



MACRO Voices
with hedge fund manager Erik Townsend

Lyn Alden: Energy, Inflation & much more

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Erik: Joining me now is [Lyn Alden Investment Strategy](#) founder, Lyn Alden. Lyn prepared a slide deck to accompany this week's interview. You'll find the download link in your research roundup email. If you don't have a research roundup email, just go to our homepage macrovoices.com. Click the red button that says looking for the downloads above Lyn's picture. Lyn, it's been way too long. It's great to get you back on the show. I want to start just by looking at your slide deck. You're talking about valuations. Boy, it seems to me like something's going on that with breath that seems unusual. And I haven't looked at it closely enough, but it just seems, particularly AI stocks and some of these things are just to the moon. Well it's creating, I think an illusion that everybody thinks that the market is off to the races. It's not the whole market, is it?

Lyn: Yeah and first of all, thanks for having me back Erik. Always happy to be here. And yeah, we're definitely seeing some big divergences in the equity market, both in terms of risk on and risk off, but also in terms of growth and value. And so for example, on the first deck there, I show Apple versus CVS. And these are just kind of two examples of large cap stocks out there. The funny thing is that analysts consensus forward earnings estimates are actually not that different between the two companies. They both had like a period of kind of two year earnings stagnation here, they both have kind of slow forward growth. Basically, they're both at the end of the day kind of value stocks, that they're not exactly fast growers. But we see Apple trading at well over 30 times earnings and has surged much higher this year. And all of it was valuation based. Whereas we look at a lot of the, you know, kind of either the cyclical value or even the defensive value. A lot of these companies are just trading at like high single digit price-to-earnings ratios. Kind of completely left for dead, totally kind of uninterested by the market. And, we can kind of go through sector by sector and see that some of them do have headwinds. For example, healthcare has been facing some regulatory headwinds, for example, but a lot of that is just, basically, there's so much risk-on condition focused in the tech sector, that a lot of other areas, especially defensive value like healthcare has just been completely left for dead.

Erik: Lyn, I know something that you and I share in common is we both have a background in engineering and technology before we got involved in finance. So I particularly want to ask you about not just this divergence in general, but specifically, with respect to artificial intelligence, it seems to me like we're having a repeat of the late 90s where everybody decided that dotcoms were the thing to buy. Nobody knew what they were, nobody cared, they were just Wall Street guys getting on planes going to San Francisco buying up tech companies without knowing what they were buying it. At least the way I'm perceiving this. I'm very curious to hear your take on it.

Everybody's talking about the big AI stocks like Nvidia, and so far as I can tell, most of the market participants that are buying Nvidia because it's a big AI stock, don't even realize that NVIDIA has absolutely nothing to do with AI, they make graphics cards. And it just happens to be a detail of technology. An oddity of technology that just like cryptocurrency mining, the computers inside the graphics card are better for these generative AI applications to run on, and they work faster there. And so that's why they're using them. It's not like in NVIDIA was the one to invent any of this artificial intelligence technology. I don't see any reason if you think about Warren Buffett's idea of a moat around a company, I don't see anything NVIDIA is doing to you know, protect its market share in AI. They don't know anything about AI, they're making graphics cards. But because graphics cards are the fastest way to run AI programs. A bunch of finance guys have convinced themselves that NVIDIA is driving AI or at least it feels that way to me. How do you see this whole AI craze and what do you make of it?

Lyn: Well so back in dotcom Bubble kind of you know, looking back on it decades later, what end up being the case was that, the big vision for how a lot of the internet companies would change our life ended up being true. But of course, the problem was a lot of it was front loaded in terms of valuation. And the market did, you know had a very inconsistent job of sorting out which companies were ultimately going to take the market share. So the ones that kind of blew up and crashed and never came back and other ones like Amazon that blew up crash and then, of course had a very long growth story ahead of them. So I'm kind of using AI through a similar template in the sense that it's real, it's here, it's impactful. It's going to change how we interact with things in the next several years. And of course, AI is not new but when something hits a new threshold of quality and expense and is able to actually become economical, that's when it becomes relevant and that's kind of the stage that AI seems to be at now. And you know, the natural I think Wall Street reaction is to go for the picks and shovels play. So it's not that surprising that they bid up NVIDIA very hard. And I think that over the next 10 years, they're going to sell a tremendous number of graphics cards. But right now there's no margin of safety priced into that stock. And we have to remember that they rely on companies like Taiwan Semi to actually make the chips at the end of the day.

And so I don't really view Nvidia, especially after this massive run up as the place you want to be heavily concentrated. And instead it's really, there's a couple of ways of looking at it. You know, one of the things I did early on was, I leaned into stock like Adobe for example because Adobe hadn't really run yet, it had already kind of corrected from the sugar high that we had a couple years ago. And some of the early thesis around that would that it be that this kind of just might disrupt a company like Adobe, where it has started becoming more and more clear that Adobe would probably absorb a lot of these technologies that were already incorporating generative AI into their offering, and they weren't really at the kind of the very high valuation that NVIDIA was. But since I got into that one, I mean that stock has kind of gone straight up to, and so I wouldn't really call that as having a ton of value left either. So I think a lot of the low hanging fruits already been run away with, and investors have to be very careful that what they invest in. And there's a couple of ways of kind of go forward. One is that you can invest in the positive, like you can say what companies will be made better by AI. But and you can also look at which companies likely won't get disrupted by AI, at least in any sort of like investable time horizon. So

instead of necessarily trying to follow the trend, you can also just do a review of your portfolio companies and check which ones won't be disrupted. And that will get I think, probably what we are going to talk about is areas like energy, and materials, kind of real world stuff that I think that AI is kind of nowhere close to impacting.

Erik: I want to come back to the AI question from a different angle now because so far, we've talked about it from you know, where's the market opportunity to buy Nvidia or do you not buy Nvidia? Let's now talk about the impact to society of this very rapidly growing and rapidly accelerating generative AI technology. As a former technologist turned to finance person, I'm very curious to get your take if I sort of think there's a spectrum of what people think about AI ranging from, let's say the zero is I think it's a fad, it's going to blow over it's not important. One is it's going to change business, a lot of industries will be materially changed. Three is it's a threat, it's a risk. And let's say four is the outright okay, the terminators coming, it's just a matter of time, this is going to be the end of humanity. on that scale. How do you assess what AI is going to mean to society?

Lyn: Well, I think with every passing month, we get more data points. Right now, I'm in the middle, where I view it as a very powerful tool that will make a lot of businesses more streamlined. So this is like, a lot of what technology does is it makes things way cheaper, way more accessible, at least in the areas that it's able to impact. And so I expected basically the cost of certain types of business overhead. The cost of certain types of legal overhead, the costs of production. I think, basically, right now we have all these different software packages, like different creator tools, they could be things like Adobe Photoshop, but they also could be various engineering design software. And as we incorporate AI into more and more of those things, it lowers the floor of skill to get a workable usage out of it, right. So there's always going to be a case where more experienced operators and that software can make more of it. But by like obfuscating away a lot of the details of those tools, it makes those creator tools, something that 5x people more will be able to use in the long run. So I think this unlocks, it doesn't lock a lot of like long term economic value. And just like anything else, it's going to be way blown out of proportion, from time to time. And I think we're in one of those phases now. And I generally take the, you know, I think that it'll probably surprised to the upside in terms of how it impacts us in terms of software. But I generally take the under on its ability to heavily impact us in the physical world. So the impact on robotics, the impact on energy usage, at least until there's certain kinds of new physics breakthroughs or things like that, you know, kind of in this in this more investable time horizon. I don't really see it as super impactful for those more real world types of areas.

Erik: Lyn, let's move on to another subject near and dear to my heart, which is energy. You say on the second slide here energy is under owned. Well, I own as much as I can afford. I guess other people don't see it yet. What's going on here?

Lyn: So I think across the spectrum, whether you go for the underlying commodity or the equities that are associated with it, energy has kind of been left for dead and that kind of falls in line with what I was talking about before with the Apple versus, you know, CVS comparison or the tech versus healthcare. Energy is another one of those areas. This time is more cyclical

value rather than defensive value. But it's an area where even during the big price spike of oil last year, a lot of the equities never really got over, like, you know, excited about it. Neither their stock prices really soared. Nor did their management teams kind of take those prices as though they were going to stay. And so you saw very conservative behavior, both by investors and by management. So investors were careful not to bid the prices up too high. In management, use a lot of the kind of the windfall profits they got from that period to pay down debt, pay dividends, do buybacks, maintain their drilling rather than put it all back into the ground. And so we're in a situation where energy's corrected pretty significantly. But we've not really had any sort of large CapEx cycle. When you look around at the supply side, we're still rather tight. And so I still view long term, the full energy complex as generally under-owned and an area that investors should be looking at a three to five year view. You know, if you're looking around the market, you're concerned with, say, the valuations at the top seven stocks, you're concerned about the valuations of the NASDAQ as a whole, when you look at other certain other types of the market, I think there's areas like healthcare, there's areas like energy, there's certain select emerging markets, like Brazil or India that are interesting. But there are other pockets, I think of value compared to what you can get in those big tech stocks.

Erik: Well I definitely agree with you on the bullish outlook for energy. Needless to say, it's much easier to make that fundamental call than it is to time the market, but you've actually been pretty darn good at timing the market, because when I interviewed you shortly after the Ukraine invasion peak in energy prices. You were very much on top of the market, you said look, we've had that peak, we're headed down. We got to ways to go, we could get to \$70. You've nailed that call and then you said we're headed back up, as we get that reckoning with the reality that supply just doesn't have a lot of room to grow here. I couldn't agree more. Do you think that the rally we're seeing now is the beginning of the big move or is it maybe still another economic weakness print that's going to scare the market back down to test those lows?

Lyn: So the short answer is I'm not sure. But I think the fact that there's been somewhat of a rally and recovery is really worth watching. I think it's a genuine one. And a lot of people in their mind when they think of recession, they assume oil has to crash. And that's because the past two recessions we've gone through had been pretty unusual in that regard. One of them was obviously the COVID lockdown. And other one, the Great Recession of 2008-2009 was one of the biggest recessions on record. And also it happened after a better part of a decade of a lot of CapEx, a lot of new energy supply coming online throughout the 2000s and this decade. And so the recency bias says okay, if you have to have a recession, that means, get out of energy. Whereas you're looking at other recessions like say, the dotcom, the post dotcom bubble recession, oil often just chops along through them. In fact, when you look at the past, say 50-60 years of total energy usage, it's only gone down worldwide five years and three of them were in the early 80s. One of them was 2009 and one of them was 2020. Many recessions, global energy usage still goes up. I do think that the economic weakness that the markets in right now is has played a role in keeping prices down. And I do think that there is still significant risk of recession late this year, early next year. And so I'm not necessarily expecting oil prices start going vertical right away. But I do think that my approach with this whole kind of my long term energy outlook is to not really overthink it. I think the supply and demand looks a very strong

position. And I'm not going to assume that there's going to be some big downward crash. And so I'm long in the industry. I am willing to kind of like lean more in should we get further periods of weakness, but the further you look out this is supply and demand situations very favorable.

Erik: Let's move on to page four on your deck shale dynamics. I was particularly interested just to look at the rig count chart. We saw that really nice sustained recovery in the rig count. That's on the left side of the chart. That's the purple line. From the end of the pandemic, we saw that really solid recovery in the rig count. Okay, US shale patch going back to work, going back to work. Wait a minute, looks like it peaked. What's going on there? Is that the beginning of a change? Is there a fundamental driver behind that peak?

Lyn: Yes, on this chart about seven months ago, it shows that US rig count peaked, and it's been a little while since I made this chart. So it's actually about eight months now, I believe. And when we look back at the prior to. Generally, there's an 8 to 15 month lead time between drilling activity in between, you know, the top in overall US production. And so if this is, you know, for kind of watching activity, we should expect that in the months to follow unless we were to see some sort of turnaround, that US oil production is probably going to peak at a similar level as it did before. I think a lot of the low hanging fruit has already been drawn from shale. And now it's no longer this kind of big new source of energy production for the world. That's where the majority of growth was. And now that's kind of tapped out. And so, a lot of this goes back to the point where I said before, that a lot of these energy companies were conservative, instead of, aggressively taking their income and cash flows, and just piling it back into new production, and assuming that this spike was going to be sustained, they kind of treated that whole oil price spike is transitory and said no, no, we're going to focus on responsibility, we're going to focus on balance sheet improvements. And so a lot of them, they did what they had to do to maintain or mildly grow their production, but they didn't splurge like they did in prior cycles. And so, about eight months ago, drilling activity started rollover, pricing wasn't exactly sending the signal to put a lot of money into the ground. And so I think in the coming months, we're going to start paying for that, which is that our production is going to start topping out.

Erik: Lyn I took you down that path on the rig count because it fascinates me. But I should probably back up to what you wanted to tell us a little bit more broadly about this shale dynamics. What else should people understand about shale oil and where it fits into this story?

Lyn: Well, an overall factor is that shale oil is quicker to bring online. And it also depletes quicker, which means you have to constantly put money back into it in order to sustain the production levels that you're getting. And so this recovery that we've seen, this kind of post-COVID recovery. It was it kind of the low hanging fruit in the sense that, they started the rig count back up again. They tapped into a lot of their drilled but uncompleted wells. So in some sense, we could think of it as kind of like drawing down existing inventory if we were to make an analogy to another industry. And so they've been able to get a decent amount of production back online, almost back to the prior peak. But, I think a lot of people, if they're not focusing on some of the details of industry, they assume that this is just fully sustainable, that we're just going to, kind of keep increasing our total production levels. Whereas we look at actually what's

happening under the surface, some of the rate of change stuff or where a lot of this new production has been coming from, it's not exactly signaling that the type of production and growth you've seen over the past couple of years is going to continue. And that of course, has all sorts of implications for price. And so when we zoom out and think about the total supply and demand situation, the slower growth out of China, the sluggish economy here in the US and over in Europe, these things are all around the margins, loosening demand to some extent, but the supply side still remains tight. So the SPR was drawn down aggressively. And that's, you know, it's not turning back up yet. But that that that speed of drawdown certainly behind us. We also had China help Iran get more of their oil to market. And so that's been like a source of supply. But when you look around further, most of the marginal supply now is global. And there's not exactly a lot of it out there. And so I think basically, we're still in a structurally bullish energy environment, until there's some sort of significant amount of CapEx.

Erik: Lyn, I want to put this in perspective with respect to the history of shale oil and how we got here and then get your commentary on it. I know you're already aware of this history, but I want to share it with any of our listeners who may not be familiar. Almost 20 years ago, there were a whole bunch of really smart people who had a hypothesis called Peak Oil. And they predicted that a lot of really, really bad things would happen to the global economy, as we were unable to produce enough oil to keep the world running. They were dead wrong, but they were not as dead wrong as everybody in finance seems to think they were. A lot of people think, oh that peak oil theory got disproven. Nonsense. It was not disproven, what happened is all around the world, just like the peak oilers predicted was going to happen. Oil production went down and it went down substantially and it's going down exactly the way that Peak Oilers predicted it was going to go down in the sense that it cannot be increased within those oil fields without finding new productive resources someplace. What happened that the peak oil crowd didn't anticipate was the US shale revolution, which made up for that. We went from 5 million barrels a day to 13 million barrels a day in the United States as the rest of the world went down by the same amount.

Well guess what? The rest of the world is still declining because that is inherently the nature of how petroleum fields work. As you pump oil out of them, the reservoir pressure goes down. They don't produce as much oil next year as they did last year. They're all in a state of decline. And now what you've just told us, Lyn is the shale oil boom which was the salvation. That's the only reason the peak oilers didn't get proven right back in 2007-08. You're saying it's ending and I agree with you. That means there's some pretty significant consequences coming our way. Do you agree and if so, how big are those consequences and if not, what am I missing?

Lyn: So I agree with you. When we think about like longer term. The challenge is that people have a tendency to underestimate human ingenuity. And so when they're analyzing how much oil production is going to happen. It's not always possible to think of the full range of future technologies that are available to us. And so the shale revolution is really born by a combination of technologies that were maturing but also very low cost to capital. And so going forward now that the cost of capital are higher. And now that a lot of the low hanging fruit and shales been already tapped into. I do think that basically structurally some of the easy growth, some of the

offsets we've had to the decline in conventional oil is not going to be there anymore. And so I try to avoid making giant predictions like oh we've seen the all time top in global oil production. Because, I don't know what's going to happen with the Arctic or with, you know, big new discoveries and things like that. But I will also go far as to say that basically, without a significant CapEx cycle, it is going to be increasingly hard to get meaningfully new oil production. And that could certainly expand into a much longer kind of permanent, high watermark for how much oil we can get at any given unit of time. And so I think that basically, this is at least a multi-year story. And then, once we see what happens there, once we see a period of higher sustained prices, once we see more aggressive exploration activities, we can reassess what is the field look like at that point?

Erik: Let's move on to natural gas, and specifically a trade that Adam Rozenchwajg told us about, and I'm sure you remember that particular interview. Adam said hey look, you know, we've got a really great convergence trade opportunity, which is natural gas in Europe costs way more than it costs in the United States. The reason is because we're able to produce more of it in the United States. And right now we don't, we're still building the infrastructure. We haven't yet fully built the infrastructure to export all of that natural gas as liquefied natural gas. But that's rapidly being developed. So the trade that has been suggested is long us natural gas against short European natural gas, not talking about the front month contracts, but long dated contracts to arbitrage that eventual convergence. Seems to me like a brilliant idea but boy, it's been a brilliant idea for a long time and the trade is not paying off yet. What do you make of this? Is there a trade there, why hasn't it worked yet, and when do you think it's going to start working?

Lyn: So I think that's a long term position to be aware of. You know, a lot of these LNG export facilities take years to build and of course, natural gas compared to oil and many other commodities, that transportation is a much larger and more complex part of it. So natural gas is less geographically fungible than you get with oil or other types of commodities. And so as you pointed out, and as others have fully discussed, there's that big price differential not just between Europe and American gas, but also Japanese and American gas. And so over time, as we get more and more US export infrastructure. Assuming we don't have any sort of like protectionist policies that kind of cut the producers off from making use of that, then we should see over time that convergence trade. Now, the time is going to depend partially on weather and that's part of part of the reason why natural gas is so explosive to the upside or downside. It can be you know, it's very seasonal, very weather-based, very kind of locked in by these transportation challenges. And so, I view that less as like a six month trade, and more as like a trend to be aware of when you're trying to for example, if you're looking at US companies with significant gas production, and you're trying to model out there forward long term, kind of the range of outcomes, I generally would err to the upside in terms of what some of these North American gas producers might put to do. Because I do expect eventually for that, that price differential to somewhat narrow and so longer term, this is like another piece of the story I think to be aware of.

And of course, another way to play that is with less risk is some of these midstream companies. They care more about volumes and care less about price. And so, there were periods in the past where some of these midstream companies were pretty expensive. Whereas right now, a lot of them are priced for basically zero growth. And so you can get basically high single digit distribution, you can get then low single digit growth, some of them are even buying back their own units, which is unusual. And so there's multiple ways to play it. But I think that the kind of the big themes here are, there's not a lot of easy new supply like there was last decade. Cost of capital is now higher. In the end, we should see more and more infrastructure and therefore more convergence between US and foreign LNG.

Erik: Lyn, since we're on energy, let's move on to another market that you and I have both begun following in the last year or two, which is uranium. Let's start with the just really big picture where you started watching the uranium market as I started watching the uranium market. How are you thinking about nuclear energy? Are you just thinking about it is there may be a trade opportunity there right now or are you thinking okay, there's going to be a big Renaissance, and we're going to replace oil with nuclear over the next 30 years? What's your big view and where is the trading opportunity?

Lyn: So I've been long uranium since autumn of 2020. And it's something that I've not tried to time it to specifically. But it's something that I just keep as a background structural trade until the conditions for it are done, and they're not yet. And so basically, we have a similar problem there as we have with oil, in the sense that right now, there's just not a lot of new supply coming to market. If you look at the market now basically, we consume more than we reproduce on a global basis. And so we're constantly tapping into older secondary stockpiles. There's some opaqueness there. No market participant can say for sure exactly how much secondary supply there is. Of course, different analysts will come up with different estimates. And so longer term, even with just a slow rate of growth or even just a flat holding of the reactors that we already have, the long term case pretty should be fairly bullish, especially when you're comparing it to other assets out there that you can own. Basically, if you just hold underlying uranium, the risk reward, I think is pretty attractive. Now, if we do start to get to some of the scenarios we talked about earlier, like if we if we have increasingly a tougher time, increasing our global oil output, while we still have ongoing growth from low oil, consumption places like India, and other highly populated countries that are, you know, they just like just like the rest of us, they want to consume more energy per capita. They want to develop more, they want to have more material comforts. And as that demand continues, I think there's going to be a constant lookout for all types of different energy sources. And I think and I hope that we have more of a I don't know if we'll get a full on nuclear renaissance, but I do hope that the period of stagnation that we've been in, at least start to turn back up to the upside. And I think there's a number of new technologies that can help with that with that. But I also think that kind of necessity becomes the mother of either invention or in this case adoption, which is that, people get sick of having energy crises. And they look around and say well here's an energy source that that, you know, meet some of our standards and has been underused. So that's certainly an area that I'm still long.

Erik: Let's move on to base metals. I've been watching copper with great interest. I kind of hoping that we get this recession everybody's waiting for so I can buy the dip in copper. And I think it's going to be a fabulous trade for the next several years. But I also think that it's vulnerable to the economic situation that we have right now. How do you look at the copper market? Where do you see it headed?

Lyn: So similarly, I've been a little bit less optimistic on it than I have with energy. With energy I've been willing to kind of stick with even with a potential recession call. Whereas copper, I've been a little bit more careful to try to kind of wait for the cyclical timing to be a little bit more attractive. And so far, the price is held up a little bit better than I would have guessed. And so I don't really view it as a bad position here. I think basically until we have another period of renewed growth so let's say for example, that purchasing managers indices for many of the markets around the world. Until they start turning back up, I think copper is going to continue to be probably range bound. But then once you do start get that that upturn. I think much like energy, copper is like a multi year story. Where we've underinvested, it's not easy to bring new supply to market, and then there's all sorts of environmental restrictions. For example, people will say, we don't want oil and gas, we want battery metals, and then they also will say oh, but you know mining is bad for environment so you can't mine them. And so, we kind of get into this gridlock position where it's very costly, time consuming, and you know, always uncertain whether or not new projects are going to come on in a workable timeframe. So I think the long term case is still very bullish there. But I think the trigger you want to probably look for is some signs that leading economic indicators are turning back up, rather than kind of still in this malaise that they've been in.

Erik: You mentioned battery metals, I'm particularly curious about what you think cyclically about where we are in the timing of that story. The way I'm looking at this is, you know, there was kind of a battery metal craze for a while, as people saw energy transition and electrical vehicle revolution, they were smart enough to connect the dots and say okay, this requires a huge amount of copper. And then they said okay it requires a huge amount of battery metals. And that led to a craze in this. It feels like that's kind of wearing off now and I wonder if we're at the calm at the end of the first initial, you know, fascination where maybe this is the dip we want to buy.

Lyn: So that's a good way of thinking of it. So I generally for that whole space, I view copper as a cleanest risk reward. That's kind of like the one where it's no matter what technology ends up, because things change over time, they always get more and more efficient at using less and less battery metals, for a given amount of energy storage and things like that. But copper is the universal that's there in all these different things. And it's both battery metals and then it's also I think a lot of things that especially finance people miss is how much grid updates you need if you want to electrify things more, right? so they kind of assumed that if you just buy more electric cars, that's what solves the problem. But basically, if we talk about a a wholesale shift towards more and more, you know, battery storage and electric cars and things like that. You're basically saying this whole, you know, like gasoline transportation system, we have built up, all that energy distribution has to basically go over electrical wires. Now, basically, we would add

that on to what we're already doing. And I don't really think that that transition is going to happen anytime soon. But it's clearly around the margin. That's the pressure. That's like the demand pressure that's out there. And so whether it's the electrical grid, whether it's battery metals, and things like that, I think that's the part that's still somewhat under-owned. And I try to avoid all these big areas of fads or price spikes. And so I've been pretty cautious around not jumping directly into the battery metals. And instead, I've been more in like the copper side and more in these other types of new ways to play with less risk.

Erik: Lyn, I wanted to start by talking about the fundamentals on energy, because it leads into the next conversation I want to have which is inflation. I think the most important thing to figure out is are we at the beginning of a new secular inflation or was this big bit of inflation that we've just seen just transitory because it was the after shock, if you will from the pandemic. I think that's the biggest question to answer seems to me, like what energy prices do next is going to be the biggest determinant of what inflation does next. What do you think is the bottoming that you're perceiving in energy and other commodities may be a sign that inflation is persistent or how are you looking at this?

Lyn: So if you look back at prior periods of inflation in developed markets. Normally it does come in waves. So normally, you don't just get one inflation spike. Normally, you get multiple inflation spikes, because you have periods of time where central banks are fighting back or some cases government officials are fighting back with like, pricing wage controls depending on the era. And so it never really goes up in a straight line. And when it comes back down, that doesn't necessarily mean that the whole situation is behind us. And so going back to my prior point, basically until we see an energy CapEx cycle, I would be concerned about further rounds of inflation. And whether that wave starts roughly now or whether that wave has to go through another six plus months of kind of economic malaise before it starts. That's still I think an open question. But I do think that the risk still lies for an upside surprise and inflation. When we look ahead to say, 2024-2025 we'll see how the timing goes. But basically, the way I kind of think about it, we had the rising PMI and then the falling PMI. My concern is that because the fundamental drivers have not been fixed, the next time we have a rising PMI, or basically broadly some degree of economic acceleration, I do think it's pretty likelihood of coming with a side of inflation again, because the underlying problems aren't there.

And one way of thinking about it too, in addition to energy is the fiscal side. And so, when people think of inflation, they often think of the 70s. And that was very much lending driven inflation. So we had demographics, the baby boomers were entering their home buying years, year after year after year. So they were taking out a lot of credit. You had a lot of bank lending inflation that of course, you add to it, the Vietnam War and the oil embargo as a very inflationary time. Whereas the 1940s, virtually all the inflation was fiscal driven. So banks were not lending almost at all. And most of the inflation was driven by very large fiscal deficits. And as we look forward now and into the future here in the 2020s, we have this larger backdrop of just larger structural fiscal deficits. And it's not as stimulative as things like stimulus checks or childcare tax credits, because it's not kind of filtering in from the bottom up. But it still is this background, kind of slower burning stimulatory effect, or potentially stagflationary effect. And so I think the

combination of structural fiscal deficits, as well as a tightness in the energy markets is probably going to give us you know, again next time we have a period of economic deceleration, I would be surprised if that did not come with another round of significantly above target inflation.

Erik: Lyn, let's tie all of these ideas we've talked about today together into what investors actually care about, which is portfolio construction. How do we bring all of these ideas you've talked about? What do you actually buy in your portfolio to benefit from all this?

Lyn: So I think the first thing obviously, we have to do is determine what kind of market participant we are. I mean a trader is going to use this type of information differently than an investor. Generally, no matter if you're an investor or a trader, I think it's helpful to know some of the fundamental tailwinds so that you know which direction to air in when it comes to a given asset class. But because I'm on the longer term side of the spectrum, in terms of like investment time horizon, I tend to look at what's going to do well over say, a three to five year period while still trying to be cyclically aware. And so I'm kind of going with the three pillar portfolio at the current time, which is basically, one pillar is profitable, reasonably priced equities including some of the ones I showed in this presentation. But just broadly, if I look around, and I find profitable equities, I still generally view them as decent places to hold capital long term. Then also, I add a significant commodity slash inflation protection part of the portfolio. And that's still what I think is under owned in most portfolio.

So if you think of a classic 60/40 portfolio, it's very much geared towards disinflation, so it benefits from bond yields going down, that allows equity valuations to structurally go higher. And if we do enter a period of you know, waves of inflation or on average above target inflation, especially if it's if it's more energy driven, one of the ways to hedge all of your other otherwise disinflationary positions, is to have some of that direct exposure. So it could be commodity producers, it could be underlying commodities. It could be hard monies like gold or Bitcoin. That kind of assortment is how I think of that whole part of the portfolio. And then lastly, I still think there's a space for cash equivalents T-bills because, I think most of the signs still suggest that we're not out of the woods yet, in terms of recession risk. I know, the Fed meeting today, basically the Fed is now saying that they don't really see the recession risks that they saw before. But I still think that, you know, we look at it at a broad range of leading economic indicators, I still think that we're kind of you do want to basically be prepared for that choppiness for the next 6 to 12 months. I think that basically, you want to have some disinflation protection in your portfolio, even if you're otherwise structurally thinking inflation long term. And so I've been using those kinds of three portfolio, different kinds of sides of it, that I rebalance over time to kind of lean into whatever I think is under-owned at the at the moment.

Erik: We're recording on Wednesday afternoon so the Fed data has only been out for a couple of hours, but already what I'm seeing just in Twitter traffic and other notes, emails, and so forth coming across my desk is this continuing belief that okay, what this means... what it's all about is there could maybe be one more 25 basis point hike this year, but it's impossible for any more than that. And I don't understand Lyn, why everybody there's this consensus idea that the Fed has to stop hiking, just because they almost completely collapsed the banking system as a

result of their hiking. I'm not sure that that's going to stop them. And I don't know why everybody is convinced that it will. What do you think? Is it really true that the the most hawkish possibility is just one more hike this year?

Lyn: Well I think we have to consider both speed of the hikes and the oath of final level. And so it is true that they have a certain speed limit that if they go too far too fast, they break things, that's what we saw back in the springtime. Whereas if they inch up very slowly, they have more, kind of leeway to get higher. And I think we're finding out that the market is not very interest rate sensitive. So when you look at say the US market, you know, homeowners mostly have 30-year fixed rate mortgages. That's not the case for many other countries in the world. So when you look at a spectrum of how much household debt-to-GDP different countries have, and then what percentage of that is fixed rate, American households are relatively protected against that ongoing, kind of rate hikes. The same thing is true for a lot of say blue chip corporations. A lot of them used this opportunity to lower their interest rates and extend their duration. So that now, even though interest rates are much higher, a lot of them are locked in for many years. Like for example, Enterprise Products Partners, that pipeline stock I showed on one of the slides here, their average debt duration is 20 years. And so even as interest rates increase over time, it's going to put relatively little pressure on them. And that is most of the industry pressure is on, you know, very specific areas of the market, commercial real estate, unprofitable tech stocks that are relying on high valuations and constantly issuing new equity. Those types of areas are vulnerable here. But otherwise, profitable entities that have locked-in fixed rate debt are more resilient to what the Feds doing.

And we can even get to a point where inflation because this is mostly fiscal driven inflation, rather than bank lending driven inflation, that makes it somewhat stickier against the prospect of rate hikes. Because the whole premise of rate hikes and the whole premise of all that is to try to slow down bank lending. But if bank lending was not the key driver of inflation, basically, what they're doing then is they're offsetting the real source of inflation, which was fiscal driven inflation and certain supply side limitations by saying well because that all was too high, we're going to try to slow down bank lending. The problem is, if that background fiscal ongoing deficit is still there, you know, if can slow down bank lending enough to cause a recession, but then when you want to get out of that recession, and you want to, you know, allow more lending to happen again, those key inflation drivers are still there. So I don't try to predict exactly how high they're going to get. But we are seeing that, aside from certain pockets. The economy is not as rate sensitive as many of us might have thought. And I think the long term trend is still towards, you know, periods of either stagflation or renewed periods of inflation.

Erik: Well Lyn, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners a little bit more about what you do at [Lyn Alden Investment Strategy](https://lynalden.com).

Lyn: So yeah lynalden.com, I provide investment research. Some of it is free material. Other parts of it are low cost paid subscriptions for subscribers, both retail and institutional investors. And I've been working on a book on monetary history called Broken Money, so people can check that out in a month or so as well.

Erik: And that will be on Amazon?

Lyn: Yes.

Erik: Fantastic. Well, you'll have to let us know when the book is actually released, and we'll get you back for a book review interview.

Lyn: Thank you!

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