



Mike Green: Volatility, high-yield, precious metals & more.

Erik Townsend

Joining me now is Mike Green, simplify asset management's chief strategist, Mike, it's great to get you back on the show. Let's just dive right into this market. Last week, the sky was falling, the world was ending. Everybody was sure that the market was going to crash. This week, government shutdown seems to have been averted. Everybody's saying it's new. All time highs around the corner. I kind of have a feeling that you're going to say that the story is a little deeper than that. What's really going on here? What should we expect? How should we interpret this market?

Mike

Well, I think the thing that you know I'm going to talk about is ultimately the most important factor that exists in the market. It's just the mindless bid that continues to come from 401, K contributions, IRA contributions, money flowing into ETFs, mutual funds, etc. You know that money largely flows into the broad indices, the total market index, or the S and P 500, is really the single biggest beneficiary of this, and powers equities higher in a framework that is driven largely by momentum, but actually has some interesting characteristics, slightly different than pure momentum. It's what I'm calling the passive factor, and my math suggests, unfortunately, that that is now adding about 1300 base 12 to 1300 basis points a year in excess performance versus what you would expect under a mean reversion or a valuation dominated market. And so, you know, a lot of what we are seeing is, unfortunately, just a statement of how we invest, which is passively through broad indices into retirement accounts. We don't take that money out. That how we're investing is a big deal. And then the fact that so many people are investing under a government sponsored enterprise is driving the price of financial assets higher regardless of what the Federal Reserve does, regardless of the money printer goes, Burr, et cetera. Those can have real market impacts, but they're not the primary feature that's behind all of this.

Erik Townsend

Okay, I definitely agree with your characterization, but you know, it begs the question, as much as there's plenty of reason for concern longer term, is there any reason to think that this phenomenon of momentum that you're describing is ending or has ended, or that we should expect anything other than a continued melt

Mike

up? There have been a couple of things that have been concerning, right? So one of the ways that you can tell a game is about to change, or is changing is when quote, unquote, everybody figures out the rules to the game and starts playing to what they think is happening, right? And so we saw a huge amount of retail surge into very speculative stocks. We saw chasing after short, covering, etc. In this last move, there are components of that that that will exhaust itself, right? There's been some really interesting analysis on the returns of funds that are invested in Robin Hood type accounts, etc. The losses just appear to be rising. Unfortunately, it appears that, in aggregate, many of the investment choices that people are making will eventually exhaust their capital. And so some of that discretionary is very much certain, you know, has very much elements of a short term sentiment driven bubble that was created by and large from the taco type phenomenon. And, oh, this isn't that big of a deal. And blah, blah, blah, all that has a risk of running out the other effects. And this is really one of these things that, you know, I just I probably am the most annoying person on earth in this respect, because every

time we hear this narrative of, oh, this is now going to change the setting, right? Whether it was interest rates going higher in 2022 or the loss of American exceptionalism in March of 2023 we heal. Keep building these narratives that occasionally drive discretionary flows, or we're going to buy Europe, we're going to buy small caps, we're going to buy Japan, etc. At the end of the day, the structural features in the United States and increasingly around the world are largely about directing flows of retirement assets, which are copious, into the s, p5, 100. And you know, seeing that stop is going to be really hard. And then the second component of it is the mechanics of how we invest this passive factor has a concentrating factor built into it that creates a feedback loop that causes the market to get narrower and narrower. Many people are reporting this as an anomalous outperformance by the size factor. That's not what my research suggests. My research suggests that these are really the stocks that are most positively affected by the passive bid. There is a strong overlap with the size factor, meaning the largest stocks outperform. But it's not quite right. It's not quite what is actually driving this. And you know, until we change policy, or until there is a significant enough macroeconomic change to change the direction of flows, it's just really hard to see where this stops.

Erik Townsend

Mike, the volatility that we're seeing in the stock market, frankly, doesn't surprise me, because we've got a very politically contentious environment. There's lots of headlines in different directions. It makes sense. But when I see bond volatility spiking up, that kind of alarms me more, because I know that bonds are not really traded by retail investors, at least not actively. What's going on with bond volatility recently, and is it a signal that we need to be concerned about?

Mike

Well, I think you have to separate bond volatility. So there's a traditional bond volatility, the move index, which actually is created by my partner, Harley Bassman, which is similar to the VIX, it measures interest rate volatility as priced in options markets one month out, that actually is quite depressed, right? So a lot of the speculation or fears of interest rates losing control, that there is going to be a surge above 6% then 7% 8% there's really no evidence that that is currently priced into the markets. The narrative that the US was going to encounter fiscal dominance, and, you know, an immediate loss of credibility in the treasury market really disappeared fairly quickly on the flip side of that equation, when you talk about bond volatility, I also include the corporate bond sector, and there we're actually starting to see a little bit of concern pop up the credit default spreads and the spreads in investment grade have begun to deteriorate, largely because of the weakening balance sheets and operating outlook for many of the large technology companies, companies like meta, for example, have gone from a \$70 billion net positive cash balance to my rough estimate is today, they're about 30 to \$40 billion in net debt. So that's a remarkable deterioration in the strength in their balance sheet over the past couple of years, with very little evidence that the investments that they've made along that path have secured them any unique source of incremental revenues or profits. And so the bond markets and investment grade and high yield are showing a little bit more concern than the risk free markets are.

Erik Townsend

Mike, can you expand that description to include high yield bonds. Because frankly, this is a market that I thought should have crashed a long time ago, but it hasn't. So obviously I don't understand

Mike

it well. I'm not sure that you don't understand it, because my models would certainly suggest credit spreads should be a lot wider than they are right now, I build models on macroeconomic factors that exclude things like corporate bankruptcies, but even there, in the corporate bankruptcy space, we're starting to see much higher levels of corporate bankruptcy than we've seen historically, and it does suggest that credit distress does exist. Now the challenge in high yield, particularly in public market,

high yield, is as a fund, right? I run a high yield fund, I typically will receive between 20 and 25% of the cash of the assets of that fund back in cash in any given year. That's a combination of maturities which run on average at about five years. So at 20% of my cash is coming back from maturing bonds, and somewhere between seven and 8% is typically coming from the coupons associated with those bonds themselves. There's a little bit that will be lost to default in that process. I have to reinvest that into high yield. And when you have a high interest rate environment, like you currently have, the incremental production, or incremental sourcing of new high yield paper is depressed, so I have more paper that's maturing and coupons than I have paper to invest in. That forces me to buy secondary market bonds, that, in turn, drives their prices to higher levels and yields and spreads to relatively low levels. We know what's happening in the high yield space, right? It's priced at historically very, very tight spreads. That's particularly true if we compare it to areas like private credit, where we're starting to see loan spreads widen significantly. It's remarkably true if we consider it against things like business development corporations, which historically have very closely tracked high yield because they're effectively a private credit metric, those have diverged to a level that we've really never seen before. So I don't think it's that you don't understand high yield. I think it's just that there are mechanical market structure components that are currently driving high yield spreads to very tight levels, albeit wider than they have been recently. There's increased concern, as I mentioned, in the investment grade space of what's called fallen angels, which is a way of introducing supply into the high yield space without issuing new paper. That's simply investment grade companies that are downgraded and pushed into the high yield index. That requires me to sell other paper in order to buy that new paper in proportion to the index. If I'm an index investor, and can cause credit spreads to widen quite significantly. We saw this in 2005 for example, when Ford, or in general, motors were downgraded in the auto industry. Those concerns are growing. We're not yet there. But you know some leading indicators, or leading candidates for that would include firms like Oracle, for example. Ali, which could very much find itself in a distressed credit environment, and that very much belies the idea that they're going to be spending astronomical sums building out data centers to meet the objectives of some of their partners, but that high yield space is wider, but nowhere near as wide as I think it should be, primarily because of the lack of secondary supply right now.

Erik Townsend

Let me spin the question a different way, because at least in my own trading, you know, I've got a certain amount of risk capital that's deployed in risk assets, then I've got a bunch of T bills. And frankly, you know, T bills don't really resonate for me as a private investor. I don't need the liquidity of being able to, you know, cash in a billion dollars and not move the needle. It would make much more sense to get the higher yield of AAA corporates, except AAA corporates don't really yield much higher. Okay, what do I do to get more yield out of fixed income? You know, cash equivalent, safety money in my in my portfolio? Well, I go to fill in the blank. Help me out here because I don't know what to do other than T bills, because nothing that is short of high yield, which I'm very concerned for the reasons we just discussed, is carries a lot of embedded risk. I don't see where the moderate increase in risk or small increase in risk gets me any better than T bill yields anywhere in the fixed income market, and that doesn't make sense to me.

Mike

Well, I don't entirely disagree with you, right? Part of what you're describing is the relative flatness of the curve, so you're being paid well in T bills, there is reinvestment risk associated with the T bills. If interest rates, if you know, concerns about economic growth, turn out to be larger than the Fed, will cut interest rates, and you will be reinvesting the proceeds of those T bills into less attractive T bill yields, whereas if you bought a fixed income bond a longer duration, for example, theoretically, you've locked in that reinvestment for an extended period of time, you could see price appreciation as a result of that. I don't entirely disagree with you that high yield, given spreads is relatively, relatively unattractive if the economic conditions that we're concerned about lead to default performance, and I think there is key

risk associated with that. Now, the way I address that is by running a proprietary hedging process designed to isolate the impact of credit spreads. We've been very fortunate that it's worked really well and has allowed us to insulate against credit spread widenings, like happened in February March, for example. But without that, I would not be particularly interested in high yield. To answer your question, what other people are doing, though, and this is again, part of the story that's playing out in high yield and investment grade and in other areas is that searching for yield has led people to engage in strategies like covered call writing. There's an explosive growth of ETFs that are involved in various forms of covered call writing. Some are more speculative and riskier than others. Oftentimes, they will carry optically very attractive yields. What's happening there is, is that you are doing the same thing, ironically, that we did prior to the global financial crisis. You're creating synthetic forms of corporate debt. And the important thing to remember about this is that you always wanted to find an instrument not by the title that it carries, right, not covered call equity funds or high yield bond funds, but instead of it, think about their payout profile, and so a high yield bond has an incremental upside return associated with either lower interest rates. That means that I get some capital appreciation or the coupon associated with providing capital to riskier credits. All right, so the quality of the company that I'm underwriting is lower than the highest quality companies. I'm taking that increased risk in exchange for a higher premium or interest rate associated with it, but the most I can make is kind of, you know, slightly better than par and that coupon in a high yield space, if things go badly, right, I start losing principle fairly quickly, and can end up getting wiped out in that high yield bond. Blackrock just saw this with private credit that they had on their books at par 100 just a month ago, and today it's valued at zero. That's the same structure as a covered call. In a covered call, you own the equity you have sold a call option against superior performance in exchange for a fixed income component portion to it. You know exactly what you're going to get. The premium that you sold it at. You are also exposed to all the downside, right? So really, what a covered call strategy is is just synthetically written corporate debt. Optically, many of those strategies offer really high returns right now, particularly if they're done against single speculative securities, because you're embedding that value of the call option that you're selling. And these have become very, very popular. Or products that people are using to enhance their yield. It's, you know, the knock I would give on high yield is that you are writing credits on slightly dodgy companies, but you're tend to do so at prices and at Capital attachment points. That means that they're reasonably well underwritten when you enter into a high yield contract, you typically will have covenants that enforce your rights as an investor. When you go to a covered call strategy, you've mimicked that payout. You're investing, typically in higher quality companies, because you'll often do it against the S, P or against the mega cap, but you have absolutely no rights, and your attachment point is much, much closer, right? So a 10% decline in equity, for example, can cause a meaningful drawdown in a covered call strategy that really shouldn't affect, particularly investment grade or, to a certain extent, high yield performance, because those strikes are typically written much lower in the capital structure. So I like the way people are dealing with it right now is they're taking a lot more risk. Unfortunately, I think much of it is misrepresented to people.

Erik Townsend

Mike, let's talk about energy next. Oil and gas prices were something that I think your very first sub stack we talked about, refresh us what your prediction was there? Why you had that perspective, and what your current outlook is for the oil and gas market?

Mike

I wrote a piece in which I was highlighting that the price of oil had actually risen in the aftermath of Russia's invasion of Ukraine to remarkably high levels, certainly relative to other commodity assets, in particular monetary commodity assets like gold. I called into question the thought process that people were employing, which was that economic growth, if China were to reopen, would lead to extraordinarily high prices in oil. My view is we already had extraordinarily high prices in oil, and if anything, we were likely to see demand destruction that ultimately would cause the production to

exceed the demand that forecast ended up being right now we're at a point where the price of many of those monetary commodity assets, like gold and silver have risen to extraordinary levels relative to other industrial and consumed commodities. I think this more accurately reflects both the eventual move away from fossil fuels, particularly in transportation, but it probably more than reflects that at this point. So we've moved from being very, very expensive to being very, very cheap. Sentiment has deteriorated. I'm actually pretty constructive on areas like oil and in particular, natural gas, which is probably the single most levered exposure to the data center build out and AI story that I can find.

Erik Townsend

Well, I definitely agree with you on natural gas and the AI connection. I also think a lot of people are missing that one. We've talked about it here on macro voices before. I want to go back to your comments. Though, you said oil and gas are particularly, you know, under priced compared to the monetary metals, gold and silver. Let's talk about what's actually driving the gold and silver rally. Because, you know, some people say it's all about central banks and not wanting to have their treasuries canceled. This happened to Russia. Other people say, No, it has nothing to do with that. It's all about China buying for completely different reasons. Then there's other people that say it's all geopolitical risk. What really is driving this unprecedented rise in the monetary metal prices? Well, I

Mike

guess I would lean into the camp that says it's more of B than A or C. Ultimately, what trans I think I got that order right. Ultimately, I think the math is very clear in terms of what happened to gold in the aftermath of the US taking Russia's reserves, it became very clear that treasuries were not a safe asset to hold your accumulated dollar reserves in and China began to diversify aggressively. With its extraordinary trade surplus, it began to buy significant quantities of gold, both domestically and on the international market. What was really interesting about this is, in the face of that, you saw continuous liquidation of the financial gold assets like GLD and to a lesser extent, GDX, the gold equity, ETFs, GDX, J etc, we actually saw a really interesting phenomenon where the buying for from China was largely offset by selling That was coming from the US domestic public retail investor. That stopped somewhere around 2024, and at that point you reversed it. As Americans began, American retail began buying gold. Exposure again. Now it was pitched as a devaluation, as a debasement trade that they were just going to print money. It's. Etc. We really don't have any evidence of that, you know, I wish, I wish it was that simple, but it really is just a function of the American retail investor stopped selling, while China and others continued buying. That, in turn, has caused prices to move in a very aggressive fashion. And now it becomes a question of you know, do the higher prices beget yet higher prices? Does it become a self fulfilling narrative in George Soros frame of reflexivity, or do we have we pushed this far enough that now Americans, through a combination of price appreciation and reallocation of portfolios, have as much gold exposure as they want? There's some indications that that's the case. There's also some indications that China's trade surplus is starting to deteriorate in a fairly meaningful way, which reduces the amount of funds that they have for buying gold. And so it looks like gold has at least hit a near term peak. You know, the one of the reasons I think that the selling was actually occurring was because people were diversifying away from gold into things like Bitcoin. I have a very strong negative view towards Bitcoin. I think ultimately much of that will be reversed. But again, I wrote in my substack about this that if you X out that buying of Bitcoin, my calculation suggests that gold could be as high as 10,000 right now. So this has very much been financial buying, first by central banks that recognize they couldn't hold treasuries. Secondly, by retail chasing it, and we're still not really seeing the anti Bitcoin trade. There remain positive flows into the Bitcoin ETFs, which is a competitive asset to gold.

Erik Townsend

Let's talk a little bit more about China and where their relationship with the US and China is headed.

Mike

Well, I mean, this is a tricky one, because candidly, first we need to know what we're actually trying to accomplish in the United States. I think it's become very, very clear that the United States relationship with China is curated. We've moved to a position in which the two ostensible trading partners have increasingly become geopolitical rivals. My general sense is that China, that this should have been apparent to people as early as 2015 really, the emergence of xi as a compromise candidate between the two primary parties in China, and his subsequent purging of those parties to gain control really set the stage for a meaningful change in China's tone with the rest of the world, this century of humiliation and overcoming it became really operative. And in my opinion, they candidly played their hand a little bit too hard and too fast, making the United States increasingly aware of it, and putting us in a position to start making some of the hard choices about separating away from China. There's an arrogance on both parties. The United States, thinks it's going to be relatively easy to do this, or at least that's that's the way it's presented. I think in part, because it has to be China, I think views itself as having competitive advantages that are going to be largely insurmountable, and I don't think that's true, right? There was really interesting piece. The suit that was filed against the Trump tariffs was by a company called learning solutions, which highlighted that they sourced roughly 2500 products from China. Replacing each one and moving it to a different location would cost them somewhere in the neighborhood of \$6,000 per product. That works out to about 15,000 \$15 million of expenses. They had budgeted \$5 million for tariffs, and when the elevated tariffs, which are no longer in place, went through, you know, they did the calculation that they could owe up to \$100 million in tariffs. So in classic American fashion, rather than getting busy and dealing with the \$15 million worth of expenses that would be required for diversifying away from China, they chose to file a lawsuit against the government trying to claim that they were being forced to spend \$100 million that I think defines almost the relationship between the two, right? It is, it is going to be hard and it is going to be painful, but at the end of the day, it's a heck of a lot less than the tariffs. And so the real risk that you run in the United States right now is the tariff policy, which I would never choose in a perfect world, right? If we had true free trade, if there was not subsidy and monetary currency manipulation coming from China, which should have allowed its currency to appreciate to the point that its consumers became large global consumers. Instead, they chose to focus on enhancing the power of the CCP, repressing wages domestically by keeping their currency from appreciating and now they've crossed the point where the supply of workers is beginning to fall. That's caused them to become increasingly automated, and now they're stuck with extraordinary surplus production that they basically have to dump onto the rest of the world. The rest of the world doesn't want it, right? We love getting the little trinkets. We love getting. Little toys, etc. We love getting, you know, flat panel TVs, but we love jobs more. And at the end of the day, the Americans are way too munificent about the idea of free trade or unfettered access to the US markets. Europeans are much less open to it. Japanese are much less open to it. Koreans are much less open to it. Africa and South America, in many ways, are much less open to it. And so by forcing the Chinese to send product that would have historically come to the United States into those markets, the world is rapidly imposing trade barriers of its own on China, and that suggests to me that China is in a very precarious position. I

Erik Townsend

want to go back to your comments on Bitcoin. I agree with many of the sentiments that you expressed, but at a place I'm going to start that over again, guys, Mike, I want to go back to what you said about Bitcoin, because although I do share some of your, I guess skeptical concerns about Bitcoin itself, I find that the the recently promoted view that US dollar stable coins are going to be used, really, as a way of propping up the the dollar dominant global monetary system seems very credible to me. It seems like that's a way to essentially get the US dollar into the digital age without having to create a digital dollar that's actually, you know, a tokenized currency. What do you think about that genius act? Stable coin

view that it potentially kind of replaces the petrodollar system and allows a continued preference, or a continued artificial demand for US Treasury paper.

Mike

I mean, ultimately, every dollar that is released is, to a certain extent, backed by that already, right? So in order to get the dollars out, the US government is issuing paper that's going to be held by someone, all you're identifying is, let's actually make this a continuing requirement in which stable coin funds will offer people the electronic or digital equivalent of a US dollar. It can be spent, it can be used. It does not earn interest, which I think is actually a critical flaw in this system. Nor does it treat domestic versus International in any meaningfully different way. And so, like, I kind of buy into it a little bit. I do think that it's important and that it will ultimately drive further adoption of the US dollar in regions of the world that do not have stable currencies. I'm just not sure how that's positive for Bitcoin, right? The whole argument behind bitcoin as a, you know, a social good was that it provided access to a currency that could be used in foreign countries that didn't have stable systems. If, if we replace that with a stable coin, you know, not that it ever really amounted to much in Bitcoin, but that seems to undermine one of the key features that was lauded for

Erik Townsend

Bitcoin, Mike, I can't thank you enough for another terrific interview. But before we close, I want to talk a little bit about what you do at simplify Asset Management as I understand it, there were basically some regulatory changes that allow you guys to have what are effectively ETF or mutual fund like instruments that do fancy tricks that used to be only hedge funds were allowed to do. Tell us a little bit more about what the regulatory change was, and what are the products that you guys are offering as a result of that change.

Mike

Well, there are two critical regulatory changes that caused me to transition from the world of hedge funds into the world of ETFs 2019, there was what was called the ETF rule. These are all very creatively named. The ETF rule facilitated and made easier the process of applying for a traditional ETF, particularly an active ETF, historically, that was a very long process. There was a lot of concerns about transparency, and it was very difficult to launch an ETF, which is part of the reason that you saw only the large sponsors releasing ETFs, and typically only in the form of like an S p5 100, for example. That rule opened up the floodgates to active and smaller ETFs, like many of the products we offer at simplify, the second key change came in September of 2020, it's what's called the derivative rule. And unsurprisingly, the derivative rule allows you to include derivatives inside mutual funds and ETFs in particular. What it does is establish effectively, risk metrics around it, so you declare a benchmark that you're held against, you are then allowed flexibility using derivatives to have up to two times the volatility of that index. This has contributed, on one side, to the proliferation of things like 2x levered funds, or even 3x levered funds, which can then turn around and point to a 2x levered fund as their benchmark. It has also facilitated the inclusion. Version of derivative strategies like I use in my high yield product, for example, that are designed to take advantage of certain features in market structure. A really simple example of that is many high yield mutual funds and credit funds broadly, will short the hyg ETF to reduce their market exposure and allow them to amplify their single security picks that, in turn, actually places pressure on the balance sheets of dealers, firms like Goldman, Sachs, Morgan, Stanley et cetera, who have taken that high yield exposure onto their balance sheet and in a post Volker world, have to carry much higher capital against that they're willing to pay me a portion of that excess return that they get in the form of securities lending for taking that risk back off of their balance sheet and what's called a total return swap. So that allows me, at the base of my product, to effectively receive hyg Plus, typically, between 50 and 200 basis points. The nice part is that additional return almost inevitably flows during periods of market stress, and so it allows me to partially outperform in

down periods, because I'm earning a higher return on assets. The second thing that it allows me to do is include things like my proprietary hedging frameworks, where I use an equity Long, short overlay that is designed to mimic credit spreads, but to do so with a positive carry associated with it that allows me to mitigate the impact of a significant credit spread widening that couldn't have been done prior to 2020, and so we've been very fortunate. The rules have changed, but I just want to emphasize like I'm using it for a little bit of return enhancement and a lot of risk reduction. Most of the strategies that are out there have actually chosen just to embrace the the increased risk and pursuit of higher return.

Erik Townsend

And for investors who want to learn more about the various products that you're managing, what's the website or who do they call?

Mike

So the best place to go to find out more about simplify is www.simplify.us. I emphasize the.us there we have the full list of products. We have deep dive explainers on the various exposures that we have, and they're tuned to deliver everything, ranging from fixed income exposures to more speculative equity exposures, if that's really what you're looking for, as well as ways to thoughtfully create income from equity type assets. I would encourage people to check out, in particular the product CDX that I was describing. We've recently launched a product in the private credit space. PCR is the ticker there that employs similar tools to what we're doing within CDX. We have five star CTA managed futures fund run by our partners at Altus, Charlie Magara, who I believe you've had on the show. These are all tools that are really excellent in building a portfolio, as compared to simply deciding that you want to knock the cover off the ball with one particular investment. And I encourage people to check that out. If you're interested in my thoughts, you can follow me on Twitter. I'm at prof Plum 90 9p. R, O, F, P, I, u, M. 99 never anticipated having a presence in social media. It's a confusing account, but a lot of people find value in it, and then, as we've talked about repeatedly, I write on my sub stack. It is, yes, I give a fig.com. Very reasonably priced. The objective is not to make money off of it as much as to make sure that the people that are reading it value what they're reading. So if you are interested in it and you do not want to pay but you do want to read, feel free to reach out over a sub stack, and I'm happy to comp you exposure.

Erik Townsend

Patrick, Surena and I will be back as macro voices continues right here at [macro voices.com](http://macrovoices.com).