Eric Peters: On The Road From Mean Reversion To Reflexivity

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Erik: Joining me now is Eric Peters, Founder and Chief Investment Officer for One River Asset Management and One River Digital. Eric, it's great to have you back. It's been way too long. You know, I really enjoy reading your weekend notes email that I get every single Saturday. I particularly was interested in a comment that you made saying that the strongest or best I think the way you phrased it was the best armed military powers in the world are suddenly at odds with each other or in direct conflict. Tell us a little bit more about how you see this geopolitical situation. What's driving it and what it means for markets?

Eric Peters: Sure. Erik, great to be back. It's, it has been a while actually. And boy a lot a lot happen in the world. It feels like we have new things to talk about every time we get together. So yeah, what I referenced was, it seems apparent that we are. We're in a period of rising conflict and it's becoming more explicit. So this past week, I was referring specifically to the Russians claiming that the UK Ministry of Defense or defense ministry had been intervening in the drone attack on the Black Sea Fleet. And then I think what really caught my eye as well, is that we had the last week we had a Senate report that came out that actually said it was I don't know the exact terms, but reasonably likely that COVID came from a lab. And you know, that comes after a couple of years of strong statements in opposition to that theory. And I think that, you know, there are plenty people who looked at the original COVID leak and had observed that there was at least a reasonable probability or possibility that it come from a lab. And, you know yet I think, probably for political reasons, the government pushed back hard on that. So it's just interesting that that all of a sudden, it seems to be the opposite is true.

Erik: Eric, one of the rules of investing is that wars are almost always inflationary. Right now, we don't actually have a hot war between superpowers. We have a proxy war or a cold war, if you want to call it that. I think it's rapidly escalating in the direction of a hot war, but we're not there yet. Is it time to conclude that this is inherently inflationary and does that mean that the debate about whether inflation is transitory or persistent is going to be resolved as a result of this geopolitical escalation or how should we think about inflation in this new environment?

Eric Peters: There are a whole bunch of different dimensions to consider inflation and lenses through which to think about our mental models. One is through conflict, another is through and these are related through globalization. So I think we've been through, we're on the other side of this, what it seemed like an inexorable trend toward deeply integrating our economies globally.

We call that globalization. And I think we're the other the other side of that, meaning that for decades, really the entirety of my career, we have seen ever deeper integration of the global economy in different economies with one another. And that is, that is by nature, a disinflationary or deflationary force in the sense that whenever there's a shortage of something, one part of the world. If politicians, policymakers, companies, state-owned enterprises, if they all feel comfortable, more or less in looking for whatever those supplies are, that are in shortage in their domestic market. If they're comfortable going abroad to source, you know, more supply, then naturally you can solve a shortage pretty easily. And it may not even be that you're just trying to source the supply right away. And you may actually be going to a different country to try to create more supply of whatever that may be. And that could be labor, it could be goods, it could be products or services in the case of, you know, a lot of Global Services enabled by technology, call centers, whatever.

And so in an environment where there's great comfort in globalization, and there's an expectation that that will continue on, and importantly where the world is largely speaking in a peaceful environment. Then, law decisions that are made make the economy more efficient, although you introduce new types of fragilities, and one of the fragilities is that there's some type of shock in some part of that really complex supply chain. One of the fragilities is that in the event of rising conflict that all of a sudden you look at your supply chains and go they may not be as robust as we once hoped, because there could be a military conflict or something, you know, something like that. And so I think that's when you think about conflict and you think about inflation, I think that's just a really important thing to consider because we seem to number one, very clearly be moving into a direction of deglobalization and kind of the reshoring of certain critical industries and some industries that aren't necessarily critical. And people are worried about their supply chains because of rising conflict. And the consequence of that is that people start trying to look for sources of supply that aren't necessarily as efficient. And they're willing to pay a premium for those things, just because they're more stable. And so those are, you know, those are very important things to consider. I think that that's what we're seeing right now, for sure. I mean, there are other aspects to inflation. But that's a big important one, and one that I don't think is going to turn quickly. Meaning, I don't think that we are, that someone's going to snap their fingers, and we're going to enter a more peaceful period ahead. Nor do I think that there's any type of action that's going to lead to deeper integration and globalization right now. I think the trends are very strongly in, you know, in opposition of that.

Erik: Eric, I think this is monumentally important because so many people are still talking about look stop worrying so much about inflation, it's just supply chain disruptions from the pandemic, and the pandemics ending. The supply chain is going to get resolved, it's all going to be fine. Inflation is coming back down, just relax already. And I'm kind of like, wait a minute, you think pandemic screw up supply chains? Try global wars. That's a big deal. So it seems to me like everybody is starting to talk now about reshoring of critical industries and so forth. They've got the message that we need to recognize that we're dependent on a lot of international relationships that are breaking down for commerce. But I don't see most people taking the next step, at least, as far as what I'm reading, people don't seem to be going to the next step saying wait a minute, it could be that the supply chain disruptions caused by COVID were just the

warmup and the supply chain disruptions that are still coming as a result of rising geopolitical conflict could easily be several times worse than what we saw with COVID. Would you agree with that? I don't want to, you know, put words in your mouth. Am I exaggerating when I look at it that way?

Eric Peters: I don't have a strong opinion in terms of magnitude, because the supply chain disruptions that we saw, coming from COVID were obviously dramatic and in some cases immediate. And I think what we're talking about with rising global conflict is much more of a chronic situation. I think if there were a hot war, like for instance, if the Chinese invaded Taiwan, which I don't expect to be imminent, in any way. But let's just say hypothetically, if they did do that, then you'd see a dramatic impact on supply chains globally. But you don't need to have a hot conflict to disrupt supply chains, you need to have simply this reversal in this trend towards globalization and an increase awareness and concern over just the overall climate of international relations, which is what we have right now. So, you know, you see things like the US putting in place, some type of program to bring supply manufacturing back to the US. You know, that causes inflation. I mean, where are you going to find those people and how you can build those plants, and where are you going to get that machinery, etc. You know, that causes inflation. So all sorts of things cause inflation over different time horizons. I think the pandemic was a really dramatic shock, and will have a big effect on inflation expectations for a long period of time, because really the first time certainly in the US and in Europe in our lifetimes that we saw such dramatic impacts on inflation. And we also saw the ability of governments to create tons of money in a really short period of time, and that I think, has loosened the relationship that we have between kind of money and stability, and so that, you know, that has the potential to impact inflation expectations for a very long time. But anyway, I think that this period of deglobalization and rising conflict will have effects on inflation over a long period of time, and hopefully, we don't have a hot war, that's any worse than what we currently have going on in Ukraine. Because that, you know, that would obviously cause a sharp spike in inflation, although inflation probably be the least of our worries at that stage.

Erik: Another theme that I've discussed with several other recent guests has been food and energy. We've obviously got an energy crisis in Europe. My contention is that's not really a European energy crisis, it's a global energy crisis that's just getting started which is being felt the most in Europe right now. When I interviewed Leigh Gohering on this program, he told me that you know, energy is a really big deal. But just wait until the feedback loops around food kick in, and we start to get the food supply chain, which is very globalized start to break down. What are your thoughts on those topics?

Eric Peters: I agree, I don't think that this is strictly a European energy crisis. I think it's most acute right now in Europe, certainly in the developed world. I also think though that, and this won't affect the global macro markets that we trade immediately. But I think the shortages that we're seeing in energy and in food, and let's remember that the two are really highly correlated, I mean, food that we eat is more or less just energy. Like when you look at the inputs that go into food. They're mostly fossil fuel in truth. And so anyway, there's a relationship between food and energy, I think that we have under invested in the production certainly of energy and

therefore, you know, and therefore food, and the shortages that we're starting to see unfold, are going to ripple across the world. What's interesting, and I think, quite tragic, honestly, is that well intended governments in the West, and Europe, in the US, and Japan, even, we're seeing, you know, programs to subsidize energy consumption, in some cases, food consumption. And it's not that those are bad in and of themselves, it's just that effectively, what they do is they push that shortage to the countries that can least afford it.

And so I think, over the next couple of years, we should expect to see some real problems throughout the emerging world with people just not having enough to eat. And, you know, I think that will become a big issue in terms of macro markets and geopolitics when those people start moving to the wealthier countries. And so we've seen waves of that happened in Northern Africa, in the Middle East, where you see waves of immigration when there's real hardship in their countries. I think, you know, we see that to a degree in in the US with the South and Central Americans making their way up to the US at various points in time when conditions are difficult in their countries. I think it's highly likely that we see, you know, see those types of things unfold over the next few years.

Erik: Okay Eric so we've talked about food and energy. We've talked about supply chains. I think you and I agree that these are both bigger deals than the market has really absorbed yet. Well, that's very unfortunate for the world because these are horrible things. But as investors, our job is to think about how that variant perception gives us trading edge. So if we know that the supply chain problems are not going away just because the pandemic is going away, because we've got a new source of supply chain challenges, and we've got food and energy challenges that are likely to drive inflation beyond the levels that most people are expecting. How do we translate that to an investment thesis?

Eric Peters: Yeah, that's always, you know, that's always the trick. And I think we're, you know, we're mentioning, are you so far, we've talked about some things that are challenges. You know that said, humans are pretty good at in overcoming challenges. And oftentimes, you know, the great challenges make us, you know, make us better provided. We survived them so, I guess first and foremost we should hope that we don't have some type of great power hot war. We've seen smaller wars over the last couple of decades, but they don't really, relative to kind of some of the conflicts that are brewing right now, they don't really count. So when we think about the investment framework, and the world that we're in right now and kind of how to think about investing in positioning for this world. You know, well, we've talked about challenges in energy supplies and food supplies, and we've talked about deglobalization. We've talked about rising conflict, some of the things that I think will inevitably come in and out are a lot of volatility, because markets never move just in one direction. And there'll be periods where, you know in this cycle that we see ahead, where there will be expectations of, you know, of less conflict, and that will be a relief to markets and there'll be periods where, you know, energy prices come off, and that might feel good or food prices come off, or you get a good harvest. And so it'd be volatility in these markets. But I think that to answer the real question about how to position for this, I'll kind of go back to our framework for how to think about the overriding place where we are in markets.

So I'd say for the and this is big picture Eric. So if we look back at the last you know, few decades, we've been in this period of globalization, which we've talked about. What has globalization done? Well, amongst a number of other trends, what it's done, it's been a force for real moderation in markets and it's allowed economies to become evermore efficient. Also fragile but ever more efficient. It's allowed the global economy to solve all sorts of shortages and surpluses. So if there's a surplus of, you know, any commodity or any good or labor in a particular region or country, global CEOs figure out a way to maximize the utility of that excess resource or labor, whatever it may be. So when you think about what that leads to, it leads to markets that are more prone to mean reversion. Because, you know, prices jump up, and, you know, the market figures out how to how to correct that. It's been amplified by central bank policy, which has really been the dominant policy for the last, you know, few decades. And so, whenever there's a recession, central bankers, you know, come in and lower interest rates and do increasingly aggressive rounds of stimulus, which is, you know, which has kind of led to where we are right now, which we've seen massive QE programs and low rates forever. And, you know, we're finally now readjusting from that period. But starting in 2020, that pandemic, from our perspective was the catalyst that has catapulted us into a very new paradigm, market paradigm. This paradigm of deglobalization, rising conflict, politicians becoming much more important features of the market.

So for the last few decades, it was all about central bankers. Well now, once we required a large fiscal stimulus to get the world out of this, you know, this deep economic crisis sparked by COVID and our response to COVID. What you really did is you reignited politicians as actors in the economy. And so once politicians get engaged, all sorts of kind of wild things can happen, because politicians are so different from one another.

If you look at even in the US, you look at, I don't know, Trump versus Biden, very different, very different economies, you know, depending on who's in power. And so, what we think we are entering into now or in what we are already in, is a period, because of D globalization, because of rising conflict, because of the, the tendency for politicians to stimulate and, you know, a whole range of ways or impose who knows capital controls or impose different stimuluses for solar energy or, or decide to do something militarily, we're going to see all kinds of wider dispersion in in outcomes, because like the last 30 years, if central bankers had been the dominant policymakers, they all kind of did the same thing. across countries, I mean, everyone, all the central bankers more or less use the Fed playbook for the last few decades, because in a increasingly globalizing world. If you didn't do what the Fed did, your currency would get really strong and people couldn't, you know, in a world where everyone valued deeper integration with their economies in a globalization, you couldn't have a really strong currency. And so what it did is it because the US has the global reserve currency, and the Fed, more or less is in charge of that everyone had to adopt the Fed model. So we had very homogeneous policy for the last few decades, and it grew increasingly homogeneous. But now that we have politicians making big fiscal decisions, and all sorts of other decisions, including engaging in, you know, in war and hostility of all sorts, we should have much more dispersion. And actually, a world of deglobalization is kind of the opposite of this mean reversion type environment. And actually it's

an environment of reflexivity, meaning that when you have trends, they will oftentimes reinforce themselves as opposed to self moderate.

So an example of that would be, you know, if you have a shortage of fuel somewhere in the world, well what do all sorts of countries do? They don't try to figure out how to use their resources to solve that shortage, they start going holy cow, you know, what if my access to fuel is cut off? And you know, maybe we should be hoarding, maybe we should be hoarding food, or maybe we should be hoarding energy. Or maybe we need to start building domestic supplies and by building domestic supplies, it's going to require a hell of a lot more steel, or different energy inputs and labor in order to, you know, make the investment in the infrastructure to produce whatever is in short supply. And so those are markets where I think you'll start to see very large trends develop and reflexive trends mean that the price goes up, and that makes the price go up even more. Obviously, the price doesn't go to the sky. So you'll have big trends and then you'll have big crashes. And so we expect, in this kind of new market paradigm to see very large market moves. We've started to see those, trend falling is a great strategy for that, volatility is a great strategy. Dispersion of all sorts is a great strategy. I think, the things maybe the way, the right way to think about it is the things that worked best in the old paradigm are probably unlikely to be the things that worked best. Maybe they work horribly in this new market paradigm. And the things that were kind of unloved in the previous paradigm, probably going to start working a lot better.

Erik: Eric, I really think you're onto something with this idea that mean reversion is going to give way to reflexivity. Let's apply that to one specific scenario, which is evolving as we speak. On Tuesday morning of this week, rumors began surfacing saying China's going to come out of lockdown in March of 2023. And then that was promptly denied officially, but a whole bunch of people who are expert on the situation have said there is probably something afoot here and whether or not it's exactly going to be March of 23 or not, we don't know. But it's probably coming and we've probably reached a point where China is unable to continue its COVID Zero policy without getting to, you know, an outright breakdown in civil unrest in that country. We don't know as we're only taping this interview on Tuesday afternoon, of what's going to happen. So our listeners may know more about how this resolved in the short term. But let's ignore the question of whether this particular rumor is true or not and get to some time China is going to reopen. If we think of that, in the old school of mean reversion. It should be oh, well, if China's reopening. That means that supply chain issue should get much better, because China's going to keep exporting stuff and we'll have more things in the supply chain is just going to get better. Is that the right way to think about it or is there a different way in this new era of reflexivity that we should think about what China reopening means?

Eric Peters: Yeah, it's a good question, Erik. You know, these are the sorts of questions that are kind of easy to answer in isolation. So all else equal, the answer is yes, if China reopens supply chains should free up more than they would have been if China were not reopen. But the world's obviously a lot more complex than that. And so, China reopening, you know, what is? What does that really mean? Will it mean that the Chinese will start traveling abroad a ton all of a sudden? Is that what it'll mean? And, you know what will that do to all sorts of consumption

patterns and prices and current account deficits or surpluses all over the world because they have a another pretty big footprint globally. What does it mean for consumption of energy and commodities within China. Do they just go back to what they were doing before? And I think the answer to all those things is we don't really know. And you tell me, what will be the state of play between the US and Taiwan when that happens, you know, because that will have an influence on it. I will tell you that there are a lot of those things are kind of unknown, as we sit here now. And we talk about what's going to be happening in March. What I think is known is that every CEO in the world, not just in the US but in the world has woken up to the possibility that having really complex global supply chains are a real risk to their business. It's not that there's no benefit to them. They know what the benefit is. It's just all of a sudden, they're waking up to these things being a real risk. And so I think that this is a broad statement but broadly speaking, all of these CEOs are in the process of making decisions to create greater redundancy in their supply chains. They just are, they have to, they just have to.

And by the way, when you look at what has what happened to the Nord Stream pipelines. That a wake up call to every government in the world to relook at their critical infrastructure and imagine how vulnerable it is to attack, terrorism, whatever it may be. And they have to ask themselves, how robust is our critical infrastructure? And if the answer is, it's not extremely robust, then they need to start making decisions around that. And then I'm sure that they are. It doesn't mean that it will happen overnight. But these are things that I think, no matter what the state of play is, with China reopening that reopening or how we're dealing with Taiwan or any of these questions, I think we can know with a high degree of certainty that that politicians and CEOs are going to begin restoring greater redundancy to their supply chains and infrastructure. And that's a really big deal because that really has not been happening for the last, you know, the last few decades, which is why you have something like Nord Stream, which you can easily blow up, right? But if we're in a world where no one's really worried about that, then it doesn't matter. You go, let's build a pipeline under, you know, unprotected under a huge ocean and anyone with a drone could blow the thing up whenever they want. Not a big deal if no one's worried about tension, but in this world it's a very big deal.

Erik: Eric, it seems to me that in finance, we have a whole new challenge that we haven't even begun to take on yet, which is the financial industry is extremely good at looking at companies in very close detail and looking at their balance sheets and saying okay, what kind of debt do they have? What kind of subordinated debt do they have? What kind of senior debt do they have? How are we going to analyze what this company's shares are actually worth? Based on these very nuanced analyses of the debt structure of that company? Well, hey, wait a minute. What about other questions like, Is it even possible for them to keep making their product, if we start not being friendly with Company X, where their supply chain is entirely dependent on, you know, some particular product, whether it's semiconductors out of Taiwan or palm oil out of the Philippines, or wherever it comes from. You know, pick your favorite example. It seems to me like we don't have the ability to analyze companies in portfolios and say, what are the supply chain risks that are likely to arise if geopolitical relations worsen with Country X, Y, or Z? Is that something that we need to develop a system for.

Eric Peters: I'm sure a lot of people who are good at these things will make a lot of money in this environment, because most people aren't. I mentioned earlier that I think dispersion is going to be a really important theme going forward. And the flip side to that is that indexing, broadly speaking, I think won't be and, and just kind of long only investing. I think we've most likely seen the peak of that. And it's probably behind us at this stage. And so, you know, investors who are creatively minded, who are not just looking at correlations that worked over the last 10 years, but are thinking independently and trying to consider these different risks. I think it'll do extremely well. You know, we look for all sorts of different macro themes, and then think about ways to express them in markets. In our vol portfolio, we run a pretty decent sized dispersion book. And so, you know, we're looking for, we're looking for things that are starting to pop up in the world and just say well how do we capitalize on those? So an example might be well, one of the things that we really capitalize on is we thought that the world would experience... This is, you know, really pre-pandemic, we thought the world would experience a much different inflationary paradigm. In certainly post-pandemic we did. And so we built dispersion baskets in our, you know, in our vol book that bet on greater dispersion between companies that would be affected well, by inflation and would be, you know, hurt by inflation. And the market hadn't really priced that in. We looked at, say something like the LEI and issues in UK pensions, and we're like okay well all these pensions that were, they had risks in their books that they either didn't understand or were willing to take and just thought would never be realized. And that created you know, all sorts of chaos in UK markets, and it partially spilled over internationally. But we looked at that and said, well maybe we should look at US companies, which have similar types of exposures in their pension plans. And, you know, are there companies in the world or in the US right now, that have big pensions that are exposed and other companies that have, you know, decent sized pensions, but maybe they're not as big as the overall, the overall company. And so if there's a pension blow up in the US, the companies that are more exposed are going to get hurt a lot worse than the companies that aren't as exposed. And so, you know, how's the market pricing that? And it's probably pretty easy to conclude the markets probably not really pricing that because no one's really thought about that risk for a long, long time or maybe never. So, you know, these are kind of ways that around the edges that we're looking at expressing risks like this. I think there'll be all sorts of people that come up with really creative ways to reevaluate the price of certain credits because of the geopolitical situations and they'll make a lot of money.

Erik: Eric, I definitely agree that passive investing is on the way out, if not already out. If you stop and think about it, the whole rationale for passive as a strategy was really layered on top of the efficient markets hypothesis. The idea was, everything's already efficiently priced. You know the risks and so forth are baked into the price because the market knows the risks? Well, I think it's pretty clear in this environment, the market doesn't understand all of the risks, because the risks are changing very dynamically. And very quickly, due to geopolitical escalation. And also, to a lesser extent, this trend of inflation, which most people seem to be unable to recognize, may be actually secular and not just transitory, which is certainly the view that I hold. But hang on, what's the next step? Because if we go beyond, okay, it's not passive anymore, to say, well, that means it's a traders market, or it's a stock pickers market. I think we just agreed, you and I are not smart enough to understand all of these risks of all the things that could go wrong if one

particular country stops exporting this, what does it mean that the supply chain for X, Y, and Z. It's such a complicated problem, you can't possibly be smart enough to know all the answers. So if it's not passive, and it's not stock picking, in the sense of really knowing all the stocks to pick? What is it? Is it trend following at that point, or what kind of strategy should we employ?

Eric Peters: I think you need to employ people who understand the markets extremely well, and are flexible in their thinking. So it's of course true that you and I, and or, you know, there's no one out there who's going to know, who's going to know everything and have all the answers, but I just gave some examples, and, you know in dispersion in the volatility markets, which is something that we trade, a lot of in our expert in, and we've been able to find really good opportunities in those through, you know, through our macro lens, and then, you know, in our expertise in dispersion trading, and I think there'll be all sorts of, and you look at a lot of the macro managers this year, and most of them have had very good years so this is a good environment for that. I don't, I sincerely doubt that we're going to have, you know, a good year or a couple good years, and then these major macro forces of the last 30 years are just suddenly restored to balance and we go back to levered carry passive investing, you know, very low levels of inflation and accommodative monetary policy, and everything's back to normal. It was just a, you know, two or three year blip. I don't think that that's the case at all. And so I think it's important to find investors who understand the markets really well and can you know, take proactive risks.

I think, one of the ways to capitalize on this, it's been very successful this year. We run some of these strategies or trend following strategies and incidentally, we have held the view for a couple of years that in this new market paradigm, because it's, it's this transition from mean reversion pre pandemic, to reflexivity, post pandemic, and that this is going to be a, you know, probably a 10 ish year period. And I say 10 years not because it's a specific time, it's just like a good chunk of time, you'll see these decade long periods, like the 1970s, where we had very large market moves, for instance. And so I think one way of capitalizing on change is to invest in trend following because if you think of what is a price trend, a price trend is a movement in price that reflects a future state of the world is really quite different from today. And in a world where things are more reflexive, there is going to be big change. And so you can capitalize on that by investing in very smart people who know their markets well, who can identify with high conviction changes in the markets where they're expert in and then, you know, make appropriately risk-managed bets in those spaces and those people will do well. The advantage of trend following is that you can get wide breadth, so you know, across our two strategies, we cover about 160 different markets. And if you can make similar sized bets in all those markets and follow those trends. You might be wrong, intuitively about the direction of the change, and you're still going to make money in that strategies, which is great, because in a world where an awful lot of things are changing, you know, pretty substantially, you might be right about some of them, but you're not going to be right about all of them. And the good thing about a systematic trend following strategy is that it's dispassionately, just following those trends and capitalizing on those moves and you don't have had to have done the analysis, you just have to have the insight that we're actually going to see some big moves here, and then that strategy capitalizes on it. So that's how we look at that.

Erik: Eric, let's come back to this question of transitory or secular inflation. I'd like to take it a step further because first of all, I'm convinced it's not transitory. I think inflation is here to stay. I'm going to suggest that maybe it's not just here to stay, but maybe it's intentional because the way I've seen this is governments really have no choice but to inflate away their debt, is that what's happening? Are we seeing the beginning of a new regime of financial repression that's going to last for decades the way it did after World War II?

Eric Peters: Yeah, I think that that's a very important thing to keep in the back of your mind throughout this. What's happening right now I believe strongly is deliberate policy. So we've spent these last 30 years with central banks in essence, bailing out the economy in each recession. And at first it was just through rates and then increasingly became through QE, and then bailouts of all sorts. And we've finally gotten to really the natural conclusion of that journey, which is that you have very large government debts. And so when people look around, and they say well the consumer seems okay, and the banking system seems okay, it's like, well they do seem okay, because they've really been bailed out by the government. And not because anyone was a bad person or that they were making what they thought was stupid policy, they just kept trying to create sustained economic growth, and it required increasing doses of intervention to do that. And so the natural dust, you know, the destination for that journey, is a place where actually the fragility lies in the government balance sheet, and they've taken on all sorts of debt. And not only that, but they have made enormous entitlement promises to the baby boomers. And so I think, you know, when we've talked about global supply chains and deglobalization and rising conflict, etc. And we've looked at those things and we've said well, you know, those are drivers of inflation. There are other drivers of inflation too. The really big one is that there's a deliberate government policy to try to unburden the sovereign balance sheet of all these debts by creating inflation and the way you do that well you do it in all sorts of ways. We've seen what they've accomplished recently, which is not to say that they're thrilled about the pace of inflation relative to actual growth, and we've had a huge nominal increase in GDP so far this year, with really anemic growth, you know. But when you think about what that does is it increases nominal GDP, and it makes the debt-to-GDP go down even though we're running deficits.

So the way that governments ultimately do that is they, the way that they unburden themselves from these debt levels through financial repression is that they keep a nominal GDP as high as they possibly can. And that's through some combination of hopefully decent growth but potential growth in the US is probably not more than 1 or 2%. I mean, it really isn't, it could be, let's call between 0% and 2%. And so they're going to have to have a nice hefty rate of inflation over time on top of that, and then you have to keep interest rates much below those levels. And so right now, that's what you see. I know people talk about real rates being positive way out the curve. But if you look in the front end of the curve, you know, we have overnight rates reasonably low relative to inflation, which is pretty darn high, which is, you know, over 8 percent. So I think we see a long period of policy like this and so naturally, the headlines will read well, the Fed is unhappy with and inflation at these levels. I know that they are unhappy with it. They don't want to see this run away, they don't want to see a hyperinflation. And so they'll try to rein

it back in but I think what we should expect to see is, you know, on average quite high levels of inflation relative to what we've experienced for the last decade. So we could see inflation bumping around between 2 and 7%, or 2 and 8% for the next few years. And maybe it averages out at 4 or 5 or 6%. It's a much different inflation dynamic, and it will all have been deliberate through that time.

Erik: Well Eric, 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 [One River Asset Management] and particularly something new since I've known you is now One River Digital, what's the angle there?

Eric Peters: Sure so we're at our core a macro firm. We're very opportunistic. We express all sorts of views, either systematically or through our discretionary strategies. We run a about a $3 billion firm. We run risk and volatility strategy. So we have a discretionary long volatility strategy. We have a systematic, long-equity volatility strategy. We have a high Sharpe volatility RV. So market neutral strategy, which is where we express risk and things like dispersion. We have a couple of trend following strategies. So systematic trend following strategies for core markets and for more esoteric markets. We run an inflation strategy. So these are all kind of core macro type strategies that we run. We combined some of those for our clients in ways that have really helped them so we have a risk responder strategy that combines our long volatility with trend and in a very capital efficient way. And that's, that's a great diversifier for our large institutional clients. But we also entered the digital asset arena in November of 2020 with what at the time was the largest Bitcoin and Etherium trade for institution. We made an awful lot of money out of that and returned all the capital. We used that whole opportunity and entrance into that market to build out a digital asset manager. And that's been it's been really interesting fun. I think, digital assets and blockchain technology will be foundational to the future of finance. And, you know, our job is to be looking for the emerging risks and opportunities in the marketplace. And we see we see both digital assets and digital asset infrastructure as being really important opportunities. And we wanted to make sure that we really participated in that. So it's been a really interesting part of my career so far, and it's only been a couple years into it. We brought some great, some great partners into that as well. And yeah, and so that is what business looks like.

Erik: Eric, on the digital side, I really want to give you credit, because frankly, the fact that you guys made a shitload of money on Bitcoin doesn't impress me much because a whole bunch of people made a shitload of money on Bitcoin, because it was just trending at the time, what you have not done is to subsequently lose a shitload of your clients money on Bitcoin. Please explain how you manage to avoid that because it's a mistake that most people were not able to avoid.

Eric Peters: You never want to jinx yourself in markets. We're fortunate to work with a great investor on our early Bitcoin and Etherium trades and they brought enormous insights to the table and timing quite frankly. But we did make very large investments in March of 2020. And exited over the subsequent nine months or so into that large rally and generated, you know,

really quite, quite enormous gains and then return capital. And so, you know, the market was extremely euphoric. And I think, you know, when you think about market cadence, there are times where markets are in euphoric period, and there are times where they're in really depressed period. That was, it was very clearly a, you know, a period of real euphoria and just kind of grateful that we crystallized those gains and return them. I think, since then, you know, the markets really crashed. And it's not to say that, that we haven't had any exposure to that. We have had some exposure, although it's a small fraction of what we had, you know, in that run up. And we've been fortunate in not getting involved in any of these high yields in DeFi and so we didn't know our investors and suffer any of the losses there. We didn't get involved in Luna. We thought that there were some weaknesses in that whole system and managed to, you know, manage to avoid that.

Eric Peters: So we've been thankful that I think we've taken a pretty sensible macro view to digital assets. As I mentioned, I think that these will be the foundation of the future of finance. But you know, they're going to be a lot of pitfalls along the way. And so this big market decline has been one of them. I'm grateful, you know, touch wood that we haven't, that we didn't suffer any type of catastrophic losses, and we dodged all the big bullets there, which is not to say we weren't, you know, we won't ever get clipped at some point in the future. But I'm very proud of the team. We've built an amazing team that has brought great insights to this. And now I think we're really well positioned for the next upcycle. I think we'll have a very big upcycle by the way, we're seeing increased use cases for these technologies. I think they're becoming widely accepted. We're seeing regulatory competition between nations to see who can be the leader in the digital asset space. I think it's very smart for nations because this is going to be a source of great innovation. And ultimately, these technologies will form the foundation for new infrastructure for the global financial system. And so, as I said, we're going to be part of that and I'm just grateful that we've kind of made it through this market crash, you know, pretty well intact.

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