Louis-Vincent Gave: China, Energy & More

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Erik: Joining me now is Gavekal co-founder Louis-Vincent Gave. Louis, it's great to get you back on the show. You, having been a Frenchman who's lived in Hong Kong for much of your life, are very well known in finance as a China expert. So, I want to start there. And I think my real question is, okay, what actually is going on in China? Is this about, we're waiting for the Chinese economy to recover, like everybody was talking about? Because that's going to bring back final demand into the global economy? Is that what we're waiting for? Or is it more that we're waiting to find out if we're starting a major global war with China that's going to completely change the nature of trade? I'm not sure which it is anymore.

Louis: Well, first of all, thanks for having me again, Erik. It's a pleasure to be here. Pleasure to catch up with you guys as always. So thanks again for having me. Look, I think the narrative around China this summer has been fascinating. You know, you've had I think back-to-back covers of The Economist, you've had that meltdown cover on Business Week. Let's just say that the media narrative around China has been extremely dire. And to me, the first observation I have is that when it comes to China, I think people in the Western world always fall into one of two categories. It's either China's going to take over the world, or China's about to implode in a blaze of glory. And we seem to be swinging always from one extreme to the next. And today, obviously, we're in the "Oh, China's imploding" category. And I think this is for two reasons. First, of course, China's reopening has been disappointing. And here, I'll put my hands up, I messed up on this. I think I messed up a little by laziness. When China reopened, I thought, "Oh, I've seen this movie before, you know, I saw it in Europe, and I saw it in the US, and I saw it in Canada. And when economies reopen, you got all this pent-up demand, and you get all this growth, and this is going to be awesome." And I think the reason this script didn't play out in China is the very difference in the labor markets. I think what happened in the Western world was people were told, "You go home, you stay at home, and we'll pay you to stay at home." And then when we told people in the Western world, "Okay, you guys get back to work," you had a small minority of people that said, "Well, actually, I like working from home, or maybe I don't feel like going back to work." And this was especially true at the lower jobs, your McDonald's workers or your hotel cleaners or whatever else. And so all of a sudden, we found we had a shortage of labor at the low end. And that pushed wages up, that further fueled the consumption boom in the Western world.

In China, meanwhile, the situation was completely different. In China, people were told, "Okay, go home." And going home in China meant actually going back to the countryside. So you had literally tens of millions of people that left the cities, went back to the countryside. So when the government said, "Okay, you guys can come back to work," now you had tens of millions of people that swarmed back into the cities and actually depressed wages. And that's where we've been the past six months, you know, a fairly weak wage growth in China. And with that, obviously, bad consumption data, etc. Now, combine that with the fact that you've had five years of real estate crackdown, that real estate prices have rolled over by 10-20%. And pretty much any city that you care to think of, big property developers are going bust and/or have gone bust. And that at the same time, you're having all sorts of problems in the shadow banking system. And now I think you're seeing the other extreme, where people in the Western world are saying, "Aha, I've seen this movie before. This is 2008 all over again, falling real estate, property developers in trouble, financial intermediaries in trouble." But the reality, of course, is that China's financial system is completely different than that of the Western world. And the whole "Oh, China's going through its Lehman moment" is completely misplaced. And you see this, frankly, in the data. Chinese bank shares aren't collapsing, they're not going up, but they're not collapsing. You know, iron ore prices are up 50% since China reopening in late October, LVMH sales are still cranking away. So China today is… There is trouble on the real estate front there. There is trouble on the local authority front.

But if you take a step back away from the hyperbole, what do you see? Well, you see an economy that has gone from a trade surplus of 30 billion a month to 80 billion a month. You know, if you took all of China's annual trade surplus, it would be basically the 20th biggest economy in the world. China's trade surplus is almost a trillion dollars a year now. It's roughly the size of the GDP of Switzerland or Argentina or any G20 country. And behind that is a simple reality. Behind the surge in China's trade surplus is the fact that China's massively moved up the value chain in a number of industries. Where this is the most visible is autos. You know, five years ago, China didn't export any cars. In five years, China's become all of a sudden the world's biggest car exporter. And you can replicate that to earthmoving equipment, to solar panels, to trains, to nuclear power plants, you name the industry, and China in the past five years has done accomplished really pretty impressive things and become a genuine global player in pretty much any industry you care to name. So, to think that with all these strides, with an economy that's, you know, having a trade surplus of 80 billion a month, you're about to see an economic Armageddon and implosion, to me, is a massive stretch.

Erik: I want to focus on this idea of a trade surplus in China, and particularly with respect to how sustainable that is in changing geopolitical times. Now, obviously, we don't know what's going to happen. But there are lots of reasons to be concerned that we may be headed toward a direct military conflict between the United States and China. Now, if that happens, I think that there is a very widespread complacency and belief system, which I'm not so sure is right. And that belief system is… okay, look, everybody knows China's completely dependent on the US as their biggest customer. You know, if we stopped buying stuff from Walmart, China's going to go broke overnight, so they can't mess with us because their whole economy is going to collapse if they ever try to go to war with us. And you know, they're going to lose our business. Is it really the case that China is at risk of losing our business? Or is it more that we're at risk of ending up with no supplier for essential products, and that China may be more survivable than some people think?

Louis: Look, war is always terrible for anybody involved, right? And let me just first state that I actually don't think that China and the US will go to war. And, it's very much in everything that China does, policy-wise, is to avoid a war with the US. Because I think if you're the Chinese Communist Party, and you think as to how you can possibly lose power, that's basically the scenario you fall back on. That's really the only way I think that the Chinese Communist Party potentially loses power is a direct war with the US. So I really think everything China does will always try to avoid this war unless the US crosses some massive red lines, like deploying nuclear missiles in Taiwan or something like that. Failing that, you know, China will avoid a war at all costs.

Now, to your second point, this belief that, “Oh, well, China is 100% dependent on the US, etc.” I think that was definitely true 10 years ago, 15 years ago. It's definitely not true today. When you look at the evolution of China's growth, you know, I mentioned China being the world's largest car exporter or exporter of machine tools, nuclear power plants, or whatever else. All this massive growth in trade is occurring from China to emerging markets. And in fact, I think that's, that perhaps is one of the most important macro trends out there, that people, you know, that aren't spending that much time in emerging markets or studying emerging markets are missing today. What's happening right now is that China is basically allowing emerging markets to industrialize on the cheap and on credit. Countries like Indonesia, Peru, Colombia, you go there now and you find Chinese earthmoving equipment in the mines, you find Chinese cars in the streets. You go to Africa, and you find Chinese railways. So it's a lot of the growth in Chinese exports. When you look at the growth in global trade over the past five years, almost all of it has come from emerging market to emerging market trade. And here's the interesting bit: that's a part of the trade that is increasingly no longer denominated in US dollars. Because China realizes full well that the US wants to contain China. And China, and this is something that you and I have discussed in the past, but China really has no choice but to do everything she can to de-dollarize her trade. Now, of course, you can de-dollarize your trade with the US, but you can de-dollarize your trade with Indonesia, Brazil, Colombia, and others. And so, all of the growth impetus of Chinese trade in the past 5-10 years has been towards these emerging markets. So, the dependency of China on the US is no longer what it was.

Now, at the same time, you could say, “What about the dependency of the US on China?” And here again, I think the big key trend of recent years, of course, for all the talk about deglobalization, deglobalization is a massive misnomer. We're not seeing deglobalization from the Western world; we're seeing de-sinification, you know, the attempt to move factories from China to Vietnam, from China to Indonesia, from China to India or Mexico. And, I'm sure you saw all the charts that went around showing that Mexican exports to the US are now bigger than Chinese exports. And that's the structural trends of the world. We live in a Western world that imports less from China and more from everywhere else across the emerging markets, and emerging markets that import a whole lot more from China. And, both of these trends are very bullish emerging markets ex-China.

Erik: Let's stay on the de-dollarization topic, specifically with respect to the BRICS alliance. When that acronym BRICS was first coined 15 years ago, I started writing articles about Sergey Glazyev, the Russian scholar who is pushing this de-dollarization campaign, and everybody laughed at me. They just said, “You know, it's just people talking, it's propaganda, they can't do anything, the US dollar will reign supreme forever.” That was 15 years ago. Now, it seems like people are still mostly complacent and laughing this off. But the BRICS alliance, which was originally Brazil, Russia, India, China, and South Africa, is now growing. They're adding more countries, and Saudi Arabia is considering membership. It is growing more and more, and it's still being ignored. Nobody is taking it seriously. It seems to me that we have a new competitor, both to NATO and also to Western finance. In the sense, it's both a financial and, I think, it will eventually be a military alliance between these countries. Nobody seems to take it seriously. Am I the crazy person who thinks there's something to it, or what?

Louis: No, no, I don't think you're the crazy person at all. The first point I'd make is, of course, de-dollarization is a very charged word, and it means different things to different people. But for me, de-dollarization isn't as much a specific date, like the recent Cape Town Meeting or the recent G20 meeting in India. It's not as much a date per se as an overall process, a process that takes time. Amidst all the talk about BRICS and what happens to emerging market trade and how it gets funded, etc., there are a couple of key dates that matter. The first was Russia's invasion of Ukraine and the Western world's decision to kick Russia out of the dollar system. Russia is a major commodity exporter, and this move accelerated the de-dollarization of many commodity markets. This has significant implications, particularly for large emerging markets like India, which have had to access dollars for their infrastructure and commodity needs. Now, Russia offers to sell commodities in local currencies, removing a major constraint to growth for these countries.

Regarding the BRICS alliance, it's important to recognize that they are openly discussing changing the structure of energy trade settlements. Eight BRICS countries include five of the top eight oil producers and the top two oil importers in the world. They are actively seeking alternatives to the dollar for energy trade, settling in local currencies or even gold. This shift in energy trade and potential changes in the role of US Treasuries in the global financial system could have profound implications. The fact that US Treasuries have been falling in value since the BRICS summit indicates that more people are considering the possibility of a different global financial landscape in the future, one that looks significantly different from what we've known for the past 50 years.

Erik: What is your take on that possibility? Because something that I'm kind of perplexed by frankly, is. I agree with you that most of the world is saying, "Oh, my gosh, there's a chance that the world could look very different in the next 50 years than the last 50 years." I think that decision is already made. I think it's crystal clear that we're down a path beyond a point of return, that we're not going to return from. I think the world is changing very dramatically. I think that we're headed toward some kind of conflict between the global superpowers, whether it's World War Three per se or some other shaped thing. I'm not exactly sure. It depends on how you define World War Three, but it's a really big moment of change, I think, in the world. Do you see it that way? Or how do you look at the world and what's happening now?

Louis: Look, I agree with you that we are in the midst of this change. And, you know, you're always tempted to quote Oscar Wilde about going bankrupt very slowly and then very quickly. Look, I think, to be honest, when I look at things like the finances of governments in Europe, the finances of government in the United States, and I look at the behavior of bond markets, in a sense, you could say it's completely new. But then again, if you've been an emerging market investor, and as you know, I've been in Asia for 25 years, so I've done emerging markets for 25 years. It's also something that's very familiar. It's the time of the cycle where you see interest expense go parabolic, and you're seeing this in the US. And as you do, you start to see the bond market sell off. And really, the bond market sell-off only stops once you get a massive, massive tightening of fiscal policy.

Now, across the Western world, we're very far from that. For me, when I have found this past summer absolutely fascinating, because I've had dozens and dozens of phone calls from clients asking me about what was happening in China. And I would always ask, why do you care so much? What's the trade with what's unfolding in China? And then I would also add, the big story that's unfolding across our eyes right now is that OECD bond markets are going down every day. Forget China, at this point, it's a sideshow. You have the very asset at the heart of our financial system, the OECD government bonds that are going down every day. And we're even beyond US Treasuries. For me, this was most visible with German bunds. You know, if you told me that ICM surveys would hit record lows, post-reunification lows in Germany, that everything you care to look at in Germany looks horrible. Their chemical industry is imploding, their auto industry is imploding, everything looks super ugly. And against that backdrop, German bond yields go up every single day. To me, that tells you that we are moving, to your point, that the change is already here. It's already happening.

Now, I still don't think it's reflected in 95% of people's portfolios. You know, most people you talk to still have a 60/40. They have their 60% equities and their 40% bonds. If tomorrow, Erik, you go to either UBS or BNP or Morgan Stanley, and you go to their private wealth, they're going to give you a nice questionnaire, and you're going to fill out the questionnaire and spend an hour filling out the questionnaire. And then they're going to decide, "Oh, Erik, you're an aggressive investor. We're going to put you 60% in equities and 40% in bonds." Or alternatively, they're going to say, "Oh, Erik, you're a very conservative investor. We're going to put you 60% in bonds and 40% in equities." And then when you're going to say, "Well, hold on, your aggressive portfolio has actually done better than your conservative portfolio for the past three years, even though markets have gone down, because bonds have actually done worse than equities." So your correlation makes no sense. They would say, "Well, yeah, but they made sense for 30 years, so we're hoping it goes back to making sense." So most people's portfolios out there are still managed on the premise that bonds and equities have a negative correlation, and that if you get a hit on equities, your bonds will save you. Well, this didn't work in 2022. It didn't work in August of this year. Equities went down, and bonds went down. And you would think that should be the big story of the summer, not whether Chinese real estate is going down. That is really the big story. But it's a story that everybody does its best to ignore. Because to confront it basically means completely upending the way you do your portfolio allocation, the way you build your portfolios, etc.

But the reality is, we're moving. If like me, you believe that, we're moving to a very different financial superstructure, where a lot of the relationships that have worked for 30 years no longer work, then you have no choice but to put your thinking cap on and think, "Okay, how do I rebuild a portfolio in this world?" Now, few people want to do this because the 60/40 was so great for so long. It was like having Michael Jordan on your team, you know, and you're the Chicago Bulls, and Michael Jordan leaves, it's pretty hard to rebuild. Nobody wants to confront the reality that the 60/40 no longer works. But yet, it's a reality that's now staring at you right in the eye.

Erik: Let's move on to energy. We've got WTI crude oil just flirting with $90. We've been about half of our interview. So far, it's been below 90, and half of it's been above, so we're right on the edge there. Clearly, we've seen at least a change in the market. I don't want to declare it's a definitive upside trend change, but that's sure what it looks like. Is this related to China reopening? Is this related to... I think that maybe it just has to do with seasonality from the standpoint that if you're going to use energy prices as a tool of economic warfare, you want to do that in the wintertime when Europe is most vulnerable, if you're Russia. So it seems like we're kind of coming into the season. So I think about that. What do you think the driver is for the recent strength? Is it set to continue?

Louis: So I don't know if you remember this, Erik, but you and I did a chat like this when energy was negative, in the dark days. I do remember that day, the dark days of COVID. And you kept telling me, “Sorry, I've got to interrupt, it's minus 20. I got to interrupt. It's minus 45.” But yeah, so look, I think many things on energy, like you just mentioned, I think that the massive risk for the western world is that we come into this winter, and that Putin decides to weaponize energy. And that's a Damocles sword hanging over our heads for a number of reasons, but the reason you would do it is fairly obvious. I think, if you're Putin, forget Zelensky, your real enemies are Biden, and to a lesser extent, Rishi Sunak. And it's the US and Britain. Those are really the enemies you're trying to confront. And the reality is both of these countries have an election coming up this year. And, if you're an incumbent, the last thing you want is higher energy prices. It's like having an advertisement against your policies at every street corner. If gasoline prices are at six bucks, seven bucks, eight bucks, it's basically becomes impossible for you to get reelected.

So, I think if you're Putin, at this point, you think, “Well, I’ll shut down all the pipelines this winter for maintenance. And I’ll shut down Sebastopol and St. Petersburg and Vladivostok for maintenance as well, I’ll shut down the ports for three months.” Now, the reason I think this might be his thinking is, I'm sure you've noticed that China has been importing oil like there's no tomorrow. You know, China's oil imports have like gone through the roof over the past six months, and China's oil inventories have never been this high. Now, I think when you look at China's oil inventories, there's three possible explanations. The first, which is the one that the

American neo-cons fall back on is “Oh, my God, China's preparing to invade Taiwan.” So they're stocking up on oil. For a number of reasons. I don't buy that for a second.

The second, which to me makes perhaps the most sense is that China's decided, we mentioned China's record trade surpluses, China might have decided that it doesn't want to recycle those trade surpluses in US Treasuries, because what's the point? US Treasuries keep losing money, we're looking at a third negative year in a row. Plus, they can get confiscated at a moment's notice. So why would you buy US Treasuries? Better buy oil, you could always use oil. So yeah, that makes sense. Alternatively, you could come to a third explanation that Putin whispered in the ear of his best friend forever, Xi Jinping, that it might make sense to be long oil this winter. And to have some inventories. And so, I think if you're Putin, you know, why would you do that? Well, first, of course, you throw a massive amount of pain on Europe. And you throw a massive amount of pain on Joe Biden, who then has a simple choice. If oil prices and gasoline prices go through the roof, and he's already emptied out the Strategic Petroleum Reserve, what can you do about it?

One option, you can wear the political pain and probably gets obliterated in the election.
The second is he bows out, he pulls the Lyndon Johnson, and says, “Well, you know, somebody else runs and carries the can.” Or the third option, which is perhaps the option Putin is gunning for, is he decided, “You know what, given the high gasoline prices, we're going to keep our domestic gasoline, keep our domestic diesel, keep all of our products and stop exporting petroleum products to the rest of the world.” Basically, screwing over the Japanese, screwing over the Koreans, screwing over the Europeans. And my guess is, that's what Putin is trying to achieve. Because if the US does this, then Putin can say, “Oh, see? You guys have the Allies you deserve. At the first sign of trouble, they desert you.” And, you know, Kissinger's words that, "To be an enemy of the US is dangerous, but to be a US friend is fatal" will once again have been proven true. So my guess is, you know, that possibility, the lower the strategic petroleum reserves go, the more that possibility of Russia weaponizing oil against the Western alliance increases. That, to me is the biggest risk on markets today. So why wouldn't you be long oil? If that's the biggest risk, the risk that's easy enough to hedge, you go long oil, you go long the energy stocks, and you protect yourself against that Damocles sword over your head.

And I'll just finish with that quick point. If you look at the past couple years, I mentioned earlier how bonds no longer provide any diversification for portfolios, that bonds were no longer the anti-fragile asset of choice. The new anti fragile asset of choice, the one thing that does protect your equities, maybe you like Microsoft, maybe you like LVMH, maybe you like Alibaba? The one thing the one risk you're running is that all prices go to 150 bucks. So it makes sense in that context, to have energy in your portfolios, because that is the one diversification you can have and you saw this through 2022. You saw it again in August when bonds and equities went down, energy was up. Energy is now the ultimate diversification for portfolios.

Erik: Let's talk a little bit more about the weaponization scenario. Because you know, if you had asked me five years ago, tell me how this finance industry works. And what if there's a war, and there's an expectation that we're headed back to the Soviet era where there's going to be an Eastern Bloc and a Western Bloc, and you know, some countries just don't do business with each other all around the world. I would have said, okay, if that was even on the table, the very first thing that would happen is all the finance guys would scramble and they'd be looking at, if this goes back to a bifurcated world, what are the sides? What is the supply of oil to each side? What's the supply of uranium to each side? What's the supply of copper to each side? You do that analysis and say, when this geopolitical event starts to go down, where are all of the hot points? What are the things to invest in? What's going to happen? I don't see anybody doing any of that. Or if they are doing it, they're being absolutely secretive about it. I don't see anybody talking about it, I don't see anybody taking seriously the possibility that we could get into a war with both Russia and China at the same time, where the other side controls most of the natural resources in the world. Am I missing something? Or is there a bigger risk than most of the western finance community is willing to face?

Louis: First, I agree entirely with the way you lay it out. I'll add just one thing, I think, in 2018, the US basically did launch the new Cold War, when it decided to ban the export of semiconductors to Huawei. And when the US came out and said, "Look, it is now our policy, to make sure that China can no longer grow technologically and developed technologically." So I think what happened at that moment is, the US signals to the broader market "Look, we're starting a Cold War." And the front on the Cold War, is semiconductors. And that's where the battle will be fought, on the battle fronts of semiconductors, because we in the western world have a huge comparative advantage on that. And so, you did see in the following years, you know, the likes of ASML, the likes of TSMC, the likes of Nvidia, etc, go absolutely parabolic, because that was now the focus of government policy, that's where the battle would be fought, you know, capital spending would increase dramatically in that area, etc.

Now, I think that was like one element. And so anybody who thought like you did and think, "Okay, we're in a Cold War, where should I invest?" Ended up falling back on semiconductors, because governments guided us that way. Now, you and I have discussed this many times in the past, but one of my starting points when I do my research is economic activity as energy transformed. And I think along with the view, "Oh, we're starting a new Cold War." We also said, one war at a time isn't enough, we're also going to have a war on climate change. And so we're going to spend a ton of money on alternative energy, and we're going to spend a ton of money on solar, we're going to spend a ton of money on wind, and this will be money well spent anyway, as part of this geopolitical conflict, because it will allow us to isolate Russia, and basically make it irrelevant. And I think, this vision was especially strong in Europe, combine that with all the ESG constraints that we decided to put on ourselves. And a ton of capital went into that space. You know, I think over 10 years, we invested more than 4 trillion US dollars, trillion with a T, in wind and solar. And with that, we managed to move from 83% being carbon base to 81% being carbon based, which to me, speaks to the failure of those investments.

Now, we talked earlier about energy prices grinding up. I think one of the reasons all prices are grinding up and energy price and grinding up in general is that people are realizing this, you know, are waking up to the fact that wind and solar have been a capital misallocation on a grand scale, that they haven't delivered a quarter of what we'd hoped they would deliver. And this realization is, I think leading to a number of things. First, of course, energy prices are grinding higher, which is bought both a cause and a consequence of this, of the realization of this failure. And at the same time, we're seeing a shift in the zeitgeist around everything linked to nuclear. You know, nuclear two years ago was a very dirty word. Nobody wanted to talk about it. And,today, all of a sudden, across the western world, there's a realization that “Hold on…If we want to be serious about the carbon, if we want to be serious about climate change, and if we want energy independence, then we've had that solution in front of our eyes the whole time…” And even people like Macron, who did his very best for his first 10 years in power, first as finance minister, and then as President to dismantle France, has massive comparative advantage in the nuclear industry, is now starting to backtrack.

So, one of my favorite charts in my slide deck is which people can easily reproduce, you take the MSCI alternative energy index, and you take the MSCI traditional energy index, or standard G index, and you see that for 10 years, the two go hand in hand. And they go hand in hand, because at the end of the day, they both sell energy. And then in the past three years, you have a massive crocodile mouth that opens up like a huge gap, alternative energy goes through the roof, and normal energy goes nowhere. And now this crocodile gap has like mouth has like shut back down very violently in the past six months, while alternative energy plays are tanking and traditional energy plays are moving up and all of the outperformance of alternative energy previous five years has just been taken out in the past six months. So long-winded answer to your question. I think there was, as we entered into a cold war thinking, I think there was massive wishful thinking in the West. It's like, “Oh, well, we'll solve our energy needs with alternative energy.” And that's been a huge fail. And, oh, we'll have massive advantage on semiconductors. And I think that's an advantage that's being eroded as we speak.

Erik: Let's come back to the scenario that you suggested where maybe, this is the year that Putin decides that, this is the winter he's going to weaponize energy prices for the sake of advancing Russia's war interests. What does that look like to you? What steps would be taken?

Louis: Well, I think to be honest, we got to preview a little bit of it this summer. I think this summer, Putin sort of weaponized wheat, you know, he tore up the Black Sea agreement, he bombed the silos in Ukraine, he bombed Danube ports. And at the same time, he invited all of the African nations to a summit, in Moscow and told them, “Guys, don't worry, whatever happens, I'll have wheat for you guys. And I'll even give you wheat for free.” So there was a clear attempt to… because wheat prices were going up into that African Summit. And then he told all the Africans “Look, I'll give you wheat for free,” and then wheat prices came back down. Now, when it comes to energy, I'm sure you saw recently, that Russia announced that they were going to sell their natural gas to China for half the cost. And they're going to sell oil at big discounts. And you're going to continue doing that for India as well. So what does it look like? I think to be honest, the writing's on the wall, they've waited for inventories to be very low.

And then, you just basically stop exporting for three or four months, in a tight market, where you no longer have a strategic petroleum reserve. And where the ability to crank up production in places like the US or Brazil or wherever else is very limited, by the fact that a you no longer have any oil engineers, because for the past 10 years, you've told everybody that oil was a dying business. And it was, you know, you'd have to be an idiot to become an oil engineer, you no longer have spare oil rigs, you no longer have boats, you know, cranking up the production if you just shut down production in Russia, or shut down exports in Russia for three, four months. Now, you could say, well, Saudi Arabia could crank it back on, the UAE could crank it back on. But here you get into the whole personal politics of it all. It's, you know, does Saudi Arabia want to do Joe Biden a favor? It's pretty obvious that MBS has a very strong and deep personal relationship with President Trump, and he doesn't have one with President Biden.

And so, it's, you know, will Saudi Arabia help the US? In the past, they would have, because the US always was a guarantor of Saudi Arabian safety and security. And this brings me to the other massive geopolitical developments that nobody talks about in the West. But, forget the Russia/Ukraine war. The other massive development of the past year is the Iran/Saudi peace deal. The fact that China basically did its own little Camp David accord, and got Saudi and Iran around the table, to shake hands and to agree to stop fighting each other through all these proxy conflicts in Syria and Iraq and Yemen and Lebanon, and wherever else, is an absolute game changer. Because if you're now Saudi Arabia, and you think okay, Iran isn't going to attack me anytime soon, you're much more relaxed, about, excuse my French, but showing the middle finger to the United States. And I think that's what's happening right now.

Erik: Let's go a little bit deeper on what could happen with respect to Russia weaponizing prices. Because, I really think this is important for people to understand. In my analysis, if Russia took half of its oil exports off the market and just said, "We're not interested in selling at any price, where we export 8 million barrels per day today. Starting next week, it's only going to be 4 million. That's it." Most people say, "Well, they would never do that, because they could never afford the loss of revenue." And I say, "Wait a minute, why do you assume that there's a loss of revenue if you took 4 million barrels a day off the market?" First of all, don't assume that Saudi Arabia even wants to make up that difference, because it's more likely that Saudi Arabia and Russia would be working together in that scenario. But if Saudi Arabia wanted to help you and UAE wanted to help you, between UAE and Saudi Arabia combined, they might have 4 million barrels of spare capacity after the June cuts, but just barely. And they couldn't sustain it long term. So there's no way to make that up. And my contention is, if you took that much oil off the market, prices would double. Well, if prices double, Russia is not losing any revenue, are they? I mean, obviously, they piss everybody off. But it seems like we're headed toward that level of escalation. And something I see completely missing from any discussion in the West is, wait a minute, if they took half their oil off the market, they could shut down the global economy.

Louis: I'll take you back to, I don't know if you read Hank Paulson's book, *Collapse* (On the Brink: Race to Stop the Collapse of the Global Financial System). And in his book, Hank Paulson, you know, where we've used the dark days of the 2008 crisis, etc. And in his book, he says that, in the darkest days of the complete meltdown in the US mortgage market, the Russians called the Chinese and said, "Hey, guys, it's time we can break the dollar system, sell all your treasuries, sell all your mortgages, and the system will implode." And China's answer was basically, "Why would we want to do that? You know, we've benefited massively from the system. So far, we have every interest in keeping the system stable. We don't want to make the system more unstable." Now, I highlight this because I think it's a very different vision of policies between China and India. Fundamentally, China's always about promoting stability, they're always trying to keep things stable. I think Russia is, is far more as we've seen this past couple of years, it's far more of a loose cannon. And, Russia doesn't feel like it's benefited tremendously from the system over the past 20 years. It feels like it's been hard done by the system in the past 20 years. I think there's a there's a big element amongst Russian policymakers of "Let's tear this thing down." And yes, to your point, today, I think we've given them a golden opportunity to do precisely that. And so to just assume that oh, my god, yeah, it would be terrible. But don't worry, they're not going to do it. It's like, what in Putin's track record makes you believe he's not going to play that card? To me, everything in his track record makes me believe that there's at least a 50-50 chance of him playing that card, if not higher.

Erik: My take is there was 100% chance of him playing that card last year until he absolutely observed that the time to play that card is not in an unseasonably mild winter. I think he's waiting for an unseasonably cold winter.

Louis: I think there were a couple of factors that were, the US still had a pretty large strategic petroleum reserve a year ago. So you had a mild winter, you had US with the largest SPR that the US decided to empty, but it was also not really a presidential election year. Now, you have a window of opportunity. If you're Russia, where you can have a direct, very strong impact on both a British election and a US election. And you know, I think if you're Russia, those are your two genuine enemies because you didn't want Britain and the US at your doorstep. And so, you now have a chance to take the government of Rishi Sunak down and the government of Biden down. Why wouldn't you have a go? Right? Like, because to your point, maybe you make less money if you cut back your production and you export less, and the prices don't go up all that much. So you end up with less money. Do we think Putin really cares about the money? I mean, if he cared about the money, you wouldn't have invaded Ukraine in the first place. What makes you believe that in his track record of recent years, that his decisions have been motivated by revenue maximizing? I don't think that is even in his top three considerations.

Erik: And while we're on this topic of energy, and particularly the geopolitical risks that could occur with energy, I just want to point out for any newer listeners who may not be aware that I recently published "Energy Transition Crisis," a documentary series, where Episode Three is entirely about all of the reasons that I am predicting an oil and gas energy crisis in the late 2020s. And it's very consistent with Louis's views here, Louis, I can't thank you enough for a terrific interview. But before I let you go, I want to ask you a little bit more about what you do at Gavekal. And for people who are not familiar with your work, it's mostly institutional. So tell our institutional listeners how they can contact your institutional sales team for coverage. And for the retail guys who are not eligible for your institutional coverage, how can they follow your work both for the books you've written and also on social media and elsewhere?

Louis: Great. Well, look, Erik again, super, super happy to be here. Thanks for plugging my book. My last book that I wrote was called *Avoiding the Punch*. I think it's a fun read. You can get it on our website www.gavekal.com, Gavekal, as a firm, we publish research for institutional investors. We also have a private wealth arm called Evergreen Gavekal for US clients and Gavekal Wealth based in Mauritius for non-US clients. And we manage various funds, mostly in Asia out of our Hong Kong office. If people are ever in Hong Kong, they can and should definitely feel free to look me up. Before I go, I'd just like to conclude with just one quick idea for you. In this phase of the cycle, where energy prices and gasoline prices are creeping higher at a time when mortgage rates are also creeping higher, it's rarely a super happy combination. So, it seems likely to me that things are going to get tougher as we move forward. And portfolio construction is going to be more important than ever. In this world of portfolio construction, you have to look at every one of your assets and think, okay, what job is this particular asset doing in my portfolio? And the reality is, bonds haven't done the job for three years. So whatever you have in bonds, you need to rethink and put somewhere else.

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