than the Fed.

So I think that overall we've got a lot of liquidity in the system.

But it's interesting. If you take their combined balance sheets, the peak in central bank balance sheets was actually in March 2018. I think that's quite interesting to note. So we had a whole decade, going up to March 2018, where central bank balance sheets just kept on growing and they kept on pumping more liquidity into the system.

That was something that suddenly changed. The firehose liquidity has been turned off. It's not coming massively lower, but it is a bit lower.

Importantly, PBOC, probably the most relevant one, did peak out in March 2018. But the PBOC, ECB, and Fed all have smaller balance sheets today than they did then in dollar terms. The BoJ is the only one that's increased.

So liquidity has suddenly stopped being pumped into the system. And we know it's very important in markets. It's the second derivative, it's the rate of change. It's not necessarily the nominal level that matters so much.

But I also think that the liquidity situation, around corporate buybacks in particular, can change very rapidly. So one of the structural things that's happened in the markets since the crisis is that liquidity in the credit market is incredibly impaired. And this is not a novel idea. Many people have warned about this. Many of the biggest credit buyers have warned this. May of the biggest issuers have warned this.

Bank of America, I believe they are some of the biggest issuers of leveraged finance, and they've warned about the liquidity in the system. PIMCO, for example, have warned about it. So many of these big names have warned that there is a liquidity problem now. And that's because banks can no longer be the middle man to step in and provide a break in the system when things go wrong.

The reason I explain all this is credit is obviously pricing very tightly at the moment, this hunt for yield etc. But that situation can change much more rapidly than it could 10 or 12 years ago.

The last crisis was a credit crisis. I was working at Lehman Brothers at the time, so I saw it from a front-row seat. And yet the liquidity couldn't disappear as quickly as it can now.

So I think that we – as I said, there are three pillars that were driving the rally and that's why I've been a structural bull for many years.

And, suddenly, I think in the fourth quarter of this year we're going to have the growth pillar taken out. We're going to have the earnings pillar taken out in the third quarter. And I think that the third pillar of liquidity is no longer as dominant and strong as it once was and it can actually quickly turn negative in practical purposes for companies if we get a bit more of a negative view.

So if the credit cycle starts turning, it can turn much more negative very quickly. And I think that's where you get your little bit of a mini-financial crisis. And I should emphasize I'm not calling for a repeat of the Great Financial Crisis or the Global Financial Crisis of 2008 but just a bit more risk-averse environment.

So I think that's the point to emphasize.

And I think the final point you made is a good one. Hey, if the whole world is in a bad place, where do you put money? Do you keep on putting it into Europe 10 negative yields?

I think that, as I said, if the credit cycle turns, there is a lot of leverage in the system. So suddenly that – actually a lot of it just happens in deleveraging. Suddenly people start cutting down. There's less need for this money to find a home if we do get that kind of credit blowup which causes deleveraging.

So I think that's the first point to emphasize: that you can just get this wealth destruction like we see in every recession, like we see in every crisis. This is, again, not a particularly novel idea. But, because we haven't seen one in more than 10 years, people can't always think about it or remember it. So we just get that generally de-wealthing effect.

But I also say that one of (I guess) my central theories is that the US has outperformed for the last four or five years for many valid reasons. And I think that era of outperformance in the US is coming to an end – or is at an end, essentially.

And, obviously, the US is still the world's largest economy. So if it goes through a bad period, everywhere is going to suffer. But I think that it's unlikely to pick up as quickly afterwards.

And I think that there are many markets in the world, probably more in emerging markets, that will suffer that initial pain when the US catches a cold. But they won't suffer such prolonged pain, and where there's much better opportunities.

And you talked about where can you put money. There's not always liquidity, but many emerging markets do offer much higher real yields, are structurally much safer. They're much less deleveraged. Many of them do not have the external vulnerabilities they did have a few years ago. The currencies are super-cheap. I mean these are just incredible fundamental stories longer term.

Of course, emerging markets are different.

If the US equity market suddenly is going to sell off 20% plus in the next year, then obviously emerging markets are going to have periods of pain. But it won't be lasting pain. There will be opportunities there. And I think that's what you'll see. You'll see money coming out of the US equities and looking for opportunities elsewhere in the world.

Erik: I want to just push back a little bit on your final pillar of liquidity. We had a view from Danielle DiMartino Booth, a former Fed insider, earlier this week on MacroVoices.

And she said, look, the thing to watch for at this FOMC is what everybody does is they shift gears from everybody's anticipating the meeting to focusing on what's going to come next. She said the question you have to ask is this: This is going to be the Fed's – assuming that you and I both have the same assumption, which is by the time our listeners hear this interview there will have been a 25 basis point cut – that will be the first Fed rate cut in more than a decade.

Is that the opening shot in what becomes essentially a currency war that's going to cause all the other central banks to pile in and say, no, no, no, no, no – we're going to ease just as much? We're not going to let you get ahead of us. And you potentially get into a competitive devaluation situation.

Are we headed in that direction? Or could we be?

Mark: In theory, yes. In practice, I think those rate cuts are already priced almost everywhere. And most of the rest of the world, they can't go much lower. So, you know, we've gone from a situation in November last year where almost every central bank in the world was pricing hikes ahead. A lot of hikes.

And now we're suddenly in a world where, in fact, every central bank is pricing cuts. And some of them are ahead of the curve.

Look, we've already got – Bank RBA has already cut rates a couple of times and it's already pricing in rates getting to half a percent. And ECB is pricing even more deeply negative rates. Same for SNB. Bank of Japan is somehow pricing in the idea of more easing.

It seems frankly unbelievable that these countries that are already deeply negative are pricing in more easing. So they can't do much more. And, importantly, they can't do loads more than is priced.

And I think this is one of the most important things that the Fed – again, having been so positive earlier on this year, in January when the Fed turned dovish, and people were like, oh my god, what does that say about the economy? And I was like, hey, wait a sec, they surprised dovishly.

This is only a good thing for equities. This should see equities roar in the next few months. The difference is now it's hard for them to have that dovish surprise impact. We're already pricing in the Fed, making two and a half rate cuts by year end.

Yes, they still have a little bit of extra ammo to deliver more, like we need to price in the fact that they're going to cut probably 200 basis points in this cycle – ultimately 225 basis points in this cycle.

So there is more to price in. But it's not easy. It's suddenly changed.

Look, it's only a few months ago that we were pricing in rate hikes. And then it was very easy to surprise. Now the shift in the 2-year yields has just been, frankly, incredible.

And so I think that, in theory, it's right. The Fed will cut 25 basis points. And then other central banks will soon follow. Some of them have actually got ahead, it's not even following.

This is a general theme. I don't necessarily like the idea of currency wars. These are people enacting monetary policy. And, yes, currency is one side effect. I'm not sure they're directly targeting the currency. But there is only so much they can do. And most of what they can do is priced.

So, yeah, there is a little bit of positive support to come in on that front over the next year or so. But I think if we get to a world where we're pricing in the Fed cutting the full 225 basis points to get back to 25 basis points upper-bound, then in that world we're already in a super-negative world. You only get into that world when equities have already sold off 25%.

So I don't think that negates the view, no.

Erik: Let's move on to Treasuries. A lot of smart people thought once you go past 3.10 it's all over, secular bear market in Treasuries. And of course we've seen the opposite.

What has been the primary driver – in your mind – of this reversal? And does it have farther to go?

Mark: I don't have super-strong short-term views at these levels. I think it's very hard at these levels. I think it's one where –

You know, last time, every time I'm on this podcast, I'm not shy on my views. I'm going to get some things right and some things wrong.

The Treasury is one that I got right last time in terms that I said to you – it was in April of last year and I said that I did not believe in the bond bear market at all. I did not believe in that risk at all.

And I think it was a big theme at the time because yields were just touching towards 3% for the first time in years and everyone was going, this is it. And many people called for the start of the big bond bear market. And my theory at the time was that, just because we're ending the 30-year bond bull market, doesn't mean we need to go into the next long-term bond bear market.

And the reason I'm repeating this is because the views haven't changed. At the time, I said, look, I thought the top end of the range for 10-year Treasuries was probably about 3.2%. I think in November or six months later or seven months later after our podcast, it eventually reached 3.24%. But that was around the top.

My whole argument at the time was we have structural disinflation, which I just think is completely underestimated. Both from technology – not just through the Amazon effect but also just because the extraction, production, and distribution of commodities is continuously getting much cheaper. And that's also the main input for prices.

And also the demographic effect.

So we've had massive, massive asset price inflation. But that does not feed through to the rest of the consumer price inflation basket.

So I think that people are understanding those structural disinflationary impacts on consumer price inflation and therefore I did not see inflation being a threat. And therefore I did not believe that we're going to see Treasury yields go too high. Especially because last year when we spoke I didn't know that March 2018 was going to be the peak of central bank balance sheets.

So I was very much in the camp last April that there is just endless liquidity in the system and it's still being added. And I was, just as long as there is all that liquidity in the system, they are going to continue to buy yields when they get too high.

So that kind of worked out.

I mention that because, at this point now, I'm struggling to have these kind of views. I do actually believe that 10-year yields ultimately are going to have lower to go.

The other view I had last year was that we'd see further flattening in the curve. And we've now had that, certainly – flattening. We're now close to inversion in the 2-year, 10-year bid.

Many other parts of the curve have inverted. I think we will probably see a little bit further flattening at some point. And I do think that 10-year yields ultimately have lower to go.

The problem is, as you know, close to 2% at the moment, where is the next 25 basis points? I really have no clue.

My bias as a trader is to go, whoa, this has come a long way very fast in one direction. Maybe a little bit of a bounce. But, again, I would have said that a little while ago, and we really haven't seen much of it yet. So I don't have any conviction about where the next 25 30 basis points is.

But I do think that 10-year yields around here completely makes sense. That's not illogical at all. This has always been my long-term view.

And I think they'll probably continue to come lower. I think you do not see yields in the US selloff – something I've written many times last year is that I never see 10-year yields in the US getting above 4% ever again, until you have a US dollar currency crisis. Which might happen at some point in the future, but I don't see it as close.

So, to me, I just don't believe the argument into a bond bear market. I think we're in a massively wide range and that's the status quo for many years. Because I currently – for the first time in many years I have a much more bearish view on the global economy and US equities – I do think that those 10-year yields will test much lower again next year at some point. But the exact path is hard.

Erik: You mentioned the dollar. Let's get your views on the US dollar.

Mark: I remain a secular dollar bear. So in 2018 I was looking for a powerful dollar bounce in the second half of the year, which we got. And I said at the time it wouldn't be a move to fresh highs. But, again, I turned bearish.

So, basically, we've had that big powerful bounce at the end of last year. And I'm now expecting the next 10% move in the dollar will be for weakness.

Again, the timing is super-hard and in the very short term, especially given that I don't think the Fed that is going to come out just before this podcast is going to be overly dovish. I think even short term there might be a very little bit of upward pressure first.

But, as I mentioned earlier, since the era of US outperformance is at an end, I think that Trump's attitudes towards trade and his isolationist approach are forcing other countries to try bypassing the US as much as possible, and companies.

This is not easy because it's the world's largest economy. And it's something that people are very reluctant to do. But, because he's kept up this isolationist approach for a couple of years, more and more companies are just going to try having their supply chains just bypass the US.

So it's going to become increasingly less relevant. It will remain dominant, but its dominance will decline. I think Trump's currency intervention threat will help cap the topsides.

I know it's not expected to come in any time soon. But if you suddenly see euro-dollar is at 1.05 or you see dollar-yuan up through 7.10, suddenly that might be escalated. So I think that helps cap the topside of the dollar.

As I mentioned, the US actually has much more room to cut rates. So the rate of change in the US will be more drastic than elsewhere in the year ahead. As I said, most of the countries are already deeply negative, so there's not much lower they can go. Whereas the US can go much lower. And I think that will change.

And that's relevant because the reason I called for a large 2018 bounce was that the massive rise in US real yields haven't been priced. And the US was outperforming in growth.

And while the US still might do better than many on growth this year, it's where the optimism (as I mentioned at the start) is still mostly misplaced. So I think that real yields benefit will get slashed in the year ahead and the growth outlook will change a chunk.

And I think I should just mention again the secular argument of the US share of global GDP and trade is declining. And, as with its share of global reserves (which are still over 61% but slowly declining over time), these are both really long, slow, long-term themes.

We are seeing them happen. And it's very hard to trade these super-long term themes. It's important to have in mind that you can't trade them on a month-to-month basis.

I think last time I mentioned that one of the problems in the market in 2018 was that traders were really struggling to price in several of these long-term themes. And they were trying to price them in too quickly.

That's why there was this very – we believed that 2018 would see higher volatility than 2017. 2019 seems lower volatility again, but I think we're about to go back into that cycle where traders are going to realize, oh, wait a sec, some of these long-term themes, like the trade war, they're not going away. How do we price them in?

And they try to price them in too quickly. You can't do it. They're going to ebb and flow over years.

And I think another one is – actually I think we mentioned this before – is on tech stocks. The changing regulatory regime for tech stocks is one of those ones that suddenly came back into the news in the last week or so.

Again, I think that's absolutely happening, but it's happening over many years. And you shouldn't need to suddenly sell all tech stocks because there's going to be more regulatory scrutiny, there's going to be more tax cost, more compliance cost, more legal cost. But it's something you need to be aware of, that it's going to be slowly shifting over time.

Again, it's going to ebb and flow. The tech companies are going to get some victories. Some governments are going to get some victories. Maybe France, with their tax there. So I think that these are long-term themes that traders really struggle to battle with.

And I think – while that was the shift between 2017 and 2018, and I think again now we're about to go into that shift where people are going to realize some long-term themes are very, very important – but how do you work out how important they are right at this moment? And that's really hard.

Erik: Okay, so if the dollar is topping here, and we've also seen some pretty soft commodity prices, does that mean it's time to buy commodities?

Mark: I got commodities very wrong this year. I kind of gloated at having got Treasuries very right, so I got commodities very wrong. I think that was mainly due to the shift in the trade war. They were soggier than I expected, particularly on the metals side.

That does validate the negative growth outlook. But I don't have particularly any strong views. I do think that the Iran-Middle East tension is underpriced.

Not that I'm saying anything is going to go wrong. But I think that people are underestimating how much of a shock that will be if there is military action which disrupts the Strait of Hormuz. There is no ability for other suppliers to fill the gap there if the Strait of Hormuz is blocked. That will cause quite a big distortion in oil prices until that gets freed up. So that's a risk that I think might be underpriced.

I'm bullish gold. Silver even more so. Not short term. I have no particular view short term, again, for commodities.

But as QE comes back on the agenda globally over the next year, then the gold bugs will come out in force. And, ironically, when the gold bugs come out in force that's when silver outperforms.

We saw this in the last crisis when the gold-silver cross lost more than half its value between late 2008 and early 2011. So, unless deflation becomes the consensus fear, silver should keep outperforming gold over the next year.

It's complementary but tangential to my bearish views. Because if the world gets in a deep, deep crisis, this view won't actually work. But then the bearish equities view will then outperform even my expectations.

Erik: And let's talk about China, since we're talking about trade. What's your outlook there?

Mark: That's another one I think I got wrong. But, again, due to the trade war deterioration, it suffered more than I envisioned. I thought there was no more weakness last year, but I kind of argued that the long-term fundamental picture was kind of positive. It's also at the center of current problems.

And my view there is definitely shifting. I think that – again, when I was in New York and talked to a lot of investors, it's very easy to focus on the problems China has and maybe not focus on the problems in the US. And I think one of the things I will say is that they're more aware and priced in China than probably they are in the US at times.

But China is definitely at the center of current problems. And those Germany and Singapore weaknesses that I spoke about at the start really speak to the problems.

One thing I'll just say on China, while I think my view is turning more negative – last year, I strongly dismissed the corporate debt concerns and I think this has been a theme of the last few years.

I'm always: Stop worrying about the corporate debt bubble. Yes, it's a massive corporate debt bubble, but this does not mean it needs to blow up any time soon. The PBOC has many tools.

I found it really ironic that, for the first time in many years, no one is overly concerned about China's debt problem this year, just as there are signs of problems. And there are a lot of signs of liquidity problems.

You know, the Baoshang bank seizure really changed the game. It broke more links of trust. I think people have misunderstood the China credit problem. So there is not a lack of liquidity in the system. It's just that liquidity is not flowing to the people that really need it.

And, up until the Baoshang seizure, it wasn't flowing to the small, desperate private companies. And that was the link in the chain that was broken. With the seizure of the Baoshang bank, what we're seeing is more links in the chain were damaged like the small and medium sized banks and the non-bank financial institutions. So, suddenly, more links in the chain are broken and there is more of a problem.

So I will emphasize that I still don't think that the corporate debt bubble in China – and there is a debt bubble – blows up in the next 12 months because I think, again, people underestimate the number of tools the PBOC has to fight it.

But I think it's ironic that, for the first time ever, I think people should have it as a very unlikely tail risk on their radar and yet people are suddenly stopping to worry about it, which is a bit weird.

Erik: Let's move on to a couple of currencies. Boris Johnson taking over in the UK, what about the British pound?

Mark: The pound has got nothing good going for it. I've been a regular basher of the pound. Essentially, it still remains a sell-on rally. The fundamentals just remain terrible. It's one of those things, though, it's just gone in a straight line for like three months and there's a natural instinct to wonder when the pullback is due.

But the problem is that the fundamentals just keep on getting worse and worse. The collapse in the PMIs across the board recently – manufacturing, construction, and services – suggest that the country may be heading toward a recession. The current account outlook, which is the tail risk, continues to deteriorate.

The consensus estimate at Bloomberg is now 4.3% of GDP for 2019. In fact, the consensus estimate was at 3.5% only three months ago. So the collapse in the currency is not alleviating that key risk.

And that's kind of reminiscent of an EM currency. And the politics has been reminiscent of an EM country as well recently.

The UK is a leveraged economy. It's backed by a large and growing current account. It's got deeply negative real yields. And it's got poor growth. None of this is good for a currency. The only thing I'll say in sterling's favor is that all of this is super-well-known. None of it is new.

So, surely, at some point there will be some type of relief rally, just if we get a minor bit of good news. And it's like, yeah, we've got some good news, let's take some profit on our short. And that might be like a short-term powerful squeeze. But it's unlikely to be a turning point.

And I will say that, even though we've seen a lot of weakness in sterling, to me the vulnerable side in sterling for the next large gapping move is for further weakness again.

And if we do go to that No Deal Hard Brexit, I do think we'll get another large down. That might be the bottom. But I think, unfortunately for sterling ,even though everyone is bearish, even though there is likely to be the odd relief rally, the fundamentals just remain appalling and the currency is not weakened enough.

Erik: Let's touch on the Hong Kong dollar pegged to the US dollar. Until very recently, I kind of thought, hey, it's really unquestionable that they've got a very well-designed system. Nothing can go wrong.

But I think the political situation in Hong Kong right now is just really off the charts.

So is there a risk of breaking the peg for the Hong Kong dollar? And what would the consequences and knock-on effects be if so?

Mark: I think the consequences would be massive. I think the political dynamics here with China at the moment are very important.

I should emphasize I'm really not concerned about the peg going, still. I think, obviously, it's something that people need to be aware of. But I have just so little concern about this.

This is something we talked about last year. And other people were super concerned. And people keep on being really concerned. But I think there's a couple of things that aren't understood in the situation.

I think that, most importantly, the PBOC and its $3 trillion war chest stand behind the HKMA . So everyone goes, oh, the HKMA only have $450 billion of reserves, which is still quite a lot, and many people analyze how many, then, they can use in reality etc.

And I don't want to get into too detailed an argument about that because we could have a whole other podcast about that. And I've written lots about this before, kind of arguing with some other people about this.

But, essentially, the PBOC also stands behind them. And I think that's really important. So this is you're basically taking on the most powerful other player in the whole financial markets at the time when that other player also controls the rules of the game. And can control it easily.

And I think people underestimate that.

So it's not just squeezing funding rates, which is their most obvious tool. But, theoretically, they could take much more direct intervention methods in the Hong Kong dollar market. Such as, for example, closing the Nostro accounts of those borrowing Hong Kong dollar to short it.

So, essentially I never, ever want to take on someone who is way more powerful than me and controls all the rules of the game. I think that's really important. And also they're experienced. The HKMA has dealt with peg challenges in the past. This isn't a novel situation for them. So I think that experience is crucial.

And what's most interesting, Hong Kong reserves last month just hit a record high. There is no sign of attack. There is no sign of a need to intervene. So it's funny that a lot of – particularly, again, in the US – these very high-profile attackers of the Hong Kong dollar – as I always say, I'm completely unconcerned.

But if I'm wrong I'm going to get advance notice. I can change my view in time. If I suddenly see Hong Kong reserves start falling precipitously, well then maybe I'll change my mind. But I just find it bizarre that people focus capital and effort and time attacking something which is nearly going to be impossible to break on their terms. And, second of all, shows no sign of any kind of weakness.

So, yeah, I do not think it's a risk. But obviously the political situation there at the moment is worth watching. And, in terms of consequences, it's absolutely massive if something does go wrong.

Erik: Well, Mark, I want to thank you for a fantastic interview. As always, you're just a firehose of fascinating information. Before I let you go though, please tell our listeners a little bit more about the Markets Live blog and how they can follow your work at Bloomberg.

Mark: Unfortunately for some of your listeners, most of my content is only available on the Bloomberg terminal. Most of that is on the Bloomberg Markets Live blog, as you mentioned. And that's MLIV <GO>. I also do a column. But ultimately it's on the Bloomberg terminal – or occasionally a MacroVoices podcast.

Erik: Well you've got to love that, and we'll have you back again soon. Patrick Ceresna and I will be back as MacroVoices continues, right here at macrovoices.com.