Luke Gromen: The U.S. Government Cannot Afford Secular Inflation

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Erik: Joining me now is Forest for the Trees founder Luke Gromen. Luke, it's been since January that we had you on the program. Really great to get you back. I've been asking everyone about secular inflation. Now everybody can see that there is inflation. My question is, is this really transitory the way the government would like us to believe or are we seeing the beginning of a structural inflation that's going to last many years?

Luke: I think it's the beginning of a structural inflation that's going to last many years. I should probably say thanks for having me back on to start. But the reason I think it's structural lasting for many years is I think if you look at a lot of the key factors that have been disinflationary over the last 20 years, 30 years. A lot of them are going in reverse. So you know, whether you go back 10 years, we've seen a disinflationary impulse in oil and commodities, in no small part tied to US shale. US shale has been the biggest marginal producer of oil for the last 10 to 15 years. We are seeing that it is getting hard, if not impossible, to increase production at lower prices. And so we've been talking about peak cheap oil that is a structurally inflationary component to commodities.

I think if you look at another big one, globalization, globalization has been extremely disinflationary or deflationary for 20 plus years. Very clearly that is going in reverse and so if China and US trade was deflationary, or disinflationary, the breakdown of US and China trade relations, it strains credulity to think that that too, is deflationary. I think that's a very inflationary secular inflationary impulse. I think when you look at even things that are a little bit more counterintuitive, to me, I think they also point to a secular inflation. So for example, it's often pointed out that in the US demographics are deflationary that old people don't spend as much. I would question that a little bit, particularly at the consumer level. And the reason I say that is, if you look at US deferred compensation schemes, whether they be 401-Ks, or 403-B's, or IRAs. All of these programs effectively amounted to the sterilization of inflationary US deficits over the last 30-40 years. And in plain English, people could put away 10-15% of their income. And instead of having that income in pocket now, the reward was you got tax deferred status. So you put that money into assets, instead of putting that money in your pocket where you would have spent it and where it would have been CPI inflationary right away.

And so effectively, we were sterilizing inflation with these deferred compensation schemes for 30 or 40 years. Fast forward to today, you've got whatever it is 70 million baby boomers, there's an article in the journal last year, or earlier this year, noting that the estimate is that the boomers control roughly is $35 trillion in assets. And now they're all getting to an age where they have required minimum distributions that it's a technical topic, but for simplicity's sake, and just sort of, you know, good enough for government work, they have to spend about 3% of that money per year. And so again, if deferred compensation schemes were disinflationary, or sterilized inflation that would have been higher for the last 30 or 40 years, and instead, it resulted in asset price inflation, then again, the opposite this $35 trillion coming out secularly is also very inflationary. And so I think there's a number of factors and those are just three. There's probably some others I could come up with. I think they all point in the direction that there is a secular, we've seen a secular shift in the deflation, disinflation versus inflation impulse. So that's some thinking about it.

Erik: Luke, I started with that question because I've been asking everybody that question, because frankly, I think this issue of secular inflation, and that's what I think it is, is the single most important topic in macro today. You told me off the air, though, that you actually think that those of us who are looking at it that way, maybe ought to be looking at it a little bit differently, because you think there's something else that's really I don't know if it's more important, but maybe more important to start with to understand this situation? What's the something Luke?

Luke: Sure. So we were talking off the air, I think the single most important macro chart that we have and that we're talking about and that I'm told virtually no one else is talking about, and I think it also feeds into this being much more structurally inflationary than most people think, is or many people think is the fact that if you look at the US what we call the US's true interest expense which we define as Treasury spending plus entitlement pay goes right the pay as you go portion of entitlements cause those are just the effective interest to support the entitlement obligations and you add those two numbers together. What you find is that those two numbers are still 111% of US tax receipts as of the third quarter per the Treasury Borrowing Advisory Committee. And that's with tax receipts at all time highs inflated by slash aided by an epic everything bubble.

And so this, I think, is an element of the structural inflation that virtually nobody is talking about and I think it's something virtually everybody should be talking about, which is, everybody for 40 years has been conditioned that once we see these types of inflation, the Fed steps in to fight the inflation. And the problem is, is that there have been no instances in the last 40 years, where the Fed has begun a tightening cycle, where the US couldn't even afford to pay its interest out of tax receipts. And that's the case now, if we look at true interest expense, again, which is the Treasury spending plus entitlement pay goes, and so it leads to this conclusion that if the Fed tries to tighten, what you're likely going to see, before very long is a decline in tax receipts. If the Fed puts us in a recession, and we're obviously seeing significant slowing already. You're gonna be looking at tax receipts that are already below true interest expense, and probably would start falling further, while the true interest expense would probably rise because of the interest rate going up.

So there's this angle that basically every other cycle that basically every trader alive and listening to this has lived through. The choice has been inflation or slow the economy and eventually maybe make a policy mistake down the road. But what this means is that the Fed's choice now is binary. Unless the Fed is willing to tighten, and then stand aside as the US government does not have the money to pay interest expense, true interest expense without the Fed's help, then basically the only choice is the Fed keeps helping, and the Fed keeps monetizing as they've done for the last 14 or 18 months. And so that is, I think, you know, arguably, when I had that list of structurally inflationary factors before, arguably the most inflationary factor is this dynamic that the US government needs inflation to run hotter than it is today to inflate tax receipts, to much higher nominal levels of GDP to much higher nominal levels, so that the US government can cover its true interest expense.

And then we can get into defense, education, labor, national parks, veterans affairs, everything else they're spending money on. But right now, the US government doesn't even have the tax receipts to cover true interest expense. And so to me, it doesn't suggest they can't or won't raise rates. It just suggests that if they actually withdraw liquidity, it's probably going to be pretty volatility inducing, and really, really bad for risk assets pretty quickly. And then I think the Fed will very quickly have to reverse track, which I think will be very inflationary. That to me is the most important chart and macro is that the chart we have showing true interest expense, still running at 111% of federal tax receipts, which are at all time highs, aided by an everything bubble.

Erik: Luke, I personally couldn't agree more with you, I think you've made an extremely sound argument based on logical rational thought. But hang on, the folks that are in charge of policy, don't, in my opinion, really subscribe to that whole logical, rational thought thing, the way they would react, I think, at least the MMT crowd to everything that you just said is look, you don't get it, you're acting like it's a problem that tax receipts are not enough to pay the interest. You're totally missing the point. Taxes, according to the MMT crowd, and I want to stress, although I don't agree with this. The MMT crowd are rapidly gaining a huge amount of political capital in the United States and elsewhere around the world. What they're saying is like the whole purpose of taxes is just to, you know, deal with inflation and paying the bills, all you have to do is print money, and that's better. That's the way we should be doing it. What we're seeing here Luke is finally a sign of improvement. And we need to dramatically accelerate the rate that the Fed prints money, not fear it the way you're describing. Now, I don't agree with that at all. But I think there's more people who disagree with us than agree with us. And you know, the market kind of goes where the crowd wants to take it. What does this mean? Does it just make it worse? Does it mean the inflation outlook is worse or does it change it? How do you interpret this if you assume that potential policy responses coming?

Luke: Oh, I do assume that potential policy response. But I think the odds that the Fed tightens and then stands aside as rates go up, and stocks go down, and the US government has to decide if it wants to keep funding defense or send checks to baby boomers, I think there's zero chance that happens. And if you have two options. And one of those options has zero chance of happening politically and economically for that matter, then you're left with

whatever's left, and whatever's left is is there going to print the money. And so I think the MMT crowd is exactly right. I think that's what's going to happen. And I think the reason the MMT crowd suddenly has an ear in Washington, is I think there's enough people in Washington that are looking at the math, and they can't make two plus two equal $6 trillion. And they're going okay, well, how do we make two plus two equals $6 trillion? And, you know, the MMT crowd comes in and says, hey, well, you could, you could print 599,000,000,000,000, or whatever that number is. and Washington goes, okay great. MMT sounds awesome.

And so I think part of the reason why MMT is getting the traction it's getting, I think MMT getting the traction it's getting is simply a manifestation of, you know, the fact that there's no other option. That's the only way you can get the math to work. And so once you understand that, you know, if I'm right about that, that's why I say this, this this tax receipt, still being below interest expense is the most inflationary thing possible, and virtually nobody's talking about it, particularly in the context of this rate hike cycle. And you know, what we're seeing in eurodollar futures do discount rate hikes in 2022. Because the only possible answer is they're going to print so much more money than anybody thinks possible, which is, is fine. It is what it is like this was always how this was going to go COVID just pulled it forward.

Erik: Luke, the usual prescription for fighting inflation is higher interest rates. And I would say also that most people just equate the idea that will you know, more inflation means there's going to be higher interest rates, does it really work that way that interest rates follow inflation, or is it only the case that central banks respond by intentionally increasing interest rates and that's the only reason that they respond with inflation. And particularly, what is it going to mean when in this inflation, the Fed's probably not going to be able, as you say, to do that, it seems to me Luke that that potentially sets up this catalyst where at some point, you have a market realization that they say, well, the inflation is running away. And even though you know, they predicted it in MacroVoices years ago, we all just realize something which is it's running away and they can't fight it. If they fight it, it'll screw something else up. That's even worse. They're powerless, and it's running away. It seems to me like that aha moment of Wait a minute, this time around, there's really no good remedy for inflation that central banks have in their quiver. That's how it feels to me now maybe I'm missing something. Maybe they have lots of remedies that I'm not seeing, but it feels to me like they're kind of running really, really out of bullets here.

Luke: Oh, absolutely. I think they're absolutely out of bullets. I think the last bullets they have left is by repeating that it's transitory. And obviously that bullet, you know, they've fired that a few times and they're now sort of being forced to admit by events that well maybe it's not exactly transitory. And then the last bullet, I think that they really have. Really the last two bullets, if you will, is bullet number one is the lie that inflation's whatever, two or three or four, whatever it has been the heck they say it is. It doesn't really matter. It's laughably low. And so if they can sort of, you know, contain the Overton window of discussion to, oh, gosh, CPI is three and that too, oh, it might go to four, inflation expectations are five. You know, that's their last it's a jawboning, their jawboning. The reality is inflation's probably running eight to ten. Maybe it's running higher at the moment. They're sort of trying to keep the discussion of exactly how negative real rates are, you know, to a minimum level to delay that aha moment, right?

Because if, if we woke up and they said, Oh, okay, guys, real rates are actually negative 14 right now, the bond market is going to lose its mind and when the bond market loses its mind, I agree with your point that historically, the Fed would follow the bond market. But again, this is the first time I don't know in at least 100 years and maybe more well, it's the first time since World War II certainly let's go back there. So 70 years, it's the first time since the end of World War II that the US cannot afford rates to rise. And so if, you know step one, bullet one is lie about what inflation is to keep the degree to which real rates are negative, you know, minimalized, right? So that's step one. But then step two is going eventually either it's going to be recognized or if they were to be truthful about how negative real rates actually are right now. The bond markets gonna start selling off and once it sells off to a certain point, the Fed's gonna have to cap yields, and it will be that decision. Does the Fed want the release valve to be yields or does fed want the release valve to be its balance sheet, and the only political and economically palatable choice is for the release valve to be the Fed's balance sheet.

And at that point you'll just see and what it'll just start feeding on itself. And the Fed's balance sheet will go 8, 15, 25, 30 trillion, whatever the number is. Inflation will officially go from five to seven and will be running at 20 or 30. And after, you know, five years of 20%, inflation. US debt-to-GDP we'll be back down to 70% from 130% as GDP skyrockets, while interest doesn't and you know, bonds will go from buying you filet mignon to buying you dog food. And you know, a bond and that'll be that will then be the position where the Fed can raise rates, again. They can normalize policy. And I think that's the prescription. I think that's where we're going. I think we are much closer to that aha moment than we were six months ago. I think that aha moment might be in the next 6 to 12 months, but we'll see. But it all feeds back into that structurally inflationary outlook.

Erik: Let's talk more about how big the aha moment actually is. Because maybe I'm not making up a story in my head. But it just it feels to me, like most people are not seeing the the secular inflation argument. They seem to be largely persuaded of this transitory argument. The moment where you get to the vast majority of market participants roll their eyes and know that the Fed is full of it, when you know it. We know what's really happening here. Aha, it seems to me like that could be just a profound change, where everybody finally realizes, Oh, my gosh, we really are at the beginning of a 1970 stylized inflation. I don't think we're anywhere close to it. And I don't know why I say that I haven't, you know, taken surveys or looked at statistics of sentiment, but it just feels to me like most people don't get it yet. Would you agree? And what do you think it could mean? How big is this aha moment? And what could it mean as a market event?

Luke: I agree, most people don't get it yet. I think the reason most people don't get it yet is you know, it's sort of the common knowledge game that Ben Hunt has talked about, right? It's like everybody in Hollywood knew Harvey Weinstein was a bad dude. And nobody talked about it. And then all of a sudden, everybody talked about it and he was canceled, and he was arrested and, you know, going to jail or whatever. However, that worked out. I think it's the same thing. We've seen it, I think there is, particularly as it relates to the US. This exceptionalism, we've got

the reserve currency, and, you know, it hasn't happened in my lifetime. So it's never gonna happen, you know, which was, by the way, the exact same thing everybody said about home prices falling nationally 15 years ago, even though it had happened before. It just hadn't happened while they were alive. So for their view, it hadn't happened.

And, you know, I think the Afghanistan situation is a perfect example, too, right? I mean, that was, you know, 20 years ago, we invaded a place called the graveyard of empires, with no debt on our books, We were running surpluses. And the overwhelming consensus was we had the best military in the world. And so the graveyard of empires would not apply to us. You know, we have the best military in the world, we have the reserve currency. And so you know, what could possibly go wrong? 20 years later, we were massively indebted. We have outsourced our manufacturing base to China, or at least a quorum of it. We had no adversaries then. Now we have a big adversary who is gone, you know, as of last week shooting hypersonic missiles around the world, while we were busy chasing guys in, you know, in Toyotas with technicals on the back of them. So there's this aha moment, right, where, you know, I think it's gonna be like what we saw at the end of Afghanistan. It's like, well, the Taliban will never overtake Kabul. Well, it'll take 90 days for the Taliban to overtake Kabul. Well, it's gonna take three days, well, oops, they just overtook it and I think the key in all of this, whether it's the Weinstein situation or home prices, or Afghanistan. It's the combination of an ignorance, a willful ignorance of the politics of the situation, and dogma.

And so I think right now people say, Well, you know, I don't think they're aware of the politics of the situation. And by that, I mean, if you are just repeating yourself that that is always deflationary. Yes, that's true, until the sovereign is where the debt reaches. And that's a different game, because once the sovereign gets into too much debt. The question is, are they going to print the money or not? And they always print the money. They always print the money. And you know, people say, well, Japan. Japan, well, Japan's a twin surplus nation that has a net international investment position of positive 70% of GDP. They could at any point, call in the positive 70% of their GDP that is sitting in foreign assets. So they could call the US and say okay, Mr. US, we want you to send us 4% of our GDP every year in net assets for the next 70% divided by 4% is what 16%- 17% or 17. So 17 years in a row, Japan could literally just take 4% of their assets. Foreign assets and bring it home. The US doesn't have foreign assets. Our net international investment position is negative 70% of GDP. We're running twin deficits, not a current account surplus, like the Japanese do. There is no foreign assets to bring home.

The foreign asset to bring home is you pick up the phone, you call it the Marriner Eccles building and say, Hey, J. Pow print us more, print us more, print us more. And that's where I just think that between the dogma of well, you know, we're the US, we have the reserve currency, it's not going to happen. You know, ignoring the politics of do you really think they're going to cut off 70 million baby boomers, and then just not realize the difference between us and Japan, which is their massive current account surplus, massive net international investment position, you know, to the positive versus us are twin deficits, negative net international position. So I just think, as we move forward, you know, when does this hit the aha moment? I think it's all of these factors have always been true. It's sort of like the Weinstein thing, it was always true. There were jokes

about it in the 90s. So when does everyone go oh, God, because it's been true, because it's true. When they go, Oh, god, it's not going to be like, oh, it'll take years and years. It'll happen fast.

And so, you know, to me, that trigger is probably from my view is the Fed tries to tighten, it goes galactically wrong, stocks go down, yields go up, and Treasury market. Fed comes back in and does another $3 trillion or $4 trillion in QE. And then that might be the aha moment where everyone goes, Oh, my God, they are, they're never getting out of this. Every time anything goes wrong, the balance sheets going to go up nonlinearly. And then it starts to get interesting, right? Because now you've got all these structurally inflationary factors anyway, they start to become really embedded. And then we just inflate the debt away until it gets to a level that they can normalize policy without blowing things up.

Erik: Let's talk about what this is going to mean for the stock market Luke, because if I assimilate the different things that you're saying to me. First of all, it seems politically that the Fed really needs to stay on there. And look, we're tapering, and we're serious about it, messaging, at least for a while longer. And what you're saying is, if hypothetically, they really and truly meant what they said, and they were going to just, you know, normalize their balance sheet. And that's it the markets on its own. I think you and I agree that would result in an outright market crash. Really big, bad news. But we also agree, there's no way that they're ever going to actually let it go that far. It'll get to a certain point, and it'll be the Fed to the rescue as usual. That all sounds like just the right narrative. But wait a minute. Sounds like I can't use economic fundamentals to make any investing decisions, because this whole thing is about politics and policy. How do you navigate this in terms of asset allocation?

Luke: I think you got to go back. I mean, I think you got to go back to the economic books as they apply to emerging markets with balance of payments crisis with balance of payments problems, because if you take the masthead off of the US is, you know, sort of term sheet except for the reserve currency which is a huge, which is a huge you know, exception, don't get me wrong. But obviously you and I've talked at length about how that is being chipped away by a number of different factors, etc, etc. But if you take the US flag off the masthead. Our setup looks like an emerging market with balance of payments problems. And foreigners are net buying our treasuries that was sort of, you know, the key part of the reserve currency, as far as this balance of payments goes as we ran balance of payments deficits, twin deficits and foreigners financed us.

And increasingly, they're not buying treasuries. They are basically buying our stocks, right. So we are effectively selling corporate America and American real estate to the Chinese to finance US government spending, which is, which is fine. There's still capital flowing here. Politically, we're seeing where that's becoming a problem. But that's a bit of a separate issue, but they're not buying the treasuries anymore. And so once the US was a massive twin deficit nation whose Treasury debt was no longer being bought in sufficient amounts by foreign central banks or foreigners in total. Basically you put down the USA 1971 to 2014 economics book and you take out the, you know, Argentina playbook or you take out, you know, Turkey, or you take out any

number of twin deficit nations, not because I think they are going to necessarily get that bad, but that's the same type of dynamics and that dynamic is is when twin deficit nations lose their foreign financing, inevitably, the central bank begins financing them, and that's where we are and the Fed's done a great job of saying this isn't them financing. That they're not monetizing the debt and you know, they can say they're not monetizing the debt all they want. Bernanke said in 2011, they were gonna take the balance sheet back down to you know, whatever they started at 800 billion, right? Which is where it was in 08' when things went pear shaped or pear shaped.

And the fact that they have not got It means they've monetized the debt, which is fine. It is what it is. Again, this is how it was always going to end. But I think that's what you have to start doing in terms of asset allocation. You know, it's not the US of 1971 to 2014. It's the US with Argentine characteristics of 2014 through probably 2030. You know, whenever, however long it takes us to inflate enough of this debt away, that they can kind of go back to the US of 1971 to 2014. And, you know, if they're gonna inflate the debt away, I think you want to avoid bond markets, and I think you want to own assets that do well as they're inflating the debt away. So it's Bitcoin, it's gold, it's equities, it's commodities, it's real estate. I mean, look, the US government is giving Social Security recipients next year, a 5.9% COLA, cost of living increase at a time when the Fed is holding mortgages at 2.9% by buying 40 billion a month of them. And it's like, okay, you're gonna give me a negative mortgage rates are negative 3% real? Okay, I'll buy a house. But what about prices? Well, they're paying me 3% to buy a house. Okay. You know,it's this emerging markets economics playbook that you just have to transition to from, you know, the developed market, the reserve currency, you know, developed market that we all sort of grew up under.

Erik: Well, look, if you want my prediction of what is not going to play in American politics, it would be the day that labor is saying to the government, why are you allowing our fortune 500 companies to send all of our jobs over to China? And the answer is, because China owns our fortune 500 companies, and it's kind of up to them. And, you know, we say this stuff, kind of sarcastically but it's the direction that we're headed in. You know, we're selling off corporate America, to foreign investors so that they can set the policy and it is US government policy that is causing that massive foreign investment in US equities. And I don't think anybody's really looking at the big picture of where this all is headed. Let's talk about bond yields. Now, though, because, you know, a lot of people I'm talking to her saying, look, as much as we see some inflationary pressures. The situation, as you've said, Luke, is the government can't possibly afford to allow bond yields to rise meaningfully. So look, we're stuck here at basically super low yields for the next 10 years. Don't even think about a big bond short, you know, that's not going to be your inflation play. Does that make sense?

Luke: Absolutely. Yeah. I wouldn't short bonds here on by themselves. I would short bonds the finance 101 way that I just described, right? If the Fed wants to hold mortgages at 2.9%, while the government hands out a COLA adjustment, the social security of 5.9%, great! I'll borrow the money. I'll short the dollar, I'll short the bond that way, right? I'm short on mortgage, and I'll buy the real estate. And I would want to own it. That's how I think if you want to short bonds, and I

think that's a good way to do it. I think that's the way you do it. You borrow the money, short the bond the finance 101 way. Borrow the money and buy the underlying asset because that's exactly right. I think it's the political imperative. The political economics of the situation is the debt so high, the deficits are so high, we're so de industrialized, there is no ability to raise rates in any real way. And so the Fed will have to cap rates.

And, I think there are very smart and connected people saying they're already doing so on sort of a pseudo you know, pseudo basis quietly. And if I was them, I would be doing as quietly as I could to because the day they come out and say, we are moving to yield curve control, that, you know, if you ever hear the Fed, say yield curve control, or its equivalent explicitly. That they are announcing explicit policy, that will be the Fed checking into the Hotel California. They will be saying, we are going to grow our balance sheet until we've created enough inflation. That US debt-to-GDP has gone from 125% today to 70%. And at 70%, we will be able to raise rates without blowing up the world. And that will be that. And so if I'm the Fed, I am trying to never have to say YC, yield curve control. I don't think they'll be able to avoid it inevitably, indefinitely, I should say. But ideally, they just sort of do it quietly. But yeah, I agree. I don't think rates are going to go up a lot, you know, beyond certain points. And I will probably get in close to those points. When you look at things like the 30-year and the 10-year treasury bonds.

Erik: Look, something just crossed my desk today. I saw an article talking about junk bonds and the number of junk bonds that are now negative yielding in real terms. So you stop and ponder that. You're literally paying a premium for the privilege of accepting default risk. When you buy those bonds. That's what it is. And it seems like that's got to be the most screaming short in the history of finance that you could just short all of these junk bonds because they just have to crash. Wait a minute, look, I had that idea more than five years ago, and I lost a shitload of money shorting junk bonds way too early. How do we know when it's time? I mean, I think you and I and our listeners can all see that this junk bond situation of negative real yields on high risk credit is insane. It doesn't make any sense. But it hasn't made sense for a long time and junk bond prices keep going up.

Luke: When does it make sense? I think you'll know it's time to short that when the US I think the key to watch is US debt-to-GDP. When US debt-to-GDP is at 70% not 125%. Then I think you can consider putting on that trade. But until a rise in rates anywhere, you know, until until a rise in rates anywhere blows up the system. And again, if the system goes into any deflationary impulse with US true interest expense is still above tax receipts. The US government says sorry, we're not making the coupon payment on treasuries. Sorry, 70 million boomers, you're getting less money this month for Social Security until they've inflated this thing enough that that is comfortably no longer true. I would just rather structure the trade differently, which is again, that finance one a one way. Don't short the junk bond, just buy bitcoin, buy Ethereum, buy silver, buy gold, buy you know commodities, buy stocks, buy, you know, an ocean house, buy a lake house, buy something that is more finite, then, you know, this silliness that you're seeing in the bond market.

And then again, once US debt-to-GDP gets down to 70%, which is probably again, you're talking about 20% inflation for five years, then, okay, maybe you can see rates rise, and at that point, I think all those hard assets I just laid out are probably worth a lot more than they are today. And then you know, you can decide, okay, what's the coupon that I want to own that I'm willing to accept for, you know, these assets. But, I think the metric to watch and this gets back to that point of, you know, the economics books. What economics books are we watching for? It's all about the sovereign. Once the US government has delevered enough by basically screwing bondholders on a real basis, then I think you can, you know, think about shorting bonds nominally, but until then, I think bonds will be fine nominally, but I think they're going to continue to get killed on a real basis particularly relative to Bitcoin, stocks, gold houses, etc.

Erik: Luke, let's touch on the US dollar. A subject that you've been extremely outspoken on in the past. What we've seen and I think it was very much showing that you had been perhaps right was a lot of weakness earlier this year in the US dollar. According to some people has turned around, we saw the bottom at 89. And you know, it's all uphill from here, we're headed to 120. What's your take? Is the US dollar demise still on? Or what what's the timing? What should we expect to happen next?

Luke: I think what we've seen I think, empirically if we look back, the level of the dollar as measured on the Dixie that blows up the world has been falling. Steadily, each side, right? So in 2017-2016, I guess late 2016. Dixie, if I remember right, got as high as maybe 106, something like that. And then you know, 2020, it got to you know, 98 and it started having problems. And then you know, a couple weeks ago, we got to 94 and it's like, you know, the market starts having indigestion. You know, there were some other factors that work there too. So I don't want to ascribe all that to that. But that makes sense. And in a world that is short dollar debt through the you know, the Eurodollar system. And that eurodollar debt keeps going up and the US debt keeps going up and the world keeps becoming more interconnected. And the rest of world keeps becoming a bigger part of global growth and US growth. Then over time, the level of the dollar that you need to hit before things start going pear shaped comes down and we're seeing that.

And the flip side of that is and we saw this last year is so that's sort of you know, if you think about it as a graph, right. The level of US dollar that creates a crisis is a line that is going down into the right. At the same time, the level of the dollar on the downside that creates a flood out of the dollar is a line that's going up into the right and I think we saw that earlier this year where we got the dollar down to whatever it was $88-$89 and you know, we're seeing you know, Bitcoin at $61,000 and lumber at whatever $1,600 and oil is still going up. Commodity still going up. Stocks going up. There was basically wholesale flood out of the dollar. And I think over time that number goes up, because I think as the debt rises. As we get closer and closer and closer to this aha moment, where more and more people realize, Oh, my god, they're gonna have to cap yields until they inflate away the debt. There is this sort of level of the dollar that below which you're going to get a run out of the dollar. And I think the Fed wants to avoid that. And the challenge is that those two lines are converging. So if you think about the upper bound as being the level, though, of the dollar that breaks the system is starting, you know, going down into the

right, and the bottom level of the dollar that creates a run out of the dollar, which, from the Fed's eyes also breaks the system in a different direction, that number is going up into the right. In between, there's the Fed's operating room, and the Fed's operating room keeps shrinking and shrinking and shrinking.

And so I think right now that range is, you know, 89 to 94, and, you know, a year from now, it'll probably be 90 to 93. And maybe sooner, but eventually, those two lines are going to cross. And where those two lines meet, that's our aha moment. Because now there's no policy to do. And I think then we get sort of the flood out of the dollar into sort of everything else. We get our significant inflation in a compressed period of time. And you know, then the Fed after, you know, they inflate away the debt enough they can normalize policy. I really think we've been watching that action in the dollar, really since 2016. Ultimately, I think it will be resolved with a much weaker dollar. At any given time. If the Fed doesn't do enough, though, you can get dollar spikes and we've certainly seen that in 16 and then again in 19 to a lesser extent. 20 certainly early on. And then the stronger dollar we've seen since I would call it May when the Fed started jawboning that, hey, we're gonna taper and it's transitory and sort of this, you know, playing the only you know, the only couple hands they have left.

Erik: Luke, you mentioned Bitcoin a couple of times. I wouldn't be the slightest bit surprised if Bitcoin is over $100,000 less than a year from now. Let's say six months from now. No, that doesn't mean my view on cryptocurrency fundamentals has changed. My view is that this week, the ETF started trading. That means that the people and how it's possible that people have money to invest in we're unable to figure out how to buy bitcoin. It's now idiot proof. Anybody can buy bitcoin. And my prediction is that all of the stupid people who were unable to buy bitcoin before because it was too hard, now have an ETF to use and I think it could dramatically increase interest in Bitcoin over the next year. I wouldn't be surprised if it's a setup for a blow off top and a crash, but boy, huge capital inflow. What do you think? Does that make sense? What are you expecting?

Luke: Yeah, I could easily see it being $100,000 a year from now probably sooner. Again, I think it depends on policy. Look, I think if the Fed came out and said, you know, as an extreme. If the Fed came out and said, listen, we've got an $8.3 trillion balance sheet, and it's going to be zero by Christmas. Bitcoin would probably go down quite a lot, along with pretty much everything else in the economy, etc. So I think it is dependent on policy, but I think the level. How draconian policy would have to be to stop the freight train, that's Bitcoin rises, you know, almost by the day, and you know, so I see Bitcoin going a lot higher as well. I think the ETF thing, you know, to me, it's still way easier to buy bitcoin on Coinbase, then it is through a brokerage account. And I don't know that this changes. Where I do think that this could be a game changer is if we start seeing the Bitcoin ETF show up as a 401k option. Tou know, so for example, for me, right now, I don't have that. I can't touch that money. It's sitting in, you know, sort of older, traditional, we'll say financial instruments. What I have an interest in having money that I don't need to touch for 20 years, and putting 20% of it in Bitcoin. Yeah, I would do that. I would absolutely do that. And my guess is I'm not the only one. So I think to the extent that they create this, you know. This ETF and it allows its introduction into deferred accounts, you know,

where you don't have to worry about the day to day volatility. You just have to go right, it's probably going to be higher in 20 years then it is today. That I think could be really powerful. And I agree that could absolutely, I don't know, a blow off top, but I think it could certainly drive it meaningfully higher overtime.

Erik: You know, it just occurred to me as you were speaking that regulatory changes will have so much to do with this because if you think about it. A lot of people think the reason that gold is not a whole lot more popular is because FINRA regulations. Basically professional financial advisors are not allowed. It's against the rules for them to say, hey, you should be doing what I'm doing in my own personal portfolio, which is you know, I'm 40% in gold or whatever their number is. I'm just making that up on the top of my head. It's against the rules for licensed financial advisors to recommend a large allocation to anyone other than an accredited investor because of suitability rules. And, you know, as the rules get defined. Brand new uncharted territory. what is the maximum percentage allocation of a retail investors portfolio to cryptocurrency? According to FINRA rules that haven't been written yet. Well I'll tell you what, when they get written, they're gonna have a huge impact on the market. And it's gonna have nothing to do with whether Bitcoin is valuable or not. It's going to have to do with the rules for who's allowed to recommend them to customers. And I think that knowing things like what's coming next. How FINRA, in terms of suitability guidance for cryptocurrency is going to be huge trading edge for anybody who's got that information, because it's going to define how this gets adopted. Would you agree and where do you see that heading? What do you think's gonna happen in terms of, you know, criteria that will eventually be established for suitability of retail investors investing in cryptocurrency?

Luke: I agree, it would be a huge, it would be a huge edge to know that ahead of time.

Erik: Some people do. They're making lots of money on it Luke.

Luke Gromen
Don't get me started. Yeah, right.

Erik: No, it's only China that has that has corrupt government officials. Never happens in North America.

Luke: It's not corruption, it's lobbying Erik. You just you have to get the terminology.

Erik: Right!

Luke: No, I think it raises an interesting game theory question that I think applies not just to retail investors, but I think it applies to central banks too. Which is, Bitcoin as structured as effectively, it's a neutral reserve asset with an energy tie and a decentralized, and it has an algorithm that's going to increase its value as the aggregate amount of the economy grows. It's very very elegantly beautiful. And the point is that, at some point, central bankers. Again, I'm going to take it to the extreme because extremes inform the means. At some point, Bitcoin if

taken to the extreme, completely make irrelevant central bankers, they're completely irrelevant. The allocation of capital will be set by Bitcoin. And if it's allowed to get to that case, so the question then is, okay, when will central bankers realize this? I think they do on some level, but I've generally been naive to, relative to how much credit I give them. But at some point, they need to defend their franchise, and the only thing they have on their balance sheet that can defend their franchise is gold, right? So it's forever It's been in central bankers interest to kneecap gold. And we've seen how effectively they've done that.

They can't kneecap Bitcoin, because it's decentralized and because there's no allocated gold market like there is in London that's allowed to expand the leverage, you know, effectively, infinitely, etc. So, it's interesting, because to me, you know, I love Bitcoin. I also love gold, because I think at some point, central bankers are going to be smart enough to realize they need to defend their franchise, and the only thing they have on their balance sheet to defend their franchise is gold. And the only way to do that is basically take the ceiling off of gold, and let it go to its real price. Does that mean gold will beat Bitcoin? I don't know. But it does mean that gold probably, you know, at least add a zero at the end of it, maybe two. And so that to me. That's why I think Bitcoin and gold are allies in that way, that's why I still own both. But how that relates to your question about the federal thing is, I think it's the same game theory of financial advisors is at some point, you're gonna have enough, you know, major asset managers, and RIA's that are seeing assets, walk out the door, and you know, going to, you know, coinbase, and then moved off a coinbase into any number of custodial options that allow people to self custody assets, etc.

And, you know, I don't know what the level of assets that have to walk out the door for FINRA to sort of defend its franchise or to have the RIA's and what have you around the world to defend their franchise. But I think there is a level of assets that that takes place. And so I think that's how I would frame sort of the regulatory side. I don't think we're there yet. But with as fast as Bitcoin and crypto is moving. I don't think we're five years away. We're probably two years or less to that happening. Both at the Central Bank level and probably at the federal level, too. So you know, let's see, I agree, like I said that knowing ahead of time, you know, knowing ahead of time of either of these things, it's going to be a political decision, and it's probably going to benefit those who are able to get in front of it ahead of time.

Erik: Luke, I can't thank you enough for a terrific interview. But before I let you go. Please tell our listeners what they're going to find at fftt-llc.com. That's the Forest for the Trees website.

Luke: Absolutely. So we've got a number of different links there. Some information about how you can find out more about our retail investment products, our institutional investment products. A little bit more about what we're up to. You can also see what we're up to on twitter @LukeGromen. I have a pretty active twitter feed there so either place check us out and appreciate you for having us back on.

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