MACRO Voices
with hedge fund manager Erik Townsend

Diego Parrilla: The End Game Is Inflation But The Path Is Unclear

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Erik: Joining me now is Diego Parrilla, a portfolio manager for [Quadriga Asset Management] and best selling author of the books, "The Anti-Bubbles" and "The Energy World is Flat". Diego it's great to have you back on the program. A man who follows energy markets and whether or not they're flat or not, I gotta believe is thinking about inflation. But I'd rather have you tell me you're a deflationist because we can't seem to find any smart deflationist left. Let's start with inflation versus deflation. How do you see the whole story?

Diego Parrilla: Well, thank you for having me back. Look, I think the endgame is inflation for sure. But what is very important to understand is they're very very strong forces in both directions. Clearly, on the deflationary side, we're dealing with, you know, potentially unemployment. Obviously, the economy is recovering but still lagging substantially. We have technological benefits and considerations that are deflationary. We have demographics, we have overcapacity, we have malinvestment, we have potential bubbles, which are hugely deflationary. So all these things point one way, however, there's just one thing, or one major force on the other side, which is money printing in the trillions. That is basically more than offsetting them all and beyond. So it's almost as if the more deflation in the system, the bigger of an excuse, and the more room, central banks have to print or try to print their way out.

Needless to say, the trillions of money printing are not solving problems. They are really doing a number of things. In the first instance just delaying the problems. You're kind of kicking the can through debt. Second, and very importantly, we're transferring those problems through currency and trade wars, which is hugely relevant. And we're seeing a lot of action in that front with the dollar and everybody else trying to print their way out. Thirdly, we are transferring the problem or transforming rather the problems, which is, as you mentioned, inflation as well as inequality let's not forget. And eventually this is all leading to bigger issues.

So I think the inflation-deflation debate, based on the fact that there are lots of issues and deflationary forces. But ultimately this major one, and I believe eventually getting worse. We know that mommy and daddy pretty much have no choice, but have to come back and do more of the same. So it's just a matter of time before this fragility gets tested. And I think more to come, the scenario whereby we grow our way out and you

normalize things, you know, I think it's wishful thinking. But yeah, I hope I'm wrong. I think the decades of, you know, artificially low interest rates, and these artificially high valuations. And these bubbles we've created everywhere are a ticking bomb. And that's why I think it's a matter of time that inflation picks up. And I think in that sense, we're looking at, you know, this first phase of contained optically stable markets, but I think things could accelerate. And that's when things start to get a bit more tricky. And to some extent, is what we're starting to see in the rates markets as a message to the Fed.

Erik: Let's go a little deeper on the rates market. Ever since Joe Biden took office and announced an intention to engage in fairly aggressive deficit spending. We've seen a backing up in long-dated Treasury Yields, and on the Monday that you and I are speaking a few days before this interview will air.

The big news that hit the tape was fund manager David Tepper kind of declaring, okay, I think it's gone as far as it can go. The backing up of yields in terms of a panic reaction or a knee jerk reaction to the Biden administration is over, and therefore he's declaring should be, you know, all uphill from here, in terms of equity prices. How do you see this rates market, and particularly the long-end of it 10-year and 30-year, and at what point do you think the Fed is likely to start to intervene, whether it be with Operation Twist or something else?

Diego Parrilla: Well, I think it's helpful to put things in perspective, you know, we are heading into 2007-2008. We have, you know, a yield curve with nominal yields and rates around 5%. And that was an incredibly flat curve. Your front-end, your Fed Funds, your 10-year, your 30-year, they were all sort of hovering around that level.

Post-2008, you have these major moves down in the front-end of the curve with QE, but the back-end of the curve initially stayed reasonably high. It was considered to be more of a short term temporary thing and short term rates tried to the job. And then as these temporary things become permanent, the pressure on long term yields increases. And in Europe, we introduce negative interest rates, you go all the way into negative yields all the way out, and basically long term yields come off, arguably, for a sustained period of time, and then we go into 2018. Right? That situation, when, same as Jerome Powell's autopilot, we got to the point where the normalization took us to about 3%. Once again, you have a very flat curve, you know, the front, the belly, the back-end, it was all more flat, the market pricing hikes, and obviously, following almost a decade of printing and debt, of course, you know, the system starts to implode.

And as a result of that, and since then, what obviously has been the biggest shock in memory, which has led to the biggest response across, you know, monetary and fiscal as well, we go to this situation where everything goes pretty much to zero, right. The front-end, but also the long term yields collapse to previous, to historical lows. What we're seeing now, I think it's a bit of a repeat, where we see this move up, as you point out, what's the limit? You know, the 30-year to 25. And the 10 year to peak at 1.60 are still somewhat a long way... I mean, the 10 years, pretty much half of where we were in 2018. Whereas the 30 years is two thirds of the way.

But I think given the massive increase in debt, we're once again in a situation where the system can't really cope. I mean, as I always say, all the listeners on this call can afford a trillion dollar mortgage at zero. The problem is when rates rates go up, even marginally, right. So I think in that sense, the one thing that it's hugely important is not just about yields, is to understand that everything else, you know, these artificially low level of interest rates, which we've had for a long time, have created artificially high valuations in multiple other assets.

And everybody I guess, understands the relationship between fixed income and interest rates through duration, right, so you look at 10-year bonds, or 30-year bonds and you see the impact that interest rates have, what is very obvious, in my opinion, and less well understood, is the idea of equity duration. And this is effectively the sensitivity also to long term interest rates. And, you know, I think here, the math is less obvious.

There's tons of academic work that looks into equity yields, and as a result by comparing that to the equity risk premia, and you have this situation where people are comparing apples and pears, right, you compare whatever the S&P or the NASDAQ with 10-year yields, and people would argue, Treasury yields, and people would argue that they are equities are cheap, or whatever. I mean, it's pretty obvious. I think anybody here will be bait, that equities are expensive in absolute terms, that's, you know, by every, any single conventional measure, they're incredibly expensive, and we're coming up with new measures. But this fallacy in our opinion, that equities are cheap on a relative basis. It's such because the according to our numbers, the duration of the S&P is roughly about 28 years. So when you look at and you compare whether equities are cheap or not relative to fixed income, you need to compare to that back-end. And certainly, we published some analysis on this called no premium in equity risk premium. The situation is way worse for growth stocks and things like the NASDAQ, where the duration is, in our view, closer to 40 or 50 years.

Just look at what's happened to long-dated bonds. And that's really just purely for my duration rates perspective, what should be happening, and, in fact, what's been the case with the NASDAQ. But certainly we think that they are limits Pinpointing exactly to what's that number, I think we could do some back of the envelope exercises and say, well said risk parity was all else being equal, you know, what sort of level were we in 2007 when we popped, you know, basis 5% interest rates and level of debt of x. That translates roughly to where we were perhaps in 2018 with rates at three. And I think it's fair to say that where we are now is not far from those levels, if not surpassed.

And if you combine that to basically the linkage between all the other bubbles we've created in the process, and the sensitivity of the system to long term rates. I think it's a very fragile situation, which basically, it's a matter of time either, you know, if this move up in long term view is unchecked, and the Federal Reserve is as always positioning these things as temporary. If if this thing, you know, continues this way, I think you will see a bigger shock on the equities, which will almost self correct through the fixed income. And I think it could be either something you do preemptively or just forced to do

it. And, and I wouldn't be surprised if you have a combination of both. So, you know, as the equity market start to be under more pressure, the Fed gets active, even if they don't make the formal full announcement, they're already monitoring and watching. So they're putting a straight face now claiming this is all healthy. This is potentially very dangerous, very fragile. And I think there's a number of mechanisms by which this accelerates, perhaps the most obvious one is volatility.

Erik: You know, this fascinates me this idea of equities being valued based on bond rates. And you can make this logical argument that says, given where Treasury rates are, equities are actually undervalued. And people act like that's just perfectly logical. It seems to me Diego as soon as you get to negative Treasury yields, which we've already seen in Europe, doesn't that mean that by that measure, equities have a value of infinity?

Diego Parrilla: Well, absolutely.

Erik: At what point do you acknowledge that this is kind of crazy. To measure it this way.

Diego Parrilla: It is. Absolutely, I think there are so many crazy things out there and negative nominal yields was negative real yields and sort of how things are playing out. That's as you're describing it, is the change in rules of the game, right. And I think what's very important that everybody understands, is this is 100%, artificial. Okay, it's 100% artificial. The whole level of front-end interest rates is artificial. Then, that starts to put pressure on long term yields through carry and desperate search for yield and QE and manipulation of long term yields. If those things decided to have a life of their own and challenge valuations, then no worries, let's do Operation Twist, and QE, and manipulate long term yields as well. And that crushes volatility, and you just continue this fully artificial setup, which all it's doing is creating this ginormous complacency and bubbles.

And yeah, I mean, you can think about once upon a time, you know, you would like to short, the Widowmaker, you know, the JGB market. And you would argue at one point, if you're playing by conventional rules of the game, yeah, if I'm shorting this thing at 99.99, then what's my downside? Right, because it's just 0.01. And suddenly, you go into negative rates and negative yields, and it's kind of game over, you know, the bond market doesn't have a ceiling anymore and it just becomes a number.

And I think that translates directly into equities. And this whole fallacy, eventually creates these bubbles. That are, let's not fool ourselves there by now too big to fail. And this is where we are. We are in a situation where we just build this massive house of cards with the wealth effect, kick in the machine, and then we're all have this perception of wealth. You look at your bank account, or your share price, or your Tesla or whatever you want, a Bitcoin and you see all those valuations without recognizing that perhaps it's all artificial.

And what we've seen over and over in this crisis is you know, when the emperor has no clothes, and these things get exposed, it's systemic. And that sort of forces mommy and daddy to come back and just do it all over again. And so we're in this from a game theory perspective, back to your first question on inflation, it's pretty obvious we're going to end up but the danger here is so obvious. And he looks so clear that mommy and daddy have a vested interest in not letting this thing collapse then what shall we do?

Shall we just lever the hell out of this and just play the game and go all in with all and then the problem is you're gonna have these major, you know, bold moves and shake outs, as we have, you know, we have in COVID, which could be more or less expected, but I think volatility is on the rise. And this is one of the things that will put things in check.

And, you know, so it's becoming increasingly more polarized. I mean, even the question about the debate between inflation and deflation, or you know, Bitcoin zero or a million or whatever this polarization of the world, eventually, it just translates into Vol. So one day I am correct, the day after you're correct. And this thing just swings from one extreme to the other. And then all we know is that volatility is bad news for risk, both realized, and implied volatility. This eventually creates, you know, it forces you to cut the size of the positions, and it creates a vicious cycle. As you know, volatility increases, and perhaps some of those positions get reduced and then there's deleveraging, and then correlations increase, because everybody has the same trade and liquidity tightens up.

And before you know it, you get into a dynamic where I use the analogy of fluid mechanics, where the world nature has two main regimes, you know, the laminar regime and the turbulent regime. And in a laminar regime world, you know, it's all predictable, it's all linear, it all makes sense. But once you go chaotic, into turbulent and then things get out of control. And that's, to me, one of the dangers, you know, you're flirting here with the VIX is very contained which I think if it breaks 40, you know, everything goes really out of control.

And this is why we have this situation where I think the central banks need to be ready to act and why I read between the lines. I agree with you, that it's just a matter of time that mommy and daddy come in and intervene in the long-end because it's all related. I think this path of, you know, artificial rates, artificial credit spreads, artificial or volatility, complacency, Bubbles, becomes so one way that eventually even the Fed tries to put some steam out of it. And, and the wishful thinking is they can do that without this thing imploding in their faces and they know that in order to do that they need to control to some extent and intervene and this is the dependency we're in and why I think this is such a tricky market to play and perhaps a lot more fragile than then it might look.

Erik: Well, it sounds like we agree that if you're dealing with artificial economics, and everything is being created by the Central Bank, then volatility really is your best indicator as to what's going to happen next. Now, the VIX is clearly on the rise. But you

know, it's not back to 2008 levels or anything. Should we interpret this as the market is topping and then perhaps it's time to think about a cyclical bear market starting? Or do you think it's just a question of time until the Fed intervenes yet again in a way that takes us even higher in terms of equity valuations?

Diego Parrilla: Well, I think volatility we've clearly got into a new regime, I think. A regime of more higher sustained vol. levels. You know, just about a year ago, heading to the February/March debacle. And you know, the VIX was in the low teens, right? We have this extreme level of complacency, where you know, you were able to buy insurance the cheapest when you needed it the most. Right. And after a very prolonged period of time, plus, obviously what happened, we had a spike that was only comparable to 2008, with the VIX at 80 plus.

So since then, obviously, there's been a phenomenal move up in equities, we've made way more and reached the previous highs and by a long way, and however, the VIX has been somewhat stubbornly holding above, you know, the low 20s. And I would highlight a few things. The first one is that we're in this higher level of vol. so, you know, 20, low to the mid 20s. The second thing that is very remarkable is the shape of the curve, you know, you have very very steep contango, currently, almost two points from front to second month. The front month expires in the time of this call. There's another sort of nine days to go. And so the market is actually reading this very calmly. It's looking at this moves in equities, saying look, I'm in contango, there's no panic.

Once the shape of the VIX moves into backwardation and you know this as a commodity guy as well. Once the market gives you the hint of backwardation these things can go a lot more crazy. But for the time being, it's coping with it although we're not far and I think we need to be mindful about that.

So vol is high overall, the market is in very steep contango. What does that mean for investors? It means that it's super expensive to play the VIX. If you are buying the futures and nothing happens, you're going to roll down and think about what two points mean right, two points per month. Over call it a year is 24 points on something that is worth 24-25. So you have a full 100% negative carry, if you were to do this every month, which is obviously very expensive.

But on the other hand, it's also attracting people that are saying: "Hey, I can get all these amazing carry. And so what? it's not going to explode or I will stop out or whatever". So you build this meaningful position which can compound. And this leads to my to my third point, which is vol. of vol. So the volatility of volatility. The kind of moves you're seeing on the VIX, are phenomenal. I mean, the sensitivity of the volatility of the VIX, or the moves in the VIX relative to what are in all effect, tiny moves in the S&P. So you see, you know, a 1% move in the S&P moving the VIX by three or four points. I mean, this is really phenomenal. And to me, it is a big warning signal. Okay, it's a sign that look guys, this could go, this could go any minute.

Obviously, there's lots of forces against it, and perhaps the next round of checks and other things that could intervene. But I think the VIX is an indicator and a tool that I think is one of the best defenders as to when things go completely belly up. But it's also super expensive to play, which means that you know, the timing is important. The structures are important and you have a for those who are familiar with options. There's a phenomenal contango not only in the futures but also in the Vol and the cold skew is phenomenal. Right now we're looking at volatilities for the top-end strikes, close to 300%. Okay, for a 50-60 strike. So even with with a few days to go, and the market pricing in some non-negligible probability of this kind of blow up. And the market is not stupid. I mean, people are paying for that for a reason. And yeah, I think in the meantime, it contributes to these ideas that I mentioned earlier, of, you know, complacency and fragility.

So I think this is a sign or a signal for caution. In order to have this super bull market, I think you need the vol. way lower, that would bring in, you know, strategies like risk-parity, or, you know, trend following or vol. target all of which effectively become, they're forced to buy more, when the market goes higher and when volatility goes down. That's something that we've seen missing, I mean, some of that buying, has stayed on the sidelines because volatility has remained somewhat stubbornly high. And it's not because, you know, some of the big banks and others haven't tried to get the vol. to those levels, and get that last nail in the coffin that could send maybe the S&P to the targets that they have.

But it's all, in my opinion, incredibly exciting and dangerous. And if you are prudent, in your, you know, staying on the sidelines, or we're mindful of some of these dynamics, you look stupid, until things really go. And even when they go, it's so huge, that, you know, that mommy and daddy will have to do something about it. The big question is, can they continue to do this forever? Is that something that you can assume that they can stay in control, and I think, that are potentially the, you know, marginal diminishing returns in the central bank policies, and what sort of sizes and trillions and this is something that we're seeing already, you know, with, with yield curves doing stuff, and markets being tested, and things being even more polarized?

And so I am, you know, as much as I hope that the vaccines are solving all the problems, and we'll grow our way out of this. I think there's a legacy of imbalances that we need to navigate and it's, it's challenging. And throughout that process, there's going to be a few things that could, you know, change the regime in which we're in and I think, you know, volatility is super important, because as volatility changes regime, the market, you know, fundamentals don't matter anymore. Two plus two is not four. It is whatever. And whatever the positioning of the market is. And so if the market is long, equities, then as volatility flies, equities collapse, and if the market is short gold, and volatility spikes, the market would rally.

It will just expose those speculative positioning. And so I think it's going to be a matter of time that maybe some of these things get checked. And then it's potentially quite bumpy because correlations, not only volatility explodes, but correlations polarize and that

feeds on itself creating an exponentially higher value-at-risk and brings me back to that point of intervention and central banks and it's all related. It just feels like the sequel is getting, you know, bigger and bigger is not a Lehman two, it is a Lehman squared, as I call it, right.

Erik: Diego, if I listened to all of the things that you're saying and kind of sum them together between an endgame of inflation being pretty clear. Equity market volatility really picking up sending some warning signals. Equity valuations clearly stretched by anything other than a duration comparison to treasuries. You've got a number of things that you're describing that are suggesting. Boy, risks in the system, you'd think logically, gold ought to be testing its resistances with all this going on, but in fact, the opposite is true.

Gold is not only not testing, its resistances. But we're actually at what Ole Hansen told us last week is a very critical support level that if it doesn't break, there could be a heck of a lot further downside. If we can't hold this current level, which is we're speaking on Monday morning is around $1682. Right at the bottom of the range that Ole told us was kind of the number that has to hold. Why do we have gold down here with all these other things going on? Is it entirely about real yields? Or is there more to the picture here?

Diego Parrilla: There are a lot of factors, obviously, the markets speaking loud and clearly. And there's a bunch of them we can work through. I mean, obviously, the fact that gold and treasuries are moving hand-in-hand, it's indicative. Of course, with higher nominal yields than gold or any other asset without any specific yield looks less attractive. But certainly, I think they're both in the same bucket. Right. They're both defenders. And I think in that sense that correlation could be justified. The other interesting dynamic it's, you know, we talked earlier about the inflation-deflation debate.

We could talk about the reflation-stagflation debate, and to what extent we've seen since August, when the Fed announced this changing in stance with respect to inflation, saying, look, 2% is no longer a ceiling. We're going to be accomodative, blah, blah, blah. You've seen basically industrial, commodities, copper, iron ore, cyclical commodities, like oil up, you know, 45-50%. In that very same period, we've seen gold down almost 20%. So it's a phenomenal divergence between real assets that goes way beyond just inflation discussions, right, or reflation.

So I think gold has been clearly decoupled from the commodity spectrum and is much more on the on the US Treasury. And the momentum of those flows is brutal. And I think, you know, those things, again, could be overstretched. Gold is technically clearly oversold. But again, we have a situation that goes and links us to the dollar. Right. The dollar I think a lot of the consensus positioning going into this year was much weaker dollar, people very bullish the Euro, or others like Yen, China. And obviously, we're starting to see that positioning for the time being, the correlation between gold and these currencies is high in the short term on the sell-off. I think those correlations could break. In fact, we play that very actively in our in our strategy, things that are gold

higher, dollar higher, which are extraordinarily cheap. So I think that that could be very interesting in in a vol. breakout

Undoubtedly, I think there's obviously the fact that perhaps the market got a bit carried away into the summer making all time highs, something that I thought it was just a matter of time and it did happen. We all expected a bit of a fight and perhaps a sell-off. But what we're seeing now is perhaps beyond what most of us would have anticipated and I think it's clearly a long term opportunity.

But I think we can't forget also, you know, you can't discuss gold these days without bringing crypto into the discussion. And, you know, I think here there's obviously very polarized views. You know, there's lots of people who see gold and crypto as two very viable parts of the solution. Some people are much more extreme and they see gold as just, you know, useless old money and Bitcoin as the new miracle.

I mean, I've done a lot of work into this, I published a note called "Bitcoin bubble or anti-bubble" where I do a lot of analysis on multiple dimensions, you know, purely trying to understand really, and so as I open the article. I say look, I don't want you to think like myself, I want you to think. Right. Which is Frida Khalo sentence but you know, covering a lot of arguments, I find that they are multiple areas of concern and consideration of fallacies in the process. I encourage people to read through it. Happy to talk about some of those fallacies like inflation-hedge fallacy, the scarcity fallacy, the value fallacy. .That ultimately helped me or lead me to conclude that Bitcoin is 80% bubble 20% anti-bubble and I think this is just one more factor.

I mean, it's very obvious that very phenomenal traders, you know, have embraced Bitcoin, some of them perhaps, digital gold or at least Bitcoin took a bigger part on the short-term bets. Famously, Paul Tudor Jones called it the fastest horse in the race against deflation, but that was at 8000. That horse has run a long way. And I think, whether Paul Tudor Jones or Stan Druckenmiller were notoriously bubble traders, you know, when they come into this trade, it's not because they're worth something, they just wanted a bubble, and there'll be making a ton of money on the way up and on the way down.

So really, lots of things there, I think back to gold, it's really many many factors. In my opinion, you know, gold is clear an anti-bubble in both for the fiat and the fiat bubble, as well as crypto. And personally, I think that these are levels where whilst it's impossible to just put a floor and technically, to your point, I think the markets a bit Darwinistic. Okay. There are so many people in their homes, trading historical graphs that have nothing to do with today's reality. Right, and they become a bit of self-fulfilling prophecies, and arguably if everybody's trying to buy the break, then buying the break doesn't work anymore. And you have a new predator around, which is strategies that cannibalize on people who play on this, and so I'm a bit of a, I'm quite skeptical about many of these things.

Of course, the market could look like it breaks, and then everybody's saying, and then it just bounces in your face. So a lot of caution, I think gold can be very explosive. The pressure has been enormous, liquidation has been notable. And personally, we believe strongly, although we play this mostly through options, which allow us effectively the benefit of having the downside, you know, capture the premium and then have very asymmetric payoffs. Ehereby if the market was to continue to sell off, you lose one a mark-to-market basis, but then you give yourself sufficient time, hopefully, to get to see these moves. But it's been phenomenally challenging for anybody that is strong gold or gold miners or silver for that matter, which has very strong fundamentals as well. Even from the reflation, story and others.

And so I think Gold is truly fascinating. Lots of drivers, I think it's become a very unloved. And if I put everything in balance, it is something that I believe you should accumulate. And I'm going to make this last point on gold, I think, you know, we've seen a lot of momentum in gold. You know, people who were on the sidelines, came in over the summer, because, you know once he broke, it was going to go to 3k. And then the kind of people that are now throwing the towel that probably those guys that came in.

So my recommendation is the opposite. I think here you have to embrace the volatility of the market, you have to embrace the stability of the market. And moments like this when gold is very unloved and equities are super, maybe expensive. This is not the time to ditch gold and buy NASDAQ or Bitcoin personally. I think this might be a time to just calmly rebalance. And so I think it's going to continue to move. We'll see which way it goes. You know, I don't have a crystal ball unfortunately. And again, these things are not either or. There could be many scenarios where equities and gold go up and inflation does whatever. But I think gold is an interesting asset that I think will have a role to play over the medium and long term. But it's just like everything else. It is super volatile and under a lot of pressure.

Erik: Diego let's come back to the US Dollar Index, which of course is a relative measure of the dollar strength against other currencies. For the first time since late November on the day that we're speaking which is Monday a few days before this episode airs. We finally at least intraday we haven't seen the close above 92 yet, but we're trading intraday at about 92 spot 21 as we're speaking right now. Looks like maybe we're headed toward our first daily close today above 92. That was the previous support level for several months before it broke back at the end of November. Is this a significant reversal are we headed back to you know, 102. You know a new cycle higher on the dollar or what do you think is going on here?

Diego Parrilla: Well, I think the dollar, obviously has been driving everything in the last few months. More recently, it's yields, the Treasury yields and dollar rates that are at the front of the show. But I think, you know the dollar move is interesting because, I would argue that you could almost see within the XY. You could see different components, almost like sub-sectors, right.

Diego Parrilla: So for the first part, it was mainly the dollar exposing some of the moves versus the M, the developed currencies, whereas the Euro, you know, giving way from 124, to two now 218. Or the dollar yen, which is also sort of breaking higher and gaining some momentum or dollar Swiss. And now what we're starting to see, in fact, today is the first relevant move in the Yuan, or Taiwan or others. There's obviously other types of news and things happening. But the EM train is also starting to be exposed a bit. And I think this is, you know, whether is the carry trade angle on China or other considerations that are linked.

I think the dollar move is largely a positioning move, where the long term yields and the interest rate differential is making the dollar more attractive. But more important than anything is the positioning which was super crowded. So how far can it go? What does it mean to to the overall index and correlations, I think correlations will also break, you will see certain things working better than others. You know, some of the commodity winners or the losers.

You know, so I think if you look at the overall the dollar versus everybody else, I don't see any dramatic change in trend like that is completely sustainable. You could have 5% to 10% swings one way or the other. But this is a very reactive game where you know, the central banks that are the countries whose currencies are stronger or defending themselves and are suffering from loss of competitiveness.

I think a good example is China, right? I think China since the summer, we saw the Chinese yuan appreciate by close to 12% pretty much in a straight line with zero vol. almost. And part of that was driven by inflows into, you know, positive story. People like Ray Dalio, the 10-year Chinese government bond paying 3%. And it was almost like pretty money, right. So I'm, I have a currency that appreciates, the bonds pay me 3%, blah, blah, blah. And my point is always being looked, be careful, because as China becomes a carry trade, and all these money goes in and volatility explodes. You're going to start to see some of the behavior that we've seen with other commodity currencies like the Aussie, etc.

And so I think in that sense, the dollar again, it's that volatility in rates is transferring to effects. Very obviously, I think those correlations could add to the volatility. We're seeing a bit of a domino effect, and some of them have been leading and others are lagging. But certainly, you know, for now, it's still somewhat orderly. If volatility was to explode, I think you could see some of these moves accelerate. And that sort of takes out a lot of the technical guys that watch this very carefully. And, you know, stick them in into the new positions all knowing that if you do the numbers, and two plus two, it should equal four eventually.

But in the meantime, you know, 1.9 trillion and another 1.9, and then Europe and then the other guy. This is this is all just parallel inflation and I think you could see, again, back to gold, you know, some of these assets and correlations breaking. And that could be that could be interesting.

So, I think overall, the directional move one way on the dollar doesn't just the index doesn't do justice to what's happening inside. You need to look into the attribution of the different components, you know, carries and other considerations. And if we go into a risk of move, I think overall, the dollar rallies, but it's not necessarily a sustained rally. it will be something that could run, but there will be responses, for sure. We've discussed that before with the Fed and yield curve control and volatility.

So it's once again, it almost feels like when you trade carry, you know, you make money 95% of the time but it's that 5% of the time when things go against you that can blow up so badly. So I think on many markets feel a bit like that carry situation where Vol. could expose some of the positioning but yeah, the dollar story goes very closely with rates and vol. and equities and it's all part of the same somewhat artificial setup where the currencies will be controlled to a certain extent, not just by the Central Bank but also as a response function to other central banks who are trying to achieve the same game.

And that's why currency wars and trade wars are so relevant, right, to the whole thing. Currency wars is really trying to transfer your problem to your neighbor by devaluing your currency. And trade wars is the mirror image of currency wars. It is trying to defend yourself from those that abuse that monetary abuse, someone effectively becoming more competitive through the effects channel. And by you putting tariffs, you're neutralizing that effect.

So currency wars, trade wars, go hand in hand. I think they're on the rise. The globalization has been reversed into, at least, you know, polarization, and with two main polls. With China emerging and the US. And again, this is all supportive once again, of you know, volatility, and geopolitics and many other things that are inherently in these markets, and that I think are considerations to worry about. But yeah, the dollar, absolutely key technical levels, very important. I think it all goes hand-in-hand and watch out for vol. and positioning.

Erik: Well Diego, I can't thank you enough for another terrific interview. Before I let you go tell us a little bit more about your books, "The Anti-Bubbles" and "The Energy World is Flat". And also for the benefit of our institutional and accredited audience, please tell us a little bit more about where they can follow you and find out more about the fund you manage for Quadriga Asset Management.

Diego Parrilla: Yeah, I wrote two books, ***The Energy World is Flat*** published with my good friend, Daniel Lacalle. He's also been with you a few times, and ***The Anti-Bubbles***. Both of them presented very contrarian thesis at the time of writing. The Energy World is Flat, Oil was sort of 120 people in theory calling for $200. And, you know, we were calling for the flattening of the energy world with sort of $30 to $50 oil. That was probably science fiction to many people, when we first published. Then it became sort of current affairs and now it's history.
A similar thing is happening with The Anti-Bubbles where I published in 2017, talking about, you know, this idea of monetary and fiscal policies without limits and many of the things that we're seeing today are being reinforced. Obviously, that endgame is critical. I

think that the important thing for investors and for everybody to understand is that there's a paradigm shift. The rules of the game are changing and I think the next decade will be very different.

And perhaps just two takeaways, which are very important and linked to your point on the strategies that we manage. I use, you know, the analogy of when you build a portfolio, I think it's very important to understand that it's a team. And as a team, and I use a soccer team or football team because I'm Spanish, but you could use any team. But in soccer, you know, you need strikers, which will score goals and make your money through capital and income gains. But you also need goalkeepers and defenders that will basically do the mirror image, they will make a lot of money in crisis and I think that's incredibly important. As a coach, you have three jobs, you need to define the strategy with which you play.

And unfortunately, this leads me to a key message that we talked about in previous interviews, which is the concept of false diversification. The idea that people build a team thinking, Oh, I own different asset classes, equity, credit, high yield, Yen, commodities, private equity, private debt, and when a crisis comes, and they all fall synchronously in a big way. So you were not really diversified, you thought you were diversified.

So I think the first key thing that we tried to address with our strategies is to bring goalkeepers and in that sense, my strategy was best in the world in February last year. One of the best in March, it has suffered more recently. But as a team, I think the strategy proves the point. And I think it's very important to embrace this to be 80 of the market and the volatility. Therefore, times like recently, where you know, some of the goalkeepers like volatility or gold are being being sold, I think is an opportunity to rebalance.

So I think that's important. If anybody wants to discuss in more detail, you know, feel free to reach out through Twitter @ParrillaDiego or also through LinkedIn. I'll be happy to send the information but I think it's very important to play with goalkeepers in this match. And I think the second key consideration is when you build your team, think about inflation.

With inflation, as part of the endgame. It is not just good enough to have strikers, midfielders, and goalkeepers, you know those strikers, midfielders, and goalkeeper should have a long inflation bias so you should favor equities to credit. You should favor real assets to cash and you should definitely favor anti-bubbles to fixed income. With that, I really appreciate and thank you for the opportunity. I hope people found it helpful and I look forward to much cooperation and success. So best of luck and overall much health to everybody in this super difficult times.

Erik: And Patrick Ceresna and I will be back with our postgame segment as MacroVoices continues right after this message from our sponsor.