Mike Green: Banking Crisis, Debt Ceiling, De-dollarization and more

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Erik: Joining me now is Mike Green, Chief strategist and portfolio manager for [Simplify Asset Management](). Mike, it's been way too long, it's great to get you back on the show. I want to talk about everything that's going on. But let's start with this banking crisis. You know, this is one of those things where it seems like everything's okay. But wait a minute, this whole system is designed with an incentive for them to tell us everything is okay, when it's not okay. Because this is a confidence game. So how do we make sense of this? How do you even know when the banking crisis is over?

Mike: Well, the quick answer is that the banking crisis will be over when we actually start to treat the underlying condition. And the underlying condition, unfortunately, is that banks themselves are or depositors or more accurately long a call option on their deposits at banks. They can withdraw them at any time. The value of that call option is a function of the spread between interest rates that are available elsewhere, for example, in money market funds, versus the interest rate that they can earn on their deposits. And the value of any call option is positively associated with the increase in volatility. So by hiking interest rates incredibly rapidly, and driving an extraordinary spread between what banks could afford to spend, and to pay on their deposits and what it can be earned on returns from US Treasuries. They created a huge hole in bank balance sheets, the only way to reverse this was one to have moved much more slowly to this process of this level of rates. And two, no unfortunately, they're going to have to reverse it.

Erik: Mike, let's talk about how far we are in this story and what's coming next. Because you know, first it was one bank, Silicon Valley. And don't worry, nothing to see here. It's all contained. It's just one, there won't be any more than you know. We had Credit Suisse, then First Republic. It seems to me like it's pretty darn clear what's going on here, which is that we have a contagious situation, that the banking system was not ready to respond to the Fed hiking as aggressively and quickly as it has. Banks are in trouble if anybody withdraws their money and now I think we've got a systemic problem where there's a strong incentive for everybody to withdraw their money, because there's not a lot of good reasons to stay with your smaller regional bank when federal policy is pretty much you know, skewing the risk in favor or to the benefit of the bigger banks. It seems to me like we're systematically putting the regional banking system out of business almost looks like we're doing it on purpose. What's really going on here?

Mike: Well unfortunately, I think that's largely correct. Although I would highlight that, you know, we talk about regional banks. We're actually not talking about local community banks. We're talking about very sizable institutions. In the case of Silicon Valley Bank and First Republic. These are actually institutions that had nationwide footprints. They had branches across multiple state lines. And in asset numbers that are measured in the hundreds of billions of dollars as compared to just the billions which of course, feels like a tiny sum these days, except for any individual. You know, the simple reality is I don't think that there was intent behind this. I don't think that the objective of the Fed was to try to systematically eliminate the regional banking system. I think that this is a foreseeable byproduct of a very flawed policy of trying to tackle inflation with the extremely rudimentary and blunt tools of interest rate policy. So you know, many people will correctly point out that the high inflation levels that we had are unacceptable. The question is, how do you handle that process? The Fed behaved like anyone with a hammer, treated it, everything looked like a nail. And so they pounded the crap, I think, is the technical term out of screws and nuts and bolts.

Erik: Did that happen because the Fed perceived that there was a time urgency that, you know, if they didn't go as quickly as they did that inflation was going to run away? I mean, why were they in such a hurry?

Mike: So when we think about solving the banking crisis, ultimately, we have to reverse what caused this. The question is, why did the Fed choose this path if it was almost inevitably going to lead to this outcome? Right, when you hike the interest rates in this manner, there's very predictable effects. This type of extreme move in interest rates, understandably leads to deposit flight as people recognize that there are far better alternatives and keeping money with banks. Likewise, the assets that the banks hold. Various forms of mortgages or longer term government debt of any variety is going to plummet in value. And so the underlying collateral that is held in the form of assets against the liabilities of deposits deteriorates. The bank credit quality deteriorates regardless of the credit of their quality of their underwriting. So the question is kind of, you know, why did this happen? Why did we engage in this behavior? And there's, you know, a couple of interesting answers. The first one is very straightforward. It's my preferred solution, which is simply the Jay Powell is incompetent. He missed the inflation story to begin with. He followed that up by deciding that he was going to move much more rapidly to try to make a make up for lost time. And as Warren Buffett said, you know, many years ago, you can't get a woman to have a baby in one month by having sex with nine different women over the course of one month, right. It still is going to take as much time as it's going to take. We simply push through too many hikes into inappropriate of a fashion. In my opinion, it's evidence of his incompetence. Now, the defenders of Jay Powell strategy, I think actually have an even more problematic rationale for it, which is that this is an individual who believes that he is personally responsible for the direction of the US banking system. The direction of the US economy, and that he is a man on a mission to weed out all forms of malinvestment and financialization from the US economy. My solution that is incompetent simply means we made a bad choice. The second interpretation unfortunately suggests that this is an individual who lied to Congress, who misrepresented his objectives, and is decided in a Robert Moses type framework that he is the unique individual who has the vision for the US economy, that is way outside of his purview. And if anything, I would suggest it anyone who thinks that that's the appropriate actions for a Fed governor to take is exactly as Jay Powell, effectively entranced with the mythology around Paul Volcker and far more interested in his legacy than he is in actually solving the problems at hand.

Erik: Let's talk about the behavior, not just the regulators, but of the marketplace itself because it doesn't make sense to me. Let's put this in context, Mike. What we've just been through. What the world has just been through. The big story of 2023 so far has been the Fed raised rates too quickly, to the point that it shocked the banking system. We had the collapse of Silicon Valley and First Republic, the near collapse of several other banks, and the potential that this could turn into a great big thing. If you think in terms of rational expectations theory. The way that markets are supposed to work. Okay, what happens when something really big and bad happens? People think about it, they say oh shit, you know, let's not let this happen to me. So where was the problem? It was managing fixed income, duration risk. In other words, the kind of stuff that bond managers do for a living got done poorly and that's what led to all of this. So you would think that what would be the hottest thing right now would be okay, whoever the active bond managers are who did see this coming, the guys who were smart enough to know that interest rates were going to be increased that that this whole thing was coming. Everybody should be just ringing their phones off the hook. Everybody wants into managed bond funds. But this article that you sent me, and pensions and investment says almost the exact opposite. Why would people be running away from active management of the exact kind of risk that just blew up on people that got complacent and didn't pay attention to it?

Mike: Well as you know Erik like one of the things I'm most well known for is the work that I've done around passive investing. The role that it plays in markets. And the article that I sent you is actually reprinted in pension investments, I assume with permission from Bloomberg who had originated with and it's a profile of the growth of passive investing in fixed income. And what they're highlighting is the passive investing has gone from 13% of the fixed income market to north of 30% in the last decade, despite the outperformance of active managers, and the challenges that we've seen within the overall bond markets have led to losses and many of these passive funds that were worse than the active managers. Now, this creates a quandary for the defenders of passive management because we're not seeing superior performance. And yet the same type of flow dynamics are happening within fixed income that are happening in the equity markets. And it goes a step further if you actually read the article and again, this is available on Bloomberg and various other sources. It profiles, Vanguards trillion dollar man, right? This is an individual who has...

Erik: There is a link for our registered users in your research roundup email.

Mike: Okay, perfect. So this is this is an individual who has no opinion on Fed policy, right? Is not attempting to predict it, is not attempting to do anything. And actually, if you think about what's happening with the growth of passive vehicles and the structure that they use in bond markets. Passive bond funds allocate investments on the basis of the market capitalization of the various bond issuers. This is precisely why we saw the duration exposure, the riskiness of the bond market, its exposure to lower interest rates are to move higher and interest rates rise by more than any time in history. It's a very technical explanation. But if you simply think about what bonds do best as the Fed cuts interest rates. Low coupon, very long dated bonds, right? So 100-year bond, zero coupon, if it's issued at 2% interest rates and interest rates go to zero, that bond is going to explode in value. It becomes a giant portion of the index. And in fact, this is exactly what we saw. We saw bonds like the Austrian century Bond was issued, you know, too much ridicule in 2019, I believe it was appreciated to more than two times its face value, right? That meant that it received twice the weight within the bond indices. Who's buying it and that proportion? Turns out it wasn't European pension plans trying to asset liability match, etc. The largest buyer was Vanguard. Right, what we saw was the impact of passive investing on bond markets, in the presence of interest rate cuts caused the duration sensitivity of the bond market to explode. Those same bond funds became the biggest beneficiary of the decline in the bond market by attracting a record $1 trillion in excess of the outflows from active managers. So in other words, despite the fact that the bond funds underperformed, despite the fact that the active managers outperformed, we fired the active managers and replaced them with a low cost passive managers who did nothing but try to mimic the index.

Now, why would that happen? The answer is really straightforward. This is always been a marketing story. This has always been a distribution story on the passive side. Yes, a very compelling narrative of low cost asset management can be made. But the tools that are being used and the approaches that are being used are robbing the market of any intelligence or predictive capability. So now, of course, what we're seeing is we're seeing markets that are incapable of making forecasts. We've watched super talented, you know, macro managers who bet on higher interest rates get blown up in the first quarter this past year. The number of victims of a two year bond or a short term level of interest rates, they got way out ahead of itself in a totally irrational framework built around Jay Powell was hikes, you know, blew up in everybody's face in the first quarter created incredible losses. Took out guys like Adam Levinson of Graticule caused huge losses from former Soros investors, etc. This is a direct byproduct of a market that no longer incorporates information. And is that article makes painfully clear the only thing that matters is flows.

Erik: Mike, let's talk about the debt ceiling. You know, it seems like it happens each spring we go through this whole thing. I thought the most interesting comment that I've read so far was from Stan Druckenmiller, who said, it is just so sad that everybody is focused on the debt ceiling, rather than on the more substantive issue, which is what we're going to do when the problem that the debt ceiling was designed to address never gets addressed, which is we have a major fiscal problem with too much debt. It seems like we're not going to focus on that we're going to have the usual preoccupation with the debt ceiling, and let's make a big political crisis out of it. Well, how do you see this proceeding from here? Is this going to be the big issue for the next several weeks?

Mike: Well unfortunately, I think they're all linked right? So if we were actually experiencing a collapsing equity and bond market, if the concerns of individuals like Stan Druckenmiller were being properly reflected in volatility or in asset prices, you know, and I say properly, because candidly, I can't know what those are. But voters like Stan Druckenmiller in terms of discretionary management, have clearly expressed their views. If that were actually happening, my sense is that the urgency of avoiding this issue would be significantly greater. Unfortunately, again, going back to the point that I make on passive until people start to lose their jobs, until the flows into these passive vehicle stops. I don't know how markets are supposed to incorporate this information and send the information to Washington about how serious this problem is. And so unfortunately, just like COVID and I hate to use that analogy but um, you'll understand why. You know, if you remember in COVID, it became very clear to financial market participants that something important was happening in December 2019, January 2020. And unfortunately, those who tried to get ahead of it by shorting in January, were blown up as the market went to new all time highs in February, right? Only to collapse into March. So you've seen this type of behavior before where the crisis approaches, the market is blissfully incapable of absorbing the information. And it's exacerbated under these conditions. Because what's happening is this, Janet Yellen is effectively paying down the checkbook without putting any money back into the savings account.

So by not issuing bonds, the key role of bonds is not to actually fund the government is to soak up the liquidity of the money that is spent by the government right? You're effectively turning around and saying to somebody who receives dollars, I want you to put them into a, you know, to steal from the Al Gore parody on SNL many, many years ago. I want you to put them into a lockbox that we call a bond where you really can't access them for an extended period of time. That supports the value of the dollar by providing a non inflationary place to put your excess savings. When we stop issuing those, those excess savings have to go into alternative assets. They have to go into spending, etc. It's a support for the economy and financial assets. That is unfortunately going to reverse really hard the minute we decide to lift the debt ceiling, then we're going to get hit by the double whammy of the Treasury general account, that checking account being refilled. And the quantitative tightening of Jay Powell coming through into a market that is already vulnerable because banks are increasingly unwilling to extend credit. So this is shaping up to be a very adverse event for markets. And the markets have no mechanism for incorporating that information, short of massive employment loss.

Erik: Let's talk about what would happen if there was a technical default because something I've noticed this time, although I do think the most likely base case scenario is same as usual, we're going to raise the ceiling and go through the motions as we usually do. I'm noticing a larger number of politicians being a little bit bolder though talking about maybe going ahead and allowing a technical default to occur for negotiating purposes in Congress. Mike, I'm personally of the view that that's really really playing with fire. I think even a technical default, that gets corrected and cured a few days later, is potentially a big deal. What do you think? Is it a big deal if we had a default technically, that just lasted a few days, then they pay it off afterwards?

Mike: So I think there's two answers to that question, unfortunately. The first is I agree with you. I think the gamesmanship and the brinksmanship are naturally enhanced by in my opinion, the increasingly bloviating nature of our politicians. There are no real consequences for absolutely stupid statements on either side of the aisle. I'm not defending one party versus another. But we've created conditions under which they can say anything they want, much like we behave on social media without as Mike Tyson observes getting punched in the face. That's raised the stakes and raise the risks of an error. And as Stan Druckenmiller correctly points out, you know, there is no substantive discussion around what do we do once we resolve this very short term problem. And I agree with him that that's the much more tragic component to it. If there is a technical default, the answer has two separate components to it. First, there are unquestionably individuals who will encounter stress because their social security check doesn't clear or isn't received because payments are delayed to various contractors, etc. That in turn creates a ripple of liquidity through the system that causes very unpredictable results.

Mike: The second component, though, is is that a premium suddenly gets placed on holding cash to meet obligations. Because if you think about what's actually happening within most corporate treasuries, or in many ways, in most people's portfolios, they're expecting a series of cash flows structured from maturing bonds returning principal, you may choose to reinvest those, you can also use those to pay your bills. The minute it becomes questionable whether or not you're going to get paid on time through the maturation or the interest coupons on those securities, you suddenly have to raise the quantity of cash that you're holding. And if you increase the quantity of cash, that creates the sort of catastrophic outcomes that ripple through the system where the cost, effectively hoarding of cash raises the cost of capital for everybody in the economy. There's a further component of it... It just makes us look like morons right? And that matters on the global stage when you're supposed to be the world's policeman. We joke about cops going to donut shops as compared to doing their jobs. And ultimately, that lowers our trust and satisfaction with policing efforts, creates conditions under which we start talking about ridiculous things like defunding the police. When we see this type of behavior out of Washington. We want to defund the government. And suddenly we're left with really poor decision making.

Erik: Mike, let's go a little further down that path, because I think this de-dollarization trend is something we really need to talk about again. You know, when I first started talking about de-dollarization as I became aware of Sergei Glazyev efforts more than a decade ago. People just laughed me out of the room. You know, the US dollar is the center of the universe, it's never going to change, it's always going to be that way. It's the world's reserve currency. It seems to me Mike, that we're getting closer to the point where the pushback the blowback from other countries who are sick of that. They don't really have a viable alternative yet, but it seems like they're working pretty darn hard on coming up with one. Where do you think this is all headed with respect to the attitudes and intentions of other countries regarding continuing the US dollar centric global financial system?

Mike: Well, I think you hit on two very important distinctions, right? One is there is unquestionably a desire from other parts of the globe to not use the dollar standard for the dollar is world reserve currency. And I think this actually brings up an important point that most people fail to fully appreciate. For most of the second half of the 20th century, the dollar was actually not the global reserve currency or the world's reserve currency. There were two world reserve currencies. There was a segment of the global economy that utilized dollars and was engaged in trade amongst Western nations. And then there was a second Ruble bloc that relied ultimately on the Soviet Union for its monetary policy, which was, to put it politely somewhat disastrous. My sense is that we're looking at something unfortunately, very similar. And just as the outgrowth of the Soviet Ruble based block was a function of the rejection by Stalin of the US Dollar as the global reserve currency. There's a very real risk that Xi or Putin or others who may follow in their footsteps chooses to try to amplify their national objectives over the global environment. And in fact, that seems increasingly likely. The problem with those models is that, you know, and I've said this elsewhere, the expression all roads lead to Rome. It is equally true that those roads are bi directional and lead from Rome. But the simple reality is, is that at the heart of any empire or global reserve currency, you need to have consumption.

And the problem for Russia, the problem for China is that they actually don't have consumption centered at the heart of their economies. Right, so China wants to export its surplus to the world, and is hoping to finance that by getting people to take Chinese Yuan, that unfortunately doesn't create the reverse demand for that Chinese one and the other direction. The Chinese have no mechanism other than lending money, to allow people to obtain those one. And in turn, that system then becomes even more levered than the dollar system that we've described. So at its core, it's a fundamentally flawed attempt to replace the US dollar. As I expect, in almost all fundamentally flawed attempts, it will gain momentum and then collapse. And I think the much more real risk than a collapse in the dollar is actually a collapse in the Chinese Yuan is the news is increasingly drawn around China. That is a combination of their poor behavior on the global stage. And the inconsistencies of that model that create conditions not dissimilar to what happened to the Soviet Union as its capacity for absorbing the risks of the rest of the system began to collapse. They were forced to shed their satellites. I can't see any difference here in China.

Erik: Mike, I think this is a good time to bring up some of the topics that you and I have been talking about for years now. But we've been talking about them and the might happen someday. You and I both said, look, the cryptocurrency thing is interesting, but what's really going to be interesting is when CBDCs hit the stage because governments are going to have the opposite objectives than the cypherpunks. They're going to try to design these digital currency systems to limit and oversee as much of your life as possible as opposed to giving you economic freedom, which was the goal of cryptocurrency. Well, you and I talk in a podcast about that and you know and a few people listened but now it's all happening. Right now we're seeing CBDCs hit the stage. We're seeing a lot of governments starting to talk finally about whether they're going to outlaw cryptocurrencies completely. There's more and more going on that front. But particularly, what I see that I think is most interesting, is government starting to recognize what I said in my book five years ago or six years ago now, which is that the biggest benefactor of digital currency is governments because of the opportunity to have a greater control over society. Seems like it's now finally hitting the stage things we've been talking about. Do you agree that it's happening now are starting to happen now? How long do you think it will play out? What do you think happens?

Mike: Well, unfortunately, I agree with you. And unfortunately, my my worst fears are being realized. And there's somewhat encapsulated in the earlier discussion around Jay Powell, right? Had the crypto community or the Bitcoin community, particularly the Bitcoin maximalists actually spent their time arguing for here's what we would like out of a monetary system, as compared to you must adopt our system, which will make me extremely rich, or it's all going to collapse, and you're all going to die, which is a summary effectively of what they said. You know, we might have actually made some progress to saying no, here are the important components of a digital currency and a system that is based on instantaneous settlement, etc. that has the potential to include all the control features. But if you behave as a bunch of narco capitalists and effectively say there's no role for the state in currency provision, there's no role for the state in policy setting. The state is naturally going to create currencies or create tools that fight back against that in their creation process. As a result, the CBDCs that are being proposed have exactly as you described, significant control features and significant capability to effectively strip away the privacy of individual transaction histories, individual behaviors, etc, that candidly I value very deeply right? And I it's important for people to understand this.

I don't care if you and I decide to use a $20 bill to put a side bet on to economic activity that we can describe as well, the Buffalo Bills defeat the San Francisco 49ers right? Completely irrelevant, allows me to use money to settle private debts in a way that says to the government, this is really none of your business. And it allows me to express my personal preferences without the concern of who's looking over my shoulder right? When you introduce the type of social credit systems that China's proposing that are being increasingly incorporated into the technology and tools that the US is proposing for its CBDC. When we create those types of dynamics, we're actually creating a society that becomes almost a, you know, Plato's cave imitation of an actual economy, where we spend more of our time trying to figure out, what are people watching in my behavior as compared to what do I actually want to accomplish with my behavior. I'm terrified of it. And it makes me extremely sad that we've gotten to this point. But we allowed ourselves to be led here by a bunch of people who had no idea what they were talking about.

Erik: Mike, I want to move on to a topic that I've been thinking about a lot lately. I'm pretty sure you have as well and that's artificial intelligence, generative AI and the trend. There's been a major acceleration of progress in artificial intelligence in the last 6 to 12 months. I'm not sure if it's going to continue. But frankly, I don't think it's a good thing. Chat GPT, generative AI in general, what do you think? Where do you think it's headed and am I right to be concerned?

Mike: So the quick answer is, I think that there's as with all technologies, there's both promise and danger right? If you go back to John Henry versus the machine, you know, the famous poem, the argument effectively boiled down to the strongest man could defeat the machine, but he died in the process. Now, I kind of look at that. And they say well that's a silly thing to do. And so we're somewhat forced into embracing aspects of this. Doesn't mean we need to fully embrace it. Doesn't mean we shouldn't have conversations about how we want to place limits around it. Or even more importantly, how we want to deal with the social ramifications of the equivalent of replacing much of the agricultural labor that existed in the US in the 19th century or many places around the world. That led to the general impoverishment of small farmers, forced people into city environments, etc. And, of course we're all familiar with Upton Sinclair, the jungle and the disasters that befell human beings when we didn't properly consider the costs of putting people into warehouses, factories, etc. So we're in a similar situation here, although this is a different type of technology because it actually instead of replacing human physical capability. It replaces humans intellectual capability. And this is happening at exactly the same time that for the very first time, we're experiencing symptoms of surplus of the highly educated members of our society.

I've actually written about this extensively on my Substack, I'll provide a link so readers can take a look at that. But one of the things that's so interesting about what's happening is that in the past, basically 15 years, we've seen nearly a doubling of the number of people in the labor force that have college degrees, right? We're starting to see for the very first time, the levels of unemployment for those with college degrees, begin to move towards the levels of unemployment that have historically been associated with far less skilled occupations. The real challenge that that creates, is that individuals incur significant costs to go to college. They give up many years of unproductive labor as they pursue that, although it's debatable whether they're pursuing college degrees, or college partying degrees in many situations. And unfortunately, again, we've robbed the system of the ability to signal that through our policy of educational support in the United States, where we treat a degree in French medieval literature as worthy of the same type of support as a degree in mechanical engineering. So we have all sorts of problems in the system. Unfortunately, that's now coming to a head at exactly the point that we're introducing this AI. And I think what we're unfortunately going to see is the same type of displacement and challenges on a social framework that occurred during these periods of transition and in historical dynamics. The long recession of the 1870s. The Great Depression was largely the displacement of agricultural labor. There is phenomenal discussions around this in various historical books, looking back on those dynamics, but the introduction of things like the McCormick Reaper, etc, dramatically improved production and ultimately led to significant unemployment or underemployment in the agricultural sector, that caused people to flow into cities where they became available for industrial employment.

And then industrial employment peaked and began to flip with the Great Depression, where we could no longer project that in a linear fashion. You know, that type of disruption, I think sits ahead of us with AI. And so I'm less concerned about the deployment of the AI and the risks of quote, unquote, paperclip world where an inappropriate series of instructions have been handed off to AI. And it proceeds to destroy the world. I'm much more concerned about the social ramifications of that degree of displacement without a strong consideration for how do we share the benefits associated with those gains. If we simply allow them to accrue to those who happen to own those technologies and benefit from the first mover dynamics. That's going to be really unfortunate, it's going to lead to significant social stress that I think we're really unprepared for.

Erik: Mike, we're in strong agreement that the issue is not the obvious issue. And I just am not sure how many levels of unobvious issue there are. Because most people when they talk about AI, the specific fear they have is this idea of a singularity where the machines become smarter than we are. And they plot an evil sinister, you know, conspiracy to get rid of the humans. That's the scenario, the essentially the Terminator movie scenario. I don't worry about that at all. I don't think that's a big risk. I think it's just the kind of stuff that science fiction causes human beings to get fearful about. But when I think about just the risk of economic and social disruptions. If what's left of the middle class gets replaced by a combination of screen scraping and chat GPT. It's the elimination of the middle class. That's the social event that leads to potentially, you know, violence and all kinds of crazy things happening. I think that's a big risk.

And I think there's also a risk that way too many people are assuming that safety mechanisms built into this, you know, don't worry, you're not going to go on to Chat GPT and ask it to come up with the best strategy to bomb and take down the New World Trade Center after the last one got taken down. Well, there's some kind of, you know, circuitry or programming in there that says, I'm not allowed to help you, you know plan terrorist acts for them at the beginning of time Mike, it's been very easy for people who understand technology to disable safety features like that, you know, let's turn off that feature and enable the version that can do anything. I've got to believe that we're going to get to the point where everyone from terrorists to conmen I don't think it's a fear of AI is smarter than us and it's scheming to put human beings out of work. I think it's handing an incredible amount of power to spammers, to conmen, to online scammers, to people who run internet you know, scams they can be automated.

Mike: Right, in Nigeria, those scammers armed with Chat GPT can create compelling narratives. And instead of saying hey, I'm locked in a prison or you know, so and so is locked into prison, here's a direct duplicate of an invoice that you need to pay, etc.

Erik: And they can generate the invoices in real time. And they can impersonate other companies, they can create official looking documents, they could do all sorts of things. And I'm sure that the people that Open AI have provided some control that Chat GPT won't do sinister things for you. Unless you figure out how to disable that programming and then it will.

Mike: So yeah, first of all, what you're saying, I think there's definitely truth to it, I actually tend to be a little bit more sanguine about those components. There's a never ending race, right? That that is mimicry and predation. We see it in nature, where caterpillars pretend to be snakes and snakes conceal themselves with camouflage, right? So that dynamic, I think, is actually well established and is something that we just have to accept is going to occur and the systems to deal with that tend to be pretty robust over time. The flip side of that is why do people engage in that type of behavior, and some people are crazy. And we have, you know, an unfortunate epidemic of untreated mental illness in the United States that I think is tied to many of the social problems I was alluding to before, as well as the failure of the state to make rational choices around the treatment of individuals in a manner that could be reflected in that positive way. So like, there is a very real concern that somebody moves from using an AK 47 or an AR 15 to using chat GPT to engage in terrorist type activities. I fully accept that. And I think that's an unfortunate reality that is exacerbated by many of the policies that we have in our country and around the globe. I think the much bigger question, though, that emerges out of that is how do we productively engage people, because what's really happening with chat GPT in my opinion has a super interesting feature right? And I've tried to highlight this for people and I'll use the example again.

When Europeans first came to North America, probably the single greatest skill would be to speak Native American, right to have learned the language to be able to function as a translator, because it gave you access to the continent of North America in a manner that allowed you to stake out land that allows you to properly survey resources and identify them, etc in a world that was dominated by the Agricultural Resource. I actually think something very similar happened in the last 50 years, in which the most valuable talent was somebody who close to natively spoke the language of computers because it liberated them to identify resources to figure out ways of solving problems that simply didn't exist for the rest of us. Mathematics in terms of Wall Street played a similar role. The interesting feature about chat GPT is it becomes a universal translator. Suddenly, it is a true natural language translator between an instruction set for computers, and the instruction set that were taught on an individual basis. And the world is filled with stories of how chat GPT or tools like chat GPT are leading to revolutions in code writing, computer programming, etc, where productivity and services is beginning to explode. Right? It's completely insane to me on a on a services standpoint, that I still have to walk into the DMV in California to do the majority of the transactions that I want to do. The idea that that can be replaced and those extremely surly resources that we call human beings employed at the DMV, could be redeployed in productive and positive ways is an extraordinary opportunity for us as a society right?

We're talking 70 plus percent of the economy has the opportunity to be reconfigured in the same way that agriculture was reconfigured in the same way that manufacturing was reconfigured in the 20th century. Again, the real risk though, becomes how do we handle that transition? Because if that transition involves everybody paying a toll for any economic activity to an entity like open AI, or Microsoft, well then effectively all you've done is crowned you know, the terminator or Skynet given them the ability to place a toll on humans ability to think and interact. I think that's just a fundamentally flawed model. And so we need to be really thoughtful about how we engage in this process of serious discussion around how does the world change when you introduce something like English, right? Because that's really what we've done, we've created a language that allows us to natively communicate between human beings operating in a carbon based world, and computers operating in a silicon-based world. We've given ourselves the opportunity to merge those into higher functioning on both fronts, and now becomes a question of who benefits most? We don't know the answer yet.

Erik: Mike, I can't thank you enough for a terrific interview. As always, before I let you go, though, I want to talk a little bit more about what you do at Simplify Asset Management. You've been there I think, a couple of years now. What does the company do? You run several funds, I know most of the work that you do research and so forth ends up on the simplify.us website. So what can people expect to find there? What kinds of funds do you guys manage and tell us more about what you do at Simplify?

Mike: Sure, so you're right, I've been with Simplify for a couple of years. I joined because there was a change in the regulatory framework that allowed us to create ETFs that incorporated the types of derivative strategies that I've been historically known for prior to 2020 that really wasn't possible. So if you look at Simplify funds, you'll see very traditional exposures that have wrinkles around them that have been created into improve performance. Increase downside protection, allow individuals to express a particular point of view, and do so in a manner that would have traditionally been associated with the high fee hedge fund world. We're introducing those into the much lower fee, much more accessible ETF space where we not only do we benefit from the change in the regulatory structure in terms of just being able to provide them, but also by incorporating strategies like hedging, etc, into the ETFs. We make them more tax efficient so you don't need to transact in the same way incurring the taxes around them. In our opinion they're many of the best solutions for many of the problems that people face in today's markets.

If you're looking across what we're doing at Simplify. We offer everything ranging from commodity exposures that have incorporated combination of trend following, and strategies that are designed to identify value within the structure of the commodities markets, to strategies that incorporate true macro components. For example, the Simplified Macro Strategy to leverage expressions of rates so that you're able to pick up things like a short-term interest rate exposure that behaves much more like a longer term interest rate exposure. I've been thrilled to be able to partner with the individuals at Simplify to offer these types of products to you know individuals who historically have not been able to access these strategies and I encourage people to check out our products.

Erik: Patrick Ceresna, Nick Galarnyk, and I will be back as MacroVoices continues right here at macrovoices.com