MACRO Voices

with hedge fund manager Erik Townsend

Louis-Vincent Gave: China, Russia, US Dollar & more

December 30th, 2021

Erik: Joining me now is Gavekal co-founder Louis-Vincent Gave. Louis, it's great to have you back on the show. I want to start with the big picture of where we stand in markets. Seems like the recovery was on and then we got the Omicron scare. I don't know what your take is but I've been looking at the data and as far as I can see, it's gonna be a while before the death toll climbs above zero. I don't think this is really the problem that the White House would like to make it out to be for some reason. What do you think's going on here and what does it mean for markets?

Louis: Hey, you know, roll out the usual suspects, right? We've had really a few ugly weeks, right? You got energy down 20%. I think last I checked that the Russell 2000 growth was basically given up all of its gains for the year and was roughly flat for the year. Think you got Bitcoin that more or less lost a quarter of its value? And I think behind all this, you've had a lot of things get slaughtered. Right? A lot of former, you know, beloved names of the general public, whether your Zoom videos, your Beyond Meats, your PayPals, your Spotifys, your Mercado Libres, or your Alibaba as pinned wood roads. So yeah, it's been a bit a bit of a bloodbath. You know, is it? It's, you feel a little bit like, you know, we allowed the usual suspects, right. So you've got, you know, COVID or Omicron as a potential suspect. You obviously have, you know, Fed sounding more hawkish as another potential suspect. And then you have, you know, continued China's slowdown and Evergrande finally, you know, slowest moving bankruptcy in the history of slow moving bankruptcies, sort of hitting the wall again. So, you know, you, I think you can find quite a few, quite a few usual suspects.

The reality, though, perhaps the simplest explanation is, you had a lot of things that were priced for perfection. And perfection is a hard, hard status to achieve. So if you look at a lot of the things that got absolutely smoked, it's a lot of things that were, you know, frankly, really, really over valued. And again, that only works, you know, if you buy things that are massively overvalued, that can only work for so long. Meanwhile, you know, if you look at the Russell 2000 value, it's still up double digits for the year, and the correction has been nowhere near as bad as the Russell 2000 growth. So I think for me, the interesting question is, alright, is the sort of massive growth bubble that we've experienced, really, since the start of COVID. Is it now running out of steam? And I think the answer is, you know, and I don't think that's linked to COVID. I don't think that's linked to China. I think the answer to that is linked to, to your view of Fed policies, as you look ahead.

You know, if you think the Fed continues to inject tons of money into the system, then there's no reason to think the growth bubble rolls over. If you think okay, you know, 2022 will be most likely a year where markets, you know, Fed starts raining stuff in, but also possibly, where market starts pricing in a post 2022 environment of just less of marginally more fiscal restraint. You know, if you assume that the Democrats are going to get a walloping in November, which seems to be on the cards, then do we have an environment like we did from 2010 to 2016, where a Republican Congress just refused to expand spending. So then you move from an environment of super easy fiscal super easy money to marginally harder money, and definitely tighter fiscal. And yeah, that's all of a sudden, maybe all the very expensive stuff starts to struggle. I think that's where we are.

Erik: Well Louis, the Fed says they're serious this time about tapering and reducing their balance sheet and so forth. Why would we believe that this time?

Louis: Yeah, you know, what, I feel a little bit like when I tell off my teenage boys, it's like, come on, guys. You know, this time I mean it! And I think I've said it too many times for them to take me seriously. The reality is I'm sort of, actually let me backtrack a second, Erik. Because, you know, I think the last time you and I spoke, you know, we were talking about inflation. And it was, you know, I think it was it was probably nine months ago, and I made the case for much stronger, much higher inflation. Now, the interesting thing is, if we look at this year that we've just had, you know, starting this time last year, consensus was for two and a half percent inflation. We ended up having 6%. Now, if this time last year, you thought, you know what, we're gonna have two and a half percent inflation, you would have thought, therefore, bond yields aren't going to move very much. Therefore, the US dollar will probably stay well bid, and therefore, US growth stocks will continue to outperform. And lo and behold, we had 6% inflation, the US dollar stayed well bid, US Treasuries haven't done very, you know, have been fine. And US growth stocks have massively outperformed so, you know, inflation was a massive surprise but it had no impact on the markets. Didn't impact the bond market. Didn't impact the currency market. Didn't impact the stock market.

And I think the reason for that is pretty simple is that the markets fundamentally don't really care about macro. They care about the policy environment. So they care about how perhaps the macro might impact the policies. But, you know, this past year 2021, was a year where you had accelerating inflation. And yet the Fed kept doing QE, you had accelerating inflation, and that yet the US government kept talking about spending even more money and growing even bigger budget deficits than it was doing. So the markets responded to this, not to the inflation data, they thought eh we got easy fiscal, easy money. Now, as we project ourselves forward, that's indeed the big question for 2022 is we've had a big divergence between market performance and the macro, because on a policy front policy stayed the same. And the macro change, but policy stayed exactly the same. In 2022, do we get the policy chang? Ehe Fed says we will, I'm doubtful, I actually think the more important policy change will come in 2023. And there'll be on the fiscal side. We will basically get another tea party congress that will freeze government spending.

But you know, as you look forward to 2022, I think what you have is a Biden administration that will try to spend as much money as possible, to try to save its electoral result on the one hand, and on the other that will sort of prevent the Fed from tightening too much in here. I know, you have my friend, Luke Gromen often on the program. And, you know, I sort of agree with him that it's very hard for the Fed to tighten meaningfully because if they do they risk creating a bond market meltdown, which, you know, would have an impact on equity prices, and would have an impact on real estate. And given you know, how important asset prices are to the US economy, the Fed wouldn't be able to stay very tight very long. So, yeah, sure, at the margin, they'll move a little bit on the tighter side. But I, you know, let's not kid ourselves that they're ever going to get ahead of this inflation curve, for a very simple reason. And that is that inflation is not a bug. Inflation is the feature, you know, every policymaker everywhere in the world is following inflationary policies, because fundamentally, that's what they want. They want the inflation to deal with the big government debt problem, because that's how you deal with it. So, you know, we're always going to have monetary policy that's way behind the curve. Again, that's not a bug, it's the feature.

Erik: Let's talk about where this goes. Because there are a lot of people who hold this opinion that boy, the Feds arms are going to be tied here, their hands are going to be tied behind their back, because we're going to get to this situation of inflation that they won't be able to fight by raising interest rates. Is that a real concern? Is it really true that there's a trap there or can they just let inflation run hot?

Louis: Well, to be honest that's the debate, as you point out that everybody's having and I think the answer will lie not with the Fed but with energy. You know, the reality is most economic activity is energy transformed in one way or the other. And, you know, the big difference between, say, the 1940s, 1950s, and the 1970s was the difference in energy. You know, in the 40s and 50s the Fed did keep interest rates very low. They, you know basically did yield curve control, real interest rates were massively negative. And that's how the US got out of its massive debt situation, by an essence, spoiling bondholders over the course of a generation. In real terms, bondholders lost 60% of their net worth, through the 40s, 50s, and 60s, and then the 70s what shifted, why it got nasty, was that energy prices went through the roof. Because through the 40s, and 50s, and 60s, energy prices were very low, very cheap, very stable. So I would say that, you know, as you look, as you look at this environment of, you know, tight labor force of supply chain dislocations of rising prices everywhere. As you project yourself forward, and at the same time, very easy monetary policies and very easy fiscal policies. As you project yourself forward. You know, if you think that we're going to enter a new golden era of cheap and plentiful energy, thanks to all the investments we've made in solar and wind and elsewhere, and that these investments really start to pay off, then I don't think you need to worry too much. Yes, we'll have real interest rates in negative territory, but the environment will be very similar to what we had in the 40s and 50s. And basically, government debts will be taken care of over time.

If on the flip side, you think hold on, we're entering into a period of energy stress because, you know, for the past few years, we've spent all the money that we were going to invest in energy, investing in wind and solar. And these aren't giving us the kind of returns on investments that

were hoped for. And we haven't invested enough in natural gas, we haven't invested enough in oil, you know, the inventories are low everywhere around the world. So we're entering into an energy crisis, you know, energy prices are going to spike up, then the inflation story gets a whole lot nastier a whole lot quicker. And it gets nasty, perhaps not on the policy front. But on the politics front, where, you know, you start to see populist be elected. Because you know, rising energy prices usually means rising food prices. And, you know, having high energy and high food is a very tough backdrop for any policymaker to run for reelection. So then you start seeing, you know, bad electoral outcomes, I don't know, in France and Italy or elsewhere. So, you know, for me, the big linchpin in 2022 will very much be energy. I happen to be an energy bull. I think we've set ourselves up for a big energy squeeze. So I think that's our outlook for 2022. If I'm wrong, however, if you know, the energy situation isn't as dire as I feared it to be, then policymakers won't have to worry about the higher inflation.

Erik: Well, unfortunately, Louis, I am in strong agreement. I think that the final years of the era of oil will be defined by very very expensive oil, not by cheap, by the way, a lot of people are assuming. And I say that because we've completely stopped making investments in new exploration and production, for oil. And yeah, we're gonna phase it out. That is a good idea. That is the right plan, but it's not gonna happen overnight, and we are phasing out oil faster than we're phasing in its replacements. And I think it's going to lead to some really serious problems.

Louis: I think it's actually worse than that Erik if I may. I'm sorry to interrupt you.

Erik: No no, I think it's worse than you think. We will have an argument about this!

Louis: Well, let me tell you how I look at energy very briefly. You know, for me, there's really, if I look at the past 20 years, there's really two different periods, there's a 2000 to 2015. And then there's a 2015 to COVID. Basically, you know, 2000 to 2015, the world goes from using 400 exajoules jewels a year to 500 exajoules a year. And out of that 500, 61 comes from China and out of that 61 from China, 51 come from coal. Meanwhile, there's basically no increase in the consumption of energy from 2000 to 2015, across the OECD. So basically, what happened between 2000 in 2015, to cut a very long story short, is that the world decided, you know what, I still want to consume a lot of these goods. But I'm going to outsource the production to China. And China's going to produce them, not with expensive natural gas and not with expensive oil or expensive nuclear, but China is going to produce them by using very cheap coal. Because coal is much cheaper than everything, anything else. You know, if it wasn't so darn polluting, we'd be using nothing but coal. It's easy to move. It's cheap, cheap to move, it's easy to exploit. And there's so much of it around the world. So what happened between 2000 and 2015 is basically half of the world's increase in energy supply was done by Chinese coil. And at the cost of just enormous environmental devastation in China, you know, you were spending time there at the time so was I.

And then in 2015, China basically says, you know, what, I'm done. You know, I'm, you know, I've got, I've got babies dying of asthma, I, you know, I can't do this anymore. And since then, coil used in China has flatlined. Now, we were saved because in 2015, the US oil and shale gas

boom kicks in. So the US moves from five and a half million barrels per day, to 13 million barrels per day. And instead of using Chinese coal, we use US natural gas and US oil. But that boom is now over, because that boom was massively capital intensive. In fact, it was capital destructive. More than $300 billion were destroyed in the shale oil patch. It was massively destructive. And that brings us to today. Now, you know, COVID has set us back in terms of global energy use. But if we think that by 2022-2023, you know, will be roughly back to normal in terms of global travel in terms of everything else, then basically, that means that between now and the end of 2023, the world will need to produce an additional 50 or 60 exajoules, knowing that it won't come from Chinese coal, and knowing that it won't come from the US oil patch. So where's it gonna come from? The answer is, I don't know. But I think that's problematic.

Erik: Louis, since we're on China, I want to broaden that conversation and talk a little bit more about what happens after the intense COVID crisis that we're in kind of passes. Because before COVID, we had President Trump in negotiations with Xi around an economic deal that was sort of starting to come together. And of course, now we have a new administration. What is going to happen between the US and China? And what is it going to mean, both geopolitically and for markets in the aftermath of COVID, when we start to ask questions about who was responsible for this, and whether or not China withheld information that they shouldn't have withheld, and so forth?

Louis: You know, the honest answer is I don't know. Here's what I do know. What I do know is that for my whole career, up until very recently, Chinese policymaking was driven first and foremost by the need to create jobs. Right? It's for very simple reason, you had roughly 20 million people that were leaving the farm every year to move into cities. And with this kind of demographic shift, I think if you're a Chinese policymaker, every morning, you woke up thinking, you know, how am I going to absorb these 20 million guys. And so all your policy was was driven towards that. That's why every time you had a slowdown, whether it was in 2003 with SARS or in 2008 with the mortgage crisis, or 2015. Each time you had a slowdown, the Chinese government would step on the gas, it would tell its banks to lend, it would add infrastructure spending, it would add excess capacity onto excess capacity, because the number one government priority for the past 25 years was creating jobs.

Now, have you noticed, of course that I'm sure you have that China's been slowing down hard. That real estate is being phased planting. And if you notice that this time around, there is no government stimulus, right? There's no government pressure on the banks to go out to lend. There's no adding excess capacity on top of excess capacity. And I think the reason for that is twofold. First, the job imperative has disappeared. You know, up until 5, 6, 7 years ago, the workforce in China just demographically was still growing by about 10 million people a year. Last year, China lost 3 million workers. By 2025, China will be losing 7 million workers. By 2030 they will be losing 10 million workers every year. So you know, the need to create jobs is no longer there. You know, so that's the first big shift.

The second big shift is the perception that the US is out to get them. And here I'd asked you Erik to put yourself into Xi Jinping's shoes. And I think you and I have discussed this before but

if you're Xi Jinping, the most traumatic event of the past few years isn't COVID and it's definitely not Evergrande. The most traumatic events of recent years is Huawei. You know, Huawei was your industrial pride and joy. It was the first time China had a genuine global brand. And it was the first time that China had a company that was taking on Western companies and winning market share the very pinnacle of technology. And the US comes in and destroys that. It destroys it in three months. Now, you might say, well, you know, that was Trump doing Trumpian things, and now with the more normal administration, things should get back on track. But the reality is, if there's one constant between the Trump White House and the Biden White House, it's in the China policy. Just a few weeks ago, you had Gina Raimondo the US Commerce Secretary come out and during a press conference say that it is US policy to slow down China's rate of innovation. Now, granted, this might be US policy. But I would think that's the part you don't say out loud, right? I mean, to come out and publicly say, you know, our goal is to slow down China's rate of innovation. I mean, if you're China and you on the other side, you think okay, well, good to know. Now I have to cushion myself against potential US attacks.

And here China has three major vulnerabilities. its dependence on foreign semiconductor is one. Its dependence on foreign energy is another but its biggest weakness by far is its dependence on the US dollar. The fact that all of all of China's trade is denominated in US dollars. And by the way, look at right now, you know, and these Ukraine-Russia tensions, what is the US threatening Russia with? To kick Russia out of the SWIFT system? Right. I mean, that's the sort of no pun intended the trump card in the US Deck. That they can always kick somebody out of the international financial system. So if you're China, you think okay, that's the part I need to address. And so policy shifts from creating jobs at any cost to having a strong currency because the only way you can de-dollarize your trade is if the renminbi is stronger than the dollar. And so you have the situation as we've seen in the past 18 months, where, in spite of China having by far the worst stock markets of anywhere in the world. In spite of China being basically the only place in the world where growth has been massively disappointing. Well, against this backdrop, the renminbi is actually the world's strongest currency, which is pretty much the opposite of what every China Bear thought, right?

Every China Bear thought, oh, China's going to slow down and the renminbi will go down massively, well, no. Because now, the onus of policy is no longer job creation, the onus of policy is have a strong currency. And, you know, we're all the fruits of our own experiences. I'm French, I grew up in France. And for me, and I'm sorry to be long winded about this. But, you know, for me, when I was growing up in France, I started in the 90s, in the financial world, and I worked for a French bank called Paribas. And at the time, French policymakers had decided that we needed to create the euro, and that there was nothing more important than the French franc being on a par with the Deutsche Mark. And that anything would be sacrificed on the altar of that goal. And so if that meant that French industry would be destroyed then so be it. If that meant that, you know, Paris real estate went down 50%, then so be it. And if I'm a credit union would have to go bust, and Paribas would have to be merged, then so be it. This is where you are in China today. In China, today, the goal, the policy goal has shifted from create jobs to needing a strong currency, which is why the Chinese bond market, government bond market is

the world's best performing bond market, just like the French, Italian, and Spanish bond markets were the best performing asset classes in the 1990s.

And so the policy settings in China today, again you take your playbook from Europe and the 90s. And that's where you are. Now, what this means, concretely is that, if you expect a strong dollar in 2022, then that means that China's ability to ease will be very limited, because they need the renminbi to be strong against the dollar. If like me, so if you think oh, the Fed is going to get ahead of this curve. They're going to tighten, and they're going to put the inflation cat back in the bag. And, you know and you should expect a much stronger dollar from here. You know, if that's your scenario, then don't expect any stimulus in China. If however, like me, you believe, you know what, in 22 the Fed will be a day late and a dollar short all the time. They're always, you know, they're they're not going to tighten very much because frankly, they can't. Then it'll mean that the US all won't be so strong. And it'll mean that the PBOC will have more room to ease and the way they'll ease is they'll tell the banks, hey guys, you can make loans again. And if they can make loans, again, what's going to happen is every property developer will tap credit lines, and buy back debt at 40 or 50 cents on the dollar. Because whatever gain you make that 50 cents gain you make, will flow straight to the earnings bottom line. So, you know, I think if you're bullish on the dollar, then you you just keep on buying US growth stocks and US Treasuries. If like me, you're bearish on the dollar, because you think the Fed won't be able to do very much, then there's a terrific opportunity in high yield debt in China, because very soon, China will be able to ease

Erik: The opportunity is in high yield debt in China, elaborate?

Louis: Absolutely. Well, for the reason I highlighted, it's tomorrow, if China does start to ease, because the US dollar is weak, and therefore they have the the ability to ease, then that means every property company out there that's got a bond trading at 40 cents on the dollar, will be able to get bank credit lines, and once they get the bank credit lines, they can turn around and buy back their debt. Because why wouldn't you buy back your debt that's trading at 40 or 50 cents on the dollar. It's the simplest way to repair your balance sheet. Because you swapping debt for debt, except that you're booking 50 cents of profits for every dollar that you've borrowed. And that 50 cents of profit goes straight into repairing your stretched balance sheet. So I think that's a potential trade for 2022. But again, that assumes that the Fed sort of stays behind the curve. Otherwise, you'll be better off just staying in Chinese government bonds.

Erik: Louis, let's expand the conversation to include Russia, because what you've told me so far is that a lot of this is going to depend on how the energy thing goes, well guess what? Russia has a pretty big say in that. The other thing I can't help but observe is it seems like the US is really testing both its Chinese and its Russian relationships to the point where, boy, you know, Russia and China could make a deal at some point around energy that maybe doesn't benefit the United States as much as we would like. What are the risks? What could what could go right, what could go wrong? And what should we be thinking about influencing that triangle of power between the United States, Russia and China?

Louis: Well, look, I'm a bull on energy. So, you know, it's not that much of a stretch to imagine that I'd also be a big bull on Russia. And I'm a bull both for the cyclical reasons surrounding energy, but also some more structural reasons that that you allude to. Look, the reality is that, you know, China and Russia are the most obvious natural trade partners in the world, right? Russia produces all the commodities that China needs. And China produces all the consumer goods and the finished goods and the capital goods that Russia needs to continue industrializing. So, you know, for them to, you know, if there's one, you know, sort of bilateral trade relationship where you can imagine that trade will continue to expand at many times the rates of GDP growth, it's got to be that one. And so, you know, and you know, the more trade you have between two countries, usually, you know, if you're a believer in Ricardian equivalency and Ricardian comparative advantages, then, you know, you got to look at it positively.

But I think there's another reason to be honest, to be bullish Russia. That if we look at the past 15-20 years, the reality is that China got involved in a lot of businesses that China probably should not have gotten involved in, in the first place. Things like Petrochem, things like steel, like aluminum, you know, things in which China really has no genuine comparative advantages. You know for the steel, China would ship in the iron ore from Brazil, ship in the cooking coal from South Africa or Indonesia, mix it in China, and then sell it, you know, re-export it down to Australia, for example. Now, you know, what's the reason for doing that? Why would China do that? Well you can say, well, they had a cheap cost of labor. But you know, when you produce steel, or aluminum, or petrochems, the labor doesn't count for all that much. What they had was really the ability to pollute the hell out of their atmosphere. And again, to use very cheap domestic coal to produce cheap electricity. If you think that this thing is now gone, this ability and willingness to use cheap coal and cheap electricity, and that's, that's now gone, then a lot of these businesses are going to go back to where they should have been in the first place. And where a lot of these businesses should be is Russia, you know, Russia has very cheap electricity, because it's got hydro, it's got nuclear, it's got coal. It does still have the ability to produce, to pollute because it's such a big country.

Louis: So you know, the steel production should move to Russia, the aluminum production should move to Russia, the Petrochem should move to Russia. And I think all this is going to happen over the coming decade. So no, I am. I am very bullish on Russia, I think a lot of things are lined up. And then you know, finally, if you look at monetary policies, Russia is one of the few places around the world where the central bank has been hawkish against inflation. You know, you've had two year yields have gone from 4% to 8.5% in 2021. You know, so there's room in the future, as you know, inflation rolls over around the world, as things slow down. There's room for Russian interest rates to go down, which is more than can be said in most countries. And as you and I both know, there are few more powerful forces tailwinds for a bull market than falling interest rates, right. So I think there's lots of reasons to be excited about the Russian market.

Erik: Louis, you're a perfect guest to ask this because you're originally French, but you're very familiar with the American financial system, you know, I can't help but react when I hear you talk about the American government threatening that they're gonna take those stinking Russians

and cut them off from our SWIFT system. Now, the American government is the only government on earth that's arrogant enough to threaten to cut somebody off from SWIFT. A consortium that's owned in Europe, it has nothing to do with the United States. But the United States apparently thinks that it has the authority to regulate that for the whole world. And they have threatened the SWIFT consortium before that, if they don't toe the line and do what the US wants, that they'll be cut off from the US somehow. When do we get to the point where the whole world says, you know, we've had enough of the US government trying to tell everybody else what to do, we'll make and they've already built the replacement system for SWIFT, but we're just going to cut over and forget about SWIFT because SWIFT kowtow to the United States. We're going to use a different one that doesn't do what the US wants. And we're going to let Russia and China have the trade relationship that they need. And the US become secondary to all that. Needless to say, the US has never liked that idea. But I wonder if we're getting closer to the day where the rest of the world says, you know, we're done letting the US tell us what to do.

Louis: Look I think you're touching on a very important point, which is what's the US has single biggest competitive advantage? It's an interesting question. When you ask this to Americans, Americans will say, oh, you know, we have the rule of law. And we have some of the world's best universities. And you know, we have a very strong and dynamic entrepreneurial class and all of which is true, of course, but you know, all of which can be said of many countries. The reality is what sets the US apart from anybody else aside from the size of its military is what sets the US apart from every other country out there is the fact that the US has the world's reserve currency, right? That because all the global trade is denominated in US dollars, or almost all global trade is denominated in US dollars. The US you know, when a crisis comes like 2020 or like 2008, the US can basically run unlimited trade deficits and budget deficits, and in essence, have those deficits funded by the rest of the world. And this is by far the US biggest comparative advantage. And it's interesting, because, indeed, to your point, when you ask Americans what the biggest comparative advantage of the US is they never come up with that.

When you ask foreigners, that's the first thing they always fall on. It's like, oh, well, the US has the US dollar, you know, that's the exorbitant privilege and all that. So to your point, you know, can they reach? Could we ever reach a point where the US basically leans too far above its skis in terms of using that exorbitant privilege? It's a very tough, tough one to answer to be perfectly honest. You know, the way I look at it, is, you know, and I think you and I have discussed this before, but you know, currencies are like a computer operating system, right? I'm going to go out on a limb and bet that you use Microsoft. And the reason you use Microsoft is everybody else in finance uses Microsoft. So when you need to exchange files, or, you know, when you need to hire somebody to work with you, you can just assume that they know Microsoft and changing systems is extremely, extremely hard. You know, to move to another system, you have to prove that the next system is better and/or cheaper, and probably both.

Now, when it comes to SWIFT, you know, there is no doubt that in recent years, the US keeps going further and further into weaponizing the US dollar and to basically telling people look, you

know, toe the line, or else and, you know, you saw the massive fines that were imposed on BNP for example for having the nerve to do business with Sudan even though there were no French government sanctions against Sudan. But because the business was denominated in US dollars that the BNP had to end up paying billions of dollars. I think it was like 8.2 or something billion dollar fine to the US government. And so, yeah, I think there is increasingly a sort of unease around the world as to how the US has weaponized and keeps on weaponizing the dollar. On the flip side, you know, replacing it is a real challenge. And that's why, you know, when the US government tells SWIFT, this is what you have to do or you know, we'll take the US dollar off SWIFT. SWIFT really, you know, is not in much of a bargaining position, right? It says, okay, then I guess we have to do it.

That's what China's trying to do by promoting the renminbi as a trade currency around Asia. You know, some people would argue that the solution to an always ever expanding American government is cryptocurrencies and is, you know, Bitcoin or whatever else. You know, that was, that was the hope of Europe when they launched the Euro. But that's been a dud for all the reasons that we know. So look, my point would be that, if the US turned around and said to Russia, okay, you're kicked off the SWIFT system, it's not going to trigger a collapse in the US dollar immediately. But it will be one more incentive for people to look for alternatives, and that at some point, you'll reach a tipping point, but I don't think we're at that tipping point.

Erik: Let's talk about precious metals, Louis. A lot of people myself included made a prediction, we thought that the US government was likely to debase its currency with a lot of continued quantitative easing, and we got it right. And we predicted that was going to lead to a lot of inflation and we got that right. And guess what the next prediction was gold goes to the moon because of that. And that really hasn't happened yet. Why not and what comes next?

Louis: So I've always looked, well, I've tended to look at gold as really a play on emerging markets. And you know, I've been bullish on gold because I've been bullish emerging markets, but I've been wrong to be bullish in emerging markets. You know, the reality is, if you look at Gold final demand in the world today, you know, you have a big third that's in India, a small third that's in China, another 20% or so that's in the Middle East. So you know, most of the final demand for gold happens in emerging markets. And you can you know, you also have strong demand from places like Indonesia, Vietnam, etc. So, what happens is, I think when emerging markets are thriving, you get strong final demand for gold and the price goes through the roof. This is what happened in the period 2001 to 2011. You know, during that period, emerging markets were doing very well, China was booming, and everybody was riding China's coattails.

You know, in recent years, emerging markets have struggled. China's been slowing down and there really hasn't been anybody to pick up the mantle from where China left it. You know, I think there were high hopes that you'd get strong growth from India. There were high hopes that you know, Latin America was finally getting its act together. But you know, the news in emerging markets in the past couple years has been tough. You know, most of them have struggled to deliver adequate COVID responses. commodity prices have been quite volatile which is problematic for some, you've had some bad, you know electoral outcome and others like, you

know, Chile which Chile, which had been a big success story for years, all of a sudden there's an overcast. Again, China's been slowing down. So you put it all together. And I think that's the main explanation for why gold has done fairly little. It's again, it's a derivative play on emerging markets. Now I happen to be just as I am a bear on the US dollar. I am a bull on emerging markets still. And so you know, I own some gold, but I know why it hasn't done well and I'm not that fussed by it.

Erik: Do you think that cryptocurrency taking market share is more people believe that cryptocurrency is a better hedge against currency debasement is part of it, or is that not affecting gold?

Louis: Yeah, you know, that's the big debate. The reality is cryptocurrencies are so new that it's hard to know, but I'm not sure that it is really that much of a factor to be honest. I know, it's the go to explanation. But I look at most of the people that I know who are trading cryptos. And, you know, very often it's like, you know, 25 year olds and sort of younger people who don't strike me as the typical guys to buy gold. You know, I think if cryptos hadn't been invented, perhaps the mania and the bull markets on growth stocks would have gotten even crazier, because the real correlation is actually not between gold and cryptos. Increasingly, it's between gold and the NASDAQ. Right cryptos are increasingly a sort of hybrid beta version of the NASDAQ or of the Russell 2000 growth. Partly because, you know, the guys who trade cryptos are the same guys who trade those meme stocks. Partly because the guys who trade crypto are not doing it so much for long term capital protection, but you know, for short term speculative reasons, which is what happens when you have that kind of volatility. You know, I can't imagine that anybody looks at Bitcoin with the volatility that it has, and thinks, you know what, I'm gonna buy this because this will be good for my retirement in 20 years time. I know it'll keep value. And maybe they are, but that seems crazy to me.

Erik: I agree on both points. They are and it seems crazy to me too. Louis, I can't thank you enough for a terrific interview. But before I let you go, tell us a little bit more about what you do at Gavekal Research.

Louis: We study markets! Yeah, no we publish regularly. We're based in Hong Kong and Beijing. So we publish mostly with a strong, we publish macro research with a strong China bias. I should highlight that I've just published a new book. So I feel I should plug it. Our research tends to be for institutional investors. So it's, you know, it's kind of it's sometimes too pricey for some people, but I have a new book that you can buy directly from our website, gavekal.com. The book is called avoiding the punch, and is really focused on basically how to build a portfolio in a new inflationary environment. So, you know, I think that book can give a good overview to people as to how we work.

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.