Jim Bianco: COVID-19 & Risk Parity Unwind – What's next for markets?

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Erik: Joining me now is the one guy in finance who was all over the coronavirus story even before I was. That's Bianco Research founder, Jim Bianco.

I want to refer our listeners – we don't have a slide deck today because Jim has just been flat out with the various situations in markets. Jim's timeline on Twitter has some of the best graphs and charts showing the case growth of COVID-19 cases around the world. So I encourage our listeners to check that out.

Jim, I want to start with the big picture of, okay, monetary policy two weeks ago versus today is a very, very different story. I think some of our listeners have been overwhelmed.

We know there was a massive intervention last weekend. We know there is an alphabet soup of new accommodative facilities, but almost nobody can keep track of all of them.

Give us the big-picture summary. What has happened? What are central banks doing? And what's the summary of all the actions that they've taken?

Jim: What central banks are doing – let's first of all go to the top and say there is going to be a pre-virus world and a post-virus world. And that I think this virus – I'm with you, I think is going to be the defining thing of this generation.

The marketplace – we have to talk about that more later – but the market place right now is saying that the post-virus world is a completely different set of valuations. It's going to be de-globalization, de-risking, higher inflation, lower multiples, restrictions on trade, restrictions on travel, and the whole nine yards along with that.

So we've got to change the way that we are doing business. And that means all prices have to come down.

Now that all prices are coming down, central banks are seeing what's happening and they're trying to stop it. And I don't think they can.

So they've been pushing out this set of rules and regulations and new programs. In fact, Christine Lagarde actually put out that the ECB will have no limit – on her Twitter account at

1:30 in the morning in Paris.

So they're doing this stuff 24 hours a day right now. The Fed made their announcement of a money market liquidity fund facility at 11:30 at night, last night.

Now what's happening, simply put, is, as the selling began at the beginning of the month, late in February, the dealers that make markets were seeing everybody sell to them. They were buying from them. They bought to the point of their balance sheet. They couldn't buy anymore.

Everybody's continuing to want to sell to the dealers. And the dealers are stuck. And they're having a very difficult time making markets.

That is primarily showing up in the credit markets.

The Federal Reserve and some of the other central banks, seeing the problems that the dealers are having – their balance sheets are full, everybody has sold to them, they can't buy any more – said, look, we will offer you repo at a trillion dollars a day.

Now, that's really meant to just be an eye-popping signaling number, a trillion. The real number is actually infinity. They will offer as much as the dealers can take. But they put a nice big round eye-popping number on it. But if they wanted two trillion, they would give it to them. They wouldn't just stop at one.

But the problem with the dealers is they're not taking any of this repo infinity (if you want to call it that). And the reason they're not taking it is the last 12 years, in the post-crisis world, what we've been doing is creating these – regulators have been putting out all these rules to prevent banks from leveraging up.

That was the problem in 2008. So it's Basel III, it's the BIS, it's the European Banking Commission, it's the ECB, the Fed, the FDIC, the OCC, M-O-U-S-E. All of them together have put all these rules.

So the Fed says, here's your trillion dollars. And the banks go back to them and say, *I've got all these rules. I'm not allowed to take any of the money.* Yesterday they took $10 billion of it. $10 billion of a trillion dollars is what they wound up taking in total.

So the Fed then said, *okay, your balance sheets are full and you can't expand them any more through taking my trillion dollars of repo. So I'll drain your balance sheet*. And that's QE.

They were, through yesterday, buying $40 billion of Treasuries a day plus some mortgage-backed securities on top of that. In other words, I'll reduce your inventory by $40 billion. I'll drain it. And then you can refill it.

This morning, the Fed announced they're going to $75 billion, starting today. And $75 [billion] tomorrow. Plus more MBS.

And the ECB yesterday announced that they are going to do something similar. We're going to try and drain their balance sheets so that they can then refill them by making markets.

The problem is – and I put this on my Twitter timeline just in the last 24 hours – if you look at the ETFs, the bond ETFs, they are trading at enormous discounts to the NAV, the net asset values.

So the net asset values of these – and I'm talking about the five largest bond ETFs, not some random ETF. I'm talking about AGG, BND (Vanguard's total bond fund), TLT (the 20-year Treasury), LQD (the large corporate bond fund by iShares), and HYG as well. Those type of funds.

If you look at them collectively, they're trading at massive discounts. Meaning here is the price of all the bonds in their portfolio, here is where the ETF is trading, up to as much as a 4% to 6% discount. Which is incomprehensibly big for the bond market to see those kind of discounts.

And the reason that you're seeing those levels of discounts, that is the market telling us that the real fair value in this post-virus world is far lower prices.

And the dealers, even though they're being drained and being told to make markets, they're still stuffed with all these securities. They don't want to mark them down and take gigantic losses.

So that's been the rub. And that's why the market has been so dysfunctional the last several days. Does that make sense?

Erik: It makes a lot of sense.

Now, I got an email this morning from a very well-connected CEO, a regular listener to MacroVoices, telling me that one of the issues that a lot of the banks are dealing with is market makers. They're trying to send people home, to work from home wherever they can.

But by law – FINRA Series 24, I believe – market makers cannot make markets from home. That's against the law. And apparently there is no waiver for that.

And they think that one of the issues is there's people getting sick on trading desks. And they can't send them home because the market makers are not allowed to work from home. Hopefully that will change.

I don't want to focus on that specific issue. But it seems to me like it's indicative of a much bigger problem, which is (I think you and I agree) this crisis is just barely getting started in terms of what's coming to the West.

What happens when we want to keep financial markets open (I think it's important to keep financial markets open), but the key players are unable to work from home and it's not safe to have them in institutional trading floors anymore.

What kind of systemic risks does that create that perhaps nobody had ever thought about?

Jim: Yes. To your first point, that's just more of the same. We've put together these rules. And, in fairness to the regulators and everybody else, no one before January ever even contemplated what if there was a global pandemic that required a complete shutdown of the global economy? That was something out of science fiction and not something that you would have to consider when writing regulations.

And the problem with all regulators is they're very slow after years of putting together rules.

Whether it is you can't make markets at home, or you can't change your leverage rules for the banks, or even if it's the CDC telling the flu campaign in Seattle you're not authorized to do COVID-19 tests – even though you single-handedly found the clusters in Seattle, you have to shut down because you're just not per our regulations.

That's the way all regulators think. And so it's going to be difficult for them to give away that power and say, okay, we're going to have to change all of this.

In the meantime, that just means that markets will stay dysfunctional. They'll stay problematic. Markets will continue to try and sink lower and lower as we go from here.

And the risk is an overshoot, an overshoot on the downside.

The S&P is now down 30% in exactly a month. One month ago today, February 19, was the all-time high. And now we're 30% down. The fastest from all-time high to 30% ever (not even close), 1929 was the old record.

The fear is that metastasizes into 40% or 50% in short order. And I don't think the financial system can handle that kind of a decline without there becoming a full-blown financial crisis.

Look, we might be on the verge of one right now because of all of these losses. I think the only reason people don't think there is one, I think there is a lot of shock. *I can't believe this is happening. This isn't really happening. This market has to rebound, Erik. Right? Please tell me it's going to rebound and it's going to be okay.*

So that hasn't really sunk in to everybody just yet.

Erik: Jim, I think the reason it hasn't sunk in is because (I would argue) that this entire 10-year greatest bull market in the history of the stock market that began in 2009, to me, the enabler of the entire thing is what used to be called the Greenspan put. And More recently the Fed put.

The notion that, hey, if things get really turned south, the Fed's got our back. They're going to bail the market out.

Jim, I would argue that the Fed put expired at about 6:15pm on Sunday evening.

And what I mean by that is on Sunday we had what I think was the biggest monetary policy intervention in recorded history, as I understand it. And everybody thought, okay. Well, surely that's got to just send markets to the moon, to the upside.

We ended up with futures limit down within 15 minutes of the Sunday futures open, opposite expectation. Jim, to me, that was the moment where the market's confidence in central banks to be able to solve any problem failed. And it failed spectacularly and instantly.

Would you agree with that? And, if so, what are the consequences and implications of the Fed put having expired?

Jim: I completely agree that it did expire at that point. Or maybe even a little bit before. But that was definitely the whack to the face that it doesn't work.

And the reason the Fed put expired is because, fundamentally, we've got the wrong prices. Fundamentally, I think the market thinks that the proper price is still lower. And we're unwilling to accept that that is the case.

Erik, maybe you've seen the same thing I do. All my friends that offer their opinion about the market to me, almost 95% of them are trying to pick a low. I can't find anybody at this point that still thinks that this market should still be sold. Everybody is still trying to pick a low right now.

No one can conceive of this idea that, no, maybe it's a new era. It's a new post-virus era. And the post-virus era means that we are now in an era of lower prices.

So the Fed put only works if your prices are somewhat near fair value. Then if your markets are functional and the Fed comes in and it does things aggressively, then it can help boost markets, the buy-the-dip mentality.

But when you've got the wrong prices, and you know that because your markets are dysfunctional, you could announce infinity. The Fed could just say infinity and beyond on everything.

It's not going to change the reality that the market thinks it's just in the wrong place and it could wind up going lower.

Erik: Jim, I could not agree more.

The one thing I get from all of our listeners on Twitter, I get emails saying, *by God, haven't you covered your shorts? Don't you see? This is the bottom*.

And my reaction, Jim, is wait a minute. The market hasn't even begun to come to terms with what's about to happen. Everybody is finally starting to realize, okay, we've got a problem. They haven't come to realize that it's entirely possible that Hubei Province could be a proxy for what's about to happen to the United States. And I made the case in my podcast yesterday for why I think that is entirely possible.

So I'm your one guy that you know who thinks this is not a time to look for the bottom. It seems painfully clear to me – if you look at Page 8 of the Ferguson report that I talked about on yesterday's podcast – it seems clear to me that when would the logical time be to be buying the bottom? End of May, first of June. I think that's when the market bottoms.

But I want to come back to the Fed put having expired, because the question then is what are the consequences and implications? And what will happen next? And what should be done next?

Something that you've said publically, Jim, is if the low that we've seen doesn't hold – and it looks like it's not holding – you think that regulators are likely to shut down financial markets entirely.

What I haven't heard from you publically is do you agree that that should happen? And if so why?

Jim: You're right. Let me be clear on this. When you start talking about shutting down the financial markets, you're down to two terrible options.

Option #1 is let the markets freefall and let the damage that they may cause ensure.

Option #2 is to halt the markets from having that freefall and the damage that may ensure.

There is no Option #3 – the market bottoms and it goes back up and the problem goes away.

So you're stuck with two very bad options. I think regulators do not want to close markets. I think there's going to be a progression of how they'll attempt it.

Progression #1 is they throw everything but the kitchen sink at it, which is what they're doing now. And, by the way, Erik, as we're talking, the Bank of England just cut interest rates just three minutes ago.

And #2 will be they'll ban short selling, they'll ban leveraged and inverse ETFs, they'll allow only liquidation trades only. They might ban stock index futures or maybe shorting of stock index futures. They might ban put buying or something like that. They did versions of that in 2008.

And that's already taking place in Europe. They've started to ban short selling and the like.

And then #3 – if that doesn't work and the market keeps going down, they have to look at some of their big banks, some of their big financial institutions and say *we can't let this keep going*. *They're going to fail. We're going to have 10 Lehmans on our hands. So shut it down.*

And you shut it down to the time that you wind up saying now we've tested enough, now we understand what the problem is, now we know where the economy and markets should be, let's reopen them and price to that level.

And then hopefully, even if that is a lower level, it's a one-time markdown and then we can spend that time figuring out what we're going to do and then go forward from there.

So I understand it's not an ideal situation. I fear that that's what they're going to do.

I'm sympathetic to that argument because I'm also not thinking that – the other thing is just let it go to hell and we'll figure it out after – that might actually be worse from there.

Erik: Jim, I hear you loud and clear. But I see those two options a little bit differently.

As you said, Option #1 allows things to melt down. And my prediction would be that I don't think that Americans have even begun to come to terms with what's happening. I think the people that are looking to buy a bottom are completely missing the story. And I think there's a lot of downside still to come.

So I agree with you that's very ugly. It potentially leads to systemic problems that are not just about people losing money on the market but that really affect the national economy and so forth.

But I see Option #2 differently. As I see it, the choices are either you can continue to have transparent price discovery and watch prices go down. Or you can close markets and values continue to go down exactly the same way.

But it's exactly the same as an ostrich digging its head into the sand. What you're doing is you're not able to see what is still happening.

And the other consequence of that is it means that you cut the people who might need to tap their savings the most off. The guy who needs – even though he's selling at a very unattractive price – the guy who needs to sell some of those stocks in his portfolio because he's got to feed his kids and he lost his job because of the virus, that guy loses access to the markets.

So I don't see the Option #2 as being any better than Option #1. I want to give you a chance to tell me if I'm wrong and why I'm wrong.

Jim: Well, the thing is, you're not wrong. The problem is that, again, I want to emphasize you're down to two terrible options here, is what we're down to. There is no sunshine and flowers option that we haven't considered there. I just wonder which one would be worse in the long term.

Now, again, I'll also mention that they'll do this in stages. Like I said, the next step will be ETFs and they'll ban short selling and stuff like that.

When we say "shut down the market," I do think that they will probably put some kind of facility in place for people to maybe borrow against those holdings, or money market funds would still be around to allow liquidation.

But it is an option to be considered. I don't think that markets are quite bad enough now that that's there. But if we have another serious down leg, I think that that's on the table.

I am not going to defend the "close the markets" to my dying breath. Because I think we can agree, Erik, that we're talking about two terrible options here. And there isn't a third one.

And let's hope that we don't have to be having that discussion. But it is one that people should consider if things turn much lower as we continue to move forward, that that is probably going to be discussed.

I understand the Philippines tried it last night. They closed their market. It reopened today and it fell 24%. So there is that risk. Like you said, it just keeps getting repriced and it just reprices lower.

Erik: And I just want to point out, for the benefit of our listeners, all of the research shows that speculators reduce volatility in markets, not increase it. Short-selling bans not only don't work – it's been proven over and over again in research and analysis – but they can actually be counterproductive and exacerbate the problem.

So I don't think that's a good thing. But that doesn't mean it's not going to happen.

Jim, I want to move on to another major subject, which is on MacroVoices for years now we've talked about a specific scenario that I've been very, very concerned with.

There's a rule in finance which is *the things that you have to worry the most about are the things that most professionals agree are not just unlikely but impossible*. And one of the things a lot of the people think is impossible is a breakdown in the historic inverse correlation between stocks and bonds.

And what I've said for years is someday we're going to have some kind of crisis where we've blown these bubbles in both the stock and bond market, they're both going to start selling off at the same time. And when that happens, watch out. Because it's going to force the unwind of the entire risk-parity complex, which is the biggest institutional trade in existence.

I am very, very intrigued by this backing up in yields. You are a fixed-income guru. I fear that what we're starting to see is that breakdown of correlation, where stocks and bonds are starting to sell off at the same time.

Is that what's happening? And, if so, what does it mean?

Jim: Yes, I think that's exactly what's happening is that the correlation is breaking down. Let me go with what it means and then I'll tell you why.

It means that, on the institutional side, risk-arity trades and risk-parity strategies are not working. Risk-parity strategy, if you're not familiar with it, is you're trading the relationship between stocks and bonds, swapping back and forth between them.

But when the relationship changes, you're just trading one losing position for another losing position. You just keep going back and forth.

The biggest risk-parity trader is Bridgewater. They reported last week that they lost 20%. And so you've started to see that start to play.

On the retail side, the whole modus operandi of the wealth management business, which is booming in the United States – 400,000 wealth managers that are driving the market – is everybody needs to be in the 60/40 portfolio. Because the 60/40 portfolio has that 40% fixed income leg that's supposed to protect you on the downside.

Well, that isn't working either is what's happening. That's been falling as well. So that's been creating a lot of pain on the retail side.

Now, why is that happening?

The answer, I think, is inflation. The reason – first of all, the stock-bond relationship is not stable. It does change over time. It goes from being both of them move together to both of them moving inversely (or negatively correlated) to both of them moving together.

The current stock-bond relationship that we [now] have started between '98 and 2000, that is where stock and bond prices move opposite, or yields and stocks move together. And the reason it started around '98 to 2000 is (you'll remember) that was long-term capital, the Asian financial crisis, and the tech bubble.

And coming out of all of those events, the word "deflation" became a front-and-center idea for

20 years. We worried at varying degrees for deflation.

In a deflationary mindset, when stock prices go down, we're afraid about deflation. You run the bonds. Once stock prices go up, we are not as afraid of deflation. You get out of bonds. And so that relationship held.

But if you go to an inflationary environment – and that was the '70s and the '80s – when you fear that inflation is returning (mainly the '70s), bond prices and stock prices both go down. Yields go up and stocks go down. Same thing. And that is bad for them.

And when you are relieved that that there is no inflation (the '80s), they both go up together.

I think what's happening is that the market is saying that 20-year deflationary era is coming to an end and the era we're about to transition into is going to be an era of inflation. And that you're now going to see stock and bond prices go up and down together.

And that is going to take a while.

First of all, it isn't a light switch. Well, this is the old relationship, this is the new relationship. When we switched from '98 to 2000, it was fully two to three years where it seemed like it broke down, it reconnected, it broke down, it reconnected, it broke down, and then it stayed broke down.

This one will be the same way.

The stock-bond relationship is changing. Stock and bond prices will move together, not opposite each other. So that when you see a hint of inflation or you see a hint of problems, they both fall. When you see things getting better, they both rise.

And that is going to change the whole way that 30 million people have their money with wealth managers. And it's in some version of a 60/40 portfolio. 36 million accounts need to be changed.

The whole way that Wall Street hedges itself and views the markets in a risk-parity framework, that's got to change.

It doesn't have to change today. That relationship will vacillate over time. But I think that it is about that we finally are transitioning to an inflationary period, something we haven't seen in at least 20 years.

We're not there now; that's a post-virus thing. And we're about to head there as we get through this initial crisis with the virus.

Erik: Jim, I want to make sure that we put this in perspective. Because we had a major blow-up in markets at the beginning of 2018.

What happened was the whole volatility complex basically blew up in one day. And the reason that happened was a very, very small little clique of guys figured out how to monetize the contango yield in the term structure of VIX futures. And it was a picking-up-nickels-in-front-of-a-steamroller trade. It produced just terrific returns until the day it blew up.

And they all got their fingers burned.

That was a tiny, tiny, tiny, little, small, miniscule percentage of the people in financial markets that were even involved in that trade. And their activities caused an event that sent ripples through the entire financial system.

What we're talking about here is not that.

We're talking about everybody who's got a 60/40 portfolio. That's basically 99% of retail investors, plus most of institutional finance.

Most of the big hedge funds like Bridgewater and so forth, what they're all about is kind of a turbocharged version of that 60/40 portfolio. They've got equities and then they use leverage to lever up the bonds.

The only way, Jim, that they can justify having that leverage – because normally leverage involves an extreme amount of risk that would not be appropriate for an institutional portfolio – the way they justify that leverage is that that risk of leverage is hedged by the equity portfolio and the inverse correlation.

What it means – and this is the part I really want you to tell me if I've got it wrong, because you're much closer to these institutional guys than I am – what I understand it the way that they do business, if the correlation breaks down, they're forced to unwind their trades.

It's not a question of anybody panicking. It's a question of, oh, the numbers say this, I'm now forced to do that. And that, in this case, sell all the bonds and all the stocks.

Is it really as simple as that? Or am I reading too much ZeroHedge?

Jim: Roughly, the framework is right. First of all, the 2018 period you referred to, I love the word is volmageddon, and that is what we referred to it as. But let me put it to you more basic.

They are allowing themselves to leverage and be aggressive because there is a belief that there is this gigantic asset class, the Treasury market, that I could run to for a hedge. I could be way out there on the edge, you know, risking it all. Because in a heartbeat I can go and protect myself in the Treasury market because it moves in the opposite direction all the time.

But if on the other side you start to realize I'm way out there on the edge, and if something goes wrong, there is no net now. There is no, oh, just go engage in buying some derivative space on Treasuries or swaps or something like that. And, therefore, if I lose on this primary trade I will offset it on this hedge.

There is no hedge. There is no thing you can do to protect yourself.

There is *one* thing you can do to protect yourself. Sell out of your position, liquidate your position.

So, yes, that's exactly what's happening is that they're starting to realize I don't have a way to protect myself anymore. Or, I do. It's called liquidate and go to cash.

And I think that that's part of what's also driving the immediacy of these trades right now. That they can't do it.

Like I said, I saw this in the fourth quarter of '18. In the fourth quarter of '18, when the stock market – you recall, the Fed was talking about hiking rates. And then the market sold off 20% and everybody was screaming at Powell that he had the wrong strategy.

The bond market, the high-yield market, was looking a little bit wobbly. But nobody sold anything in the high-yield market because they said, hey, we've got HYG, I could short that. We've got credit default swaps, I could protect myself on that. I could be – put options on HYG.

And so I'm not going to sell my big massive portfolio of illiquid securities. I'm just going to ride it out with a hedge. And then when I think it's all done with, I'll get rid of the hedge. Because the hedge is easier and more liquid to put on and take off.

You don't have that now. You don't have that now in dysfunctional markets. You only have liquidation.

And that's where I think that – that mentality is there in some places. Their hope is that those hedges will return and that that risk can come back. But if these relationships have changed, those hedging opportunities are not going to come back.

Erik: Okay, Jim, I want to put this in perspective.

Because, on one hand, what we're saying is with this changing correlation it forces people to liquidation and they don't really have another choice. Meanwhile, not only can they not hedge anymore, but we also agree that the Fed put has expired.

Now you say the only option is liquidation.

I just want to be really clear. Liquidation is not a solo act. It takes two to tango. Liquidation means selling something, which somebody has to buy. If we've got all of institutional finance and all of the panicking retail complex selling both stocks and bonds at the same time, who are the buyers in that scenario?

Jim: Well, there isn't. And that's why, as we talked about in the beginning, the dealers are full, the markets are dysfunctional, and we've seen the biggest collapse ever recorded off of an all-time high in markets.

This is, like I said, it especially shows up in markets that are not traded on regulated exchanges, like in the credit markets and stuff.

So this is why these markets are so stressed and this is why these markets are trading at such difficult levels right now. And why I think that it's still a little early to call for a low in the markets.

You're just trying to catch the proverbial falling knife. Maybe you get lucky, but it's never a good strategy to do that.

Erik: I really want to pick up on that point, Jim, because I couldn't agree more. And something that I keep hearing – the biggest bit of feedback I'm getting both on Twitter and emails from listeners is, *okay, surely you know this has gone all the way down 30% and it's got to be time to buy the bottom. What should I buy here?* That's the question I get.

The other thing that I hear a lot is *it's interesting, the way this one went. Because we've gone all the way down now. But what was curious about it is it happened much faster than previous crises. In previous crises, at this point timewise, we'd only be one third of the way through the crisis.*

And I think what people are missing is what if we're only one third of the way down? What if this is only the first third of the price movement?

And the reason I say that, Jim, is I really think in the United States of America that hardly anybody has come to terms with what's about to happen.

If you look at Ferguson's report, which we talked about in detail on yesterday's podcast, what it shows is we're at a point now where we haven't even gotten to beginning to overwhelm health-care systems. We haven't gotten to the point where the reflexive feedback loops start to kick in.

We haven't gotten to the point – and when people ask me, *well, if you don't think this is it, what's the number?* And I tell them there's no number. I don't know the number.

But when I think it's logical to expect markets to maybe start to bottom would be the end of

May, beginning of June. Because that's the peak point on Page 8 of the Ferguson report. That's when we're going to have the most blood in the streets, in terms of the virus effects peaking.

And what we've seen so far is this market is not anticipating ahead of time what's going to happen. The market only reacts to these virus events after they've occurred.

You and I were talking about this at the end of January. The market kept going up. It wasn't until the cases started happening outside of China, even though all the smart people knew that was going to happen.

Markets didn't move until the evidence was there. And so, by that logic, I don't see why you would expect markets to bottom until the end of May.

What's wrong with that logic? Because I want to make sure that I don't say that and not have our listeners hear the other side of the story.

Jim: There's nothing wrong with that logic. For those that want to buy a bottom – okay, the market's fallen a lot. And that's your definition that we need to make a bottom.

What's the consequence of this? What happens when the virus goes away? And I think most of these people, their answer is we go back to work and everything returns quote to normal. What if it doesn't?

Then you have to start contemplating that maybe what these markets are trying to tell you is that coming out of this is not going to be the same as it was going into it.

Even if we find a vaccine, I don't think it's going to be the same. I think things are going to change in a lot of different ways as well too.

When I say it's going to change before we even find a vaccine – the Neil Ferguson report. By the way – I mentioned this to you offline, I mentioned this to the listeners – he announced yesterday he tested positive for COVID-19 as well too. He talked about all of the suppression techniques that we could use to flatten a curve and not overwhelm the health-care system.

But the thing that supposedly got Trump and the White House really eye-opened was this returns in the fall. This returns next year. So it isn't we flatten the curve, we try to lessen the burden on the health-care system, and then it burns out and it goes away forever.

It only goes away when one of two things happens, according to the report. Herd immunity, which is 70% or 80% of the population of the planet gets this and builds up an immunity to it. Or a vaccine.

So we're all preparing to work at home. We're all preparing to have our kids be homeschooled online. We're going to do this again in the fall. We're going to do this again in the spring of '21.

Until either herd immunity or a vaccine comes.

I bring that up hoping that is not the case.

But the reality is why do you think markets are doing what they're doing? This is what they are afraid of. So why are you in such a hurry to pick a bottom? You would be, only if you think this is going to be temporary. It will go away and then it will be right back to January 2020 as if it never happened.

I cannot imagine that that would be the case.

I could see in the post-virus world that we're going to do this, not only over and over until this is over, but the next one.

Every two to three years, there is some kind of pandemic that comes out of Africa or Asia – SARS, Ebola, MERS, H1N1, bird flu. We didn't take any of those seriously. Well, when we're past this one, 2022, 2023, and the next one comes – because there is always another one – we're going to shut everything down all over again.

And then we're going to say, well, nothing came of it, nobody got sick. And we're going to say, aha, it's because we shut everything down. Or maybe it wasn't that serious. Not after 2020. We're not going to pretend that these things aren't serious anymore.

So my point is we're not going to go back to where we were before. So that's why I think that we need to understand what these markets are trying to tell us. And I don't disagree with them. I don't think that these markets are wrong in their assessment of where we're going next.

Erik: Jim, so far we've been discussing this in terms of the virus, as if it's all about the virus. I'd like to introduce another possibility.

I would make the argument that, for the last 10 years, we've had what a lot of people have criticized as a completely unsustainable system. One in which the previous free-trade, free-market capitalism was kind of replaced by central banks and central bank liquidity fueling a massive bubble in both stocks and bonds at the same time.

And, because that correlation was working, it allowed people to just keep laying leverage on, leverage on more and more. The bubble kept getting bigger.

What if it turned out that, although the virus is a really, really big deal – I think we agree on that – what if the main effect of the virus on financial markets was not its direct effect but rather that it's serving as the pin that pops a bubble that systematically needed to be popped or was going to pop someday anyway?

Maybe this was just the catalyst that brought about a collapse of what's been built for the last ten years (I would argue) on kind of false pretenses.

Jim: I think that's exactly what it was. It was the pin.

And I'll remind everybody – let's look at some previous examples. Well, you know they'll say, *you remember SARS. I don't*.

Yes, do you know what day SARS was announced as a global pandemic? Two days before the Iraq war began. We were preoccupied with other things. And that was April of 2003. The markets had already, were just completing a recession. They were just coming off of 40% decline. There was a risk attitude in markets best summarized by the Federal Reserve.

In March of 2003 – the Federal Reserve used to offer this assessment of the economy, and they said the assessment of the economy was so uncertain that they couldn't offer it.

Well, if you're going to have a pandemic in that environment, when everything is already depressed and you have fear, you're not going to get much more of a depression in markets.

1918 was the same thing. Markets were depressed in that year because we had just fought a terrible war. That's why the Spanish flu did not wind up having some kind of a negative effect on markets.

This one came at the height of a raging bull market. This one came at the height of a market that supposedly had the perfect hedge. Go ahead, risk the farm on everything. And you can run into liquid Treasuries in three seconds to protect yourself if it doesn't work.

And this was the one where everybody's got to buy stocks. The famous Trump tweet of January of this year. Stock market's up 90%, why aren't you and your 401K? It's not too late.

And I'll only say don't totally blame Trump on that. He was reflecting a mentality that a lot of people had. It was when this one came, not what it was.

SARS might have done this, if it came in January of 2020. The Spanish flu might have done this if it came in 2020. But they came when markets were already depressed at near-recessionary levels to begin with.

This one came in the 11th year of an expansion when the president of the United States is running a re-election – you need to re-elect me because the stock market is up. That was the belief that we had on it.

So, yes, this was the big pin. You never know what pin is. But you know the balloon is ready for a pin. And this just happened to be it.

Erik: Jim, before we close, I want to first salute you because you're the only guy I know of in finance who has been consistently two steps ahead of me on this whole coronavirus issue since Day One. You were on top of this and your graphs and charts and your projections of the exponential growth curves have been incredibly insightful.

So, as the guy who saw this before everybody else, my final question to you is this:

What do you see that maybe nobody else is seeing yet? What are your new theories that maybe aren't fully vetted yet but you're thinking about that maybe no one has seen that might be of interest to our listeners?

Jim: Okay, I've got one about China. And I'm going to throw out a big number. And let me define it. China says that they're 81,000 cases. I think that they're off by orders of magnitude. And I think that they're off by 1,000-X. Now let me explain that.

I think there's 81 million cases in China. Let me rephrase that. That's 6% of the population, meaning 94% did not get this. That sounds entirely reasonable, that 6% of the population of China got this. Not 81,000 but 81 million.

Remember, that's a country of 1.4 billion people.

They say that they had 3,400 deaths. I think that that's off by 1,000-X. I think it's more like millions.

Now the reason I say that is, well, wait a minute, a death is a binary thing. You're either dead or you're not dead. Keep in mind that in the Chinese health-care system they do things a little differently.

There was an exact example of this came around in February. An 85-year-old man with a heart condition contracts coronavirus. He's in his house under quarantine and he's feeling deathly ill. He leaves his house from quarantine to walk to the nearby clinic. He has a heart attack and dies one block from the clinic. And there was a famous picture of him lying on the sidewalk.

The health-care system in China will list him as *Cause of Death: heart attack*. It's accurate, because he died of a heart attack. But they don't list a secondary cause like we do in the West.

So I think they're grossly underestimating the number of people that have died from this.

Now why is that important? Because I do think that they've finished a wave and that they've probably flattened out, but at a much, much higher level. They are trying to restart their economy.

And I'm going to give you one statistic. TomTom is the GPS tracking system that is in a lot of cars. TomTom has real-time tracking of congestion indexes for major cities around the world. You can go to their website and find out to this minute what are the congestion patterns in any city.

If you look at Milan and you look at Rome, in Rome and Milan, they are showing congestion patterns are down 20-ish% maybe 25% thereabouts, depending on what time you measure it.

In China, where the government is still trying to announce we are restarting, we are getting back to business, they are still down 40% to 50%. I think the biggest story that we're missing – but, oh, it's all over within China.

We don't understand the amount of emotional and psychological damage that this did to the Chinese economy. You don't shut down the Chinese economy for 81,000 people that caused 3,400 deaths in a country of 1.4 billion.

You do it because it's far, far worse.

And that emotional damage is far, far worse in China. And you also see it in social media and you also pick it up that the amount of social unrest, the amount of complaining to the government. The amount of complaining online is the highest that they've ever seen, that people are very angry that this happened to them.

This is leaving a mark in China. And that's what I think we need to understand. It's going to leave a mark in Italy. It's going to leave a mark in Iran. It's going to leave a mark in Europe. And it's going to leave a mark in the United States.

We don't know what that mark is going to be, but we can see that China is really struggling to get back to normal, even if their caseloads are as low as they say.

But it is much more damaging than anybody thinks. They just did not sit at home and watch endless hours of streaming videos and then they're going to go back to work like nothing changed.

Erik: Jim, before we let you go today, please tell our listeners what you do at Bianco Research. You've got a day job that's not solving the world's problems and being the first guy to see the coronavirus situation.

What's your normal day job? And how can our institutional investors find out more about what you offer?

Jim: Bianco Research is an investment service that is primarily designed for institutional investors. It really revolves around macro and the fixed-income markets. I am affiliated with an institutional brokerage firm called Arbor Research and Trading. It has a bunch of bond brokers that do trades. Or you can purchase subscriptions to our research as well.

In these unusual times, I've really turned up the volume on social media:

LinkedIn: James Bianco
Twitter: Jim Bianco (@biancoresearch)

You'll find a lot of what we're doing now. Because markets are so fast moving and, when you put out a daily letter, it's like, wow, look at this. I can't wait 20 more hours to let the world know about this.

So I've been doing a lot more of that on social media and probably will until things calm down. I won't go to zero when it calms down, but I'll do a little bit less of it there.

And then there is our website biancoresearch.com. You can request a fee trial on our website and you can get right in and see some of the stuff that we do.

Erik: Well I can't thank you enough for a terrific interview. We look forward to getting you back in the future. And again listeners, @biancoresearch is an absolute must-follow on Twitter to stay abreast of Jim's latest charts and graphs regarding the coronavirus crisis.

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