MACRO Voices
with hedge fund manager Erik Townsend

Diego Parrilla: False Diversification and Risk Parity Unwind

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Erik: Joining me now is Diego Parrilla, portfolio manager for Quadriga Asset Management and bestselling author of two books, both *The Energy World Is Flat* which he co-wrote with Daniel Lacalle, another very popular MacroVoices guest, and another book, which we talked about in Diego's last interview, called *The Anti-Bubbles*.

Diego, it's great to have you back.

Needless to say, what's on everybody's mind is, holy cow, look at the stock market. It seems like there's a lot of good arguments being made that we've still got a global pandemic. It's not over. There's riots breaking out in the streets. There's a lot of stuff going on. But, boy, the market, tapewise, just couldn't look stronger.

What do you make of all this? And how should investors think about it?

Diego: Well, first of all, thank you for the invitation. It's great to be back.

I think there are really three major tectonic forces that are driving global macro. And, to a certain extent, they are pushing and pulling in different directions.

The first one is the fact that the damage was already done. So this is the idea that a decade of, effectively, artificially low interest rates and monetary policy without limits had transformed the investment framework from, what I would say, the transformation of risk-free interest into interest-free risk.

You have something like the bond, 10-year bonds going from 5% on the 10-year to 30-year negative nominal yields. This is effectively creating a total distortion of asset prices, effectively driven by mainly artificially low interest rates. But we'll discuss this at length with the belief in the central bank put, the complacent, desperate search for yield and how that has created a series of global synchronous bubbles without precedent.

Then the second thing is we are suddenly hit by a shock without precedent. It's been a shock in multiple dimensions.

It's been a volatility shock where the VIX went close to 90 – levels we haven't really seen since 2008. It's been, obviously, a demand shock with things like oil going into negative oil prices and massive destruction of jobs and the economy. You have, obviously, a supply shock with logistical chains. You have a health-care shock. You have a political shock. You have lots of things.

And this is obviously making things even worse.

Then you have the third force, which is effectively a monetary and fiscal response without precedent both in terms of the size, which has dwarfed in a way 2008, the speed at which it happened. Just within a few days or weeks we had the mobilization. Again, way notable than 2008.

In terms of scope, so the Fed going and basically buying beyond government bonds going all the way to high-yield. And, also hugely importantly fiscally, which is something that had been planned for – you look at Europe. The transition at the central bank was already realizing the fact that monetary policy might be approaching its limits and how we would need to combine this fiscally.

So we've seen the recovery fund, we've seen all sorts of MMT with checks given to people, increasing spending, increasing debt. And we cannot underestimate the impact of this third force in multiple ways.

First of all, obviously, cutting the tail risk associated with the utter collapse. It's only a few weeks ago that lots of people were calling for a depression like in the '30s. And suddenly it's all looking at historical highs. It's just extraordinarily brutal how things have moved.

But also, quantitatively, once you remove this tale, the narrative of the market, the central bank put and the squeeze of lots of shorts has obviously contributed. And what we're seeing now also is signals being triggered.

You have volatility coming off from high levels to around 25%. You see very strong trends. And you see, arguably, some FOMO. But, more importantly in my view, also a lot of quantitative buying, which be careful with that because I think we've seen this movie a few times already.

I mean, we saw going into the end of 2018 how trend followers were max long at the top in leverage form only to effectively be taken out. It was a sharp move increase in volatility and collapse in price, which effectively forced them to buy it back all the way to 2019, only to be taken out again in 2020.

It's almost like this roller coaster. It's almost Darwinistically looking to take out all this massive increase of day traders and things that you might be fooled by, these short-term dynamics.

So I think that from a bigger perspective this is not a healthy situation. The damage has been done. The current shock is to be assessed, really, how much permanent damage versus temporary.

But what we know with some degree of certainty is that perhaps the virus will go hopefully soon and things will improve. But a lot of this liquidity will stay.

And I think this has been a dominant feature in the markets where central banks and governments use these opportunities, these crises, to introduce dramatic measures. And then they take years to, if anything, to unwind them. And they become permanent.

So we've seen that dynamic happen after 2008. And that's why, perhaps, we have distorted even more what was already a highly distorted picture.

So it's really, I think, this shock has an extra level of complexity, which is the transformation of the world we live in. I mean, there are some businesses that are experiencing challenges like never before. And they are probably gone by now and there is a lot of opportunity.

So I think this shaking up of the world, considering where we started, the dimension of the shock, and this sort of response, this creates a highly uncertain world, certainly in my view highly distorted.

Erik: Let's talk about the US dollar next.

Those of us who thought that there was going to be an upside resolution for the US dollar because of the extra flight capital moving into the safer currency and so forth, we've been surprised.

We broke out of a trading range where we were really consolidating above 99 for about six months. And just in the last couple of weeks it's broken down to below 97. Most of that owing to a move on the euro.

What do you make of the dollar? What comes next?

Diego: Look, currencies, at the end of the day, is a relative game. It's very hard to call just the direction of the one thing. It's all relative. If I print a trillion dollars and you print a trillion dollars, then we're flat.

What we're seeing with the dollar, I don't think the US could be trying any harder to devalue the dollar. They are benefiting from the US dollar being the reserve currency and the large benefits associated with that. Not only seigniorage, as the central bank can print its own currency, but also with lots of people parking their money with you on the belief that you won't do crazy stuff.

And I think – if you think about what's happening and the response, it's a clear exercise when you start bailing airlines and energy companies and whatever it takes, and you do that with money that is being effectively printed and lent, what's your downside?

I mean, you are the central bank. And the minute central bank independence is gone, what's your downside? I will do this in whatever-it-takes fashion. And Powell has clearly said that.

Your downside is obviously some kind of lack of credibility, some sort of inflation, and some sort of devaluation. Which, arguably, is something the US wants.

Behind the global monetary policy, which is sold and presented as domestic, doing what is good for your own country, there has always been a big factor that is international, the exchange rate.

And the proof – if you think about why we've had negative interest rates in Europe, it's pretty simple. The only reason we have negative interest rates in Europe is because the Federal Reserve in the US was at zero. And we needed to have a negative interest rate differential to devalue the euro – in defense, by the way, to the attack of post-2008.

So, ultimately, the dynamics with the currencies and the monetary and fiscal policies without limits are leading to competitive devaluations. And, in turn, is also leading to inflation dynamics. Whether you see them or not, and how they manifest on to the exchange rate, and how it matches Europe printing both in absolute and relative terms to the dollar, you could argue that Europe is actually printing even faster than the US.

I don't really see this currency race – I use the analogy of a long-term race like a marathon. In the short term, honestly, we're talking weeks or months. Who knows? It's complete noise, to some extent.

But over the longer term, I think that, in this currency war, it is pretty clear to me who will win. And that will be gold.

And it's pretty clear to me who will lose, which are currencies that are printing and that have a lot of hidden leverage and lots of internal bubbles and inflation, such as China, not just the usual suspects, being Brazil or South Africa or others.

So, in the middle, when you look at the dollar and the euro and the yen and the Swiss franc and the sterling, I think the dollar will come strong because some of this shortage in global dynamics.

But against that, you can see that the US is really doing whatever it takes to try to devalue. Mind you, you can read between the lines what is happening and how they are expressing that they have infinite tools and they will use them.

So that's really, once again, bringing us to the topic of inflation.

Erik: Diego, I couldn't agree more with what you just said about gold being the ultimate winner in this race to the bottom between the currencies. But, as we're speaking on Monday (we recorded this a few days early this week), gold is back down to retesting levels not seen since early April. It almost looks like we're seeing the beginning of a technical correction to the downside.

Does that just mean this is a big buying opportunity here? Or is it maybe the case that we've got some down before the big up-move happens?

Diego: I don't have a crystal ball and I tend to look at these moves with a medium- to long-term perspective. I'm on the record thinking that gold might be $3,000 to $5,000 in the next three to five years. So with that mindset, a $20 to $30 correction is just noise.

Clearly, the market has been – what we've seen is not just gold. You've seen quite a few other tails or hedges that people might have in their portfolios against potentially a risk-off scenario. So you see them moving in dollar-yen or the Swiss franc or even Treasuries, and of course gold or the VIX. They're all kind of telling you the same story.

And I think that the move we're seeing is more of a relaxation of the tail and some hedges being taken off and perhaps some shorts or some people being squeezed out.

But I certainly don't think that this is over.

And when you look at these different assets I discussed, I think, yes, this could be an opportunity to add or to rebalance the portfolio. And every time we talk about adding, you need some dry powder, you need to have some money on the sidelines.

But I think this, to me, is more about rebalancing portfolios. You have to have both, as I call it, strikers and defenders.

And when you have these portfolio dynamics when equities perhaps are overshooting on the upside or oil might be shooting on the upside on the short term, when you have a more balanced portfolio, and you have the ability to take some of those out and add some of the defenders in, just like you would do in the same situation when the market goes the other way.

So when equities collapse and some of these hedges or safe havens do very well, you can basically take some profit on that.

So I take this view that you can't fight the stupidity of the market. You cannot fight the (quote unquote) irrationality of the market.

And what we've always done is we try to embrace that volatility, that stupidity, that irrationality. And in order to do that you need to have a team. You need to have the different pieces.

If you are just positioned one way, then this is potentially very painful. If you are leveraged, then you're dead.

And so I think that these short-term volatility dynamics are noise. But there's lots of people who base their entire trading strategies on technicals and things that for me would be noise.

Yeah, they're probably very good at that and maybe they're very successful. But it's not something that we look at.

So, for us, these are, again, big moves. Structural. We play through options. We take advantage of these moves through multiple ways. And, certainly, as these moves increase then we like to add. And this happens through rebalancing.

Erik: You mentioned crude oil a moment ago. Let's touch on that. Saudi Arabia kind of surprised the market this past weekend when they raised prices on exports of oil to Asia by the largest amount I think on record ever. About a $6 increase that most people didn't see coming.

And, even before that happened, I've been really surprised by the strength of this rally.

Something I noticed about crude oil on the way down was, well, the stock market could be held up by Fed-speak and so forth. You know, crude oil couldn't be immune to the realities of supply and demand in the physical market place. It seems like on the way back up it feels to me like it's gotten ahead of itself.

Is that just me being pessimistic? Or what do you make of the very rapid V-shaped recovery that we've seen so far in oil prices?

Diego: I would agree with you. If you think about anticipatory assets such as equities that might be discounting in the long-term picture versus the front-end oil, they are obviously very different. And it's clear it surprised everybody.

When you think about the severity of the demand destruction, the increase in inventories during that time, and the delayed response of OPEC probably insufficient at the time, I mean it really took quite a bit to reverse this.

And you have a second-order effect. Like China. And potentially people don't want to go on the transport public and they want to go in their own cars. So it suddenly has this incredible pickup in gasoline, while diesel and kerosene are still very subdued.

So the OPEC dynamics, there are limits to what they can do. And certainly they have to do something. Because, with that level of oversupply, then once you get to tank tops it's game over.

And I think that issue is still there. We have roughly a billion barrels of inventory overhang to deal with. And it's not like suddenly the demand surprises on the upside and the market is balanced that everything is over. You still have massive inventory to work through.

So you have to – I think it's something that, again, the danger is still there. The danger is much more on the tank tops, let's say, than the other way.

There are multiple risks, in my view, ahead. And I would agree with you that perhaps the momentum and the move – again, going back to not only physical guys but also the financial flows, which might be taking place in the front and spreads and stuff, have been contributing.

So I think the general view is the market is almost pricing a perfect recovery right now, at least in the near term. And perhaps short term the risk might be skewed to lower prices. Not a collapse, but I think mid-30s probably makes sense from the low-40s where we are now.

Medium and long term, I think the challenges will be to balance back that inventory situation and to what extent the demand recovery is for real and what damage has been done also on the supply side.

But I guess the consensus is probably more constructive there, where probably $45-$50 is a reasonable target medium to longer term.

But the problem, as you know, for retail investors – and I think this has been the real shame in these moves – is how painful can the contango be for retail investors for buying the ETF. And it's part of the learning, I guess.

But you're not just buying the price. Oh, I want to buy oil at negative prices. Great, let's buy your size. It's not as simple as that. So I think there are some challenges there in terms of implementation.

And, again, I think you could combine that view that short term, perhaps, things are a bit overdone with, I think, the associated contango and negative carry rate with the long-term view that is more constructive.

It's not that easy to play. But I would think short term cautious. Medium and long term more constructive.

But mind the carry. Because it can eat away capital and create permanent loss of capital, as you know.

Erik: Diego, you mentioned inflation a few minutes ago. I want to come back to that.

The theme that we've seen with a lot of our expert guests is, with differing time horizons, they see maybe a shift from the disinflation to deflationary macro backdrop of the last decade toward either stagflation or inflation.

So I guess my first question is do you agree in general with that view? If so, is it inflation or stagflation? And perhaps, hardest question, how long does it take and what does it look like? What does the process look like to get from here to there?

Diego: Well, I would say stagflation. And I think its timing is unknown.

But I think it's important to understand, you know, lots of people look at the dynamics and they say, well, you have massive unemployment, you have technology, you have demographics, you have overcapacity, we have the bubbles.

These are all very inflationary forces. At the end of the day, the way I think about this is, look, the more deflation you have the more room you are giving central banks to print even more without effectively showing. So it's almost like a freebee that they have.

But let's not fool ourselves. Inflation is 100% a monetary phenomenon. And the way I explain this is it's not really about the price of your house going up. It's not really about the price of bread going up. That's not inflation.

Inflation is about the value of the money that you use to buy that bread or that house going down.

And if you think about the sheer amount of printing out of nowhere, out of thin air – it's not even paper anymore – out of zeros and ones and digits and bits – this is just, I think, unavoidable.

And if you think about it, it's the end game of a decade where you've been literally just distorting valuations and creating bubbles through excessive monetary and fiscal.

So there is no other real way out, I think, than inflation. And this is what central banks want. This is the way to get your way out of the excessive debt.

It's obviously a big problem for cash. It's a big problem for many things.

The problem is what I call the frog in boiling water. We are being diluted – the target officially is 2%. So you would argue 2% is, I think, scientifically calculated so that it is small enough that we frogs in the monetary pot are staying because it doesn't look that bad.

But if you actually stay in this for 10 years, you're going to get 20% compounded. And if you're in this for 20 years you're looking at closer to 50%. So once you see that over that horizon your money has been stolen, really, through inflation, then you see that's so.

Right now it's even worse.

We are outright negative rates. We have very deeply, potentially, negative real rates. So beyond the naivety of savers who don't see that inflation, because the goalpost has been moved and all the other forces, I think this is happening.

Perhaps Phase 1 and the Gresham's law is obviously much lower. You're looking at dynamics where it's not so obvious.

But anybody that has experienced inflation – lots of listeners maybe in Latin America or other places know that once you go into Phase 2, where inflation expectations kick in, then the process accelerates massively.

To what extent is this likely to happen in the near term and what are the catalysts is harder to play out.

But I think more importantly it has created a change in the rules of the game.

We used to think – and this is pretty much since fiat currencies were introduced – this is a game where central banks were effectively given the keys of the printing press and where independence of the central bank was at the forefront. And as Voltaire would have told us, paper currencies eventually revert to their intrinsic value. That is paper.

So in this dynamic, where we are faced with non-independent central banks and where inflation – i.e. the fact that they would abuse that printing press because the government which controls them forces them to do that – I think that's the conventional rules of the game.

So if you thought about, oh, inflation is going to be the problem, therefore they are going to hike interest rates, therefore bonds are going to go down, I think you would be missing the new dynamics. Because my feeling is that the bubbles we have created are so huge they are effectively too big to fail.

And this is the new enemy. So it's no longer about inflation. It's really about bubbles.

So the reason we will have potentially inflation, people might think hiking rates are coming, it's not going to happen. Because if you hike rates, then it's pretty much game over.

I mean, if you hike rates, not just the zombies it's just the entire system, I think the bubbles would collapse. It's not just bonds. It's the entire thing. This construct with zero-negative rates.

So the rules of the game have changed and we need to acknowledge that and know that, in my view, we're likely to go to a world with zero interest rates and inflation. And, effectively, monetary policy and fiscal do not solve problems.

No matter what central banks will tell us, they can prevent the utter collapse of the system occasionally, but if you don't remove these things and you just keep abusing them, they're not really solving any problems. They're just delaying, transferring the problem in the form of currency wars, transforming the problem in the form of inflation, and eventually enlarging the problem.

So I think inflation is at the forefront of the next 10 years. And, just like I summarized the previous 10 years as the transformation of risk-free interest into interest-free risk, I think the next 10 years is the transformation of bubbles that are too big to fail into inflation or, more likely, stagflation.

Erik: Diego, I want to take all of these macro concepts and tie them together into actual portfolio construction concepts, because that's what matters the most to investors at the end of the day.

You and I talked off the air about what some people have termed false diversification, the idea that the old rules of diversification don't quite apply the same way because some of the dynamics of some of those asset classes have changed.

Please expound on that. What are we talking about and why is this important to understand?

Diego: It's hugely important. I call portfolio diversification confusing two simple things. One is – my portfolio has a lot of things. So I have a bit of oil, I have a bit of Argentinian bonds, I have some Amazon, I have some whatever government bonds, and you have a lot of things. And you think you are diversified. The conventional asset-class diversification.

The reality is that when these crises have come, many of these assets, if not all, have actually behaved just the same way.

So correlations actually polarize and you go from a portfolio that looks diversified and assets that are uncorrelated to everything collapsing at the same time. So the false diversification is the risk by which investors think they were diversified. And the reality is they were not.

And this can actually result, unfortunately, in some way as a hidden leverage. It's happened to many retail investors. But it's also happened to the most experienced investors. Ray Dalio and his risk parity, right?

I mean, look, I have bonds and equities. And they are negatively correlated. And therefore I can lever my exposure and I'm always hedged.

And the reality is in March both were collapsing in ways the models were not predicting. Volatility explodes, correlations break. And, bang, we get alongside with many other people completely under a lot of pressure.

So what you need – and this is something that is not easy to achieve but it is what we specialize in – is really you need to find assets that are not just negatively correlated on paper. You need things that behave in a given way.

This leads me to this eternal debate between bulls and bears. I mean, if you are in there you just see all day, hey, I saw the dollar bulls, the bear bulls, and everybody is I'm right, you're right, and now this is going up, this is going – it's just a whole day fighting over who's right or who's wrong.

And, to me, this is kind of going back to my point earlier. This is not about being correct or being a bull or being a bear. It's about having the right team.

You want to have the best bulls in your team and, effectively, your strikers in your team. You want them to score your goals. I mean, the market goes up, you want to make sure that you have parts in the portfolio that will score goals. Yes for yes for yes. And that's their role.

Your role is to score goals, of course. We need to balance out the downside risk when things go wrong. So in an ideal world, your strikers are call options. You want to buy a call option on S&P or whatever.

The other side is you also want to have strong bears. I mean, you want to have guys that, when things go really wrong, no matter how unpredicted or surprised, they will do very well.

And these are things like options, S&P puts, or gold, or different ways that combine.

And this is really what we specialize in. We were 19.1% in March. And currently – and we also made money in April and May, by the way.

So strategy, you need to find ways in which you create that correlation of minus one when you need it. And so when you build these themes of strikers and goal keepers and you can rebalance them, I think it's actually really powerful. And you are embracing that irrationality, that volatility.

And I would take my point farther. I would say that there's lots of strategies that are being sold or mis-sold as one thing – and the capital sin in the industry, in my view, is to say that you will do one thing and you will do something else.

And, in that sense, a lot of the trend-following strategies, arguably, have been sold as correlated and diversifiers. And in reality and by construction you don't need to be a genius to realize that the CPAs are long the market at the top when the trend is strong and the volatility is low. So they're max long leverage.

So that's not really – you cannot be a defender, in my view, when you're max long equities, for example, at the top.

So in that sense, the false diversification is critical to understand, potentially, accidents. And, most importantly and most dangerously, it can lead to hidden leverage.

Look, if you were buying a leveraged ETF, three to one, you went in with your eyes wide open, you knew that the market is down 20% to 30%, you are most likely completely wiped out because, at that point, your $100 are 10 cents and it is literally impossible that you will ever make your way up.

So they are very dangerous. But it is something that you do with your eyes open.

But very often, these very highly leveraged positions, people are not quite aware that they have them. And this is where it’s not just about the volatility of the individual players which can explode, it’s also about the correlation between the assets.

And I think this is something that, again, we are spending a lot of time educating investors in, first of all, avoiding these big drawdowns and these risks, avoiding the leverage, and trying to find ways in which those themes will be more balanced.

Because then, again, you can embrace the volatility of the market.

And, in that sense, this is what we set up to do. The universal strategies out there, probably the ratio of strikers to goalkeepers is 999 to 1. And it’s quite easy to find long-onlys and ETFs and long biased and everything else.

In this environment, it’s a lot harder to find good goalkeepers and defenders. But I would argue that the next 10 years, whatever is the dynamics, it’s much more about finding that balance in the team than just pretending that this is just going to be like the last 10 years, you buy the dip and this is it.

I think we are in a very different scenario.

I got asked by one investor of ours said, look, Diego, someone seems to be converting to your thinking or at least expressing it.

And he put it very nicely. He said, listen, I’ve spent the last few decades trying to, effectively, optimize between large cut, small cut, developed market versus emerging market, value versus growth. Whatever. EM, DM. All these things.

The reality is that you’re just optimizing your strikers. They’re all strikers. They’re all the same thing. And so this guy realized this is more about balancing the offense and defense.

And I think that, again, it is much more important to find the right defense and offense balance than just optimizing your strikers. Because without defense I think this match is going to be very, very tricky.

Erik: Diego, let's expand on this theme that we're discussing about false diversification. Particularly, there is a theory that's been bouncing around which is so much faith has been placed in the risk-parity strategy, where a lot of institutional investors are long equities and leveraged long bonds on the idea that bonds and equities always have inverse correlation.

If that correlation were to reverse so that bonds and equities started selling off at the same time, it would force a major institutional unwind of what's probably the most popular strategy in all of institutional finance.

Is that just a conspiracy theory or is that a realistic scenario? And if the latter, how realistic is it? And how big is the risk?

Diego: Well, it's pretty real.

But even before we get into correlations, when you look at the track record of these strategies and – let's think about both parts of the trade.

Your equities right now, you're looking at, let's say, the S&P around 3,200. How balanced are the risks? Who knows? But certainly you could have a very significant downside. It's not inconceivable that you could have a 10-20-30% downside.

On the other hand, when you think about your bonds, your Treasuries, and you're looking at yields in the 10-year Treasury at, call it, 60-70 basis points. If yields went to zero, your best case scenario is you will be making 6-7%.

So the first order of the problem is that these conventional 60/40 balanced portfolios – or the sister strategy risk-parity, which actually levers those components because of this – it's in a way an extrapolation of dynamics that are assuming that if equities went down by 30%, in order to get your 30% basically coverage, you would be looking at deeply negative interest rates.

This is even worse in Europe because we're already in negative rates. Plus, in some cases, many of these issuers have significant credit risks. So Spanish government bonds or Italian bonds or whatever have negative yields. It's just remarkable, if not insane.

So the first point I would make is be careful with extrapolating historical returns. Because the distortion of monetary policy, through artificially low interest rates or negative interest rates, is creating a very asymmetric profile where you have a lot of downside on the equities, arguably. And not that much upside.

So, in that sense, I tend to describe the German bund, the government bond, as Franz Beckenbauer. And for those who follow soccer, he was this legendary German defender who was fantastic and they won the World Cup in 1974. But he is now 74 years old. So, yes, he used to be a great defender. He's actually not as fast in his ability to defend.

The second point you made is on correlations breaking up. And I think this is something that we've experienced very clearly and in a very meaningful way here in March.

And it's important to understand, a bit like real life in nature – and if the listeners have studied fluid mechanics, for example, you have a very stable sort of laminar regime, where things are linear and predictable. And then at one point things go turbulent. And then, vroom, things behave in a different way. This is nature.

The markets are a bit the same. You have laminar regime and then you have turbulent regime. And when you go into turbulent regime and volatilities explode, you start a mechanical process that is unstoppable.

I mean, if you have your value at risk (your VAR), both through implied and realized volatility, as volatility increases your value at risk increases and you're forced to cut.

It doesn't matter whether you are day trader and you're taken out in three seconds because the market is moving 5% up and down every day or whether you are a hedge fund whose value at risk has tripled and you are forced to cut.

You have, effectively, forced liquidation.

As you start having forced liquidation because volatility goes up, then you start to see that everybody has the same trades. And then correlations start to increase. And when volatilities increase and correlations increase, then the value at risk increases geometrically, or exponentially.

And this creates an even bigger wave of forced liquidation, which effectively starts potentially impacting liquidity. So good luck selling those high-yield bonds in the middle of a crisis.

And then these things boom. Even Treasuries gapped. I mean, it's just hard to believe.

So this is something that is actually very predictable and it's very mechanical. So in that sense, the correlation breaks that you are discussing is something that could be triggered by many things.

I mean, right now, it's like oh my God, now find, yeah, yeah, of course, we're pandemic under control. What else? You could have massive escalation of tensions with China. You could have hundreds of things that could happen that could trigger another wave of forced liquidation and correlations and stuff.

And if you think about the size and the leverage of these positions, they actually feed on themselves.

So once again I don't think you can – I mean, you can count the beans and try to see at what point level things start to unwind and what is the pain threshold. And we saw that in March.

I'm sure that adjustments have been made so things will not happen exactly the same way. But it's naïve to think that we've got it all figured out and it's not going to happen. Because it's just going to happen again.

And the more complacency we have about the fact that it will not happen again, and I should have bought the dip, then the bigger it gets.

And I do have that feeling that we haven't really solved things. These things are actually compounding and getting larger and larger. So we'll see. But the size is very meaningful. I mean, it's huge exposures that are subject to this arguably hidden risk and leverage.

So time will tell. But I think we're bound to repeat them again. But, obviously, I don't have a crystal ball for when. But mind those hidden risks.

Erik: Diego, I can't thank you enough for a terrific interview. Again, for our listeners' benefit, the titles of Diego's books are *The Energy World Is Flat*, co-authored with our good friend Daniel Lacalle, and *The Anti-Bubbles*.

And there was a discussion about *The Anti-Bubbles* on my last interview with Diego, so if you want to learn more about that just put Diego's name into the search box at macrovoices.com.

Diego, before we let you go, please tell our listeners your Twitter handle and how they can follow your work

Diego: My Twitter is @ParrillaDiego and you can DM me. If anybody is interested in following the views or also getting more information about the strategies that we run please DM me or send me an email: diego.parrilla@quadrigafunds.es.

Erik: Okay. We look forward to getting you back in a few months for another update.

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