MACRO Voices
with hedge fund manager Erik Townsend

David Hay: The Case for Greenflation

October 28th, 2021

Erik: Joining me now is David Hay, founder and Co-CIO of Evergreen Gavekal. David, it's great to get you back on the program. I've been asking everybody the same question as an opener, which is okay, inflation, are we talking secular structural inflation, which is what I think or do we believe Janet and their friends in the government who say, it is transitory. So I want to get your take on that. But particularly, you've been writing about something called *greenflation*. What the heck is *greenflation*?

David: Well, firstly, thank you very much for having me on the show. It's a privilege, especially since I just listened to your podcast last week with one of my heroes, Luke Gromen. And he did not talk about re-inflation last week, even though he's written on that somewhat. So I appreciate the opportunity to talk about that. Because I think it's hugely important. And I think it plays a significant role in this debate about whether inflation is transitory, as the Fed is saying, or it's much more enduring, which I'm with you on that and Luke. And, you know, frankly, based on the Fed's forecasting record, which is horrific. And I think the fact that they're saying it's transitory is probably a pretty strong indication that it's not. Maybe once they finally concede that it's here for years, that'll be the time to take the other side of the trade.

But basically, the idea of *greenflation* has to do with the reality that the planet is involved in a great green energy transition. And just one key element to this, which I think is inarguable is that this is the first time in human history that we're moving from more efficient fuel sources to less efficient fuel sources. And I'm aware of, you know, of all the environmental reasons why we're trying to do that. But that doesn't change the fact that it's extremely daunting to make this happen, and especially on the very ambitious and I'd say, overly ambitious and unrealistic timeframe that policymakers around the world are trying to achieve. And we're seeing the wages of this already, with tremendous energy inflation occurring in Asia and Europe. I think most Americans are unaware. We have natural gas that's doubled. Natural gas is trading for around $6 per million British thermal units, MMBtus, but in Asia and Europe it's $30 or more. So you've got, you know, really a shocking amount of energy inflation occurring and real risks of rationing, and outright shortages that could take lives if the winter is cold as a lot of forecasters are predicting in Europe.

So, you know, we've got this war on fossil fuels, where you get a number of American cities that are trying to prevent natural gas being utilized, and fighting the transmission of hydrocarbons, you know, pipeline shutdowns, even existing pipelines. There's the New Yorker gave the

platform to a Swedish professor. He's written a book on how to blow up pipelines. He's avidly recommending that people go out and blow up energy pipelines. It's just unbelievable that he would be given that kind of a forum. But regardless, I mean, obviously, we know that US policy is very anti-fossil fuels. So guess what, this is the first time in history that we've seen huge price spikes without a supply response. So we're still around a point in this country where the drilling rig count is inadequate to offset the decline rate in the shale area, which is, of course, where we've had the tremendous growth of both natural gas and crude oil is because of shale. That is, you know, Erik, and a lot of people don't. Shale has an extremely rapid decline rate. So you have to drill a lot just to stay even. And that's hard to do when you've got pressure from your investor base about ESG. And you've also got pressure to not make those investments, but rather to buy back shares, which these companies are doing. So all these things are feeding this green inflation type of thing. And it's not going away, it's going to be with us for years to come. Whether it's right or wrong.

Erik: Well I have to confess this is the first time I've heard the particular phrase *greenflation*. I agree with you but...

David: Good! I created it. I'd like royalties, because I'm starting to hear some other people use it. Nah I am teasing...

Erik: I want to push back a little, it's, you've come up with a very catchy, I love the name. But I think what the gist of what you're saying is, hey, green energy is going to be more expensive. And it's an understood thing, that we're trying to make the planet a better place. And that doesn't mean you're gonna have to have some additional expense. But if green energy costs more than, obviously, the cost of energy is an input to the cost of everything. I think you've made that point. But I also think you just made a different point, which I personally think is even stronger. And I'll call it not *greenflation*. But really stupid policy-flation. And that is where you say, look, let's vilify the oil industry. Let's take the people who are producing energy the old way. The kind that pollutes the environment, which is the only way we knew how to do it a few years ago. The people that are still in that business, let's make criminals out of them and let's punish them and treat them like bad people. And whatever we do, let's make sure that we never ever, ever invest money in their companies so that they can create more of those polluting resources because we have to clean this planet up. Okay, great. So you've just taken the people that are your lifeline to run the economy on, and you've turned them into the villains, and you've cut off their funding, so they can't make any more oil wells in order to keep up with the current supply. And you've also got this pipe dream that the whole world is going to be driving Teslas in three years, which is just not real. Where's all this headed?

David: All very well said, Erik. It is kind of mass insanity and that is what I'm seeing around the world in so many ways. It's just these policies that are illogical, irrational, and borderline lunacy. And it's not that it doesn't make sense to try to emit fewer pollutants, it obviously does. But what you're seeing is, as these energy crises hit in Asia and Europe is a surge in coal usage. And of course, coal is one of the worst forms of fossil fuels that you can use. I mean, CO2 is not a pollutant but NON2O, nitrous oxide, which comes from burning coal is an extreme pollutant, and

really kills people. Another thing that's bizarre about this is that 2 to 3 million people die every year in the developing world because they don't have access to clean burning fossil fuels, such as natural gas and propane. So actually, US energy industry is making a big shift to export large quantities of propane to, for example, Africa, so they don't have to burn dung and wood and other nasty things in their little homes, which is a terrible frequent for people's health.

So really, you know, I do I think you're right. I mean, it's like we're treating the energy industry like the tobacco industry 20 years ago. Actually wrote one of our newsletters back in December called totally toxic. That, you know, instead of saying, hey, we can't run our planet in this day and age without energy. So to demonize this industry, well, guess what they're gonna say, we're not going to produce. We're just gonna drill a little bit here and there where they have fantastic returns, but we're not going to get that typical supply swing. So you know, I'm a big believer that the cure for high prices is high prices. But that's not going to happen in this environment. And that's why I believe that the *greenflation* is going to be quite persistent.

Erik: Now, for the challenging part, David, let's take these ideas and talk about how to translate it to an investment strategy. Because I see this as very difficult. One of the things that's going on here is oil companies are not getting investment from funds because ESG mandates are basically vilifying them and saying don't. In theory, that ought to mean that those oil companies are exceptional values, because they're not getting the buyers from the funds, and therefore, you know, you can buy them on the cheap, and it's a fantastic deal. But wait a minute, I'm not sure it's a fantastic deal to buy something on the cheap, if there is this somewhat insanity driven, public agenda to treat those industries like criminals, even though we're dependent on them for the lifeblood of the economy. So does this mean that investing in oil companies is an incredible opportunity because they're undervalued right now? Or does it mean, it's a dumb idea, because they're gonna continue to be the victims of all this?

David: I think it's the latter Erik and I can tell you why. And again, this relates back to the newsletter I wrote totally toxic. If you went back and bought Philip Morris, 20 years ago, you would have absolutely crushed the S&P. I can't give you the exact data off the top of my head, but it's immense. And that was, you know, those guys produce products that actually kill people,. Not that are essential to the operation of industry, and, you know, basically maintaining human welfare, which, obviously, fossil fuels have been incredibly beneficial ever since they were invented. The energy density of gasoline, for example, is just remarkable. But the reality is, even with the, you know, a horrible product, for the last 20 years, they've been phenomenal investments. So I think that's what you're setting up for.

But what they did was they basically decided they're just gonna raise prices. They're not gonna go for market share, they're gonna buy back immense amounts of their own stock and raise dividends. And that's exactly the model that the energy industries are already following. So what you're seeing is that a number of these companies have 15% free cash flow yields, and even in the mid 20s, for some of the mid-tier operators. And so yes, I think those are going to be very good investments for years to come. And I think the fact that so many different types of investors around the world won't touch them is actually a good thing for the contrarians. So I

would argue it's a very good setup for years to come with energy despite and maybe because of all the hostility towards the industry.

Erik: Now, I'm just going to push a little harder on that. Because if I think about what you said, is it really an opportunity for those energy companies, which are going to be the ones that are victimized by stupid government policy? Or would it be smarter to say no, I'd actually rather bet on just energy prices. Buy the crude oil, by the commodity rather than the companies that produce it.

David: Well that's a good point. And I think the answer is yes. In fact, to your point, what's interesting is the Futures Curve in oil. So right now oil is trading in the mid 80s, WTI. Brent a little closer to 90. And yet, if you were to go out to 2023, two years from now, it's $15, a barrel lower. And if you go out another year, it's $20 a barrel lower. So you could buy those futures contracts and just let them go and you're going to get a higher rate of return just having it converged at today's spot price, which I actually believe is going higher. I think prices are instead of going lower as the Futures Curve implies. They're going higher, because we have an extreme shortage of oil right now. And it's getting more and more acute, which is exactly what the futures market tells you. When you have that kind of what's called backwardation, where the spot price is so much higher than the futures price. It's telling you that the markets in an extremely tight, even deficit supply situation, by the way, the International Energy Administration or agency IEA, has drastically underestimated the demand of crude oil for years and that number today is about 2.8 billion barrels. That's how much they underestimated demand. They continue to do it, people continue to focus on their numbers, which is amazing. They've just been as inaccurate, frankly, as the Fed has with their economic forecasts.

But it's an important point in this way regarding equities is because equities are based upon earnings estimates, right for earnings estimates. And before earnings estimates are a function of the Futures Curve. So those earnings estimates are incorporating, you know, $65 a barrel oil. And if it's going if it's just going to maintain where it is now, those earnings estimates are going to come up drastically. And I think that's exactly what's going to happen. I think that's going to be your next up lake in this energy bull market. That has been playing on. I mean, years ago, Jim Cramer was telling the world energy is uninvestable. And yet, you know what's been by far the best performing sector this year, not counting cryptos. Energy is up over 50% this year. Even the mystery pipelines are up over 50% this year. Who would have thought a year ago, we were pounding the table on energy back last December, I wrote that totally toxic newsletter. So it's still very much of a contrarian play. And I think it's gonna stay a contrarian play, frankly. And that's kind of the good news. And plus, as you know, the dividend yields on many of these companies are extremely high.

Erik: Let's move on to the stock market more broadly, and just talk about where equities are headed. Because, boy, you know, there's so many reasons it'd be the last time we had a taper tantrum from the Fed. I mean, it was a big market crash and everybody was afraid the bond market was gonna crash, the world was coming to an end. We've gotten to a point now where it seems pretty darn clear that the equity market can shrug off just about any news and keep

marching higher. Is that just set to continue because of central bank largesse or do we have a day of reckoning ahead of us? And as we address that, you sent me something this morning, talking about a Paul Tudor Jones quote, talking about range expansions. What's a range expansion? How does that fit into the story?

David: Well, that is his term. It's something that we've used with different terminology for years. I think it's the best way to make money and avoid losing money. Anything I've ever stumbled on. I do think most people in industry just intuitively get it that when something has a major breakout. Look, let's go back to the S&P, one of the biggest mistakes I've made in my career was when the S&P had its big breakout over the 2000 high back in either 2012 or 2013 was around $1,550 on the S&P. A clear breakout to an all time high. And I missed it. You know, at that point, I was worried that the Fed was already doing QE, was artificially stimulating. That there would be a day of reckoning much sooner than it turned out to be the case. So you know, bad mistake to have missed that warning. If you want to look at one today that's giving you a tremendous buy signal. Look at what's happening with the Japanese stock market, which recently made a 28 year new high. And so in our way of looking at the world. I think Paul Tudor Jones would agree with this, the longer the range has been in place, or the trading range, basically, just something's been oscillating between 20 and 40 for many years, and it goes to 42. That's telling you that something has changed, and it's likely to keep on running. So that's really what it means.

Paul Tudor Jones said something to the effect that when a range expansion happens, whatever it is, is going to keep trending in the direction of that range expansion, which is just another way for us to say if something's breaking out, it's likely to keep going. And oftentimes it's really quite a big percentage move after the breakout occurs. And what's really interesting and really relevant to the images that I sent you earlier, which are to do with the economy of things like inflation, or the you know, the job the jobs market. Ehen you see these breakouts occur, let's say with inflation, and that was a big warning signs earlier this year that the Fed was wrong about inflation being a flash in the pan. So it's amazing, it's almost like fractals, you know in math you see fractals in real life. You see this pattern replay itself time and time again. So I mean, for your listeners, I think one of the key takeaways, and again, I've learned the hard way over my 42 year career is that breakouts and breakdowns are hugely important. And you can see that at some of the Chinese stocks earlier this year when they broke below multi-year, below where they were even during COVID. That's a classic sell signal. So hopefully I covered that.

Erik: Okay, David, that covers a definition or an explanation of what these range expansions are. But help me connect that to the current stock market. Because it seems to me if I look at the S&P chart. I don't see a sudden breakout out of a trading range that has existed for a long time, what I see is a march straight up for like 10 years that I think is driven by central bank policy. And I thought it couldn't possibly last this long. And clearly I've been wrong. Where is the breakout here?

David: I'm right there with you. I mean, I don't think any rational person would have believed six or seven years ago that we would still be not only doing QE but that we're actually doing MMT, modern monetary theory, which is, you know that that is one point that I'd like to make, because I hear people say well, they're doing QE. They're not doing QE, they are doing full blown MMT. And that's what's different versus 10 years ago. As you're aware. I think it was Dylan Grice you had on back a number of months ago. And he was saying, geez, you know, I really blew it back in early 2000 teens, because I saw this money being printed, and I thought it would be inflationary, and it was asset inflationary, but it didn't create CPI inflation. But this time is very different. Because not only is the Fed creating trillions of dollars of their magical money, but it's actually getting spent by the federal government. Federal government has spent $14 trillion since COVID started, which is about 1.2 billion every hour. It's a pretty sobering statistic, about 7 trillion of that 14 trillion has been deficit spending.

So and the Fed has bought a large degree of it. Now some of that is gone into mortgage backed securities. But I don't think it really matters. As long as the Fed is buying securities with fake money. It's, you know, it's really debt monetization. And that is, of course, the hallmark of MMT. And the proof that we're doing MMT is that Stephanie Kelton, who is one of the founders of the whole MMT School of Economics, if you can call it that, is very happy with what the Fed and the federal government's doing. And of course, we have another multi trillion dollar spending orgy coming up here with it's going to get downsized a little bit, but it's still going to be a shocking amount of money. The folks at Invesco say that the money supply, which has already increased by $5 trillion since COVID, is going to increase another 3 trillion. So it's a very inflationary set of circumstances that we have currently.

And it you know, I think, if you look at the history of MMT era. What you'll see is that you get this initial asset boom, because there's just so much money sloshing around. France did it back in the early 1700s. And they had a terrific stock market boom. And then of course, real inflation showed up. That's always the Achilles heel of MMT. Which even people like Stephanie Kelton admit. And they say, well, when it happens, you know, you can raise taxes. Okay, well, maybe we can raise taxes a little bit or the Fed can start tightening. And I think that's the real fallacy. I mean, the Fed's always telling us that they can tighten if necessary to control inflation. I think in this environment, their ability to tighten is almost nil. I mean, they have truly, you know, the old saying, they painted themselves into a very tight corner. in the Fed's case, they printed themselves into a very tight corner.

Erik: If you go back to so many smart people in let's say, you know, early 2000 teens, 2010-11-12 in there. Lots of smart people were saying, look, this thing has been driven by this rally has been driven by Central Bank largess, and there's no free lunch. And it's certain that a big crash is coming someday. I used to believe that very passionately. And boy, I've been wrong for a full decade. I've come around to a different view, which is yet the part of that story that was right, is this all comes to a very, very sad ending someday. But I think it is more likely to be an inflationary Great Depression where the direction is up, not down in nominal stock prices. Because what's happening is that inflating currency is causing people to flee to hard assets, like real estate and precious metals. But of course, the biggest asset class that you could escape

into would be the stock market. So I think it is a very, very big day of reckoning that's coming. But I don't think it's a crash. I think it's a melt up that sets off just unbearable inflation. Does that make sense?

David: Well, I would say yes. I actually think that you're onto something. If you look at the history of inflation in stocks, is that stocks struggle, at least most stocks struggle when you go from low inflation to rising to moderate inflation. Interestingly, we haven't seen that yet right? The stock market's up 23% this year, the S&P, even though inflation is clearly going from low to more moderate or high moderate. So that hasn't happened yet. Now, maybe it will. But it's interesting that If you use the 1970s as a template. The stock market did very poorly, but hard asset base stocks did extremely well. And I think that is the more likely performer over the next decade are those that are resource basically that are scarce, they own scarce assets.

And you know what is and that's one of the thing if you've ever heard Tony Deaton interviewed, brilliant man that Grant Williams, my great friend, Grant Williams has interviewed multiple times. And Tony Dean says invest in scarcity. Well, what's not scarce, certainly not treasuries which are being created out at an unbelievable clip or the US dollar that's not scarce. So I think you want to be invested in scarcity. And I think a lot of US stocks aren't scarce. I mean, with all the IPOs that are occurring, just the any going to quasi stocks with things like SPACs that are being created overnight. And so there's, I think it's a two tier market, basically. I think there's parts of the market that are absolutely nuts. And ironically, those are the parts that don't do well, with rising inflation. You know, these highly speculative securities, because rising interest rates, which comes along with inflation, tends to be very hard on high multiple securities. And it tends to be much friendlier on those value plays that also have scarce assets on the line, though.

So it's, I think you're right, though, I don't think we're gonna see, you know, the typical, you know, grinding, multi-year bear market. I think what we're looking at kind of these flash crashes when obviously, what happened back in March of 2000, was one of the greatest buying opportunities of all time, but it happened at about three weeks. And really, like one week, toward the very end of short, like between March 15, and March 23. That was really the grapevine window, you had to move fast. And I think that's what's going to be the next time we have a market problem, because I'm convinced. And by the way, one of the reasons that we went bullish back in March of last year was because the Fed did what I've been saying that they were going to do for several years, which most people thought it was crazy about, which was that they were going to target credit spreads. They would actually start buying corporate bonds to bring credit spreads down. And that's what turned the market back on March 23 of last year.

Well, this time, I would go so far as to say I believe in the next bear market, the Fed's gonna buy stocks. They will print money to buy stocks, which is another way of saying I think you're right. And I think because they can pull that off, that will again, rally the market. Interestingly, they didn't have to buy that many bonds. They only bought about $18 billion worth of bonds. Just the fact that they told the bond market, we've got your back, like kind of the same things gonna happen with the stock market. Once people say, hey, the Fed's buying stocks. We will buy stocks. So you know, if you get a 15-20% pullback. I think that's about it for the time being. Now

eventually, at some point, I mean, obviously, if inflation becomes too much of a problem, then every time the Fed says we're gonna print to do this, you know, that instead of being beneficial, it's counterproductive. And I think they're at that point in the bond market, but in the stock market, they could still have a huge impact.

Erik: David, you mentioned that quote from Paul Tudor Jones, who I'm sure most of our listeners know is an extremely famous futures trader. Legendary name in the industry. I was really surprised by a quote that I saw, I think, it was on Zero Hedge or someplace saying, Paul Tudor Jones supposedly said that in the next reckoning, that he thinks cryptocurrencies might do better than bonds as a safety asset. Boy, I was really surprised by that. I'm going to go out on a limb here and suggest that perhaps I might personally understand tokenized Secure Digital bearer assets, including cryptocurrencies a little better than Paul Tudor Jones does, but you know what, I'm a great big nobody in the world of finance, and he's a great big somebody. And when you get people like that, saying cryptocurrency is the future. It's gonna be awfully difficult for governments to outlaw it. So I'm really wondering, what's going to happen with this crypto craze? I think it's a craze more than a good idea. But it's taking on proportions much larger than I ever thought possible. What do you think?

David: Well, I'm right there with you. I mean, obviously, bitcoins got a market cap equivalent to Tesla. A trillion dollars for something that is just as kind of amorphous item and I'm not at all denigrating the blockchain technology, and that that's not going to be a big part of finance going forward. I think it will be and I think bitcoins a survivor. I think Ethereum is a survivor. So those things have. I do think there is I mean, obviously, there's this built in scarcity. So getting back to what I said about Tony Deaton. So bitcoins got that going for it. The problem is, I think the rest of the crypto universe or crypto space is very questionable in certainly in terms of scarcity. I mean, Dogecoin, which got up to a market cap of $80-$90 billion here this year. And it's just a joke, and the founder came out saying it is a joke. It's created an unlimited supply. A lot of these things have unlimited supply.

Plus, you can obviously come out with an I think there's something like a dozen different Dogecoins now. So that's the problem there and the other problem is Tether, which is something like half of all Bitcoin purchases occur using Tether. And Bloomberg Businessweek just had a cover story on Tether and basically, pretty much recapped, a newsletter that we put out back in the summer called untethered, that used a lot of the information that Grant Williams and George Noble and Bennett Tomlin came up and they've done tremendous forensic investigations along with a lot of governmental authorities of just what a con job Tether is.

I mean, if you haven't read that Bloomberg article, I'd recommend or email us and we'll send you our untethered EBA that we did. So to me, that's the concern is that at some point, if there's a blow up in the stable, so called stable coin, which I think is more like feeble Coin World. Then that could really spill over and if bitcoins extremely extended in price as it is right now. And it has had these multiple crashes in its history. But I think the remarkable thing about Bitcoin that tells you there's something there is the first asset class, if you call it that, which I think it is now. It wasn't at the time. But back in 2017, what got me writing my book called Bubble 3.0, was an

enormous bubble in Bitcoin in 2017. It was at that point, the biggest bubble of all time. Like all bubbles it crashed and went down 80%. But what I've never seen happen before is that it's gone up and not only made a new high, it's basically tripled from what was like an outrageous point, you know $20,000 back in late 2017. So there's something to that, that I greatly underestimated.

And I think that's kind of what he's picking up on. And I think the thing with bonds is, he's right, I mean, bonds are not performing their counter balancing function to an equity portfolio any longer. The 60/40 portfolio that was, you know, the champion for basically 40 years, I think is gone. I think that the 40% in bonds could actually be a risk enhancer, rather than a risk mitigator. Because if the problem is rising inflation on a secular basis, you're just gonna lose money and lose money, and lose money. And I think that's what frankly, has to happen. That's how the Fed or the federal government needs to deleverage is by keeping interest rates suppressed, and running inflation hot and they'll, you know, they'll try to understate it, which they're already doing. With the enter that if you want that. But I think right now, the Fed, for the most of the last 40 years, I think inflation numbers have been reasonably accurate. But I think in the last couple of years, in particular, they really started to diverge from reality.

So that's the problem with bonds and a rising inflation period. Look at the 1970s, bonds were that you're losing money on bonds is the same time they were losing money on stocks. You know, I personally believe we're going to a decade that is more similar to the 1970s. One of my colleagues on the Gavekal side, Anatole Kaletsky, who is extremely highly regarded in Europe, and he's been mostly right about the macro environment over the last dozen years, he's saying this is going to be the 1950s. And that these policies that we're following are actually going to be vindicated. They're the right thing, and we're gonna have low inflation and high growth. And I don't believe it, but we're running his overview as our guest newsletter this week. We try to show both sides of the argument.

Erik: You know, I think what you said about Tether is really important. I mean, it is just so obvious to me the Tether stable coin, they've supposedly got a bank account in the Bahamas, that seems very sketchy. The whole thing to anybody's looked at it in detail. It's just crazy. But you know what, if you look at the average Joe on the street, they're not listening to MacroVoices, they're not listening to you. You take somebody as famous, as infamous in the industry as Paul Tudor Jones. So there's a lot of other people that have been saying similar things. I can see very easily how you could get a trend going, where a lot of retail investors are saying, Boy, I should get rid of the 40% of my life savings that I've put into bonds, because all these guys are saying the bond market is crazy with what the government's doing. I should put it in something safe, like Tether. That's what I should do. And I mean, frankly, I shouldn't probably say this in the air. But I think that Mr. Tudor Jones should restrict his public comments to topics he understands, because although he is a far more accomplished futures trader than I'll ever be. I don't think he knows what the F he's talking about.

David: Well, he may be looking at charts and I think that's the only way to really trade effectively trade bitcoin is to use chart technical analysis and maybe extreme sentiment readings. So when you know people are in complete panic mode on Bitcoin. That's when you

step in and buy it. But I personally think and you know, I'm no crypto expert. I've got a great friend who is and my big fear is I've conveyed to him is I think you can have a blow up of these other cryptos you know, the 99% that are absolutely I'd call them to be a little profane, I call them shit coins. I'm not the first one to refer to him that way. And there's an enormous amount of leverage involved. And then you got all these, like Home Fable coins, the Tethers. To me, it just it's like the classic speculative asset class in very late stage bubbles. So I think there's going to be an enormous shakeout in that space. And when there is I think that's when you step up and buy Bitcoin or Etherium. Because I do think there is obviously persistent demand for these guys. There is a need and I think it's a direct function of these extremely dangerous central bank policies in the western world.

Erik: Well, I think that it goes beyond the the money printing. If you look at what's going on. Bitcoin really is a challenge to government issued money. It is an effort to create private label money to replace government money. And that dramatically undermines the government's authority in many ways. And what governments are doing is laughing at it saying, silly little children think that their silly little currency is going to replace the US dollar. Well, if they continue to ignore it, it really will. I mean, it is a better kind of money, they should have learned from it a long time ago, outlawed it and figured out how to incorporate it in government issued money. But they're not going to do that. And they're not apparently going to wise up to what's really going on here. If it continues much longer, it will reach a point of no return where even though it didn't make sense, it will be impossible to stop it.

David: I do think central banks in the west or in China as well are going to try to come up with some kind of digital coin of their own. How successful that will be? I don't know. I mean, obviously, it doesn't appeal to the people that feel like they're, they're outside of the fiat or governmental controlled ecosystem. So I think that's going to be a big hurdle that they have to deal with. And Tronic popularized. I mean, they can come out with them, but can they actually make it popular is a whole another story. So I don't know but I do think that it's here to stay. But I also think you're just gonna have enormous volatility, you already have it. I mean, I'm not I'm just I guess to be like George Soros. I'm not predicting, I'm just observing. There's just going to be because there's really, there's just such a psychological element of these things. You're not getting earnings, you're not getting dividends. So the price is whatever the speculative profits honored to be given time.

Erik: Let's move on to cryptocurrencies competitor, which is gold. The historical scarcity asset that you use it as an inflation hedge. Boy, the inflation that was predicted by the gold bugs happened, but the big run up in gold prices predicted by the gold bugs hasn't really happened yet. We're just as we're speaking, on Tuesday, I'm looking at what might be another false breakout above the 100, 200-day moving average, which are both co-located in the $1,790s. We had a couple of daily closes above, but it looks like as we're trading right now, we're back down below those key resistance levels. Where's this all headed?

David: Well, I think gold is going higher, probably a lot higher, but it's not going to be you know, like a straight shot, it's going to be the typical up sharply heart correction when their

sentiment gets too bullish. And, you know, just this back and forth, but you know, jaggedly, higher, but obviously, last year, they had an enormous move in gold and silver, particularly the miners, and I do think that is the better way to play. I mean, I'm not saying you shouldn't have some actual physical gold and silver. But the miners just like with energy, it gives you a lot more bang for your buck plus you get dividends. And these mining stocks are very cheap, and they're generating a lot of free cash flow. They're also buying their own share.

So, you know, that was such a near death experience with the mining stocks and with the energy stocks that these management teams, the guys that were the perma-bulls are all been kicked out once they're in there now or very careful stewards of shareholder capital, which is a good thing. So I think that's the way to play it. And they did have spectacular moves last year, we did a lot of profit taking during that. But at this point, I think the gold miners are back in accumulation mode. And I just think there's so much upward pressure that if you look at foreign central banks, not the US but foreign central banks, almost every single one of them is an aggressive accumulator of gold. And they're not aggressive accumulators of treasuries. Basically, foreign central banks have quit buying treasuries. So they're buying gold. They're not buying treasuries, and I think they're on the right track.

Erik: David, I want to move on to something that we've talked to your friend Louis Gave about in the past, which is Gavekal, which is an institutional research firm tends to break the economy down into quadrants. I know that you guys use that at Evergreen Gavekal as well. First of all explain what are these quadrants? What are they? What do they mean? What does it have to do with anything and how does that fit into your investment process?

David: Well, there believe is at any one time the global economy is in either in one of the four different categories. One is a deflationary or disinflationary boom, a deflationary-disinflationary bust, an inflationary boom, or an inflationary bust? And obviously, right now, it's the question is, which is from the inflationary standpoint, are we in a deflationary boom or inflationary bust? Interestingly, Erik, if you look at Google searches for stagflation, which would be the inflationary bust. The searches have gone ballistic in recent months whereas inflation searches have gone way down. So it would tell you that and you're starting to see this including with energy, where you're getting some experts to say that because energy prices have gone up so much, we're going to have a recession next year. So again, that would be an inflationary bust kind of scenario, similar to what happened in the 1970s. That I think is the big question of the next 12 to 24 months. Which of those two quadrants is the global economy in?

At this point, I put myself in the inflationary boom category, but this isn't as high conviction as some of my other calls. And the reason I believe that I think this is a lot like after World War Two, where the economy was basically shut down, at least, the private sector economy is all focused on the war effort. And US consumers built up a tremendous amount of saving. Coming out of World War Two, a lot of people thought, Oh, we're gonna have just like some people are saying today a nasty recession. And for the reasons of all those soldiers coming back with no jobs, and because the government was going to be buying aircraft and aircraft carriers, and so forth. And instead, we had a fantastic post war boom, but with quite a bit of inflation, Inflation

was running in double digits for a while in the late 1940s. And what that allowed to do kind of back to one of our major themes of this call as podcasts is. It allowed the government to drastically deleverage from 1945 to 1952. By 1954, we had the debt-to-GDP down to about 70%. It had been about 120%, at the end of World War Two and that's what I think what we're gonna see happen again.

Both of, you know, fairly rapid economic growth, because we have $2.3 trillion of excess savings that consumers are sitting on. That they accumulated, because of all the excess of government stimulus and the inability to spend, you look at what's going on with the auto industry right now. I mean, it's in a nasty recession. And at some point, we're going to get cars again, and people are going to buy cars again. So I do think that we're going to have a year to two very good economic growth, but with a lot of inflation. And interestingly too Erik, that, if you look at...

Erik:
Wait a minute. Back up a second, maybe I misheard. But did you just say you're expecting government deleveraging. You're saying that we're going to get responsible and pay down our debts?

David: Well, I wouldn't say responsible this is a stealth form of default is high inflation, right? But it's already happening. It's already working.

Erik: Yeah. Okay. So you're saying de leveraging, not by paying any debt down, but by inflating to the point that that debt loses purchasing power?

David: Yeah, God, God forbid, we would pay any debt down with real money.

Erik: It really sounded like you were saying that for a minute there.

David: No, but if you look at what's happened to the debt-to-GDP over the last year, it's gone from 135% to 125%. So it's already happening. Now, there's no free lunch. Who loses in this? Well just like who lost in the tremendous deleveraging the US actually lasted from 1945 to 1980, where we brought the debt-to-GDP down from about 120%, down to around 25% at the end of the 1970s. The stagflationary 70s actually did the trick and turn that's what allowed Volcker to be able to really crank up interest rates to 20%. So I know Luke Roman believes that once we get debt down to more like 60-70%, then finally the Fed can allow interest rates to go to something that's, you know, actually, you know, truly a real yield. But you know, right now, I mean, the Fed would have to raise rates 40-, 500, or 600 basis points to get anything close to a real yield. And that ain't gonna happen.

Erik: David, we've been talking about inflation. But I think it's really important to break that out. Are we talking about just prices? Is it ever going to be wage inflation, where people actually get paid more that they can pay these new prices? And what's going to be the interplay between

those because, you know, there's different kinds of inflation whether it's wage driven or cost driven, and so forth. How is this going to play out?

David: Well, it's interesting to look at how it's playing out already, and looking at what's occurring, and just kind of following the trend. And obviously, there's a lot of wage inflation. What's interesting is it's the wage inflation is apparent everywhere except in the official data. And by that, I mean, if you look at like the Atlanta Fed's tracker, it's, you know, it's looking at 3 to 4. If that you look at the real world. And it's just unbelievable. I mean, just one anecdote is there are nurses in the Seattle area that are getting paid $200,000 to $250,000 a year. And that's what happens when you have extreme shortages of essential workers. You start to get some unbelievable pay increases. I mean, you're seeing it all over the place in terms of union militancy, which is back. It's back both in the United States and Europe. Strikes are happening and wage settlements are pretty amazingly high.

And you look at what Amazon is doing and all the inducements that they're offering to hire another 125,000 workers. I heard John Mackey, the founder of Whole Foods, still the CEO of Whole Foods, and he said they have 125,000 employees, and they need 15,000 more employees. They got 15,000 job openings everywhere you go it's help wanted. And I think that's one of the real fallacies of the inflation is transitory, transitory narrative is that wages are very sticky. And there's a lot of upward pressure on wages, which I think is not fully played out. The other thing that hasn't fully played out is rents. Rents have been indicating very low inflation until lately, and the Fed's owner equivalent rent is really kind of a bogus thing. But regardless, rents are now starting to really kick in. So I think the Fed is going to have a problem, what I call the REW problem EEW of rents, energy, and wages as we go into 2022. And I think they're gonna REW all the times they told us that was temporary inflation. So I think that's a big big deal and a big big change.

Erik: Well, David, I can't thank you enough. For a terrific interview, but before I let you go, I want to talk a little bit about what you do at Evergreen Gavekal. You know, when we used to have Louis Gave on. The feedback, we always got the institutional audience loved him. But the complaint we got from our retail audience was, hey, I want to subscribe and it's only priced for institutions, I can't get it. Now, it sounds like the way Gavekal has solved that problem is to merge or acquire I'm not sure what the relationship is or partner with your firm to essentially be their retail end. Does that give people access to Gavekal's institutional research or some watered down version of it, or what's the product on offer there?

David: Well, that's great, great questions, a series of questions there. And we are partnered, we're not owned, certainly not fully owned. We have a minority ownership with Louis himself. And we do offer some of the Gavekal research. So it's a limited or as you would say, a watered down version. But we also do a weekly newsletter. So once a month, sometimes twice a month, we actually published Gavekal research. The rest of it is either something that I've written or we use guest sources. You know, like Luke Roman, or Grant Williams. You know, some of the really some of the brightest minds out there, we will run as a guest issue. And people can't complain about the price because it's free. So somebody really wants to get at least partial

access to Gavekal. See what I'm thinking, what our firm is thinking. You can subscribe to our Evergreen virtual advisor, Eva, is that what it is for short, and I'm also publishing some of the chapters of bubble 3.0, my new book in that, because I really do believe like, I think you do that this is the third bubble of the last 25 years. So that's a really good way to connect with us. And we obviously manage money for individuals. That's really our main thing. We're one of the few people that still does research. We are definitely not part of the passive investing herd these days. I think it's a great opportunity to actually think and do things differently. So that's a little quick overview of Evergreen.

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