MACRO Voices
with hedge fund manager Erik Townsend

Dylan Grice: Are Central Bankers Politicians or Economists?

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Erik: Joining me now is Dylan Grice who's probably best known from his days at Soc Gén. But these days, he's co-founder of Calderwood Capital. Dylan, great to have you! First time on the show. Let's start with a question I've been asking just about everybody, which is boy, all of our favorite deflationists have turned into not just inflationists, but many of them secular inflationists who really say this is maybe another late 60s, early 70s, beginning of a big event. Would you agree with that? And if so, what are you doing about it?

Dylan: Well, hello, Erik and thanks for the big opening question. It's a tough one. So to kind of rewind for 10 years, to be brutally honest. I was very much in the construction inflation camp, I was very much of the opinion that we were about to see the whites of inflation's eyes. And that it was going to be the defining characteristic of financial market behavior, really, across the asset classes. It was gonna be the driver of asset returns really, over the next decade. Of course, I was I was thinking this in 2010. And, and I was writing about it a lot. And the fact is I was completely wrong, and so I'm kind of very hesitant to make the same mistake again. And I think, and I look back on it. And I look at some of my reasoning 10 years ago, when I kind of thought that, you know, inflation was about to take off, I actually kind of retrace my steps, and I re-read some of the stuff that I wrote.

And what it actually said was, so back in 2010, when I remember the prediction that I remember making that I wrote. I said in 10 years time, we'll be looking at the whites of the eyes of an inflation problem, and not an inflation not by 100 or 200 basis points, but inflation, which is becoming uncontrolled inflation, which is getting out of control. And so inflation of a kind of four to five percent rate and a rate which was accelerating, Right? So that was my prediction in 2010, for what the world in 2020 would look like. And kind of pandemic aside. 10-year breakevens were 50 basis points lower on the eve of the pandemic than they were when I was making my prediction. So I was just horribly, horribly wrong. And I think, you know, you got to kind of try and understand why you were so wrong before you try and make you know, the same prediction again. So, you know, I guess the kind of the summary answer is, I don't really know, the simple answer is, I'm not quite sure.

Erik: Well, I was reading your Birkdale in 2010. And I agreed with you emphatically and we were both emphatically wrong together as a result. So you know, here we are. And it seems to

me that at this point, the evidence is just so overwhelmingly clear that we're headed toward a secular inflation event. But you know, I kind of thought that 10 years ago, too, and we both got it wrong. So what do you do in from a process standpoint, when you know, you've got a really important view on the market, that happens to be the same one that you got really badly wrong, not that long ago?

Dylan: Yeah. Well, that's I mean, okay, so that's, that's a great question. And I think, you know, how do you build a portfolio on the assumption that some of your key inputs might be completely wrong? How do you build a portfolio which is robust to your ignorance. So that's kind of, you know, that's what we try to do at Calderwood. That's what I've been doing, really, for the last kind of seven or eight years at the family office. When I left off Générale, went to work at a family office in Switzerland. One of the largest family offices in Europe. And I kind of helped establish their liquid investment decision. And the starting point for our investment process was really one of accepting your ignorance, and not trying to, which I think is very consistent with the capital preservation mentality, right? So if you're trying to, you know, if you're trying to kind of 10x, or 20x, or 100x your money, then that's a different kind of mindset. You know, you're actually making bets on things that you think, you know, because you're trying to get rich.

Whereas when you're in the kind of family office, and you're helping to build a family office, the families are already rich, they just don't want to be poor. So, the focus isn't trying to kind of pay another 20 or 30x the capital. The focus is on, you know, keeping, maintaining its purchasing power first and foremost. And secondly, hopefully growing that purchasing power in real terms, but it's a mindset. And the mindset, the starting point is ignorance. So I think if you're doing that properly, it shouldn't really matter whether you get inflation right or wrong, right. And so, that's kind of where we're at, you know, for money management perspective. To answer your kind of question on inflation, you said that today, it's more compelling now than it even was then. And I completely hear you and completely understand. But I think that's just something about, we clearly didn't understand, we clearly don't understand inflation as well as we think. And by the that's not just guys like guys who've got it wrong, right? That's not just the guys who saw QE, you know, put two and two together and came up with seven and got completely the wrong answer. Right.

I think what that what that episode demonstrates is that people, just, guys like us didn't understand inflation as well as we thought, right. But you can flip it over. And I think that a lot of the MMT guys, and girls - Stephanie Kelton for example, they're kind of premises that they do understand inflation, right? Their premises that we can spend all this money, we can print all this money, and we can print this money, and we can do lots of good stuff with this printing money. And it's not going to cause inflation, right? Because we just know, because, look, it hasn't caused inflation in the past, or it's not gonna cause inflation in the future. So they are the ones who are equally, I think that they are also deluding themselves into thinking that they understand inflation. And I think that maybe an advantage that we have, certainly advantage I feel I have is that I actually kind of know that I don't understand it. And I, I can kind of build a portfolio that doesn't need me to understand that. Right, I just have to understand that it's a risk that may or may not materialize?

Erik: Well, it seems to me like what we know, is pretty clear, which is that there is a huge amount of fiscal stimulus and money being created. The mistake we made last time was that QE was creating bank reserves that didn't really go into the real economy and create competitive demand for goods and services. Seems pretty darn clear to me that the list of people that are being offered handouts of some kind, transfer payments, some kind of stimulus support is pretty darn long. And there are not conditions attached to what you have to spend the money on, you know, you get your stimulus check. You can spend it on whatever you want to spend it on. So it seems pretty darn clear to me, but you know, as you say, we were kind of wrong last time. What do you do? Are you a big investor in inflation hedges, like gold and crypto and other things that people who are inflationists invest in? Or how do you approach it?

Dylan: Yeah, you know, that's a really, really good question. I mean, so the simple answer is so okay. So I mean, by the way, yes, I agree with you, right, that kind of money is actually going into people's pockets. Whereas before it was going into the financial system, ie, bankers pockets, and it was also going into rich people's pockets, right. Because it was inflating asset prices, although there's plenty of that this time around as well, right? But yes, you're actually kind of helicopter dropping money into people's bank accounts and that's different. And ultimately, I think, you know, if you can conduct a kind of thought experiment, this kind of idea that central banks can create inflation, which you hear a lot of, and you used to hear a lot of, it's, you know. I've always had a problem with that argument. Because if you just think of the following thought experiment.

Suppose you put $1 billion into every American's bank account, right? You printed a billion dollars for every single bank account, what do you think would happen to inflation? Right? Obviously, it's going to go up. It has to be right? And then you say, well, that's obviously stupid, because they will never do that. And he said, Okay, well, suppose it wasn't a billion, Suppose it was 1 million, right? And he said, Well what do you think the effect would be? Do you think the effect will be inflationary or not, and of course, it should be inflationary, right? You know, people would just suddenly start going out and spending money, and there wouldn't be the kind of supply to meet that demand. And so prices go up. Well, you know, they would never throw a million either, right? And then say, Okay, well, you know, what about $500,000 or what if it's $100,000. Or whatever, you know, at some point that has to become inflationary.

And so we've now opened up that door, and we're now walking down that path, and I'm not quite sure what the way back is from it. That's now become a policy tool. So I totally agree with you that does, actually, that's a tick in the box for the inflationists. That's going to be inflationary. And then the second thing as well, even if it's not inflationary this time around, then there's no constraint on them doing even more next time around, so they'll do even more. So you know, where's the constraint on this? And the answer is, I don't think there really is much of a constraint and so I totally get the inflationists' argument and their fears, and frankly, I have huge sympathy with them.

But I think that the irony is that, what that means is inflation, the inflation trade if you like, or the inflation protection is kind of easy, right? I don't think it's difficult to get inflation protection in your portfolio. Right, as you said, gold, crypto, you know, someone this morning, some fund advisor gave feedback on our fund. And they said that they didn't think our fund was worth it because you could get inflation protection from inflation protected treasuries. So, you know, okay, you're locking in a negative return if you buy TIPS today, what's the neg, what's the yield? Negative 70 or negative 80 basis points on the 10 year, I think. So that's a guaranteed loss of purchasing power if you buy TIPS. So, you know, arguably the inflation hedges, the reason again, but they're arguably quite expensive, right? They're not that attractive. So I think you have to think carefully about what you're doing there. So that's the first point. The second is, you know, in the 1970s, you're not going to stagflation, you get recessions as well as inflations.

And so you want that, you still actually want some kind of protection for that deflationary tail, right? You know, when you see a market crash or a market event. What that is typically pricing again is some kind of recession, or some kind of credit event or some kind of depression. So, in other words, these kind of left side tales are kind of pricing in the pricing of deflation. And so if you want tail protection until hedging. What you're also seeing is you want deflation hedging. And so that's a difficult thing to get. And so, in terms of the challenge of building a portfolio, the kind of inflation-deflation argument, I don't actually think it's as difficult or as fruitful, because ultimately, you know, we're all guessing. The question is, well, okay, what is the inflation trait? Or what is the tail protection? I think that's, you know, that's the most difficult one to answer. I'm not sure I have a good answer, by the way, but I think that's a more difficult question.

Erik: Well, since we've taken the unusual approach, Dylan of starting this interview, talking about things we're clueless about, let's move on to Treasury yields. Something that I mean, I can tell you, I equivocally, that the US 10-year yield is the most important thing to figure out in the world of macro right now, today. I personally have no clue where it's headed next. Do you?

Dylan: I don't but I think that you know, I think there's a kind of obvious asymmetry, right. I mean, I said that the thing that actually kind of engages me or has engaged me and my partners for the last few years is, you know, what does it look like when you have a bear market in bonds? And I don't just mean, you know, over the last, you know, last quarter, which was a big move, right, you know, we saw a very big quarterly move of 80 basis points. And, and the 10 year was actually an outlier. If you go back kind of, you know, 120 odd years of data. It was kind of, I think it was third percentile or something like that third or fourth percentile. So that was a big move, but it's not a bear market, Right? That's a bad quarter, a bear markets it's when you say, well, you know, in five years time, the 10 year Treasury yield will be 5%. You know, and 10 years after that, it will be 15%. And 10 years after that will be 25%. In other words, a structural bear market, which grinds higher. It's these yields grading higher and higher, and really kind of defines this, you know, the current generation, and then the upcoming financial generations careers, right. That's the kind of bear market that you're talking about.

And in terms of the kind of the probability distribution of what happens, the range of outcomes. Clearly, you're not going to get in 20 years time. I'm willing to bet quite a lot of money that you're

not going to see minus 20% yields. Right? But I do think there's a very good chance we'll see plus 20% yields. So it's massively skewed. And I think it kind of bothers me really, it does. I think it's quite scary to think about what do you think the equity market looks like when government bonds are at 20%? You know, what are these private equity funds? What did their IRR look like? When you're looking at 20% bond yield? Right on the journey to that 20%? What does venture IRR? What do they look like? And you know, and that's kind of what etc, etc, etc. Where's real estate? You know, I think that that's kind of quite a kind of worrying idea. And I think if you're not, if you're not thinking about how to protect it, you know, and you're a fiduciary or something, you're not really doing your job properly. Frankly.

Erik: Dylan, you recently penned an article saying that there is plenty of room for a big rally in crude oil. I happen to agree with you, but I am very curious to get your reasons.

Dylan: Well, you just seen a complete collapse and incapacity, you've seen a collapse in CAPEX. So I think that the oil market is gonna be incredibly tight basically over the next few years. And that tightness I think, is something which is gonna really bite. You know, the oil markets haven't recovered since the shale Gale really. The kind of 14, and just as they were getting back on their feet, kind of '18,'19, they got hit by the pandemic, and you're negative good prices, you know, was the kind of the poster for just how crazy that time was, you know. There has been absolutely no investment in the supply chain. I think CAPEX is probably about half what it was pre Shale Gale. Even the shale guys who are kind of notorious, notoriously poor capital allocators are kind of saying that they've now got, they've got this kind of new religion, which is kind of shareholder value. And you've kind of realize that, you know, shareholder value isn't the same as kind of, you know, drilling every opportunity.

So I think there's been this kind of change and the mindset, and the kind of swing players. And I, you know, I said that you're just more kind of, prosaically, there's just not going to be the supply to really meet future demand. And then, so that's why I think you got, you know, you get higher crude prices from here. I think in the kind of markets like in the stock market, you know, or, you know, private markets and credit markets. Obviously, there's this whole kind of move towards the energy transition. And obviously, that's the thing. And so I think people have been very very quick to kind of conclude that oil demand is growth is going to be a thing of the past. And that oil is kind of yesterday's commodity.

And I think it's kind of difficult really, to see that certainly on a 10 year view, I think that you're probably going to see more oil vehicles on the road over the next 10 years rather than less. If you actually back out Bloomberg numbers from Bloomberg's New Energy Finance survey. I think the implied growth rate for combustible passenger vehicles is something like 70 basis points a year, annualized over the next 10 years. So 10 years will be more petro-fueled passenger cars, not less. And of course, you've still got heavy duty trucks, there's no, you know, no hydrocarbon solution for trucks, for heavy duty vehicles, with petrochemicals. So and by the way, I'm not saying that this is a good thing. Right? That's just what it is. That oil demand is going to grow from here. So you've got growing oil demand at a time when you've had an absolute collapse and in the capacity of the supply chain. So that's, you know, I think that that's,

you know, we need more. The world needs more oil supply capacity, and the only way you get is with higher prices, so I think it's pretty standard commodities cycle, really.

Erik: Yeah, this is something that fascinates me quite a bit, you know, I think there's no doubt that we are in the beginning of a process that takes us to decarbonization, and eliminating the need to operate vehicles with fuels that are derived from petroleum. But boy, a talk about people in mass under estimating the size of a transition. And I just, I can't believe you know, people are talking about five years from now there won't be any more vehicles, you know, oil, or gasoline or diesel driven vehicles. I think this is going to take longer than anybody takes, and particularly what I don't hear any public discussion about is the necessary build out of the electric grid that would be required in order to support all these electric vehicles people think are coming tomorrow morning. How do you see this playing out? And what are the the gotchas, things like the build out of the electric grid that nobody's talking about? That maybe you're seeing that other people aren't?

Dylan: Well, I think, you know, I'm not sure that we have any kind of great insight into their kind of specifics of the energy infrastructure to be honest. You know, we've got some kind of, we've looked at a lot of energy. So we're a fund a funds, right. So we look at across the whole kind of spectrum. We've looked at a lot of kind of energy specific managers, but they're typically very niche and, you know, very kind of narrow the main kind of sectors of the energy market. And so I kind of make that excuse, before I kind of give my answer as to what the conclusion we've reached is that, I think there's just probably a more broadly than just oil. I think we're looking at the commodity bull market, you know, again, because what we've seen really since the, the kind of GFC, you know, and certainly since the collapse of 2014 has been this real collapse and capacity. It's not just true in oil, but it's true in most commodity markets. I mean, uranium, I think is a kind of obvious decarbonization, one that I think is very, very interesting.

But just more generally, I think that we're probably looking at a commodity bull market, and you know, for the battery, for the batteries are going to need to be built for the for the grid infrastructure that's, that's going to need to be built. So I think in terms of making bets on the future, you know, that would be one that, and obviously, I've just kind of spent time talking about how we try not to make those bets in the future. But, you know if we can kind of put ourselves in a position where, if that happens, we're going to we're going to do well, and if it doesn't, we're still going to be okay. That would be that would be one of those areas, one of those commodity markets more generally, I think are probably set for I mean, they're already on fire at the moment. But I think that they're set for probably a kind of multi-year bull run from here.

Erik: I want to pick up on the way you've said a couple of times that you really try to focus on not making assumptions, or making bets on things, if you kind of feel like inflation is where we're headed. But you don't want to place that bet, because you could be wrong. And you don't want to make the wrong bet on electric vehicles because you could be wrong. What do you end up doing in a portfolio, then, if you're trying to avoid a directional commitment.

Dylan: So maybe I haven't been articulating it, maybe as clearly as it should, it's not that we try and avoid the bet because you frankly, you can't avoid the bet. Right? It's like, you can't avoid risk. Because if you get out of bed in the morning, you're taking risk, right? Because if you stay in bed, then you're just taking a different kind of risk. You spend the rest of your life in bed, and you're risking all sorts of kind of, you know, muscle atrophy and certain diseases and you know, it's horrible. So there's no way to avoid risk. And so there's no real way to avoid some bets. What I'm actually seeing is that we're kind of looking for just a very, very skewed return profiles.

So the way I kind of think about the portfolio, suppose you want to take a bet on? Alright, you know, we've talked about inflation. And I think, you know, we're on the same page is we think it's something that we're both worried about. We both want to, suppose we both want to take that bet on inflation. Well, we could see, you know, it's just the obvious thing, right? inflation is going to go up, yields are going to go up? We're going to enter a bear market in duration. Why don't we just short government bonds from here, right? We've got treasuries, short JGB's or something. Okay. And, actually, JGB is not the best example, short treasuries from here. The problem with that is if we get it wrong, we're going to lose money. Right? If we get it right, fantastic. We're going to be heroes. And I'm sure in 5 or 10 years time, there will be plenty of heroes who got that call, right? But the problem is disappointed people who've been putting that trade on who have ended the careers or who has got themselves into trouble because they have been wrong, right? Because it's actually quite a symmetric bet. Right? If you're right on inflation, you're gonna make a lot of money. But if you're wrong on inflation, you're, you know, you're gonna lose a lot of money.

So the typical way to get around that is use some kind of derivative structure where you got the option, right, so you buy an option. The problem is, you buy options, you have to pay the premium, right? So typically, the premium is priced so that it's actually quite difficult to make that money consistently by just buying options all the time, right? The guys who make the money from options are the people who are selling the options, typically. And so it's just how do you have your cake and eat it? How do you get yourself in a position where you say, well, okay, if inflation reps from here, we're going to be fine, right? We're actually going to do pretty well. But if inflation doesn't rip from here, we're still going to be fine. Right, we're still going to do quite well. And I think that's what we tried to do. And I said, I think that's the challenge. That's where the intellectual challenge becomes, you know, a bit more interesting, you know. Anyone could buy gold or go short gold if they are a deflationist and anyone can do that. But it's very symmetric. Right? You know, building asymmetry, I think, is much more interesting. So that's what I meant.

Erik: And where do you see the most opportune asymmetric trades in the market right now?

Dylan: But it's not necessarily a trade, so much as a strategy. Right? You know, I said, we're a fund of funds. So we invest in different types of managers, and they do different types of

things. And, you know, if you kind of think what it takes your managers to invest in. You say, well, you know, you said you don't want duration in your portfolio, right? So you don't want any fixed income. And actually, if you kind of broaden out that idea, with kind of TIPS, you know, a negative yield, right? Because it's not just that nominal duration that has been on a tear, but real duration has actually been real duration, inflation expectations have been quite stable, you know, over the last 10 to 15 years. Arguably actually, over the last 20 years. So the bull market has been in real duration, right? Not nominal, not just nominal duration, it has been a real duration. And it's gone to such an extent that real yields are now negative in the inflation protected securities market.

So suppose you say, well, we don't just want nominal duration. We don't want any real duration either. Okay well, that means we don't have any nominal fixed income, we don't have any government bonds, we don't have any corporate bonds, we don't have any credit. Really, it's only fixed income credit. But we don't have any real duration either. Well, that's equities, right? And it's obviously TIPS. But if we are seeing we don't want any real duration in the portfolio. We don't want any nominal duration. We're also saying we're worried about inflation risk, right? We worry about duration risk here, right? This is not a trade that we want to be on. But if we don't want to take that risk, that means we can't take equities, we can't take credit, we can't take government bonds, we can't take anything that looks like those things. So we can't take private equity, we can't take venture, we can't take long-short equity, we can't take event-driven, right? We can't take kind of vanilla structured credit, cause that's all based on just equity in disguise. Right? We can't take risk arbitrage. Well hang on, what can you take, because you just named 85% of the alternative investments universe. So that leaves us with that 15% of the alternative investment universe, which isn't any of those things.

So that's kind of what we do, right. And if you get, you know, once you start thinking in those terms. It leads you kind of down a, you know, it leads you on a particular path that we've been on for a few years now. And that is, as I said, as kind of hedge funds as niche strategies. It's very, very high expertise, narrow domain managers, who frankly don't know a whole lot about much, but they really, really know what they do, and say no, and allows those to kind of create a very kind of idiosyncratic portfolio, really. As well as the portfolio of very kind of orthogonal idiosyncratic risk. But you know, we get to be very precise about the risk we want to take. So if we don't want to take duration risk. We don't take duration risk. Right. And so, you know, that's I don't know if that answers your question. I'll kind of stop there. But that's how we do it. It's not the trade, it's what's the strategy, or what's the portfolio construction strategy? That's how we answer the question.

Erik: Dylan, since you're in Europe, I want to get your perspective on the ECB under its new management and just big picture, where are we headed in terms of what I think is a competitive devaluation between central banks, but where do you think central bank policy is headed globally? From here in this new era that we have with new leadership in both the ECB and the Fed?

Dylan: I think these things typically move in tandem. And, you know, one of the things I found quite kind of astonishing, and we have questions on ECB, which is to kind of kick off with the Fed. Because I think the ECB is really kind of, Lagard I think, in many ways is echoing Powell. But Powell really kind of set the running, I think it was at Jackson Hole last year when he really made a big thing about how he thought it was their job to do more good, and the economy and to do more good in society. So I don't know if you, you know saw. If you read directly on his speeches, but he made a big deal about how, you know, the problem of unemployment is unevenly distributed, and in particularly hot, disadvantaged minority communities. And he saw as the Fed's role to really, really write to the rescue.

And so part of his kind of thinking is that unemployment needs to be lower. And the Fed therefore need to drive unemployment much lower than it has been in the past. Because this is the way that the Fed can really help these disadvantaged, poorer minority communities. Alright, so there was this kind of social aspect to Fed policy, political motivation to Fed policy that you're kind of seeing. And I just kind of feel, obviously, he's been more explicit. But I think we've gotten you know, Lagarde, she's a politician. She's a former French finance minister. She's been at the IMF. She's political. She's intensely political. And I just feel that we're seeing a kind of echo of Powell's sentiments by the ECB, really.

So I, you know, I feel that we're actually just seeing a huge kind of policy mistake, a global kind of policy mistake being led by the Fed, but I think all the other central banks are kind of falling into line and that policy mistake is kind of hiding from making the big decisions, hiding behind the CPI, and hiding behind this idea that CPI is not a problem. So, you know, policies fine. The CPI is not wrapping here. So, you know, so everything's gonna be fine. You know, CPI is still, you know, roughly 2%, or one and a half or whatever. And therefore, the fact that credit spreads are like crazy ties, the fact that underwriting is being done on crazy terms, the fact that you've got signs of froth and excess in pretty much every market you look. Whether it's SPAC markets, crept through markets, and credit markets. None of that matters, we don't have to pay attention to that, because the CPI is just fine. I think that's the kind of policy mistake that we're seeing at the moment.

Erik: Well, let's come back to what you said about the ECB and the Fed both becoming politicallized or politicized, I guess is the word. Christine Lagarde has made comments I make the joke, you know, the Fed has a dual mandate of steady employment, and, and so forth. I think the ECB has taken up a dual mandate of solving climate change and racial inequality. She's almost come out and said that, not quite, but pretty darn close. It sounds like you and I agree that there's a trend here, which is, there are politicians, people like Jerome Powell and Christine Lagarde, who were politicians at heart, who were in positions where they really ought to be focusing on the ball that's in front of their face, which is the economy.

But as a politician, they know what's appealing right now to reach out. And, you know, if you're trying to win political points, you definitely want to do it on social justice in some way. And they're somehow you know, there's this charter or mission, scope drift that's going on where central bankers are saying. You know, I might be a central banker, but at the end of the day, I'm

a politician, and politicians always look for the social justice when they can make in order to be more popular politicians. What are the risks of our central banks turning into politically motivated mouthpieces, if you will for politicians, which is what these people really are?

Dylan: I mean, to actually kind of go back to one of the things we were talking about earlier, which is inflation. Kind of wary that all roads leads to inflation risk discussion. But when I did go back, I said, remember, I said, you know, I was kind of confident that we were on the foothills of an inflation crisis, you know, 10 years ago. And, you know, here we are, we still haven't seen it. So I went back, and I tried to pick apart my thinking and what I got wrong. And one of the things that I really kind of underestimated was, it was the role of central bank independence, right? And, you know, the notion that more money printing must invariably leads to higher inflation, like next year, or the year after, because historically it has been, but there were plenty of episodes historically, where that had been the case, and previous episodes where that had been the case. The central banks were run really badly, like really, really badly. And certainly, in the UK, the central banks were overtly nationalized, right?

And so it wasn't the central bank that set interest rates. The central bank was basically just, you know, the central bank governor was basically just the guy pulling the lever. Whenever the finance minister, the Chancellor Exchequer in the UK, told him to, right? So it was the finance ministry, it was the chancellor, who decided when to change interest rates. And of course, the Chancellor was a politician, he was an elected politician. And it was a huge advantage to the incumbent prime minister or to the incumbent political party in the UK that you control interest rates, because what you could do is you would basically keep interest rates too low, and the run up to an election. Because obviously you would generate that feelgood factor and the feelgood factor typically benefited the incumbent.

So once you'd won the election, once you'd kept interest rates too low, you won the election, the economy's overheating, inflation is rising, then you jack up interest rates in any great recession, because you think, well, obviously, this is going to heart and everyone's going to be really irritated and annoyed at us. They can't vote for another four or five years. So we might as well get out of the way now. In other words, there was a huge political cycle and interest rate setting and arguably, the political cycle was the dominant cycle. It was the dominant kind of informational input and to interest rate setting. Right. So the political cycle of interest rates, I think, was one of the real reasons why you had such an inflation problem in the 70s.

And the removal of that political interference was one of the reasons why I think inflation actually went on the secular downward path. And I think if you re-read the literature of the 70s and 80s on central bank independence and inflation targeting. I think it's kind of obvious that it had just such a hugely powerful effect on the kind of the structure of inflation expectation setting, and the structure of interest rate setting, the dynamic of interest rate setting. And I think that really, because the underlying idea is that which I think is true, is that economies are fundamentally deflationary. Right, you know, it's by the human condition to try and do more with less, right? Ever since some caveman picked up a spear, and kind of threw it at an animal, he was trying to do more with less, because it was much easier to throw the spear than it was to chase the

animal. And then when he put some kind of a piece of flint, sharpened flint on the end of that stick, you know, and so on, and so forth. So I think it's very much who we are, we're trying to do more with less. And that's basically in other terms, that's deflation.

Dylan: So the economy is deflationary and by the way, you know, yes, I've never really quite understood this fixation with deflation being this terrible thing that we all have to be really scared of. Anyway, if the default position of the economy is deflation, when you introduce this political calculus into interest rate setting, then you start to create inflation. So I think the removal of that political calculus, which is what we saw with central bank independence, is really what allowed economies to start behaving a bit more like their usual selves, which is kind of, you know, deflation machines. So that's kind of the first part, that's kind of the politicization of central banks. What does it mean that the central banks have, I think, we now have virtue signaling central banks, certainly for the first time, maybe in history. And otherwise, we have highly politicized central banks you're trying to do, they're trying to achieve political goals. I think that this is a huge step backwards.

And I think that this undoes a lot of the benefits to having an independent central bank, because Greenspan was clearly political. Any notion that Greenspan was not a politician, you know, I actually once had a dinner with Sebastian Mallaby who wrote the biography in Greenspan. He spent four years with a guy, and someone at the table said, you know, what's the one thing you learned about Greenspan that you didn't know before and that you think would really surprise people? And he said, you know, straight off the bat, the one thing that people don't understand about Greenspan is that they all think he's some kind of technocrat economist. He's a politician. He's actually deeply political. He loves Washington, he loves the power. And so central banking, Bernanke, he was exactly the same. I think that central banking attracts that type of personality. And increasingly, with this virtue signaling that you're seeing at the ECB or the Fed, I think that you're actually seeing the renewed politicization of central bank calculation.

And therefore, I think that ultimately creates a kind of inflationary impetus and to kind of policy setting. So very long answer, but I think that's where it does ultimately make me much more nervous about inflation. And I think, even aware of the mistakes I made 10 years ago. You know, I can see how this is a new piece of information, the growing politicization of central banks, and this new unconstrained tool of the printing press that says, you know, I think this is a new data point that we didn't have 10 years ago.

Erik: Dylan, I can't thank you enough for a terrific interview. But before I let you go, I want to talk about popular delusions, the newsletter that you write, this is one of the better ones, it's not a free one. Unfortunately, I guess some of your investors in your fund get it for free. But you do have to subscribe. We got a free sample for our MacroVoices listeners. Listeners, you'll find the download link in your research roundup email. If you don't have a research roundup email, it means you're not registered. Just go to the homepage, macrovoices.com. Click the red button that says looking for the downloads above Dylan's picture. Dylan, tell us about popular delusions, what it is? What people can expect to find there.

Dylan: Yeah, well I think we see a lot of very interesting stuff and financial markets. You know, as you know, the primary focuses on running the fund. We invest very niche strategies, very niche managers. And so we're kind of informationally, we're a very kind of, we set a very interesting juncture. There'll be anything from, you know, reactive and reinsurance markets, life insurance markets, synthetic credit markets, credit markets, private credit markets, cryptocurrency markets, litigation markets, etc, etc, etc. You know, and a whole bunch of other stuff as well.

And of course, we kind of pay attention to the more vanilla asset classes. We're very kind of, a lot of our subscribers are institutional asset managers. So we're kind of, I think that we've set a very interesting kind of informational vantage point. And so and we write about it, we write about what we see in the fund, we write about some of the opportunities. It is geared towards actionable investment ideas, right. So it's more than just a kind of commentary on, you know, whether we think that central banks are, you know, doing the right thing, or no, or any of these kind of higher level conversations, which is why we do actually charge for and don't give out for free. But we leverage, really the research that goes into the fund, and we publish it so that even people who don't invest in the fund can still get access to our thinking and, you know, hopefully get some value from that.

Erik: And the sample issue here has both an article about uranium as well as an article about what will happen if treasury yields continue backing up and will it burst or derail the bubble in equities? Dylan, for people who are interested either investing in your fund for accredited investors or just contacting you, if they want to subscribe to the newsletter. How should they do so?

Dylan: Well, the easiest way to get hold of me is on Twitter. So you know, I'm there @dylangrice, I think it should be able to find me easily enough. I'm kind of in and out. I'm not super active on it. But I'm active enough to reply to messages, you know, pretty quickly.

Erik:
Fantastic. Well, we look forward to having you back for another update. Patrick Ceresna and I will be back as MacroVoices continues right after this message from our sponsor.