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with hedge fund manager Erik Townsend

Lyn Alden: Revisiting Inflation/Deflation Signals

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Erik: Joining me now is Lyn Alden, founder of [Lyn Alden Investment Strategy](#). Lyn prepared a terrific slide deck to accompany today's interview. Registered users will find the download link in your research roundup email. If you don't have a research roundup email, it means you haven't registered yet at [macrovoices.com](#). Just go to our homepage, [macrovoices.com](#), click the red button that says looking for the downloads.

Lyn, I have really been looking forward to getting you on the show because, frankly, one of the biggest names that's come up in reaction to Jeff Snyder's interview last week was yours and a lot of people saying, hey, wait a minute, Jeff is really telling us a story that banks heavily on the idea that the bond market is a really solid source of information. And of course, a lot of people are saying wait a minute, if the Fed owns 30% of the 30-year Treasury issuance, or whatever the statistic is, I've lost track of it. It's kind of hard to believe that there could really be efficient price discovery in that market. So what did you think of Jeff's interview overall? And in general, this discussion about secular inflation. Which side of the debate are you on and particularly what do you think about the value of the bond market as a predictive signal?

Lyn: Well, thanks for having me on, Erik. Always happy to be here, big fan of your podcast. And you know, when it comes to Jeff's work and I have a lot of respect for areas that he covers. And one of the things we agreed to touch on was, you know, some of the things right, I view differently than his discussion on your podcast. So the areas that I would have viewed differently is that I am more in the inflationist camp and had been for the past couple years. And I don't view bond markets as being a particularly reliable signal about forward inflation expectations overall. And I think history bears that out. So I'm happy to go over a couple of the, you know, the slides that I brought here to kind of cover those points, but that kind of sets out, you know, that the areas that I that I view things differently on. And so if you look at, for example, you know, kind of set the stage, the first slide deck, we can see kind of the long term, century long fiscal monetary policy that we're working through, right.

So, as the chart shows, I think, you know, the 1940s are an interesting comparison. Obviously, they don't cover every aspect of it. But in terms of fiscal monetary policy, I think that that's the closest period that we have. And so you had Jeff discuss that period. So I think that was, you know, that's a period I like to focus on too. And so I think that's worth exploring in more detail. So as we saw, you know, everybody, when they think about inflationary decades, they think

about the 70s. But as we can see from these charts, the 70s are actually quite different. So the chart on the left there shows debt as a percentage of GDP, and I break it into federal debt versus non-federal debt, and non-federal debts, mostly private debt, you know, companies and households, a little bit of state debt in there as well, such as all the debt that's non monetary sovereign. And then you have federal debt, which is a pretty different beast. And we saw that, you know, private debt peaked in the early 1930s. And then again, in the 2008 and 2009 period, and those are associated with major, you know, deflationary banking crises.

And then what you have is, you know, the echo from that, you know, a decade later, is that you had basically periods of stagnation, and then some sort of external catalysts that resulted in a lot of debt building up on the public sector. And that tended to be more inflationary. And when we look at the chart on the right there, we can see that, you know, basically, short term interest rates go to zero during this banking crisis for the first time in decades, combined with the monetary base going up. And so that tends to be somewhat of a not particularly inflationary period. But when you go later into that you have massive fiscal deficit spending. At a time when interest rates are super low, and the Federal Reserve's monetizing it, that's when you're more prone to get that inflationary type of environment. So I think the biggest difference between this the 40s, and 70s, is that in the 70s, because debt was low, they were able to raise rates to rein in inflation, which was in large part driven by bank lending, whereas 1940s, they were unable to raise interest rates, because debt was so high, and inflation was coming from fiscal spending, rather than bank lending anyway. So it's unclear that raising rates would have even helped. And so basically, you had a big disconnect between rates and inflation. So on the second slide there, I showed this, I show basically, you know, the on both those charts, the blue line is the year of your CPI. So you can see that both the 40s and the 70s, on average had pretty high inflation. And the big difference was that in the 70s, interest rates generally kept up with inflation more or less, whereas in the 40s, you had a complete disconnect between inflation and rates because you had a period of financial repression. And I would contend that the 2020s are shaping up, at least in this regard to be more like the 40s we're gonna probably see ongoing disconnects between inflation and bond yields.

Erik: I think that's a really important point, Lyn because so many people are saying, oh, boy, inflation, we got to think 1970s. What lessons did the 1970s teach us. You're making the argument that the 1940s are the better place to look? I'm sure you've taken the next step, which is okay, what do the 1940s teach us? And what should we be learning about what might be happening next? Because I think it is a very similar financial repression. Can't really respond to the way we did in the 70s with increasing interest rates, because there's no room to do that with the amount of debt that exists. So what should we expect and what are the lessons from the 1940s that apply to the current environment?

Lyn: Well, I think I think overall, basically, you have to consider this to be an era of wartime finance. So in the 40s, you had actual war, whereas in the 2020s, obviously, it's a different type of war. But we've had, you know, for example, Biden as referred to it as wartime finance, right. So it's a similar type of, of being classified as an emergency response. And it's a large part, you know, you had the pandemic and the lock downs, obviously, but that, you know, the bigger

issue is that a system that was already very highly levered, and it was towards the end of this long term debt cycle as the prior chart showed. And so that's kind of the emergency of having a highly levered system, they can absorb shocks, that has kind of been optimized for efficiency over resilience over the past 25 years, and then being hit by that type of external shock anyway, which sets up a larger than expected problem.

And so the similarities between now in the 40s are that debt is super high. And so they're unable to meaningfully raise rates, despite inflation. And then two, you know, you have that kind of rising populism that kind of, you know, support that type of fiscal spending. And so I think that that's the biggest comparison, so that really the fiscal monetary policies were similar. Now, there are some differences. So for example, back in the 1940s, the United States was a trade surplus nation and a net creditor, right. So we were kind of the emerging market of the day kind of rising power over as now, we're a structural trade deficit nation. So in some ways, we look more like the UK of the 1940s, and the United States in the 1940s. And then, you know, two you obviously, have different demographic trends, and different technology environments, and also equities, and real estate are going into this decade at higher valuations. So the equity performance of the 40s, maybe less instructive, so there are certainly differences. But it's really the era of the inflation of monetary policy and fiscal policy that I think is the most instructive for this period.

Erik: Lyn, tell me more about the details of what happened in the 40s with respect to inflation, and particularly Jeff made that point of, hey, you've got to look at whether consumer prices are increasing because of monetary inflation, or because of, you know, some short term factor in supply chains. Is that instructive? And what can we learn from the 40s? Because obviously, in the 1940s, with the war going on, you know, you had disruptions to supply chains then to so it seems like there's a lot of comparison there. What do we learn from the 40s and particularly with respect to inflation. What does it mean?

Lyn: So slide deck three covers some of the details of inflation of the 1940s. And that's an area where I view it differently than Jeff. So on one hand, you did have supply chain issues, right? I mean, you basically, you dramatically increase the money supply, with all this fiscal spending. And basically, there's a global demand for commodities and labor, because you needed every resource you could get during the war period. And you had, of course, real world constraints on how fast you could produce those things. You had periods and waves of price controls, and you had a rather inflationary period. But it was more often on then the 70s. So rather than kind of persist inflation, you had these big spikes, and you had cool off periods. You know, the part that I would disagree with Jeff on is that he talked about how this was, you know, supply shock driven and prices went back down. But we look at the numbers, that's not really the case. And so on the left there, I show basically year-over-year CPI right. So that's where you, you know, I believe he showed a similar chart that we have, you can see that the rate of change of inflation very dramatically, you'd have these big spikes of inflation, and then it would go away, even at minor deflationary periods.

But the chart on the right shows CPI in absolute terms. And what we see over the course of the decade is the prices went up 80 to 90%. and then permanently stayed there. And so basically, every time you got a big inflationary spike, instead of giving that all back, when the supply chain abated, it would just kind of go into a plateau for a period of time, but you'd have another leg up in prices. And so basically, if it was purely supply, shock driven, like let's say, a copper mine gets flooded, or a gas line breaks, for example, and there's a disturbance in some sort of commodity. You know, that's the type of supply shock that when all is said and done, you call back those price gains. And you go back to kind of what the environment was before that happened whenever that's resolved. Whereas if you have an environment like the 40s, where money supply goes up dramatically, and you basically have these periods of running its supply shocks. When that supply shock goes away. It's not that prices, you know, they don't keep going up at the same rate that they were going up before, but they generally on average, remain at that much elevated level. So by any measure, you look at it, the 1940s were incredibly inflationary. So you had depending on what measure what specific time period to look at, you had 5 to 6% average CPI growth, you had rapid money supply growth, and those prices on aggregate were permanent. You basically, you lost purchasing power if you held bonds or cash during those periods.

Erik: Now I see a major difference though, which is before World War One, we had a formal gold standard. And of course, after World War One, we had the Bretton Woods system, which was kind of a pseudo gold standard. But the point is, there was not an ability for the central bank, to use quantitative easing to just increase its reserves. And as some people call it, print money. The game has changed. And I would say that you mentioned earlier populism, I think MMT is gaining a lot of traction in political circles, it seems that, to me, maybe there's going to be a government sentiment toward responding to inflation, doing something that you and I might think it's kind of counterintuitive, which is literally making more money using more stimulus to basically bail the low income earners out of the inflation trap that they've been stuck with, and use that to kind of just keep the party going and keep the inflation going. Because they need to inflate away all of that national debt. Does that make sense? Am I right to be concerned that that's the way it could go cause I don't think most people are planning that possibility.

Lyn: Yeah, I mean, in short, I think that the Fed is not going to tighten as much as people would expect, given the inflationary backdrop. I don't think it'd be like the 70s, where they're constantly trying to fight it. Now, I think that in rate of change terms, they go through periods of tightening, right, so when there's excess reserves in the system and we're there's no kind of new fiscal package on the table at the moment, I think they can try to reduce their rate of asset purchases. If they get far enough, they could potentially throw some 25 basis point hikes in there. But I think they're essentially going to be structurally behind the curve. And I think that this decade is more along the lines of these large fiscal spending packages. And if you look at the 40s, it's interesting. Of course, they didn't have the term quantitative easing back then. But they still had the capacity to do essentially what that was under a different name.

And so during the 1940s, the Federal Reserve increased their holdings of Treasury securities by about tenfold. And specifically, that all happened between 1942 and 1945. They basically, you

know, they had to buy a large amount of treasuries in order to maintain their yield curve control peg. But in addition, they also mobilized the banking sector. So the commercial banks became very, very large buyers of Treasury securities, so that you kind of had a period of financial repression in multiple ways. You mobilize every resource you could to get those bonds financed. So the public were encouraged to hold bonds, banks were encouraged to hold bonds. And then the Fed also did dramatically increase their balance sheet, in what today, we would call QE. So even though they had the gold standard, they essentially ignored the gold standard. And it was still, you know, for a period of time maintainable that didn't get marked to market until 1971. But if you looked at say the money supply going up quite a bit, it became increasingly untethered from that gold backing.

Erik: Moving on to page four, you're showing us bonds and inflation. Tell us your understanding of the relationship between bond yields and inflation. Does one predict the other? How does this work?

Lyn: So I think in the tactical sense, bonds have informational value about inflation, but especially during periods of financial repression, they're not always very clear signals. And the chart on the left here shows in blue that's simply the 10-year Treasury rate over time on an annual basis, and it goes all the way back to the 1800s. And so that's the, you know, the expected forward return you get from holding that bond to maturity. And then the orange line shows what actually happened with those bonds on an inflation adjusted basis, if you bought those bonds that year, and held them to maturity over the next 10 years, 10-year treasuries. And what we see is that the three inflationary decades of the 1910s, the 1940s, and the 1970s, you got absolutely killed in real terms if you bought and held a 10 year treasury to maturity. So you get as low as, you know, negative 5% compounded annualised returns, which over the course of a decade is like losing 40% of your purchasing power.

And so, you know, the bond market, it is smart money in a tactical sense, right? Because it's not, you know, it's largely institutional driven. And it pays attention to these shifting patterns in GDP growth and kind of, you know, acceleration or deceleration. But it still gets absolutely blindsided for one reason or another, whether it's because they were actually blindsided, or because they saw it coming, but we're financial repressed. And so all these periods of actual major inflation, the bond market did get caught off guard and did lose a ton of value. And as we see that, you know, the bond market in real terms did just about as bad in the 40s, as it did in the 70s. In fact, T-bills did far worse in the 40s than they did in the 70s. And the chart on the right shows, again, we have, you know, much like the 40s. You know, so far at least, we have a big disconnect here in the 2020s between what inflation is doing and what bond yields are doing.

And my contention is that it won't be a straight line, just like the 40s and the 70s were not a straight line in terms of their inflationary potential. But, you know, I think basically you're gonna see a big disconnect, where it'll vary over time, but that bond yields will fail to fully account for the inflation that we're seeing, and they might show up in rate a change terms, right? So they can predict these periods of contractions or expansions. You could have fiscal roadblocks, you

could have rising virus case counts, lockdown patterns. You could have things like that, that change the acceleration or deceleration of inflation. But I think overall, when we look back on this decade, there'll be one that's kind of marked by these inflationary events that bond yield just, you know, basically got blindsided by and did not pay an interest yield that actually compensated for that level of inflation.

Erik: Lyn, how do you see this playing out when we get into this, what I call it interest rate trap. We're going to have a situation where inflation is eventually going to dictate that at least under normal monetary policy, you ought to raise rates, but it'll be raising rates in an environment where it's nearly impossible to do so. What do you think the resolution to that quandary is going to be?

Lyn: So I think there are a couple resolutions. I think that the phase we're in now is jawboning, where you basically have create a narrative of plausible deniability, right? So you can't just say, look, inflation is running hot, and we're just gonna let that happen. We can't do anything sorry. That's too high. We have to monetize it, that's not what you do. Instead, you basically keep the debate alive. Like right now, for example, there are inflationists, there are deflationists, there's this active debate about what's inflation going to be and that that maintains a degree of plausible deniability. So the bond market can say, look, if inflation gets hard enough, the Fed will probably try to fight it and there are other people pointing out that, you know, they realistically can't do that.

And so I think the pattern in the near term and probably, you know, extending out a few more years, is you keep pointing to the supply as you try to make it look entirely like a supply issue. And you say, oh, if it wasn't for these like one time unique events, we wouldn't have this high inflation. And you basically try to disconnect it from your own policy choices, either fiscal policy or monetary policy. And you try to push that on to these external factors and they kind of wash your hands off. And so every, you know, every major inflationary period, pretty much, by definition has some sort of real world constraints or bottlenecks. That's what inflation is, essentially, you have an increase in the money supply, and then some sort of constraint that prevents you from just creating a limited goods and services.

So in the 1910s and the 40s, you had these war decades where you had, you know, big surges in commodity and labor needs. In the 70s, you know, you went off the gold standard. So you had a monetary issue. again, you had a big increase in the money supply. But then you also had, say, US oil production peaked in 1970. So you became more reliant on, you know, foreign imports, you know, the kindness of strangers, essentially. And so you had these real world constraints again. So basically, every time you get a mixture of money supply going up quite a bit. And then commodities being tight for one reason or another, you're bound to get more price increases. And so I think that the pattern is essentially to divert attention to the supply side, and then let the market debate it for years while inflation runs hot over bond yields and only in hindsight, do then you look back and say, wow, we really got devalued over the course of this decade.

Erik: Let's move on to page five, where you're showing broad money versus the consumer price index. Let's talk about what money supply growth historically has done and how it relates to inflation.

Lyn: Yes, it's a complicated measurement, because there are different ways to measure money supply. And there are different ways to measure inflation. But what this chart shows, you know, I try to factor out in this chart the annual noise, because one year changes don't necessarily tell us a lot. Sometimes you get a spike in money supply, and it takes a year or two for price increases drop, for example. So what this does, the chart on the left there shows five year cumulative broad money supply growth, that's M2 and five year cumulative CPI growth, you know, basically these rolling five year periods to look for these kinds of sustained growth in prices of money supply. And what we see is generally there's a correlation between money supply, growth, and inflation. I would describe it as that money supply growth is a necessary but not sufficient condition. For prices going up. Generally, you need money supply growth, and then some sort of physical constraints. So for example, in the late 1800s, when you had Industrial Revolution combined with a lot of land, cheap land, you had a pretty big disconnect between money supply growth and inflation.

You had a similar one in the, you know, the 90s and the 2000s, basically, last 25 years, because you had globalization. You had a labor arbitrage, a disconnect between productivity and wages. So those periods saw basically less inflation than you'd expect from money supply growth. But if you look at the 1910s, the 1940s, and the 1970s, that's we had this really strong correlation between money supply growth and inflation, because you also had these constraints that kind of push that to happen. And the chart on the left, that goes back to just a year over year chart, but what it tries to do is it shows the source of the money supply growth because it's really, in our fiat currency system. There are two ways to create Money in some sense. So the classic way is loan growth. Banks lend money into existence. And so if you look at, for example, the late 1800s, you see that, you know, deficits were not a big part of the money supply growth, and that the money supply growth and year over year bank lending growth are pretty much the same number. All that money supply growth was actual bank lending.

And we also saw the 1970s, that a lot of the money supply growth that we saw during that time was actual bank lending. And then as you got deeper into that decade, you also had fiscal deficits, kind of adding fuel to the fire there. But it was really a bank lending driven money supply growth period. And the differences that we saw in the 1910s and 1940s. And now in the 2020s, is that you see a large fiscal stimulus. And that's what drives the money supply growth, rather than bank lending. So that's where that's where I would agree with Jeff, for example, that the 40s and the 70s are structurally different on where the inflation is coming from. You know, the monetary inflation and the price inflation, you know, they're coming for different reasons. But at the end of the day, it's still the same result of money supply going up quite a bit. And prices going up quite a bit and then structurally staying there forever.

Erik: Well, I think that the fiscal spending aspect of this is really important, then, because a lot of people would say, look, quantitative easing is not growing the broad money supply, which

you're showing here, it's only the narrow money, the base money, the money that really matters is the larger broader money supply that has to be loaned into existence by the commercial banking system. You're making the point that saying, wait a minute, commercial banking system is one way but fiscal stimulus is just as effective at growing not just bank reserves the way quantitative easing did, but the broader money supply? Well, that seems to me like that's inflationary. And boy, if you analyze the political climate, I think there's a lot of willingness to do a whole lot more fiscal stimulus in years ahead. So what does that mean in terms of what we should expect?

Lyn: Well, so for all that should be inflationary, especially if it's not combined with reductions in debt. And so we see if you look at a chart on the right, again, if you look at the 1930s, you saw an uptick in fiscal spending, right? So the orange line went up. But it was still very deflationary decade or disinflationary decade, because loan growth collapse so much, because you had so much loan defaults. And so even though deficits went up, it was more than offset by that reduction in bank lending. And so you actually got a contraction of money supply in the 1930s. And then similarly, when you had the 2008-2009 crisis, we saw these large fiscal deficits, but it was offset by an equal amount of loan destruction. And so if you looked at money supply over the course of the global financial crisis, it was virtually unchanged, like compared to its prior pattern, you just continually kept going up slowly. And it wasn't very notable. And what characterize 2020 and 2021, was that we, you know, we didn't have much bank lending, but we didn't have a destruction in bank lending either. And then we got these massive fiscal stimulus efforts and that that's what added money to the money supply.

So QE alone, just increases bank reserves and basically has implications for the for the financial system. But it's the combination of that with these fiscal stimulus. So whether it's doing massive infrastructure spending, or it's handing money to people, or it's cutting taxes, without cutting spending, there's multiple ways to do it. But by getting money out into the system, that increases people's actual broad money. So their checking accounts, their savings accounts, the currency circulation, that goes up substantially, while the number of goods and services runs into some sort of constraint. And so basically, that's what I would argue, is fueling the inflation. And so, you know, my base case is that we're going to have structural deficits over the course of 2020s that are going to largely be monetized, and that they're not going to be very effective at fighting inflation.

Now, the caveat is that I don't think we're going to go in a straight line. And so for example, I can see a scenario where in say, late 2022, you get an election result, you have more gridlock in Congress, we already see some gridlock in the Senate. Right. So if you get more gridlock in the Senate, you could certainly go a couple years with more limited fiscal spending. And so I think that, you know, there will be periods of time in the 2020s decade, where the inflationist will look like they're really correct, like right now for example, and I think there will be other periods where the transitory inflation is looked like they're correct. The deflationists, the ones that say, this is not real inflation. You know, I think there'll be periods of time where fiscal spending cools off, and CPI levels out for a period of time and it looks like things are stabilizing. And I think the aggregate when you look back probably over at the end of this decade, look back over the

2020s I think we're gonna have called it an inflationary decade. I think it'll look like the 40s in the sense that you'll get these bursts of inflation that are not offset by increasing yields. And so basically, people holding bonds and cash will get devalued, whereas people have that have more hard asset exposure, fortunately preserve their purchasing power better.

Erik: Moving on to slide six, you're showing a comparison of inflation in different countries. Where is the relevance of the national perspective come into this?

Lyn: So one thing I try to show is that it's not just a one country phenomenon. I mean, this story is essentially similar for much of the developed world. Now, there are differences, right? So there are, you know, some countries have structural trade surpluses, some of them have structural trade deficit, some of them are running bigger deficits and others relative to their GDP. And so, on the prior couple slides, we showed the United States, you know, five year cumulative broad money supply growth compared to CPI growth. And this one just shows a similar chart for the UK, Japan, Australia, to give sort of a global perspective, because if anything, other countries have had tighter correlation between M2 and CPI than the United States, because the United States have been somewhat unique over the past 150 years, in the sense that, you know, we're the ones that had unlimited land in the late 1800s. And were the ones that globalized more basically ran, you know, structural trade deficits more over the past 25 years. So we see that, you know, the United Kingdom there, the five year cumulative money supply growth and CPI growth are very, very similar charts. You know, you kind of had one following the other. Japan also shows a similar outcome. And we also see that, you know, basically the hyperinflations, during the war years.

And generally, when you have a period where there's a big disconnect between money supply growth, and inflation, you generally get radical productivity. Basically some sort of technological shift, or something allowed that to happen. And so in the United States in the late 1800s, and the 2000s, that was because of globalization and unlimited land. Whereas, for example, on the Japan chart, we see that after World War Two, they entered this period of dramatic productivity where you had inflation come back down, while money supply growth remained very high. And essentially, what that was, was they were organizing society in such a productive way that they, you know, basically pull themselves out of that catastrophe. And then Australia over there shows again, much like the UK, there's a lot of correlation between their money supply growth and their CPI over any given five year rolling period, their biggest disconnect was over the past 20 years, where they had pretty rapid money supply growth, but not really CPI growth. And that can be largely attributed to their connection with China and more broadly, emerging Asia basically you had this huge commodity demand out of Asia, and Australia's geographic positioning. And of course their commodity positioning allowed for very strong ties.

And so they went kind of record period of time, without a recession, you know, they had this huge bubble build up in their housing market from foreign demand for their housing. And so Australia had this kind of period of pretty high productivity, where we managed to have a big disconnect between money supply growth and CPI. So generally, I would say that when you're looking for price increases, you're looking for two things, you're looking for money supply

growth, and then you're also trying to judge the measure of real world constraints. And so you know, that's generally commodity constraints. But it also can be all sorts of infrastructure and supply chains. I think a final point with this slide deck is if you look at Japan, people always wonder, why doesn't Japan have inflation, given the fact that their central bank is kind of the loose cannon of all the central banks are the ones that own more than 100%, you know, their balance sheet is more than 100% the size of their GDP. And what we see there is that actually, Japan is at very, very low money supply growth, broad money supply growth over the past 25 years. You know, despite the fact that their bank reserves went vertical parabolic, their money supply didn't. And that's because even though they increase their public debt dramatically, and they ran these kind of average 5% fiscal deficits that they monetized, they dramatically reduce their corporate debt. And so they were destroying, they're basically reducing private loans at maybe a rate of, say, 3% a year, while they're running fiscal deficits of like, 5% a year. And so the net result was somewhere around the lines of 2% annual money supply growth, which is very low. And so that's in large part why they did not have high inflation, because again, it is a different routine, looking at money supply growth versus simply bank reserves.

Erik: Lyn you and I both know that energy is a critical factor in understanding any inflation picture. And it occurs to me that this inflation that's beginning now is coming kind of at the end of the age of oil, you know that we're not done with fossil fuels yet, but the world's pretty much decided that we're going to move to electric vehicles. And unfortunately, what's happened is that means that it's become unfashionable to invest in any more oil production in discovery of new resources. How is the final chapter of the age of oil going to end? Is it a question of oil losing value because nobody needs it anymore? Or is it more likely to be the case as I think that what we're going to end up with is kind of abandoning new investment before we're really done relying on oil to the point where we get an oil price shock in the last few years of the age of oil. How do you look at this? And what do you make of energy? And how does page seven fit into the story?

Lyn: So over the course of the 2020 decade, I have a bullish view on energy. Now I have less of a view on any given six month period, I don't follow it, maybe week by week to the level that you do. And you know, basically, that can depend on OPEC decisions that can depend on shifting rates of demand growth, you know, basically on the margins. And so there's all sorts of things that can happen over a given 6 to 12 month period. But I do think structurally, we are setting up another bull market in energy. And, you know, one thing I think, is that I think the death of oil and gas is somewhat overblown. So the chart on the right there just shows global energy consumption by source. And what we generally see is that, when we find a new energy source, we add on to the prior one. And we don't really stop using the prior one, the prior one just becomes a lower percentage of our total energy. And so when we found coal, we still burn wood, we just kind of stopped increasing our wood burning, then we found oil, we you know, we slowed down our coal consumption. We started using oil, but we didn't eliminate coal. And same thing with natural gas, nuclear, and then some of these newer ones like wind and solar.

And it's also important to think on the on the global scale. And so for example, one country can certainly reduce their energy uses of a certain type of energy. So for example, the United States

can cut down its coal usage as an example, or Germany can cut down its nuclear energy. But you know, that generally shows up somewhere else. And so for example, while the developed world has trimmed its coal burning, we've seen Asia continue to rise up in terms of its coal burning, because that's the energy source that they have available to them in their region. We've also kind of shifted some of the most energy intensive manufacturing, out of developed markets and into emerging markets. And so we've kind of just shifted the balance sheet of where that energy consumption is taking place. And it makes it look like developed markets kind of constrain their energy usage more, but it's not really true when you consider the full supply chain implications.

So overall, I think the age of oil and gas is still gonna be around for a while, even if the growth rate overall is slower, you know, maybe even just, you know, zero for a long period of time. And that, when we look at the supply side, as you mentioned, when there's lack of interest in investing in it, I think that's where you set up supply shocks and price increases. And so there's a combination of that. So one is the rise in shale oil over the past decade, you know, basically the 2010s can be characterized as a commodity abundant decade. We had this slowing growth of all the BRIC nations, China and the other emerging markets, combined with, you know, all this non profitable shale oil. You know, most of that was not free cash flow positive for the companies, they were very reliant on issuing equity and debt in order to finance all of that. And so we created this period of commodity abundance, but that's been gradually tightening. I mean, investors are tired of, I think lighting money on fire with basically financing the shale companies.

And then when you when you add fuel to fire with ESG mandates that make you know, pensions and other large pools of capital decide not to invest in them anymore. It means that, you know, the companies that are investing in more oil and gas production have to be very prudent with the projects that they do. They have to kind of finance what they're doing with their own free cash flow. And they have to be self sufficient. And so I think that's, you know, that's a trend we're seeing, basically, if you looked at investor presentation years ago, they were talking about how much they're drilling, how rapidly they're growing. Whereas now when you look at slide decks of oil companies are often talking about how constrained they are, how high their hurdle rate is for drilling. You know, what their returns on investment are, how much capital they're giving back to shareholders in the form of either debt reduction, or buybacks, or dividends, or special dividends. So it's really about capital return, and per share metrics, rather than growth at all costs and I think that's a big structural shift. And I think that's an important part of the supply, you know, characteristic going forward.

And the chart on the left, again, it shows five year CPI growth, so that's in orange. And then on a different axis, I have five year oil price changes. And we see that you know, all the inflationary decades of the past, you know, 100 years, pretty much basically commodity, especially energy going up a lot is a key part of those inflationary decades, hard to get an inflationary decade without constraints in energy and commodities in general. Now, it's not necessarily a sufficient condition. So we saw, for example, in the 2000s, that you had less CPI increases than you'd expect from what we saw in oil. And that's in large part because you had globalization. You had a lot of oil demand come from other countries, and you had enough disinflationary pressures

from technology and global supply chain to kind of offset a lot of that. But in general, for the last five, six years, we've been in this oil bear market. A very bad state of, you know, kind of oversupply, unprofitableness like we discussed. And I think that that period is, you know, obviously, I would argue coming to an end that we have a tighter market going forward. And that that is, on average a more inflationary condition, especially when you combine it with these money supply increases.

And so overall, I think that any economist that focusing on the big question of inflation versus deflation has to have an idea of, you know, key commodity markets, as well as infrastructure limitations. So they have to look at what does energy scarcity look like over the next 10 years. Is it abundant or is it or is it tight? They also have to look at key things related to electrification, so copper, nickel, cobalt, all of these key grid and car battery metals, right? And they say, okay, are those tight? Are those likely to be expensive over the next 10 years or are we just a wash in them? And generally, the answer points towards being more tight in those relative to the amounts that you would need to not only build all those cars, but also redo the grids in such a way that you can actually, you know, plug those cars in and not have rolling blackouts. And so when you add that together, I think that point to the 2020s, again, being a more inflationary decade, on average, than the 2010s. Because, I think investors get caught up with recency bias. And they assume that these commodity abundant decades last forever, whereas these things tend to go on these big you know 5, 10, 15 year cycles.

Erik: Lyn, let's talk about where we're headed in terms of monetary and fiscal policy. For a while, it seemed like there was a little bit of rhetoric in the system that President Biden might actually fire Jay Powell. Seems like now, maybe Powell's position is safe. What do you think is ahead in terms of both the composition of the FOMC board, and also the policy decisions, both FOMC as well as fiscal policy decisions by the Congress, as we look ahead into a year where throughout 2022, the Democrats will still have control of both houses of Congress, although there are more and more questions about whether or not that will continue to be true after the 2022 elections.

Lyn: So generally, in any country, where you get debt-to-GDP over, especially over 100%, let alone you know, over 80% or so, you start to see less independence from the central bank. You know, it might not be explicitly stated, sometimes it is, but, you know, basically, they start to work closely together out of necessity to maintain liquidity and functionality in their sovereign bond markets. And so, for example, during the 1940s, you know, you had a nine year period where there essentially was no central bank independence. And, you know, one of the Fed's mandates was basically to, you know, finance the war effort at rates that were low, despite what inflation was doing. And we saw that, you know, during 2020, as well, where you had that corporate bond, you know, vehicle, they basically that off balance sheet vehicle, and that was a combination of the Treasury and the Fed, because the Fed couldn't do that unilaterally, but what they could do was financing from the Treasury to cover any losses that they could have. And that basically was them, you know, buying a small amount of bonds to try to restore confidence in credit markets, which seemingly worked very well.

And so I think that we're probably going to see more of a pattern of that in the 2020s, where the Fed and the Treasury kind of have this, you know, kind of less distant relationship than they're, you know, supposed to have in a theoretical framework like this. And Powell has shown his ability to be flexible. I mean, he came in as, you know, someone that was perceived as you know, leaning more hawkish than, say, Janet Yellen was, and he stepped his course of raising rates and keeping, you know, their balance sheet reduction on autopilot. But he basically was forced to pivot a number of times when something in financial markets broke. And so for example, in Q4 2018, you know, everybody talks about, you know, the famous Powell pivot, but you know, S&P 500, went down 20% in one quarter, but really, under the surface, it was the credit markets that were freaking out. So there are no junk bonds issued for six weeks there. You had basically, you know, credit markets froze when it became clear that he was kind of on this War path of tightening. And so when things became dysfunctional, he quickly backed up those comments and said, no, no, we're gonna be data dependent. We're gonna respond flexibly.

And then when you had the repo spike of late 2019, again, they responded immediately by, you know, using the repo facilities and then buying T-bills. And then when you had Treasury market dysfunction in quarter one of 2020, in response to the, you know, the pandemic crash and all that the spiking dollar, he quickly brought out the various ways to kind of provide liquidity to foreign central banks as well as to backstop the Treasury market by buying a trillion dollars worth of treasuries in three weeks. And they maintaining ongoing purchases now for another year and a half, or it could be up to more than two years. And so he's shown this willingness to be totally flexible in a way that clearly works, I think, you know, with the administration's agenda, and so there was not an imperative to replace him. And basically by leaving him in place, it maintains, I think, some degree of narrative separation, right, because you have, you know, the President did not appoint him but reappointed him. And so that kind of keeps the illusion in place of there being some degree of central bank independence, when in reality, you know, he's still dovish enough to basically, I think, meet their goals basically when something breaks in financial markets that gets fixed by more Fed liquidity.

So it might not be as proactively dovish, as some of the other members might be, like, let's say Brainerd, but it's still dovish enough that it doesn't conflict with fiscal goals, you know, regardless of who's in charge. And so I think that's because they've kind of trapped themselves into a corner mathematically, it almost seems less important, who's running the Fed, as long as there's some degree of competence there in terms of being able to roll out these programs fast enough. And so my overall base case is that, you know, I think, you know, the Fed's gonna try to tighten slowly. So they're going to try to reduce the rate of asset purchases as they've said. If they're successful in that they might do some 25 basis point hikes. But I think it's gonna be this complex narrative of trying to point to the supply chain issues as being the major cause of inflation, which gives them cover to act slowly. And basically stay behind the curve of inflation and keep, you know, keep the financial pressure in place, keep bond yields below the inflation rate, keep their short term interest below the inflation rate, and be slow to address that, even as they seem like they're slowly making progress towards those goals.

Now, I do think that, again, I think there could be periods of time where you get fiscal gridlock. And you know that you have a combination of Fed tightening, and then you have a reduction in fiscal spending. And so you can get, you know, get a cool off in inflation. You can get a cool off in GDP growth, and then you could have some sort of market dysfunction that requires the Fed to come back in and up their QE. And I think that basically under Powell or anyone else, if they saw acute dysfunction in one or more markets, whether it's Treasury market, or repo market, or credit markets,. If you have that multi-week dysfunction, basically, the markets kind of trained that they're probably going to step in and reliquefy that market. And that's kind of trap that they put themselves in. And so I think overall, I view fiscal policy as being more important to watch than monetary policy, on average going forward. Even though monetary policy is obviously very important around the margins.

Erik: Let's translate all of this to what investors ought to do about it in their portfolios. It sounds like you and I are very much both on a secular inflation view. We don't think it's just transitory. But we do think it's not going to be a straight line. And we've already seen some pretty big moves up. What is the investor positioning for this? Is it gold? Is it crypto? Is it oil? If it's oil, is it in the commodity or is it in the EMP stocks? And is it potentially someplace else like broader base metals and other commodities?

Lyn: So I'm playing it in a diversified way. And so I think the general trend you want is to have real assets, things that can't be printed, things that are scarce in some way, and that are not at bubble valuations. And so I like a combination of commodities, energy, Bitcoin, precious metals, certain types of real estate and certain types of equities. And I think that, you know, depending on how investors play, it partially depends on what type of investor they are, where their expertise lies. I think energy can be played with buying, for example, long dated futures, or with buying a diverse basket of the energy producers that have say long, long reserves, low production costs and reasonable balance sheets. And you probably want to diversify your jurisdictional exposure to reduce, you know, the tail risks associated with different markets trying to suppress their supply.

And so I think that there are attractive American, Canadian, European and say, Russian oil producers, you could buy to spread out your risk. And so there's a couple ways to play that. I think that, you know, and metals that are associated with electric vehicles are attractive. I think that they, you know, there was a period where I think copper was overbought earlier this year. So those can go through waves of being over enthused. But I do think structurally, things like copper and nickel are attractive going forward over say the 5-10 year period. I think that you know, Bitcoin is one of the fastest horses in terms of say risk adjusted returns as a percentage of a portfolio. I think that there's still probably value accrual left in that asset. I think that basically its overall market cap and its percentage of global assets is still probably going to increase this decade. And so I like that play quite a bit.

So basically, my overall approach is to recommend spreading it out to some extent, and then focusing on whatever they happen to be an expert at right? So if someone follows the energy markets closely, if they follow Bitcoin closely if they follow equities closely, then they have, you

know, an edge there that they can exploit compared to other investors. But I think the main thing is that bonds are not likely to do very good on a inflation adjusted basis, whereas real assets are likely to do better. But because it's also not going to be in a straight line, you know, there is a case for holding things like, you know, short duration tips and things like that various dry powder that you can use to rebalance into these periods of, say, counter trend moves within this broader inflationary decade. So it depends on what an investor's time horizon is, and how much they're willing to trade around that. So it's not foolish to own some cash and bonds, even if they're getting devalued, if you're willing to, you know, use those to buy dips or corrections in assets that you think are fundamentally attractive when they go through those dips.

Erik: Lyn, I can't thank you enough for a terrific interview. But before I let you go, please tell us a little bit more about what you do at [Lyn Alden Investment Strategy](#) and what services are on offer there.

Lyn: So I provide basically a macro overview kind of like we discussed here. And then I also cover some individual assets, whether it's, you know, certain equities or news on Bitcoin or you know, certain topics around these more specific kind of micro decisions. And so I tried to mix the high level view with the low level view, and you know, I have public articles, I have a free newsletter and then I have a low cost Research Service for, you know, both institutional clients and, you know, sophisticated retail clients.

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