

Erik: Joining me now is [Simplify Asset Management's](#) Chief Strategist and Portfolio Manager, Mike Green. Mike prepared a slide deck which only contains one slide, so I guess it's not a slide deck, it's just a slide. But boy, it is a doozy. You're really gonna wanna see this chart, so I strongly encourage you to download that to accompany this interview.

Mike, it's great to get you back on the show. I've gotta ask you, because you've always been a voice of reason in my investing life I feel like I did at the end of January, beginning of February of 2020. I thought there was just information so obvious that the market had to discount it, and it wasn't.

And I felt wait a minute. Usually, when you're the only guy who sees it, it means you're wrong. But boy, I was so convinced, and I'm convinced now. I don't think that the market gets it, that we've got a really big problem with energy flows, and it seems like, it's just another reason to rally the market.

S&P all-time highs. I don't get it. Help me.

Mike: The good news is that rising energy prices increases earnings for the energy companies which have been powering the S&P. I'm totally joking when I say this. No, look, you already know what my answer is going to be. Unless the news meaningfully impacts employment, and therefore contributions coming from 401Ks or other equivalent strategies, I don't see any reason why the marginal pricing behavior for the S&P should change.

We have the mindless bid coming from the passive robot where money is flowing into 401Ks on a continuous basis and into retirement accounts. Nobody called Vanguard and said, "Change your allocation schema." Nobody called BlackRock and said, "Your model portfolios need to change." And as a result, they don't.

And so when you get a drawdown, as we had from the February 27th until basically the early April lows, that triggers multiple forms of rebalancing. The most important of those in terms of its initial implementation is gonna be a target date fund which uses a threshold level for rebalancing out of bonds and into equities.

Every time you see that anomalous behavior where equity markets are rising and bonds are simultaneously selling off aggressively, we'll hear all sorts of narratives about, the end of bonds, Etc. But the simple reality is that's just a portfolio that has allocations between bonds and equities that is rebalancing itself at a massive scale.

And unfortunately, that's what I think we saw. And I don't see any reason for it to change until unemployment begins to rise significantly, retirements begin to increase significantly, and that bid coming from the passive robot comes to an end or turns negative unfortunately, that o- that sounds like I'm bearish because I keep saying the markets are irrational.

What I'm reminding people is the Keynesian the Keynesian statement, "The markets can remain irrational," quote unquote, "far longer than you can remain solvent." We saw that play out fiercely in April, where hedge funds decided that they wanted to hold their favored names and instead increase their shorts.

And when markets reversed, we had an unbelievable amount of short covering. We saw fast-moving strategies like CTAs and to a certain extent, vol control strategies rapidly scale up their exposures. Risk parity had some leveraging up, Etc. So basically everything hit all at once. That's the chart that I shared with the listeners, showing that we had a record one-month flow into equity markets, and surprise, we had a record one-month performance in equity markets.

It had nothing to do with any thoughtful application. It had everything to do with positioning and with a mechanical bid.

Erik: Let's talk then about what would happen next, because I suppose with the COVID pandemic, there was a brief little emotional freak out, but then the market looked completely through it, and we saw, as a result of a lot of money printing, a rally to fresh all-time highs right in the middle of the pandemic.

Are we headed into a situation where we do have a major economic dislocation? Things are shutting down all over the world because of an energy dislocation, which I think at least in some parts of the world, as far as I'm concerned, has to be inevitable at this point. Does that just mean that it's time to celebrate and rally to even higher highs on the S&P?

Because as Louis Gave said last week, it's probably gonna be other countries that feel the massive human suffering as a result of this, and not so much the bigger developed economies. Does that just mean S&P keeps going up from here?

Mike: The painful reality is that as passive continues to gain share and it owns more and more of the market will behave more and more like a low float stock because Vanguard or BlackRock are not going to change their positioning unless they receive a sell order.

And so the simple, the simple math is this gets crazier and crazier. And y- I have to confess, like when I made that forecast, it was with some pr- trepidation because there's always periods of craziness in markets. It's hard to imagine an environment much more crazy than late twenty twenty-one, when people were receiving significant stimulus payments.

But even more importantly in that time period, they were getting their paycheck and they were staying at home and they weren't incurring all of the costs that I've identified in things like, my poverty line analysis like childcare and transport to work and fancy clothes that you have to wear to work, etc.

We all wandered around in our pajamas and decided to buy stocks with our spare time. The difference is this time we haven't seen the stimulus. What we're seeing is an increase in costs, and consumer balance sheets are significantly weaker, than they were in the '21, '22 time period when we suspended debt payments, etc.

But within the moneyed class, those who effectively have money and have the capacity to spend it we're not seeing much of a disruption, and I don't think we really will until the Fed ultimately begins cutting interest rates and reducing that income transfer to that, to that cohort.

it's a v- it's a very strange place to be, where cutting interest rates could actually be contractionary, because of the, the give or take ten trillion dollars in short-term instruments that are linking their payments to the Federal Reserve's policy that's created an extraordinary pulse of income that is really fiscal policy, but not identified as such.

Erik: Let's take a look at the sole chart in your chart deck, which is really staggering for me to look at given the news flow backdrop upon which it happened. Listeners, again, you'll find the download link in your Research Roundup email. Mike, what you're showing here is basically the biggest inflow ever in history, and you told me off the air, even though this chart only goes back to twenty sixteen, you said there is no prior example of a bigger inflow any time in U.S.

history ever into the S&P five hundred other than the one that's happened in the last month or so on the back of news that we've got a massive global energy dislocation, which hasn't quite hit the tape yet, but we know it's coming because we've used up that six-week lag of delivery times. We're burning into all the buffers of of s- spare oil that was sitting around in storage.

We're about to run out of diesel fuel and jet fuel globally and have a massive crisis on our hands, and that's been I don't wanna say the cause, but that has been coincident with the biggest inflow into the stock market in recorded history. Explain. It does sound crazy,

Mike: doesn't it? It does. Pa- part of what I would emphasize on this chart is if you look through the discretionary portions here, we're really not capturing anything that is happening other than systematic flows.

And so I just wanna caveat that, y- we do see flows into things like SPY, VOO, and IVV on a discretionary basis, where people ultimately decide everything is great, we should buy back in But ironically, that was among the smallest parts or smallest contributors to this. So this was really a mechanical bid that was caused by CTAs trend following strategies, basically having to rapidly reverse their move into a net sale.

They reversed that within a month at a pace that we have candidly never seen before. Vol control strategies. As volatility retreated and never really hit the realized levels that the implied volatility was pricing, we were emphasizing at Tier 1 Alpha, where I shared the chart from, that, we were behaving like a market that had already crashed.

People bid for protection, the discretionary bid was there, and it didn't materialize, and so they were forced to cover shorts. They were forced to cover their protection. That led to a collapse in the VIX. The VIX itself then becomes a profit center as people short the VIX, creating a synthetic long.

All of this has no real thought behind it, right? That's the frightening part of this, is that I don't think it's that people are looking at your analysis and saying, "It's wrong in principle." I think by and large they're saying the market is telling me it's wrong," right? And that means that it's wrong, at least in the short term, until it actually starts to hit the employment numbers, until it starts to actually hit the flows into the market.

But, the the machines did what the machines do.

Erik: Okay. Now, before the inflow happened I see what looks to be the fifth largest drawdown or outflow from markets. I assume that was the buildup to this current energy event that caused that. So you're saying the market correctly discounted what everybody knew was coming, then because it takes six weeks to two months for big ships full of crude oil to transit the entire planet the algorithms and the CTAs didn't really build in that lag effect.

So they're recovering and basically going to massive inflow into the market because the market has proven wrong the prediction that we're gonna have a big energy disruption, or at least that's what the algos think is going on, and that's the reason for this? Yeah. Is that

Mike: really it? With the exception of the thinking part, right?

They are just mechanically tuned, so a trend following strategy will take consideration of volume and volatility in establishing the trend. But most importantly, they ended up getting short, right? They did exactly what you would expect trend following strategies to do as we flattened out in 2025 and basically made no real progress for an extended period of time.

CTAs began to take down their positioning. As we sold off, they increased their net short positioning. And then as the market reversed rapidly, they were forced to cover that, and as it continued to power higher, driven by the inflows in 401Ks, 'cause once the discretionary trader has sold their shares remember the line from speculation or reminiscences of a stock operator, "I'll lose my position," is why he didn't want to sell in a drawdown because it was a bull market.

CTAs are very similar. Hedge funds are very similar. Cover the position and ask questions later. You can construct a narrative at any point in time, and candidly, I think that's what we've by and large done.

Erik: Okay, what happens next?

Mike: The way we're looking at it i-is that ultimately those systematic strategies have now returned to basically a fully invested position, and so the market has lost that ammunition.

The 401K flows have shifted strongly in favor of equities. We're now actually potentially looking at a rebalance back towards bonds which have suffered under this environment as you're well aware. Although, for all the hoopla about the directional move in rates, we really haven't gone anywhere there for an extended period of time as well.

And so we're starting to see the inflows into fixed income return but they're not returning at a pace that is yet large enough, and this is particularly true at the back end of the curve. They're not returning at a pace that is large enough to offset the net issuance or lack of demand for that product, particularly as people are moving away from sixty forty type strategies and increasingly embracing

things like trend following, which has actually done quite well in its recovery off of off of the, kinda April sell-off.

The quick answer is that my expectation is that our bias should be bullish, but in a much more muted fashion for the next couple of months, and then we'll see if the idiosyncratic event of an actual energy stock out leads to job losses, leads to... Or whether it's coming from AI, right?

Whether that actually begins to manifest itself as actual job losses rather than what we've seen so far, which is a low fire, low higher environment that's particularly affecting the young

Erik: Let's talk about scenarios of what happens next as a result of the Iran conflict. I'm gonna say it's extremely likely that in many parts of the world there will be an extreme price increase, or there will be caps placed on prices, price controls will be put in place, and that will lead to shortages where it's impossible to get any supply of diesel fuel and jet fuel particularly.

I don't think that's going to necessarily happen in the United States, but I think it will happen a lot of places around the world, and what remains to be seen is the extent to which there's a price transmission. If the price of diesel fuel in Singapore is, \$39 a gallon, what is the price of diesel fuel in Santa Monica?

I don't know how that's gonna play out, but it seems to me like there's gonna be at least some price transmission. What would you expect the result of that to be on US markets if that happens?

Mike: I think there's so I think you hit on something that's incredibly important, and it's one of the reasons why I very much push back on the idea of this is like the 1970s.

There's two primary differences. First, in the 1970s, the marginal buyer of oil on the international stage became the United States. We effectively, moved from a net exporter to a net importer. That meant that the world's richest consumer was suddenly bidding for oil versus everybody else. That more than anything else is what made the 1970s unique in that framework.

The US could afford significantly higher oil prices than the rest of the world could, and they were the marginal consumer for globally traded oil. This time around, it's the emerging markets that are the incremental consumer the marginal consumer for oil in particular, and candidly, they're kinda tapped out in a lot of ways.

You're already starting to see that type of behavior, the demand restrictions, the limitations flowing out through many emerging markets. Many emerging markets are beginning to experience near catastrophic conditions, particularly as it relates to fertilizer and agriculture. They're doing everything they can to avoid those price increases, but they simply are less well-positioned than the United States, and I realize this sounds, crazy given how bad it was in the United States.

But many of those emerging markets are less well-positioned to handle these prices, and they, I, I hate to say it, but I would somewhat include Europe in that mix as well. The second thing is that there's just not the population pressures that there were in the 1970s. And a really interesting chart I probably should have included in the chart pack is looking at real rates relative to population, or more accurately, labor force growth.

The high real rates or the high rates that we experienced in the 1970s were largely, and the inflation we experienced in the 1970s, were largely a function of that oil price shock, as we already mentioned. But then more importantly, just the simple reality that there were boomers and young women streaming into the labor force, demanding the capital that's required to keep a labor capital ratio somewhat constant.

If you allow that number to, the quantity of labor to exceed the quantity of capital, you will experience falling productivity. The 1970s were all about trying to maintain that pace of business activity, and it required significant capital that the Federal Reserve candidly stepped in front of and somewhat prevented by raising interest rates as high as they did.

This time around, labor force around the world is actually shrinking. The United States labor force growth over the last five years, even with the population adjustments from the surge in immigration that has not yet been removed from much of the labor force statistics, it really only hit about 1% versus about three and a half percent per year in the 1970s.

My hunch is that we're not gonna see anything even remotely close to the sort of gasoline or oil price spike that we saw in the 1970s, where we saw 500% sort of increases. But the pain that is gonna be felt in the emerging markets is significant. And as you're correctly pointing out, the answer in many situations will be, we'll do without.

That means that we will likely see, dramatically reduced production levels for many food stuffs, etc. We are somewhat fortunate in that we're very well

supplied. We've had extraordinarily strong growing seasons. Many forms of soft commodities have been over-supplied for the past couple of years, and so we're looking at inventories that are relatively high there.

But there's no question that this is going to flow through as price increases in agriculture, assuming that the harvests, y- you know, are diminished by the reduced application of fertilizer. Likewise, the ability to get stuff to market. If diesel prices are extraordinarily high, the vast majority of agriculture is transported by truck.

That means there will be less shipping available or less transportation logistics available for the delivery of those crops, and some may very well rot in the fields unless prices are much higher. And so this is the paradox of capitalism, right? In some ways, we should be celebrating higher prices because they're sending a much needed signal And they are allowing agricultural producers to somewhat offset the cost of fertilizer.

But that's painful for households. And in the United States, we're already seeing a growing fraction of households being forced to do things like increase their pawn shop activity at the lower end or their credit card activity, and that becomes very difficult as we look at credit card delinquencies beginning to spike, Etc.

This is creating conditions under which people are just gonna have to do with less, and that means lower household formation. It means households are going to decide to move out of a individual apartment and move back in with their parents, for example, where you would reduce your net consumption.

We're seeing the signs of all of that, and I, I, I joked on Twitter the other day that, BNPL, buy now, pay later, is actually turning into buy now, pawn later as households are scrambling for cash.

Erik: Donald Trump is set to meet later this week with Xi Jinping. It seems to me that China's reaction to all of this and Trump's ability to negotiate with China is gonna play a major role in it.

China has more crude oil and frankly everything else stockpiled than just about anyone. So it seems to me if China says look, get some positive PR by coming to the rescue and saving a few c- smaller countries around the world by sharing some of our strategic petroleum reserves and helping them out in exchange for some concession," that's one thing.

If China goes the other way and says, "Every drop of oil that we have is for us, and we're going to, block any export of finished products to other countries until this mess is over," that's a very different outcome. W- Am I reading those tea leaves correctly, and how do you think this is likely to play out later this week?

Mike: I agree with how you're reading it. So far what we're seeing from China is largely every drop is precious. We're not going to share any. that makes sense. China is a very insular society and candidly has always prioritized China over any other country. That's not a bad thing, by the way. I wanna be clear.

That's part of the process of capitalism broadly is we all should be seeking our own self-interests. But we need to recognize that has implications for how we're perceived going forward. In the United States we see very clearly what's happening in our society and our economy. Our news is very attuned to it.

We don't have that sort of transparency as it relates to what's happening in China or candidly for that matter Iran, which is largely in a blackout from the internet. And so the real question that you have to ask yourself is how much is China suffering in this process? And the evidence that we do have is that they are actually being hit quite painfully, and they've stayed remarkably quiet in this engagement with Iran.

my hunch is that, Trump will find a relatively receptive Chinese audience that is basically looking to cut some sort of a deal and ameliorate some of the pressures that are being placed on the Chinese economy. The flip side of that is, the downside to putting in a mercurial individual like Donald Trump is candidly I don't think anyone knows what he's thinking as he goes into these discussions and negotiations, and is he going to settle for a quick deal that may be much less than he could otherwise extract?

Candidly, we don't know, and I think that's been one of the real challenges for the U.S. military as well in conducting operations in Iran, has been the uncertainty around what policy is going to emerge in the next twenty-four hours. It's a very challenging environment that in some ways can be helpful.

My, my wife used to call it the crazy monkey approach, right? If you just act crazy enough, people will largely leave you alone and try to placate your behavior. But the flip side of that is it makes it very hard for the people that are, quote-unquote, "partnered with you," like the U.S.

military with the commander-in-chief, to anticipate the direction that you're gonna move. And I-- this is very much a wild card. But what has been

communicated to me is that China is much more interested in this in this meeting than the U.S. is, candidly.

Erik: It seems to me that China is absolutely pivotal to the outcome of the Iran situation, because if China takes the stance "Look, Mr.

Trump, we are trying to be patient here, but we're not going to tolerate much more of your interfering with our ability to import oil from the Persian Gulf, and you've got to work this spat out right away within a certain amount of time, or else you're gonna lose a lot in your relationship with China, and it's going to only make things worse."

If it goes in that direction, it seems to me like, that's very different than if China says "Look, we're willing to cut a deal with you and help you in Iran," which frankly I don't see is very likely. But it does seem to me that China is in the position of greatest power here. They could throw this Iran situation either direction.

Mike: I, I think there's definitely some truth to that. I think it would lean more towards if they were to decide enough is enough and basically communicate that to Iran. I agree with you that seems unlikely given that they have been an active partner with Iran, and Iran is a significant source of their crude oil.

This is gonna be an interesting question. We don't know what the Iranians are thinking at this point. We don't have full transparency in terms of what their actual position is. Part of the reality of why I would argue entities like the UAE are choosing to leave OPEC is if Iran continues down the current path and damages its oil production capability, China is gonna have to recognize that and will be looking for alternate sources of supply as well.

And so it, it does feel like this is that we're in a point where the narrative within the United States has been very much about the impact on the United States without significant consideration for how things are really playing out in Iran or China or other regions where we have much less transparency.

Erik: Since you mentioned UAE pulling out of OPEC, I'm very curious to get your take on what this means to the future of global oil market reserve or spare capacity. Seems to me like we were already down to the point where really the only OPEC countries that had any spare capacity were UAE and Saudi Arabia.

Feels to me like s- UAE has signaled pretty clearly that they're gonna pedal as fast as they can and make as much oil as they can and keep selling it. Does that

mean that we've reached a point where either Saudi Arabia is the only spare capacity on the globe? Or, a- and I would think in that situation, they probably pedal as fast as they can too.

So it seems to me like maybe that creates an illusion of a recovery in the sense if everybody's making as much as they can coming out of this crisis, it probably drives prices down in the short term, but it also means there is no spare capacity going forward. Do I have that right?

Mike: I think you have that right.

I wanna be careful on that, though, because again, the miracle of high prices is that it does stimulate production. And so it, it is important to recognize that right now we are beginning to see some of the supply response. UAE would be a good example of that. Likewise, we're finding lots of alternate ways out of the Persian Gulf.

Pipelines are running at max capacity. By and large, they have not sustained significant damage. And it is becoming very clear that there need to be alternate approaches, and this is gonna be particularly true if Iran is successful in articulating that it is in control of the Strait of Hormuz on an extended, period of time the other reality though, and this is something I wrote about in '22, and if you remember, the projections were that, we were gonna see a surge in oil demand and that oil prices were going much higher, and that as China reopened from the COVID events, that we would see an incredible surge of demand that would power us well above the 106 million barrels that were the forecast.

My argument was that we actually had multiple demand curves. The developed world was already in decline in terms of its oil usage. China has proven to be far less hungry for oil, despite the fact that they have been stockpiling, as you pointed out. Their demand has disappointed expectations from that time period.

And when you see price surges like this, it rapidly leads people to seek ways of conserving oil and trying to do the same thing more effectively. Again, that's the beauty of capitalism. You send a price signal through, and people adjust their behaviors to it. My hunch is if anything, this actually pulls forward the peak oil demand story with a notable caveat being that you'll likely see some significant restocking demand.

But I'm less worried about the supply side in oil, in the same way that I'm not that worried about whale oil populations. I'm much more concerned about the

demand implications as we look out past the inelasticity of a three to 12-month time period.

Erik: Speaking about longer term trends, let's talk about inflation more generally and where it's headed.

We just had an inflation print. You told me off the air you're a little bit concerned about the stale birth/death model data. Give give us some perspective on that.

Mike: Yeah. So there's a couple of narratives that are going on. One is that there has been, a re-acceleration of inflation.

Again, another chart I probably should have included, I posted it on Twitter earlier today, is that we are dealing with residual seasonality in our inflation prints. The non, atypical seasonality associated with COVID and then the Russian invasion of Ukraine threw off the seasonal adjustments from the BLS quite dramatically to the point that we're print-- in, in the fourth quarter and first quarter, we're typically printing about half a percentage point higher than the actual inflation is running.

That's due to the seasonal adjustments being made against an atypical seasonal pattern. if you look at the second half of this year, I wrote a Substack on this called The Year was 1816 or 1815, which was the year without a summer. We're not seeing any of the seasonal pressures that we traditionally see on things like rents, Etc which make up a far larger portion of the CPI That is a really critical thing to understand.

The second is that the birth-death model, which you were referring to, this is the assumption of entrepreneurship and new jobs that are created. It has also been the source of the terrible downward revisions that have been made. Birth-death was originally introduced as a tool to try to reduce revisions.

Unfortunately, a number of technical changes in how data is reported and collected have led to the BLS continually overestimating how many new jobs are being created by new businesses being formed. That is, that those corrections won't emerge until what's called the Quarterly Census unemployment and wages, which is the gold standard for measuring that data.

We have that through September. That's why we had such terrible downward revisions in the '24 and '25 time period versus what was initially reported. That is on hold until basically next month when we'll get the updated fourth quarter

data. My assumption is that the birth-death continues to be over-reported and adding about 100,000 jobs.

And so if you include that in the data, we actually are not really seeing any improvement. We continue to lose jobs. And importantly, even if you look at the official data, I would highlight that our labor force is now starting to shrink in the United States. We have a drawdown from peak labor force that is roughly in line with the worst recessions that we have seen over the past, 50 years.

It's very hard to reconcile those two data points with the idea that the US is suddenly accelerating and that what we're seeing is an overheating of the economy. I think unfortunately, we're just, w-we are dealing with really bad data quality, and the revisions will likely pull that lower.

All else equal, that suggests that there is less inflationary pressure over the summer and into the fourth quarter. And beyond that point, I don't have the same clarity because I don't have the ability to model fully what the seasonal will do until we've received that data. But it does appear that we are shifting back into a more normal seasonality and all else equal, that should lower both inflation and then we'll get the downward revisions in employment.

I continue to think there's a reasonable chance that, Kevin Warsh comes in, and by September he's suddenly looking at inflation running less than we had anticipated. The tariff surge will have been over at that point. People are highlighting that we anticipated that would flow through in goods.

The crazy data is that goods inflation is basically really low, which suggests that companies are eating most of the tariff increases either in the United States or in supplying countries. And I think there's a very high chance that Kevin Warsh suddenly wakes up in September, October and realizes that he has to cut and cut more aggressively than anyone had anticipated.

Erik: That's fascinating because it seems to me that you and I have m- broadly agreed on what's about to happen energy-wise, which is we're gonna have a real energy crunch globally as a result of this Iran conflict. If that happens, doesn't that create a fairly long-lasting and persistent inflation driver?

Mike: Not really, because if you think about what we're talking about, we're talking about the fastest moving components of inflation and also the most inelastic. And so if we do end up seeing, businesses shut or air flight curtailed that prevents activity from happening. And I think it's important for people to

recognize that unlike COVID, we now do have the potential to work from home.

We've discovered that is a solution. And so could I see an oil surge accompanied by another dramatic reduction in people's mobility and reduced demand from transportation, Etc? I think the answer is yes. And as you pointed out, one of the key risks becomes a supply response in oil that is met at the same time with a demand reduction.

Y- I'm not gonna draw the direct analogy to 2008 'cause I don't think it's actually quite-- it's actually fair in that analysis. But remember, oil prices can fall just as quickly, if not faster, than they can rise.

Erik: That's definitely true. Oil prices increasing is definitely inflationary until they cripple the global economy and cause a Great Depression.

Yeah. In which case it's definitely- Yeah ... not inflationary at that point. It's

Mike: definitely not inflationary at that point. And that, th-that is, that's the uncertainty. And again, most of this pain is being felt outside the United States, and by outside the United States, I'm including California which, has just absolutely absurd restrictions on oil production that make it much more like an Asian, a Southeast Asian country in terms of its import patterns.

And there we're already seeing pretty strong evidence of behavioral change associated with gasoline prices hitting the levels that they are in California, where you know, one of my team members works out there and was sharing with me, pictures from the pump where they've exceeded \$7. I laugh in a crying sort of way that Trump found it appropriate to highlight how cheap gasoline prices had fallen in January, February and now, is basically trying to ignore that they've moved in the opposite direction, putting incredible stress on many of the households candidly that had hoped that Trump would strengthen their position.

But, the simple reality is that is the way it plays out. If we end up with actual shortages, meaning that we have to reduce consumption, you could simultaneously see a supply, a positive supply shock and a negative demand shock that would manifest as oil prices falling very quickly.

Erik: So when you say that Kevin Warsh may by September be in a situation where he unexpectedly has to be cutting aggressively, are you implying that means he'll be reacting to a not necessarily 2008 sized, but a global economic slowdown that would be bringing that about?

Mike: It certainly seems that's the logical conclusion from what we're experiencing, and that's particularly true, as you point out.

If the current disruptions that have been largely ameliorated by the release from strategic petroleum reserves, if we find that we cannot draw those down significantly further, and I would highlight that many countries that have tried to keep pricing basically keep pricing capped, had their balance sheets stressed already in an attempt to do that in 2022.

The UK would be a really good example of that. the capacity to continue to support that is just significantly less. And we are looking at a situation in which i-if this continues for an extended period of time, the absolute shortages of oil will really begin to hit those areas that are the marginal consumers, primarily the emerging markets.

Erik: I certainly agree with that. So what happens, let's say we get to September and Kevin Warsh is cutting rates aggressively because of a global economic slowdown. What happens to your chart then? Do we get an even bigger inflow into semiconductor stocks?

Mike: it depends on what happens to employment on our path there.

And it depends on the mix of employment as well. So part of the perverse dynamic of the low hire, low fire environment is that by and large, we've retained relatively high earning individuals who are fully trained and capable of operating at high productivity. What we're seeing is a reduction in the hiring of new labor force entrants, those who need to be trained, those who don't meaningfully contribute to productivity, but actually disproportionately contribute to marginal demand.

You move out of your parents' house when you get a job, you move into an apartment. Somebody had to build that apartment, put a dishwasher and a, oven in there and a refrigerator, Etc. All of those things have to be done in advance of that. We're seeing very weak hiring at the younger level, And unfortunately, that means that demand is likely to be relatively hit in those segments, and that certainly is being supported by data we're getting from apartment rents, Etc.

On the flip side of it, it means you continue to pay the 55-year-old because now instead of training a 25-year-old, they're training an AI, and that has extraordinary value if we're able to pull it off and it turns out to have the productivity impact that many people think it might have. y- the only analogy I can draw to this is the end of the guild system in the 19th century, whereas w-

you know, where the Industrial Revolution began to move from things like textile mills into actual factory production.

Many people love Victorian homes without realizing that the popularity of those homes was driven by a collapse in the price of things like filigreed wood that was driven by the Industrial Revolution. That created, that growth created a demand surge for the artisans that were already trained so that they could build the factory jigs that could be used to produce those low-cost products, but it destroyed the apprentice business.

And so unemployment became highly cyclical and very sensitive in the mid part of the 19th century. In the panic of 1837, for example, unemployment hit 63% in New York City. I don't think anything like that's going to happen because we don't have the same rates of population growth, in particular in the United States.

But I do think it's really critical to understand that we are basically putting, those who should be rapidly moving up the productivity curve and the learning curve, we've basically put them on ice and told them, "Congratulations, you've got a an engineering degree or a degree in French medieval literature from a prestigious institution that qualifies you to work at Starbucks or drive for Uber."

that's a real cost, and it's similar to what we've seen in recessionary periods where it creates much lower lifetime earnings, and we don't yet know how that is gonna play out, but it's showing up very much in the data. The hiring rates for those 55 and up is up 84% year over year. The hiring rates for those 29 and under are down 25% year over year.

It has all the signatures of that sort of breakdown of the guild system and the apprenticeship system and a- again, if I told you I knew how it was gonna play out, I'd be lying to you.

Erik: Let's move on to the subject that you are famous for and in fact have now literally written the book on, which is active versus passive investing, or probably more accurately, the potential unintended consequences of the passive investing trend of the last several decades.

It seems like the chart that we looked at earlier was pretty strong evidence that you're right that these passive flows do funny things in the market that it seems to me eventually lead to some potentially very negative outcomes. Am I right to be worried about this, and how worried should I be?

Mike: I think you're right to be worried about it. I think we have to acknowledge that we continue to see strong flows and we are not yet seeing the negative outcomes. What we are very clearly seeing are the inflationary components of the impact of passive investing, where buying at any price is actually required by fiduciary duty, not by a thoughtful application of discounted cash flow analyses, Etc.

W-we experienced two remarkable events in our lives, Eric. The first was the transition from defined benefit plans to defined contribution plans. There's a fantastic white paper that was just released in 2025, made it into the Financial Analyst Journal in March of this year by a gentleman by the name of Coimbra, and what he highlighted is the mechanical properties of the importance of that shift.

When you move from defined benefit plans, which guarantee you an income stream, to a defined contribution scheme in which you have to accumulate assets in the hope that either the income from those assets or the sale of those assets are going to allow you individually to secure your retirement. It creates an extraordinary outward shift in the aggregate demand for financial assets.

As an individual, I have absolutely no idea when I'm going to die or how long my retirement is going to be. As a result, I have to accumulate as much assets as I possibly can. In a defined benefit plan, the statistical properties of a large population allow me to accumulate assets and try to generate income against an actuarial o-outcome.

The reason that system failed in the 1960s and 1970s was because people began living much longer than we had anticipated. The retirements were much longer. Now we're looking at a situation where everybody is basically being forced to assume the worst case scenario. That means that they are both accumulating more financial assets and they are spending less out of that financial asset base than they otherwise might.

The traditional 4% withdrawal has been replaced by something closer to a 2% withdrawal Which means that we are hoarding financial assets, which naturally causes prices to rise. The second phenomenon is the growth of passive investing. Because we basically told secretaries and janitors that they needed to become experts at stock picking, we arrived at a conclusion that minimized the amount of activity that they had.

Market cap weighting is unique in an index construction in that it doesn't actually require you to continually rebalance your portfolio. The market pricing,

by and large, does that for you. The only impact is on the marginal flow, your net contribution or your net sale. That also has an inflationary impact.

And so we have had two distinct phenomenon that are related and both inflationary to financial assets over the course of our lives. And because of the demographic bulge of the baby boomers, that's gonna eventually reverse, and we will find ourself selling-- ourselves selling those assets in order to secure retirement.

The relative shortage of labor suggests that those retirements are going to prove to be much more expensive than people had anticipated. We're likely to see inflation in elder care at the same time that we see much more deflationary pressures in areas where we're beginning to see population growth turn significantly negative.

Colleges would be a good example of that. we're watching basically the reverse of what happened with the baby boomers coming into the system. When the baby boomers came into the system, we had to build a ton of maternity care, maternity wards. Most hospitals in the United States were built in the 1950s and 1960s primarily to accommodate the surging population and the growing number of births.

Now we have a growing number of deaths, and we've done a terrible job of preparing for it. And so it's only logical to conclude that y- you know, that which we need less of will likely become less expensive and that which we need more of, i.e., end of life care, is likely to become significantly more expensive.

And this is one of the real tragedies of where we sit today because old people are candidly scared, understandably they don't know how long they're gonna live. They don't know what the high volatility asset mix that they have gotten themselves into is ultimately going to yield. And they continue to see headlines from including people like myself that say the expected returns to equities, given these levels of valuations, should be quite low.

If I heard that and I was uncertain about my retirement, and I was uncertain about when I might, run out of money, I would be less willing to spend as well. And then we have the paradox of thrift, which basically says the lack of spending from the old impacts the income of the young. And we've created a condition under which the old people are scared and the young people are really unhappy, and it's not a good mix

Erik: You've written a book on this subject.

I know that because as a follower of your Substack blog, w- I've been teased by a number of sample pieces of that writing. The book is titled "The Greatest Story Ever Sold: The Unintended Consequences of Passive Investing." It looks like it won't be released until the end of June, but it's available right now for pre-order.

Listeners, we've got the pre-order link on Amazon linked in your research roundup email. Mike, what is the book about? Tell us what to expect when it's released in June.

Mike: So the book is really actually about the destruction of price discovery. The implications of passive investing and the demand for financial assets has created conditions under which the most important price that we really receive in the economy, the price of equity, the price of debt, are increasingly being outsourced to algorithms.

And so it brings us full circle back to that chart that I shared, where systematic strategies that have never done a discounted cash flow analysis in their lives are dictating the prices that we're seeing on screens. We're trying to attach meaning to that, because that's really what price is. Price is the mechanism of information exchange in a market-based economy.

If you destroy that process of price discovery, the consequences are understandable and foreseeable, and perversely create many of the conditions that we now experience in our lives. Everything ranging from gambling and the growth of speculative activity in financial markets can largely be tied to the phenomenon and the choices that we made in how we choose to fund our retirements.

Those decisions were made back in the 1970s when we had very poor information on how financial markets actually work. Since I began my work in 2016, there's been an explosion of academic research that is highlighting the adverse effects, on price discovery of the growth of passive investing and the demand for defined contribution plans and the government sponsorship of certain areas as being preferred, what's called the qualified default investment alternative, that by and large is directing the retirement assets of the United States into the largest public companies that until very recently had no real reason to receive those inflows.

And so the book is actually about the, what happened why it matters, and what is likely to occur given that we have severely impacted our capability for price discovery in a capitalist economy.

Erik: And again, that is available for pre-order right now on Amazon. Mike, you also-

Mike: Now with one caveat.

I just wanna actually highlight that date has been pushed back. We're actually targeting a release on October 19th, which will be the anniversary of the crash of '87. Oh,

Erik: okay. So we should not not believe the June 30th date on on Amazon.

Mike: Don't believe the hype. Correct.

Okay.

Erik: Coming from the the source itself. You gotta trust that signal, folks. Let's also talk, you manage several funds for [Simplify Asset Management](#). You also write a Substack. Tell us about those as well.

Mike: Sure. It is a hedged high yield product, and so it attempts to mitigate the impact of credit spreads.

That has been a very challenging period since April of 2025. We've seen credit spreads by and large tighten significantly, even as we're seeing signs of credit deterioration in the broader economy. Part of that is, of course, due to the passive bid. As money flows into these strategies, they buy the highest priced securities disproportionately.

That has driven a bifurcation in the high yield market, just like it's driven a bifurcation as we've seen in U.S. markets where there's the 493 and the Mag Seven. the but that product is certainly something that people can check out and take a look at if they are interested in a more protected version of income generation.

And candidly, I think this is gonna be one of the real critical realizations that people have is that they should be taking advantage of these high prices to rotate into areas in which income can be generated. The Substack is Yes I Give a Fig. It is yesigiveafig.com. It's available on Substack.

You can search for Michael Green or Yes I Give a Fig. It is available weekly. I try to put it out early Sunday mornings more or less every week. It is the outgrowth of my own personal note-taking and thought process more than a

desire to put charts or trades in front of people, and it covers topics ranging from a discussion of the poverty line, a piece that went viral to the type of work that I'm doing around passive, to insights in terms of markets that, people would be more familiar with seeing from other areas.

As I describe it, it's basically how I clean out and clear, and straighten the attic that is in my mind behind my overly large forehead.

Erik: Mike, I can't thank you enough for another terrific interview. Listeners, be sure to stay tuned 'cause we've got Rory Johnston coming up for an update on Gulf oil flows and what comes next in the Strait of Hormuz.

Patrick Ceresna and I will be back as Macro Voices continues right here at macrovoices.com