Darius Dale: Inflation is officially on hold but just for now

July 22, 2021

Erik: Joining me now is Darius Dale founder and CEO of 42 Macro. Darius prepared an extremely complete chart deck for today's interview. I strongly recommend that you download it. Registered users will find the download link in your research roundup email. If you don't have a research roundup email, it means you're not yet registered at macrovoices.com. Just go to the homepage, macrovoices.com, click the red button that says looking for the downloads. We're going to be referring to the slides in that deck. We're not going to have time for all of them. But I encourage you to go through all of them at your leisure because it's a really great deck.

Darius, I want to start with a story which you know, when we booked you for this. We said listen buddy, we're really looking for a deflationist because we've had so many secular inflationists including myself, we want to offset that with an opposing view. And you said, sorry, I'm a Model-Driven guy. And my model says inflation, then something changed, because I got an email from you just a couple of hours before we did this interview on Tuesday morning. And you said you might get your deflationists after all. What did you mean?

Darius: Hey, thanks Erik. It's great to be back. So in terms of what changed, we run this dynamic factor model that we use to now cast what we call the dominant market regime or what we believe or how we believe investors should be orienting their risk management exposure. As we show on slide 6 through 13, that system, and it's born out of 42 market indicators that were scoring through the lens of our volatility, just a momentum signaling process. That system finally tipped in favor of deflation, as of this morning Tuesday, July 20.

Erik: Now, is that something that, you know, tips back and forth every couple of days? Or is this something that tends to only give you a signal every, you know, few years or so?

Darius: Yeah, no that's a great question. So it pretty much lines up with the rate of change cycle for growth and inflation. So taking a step back, you know, looking at the slide deck. On slide three, we outline the sort of regime segmentation process that we use to measure, map the bottom up macro regime cycle. And we're looking at this through the lens of the trending rate of change of growth, which we've measured through the OECD CLI indices and we're looking at this through the trending rate of change of headline CPI.

And so ultimately, in terms of how often the system signals a change in the state of the markets, which we believe are ultimately just pricing in those trending rates of change of growth and inflation. You know, that happens two and a half times per year, where you really get a meaningful shift in that system. So, you know, a couple times a year. On average, two or three times a year, investors really do have to reorient their risk management posturing, ie, what they're buying dips in? What they're selling rips in? How much cash do they have? How much, you know, leverage and credit risk are they taking in and across the portfolio? So we got that signal this morning and you know, who knows how persistent it's likely to be. But I can make a case, a very strong case that it's likely to be persistent for at least a few months.

Erik: Now, on page three, it appears that this whole slide here is telling me I want to choose which one of these four possible places I am on your grid. So we just said we moved from increasing inflation to decreasing inflation. So we must be on the left half. Are we in the top or the bottom? Because I don't know how you're measuring the trend in growth, whether it's still accelerating or not? Or how do you measure that?

Darius: Yeah, actually a better slide to see that would actually be slide 25. So this is showing our United States GRID outlook through the lens of that regime segmentation system. And as you can see, we've been in a state of trending acceleration from economic growth perspective, since going all the way back to July of 2020. In fact, the economy bottomed in April of 2020. But it wasn't until July that we actually started to record a trending acceleration. Our model has that trending acceleration projected to culminate in August next month. Followed by sequence of six to seven, seven deflationary months from the perspective of this model. Now, when I say deflation, I don't mean outright year-over-year m declines. It's really just a nomenclature associated with the confluence of trending deceleration and both growth inflation.

Erik: Okay, now I just have to you know, when I look at a chart like this boy, we went to, it seems like the center of the chart where these two axes intersect is kind of the the mean, what a huge deviation there was out to looks like May of 21 was kind of where we got to almost the extreme of your scale there on the right hand side. What does that mean? Why was there such a deviation? And was that a trend reversal or how do we interpret that?

Darius: Great question. So the X-axis shows the trending acceleration or deceleration and inflation. And so being that positively skewed on the chart to the right side, obviously implies there's a meaningful acceleration and inflation. It's actually easier to see in time series format on slide 28, where we show the secular view on US inflation, and then we zoom in to show the cyclical view on US inflation and conservatively, there's two key takeaways that I'd make on this chart. One, we've clearly broken out of the post-crisis era sort of sector in terms of the stationary mean of inflation. We're significantly higher than that. We're obviously higher than most economists expectations. Least heading into the last few months.

And the second point I'd like to make is that our models and we run two models simultaneously. One's called our stationary mean reversion model. Obviously implies stationary mean reversion is the framework. And then we run a second model called our agent-based nowcast model and then we split the difference between the two to formulate the basis of our growth inflation projections. As you can see from the chart on the right, we have inflation decelerating, or disinflating, really starting in July throughout the balance of our projection period, which extends all the way into the middle of next year.

Erik: Now, obviously you could have a little blip down, that wouldn't mean anything, but you're interpreting this as a trend change. What do you use in order to measure that? Is it like a trend following moving average thing? Or how do you decide when there's actually been a reversal of direction and movement of these charts?

Darius: Yeah, so I mean, it's a confluence of cyclical momentum, a sequential momentum and the associated build up or dissipation there in. And it's also a confluence of the mean reversion towards that stationary mean. Now we'll say this about the time series. I have a belief, you can consider me a longer term inflationist. I'm shorter term disinflationist, but I do believe the stationary mean of the US inflation time series, broadly, core PCE, headline inflation, core inflation, things of that nature, have transposed themselves higher relative to where they were in the in the post-crisis era.

If you look at headline CPI, for example, the stationary mean above that time series really from 09 or really outside of 2010, up until the end of 2019, was somewhere around 1.5%. If you look at the chart on the right again on slide 28. In terms of where we're likely to bottom in the middle of next year on inflation. It's very likely that we start to reaccelerate in the back half of 2022, from an inflation perspective, but we're going to be reaccelerating from levels that are much higher than you traditionally would start to reaccelerate from. I mean, it implies a stationary mean of about 3% now for US headline CPI, relative to a stationary mean of about 1.5% in the post-crisis era. So that's a big deal longer term, I just don't know that investors have to price that in today.

Erik: Now, I want to make sure I'm understanding this because it really resonated for me. But I could be grasping at straws here and trying to put my own view on this. I personally am very much a secular inflation guy long term. And I'm not smart enough to figure out short term. I think what you're telling me is we just had the first wave of the secular inflation, which I expect to take a full decade to play out, if not more. You're saying it looks like that first wave is ending. But it sounds to me like you're also saying you see the second wave coming, just like I do. Did I get that right?

Darius: You nailed that, Erik. Thank you for understanding that. It's really about the sequence of events, I think a lot of investors are brilliant, and they and they really focus on the destination or the outcome. And I do believe that's important if you're a long term strategic asset allocator. However, if you're like most of us who you know, eat food, and breathe air, and go to sleep. We have to worry about the sequence along the way, because the sequence is obviously ultimately where our P&L is derived from. And in terms of getting to that second wave of inflation, it's very likely that we have to actually work through a meaningful acceleration and base effects, and a meaningful deceleration and economic activity you know, between sort of, let's call it September of this year, October of this year, and really go all the way through the middle of next year.

Erik: So on page 25, obviously, some of these plot points that you're showing are in the future. So they're projections, not current data, and you go all the way out to June of 22. So it sounds like if I'm a secular inflation guy, you're telling me that probably through the middle of 22, I'm going to be having opportunities to get that second chance to buy copper and other things that would have been inflation hedge trades would have just gone too far too fast to be getting on them now. Does that make sense? And how else should I as a secular inflationist be thinking about the opportunity? If you're right, in this model, you're basically saying, I got a second chance to get in at the bottom before the next inflation runs away? And I probably got plenty of time to take action. Is that the way I should interpret this? Or how do you advise your clients in terms of what they do with this information if they have a long term, secular inflation view?

Darius: Yeah, I mean, the starters I mean, so whenever you talk about going into a deflation market regime. Again, we highlight the market regime signals probabilities and the dominant market regime on slides 11, 12 and 13. Whenever you go into a deflation market regime, it obviously sort of implies that investors should be taking down their risk-to-cyclical assets. At 42 Macro we call that high grading your exposure. So within the equity market, you're getting into more size, you're decreasing earnings volatility of the types of stocks. You’re downshifting your beta. You know, in the credit markets, you're obviously you know, sort of going up the capital structure and in on the credit spectrum, and obviously, buying duration, allocating duration, allocating to gold, allocating to the dollar, the yen, the Swiss franc.

So that's sort of your traditional deflation playbook. Now obviously if you're a secular inflation as I tend to be just going back to our stationary universe in discussion. You know, that means a lot of the stuff that you believe in longer term is likely to sell off or indoor experience a trendy bout of volatility. So you can buy put exposure against that, although I would argue that view has been as widely shared by most market participants.

If you look at slide 23, what we show on that slide on the left chart, is the relationship between sort of the near term at the money put implied volatility versus the near term realized volatility regime with the local volatility regime, and, you know, across the board for most sector style factors, commodities and you know, sort of major macro exposures. There's just a tremendous amount of premium out there in the market today. So either one of two things has to happen, the market has to go down a lot to realize all that put premium, or the market cast a melt up because dealers have to cover those hedges, if we don't actually see that realize volatility. Obviously, the transition to deflation from a market regime perspective implies that the probability of realizing all that volatility is much higher than it was prior to today.

Erik: Darius I'm feeling this confluence of different factors because on the one hand, you're a Model Driven guy. You're telling me your model, and your signals are telling you very clearly, we're headed into a deflationary or disinflationary regime. But you're also telling me that you're a long term secular inflation kind of guy. Despite the fact your model says the opposite in the shorter term. So why do you think that in the longer term? I mean, I've got my reasons, but I'd like to hear yours. And how do you navigate this when your model is telling you, at least for now, that long term view is not ready to happen yet?

Darius: Yeah, that's a great question. So for starters, I do believe that we are well on the path towards realizing that long term view. However, the path is not going to be linear, and we have to deal with decelerating economic activity, decelerating inflation, you know, for at least a year, until getting to that second wave that we discussed. You know, so as it relates to what from my perspective, what drives asset markets from a longer term, you know, headwind or tailwind perspective. I think there's four main secular forces in the economy that investors either have to risk manage, or they're being forced to risk manage.

Number one, I think, or this is in no particular order. But number one, that's demographics, that's on slide 34. We look at that through the lens of the five year old age dependency ratio relative to the working age population, that five year for CAGR. So demographics are still where they are, that hasn't changed. So that's disinflationary. On slide 35, we show the balance of payments risk on the x-axis, we show the current account balance as a percentage GDP. On the y-axis, we show the fiscal balances as a percentage GDP. So as you can see where the US dot is all the way down there to the left. We have a lot of secular pressure on the dollar. It's a major headwind, to the US dollar, and from a flows perspective. So that's something that we certainly think needs to be ironed out.

And more importantly, I think, the real key takeaway from this slide, and not to make your your listeners jump around, I think that the most important takeaway from this slide is that somebody's got to finance these budget balances. Whether it comes from foreign demand, you know, in terms of, you know, the dollar recycling that we demonstrate on slide 54, again, make your listeners jump around. On slide 54, we show sort of the trend in dollar recycling on terms of foreign central bank assets relative to treasuries relative to the US debt. That's obviously been straight down into the right for an extended period of time. So that means the Fed really has to step in. If you look at slide 55, to incrementally finance all that that public debt. Now, the issue with that, if you jump again, to slide uh, slide 57. You know, the issue with that is it doesn't seem like this Federal Reserve has really sort of bought into the MMT, you know, really transitioned to MMT. And part of the reason obviously, is we haven't seen a tremendous amount of turnover on the FOMC.

But I also think the cyclical inflation pressures really spooking some of the Fed officials that would otherwise be on board with us to transition. And the reason I bring that up is because when you look at Terminal Fed funds rate expectations through the lens of five year for overnight index swap spreads. You know, those have plummeted since the end of March. I mean, we're talking about down a full percent. And to me that move down a full percent is really, you know, and it obviously accelerated post the June FOMC. I think that is really indicative the market saying, Oh, no, wait, this is still kind of the same FED that we're used to, right. It's obviously a little different $120 billion of bonds a month with GDP growing, you know, 10%, you know, annualized, that's obviously a little bit different than what we saw in the post crisis era.

But in terms of their willingness to really take the cap off long term inflation expectations, and really allowing those to seep into the real economy. They haven't changed.

And that's what they signaled to investors with their hawkish dotplot revision, going back into the middle of June. So this likely means that we're going to have this START-STOP process. If you go back one slide to slide 56. We're gonna have the stop start process in terms of how do we finance these budget deficits. So that brings me back to my point at the beginning of this discussion, you know, the Treasury market sits atop the global capital structure. You know, who's going to finance all these budget deficits? Well, either the FED's got to do by accelerating its balance sheet purchases or at the bare minimum not tapering, or it has to crowd out the private sector and crowding out equity issuance crowding out corporate debt issuance crowding out, you know, speculation and other assets, just so that you can sort of feed the beast, if you will.

Erik: Darius, I'd love to understand your perspective longer term, because the way I see this is, you know, you just said looks like the MMT crowd has not taken over the government yet. I agree, they haven't yet... yet! With the underscore on yet, the way I read the politics, I think it's coming. And I think that we're headed toward a situation where the younger generations are really going to push back on the boomer generation and say look, we don't like your systems and your rules. We're changing the game. So, you know, that doesn't happen overnight. I really see that's where it's headed. Am I on the same page as you are or do you see this differently? What's your long term view of where we're going?

Darius: Yeah, no. So if I if I have one long term view. It's really born out of you know, some awesome work, you know, by guys like Neil Howe with the fourth turning. Peter Turchin, author of ages of discord in terms of sort of the historical-political response to these types of setups in the economy and in society. If you look at slide 37, so you know, rounding out the secular drivers that really impact asset markets. On slide 36, is the leverage cycle, which we look at, through the lens of private not financial sector credit GDP on a three year Z-score basis, and also through the lens of the private not financial sector debt service ratio on a three year Z-score basis. That's a mouthful. But the key takeaway, when you just glanced at this slide is that, you know, a lot of economies, including the United States of America, have really levered up to combat this cycle from a private non financial sector credit perspective. So that implies that we're going to have a real tough time sustaining economic expansion in the absence of a tremendous amount of incremental stimulus.

And I think we're going to find that out. And maybe Biden is aware of this, I doubt it. But certainly, it seems in terms of the panic that they're, you know, perpetuating out of that side of the aisle in DC. It seems to suggest that they're well aware that they got to do more to keep this game going. And that brings me to my final secular driver, which I think is the most most relevant one, to the discussion between secular inflation and secular deflation. On slide 37, here, we just show the x-axis, the Gini coefficient. For your listeners who don't know what that is, is the measure of income inequality. Higher is more unequal. And then on the y-axis, we show the headline unemployment rate. Well, if you can just you know, see where the US dot is north of 40 on the Gini, and right around six in unemployment rate. You know, we're sort of hanging out with emerging market economies now.

We're no longer down at the bottom left of this chart, which is where you would expect to be as one as a major superpower, but certainly, as a developed market economy in today's setup. So the fact that our dot is there, in my opinion, is really perpetuating a lot of the zeitgeist that you see out there from both sides of the aisle in terms of, hey, we're getting a raw deal. Hey, we're getting screwed. I mean, you had protests in the street last summer, and they had protests in the capitol from the other side of the aisle, you know, this winter. I mean, there's a clear amount of anger and frustration out there in the society. And part of it, in my opinion, is driven by on slide 38, the breakdown in the social contract. And so what I'm showing here on slide 38, is the blue line shows employee compensation as a percentage of gross value added, the red line shows corporate profits as a percentage of nominal GDP. And as you can see, just in terms of where those lines, those respective plots that trended you know, really, for 50-60 years prior to 2000. You know, we've really turned that on a tab in the last couple of decades.

And obviously, we've got some pretty key drivers of that transition. You got globalization. You know, China joining the WTO in 2001. You've obviously had the proliferation of the internet and the digital economy and all the disinflation that's brought relative to wages. And then you've also had a lot of industry consolidation born out of, you know, the private equity bubble. And so, you know, there's a lot of people out there that feel angry and frustrated and I think they are aware of that transition. And this is my opinion, why we're seeing such bipartisan support for trillion dollar budget deficits, obviously, going back to Trump. You know, he proved that this sort of concept of fiscal conservatism in the US, particularly born out of the right side of the political spectrum was really dying.

And part of the reason it was dying is because, you know, I think poor people from the left really migrated to the right, because at the end of the day, it wasn't really about, you know, Republicans versus Democrats. It was about populace versus austerity. I'm not sure if I'm saying that word correctly but I think people know what I mean. We're either going to be “austerious” or gonna be populist, and I think that's the real big transition in the economy.

So you have that from a political perspective. But then you also have on slide 40, a lot of the secular drivers of disinflation are still intact. You know, the labor force participation rate is still obviously hampered by demographics. The velocity of money is still on its lows relative to a 30-40-50 year time series. And then on slide 41, you know, corporate America continues to be dominated by monopsonies and a broad based preference for capital expenditures over labor. The blue line shows the market cap of the S&P 100 relative to the S&P 500. That's up into the right and the red line shows the compensation of employees relative to CAPEX and it's down to the right. So a lot of these drivers are still intact. But ultimately, in terms of how we think it resolves itself, we ultimately think that the 2020 election was no fluke. We're certainly moving in a direction where populism is not only sort of welcome, but it's cheered on by both sides of the aisle. And I think you know, Mitch McConnell is gonna have a tough time. Next fall, if he doesn't understand that

Erik: Darius, that covers the inflation view. Let's bring it to monetary policy, what's going to happen? Because, you know, in theory, the way this is supposed to work is when we get inflation, central bankers respond by increasing interest rates. Seems to me it really is different this time in the sense that they're really not able to increase interest rates the way Paul Volcker did in the 80s, because they just don't have room without bankrupting the federal government through its borrowing costs. So I feel like we've got this inflation trap that we're setting central bankers up for where they're going to get to the point where their hands are tied, and they say, Uh Oh, we can't do you know, we just can't print money to solve this problem, because that exacerbates the inflation and they're screwed. Am I right to think there's a trap there? And what do you think is coming in terms of central bank policy?

Darius: Yeah, no, that's a great question. And I think you hit the nail on the head in terms of why that trap is maybe why our market regime signaling processes is transition to deflation. I think asset markets are starting to figure out that if they did have a sniffle as a function of the Delta variant, as a function of decelerating growth and inflation, as a function of any sort of headwinds on fiscal policy and incremental fiscal stimulus. That the Fed can't necessarily step in and accelerate its pace of purchases. In fact, it might actually have to be sort of stepping into a tapering process, you know, into and during a market decline, which is obviously extremely anomalous relative to sort of, you know, how Fed policy, the reaction function has historically worked. So in terms of that, you know, kind of ironing that all out, jumping to slide 44, this...

Erik: Hang on one second before we move on, I want to go back to that cause wait a minute. You are saying that you think the Fed would actually taper into a market decline? Because the risk of being cynical, I feel like for the last few years, if there's anything we've proven, it's that the Fed will basically do anything to bail the market out? I don't think that's just a writer the way it should be. But it seems like it's the way it is. Why would you think it would be different now?

Darius: No, I actually don't think it'll be different. But I think that the markets need to find that out. And that, to me, is the scary part about, you know, from the perspective of investor consensus, that's the scary part about having a five handle on inflation, is we don't actually know and more importantly, we don't actually know what to look for in terms of the FED's new mandates. I mean, they obviously have a new average inflation targeting mandate, they have a new sort of maximum and inclusive, you know, emphasis on inclusive employment mandate. And so the reality is, I don't think the average investor, myself included really understands, you know, what does it take to actually achieve and accomplish those mandates.

And quite frankly, I think Powell's done a masterful job of explaining that to investors and policymakers that, hey, we don't know either. We're kind of, you know, we're kind of feeling our way out on this as well. So, ultimately, I just think that asset markets, if we're going into a regime, where investors are going to start to receive broad signals from both economic data and other market participants, that we should have a risk off tone and discipline to our risk management. I think that there's a risk of that, that feeds upon itself for at least a couple of months, because, again, we're not going to see a Federal Reserve that's going to be brazen enough that the early onset of that downturn. That market volatility, to say, hey no, we got your back, you know, we're gonna hold your hand. And that, to me is a potentially big deal for asset markets, at least, for you know, in terms of the next two to three months.

Erik: Thanks for clarifying that Darius. I think you were talking about cyclical forces in the economy before I interrupted you.

Darius: Yeah, of course. So, you know, just a few charts in that, you know, on slide 42 this is something I have a firm belief in is that, you know, one we already have, you know, lower highs and lower lows and economic surprise indices. And obviously, you know, going back to Friday's consumer unit. University of Michigan consumer confidence report, you know, that was kind of the most recent and a series of sort of negative economic surprises, and I certainly think that's something that has the potential to persist throughout the back half of the year. If you look at slide 43, we have growth expectations, you know, meaningfully elevated. You know, we're still tracking at 6.6% for 21 and then 4.2%, we actually ticked up most recent data point for 2022.

Well, the problem with those expectations being as elevated as they are in the confluence of a simultaneous deceleration and growth and inflation. It means that investor consensus and what I mean by that or sorry not investor consensus, economist consensus, and analysts consensus is very unlikely to take their numbers down, you know, sort of by meaningful enough degree to have a real reset, which means that if we do start to see some trending asset market volatility. You know, more declines in the stock market, more declines in risk assets broadly. You know, it's going to be met with confirmation that okay, the economic outlook yesterday relative to very lofty expectations are deteriorating so that to me is it's almost like we have this sort of air pocket of no more good news out of the economy from a rate of change perspective. We're not going to get bailed out, at least not in the near term by the Fed. And oh, by the way, fiscal policy could potentially be setting up to disappoint to the extent that the republicans don't play ball and you actually have one or two democratic senators defect.

Erik: Okay Darius, how much downside could we be looking at here?

Darius: So I'll start by saying I think it's pretty aggressive to have price targets in general. I mean, I think, you know, anyone managing money, even their own money realizes that price targets are a fool's errand in this business. But, you know, I have been anchoring on the 2009-2010 analog, because I believe it's a really good sort of, you know, sort of not only does the price chart analog look really good. But it also makes a lot of sense, from a bottom of macro regime perspective, as well. So if you look at slide 59, what we're doing is we're overlaying the 2009 experience to the S&P 500, relative to the red line, which is the, you know, sort of 2020 to 2021 experience. And what you can see is that, okay, both plots bottomed in March. That was sort of the nature of the economic deceleration that we inflected in the spring in both years and accelerate it for over a year from that point forward.

And then ultimately, you know, the blue line, the 2010 example, started to sell off as the rate of change cycle for growth was peaking, right in line with that. And then ultimately, on slide 60, we had a 16% drawdown in the stock market that in my opinion, was a confluence of, you know, that rate of debt natural healing process off the lows of the GFC really coming to conclusion. And then you also had a termination of QE one in March of that year. So you had a liquidity drought during summer of that year that really culminated in a 16% drawdown in the stock market. I think that's a very reasonable expectation. I mean, the setup from a bottom up, macro regime perspective is almost perfect.

You know, and you also think about, you know, the setup from a top down macro market regime perspective. And in terms of how policies feeding into that, it's very likely that, you know, the bare minimum, the bare minimum, the Fed can't do anything else. No, they're not going to go from 120 billion a month at 80 Treasuries, 40 mortgage backed securities, to I don't know, 150 billion a month on a 10% correction in the stock market. You know, certainly not with inflation north of 5%. You know, north of 4% for something like core PCE. That's not going to happen. So you're probably going to have to see a bigger drawdown in risk assets to really get the Fed to materially punt its policy tightening expectations into the future.

Erik: Okay Darius, so it sounds like you're saying the FED's in a box and you think that could result in about a 15 or 16% drawdown in the S&P with the caveat that price targets are never really that meaningful?

Darius: Yeah, no, totally. I'm just using that as a natural analog, again, based on the fundamentals and the price action really kind of agreeing with each other. So I think it's reasonable to sort of say like, it's unlikely to see a major material drawdown. You know, something that would obviously be a bell ringer 30, 40, 50%. Like, you know, some of your guests have said in recent past. You know, I've seen analysis that will suggest that, you know, potentially on the tape. And mostly through the lens of valuation. There's two ways we look at valuation. One is through the lens of our sort of quantitative valuation overlay. And I think we use, so in terms of how we look at the stock market. You know, we're looking at the next 12 month PE ratio. The spread of the next 12 month PE ratio relative the MSCI ACWI on a one year Z-score basis, and we're right up at around 1.7. You know, this is pretty, pretty rich, you know, in terms of where US equities are relative to global equities.

But, I also think when you look at, you know, something like, you know, the real earnings yield for the S&P 500, which is on slide 72, that number has recently declined to minus two, which is, you know, right around the sort of all time lows for this time series. And the reason I bring that up is because five of the last six times, we've seen the real earnings at the real S&P 500 earnings yield as deflated by headline CPI go negative. It was just on the precipice of a major, major correct crash in the stock market. So if you look at all you know, the kind of the six or seven of the last major crashes. Five of them have been presaged by this time series. The real earnings yield going negative, and we're deeply negative as of now.

So I do believe and you look at something like Bitcoin, which would be on slide 71. You know, at least over the last, you know, four years. Bitcoin has historically led, you know, major drawdowns in the stock market or things that I think investors would consider to be something they want to risk manage ahead of time. So that to me is something that's sending a dour warning signal from a near term perspective. And obviously, the earnings yield analysis is sending a longer term bearish warning signal, but ultimately, I don't think that's a likely probability. You know, I certainly don't... If I've learned anything from joining this industry in 2009 to getting to this point is that you know, there's just a lot of Wall of Worry out there.

Darius: And you know, that Wall of Worry and in most recent sort of thing on the the Wall of Worry is China. Right on slide 76, we're talking about the Chinese credit. And we've been talking about for an extended period of time. You know, the Chinese credit impulse rolling over and leading to pressure on commodities leading to cyclical. They're leading to pressure on Chinese assets and ultimately, pressure on commodities in that order. You know, that's something that's obviously been rolling over. But again, I just don't think it's prudent to go out there and say, hey, I think the stock market's gonna go down 20, 30, 40% in the context of the Fed buying $120 billion of assets. I think that's just crazy.

Erik:
Darius, you've given me all kinds of interesting new perspective. :Let's try to assimilate all this into kind of a conclusion. What do I take away? I mean, basically, it's long term secular inflation, except not right now. Back into deflation or disinflation for a little while. But it's still coming back to inflation someday, and you know, Fed policy, we've covered a bunch of things. How do we net this down to what do investors do with their money in the next year or so?

Darius: Yeah, no, that's a great question. That's the number one thing we specialize in at 42 Macro is what to actually do with your money. You know, it's don't get me wrong, there's some phenomenal investors out there who put together, you know, wonderful slide decks about the future and it's great. But ultimately, I think, if you lack the understanding of the sequence, and the risk management of it all, quite rightly, the research just isn't actually more valuable. So we really try to focus on that. That's not to say we obviously have everything figured out or right all the time. But it certainly means it is an explicit focus of our product. Slide 14 and 15 you know, we sort of highlight, you know, the pivots investors should be making across all four grid regimes with respect to those market regimes. So obviously, the circle on the right shows deflation. And so as recently as a couple of hours ago, you know, we sent out a presentation to our subscribers and said hey, we're pivoting to this full deflation portfolio.

So obviously, it means you should be you know, 80% in fixed income and FX, and 20% in equities and commodities, and those numbers aren't arbitrary. They're obviously rounded numbers, but they're based on our grid asset market back tests. So we're looking at, you know, everything that takes to the lens of global macro, US macro, US exposures to understand, you know, what's the annualized expected return in a potential regime. What's the percent positive ratio, the percentile, the return, the volatility, the covariance, the insides. All those, you know, important descriptive statistics to ultimately get to those pie charts on slide 14 to 15. And so we've recently on slide 15, came out of a scenario where we were hybrid allocated for Goldilocks and deflation because we knew deflation was coming. And then as recently again, as today, we put the full deflation playbook on. You know, out of respect for our paying subscribers.

I’ll keep the actual, you know, sort of ETF exposure that we're highlighting and sort of the ultimate cash allocation, you know, off the record. But, you know, obviously, you're listeners can come check us out.

Erik: Darius I can't thank you enough for a terrific interview. Listeners, I do encourage you to peruse the entire slide deck at your leisure, it's got a lot of interesting slides. Fair enough on what you said about respecting your paying customers as far as the actual ETF allocations. Give us just a quick 60 second elevator pitch on 42 Macro. Is it just for institutional investors? Is it also available to retail? Tell us more about it?

Darius: Yeah, no, it's available to anybody who's got a 50 bucks a month to read my morning note. 50 bucks a month to look at our weekly portfolio construction changes and 100 bucks a month to look at our slide decks. I mean, quite frankly, you know, we obviously, you know, have partnered relationships with all the major Wall Street firms and on the buy side and large RAs, but we also spend a lot of time liaising interacting with retail investors. You know, some of our biggest clients are, you know, just people, retired rich people. And so quite frankly, at the end of the day, I really believe in at 42 Macro, is the democratization of institutional grade macro risk management. A lot of people do macro but they don't necessarily have a real rooted macro process for making real thoughtful portfolio construction and changes they're in and so that's what we focus on 42 Macro. I have a lot of experience with that, a lot of experience in regime segmentation and understanding those whole processes and the sequence of it all. So, to the extent that sounds good for you guys, check us out. Otherwise, we'll catch back here on MacroVoices next time.

Erik: Well, Darius I can't thank you enough for a terrific interview Patrick Ceresna and I will be back as MacroVoices continues right after this message from our sponsor.