Viktor Shvets: Inflation is still a pendulum but will eventually yield to disinflation

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Erik: Joining me now is Viktor Shvets, Head of Global and Asia Pacific strategy for Macquarie. Viktor, it's great to have you back on the show. Last time we had you on, the episode was titled, The Inflation-Deflation Pendulum. And at that time, there was still a huge amount of debate, a lot of people thought there was going to be no inflation. And of course, sure enough, we've gone from a situation where everybody questioned whether there was ever going to be any inflation to a lot of people now think it's running away and it's going crazy from here. Is it still a pendulum and where are we in this story?

Viktor: Yes Erik, I still believe we are in the pendulum. I think the last time we spoke and I tend to look more at G5 inflation, which is US, UK, Eurozone, Japan and China, which is much more representative of a global inflation requirement. I think I was arguing that inflation will peak at the very end of 21, early 22 at around 4%. Now, we now have December numbers, and it actually in December was 4.5%. So did we have a much more significant surge? and the answer is yes that particularly applies to US, to a lesser extent the UK. But we did have a much much stronger sort of jump in inflation. The question, however, is why do we have inflation? I usually tell us people, were you really concerned in December 2019 that we're going to run out of people. Were you really concerned in December 2019, that suddenly we will have shortages of goods? Well, the answer is that you did not. And if you think of real global demand, it's only slightly ahead where it was at the peak of December 19. More so in the case of the US less so in other countries. But what actually happened? We had a collapse and recovery. Now that recovery mostly shifted towards goods, depending on the country, the goods demand is about 10 to 20% higher than what it was prior to COVID. So if you think about the trend line, we're about 10-20% higher. But if you look at services demand, it's about 10% lower than it was in the past. So it's not necessarily that we have explosion of demand. But rather we had a significant relocation of demand between goods as well as services. And so as a result, we suddenly start running out of truck drivers, our warehouses are bulging. Suppliers could not properly estimate what demand will be. And so they are underinvested or they go out of business or they were hoarding. And so the result was, to me that most of the inflation we have experienced, it's still the case that demand and supply curve have not moved in tandem or in unison over the last couple of years.

And so the question becomes, as we go forward, do you think that's going to happen, or that's going to get fixed? Now, if you think of most numbers, whether it's New York Fed, a global supply index, whether you look at ISM indexes globally, including US, what you started to see is some easing of pressures. around November-December. It's really picked looks like around October. Now, nobody could argue that if suddenly we have another COVID, or we have another sets of disruptions, it can get worse. But at this stage, it looks like it's starting to ease. So the question to me as we progress through 2022. Yes, G5 inflation was higher. As I said, it's I think it's going to peak around four and a half. I don't think it's going to go much higher. The core inflation is about three, I think it's going up a little bit more in the next couple of months. But beyond that, it really comes down to the fact, can we get demand and supply curves moving relatively in unison? My answer is yes. And I think the last time I spoke on your program, I was saying by the middle of 22, a lot of supply and demand issues should get much easier. And by the end of 22, we're going to get surpluses of goods rather than shortages. The only exception to that will be anything to do with digital economy. In other words, cobalt lithium, rare semiconductors. But most of the other things, I believe we're more likely to be in surplus by the end of 20 to early 23. The other big question mark, is that can you continue stimulating demand, that's when you go to fiscal and monetary policies. And my view remains the same that we picked in the fiscal support around July August of 2021. We've already been coming off for about six months, but that sort of erosion will accelerate as we go through 22 and 23. Pretty much every country wants to control their deficits wants to control their debts.

So if you think of again, G5 economies we peaked at about 11-12% fiscal deficits in 21. That's going to be down to maybe around 6% in 22 and maybe closer to five in 23. Now, that's a biggest fiscal contraction since World War Two. And unless something terrible is going to happen, I think that contraction will be a real. Nobody is going to go for primary surpluses, nobody is going to be doing crazy stuff that we used to do. But nevertheless, fiscal delta will remain very negative. And the same applies to monetary delta. Almost every central bank is now believing that they are behind the curve, which I disagree with. But nevertheless, that's what they feel and so monetary delta will be declining exactly the same time as a fiscal delta. And so without fiscal and monetary support, without really cyclical recovery, the way we had nearly 21 I think both reflation and inflation will start coming off. And so both growth and inflation at the end of 22 will be lower than at an earlier part of the year. Now how far lower? I think G5 will end up with probably around 2%, down from 4.5%. Even more inflationary countries like US and UK, probably will have inflation at least 300-400 basis points lower.

Now, how can we go wrong in this thesis? Well, a couple of things can go wrong. Number one, supply and demand curve don't move together. There are other disruptions, things happen, and you just can't get ahead of the curve just like we couldn't in 21. The other problem will be if central banks as inflation persist into early 22. Just overdue sayings in other words, they really commit a sequence of policy errors that will very quickly extinguished both growth and inflation at the same time. And the third area is really external factors. We did that we can't control things like geopolitics. Nobody is factoring in right now anything to do with Russia versus Ukraine, or South China Sea or anything else. So don't say a question, Erik, I'm stealing the pendulum. I'm basically arguing that without public sector, without strong fiscal and monetary support, disinflationary forces are stronger than inflationary. And so if you remove those props, inflation will go down, our gross will go down. And the question then becomes really whether you should start stimulating again into 23.

Erik: Wow, there's a lot to unpack there from the geopolitics and everything else. Let's start though with monetary policy and its relationship to the stock market. We have a situation now where the Federal Reserve has signaled very clearly that their intention is to taper asset purchases, eventually reduce their balance sheet and so forth. Now, the last time this happened in 2013, it was the so called taper tantrum where the stock market basically started to move down dramatically, until the Fed kind of changed their tune. Now, this time around Viktor, it seems like we're not having any taper tantrum of the stock market. Some people think that that just means market participants have become too complacent. How do you interpret this? Why is it that this time around the Feds talking about doing things that in the past would have been very negative for the stock market? But you know, we're only a couple weeks off of all time highs and not that far down from them.

Viktor: Well, there are two or three questions here. Number one is one of the key elements is really our equilibrium rate or natural rate. In other words, what Federal Reserve is trying to do, and they describe it as being guided by the stars. One of the things they're trying to do is to identify what is the neutral rate, which is neither stimulatory nor significantly contractionary that keeps the economy in balance without generating inflationary pressures. And one of the things we have seen over the last 30 years that US, Eurozone, everybody else really our equilibrium rate has come down dramatically. In the case of the US anywhere from 50 to 5% or so 500 basis points to close to zero today. If you think of the Eurozone from 3.5-4% to probably negative 100-150 basis points. So right now, interest rates are deeply negative, even if you look at the 12-months moving average CPI rather than monthly numbers. Or even if you look at, say five by five breakeven rates, you still are deeply negative in official terms. And so the result is that real rates are lower than equilibrium rates. And so the result is that stil supports asset classes. What happened in 2007-2008, as well as in 2013 is that real rates moved way above the equilibrium rates. And that's why you had a collapse of asset prices very quickly.

So right now there is still room to move. And the question that becomes how many moves can we do and nobody knows the answer. I mean, there will be all sorts of brokeres, investment houses will be telling you, our strategy has got a black box and he come up with a number, which is 2.13 or 2.25, or whatever. Everybody will try to guess what that break point is but there is a break point. And that break point is determined by R*. And because R* is not observable, you can't put it on your Bloomberg screen. It's estimatable and and it's very hard to be exactly certain. Where are you relative to this neutral rate which the Federal Reserve will try to maintain. My personal view remains that we are highly financialized, we are highly leveraged, we are totally committed to asset prices as a cue to every decision we've made. Which means if it starts coming close to R*, asset prices will collapse. And as a result, Federal Reserve and other central banks will have no choice but to backpedal.

Where are you going to see the tension? The first area will be interbank market and the repo market, then it's going to flow through into the high yield markets and high yield spreads. After that it will flow through into emerging markets, and then much more broadly into high grade and equities then in turn will be captured by the liquidity ratios that our Federal Reserve and other central banks use. Whether you look Goldman Sachs ratios or Kansas Fed or St. Louis Fed doesn't matter. They all using the same variables. And so as soon as you see this tightening of liquidity starting to happen, you can almost guarantee that an army of governors of Federal Reserve will emerge out of the woodwork and start changing the narrative of what Federal Reserve is trying to do. My personal view is that maybe they'll get away with two or three tightening cycles, they will certainly taper. Maybe they will try to avoid flattening of the yield curve. Because right now 5 by 30, is really touching 50 bps, which is unbelievably flat long term Yield cure. In order to avoid some of that flattening, maybe they will do some QT. In other words, they'll physically use the balance sheet rather than just rates. But at the end of the day, we are financialized, we are leveraged which totally dependent on asset prices, and the public sector, which means your room for maneuver is incredibly, incredibly narrow. And so all of those guys suggesting six cycles, seven cycles, eight cycles, there must assume that private sector returns to its bigger, and if no longer requires public sector and economies can run on their own. To me, that's a big assumption and I think it's an incorrect one.

Erik: Viktor, you mentioned that we already have deeply negative real interest rates. I don't want to pick up on that because a lot of people forecast that outcome several years ago. And what they said is that in an environment of extremely low nominal interest rates will eventually have a return to inflation that will push us into negative interest rates. And be sure certain, absolute outcome from that is the price of gold has to double. Well, they got the prediction right about what was going to happen with interest rates but gold hasn't gone anywhere. What was wrong with the logic? Why hasn't it worked out the way they thought?

Viktor: Well, I think gold fulfills a variety of sort of objective or criteria. One of them is inflation. The other criteria is geopolitical and social dislocation. The other criteria is economic dislocation. And so I think what was happening, the market is very much focused on recovery. They tried very hard to focus on value and cyclicality. They try very hard to focus on mean reversion. And they're not yet thinking so much about geopolitics. They're not thinking so much yet about social dislocation, political dislocation. Yes, rates are negative. But on the other hand, I think more people looking more for recovery. They debating whether the earlier part of the recovery cycle meet the end of the recovery cycle. People are debating how much pent up demand is there in the marketplace. What are the excess savings that have been accumulated and how those excess savings are going to be unleashed. From my perspective, there is no excess savings, there is no pent up demand, cyclical recovery already occurred and geopolitical and political tension will increase, which means gold theoretically should do better. But that, to me, at least explains why gold has not moved. Now a lot of people debating the role of cryptocurrencies and whether they actually substituting for gold, I don't see the evidence that cryptos are used primarily or even necessarily as inflationary hedge.

Erik: Let's go back to talking about what we can expect from monetary policy. I for one think that the pandemic is about to transition into an endemic phase. I think that the Omicron variant is going to be the thing that essentially moves this crisis from its pandemic to its endemic stage. And I think the economy is going back to normal in the next 6 to 12 months. Let's suppose for sake of argument that I'm right about that. I have to tell you, Viktor, I can't decide whether that's good or bad for the stock market, because the obvious, you know, intuitive, seems like it makes sense conclusion is, well, if one of the worst things to happen to humanity in decades, if not a century, is finally ending, that's got to be good. But hang on, it was the government stimulus in reaction to this crisis that seems to have propelled markets much higher than they were before the crisis. So for all I know, that means that the world getting better, you know, if bad is the new good, then maybe good is the new bad. So does the market go down? And for that matter, should I be anticipating that the Fed is going to do what they say and that we're going to be dealing with more and more tightening of monetary policy in coming months and years or is that all a smokescreen and it's really going to be easing that I'm going to be dealing with down the road and not what they're telling me?

Viktor: Essentially, a lot of people assume that what went wrong over the last couple of years was COVID. Now COVID is terrible. And it's humanitarian and other disaster, nobody would argue.But COVID has not altered the way we operate our economies anymore than Black Monday for example, in 1987 altered our dependence on monetary policy, or any more than global financial crisis altered the essence of our policies. So yes, COVID is an event. It's a major disrupter. But it hasn't changed the policy settings. Now, a lot of people would argue, Viktor but we had a massive explosion of fiscal spending. Absolutely. And that was a response that needed to be done, because monetary policy cannot deal with pandemic. But we have not yet sort of proceeded to the next stage to argue that from now on public sector is the only driver left in the economy. That from now on things like universal basic income guarantee is a must. From now on, people must recognize that affordable housing, affordable education, access to broadband, things like affordable health care is a human right, not a business. And therefore it must be operated in or heavily regulated by the public sector. We have not yet reached the stage of embracing MMT as a way for paying for all of this. And so to me, to argue that COVID has moved us from monetary to fiscal levels is incorrect.

Now, eventually, I think we'll get there because we're going to have many other setbacks. We're going to have a generational change, demographic change. I think, eventually, 5-10 years from now, we're going to make a transition. But that is not the story of today. So to me, COVID, hasn't actually changed the underlying policy settings. We're still very much driven by financialization, we're still very much driven by leverage, by assets and asset prices being acute to what we do. It's still very much driven by technology that continues to lower marginal cost. We're still driven by demographics, deteriorating demographics, and most places, and we're still very much driven by wealth inequalities. Remember in most countries, the bottom 50-60% of the population own nothing, and almost all assets up to 70% are concentrated really in the top one to 10%. And so you can argue top 1, top 5% pretty much everything and the bottom 50 60% own on a net basis, nothing. But those people must continue consuming, they must be encouraged to continue to borrow and consume, because remember, otherwise, the assets control by the top one or 5% will simply collapse. And so the role of Federal Reserve is not inflation or unemployment, that's not their mandate. Their mandate is being an interlocal, effectively, between two spheres. One is financial markets and capital markets, which are 510 times larger than the underlying economies. And the other thing is underlying economists where normal people live and reside and cook their meals and do whatever.

And so the interlock is between the two, They must make sure that those two spheres are moving in unison, or at least in some degree of harmony. And so to me, that's the essence of our economies. And that is why we relied on rolling asset bubbles to generate growth rates that capital markets find acceptable, and also societies find acceptable. That's why rolling bubbles was absolute necessary in order to preclude the R* or equilibrium rate collapsing to a much much lower negative level. And so to me, that's the essence of our economies. That's the essence of our life. COVID did not change that. COVID contributed to acceleration of thinking about how we can use other tools, not just monetary tools to drive the economy forward. From a market perspective, the way I look at it is that nothing has changed. If public sector stepped back in terms of our monetary and fiscal supports, disinflationary pressures become much stronger, reflation goes away, growth goes away, public sector needs to come back again, and stimulate again. And I think to me a return to normality, the only thing it will do, it will allow demand and supply curves to move much more in unison. And that's good or start deflating some of the spike of inflation that we have experienced.

But beyond that, it doesn't alter our investments. Now, the other thing to consider, of course, is ESG. ESG was sort of an idea looking for something to do a couple of years ago. But now it's real, and COVID Definitely accelerated our move towards ESG. Now, ESG is both inflationary and deflationary, but it's much more inflationary in the shorter term. And so the question is whether ESG policies will actually add to inflationary fire. Now, to my mind, 22, 23, 24 ESG will make very little difference to either demand curve or supply curve or inflationary outcomes. Beyond that its impact will strengthen. Now, why is that? Well, the way people work is or the way societies work. Is that in the first instance, you have to recognize there's a problem. And that was the issue for 2020-21. This is when we start hugging each other and promising unrealistic targets. Having done that, and that will be the story for 22, 23, 24. We would need to modulate it, we would need to recognize our limitations. Can we do ESG? It was like nuclear energy. What about societal goals without universal basic income guarantees? How are we going to do this. And so tempering it, aligning it much more with reality will be the story of the next three years. So I don't believe ESG by itself will actually make a difference. But that's a separate major topic that is actually could become much more important as we go forward.

Erik: Let's come back to that one. But right now, I want to come back to something you said earlier, which is geopolitics, I really agree with you that it's such an important issue. I just don't know what to make of it because it is such a complex topic. But the way I look at this, you know, we had entire generations that were trained by governments to fear the Cold War, because you know, there's people who disagree with our ideology, who have weapons that could literally wipe out our civilization. We've got to take this seriously. Well, if you look at what's really going on Viktor, the development of hypersonic weapons is probably what's happening right now is as big of a deal as what was going on at the height of the Cold War. For some reason, general society is not worried about the fact that we could have a nuclear conflict between superpowers in our lifetimes. I'm still worried about it, are you and how should we think about this whole geopolitical situation? China, Russia, United States, post-COVID, I'll make a prediction that everybody had the good sense to not point fingers and try to blame somebody for COVID during the crisis. I think after the crisis, there'll be more calls for accountability. What happened here, who screwed up? Who could have done better? And I think it's going to lead to more tension between the US and China. Where's this all headed?

Viktor: No, you're absolutely right and the markets are not factoring in any setting for geopolitics. Generally speaking, the markets always believe that politics will fix geopolitics. And by the way, over the last 50 or 60 years, that was pretty much exactly the right answer. And if you're not too concerned about it, you would have missed a lot of opportunities. And so the question is, will the politics continue to fix geopolitics? As we continue forward? The classic example is Russia versus Ukraine or Taiwan and South China Sea on the other side. US versus China, Europe versus Russia. And so the question is, how much should we reflect into our thinking about the markets about prices, particularly commodity prices. And also how much societies should be thinking about it? Now, I think you are, you're right to argue that we've become complacent. And whether it's new weaponry that is coming through, whether it's asymmetric warfare, that is becoming much more prevalent, whether it is a geopolitical splits whereby certain parts of the world do have a very radically different views, how both societies, economists and the systems must operate. Nobody wants to deglobalize. When people say we're deglobalizing. No, we're not the globalizing. All we're trying to do is to reshape globalization to the liking of individual countries. And what the places like China or Russia want that globalization to look like, is nothing like what the United States for example, or Anglo-Saxons would like those system to function with.

So are you going to have more and more of those challenges? Are you questioning the system, not to dismantle it, but just to co-opt it and hijack it. So nobody is going to dismantle WTO, nobody's going to dismantle the United Nations, nobody's going to dismantle any of that. What those countries are trying to do is to hijack them and basically refashion them in a different mold that is much more suitable to absolute national sovereignty for example. Absolute non-interference in internal affairs, no matter what those countries do to themselves or to other countries. And so that will get much, much stronger and harder to negotiate as we go forward. And so politics will have a problem containing geopolitics unlike the previous five or six decades, when they've done exceptionally well. And the reason it's harder, not only different countries move at different speeds in a different directions. But also people within those countries move in different speeds in different directions. They said the outcome of the Information Age sort of fusing with financialization. This is a difference between you know, a high in New York well a London in Northern England or you know, Sydney and Brisbane or whatever. And so, so what you have, you have those tensions within the countries, and you have tensions between the countries and that's going to get harder and harder to reconcile.

At the same time, here are very narrow windows of opportunities for both China and Russia to establish what they believe to be the right system, whether it's a sphere of influence, you can talk about sinus sphere, you can talk about Russian world, or Russian speaking world, and right now seems like the right opportunity for them to try to fix what they believe to be a problem. Now again, for investors it's incredibly hard to try to put a probability on it, other than just playing commodity markets. And that's what they're doing right now. They're basically saying, okay, oil price will go up, or they say uranium price will go up. Apart from playing commodities, it's incredibly hard to know what those numbers will be.

But in turn, my view is that what you must assume that geopolitics will be just another variable edit to our addiction to assets, our financialization, technological progression, demographics, extreme inequalities, you just add geopolitics. That's even a stronger argument why our economists will become much more state dominated and much more state driven and therefore performance of various asset classes will continue to be in a pendulum as I discussed, depending what the governments want to do and how much they actually put their sort of their thumb on the scales.

Erik: Viktor, we've covered quite a few topics here. Of course our investor community is most interested in what's priced wrong and where are the trade opportunities here?

Viktor: Absolutely! As George Soros has consistently been saying, discount what is known and trade on what is not known and that's how you make money. Because most investors, economists, commentators, etc. They're a bit like lemmings. They all go in the same direction and suddenly, they will move in mass from one area to the other. And so what's not discounted? What is discounted first of all? Well what's discounted is there will be three or four tightening cycles, central banks will become more aggressive, but not too aggressive. Hopefully, we will have transition from a pandemic to endemic which means cyclical growth will be strong enough to withstand fiscal and monetary crops being taken away. So that's what the market prices right now. Now, what they don't price is first of all, the possibility that as inflation sticks around a little bit longer, particularly in the first several months, that central banks feel that they are completely cornered, and they go much more aggressively. Now that will result almost immediately in crashing both growth in inflation and getting into steep disinflation much faster than what people expect.

The other thing that is not prized is even though I do think we're going to go from pandemic to endemic, we are traveling on the Greek alphabet right? There is I think we've covered so far eight or nine letters of Greek alphabet, there's 24 of them right. So there is another like 15 to go. And what is not priced in is in fact non endemic that we actually do find variances that creates further significant dislocation. Remember in 21, we always expected the demand and supply curves will kind of start getting closer together. They didn't. And part of the reason they didn't, because we never got ahead of COVID through 21. So the market is not assuming that we're going to have that sort of a disruption.

The other area the market is not assuming is what we have discussed and that's geopolitics, whether it's Russia versus Ukraine, whether it's South China Sea, whether it's Taiwan, whether it's something else, or whether internally domestic politics, that will make a significant difference. On the positive side, the market is also not assuming that fiscal deficits will go up. And you know, there is a possibility they might, particularly if we have confusion on politics and policies arising of our more pandemic style behavior. In other words, more lockdown, more interruption of trade. And that could lead you to high deficits, including re-initiation of programs that are currently sunsetting in most countries putting them back on. So all of that is not in the mix. What is in the mix? You go from pandemic to endemic. What is in the mix is monetary policy gets tighter but gradually. What's in the mix? Fiscal of Delta comes off, but there is enough recovery in endemic to keep you in a reasonable shape.

Now people are rotating into value and cyclicality in other words away from technology. And the reason being clearly they expect higher rates. The problem was this argument, we can't sustain higher rates, that is not possible. That's what we discussed about R* or neutral rate. And the other thing to argue is that a NASDAQ today is not NASDAQ 2000, it's trading at 30 times not 100 times. And you have to separate the new comers versus existing players. And a final thing to argue is that if you don't have a lot of cyclical recovery, if fiscal and monetary delta is negative, why would you go into cyclicality? What drives you to there? People say well low multiples, but that's not a good enough reason. Because most valued cyclical companies don't have a pricing power. They don't have the margin power, anything like what the new economy and the new sectors have. So to me, that's probably where I kind of disagree with a market.

Erik: Viktor, we're actually speaking on Tuesday morning, a couple of days before our listeners will hear this interview. But I'm looking at the 10-year yield up to one spot 85 today. I think that's probably a couple of years it's been since it's since it's been that high, we kind of stopped at 170 to 175 last cycle. Is this of concern? Does this tell us that boy inflation is really on. This is the beginning of a takeoff of secular inflation or is this no big deal?

Viktor: Well, the interesting thing is, we have gone up from 1.53 to call it just over 1.8. But five by five inflation, their breakeven rates are still around 2.1 or so. Now, what it basically tells you the market somehow believes that there is real growth coming through, because what we have seen is a rise in real rates. And I personally can't see where the growth is going to come from. And I think that's part of the reason why 30yr money, really have difficulty staying much above 2%. 20yr money has difficulty staying much more than 2.2%. You know, 5 by 30 Yield Curve cannot even keep 55-60 bps, which only occurs during recessions. So that's what the market is saying to us is that I disagree with this judgment. And you can argue maybe five by five does not reflect true inflation, when the TIPS doesn't reflect true inflation. But even if you look at the consumer inflation surveys, they all highlight that people expect more inflation now less inflation later on. So that's not similar the way the TIPS are also structured. So to me, that's what the market is saying. And that's why if you have more real growth, more and more people move into value and cyclicality because there are more opportunities to make money at a cheaper multiple. As I said, I disagree with this basic premise that is actually going to be more real growth coming through.

Now, the other side of it is is that as you increase real rates, as you come closer towards your star, the volatility of asset prices will increase. As you correctly highlighted, we haven't seen one 1.8-1.85 on the 10-year since before COVID, you really have to go to the sort of middle of 2019 to see those sorts of numbers. And the question becomes, if we continue pushing it up, which is what Federal Reserve is doing, and what the market is anticipating is going to happen. At what stage is it going to break furniture. And nobody knows the answer. Because nobody knows where R* is including Jerome Powell. And we sort of niching along and trying to figure out just one step at a time, just to see where it is. And as soon as liquidity collapses. As soon as all the liquidity ratios go through the floor. As soon as you have Kansas Fed or St. Louis Fed, financial condition index getting very tired, as soon as you have thoughts, you know, seeing spreads on the high yield market starting to increase.

As soon as you've got a problem with the plumbing, because remember, when we start Qt, this is when we're going to see the plumbing problems, this is also where we're going to see commercial banks not prepared to venture into risk areas, because they no longer have the same amount of collateral that they require. As soon as we start seeing that, that's where the break point will arrive. And that is when the Federal Reserve will have absolutely no choice but to retreat. Because remember again, their mandate has nothing to do with inflation and employment, and everything to do with a volatility of asset prices. And so is it 2% is a 2.2%? I don't know, nobody does. The only thing you know is that there is a limited room for maneuver. And every time we do those exercises, that room for maneuver gets smaller and smaller, and smaller and shallow. The only way to overcome this death spiral is to change your policy from monetary to fiscal. And as I said, there is no evidence right now that either population, public society or politics seem to agree that that is the right answer.

Erik: Viktor, I want you to imagine that I am a speculative trader, my risk appetite allows speculating as George Soros put it on the unknown. And I want to make a bet, which is I really think although I don't know for certain. I got a strong hunch that Omicron is going to be what shifts us from pandemic to endemic phase of this crisis. And it's going to result in the economy opening up faster than people expect over the next six months. I could be right about tha or I could be wrong about it. But I'm willing to risk some money making that bet. How do I make the bet because I know how to do it with crude oil. I see that one. And I'm already about as long as I dare to be on crude oil. But other asset classes, I can't decide if this is good or bad for the stock market based on what we've been through.

Viktor: It could be both. Absolutely right. It could be both! Now, the thing is, again, if we go into endemic stage, that basically implies that demand for goods will come off, and demand for services will significantly increase. As I said early on, it doesn't strike me that we actually have the spillover into labor market or wages. For example, there is absolutely no evidence in Eurozone, China or Japan that is occurring. Even in the United States, most of the very significant wage increases are occurring in a disrupted sector. And so if you think of that way that we just concentrated more in disrupted sectors, that labor participation rates are low and real wages are negative, it strikes me much more as a disrupted labor market rather than the labor market are running out of people.

And so one of the things will happen when we go to endemic is that disruption of the supply and value chains, disruption of the labor market will become less pronounced as we go forward, demand will shift services away from goods, there will be surpluses that will emerge. As I said earlier, I think we're going to be in surplus of most commodities and goods by the end of 20 to early 23 rather than in deficits. And the exception to that are the digital or digital related commodities and products. So to me, it's still very much the argument that disinflationary backdrop is still very strong. It's driven by financialization by debt, by asset prices, by demographics, by extreme inequality, by technology. And if the government steps back and go into endemic stage, private sector is not strong enough to maintain either gross momentum or reflationary or inflationary momentum. Now, that basically tells me that you should still be very much into new economy rather than the old economy. And that is why I only buy cyclicals and value when it's extremely distressed. But right now, nothing is really extremely distressed. And so I prefer still very much on the thematic area, i.e. replacement of humans, augmentation of humans, entertaining humans, betting on social geopolitical dislocation, new energy platforms, new transportation platforms, disruptors, but you need to mix it in sort of inappropriate way.

So for example, capital goods companies are usually regarded as value in cyclicality. But in fact, a number of them are becoming very thematics. Because the new world cannot appear unless we build a new world and capital goods companies are the ones who are going to build it. The same applies to commodities that you need for the New World as you go forward, including semiconductors, but also your copper, your nickel and the rest of it. The same applies to new startups that actually will operate this new world, everything from meta to elimination of factories and duck factories, to robotics, automation, to new energy, new transportation. But then there are also existing companies today that actually adapting to this environment incredibly well. And they use technology, they use products distribution differently. Again, some of those companies will be delivering productivity five or six times faster than the frontier in every industry that you operate.

So to me, and I describe it as quality, sustainable, growth, and thematics. It's sort of a mixture of all of that, that creates a real sort of a reliable portfolio that you can build. Now, you can bet now and again on the old price, that's fine. You can bet now and again when cyclicals are completely distressed that's absolutely fine. But if you want to invest to me, that is really the only investment strategy that I think that makes sense. And again, that strategy will avoid some of the volatilities. So for example, if you look at things like Ark, they have crystallized volatility of 40, 50, 60%. That is really not acceptable to a lot of either private investors or or fund managers by mixing all of those themes by mixing commodities and capital goods companies. By mixing the new startups with it, existing players were doing things differently, I could actually create a much more viable portfolio.

Erik: Viktor, I can't thank you enough for a terrific interview. But before I let you go, I want to touch on your book, *The Great Rupture, Three Empires, Four turning points, and the Future of*

Humanity. Wow! what a title. tell us what brought that book about? What's it about and where can people order it?

Viktor: Well Erik, it's exactly about some of the issues we've discussed. It's about technology. It's about financialization. It's about how AI economists are changing. It starts from looking into the past and saying what happened over the last 500 years and the second half of the book looks at what's going to happen over the next 20 or 30 years and how our societies and economies and the markets are going to change.

Erik: And again, the title of the book is *The Great Rupture, Three Empires, Four turning points, and the Future of Humanity by Viktor Shvets*. Viktor 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.