MACRO Voices
with hedge fund manager Erik Townsend

Alex Gurevich: A Deflationary Depression Lies Ahead

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Erik: Joining me now is Alex Gurevich, fund manager and founder of HonTe Investments in San Francisco. Alex prepared a chart deck to accompany this interview, you'll find the download link in your research roundup email. If you don't have a research roundup email, please just go to our homepage at macrovoices.com and click the red button above Alex's picture that says, looking for the downloads.

Alex, I've been really looking forward to this interview with you. Because, as you know, and most of our listeners know, one of the most important rules of investing is when you have a strong view to seek out smart people who disagree with you, because maybe you're the one who's got it wrong. I have some views about inflation, which I think is not transitory. I think we're at the beginning of a secular inflation. And I'm also getting frankly, pretty darn concerned about some of the macro shock events that we're seeing the the Sterling crash, it seems to me like it's not a big surprise after the policy mistakes, in my opinion that the UK and most of the European Union have made makes me wonder if we're headed toward a real calamity in Europe currency crash, that kind of thing. I know that you're someone who's incredibly smart and gifted and don't share those views. So please help me understand your perspective on all of this. Inflation, is it going to get worse? Is it is it a big deal? And what about these systemic risk events, the Sterling crisis, the seemingly runaway appreciation of the dollar to a blow off top? And a lot of non-usual things going on right now? What do we make of all this? How do you interpret it?

Alex: Erik well first of all, thank you for having me back. It's good to be back. It's been a while and it's always a pleasure. Those are definitely the subjects you're bringing the salient subjects for the day, like what we're thinking about what we're pondering. Definitely, we were all watching in aw the price action in Sterling over the last few months, and especially over the last few weeks. Yes, I'm actually not sharing the view that European and British economies are collapsing. In fact, I actually relatively positive and positive on euro and positive on Sterling, and I'm positive on stock markets and economic growth there. And I want to try to unfold why. However, having said that, I am positive. I agree with the concerns about the systemic risk there. And I will be the first one to admit, I do not know the scope of systemic risk. I also do not know how post Brexit for example, Britain will recover its current account, because definitely Brexit hurt the current account balance which led to currency depreciation, can they return the balance of payments? What are they going to export right? What does Britain have to make to sell to the world? Those are legitimate concerns. But I'm also going to talk to you about why I'm reasonably positive on this region.

Alex: Does it make sense?

Erik: Makes sense to me.

Alex: So first of all, a few days ago, or maybe like a couple of weeks ago, when did Britain came out, the new prime minister came out with a very expansionary fiscal policy and that caused a currency crash, like a really precipitous acceleration of pound down. For me, that was actually a very strong buy signal for the pound, not the fact whether it's down or up on the day, but fiscal expansion. Fiscal expansion is actually very positive for domestic currency when it's not being accommodated by their central bank. Now, the argument is that people are making that it is being accommodative that the bank of England is way behind the curve, that their policy is way too low relative to their inflation. I think we can address those further on because we wanted to talk about inflation and why I don't think that central bank policies are a total accommodative. And I think they're tremendously restrictive right now. And I actually think that the banks, the central bank score right now seem to be like behind the curve, like Bank of Japan, and Bank of England or the banks will have the last laugh, as the rest of the world will headed to catastrophic deflation. They'll have a more balanced policy, because they will not have to cut rates so precipitously because they will have more kind of pent up monetary looseness to combat the global monetary contraction that is happening.

So I actually think that Britain is going to find itself in a decent position, they will, they're doing fiscal expansion to stimulate the economy, and they're gonna methodically raise interest rates not accommodative. And that combination of those things, actually is very positive for the economy, because that will improve their current account just by the virtue of their debt becoming more plentiful and more attractive. Because when you issue that for us, and that at some price buying it and that improves your capital account balance, which in turn improves your current account balance. It's almost no choice, this process has to happen. And I think Sterling has much higher to go. And Europe I think has to work through some issues. But I think it's on a good track, because one way or another, Europe is facing an energy crisis. And we're in now that is facing a lot of dysfunctions and bureaucracy. But what my anticipation is that they're kind of cornered into inevitability of action. So they will inevitably have to do something about the energy infrastructure, and get rid of the foreign energy dependence, or diminish it, and eventually, which will eventually improve the terms of trade.

But that actually creates a huge area for fiscal stimulus that is coming in the next few years. First of all, both in various defense budgets, and then the area of energy infrastructure. So that's good for stock market, that's good for domestic currency. That's good for growth. I feel it is somewhat inflationary, the situation in both Britain and Europe is somewhat inflationary. But I think only a year or two from now we'll think of it as a good thing, not as a bad thing anymore. That's my central view.

Erik: I want to follow up specifically on the energy crisis in Europe and the UK policy response. Because as you were talking, something I realized is my own inflation is to buy us is probably contributing to my view on this because when I heard that the intention of the UK new

prime minister Liz Truss was essentially a program of handouts to make it easier for people to pay their energy bills. That as you know, doesn't solve the problem of high prices, high prices are the solution to high prices. You need to create more supply, and you need to reduce demand and giving money out to people just makes inflation worse and makes the energy problem worse. But that is coming from someone who sees this as an inflation problem. I suppose if you don't have that view, then it probably makes sense, given the dire circumstances to do that. Do you think that fiscal policy that gives money to people that in my opinion undermines the demand destruction objective that they should have is good policy? Because I can't possibly say oh, how could be good policy if you have my inflation view? But if you have a deflation is view, maybe it is what do you think?

Alex: Yeah, well, you know, the interesting, the handouts are a funny thing. Because imagine that every time you like, okay, we can talk in pounds and dollars, right mentioned every time you go to the gas station, they give you $1 or a pound, right? The government subsidizes this transaction by a pound right? Now there's two ways to subsidize it. They give it pound to the owner of the gas station, and then gas costs half a pound less, right. And both the customer and the gas station are better by half a pound, right but the registered price now half a pound lower right for the gas. Now imagine the opposite, they give half a pound for the customer for the buyer. Then their price goes up by half a pound both sides against split the profit. Both sides make the same like whether you give the pound directly to cut subsidize the buyer by account the demand by account or supply by a pound. Everybody ends up with the same amount of money, but the price is different by pound. Does it make sense or am I talking too fast?

Erik: No, it's not too fast. I understand. I guess what I what it seems to me...

Alex: Deflation or inflation, whether you stimulate demand or supply, but it's really the same thing, right, nothing really changes. Everybody's in the same place in terms of their financial outcome. And that's why I was a little debt but that's part of the reason why I don't really believe in the catastrophic inflation now with that kind of supply pull, demand push catastrophic. It's not really what I think of dangerous inflation. It's more of like illusionary inflation create. The illusion that it's very real in terms of what people have to pay for stuff, but it's created by this very particular circumstances, and we can go into inflationary situation later, but I really would like to discuss it.

But yes, I think clearly, fiscal policies, clearly no doubt. If fiscally you're going to hand money out that's inflationary. But if for every dollar you can doubt you issue a bond, which is not being bought by a central bank, and by somebody else, you second this money that you put into the circulations right back out of the system by selling a bond. So every bit of fiscal expansion is being sucked out back by issuing government debt, which is not accommodated. Now, you could argue that it goes a little different places like when you give money to low income people who have marginal propensity to consume it feeds into inflation stronger than the money you take out from balance sheets by reducing by like by selling bonds, because that hurts more asset prices rather than consumption. So there are some imbalances there. But eventually, the reasons spiral down and asset prices will probably affect consumption as well eventually.

Erik: Let's move on to the inflation topic then because for more than a decade now my view has been ok, very, very strong deflationary macro backdrop is clearly been dominant for the last decade. And the way I've looked at things is, look, you can have all these discussions about pros and cons of QE, is it good? Is it bad? whatever. At the end of the day, you can paper over almost any problem with printed money if you've got a printing press and you have the luxury of a deflationary macro backdrop where you don't cause a problem when you print that money. What I've always said is someday, the way the shit really hits the fan, is the day we get to secular inflation to the point where any attempt to try to salvage the economy by printing money or subsidizing anything, just exacerbates the inflation and makes it worse at that point, central bankers hands are tied, and they can't do anything. And I've said it's coming and I don't know when, and, you know, is we've come out of the pandemic. I thought, boy, the inflation is really visible and then all the experts said no, no it's transitory and it's peaked already. Okay, well, then the same exact people that said, it's peaked. Now it hasn't quite peaked and it's still transitory. Seems to me, like there's an awful lot of evidence that we may be headed into a new secular inflation. I'm not smart enough to forecast or predict these things. But it does seem like most of the experts that have been very, very confident that it was transitory or that it peaked already haven't been right quite yet. So how do you see this? Are we really still in a deflationary backdrop? Is that going to persist?

Alex: Well, I think first of all, you were correct about a number of those things as exhibited by actual printed numbers and the price action right? Before we start arguing about what happens in the future. Let's look at page three on my chart deck, is this is the chart that they used to call the one chart I've been following it for many, many years, it's a chart of role adjusted bond futures. And as you can see, depending on how you draw the channel for 40 years, US bond futures were in a rising channel. And depending on how you draw this channel, I probably like this scared it's drawn a little generously. But you could argue that it broke to the upside a little bit in 2020. But there is no question that no matter how you draw this channel, it broke down. This is a channel that there's no question that it broke down this year and the scope of the bear market and...

Erik: That does not strike you as a sign of maybe a secular inflation beginning?

Alex: it's just something to pay attention to. I do not. First of all, I never derive from price action on assets, any economic conclusions. That's not how my mind works, but I just pay attention. Price Action tells me only about price action. Like I don't think that because bonds went down that's inflationary. I think that there is a weight looking back because price action, we see what has happened over the last two years, right. And we can see that over the last few years, we no longer could say that we're in a secular bull market on bonds. That's not an argument from my perspective, it's a fact. The secular bull market and bonds that went from 1980 to 2020 finished in 2020 and we played out a bear market. The question is, is it the end of short bear market or are we going into longer secular bear market in bonds? And I'm very convinced and very strongly convinced that it's just a short bear market in bonds and I will try to explain why. But...

Erik: Okay, so this we should think of this as is the Head fake that is maybe going to trick a bunch of people into thinking that the situation has changed your thinking this is going to be a false break down and we'll be back up in that channel on page three in what timeframe within a year or...

Alex: I don't think we will be back on this channel I think what will the rally tremendously through this channel on the upside

Erik: Above the channel? So you're you think we're going to penetrate we're below the channel now you think we're gonna penetrate the channel and trade well above the top of the channel?

Alex: Yes, which is kind of hard to imagine, because we're looking at 200 prices, we're looking at zero interest rates on 30-year bonds. But it might sound a little extreme and sensational for me to say that because there's all sorts of sensationalist to say that right? It could be a lot of other outcomes. But I want to step by step explain why I think, feel so strongly. There are different forces on Play. And I think you're correct that they are some secular, there are some very short term inflationary forces. There are some deflationary cyclical forces, then there are semi-secular inflationary forces which have to do with like green energy transition, change of globalization, that kind of world order, and then there are longer deflationary tails. So between those four different trends work against each other, all sorts of things can play out. But I want to kind of in my simplest way of the view, what I do know, I want to explain why I'm so confident that rates will be zero years from now and stay zero for quite a while.

Erik: Please do, I'm all ears.

Alex: Yeah, probably never had such a strong confidence on those a couple of times and I had similar confidence, probably the only time I could possibly have had stronger confidence and being long bonds is 2014. And the second high confidence point was 2018. And that's in the recent history. The other point was more about my confidence and this comparative trade in 2002. But I really have that high confidence. So first of all, I was listening very carefully to Powell, during his press conference, and I was trying to understand, is there something they know that I don't, because my assumption is that they know more than I do, because they all have all the information they spend all their day studying this stuff. I'm not an economist. So I told myself, I'm just going to go by what he's saying. I'm going to not going to contradict anything he says.

Now let's go through what he says. He reiterated that the legs from policy are long end variable. This is a very difficult thing to internalize no matter how many times will repeat that it's very difficult to believe that that the policy does not affect inflation right away. And right away means the lack of actual inflationary impact is between one and two years, saying that it's one year, that's generous. Now, let's everybody I'm invite our listeners right now to close their eyes, take a deep breath, and really try to internalize the idea, nothing we see about inflation, and job market in 2022 has anything to do with policy in 2022. So the policy changes in 2022 had absolutely

could not possibly in any imaginable world have any effect yet on inflation on job market, The job market probably has the last leg than inflation. So the job market that we're seeing right now is a product of economic conditions in 2021. And the inflation numbers that we're seeing right now are the product of fiscal and monetary policy in 2000. So let's just all think it through imagine this, like nothing that they do has any effect on those numbers right now. So now we've took a pause right? Now, let's go to the next step. Powell himself said what are they watching it? What is their favorite measure their favorite measure is core PCE, right? And he mentioned that it's very stable, like three years, he talked about three years, 6 months, 12 month. 4.8, 4.5, 4.8. It's high but it's not spiraling up, it's stable over the year of 2022. That means that the economic and financial conditions of existence from 2020 and 2021, which were tremendous rally in stock market, which were unprecedented monetary and fiscal expansion, led to stable and high poor inflation this year.

They also led to the job market the way seeing this year. The job market and the inflation numbers that we'll see, the next two years are going to be the product of monetary and fiscal conditions right now. We'll have negative fiscal impulse, we'll have unprecedented rise in interest rates, we have tremendous rise in dollar, which also some tightening, we'll have a collapse in asset prices somewhat unprecedented, too, because we very seldom had both bonds on stocks go down with just shrinks collateral, and takes out ability to lend from the financial system. None of those things yet could possibly in any world have any effect on inflation with job market that we're seeing today. They are affecting the job market inflation we're seeing in 2024. So what we're going to see in 2024, is the product of what is happening today. So are you following me up to the step? Absolutely. So now the question, the real question is, and this is where you can, like, I might be like coming on very strong and saying like, I got it, there is no other point of view. There is a argument point, because the question is whether the measures that have been taken in 2022 have enough traction. Whether they will really bring inflation down right? That's the question, that's the trillion dollar question. Now, we can not judge whether if attraction from inflation numbers today is irrelevant to the idea whether fair construction, so we can only look at leading indicators. And we could disagree about them. Because, for example, one counter argument to my argument I was seeing is that like wages are doing really well. And the wage inflation might be entrenched. And even if inflation moderates somewhat that only will raise will only be supportive of real wages. And if real wages go up, that consumers will continue being in good shape. People talk about credit impulse and various other indications showing the balance sheets are still strong. That is a counter argument. However, what I do see is asset prices coming in. I do see commodities prices falling. Why do I think that sooner or later consumer and everything else will break down? Well, because the Fed told me so. They told us that they are determined to bring inflation down to 2%.

Now, we already accepted as an axiom, that nothing they do will affect inflation for one to two years. So by the time inflation starts coming down, they will see actual inflation coming down as a lagging indicator that they will be one or two years behind the curve, they will have been tightening for two years over the period of time that they should have been easing, which by the way, I believe that currently the correct policy would be to be easy. But theya are still tightening,

because they're still looking at the lagging indicators. Suppose current policy is not high enough. Maybe I'm wrong, while they'll keep tightening until it is. Maybe they'll tighten to 4%, maybe a little tighter to 5%. Who knows what the terminal rate is. But they spelled out that they're gonna tighten it till they see lagging indicators coming down? How can they when inflation starts coming down, there will be additional tightening happening from the fact that real rates will go up. Because if inflation is 5%, let's say core inflation is 5%. Because headline will jumping all over right? And right now, we still have negative real rates backward looking quite a bit negative. If it comes down to zero, suddenly, we'll have quite a bit positive real rates and the environment, overall fragile economy, those positive real rates will be decelerating the economy very fast, and there is no way they're in the mindset of immediately cut rates, they're still looking to raise rates. So they kind of make themselves in a situation of being behind the curve.

Erik: Let's go back to Jay Powell and core PCE and the Feds focus on core PCE, I remember the speech that you're talking about where Jay Powell said that, and if I'm not mistaken, what he actually said was, the reason that we focus on core PCE rather than headline is that the monetary policy tools that we have, don't really work on food and energy, the things that are excluded. And it seems to me like whoa, when I heard him say that I almost fell off my chair because I follow energy very, very closely as an oil trader, I recently interviewed Lee gearing about what he thinks is a coming global food crisis. And I'm thinking, okay, the two things that are completely out of control that we don't have a solution for, in the case of energy, it's just a matter of insufficient supply. We haven't invested in new exploration and in development of new supply capacity. And we could, it's not like the world ran out of oil, but we stopped drilling the oil wells. And we're getting to the point where we're out of spare capacity. And from a policy standpoint, everything that governments are doing is discouraging solving that problem.

Now, it's all solvable problems Alex, but they're solvable problems that take five to ten years to solve, because you don't just build an atomic power plant, or, you know, an aggressive plan of deep offshore drilling or something overnight. It takes years for that stuff to play out. So it seems to me, Alex, that by the Feds own admission, we're facing a situation where the tools they have to fight inflation don't work on the kind of inflation that it seems to me is nearly certain to continue. What am I missing?

Alex: Well,I guess my disagreement…I agree but what I disagree that I don't even call what's happening inflation, because I agree with you. And I agree with them, the tools almost work backwards. Because think about what happens if you raise interest rates, it becomes all the harder to start even it's already very hard to start a new prospecting for a low new drilling venture. How does raising interest rates will encourage people to do it right?

Erik: Oh, no, that's not the solution clearly.

Alex: They are contributing to the energy prices by raising crisis by raising interest rates. I don't think I will help them that result raising interest rates resolving the food crisis. Food is one worse than energy. Because what happens? I think personally, what's going to happen to

energy is that energy demand will just dramatically crater over the next two years like very, very seriously, because the point is that...

Erik: How does that work?

Alex: Well, dollars have been taken out of the system, there is no question of that amount of dollars in the world to pay for anything shrinking, first of all, through the rise of dollar through the unwind of balance sheet and through the rise of interest rates for the collapse on asset prices, which creates less which creates less collateral. So though there are some less dollars, there's less dollars to pay for everything. So people need energy not there are certain energy needs which are a lot more elastic and certain less elastic. So manufacturing takes a lot of energy. People don't have money to pay for this energy, they won't pay for it. If you keep making you dollars like they did in 2020, in 2021, this dollar will go somewhere. And wherever there is a shortage of anything, they'll pour into it, and it will spike. And that's what we're seeing today.

Again, we're seeing today the energy spike as a result of monetary policy of 2000 2021. Going forward, there will be not enough dollars sooner or later, when people run out of dollars, they just won't have dollars to buy oil with. So which means that like we seeing stuff like manufacturing plants being just shutting down in Germany, that's not an inflationary process. Yes you could say like, yes, whatever we just making will be even more expensive, because it'll be harder to get them. But I don't think that's the kind of inflation that you fight with monetary policy. In that sense. I think they're correct. What's happening is just that economy will have to be forced to shrink to accommodate if there is not enough dollars.

Erik: Okay, let's back up for a second because I want to make sure I understand this. At first my reaction was to say, wait a minute, Alex, what are you what are you talking about? How is demand is going to crater because if you've got a certain amount of economic demand, there's got to be energy demand. The only way I could see demand cratering completely would be in a deflationary depression. It sounds like you're saying, yeah, that would be it a deflationary depression. That's what's coming in my reading you right, because you didn't say deflationary depression.

Alex: Direction like going to deflationary depression and paradoxically, this is going back to the beginning of conversation. We talked about systemic risks, especially in the US, they seem to be not so much systemic risks. And that's why I think we're going into depression. Because in the past, at this stage of the cycle, something already blew up. Like it would have something like a global financial crisis happening, right, somebody's going bankrupt major high profile things happening, clear crisis, and the Fed would quickly pivot. In every other situation by now, they would have pivoted. But because we have high inflation, because nothing quite backward looking inflation, because nothing has blown up. It seems like there is no choice for them to just drive this economy into the ground. Slowly and painfully. It's not an overnight thing. Just as this bear market in stocks, it's not like a crash of March 2020. It's been going on for several months with a lot of rebounds, a lot of bounces, but they keep driving this thing into the ground. Because they are sucking out dollars out of the system. And I see really no way out of it. I think

when I say no way out, clearly, they're always out. What I'm, every time I make such a strong statement, I just want to be retrained for listeners, I think in terms of probabilities, what is the most likely outcome? So what I'm saying is that there is no way for me to not think that this is the most likely outcome deflationary depression and post probably global depression, in which paradoxically, I think the people who will look best will be Europe and Japan.

Erik: Well, this is an absolutely fascinating conversation, Alex, because you're one of very few people in the world who I think would agree with me that we're headed probably or maybe toward a global depression, not recession, but depression, really bad stuff. Yet, I see it is painfully clear that if you can see there's a depression coming, it ought to be obviously clear that it's an inflationary depression. You're saying the almost exact opposite, which is, the only way for this really to play out is a deflationary depression. And it's I'm just getting my head around that. And I started to say well Alex, it can't be that because look at the energy situation alone. In order to run anything remotely close to the current economy, we're going to have producing assets continue to deplete, which is just the natural way that oil wells work. We're not replacing them, we're not going to be able to meet current demand. So prices can't possibly crater. And I think what you're saying is no, no, I didn't say meet current demand. I said, the economy completely goes to shit. And that's the way you get to low energy prices is because it's not that we found a solution. It's not that we found a better way. It's that we had an economic dislocation that was so bad, that things are shutting down so much that we're not consuming that much energy, because the world is a very screwed up place. I want to make sure that I'm not reading too much into that, because those are some pretty darn strong statements. I agree with them on every aspect of it, except that we see inflation versus deflation differently, which is fascinating.

Alex: Well yeah, that's, yeah, I guess more or less this is this. This is what it is...

Erik: It is that strong, though. You're saying we're depression, not recession and you're talking about energy demand destruction. That's huge.

Alex: I think depression versus recession to me, it's not just about the depth. I think it's just going to be a longer it's going to be longer than previous recessions, and more broad because we're having, even though as I said, I'm slightly more positive on Europe, but Europe is no matter how optimistic can be in Europe. It's still of dire straits. And as I mentioned earlier, I might not see a lot of problems with it. So Europe is cutting a lot of problems, US is driving itself into the ground relentlessly. And China is kind of in trouble too. So we have three biggest regions in the world synchronously going into kind of recessionary environment. And in the middle of happening this, as you pointed out, and as your prices are probably going to stay high, until we see dramatic shrinkage of demand so that access tightening and central banks are draining out liquidity, this is a very negative situation. And I don't know how to get out of it. I mean, over the 10 years, probably resolve it by finding alternative sources of energy, building energy infrastructure, but it's kind of like they say that which is not sustainable cannot be sustained. If there is not enough dollars to pay for energy to maintain the economy at current levels, economy will not be maintained at current levels. It's that simple.

Erik: Let's go back to page three. And the title, of course, is really starting to resonate. For me the one chart, it seems to me that if we look at this channel here, and the breakdown that has begun below the bottom of the channel, as we discussed earlier, you think that's a fake break, and that eventually we're moving much higher. It seems to me that watching what happens here is about the most important thing that an investor can do. Because either you're right, in which case, this head fake is going to continue to frustrate people like me who think that this is going much lower. And eventually it's going to reverse and go much higher and I'm going to be wrong or you're going to be wrong, and it is going to go much lower. Boy, it's awfully hard if you're not absolutely certain which it is to put trades on. Because the trades I'm putting on, I'm betting that you and I are on the opposite sides of we're both smart guys. But if you don't get this inflation versus deflation thing, you can't possibly navigate this environment, can you?

Alex: Yeah, that's tough of course, what I tried to focus his bet on things that I have more certainty about. When I think about bonds and I look at this chart. Obviously, I'm a little cautious because this chart looks like you look at the numbers and looks like to me like it's going to a 100 if I just look on the chart, right? Which means 6% yield on the on bonds, right? Visually, it just looks like it's going there. To me, like as a amateur Chartist, I have to remember bonds is just an asset. Assets has buyers and sellers, there is no right price for it. It can go to any price where buyers meet the sellers. So if bonds crashed another 10 points and yields go up another 100 basis points. That's just what happens. Because they are more sellers and buyers. I am interested in like more like where the policy will be two or three years from now. And I have very strong conviction that the most likely level is zero for policy to be two years from now. And this is where I focus my interest. Because no matter what the charts and the markets and the technicals do. if the Fed starts cutting rates at the beginning of next year, as both myself and the market project them to do, they probably will not be able to stop and they will go all the way to zero or at least significantly lower.

Erik: And to make sure that I understand this, the reason that you are expecting interest rates to drop to zero in the next couple of years is what specifically because economic activity is so badly damaged that they have no choice but to try to stimulate the economy.

Alex: Yes and I think they will see inflation numbers go negative.

Erik: So you're not expecting disinflation, you're expecting honest to God, deflation prices going down on stuff?

Alex: Yes, that's what I think is the more likely scenario, because if if the expansionary policy of 2021 led us to this level to the levels of core PCE being stable between 4 and 5%. And that it tells me that the current policy will lead it to be negative one, negative 2% two years from now.

Erik: Alex, let's move on to page four, because I know a lot of our listeners are dying to get to the punchline here, which is what does all of this mean for the stock market. If you're talking about deflation, persisting for several years, much lower policy rates. What does that mean in terms of what we can expect for equity markets?

Alex: Okay, yes, that's definitely probably the question that is on the minds of a lot of investors. So I invite you to look at page four on my chart deck. And this is a chart that I published in my book first in 2015 in my first book, The Next Perfect Trade, and I alluded to this relation in my second book, The Trades of March 2020 that came out earlier. When did it come out? It came out earlier this year. I'm like already losing track of when I published.

Erik: The last time you were interviewed was when the book was coming out. I remember that.

Alex: Yeah, well, it's been a long year. Look what happened in the markets this year. So it feels like it's been a long time ago, right? So, what I'm saying is I refer to this chart a lot. If you see you have an orange line and a blue line and they have a pretty decent fit, you can see that there is a correlation there. And the orange lines show so for any given moment, the blue line shows us, how did interest rates change over the last two years, and the orange line shows us how will the stock market change over the next two years. So what this chart shows this is a lag fit. How interest rate momentum predicts US stock market momentum. And the fit was very good. For example, you see the spike in blue in 2016. What happened in 2016, on terms of I'm just going into more recent history, that was Brexit rates went down, stocks were kind of looking weak. And you see the big spike in orange. That's what happened over the next two years up to 2018, we had an excellent rally in stock market. Now look at the blue line in 2018. That was the corresponding to the rise of interest rates from 2016 to 2018. And you see the corresponding down spike in orange, which means that between 2018 and 2020, we've had, we've had a poor performance of stock market, including COVID right? Now go to 2020, we see the blue line going way up, and which was reflect probably as high as it's been, you could kind of see like it's right at the top of where it's ever been. That's how much the interest rates have fallen around COVID time relative when they were two years ago. And you see a huge orange spike around that, which is a huge performance of stock market between 2020 and 2022. Since then, the synchronicity was not that great. What happened is that stock market started to fall even more precipitously than it usually does in those situations. And I think I suspect is because the tightening was multifaceted, not just from interest rates, but also from fiscal policy. Do you see that orange line, which shows two year on year performance of stock market, how it went from like, 100%, up on two years to almost flat on two years.

Erik: Alex, I just want to make sure that I understand how I should be interpreting this chart. Do I understand correctly that the blue line is basically a forecast of where the orange line should be? So if we look at where the blue line ends at the right edge of the chart, that on the right scale is showing us where we are in the bond market, but then we look on the left scale. And we find that that's projecting about a 57% decline in the S&P is what we should expect. Is that a peak to trough decline or what kind of number is that.

Alex: Roughly peak to through I would say because it's a percentage decline.

Erik: So basically, you're saying the bond market now is telling us to expect the S&P to get down to essentially a 58% or 42 to reach a value, which would be 42% of its previous high at $4800.

Alex: Yes, something like that. This is not a very as you can see, the field is not very precise.

Erik: So that's about 2000 on the S&P, that's that's a pretty darn low number.

Alex: Yes, that's a pretty consistent with how this chart has been working out over the last 25 years or so.

Erik: Okay, but you're are saying around $2,000-$2,100 on the S&P is about what's being targeted, or what this chart is indicating may be coming.

Alex: Yes. If you just take, I will not put so much value like I wouldn't be so focused like it doesn't mean that I will be personally targeting $2,100 because this is just one indicator. Those feeds are fuzzy and not always perfect. But yeah, something like this seems quite reasonable and I think it's quite consistent with the idea of synchronous, global depression.

Erik: Alex, I'm just processing all of this because frankly, a lot of people think that I'm a little eccentric and awfully bearish about where things are headed. I've been telling people when the S&P was still well above $4,000. I said, hey I don't understand why it's above $3,000. Everybody told me $3,000 was a crazy low number you're talking $2,000? How should I interpret this bearishness? Are you really thinking this is end of the world stuff? Or is this just a cyclical thing that the economy has to work through? How do we make sense of what you think is coming?

Alex: I definitely don't think about the end of the world. If it comes, it will catch me by surprise. I'm reasonably positive about an optimistic about the future of the world. I don't think there's anything strange or unusual about 50-60%, top to bottom on S&P 500. That kind of happens before once in a while, like you can see that happening in 2007, for example, something similar, and you can see it happening in 2000. Maybe not exactly those numbers, but it will be very consistent with those numbers and the interest rate momentum and the overall momentum from interest rates and fiscal policy and balance sheet is more negative from any of those occasions. So I don't see any reason or any reason to be like disturbed by the fact that it may go there. Having said that, my bearish is on stock market always has a caveat, I believe that in the long run stock market always will go up. It is more likely to go up than down. And as soon as policy pivots and interest rates will actually, that as soon as this blue line and this blue line can start going up pretty rapidly, because both what we saw two years ago is kind of catching up to us to higher rates. And if there is people can set it to go down, this blue line will start going up very rapidly and forecast them a better outcome for stocks. And when this blue line will cross the zero again, when the rates are lower today, when they were two years ago, I will probably be a buyer of stocks. Honestly, this indicator just worked so well for me under law over the last 25 years, I see no reason not to continue following it.

Erik: Let's move on and talk about the consequences to the US dollar, which you've got charted on page five. Now this is a fascinating one Alex, because there's so many people who will tell you, the dollars days are numbered, it's going to be replaced as the global reserve currency, and therefore the dollar is going to crash. It's going to zero. And I have a very different view. My view is yeah, I do think that the dollar is going to be replaced as global reserve currency. But I think that the dollar is going to appreciate in a global flight to safety as a lot of that bad stuff that you talked about happens. And I think that the biggest risk to the global economy is an out of control appreciation of the US dollar. How do you see this? Are we worried about the US dollar going up or down? Where's the risk? I think it's a risk of too much up?

Alex: Well, first of all, I have to admit dollar has been confounding over the last year or two. Because notice, if you look at the charts, and I posted the chart, like look at how it acted during different periods of time. In 2020, it started to go down from like 100 to 90, once the original crisis was over, and they started to add liquidity. And I started to think that we might have $1 down cycle like we did from 2001 to 2008. When it went from 120 to 70. I was really thinking we might have a huge kind of long term bear market and the dollar. And obviously, that's not what happened. I think that usually what I do think is usually happens at the very end of the cycle, dollar usually goes down. And that is actually one of the counter arguments to my point that we're in the edge of recession in the US because look, for example, at the events of 2018. When we got to the end of cycle in 2017-2018, both dollar and bonds went down at the beginning of 2018. And only then dollar started as things rolled over dollar started to go up. So it feels to me that before while the dollar is still grinding up, that's actually not an environment, which typically is conducive of beginning of severe recession, first dollar has to sell off. So my central scenario is that probably the dollar is going to actually grind up maybe possibly to 120 again, or I don't know where it wants to be in it could continue grinding, but at any point, it can have a severe correction. And that would be a sign probably that things are turning around.

Erik: You're a fixed income expert, Alex. So I'm sure you must have an opinion on this question of the dollar and emerging market debt. The argument that a lot of people have posited as essentially, that there's so much dollar-denominated debt that if you get above a certain level on the dollar index, it becomes impossible for all of those countries that have borrowed in dollars to repay, because they would be repaying a much larger multiple of their original borrowing amount as reflected in their own currency. Is that sensible logic? Is that the right way to think about this? And if so, what does it mean, given the circumstances?

Alex: Well, you know, I'm somewhat confounded by this question. Because yes one would argue that there should be an emerging market crisis, but we're not seeing it. Brazil is doing quite well, which is usually like a good Bellwether. Mexican currency is stable. Interestingly in Turkey, for example, you could add your commodity currencies are doing well, right, because commodity prices have risen and they're catching up with dollar being stronger because their commodity producers and whatever they're having good terms of trade. But look at Turkey, Turkish currency has been depreciating. And they've been cutting interest rates. So they've been really divergent from the global policy, but it's depreciating very slowly and over the last

few months, it was actually I think, depreciating slower than projected by the forwards. So if you were holding Turkish Lira forward. You're actually making money over the last few months. Something really strange is going on in the world. The one emerging market that is melting is China. This is one place where I think you're seeing, we're seeing a budding meltdown. What causes this dynamic? Why there is no emerging market crisis just triggered by I think maybe dollar is not enough, just dollar here is not enough to cause an emerging market crisis. Maybe this time, the emerging markets release the interest rate sufficiently and Brazil was kind of ahead of the game raising its own interest rates quite aggressively last year. And I think they got ahead of the game. And now they see in strong and stable currency. You can have all sorts of interesting theories about that. But do you see like, I want to pose back to you do you see an emerging market? Other than hypothetical meltdown that should occur? Do you see any signs of the meltdown actually occurring? Because I don't.

Erik: No I don't see them and that's a quandary in my mind. And the question in my mind is okay, there has to be some number, some level of the dollar, where the repayment of that emerging debt becomes insurmountable. It's impossible for them to pay it back and at that point, they just give up and say we might as well default because we know that's where it's going to end up anyway. It seems to me, there's got to be some magic number for the dollar index that when it gets to that level, it's all over for EM. Well, a lot of people thought it was 110. Obviously, that's not the number because we got all the way to almost 116. And you know, it hasn't broken yet. It seems to me if you know that magic number, you're got an incredible amount of edge as a trader. But of course, that's an unknowable thing. So I thought I'd ask in case you had any insights?

Alex: Well I have one idea about this and that is the same thing. I think that is related to what's happening in the US economy and to the US consumer. And why, for example, are we seeing the US consumer very robust, because you could make the same argument about US consumer, why are people like not. We don't see a dramatic pulling back from US consumer despite the fact that interest rates have risen and asset prices have fallen. I think that there was a really big cushion building in 2020 in the world system by so many dollars being supplied in the world financial system, that there was so many dollars sloshing around that they kind of padded out the situation in various direct and indirect ways that possibly like through various swap lines and various holdings, we might not see it in exact numbers of foreign exchange reserves for various countries. But what I feel is like there is a lot of cushion. And right now this cushion is being sucked out. Same thing consumers like we're not seeing immediate consumer crisis, because everybody's personal balance sheet is pretty good. And even balance sheets and corporations are pretty good going into these. So nothing blows up right away. And I think that's what's happening to emerging markets. The cushion was such a good cushion built in in 2020 where you print dollars, that it takes a long time to suck those dollars out.

Erik: Now, Alex, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners a little bit more about what you do at HonTe advisors. We do have a large institutional and accredited audience that are eligible to invest in hedge funds. And also, you've got two books out now,. We've covered... I don't remember if we did interviews on both of

your books, but certainly the more recent book, we did an interview here on MacroVoices that listeners you just put Alex's name in the search box at macrovoices.com. You can find those previous interviews, but tell us what's in the books and also how people can contact you if they're interested in the fund.

Alex: Thank you very much. So, as you mentioned, HonTe advisors or HonTe investments depending on how you look at the name. The website is www.honteinv.com and accredited investors can go to this website and find out about investment opportunities with us. We'll have both institutional and retail oriented programs, but they're all for accredited investors. I can be followed on Twitter @agurevich23. And on this, all the links to my books and my company's website could be found on twitter. With regards to my books, yes, I have two books out. The first one came out in 2015. It's called The Next Perfect Trade. And I like to compare it that if you were the medical student, the first book is kind of like an anatomy textbook and this book I discuss my principles of trade selection step by step. But my second book, The Trades of March 2020 is like working into an actual operating room. What I do in this book I show blow by blow what is happening in a command center or a hedge fund during a pandemic crisis and what it's like to navigate crisis while you're both personally and professionally under pressure. I feel like this book has done a really good job if I may say so myself, but showing people what it's really like to be there in the trenches when the crisis happens.

Erik: Patrick Ceresna, Nick Galarnyk and I will be back as MacroVoices continues right after this.