Jim Bianco: FOMC to China to Dollar to AI

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Erik: Joining me now is Bianco Research Founder, Jim Bianco. Jim, it's great to get you back on the show. It's been way too long. Let's start since it's an FOMC week. It will be yesterday to our listeners who are hearing this Thursday. It's this afternoon for you and I. FOMC met, what happened? What does it mean for inflation, for Fed policy, for bond rates, and so forth? What are we looking at?

Jim: Well, as everybody knows, the Fed did not raise rates for the first time in 14 months, 15 months. And the question is, is it up? You know, the terminology we're using... Is it a skip or is it a pause. Skip would mean that they are going to hold off by not raising rates for maybe one or two meetings. A pause would mean that they're not going to raise rates for several meetings, or which could eventually wind up into being the end of the cycle. The interesting thing that came out of the meeting, this was the quarterly meeting where they do the update of the dot chart, and the 2023 dot chart and that's all the members of the Fed put down where they think the funds rate is going to be, at the end of the year, showed that they think that we're going to have two more rate hikes this year. Two more 25-basis point rate hikes. Remember now, we have four meetings left. And so they're going to raise rates 50 basis points between now and the end of the year. Of the 18 members that filled out a dot, 16 of them had the rate head funds rate going up at least once. The two that didn't had it unchanged. So there's no rate cut that is being suggested here. So it's being referred to as a hawkish skip, because they really laid the groundwork for it. They stopped raising rates, but they're not done. And lastly, there is a precedent, because in the last couple of months this year, we've seen both the Reserve Bank of Australia and the central bank in Canada both stop raising rates saw inflation firm a little bit and then restarted raising rates. So there's been other central banks that have done the skip or the minor pause thing already this year.

Erik: I think it's really important to focus on the way the market is perceiving this, which frankly as far as I'm concerned is kind of out of sync with what I think they've really been saying, which is the Fed has said look, we're going to pause our hiking cycle. The Fed's not saying anything about cutting rates. And everybody is saying well of course what this means is that dovish pivot is coming any minute now. It's just right around the corner. Why is it around the corner and what if it's not around the corner? And specifically, what if the Fed doesn't share this perception everybody else has that the Fed has got to cut rates this year? Is it going to take a big market event before that actually happens or what do you see on the horizon?

Jim: Well, let's talk about a dovish pivot. When was the last time that the Fed did a dovish pivot? And the answer is 1995. It's been 29 years. And what do I mean by a dovish pivot? Well they cut rates in 2020, yes. That was panic, you know, the economy was shutting down because of COVID. And the Fed panicked and they chopped rates to zero, before that they cut rates in 2007. And in 2008, that was the last rate cut cycle. That was panic, we were going into the great recession. And they cut rates down, you know, as part of a panic. The rate cutting cycle before that was 2000-2001. That was a combination of the tech bust and 9/11. They cut rates panicking, because they saw that the economy was going to hit the skids. And in the case of 2001, they held rates at 1% until 2004. So a dovish pivot, I think what people mean is the Fed is going to take a victory lap. Hey, we vanquished inflation, we went up to restrictive and now we could back rates off and tell everybody job well done. Well, they haven't done that since 1995. And that was a completely different era when they did that. So is there going to be a dovish pivot? Well history says no, the only time the Fed starts cutting rates is when everything's going to hell, and they're panicking. And that's not a good environment to own stocks or risk assets in general. But to your other point, the markets, yeah you're getting two radically different answers out of the market. Now on the bond market, you're seeing higher rates, you're seeing now you know, pushing 4.75-4.80% on the two-year note, which is getting close to the cycle highs which is 5.07 back in March. So interest rates are saying, look, there might be more inflation. There might be more problems. There might be more rate hikes.

The stock market well that's a difficult one to say because, as you probably know and what everybody's been talking about this has been a highly concentrated rally. So you've got 8 or 10, big mega tech stocks, you know, led by Nvidia and Apple. Nvidia and Apple alone are half of the gains, the 11% gain in the S&P this year, two stocks. Eight stocks, which would be the FAANGs plus Microsoft, Nvidia and Tesla account for the entire gain in the S&P 500. The other 492 stocks collectively are unchanged on the year. So what's the stock market telling us? Well, if you look at everything else, or if you look at the Russell, or the equal weight S&P, all of that is saying not much is going on in the stock market. But if you look at the cap-weighted indexes, and we're running Nvidia to a trillion dollar market cap, and we've got Apple, which started at a $2 trillion market cap and is up 40% is now approaching a $3 trillion market cap. Yeah, the S&P is up because of like a handful of stocks but is that indicative of what the economy is doing? I don't think it is. So there is a difference between what the bond market is saying, what the stock market is saying. And like I said, I don't know where people think there's going to be a dovish pivot, there hasn't been one for a generation. It's only one the Fed is panicking that they cut rates.

Erik: Well, it seems to me this is actually pretty clear, which is what's going to happen is there will be a dovish pivot, when the Fed is panicking. And the Fed won't panic until markets really start to crash, not just a little bit of down, but we're actually in a crash condition. And I think that we'll get there if we keep hiking rates we will eventually get to the point where we cause a stock market crash, and the Fed will have their opportunity for a pivot. But I think to expect one, before something really, really bad happens in order to bring it about is crazy. I don't know why anyone expects a dovish pivot, that is not preceded by something really, really bad bringing it about.

Jim: Right and that's exactly the case. You know, the old adage that the Fed hikes until something breaks. You know, that's been a big debating point for the last year or so. Well, did we break last year with the 25% decline in the stock market or the worst bond market total return in history, which both happened in 2022? Did we break with the banking problems in the spring of this year? Was the breakage all of that or is there something else to come? But you're exactly on point. If you think there's a dovish pivot, and you buy stocks now, the first thing that has to happen is you have to lose a god awful sum of money, and then the Fed will ride to the rescue. Now, why would you want to jump in front of that? I could understand if the stock market crashes or is going to hell and the Fed starts pivoting, that after the market is down significantly, you might want to jump in. That's a different story. But I think what the dovish pivot that they're suggesting now is like 95, the Fed will just say, we've done enough, now we can back off on rates. And you know, we could kind of just take a victory lap and say that, you know, job well done. But that's not the way that this Fed has worked for a generation.

Erik: Jim, coming back to Fed policy, I want to talk a little bit about the US dollar, and particularly we had that big rally up to what was it... $116 on the dollar index. Do you think that that is a final high in the dollar and particularly, you know, as we think longer term, something that's always interested me is this question of dedollarization, the eventual replacement of the US Dollar as the world's global reserve currency. I think you and I would probably agree with most historians and economists and so forth, that the US deserves what was actually described in the 1960s as an exorbitant privilege of being able to essentially borrow money for free because there's so much demand internationally for the global reserve currency and for debt that's denominated in the global reserve currency. The US has received that benefit. There's one fellow who disagrees and actually thinks that the US would be better if we didn't have the reserve currency status that it's causing us. It's become a burden as opposed to a privilege. Well, that guy in his name is Jared Bernstein was just confirmed as the chair of the Council of Economic Advisers, which is like the senior advisors to the US president on economic policy. That seems very relevant to me. What do you make of the guy who kind of wrote an op-ed in 2014 saying we ought to ditch our reserve currency status. It doesn't help us. I think he's crazy to think that but that's what he thinks. He's now in charge of policy for the White House.

Jim: Yeah, so you know, one thing about Jared Bernstein is, you know, during the Obama administration, he was a policy adviser to Vice President Joe Biden. So he has a long history with Joe Biden. He has been working in the White House as an advisor to the president, but now he's been officially confirmed to the Council of Chairman of the Economic Advisors, the CEA. He has been a voice in the ear of the president for a long time. So I don't think anything is materially changed when it comes to influencing Biden when it comes to Jared Bernstein, because he's been such a long history with him. And also, he's not the only person that the President has on his Economic Council. of course, it's headed by Janet Yellen. There's, you know, Gary Gensler, the SEC. There's Lael Brainard, who is the National Economic Chairman who used to be the vice chairman of the Federal Reserve. So yeah, I completely agree with you that this idea that the US would voluntarily not want to be the reserve currency is a form of suicide. Of course, you want to be the reserve currency as you point it out, that one of the benefits of being the reserve currency which Americans have taken so far for granted, they don't even realize it is everything is priced in dollars. When you look up the price of crude oil, it is priced in dollars, Europeans have to look it up and see it's in dollars, and then they have to convert it into their own currency. Another friction, another cost, we don't have that. When it says it's $67 a barrel, we pay $67. For it, they have to convert $67 worth of euros which changes every day, and the price changes every day. So that's why it is an additional burden on them.

So of course, we would want to keep it. It would give you at least on the reserve currency front. Alright, you could tell me the dollar sucks and you could tell me all the problems that the US has from political, to fiscal, to economic. And I'll jump ahead and say I agree with you on every everything you say. Okay, what's better? What is a better alternative? And remember, the point of the reserve currency is, it is the lowest cost alternative. You price things in dollars, you use it as the reserve currency cause it's the cheapest for the world to use. Is it the Euro? Is it the Chinese yuan? Is it the Russian ruble? Is it Bitcoin? Is it some made up currency of a basket of other currencies? The answer is no. All of those options have been out there forever. And the reason that they never get any traction is because they're all more expensive. If you want to price your currency, price in Saudi Dinar, or you want to price your Russian rubles, or Chinese yuan, good luck trying to sell several 100 million dollars of oil a day in a currency that is not liquid enough, and maybe doesn't have the rule of law, doesn't have the status, or the the depth that the US dollar does in the world reserve payment system to try and you know, effect that kind of trade. It'll cost you a lot. There'll be a lot of friction, there'll be a lot of liquidity slippage that you would have. So the US dollar, yeah, it's got a ton of problems. The benefit it has is it's better than any other option that we have. That doesn't mean there won't be an option someday to replace the dollar. It's just not evident right now.

Erik: Wow, I have to strongly disagree with the last comment. Despite that I agree with everything you said before that because we couldn't agree more Jim, that the US dollar is the world's global reserve currency still for one reason, and one reason only, which is there is no viable alternative. And that's despite the fact that a lot of people around the world have been looking for that viable alternative for a long time. As you say correctly, the problem they've had, is people have wanted to engineer, you know, the financial engineering guys are saying we need a new reserve currency, that's not the US dollar. And what they have been unable to overcome is you can't get there from here specifically, because you need a replacement for the US bond market. You need the depth and liquidity of the US Treasury market to provide a suitable storage location for central bank reserve assets, something that can absorb central bank sized capital flows. Nobody's ever been able to come up with a another currency that can do that. And that's because it's a financial engineering problem.

My contention is that if you replace the US dollar with a digital currency, now achieving that depth of liquidity is still as big of a challenge as it was before. But it's not a financial engineering challenge. It's a software engineering challenge at that point, and it's an overcomable problem. That's the reason I predicted in 2018 that Russia and China would jointly work to assert a sovereign digital currency designed to replace and compete with and eventually replace the US dollar. And the thing is Jim, not only are they doing that... They've announced they're doing. They're hard at work at doing that and the whole World is ignoring them completely. That's just China and Russia talking about digital currency blowing smoke, who cares? I think we should all care a whole lot. I think they're onto something. And if there is a way to replace the US Dollar as a global reserve currency, the only way I can see to do it is with a digital currency that can use software engineering, rather than financial engineering to achieve those depth and liquidity characteristics that so far nobody else has been able to replicate that are currently enjoyed by the US dollar.

Jim: You know what, I actually agree with you. When I said, you know, someday there might be a replacement for it, you know, it's still ways away. China and Russia are working on it, but they've got one big hurdle, they've got rule of law. You know, do you trust the Chinese and the Russian government that they will treat your currency like the US did? I think that from an economic standpoint, what we did last year, when we sanctioned the reserves of the Russian Central Bank for the first time ever, maybe banned them from the SWIFT system and the like was a dangerous precedent. Because one of the things that dollar had for rule of law was everybody knew that it was going to be, there was an equal playing field for everybody. Now, you could say Russia was a bad actor. Well, China's going to start thinking the same thing. I mean, France is not going to lose sleep over. The UK is not going to lose sleep over it that we're gonna ban their reserves. But some of these developing countries and emerging markets, they will start to worry that if they get on the wrong side of the US, that they're going to get punished. And they might consider some kind of digital currency that are sovereign currency made up of Russia and China, that could very well work for them. And by the way, that emerging or developing country that might want to consider it that is having strange relations with the US is Saudi Arabia and OPEC. And that they might want to look at something like you know, their currency not because it provides them with a better way to trade. But they won't get rugged, they won't get the rug pulled out from them by Washington where there's a fear that they might right now. So that's why I said someday there might be an alternative to it. It's just not immediate, and I agree with you. You cannot walk around saying my currency sucks, but everyone else's is worse. So therefore, I'm good. Now you've got to try and continue to maintain your dominance otherwise somebody will take it away from you over time.

Erik: Let's come back to the stock market. So many of our guests have said look, the bottom is not... the bear market is not over. But you know we're I think as of today, we're looking at our fourth daily close on the S&P above the 61.8% fib retracement of the entire bear market. Now is you know, as well as I do Jim, one of the lores of technical analysis is once get past the 61.8 retracement, if it doesn't turn around there, it's probably going all the way to 100%. Does that mean that the bear market is over and we're really in the beginning of something or are we just on the cusp of a major reversal here?

Jim: You know, that's a good question because you're right, if you look at the S&P, it does look like it's on the verge of breaking out. And that's what's got people correctly excited about its move. But if you look at the equal weight S&P or the Russell 2000, you know and I'm trying to get further away from the NASDAQ 100 companies, which are really going crazy because of AI and the promise of AI, is you get further away from them. As I mentioned before eight stocks have led the entire rally in the S&P. You're not seeing that kind of broad confirmation that you might want to see. So are those large mega cap companies breaking out? Yes. Could they keep going higher you know, driven by the NASDAQ 100? Yes. And could you make a lot of money owning them? Yes. But then be careful because when they go over this side, there's going to be a very limited window to get out. But that's kind of the way that parabolic moves are. You make a lot of money real fast, and you lose a lot of money real fast on the other side. But if you're looking at the broad confirmation that the entire market is getting ready to kind of move higher and move past the bear market of 22. I'm not seeing it much anything else other than the big mega tech companies. Does that mean we're going to go back to the October 22 lows. Look, it might still be another year or two. We might just be in a long period of consolidation. I think that that's the more likely scenario with the broad market when you've got, you know, on the one side, you've got the mega cap companies going up.

By the way on the other side, if you want to talk about the flip side of that who's doing terrible is the property stocks, especially the office REITs and the financials. They've been getting severely crushed. I mean, even though that the regional banks have rallied, and some of the property stocks have rallied, they're still down 20 or 30% on the year, and that's after being up 15% in the last week or two. So they are on the flip side of it. I've also argued, and the reason I brought that up is history shows, it's really difficult to get an uptrend in the market when the financials are under pressure. Now let me be clear, they don't have to lead, you don't need the financials to lead. They just can't be a mess, which is what they've been, and imploding on themselves, which is what they did from March to May, you know, and that's why the broad market went nowhere, from March to May. And it was eight or ten stocks that continued to rally and the way I explained it is, you know, the Nvidias and the Apples of the world don't need a bank. They're strong enough on their own that, that they kind of transcend the banking system or their narrative is strong enough that can transcend the banking system. Everybody else does... at least in the banking system that's not a mess. And you know, even though the bank stocks have been doing better, I don't think we're out of the woods yet. And as long as the bank stocks have a question mark on them, there's going to be a problem with it.

Erik: Let's talk about China because China was supposed to be according to a lot of people's narratives. This will turn round, everybody's saying, okay I don't know the timing exactly but at some point, China is going to reopen their economy. And boy, watch out aggregate demand is going to go through the roof, oil demand is going to be back overnight, you know, it's going to knock your socks off, just wait! Well, we waited and it didn't happen quite like that. What's going on?

Jim: You know, you're right. What's happened in China, I've been very shocked by because remember, they had zero COVID. And then they had the protests and the political pushback about zero COVID around Thanksgiving. And then in December, they just, you know, Chairman Xi came out and just said okay, it's over. It's all over. And then the world fund managers in January, were as bullish on China as they are on AI today. I know that was only six months ago, but it was because they said China's going to reopen, their economy is going to boom, everything's going to take off, we got to get long China. Well, China did reopen. If you look at measures of subway traffic in the major metropolitan cities, it's back to pre-COVID levels, people are out and about, it's no longer a ghost town, things are happening. But then something really strange also happened at the same time, their economic growth really didn't pick up, you know, it's like, okay, all of a sudden, everybody got out of the house and started doing things again. But economic growth has been a real disappointment, their stock market has struggled. Earlier this week, the Chinese central bank cut the repo rate... They eased because things are going so poorly in the middle of a reopening and now that's got people worried like me.

What about the property market? Well, the property market was overheated. And the property market was a problem. And it was a concern about the losses that were piling up on the banks. And four or five months ago, people said well don't worry, everything's going to reopen, people are going to go back to work, they're going to get their bank account replenished with wages and everything else, and maybe some gains from the stock market, and they'll be able to afford those overpriced homes. Well, it didn't happen. So does that mean we can now look for another downturn in their property market and more problems on their banking system? So what I'm trying to say is that, I think if you were to ask me, what is the biggest disappointment in the world economically speaking in the world, is what a dud, the reopening of China has been so far.

Erik: I want to come at this same question from a different angle. And I'm not sure if the other angle explains the apparent dichotomy here or what but it seems to me, like most people are looking at this China question in terms of okay, well, you know, when we first looked at it, we thought that the demand was going to look like this. When they reopened, this was going to happen, and it turns out that... wait a minute, what also happened in that intervening time is some really, really major geopolitical. I don't even know what the word is for it. Monumental events have happened in the course of human history, where it looks like the US and China and Russia are going to be pitted against each other at least in a new Cold War if not in World War Three. So we've got a completely different outlook for what our relationship is likely to be with China over the next 20 years. How much do you think that is playing into? Maybe the lack of exuberance about China's economic recovery.

Jim: Well, I think it is in terms of the financial markets, and it might be holding back the foreign flows into China to some degree. But if the answer was that the GDP of China, which is driven by Chinese people doing economic things. That was supposed to take off, because remember, they were literally welded into their apartments. They would weld the front door shut so that people could not leave to enforce Zero COVID. So those front doors were basically, you know, blowtorch open and people were supposed to get out, go back to work, make money, go to the store, spend, shopping. If you remember, the first couple of weeks when Zero COVID was lifted, every airline ticket for a month was sold out in China because finally, I can not only leave the house, which I have not been able to do in months, I'm going to get on a plane, and I'm going to go somewhere nice within China. Chinese people going and traveling within China. And that was supposed to lead to big economic growth and that didn't happen. So while I agree with you, that there is big economic concerns out there between Russia, China in the United States, that shouldn't have affected the domestic consumption and the domestic activity of Chinese citizens being open or being allowed to reenter the economy. And yet, while they did, growth has really disappointed.

Erik: What do you think the potential consequences of an escalating Taiwan conflict are? Let's assume that there's probably going to be several rounds of blowing smoke before any actual bombs fly. But it seems to me like we're getting more and more to the point where China is being pushed to confront Taiwan. What's that going to mean to global trade and particularly semiconductors?

Jim: Oh I think it'll be devastating. And what I worry most about is I agree with you, you know, most of everything that I read is, oh China's rattling, and they keep you know doing flyovers into Taiwan airspace and maybe, you know, sail some warships into within 12 miles of Taiwan in provocative acts, but don't worry, if there's going to be a move on China, it's still many years away. Okay, I have no position to argue that it's this or that. But the risk of an accident is really high. In other words, they sail a warship into, you know, the Taiwan Straits which is within the domestic waters of Taiwan and the Taiwanese feel like they have to respond or show some kind of a response, and then a mistake happens, and then things kind of get out of control. And so there is that but you're right, if we ever got to that point. Right now, I think it would be devastating for the economy, because I would argue to you that the two most important commodities in the world are oil and semiconductors. And if we were to see some kind of a embargo or restriction on the trade of semiconductors, remember Taiwan semi is the largest semiconductor manufacturer in the world. It would have enormous implications.

Now, what are we doing about it? We're talking about reshoring. You know, the Intel's of the world are talking about building fabrication plants either in Arizona or Ohio to try and relevate their need to get chips from Taiwan. Okay, great. That'll take 10 more years, plants are not easy to build. You can't throw those together in a couple of months. So yes, I think there is a vulnerability there. Maybe the Chinese have a longer term timescale as to what they want to do with Taiwan. Remember we think China is made up of 19 provinces, they think it's made up of 20. And the 20th being the province of Taiwan. So they would never consider it to be, you know, an aggression on a foreign nation, it would just be it would be almost like a police action within their own countries the way they would view it. But of course, the world would view it differently.

Erik: Jim, I want to move on to a topic I know you pay close attention to which is the inner workings of the financial system. We've been told, okay, look the debt ceiling thing that don't worry about it, it's been resolved. Okay wait a minute. What does that mean, in terms of the mechanics? Has it really been resolved. Is everything in place to pay all the payments? Do we have to worry about the Treasury general account being sufficient to make payments? Is the debt ceiling really behind us or is there more still to come?

Jim: I think there's two points that we need to really understand here. First of all, when the Treasury issues a treasury bill, let's just use a bill or a bond to. If you buy it, your money goes into the Treasury's general account. For purposes of this discussion, that is money that leaves the financial system, it's in the government's account held at their bank, the Federal Reserve, it's money that still exists, it's just not part of the financial system. So when we were having the debt ceiling, you know, shenanigans, the Treasury has their general account, think of it as the government's checking account had about $500 billion in it, you know late last year, and it was running down because we hit the debt ceiling in January, and they couldn't get you more net new debt. What I mean by net new debt is if a $10 billion treasury bill came due, they could issue $10 billion to pay it off, but they couldn't issue $11 billion dollars. So the extra billion would be for government finances. So as they were running it down, they were running down their debt ceiling, because the government had to pay its workers, pay benefits, pay its vendors, that money was being shoved back into the financial system. So ironically, the debt ceiling debacle with the rundown of the TGA, their checking account was an additive, it was a liquidity boost. It was pushing money into the financial system.

Okay, so now at the beginning of the month, we raised the debt ceiling, or we suspended it to January 1, 2025. So now the Treasury is free to now refill its checking account. It got down to $23 billion, that would be like you or me having a $1.50 in our checking account to put that in perspective. And they're talking about that at the end of the month, they want to go to $450 billion in their TGA account. Plus they did all these extraordinary measures where they borrowed from their pension plans and some of their trust funds and that was another $330 billion. So they're going to try and raise net new money of around $700 billion. $450 billion for the TGA and the other $300 billion to play off the extraordinary measures. That is a drain of liquidity from the financial system. So you buy these bills that they issue, you're taking money out of the banking system, and you're giving it to the government, except we now have a new dynamic here, the Feds reverse repo facility. What that is, is there's $2.2 trillion in that research facility. And it has about 115 counterparties mostly money market funds. And let me be clear up here, it's a perfectly legitimate investment for the money market industry. About 45% of all the money in money market funds is at the Fed in this $2.2 trillion. They give the Fed, they do an overnight loan to the Fed or reverse repo is what they call it, they get paid 5.05%. Very simple, very easy, the greatest counterparty you could ever have is the New York Federal Reserve. What is also money that is outside of the financial system.

So a lot of people have been very sanguine about this idea that we have to refill the TGA. Because they say, well what'll happen is when the Treasury does all of this massive following money market funds, who traditionally buy treasury bills will just take the money out of the reverse repo facility and use it to buy T-bills since its money already out of the financial system, it will be going to another account already out of the financial system, no change of liquidity. But if it isn't coming out of RRP, reverse repo, it's going to have to come from the banking system. And that could present a problem because the last three times we ran down the TGA and then refilled it that would be August of 2019. December, late December of 2021. And now, the last few times we've done it, we ran into problems. August 19, September 19, the repo market blew up. Late December 2021, January 2022 was the high in the market. The other time we ran up a big amount of borrowing and ran down, you know, and drained the financial system of a lot of money was COVID in March and April of 2020. That wasn't because of the debt ceiling, but it had the same effect. It drained a lot of money out of the financial system. Markets were wild, the markets crashed and then recovered. They were completely especially the bond market dysfunctional during that period, and that the Fed was working almost around the clock to try and solve the liquidity problems in the bond market.

One of the reasons why is because we pulled a trillion dollars out of the banking system because we raised an obscene amount of money because we had all of the pandemic responses, the PPP loans, all of the stimmy checks. Well, that money had to come from somewhere. They raised over a trillion dollars of treasury bills and that money came from the banking system. So what I'm trying to say is, as we refill the TGA account, it is a drain of liquidity. If it comes from money within the financial system out of it. If it comes from a drop in the RRP, then it is not. Now we're talking on June 14. Early earlier this week, the Treasury issued $296 billion of securities. Treasury bills of various maturities, a 3-year note, a 10-year note. All of those settle tomorrow, June 15th. We will find out tomorrow, Friday, and the Monday who bought those $296 billion. They've already been auctioned, they've already been bought. But what did they be used to pay for it? Is it going to be money being drained out of the financial system or will we see a big drop in the RRP. Aa big drop in RRP would be good. That means it's already money outside the financial system going to another account, no big deal. If we don't see a drop in RRP, it means money coming from the banking system reserves out of the banking system, going to the Treasury. The last three times we saw something like that, eventually financial markets ran into trouble. So in the next week or so we should have a better idea of how this is going to play out. I frankly don't know which way it's going to go. But I do know it is an issue and it is an issue that we need to pay attention to because it could depending on how it plays out, have some ramifications.

Erik: You said that in past examples, it hasn't worked out well for financial markets eventually. How not well are we talking about and how long after the event did it take before the unfortunate result occurred?

Jim: Right, the reason that it didn't work out well in past examples is we didn't, you know, in 2019 and 2020, there was a couple of billion dollars in the RRP. Today, there's a couple of trillion dollars, a 1000 times more in the RRP. So there is a pool of money outside the financial system. But in the other ones, it was August of 19, six weeks later after a $300 or $400 billion raise by the Treasury, which means sucking $300 or $400 billion out of the banking system. The repurchase or the repo market, the standard government collateral repo market ran into trouble. ou could probably get Jeff Snyder on to talk to you for a whole episode about what happened with the with the repo market in September 19. But it was preceded by a big drain of liquidity by refilling the TGA. The TGA soared in March and in April of 2020, because of PPP and Stimmy checks, they had to raise all that money. That was exactly the time that the stock market crashed, recovered, the bond market became completely dysfunctional. Remember that the Fed at one point was buying almost $100 billion of Treasury securities a day to try and stabilize the market during that dysfunctionality.

Late December, like literally the week before Christmas of 2021 was the last time that we raised the debt ceiling. They raised something like over the next five or six weeks into the middle of

February of 2020 like $700 billion again, there was no RRP to offset it. And what happened it was the top of the bull market, and we wound up seeing stocks fall 25%, we saw the bond market eventually have the worst year ever. Yes, the Fed started raising rates in March. But the market was really under pressure almost from the day after the RRP was filled. This time, I think it'll be a little bit more of a delay because you've got this offset of the RRP that you could use to pay for all of this securities. Maybe it doesn't happen this week. Maybe it happens in the rounds of issuance next week or the week after. So there'll be a little bit more leeway by the market by saying before they announced that we either are not going to have a liquidity event.

Erik: Jim, I want to come back to artificial intelligence, something that everybody's aware of is that you know, invidious stock and a lot of these companies that have been mentally associated with AI and I stress mentally and I'll go a step further emotionally associated with AI. These prices are just through the roof. Now, if you just take a step back and think about this, Nvidia hasn't done anything that is profoundly, you know, changing the landscape of AI, they make some chips that happen to be useful to people that are doing AI and you know, it's a commodity, it's not a big deal. Why are we seeing this? Is it just an another dotcom Mania where Wall Street doesn't know what they're buying, but they think it's hot, so they're buying it anyway. What's going on with AI because the fact that these chip makers are through the roof when really there's no moat around that they don't have any intellectual property that's good forever. They don't have anything locked in, they just got the chip that happens to be hot right now. Why is this AI trend having the effect in the parts of the market that it's having and where do you think it's headed ultimately?

Jim: I would argue to you that, you know, the old adage, the two things can be true at once. I think there's enough memories from the late 90s oh this internet thing, you know the famous Paul Krugman line from the late 90s, it'll be just as important as the fax machine when all of a sudden done. And a lot of people poopoo the internet and a lot of people that didn't, and jumped onto that bandwagon made a lot of money. And I think this time around, people are more willing to jump on any kind of a technology idea, sight unseen. Look we saw this with crypto, you know, just a few years ago as well, too. So I think there's some of that mania going on, I don't want to miss out on the next big thing like I missed out on the last big thing. I also think that the hype around AI, you're right, that the videos of the world and stuff like that they're not the content producers, they're the picks and shovels. I'm mixing my metaphors here. And that's what everybody seems to be going for. But I do also think that the hype around AI is real. And it can be let's say over 20 years, not over the next six months. It can be really impactful and transformative on the US economy, allowing computers to do things that we can't do now.

Now, historically what we found is the mistake that people make over and over again, and you see this with the banks. Brian Moynihan, the president of Bank of America said yeah, we're spending all this money and all this effort on AI because we think it's going to replace customer service. And it's going to allow us to lower our costs and increase our margins. No, it's going to rewrite your business model is what it's going to do if it meets its promise. The business model of banking will change in ways you don't understand, I don't understand. It won't just allow you to lean out your workforce to put a couple more points on your profit margin, and it will do a lot more than that. And so this is the big hype about AI. Remember, I like to say, when Steve Jobs held up the Apple iPhone 1 who raised their hand and said that's the end of the taxi business within three years. No one knew what we were unleashing with that technology. I would argue no one knows what we're unleashing with this AI potential. And again, it's got some time.

So two things can be true at once, we're overhyping some of these stock because of the last cycle and it can be transformative. And if you want an example of it, let's go back to late 1999. Time Magazine's Man of the Year, they were politically incorrect, called a Man of the Year at the time was Jeff Bezos of Amazon. And the reason he was Man of the Year in 1999, was of the online retailing was going to change the very face of buying things. 23 years later, we now know that that was exactly correct. Online retailing did change a lot of things, that if you bought Amazon stock in late 99 at the high point, you paid $100 for it, like the wiki was on Time Magazine's cover. By the fall of 2001, it was at $6, it fell 94% and then by 2010, it was still at $95, it took you 11 years to break even. Then, over the next 10 years, it went from $100 to $3300, it 33X and it lived up to its hype. So buy Nvidia, buy all these AI stocks, in 23 years, you might be doing very well. But first, you'll lose half or three quarters of your money and be down for three quarters for a decade. And then you might start to see some return. I'm not saying that's what's going to happen now. That's what happened the last hype cycle. So like I said two things could be true at once we're overhyping, a lot of these stocks. And you got to be careful of what happened with the Internet stocks in 2000. The you know, the internet fulfilled its promise over the next 20 years. But those stocks did nothing for a decade lost you a lot of money. And yes, AI can produce or has the potential of giving us the all of the hype that everybody thinks again in many years not right now. But yet we can also be overhyping the stocks at the same time.

Erik: Well, Jim, I can't thank you enough for a terrific interview. Before I let you go though. Let's touch on what you do at Bianco Research starting with our institutional listeners. Please describe the institutional research services that you provide. But also for our retail audience, you're on Twitter and you do a fair amount of writing. Let them know where they can follow your work.

Jim: Yeah, so Bianco Research does provide a daily, weekly, and even a monthly product on institutional research on the macro level, a lot of the topics that we've talked about in this interview so you can request a free trial on our website, Biancoresearch.com. It is priced as an institutional product. Then what I have done is I've been very active on social media, especially LinkedIn and Twitter. Twitter more than LinkedIn, I should have mentioned that first. So if you're not in the market for institutional type levels of research, you can follow me on some of the social medias and I do eventually will, you know lay out some of the themes that I've been talking about and the stuff that's behind our paywall.

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