Jim Bianco: Persistent Inflation/Bond Yields/DeFi

September 16th, 2021

Erik: Joining me now is Bianco Research founder Jim Bianco. Jim, it's great to get you back on the program. It's been such a long time. For any new listeners who aren't familiar with Jim. He's kind of our MacroVoices hero, the guy he along with Dr. Chris Martenson, who really helped us be the first financial media outlet to call the COVID pandemic. So Jim, it's great to have you back. I think we've already covered all the pandemic stuff back when so I want to talk about the new big trend, which I think is not just transitory inflation, like Janet says, but I think this is secular. What do you make of the inflation trend? And please make an argument either for or against secular as opposed to just cyclical inflation.

Jim: Yeah, put me in a persistent camp. I mean, that would be the opposite of transitory. I do think that what we're going to find over the next several months is the inflation is going to stick around a lot longer than we think and it's going to be a bigger problem than we have. Let's take the data. For starters, the day we're talking is the day that the CPI report was released. And let's break it into two broad categories. Transitory inflation, and that would be things like airline tickets, restaurants, rental cars, hotels, motels, in the like, and non-transitory items and what you'll find is that the transitory items have definitely peaked, and they're on their way down. But the non-transitory items, that's everything else, with the big part of that being shelter inflation, which includes owners equivalent rent, and rents of primary residence, that's moving up. And that's at the highest level, at least in four years and making new highs.

So there is a transition going on in the inflation dynamics from the transitory stuff, to the more persistent stuff. Now, I'm not of the camp, that inflation is going to be big numbers, like 5, 6, 7 percent, because I do believe that demographics, globalization, and technology will hold it down overall. But I think we could see a three handle stick around a lot longer than we think when it comes to inflation. And why is that an issue, because we've got a 1.25 10-year note yield. If we had a 3.50 100-year note yield, no big deal. But when you have a 1.25 10-year note yield, and you have a realization, that inflation might stick around in the three handle, that could pose a problem for the bond market. And if the bond market eventually gets a problem, then everybody has a problem.

Erik: We really haven't seen very much wage inflation yet, which a lot of people think is what starts that self reinforcing cycle where the wage inflation, you know, means that the cost of everybody operating their business goes up, and they all raise prices and then people feel like

they need more money and they ask for higher wages, and it just keeps cycling. Why haven't we really seen wages take off as we've seen commodity prices take off?

Jim: Well, and to one extent, I do think we have seen wages take off. And the reason I think we've seen it take off is because it has been rebounding from the pandemic lows. So you know, it's gone down, it's gone up. And it's now starting to make new highs. But to your larger point, you're right. A lot of people don't think we've seen a lot of real big inflation, but I think it's coming. And the reason I think it's coming is what the pandemic did, is it accelerated trends that were already in place. One of the trends that it accelerated, were, you know, conceptually speaking, 20 years ahead of where we should be, is in remote work, work from home. There is a big pushback in the economy right now about returning to the office and it's not about health. It's about that they don't want to be there, that they've looked at the situation. And they've said, that I've shown for the last year I could work from home. I don't want to be in the office anymore. Well, a lot of managers want people back in the office. A lot of businesses want people to take jobs where they have to commute to those jobs every day think waitress, think surgeon, think policemen, think construction worker. And the way that a lot of people are getting people to take these jobs is they're going to have to pay them more money. And I think we're beginning to see that now.

In the latest payroll report, the wages in the leisure and hospitality industry is up over the last three months 18% annualized rate over the last three months. Now, it's rebounding from a depressed low. So year over year isn't quite that big. But give it a couple of more months and I think you're gonna see these numbers start to really move. So I think there's been a change in the nature of work. And I might add, when I say there's been a change in nature work, it really comes down to where you are in your station in life. If you are a manager or an executive with people that you employ. You're probably thinking oh, there's no change. They'll come back. They'll run out of money and they'll come back. And if you're a little bit younger, or if you're in that category of people that think that they've proven their job at home, you're thinking, no, we like it the way it is right now. We don't want to change, I'd rather quit my job, then go back to the office and we're seeing a lot of that right now.

Erik: Okay, Jim. So you're saying inflation is here, it's going to be persistent. Now, I want to talk about what that means in terms of what we can expect in markets. But let's start with monetary policy. Normally, we're taught well, when inflation shows up, central banks respond by increasing interest rates, that's the traditional way that you fight inflation. A lot of people, myself included, have argued that we're now in kind of an inflation trap situation where the Fed can't really afford to significantly increase short term interest rates, because it would dramatically increased the US government's cost of borrowing, and it would essentially bankrupt the country. Is that a real concern and are we in a trap situation where it won't be possible to fight this inflation that you see coming because of that situation that we're in?

Jim: Yeah, let's put it in terms of the way that the Fed is looking at things right now. They are suggesting in a lot of their work... Well, let's back up. In 2019, they had a big thing called Fed listen. So it was a tour across the country and the takeaway that they had from that was, we

need to focus more on employment. So last year, summer of last year, they put a subtle change to their employment number or to their mandate, where they're emphasizing employment. And that's where they talk about average inflation targeting, let things run a little bit hotter, because we've got to get people back to work. Within that respect, they've been pushing back on inflation constantly by saying, Oh, it's transitory. Of course, they never tell you what transitory is, or do they tell you what they're doing about inflation to make a transitory. And the answer is they're not doing anything to make it transitory other than just announcing that it's transitory.

So the Fed wants us to believe that inflation is transitory so that they can focus on the unemployment part of their job. And that's going to lead to a head at some point, as you said. On the one hand, they want to keep everything easy. They want money to keep flowing, they want markets up, they want people to feel aggressive, go out and hire, keep the economy moving. But if that means headlong into persistent inflation, and what that does persistent inflation to for the Fed, it makes bond investors think to themselves, I don't want to own bonds anymore. Because if this 3% inflation rate is going to stick around for a while, why do I want to own something with a negative yield that loses me money and then they're going to have a real problem on their hands. So yeah, I don't think the Fed is going to ever admit that there is persistent inflation. They're going to have to be dragged, screaming, and kicking by the markets in order to act on it. They'll just always dismiss it, they'll always say there's nothing to see here. They'll always look to continue to stay easy.

Erik: A lot of investors believe that there's an inherent relationship that is inflation picks up interest rates pick up, is that how it works? Or is the interest rates picking up something that only happens when the central bank through monetary policy is taking action to fight the inflation?

Jim: Oh, I think it's the latter. I don't think that there's a one for one relationship between inflation and interest rates. Now, big picture, if you want to show me 100-year chart of inflation and 100-year chart of interest rates, yes, you could then say that when inflation goes up, rates tend to go up and when inflation goes down, rates tend to go down. But in the interim, there can be many months or years, where they seem to diverge. Ultimately, remember, it is bond investors that buy bonds, and it is whatever motivates investors to want to own bonds or not own bonds. And one of the big things that motivates them is monetary policy. So if you've got an accommodative monetary policy with no inflation, and that the Fed is aggressively pushing up bond prices, I want to own bonds, because the Fed is going to be the wind in my back. If you've got a monetary policy, that is fostering inflation, meaning that my value of my money is going to depreciate faster than the interest that my bonds are going to give me, which is known as negative real rates. I don't want anything to do with bonds at that point. So I agree with you, it's really about monetary policy. So as long as the Fed can just continue to be easy. The bond market will stay okay when the Fed is forced to be a little bit more aggressive on monetary policy, then the bond market can run into trouble.

Erik: Now, Jim, you're an expert on fixed income. Something that's really been on my mind a lot lately is a lot of people are saying, look at this 35-year, maybe it's longer than that 37-year,

whatever it is bond bull market that we've had since the early 80s. We got down, I forget what the intraday low was 25 basis points or something on the 10-year at one point. And a lot of people are saying, okay look, surely the bond bull market, it's gotta be over now and I think that's probably right. But then they jump immediately to therefore we're in a secular bond, bear market, it's time to short everything. And I think wait a minute, when interest rates bottomed after World War II, it was like 10 years before they really started taking off to the upside. So if first of all, do you think interest rates have bottomed? But if they have bottomed, does that mean there's necessarily a secular bear market to follow? Or does it just mean we're gonna stay bottom for a long time?

Jim: I think they have bottomed. You're right, it was 39 years, and we hit 33 basis points in the 10-year in March of 2020. I think that was it. And you're exactly right! I've used that same analogy myself to that following the 1946 low in bond yields, which was a little over 1%. It was another eight years or so that you know that bonds still traded around one and a half, before rates really started to move up, especially by the time you got to the late 50s. So I think what you'll see is you'll see interest rates are going to continue to probably meander around, you know, this one maybe to handle for a while. Now, what's different now than in the 40s, in the 50s, is the sheer amount of leverage and financialization, that there is in the bond market. Back then, the bond traders, they were bond traders, but they weren't, you know, as aggressive leverage traders as they are now. And one of the things that I cautioned about is yes, if you're waiting for a big rise in rates, that's probably not going to happen for a number of years. But could rates shoot up to two and a half percent? Sure. And if you're not a bond trader, you might shrug your shoulders and go one and a quarter, two and a half. Is that really that big a deal for the economy? If I'm borrowing at a mortgage at 3%? Is it now all of a sudden not work at four, four and a quarter? Yeah, you're probably right. It's all the same there.

But for bond traders, for leveraged bond traders, for bond dealers, a move from one and a quarter to two and a half, very painful, big losses, especially if it comes very quickly. So that's where I think it matters. And if the bond market gets wobbly, everybody else will get wobbly. Everybody else would be the stock market, the commodity markets, the gold markets, they would all respond in kind, I think, to a wobbly market. So keep in mind that even though I might say look, I think we could see two and a half percent on bonds, you know, within the next year, which I do think that can wind up still being very painful for people in the bond market.

Erik: Let's come back to my question of are we actually looking at just a cyclical pickup in rates here or is there actually an argument for a secular bond bear market that's already begun?

Jim: I think there's an argument for secular bear market in bonds that is already begun. Look, the three big factors that are holding down inflation. Remember, 100-year chart bonds, 100-year chart interest rates, they seem to move a lot together with each other. The big factor that's holding down inflation is demographics, globalization, and technology. Demographics, we're getting older. As we get older, we tend to want to consume less stuff, you consume the most stuff when you're in your 30s and your 40s. When you're starting your career, and you buy a house and you have kids, but when the kids all grow up and they leave and your grandparents

and you retire, you consume far less. Globalization, you know, I could build this anywhere, wherever the cheapest costs are and the relentless push of disinflation, or even deflation from technology, making everything cheaper and cheaper, is held stuff down.

Well, now that we're in ‘21, you could argue that some of those might be questionable. Let's start with globalization. Yes, globalization was a great thing. But all of a sudden, there are nationalist movements all around the world, there is tension with the biggest manufacturer of the world, and that is China, as well, too. And so you could argue that maybe we've seen peak globalization or we're very very close to peak globalization. Demographics, there is a big wave of Millennials and Gen Y right behind them. That is coming up, you know, in the demographic chain. So while we think about the economy aging because of all the aging baby boomers. In a couple of years, that's going to start to revert back the other way, as the Gen Y’ers come into their adulthood more often. And the millennials get a little bit older, and then they start wanting to buy houses, buy cars, have kids and the like. Technology is the one thing that could continue to exert downward pressure on interest rates but that's not enough by itself. It needs the D in demographics, and it needs the G in globalization and those two might be questionable If they are, there's your case for that inflation down cycle ended too and we might start to see a turn up in inflation.

Same thing, remember, inflation started to turn up in the early 60s. It took 10 years before it really started to take hold in the 70s. I think you could see something similar to that now. We've got a bottoming in inflation and now we've got potentially a turn higher in inflation. One last thought for you on inflation. If you look back to the 1970s forward, and you look at the inflation rate. The average inflation rate of every expansion was lower than the previous one. So the 70s had higher inflation than the 80s expansions. The 90s expansions had lower inflation than the 80s, so on and so forth. That cycle might be breaking now. The average inflation rate we've had since April of last year with the end of the recession is much higher than the average inflation rate that we had between 2000 and 2019. That'd be the first time in nearly 50 years that we've seen a turn up with the expansion. And so that suggests to me that maybe we've got a secular turn in the inflation rate. But again, don't think that we go from an inflation bottom secular turn to some magically high number on inflation right away. That could still be a decade plus away. But for right now, we're talking about a bottoming of inflation.

Erik: Okay, let's translate this to how you actually make money in markets. Because it seems to me we've gone from really easy to really hard. And what I mean by that is in a bond bull market, you fixed income guys from my perspective, don't have to work that hard. You buy long bonds, you get a little bit of return on the coupon and a whole bunch more return on the capital appreciation thanks to a trending market and you're done. But if you think the opposite is happening, it's not quite so easy, because in that case, you had a double tailwind, when you got capital appreciation and the coupon helping you. If you're going to short bonds, because you've got a secular bearish view, you've got to pay the coupon in order to be short and depending on how you're doing that short, whether it's in futures or in the actual bond market, you may be paying a borrow cost in order to short those bonds. So it seems like it's much harder and then you just made it even harder than that. Because when I said, is it about to really take off and go

the opposite direction fast. You said, no it could be a bunch of years before anything big happens. So what do you do in terms of how to trade that?

Jim: Yeah, it's going to be difficult. This is where the bond investor is going to get paid to earn his living right now is to try and do something in this environment. So the first thing I'd say is that the secular nature of interest rates is over. You're right, that you know, you just had the wind at your back, just be long the market, and don't do something stupid, and you made a lot of money. Well, now, you're going to have to be a little bit more nimble, you know, picking the right credits, picking the right instruments, playing the yield curve correctly. This is all really hard stuff to do, as well. But let me write your question bigger. And let me say that if you were to look larger, say to the equity market and everything else. Let's talk about how the markets have been working over the last several years, they've all been flow driven. If you look at valuations in the stock market, you'd be very hard pressed to make the statement that something in the stock market is cheap. There's nothing cheap about the stock market. It's either fully valued, or it's overvalued. But why is it that it just relentlessly goes up, because the flows just relentlessly keep coming into the stock market. Just like the flows relentlessly keep coming into the bond market.

Now, the difference is, the flows in the bond market are largely coming from central banks. the Fed is buying $120 billion a month in bonds, that's one and a half trillion a year, as I like to joke, they're buying bonds, so you don't have to, and all that money then reaches for risk and buy stocks. And most of that, that it's going into the stock market and flows is going into index funds. Look at a chart of the S&P and look at a chart of the Russell 2000. They don't look much alike at all. And really what it is, is that most of the indexes are tied to the S&P, so it relentlessly goes up because money's flowing in. And there's a little bit of indexing in the Russell, but not as much as there is in the big cap index and it is a little bit more independent of just the flows.

So as long as the flows continue, bonds will, you know, meander sideways and probably have their fits and starts a little bit, stock market will keep going up. You get a belief that inflation is persistent. And it demand that the Fed do something about persistent inflation, that's codeword for stop buying bonds. And if the Fed's gonna stop buying bonds. I don't want anything to do with bond yields with the negative real yield, they sell off, the stock market gets very, very wobbly. So really, this is a story of you're playing flows, you're not playing valuations, you're not playing relative economy recoveries. And the flows at its bedrock is central bank flows. Whether it's the PEPP program from the ECB, or the Fed, or the yield curve control programs from the Bank of Japan, or the Reserve Bank of Australia, they are producing flows money to own bonds, even though they're having a difficult time going forward. But more importantly, they're telling everybody, you don't have to worry about the bond market too much. Go ahead and speculate in stocks, but the minute you get a perception that inflation is persistent, all that starts to reverse, and then you've got some issues on your hands.

Erik: Jim, do you think Jay Powell is going to be reappointed as Fed chairman and if not, who is on deck and what are the consequences of a different chair?

Jim: Well, let's start with yes, I do think he's going to get appointed. If you look at the prediction markets, like predicted.com, there is a betting market out there that's got him at 90% being reappointed. Now, what's important to understand about this is the progressives in the Democratic Party led by Elizabeth Warren, have made it very well known. They don't want Jay Powell reappointed, full stop they want him out. Their preferred choice is Lael Brainard, who is a Fed governor as well, too, and she's more of the progressive camp as well. Now, normally, when the progressives push on the Biden administration, they kind of get what they want, but in this case, doesn't look like they are going to get what they want, because there's a fear of markets. There's a fear that if we don't satiate the markets by giving them the guide, the comfortable sweater of Jay Powell, and we give them an unknown in Lael Brainard, that could upset things. So they're going to at least acquiesce to that. So I suspect that Powell will be reappointed. If not, it will be a big shock. His term ends at the end of January if you work backwards with the senate calendar to get him nominated, hearings, vote. It's got to come out probably in the second half of September, the announcement that he's going to get reappointed.

Where I do think you might see a change is Rich Clarida, the Vice Chair might be out, and that they may give Lael Brainard that position. They like her in the administration. She was on the shortlist to be treasury secretary. The scuttlebutt was she was ready to quit the Fed when she didn't get treasury secretary and they told her sit tight, we've got other plans for you. That was kind of a wink nod that maybe Fed Chairman well, if they don't give her that, they got to give her something. And so I wouldn't be surprised if she winds up becoming the vice chair. And if at very least, the head of regulatory supervision for the Fed. Now, that would probably be a negative for the banks, because they regulate the banks directly. But it wouldn't necessarily impact monetary policy. But if anything deviates from that, and what I largely explained is somewhat of the consensus thinking, which I think in this case is right. Paul doesn't get it. Brainard doesn't get it. Clarida stays, some other thing that wasn't mentioned. Then you've got potentially a market moving event on your hands, the big one being, if they don't give it to Jay Powell, and they give it to somebody else. Because the other problem that they've had is they've looked at other candidates Raphael Bostic of the Atlanta fed, as one example. Problem with him is he's a hawk. And that's one of the reasons why he's probably been scratched off the shortlist, because the markets wouldn't like the idea of a guy that if it was up to him, we'd already be in the taper right now. It's not up to him. He's just one of the regional presidents. He's not the Federal Reserve Chairman.

Erik: Jim, so far, we've been talking primarily about US policy and markets. Let's expand this globally. And I want to talk specifically about China because I just see between the China conflict with the West seems to be heating up. I just saw over the weekend. It looks like China's relations with Taiwan are heating up. Where is this headed both economically and geopolitically? And what should investors be thinking about here?

Jim: So let's put this in a little bit of perspective. This started a year ago, when Jack Ma, the head of Alibaba and Ant financial gave a speech and he basically criticized the banking system in China as being unfair for the working class and the poor. And that kicked off a whole series of events at that point, starting with Alibaba spun off their financial services into Ant financial. At its

peak valuation, it was worth $150 billion, 50% more than Goldman Sachs. That was largely taken away from him by the Chinese government. In the news this week, they're very popular money transfer app Alipay is being told to divest itself of its lending and breaking it up into a lot of different avenues. The Chinese have also come down hard in a lot of the tech companies. They've come down on Didi, that's their ride sharing. It's five times the size of Uber. They've punished them for listing on the New York Stock Exchange and not staying in Hong Kong, or in Shanghai, as far as listing to raise capital. They've come down on their education companies. In China, it's very competitive to get your kids into school. So there's this after school tutoring programs, which are so big that they're publicly traded companies. But a lot of these after school tutoring programs have been really geared towards getting your kids to pass tests to go to a Western University, either in the United States, or in Europe. They've cracked down on that as well, too. And they've been cracking down on a number of companies, as well.

I think it's made China uninvestable from a foreigner point of view. If you buy a Chinese stock, and it goes up, what do you own? They've already shown that it might be the CCP that owns these companies and you're just a caretaker for them, until they decide that they're going to take it from you. And so that's the real fear that you've got to have. You know, question is, what do you on? The bigger question is, what is China doing? Why are they doing this now? I think it has a lot to do with their economy slowing. Their economy is definitely slowing. Their economy definitely has some issues. There are some rumblings within the Chinese population. Look, they're very unhappy about having to be locked down last year, they're very unhappy about the lack of opportunities that they've had, as well, too. They're very unhappy about the amount of opportunities that the wealthy have had in China. So they've been kind of soaking the rich. I think they're doing a mistake in China to the extent that they need an entrepreneurial class to create the Ali pays, to create the Didis, to create a lot of these companies as well, too.

And if those budding entrepreneurs are not treated well, they're going to go somewhere where they are treated well, whether that's Silicon Valley, or Europe, or Singapore, or anywhere else. Certainly can't be Hong Kong anymore, because they've effectively taken over Hong Kong as well, too. So I do think that in the picture there, there is a message for investors. What do you own if you own China and is this a signal that China is slowing? And let's go back to our earlier conversation about globalization holding down inflation. That's another reason why we could see fraying of the globalization between China and the West,. If China wants to continue to promote policies that are going to be at odds with Western values as well to.

Erik: Jim, we just did a special with Dr. Pippa Malmgren and Clint Cox for our August Summer Special talking about the coming decentralized finance revolution. And I am absolutely convinced, although I don't think that cryptocurrencies themselves have as big of a future as the crypto fan club thinks, I'm convinced that the technology they invented is going to be used by someone if not the crypto people then by central banks to completely change not just the currency system, but the entire global financial system. I think most Americans just assume obviously, that's a big bunch of technology and financial progress. So it's going to happen in the United States. You think it's going to happen in the United States? Do you think that maybe the

Chinese government's a little bit ahead of the US government in terms of figuring out how strategic this is to the future of the world?

Jim: Well, I agree with you that the United States has got a real issue. Let's back up. Decentralized finance, is the ability to do banking, without banks, do brokerages without broker companies, to do trading without exchanges, to do insurance without insurance companies. We don't need those companies if decentralized finance fulfills its promise. In the United States, when you say here's a way that we could do banking without banks and we don't need brokerage because we don't need exchanges everybody looks at gas in horror, especially the regulators because that's their livelihood, we can't have that. But if you look in the rest of the world, where the majority of people in a lot of countries are unbanked, that is an opening, a real opportunity for them to raise their standards of living. So I agree with you, decentralized finance and the whole ideas behind it is coming one way or another. The loser in that scenario is the top dog, the reserve currency country that has all of the institutions and that is the United States.

But if you look at a breakdown of where crypto currency trading is taking place, chain analysis does a good one of this. Of the top 20 countries where you can find crypto trading, only one country, one developed countries in the top 20. And that's the United States at number nine. Vietnam happens to be number one, and they got a new entrant in number 20 and that's Afghanistan. And that's because there's no functional financial system in Afghanistan, and they're turning to crypto in a big way. Because remember, the one constant that every country has is cell phones and mobile phone usage. So everybody can download an app and can get started with crypto even in Afghanistan, if they have to. So don't automatically think that it's all terrorist money and drug money that's doing this. This is the merchant and the consumer on the streets of Kabul trying to figure out how to earn a living and how to get paid is what this is.

And the reason I detailed that is because that's where it's coming from. So if the United States, if the SEC, or the CFTC, or who I think is behind all of this, as Janet Yellen at the Treasury is going to want to say crypto bad, decentralization, we have to you know, and they keep using the words investor protection, where I think they really mean incumbent protection, then the US is going to sit it out, we'll just let the rest of the world design the new financial system. Or we could say, look, we've got a handle, we've got a hand or experience in running a global financial system, let us help you design this system as we move forward from here. Right now, the US doesn't want to do that. The US wants to try and regulate it out of existence, but they're not going to be able to because it's so much in the rest of the world.

And let me push back one place a little bit on you here and that's China. China's thrown all the Bitcoin miners out of its country. China has designs to have its own digital currency, the digital yuan with hopes that it would become a reserve currency, not the reserve currency, but a reserve currency. The problem China has been facing is they've been testing their digital yuan in China and a lot of people shrug their shoulders and say it's nothing big. I like alipay better, I like WeChat Pay better, it does more things, it's more interesting to me than your digital currency and in typical Communist Chinese fashion, when you've unveiled a product, and then they said that the private sector has come up with a better product, they say, Oh, well, let's

make the private sector version worse. So let's break up Alipay. Let's put restrictions on WeChat Pay. Let's make them crappier so that our substandard product, their digital one looks relatively better. So China's at risk of missing this two, largely because they've got their designs on their own digital currency, the digital yuan. They're probably going to roll it out at the Winter Olympics, and then push real hard after the Olympics to try and see if they can get adoption on that as well.

Erik: Now obviously, it's hard to have a crystal ball here. But it seems to me that all of the smartest guys in finance, all see the same thing that you and I do, which is clearly there's going to be a decentralized finance revolution that's going to change everything and disintermediate finance, and it's going to be a completely different landscape 25 years from now. But each one of those guys seems to have a different vision of what that actually means and what it looks like. So let's hear your version, Jim.

Jim: Well, first of all, let me say you're absolutely right, because you could basically back up 20 years ago, or 25 years ago, and talk about the vision of the internet and you could have been completely right and said, I think that things like search are going to really drive the internet and internet retailing is going to take off. And 20 years ago, you would have plowed all your money into Lycos and you would have plowed all your money into pets.com and both of them went to zero. Okay, okay, well then, you know, maybe then I'll put my money into AltaVista, and it went to zero as well, too. And then you would have given up on the idea that the internet was going to be anything more than a sophisticated fax machine, as Paul Krugman famously said in the late 1990s, and then it took off and it changed everything. That's the problem you're going to face with decentralized finance.

Yes, I can agree, you can agree with a lot of people. Boy, this is coming and this is going to be big. But how? How do I invest in it? How do I make money on it, where's it going to be big? The risk is, the big thing that it's going to be doesn't yet exist and a lot of the stuff we're investing in now might all be destined to go to zero. And the Google of this that's going to be the transformational part is still to come. Remember, Google didn't even come into existence as far as a public stock until 2004, four years after the tech bust, as well. So that's going to be the issue with it. Right now, I think, as I look at everything, I think the place I'm focused most on is in the blockchain technologies and tokens that have smart contracts tied to them. That would be Etherium, that would be Cardano, that would be Polkadot, that would be Solana, and the likes of those. And to say, are those technologies and are those systems that they've set up those protocols that they set up... are they in the process of becoming the foundation for this DeFi world? And I think in some respects, the answer is yes. For most of them, they all have their issues. Some of them, like the Solona's is of the world are not decentralized enough so that one or two actors can have a big influence on them.

Some of them like Etherium are very decentralized so no one can exert control over it. But its processing is too slow to actually try and be the foundation of the world's financial system. They need to speed that up without losing their decentralization, they've got some plans for it but that's a tall order as well, too. And there's more ideas that are coming as well. But, I would say

to most people, this isn't necessarily, we're not necessarily at a stage where it's, here's how you make money in this. I want to say this is more like the early 90s. Spend some time to understand the space, spend some time to learn what's happening in this space because it is going to be big, and it is going to be significant, although maybe it's not going to be Ethereum or maybe it's not going to be Cardano, or Polkadot, or Solana, or any of these others. Maybe it's gonna be something that doesn't yet exist, or maybe it will be those and others as well, too. So I still think we're kind of at the feeling around in the dark spot. But I do think we are all on a journey and we all know where that journey is going to lead to. As you said, Erik, in 20-25 years, there's going to be a wholesale change in the financial system as we know it today.

Erik: Let's talk about your expertise area, which is fixed income specifically. It seems to me that decentralized finance has more applications in fixed income, probably than anywhere else. And the reason I say that is, as you alluded, once you've got programmable money and smart contracts. A bond could literally be something different than what it is today. A bond today is a promise for an issuer to repay, if they keep their promise, but you could design a new kind of bond Jim, where it's an obligation to repay where the system itself essentially forces the issuer, if it has either savings or income. You know, if it has a revenue stream, it could be designed to essentially capture that revenue stream. So you could have revenue bonds that are programmed in through smart contracts. That seems to me like as soon as somebody comes up with a really novel, innovative, and I don't think it's a software guy, but I think it's a fixed income guy like yourself, that says, wait a minute, we could never do x before. But we can do it now. Because we've got this programmable capability where even if the issuer wants to default, they can't, seems to be like that. If somebody invents something like that, it could be a total game changer for the fixed income market. Am I wrong?

Jim: No, you're exactly right. And I think you know, to make it better understood for people. Let's say the same thing you did with the terms that you hear in the crypto space tokenomics. One of the things you're right, you've got smart contracts, you've got programmable money. Okay, so bunch of coders know how to program money. But how do they set up the proper incentives and how do they set up the proper reward systems so that a token, which would be the equivalent of a bond that you were talking about in your scenario would flourish. That people would want to own that token. By owning this token, it gives me some some kind of rights to a revenue stream, an asset, or some kind of privilege that you know, you can get from the token that you can't get from other places. I give you a good example, there's been an argument that's been made and I happen to agree with this argument.

That one of the things that say a Tesla and an Apple have going for it is that the people that buy Tesla's and buy Apple phones tend to own their stock. They tend to be cheerleaders for those stocks, as well, especially Tesla. I mean, most people that own the Tesla car also bought the stock. And then they brag about the company because they're a part owner, they want to see the stock go up, and they benefit from it. How about a dollar store, a Dollar Tree, or a McDonald's, most of the people that shop at those places are not owners of the company, and they don't own the stock. But what if they issued a token, and that token gave them discounts in certain privileges. And as they talked up the virtues of those companies or any other company

along those lines, those tokens appreciate in value. And all of a sudden, they now partake, in the same way that a Tesla owner owning Tesla stock. You could change the whole dynamic of the way that markets work and that market structures are structured.

The other thing that decentralized finance does, is it removes the privilege out of decentralized finance. The difference between you and me and Warren Buffett would be the number of zeros after the size of his order, or our order. It would not be the terms of the deal. Because I've always bristled about these books that say invest like Warren Buffett, boy, I would love to, I would love people to call me up and give me sweetheart deals out of the blue, like they give to Warren Buffett, but they don't. I don't get the same deal that Buffett does. But in a decentralized finance world, we all get the same deal, he can just add more zeros to the end of the deal. But the terms are all exactly the same, as well, too. So you're right, this can really democratize finance. This can really change the outlook for the markets. And, of course, no one wants that right now.

Like one of the big things that we have is we have this thing called accredited investors that need to have a million dollars in order to put your money into like some kind of a hedge fund, or some kind of a limited partnership that could give you, you know, abnormal returns, because they've decided that as a substitute for investor intelligence, we're going to use net worth. I think that's a terrible rule because there are plenty of people that don't have a million dollars that are completely capable of understanding a lot of these products, and should have the opportunity to invest in them. In the decentralized world, that won't be, everybody gets the same deal. So yes, you're right, it will change a lot of how this system works. It will democratize it, it will give everybody a fair footing on what they can wind up doing and it could turn everybody into a projected owner or a advocate for whatever it is that they own. Even if it's down to like a McDonald's or something like that, which you largely don't get right now.

Erik: Jim, part of your answer was that it democratizes finance. But you also said earlier that this is going to enable a market without brokers and a market without institutions. The ability to trade assets without middlemen. It seems to me that if you democratize finance, you're really putting a lot of very, very powerful people who were behind the biggest lobby in the United States, the Wall Street political lobby, you're kind of putting them out of business with a lot of what you're talking about. So how's this gonna go? Because on one hand, it's very clear to me that the future of finance is decentralized finance, that's where it's all going to be. But you know, usually the people that are being displaced, the dinosaurs that are getting put out of business, don't go down without a fight. So are people going to wise up and be part of the future or are they gonna fight this?

Jim: Oh, they're gonna fight it and they are fighting it. 50%, five zero, 50% of all crypto owners reside in Asia. There are more crypto owners in the continent of Africa than there are in the United States right now. If you look again, at the chain analysis numbers. They're not going to accept that the United States Securities and Exchange Commission is going to shut all this stuff down in the name of investor protection. They've never had investor protection. They've been unbanked. They have been subject to scams and to losing their money for their whole life. They

see this is a way for them to have a fair fight in the economy and in the money changing business. And so I think that, yes, they're going to fight it. But they, Janet Yellen or Gary Gensler cannot convince the continent of Africa or the continent of Asia to give up on this because it's in their interest.

The Chinese can't even get their own population to really give up on this even though they've kicked all the miners out of their country as well too. So I ultimately think just like Big City Mayors with Uber. You know they threw them all out. They called it illegal. They said you needed to get a taxi cab license to operate on their streets, but their populations wanted it so bad that they were forced to basically cave and allow it to happen. The same thing will happen here. Now that I've said that, it's not going to be clean, and it's not going to be simple. It can be very messy along the way as they try to fight on this, but I do think that you're right. They're not going to give up without a fight. But at some point, they're going to have to realize it's a fight they can't win. And then the question is, is just how bad do they want to wreck everything on the way out the door?

Erik: Jim, I can't thank you enough for a terrific interview. But before I let you go, please tell us a little bit about what you do at Bianco Research and for our listeners who want to follow your work how they can do so.

Jim: We are an independent research firm. The best way is you can check out our website at Biancoresearch.com follow me @biancoresearch on Twitter, or Jim Bianco on LinkedIn. I try to post things from time to time in both of those spaces as well too.

Erik: And I've seen a lot of excellent articles on LinkedIn particularly. Jim, we look forward to getting you back on the program soon for another update. Patrick Ceresna and I will be back as MacroVoices continues right after this message from our sponsor.