Simon White: Inflation, Stocks & Why TINA is Coming Back

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Erik: Joining me now is Simon White. Many of you remember Simon when he was a co-founder of Variant Perception. That's the leading indicator guys that we like to get on the show every three months or so. Simon has moved on now and is Bloomberg Markets live macro strategist. Simon, it's great to get you back on the show. Listeners, Simon has prepared a slide deck, you'll find the download link in your research roundup email. If you don't have a research roundup email, it means you haven't registered yet at macrovoices.com. Just go to macrovoices.com, click the red button above Simon's picture that says looking for the downloads. Simon, I want to start with what's on everybody's mind the long awaited recession, is it really going to be forgotten in favor of a soft landing or is the recession still on the horizon?

Simon: Thanks Erik for having me and that's a great question to begin with. So, I would say I think the consensus has certainly seems to have shifted much more towards soft landing, no landing scenarios. I mean, stepping back, there's an issue here with none of these things are very clearly defined. So I think everybody's in a position where they can be right or at least not proven wrong. Although I think a hard landing is fairly clear, like if we get recession. But even then, a recession is not something that's clearly defined either. I tend to go by the MBR, like they're kind of the arbiter of whether there's a recession or not, and they give some guidelines about what they call a recession or not. But even there, that there's a lot of kind of fuzziness around the definition. So I tend to look at recessions, you know, economies kind of switch into recession, so they are a regime shift. And I think that's what really kind of catches people off guard is recessions, they're pronounced, they're protracted, and pervasive, the three P's. I'd say there's a fourth P as well. And they are precipitate, and they tend to happen very abruptly. So that's what I've tried to show in the chart on slide two, the right hand chart. And they tend to happen when you get interactions between hard and soft data. So soft data is your market data and survey data, things like ISM, and consumer confidence. And hard data, things like, you know, industrial production, retail sales, etc. And when these two tend to operate off each other, and they generate a feedback loop, and past a certain threshold, that they hit a cascading point. And that tends to be when you get recessions. And what's kind of interesting about the chart, is you'll see that there's a number of times when you have a stress in the soft data. But you don't get a stress in the hard data, and you don't get a recession. And they are really the times, you know, the Fed is kind of this, what the Fed is all about, right? The fable Fed put is essentially, if they can stop soft data stress, bleeding into the real economy, and then creating one of these

feedback loops, then they've done a reasonably good job, you know, they prevented a recession.

And where we are today, again, if you look at the chart, as you can see that both hard data and soft data are stressed, and they're past a threshold that has normally been associated with recession. So I think we're at a very kind of like, hot point, the soft landing narrative, I think is, as I say, I think is basically misguided. I think that often, just before a recession happens, people tend to be off their guard, and rapidly, you get a decline in the data. And that's exacerbated by the fact that most economic data, some of it considerably so is revised. And here's the kicker, it's often revised at most at turning points like recession, so going into recession, you're kind of most blind and the data is most wrong. So you know, we've got a number of things that are standing out to me right now, that I think are consistent with prior recessions. So the claims data, now you can look at that in two ways. You can look at the national data, which is what most people focus on. But you'll get a lot more information content. If you look at claims data by US state mentioned, you know, recessions, one of the attributes they have as their pervasive. So you tend to see things worsening across sector and geography at the same time. And the claims data by state picks that up. And what we've seen over the last few months is that you're seeing deterioration in claims data across quite a high number of states to a percentage of states that's been consistent with a recession in prior years with a very high kind of hit ratio. And that's the unemployment claims and continuing claims as well.

So I think the recession is much more likely than the consensus believes and I think when it does happen, it will happen much more abruptly, the data will suddenly take a massive turn for the worse. And also subsequently, the data will be revised a lot more. And we won't know, we never do, we never know we're in a recession. Ex-ante is only ex-post. And that's really where it gets interesting because obviously telling someone that a recession has already happened, it’s useless as an investor and what obviously, as an investor, you want some sort of leading idea that you're going into recession. Because equities are kind of like not super quick in terms of like they don't sell off a long, long time before a recession is deemed to have started. But they do sell off a little bit before and they sell off obviously, through the recession, you get a good drawdown then, and that they start rallying before the recession ends. So if you look at where the reactors are behaving right now, in the median sort of around recessions, or the median after bear market, so the bear market that we've not quite left, depending on how you define it, but we've certainly not made a new high back in there, January 2022. You know, right now, markets are behaving in a way that's consistent that this is a bear market that is not going to be followed by a recession. So it's clearly not yet priced and complicating the issue as well. Something maybe we'll get into later on is I don't think this will be a normal recession, certainly not the garden variety recession that most investors will be used to, because I think this recession is going to be accompanied by elevated inflation. And that really kind of complicates matters and changes what people are perhaps expecting going into a recession.

Erik: Simon, we recorded this segment mid-session on Tuesday when the S&P was trading around 4,330 on the December futures contract. Tell me about how you see this market, is the sell off that we've seen for the last couple of weeks, I guess I think of this as a lot of us saw the

recession coming or we're telling ourselves we saw it coming. But then we saw this bear market rally continue well beyond the 61.8% fib retracement all the way up to 46 something before it seems to have topped.. Was that a top? Are we seeing the beginning of the market discounting this recession? Is it time to short this market? How should we interpret this weakness we've been under all the short term moving averages for more than a week now.

Simon: This has been something that's keeping me awake for the last few weeks, because there's a huge amount of going on right here. We have the recession risk, which has been ongoing. And as I say, it's not clear until after the fact that you're actually going into recession. As I say, there's a number of things that I look at that are consistent with a recession beginning in the very near future. So there's potentially something like that it's been sniffed out of the market, but we haven't really had you know, we had the JOLTS numbers that surprised to the downside a few weeks ago. You know, we've had the fact that had been noted that payrolls has consistently been revised down this year, but have not had anything, really recently, that would suggest that all of a sudden that the market is getting sort of recession vibes. So I'm not 100% sure is generally a growth story right now. Again, we've got yields rising quite precipitously high and quite fast. And, again, that's something we can get into in a bit more detail. And if you look at breadth, I think some of the breadth indicators are showing signs of deterioration, they are not like red alarm bells level, but they are giving signs that you will kind of want to be tactically negative right here. But complicating this issue is on a sort of more medium term basis. And, you know, I looked at this back in March and April, is liquidity is still very supportive for risk assets. And that was something that was kind of interesting early in the year, because people were fairly negative, back in say March sort of time, sentiment was certainly less good than it was, you know, say a month ago. The excess liquidity, which I think is one of the better measures of liquidity to look at, and I define that as a difference between real money growth and economic growth, started to turn up. Not only there's an empirically leading relationship with risk assets, and in fact, we have a graph of that on slide three, with the price of oil, it tends to be quite a contrarian, inherently contrarian indicator, because growth is slowing down. But then money growth picks up and responds to growth slowing down, inflation is a lagging indicator. So it comes down and you get excess liquidity rising.

And that excess liquidity, you know, money growth is created by banks, and it's created by central banks. And what isn't used up by the needs of the real economy is essentially excess and it intends to find its way into risk assets. So I think that was a real key thing that that indicator, that liquidity started to turn up back in March. And I think that's one of the reasons why markets like oil and stocks had been rallying, for most of the past three to six months. So in a medium term basis, that hasn't turned back down, you know, excess liquidity is still rising, and it hasn't turned back down. I've some reasons to believe maybe in the next three months or so, it may start to turn back down, but it isn't turning back down now. So you kind of got to be strategically still in a medium term positive on equities, but on a longer term, even longer term basis structurally. I think that's very interesting, because I think there's a number of things that people have not really priced in yet, you know, we'll touch upon inflation in a second, but I really think that's a huge game changer for a whole number of things. Probably one of the most

important ratios in finance, which is the stock-bond ratio. And I think that's really going to sort of play havoc with asset allocation over the next few years.

Erik: Well, you read my mind when you said inflation comes next. I definitely want to talk about this. Because, boy, I think that we clearly agree that a secular inflation is likely to return. Something I've learned, though, is I think that a lot of the people who also think that think it for completely different reasons. So I'd like to focus on why specifically, you think there's going to be a return of inflation, is that a secular inflation? Is it going to be with us many years and what are the drivers?

Simon: So I think you have to stand back, you know, quite a long way at first, in terms of over the last few years, I think a lot of people have not maybe fully understood really why we're getting inflation in the first place. I mean, the classic excuses if you like, are the pandemic, and Ukraine. But I really think they're more proximate reasons, rather than the remote reasons. I think the remote reason behind pretty much every inflation historical inflation that we've seen, is the central bank monetization of large fiscal deficits. And that was something that was already in place, even before the pandemic, so governments essentially, central banks had kind of run out of road. So traditional monetary policy, had really been losing traction, because there was a flirtation with MMT-like policies. And, you don't get inflation if central banks create money, but no one's really there to spend it. And you can't make the private sector spend it, you know, you can lead a horse to water, but you can't make it drink. All we had was asset inflation, we never really got any consumer inflation. But in the lead up to 2020, you know, 2018, 2019, you start to see this rise, and fiscal spending, and you still had these massive central bank balance sheets. And that really, when you had the supply and demand problems that came out of the pandemic, and then they were exacerbated by Ukraine, they were to some extent, bad luck. I mean, I think they created some sort of inflation. But I don't think they would have had the same traction as they otherwise would have. And the analogy, again, is the late 60s, early 70s. And again, everybody blames inflation of the 70s on Nixon closing the gold window, the Arab oil embargo in the 70s. At the end of the 70s, you had the Iranian revolution. But really before that, in the late 60s, you had once again, you had rising fiscal deficits, and easier central bank policy. In fact, the Fed overestimated the productive capacity of the economy. And that's one of the reasons why they ease too much.

So again, it's separating the remote from the proximate reasons. And as I say, I am of the view, the remote reason is large fiscal deficits that are being monetized. So that's where we are today. So we've had we've now got much larger fiscal deficits, even after the pandemic, and we still have very bloated central bank balance sheets. So that's the real underlying cause of inflation. The next question is, what has the Fed been able to do about it. Now, you would think after over 500 basis points of hikes over the last year or so, and inflation down from say, a high of just over nine down to three handles somewhere, you'd like to think the Fed has had a lot to do with that. But really, if you look into it, I don't think that's the case. And you can look at an indicator that the San Francisco Fed creates, it's the core, acyclical and cyclical PCE. So they essentially separate out the PCE, the core PCE into the cyclical components, and these are the ones that correlate very highly with essentially with Fed policy, and the acyclical is everything

left over. And what's really interesting, if you look at the acyclical, that's the one that's driven pretty much all the drive down in core PCE, the cyclical side hasn't really budged. So the Fed has really had no direct impact on inflation. And another way to see that, you know, how does the Fed normally get inflation down? It does so through the vector of the labor market, and there's still hardly any slack in the labor market. You look at obviously the unemployment rate, you look at productivity, and that's really not budged.

So the Fed has probably thus far, had very little direct impact on bringing inflation down. What has driven it, and I think this is in some sense, the elephant in the room, is China. You know, China came out of the pandemic as the only country to have actual consumer deflation, and they're still struggling to regenerate and kickstart growth. If you look at that acyclical core component, it correlates very highly with China PPI. And in fact, you can see on slide four, a direct relationship with US CPI and China PPI. And China PPI, okay, it's been in the doldrums. China is having a real struggle bringing its economy back to, you know, to revive its economy, but it's beginning to have a very small kind of traction. So, CPI is beginning to pick up and they don't have the tolerance really to allow their economy to remain in the doldrums for so long. So you are going to see inflation return and China, that inflation is going to feed into global inflation. At the same time as well, the Fed has not really had any direct impact. So even if the Fed policy starts to have some impact, it's going to meet these re-rise in inflation. So that's really the structural reason, if you like why I think you're going to see a second rise in inflation. But to be clear, I don't necessarily think we're going to see a new peak in CPI. But I think we'll see another rise. And that's not priced in by the market right now. If you look at CPI fixing swaps, they're really not anticipating any particular reacceleration in CPI. So I think, again, that would catch a lot of the market unawares.

Erik: Thank you, that was an excellent, as you said, high level perspective. Let's zoom in now to the much more timely this week kind of data. We've got a couple of things going on a breakout, or I don't want to call it a breakout, a move above 105 on the dollar index. 105 has been an important technical level in this market so I see that as significant. But I think you also mentioned gold at some point in there. We see gold on Tuesday this week, as we're speaking, breaking down pretty decisively below its 200-day moving average on the continuation chart. It hasn't quite gotten down to the point of the lows we had back in June and July. But it's pretty darn close. Looks like it might be headed there. What are these things telling you and how do they play into this inflation story?

Simon: Well, I think the dollar is really being key here for a number of reasons. And this gets back again, to how you really look at the markets and how you really look at stuff on a data driven perspective. So that one of the best leading indicators for the dollar is the real yield curve. So there's a huge amount of focus, as I'm sure you're aware Erik, on the yield curve. And I remember looking at the yield curve back, you know, 5-10 years ago, around the last recession, the GFC recession. There really wasn't the same amount of focus on the nominal yield curve back then certainly as a recession scare. But now, every man and his dog talks about the yield curve. And the problem, of course, is that there's such a long variance between the time between when it inverts. And when you actually get recession, for it to be of much use.

What I think is hugely more useful, especially again, when we're in an elevated inflation environment, is the real yield curve. So I look at like 2s10s real, so deflate the two year by CPI and I just look at 10 year real versus the breakevens. And that has been, since the last 9 to 12 months has been heavily falling. And that really gave a lead on the decline in the dollar that we saw back on October. So basically, we saw the dollar decline from October to July and and over the last few months, last two months I guess, the dollar has began to rise again. So that trend is still really intact, that trend in the real yield curve. So I think on a medium term basis, I think the dollar primary trend is still going to be lower. And what that does, and what that has already done is that has supported excess liquidity. So I talked about excess liquidity earlier on, that's the difference between real money growth and economic growth. But a key part of it is, it's in dollar terms. So you look at it for the G10, so you look at the G10 money growth, and you put everything in dollars. So when the dollar weakens, that gives a boost to excess liquidity. So that's one of the reasons why excess liquidity began to rise along with the fall of inflation and, you know, the stopping and the falling in money growth.

So, that then, points to excess liquidity remaining supported perhaps into, you know, late this year into early next year, which debtors parable should keep risk assets supported. When it comes to gold, gold’s kind of been interesting, I think in some sense, it could have already fallen a lot more than it would normally, given the rise in real yields that we've had. So I wonder if that's some sort of catch up that we're seeing. But overall, again, in this sort of environment and in an elevated inflation environment, especially in an environment where the stock-bond correlation is positive. and I was looking at this just the other day there, Gold is generally in a very good spot, gold tends to perform well in these environments. So unfortunately, it has the high volatility attached to it. And you know, as I say, right now, it's selling off and it's feeling some of the heat but again, it happened in the GFC. It was painful to hold, right? Sometimes when you need something like gold to perform, it doesn't quite do what you want to do. But if you are a longer term holder, and I think it is something that will ultimately do what it's supposed to do, which is not only be an inflation hedge, which is kind of only part of it, I think that's overly simplistic when it comes to gold. But really an insurance just against any financial upheaval. I think ultimately, that's what one of the gold's best attributes, so people can hold onto it over the longer term. I think it will ultimately do what it's supposed to do.

Erik: Simon, I couldn't agree with you more. And I think your views on secular inflation are extremely consistent with my own. But our job as investors is to consider the possibility that we might be wrong. So when I think about someone like Alex Gurevich telling our listeners, he sees a nearly opposite scenario where he thinks that we're headed toward deeply negative interest rates. And you know, really heavy, heavy, heavy deflationary recession. If not depression is what Alex sees on the horizon. Let's imagine that you're a listener who listened to Alex's interview, listened to this interview, really thinks both you and Alex are both smart guys. And the guy wants to design his portfolio, so that it's hedged to succeed if either you're right, or Alex's right. I don't know how to design that portfolio. Is it possible? Is there a way to get this secular inflation call wrong and still be successful in the market?

Simon: I think it's a very good question. And by that, I mean it is also a very tricky question, because, you know, I've thought a huge amount about inflation. And you know, whether you're wrong, I think the key thing to say is, if you get inflation correct, I think a lot of other things fall into place. You know, in the environment leading up to when inflation began to become elevated in 2020-21, we didn't have to really think about inflation, right? It was kind of like it was the so-called nice decades that non-inflationary continuous expansion. And all, as I mentioned before, kind of rules of thumb that people kind of relied upon, like stocks and bonds being negatively correlated. Financial assets being basically the only game in town, taking on leverage didn't really matter to some extent, how much leverage you took on because rates were going to remain low. You know, all these things didn't matter when inflation was kind of low and stable. But now it's not, it really is a huge game changer. So if you get inflation right, you're probably going to get a lot of other things right. But I think it's such a huge bifurcation, in terms of the decision tree, whether you get high inflation or decision tree, whether you get very low inflation, it's difficult to conceive of something that's going to work in both of these extremely different worlds, if not universes. So the usual thing would be, if you are going for, say, an inflation hedge, find something that if you're wrong, obviously, you want stuff that's highly convex, and things that have very low negative carry, that you can hold on. Now, I've not looked at this recently, but I remember going into this inflation back in 2020 time, one thing I was looking at was paying long dated pair swaptions. And the beauty of that trade, if you thought was going to be inflation, you know, rates were super low, the curve was very kind of flat, rate volatility was also low, and the cost of putting that position on, because everything was kind of flat was tiny. So even if you're wrong, your bleed was minimal.

So I would suspect that you're not going to find trades that you are right in both scenarios. You're going to have to find trades that are extremely convex and cheap to hold on even if you're wrong. I've looked, given my view, I look more closely at inflationary ones, but I'm sure you'll be able to find ones that would also work in a deflationary world. I will say one thing though, I think it's not really factored in and appreciated. I think people are still playing off the the old recession playbook, which is, you sell stocks and you buy bonds. Really, that's unlikely to work in an elevated inflation backdrop. So obviously, if we get a deflationary thing, yes bonds will rally quite hard. But even if you know, I think in a normal recession, we don't get any extreme inflation or deflation, I still think people will rush to buy bonds. But that might be the wrong thing to do. Because in an environment where you have Phillips curves that are nonlinear and unstable, which is what you get when inflation is elevated, and you don't have the same relationship with unemployment and inflation that led to bonds, has been a very good recession hedge. So instead, what happens this time is we get a growth shock that comes with inflation, and you can get stocks and bonds selling off together. So I think there's lots of trades that people are expecting or investment rules of thumb, people are expecting they're going to be as normal, but I just don't think that they are correctly priced in. And partly through recency bias, but also partly I imagine as well through institutional constraints, because if you can't really hold any financial assets, I mean, there's not really much left. I mean, they're such a huge part of the investment landscape. Last time I looked, I'm sure it's roughly 90% financial assets and 10% commodities when it comes to market traded stuff. So you really don't really have anywhere to

go so I don't know where that's going to lead but I just don't think this market is even remotely prepared for inflation that's going to re-accelerate and remain for a long time.

Erik: Simon, another theme that I've heard from some of our expert guests is that we should be watching for a credit event. People have said, if you want to know where the shoe is going to drop on the next big leg down in the bear market, it's going to be after some kind of credit event hits the tape. Is that what you're alluding to on page five?

Simon: Well, I think credit is something that's extremely interesting, because it's not really behaving in a way that it has done in normal cycles. So normally, again, if you are data driven, and you follow leading indicators, one of the best leading indicators of the last 20 years has been credit spreads, especially high yield credit spreads. But if you look at a number of indicators, tells me that the credit market is you know, the credit cycle is deteriorating. So, we've seen banks, for instance, are tightening lending standards, demand for loans are falling, charge off rates for loans are rising. And very interestingly, and I have that chart there, bankruptcies. So you can look at bankruptcy filings. So they tend to lead official chapter 11 bankruptcies. So Bloomberg amalgamates them, I think you'll look at companies that have gone into court filing for bankruptcy with liabilities of over $50 million. And normally, that these bankruptcy filings track credit spreads, high yield credit spreads. And you can see from that chart, that lately we just we just haven't had that. You've had this rise in bankruptcy filings but credit spreads haven't really reacted to that. And I think there's a number of reasons for this. I think one sort of relationship I'm sure many of your listeners familiar with is very high correlation between the VIX and high yield spreads, which is the chart on the left hand side. And that's for a number of reasons. Well, one reason really is just about the capital structure. So really, the equity is kind of the sliver of capital between assets and liabilities. So that when you get cash flows become stressed, the equity tends to have to bear the brunt of the stress that tends to be very volatile, and high yield is not far above equity in the capital structure. So you tend to see a very similar relationship between the two. But interestingly, there's an even more direct input here. And you know, VIX, low VIX, I think is one of the reasons why credit spreads are preternaturally looking low and not necessarily are, probably not at all reflective of what's really happening. And that said that the so called Merton distance to default model and that model basically people use to help model credit spreads. And if you assume the equities are perpetual call option on the solvency of a firm. And then you use Black Scholes essentially to back out the volatility of the asset, which is unobservable. But one of the inputs is the VIX, or something similar to it and because the VIX has been very low, and that VIX has been driven low by I would say two main reasons.

One, is implied correlations have been very low. And the reason for that is most likely due to, you know, the very narrowness of the rally that we've had this year, the AI driven rally this year so far, so called magnificent seven. And the second thing I would say, is probably a large part to do with option speculation. So I think gamma hedging has repressed volatility as well. And that's probably been exacerbated, to some extent by 0DTE options. So these things have driven the VIX lower and I think that's impacted into credit spreads. But therefore, I don't think they are a particularly good barometer now of what's actually happening. And I think that's been further

obscured by the private credit markets. So the private credit markets now is huge, you know, one and a half trillion dollars, things like leveraged loans and NAV loans and things like that. But because it's essentially off market, I think it's obscuring price discovery. So the normal kind of sequencing that you would get in terms of like loans going bad, and then in the market being generally aware of that, and that being reflected in credit spreads, I think that's been massively delayed and distorted. So really, credit spreads are probably not really telling us what's actually happening under the surface. And that would be another reason why you know, I mentioned earlier recessions can happen quite quickly. I think, in this cycle, all of a sudden, that we discover credit significantly worse, or say, we get a sudden rise in the VIX, and that feeds into credit spreads. You know, all of a sudden, things suddenly get very, very bad. And credit spreads themselves are probably one of the kind of the strongest vectors, if you like, between the real economy and between markets. So when credit spreads widen, they're very quick to generate one of these feedback loops. So that I think is as a risk goes for, say a recession, which I think is more likely right now to be mild. But if I had to say what a risk factor was that recession could be be more serious than that. That could be credit markets suddenly deteriorating to reflect the true underlying fundamentals.

Erik: Let's go a little deeper on your comments about stock-bond correlation, because one of the predictions that we discussed, I want to say, a couple of years ago on this show with several different guests, was this idea that there was so much of institutional finance tied up in risk parity trades. That a lot of people were predicting, look, if you got a forced unwind of risk parity, where you had a breakdown in stock-bond correlation that started selling off both assets at once, because people were de-levering risk parity portfolios, that could potentially start kind of an avalanche effect, where once it gets going, it can't be stopped. It seems like the prediction of the stock-bond correlation, you know, switching into positive has already happened, which people were predicting back then. The prediction was, if that happened, it could just start this avalanche, which it goes totally out of control, and nothing can be done to stop it. And you know, the markets crash. Is that still a risk? I don't follow, you know, how much exposure there was on risk parity trades institutionally two years ago versus today? Is there still as much risk as there used to be and what could happen if this stock-bond correlation continues to stay positive?

Simon: Well, I think the risks, certainly risk parity and all the things you mentioned, it's certainly a possibility. But when I last looked, I think risk parity is something like $120 billion strategies under management, you know, that's probably dwarfed by the more traditional 60/40 portfolio construction. I imagine that we're talking hundreds of billions, if not trillions, are multi-asset portfolios with roughly the sort of ratios and I think they're all risk parity, and the whole kind of 60/40 construct really starts to come unstuck when you have the stock-bond correlation, moving positive. And again, this is one of these things, I just don't think the markets really caught up yet again, either through recency bias, or just through institutional restraints. I mean, not really sure what you're supposed to do other than, you know, pile everything into cash. And obviously, that's most likely not feasible for a lot of managers. So now that you've got this positive stock bond correlation. Of course, the reason why bonds have been so attractive over the last 15-20 years to so many investors, and that's what's driven the term premium or one large part of it. So

quantitative easing has also been part of it but driven term premium to lows, they've been very sought after, you know, they're a portfolio hedge. So they're damping returns, so you get better risk adjusted returns, but without really impacting the total return, compared to equities that much. And there was a recession hedge as well. And already alluded to the fact that, you know, that only works when you have a linear sort of normal, stable Phillips curve. And we just don't live in that world anymore. So you know, this stock-bond ratio, being positive will lead a lot of people eventually, I think, when they realize it's not an aberration. It's something that's here to stay. And the reason by the way, why you tend to get stocks and bonds moving together, we saw in the 70s, as well as it's driven by inflation expectations. So inflation essentially is just starts to drive everything and stocks and bonds start to move together. So you know, I think when people realize that it's not an aberration, it's something that's going to be here for some time, it's obviously we're going to have, people are going to have to start to make decisions on why hold bonds if the two reasons why you originally held them don't really make any sense anymore. And then what do you do?

Erik: Simon, let's imagine what you just said happens, which is, there's a realization in markets, maybe somebody famous says something publicly that hey, you know, look folks, we've got correlations that are positive between stocks and bonds, it's here to stay, it's a new secular change. And there's a realization that oh okay, this hedging function that we're used to for, I don't know how many decades, it's been that everybody has used that hedging function, but it suddenly isn't working. Does that potentially have the risk of creating a self reinforcing vicious cycle of selling, selling begets more selling, and you basically have a crash of bond markets as a result of the market realizing, hey wait, bonds, as you just said, don't serve the function that they used to serve, maybe we don't need them anymore. If everybody doesn't need them and sells them, boy, who's going to finance the government?

Simon: I don't think you get that kind of, you know, worst case scenario, certainly not anywhere in the near future. But I think people will be looking at their portfolios. Like, what's the point in holding on to this asset that you know, as I said earlier, it's not doing what it's supposed to do. So, then you go, what are your alternatives? So you go look at corporate debt. But the problem there of course is the corporate bond markets are kind of dwarfed by the Treasury market. So you know, you can't have everybody really, try to replace their treasury with corporate bonds. Then you might look at things like commodities or gold. And actually, if you look at them, they actually do improve the risk adjusted returns and positive correlate environments, stock-bond environments. That again, you've got the same problem and you can, you know, you're a manager there with hundreds of billions under management, you cannot go into commodities, you can't go into gold, things like that. So they're not really viable. And cash isn't an option either. Cash right now is very attractive, over 5%. But you've got rollover risk, and you have to justify fees, you can't really just pile your money into three month t-bills. It is kind of like a cul de sac. And I am wondering whether people just think, why don't I just buy more equities, because I need higher returns. Obviously, in a positive stock-bond environment as I mentioned before, you have a higher cash, you tend to have higher cash rates. So you've got a higher bar to begin with anyway. And you might conclude and given your constraints, in terms of liquidity, in terms of where you are with risk adjusted returns and also, you're not getting any

benefit from owning bonds anymore like you did, you might just decide to up your equity proportion. And that might make sense again from an individual sense. But does that really make sense or is that good for the market as a whole? I mean, I don't think so, you know, you have much higher concentration risk. But if you've got no viable hedge, no real alternative that's really ticking all the boxes, then it might be something that happens, you just have this environment where people are kind of going back to TINA (There Is No Alternative) essentially, but TINA with a vengeance. And people just think, there's nothing else they can do apart from buying more equity. So I don't think you get the crash in that way. I don't think it happens overnight. But I do think that the penny will have to eventually drop and people will have to re-examine how their portfolios work. If we are right that is, of course, that we are in an elevated inflation regime.

Erik: Simon, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners because they're used to thinking of you as a Variant Perception guy. You're now Bloomberg Markets live Macro Strategist. What exactly does that mean? I think you write a blog. Where can people find that and tell us more about how they can follow your work?

Simon: Yeah sure, so the Markets Live, it’s not just the blog I write. So we have a whole group of people at Bloomberg that are around the world. So it's a blog that people write about, very markets focused, and it's 24 hours a day, you know, all through the week. And on top of that, I also have a column that's twice a week called Macro Scope. And there, I cover a lot of the same stuff that I will cover in the blog. It's a very kind of stand back, try and see the wood for the trees, broad kind of macro outlook.

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