Mike Green: Investing Opportunity in an Increasingly Uncertain World

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Erik: Joining me now is Mike Green, chief strategist and portfolio manager for Simplify Asset Management. Mike, it's great to get you on the show. I want to dive right in because it was boy, next month, I think or in January, it will have been two years since you first told me off the air in a private phone call that World War Three had begun a year prior to that. And at the time, I have to admit, I was completely dismissive. I thought you were off your rocker. But in hindsight, what I recognize is, the reason I wasn't listening as I should have been, is the phrase World War Three, to me really equated to certain and impending imminent nuclear Armageddon. And I thought you were crazy to think that. That's not really what you thought that's not what you meant. So let's start by clarifying what did you mean, when you told me almost two years ago now that a major new war cycle had begun?

Mike: Well, first of all, thank you for having me back. And your initial assessment that perhaps I'm off my rocker was the right one. But what I meant by World War Three was effectively we were moving into a regime in which, the frenemy coopetition dynamic between China and the United States in particular, had degenerated and had really begun to generate starting in 2013, into a next phase of competition, where we were really focused on effectively carving up the rest of the world into spheres of influence. And that we were going to engage in a series of competitive trading dynamics, competitive financial market manipulation dynamics, and proxy wars, that could under bad circumstances escalate out of the cold war type framework that we were familiar in the Soviet Union, and potentially turn hot.

Now unfortunately, I think that as time has passed, things have gotten hotter. And the question now is, can we avoid an escalation? That takes it much further, but it does, I think most people would acknowledge, as you kind of have, that we've begun to very clearly move into a competitive mode that often involves degrees of violence, that feels very different than the coopetition that we were engaged in for the better part of 30 years following the fall of the Soviet Union.

Erik: Okay, so we know that what it's not when we talk about this new war cycle is impending nuclear Armageddon. We're not talking about that but I think we're also not talking about the same thing as the Soviet American cold war that lasted for decades. We're not talking about the same thing as World War II, where soldiers and trenches and tear gas or mustard gas, whatever it was, what are we talking about? What are the dimensions that we should expect to this ongoing war? It sounds like it's kind of not the same as a Cold War, because it's a little hotter than that. We've already got proxy wars going at least with the situation between US and Russia.

It seems to me that the war in Ukraine has been escalated in some respects, to reflect a tension between the US and Russia as opposed to just the Russia,-Ukraine situation. Certainly, the United States has pledged much, much, much more money to the Ukraine defense than any other country has. So it's not a Cold War. It's not really a hot war, yet. It seems like it's more than just a proxy war. Is there something else as we think about Vietnam as to what this is supposed to look like? How do we know what's coming?

Mike: Well, I would describe that what's happening in Ukraine between the United States and Russia is not even so much about Ukraine or Russia, for that matter, as much as it is about the US reasserting its control over Europe. Right. And so what we've seen throughout the last decade is Europe, particularly in the form of Germany has flirted with Eastern alliances, right? Do we integrate ourselves more closely with Russia? You know, the leaders of Germany have with a disturbing degree of regularity become significant financial figures in the Russian sphere of influence. And the relationship obviously, between Germany and China had superseded from a trading standpoint. The relationship between the United States and Germany had, I would largely argue that what we've experienced over the last year and really, kind of over the last seven years, in some ways with the original invasion of Ukraine, has largely been a function of the US trying to reassert control over Europe, making it again energy dependent on us in many ways. What we're engaged with in Europe is a lot like a Lend-Lease program where we are now driving Europe increasingly into a debtor relationship with the United States where their access to food, their access to energy, fertilizers, etc, increasingly depends on our willingness to export it to them That, to me feels like a much more accurate description than a simple competition between Russia and the United States. It feels very much about separating Europe from the sphere of Eastern influence.

Erik: Well Mike, I want to credit you because you definitely saw this coming before anyone else that I know. I would think that probably qualifies you to have some insight as to who's behind it and what the motive was, because it seems to me, you know, you said we're moving from a trend of friendly competition into borderline hot wars here. Who wanted to make that change? It doesn't seem like a very friendly thing to do. Who's behind this? What's their motive? Why did they want to escalate friendly competition to proxy wars?

Mike: I think that there are multiple players behind it, right? I mean, we went through something very similar, like the relationship that we currently have with China, with Japan in the in the mid to late 1980s. And it was ultimately resolved in a manner that I think that we're trying to get a resolution in Europe, again where effectively Japan rolled over and said fine, we will remain instead of being in competition with the United States, or trying to become a rival, right, as Japan is number one. We're going to accede to trade limitations, we are going to bend over on the auto exports. We're going to increasingly integrate ourselves with the United States functionally making ourselves a tributary to the United States in perpetuity. My guess is that, while I highly doubt that people are expressing it at the highest levels in exactly this term, that's largely how we're trying to restore the relationship or re-integrate the relationship with China. We will not accept them competing with us in the way that they appear to want to compete. And that became very clear under Xi starting in 2013 that they were prepared to do. And as a result, we ultimately have to create conditions under which they fold in a manner similar to the Japanese.

They just might be a lot more difficult to get to fold in that manner. They might be willing to institute much worse hardships on their population. And that's really going to be the unknown is, who ends up being able to bear the pain, the greatest? Is there sufficient pain for the United States to cause it to rethink this process? One of the real challenges I would argue is that as much chaos as we may feel with a bond market down 20% in the stock market down 25%, or NASDAQ down 25% in the US. We are really not experiencing any pain, while there's fairly significant pain going on around the rest of the world.

If you were to frame this in a similar fashion and look at the 1920s for example as an analog. I would argue that there's a lot of similarities where the US really has not in any way yet suffered. You can go to Europe and experience fairly significant hardship, fairly significant sacrifices that are being made, where businesses are failing and being nationalized in order to keep their energy flow independent and on. Right? effectively governments are nationalizing things like the energies, the energy firms in Germany, precisely to be able to continue to finance them, right? These businesses independently wouldn't be able to access the credit required to make the purchases that are necessary.

So, this feels to me, like we're moving towards the same sort of framework that actually characterize the 1930s where the US functionally forced the multinational corporations and multinational individuals, right? The elites who were able to travel around the world and pretend that they were citizens of the world. We forced them to choose, are you going to be Americans or are you going to be internationalist? And if you're going to be internationalist, then there is going to be substantive penalties associated with that everything ranging from loss of economic freedoms to potentially loss of your businesses. We are moving towards, we've tried to push I would argue China and Russia into something very similar to what we saw with Germany and Russia in the 1930s. The Molotov Ribbentrop protocol where you know, two relatively weak individual players are forced to collaborate hoping that they're that they can reclaim effectively a degree of independence and autarky that they can't do individually. I think the odds in the prospect of that are quite low. But that doesn't mean they're not going to try right. There's an incredible incentive.

Erik: I want to make sure I understand this analogy to the 20s with respect to what comes next because, as you say, the 20s were party times in the United States, everything was fine. But then came the 30s and the early 40s, which was anything but a happy time in the United States. So are you saying this is the calm before the storm and it's going to get much, much worse domestically in the United States or are you saying we're insulated and we're not going to experience the effects of this conflict?

Mike: I think unfortunately, we have a choice. Right. And I would argue that this is one of the reasons why I'm so vociferously opposed to what the Federal Reserve is doing. Right? I think the Federal Reserve is moving to address an inflation that can much more easily be explained by supply disruptions than by a monetary phenomenon. They're attempting to address it with monetary solutions that are causing the US dollar to skyrocket around the world, and leading to conditions under which you could have a seriously coordinated global recession. Acquainted people that I listen to, my good friend, Alex Gurevich, who was on your program a couple of weeks ago. I think Alex and I see this very similarly, in the dynamics of inflation really haven't been monetary in their nature. And I know that's frustrating to people. And I'm not suggesting that there hasn't been significant amounts of intervention on the monetary policy side. But the inflation that we've experienced has largely been a byproduct of an incredible amount of stimulus that was pumped out into the US economy, while supply chains were largely shut. And the challenges of reopening those supply chains very similar to the experiences we had post World War One. And again, post World War Two. In both situations, we recognized that we needed to reorient and reconstruct the US economy, and therefore we didn't hike interest rates and shut off capital formation.

This time around, we've decided to respond to a very real signal that requires the US to make very substantive investments in terms of changing our output structure, forcing us to become more energy independent, to make investments in energy, to make investments in industrial production, to make investments in infrastructure. And our reaction to that by hiking cost, the cost of capital so dramatically means that none of that is happening, or far less of it is happening than otherwise would.

That policy feels like a just a terrible mistake in the context of what we're experiencing. And Alex candidly introduced the idea, and it's one that I would unfortunately support. This could very well turn into a much less stable situation than we think. And that is, unfortunately, what the 1930s were right? It was a period of such intense uncertainty, that you only would actually do something from a business investment standpoint. Basically, if you are guaranteed by the government that you would be made whole. Like that's, that this is the Russell Napier story about fiscal dominance and a government driven investment spending boom. This is the same narrative, I would argue that Alex is highlighting when he says what we've experienced so far, you know, is not the slowing down of inflation that we're seeing right now. This has almost nothing to do with Fed policy, Fed policy is not going to hit for a couple more years, you know, the unwinding of the explosive increase in home prices, durable goods, etc. Those are largely predictable simply on the basis of the unwind of the dynamics of the pandemic. Now, the Fed is complicating that and exacerbating those conditions. And that candidly, is a little terrifying to me and does look very much like the liquidate stocks, liquidity labor framework that led us into the Great Depression.

Erik: Okay, I really want to understand this one Mike because until this conversation, I've been thinking about this war cycle. Okay as much as the deflationists had made a good argument, they must have it wrong, because wars always tend to be inflationary. I thought that this war and the geopolitical escalations that we're seeing, we're likely to be confirmations that we're really in a secular inflation. It sounds like what you're saying is no, it really is the case that the Fed stimulus and reaction to the pandemic is what got this whiff of inflation going, but it sounds like you would agree with what I assume is still Alex Gurevich's view, which is this is ultimately headed toward a really serious deflation and potentially into depression. Is that right?

Mike: Unfortunately, I think that I mean, look, I think anytime you say something along those lines, you have to put an element of uncertainty into it, right? Like, there's no way to know that the next great depression is coming. For the very simple reason that I don't have all of the information available to me that would be necessary to predict that and I also don't know what other people will change in their reactions to the mere, post, you know, positing of that that hypothesis, right? But the simple reality is that we're engaged in the same type of collateral destruction that leads credit systems to implode. Right, we all can see the stress that is beginning to emerge in the corporate sector, particularly amongst the heavily levered entities. We can see the stress beginning to emerge in the household sector, particularly against those who are significantly exposed to the housing component. And we're seeing the underlying characteristics of an economy in which people are deeply unhappy, despite the fact that supposedly everybody has jobs. And there's tons of opportunity for people to upgrade, and move into new roles. Like the circle doesn't square is the easiest way to frame that. And as a result, you have to consider alternatives.

Your idea of the underlying inflationary dynamic. I agree with you that in terms of relative prices, at least on a short term basis, we're likely to see much higher energy prices. We're likely to see much higher “rare earths,” right? And let's just remember what rare earths are. It's not that they're particularly rare, it's that they are rare relative to dirt, right. And as a result, they're expensive and dirty to process. We just don't like to do it, we'd rather put the waste and environmental pollution elsewhere. But for national security reasons, increasingly, we're being forced to confront the reality that we're going to have to do some of those things on our shores right? And that requires a reorientation and a rejiggering of US society that gets people to do some of these things that we just don't want to do right now. Right? That unfortunately, is what really rough economic times mean, it means people are forced to make choices that are suboptimal versus where they are today.

Erik: With respect to that reshoring of critical industries, the way I've been thinking about this is look, the whole globalization trend. What was the driver behind it? It was the exploitation of cheap overseas labor. So if for national security reasons, you're going to say, okay, we can't buy all the cheap stuff from China anymore. If we're potentially going to risk going to war with China, we need to get that back in the US. Well, maybe that's the right decision, but it's got to be much more expensive to do that. I would think that's a really strong secular inflation driver, isn't it?

Mike: Well, again, the definition of inflation is an increase in the general price level right? So it is M going up and therefore P rising as Q does not respond and velocity stays constant in the MV equals PQ equation, right? What we know is, is that when we raise M, velocity falls and so the question of is this a monetary inflation is very different. What we saw this time around was we saw the government support demand for actual products and services, despite the fact that the supply of them was relatively limited. So we drew down inventories and then had to deal with the bullwhip effect as it worked its way through the system. Importing tons of stuff through our ports that are not prepared for the surge of goods, etc. So, I fight against this idea that this is quote unquote, inflation. If it's a relative price signal that says, this gets more expensive, and therefore you need to devote more of your budget to it, making sacrifices elsewhere, right. That's a shift in relative prices. That tells you something about future consumption and future investment opportunities. So it is not... as frustrating as it sounds to people and you know my partner, Harley Bassman, I drive him crazy with this. But it is unfortunately, very true. It means something very different if you say the price of raw materials is going to go up relative to the price of dinner at Applebee's. That's a very important distinction.

Erik: It seems to me like an even more important distinction is that last time we went through this in the 1920s, and 30s, the United States was a creditor nation. The United States is now the biggest debtor nation in the history of the world. It's a completely different debt dynamic. And you're talking about something happening, which is going to have profound impacts on credit markets. So how would this time be different from last time considering that our starting point is massive indebtedness, both at a national level and also households are much more indebted than they used to be?

Mike: So part of the dynamic behind indebtedness right, remember is a function of just maturities. So all debt is somebody else's asset. And when you talk about the dynamics of surplus, it allows me to capitalize all sorts of things that I otherwise couldn't. If I'm living hand to mouth, my prospect of taking on debt to finance a purchase, which I'm going to need to reduce future consumption relative to my productive capability in order to pay back that deb right? You know, I can't do that if I'm absolutely at subsistence levels. And so a wealthier society almost by definition is going to become a more indebted society. The second component is, is when you talk about the indebtedness of the United States and this I realized feels like a very false distinction to people. But in the 1930s, remember, we had an obligation to meet our debt in the form of gold. Today, we don't have that convertibility. And we fully defaulted on that in the 1930s, despite all the components that you're highlighting, right? That we were actually the world's creditor nation. Why did that fall apart for us very simply because the collateral that we had underpinned all that debt with fell apart, right? That was actually the lead into the 1930s, Great Depression were things like the collapse of German bonds, or Russian bonds that had been held by US investors an western investors, as those businesses effectively had to be written off and written down. The overall collateral and a credit based system collapsed into something that had a very specific deliverable in the form of gold, and we had to default against that.

Have we done something similar? Are we likely to do something similar in real terms? Sure that could certainly happen? Will we see ourselves print money in response to various events that could lead to significantly higher prices or at a higher general price level? Absolutely. Could we see us decide that we need to reorient our society to produce the goods and services that we want to consume closer to shore? Again, like it does feel like that's the right answer. But that is, you know, getting there is a function of making hard choices in our society. And so far, it feels like our bias is just not to make those hard choices yet. Again, speaking to the need for economic discomfort. And I hate this, I don't actually think that it's necessary. I think we're making poor choices to that exacerbated. But we don't have to make those choices in the way that we're choosing to make them. But we are making these choices.

Erik: What's not adding up for me mentally right now, as I'm processing all this is it seems like on one hand, if I take, you know, Ben Bernanke's explanation, at least as I've struggled to understand it has been the cause of the Great Depression was the gold standard. And if we had had the fiat money system that we have now there wouldn't have been a problem. Well, presumably, what that means is it would have allowed the government to respond by printing money, like it's going out of style in order to paper over our problems, which it seems to me would be just profoundly inflationary. And that may have actually been the goal. But you and Alex are both talking about deflationary outcomes. So what am I missing here?

Mike: Well, again, it just becomes a question of against what, right? So yes, that would have been profoundly inflationary in the Great Depression, which might have meant that the price level stayed stable. Right. So when Alex and I say that this is deflationary, and we say that money printing is likely to return in one form or another to offset those risks? It's not because we're actually saying the objective is to get the price of copper to $10 a pound. The objective is actually to keep prices at a relatively constant level in what is likely to be a severe economic shock, right? What I would argue people are largely forgetting as they start talking about things like copper, right, non-ferrous metals and the electrification of the future, etc. Remember, places like China consume 50% of the world's copper in their housing markets, in their plumbing markets, in their electrical infrastructure, market, etc. Much of the commodity boom that we saw from the period of 2000, roughly until the period of 2012, was a function of China reindustrializing, and putting itself in a position to have the infrastructure to service the needs of the West.

Now you're talking about places like China actually facing contracting populations, and a loss a significant loss of market share in the global export space, and almost certainly that is likely to lead to them turning around and mining effectively their own copper supplies, in the form of tearing down buildings or tearing down unnecessary infrastructure and reliquefying a lot of those supplies, right? So I can create a story that says, yes, the price of goods assembled and manufactured in China go up. At the exact same time, right, because we're replacing them with more expensive labor elsewhere in the world, although I do think that technology can play an important role there. But at the same time, like the price of copper could very well fall. Under those conditions, the price of iron could actually fall significantly, the price of cement, or fuel could fall fairly significantly under those types of conditions.

Erik: Okay now, I'll hit you with the biggest challenge Mike. Let's translate this to implication for markets. I want you to imagine you're speaking to an audience of professional portfolio managers. You've just told them that the price of just about everything could go dramatically up or dramatically down. So what traits do you recommend in that environment?

Mike: So this is actually one of the things that I would highlight. And I appreciate the way that you said that it could go dramatically up, or it could go dramatically down. I don't know what the right level is, right? And I'll just lay that out there as simply as possible. There's too many pieces that are moving. So when you're in that type of position, and this is something that I've spent a lot of time talking about recently is you basically want to use strategies like trend following to allow the market to guide you in that direction. Right? I don't know the right price for copper, I don't know what the right price for oil, right. What I do know is that the incredible degrees of confidence that people were expressing around the fact that global demand for oil could never fall. And you know that when China reopened, we were going to see the prices explode to the top side. That's now beginning to turn very much to the well, OPEC is not going to produce into these conditions. Right? Again,I would argue that components of OPEC's control could be perceived as much more fragile than the market generally looks at it, right? I don't see MBS (Crown Prince of Saudi Arabia) for example, as a particularly strong leader. I don't see Putin as particularly well placed under this current framework either.

So we just genuinely don't know how this is going to play out. In that situation, you want to use strategies like trend following to try to figure out what is the right price. Let the market guide you in that direction and don't pretend to have all the answers under that type of framework. Right? So increasingly, I'm relying on strategies like trend following to give me an answer to that uncertainty. So that would be one of the things that I would highlight. The second thing that I guess I would highlight for people is that if I think about interest rates in a slightly different framework, and instead of thinking about interest rates as simply being particularly interest rates that are set by a central bank, you know, as being set to try to drive monetary policy, and instead being used to effectively drive fiscal policy, it actually starts to take on a more interesting framework. One of the things that I alluded to before, I think is actually increasingly true, which is the uncertainty around financing costs, suggests that the current level of interest rates is probably too high, meaning, fixed income products actually become somewhat interesting. But at the same time, the second component that I would highlight is, is if I can get 4 or 5% from a US Treasury bond. Then suddenly, I need to actually much more critically evaluate any other expenditure that I make. Right now, does that mean that it's the same as the 15, 16, 17 ,20% levels that we had under Volcker? No, but also under Volcker, we had a much more robustly growing economy. We had population growth that was significantly higher, we had a global environment that was growing much, much, much more rapidly. And as you know, and I've shared this with enough people now that most people should know this. Like, the story that we tell around the 1970s is actually not a very good one, right? The 1970s were largely about massive population growth throughout the world.

In particular, in the developed world, we saw an incredible amount of growth amongst those who were recently graduated from school and wanted to enter the economy. So the demand for houses the demand for cars, the demand for homes, were just off the charts. We had more jobs created in the 1970s, despite the tag of stagflation than we have in any decade since. So the concern, I guess I have around looking at interest rates in the way that they are is one we shouldn't use a trailing inflation. Two, we should broadly recognize that interest rates look really attractive. Again, Alex and I are very aligned on this. But the third component that I would highlight about high interest rate policy, and more accurately volatile interest rate policy, is it reduces the private sectors ability to make decisions, and it increasingly guides you into frameworks where you have to ask, what is the government actually want me to do? Right? And so that can mean everything ranging from you know, a focus on rebuilding the US this dynamic of onshoring what are the hurdles is going to be that are put up against almost every other use of capital, when the US is capable of basically saying, okay, we're going to offer people 4% risk free. And if you do what we tell you to if you build the facilities that we want you to, we're going to offer you subsidized access to capital, right? That's really what I think Russell Napier is highlighting, for example.

Erik: Let's talk about US Treasuries specifically, because as I just consider all of the past possibilities here. It seems to me, like one argument would be, if you assume that the US is going to maintain control over the Treasury market, they've already taken rates pretty high compared to what we could probably afford in terms of servicing the national debt. Alex Gurevich, whose views you seem to agree with on many fronts thinks that those rates are going dramatically lower. That seems to be kind of a generational buying opportunity for treasuries. Because especially if you buy duration, byy the 30 year treasuries, you can make that 5% holding to maturity. But more importantly, you can make 20% in the next couple of years, if you see those rates come dramatically back down. On the other hand, you've also said that this is a war that's not with Iraq or Afghanistan. We're talking about China and Russia. Very, very well armed and powerful nations. If the US starts to be perceived as losing that war, to the point that US Treasuries are no longer considered to be the safe haven asset that everybody moves to in a safety trade. And you see an uncontrolled sell off in US Treasuries, then you could have, you know, a collapse scenario where it's a self reinforcing vicious cycle. The end you see a collapse of treasuries. So how do I think about treasuries an incredible bargain right now as Alex seems to have suggested or are they potentially a big risk trap?

Mike: I think, unfortunately they're both right. And that to me, is part of what makes investing at this point in time. So interesting. Again, just like commodities, I can't tell you what exactly the right price for treasuries, is. As you articulated, the current level of interest rates is too high for the US government to really be self funding. We're unable to be able to survive at this level of interest rate. With very few exceptions, when that's been the case, you have not seen governments choose self immolation, they have chosen to make themselves solvent that would just involve cutting interest rates in the United States, right on a policy basis. To the extent that we can increasingly become autarkic and we can produce our food internally, that we can produce our energy internally, or that we're forced to do so for our trading partners underpins our currency in a way that I would argue is largely the explanatory power behind why the dollar has been so strong right? As the dollar has gained strength, you've seen the current account deficits, the trade deficits of Japan and Europe just explode as they increasingly are reliant on the US to provide them with very basic goods. I don't see any reason why that's going to turn around in any short order. And until, you know, and this is kind of the exciting part, right, until the choices are made to radically restructure our energy systems. And to me, that hits on many of the themes that other guests have talked about things like nuclear, etc. The simple reality is that we have to move in that direction on a global basis. We're just not ready to embrace it yet.

Erik: Now, I have to believe that gold bugs listening are going to say that gold is the answer to everything, because you're talking about a degree of uncertainty, that gold is a perfect hedge for. The counter argument would be look, gold used to be the perfect hedge in different times. These days, gold's just shiny metal, it doesn't make any sense. How do you see this? Is gold a place we should really be thinking about investing here?

Mike: Well, so I would argue that gold has a combination of really interesting properties and also an underappreciated failing. If you think about the historical model in which gold was pegged, or the dollar was pegged to gold. All right, anytime you entered into a secular or structural inflation, as we experienced in the 1970s for example, or even a debt crisis as we experienced in the 1930s, where we were going to default against that and therefore needed to devalue the dollar. If you just think about the payoff structure there, it's incredibly one way, right? There's an incredible right skew to that dynamic, where overnight, the Treasury can devalue the dollar leading to a 60% appreciation of gold. Right, that right skew characteristic has unique properties and hedging a portfolio. The problem is that it no longer has that characteristic, right? There is no scenario in which the US government could wake up one day and say, Okay, we're going to devalue the dollar against gold. You know, various claims to the opposite, like sure they could wake up and they could print like mad on a particular day. That's likely to be occurring in a time period in which the credit system is collapsing. So your ability to exploit that through gold is going to be somewhat limited, but The underlying feature of gold having that extreme right tail movement is unlikely to be materialized under the current framework, right? It has much more to do with a slow methodical grind, where you're effectively describing it, as you know, I think gold is going to gain against the S&P, for example, over a period of time. That's just a very different investment than betting against a pegged currency. Right? If you want to bet against the Hong Kong dollar breaking, that has very different characteristics than betting that the S&P is going to go up and its role in a portfolio is quite different. That's my only complaint against the gold dynamics. Right? I just, I think that there tends to be a fundamental misunderstanding of what happened when we de-pegged versus gold, it lost a lot of those portfolio hedged components to it. And by the way, nobody really actually experienced it in the United States, because before those devaluations occurred, gold was made illegal to own right. So from an institutional standpoint, that has its own unique challenges.

Where I would argue we've seen some interesting dynamics happening and gold is you have seen some signs that the dollar strength got ahead of itself. And we've seen a remarkable reversal in the dollar. You know, one of the fun things I did in preparation for this was go back and listen to several episodes. And if you just go back a month ago, there was zero contemplation of the idea that the dollar could fall below 110, much less be in the 106 range where it's been recently, right, so we've seen really sharp moves in the currency space. And by and large, that's been echoed in gold. It also has helped that crypto world has blown apart and taken away a competitor to gold. So all of those are a very long winded way of saying I think that there are reasons to look at the uncertainty that we face and what you correctly describe as a bimodal outcome, we are kind of risking everything, to put China back into a place where it no longer threatens us. That could work out very badly for us. It also could lock in another century of, you know, another American century. And I realize I'm speaking my book, both as an American and as an investor. I have to place odds on us in this scenario.

Erik: You mentioned nuclear a few minutes ago. I want to come back to that. Because on one hand, it seems to me I'm convinced that we have a major energy crisis. Regardless of the whole carbon question of whether we need to eliminate fossil fuels for the sake of climate change, we're going to have to replace fossil fuels because Hubbard's peak is real, even Dan Yergin, the biggest critic, public critic of peak oil theory, back in the early 2000s, was quick to acknowledge that they had the right idea. He just said it wasn't going to be till the 2030s, that it actually became a factor. Well, the 2030s are just around the corner now. We're going to have to replace fossil fuels, no matter what, it seems pretty clear to me that the way this is going to happen is we're going to avoid nuclear because of its political difficulty of people accepting it, until there's no choice and then all of a sudden, it's going to be the only choice. And if you think about that, as an investor in free markets, you think, Boy, I gotta just go headfirst into as much physical uranium trust shares as I can possibly get my hands on. But then I think, wait a minute, you're describing potentially an outcome that sounds very much like World War Two, where the government says, look, whatever amount of uranium we need, in order to nuclearized, the American energy grid, we're going to take at a price that we dictate will tell you how much we're going to pay, and you won't have a choice, we'll do it under the figure what it's called defense acquisition act or something.

Mike: Defense Appropriations Act...

Erik: So should we be thinking about something like physical uranium investments as an incredibly ripe speculation? Or is it actually a speculation that's wrought with problems? Because by the time we really need it, maybe it's not going to be free markets that determine the price?

Mike: Well, and unfortunately, I don't think it's going to be free markets that determine the price. The question is just, is the price that is determined under that effective eminent domain framework? Is that still a very attractive price, right? My bias would be yes, that it still makes sense. I think the bigger question is what it really means to have an energy crisis, right. So in the western context. Again, that means a shift in relative prices. Right? I am less capable of getting x, y, z, because I need to pay more for my energy. At the same time, we use a lot of energy very inefficiently. Right? We saw that in the pandemic where everybody is suddenly at home with a car and we realize that we want to run out for are very short trips to the grocery store as compared to what used to be a weekend shopping excursion, right? where you'd go buy a week's worth of groceries, suddenly, we were buying days worth of groceries and experimenting, I drive my wife crazy with that behavior, by the way. So when you when you think about that type of dynamic, and that ability to shift their behaviors, I think people tend to under appreciate how innovative people can be in response to that. You see this in Europe, right where people have functionally taken the Jimmy Carter approach. Okay, let's turn down the heat and let's put on a sweater. And yes, we're very fortunate that we got warmer than normal weather. But guess what we're able to meaningfully reduce our energy consumption. Right now, is it sustainable? Probably not, but not because of the sweater component, but much more as, as you know, people like Doomberg and others have highlighted because of the industrial base deterioration, right? You cannot run an industrial base in which you are that disadvantaged versus the US.

But on a short term basis, like that is the innovation that occurs. And some of that is going to be remarkable and wonderful, right? High gasoline prices will lead to much more efficient internal combustion engines and much more efficient hybrid vehicles and eventually to electric power or to fuel cell vehicles, etc. We're starting to see that play out already. And I know people are going to scream into the phone saying there's not enough copper or nickel or heavy metals to make every vehicle electric. Again, it becomes a question of what is the innovation that occurs? Right, I don't have to solve those problems. That's the wonderful part about a market based system is somebody else has the incentive to go out and make very modest improvements. And those modest improvements eventually accumulate into radical change.

Erik: Our listeners have heard me talk at nauseam about the energy crisis that I'm convinced is coming. And I've said that China reopening is going to be the big catalyst that brings it on. First part of the question is do you agree with that view generally and if not, why not? But the second part, since you've got so much insight into this new war cycle is why do you think China has been so slow to reopen? A lot of us think there's probably more to it than just the advertised reason of, you know, concern about COVID. What's really going on behind the scenes and why is China been so slow to reopen their economy?

Mike: Well again, first, when you say, I have so much insight, like I just want to be very clear, like these are opinions that are have been derived from the facts, as I see them with very little unique information that I would either declare, I have the ability to share or if I had that the willingness to share it. So I just want to caution everybody that this is what I'm seeing, and the way I see the game unfolding.

Erik: Well, you called the war cycle before anybody I know, by a year or two, so I'm still listening very intently Mike.

Mike: I appreciate that but again, I just want to be very, very clear that like, I'm not on speed dial with Joe Biden, and I'm fairly certain if I was, he would have already forgotten which number that was. So, I just want to be really, really clear on that. My take on China, and I've argued this for a while now is, is that China operated under a very simple principle. You don't protest, we will make you rich. And the minute you can no longer make people rich, you can't actually rely on that. And so you have to stop them from protesting in a different way. To me what's transpiring in China is a very simple reflection of what is called the political J curve, right? where you migrate to stability. There's really only two forces, two places of stability, you either have an incredibly successful society in which people are broadly so happy that nobody really wants to get particularly worked up and disrupted, with some exceptions as the United States. The second form of incredible stability is effectively North Korea. And so China, while we had hoped that they were going to migrate towards us, instead is very clearly migrating back towards North Korea. They're locking down their economy, they're locking down their citizens, their citizens ability to travel around the world, or to accept foreign visitors who have any link to China other than already significant investments in the form of factories and invested capital that they can no longer get out of China and therefore have an incentive to toe the line. You know, those are the only people allowed in and out anymore. Right? And I can't see how that unwinds. I don't see how you suddenly wake up and say to the Chinese people, you know, yes, we've been the best country at handling COVID and by the way, would you really like to take a discounted flight to the United States so that you can see all the misinformation that they're going to share with you about how bad it was in China compared to the rest of the world? Right or how much longer we kept you in locked down. They just can't do that, right? It's the same thing as the Soviet Union in the 1950s, 60s, 70s, where they effectively had to use the truth, Pravda means the truth, to spread absolute misinformation amongst their own population. And it seems like that's the path that exists in China today. That it's far more important that we view this as a political framework than we view this as a disease framework.

Erik: Mike, in the last few weeks, there's been a fair amount of confusion in the West about how to interpret certain signals coming out of China. There was first a report that someone who seemed to be pretty well in the nose said that a committee had been formed headed up by a senior person in the CCP to plan the reopening of the Chinese economy. And there was a rumor that maybe they were targeting march for a full reopening. Then we can prior to last that would have been fifth or sixth of November, Bloomberg reported that hopes had been dashed because China had reaffirmed its commitment. That was in a speech that I think she gave on the fifth of November, saying that they were completely committed to their COVID Zero policies. Bloomberg interpreted that to mean that they were disavowing or denying the reopening rumors. But I don't personally see it that way. I think they were just trying to save face on their COVID Zero policies. Subsequent to that. The next thing that happened was there was an easing of border restrictions. So they've reduced the quarantines. They've eliminated the double quarantine, if you went to one city in China and then moved to another city, you used to have to do another quarantine, that's been eliminated. It seems like there is a trend toward at least beginning to ease some of the COVID zero policies, despite the fact that the official policy statement is to reaffirm their complete commitment to them. I'm interpreting this as something is afoot, they are moving toward a reopening. But that seems to be a minority view. How do you see it?

Mike: Well, I think it just depends on how you want to define reopening. Right. So is reopening going back to a world in which Confucius Institutes are all over the United States and Chinese students regularly attend school, particularly graduate school in the United States with very few limitations. Of course not, like we're not reopening back to that world. But are we reopening for business purposes? Probably. Right. I mean, it feels like that's a reasonable expectation that at some point, China is going to allow Westerners back into China to check on their factories, to check on their investments, to share their expertise, to engage in various behavior, and likewise allow those who are good and loyal party members to travel abroad and check on their investments.

In the same way that the Soviet Union was, quote unquote, open. Right? And you were able to travel if you're a Soviet athlete, you just traveled with a handler, right? Who made sure that you didn't defect. I don't see why China has to reopen in a free and open way, it can just begin to travel again. Right? It can it can open up for business, again, with Westerners really not going there very often and the reverse, right? And the only Westerners allowed in are those who are already effectively captured because of the amount that they've invested in the country that they'd otherwise have to write off, right? I mean, there's almost no circumstance, that barring the actual escalation into open war, that Tim Cook is going to speak unfavorably about China because he understands that as a CEO of a large American multinational, he places the assets of apple at tremendous risk if he speaks openly.

Erik: I'm talking specifically about reopening in the context of resuming their industrial production and therefore consuming energy, particularly crude oil the way they used to.

Mike: Well again, a huge chunk of crude oil is used for transportation. And when I think about in particular things like jet travel, etc. Like I just don't expect hordes of Chinese tourists to be traveling around the world again. I just don't think that's ever coming back. At least not until this, “war” is settled and we've decided who gets to rule the globe. Like that, I would argue is kind of the thing you know, this whole theory of deglobalization kind of makes sense when you can actually say to people you'll never really understand or experiencing experience anything that's going on around the world. But in a world in which telecommunications or physical jet travel make it possible for us to circumnavigate the globe. have been give or take 25 hours or instantaneously over zoom. The idea of true deglobalization to me feels almost impossible to imagine. What we really have is the need to resolve whose methodology or whose viewpoint is ultimately going to prevail. We either need to decide that we can accept the fact that we have radically different political frameworks, and radically different outlooks on life that, unfortunately, are truly at odds with each other. But you cannot have a totalitarian Marxist framework up against a capitalist however, captured you want to believe that system is they actually can't exist in harmony. Right? Because by definition, they're fighting over resources.

Erik: Mike, we've had a fair amount of gloomy, gloomy discussion here something I've really learned from studying Neil house work on the fourth turning is you have to understand that this is a necessary part of a long term, historical cycle. And one of the aspects of fourth turnings is it always sucks to live through them. But the upside is, they always pave the way toward a better future. So let's end today's interview on a positive note, what are the things that we can look forward to, from the perspective of these changes, maybe paving the way toward a better future?

Mike: Well, I think unfortunately, that's exactly correct. And it's ironic, I just wrote a piece for Barry Weiss, about the Sam Bankman-Fried and FTX saga. And one of the things that jumped out at me was a very Neil Howe type observation, which is, Sam Bankman-Fried has articulated that he's a Benthamite, a follower of Jeremy Bentham or utilitarianism, which I've summarized elsewhere in the crudest form is the ends justify the means, right? This is the framework that how highlights, as the true believers who are certain that they have the solution to the world's problems, are currently rising to a position of power. That's one of the reasons why I'm relatively comfortable to say that we're experiencing a form of conflict that is much deeper than most people have acknowledged at this point. Right? You genuinely have people in both the west and in the East who are convinced that they have the unique solution in a form that is a religious fervor, right? Think of the excitement of a Walt Whitman or a firebrand abolitionist in the US in the 19th century, and the fracturing that led to in the US population. We're working through a lot of those problems in a very similar framework. And often those problems are really tied to exactly what you've highlighted, which is energy crisis is right? We've moved from an environment in which we had unlimited amounts of energy relative to what we would have historically expected to one where we're suddenly forced to say, do I really want to make that additional trip.

The stuff that excites me is actually the innovative solutions that will emerge to that. Right. So the conditions of want and the conditions of higher prices that are signaled in a free market system tell us that we need to make investments both in the production of energy, which is where I would argue that far too many people are uniquely focused, right? They're just saying, we need more energy. And also very focused, but you also need to focus on the idea of various ways of using less, right? And so everything ranging from 3D printing, and additive manufacturing technologies, to automated cars, to reduce need for transport for a variety of reasons. The onshoring capability of the US economy as we effectively do with manufacturing, what we did with agriculture, which is remove the labor content of it dramatically. I absolutely see those happening in the next 15 to 20 years. It's not going to be painless, it's not going to be fun in a lot of ways. But on the flip side of that is a world that has, from our perspective today, infinite energy and infinite products and services, relative to the what, you know, what I think most people would have a hard time imagining is the scarcity of today. But the simple reality is the scarcity of today is identical to the surplus that we would have experienced in the 19th century relative to our forebears will look back on the early 20th century as a period of suffering and want because people weren't able to get everything they wanted delivered to them at exactly that point in time. So I actually look forward to a lot of the innovative and to steal from Cathie Wood, and it makes me somewhat want to throw up in my mouth to repeat these things, but there is truly disruptive technology that is underway in everything from desalinization, to manufacturing technologies, to artificial intelligence, etc. and if we harness them properly, our children will have much better futures than we have.

Erik: Well, Mike, I can't thank you enough for a terrific interview. And what I always say at this point is, before I let you go, tell me what you do at Simplify Asset Management. I feel like I'm kind of setting you up though, because I thought what you do at Simplify Asset Management, which is to manage ETFs, including a macro ETF which seems like a great fit here. But I just feel an obligation to our listeners to point out, you did tell me earlier that you really think that trend following strategy is the way to play this. Trend following is generally only available through commodity trading advisors that are licensed by the CFTC, and not through ETFs. But through funds structures that are only available to accredited investors. So I hate to set you up this way. But what do we do with an ETF guy in a world where you think, by your own admission, CTAs are the way to play this?

Mike: Well, so that's actually part of the reason why I joined Simplify was that there have been a series of rule changes in particular in and September of 2020. There was a rule change called the derivative rule as it related to ETFs. This allows ETF strategies to incorporate everything from derivative components, to futures, etc. And trend following is now actually available within the ETF framework. We offer a product, I encourage people to check out our website to review that product. Others, you know, do the same. So this, there are several choices out there, they are priced at a fraction of the cost of traditional commodity trading advisors. And in many situations, I think you'll find the performances is actually quite powerful. The strategies we run, we've built them for liquidity within the US market, specifically selecting products that complement equity portfolios. We recognize that most investors will have an underlying portfolio with a high degree of equity. So we exclude equities from our trend following strategies, so that people don't become overexposed to equities in that framework. But we include everything ranging from interest rates, to commodities, to energy components, etc, and will be continuing to expand those products. We built the back office and the capability so that we trade those and rebalance them on a daily basis so that you're not dealing with stale trend following strategies, which others struggle with. And so I'm really excited about that space. I think this is actually one of the areas where real opportunity exists. And you mentioned the macro portfolio. That macro portfolio in part reflects the allocations to strategies like trend following that I think increasingly have to take an important role, when you have this degree of uncertainty as to what the world looks like next. Again, I don't know what the right prices are for many of these things. I'm going tolet the market try to guide me to them.

Erik: You said something very important there that I wasn't aware of about a regulatory change. I was a CTA and managed commodity pool operator myself. I closed my fund in 2018 but as of my knowledge which predates 2020, the problem was ETFs were not allowed to commit any more than 5% of their capital to margin on commodity trades period. And is the only way around that was you had to be restricted to accredited investors in a managed commodity pool. Are you saying that's changed and if so, what's the ticker for your product in that space?

Mike: So those rules have change. They've changed quite significantly. There are structural frameworks around how to consider how to build these products that have limitations in terms of the degree of volatility, the degree of concentration, etc, Much more in common with traditional 40 acts components just adding in products like futures. You have to be careful about the way you trade them, you do have to build up full ISDAs, you have to put in place organizational back office components that allow you to make sure that the taxes are handled appropriately, etc. And that, for me has been the exciting part about working with the team at Simplify, because they're about as good as anyone I've seen doing this stuff. The team is very experienced in the ETF space. The simple answer is almost anything that can be done within a CTA can now be done within an ETF. The real limitation that you have is the daily liquidity and market liquidity of intraday transactions. We work really hard to make sure that the product remains liquid and only focuses on products in which we can transact in size and do so during US market hours. But other than that, you're going to find almost no differences today.

Erik: Mike that's fantastic news for retail investors. What is the ticker symbol for your product in the commodity trend following space?

Mike: The ticker is ironically CTA as in commodity trading advisor. Again, the team is fantastic at picking out names of products. And I would encourage people to check it out on our website.

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