Julian Brigden: As Good As It Gets?

February 11th, 2021

Erik:

Joining me now is Julian Brigden, founder of MI2 partners. Julian is known for his graphs and charts. So you're not gonna want to miss the chartdeck, which Julian prepared for today's interview. Registered users will find the download link in your research roundup email. If you don't have a research roundup email, that means you're not yet registered at macrovoices.com. Just go to our homepage, macrovoices.com, look for the red button that says looking for the downloads.

Julian, I want to say not quite a year ago, but last spring, as markets were bottoming, you turned super bullish and everybody said that, Julian, you're crazy. There's a global pandemic going on. What are you smoking in Colorado, dude? And sure enough, it seems that you've been right. I don't know that you perfectly nailed the timing of the bottom, but it was pretty darn close. And it has, of course been straight up ever since in the market, very consistent with your expectations. But, my big question to you, as we start to dive into the slide deck here is okay that was in the spring. But now that we're back to all time highs, new all time highs. Are you still bullish?

Julian:

Thanks, Erik. I mean, yeah, it's been a good run. I think in fairness, if I take a step back, I structurally want to remain pretty bullish. I do think in certain trades, we're in the second innings of some of these trades. I mean, I look at things like commodities and I think we're in for a multi-year trends in some of these areas. But, to your point, it's been a good year. And, you know, when we look at the models and the slides and our leading indicators, some of them are just at sort of levels where I think one needs to be a little bit more nuanced here.

So for example, if you look at the first slide that I put in the deck, it's just a model of ISM manufacturing and the ISM manufacturing series. And I mean, it's had a stupendous rebound, right? I mean, this is what we played in 09'. In the summer of 09' people were once again, getting very bearish would come off the lows of the spring, after the GFC. And people were saying, Oh My God, the underlying economy is really damaged, we've got huge problems. And yet, these PMI models just exploded to the top. So that got me very, very bullish. And we were looking at the same thing again, this time, and markets love these soft, fast moving metrics. They use them as a leading indicator.

But at the end of the day, these things are really month-on-month rate of change metrics. They don't really measure the absolute level of economic activity, they really just measure the rate of change. So, the minute that you stop following, these things actually start to

rebound very strongly. But as we stand here, having played this sort of rebound the reality of the situation Erik is, it doesn't get any better than this. I mean, this is as high as these things ever get. It doesn't mean they're going to collapse. I mean, I think there is a reasonable chance that we can bump along the ceiling as we did under Trump's first few years when he was pushing the fiscal stimulus. But, even if we don't, we're going to settle down into sort of the low 50s, which is two and a half percent GDP growth.

So it's just that that kind of initial phase has dissipated a little bit. And then you look at say the second chart, and I think this is where the rubber meets the road a little bit. This is just a chart where you look at the rate of change of consumer confidence over GDP. And you can see there's a bit of a problem here, the consumer really and it has an awful lot to do with the next slide we will talk about. But the consumer doesn't really appear quite as rosy and as healthy as the current market narrative would suggest and one has to ask myself in this situation, is the level of spending that we're seeing in the economy just being propped up by additional fiscal stimulus. And I think that is a real issue. I mean, we're going to get it doesn't mean it's a negative. But once again, when you kind of look under the hood, things that are not quite as sexy. And the fundamental problem, actually is when you look at the next slide here. So there's good news, and there's bad news in it.

So when you look at total, nonfarm payroll in red here against the jobs data: job opening and losses data. You can see that it looks like we're going to rebound even further in the total nonfarm payroll. And that's kind of my expectation that we are going to probably add about another 45 million jobs. The bad news is that least thus far, and that's certainly what we're seeing in terms of this loss of momentum in terms of the recovery of jobs. It doesn't look like we're going to go back to 130 million jobs, we're almost certainly going to end up having lost about four to 5 million jobs and probably permanently and that means that we're going to end up with an unemployment rate somewhere in 6 to 7% range. And from a policy perspective, that just means that you're going to need continuing, ongoing policy support and policy help to keep this economy going.

Now, the good news is that certainly seems to be coming through in spades, certainly on the fiscal side. But the bad news is when you look at the monetary side, which you can see in this next slide, slide five. Now, there are two commonly used financial conditions index. And just for listeners, let's remind ourselves, look, the Fed controls Fed funds, but at the end of the day, that is just a vehicle to influence broader financial conditions. And when you create a financial conditions metric, it basically has five components: short term rates, you can use Fed Funds or two year yields, long term yields, typically 10 years, credit spreads, stocks, and the value of the dollar.

Now, the other this one is the Chicago Fed and I actually prefer this one, I think it works better for what I would call domestic financial conditions and then there's the Goldman Sachs one, which is also quite commonly used and I actually use that for overseas dollar financial conditions. The reason is, it has a much much heavier dollar weighting it would appear. They didn't give you the exact metrics, but that would be what it looks like to me. And you can see here with the Chicago one that despite everything, like despite the fact that bond yields have fallen a long way, despite the fact stocks rebounded, despite the fact the dollar has been a little weak, we're actually not back even to financial conditions as they were at the start of 2020. So this is a singular problem for policymakers that it's quite difficult, you know, there is no more

ammo unless you're willing to go negative yield at the front end to push yields down, if anything, it's highly unusual to see. And we talked about this many times in the past Erik, remember I showed you charts of the Fed's balance sheet against bond yields. And whenever they typically did QE, bond yields rose not fell because QE is, as it says, on the top of the of the tin, you know, reflation and bond yields don't fall in a reflationary environment. So this fall that we've seen post-COVID is quite unusual.

So, the risk is actually going forward that as they do more and more QE and the economy recovers, actually bond yields will rise, and that will reverse some of the easing of financial issues we've seen. The dollar is not that easy to get significantly weaker, because people like the ECB and the BoJ aren't gonna like it. I don't think there's much they can do to stop it, ultimately, but the Fed will have to try quite hard to get us there. Stocks are already at nose bleeding, Lehigh levels, and credit spreads by name, and you really can't get them much tighter than they are now. I mean, I think if you take something like, you know, Triple C against B spreads, you're about as tight as you've ever got historically. So the point is, this monetary pulse that we've got is really limited, which leads us to most of the heavy lifting going to be have to done on the fiscal side.

Now the good news is the Biden ministration is determined to do this. I think the market is still probably under estimating the ability of the administration to push through the stimulus package I noted yesterday, Goldman Sachs came out and upgraded their timing for their first rate hike because they thought that they could get through $1.5 trillion on this round. I'm still pretty convinced, talking to my friends, you know, who follow this stuff more intricately than I do that we're looking at probably $1.9. We're much closer to the 1.9 than people realize. So they're certainly willing to spend the money and there's another big infrastructure package coming in probably Q3. Policy be planned for Q3. But this can come at significant cost and I think this is where I'm beginning to get a little bit more concerned about markets. So we've had this sort of free ride up until now, where essentially, we haven't had to play any of the cost for the spending and the stimulus that we've added into the system.

But we've been here before, Erik, I mean, you and I have talked over many, many years and you know, one of the big conversations we had was when back in middle of 2016, we started to turn extraordinarily bearish on the bond market and the dynamics are not vastly dissimilar. If you cast your mind back then, we had in late 2015 the Fed raised rates, China was devalued, all the policymakers run off to Davos, they start talking about the economy rolling over again. They come out and unleash a wave of reflation stimulus policies again, then markets take off in early 2016 by particularly oil and commodities, and by early 2000, and by the middle of the year, our models were kicking up really expansively on inflation.

Then, the bond market fell out of bed. And I look at the dynamics now, and they remind me of that period. And, you know, we should understand that this level of fiscal stimulus and once again, we've talked about this next chart a lot over the various shows that I've done with you and this is this sort of analogy to the late 60s and this just amazes me. This is just, you know, a rhyme that just keeps giving and giving and giving. So, if you looked at the early 60s, we had this Halcyon period of super low, stable inflation. I think the average rate was about 1.3%, from sort of 59' to 65'. Back then we didn't have the level of debt. So no central banker was running around with a sort of waving their hands in the air in some sort of international sign of distress about deflation. This was really Halcyon postwar economic growth period. Bonds did

well, equities did well. Everything was fine. Kennedy gets assassinated, Johnson sweeps both houses just like Trump did. He's able to push through his personal agenda, which was the great society. It happens in an economy which is already doing extraordinarily well.

The Fed miscalculates thinks they can let things run a little bit hotter than they could, inflation breaks out in sort of 66'. They come in and they hit it hard and inflation jumped at that point towards 3%. They hit it hard, the equity market cracks, coincides with a downturn in the housing market. And they panic and they give all those rate hikes back and the economy catches again, much quicker than they think. And the reason was, that there was ongoing fiscal stimulus.

So I think, you know, the rhyme breaks down a little bit because of the COVID news that we've, you know, and the events that we've had. But essentially, that's what's happening. We had Trump come in, he initially overstimulated the economy, the Fed hit it hard. In 2018, we obviously get the equity wobble, they back off. Okay. COVID comes in the interim, but now we have a much larger on-going fiscal stimulus package in the works, which is a keen, you know, fighting COVID is in a way similar to fighting a war like we did with Vietnam. And I don't think we should expect the outcomes to be significantly different. And it didn't take long, only five years to take inflation from 1.3% to 6%. And even if you look at the feds own paper and their own work, they'll tell you that inflation expectations become unanchored within a shorter period of two years. In other words, from that point onwards people start to indulge in behavior, that in itself generates the inflation because they expect higher prices.

And, to my mind, this is the single problem facing this sort of risk asset run up that we've had. Up until now. We haven't been challenged by bond markets, just bond yields are rising a little bit, you know, but the equity guys are saying, well, this is great. You know, this is the steepening of the yield curve. This bear steepening is in itself a sign of reflation, and they're right. But bond yields are still remained highly contained, even though things like breakevens have just ripped, and we still think they'll continue to do so. But I'm just wondering whether we're getting to one of those points where it's going to be a little harder to control. And I think when I look at markets, valuations are so extreme, that it becomes a little problematic, because what you've really done in this run up, is you push some valuations, to really really high levels.

So by that, I mean, if you look at a stock like Apple right. Linchpin of arguably the US equity market, so going into COVID, Apple was trading in the mid 20s, in terms of P/E, it sells off into COVID, then it rebounds. But if you look at this next chart, what you'll see is it really exploded when the Fed stopped doing QE last summer. And that's quite an unusual price action because historically, when you go back and look at the price action around those pivots in the Fed's balance sheet. So they're either expanding the balance sheet or they stop expanding the balance sheet. The pattern was extraordinarily clear.

During bouts of balance sheet expansion, you bought equities and you sold fixed income, you sold bonds, yields rose because it's reflation when they ended QE. You sold equities and you bought bonds, because it's disinflationary. It's very simple, but this time that didn't happen. You might have sold the broader market but you bought a specific type of equities. You bought these so called growth names, which we know is an oxymoron because these are names that can grow when there is no growth. So essentially, they become replacements for treasuries. I like to refer to it using the phrase exact treasuries, right? They are literally replacement for treasuries. And that's great. In theory, it's worked very well. But there is

a singular problem here and the singular problem is that what happens when bond yields start to rise? Okay, what happens to these mega cap tech names, which are the linchpin of the US equity market, and the reason why it's outperformed all its peers across the whole world, what happens to these names, if and when bond yields rise? Because it's pretty clear to me that most equity investors don't understand the degree to which they have essentially written a put by buying these names on the bond market. Okay, so if the P and Apple has gone from, you know, 25 to 40. And at one point, just before the last earnings, it was mid 40s. And it's a 2% yielding stock, what happens to Treasury Yields go from one to two, and apples yield to keep it attractive in the sexy place to put your money has to go from two to three, all the things being equal, Apple stock has to half to do that.

And this is the single problem. Now you've pushed prices in these markets, Erik to a point where you're beginning to create stress across the cohesion of these markets as they interact. So, you know, great, we push equities higher, but in the process of pushing equities higher now that we've got some growth coming back into the economy and some signs of, you know, insipid reflation coming back and inflation. If you push equities highs ,do bond yields go higher, and if bond yields go higher do the leading stocks in the US equity market start to come down because they'd be super high P/E predicated on low bond yields. So you, you've essentially stretched valuations to the point there, where the interaction between markets becomes much more dynamic. And that can create room for problems. Right? I mean, you know, look at this next chart, I mean, Tesla, for example, I mean, Tesla. I've shown you numerous charts over the years that I would refer to as classic bubble, there is absolutely no doubt that Tesla is a classic bubble.

Erik:

Now, let me interrupt you there, Julian, because okay, I see on the chart, Tesla sure looks like that classic bubble pattern where maybe if it hasn't topped yet, it's gotta be awfully close. But wait a minute. We are in an environment where the Fed has never been before nothing close to it. And Tesla may have a chart that looks like it's in a classic bubble, but it's also run by a world class conman, the richest man in the world. Think about this trillion, the richest man in the world is a man who has never run any business profitably in his life. That is conman skill that makes PT Barnum look like an amateur. So Seriously?

Julian:

Yes absolutely. Yes.

Erik:

Yeah, by the way, I think he's going to take Bitcoin to the moon next, and Tesla would benefit tremendously because Tesla has bought a huge position of Bitcoin. I wouldn't be surprised if Elon has a strategy to rescue Tesla by making more money from Bitcoin trading than he has ever made in the car business, because frankly, he's never had a viable business plan. And I think it could work. So you know, we're in just completely uncharted fiscal and monetary policy territory here. So how sure? I mean, are you ready to short it?

Julian:

No, no. And what I was gonna say, Erik, is, it is a classic bubble, but you really only know a classic bubble, when you've had the bull trap rally. So if we just assume for a minute, and I'm not assuming, at this point, that this is the top. So the bull trap rally would go something like this. You would break the neckline at 800. Okay, and then you would see a very sharp accelerated drop. A drop that could take you in a stock like Tesla, possibly, I mean, certainly down to 600 but possibly even as low as that sort of 470 line where you intersect with that 35 to 45 degree line, which is another key component of a classic bubble. You would then bounce, Erik, you'd come back up towards the neckline, but not ever exceeded it. And that's really the only point where you know that you've got the bubble. Okay, that the top is in.

Now from here, I'll be honest with you, I don't necessarily disagree that this thing could go to 1200. I tweeted rather critically about some analysts who come out and was talking about their prowess in the potential prowess in the insurance industry in the H-Vac industry. And I said, you know, these guys are just like bloody ambulance chasers. Right. I mean, they just you know, players, this has got nothing to do with fundamentals whatsoever. Not that the damn thing has had anything to do with fundamentals up until now. But he was calling for 1200. So is that possible? Absolutely. The only point that I've got Erik is Tesla went parabolic exactly the same point that Apple went parabolic, when the Fed stopped expanding the balance sheet.

So that disinflationary pulse, and you bought, you know, to be honest, it one of the ultimate growth names, okay. And Tesla was was part of it. So this goes back to this interchange in this these feedback loops between markets. You know, what if now, we are starting to see the inflation, and I think it's going to come through in spades. And what if that does stress bond markets? And what if those bond markets start to feed back into these super high P/E stocks? Like, could this be the top in Tesla? And the answer is it could. I'll only know, once we've completed that bull trap.

But it is, to me what this really really pivotal point, and that's why I'm getting a little bit more nuanced on risk. And in a way, the last chart kind of sums it up, and it's the big debate. Okay, because we know we have loose fiscal policy. I mean, we have loose fiscal policy, like, which the world has never seen. I mean, when I was running through some of the numbers that were the deficit projections, as you look out over the next few years. You know two of my clients independently said, Oh, my God, these are numbers that have Banana Republic wouldn't be allowed to run. I mean, the numbers are just flabbergasting.

So we definitely have loose fiscal, the big debate though is what is the Fed going to do about this? Okay, are they going to accommodate it? In other words, essentially move to an, you know, MMT scenario where they basically underwrite that issuance. Because the issuance numbers are off the charts, Eric, I mean, we're not even. We're going to be running deficits that are more than twice total private sector savings in the US on an annual basis. So there's just no way that we ourselves can fund this. There's no way that foreigners are going to want to fund it. Certainly at the level of bond yields as a standard at the moment. And maybe the Fed can just let the market rate for bond yields clear as an economic rate. But you tell me what that is. Is it two and a half? Is it three? Is it four? Right? I mean, let's just look at some of the forecasts of you know, what people like Goldman Sachs are penciling in for the end of this year. Right?

Erik:

But but hang on a second, Julian, why in the world? Would the Fed for the first time in years, allow the bond market to clear at a market rate when they can just buy up all the issuance with printed money?

Julian:

So I'm absolutely with you. I'm just saying I don't think they can. All right. I don't think there's any way that they can, because then you're talking about loose fiscal, tight monetary. And you can see on this chart where I put the bars in, you can see the periods where the Fed has. We've had loose fiscal, but we've had tight monetary. So in other words, the Fed has let the bond market kind of clear at an economic rate, and they've been tightening to offset that fiscal impulse. And the dollar goes parabolic. And to your point, Erik, there is just no way, given the valuations of things like Apple and Tesla and all these other things that we can allow that to happen.

I mean, if you if you wanted the bond market to clear, then okay. Well you just accept, you know, 50% lower price on your Apple, which probably means the US equity markets dropped 30%. Right. So I'm completely with you, sir, that that's what they have to do. My only concern is that is actually a deeply distasteful thing for them to do. Right? For them to run, loose fiscal, loose monetary, which I think is the solution.

In other words, they hold real yields down nominal yields can increase they did in the late 60s, but real yields fell, is crossing a Rubicon where essentially they abandon any pretense at independence. You can see from the debate that's going on internally, they're inching that way, but they haven't got to that point. Right. I mean, you know, if I use a silly little analogy, it's it's like really crap Star Wars movie. I can't remember which one it was, where Darth Vader is still not Darth Vader, and he's uhm-ing and ah-ing, whether he's good and he's bad. And he's fighting these internal battles. And in the end, he goes off and kills all the kids in the Jedi training school and he turns bad. He embraces the dark side. The Feds got to do that. Like they're going to have to, you know, underwrite trillions of dollars worth of debt issuance because we can't do it in a market economically, clearly right without crushing the recovery in the economy and the equity market, etc, etc.

But they didn't really want to go there. They still hope I think in their hearts that this is a normal world. And you and I know that's a joke. So I do expect a bout of pain. I do expect them to be challenged before they come in and say, okay, your name's the Fed, we're locking in 10 year yields are, you know, one and a half percent and see in five years time. And that's another reason why just at this point, I'm turning a little bit more circumspect on risk. And it goes back to this sort of link between these markets.

You know, if I think inflation is coming through and it's coming through in spades, it's coming through extraordinarily quickly, Erik. And there's a challenge potentially coming to the bond market as there was in late 2016. When bond yields popped very aggressively, having moved off the lows in the summer, they then shot up. Now is a time to just be a bit more circumspective. I'm still running from my macro insiders portfolio. We're still pretty long risk, we haven't shorted anything, all we've done is tighten the stops and take some profits on some really illiquid things that I'd worry, you know, could get really dislocated in some sort of, even if it's a short bout of risk-off before the Fed goes, Okay, fair cop. You know, here you go. We're

back in again. And that's kind of where I stand at the moment, because I just think we're at this handoff. There's a lot priced into these markets that have had a great run. We've had a great run. Most people had a great run, but we're pushing the envelope now.

Erik:

Julian helped me understand the upside risk to Treasury yields or downside risk to treasury bonds, the same thing. You know, I hear so many smart people our mutual friend Grant Williams I was on recently on a podcast I was listening to this past weekend. And his partner Bill Fleckenstein says you don't watch out, you just watch out when the bond vigilantes come into town, and all of a sudden, you know, it's like a horse ripping the steak out of the ground and running with it. I'm thinking, Wait a minute, just two sentences before that I think it was Bill who commented that the Fed already owns a third of the Treasury issuance. What's to stop them from buying the next third?

And the answer, of course, is at some point, you get runaway inflation and blows up the dollar, you lose reserve currency status, etc. But those are all big deal things that haven't happened yet. In the next two or three years, what's to stop the fed from saying bond vigilantes we'll steamroll them, we'll just buy all the bonds we need to in order to get the yields where we want them, which is low.

Julian:

Frankly, nothing, Erik, nothing is to stop them from doing that. Right. But as I said, I think that takes a mental step. I mean, I've talked about the late 60s a lot over the world, really, since Trump got elected has been kind of the model, but historical sort of analog that I've been following. And back then, we had a Fed President called Bill Martin, and he was actually the longest standing post-war or the longest standing fed president in history. And back then we had a fixed exchange rate, Bretton Woods, and kind of the job of the Fed if you go and look at their meetings, oh, my goodness, there was so many notes, because it was every two weeks, right. But essentially, you go through it and they're tracking things like gold flows and current account flows and capital account flows, because they're worried by, you know, how to hold the system together.

So Johnson comes in, and Johnson says, I'm going to launch this great society and at the same time we start fighting the, you know, in the foothills of the Vietnam War, and suddenly all these flows start to turn against the dollar. And yet the Fed is there to try and hold the system together. And they're faced with a dilemma. And the dilemma was, do we tighten rates and essentially push back against our fiscal masters? You know, exert that independence, which we saw, obviously, someone like, you know, Paul Volcker do a decade later, or do we accommodate government? And Bill Martin came out with a very famous saying, where he said that the Fed is independent within government, but it is not independent of government.

In other words, if his government is the manifested will of the people, then it's not for us to kind of fight against that. And so what they did was they accommodated it. And essentially, to help pay for Vietnam, we did stealth QE, which is why the monetary system fell apart in 72'. And the dollar dropped 50% against the yen and the Deutsche Mark. And I think that's where we're going, Erik I just think it was a pretty big step for Bill Martin to do. And I think it's going to be a pretty big step for a number of Fed officials to do. I think we're quite close to it with Yellen, you

know, in Treasury and Powell, but I still my sense reading what these guys are seeing, seeing the pushback that we've had from say capital and and bostik on rates, is there is a vestige of independence there that needs to be beaten out of them and to do that, almost certainly takes an element of pain. And that pain, I think, would be perfect if you've got a wobble in the bond market. It causes the equity market to drop, you know, 20%, the dollar to spike and then the Treasury read them the riot act. And then at that point, they say, we're just going to buy the whole lot. And they can, and I think they will. I don't think they've essentially got any choice. It's just a transition mechanism. It's the pathway that's, that's less clear. But there are huge consequences for that, right. And they're summed up by this last chart, you run loose fiscal, loose monetary policy, you're going to annihilate the dollar.

Erik:

Julian, your focus on the late 60s and inflation really gets my eye because you know, so many people have their own favorite indicators. Some people like to look at the second derivative of growth rate of change, and the rate of change, and so forth. What I look at is the rate of change in the smartest people I talked to here on macro voices, that normally I get just opposite views from lots of smart macro people. And recently, it's like all the smartest guys in the room are coming around to a secular inflation view.

Some of them think it already started. Some of them think it's two years off. They all have a different spin on it. But it seems like whether it was Jim Bianco last week or a couple of weeks ago, Russell Napier, it seems like all of the smartest guys in the room are saying we are in the late 1960s in terms of a major secular inflation. And the thing that I think is fundamentally different is in Paul Volcker said this himself before he died, he said, look, what I did in order to stop inflation in the 80s would never work today because we have a completely totally different situation in terms of indebtedness. There's no way you could possibly get away with the policy cure for inflation that worked then.

So what I see here is that we're headed into what the Austrian economists call a crack up, boom. A government led credit expansion that will probably for several years to come drive much higher asset prices, a booming economy at least for the first few years, because you print enough money, it's got to go someplace. And eventually it all leads to runaway inflation, which will be impossible to control because, you know, raise rates is something you can't do without bankrupting the government. What you want to do is try to inflate away the real value of that debt. I think that's what they're going to do with a combination of financial repression, runaway inflation, negative real yields for a period of several years now, eventually, you know, the Piper always has to be paid. But you can you know, von Mises didn't call this a crack up Blip. He called it a crack up, boom, because it can go on for years and years and years, and create the appearance of prosperity, when in reality, it is like a, you know, an irreversible atomic explosion of finance, where eventually the whole thing blows up in your face. But that's years and years and years off.

Julian:

Correct. And I would utterly concur with that. Erik, I mean, I think, you know, I agree with everything that. You can't allow, you can't do a Paul Volcker right at this stage. I mean, not until you've eviscerated the real value of the debt. That doesn't take as long as you would think I

mean, you know, in the 60s, you know, we managed to get to 6% inflation with a fixed exchange rate. And, I mean, pretty much controlled prices across everything. Like the Seven Sisters Control, the big oil companies control the oil price, right.

So one of the reasons why we ended up with the war in the Middle East is because we were trying to hold down oil prices. And then you know, OPEC came about because their income was being eviscerated in real terms. Gold prices were controlled and all these things that we control, and we still managed to get to six. But it was another decade on from that, that Paul Volcker came into town, right. So, you know, in 15 years, you can really, really, really eviscerate the value of the debt.

So I don't even think we have to consider Paul Volcker at this stage. You know, I've been on this inflation kick since 2016 since Trump came in. I mean, it's just plain to me that when you look at the picture, Erik, it's to embrace inflation. You need to be at the right point societally, not just in terms of fiscal and monetary policy and fiscal policy is a manifestation of where you are in society because you vote a government which is going to pursue certain things, but there are many, many traits that we have now societally that inflation is one of the few potential solving mechanisms, right? I mean, we have wealth disparities between old and young, right?

Well, the way you deal with that is you run inflation hot, the wage increases go to the young, and the value of the assets held by the old fall in real terms, we have income inequalities, which are extreme, you had that during the 60s, right, we have all of these factors, which are starting to combine, which society are telling us we need to change because otherwise, you know, if you believe in something like the fourth turning, this is what I euphemistically refer to the period where you have heads on sticks, right? If you don't address these problems, you're going to have a society that's going to break down and they're going to be chopping people's heads off, just like they did in, you know, in France in the revolution and sticking them on a bloody pole.

So the easiest solution for government is to print money and to suppress yield. And I totally agree with that. It's just that transition point right here right now, I'm a little nervous about because I just don't think they fully crossed over to the dark side, I think they will. But I just think is going to take a bit of pain. I'm concerned it is. So while I'm still running a broadly risk-on trade and portfolio, I'm just being a bit more circumspect about risk management, taking profits on things that have, you know, extraordinarily illiquid like corn, for example. We had a very profitable trade in and tightening stocks elsewhere. Because I agree with you, Erik. That's where we're going. But as I said, this inflation gig I've been on for now for five years, people thought I was nuts. Right. We talked about it back in 2016.

Erik:

Well, I think when we talked about it then you were clear in saying it's, it's coming. It's it's not quite here yet. And perhaps it's still not quite here yet. But it's a heck of a lot closer than it was before.

Julian:

Well, this is the point, right? We went to zero inflation in, you know, the GFC. And now we're starting off from really at one and a half to two. And that's what kind of happens if you look

at the charts of inflation, they become, it's like that accelerative oscillation you get one of my clients pick this thing up. And you know, you start, you have a sine wave, and it runs normally. And then you kind of hit it at the wrong point. And the oscillations just increase in amplitude every single time. And this time, they're doing that, but they're just building slightly higher basis, every single time. And that was actually the method that you saw in the late 60s, in the 70s. You never quite got down to the prior lows. You kind of stopped at the prior highs. And then you built on it again, and you built on it again, you know, in a way that policy error begets kind of policy error. Even if to be really cynical, you want to call this a policy error, because I think it's partly a policy solution.

Erik:

But I think the hesitations that you're expressing as I understand them around equity prices. And so far, they you're saying look, things have run awfully far, awfully fast. Maybe there's a pullback here, but you clearly see that this isn't over completely. There's more upside coming for equities. Eventually, as this reflation or inflation kicks in, I want to talk a little bit more about the longer-term because it's hard to know what's going to happen in the next six months. But what I see here is eventually, the US government is going to print money and spend money and a lot of both. And eventually we're going to get to a situation I don't know how long it takes, where inflation does start to run away. And that's the point where they're going to let it run away because by then they will have convinced themselves that it's not a threat, and they're going to average inflation instead of worrying about...

Julian:

transitory, blah, blah, blah...

Erik:

...all that stuff. And in also it is going to feel like everything is wonderful because inflation for the first few years, every major inflation has been interpreted by economists at the time as "Hey, the economy is booming. Everything is great.|

Julian:

Well, grease the wheels

Erik:

You get to a certain point and the inflation becomes detrimental. And in the past when you didn't have an over indebtedness problem. There was a very, very painful solution that Paul Volcker is famous for pioneering, but it was possible. It's not possible by Volkers own description now.

So the question that I really think about is okay, how many years of false sense of security where it feels like everything is great do we have ahead of us, before reality sets in and we realize Holy Shit! This is already beyond the point of no return. We've got a runaway inflation problem and no way to control it. And this is going to lead to an inflationary depression, a loss of reserve status for the dollar and all the bad stuff. Is it? Is it a year off? Is it 10 years off? I mean, what do you think?

Julian:

I think it happens much quicker. I think the world just moves quicker these days, Erik, and to to go back to that 60s analogy, as I said, you know, you go into the late 60s with many mechanisms that prevented rapid movement, controlled gold prices, right. A controlled Exchange Rate Mechanism, controlled oil prices, you know, national wage bargaining in parts of Europe, right?

I mean, many things that were designed to quash some of those accelerative oscillations that I talked about. It's not the case anymore, like we have freely tradable market, right. And we've just seen what, you know, how far quick and Bitcoin can go, which is something that, you know, Raul who here and I, you know, collaborate on the macro insider portfolio has been all over. So, you know, God forbid, what happens if, if this thing really starts to move quickly? I mean, does this go to a 100,000. It can easily do it. Right?

So I think the answer is much quicker than we think. I mean, I have some dollar models, which and I think this is, for a US perspective is kind of the Achilles Heel. I have sine dollar models that suggests that by early 2023, so two years from now, the dollar has lost another 35 to 40% of its value. That's going to create problems, right, that's going to create problems, particularly in a world where the holders of our reserves, unlike the 60s and 70s are not our friends, right? I mean, it used to be that Japan, Korea and Germany held our reserves, and we provided them with strategic defense. Now, our reserves are held by the likes of China and not easy to say that our friends, certainly not the CCP.

Erik:

Julian, let's talk about how we know when we're at the point where it starts to turn from good to bad. When I asked Russell Napier, the same question, he said, watch observed and reported CPI inflation, once it's past 4%. That's where you start to worry about it being negative for the economy in the stock market as opposed to positive. Would you agree with that number? But more importantly, is that the right metric to be watching to tell you when we turn from good to bad?

Julian:

I mean, I can see in some of my models. I mean, I was looking through some of the PMI reports. And some of the details of the PMI reports the other day and some of the Q&A and observations, particularly for some of the like the market reports who do really very good work. And there was an observation in US manufacturing PMI, about company prices, increasing at the highest rate, and since July of 2008. You won't take a guess where CPI was in July of 2008. Nope. 5.6%. So, if Russell's level I'm not disputing is four, we can be there much, much quicker than people think. I'm not really sure, as I said that it's the metric because the metric, as I said, is more. It's a process that gets us there.

So as I said to really get us through the higher inflation environment. First, we've got to have the Fed acquiesce and admit that they're not going to fight it. Okay. And then they're going to have to hold down bond yields so the bond market can't fight it. And then, as I said, to me, the thing that's going to cause the most pain. The thing that becomes an issue is not bond yields because they're pegged. It's not equities, because they're ripping because real yields are

extraordinarily low. It may not be US equities that are ripping the most. I think there are other things that can outperform, as I said, particularly in an environment where US equities already grossly overvalued. It's the dollar, to me the dollar is the potential Achilles Heel for all the reasons that you've talked about.

And I'm not, please please please, don't put me in the we're going to replace the dollar as the reserve currency, the Chinese are going to replace the dollar as the reverse of currency. Well, it may in 10 years time, but ain't gonna do it by 2025. And I think that crisis can occur before 2025. But it doesn't mean the dollar can't fall in value and fall precipitously in value, because it's done that in the past, Right. I mean, it fell in the 70s from 72 to sort of 79 it basically fell 50% against the other major currencies. Markets demise as the reserve currency just fell 50%. But it would cause huge problems here, Erik, right. I mean, we just cause huge, huge problems. I mean, inflation would be rampant. So to me, the metric I'm looking at is more the process that gets us to the point where the dollar can start to slide. And that is when you get problems.

Erik:

Well, Julian, I can't thank you enough for a terrific interview. But as we close, please tell our listeners a little bit more about what you do at Macro Intelligence 2 Partners. MI2, not to be confused with James Bond's employer, MI5?

Julian:

So yes, of course, you know, being a Brit and a little boy, I had to do that play, because we all want to be James Bond. So MI2 is our institutional product. It goes off to hedge fund real money managers, family offices, that sort of thing. And anyone who's interested in that can contact us at support@MI2Partners.com then we have a joint venture, as I mentioned with Raoul Pal, which goes by a real vision that's called Macro Insiders. You can find that on the Real Vision website. And it's a lot cheaper. It's a slightly different products aimed at the thing, but we do really quite actively help you manage your money and run risk and do stuff like that, which institutional investors really don't need. And then thirdly, if you just want to follow me, follow me on @JulianMI2 on Twitter. And yeah, and then you can see what I'm sort of pontificating on those on those various things. I'm also on LinkedIn, and you can find me there as well.

Erik:

Well, thanks so much for another terrific interview. Patrick Ceresna and I will be back right after this message from our sponsor.