Paul Krake: Mega Themes for the 2020s

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Erik: Joining me now is Paul Krake, founder of View from the Peak. Paul, it's been several years since I had you on the program, it's great to get you back. I want to imagine because so many people have said that in finance the week after Labor Day tends to be kind of when the big boys get back from the Hamptons and things start to move. I want you to imagine you've been running the macro desk for the biggest bank in New York for the summer and the big boys are back from the Hamptons, and your job is to brief them. What are the macro trends that they need to be thinking about? What are the thematic, macro things that are on the horizon? What should they be thinking as they take over the reins of the macro desk?

Paul: So Erik, am I in the office or am I still at home?

Erik: Hahaha, I don't know.

Paul: Because that is obviously a big part of it, right? Because, you know, if you're looking at this, you know, if you look at the world through a traditional macro lens. A lens that I think is structurally flawed, and we'll get into that a little later, but this rolling three month, this rolling three month cycle that that the macro world tends to live in. You know, obviously, if you're looking between let's take a little further and say now, in the end of the year, you've got the sort of the two, I think there's two major narratives that you need to think about or three. Firstly, is COVID and the and the transition towards the reopening world, Delta variant, then the vagaries around that, and how that's affecting different parts of the world, putting them in different cycles and the like. Secondly, and most pertinent to the value of asset prices is the prospect of tapering. Do they? Don't they? When when does that begin? And how does that work into the economic framework that we look going into 2022.

And the third thing, which again, we are looking through this rolling three months window is is common prosperity is the notion of what China is doing. And that Erik, I assume we don't have five or six hours to explore that in the depth that that deserves. And I think if if I was to make one observation at the morning meeting at my very large investment bank, where I run macro. I would say to everyone to look at this through a blanket approach or a singular lens is the wrong way to look at China currently, because it is much more nuanced and complicated than most people think. And, frankly that framework of China and common prosperity is more than a three month is more than a three month view. And I think, frankly, the other stuff of the lingering effects of COVID, or this is what I call COVID scarring, how that plays out. And obviously the implications for tapering, a rate tightening cycle. Do we actually get to that rate tightening cycle obviously goes further than the end of the year, but within the three month window, that's what we think you should be thinking about.

Erik: I like some of the longer term thematic thing. So beyond China, what other thematic macro trends should we be thinking about?

Paul: So Erik, the way I'm sort of thinking about this, and I think it's my own deficiencies. But again, I'm not going to be the one who takes on the algorithms that win so within that three month window that I was talking about, I mean, you know, the ability for you and I as human people to outperform the machines is remarkably difficult. And we've got every year that goes by shows how much more difficult that process is. So and I think before we started recording, we started talking about, you're changing the framework for macro, and I think we need to be doing that. And we'll try to look through a much further timeframe. And obviously, that's easier said than done because you know, we are victims of mark to market. And you know in the embedded volatility and the vagaries of prices, which we you and I have no control over, can stop us out of the best laid longer term thinking.

But now, I'm looking at the world through what I call mega thematics. And, you know, obviously, you have to have a bunch of assumptions when you look at the world through mega thematics. You know, I'm a believer that rates will not rise for years to come because of my inherent disinflationary biases so that's part of it. Let's word it slightly differently. If you were going to build a research business, or you're going to build a trading business, what areas should you look at? How should you bucket the research process? Right? So everyone's got to have a climate bucket. So you've got to be doing climate research, because you can't do research on China. You can't do research on the ECB, you can't do research on oil and gas without having looking at that through a climate lens. You know, Goldman says $50 trillion by 2050 is going to be spent to decarbonize the world. Alright, so let's say there's a margin of error of $20 trillion aside on that, right. It's a big bloody number. Right. So to climate has to be front and center in people's analysis for the next two decades, three decades and beyond, because it's going to be the epicenter of everything.

You know, China is going to be the world's largest economy, most of us are deeply skeptical about Chinese data. The one data point you can be confident in has got, it's got four times the population of the United States, and eventually it's going to be the world's biggest economy. Now, whether that's the world's biggest economy that has truly outsized global influence, whether it's the world's largest economy, where its asset markets are reflective of its economic might, whether it's the world's largest economy and looking inward from a technology, from a technology perspective, whether it's the world's largest economy with a currency that is a true rival to the dollar well they're all things that remain to be seen. But the amount of funds that I know wether they'll be the macro, be them global long-short equity, be them credit, who don't have dedicated China research is I think, exposes the flaws in the ways that we're looking at macro markets, because China does dominate a lot of them.

And then you've got, you know, other big mega themes. Demographics is one of them, obviously, which is Japanification of the world argument that goes with deteriorating Western demographics, you can look at AI, you can look at biomedical, you can look at digitization, we can debate whether crypto and blockchain deserve to be in the group of mega thematics. And then for me, the one that I'm very, very focused on longer term is the notion of what I call the transformative 20, which is the 20 companies that I think we'll redefine the ways we work, we shop, we travel, we communicate. And, you know, every decade since you and I were boys, every 10 years, the top 10 market cap companies changed. And I believe that cycles has come to an end. So you know, Exxon was once the world's biggest company, but Exxon will never make cars where Tesla can be the world's most profitable energy company. And you know Pfizer can never do search, but Google can do healthcare. And if I'm Jamie Dimon, and I'm looking over my shoulder about who my biggest rival is, well, it's not HSBC or Citibank. It's probably Amazon.

So the addressable market for these 20 companies is simply remarkable. Man, I think that, you know, for me, you've got if you as a macro investor and I get this as a cliche the Google is the new dollar yen, but you know, you've got to have a handle if you're a macro investor on what those 20 transformative companies are doing. You know, the fact that they're the majority of them are domiciled in the United States, for example, has real implications for the value of the dollar. You know, are you going to see structural dollar weakness if the world's greatest companies remain domiciled in the US? It's an open ended question. So there's some of the sort of the way I sort of view the world, which is, and again, I don't use the word macro, like I used to Erik, and frankly, I shy and run away from it a lot. Because, you know, macro does have a rate and currency connotation. And you know, rates around the world are anchored at zero and the Sharpe ratio of currencies is what it is. You know, to be a true modern macro investor, macro has to have a broader definition.

Erik: I want to come back to climate and the tapering and a lot of the other things that you mentioned in that first answer, but let's start with China and really focus on China. Tell me what you mean by the situation in China, because I've talked to some people who've said, look, the situation in China is bad. They're really struggling under, you know, COVID and lock downs and boy, the Communist Party could risk losing power, because of how bad the situation is there. And I talked to other people, and they say, look, China's clearly got a plan, we've got a very realistic risk of them starting world war three with the United States and winning. Okay, wait a minute, those are two very different stories. And yet, I hear lots of people sort of all talking about China is the most important thing, but they've got wildly different views on what's happening in China, what's your take?

Well, and there's also a third one, where China just does what it does looks inward, becomes the best society it can be and doesn't really have global ambitions of a military nature. Right? So there's all these things. Now, let me let me give you the the optimistic version of this and where I think that the uber-bears who have consistently gotten China wrong, right? So let's with the framework of why they've gotten China wrong, right? And I'm not talking about you know, those who have been bearish on China for five years or so I'm going back let's go back to Deng

Xiaoping right so the two great foreign policy mistakes the United States made in regards to China was a belief that you couldn't have an economic prosperity without political freedom and to go back and quote Bill Clinton that controlling the internet is like nailing jello to a wall. Well, China nailed jello to a wall, right?

And the third one, which my good friend Louis Gave was talking to me about recently. You know, Louis made the point that maybe you can have a closed capital account and still be on an organic path to being a reserve currency. So there's all these misconceptions that have been made against China. And certainly, look let me start by saying, I'm not here to defend the indefensible in regards to the actions of China domestically, I mean, their behavior over the years in many ways against, you know, against the Uyghurs and in Tiananmen Square back to '89 and the like has been absolutely apparent, but it doesn't mean that the model is going to fail. So, you know, you get to the rise of Xi Jinping. A new style of leader, a leader who has taken very much a Maoist view on having the charismatic leader that the party can get behind and sees that the Western world is pushing back against China in a myriad of ways. You know, you've got semiconductor embargoes, and you've got issues over its sanctions over human rights. And then, you know, the Chinese feel that they are under siege from the Western world.

I mean, China never tried to deliberately destroy a global brand like Nike or Starbucks, but Huawei, China's true global brand back in the, you know, from 2015 onwards, was under systematic attack to put it out of business by the Chinese government on the basis of intelligence which was flimsy which was flimsy at best, right. So China feels like it is under siege. And you know, China has an energy vulnerability, it has a technology vulnerability as was exposed through the semiconductor embargoes. And it also has an over dependency on the US dollar, which is playing out through a slew of changes that are being implemented right now. So that's the framework that I think is in place. Now let's look at the the blanket approach that people are taking the China. An approach which I think is deeply, deeply flawed, right. So suddenly, China is uninvestable. And you've had these draconian measures against Ant Group and against Meituan against Tencent and the like, and it's making China uninvestable. And it's a sign that the fragility of the Chinese Communist Party because they have to clamp down on these great companies to control them. Or they're just doing what every other country in the world wished it could do.

So Erik, just think about this. So my 14 year old when I told him that kids in China were banned from playing video games or only can play video games for three hours a week, the look of horror on his face, as in, he looked like he wanted to get on a plane and fight for the rights of Chinese teenagers to blow their eyes with video games, right? But you ask me, you ask other parents, and a ban and restricting access to video games. Maybe not a bad thing. Maybe not a bad thing, right? Meituan comes out and it gets a fine because it doesn't pay its drivers minimum wage. The stock's down 17% and Meituan is uninvestable until you realize that that's the same thing London did to Uber. Data privacy provisions, you know, the new data privacy laws are very, very similar to GDPR. Right? So I think what we face is a massive, massive double standard here and a good a good example of this is as follows. Tencent gets a $50 million fine over Tencent music in terms of an acquisition that created the monopoly of 80%

market share in music streaming for Tencent music. On the same day oh and sorry the stock is down 8%. Same Day, the EU fines Amazon 900 million euros for a breach of anti competitive regulation in Europe, right? A 900 million euro fine, stock doesn't move. Right?

China is uninvestable because it's putting anti-monopoly regulation on its companies. Eu does that to Amazon, and that's okay. Right? So I think that if you look at a lot of the the tech regulation that you have witnessed, it's really popular. It's really popular, right? Because we have to, at all times distinguish between the Communist Party and the Chinese people. And the Communist Party is all powerful and the like, and we have seen them do, you know, whatever they want, but enforcing regulation that's popular amongst the people is a hell of a lot easier, right? So Chinese consumers are no different to British, Australian, American, or Canadian consumers. They know when free is not free. They know when they're getting screwed. They want their privacy protected from companies who are going to abuse that data. So therefore, a lot of the measures that we have seen and particularly the measures that we saw in regards to for profit tutoring, which was extreme, and by the way, we saw something similar in the United States in 2010 when President Obama banned for profit private student loans, you know, it's this stuff is really popular. So the optimist in me says that a lot of the measures that we have seen related to Chinese tech are measures that, you know, the US wished it could do, but it has a polarized political model that means that, frankly, not a lot gets done. And the EU does have GDPR. But GDPR took years to implement, because you've got to have 27 countries in consensus for things like this. You know, these measures look really harsh in China, but the party being the party means that it can get stuff done.

Erik: I want to ask you about a specific aspect of this China situation, which is Hong Kong has served for decades as kind of the western liaison or gateway city to Asian finance, to the point that you and I both have been Hong Kong residents. But neither one of us is spending our time now in Hong Kong, because of the changes there and the loss of independence that's occurred. What does this mean for the finance industry, and for Hong Kong and does Singapore come into the equation?

Paul: I think that Hong Kong plays a vital role, particularly in the context of what I think is the inevitability of the delisting of Chinese shares from US exchanges. I do think that's coming. I don't think that's avoidable because at the end of the day China views data as through a national security lens. And the Chinese are simply not going to let Chinese regulators fly to Shanghai and go through the books and records of its strategically important companies. Right? And I think what you'll see with Hong Kong is Hong Kong is going to play a vitally important role in the next three years as being the safety valve that allows those Chinese firms that are listed in New York on the NASDAQ or NYSE in particular, to move to Hong Kong if they haven't already done so. So I think it plays a very important role in in that regard. But look longer term, from a purely capital market standpoint, the regulatory environment is going to morph more towards the Chinese regulatory environment, then having Hong Kong's own independent regulatory environment. Now, and that's purely from a capital market standpoint. You know, look, I don't think there's a threat to the Hong Kong dollar anytime soon, because obviously, that creates, that does create... it's the organic source of separation between China and Hong Kong, which it will eventually go away. I mean the Joint Declaration as you know, as it stood when as Deng Xiaoping referred to her as that woman negotiated it. You know, it doesn't resemble what they put together. Right? And it wasn't the intention of what Chris Patton was thinking about in ‘97.

And, you know, so I think that Hong Kong is not the place that you and I fell in love with. It is, you know, it's an incredibly problematic place, less so for expats, but you know, it's certainly not an appealing place for expats to live like it used to be. Certainly a very problematic place for Hong Kong families who have been there, who are indigenous Hong Kong families who have been there for a very long time. Look, I think the future is very bright for Hong Kong as a capital market as this transition away from, you know, capital formation in the United States. You know, it takes Texas partner could be another, it could be another three years. Singapore will be always there in the periphery. But, you know, from a capital market standpoint, Singapore has continued to be a constant sort of disappointment in that regard. So I think there's life in Hong Kong left. Yet, I think that the, you know, again, it's all about the capital market side of things. And, you know the place you and I fell in love with, it's not that place anymore.

Erik: Paul, when you introduce the concept of mega thematics earlier, you mentioned climate is one of the important considerations there. Let's talk about climate and that also this broader ESG trend, which frankly, I think is more marketing than reality. What do you make of it? Let's start with climate what's important there and then how well is Wall Street responding to that need with its ESG offerings?

Paul: Yeah, and it's so just to make the point, Erik, that, you know, we're launching a whole product called climate transform, and you will not see the word ESG anywhere and what we do, right? Because we don't do ESG we do climate research, and it's very, very different. Right. So I think of ESG as a fiduciary obligation. I think of it as a legal and accounting way of organizing oneself where, what I call climate research is investing in in climate technologies and climate companies that are going to help in this decarbonization process. Now, look, I think it's vitally important not just through the sheer numbers of the sheer amount of dollars that will have to be spent in this decarbonization process, but I think the ECB is a wonderful example of this who is prioritizing, you know, carbon-related infrastructure as part of its as part of its agenda. And I think that's a remarkable development, which will mean, you know, talks about the, you know, the monetization of green debt. You know, the ability make it much easier for deficit spending on European infrastructure. You know, the opposite is massive asset allocations, which is in regards to what industries are investable and the like which is part of the ESG angle, and I think just as you know, investors had the right to pick and choose whether they wanted to invest in tobacco, I think that investors should have the right to pick and choose if they want to invest in carbon heavy in carbon heavy Industries.

But you know, I think that there's that angle, I think there's the angle from a research perspective of, you know, really trying to quantify what the carbon bills are going to be for a company like Total, or NHP, or, Freeport, or whoever it is, you know, and it's hard. If you try to find estimates of what the carbon liability is for these companies, it's really difficult to do. So I think that, you know, the amount of research that has to go into this is going to be just enormous. And I wrote on the weekend that I think that if we're rethinking the way that we build a research firm, you know, you don't have mining analysts, oil analysts, utilities analysts, and mobility analysts, or all those other analysts, you have them all under the climate bucket, because, you know, the regulatory frameworks, the taxation implications, the funding implications are going to be relatively homogenous across a lot of these sectors. But the big one for me and the big challenge Erik that I face, for someone who has been a card carrying disinflationist for a very, very long time, is the notion of the inflationary impacts of the climate adjustment. And, you know I'm a huge believer that the consensus of the sale of 30 million EVs by 2025 is just going to be way off base. I think the number is it 40, is it 45, is it 50, it's some huge number, right? It's an enormous number.

But it's not mutually exclusive, because of the lack of investment that's going into, you know, into fossil fuels, that, you know, if you sell 40 million cars in by 2025, you've still got what 400 million vehicles, cars, scooters, motorcycles that are running on petrol, right? And that's an environment for $150 oil, $25,000 a tonne copper, these sort of numbers, which, you know, have rather hefty inflation implications if they play out like that. So, you know, the climate transition does have consequences. You know, look, if we crack the code to, you know, to zero cost energy, I mean, that's, you know, that's a remarkable world that we would live in, but you know, we got to get from A to B. And we're very, we're a lot closer to A then we are to B and for all the opportunities that exist because of the climate agenda. There are plenty of externalities, and one of those major ones is a potential inflation externality.

Erik: You know, I think it's really important to think carefully about this phenomenon that you just described of people overlooking with a lack of investment that I think is really important. You just described a lack of investment in oil & gas, because so many people have convinced themselves that oil & gas is going away, because we're all going electric vehicles is going to solve everything. Well guess what else they're not investing in, it's the build out of the electric grid that would be necessary to support all those electric vehicles. So you can't replace the oil & gas with the electric vehicles that you don't have the electric grid to support. Yet, we're making all of this huge investment because things like Tesla are incredibly cool and sexy and hot to invest in right now. But the products they're building won't work unless we do some other things like build out the electric grid that nobody has a plan for. What do we make of this?

Paul:
Well, I think we've got to be when we say we, I think we've got to be very careful about this. Right? So, you know, if we, if we if we as China will, what you've just said is wrong, because john or China's got a handle on that, right? Because they're building they've got they've got a plan. And they've got a they've got a industrial policy that revolves around this and climate as a priority. And every facet of this climate priority has been fought out to the nth degree. Now, is it going to happen seamlessly? Absolutely not. When the coal industry employs as many people as the population of Norway, you know, you've got some, you know, this is not a seamless process. On the other side of the coin, I think you've described the US perfectly. You know, it's going to be very problematic longer term. I mean, how do you get, you know, how do you

encourage Shell and Exxon to build, you know, to have electric charging stations inside all of their gas stations. Right? How do you have a standalone charging center which is a huge infrastructure spend across, you know, across i95 or route 66, or wherever it is to allow the current range of cars, which will grow significantly over time, no doubt about that. These are huge costs.

I think Europe is somewhere in the middle. I think that Europe is, you know, particularly with the help of the ECB is in a better deficit position than the United States is in currently, and there's certainly more of a, an overriding priority to make sure that every facet of climate infrastructure is met. Again, doesn't mean it's seamless. But look, the problem the US has is that, you know, you have this polarized government, which means that very, very little gets done. You know, you're on these rolling two year election cycles, which means that, you know, if I put this way, Erik, if I was to tell you that, you know, after all the spending that we've witnessed in the last couple of years that we get to the 2022 midterms, Republicans take the house, as they statistically will since 1938, there's only been two instances when the incumbent party has actually taken seats in the House. So let's assume the republicans take the house in 2022. Are we discounting that there could be a tea party movement where they just turn around and say to Joe Biden, all these social programs, all these all this green agenda. No! we've spent too much money we are shutting that down. You know, and we go back to a tea party style movement. I mean you can't discount on that. But the one given in all of that environment is the prospect of true structural change, whether it's climate infrastructure spending, whether it's tax reform, whether it's dealing with, you know, unprecedented income inequality, whether it's dealing with social issues, whether it's environmental issues and the like. All these things don't happen in an environment where you're on these rolling two year election cycles. And one of the big victims of that is what you just alluded to, which is how do you have a full climate infrastructure in a world where politically it's incredibly hard to implement?

Erik: Well, I think that related to that, too, is going back to some of those shorter term macro factors. Let's talk about rates, you know, we've got the Fed threatening, again, to taper. Are they really going to taper someday? Is this just talk and what does the actual cost of capital becoming nonzero again? What's that going to mean to all these other trends?

Paul: Well, okay, so but again, there's two things we need to think about. There is tapering and then there's raising rates. Are they going to taper? they're gonna taper. They will. It's, you know, I think it's pretty safe to say that there is no good reason to have emergency measures in an economy that is growing at the rate of the US economy is growing at. Well, I think a better example is I haven't heard a Fed official in six months, tell me a good reason why QE is good for the real economy. Right? I know, it's good for asset prices. But I haven't heard why it's good for the real economy. And, you know, I think that we have a Federal Reserve that is so fixated on asset values or preventing assets from contracting and thus tightening financial conditions. So everything revolves around that. And we can have still have emergency measures, you know, some 18 months after COVID began, when there's clear evidence that, you know, economically we don't need that.

So tapering is coming, you know, are we going to get to the Feds unemployment targets by year end, that's touch and go. So you'll be tapering into 2022. But the scenario I've got Erik, which again, does have a lot of ifs to it, so please forgive me for this. But you know, what do we do? We can be confident that growth from Q2 onwards, growth and inflation from Q2 onwards is going to be slower than it was in 2021 just purely due to base effects. You know, you will have because they are a contentious midterm election coming up in November of 2022, which means that the chances of the Fed raising rates or hiking rates in Q4 is relatively, I think, relatively slim. So if you are going to get a tightening, hopefully it happens before Q4. But you would be clearly if the Fed does raise rates in 2022 and 2023. I would argue that they are raising rates into a slowing growth environment. Right? So my if scenario which gets me to 10-year yields at zero in, you know, in the second half of 2023 is as follows.

That growth slows, the Fed doesn't get a chance, you know, they may finish tapering, but they don't get a chance to raise rates because growth is continuing to slow because of base effects. Republicans take the house in 2022 and what we can be confident in is that they're not going to support reconciliation. Our deficit in 2023 is going to be a fraction of what it was in 2022. And, you know, frankly, there's no free lunch with all of this. You know, if you take a deficit from 18% of GDP down to, let's say, down to 6% of GDP, which were all 7%, which was the non-crisis high under President Trump post war that is. Suddenly you've got a scenario where growth is collapsing in 2023, because of fiscal contraction, and they haven't raised rates and that's my scenario for rates to 10 yields to go to zero, as we go into 2024, and the year of the next presidential election.

Erik: And how long do rates stay at zero or very close to zero?

Paul: I think it's considerable. I think it's a considerable amount of time. And again, my structural disinflation biases are coming out thick and fast here. You know, I think that you know, if you put it this way, if you've got a recession, if you have recession late 23, going into 2024. A recession, by the way, that has been with the first recession that we go into where we have zero interest rates, right? And here's where we get into... if we're looking two years forward, there's more questions than answers. Right? So is there pressure, because the two year note goes negative for the Federal Reserve to go to negative yields? You know, is there pressure for QE to look at other and other assets? Clearly what we've seen with quantitative easing this time around was absolutely unprecedented. You know, do we have the investment grade bailouts that we had, like we had with every other crisis. And I'm not saying we have the makings of a crisis in 2024. But you are going into recession with your potential recession with zero interest rates. And that's not and that's not a good outcome for anybody.

And then we get into the arguments, Erik about, you know, Japanification, bad western demographics. And you know, I look at it this way, we keep talking about a normalized world, right? What is the normal? What does a normalized post-COVID world look like? Well, if we go back to what the world looked like, pre-COVID. Well, that was a disinflationary world, right? It was a deteriorating demographic world. It was a world where the dollar was doing very, very little. It was a world where were growth equity outperformed. It was a lost decade for emerging markets. It was a decade where Chinese assets outside of tech did next to nothing. It's a world where Asian growth becomes a greater percentage of global GDP. But you know, at the end of the day, if I will, if we are normalizing, and that's normalizing deficits, normalizing with COVID, normalizing growth. Well, the world we left behind in 2019, and before that was a disinflationary low growth poor demographic world and that's the world I think we return to.

Erik: Well, let's talk about some of the knock on effects and consequences of that, because one of the ways that some people value equities, is by comparing the yield that the dividend produces to what the yield is on the risk free rate, the so called risk free rate of treasuries. Well, if the Treasury rate is zero, then in theory, equities are valued at infinity. And as much as you want to say, well, it's impossible for them to go to infinity. Dude, look at the S&P chart.

Paul: Never say never. And Erik, you by the way, what I'm about to say, is gonna annoy everybody so please forgive me. And you got to so you basically have two arguments here, right? And by the way of these two arguments. I tend to favor a watered down version of what you implied, right? So, you know, if you've got rates at zero, and they're stuck at zero, and you've got a 10 year yield at zeros, assume, right? You've got two scenarios, theoretically, both correct and both polar opposite, right? And those two scenarios are the one that you described, which is where you look at the world's best growth in cash generative companies, and you think about what the value of those forward earnings are. And if you imply a discount rate of zero to those, then the implied multiple on the world's greatest growth companies is really darn high. So Microsoft is fair value at 50 times forward, 60 times forward, 70 times forward picking up, right? Could be infinity. Right? Picking up. That's theory number one. Theory number two is that you know, zero interest rates are implying where the growth dynamic is. And if you add a reasonable risk premia to equity risk premia to that low growth rate, you've still got a low growth, right, right? And that you know what all we've done in a world that doesn't have further multiple expansion because you do have just a slower growth, a slower growth and slower profit environment. That that actually is a an era of weak returns in the years ahead.

So both of those arguments are theoretically correct and absolutely polar opposite. Because I focus a lot on these 20 transformative companies, and pick themselves and we can debate the others, you know, that they are. So you know, the cash generative nature of what they do. The dominance of indices for these companies like, you know, like Microsoft and Amazon and Apple, etc. And also the addressable markets that they have, you know, again, if we were to wake up tomorrow, and Amazon is the biggest rival in life insurance to a comapny like Liberty Mutual, would you be shocked? Probably not, right, because the addressable markets and what they can do, because they attract the best people, they have the best data. They have, effectively, a negligible cost of funding, they can achieve a lot. And that's an environment for Microsoft in five years to be a $4 trillion company and Amazon to be a $4 trillion company and Apple being on its way, when the Apple Car comes out to be on its path to being the first $5 trillion company right? I tend to favor those arguments a little better then the low growth, the low theoretical return. But again, it's complicated. And it's very annoying, because they're just totally different outcomes.

Erik: So it sounds like the bottom line is the companies that are able to make a profit, even in an environment where the entire economy has completely broken are the ones you invest in, because you have no choice.

Paul: You have no choice, yea you have no choice, and you had no choice now.

Erik: And it explains why the FAANG stocks have seen this just extraordinary breadth divergence.

Paul: Yeah and look, do I want to own Virgin Galactic? No! Do I want to own Peloton? No! I mean, there's a difference between the reopening stocks and these companies that are so structurally imperative to everybody's life. I mean, I'm a slave to my iPhone, I'm a slave to Google. I've got you know, my wife thinks I'm having an affair with Alexa. Right? I mean, we're all here. We're obsessed with this stuff. And we never, and these are so ingrained in the ways we shop, we travel, we communicate, we work, that, you know, I don't see a scenario outside of an inflation scare and spiking rates and flipping that, you know that the value of those quality cash flows flipping that on its head. I don't see why these companies don't continue to, at a minimum earn supercharged, supercharged profits in and not only in the sectors they're in, but in future sectors as well.

Now, obviously, tech regulation is is a big part of this. And we've seen what's happened in China, if you can regulate tech companies. But look, it took 10 years to get the antitrust case against Microsoft settled, right? I mean, do we expect the United States government to move any quicker against an Amazon that I've got no idea what that company looks like, in five years time. And I don't know what Facebook looks like in five years time. And God knows how much money Google's gonna make out of healthcare in five years time. So what are these companies look like in the years ahead. Put it this way, without regulation, and without an inflation shock, the path to their continued rewriting to become $3 trillion, $4 trillion, $5 trillion companies. I think is a is a path that is well lit.

Erik: Returning to the mega thematics, something you'd haven't mentioned yet is this digitization trend where we've seen everything from digital currencies like Bitcoin that were designed to compete with government money to governments beginning to look at Central Bank Issued digital Currencies, to now really the hottest trend I think in finance is DeFi, decentralized finance looking at using these digital bearer instruments in order to make other things not just currency, but things like stocks and bonds and so forth, tradable just like digital currencies. Where's it all headed?

Paul: It's headed where who implied it was headed. Now, whether or not it's and again, I think we've... let's separate the digitization and the cryptocurrency side of things, because I can be incredibly bullish on digitization and skeptical about the role of cryptocurrencies, you know, particularly in a regulatory environment which is going to clamp down on this stuff and clamp down on it hard. So I think we should separate that. Look, I mean, what you know, the Chinese with their digital RMB, the PBOC referred to its role as controllable anonymity, right? Which basically implies again monitor every transaction, right? So you know, if we can get to that stage and that whether that's 10 years ahead, 20 years ahead, where wherever it is, where the digital RMB or the digital euro, for example, can be, you know, can be completely programmable where it can be sent to, you know, it can be a digital can go to a part of Germany that's just had a flood and there's a wave of digital RMB that expires in 90 days or digital euro that expires in 90 days and they've got to spend it. You know, you can go in there and make interest rates in on real estate in different parts of the country at a different level. I mean, stuff's extraordinary when we get there and and we eventually do particularly in the Chinese case.

And by the way, why at my core I was such a structural disinflation is because all these things in terms of, you know, getting rid of friction, which effectively is what, what the crypto world claims and what the digital currency world will claim. But digital at the end of the day, the core of digitization is the eradication of friction. And at the end of the day, as we've seen with COVID, you know, as we've seen with what happens if you smash a tanker in the middle of the of the Suez Canal and what that does to friction of supply chain and all this sort of stuff. It's friction that creates inflation, right? And the digitalization at its core its path is to eradicate that. It is to eradicate that friction. So I think that's important. Just onto onto on a cryptocurrency for a second, I'm a deep skeptic. I'm a deep skeptic in the context of not that it's not going to play a bigger role in portfolios. And I think we're in that we're in that phase of the transition or the evolution of crypto where people are saying it can't hurt to be 1% of the portfolio. And I think we're at that phase now.

But look the big thing for me and my skepticism about crypto revolves around regulation. It revolves around the fact that it is still you know, it put it this way, if you were to go off and ban Bitcoin tomorrow, right? Now, sure, my old buddy Mike Novogratz will be a bit pissed off, because he's got, you know, because he's lost a lot of money and the Winklevosses would probably be a little bit peeved as well. But who's really peeved? Well, every terrorist and drug and organized crime organization in the world is peeved because they've lost where they hide their money, right? So, you know, we shouldn't lose sight of the fact that, you know, these, the cryptocurrency has been able to flourish, because it has done so in an unregulated environment. And, you know, if you were to have a conversation with someone from the US Department of Defense as we speak, the reason North Korea has been so quiet over the course of the last 18 months, is because their nuclear program is funded through their gains in Bitcoin, right.

And these are the sort of things that really concern people in the Defense Department or the State Department and the like that, you know, that the cryptocurrency being the unregulated entity that it is, has been able to avoid jurisdiction and does and look, and there are some problems with this, you know, this being the libertarian ideal, because a lot of bad guys have profited from that. And, frankly, it's at odds with the goals and ambitions of not just the United States government, but the EU, [inaudble], certainly, as we've seen, is China, right? It's, you know, Bitcoin is done, it's going away in China. Right now, if you're a wealthy first tier, you live in a wealthy first tier city in Shanghai, you might have an offshore account, and you might be able to trade, that's fine. But locally, it's done, it's over. It's not going to happen because it is against the values of the party. And what I think is going to happen is that more and more regulation is going to look at whether or not cryptocurrency is a good thing for a Western society. And whether or not that is the, you know, whether it should be prioritized or not.

Erik: Well, Paul, I can't thank you enough for a terrific interview. Before I let you go, please tell us a little bit about View from the Peak and the website and what people can expect to find there when they check it out.

Paul: Erik, you've got me on a good day because we've launched, we are doing daily live webinars now for View from the Peak, which is broken down into US-China Series, which as it sounds is everything about China and the US-China relationship and also climate transform. So we're doing daily live webinars on climate transform. You can register for events at climatetransform.com or uschinaseries.com. And yeah, that's where we are. You know, again, it's me focusing more on these big mega themes and longer term thinking than the rolling three months stuff that I've been doing for a very long time.

Erik: Kevin Muir and I will be back as MacroVoices continues right after this message from our sponsor.