Alex Gurevich: Stop this conversation and pause this interview, go buy gold!

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Erik: Joining me now is HonTe Investments Chief Investment Officer, Alex Gurevich. And, of course listeners, you know Alex is a big fixed-income expert and interest rate guy. Obviously, Alex, we need to get deep on interest rates in today's interview.

But first, what's on everybody's mind is it was FOMC [Federal Open Market Committee] day.

Give us the rundown. Obviously a 25-point basis cut. What's your perspective on what happened here? What does it mean? And how do we fit this in to the big picture?

Alex: Good to be back.

So, yes, today is FOMC day. And whenever we are in the middle of our cycle, or actually action cycle – that is right now in the middle of an easing cycle – every FOMC day is very important.

Not only in terms of what happens today, what exactly they do, but also people look for clues as to the next meeting. Because it's not so easy for them to change course between meetings.

So it's brick by brick, they laid out expectations for the next meeting a few weeks ago. And this is the first significant installment of our expectations for the month of December too, not just what happened today.

As of today, the market priced like 95%, depending upon what chances you would put in. Maybe even 97% chance, depending on exact computation of ease. So it was completely baked in.

If you ask me, I would say that the actual probability was 99.99%. The reason is that there is just really absolutely no incentive, there is no scenario, no course of discussion that would likely lead Fed to actually not lower rates today. (And I can go into this a little deeper.)

You might see some dissent and some people saying that they don't want to do it. But reality is, just people are just showing their philosophical dissent.

Everybody knows that rates needed to be lowered today because market already priced it in. And if they didn't do it, it will be too much of a shock to risk assets and to the system.

And it was completely unnecessary, because there was no pressure on them. There was no inflation pressure – and we will get back to that too a little bit. There was no data pressure. In fact, data was kind of soft last month.

So there was nothing urgent that would tell them not to do it. And they could very easily do it and then manage the expectations going forward. And that's what they tried to do.

So, to avoid parsing exact words of Powell or exact questions, in a very broad sense what he tried to convey is basically what Fed always conveys: *We are currently seeing the policies level as appropriate*.

First of all, that is, almost by default, truth. If they didn't think it would be appropriate where they ended up today, then they would have done something else. So they have to, by default, be at the level which they consider to be correct at the moment.

And he tried to convey that this might be the last cut because they have, overall, a relatively positive outlook on the economy.

There were some positives, and some more negatives, some more questionable things about the economy and the global economy that were mentioned during the press conference. But overall he tries to convey that, overall, there are some risks but overall things are okay and this rate should be accommodative enough for the economy to muddle through at current growth.

And this is what he tried to convey.

However, to me, there was a very interesting element of the message which is very consistent with what I philosophically expected for long time and which I think very strongly will be the truth. But I heard much more acknowledgement of that from Federal Reserve than I ever heard before.

Basically, the way I would translate what Chairman Powell said that there will be the next rate hike, is never.

Erik: Okay, Alex. I wanted to start with today's news, what happened at FOMC today. Because, obviously, you're an expert on the subject.

But our long-time listeners also know that you are really not a what-happened-today kind of guy. You're a really big-picture thinker. And you've been extremely prescient in understanding in a long-term view what's going on and what's been driving the fixed-income markets and rates generally.

So let's zoom way back out now and give us the big-picture overview of where we stand. Last time we spoke to you, you were still looking for 10-year yields to continue to move lower, possibly to new all-time lows.

Is that still your outlook? And what's the big picture? What should we expect to see from here?

Alex: Definitely. No major changes. I'm still expecting on this cycle that Fed funds rate ends up close to zero and yields continuing to fall and longer-dated Treasuries either earning money by getting significantly lower in yields, or starting to earn significant money via carry as they did in the past year(s).

So that's – for example, even if 10-year note yield stayed where it is but [INAUDIBLE] ten went to zero would be earning low and a half-percent carry.

And I would imagine the situation to persist until yields go significantly down. I think everything points towards much lower yield.

I think current Treasury yield – if you look at US Treasury yields versus yields of pretty much everything in the world – of all instruments in the world – this is a huge aberration spike. There is – it defies my words to explain how cheap are Treasury bonds as an asset class relative to other asset classes.

I mean, there are other asset classes that might have more upside. And we can talk about gold or cryptocurrencies or whatever.

But looking in terms of a safe asset, and how historically cheap Treasury bonds are to everything else, it's been very persistent. But it's been persistent not in the sense that it's cheap and it's losing money. It's cheap and it keeps making you money as you put money in it.

And it's been it's just been a treasure trove (sorry for the pun). Treasuries are a treasure trove and they continue to be one. (And we can go over in more detail.)

And I think what is very interesting about – here is the interesting thought that Chairman Powell said: And this though was actually (in some sense it's not) every time the Fed says something, it might affect today's market most.

But it actually does not really mean very much in terms of long-term policy because, generally, as far as I'm concerned, they say things that I already know. It might just affect daily price motion.

But, for example, when they say, *we cut today but it will be data dependent afterwards*, that is not new information because of course they're going to be data-dependent.

By the same token, when they pivoted (when they so-called pivoted in the winter of 2018-2019 – I actually don't believe there was any pivot), I think their policy response stayed consistent. Things turned and they turned. It's not like there was ever any question that –

And if they did not say those things, bond market would have continued to rally because then stock market would have gone down and forced them to cut anyways. However, it is interesting to see them acknowledge certain things just as an internal mental check. So this is what he really said today during the conference call, which is very interesting.

But he has been very pushed on *when do you think is appropriate time to raise rates?* And he said, well, we really don't have any inflation pressure whatsoever.

And he was very clear on the fact that there is no reason to raise rates again until inflation pressures will become ominous again. Not just go above 2% but go above target.

Of course there are different measures of inflation. And you can argue what is inflation high or low.

But they basically need to [get to] some kind of very uncontroversial and sustained measure of inflation putting pressure on them. And this is just not in the cards. We are not seeing this.

I strongly doubt that we will see it in the near future, because what with having a strong dollar, and if they are not going to keep cutting rates, dollar will just continue getting stronger. Which is in itself deflationary.

We cannot think of a strong dollar as good or bad thing. Most people think it's a bad thing for the world. But it's also – there is no question it is deflationary for US economy. And we're having very contained –

Of course, commodity prices could turn very quickly. For example, oil is now very contained. It could rally 50%, for all we know. And it might change, somewhat, short-term inflation picture in the US.

But even that in itself probably will not be enough to precipitate rate hikes. So the bar is –

Given the global situation, given the current interest rate differential that favors US even after recent bout of cuts, it's very hard to imagine any kind of inflationary rising in the US. Which means that, basically, rates cannot go higher than now. Which means that everything from now on to downside is a free option.

And market is not pricing very much more eases. So, in the event of Fed stays on hold, you can lose a little bit of money. But if they continue going to zero, as I think, you have much more to gain.

Erik: Now, based on that view, Alex, we've come down on the 10-year Treasury yield from 3.25 more than a year ago all the way down to a low print that was below 1.50 – at least on an intraday basis it was.

As we're speaking on Wednesday afternoon after the Fed, Alex, we're looking at a 1.78 print on the 10-year. So it's backed up more than 25 basis points.

In a normal market, a countertrend move of 25 basis points is big, it's time to make a stand there. But, in this case, we've come down 125 basis points in the last year.

Is this time to make a stand and go long Treasuries? Or maybe does this backing up in yields and this natural correction that we're seeing have further to run?

Alex: Well, making a stand is a very strong statement. Because "the last stand" – that just sounds very good in movies but not very good for traders.

So when you are talking about make a stand, you have to be cautions of the fact, cognizant of the fact that things can always go further and **you just need to stay in business**.

So, with that caveat, I think it is definitely time to be long. And I'm long. But I'm long with the thought that it's quite possible to take some pain in the wrong direction there. But I think, yes, yields came down quite a bit.

But we also have more information. This is an unavoidable thing in markets. You not always can buy things at the best level. Sometimes you have to say, oh well, yes, of course we could have bought bitcoin at 25 cents or Apple computers at whatever it was in the year 2000.

And, if we were to trade in hindsight like this, we could be always perfect. If we put 100% of our position at 3.25 yield on 10-year notes, that would have been the best, right? But – and then turn and get gains continuously, right?

But it's never perfect. Sometimes you miss a big move. But what you gain during this move is a lot of new information.

First of all, we did have – the policy did change, for whatever reasons. We did find out that there was no big inflation.

In 2018, people were worried about some inflation burst in the US because of wage pressure, even though that was contrary to historical evidence. But people were for some reason worried about that.

But it did not happen.

We have more information about global slowdown. We have more information about how inflation looks, how commodity prices look. And it was new information, I think, the cap on yields is just not that far from here.

I am very relaxed to draw lines in the sand on the longer-dated Treasuries because they [are] just kind of animals on themselves and the curve can always steepen if it wants to. In the front end, however, I feel like, yeah, we can go a few basis points higher.

But how high can LIBOR go? LIBOR today – the 3-month LIBOR, for our listeners, that's a 3-month *London interbank offered rate*, which is a benchmark – today it was close to 1.91.

And tomorrow it will probably come down a bit because the Fed actually eased. Even though people knew it was going to ease, usually after ease it's going to come down a little more.

It's actually relatively very high right now because it reflects a lot of recent funding pressure and funding shortage. It has a lot of space to go down with Fed funds even where they are right now. Probably easily can go down another 10 basis points without offending anybody, which puts LIBOR at, like, 1.80. And where is LIBOR have to –

If you look at eurodollar futures, which forecasts LIBOR in the future, yes, they actually do put in a distant probability of rates going a little lower. But they are not pricing so much that there is a catastrophic loss on the horizon.

I mean, I don't think – for example, if it stayed at 1.80 forever, you could maybe lose, like, 30 basis points on the most expensive contracts. Meanwhile, there is at least 100 basis points to run on that.

So that's my point. My point is, on the front end, you have a very clear risk/reward profile. And even if you go on a shorter horizon, if you go to just the most immediate bet on the December Fed funds meeting, the current probability on this meeting is fairly low. It's like maybe 10% of a cut in December.

While there is still enough time for them to – if we see some weak numbers or maybe some weakness in the asset markets, I think – honestly, I think the probability for the cut in December is 50/50.

Erik: Woah, 50/50! I wasn't expecting you to say that, Alex. Please elaborate.

Alex: I have traded now – it's my third major easing cycle in my career, including the cycles of 2000-2001, 2007-2008 – and not counting the mid-term adjustment cycle of '98. And, by the way, where we're at right now looks absolutely nothing like '98 and absolutely everything like 2001.

And I've reiterated this idea many times, at least that's my perception. And what I've observed from those cycles, what we're seeing right now is actually not at all strange.

For people – a lot of younger traders have some – not to offend them, but they might have some preconceptions, maybe based on charts and based on how they think things should be –

but if you traded those markets, and have a visceral sense of how they trade, I have a good memory of how it looked. And it looked very much like this.

So what happens is, within the easing cycles are periodic periods of risk-on where things look – where risk assets do well. And then, regardless when what economic numbers say, when risk assets – like stocks, high-yield instruments, and spreads – everything does well, the sentiment is very positive and it feels like normal cuts are really needed. And market very easily settles on the perception: *this is the last cut*. And then, if anything, we should look for hikes.

And that happens again and again and again. And what happens, actually, is another cut. Because risk sentiment goes in waves. We are just completing a wave of positive risk sentiment. And that led us to here, to the perception that we don't need another rate cut.

Now, whether or not we'll have a negative wave of risk sentiment, I cannot be sure by mid-December. But just probabilistically, that's a pretty good chance we'll have at least a minor wave of negative risk sentiment.

It doesn't have to be the same as last year. But it could be the same as last year on the outlier. Or it could be just a more minor wave.

And if this wave of negative risk sentiment happens, then, in combination with soft economic number that we are seeing, it would be very easy to price in another cut. And, in my opinion, it's about as likely as not to happen.

Erik: Alex, considering that your long-term view is that interest rates will eventually go to zero, we've got to talk about gold. Give us the big picture.

What do you see coming both short, medium, and long term for gold?

Alex: Well, I see a secular bull market involved. I see we are at the beginning of secular bull market. I think the move that occurred so far, depending upon whether you think if from $1,200 to $1,500 is just a minor blip, is the beginning of a move which could be several times higher in magnitude.

And I think that, given how we measure the previous bull markets in gold and how we are in the cycle, I would be surprised to find gold below $3,000 five years from now.

So I think that it's a very high-positive-expectation asset right now.

Erik: I couldn't agree more with the long-term view. If you look at the challenges that central bankers have, interest rates going to zero, they're probably going to be forced to keep them there for a long time. It really makes sense.

Do you have a view about the current entry level? We've moved a lot really fast. A lot of

people, myself included, were expecting there to be a natural pullback after that. But, so far, we've just seen a sideways consolidation.

Is it time to buy here? Or do you think we're going to get better entry opportunities?

Alex: Yes and yes.

In my opinion, yes, it is time to buy.

And, yes, we might get a better entry opportunity. But it's not relevant because the upside is way too big to wait.

You see, if the upside is $3,000 dollars, say if you could go up to $4,500 on gold and make $3,000, do you really want to give it up trying to save $50 on the entry? I think you need to enter if you have that view.

It's very different if you have a different view.

But if you have that view, you need to enter. But you need to keep your position. You need to enter, you need to have no stops, view it as an option. And potentially have a little space to increase your position size if things go against you, of course, if that's how you like to trade.

What is the worst thing to do right now, in my opinion, is put in – enter at $1,500 and put some kind of stop at $1,400 and get stopped out of the trade just when you want to be doubling down. That you definitely should be avoiding.

So you should really be cognizant of what size you can afford. And you don't have to have so much size if you think that gold can triple in price.

And this is a big if, because there could be other views on gold.

But if you think as you and I do, I think you absolutely have to rush to the screen and buy gold. You need to, like, stop this conversation, pause in the middle of this interview, and buy gold – if that is the view you subscribe to.

And then sort out the entry levels as a later problem. That's how I trade. But, of course, other people, again, might have different strategic approaches.

And, in terms of timing, in a sense – I know you've been talking about this a lot – in a sense I agree that the timing on gold this year was somewhat confounding. We touched on it in our previous conversation a little bit. Because historically gold does not start moving till a little later in the cycle.

So I was a little surprised by how fast gold started to move this summer. It was a little bit not

the standard time when gold moves.

But the fact that it eventually moves, to me, is much more important than what path it takes.

Erik: I'm in complete agreement, Alex. I still think we're going to get a lower entry opportunity, but I couldn't agree more with your logic that you don't want to miss this. It's time to be invested in gold if you're not already. And, hopefully, we'll look forward to a dip down to $1,250 or $1,350 or whatever the number is, so that we can buy more.

Alex, let's move on to the US dollar. We had seen a pretty significant downside move in the US dollar ever since the Fed announced their *It's not QE, folks. Really, trust us*. *It's not a policy of injecting more non-QE money into the system.*

Just in reaction to FOMC today, the dollar index came off of a low. It looks like maybe it put in a short-term high there.

Have we seen the bottom in terms of the downside of the dollar? Or could there be more to come?

Alex: Well, it is hard to tell. Again, I'm not a big expert on calling short-term bottoms. But I would point out that, overall, unlike in the case of gold, the performance of dollar is generally consistent with this portion of the cycle. Typically, early in the easing cycle, dollar performs well.

And I think it is very important to realize when you look at the longer-term charts, even studying from one-year to five-year charts, chart of something like DXY, which is just the weight of the dollar index, is very deceptive.

Dollar, in fact, is performing much better than any of those charts imply because it's carrying very positively against other developed-market currencies. It's the highest-yielding developed-market currency.

So the dollar/euro, for example, on a total return basis, the dollar/euro is hanging around levels it has not been at since 2003. It had surpassed the levels of several years ago, even when dollar/euro passed, like, 1.05.

If, at that point, you bought dollar versus euro, you would have still made money now, even though euro is higher nominally. But, because of the carry, you would have still made money from that moment.

So that's how well dollar has been performing recently. And I think that is very consistent. I do think – I would not ignore what the Fed does with regards to dollar.

It's been long my thesis – it's hard for me to measure what this QE/non-QE buy of T-bills means.

And a lot of people are trying to prove to me that it's not actually going to affect liquidity so much. Though I think it does. It is incrementally dollar-negative, but probably not hugely. That's my view.

However, the talk about relaxing banking regulations, that is not something to be completely ignored. I think if banking regulations were to be relaxed so that banks could expand their balance sheets, that would increase the cash supply. It would incrementally look like an ease. It would be very positive for Treasuries and other physical assets versus balance sheet assets.

But – we might be going into a bit of technical detail here – but it would also probably incrementally act like an easing, somewhat stimulate economy and somewhat weaken dollar.

I don't know. And I don't think it's likely that the magnitude of any changes in regulations or those temporary measures by the Fed would be big enough to offset the broader massive trends that are going on in the world.

So the odds in the current term are still supportive of dollar.

Erik: Let's move on to the euro currency since I know that you follow that one quite a bit as well. Mario Draghi is out, Christine Lagarde is in effective tomorrow as the head of the ECB.

Does that affect the outlook for the euro? And what do you see on the horizon?

Alex: Well, the interesting thing is that the short-term and long-term effects could be very different. For example, there is a lot of talk about Lagarde as potentially being more of a fiscal impulse person.

And I think, with fiscal expansion, that the first reaction to fiscal expansion could be actually negative for euro. That's what happened in the US when they had fiscal expansion. Dollar originally went down at the beginning of 2018 after the tax bill passed. And then it proceeded to rally.

The reality is fiscal expansion is actually not currency-negative. It could even be actually currency-positive.

If you go into the math of capital accounts, it basically may serve to diminish European capital account deficit. Because, if you start issuing more sovereign debt, it might increase people's desire to buy it and not necessarily either flow money over here.

But, of course, maybe to do that the yield will have to go a little higher first, not be, like, negative 70 basis points or whatever it is out there.

So it's a difficult game to see how it's going to affect things. I do think, though – like, right now, I disclose I have no position on the euro, which is pretty rare on me. I've been generally short

euro and I recently got flat euro.

I'm long dollar against other currencies. But I don't have a strong view on the euro because I feel like it's been a pretty good run. And I feel that Europe is, actually, next year is prepared to give us relatively positive economic surprises. Because negative economic surprises already all kind of happened and been priced in.

Erik: Alex, I know that you're primarily a fixed-income and interest rate kind of guy, but give us your outlook on equity markets, both US and globally.

Alex: Well, equity markets, as we all know, have been somewhat confounding to many people. I've heard you talk a lot about how you struggle yourself with the dichotomy between feeling that fundamentals are negative for the equities but, technically, they continue to perform really well and continue to shrug off any selling pressure very quickly.

And it's as if there is someone standing by to buy equities all the time. And this has been the flow situation.

Generally, when I have a very strong conviction I'm generally not afraid of adverse technicals and adverse lows.

However, with regards to equities, it is not my strategy to ever go short equities. The reason is that over super-long horizon, being short equities is generally always wrong (with some very few regional exceptions) because, eventually, equities rally.

And, right now, when you ask me what I think is going to happen to equities, I'm caught between what is it called between a rock and a hard place.

On the one side, historical pattern indicates that we should be topping here. Early in the easing cycle equities – even when pre-recessionary conditions form, typically equities perform well, but in the more choppy fashion [they] make low new highs, very marginal new highs. And eventually they start the real bear market.

So what is happening right now would not be inconsistent with bear market in equities being very close to around the corner.

Yet, it's hard for me – unlike other people who feel very convinced that equities are overvalued – it's very hard for me to see equities as overvalued. That is just something I cannot buy into, no matter how hard I try.

Because I still think about discount curve and I still think about the environment of perpetually zero/negative interest rates globally. And, in this environment, anything that can generate any profit looks cheap.

So what the P-multiples should be right now is very hard to tell.

And people will come back with a given sling, P-multiples don't actually – matters are not so tied to interest rates as we can think – this kind of model of just looking at yields and trying to price equities – that it does not work, that it's all – equity valuations always mean-revert. Yes, probably.

But also I don't see any fundamental force. Like, I don't see any fundamental gravity stopping equities from going higher.

So, personally, I would generally stay out of equities. If that was – stay out of heavy speculations in equities, if it was my choice.

I wouldn't be telling people not to buy some solid companies which can make it through the cycle that they like. And I wouldn't be telling people not to short equities if they have a huge conviction.

But, in my strategy system, I would say what's the point of going short equities? You can just go long bonds. Every scenario in which equities have a bear market, interest rates will go significantly lower. So why bother with equities if you can make so much more money on interest rate futures?

And, in terms of going long, well, you could stay long since you like to stay long. But I would not be too long because, well, that's been a pretty good run.

Erik: Finally, Alex, since I know that you are a heavy-duty fixed-income guy, some people think that Chinese credit expansion is where the really big risk factor is. Some people have even gone so far as to say that a Chinese credit blowup could cause a deflationary shock bigger than 2008 to hit the global economy.

What do you think of that view? And how do you see the Chinese situation with respect to credit and fixed income?

Alex: Well, I definitely agree that there is a risk there. In some sense, Chinese situation in certain ways is new and unprecedented because China just had been so big a portion of the global growth.

And their credit expansion, their private debt has been brought, in relative and absolute levels, really, really large. And, typically, countries which have such weights of debt tend to go to catastrophic unwind. I don't know if there are any counter-examples to having this kind of debt buildup leading to catastrophic unwind.

The time horizons are very difficult with that because of the command economy and the many tools at their disposal to kick the can down the road.

It's been – people thought that things were going to blow up in 2015 and they did not. Some people were calling for a blowup of China even much earlier, even – several years before that. And they keep kind of defying gravity and muddling their way through.

I tend to – if not 100% subscribe – respect the theory that, as China slows down, even though the slowdown seems to be very gradual and moderate, incrementally becomes much, much harder for them to service the debt.

Because as long as the economy grows very, very rapidly, even if you are not profitable, you can service your debts through ever-pyramiding cash flows.

But now that the growth becomes more normal, this kind of debt expansion might – it might be very difficult to service it.

And how are they going to manage to solve it and unwind it? That's a very big question, because we don't have a history of a modern-day command economy. In the past, they have tried to do it and always catastrophically failed.

But we don't know how an economy of this size can deal with this with all the tools – with the Google (whatever they have there, Baidu), with understanding of what's going on in the country, how to allocate resources, who they need to forgive debts to, who they need to prop, where they need to inject cash.

With having all of this information can they handle it? Probably not.

I there is a – from just purely theoretical perspective, there is an elevated risk of what they call a Minsky Moment in the sense that, unlike in Western economies when you get like this gradual decline and then it's just kind of accelerating, rolling down, rolling down the hill, there is some philosophical connection expected.

Something like falling off a cliff in China. That is China will just be okay, okay, okay – until they're not okay at all. And I think that's the risk that people are talking about that you've been referring to. I think, philosophically, there is definitely a possibility of this outcome.

But I say "philosophically" because, while we have no evidence that that's yet happening, we don't know. So far, they seem to be managing to contain things. We see all those cracks in the cement. They seem to be able to paint over it and make it look like new over and over again. And at what point it will all just crash down? We don't know.

And I found that it's hard to time with – it might happen 20 years from now. And, even for long-horizon traders, that might be a little too long to wait. But definitely risk is to be accounted for.

Erik: Well, Alex, I can't thank you enough for another terrific interview.

You run a hedge fund for a living. And, as many of our accredited investors understand, you're not at liberty to talk in detail about your fund. But, for the benefit of our accredited investor audience who are qualified to invest in hedge funds, how can they contact you to get your tear sheet and get connected with what you do there at HonTe Investments?

Alex: It could be found at honteinv.com. And your accredited investors could register on this website to receive more information.

Erik: Fantastic. Alex, I really look forward to getting you back for another update. Patrick Ceresna and I will be back as MacroVoices continues, right here at macrovoices.com.