Luke Gromen: U.S. Dollar Deep Dive

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Erik: Joining me now is Forest for The Trees founder, Luke Gromen. Luke, as our regular listeners know, I've been asking all of our featured guests the same question recently, which is 'boy weakness in the US dollar relative to other currencies caught some of us off guard.' You're the guy who has been saying for years that the US dollar was headed for not just a little move down, but eventually a secular decline, a loss of reserve currency status, a sunsetting if you will of the dollars hegemony over the global financial system.

And what I've been asking all of our other guests is okay, with this weakness in the dollar is this just a little move down? Or are we seeing the beginning of that Luke Gromen moment where you're proven right? And we've had a number of different views.

It's an interesting coincidence that on Tuesday morning, as we're recording this interview, the dollar index broke at least intraday well below 92 for the first time in more than a year. So I want to get your take from the man directly. Do you think that this is the beginning of the big move that you've expected for quite a while? Or is this really not deterministic yet to make that conclusion?

Luke: Well, I think the short version is it's too early to be deterministic. I think when you look at what we've been saying it's been not necessarily that the dollar will lose reserve status, but that the dollars reserve status as structured since 1971 will end. Not only will it end, but it's in process of ending.

Because historically that system was where we export dollars and those dollars are recycled back into treasuries and basically a system where global central banks sterilize US dollar outflows by buying treasuries. When you go back to 1971 - 1985 foreign central banks sterilized about 20% of US deficits, and then from 1985 to 2002 global central bank sterilized – call it 25-30% of US deficits.

And when I say that, I mean in aggregate. In other words, for every dollar that the US debt increased, I had 30 cents of that dollar ending up on foreign central bank balance sheets. Basically, what this amounted to was that treasuries were the primary reserve asset of the world. The US government was basically emitting gold, or what used to be gold, and so treasuries were basically the primary reserve asset from 2002 to 2014. Foreign central banks sterilized 50% plus – 53% I believe – of US aggregate that increases, and from 2014 until today that number is negative 4%.

This means the way the US dollars reserve status worked for 50 years almost already stopped, and what they've done instead is reserve gold. And you've seen even as they've stopped buying treasuries, the foreign central banks have stopped buying treasuries, they’ve been buying gold. So my views continue to be that the structure of the dollars reserve status is already six to seven years into changing. I think the pace of that is accelerating.

When you then look at this particular move in the dollar, relative to that longer-term view, I have two thoughts. The first is, given the way that system worked, the US had to by definition run the biggest deficits in the world to supply the dollars to the rest of the world. Understanding that we know that whenever this system starts to break down, the end game is that the US has to print the most.

And it's not even close, because basically as that system breaks down, every nation has to finance their own deficits. The only nation used to running really big deficits by virtue of the way the old system worked is the US. So we've always known that the US would have to print the most, the question has always been and where the vigorous debate between myself and others that have been on the show is, ‘do they have to print the fastest?’

That I think ties partly into what we've seen in this latest dollar move down, which is we've all known the end game where the US has to print the most. But the US was not printing the fastest over the last couple years until COVID. And now when you look at what has happened since COVID, the US has been printing the fastest and the most and the dollars responded.

The other thing I think within this particular dollar move that is noteworthy that most commentators that I have seen on the topic are not talking about, but which I think is a monumental move in which a number of other financials analysts I've talked to think is a monumental move, is what the Fed did back in April when they exempted treasuries from the supplementary leverage ratio calculations for the US banking system. And so basically what that means is that the banks can buy effectively an infinite amount of treasury bonds and it doesn't count against their capital ratios, which was the case under Basel III up until that point.

And so it was a way of doing infinite QE through the US banking system without the Fed having to call it QE, with the wave of a regulatory wand. And what's interesting is since the day that the Fed exempted treasuries from the SLR, the US dollar trade weighted dollar index is down – I think in five months as of today – 7%. So you're talking about almost a 15% annualize rate of decline in the dollar, maybe a little bit more. You've seen gold go up about 20 or 25%, gold miners up a lot more than that.

So to summarize the answer is we've been in this change of the dollar reserve status system. I think the dollar is going to stay the reserve currency, I think the structure of that reserve currency has been changing. I think if you look within that then in terms of the tactical side of this dollar move down, the US is printing both the fastest and the most, whereas before we just knew they were eventually going to have to print the most. And then this SLR rule change that continues to not get enough airplay in my view, I think is really important thing in terms of also helping to explain this tactical move down in the dollar.

Erik: Luke, I've been transfixed for the last couple of minutes with one particular snippet of what you just said. You mentioned that you have said in the past that the US in the end game will be forced to 'print the most'. I'm going to ask you to just briefly give our listeners a refresher on that, because some of our newer listeners may not remember your descriptions of that previously.

Particularly what really caught my ear was you said, 'and we're nowhere close to that yet.' So it sounds like even in the face of the heights of the COVID crisis with trillions of dollars a week in New Central Bank Accommodation, you don't think that even gets to the 'printing the most' that you define as a necessary part of the US dollar end game. So how big is the most? But let's start with why the US will eventually have to print the most.

Luke: Well so, why the US will eventually have to print the most is if you just look at a global ranking of current account deficits by nation – and I've put it on Twitter before I can put it up there again – but if you look at the chart, you end up with the current account surpluses, surplus nations and regions over on the left. By far the biggest current account surplus region actually is the European Union, then your followed by China and Japan.

From there, things start to sort of get very plus minus, a little bit of a surplus and you have a hole right 10 or 15-20 nations that are a little bit of surplus, and you get into a bunch of nations that are basically flat. Then you get into a bunch of nations that are tiny deficits and then you get the two big current account deficit nations.

The first one is the UK, and as big as they are they are dwarfed by current account deficit nation number two, which is the United States of America. And this isn't because the US is bad or because we're particularly profligate or any more than any other nation. It's just a vestige of the way the post 1971 dollar system worked, which was we ran these massive current account deficits, and we ran capital account surpluses. In other words we emitted dollars, we became the Saudi Arabia of money, as the Financial Times termed it in early 2019. So we had to admit dollars, and then those dollars were remitted, but let me back up.

After 1971, we outsourced our jobs and our factories abroad to foreign countries. Those nations would make stuff, send it to us, we would then emit dollars to those nations in payment, and then they would recycle those dollars back into our financial markets into our capital account. And then that capital account recycling would, number one finance US government deficits, as the treasury buying treasury bonds ties into that point I made earlier about how much of our deficits were sterilized by foreign central banks.

They rolled into US agency markets providing cheap credit to the US housing market, they rolled into a subprime markets, basically funded consumer lending so that US consumers could turn around and buy more of the goods those countries were producing. So the producers were on the current account surplus side, the United States was down at the biggest current account deficit side. Now, all this works as long as those surpluses they're running are being recycled back into our capital account, into our capital account surplus.

But my first point I made was in 2014, they stopped doing that at the treasury bond level, they stopped buying treasury. So now, suddenly our current accounts deficit, which is by far the biggest in the world in which is more than 100% made up of US government deficits, not trade deficit. Suddenly, we've got to finance our own deficits for the first time in 50 to 70 years and there's no one around with enough balance sheet to do that other than the Fed. And so we tried to finance it ourselves at first and that describes what happened from 2014 through last year when you had this period of a rising dollar and you had rising LIBOR and then last year you had Fed fund rates get squeezed over interest on excess reserves.

And as the US banking system got force fed treasuries, finally the banking system ran out of balance sheet to buy these treasuries last September, and that was the repo rate spike. And once the repo rate spike happened the Fed had to begin growing their balance sheet again, and at that time we said they're probably never going to stop and then we had COVID. And they tried to stop earlier this year, we had COVID and that's why we have to print the most. If you just look at that current account chart, we run the biggest deficits. And if we run the biggest deficits and the people financing our deficits to stop financing our deficits which they did six years ago, then we have to print the most.

Erik: Luke, you said that even in the face of current events the COVID crisis, trillions of dollars a week, that we're nowhere close to printing the most yet. So how do we quantify what printing the most looks like? What amount of balance sheet expansion are we really considering there?

Luke: Well, I would say no one's close to having to print as much as we are in the end game, no one has to print as much as we do because of what I just described. Now, when we look at what the US did at the height of COVID in April, I think the number was a $35 trillion annual rate that the Fed's balance sheet was expanding at. I think, if I remember right, you smooth it out over April and May, I think the number was a $20 trillion annual rate. So that's over two months growing the Fed balance sheet at 100%, nearly 100% of US GDP rate, it's pretty meaningful. How much will we eventually have to do I think is dependent on a couple of factors. I think it's dependent on – the biggest one is US nominal GDP growth, and part of that also depends on what happens to the dollar.

So, the problem ultimately as Jeff Snyder eloquently lays out, is you've got this euro dollar system with all these dollar loans, and the Fed can't really address the problem, not directly at least as things are structured now. And he highlights that, hey this is why things are going to be deflationary, that's why the dollar should rise, etc. My view has long been that, Jeff is right that will cause a big problem. But where I and Jeff differ is when push comes to shove and push will eventually come to shove, the Fed will just buy or bail out the whole euro dollar market, they'll have to, they won't have a choice.

And to me one of the big aha moments of this year was a year ago, two years ago, three years ago, if I would have said, Luke there's no way the feds going to grow their balance sheet enough to bail out the entire euro dollar market it's estimated anywhere from 60 to $100 trillion, there's no way they'll do that and I would have said yeah, they will or the system will collapse. And I think the big, one of the big aha moments of this year was they grew the balance sheet to the $35 trillion annual rate for a month and a $20 trillion annual rate for two months.

And so, when you say, how much will they have to do? I think they've shown us they'll do whatever it takes. And the question then is, is what will it take? And that, like I said, is dependent on what's the economy doing. If we don't get a recovery, then basically the Fed's balance sheet over time is going to have to move toward fully reserving the entire global euro dollar system. So whatever that number is in your mind, that's the price target for the Fed's balance sheet. Now if the US economy is able to begin growing nominally again, whether that is in real terms or that is in inflation adjusted terms where the dollar weakens meaningfully and inflation really picks up, and the Fed caps yields, then the price target for the Fed's balance sheet at the endgame is probably something meaningfully south of the total euro dollar market needing to be bailed out.

If the US is able to post real growth, significant real growth or a massive acceleration in productivity, we come up with some new nuclear fusion portable nuclear fusion energy source and all of a sudden the US economy just broadly accelerates massively, productivity growth massively accelerates, our entitlements are easily affordable, then the price target for the Fed's balance sheet comes down even further. So really, where do we go when we say how much is the most if the Fed has to print, depends on the inputs of, what's the global economy doing? What's nominal GDP growth doing in the United States? What's productivity doing? What's the dollar doing? As it sits now, on all those fronts, I would take the over on most price targets for where the Fed's balance sheets eventually going over the next couple years.

***Erik**:* Luke, unfortunately, Professor Stephanie Kelton has so far not responded to our invitations for an interview on MacroVoices. But if I could guess what she as essentially the poster woman of modern monetary theory might say if she were in this conversation, it would be Luke you're missing the point. What you're calling the end game is not an end game, it's a long overdue social justice event where we finally figure out that what you're calling printing the most is the key to delivering social equalities and a better standard of living for the entire country. And we have been suffering from decades of misplaced policies and what we need to do in order to get to where we should have been decades ago is to continue to expand balance sheets and do what you're calling printing the most.

And the argument that she's been making is, obviously you have to worry about that leading to inflation. There are ways to contain inflation, such as raising taxes that the MMT crowd tends to favor is a technique of controlling inflation. And there are ways to make this printing the most event, not some dreaded end game, but maybe the beginning or a new beginning. How would you respond to those arguments?

Luke: I by large would agree with a lot of what she says, I don't think it's necessarily a dreaded end game either. I think it's a dreaded end game if you're long a lot of dollars, I think it's a dreaded end game if you've got too much of your net worth in treasury bonds yielding 65 basis points for 10 years, or JGB's yielding less than that, or Bunds yield less than that. Yeah that's pretty dreaded for those people, but I think bigger picture that's where this is going, and I would layer onto it.

Away from what Professor Stephanie Kelton says, I would direct listeners back to this Black Rock Institute white paper that we highlighted to our clients last August, and have been highlighting continually ever since. And this was written by former Fed Vice Chair Stan Fischer who Harold Malmgren called the ultimate behind the scenes actor, one of our best relationships on Wall Street has long called Fisher the godfather of central bankers. It was also coauthored by former Swiss National Bank President Philip Hildebrand and former Bank of Canada governor Jean Boivin. And the punch line of this report is that they said in the next downturn, in the next crisis, we are going to go direct. We are going to do our version of MMT and then we're going to also expand the balance sheet. We're going to do direct monetary financing and deficits – MMT – and then we're going to cap yields to offset any rise in interest rates that would hurt the stimulus, or that would hurt the simulative effects of direct monetary financing.

And so that's to me when I see what Kelton has written, and what she would say, which I agree with your assessment of what she would say and I agree with her assessment. Then I layer on what Fisher, the godfather of central bankers is saying, I think that's where this movie is going. In the aftermath of COVID, we're seeing signs that is rapidly being put in place. And that to me, like I said represents a significant change to the structure of the dollars reserve status, and I think it would be arguably probably a really good thing. I mean, the system we have now has people rioting in the streets. So it's probably the biggest tell there is, we can hedonically just do whatever we want, but the fact of the matter is you've got multiple American cities burning all over the country, something's not working anymore. And so when you see this white paper saying effectively exactly what Kelton is saying, except it's coming from the godfather of central bankers and the BlackRock investment Institute, to me the gravitas associated with that in terms of policy circles, and then what we've seen since March, I think it's already underway.

Erik: I'm going to take this opportunity to ask our listeners to help us persuade Professor Kelton to come on MacroVoices, both by encouraging that on Twitter and through other channels. Luke, I want to come back to the reactions I've gotten from our other guests to my question, is this the Luke Gromen moment? What Brent Johnson told us last week was, Luke is going to be proven right in the end for sure. The thing is, some kind of big catalyst is needed. You either got to have a viable alternative to the dollar as reserve currency or you've got to have a revolt where a whole bunch of countries stop doing business with the US and stop trading in dollars. Some event has to happen in order to bring about the magnitude of change that you've been forecasting.

Other guests that we've had on this program have said similar things. I can remember Dr. Lacey Hunt, not on this podcast but on an interview with Grant Williams, said watch for the emergence of a digital currency that threatens the dollars hegemony and monopoly over the global financial system. That certainly echoes the predictions I made in my book *Beyond Blockchain* back in 2018. It seems though, from what you said, you don't really see a need for a catalyst or an event to occur because you see the process is already in motion for several years now. Is that correct? Is it in Important to wait for or to watch for some big event that brings about a secular decline of the dollar? It is there any legitimacy to this argument that's a prerequisite to your predictions becoming true?

Luke: I think it’s as you look, a lot of these things tend to happen little by little, and then all at once. And so I think these guests are correct in saying I'm looking for the all at once. There was an interview, it was given by former CEO of Nike back in 2000. And what he said was ‘everybody's looking for the next Michael Jordan on the basketball court, but what they don't get is that he's walking up the golf fairway’ and he was referring to Tiger Woods. And so I would equate that to the metaphor here is that everybody's looking for the event in the events of 1944 or 1971, whatever their event might be. But the events are walking up the golf fairway and they've been walking up the golf fairway.

When global central banks stopped buying US Treasury bonds on net for the first time in 70 years, that's an event. When China and the digital currency that is very far along and they're testing it rolling out over the country, that's an event. When you see Russia, the biggest energy export in the world stop storing treasuries and instead reserve gold, that's an event. When you see the article we saw last week which showed that for the first time the majority of trade between Russia and China is not being done in dollars. It was 80 to 85% share of trade, it’s 45% share of trade between Russia and China.

And some people would say, well those are just two rogue nations. Maybe they are maybe they aren't, I try to look at it more objectively and just say those may be rogue nations, but they're also the world's biggest energy exporter and the world's biggest energy importer and consumer. And when you have the biggest export and import or anything that's called a market. And so, the market is moving away from the Petro dollar, that's a fact. You just described what it is, right?

So it's one of these things where people are looking for the all at once and then, when you talk about events and are they looking for Michael Jordan, or are they looking for Tiger Woods? We had this little thing that happened in March, that was a global pandemic, they shut down the global economy, global GDP fell 50% in the United States in the second quarter. You know, Lacy Hunt had a great point, the net National Savings as a percent of Gross National Income, it is a negative as a result of COVID. The other two times in which that chart was negative was 2008 and 1932-1933. The only other times in US history going back to 1905 or something, and I look back and go, okay well what happened in 1930? What happened 32? What happened in 33? Oh, the dollar was devalued 75%. What happened in 2008? Oh, the Fed went from an $800 billion balance sheet to four and a half trillion over the next several years.

And so, I think as I listen to these conditions that people attached to it, I tend to agree with almost all of them. I just think I'm watching the conditions that’s happening, I'm watching Tiger Woods walking up the fairway and they're looking for the next Michael Jordan on the basketball court. So I really think it's more of that type of dynamic. I mean, even when you look at Lacy saying, hey the Fed can lend but they can't spend, I agree. But the US government can spend, and suddenly if you look at the treatment of SLR, the SLR treatment of treasuries after April, boy the frictions between the Fed and Treasury lending spending, start to get blurred, best case. So I think, is there still an event to come? Probably, but I think a lot of these preconditions that people think haven't even happened yet have already happened.

Erik: Luke, you just mentioned the US government's ability to spend, let's move on to US fiscal condition. You know, it's so tempting, when you have a major crisis like this pandemic, people kind of glaze over and say, just don't question it, it's a crisis. You know the thing is the, the borrowing and spending is really accelerating, I'm not sure if I should ask when or if that eventually comes back to bite us. So what are the consequences? And how do you see this situation developing from here?

Luke: So if you go back to 2018, about this time, and I'm sure we probably talked about it at that time Eric. But at that time we were noticing, and I'm almost positive I would have brought it up at the MacroVoices conference in Toronto two years ago, because we were writing a lot about it at that time for our clients. The point is that back then we had two different, we'll call them investing greybeards. If I told you who they were, everyone would know who they are and they've been at this game a very long time, that are relationships of mine. And the thing they said to me as we were discussing the US fiscal situation was something I thought was really interesting, which was historically, fiscal problems aren't a problem until the sovereign nation in question has to print the interest on the debt.

And the US again, nominally looking for the Michael Jordan on the basketball court view, is that we're still a long way from that. And what we looked at two years ago, we called it the Moneyball View, the US’s true interest expense. And if you remember Moneyball, the whole the whole premise of the book was basically the Oakland A's were able to build a competitive team on a very shoestring budget, because baseball systemically underpaid guys that walked a lot relative to guys that hit a lot of singles even though functionally there's no difference between a single and a walk. So what we said was the US's Moneyball expense or true interest expense, to arrive at that number, you can't just look at the US's interest expense as given, you have to look at interest expense, plus the pay as you go portions of entitlements.

And once you start lumping the pay as you go portions on as entitlements, because ultimately the pay as you go portions are really just the interest expense on those really big entitlement numbers, you got into a much more troubling picture for US fiscal situation. You got much closer to that point where the US government or the Fed was going to have to print the interest, print the money, just to pay the interest on the US's true interest expense. I give all of that by way of background because as a result, basically our point two years ago is in the next crisis, the US fiscal situation is going to get irrecoverable and the Fed will basically always have to be involved from that point forward in some way, shape or form.

Fast forward to the COVID crisis and June of this year, if you look at interest expense, net interest expense not even gross, plus the pay as you go portion of entitlements, which is entitlements, health care, and veterans’ benefits. What you got was that the United States was spending 106% of tax receipts on true interest expense, on those items. That's the point where you have to print 6% of tax receipts just to pay the interest on the cost. Now in July, we had a bolus of tax receipts because of the shift of tax payments from April to July in the US, and so that number ticked back under 100%.

It'll be interesting to see what happens when the August numbers come out, and again this is a fluid number because it depends on some of those factors I talked about before. What's nominal GDP growth do? What's productivity do? What's the dollar do? What's global growth do? But the point is is that COVID blew a gigantic hole in the US budget. And we're now at that over 100% of tax receipts, true interest expense being over 100% of tax receipts. This is a problem that around the world, they are having a similar type of problem. So again, when you tie back to the 'well we need some sort of big event.' We had the event, at least on one level here. You needed an event to push sovereign debt as a percent of tax receipts into these irrecoverable situations to provide the political cover.

Because to your point Eric, there's no push back from anybody on either side of the aisle anymore, just spend the money right. So, I think COVID pushed us into a point of no return. When I say a point of no return, again it's what's normal for the spider is chaos for the fly. If I'm long a bunch of US 10 years at 65 basis points and we start doing what I think we're going to do, which is what Stan Fischer wanted us to do and which Stephanie Kelton thinks we should do, then yeah I'm feeling a bit more like the fly than the spider. If I own a lot of gold and a lot of the right types of equities, you know, long duration equities we've seen obviously with the NASDAQ, yeah I'm feeling more like a spider than a fly. So again, what I'm trying to do is just help clients be spiders not flies, because we can't change the situation, the COVID crisis blew a hole in it and we're sort of into the flat spin to mix my metaphors, it very well may be irrecoverable.

Erik: Luke, I want to pull this into big picture perspective. What you're telling me here is, we're into that kind of point of no return with the US fiscal situation. And it's clear enough that smart finance guys like you can see it clear as day, we know we got really serious problems here. Meanwhile, we're having a global pandemic that is crippling global GDP, it's a really big problem. Meanwhile, as you've said, US cities are not figuratively but literally burning as we speak. There are riots in the streets, things are really bad right now. And the S&P 500 rallied to new all-time highs on the news. Luke, please explain.

Luke: I remember Mark Farber one time saying, when things get really bad the price of everything goes up, and that comment has always stuck with me. And I think it was Mark Farber, but I think ultimately there's a lot more people than a lot of investors think, looking at the world through the lens that I just described. Which is COVID made the situation irrecoverable and there's one of two outcomes. The first outcome is the authorities don't do enough, monetary authorities and fiscal authorities don't do enough. And what we see in the streets now is a modest warm up to what comes, because ultimately you see GDP decline further, the debts that are out there become in large part unpayable. You see US government and global sovereign government defaults on sovereign debt, on promised entitlements. It just depends where how bad you want to paint the picture in your mind. But that's the first option.

We saw just a little glimpse of this in March when the S&P peaked I think February 27, 12 days later, after falling just 12 days it fell a lot but if it fell only 12 trading days, US Treasury bond market started crashing alongside the US equity market, which in my career had never happened. When the market went down big, treasuries were big and this time the treasury market was crashing almost tick for tick with the equity market. And the problem was, the thing that's really different this time, is the US's net international investment position or NIIP is negative 50 to 55% of GDP. In plain English what that means, when you compare that to 2008 that number was negative 8%, when you compare that to 1999 that number was negative 2%. And what that means is foreigners own on net assets, dollar assets equivalent to negative 50%, or 50% of US GDP or $11 trillion.

These numbers were much smaller in the past, what it means we did is we hacked our family silver from 2008 to present to fuel the economic recovery we've had since then. And so, when you have a problem anywhere because of the setup, foreigners are going to dump dollar assets to acquire the dollars they need. And so, your option one is this deflationary spiral if monetary and fiscal authorities do not do enough at any point. March, at first they didn't do enough and we saw what happens.

Now, the other side is that they do enough and then it's sort of the opposite side. It's a very big, it's good for gold, it's good for equities, nominally it's fine for bonds, bond yields don't have to go anywhere per se, it's good for commodities. Again, depending on what the fiscal side does it'll be inflationary. So far, it's been primarily asset inflationary, but the US ran an $865 billion deficit in the month of June alone. And so, if the US comes out and says, listen we're going to spend $865 billion every month until further notice, and the Feds going to take it all down. That's going to be CPI inflationary too, we haven't seen that yet but that's something I'd be looking for when you talk about what could be a quote on quote, event.

So, those are two options, right, the deflationary spiral or what I just laid out, but the question then is trying to handicap what's more likely. And to me, a very powerful motivator is or understanding of handicapping this was put out by the Dutch National Bank at the end of 2019, where they said look, if the whole system collapses we own gold because if the whole system collapses, gold will be used to rebuild the whole thing. And if that happens, it's not going to be with gold at 2,200 or 2,500 or 1,800 or 1,200, it's going to be with gold at like 22,000. So policymakers probably don't want to see that because ultimately, if they screw this up, gold is going to be used and they're allergic to that. And so, I think they would rather ere on the side of doing too much. Now again, so far it's just been asset inflationary, to really make it inflationary inflationary, CPI inflationary, the fiscal authority has to do some irresponsible things in terms of deficits, and then the central bank has to effectively monetize it, and we're not there yet.

Erik: Well Luke, I for one have complete faith in our elected officials to do irresponsible things with respect to deficits. No lack of confidence on my part there in any event. We cannot have a Luke Roman interview without going deeper than you just alluded to gold. We got to really go to that. But I want to start with a different perspective than we usually talk about. You know, you just mentioned $22,000 Gold in passing, and I can just feel the gold bugs like, oh boy this is great look Gromen says $22,000 gold.

Luke: Look, please don't use that as the title of this of this interview. That's not what I want to be on record for, I do not need that. I'm just saying hypothetically, if they really let this thing get out of hand you could see that kind of a thing.

Erik: Luke, what scares me is that I agree with you emphatically, I am overweight gold myself as well as overweight gold equities. But here is the thing, I think that if you understand macro, what you understand is that the only reason to ever expect a really big secular move up in the price of gold is if you expect a situation to eventuate, where all of the smartest people who are able to understand the economic situation, conclude holy shit I want to get my money the hell out of the financial system. I don't want to participate anymore in the efficient formation of capital to support the growth and expansion of American businesses and to make the economy a better place. I want to protect myself by getting the hell out of risk assets into something that is going to be safe, even if the currency itself experiences a significant devaluation. I'm not at all disagreeing with you that gold is the smart place for a self-serving investor to put their money. But doesn't the outlook that we both share that's very bullish on gold prices going much higher, doesn't that necessarily portend a very negative outlook for what the next several years are going to bring for the global economy?

Luke: I think it depends, I think they could, absolutely they could. Because on one level, you're absolutely right, that is I would say one leg of a decision tree of why own gold. I think the other leg on the decision tree is sort of this dynamic of what's normal for the spider is chaos for the fly, and I go back to this system we've had since 1971. The spiders in this situation were Washington DC in 2012, where The Washington Post noted that seven of the 10 richest counties in America were around Washington DC, even though Washington DC I think only emits deficits on net. That's what they do, they're in the dollar export business and then the Treasury export business. They did very well.

However, for real median wages in the United States, real median family income in United States has been largely flat since 1971. They were the flies in this situation. So to me it comes down to the reason why if gold really works, is it because the whole system has chaotically collapsed? In which case that's pretty bad, that's ugly, and you're going to want probably to do some more prepper type stuff to go alongside that, and all the kind of things that you hear, sort of the worst of financial Armageddon. The other side of it is something we saw happen in 1971, something we saw happen in 1946 and we hear it periodically throughout time, which is that the currency system as structured sees a major change.

And so if you if the reason we see gold at a much higher price is because suddenly gold is being used again as the primary reserve asset to settle imbalances, basically gold takes the place of treasury bonds as the primary reserve asset then in the global financial system. Then what you're going to see is the reason for gold rising is going to be really good for the global financial system. It's just going to be the spiders are going to be the flies and the flies are going to be the spiders to a certain degree. In other words, the Fed could be doing what Fisher said, which is directly monetizing US deficits and capping interest rates, what Fisher said in that white paper. And gold could be going through the roof, US wage growth could be growing through the roof, and if wage growth is growing 10-20% and bond yields are 65 basis points, that's actually a really good scenario. It amounts to basically a soft default across or a Jubilee across dollar debt markets.

But remember the problem of the world that Brett Johnson and Jeff Snyder and everyone says is this dollar shortage. Well, this will resolve the dollar shortage in a big way. Nominal global GDP growth would explode to the upside, bondholders would not be real happy with the outcome. But boy if I'm a wage earner in America, and my wages grow 15-20%, my mortgage doesn't move away, after a few years of that my mortgage is eminently more affordable. I probably go out to eat a little bit more, I probably will spend some more money on some other consumer goods, you basically have what amounts to a onetime significant devaluation of the dollar debt globally, over some span of time.

And this sounds crazy on some level, but you saw exactly this happen in western countries after World War II. Where you saw a span of years where real rates in Europe, Japan, some other places were anywhere from negative 15 to negative 40% real rates. People are freaking out in the US are negative one and a half right now. Can you imagine what the price of gold would be in the United States if real rates were negative 10, negative 15, negative 20 for a couple years, it would be significantly higher. But that's a situation where again, I think it's really good for part of the economy, and it gets really bad for part of the economy. But I think in net because the world short dollars, you would have probably the biggest nominal global GDP boom since 1946.

Erik: Luke, final question. I want to talk about the election outcome. What would it mean for markets, if hypothetically the result of the election is … drumroll please? We don't find out for weeks or even months and potentially we get into a situation where January 20th, Inauguration Day is rapidly approaching, and there is still a massively heated debate and nobody is in agreement as to who the next president is. Would that drive the S&P to yet another all-time high? Or would we be in another, at least temporary COVID like stock market down scenario? What could happen and also do you think that's a realistic scenario? I'm starting to really get concerned about it.

Luke: I would defer to other more political people on how realistic it is. But to me as a tourist, I agree. If it was a far out tail risk a few months ago, I think it is at the very least a fat tail risk and it might be moving into sort of the realms of real possibility in a normal distribution curve. As far as what it means for markets, I'm torn, I think about it in two ways. The first way is I go back to summer of 2017 and if you remember at the time, there was a French election where there was a far right – at least is how I understood it. A more far right French politician competing for office there, and I can't remember the French presidents name as it escaped my mind. Anyway my point is this, it was routinely used as a reason to be short the euro. Because if this far right politician gets elected in France, the Euro is going to break apart, there's more stresses.

Fast forward to today, and we have a similar situation where it's suddenly becoming actually credible that you could have some sort of contested election or something. And so, I guess in the short run it makes me think, why step in front of that train in terms of the dollar probably is not supportive of the dollar tactically. The possibility of this happening as we move into the election and then if it happened, I think it would further be bad for the dollar. I think on the other side, if it's clean cut and nobody accuses anybody of impropriety and you know, Trump leaves office or if he loses without event or vice versa and there's just it's a clean cut election, then you probably would see a big a big rebound in the dollar.

I would think just given a relief, a reversal of positioning, and just a reaffirmation that this America can handle a transfer of power just like they always have and it's been one of the big attractions for capital flows here. In terms of what it means for risk assets, the more the dollar goes down, the more the global GDP is going to go up. We saw it in 2017 when the Dollar fell 12%, we came to 2018 and most strategists on Wall Street were talking about global coordinated growth. It wasn't global coordinated growth, it was the dollar down 12% in 2017. And we saw that as soon as the dollar stopped going down, because as soon as it started going back up all the global coordinated growth narrative faded away.

And so in the short run if the dollar gets weaker as a result of this, it's probably good for global growth and it's probably good for risk assets broadly as well as commodities and gold. Ultimately, where it gets a little trickier and I just don't have a great answer for it, is the capital flight side. The capitals already here, remember we talked about that net international investment position of negative 50 to 55% of GDP, and all that capitals here. And so if the dollar falls too far or gets really disorderly, then you have to start worrying about capital flight related selling of assets. And that's probably the feds worst case scenario, because then what do they do. They basically have to let the market crash, or they have to completely destroy the sanctity of markets, or distribute maybe more apropos and destroy the remaining vestiges of the illusion of the sanctity of markets by stepping into supporting stocks, supporting credit spreads, supporting corporate bonds, etc, to stem that capital flight.

Because if you get a crash on capital flight because the dollar is weak, Feds got to raise rates to stop the dollar being weak, and that's not going to help the market crash. That's not going to help an economy crash. So, I don't know, but those are the those are the frameworks that I'm thinking about. But gun to my head I would say it's probably bad for the dollar between now and the election depending how it's handled. If the election goes okay it could be good for the dollar. And I think weak dollar is in the short run good for risk, it's good for a global economy. But beyond some unknowable tipping point, you start running risks of capital flight out of the United States and that could be bad for asset prices and put the Fed in a real bind. So, that's how I would think and talk through it.

Erik: Luke, before I let you go, please tell our listeners what they can expect to find on your website and your Twitter handle.

Luke: Absolutely. So, if you're interested in learning more about us here and more, I'm on Twitter at @LukeGromen. And if you're interested in learning more about our various research product offerings, you can go to FFTT-LLC.com (Forest for the Trees-LLC) and you can see what we're up to in terms of appearances and research product offerings. They're both retail RIA institutional as well.

Erik: Luke, I can't thank you enough for another terrific interview. Patrick Ceresna and I will be back right after this message from our sponsor.