# Juliette Declercq: Inflation is not in the cards

**December 12th 2019**

***Erik***: Well, it's FOMC week. So joining as this week's feature interview guest is JDI Research founder, Juliette Declercq.

Juliette has prepared a deck of her famous graphs and charts, which are some of the best in the industry. So I definitely encourage you to download the chart book as we'll be referring to it throughout the interview.

You can find the download link in your Research Roundup email. If you don't have a Research Roundup email, that means you're not registered yet. Just look for the red button on our home page at macrovoices.com that says Looking for the Downloads? It's right next to Juliette's picture on our home page.

Juliette, I want to get into a bunch of different topics with you. But, where it's an FOMC week, we'll have a listener revolt if I don't start with your take on the FOMC.

What did you make of this week's event?

***Juliette***: Okay, so I was here talking about the Fed a few months back, and I don't really think that yesterday's FOMC was ground-breaking. Powell has certainly embraced Mervyn King's advice to be as boring as possible as a central banker.

If I wanted to find the best way to put my feelings following yesterday's FOMC conference, I would say that the Fed basically will never hike again.

What was interesting about Powell's press conference last night was that he finally acknowledged a fact we actually discussed almost exactly a year ago, which was that the 2018 double tightening via three hikes and QT was a policy mistake.

Coming into 2019 he said, "I didn't see, and I don't think anybody saw coming the challenges that we faced this year. I think they were a surprise. Toward the end of 2018, there was still a sense that the economy was growing at around 3%. And it didn't. I didn't expect to face the challenges, but I think we did face them. And...I'm pleased that we moved to support the economy in the way that we did."

So that's what Powell said in the conference last night. The great thing is that we saw the challenge they were facing ahead so – but actually brought us the opportunity that we traded this year.

The even better news is that they are still thinking linearly, which leaves us plenty of trading opportunities for 2020.

So let's see what they think. They are confident about the outlook and especially in standing pat on rates, allowing them eventually to reach their inflation target in a persistent manner.

I think they are wrong because the economy reacts to the **change** in financial conditions, **not** its level. Therefore, inflation and inflation expectations will continue disappointing, growth will relapse, and they will cut again in 2020.

The signal will, I expect, be the US curve re-inverting, global equities just starting to struggle to make new highs, and probably renewed dollar strengths (at least versus EM and commodities).

***Erik***: Okay, Juliette. So, despite the passing of undoubtedly the greatest inflation tamer in all history, Mr. Paul Volcker, this week, it seems that, again, inflation is a problem that we as investors need to focus on. And it's not going away.

In fact, Christine Lagarde in, the ECB's announcement just this morning, Thursday morning, revealed ECB data that suggest inflation is picking up. Except it is disinflation, according to you, and the specter of deflation that is now hanging above our heads.

Juliette, can you walk us through your views and maybe help me understand. It seems like you're not at all concerned about inflation. Christine Lagarde – I know whom you have a lot of respect for – has, clearly, a different view. Or at least she's reporting different data.

Or am I missing something?

***Juliette***: Well, the first thing I'd like to say is that, by definition, central bankers have to be cheering on the economy. So, even if she thought there was no chance of ever hitting the inflation target, she would still pretend that it's possible. Otherwise, inflation expectations would basically collapse. And inflation would be feeding on itself and collapse as well.

So I'm not expecting that she will be saying what she thinks anymore, even if she actually said the opposite.

The one thing with inflation is that it is really important to distinguish between domestically-driven forces and global forces. So I'm obviously going to be taking the US here because it's the most interesting inflation picture, where a lot of investors still believe that it will pick up eventually.

So, in the US, underlying domestic inflation pressures, which are best measured via services inflation (excluding energy and shelter), have remained very tame.

And you can see that on Chart 1 of the chart deck I've provided.

You can see that core services inflation is picking up slowly but still fails to match anywhere close to what prevailed at full employment in the past two cycles. Even in this cycle, we are still far from the 3% line which was achieved in 2016.

To add insult to injuries, inflation expectations are actually at all-time lows and still falling. And on this chart I am showing the Michigan survey one [in green]. But if you look at the New York Fed, or in fact pretty much any other surveys, you will get exactly the same picture.

The problem is that realized and expected inflation expectations are reflexive – they feed on each other. So you really need a real and lasting inflation shock from here to get even close to re-anchoring inflation expectations to levels consistent with the Fed's target.

So that was Chart 1 in my chart pack.

If you go to Chart 2, you can see that the Fed's dramatic U-turn this year has failed to move the needle on the "low-forever" inflation outlook.

In fact, for the first time in history, inflation expectations have become completely immune to much easier monetary policy – supposedly. And, despite looser monetary conditions this year, inflation risks are still considered totally absent.

That's on the chart 2 of my chart pack.

This is partly explained by the Fed's unduly hawkish stance since Powell became Chair. Now, I'm not saying they did it on purpose. It's obviously part of the policy mistake.

Trump's election certainly fed the American animal spirit (at least initially), and the result was a post-election Fed irrationally afraid of inflation, leading to their unduly hawkish bias. So that was for really the domestic side of inflation.

On the goods side, it's a completely different story. With globalization, goods inflation has largely become a global zero-sum game where the central bank that scores points towards its inflation mandate is the one that basically manages to weaken its currency.

Remember, inflation is a solid (up to 18 months) lagging indicator. That means companies adjust prices each year according to past cost pressures and their pricing power. And the 2017 dollar fall has been basically the main source of reflation in the US over the past two years.

So you can see on Chart 3 that, unfortunately, the Fed's relatively hawkish stance in 2018, especially compared with its global peers, has meant that the dollar stayed bid in the past 18 months, pretty much. And this will be repaid in the form of lower core goods inflation into 2020.

You can verify that for yourself on Chart 3 where you can see import price and the dollar in green feeding directly through dollar core goods.

We've had new CPI data yesterday which is basically showing that core goods is now at zero on the year-on-year basis. And I think we're going to go back to deflation in 2020.

***Erik***: Juliette, so far we've talked about the US monetary policy aspects of this reflation situation. But isn't China a big part of the reflation equation?

***Juliette***: Erik, this is a great question. And, in fact, it's one of the key ones.

In 2015-16 and, in fact, for most of the bouts of reflation we've had in this business cycle, it was China leading the reflation fight.

The targeted investment boost through credit floods was the main engine that reflated base metals and eventually saw China's PPI move from -5% in 2015 to +8% in 2016-17. And these trends fed directly into US core goods, especially when global reflation actually allowed the dollar to weaken, as happened in 2017.

However, you will see on Chart 4 of my chart pack that China PPI is still in deflation territory at -1.5%. So don't count on China for global reflation this time.

Of course, you will ask me what's the difference between today and any previous episode? The reason China is not a source of reflation this time is simple.

Firstly, there is more awareness amongst policymakers there on the possible downside of credit – and especially private credit – which is a source of future instability and deflation.

Secondly, this mini-cycle is consciously driven by consumption being stimulated rather than investment. So there is a lot less of a need for base metal etc. and therefore a lot less of the reflation boost that we've had in the past for the rest of the world.

Thirdly, and perhaps most importantly, there is much less of a propensity to consume and invest in China.

You can observe this for yourself on Chart 5. Look at M1 versus M2 collapsing.

If you ask me, basically I think the Chinese animal spirit has been put to sleep, perhaps due to the geopolitical tensions. And the result is that new credits (which is on my chart in orange) look like they are being used to pay for old credits rather than feeding through to higher activity via investment and consumption.

You can see on Chart 5 that the green line trending down is the reason the raw industrial index is still hardly off the lows versus the substantial uptrend in the orange line, which is the main difference between what's happening today and what happened in 2015-16.

***Erik***: Okay Juliette. I promise this will be the last inflation question (and apologies for so many). But this is really fascinating and I am intrigued.

If I'm understanding you correctly, it sounds to me like what you're saying is that global inflation is like a zero-sum game where there is a fixed quantity of inflation to be had in the world.

And, sort of like competitive devaluation in the 1930s, it's like all the different governments around the world are vying for their piece of the pie. You don't get any inflation because we want it over here. We're going to steal your inflation and put it onto our balance sheet. And I guess the way that they accomplish that is by weakening their currency.

Am I reading that right? And what are the implications, if so?

***Juliette***: Erik, this is another great and absolutely crucial question you ask, which will take me way beyond the answer you expect and go a long way to convince your listeners that US rates are still too high at minimum in a related way.

So, given renewed concerns about price dynamic and the ongoing Fed policy review, we do ourselves a huge favor by remembering one key thing, which is that global central banks have equivalent mandates. They basically are all targeting inflation at 2%.

But the targets are measured in a completely different way. And, for example, that's particularly the case between the two main central banks globally, which are the ECB and the Fed.

For example, the Fed's price basket includes a hefty "shelter" weight that the ECB excludes completely. This "shelter" is literally the only source of divergence between the Fed's moderate success towards achieving its inflation target and the ECB's apparent complete failure.

"Shelter" measures, basically, the cost of home ownership. (And, arguably, that's one of the largest expenses in a household.) And that's calculated through what some of the economists will know as "owner equivalent rent," which is the cost of renting your own house.

The ECB completely omits this cost because there is no independent price for it.

Far bit it from me to open the discussion on what an inflation target should include. But I will say this: In my opinion, house price and perhaps even market prices should be included.

After all, financial repression's main pitfall is that it pressures real and financial assets higher, ensuring that home ownership becomes a Sisyphean task for new buyers. Meanwhile, pension investment becomes extremely challenging in the process.

The bottom line is that “shelter” is the largest item in the Fed’s inflation basket, and it has been the one source of reflation in this business cycle, running above 3% annually since 2015.

If you look on Chart 6 of your package, you will see that if the Fed’s inflation target excluded this component, core inflation would be running around 1% in the US since 2015 and the Fed would have never hiked.

Conversely, if the ECB boosted the housing rental component of its own target, which is currently a mere 7% of core inflation and running at 1.5% annualized – higher than where actual European core CPI is – it would probably boost trend inflation by about0.4%.

So, suddenly, the 2% target would not look so unachievable. And keeping rates deeply in negative territory would be very hard to justify for Mrs. Lagarde. The ECB would also struggle to continue arguing that the Euro FX rate is a mere input in its economic model rather than a goal in itself.

Nonetheless, the consequence is that the ECB has kept the euro artificially 10% undervalued for the past five years.

And that’s something you will be able to see for yourself on Chart 7.

The corollary is obviously that the Euro-area trade surplus versus the US has exploded since the respective Fed and ECB monetary policies diverged with the ECB’s negative interest rate policy and QE program, which started from 2014.

If the Fed and ECB were using like-for-like inflation targets, their monetary policy stances would not have diverged so greatly after 2014.

So the issue is that the euro’s distorted valuation has far-reaching ramifications, as you know. It is keeping the dollar artificially strong as, basically, the only reserve currency in the world with positive yield. This is in turn depressing the US manufacturing sector.

And, again, you can see that for yourself on Chart 8.

If it was just about depressing the manufacturing sector of the US, it would be one thing but not the end of the world.

The issue, as we must all know by now, is that the dollar’s strength is also keeping global liquidity unduly tight because it basically devalues non-dollar liquidity, which works as a dampener on global activity.

And that’s something you will be able to see on Chart 9.

Whilst it allows the Euro-area a larger slice of the global demand cake, the ECB's extraordinarily dovish monetary policy stance also tends to shrink the global cake. And the consequence is that negative rates are not only counterproductive for Mrs. Lagarde and domestically, they are also dragging global activity down. Let that sink in.

So, putting this divergence between the Europe and US as aside, I would like to go further.

In Biarritz on August 23, President Macron greeted President Trump with a one-on-one lunch before the G7 summit. In Buckingham Palace at the NATO summit last week, Macron, Trudeau, and Johnson appeared to ridicule Trump over his lengthy press conference.

The same way Biarritz marked a bottom in geopolitical tensions, I believe that London will mark a top in the global détente.

With the impeachment process ongoing ahead of the next US election, I think Trump needs cajoling. The EU has been freeriding on the US in a macroeconomic sense and I question the wisdom of refusing its leader the deference his country deserves. And I hope the American listeners on the call will appreciate my macro neutrality here.

With US trend growth melting, I think that Trump is right to target trade imbalances. And the imbalance with the EU is particularly mindboggling. The real question is should the Fed cut to zero or the ECB normalize? Or maybe both?

There is no question, however, that the trade imbalance between the EU and the US stems from market distortions and is detrimental to the world as a whole.

Together with a review of the tools available to meet its 2% inflation target, I think that Lagarde should probably review the inflation basket itself. And admitting that it is artificially too low would boost the ECB's credibility and allow for a welcome interest rate normalization for European savings and for the world.

Will this be a subject for 2020? Perhaps one that even Trump forcibly raises?

***Erik***: Well, it will certainly be my next question, regardless of what anyone else does. Is 2020 the year when the ECB hikes or the one when the Fed starts on its descent to zero?

So which side of this candle is going to burn first?

***Juliette***: I'm sorry, it's going to be another lengthy answer.

Today, Christine Lagarde gave her first press conference following her first ECB meeting as president. And, in a stroke of luck, the recent stabilization in European activity has bought her some really valuable time for a deep review of the monetary policy toolbox at her disposal.

By the way, monetary policy review is VERY much a theme for 2020 and one that I have covered at length in this week's paper.

So let's see what she has promised. She has promised that "…every stone would be turned and every option examined."

Meanwhile, don't forget that the Fed continues its own monetary policy framework review, planning to report its findings in the first half of 2020.

So what's the main reason for these reviews? (Excuse me, I'm going to get a little bit technical here.)

The neutral level of the policy interest rate – which is the natural level that keeps the economy on an even keel when employment and inflation are close to their objectives. That's the reason for the review. It has fallen globally.

And the issue is that the decline of the neutral level of interest rate is very perilous. It increases the risk of hitting an effective lower bound (whether zero for the Fed or negative), constraining a central bank's ability to counter future downturns.

So let me explain to be very clear.

When the neutral rate is even slightly positive, central banks have a lever on the economy: Rates can be cut to zero and financial conditions remain accommodative.

In contrast, if the neutral rate dips into negative territory they completely lose their lever as rates hit their effective lower bound. And, automatically almost, financial conditions can quickly turn restrictive. It can trigger a vicious circle of lower inflation expectations. That spikes real rates, triggers lower spending, and eventually turns into higher unemployment and a recession.

It's the very definition of a liquidity trap and the one global central banks are trying to avoid by pushing for a fiscal solution.

So the structural neutral rate is directly linked to trend growth, which we have seen in past interviews is the mirror of employment growth and productivity gains.

Unfortunately for employment growth, the closing of a massive demographic transition as baby boomers basically leave the workforce in huge numbers into 2030 has taken a dramatic toll in this business cycle.

You can see that on Chart 10. I am sure that's a chart that you have already seen before, but I thought it would be useful to have it here again so we'd all realize the cliff edge we're basically going through.

If you take the example of the US, it's a demographic chronic disease becoming more acute in a late-cycle environment.

So let's go to the latest NFP release, which had us at fever pitch last Friday. It showed that aggregate income growth has continued its inexorable descent. And it's now at 4.5% versus north of 6% earlier this year.

This is despite very robust employment levels. And, arguably, a strong employment market. But no trees ever touch the sky. Even if you have strong employment, you cannot grow forever.

So whether you believe the impressive NFP number or the sluggish ADP number, which basically we had two days ago, it is a matter of employment growth declining or diving.

And you can see that on Chart 11.

In the absence of organic economic growth from rising employment and aggregate income, the sad solution – which I want to say I do not condone – is to keep the global capitalism dream alive by pushing the same aggregate income towards more spending and less saving.

And, indeed, the national savings rate drives the cyclical neutral rate.

Unfortunately for the capitalism Ponzi scheme, with the exception of US corporate leverage reaching new highs, private deleveraging has very much been the name of the game for this cycle.

Against conventional wisdom, the result is that public indebtedness is rising too slowly for a Keynesian rather than too fast – and it has only just offset private deleveraging.

You can see this on Chart 12, which basically shows you that government indebtedness and the rise in public debt is just the mirror image of the decrease in private leverage.

And that's basically the end of the debt super-cycle taking its toll on aggregate demand.
This means that supply-demand imbalances are building, keeping demand-pull inflation depressed, and weighing heavily on the equilibrium interest rate.

The result to date has been disinflation, financial repression, and a demand problem that is, of course, worsened by inequalities.

But it does not have to be like that. In fact, it should not be. There is a miracle solution. And the logical Keynesian macroeconomic fix is to re-equilibrate final demand through fiscal programs.

So I am afraid government interventionism is the future.

And I know you guys won't like it, although us Europeans (and especially French) do get it. You just need to look at how many people are on strike in France to keep the government as involved as possible in keeping their pensions artificially too high. We have not seen the end of this.

But the point is, if governments run larger budget deficits to finance social programs or tax cuts, we will see final demand increase, neutral rates being lifted, and central banks' leverage on the economy being restored.

So public spending has become a macroeconomic necessity.

Yet, in line with our expectations, it has been the biggest macro story in 2019 and promises to gain further traction into 2020. You only have to watch the UK's PM-wannabes, Jeremy Corbyn and Boris Johnson, blustering to outbid each other with ostentatious promises of post-election spending sprees to realize that it is public austerity that has become taboo.

So consensus has largely jumped to the conclusion that the future belongs to fiscal policy, which is largely expected to drive global interest rates higher into 2020.

***Erik***: Okay, Juliette. So your message is essentially that you expect fiscal responses to the macroeconomic challenges that you're describing.

How fast do you expect to see those fiscal responses?

***Juliette***: Look, we have come a long way to the fiscal side already.

Last week, Japan finally pulled the trigger and announced a supplementary fiscal package much bigger than expected. Unfortunately, it is a public investment program that follows October's consumption tax hike, which is going to be a direct hit on final demand.

As President Trump learned from his 2018 corporate giveaways, you cannot respond to demand deficiency with a positive supply shock.

The same is true in Europe. In Germany, I think the "black zero" budget is on its way out after the Social Democrat leadership shifted surprisingly sharply to the left about two weeks ago. It won't be happening fast, but Germany's political center of gravity appears to be moving to the left.

Meanwhile, as climate change mitigation becomes an integral part of the ECB's mandate, there is little doubt that so-called green bonds will facilitate spending.

Generally, productive investment programs are useful for shoring up real growth. However, fiscal policies are most powerful when labor slack is the issue since they directly boost final demand through higher employment.

If everybody already has a job, it's much more difficult to get traction on the economy. Near full employment, the short- and medium-term effects on demand will therefore be very limited. And lacking demand acceleration, inflation will continue to struggle.

Understandably, governments are very reluctant to come out with more contentious measures that might stimulate demand more directly (for example, middle class tax cuts or direct social spending).

And I think the usual motto will apply: *If it ain't (completely) broke, don't fix it*. (I am really trying to use my very best British accent here).

Governments' immediate focus is still to preserve the status quo and keep the liquidity trap at arm's length. People's QE taking over from financial QE is definitely the end game.

This is likely to be implemented not via MMT though, and governments printing money at will, but with governments holding an account at the central bank from which funds can be distributed wisely according to an institutional mandate. So keeping inflation on a short leash, basically.

However, I think more politically correct plans will be tried first (and fail) before money is actually printed and distributed. I think in 2020, this gives the ECB and the BoJ the luxury of staying put.

But I really do not expect an L-shaped, non-inflationary recovery that it will justify hikes.
So, for me, this leaves the onus of driving the dollar versus the rest of the world to the Fed.

***Erik***: Okay, Juliette. Fantastic macroeconomic perspective. And I couldn't agree with you more that helicopter money is going to be the end game here.

But now I get to ask you to translate these macro views to actual trading strategies. How do we invest and make money based on this understanding?

***Juliette***: So this is my framework for 2020:

While the Fed will keep dragging its feet, I think it's evident that US rates are still too high – if not in absolute terms, at least relatively. Eventually, the Fed will be forced to continue pumping the cycle via further rate cuts into the election.

And, by the way, that is irrespective of whether there is a China-US deal or not. As we speak, I hear that Trump has yet again come out with some very positive noise on the deal he is making with President Xi. But I think we're very much close to being priced on that and I don't see much progress on phase two any time soon.

Anyway, to go back to the recommendation, I think really what you want to do is playing the "Fed dragging its feet" theme via lower break-evens. And I mean inflation break-evens. I think the Fed will eventually be forced to continue with its cutting cycle.

So you want to be playing that through long 2-year US Treasuries. And, in terms of the DM rate convergence theme, I think you want to play the short USD/JPY.

I would like to have a word as well on the EUR/USD. The long EUR/USD hefty carry really keeps me neutral on EUR/USD, especially in risk-on markets. But, with the euro becoming the borrowing currency of choice globally, I think we are bracing ourselves for a sharp move higher at some point in time of stress.

So I would warn your listeners to not be too complacent there. And to remember what happened with those borrowing in Swiss franc or even Japanese yen and a few times in history where your carry debt is wiped in 24 hours.

***Erik***: Now, Juliette, since August or so in your All-Stars appearances with MacroVoices, you have been exceedingly bullish on risk assets, particularly US equities.

Is that still your take? If now, what is your take now?

***Juliette***: Thanks, Erik, for asking me about equities. There is actually one urban legend I would like to kill for this asset class.

We really commonly hear that equities tend to be the last asset class to price an imminent recession. It's totally true. Equity prices tend to peak less than six months ahead of a recession (with the fifth wave of the bull run often actually the most rewarding). But it is completely false to say that equities are therefore a poor recession indicator.

And that's for a reason that I will expose now.

Basically, equity prices can be decomposed into two components: underlying expected earnings and the valuation multiples that we are willing to pay for those earnings.

I think of the equity risk premium (ERP) as the stock market valuation, assuming constant real rates (so basically the valuation assuming no central bank "manipulation," if you would like to put it this way).

And then I determine late-cycle conditions as the period when the equity risk premium starts rising – signaling a less resilient earnings outlook – while prices continue making new highs on lower real rates and the resulting higher multiples.

So if you look in Chart 13, in 2000 the ERP signaled the recession a year ahead. And inflation and the last 50 basis point hikes were the kiss of death for the cycle.

If you go to Chart 14, you can see that in 2007, the ERP signaled the recession nine months ahead. And the Fed was basically caught by surprise by the damages inflicted by the subprime crisis and didn't cut fast enough. A recession resulted.

So let's look at what's going on today.

On Chart 15, you can see that late-cycle conditions have prevailed for almost two years now, with the blue line trending down, whilst SPX and prices are still making new highs. Yet there is no sign of a recession.

I think really what's going on is that information overload means that households have been preparing for the worst, which explains why private leverage has, in the DM world, been trending down.

Sovereign leverage (e.g. public debt) has been rising as a result. But, obviously, public over private leverage is a source of stability rather than instability, especially now that central banks are equipped with QE and subsequent monetization to deal with the problem.

You will also argue that corporate leverage is making new highs in the US. But I think with low rates it's a lesser evil. And, let's face it, if the ECB buys corporate debt, who is to say that the Fed won't do it?

So, to go back to my chart 15, I think there is one thing I really want to be talking about is that 2018 was about decreasing valuations and lower multiples. And it ended with the December crash.

I think 2019 was exactly the opposite of 2018. We've had, basically, cheap valuation. (The SPX equity risk premium bounced off the pre-Trump range lows twice this year.) And we've seen cheap valuation and strict financial repression.

So the confluence of cheap valuation and increased macro resilience allowed our cyclical tilt since August to generate solid returns. But I am returning neutral on equities.

So why recommend taking profit when the recovery is now just being confirmed?

Firstly, I expect geopolitical risks to remain elevated. Beyond the first phase of the US-China trade deal, I am very skeptical that meaningful progress can be made, for example on forced technology transfers and SOEs' [state-owned enterprises] subsidies.

Perhaps rightly, Trump will also intensify the saber-rattling with the EU, especially as US trend growth continues melting down.

Brexit, which is just right now being decided, is unlikely to be plain sailing even with the best intentions – on both sides of the channel. And that's very simply because there is too much at stake. You know, if you only consider England and France, there is so much at stake that there is no way it can be dealt with quickly.

And, finally, and perhaps most importantly, I think 2020 will start with unattractive risk asset valuations, and already assuming a substantial macro rebound from here.

You can observe this on the final chart of my chart deck.

Going back to Chart 15, you can see that the cyclical tilt which happened since August has taken us back, as far as the equity risk premium is concerned, to the pre-Trump range highs with – And I see very few objective reasons for a break higher from here, unless you somehow believe that the 15% middle-class tax cuts are basically imminent.

So what I would like to conclude from here, and the reason why I'm going neutral on equities, is that I think that equity gains will most likely result from lower real yields and basically higher multiples from here – which basically favors going back long gold rather than staying long equities.

So in August, we actually switched out of long gold into long equities to express that belief that we would get the cyclical tilt. And we are going back to long gold and neutral equities.

When re-entering, I will focus more on the defensive sector and the US because the main reason for being long equities would just be basically that the Fed is cutting to zero.

***Erik***: Juliette, I want to come back to your switch back to long gold, because that's very interesting.

But, even before we get there, you mentioned in your last answer, just in passing you mentioned the trade deal.

Now, just in the time that we've been speaking on Thursday morning, we have seen a massive spike up in US equities. The S&P broke as we were speaking, to new all-time highs. And crude oil also broke well beyond its range resistance of the last couple of days, almost taking out last week's high.

Now, we've been talking, I haven't been plugged into the news. But I'd be willing to bet that, for the 163rd time, we just went from trade deal off again to trade deal on again.

And, based on the exuberance of the move, I'm guessing that the China trade tariffs on the 15th of December, either the US has backed away from that, or has hinted that they might back away from that, or something has happened as we've been speaking. I could be wrong, but I'm guessing that's what drove this move.

Should we be taking these trade news driven moves in markets seriously? It's something that I've been really just pondering lately because I think, frankly, that this market obsession with the China trade deal is overdone. But it seems like it continues, regardless of what I think.

***Juliette***: I think we're going to be pricing a lot of good news this week. I mean, not only potentially Brexit is going to now come with less uncertainty – well at least supposedly. Phase 1 of China-US is widely expected to happen. So I always thought of this week as the week which is going to be the next inflection point in terms of market dynamic.

But, as always, we have to remember that that's the reason why we are here. So making new highs is all part of at least a short-term topping process in my opinion. And I think we could keep making new highs, especially into the end of December, but I just don't see the risk/reward anymore.

***Erik***: Let's come back to gold then, and talk about the risk/reward there. I had been feeling like, as you've said, inflation in your view is not as big of an issue as you think a lot of other investors think it is.

Now, gold broke through its channel resistance line earlier this morning on the ECB announcement where they described increasing inflation. My prediction was going to be that that would turn into a false breakout. And it looks like I've already been proven right, that we've come back down below that trend resistance line.

Given your views on inflation, I thought you were going to tell us it's not time for gold yet, wait it out a little bit longer. You just said the opposite. So help me understand that apparent conundrum.

***Juliette***: Firstly on gold, with my thinking process and framework, I actually managed to capture I think it was like 15% upside from the beginning of 2019.

For me, gold is basically the perfect hedge for worrying that inflations are going to be basically confiscating your money through negative rates. And so we've seen the pool of negative-yielding debt going up dramatically into the month of August this year. And, for me, that's the main driver for gold.

Now, I got out of long gold because of my view that negative rates or further negative rates were not going to be the answer to the next downturn. So I got out of gold. And I actually recommended to short bubbles on that view and picked up the selloff in rates from August to November.

And I think we are basically going back into a macroeconomic dynamic where the Fed is going to be the one moving further into financial repression. And that's going to be what potentially keeps driving equity afloat or potentially even making new highs into next near.

And that's the very reason why I like gold again now. E.g., we are out of the cyclical tilt, so that means you can buy the edging asset rather than the real asset that actually you would want to own on increased macroeconomic resilience.

Is that making sense?

***Erik***: It makes perfect sense. And I think that we definitely agree. In the long run, there is just no question in my mind that gold is the big winner. What we're headed toward is some kind of – I don't know whether you'd call it MMT or you'd call it helicopter money or you'd call it something else –

***Juliette***: I don't call it MMT money because I don't think government is going to be printing the money. Which is also why I don't think inflation gets out of hand.

***Erik***: But it sounds like we do agree that what's going to happen is the people around the world – and there are more and more – and we're seeing social uprisings from Hong Kong to Chile to all over the place. Lebanon. We're getting more –

***Juliette***: Ultimately it's going to be people QE, all basically like blood in the street.

***Erik***: And it's such a perfect setup because, although it hasn't become a popular politician's meme yet, you know what's coming. Which is they are going to say, look, what central bankers have proven over the last decade is that it really is possible for central banks to conjure trillions of dollars out of thin air and to do it without crashing the economy in massive runaway inflation, which is what a lot of people predicted ahead of QE1.

Now that it's been proven that this is possible, we need to stop using the money, the trillions of dollars that are conjured out of thin air, in giving them to the rich people and instead we need to help the people in need.

And that is just such an incredibly powerful and politically tenable message. I know that it is going to take over. Now, frankly, I don't think it's a good idea. I think we're going to find that that kind of QE does result eventually in runaway inflation. I think it's going to get really ugly.

But at first it will look to be wildly successful. And I think it will feed on itself. And I think there's a huge amount of helicopter money in some form coming.

How could gold possibly not be the big benefactor of that?

***Juliette***: I see things differently.

I mean, that's basically the argument for buying bitcoin and gold and the fact that your money gets confiscated. And I just don't see, or at least not anywhere on my trading horizon, because I just don't see inflation coming on the back of that.

I think basically the problem is with capitalism and the fact that we just have to live with much lower growth. And the way we can live with lower growth is initially by having to fund some of those programs, especially like pension funds.

It's obviously not a problem only in France. It's a problem everywhere in the world, the fact that we've based the system on the fact that we were going to grow forever, which is obviously not the case.

So I think I see more like people QE as a way to transition to basically much lower growth and much lower consumption.

***Erik***: Okay, I just want to clarify because I said three different things there and then you said no way and I disagree.

I said I think helicopter money is the way of the future.

I said that I think that will eventually result in runaway inflation.

And I said gold has to be the big winner.

If I'm not mistaken, the big one that you disagree with is the inflation part. But I think you do agree on the helicopter money and you do agree that gold is the winner. The issue is just you don't see the inflation risk the way I see it.

***Juliette***: Yes. Exactly. I just don't see it as a hedge against inflation.

***Erik***: So if inflation is not the risk, do you think that helicopter money is the right answer and it's something that we should be pursuing aggressively?

***Juliette***: I think it's the only answer because, if you've got private deleveraging, it's very intensely deflationary. So, if it's not balanced by government spending, you end up in a recession really quickly. So I think it's the necessary transition.

And, yes, I completely agree it's the only way because inequalities is obviously one thing that's taken away a huge part of global demand as well. Corporates don't spend their money. They put it on an account. If it was paid to workers, suddenly you would have a lot of demand potential unleashed. And, obviously, it's the same between middle class and the above 1%.

***Erik***: Well, the good news here, Juliette, is we don't need to agree on whether it's a good idea or not because I think we do very much agree it's coming. And I think that helicopter money, in whatever form you want to describe it, is going to happen. And it's going to happen on a larger scale than almost anyone anticipates.

Juliette, we're going to need to leave it there in the interest of time. But, before I let you go, I want to ask you about what you're up to these days at JDI Research. When I first met you and had you on MacroVoices a couple of years ago, really your only product offering was for our full institutional listener base, large institutions. You were not offering anything to family offices and high-net-worth individuals and so forth at that time. I believe that's changed.

Please give us an update on your product offerings and what you're doing at JDI Research.

***Juliette***: We have two services: a comprehensive one which will give you a great understanding of the underlying global macro trends to use as an input into any investment process, really.

And we do price differently whether the institution is big or whether we're talking to a family office or a very dynamic high net worth.

Really, our focus is on the transparent tracking of our macro views through clear recommendations and, most importantly, try and cut the noise out. And only talk about what really matters to help clients advance in the markets.

I really believe that one of the reasons so many hedge funds are falling is because of the overload of information and on, basically, PMs' inability to just focus on the underlying trends.

I actually would like to, like every year for the past – actually I think it's the third year we're talking just before Christmas – I would like to offer a sharp discount to the first five MacroVoices listeners who sign a yearly contract with JDI Research.

We also have a premium service whereby clients get daily insight into my thought process. This is currently at full capacity, but get in touch if you think you have the arguments to make me change my mind. This would probably imply that you work around Paris, where we are opening an office in 2020, because I want to have more clients in Paris.

I really want to finish by wishing you all a great end of year. And I want to thank you, Erik, for allowing me to meet all those great thinkers. I have loved our exchanges through 2019.

***Erik***: Well, it's great to have you and we look forward to having you back in 2020.

Patrick Ceresna and I will be back as MacroVoices continues, right here at macrovoices.com.