Mike:	00:01:49	All right. Welcome, gentlemen. Happy Friday.
Adam:	00:01:52	Happy, happy.
Richard:	00:01:53	Happy, Friday.
Bilal:	00:01:54	Happy, Friday
Mike:	00:01:55	It feels so strange having coffee and stuff now. It's just -- I don't know what to say about that.
Adam:	00:01:59	The straight Kahlúa, dude. Come on.
Mike:	00:02:02	Yeah, there's no steam coming off that coffee cup. Just like Johnny Carson, not a stitch of steam. Anyway, welcome Bilal.
Richard:	00:02:08	Welcome, Bilal.
Mike:	00:02:10	Yeah. Welcome, Bilal. And welcome to everybody who's joining us.
Bilal:	00:02:11	Thanks for having me.
Mike:	00:02:12	Welcome everybody who's joining us. Great Friday afternoon. Riffs is at noon today. Just before we get started, let's have our disclaimer, which is that this is not investment advice. And you probably shouldn't take investment advice from four dudes on YouTube anyway. So, make sure you… this is going to be educational and fun, though, for sure. So, I'll turn it over to Richard, you and Bilal, get us kicked off.

Backgrounder

Richard:	00:02:35	Yeah, for sure. Thanks, Mike. So, Bilal, I'm going to ask you the question, the opening question that you pose to every guest, which is to tell us a little bit about your origin story, how you got to where you are, and was it inevitable that you would end up in the investment world.
Bilal:	00:02:51	Okay, great. It's great to hear that question inverted back to me. I usually ask that for other people. Well, my origin story is, I was always interested in economics from a very young age. So, in high school, for whatever reason, I loved economics as a subject. I had a really good economics teacher. So, I think it was probably more to do with the teacher than anything else. So, I ended up going to university to do economics. I enjoyed it. And then while I was at university, the types of jobs that would open up for people with economics backgrounds were management consulting, or banking. They were sort of the two big things that people were focusing on. And this was back in the late 1990s. And I ended up getting an

internship at JPMorgan in the investment bank, and I really enjoyed that. Ended up getting a graduate job at JPMorgan. And so that was a 97-98. And the funny thing was I started as a graduate at JP, had my training program in New York, and during my training program, the Russia crisis kicked off in 1998. There was a Russia crisis back then, which was associated with the LTCM Hedge Fund, which had these very huge relative value trades. Russia devalued contrary to people's expectations that blew up the hedge fund. The Fed had to try to stabilize the market. So, that was my baptism into markets and I sort of never looked back since. So, I did research early on at JPMorgan. Foreign exchange research was my main area of focus at the time.

Then in 2002, I left JPMorgan to join Deutsche Bank. And Deutsche Bank, if you recall, in the 2000s, was really building up to become a powerhouse in fixed income. They became this huge force, probably the biggest fixed income house in the world, comparable to Goldman's and JP and so on. So, I joined Deutsche in 2002 in London, and initially I was in foreign exchange research, so the dollar and EM currencies, I ran that, I ran the department. And then after the global financial crisis, kind of the whole mood music changed. Banking didn't seem so fun anymore. So, then I moved to Asia, where there was still a lot of growth happening and at the time, after the financial crisis, China did really well. And so it seemed like all the opportunities were in Asia. So, I moved to Asia, to Singapore, where I ran Asia research for Deutsche Bank in Singapore. And I learned a lot. I spent a lot of time going to China and around the region, and that was a really good fun experience.

But then in the end, I found my wife, kids. They didn't like Singapore so much because all their family and friends and everything were in Europe in London, so we moved back in 2012. So, spent a couple of years out there, then moved back to London to head up a cross market research group. Because at the time, sort of the 2010s, multi-asset research, cross asset research was becoming really big in the asset management industry. It was moving away from 60/40 and risk parity towards multi-asset funds. There were all sorts of different names for it. GARS Fund was a big one in the UK, which kind of set the tone and then everybody kind of replicated that. So, that became a big theme, having kind of more of a hedge fund type mentality in the institutional investment space. So, I did a lot of work in that space. And so I did that up until about 2015.

Then I left Deutsche to join Nomura, in London, at the Japanese investment bank, where I ran research for them in London, where I did that for about three years and that was a lot of fun. I wanted to kind of work in a smaller bank than say a Deutsche or a JP, just to get a different feel. And it was great. I learned a lot, had a great experience there. But then by 2019, I thought I've done enough working for big banks and big institutions. It's time to do my own thing to do a startup, and I love research, so I knew it had to be in research. But I wanted the culture of the startup I'd be in to be very open, very networked and so I launched Macro Hive, which is kind of a platform, a hive for research for investors, whether it's retail investors to institutional investors. But the key ethos is for it to be very open and network.

So, we have an in-house research team, but then we work a lot with outside researchers, other investors outside. We try to make everything as open and transparent as possible, which is much easier to do outside of a big bank. In a big organization, there's so many rules, compliance, and so on, where you're afraid to talk to somebody across a couple of rows from you because you're thinking you're violating some rules. And for me, research, the intellectual side of it, it's more to do with conversation with other people. There's only so much you can work out in your own head. But in the end, the best ideas come from interacting with smart people around you from different backgrounds and that generates the idea. So, that was really the culture of Macro Hive, and we've been going for about two and a half years. We're growing, we're kind of doing well, and we're really enjoying the experience.

Macro Hive

Richard: 00:07:47

So, dig a little deeper into your process now at Macro Hive. What are you guys focusing on? Is it on a global macro level? Do you focus on any specific equity markets and who your target audience is?

Bilal: 00:08:00

Yeah, absolutely, yeah. So, the approach we take is a top-down approach, which means essentially a macro, the starting point would be macro. So, we take a view on some of the structural trends in the world. So, the structural trends would be things like, what's the impact of technology on the world, the rise of digitalization, how that's going to impact the service sector? That's one of my pet topics right now. A lot of people talk about robotics and the manufacturing side, but I think for me, the big story is how is technology going to impact the service sector? So, the structural theme then there's demographics, the aging issues, then there's geopolitics, the rise of China, future of the dollar. So, kind of map out some of these sort of mega trends or structural trends, then take a cyclical view, where are we in the cycle? You know, we've got inflation right now, how long will it last? How will central banks react to it? Are there some central banks that will be slow, some fast? Are we going to have a recession or not? So, kind of take that view.

And then from that basis, then look into whatever our strongest conviction is. Then work out which asset class is the best asset class to express the view in. Is it in FX, is it in bonds, is it commodities, is it equities? So, we kind of look at all the major markets. If it's a relatively liquid market we focus on any one of those. So, in FX, it's all the G-10 and liquid EM currencies. Rates, it's all the major rates markets, equities, it will be all the major index level equities, and then maybe US sectors. But we won't go down to single company level. And then we have another layer below which is kind of more the trade idea side of things where we then build a series of trading models, positioning models, flow models, sentiment models, risk aversion models, to help with timing around everything.

And the output for all of this goes to -- we have two audiences essentially. We have individual investors, so kind of more retail level. For that audience, we deliver some of that content at the highest level to that audience. And it's skewed a bit more towards equities and crypto, because that's all retail cares about. They don't care about the finer points of rates or FX. And then we have institutional clients, which are pretty much all the biggest hedge funds in the world, for sure. And then some of the largest asset managers, and they get everything, they get all the rates of use, the curve views, the trading models, the machine learning models, and they get much more sort of intensive coverage from us as well. So, we kind of have two audiences. And each audience has kind of a different level of sophistication and different asset class interest.

China, the U.S. and the World

Mike: 00:10:38

That's fantastic. How did -- as you travel the world, your background is varied in so many ways. One of them is also very geographically diverse. How is that giving you special insights or has it given you special insights, as you've sort of traipsed from continent to continent? How do people view the research that you do? How did you kind of think about that, as you built the research department in the different ways that maybe different sectors of investors view things across different continents?

Bilal: 00:11:10

Yeah, yeah. I mean, I think it's made a huge, huge difference. I mean at a very basic level, having grown up in the UK, and in the West it's easy to become a bit arrogant, where you think the West is the most developed part of the world and is where all the action is. But if you spend time in Asia, you kind of get super impressed about how developed Asia is. If you live in Singapore, Hong Kong, Beijing, Shanghai, Tokyo, I mean, these are like -- it's like going to Blade Runner or something, it's like the future; skyscrapers, everything works really well. And so suddenly, it forces you to kind of think, okay, there are alternative models of economic development which is quite different.

And so it forces you to reevaluate the core assumptions you have about the world, which then has an implication then because if you suddenly think that the so-called Western way of doing things isn't the only way, then it forces you to appreciate, the world can change. It may not always be the case that the US may be the dominant economic power, or Western Europe. But even within Europe, there's differences. Like the difference between the UK, France and Germany is very different too. If you're a company in France, if you want to let someone go, fire somebody, it's like a two year process, you can't just lay someone off. I mean, that's a whole different… I used to work for Deutsche Bank and at the board level they had trade union representatives at the board level, above the CEO. I mean, it's like -- just a whole different way of organizing itself. So, you start to appreciate different systems, how they can work.

And then the other thing you appreciate, which really helps in the research approach is that there's a bias in markets to be very US focused. So, what you tend to do is you look at, okay, I look back, and you say, okay, I know my history. So, you say the Volker, the 70s, the 60s, the post war period. And so that becomes your only reference point to some extent. But then there's other parts of the world that have had inflation more recently. Brazil's had inflation, Japan's had deflation. And so if you suddenly widen out the countries you look at, it allows you to see other parallels to today that are not just in American history. There could be in other countries' histories, and that suddenly gives you a better sense of where things can go. And perhaps really, the biggest thing I think has been, for me, is probably the time I spent in Asia just understanding how the Chinese work and how the Chinese system works. Because to some extent, the story of the last 10 years and the next 10 years is going to be US and China, the two systems.

Of course, we have Russia, the war, which is terrible right now. But ultimately, the two powerhouses are China and the US, two different systems. They're kind of tied together economically, and they're kind of jostling for position in different areas. And other countries are kind of trying to align themselves in all of this. And that's the friction point. And so having spent time out there, it really allows you to kind of understand how the system works there, how people communicate there as well, and how to read kind of the body language as well of officials and investors.

Mike: 00:14:20 Go ahead, Richard.

Richard: 00:14:22 No, yeah. I was just going to say you raised some really interesting points, and particularly the idea that we in the West have this very US/Western centric view of the world and our understanding of events. And I wonder, what are some of the truisms that we are currently holding in our views, in markets and the world, particularly as it pertains to the recent set of events; whether it's COVID and the pandemic at large and now the war in Russia? What are some of the things that we are holding as absolute truth just saying so?

Bilal: 00:14:58 Yeah. No, that's a good question. I mean, I would say there's a few things. One is, just on COVID specifically, I would say that obviously there's been this big polarizing debate about how to manage COVID. But what you see around the world is that countries essentially tried lots of different ways to deal with COVID. And they've ended up with pretty much the same outcomes. We did a study, based on some new data, looking at excess deaths around COVID. So, not looking at deaths that are diagnosed as COVID linked, but just deaths more than normal years. And in essence, Western Europe -- every country has something different.

US, it's all pretty much in the same ballpark. You know, some countries like Sweden, Sweden was very relaxed. Other countries had much more tighter restrictions, but the COVID outcomes in terms of deaths were pretty much the same. So, for all of this kind of fighting we've had about this all, you kind of see the outcomes are pretty much the same. And that -- you can just see how that has happened across different sort of countries. So, that's kind of one very topical moment right now. But the other one, I think, relates in terms of recent events to do with central bankers, which is that there's been this perception that developed countries have credible institutions like central banks. They're the benchmarks, that they've got high credibility and then emerging markets are the ones that break the rules, and they're more lax.

But what we've seen recently is that EM countries have been much more orthodox with monetary policy than developed countries. And so if you basically looked at the actions of emerging markets over the last like year or two, they've basically been hiking rates because of inflation, whereas the developed countries haven't. And now they're catching up. So, this idea that somehow these Western institutions or Fed or the ECB are more credible than, say, the Brazilian central bank or the South African central bank, just doesn't hold. I think what matters more is not so much credibility in the institution, it's more about what has that country, what was the type of crisis each country has experienced recently, in the last 10 years. And that gives you a guide to how well they'll cope with the current crisis.

So, in the western economies, the crisis they most recently dealt with was a financial crisis. So, they don't have experience with inflation, whereas EM countries dealt with inflation so they know what to do on that side. So, that's something about institutions, I think, is an important one. And then I think, another kind of truism, so to speak, and this is more of a larger point, which is that there's this idea that if you just buy equities, you'll always make money. But if you look at the performance of equity markets around the world, like Italian markets, or even Chinese markets, I mean, there's been prolonged periods for the last like 10-15 years where they basically haven't given you any returns. And so obviously, in the US, we've had this amazing run in the S&P since pretty much the global financial crisis, since 09, it's gone up in a straight line. COVID was just a little blip.

But that equities don't always give you those returns. China, returns we've yet to go back to the peak. Italy, Italian markets have been quite weak for a long period of time. Japan's kind of, … yeah, Japan, we get to go back to the 80s sort of peak. So, that tells you that equities don't always go up, constantly. And so you kind of need to be aware of that when you have your asset allocation decision, which is kind of long equities, skewed equities, long bonds. And so the debate often is, okay, reduce the bonds and just go long equities. But if you look outside of the

US, the picture of equities hasn't really been as rosy as it seems. So, that's the other one that you really sort of discover when you sort of venture outside of the US.

Mike: 00:19:09 I would imagine too, the typical sort of both retail and institutional portfolio has drifted a lot more US centric over the last 10 years, as well, as what's working, there's been portfolio drift, but even the pressures to be competitive from a return perspective. So, some return chasing, some behavioral bias and the recency bias side, it's worked. So, more of that, puts us tilted largely to US equity markets, in many cases for most investors and fairly low exposures to commodities, I would think across the board, low exposures to EM equities across the board. It just seems like the perfect setup for a shift to a slightly different regime over the next decade that favors different asset classes. What are you seeing in that? Go ahead, Adam.

Adam: 00:20:02 Yeah. Just so I can add to that, because I think it's sort of dovetails, I was sort of curious. I think you've got an interesting perspective, Bilal, because you have a book of clients who are looking to you for guidance against their current positioning and where you think the puck's going. And so I'm just wondering, maybe if you can, to Mike's point, sort of give us some guidance on where are the clients that you're speaking to, where are their primary concerns relative to existing positioning, to the extent that you're able to sort of talk about things generally without obviously, without hinting at individual clients. But relative to current positioning, where clients are most concerned at the moment?

Bilal: 00:20:42 Yeah. No, that's a very good question. I mean, I would say that kind of the top sort of hedge funds, so to speak, I mean, the big focus is rates right now, and many of them are underweight bonds or short rates. So, they are positioned for higher yields. So, that side seems to be working relatively well. The larger debate and question is, why aren't equities weaker? So, equities, obviously, we saw a bit of a correction at the start of the year, but we've had this bounce over the last few weeks. And so that's really the thing that's puzzled many, many people. So, I would say that is a big kind of question mark, what happens there. There's also a debate on the dollar. There's a big debate on the dollar around, okay, the Fed's hiking rates so that should be good for the dollar. But then, on the other hand, the US also, there's all these debates around the future of the dollar as a reserve currency so people were kind of thinking, okay, maybe the dollar isn't going to be so well supported. So, there's lots of uncertainty around the dollar, lots of question marks about equities.

And then on commodities, I think that most people have come on board with the idea that commodities will go up. And so they are sort of pivoting towards going long commodities. The challenge there is that the volatility in commodities, and the pull backs have been so extreme, that from an investor perspective, it's hard to hold those positions. Because if you tried to risk manage them with a stop or something, you just get stopped out very quickly. So, I think there's a challenge in terms of the volatility there.

Adam: 00:22:18 Bilal, how are you resolving this conundrum with your clients in terms of action, in rates, action in break-evens, inflation prints around the world and this apparent, endless resiliency of equity markets? What are some thoughts that are creeping to the surface there?

Bilal: 00:22:41 Yeah. I mean, I would say a few things. You know, I mean, the first thing I would say is that if you leave aside -- if you pretended that the Russia/Ukraine war wasn't happening, and just look at the world right now, essentially, what you've had is you've had higher inflation prints. But at the same time, you've had restrictions around COVID being lifted around the world. So, there's this idea of this kind of reopening kind of trade kind of happening. And you're seeing that in the numbers, the PMI numbers have been very high. In the US yesterday, Europe, were relatively high. And then to some extent, and then the Fed saying we need to hike rates. But what's interesting about the Fed hikes are that the Fed isn't projected to raise rates much higher than where inflation is.

So, in terms of real interest rates, they're still negative. So, what's happened is that there was this uncertainty in the market about how much would the Fed hike. Now the Fed said we're going to hike a lot. So, in a weird way, by giving a path of the Fed hiking, that kind of helps equities to some extent, in a weird way, because you kind of know where they're going to hike eight times say this year, but they aren't going to hike to 4% or 5% where we got to before the GFC crisis. So, the Fed is basically telling you we're going to do lots of hikes, but we're not going to push real rates, real policy rates above zero, which is a fairly sort of dovish action in some ways. And then at the same time, if you look at equities, earnings numbers have been really strong throughout this whole period. So, there's actually been a derating of equities over the last few months. So, PE ratios have been falling over the last three-four months. And so in some ways, what you could say is that equities have been resilient, but at the same time, there's been a derating. So, a lot of the bubbly dynamics or very high PE ratios have gone. So, by equities going sideways, while earnings are going up, you could flip it around the other way to say equites should have been much higher.

And then obviously we have the Russia/Ukraine thing. But the weird thing about the Russia/Ukraine conflict is that initially there was a risk aversion event but very quickly, that risk premia got unwound. So, natural gas prices are back to where they were before the Ukraine sort of war. And I think the reason for that is that the transmission mechanism from Russia to the world is not Russian demand because Russia is a relatively small economy. So, it doesn't matter if Russia goes into recession, the transmission is through energy prices. And so far, effectively, the West or Europe, in particular, hasn't sanctioned Russian energy. Russian energy is still flowing to Europe. And so until that happens, you don't really get the big energy shock that could really destabilize the world.

So, in a funny way, while there was a lot of talk about sanctions, Europe didn't go all the way to sanction the most important output from Russia. So, that kind of reduces some risk as well. So, the punch line is, there's been derating in equities, earnings have been strong, there's been re-openings, so that means resilience, so stocks have been resilient in that context.

Richard: 00:25:53 So, to linger on this notion of the energy shock, the news that came out in the last couple of weeks that Western firms like, was it Baker Hughes and Schlumberger, and some of these, I think, Halliburton as well, leaving Russia, and the information that we hear is that without Western technology, some of the more technically complex oil fields would have to reduce production and eventually stop production, and those tend to cater to the East, I think, so to China. So, there's this concern now that China is going to have to pivot towards Saudi Arabia, which it seems to be doing already, and what that entails for the petrodollar system and all that. So, I wonder if you might speak to a little bit and first off, if you think that the importance of Western technology for Russian oil fields has been accurately depicted or perhaps overstated?

Bilal: 00:26:52 Yeah, yeah. No, they're all good questions. I mean, I would say that there is, even though the energy exports haven't been sanctioned directly, there is still a negative impact from all the sanctions, partly through self-sanctioning; ships can't leave, can't reach Western ports and so on. I do think the reliance on oil fields, on Western technology is overstated. I think Russia has enough sort of technology there to be able to do a lot of that. Plus, they can import it from China, in any case, as well. So, you have to remember with the sanctions regime that China hasn't imposed sanctions on Russia, neither has India, most emerging markets haven't. And so if needed, if push comes to shove, they could just import it from a third country.

So, I think that's a bit overstated. I think where there is some larger risks are, if Russia holds back its exports of like, aluminum, neon and some of these commodities to the world at large and so holds the rest of the world at ransom. And you're seeing some rumblings of that already, where Russia is saying we'll only receive rubles for our oil exports to Europe. So, it's kind of almost like testing Europe to -- or challenging Europe to say, look, will you kind of lift some of your sanctions in order to be able to pay some ruble. So, there is that. So, for me, the bigger question is more about Russia holding back exports, rather than Russia not having equipment to extract minerals or commodities.

Adam:	00:28:29	Bilal, just spend a second, maybe describing the story in neon, because I'm not sure that this is something that the broader market is well aware of and it's a really interesting piece of the puzzle.
Bilal:	00:28:41	Yeah, sure, sure. So, essentially Russia is well-known for its energy exports, oil and gas. And it's also relatively well-known for its wheat and some agricultural exports. But also, it's one of the largest producers of neon, which is an element that's used in things like television tubes, and lots of electronic equipment, lasers, for example, as well. So, anything that requires lasers, neon is required. And so Russia is one of the biggest producers in this area. So, if you cut the supply of neon to the rest of the world, there's a whole range of electronic products that won't be able to be produced. And so if you recall that, for the past few years, we've all been complaining about semiconductor chips, and cars not being able to be made because of that, and so on. So, neon would have a similar type of impact. So, that's quite a big story. Now, so far, we don't have much visibility around future plans for this. At the moment, the export is still happening. But this is something that could be quite a big deal.

The Fed and Inflation

Adam:	00:29:55	What is your sense of the Fed's ability to manage this current inflation shock?
Bilal:	00:30:04	I think that it's really hard for them to manage this because -- well, one big reason is a lot of the inflation we're seeing at the moment are coming from the supply side. So, whether it's just very high energy prices, or supply chain issues or pandemic related issues around people not working, and so on. So, they can only do so much around that all. But given that, if you do have less supply than before, the only way you can really bring inflation down then is you really have to sort of really reduce demand dramatically. So, supply has gone down and so the same level of demand would lead to higher inflation. So, you basically have to do a hard landing, you have to kind of really engineer a sharper landing, if you really want to bring inflation down. You basically have to tell people, look, just don't drive so much. And the way you do that is you have to really increase interest rates. And so the Fed has started to pivot in that direction. But they're still cautious, because as I said earlier, if you look at -- they're basically saying they're going to raise policy rates to maybe two or two and a half percent. That's the terminal rate. But inflation currently is like 8%. And so in real terms, or let's say inflation in the next year is 4%, or 3%, even. At two and a half percent, your policy rates are still negative in real terms. Like normally, when you go through a tightening cycle, your policy rate should end up being above inflation. And that means your policy is tight, and you're going to slow things down. So, it seems like the Fed is saying that given the current makeup of inflation, we just need to do kind of enough to

do a soft landing and that'll be enough to bring inflation down. But if you look at the supply issues in the world, you actually need a hard landing in order to bring inflation down.

Richard: 00:31:59

Yeah, but Bilal, shouldn't we be thinking about the inflation issue through the lens of the most recent update to their framework to the Fed's framework, which is to think about this in terms of rolling windows of inflation, and so there's an average inflation that they're looking at. And, to add to that, there's an argument to be made that because this is a supply shock and because there's now this idea in the zeitgeist and there's probably some truth that, that there's deglobalization happening, and that the US has realized that they can't afford to have critical supplies be offshore particularly in countries that might be less than friendly to them.

So, in actual fact, you should be looking to keep liquidity around so that CAPEX expenditure could be directed towards the creation of factories, to the building of factories and to the creation of the framework to provide that supply. And the fact that with an oil shock, it's quite likely that we might have a slowdown in the economic activity in the West in general.

Adam: 00:33:09

Just to inject here a little bit because I think one of the wildcards in this cycle that I think is maybe underappreciated is the fact that household balance sheets in the US especially, but around the world, really, are more flush with cash than at any time since, in the post war period. And I mean, not just a little bit more, but like off the charts more flush with access to immediate liquidity, which means, to my mind, there's a reasonable chance that the typical models for supply/demand curves are going to be pushed substantially more to the right than maybe most economists are expecting. So, in other words, we may need much higher prices in terms of supply shocks and prices of inputs, in order to facilitate or catalyze a material slowdown in demand. Just because households have a lot greater capacity at the moment to endure higher prices for longer. And so I wonder, the degree to which that may provide an extra set of complications to Central Bank policy making here.

Bilal: 00:34:28

Yeah. No, I mean, those are all really, really good points and kind of at the heart of all of this is how do you deal with a supply shock? And in some ways the answer is it's hard for the central bank to be the only actor to deal with this all. In reality, what you need is you need a supply side response from the government in some way. So, for example, you basically need a change in your trade policy to allow you to make sure that you're only trading with countries who you have strong relationships with. That's not under the remit of the Fed. That's a trade policy dynamic. You need incentives to onshore manufacturing, to make sure that you have more manufacturing resilience. Again, that's to do with issues around regulation, for example.

So, at the moment, one of the reasons companies offshore a lot is partly its costs, but also its regulatory arbitrage. Because to open a factory, if you have huge amounts of regulation to do that, it's just too difficult to do that. So, you basically do the regulatory arbitrage and have it in a country that doesn't have such high regulatory standards. And so there needs to be kind of a view on that as well. And then in terms of energy transition, for example, as a policy, again, it's hard for the private sector to do itself, it has to be sort of government led. So, in reality, what you need is you need a wholesale governmental response to a supply chain issue, and then you need to have an accord with your allies. So, right now, Europe and the US, because of the Russia thing, they've got an agreement, now the LNG from US will go to Europe, you kind of need an accord like that. So, in reality, you need all of that, to make all of this work. Just with a central bank to do this is the central bank's using a really crude device to kind of deal with all of this.

On some of the specific points that you mentioned, on the household savings, it is definitely true, the balance sheet, a lot healthier than before. The issue, though, from a growth perspective, is that if you think about savings rates in the US, they're now back to, if not below pre-pandemic levels. And so that tells you that people have, like, that they're not saving much. On top of that, their real earnings are falling as well. So, they don't have as much purchasing power as before, and whether they can dip into their savings, their stock of cash to spend, it's really, really unusual for the savings rate to go negative. It just doesn't really kind of happen. So, I think that there is an issue in the US and in other countries where the labor market at one level looks very strong.

But when you scratch away at the surface, the labor market is much, much weaker than it looks. And I think that the pandemic has distorted the strength of the labor market, because there's a lot of people just who haven't been willing to work or because of restrictions, they haven't gone out or because of schools, they've been forced to stay at home. But when you remove all of that, which is happening now, you'll suddenly realize actually, the labor market is a lot weaker than it first appears. And one way of measuring this all is that number one, if you have a very strong labor market, real wages should be going up, not down. So, basically, workers should have more power than the companies. So, they should say to the companies, your prices are going up so my wages should go up even more, but that's not happening.

Another measure is if you look at the employment ratio of the working age population, today, the overall number of working age men and women isn't back to where it was before the pandemic. So, there's still this latent supply of people. And then if you look at hours worked, overall hours worked are still below trend, so people aren't getting the hours that they need to work. So, one measure for a strong overheating market is people can get the hours. So, if you're a worker, not everyone has a nine to five full-time job. A lot of people have like hourly jobs, where you basically desperately want to get 40 hours, and instead, you only get 30 hours. So, you're not seeing that. So, there is this kind of labor market weakness, I think, that's been underappreciated. So, I do think that even though household balance sheets are relatively strong, there is some weakness there. Then also, if you look at the distribution of household savings, it is skewed to the richer end of the spectrum.

Mike: 00:38:52 Yeah. I was just going to say the fact the Fed finds itself with their new sort of equality mandate, across their monetary policy, that's another issue, right? Because the saving rate is high for a certain group of people, it's not high for another group. So, how are you going to do that anymore? You're going to need more subsidies for lower and middle class? How are you going to get money to that group while you raise rates on the other group that has the savings.

Bilal: 00:39:17 Yeah, I mean, this is one of the paradoxes of the pandemic, which is that the sectors that got hit the most were the manual sectors, the sectors where people have to face other people, people have to touch things. Whereas the upper and middle class are people who work behind screens, they don't physically have to interact with people. So, those sectors have done well because they were able to go remote and they have broadband connections, whereas people who work in transport, work in retail, the most precarious sort of professions have been the ones that have been hit the hardest.

Adam: 00:39:50 I want to stay with the inflation discussion and the ability and tools at the Fed's disposal to manage some of this. And I think -- I mean, you raise some really good points in that the Fed's tools are blunt, and they are most effective in coordination with a variety of other actors who are all pulling in the same direction. The challenge, I think, at the moment, especially is that the regulatory and trade type of policies that might be enacted here and incentives that might be enacted; these are intermediate to long term solutions.

And I think the fear here are just to invoke a framework that I've heard Mohamed El-Erian articulate. You've got this idea that inflation starts in a very narrow sector of the economy. He sort of talks about lumber as being sort of the original start of where inflation began to enter the public consciousness back in sort of late 2020, early 2021. It's obviously spread into the energy sector most acutely, but you're obviously seeing it in a wide variety of sectors. And that once this -- so you got stage one where it's very narrow, begins to catch attention, stage two is adaptive expectations, individuals and companies begin to raise prices, both because their input costs are increasing, and they're trying to maintain margins, and because the consumer is acknowledging that there's inflation, and they're willing to spend more to get the same goods.

The Fed doesn't really have any ability to moderate those stages of the inflation process. But the third stage is the most insidious, and that is where citizens, consumers begin to anticipate a sustained inflation cycle and build that into longer term expectations. And I think this is the role where the Fed can step in and have a very large impact, because this ends up being a signaling question, right? How do you signal to citizens and consumers that the Fed and policy makers will not tolerate a sustained inflationary impulse that devalues the dollar and all of the dollar-based liabilities that exist around the world? And so I think we're well into sort of stage two here.

And the question is, is the Fed going to take the action necessary to short circuit this longer term inflation expectations spiral? And so do you think the actions and the statements that the Fed has made so far are sufficient to short circuit that or do you think that they're going to have to do more? And do you think that maybe that's what we're seeing being repriced in the bond market, and it just hasn't had a chance to propagate to other asset markets?

Bilal: 00:43:02 Yeah, yeah, I think that's a fair point. I think that in terms of the Fed, I mean, I think that they've swung from being behind the curve to being with the curve. And I think they probably need to do a bit more to get ahead of the curve to really bring down those expectation. So, for example this year the market is pricing another maybe 200 basis points of rate hikes. Next year, maybe two hikes. So, the next year one seems a bit too low. So, perhaps there should be four hikes for next year. So, maybe the Fed policy rate should get to like 3%, or something like that. So, I think the Fed kind of needs to move up in that direction. And I think the Fed's done quite a bad job in its communication. And it always seems to be kind of catching up to something. So, we had the Fed meeting a week or so ago, then Powell had to come out with a speech at the beginning of this week to clarify that they are hawkish, and that's what's caused the latest move up in yield. So, it tells you that the Fed is struggling to articulate this policy that well. So, I think they're moving in the right direction to deal with it in this paradigm, and they could do a bit more.

Now on the question of the spiraling expectations. I know El-Erian, and many others, Summers, have talked about this. I personally am a bit skeptical of the whole wage/price expectation spiral sort of dynamic, partly because if you look at forward looking inflation expectations, they're all relatively stable. Most surveys basically tell you near-term inflation, and then long term, it's going to be fairly well anchored. Secondly, so throughout this whole experience, you haven't seen this sort of de-anchoring. But secondly, if you look at the relationships between expectations, consumer surveys, even if you go back to the 70s even, what you find is that it lags actual inflation. So, it never leaves inflation, it's always like, if inflation is 8% today, then inflation expectations pick up. If it goes down to 6%, it will then also go down. So, it just follows spots. And it's a bit more skewed towards salient prices like food and energy, things you interact with every day.

And so those prices move around a lot. So, I'm kind of skeptical about that spiral. And if you really did see that, I think you'd also see real wages go up much more quickly, which you're not seeing at the moment. And I think if you go back to the 70s, and the 60s, we're in a fundamental different structure of an economy to back then. Back then you had a price controls that were being lifted, you had trade unions, the power dynamic between companies and workers was so different. And importantly, one of the big differences I don't think many economists quite appreciate, or academic economists appreciate is how financialized the economy's become.

So, from the 80s onwards, since the big bank deregulations onwards, there's so much financialization of the economy, I mean, the amount of -- like the most actively traded market in the world is foreign exchange. Six trillion dollars, is traded every day in FX markets. You know, 10 years ago, it was $4 trillion. So, it's gone up 50% but world trade hasn't gone up 50%. But what has gone up is all this financialization and that's important because that tells you that a big outlet for extra money printing or high or low rates is the financial sector, always. Whereas in the 70s and before, you didn't have the outlet. So, all of that money printing or whatever just had to go to the real economy. That was the only outlet. There was capital controls back then, there was limits to how much dollars you could take offshore, that was the creation of the offshore Euro dollar market.

So, I think that's one kind of big difference today, there's this outlet that you have for inflation that you didn't have before. And so for me to really see a truly inflationary paradigm going forward, I think we need to see a reduction of the power of big companies. So, more worker power, employment rights. You would need to see some kind of shrinking of the financial sector, perhaps even capital controls. Once you kind of do all of these steps, then you'll end up in an environment where you could have structurally higher inflation and higher wages. In the absence of that, I think that, in the end, once the supply chain issues or supply side issues ease up, then inflation will come back down, and we won't have this. And so the expectation spiral won't be enough to be able to keep inflation high once all of these energy things start to come down.

The Lost Generation

Adam: 00:47:55

One a second on the -- Richard, I just want to tie together a loose end here, because you did mention the labor market Bilal and I just wanted to run a couple of things by you, because it occurs to me that this is a very different labor market than the 70s in a few ways, but in one especially important way. And that is that there are no labor unions. So, how do workers now advocate for higher wages? And seems to me that the most common mechanism that maybe economists would point to would be mobility, right, the ability to leave one job for another higher paying job. And I'm wondering if this dynamic is complicated by the fact that housing prices have shot up so substantially and so quickly, in so many of the major employment centers. And so if you bought a house, locking in a 30-year mortgage at a two or 3% rate, and rates are now four and a half, 5%, and you're looking at having to sell your house in San Francisco, or Austin or Dallas, or Miami or whatever, and move to another place to get a job at a higher wage, then you're looking at a very substantial increase to your cost of living in terms of needing to now buy a new home and get mortgage financing at rates that are a full 50 to 80% higher than what you were currently locked in at before.

So, I think this may be substantially limiting labor mobility and therefore substantially limiting the ability for people to move jobs, and that may be constraining this uptick in wages. And I'm also wondering whether maybe this massive increase in house prices and of course, in other asset prices has created such a wealth effect there's less of an urgency for workers to either re-enter the labor market or feel urgency to enter the labor market, and therefore increase the supply of labor. And the urgency for people that are currently working to seek a higher paying job because they're making so much more money on the appreciation of their home and the appreciation of their other equity portfolios than they would from a 10% increase in their pay. Any thoughts on those?

Bilal: 00:50:27

Yeah. I think they're all excellent, really, really good points, and I agree with them, all of those points that you mentioned. I mean, for sure, there is one of the big factors -- actually, there's two big factors around mobility that become very important. You know, one is house prices, as you said, it's hard to move from less economically developed areas to more prosperous areas, because of the housing costs. And then there's also a direct mobility issue as well, where if you have poor transport links, within areas, even within a town, or within a city or within a state, if the transport links are poor, that also impinges labor mobility as well, in the sense that if the subway lines, or the public buses aren't running that actively, then it restricts the types of jobs you can get even within states. And not everyone can afford a car either and so you kind of have to take that into account. So, I think one of the neglected things in lots of these inequality studies and labor market studies is about mobility, transport links within cities and within states and that's a big kind of issue.

On the housing, the other related point is, there's a generational issue here as well, which I think we also have to appreciate that the young generation, people in their 20s, essentially don't have houses, can't afford a house. And so they're basically in a really, really difficult situation. And the pandemic specifically has really hurt recent graduates from university and anyone in the education system has basically had a horrible time. And so there is this issue of 20-somethings, in particular, but even 30-somethings to some extent, who are really kind of doing worse than the same point of the previous generation of boomers or Gen X even, some Millennials or Gen Z. And so there's a generational gap here as well, which is important to recognize.

And interestingly, what the pandemic showed was that from a policy perspective, the health and safety and the welfare of the older generation was elevated above the younger generation. So, a very strong decision was said, okay, whatever it takes to protect the older generation we'll do. So, house prices went up, the economy was shut down to protect older people getting affected. But the consequence of that was younger people -- there was an educational loss, they weren't able to get the property. So, I think this is going to be an issue, a real structural issue, that we're only now starting to kind of appreciate what this means. In some ways, it's almost like a lost generation that you're going to have. And there's a parallel with wars as well. When you have a war, you kind of have this effect where there's a kind of a lost generation because they've suffered from this all.

The other point I would make about the mobility issue is that, because some of the points you mentioned about housing, and that was already the case before the pandemic that was a kind of an issue in terms of mobility between states. I think an interesting feature about the pandemic specifically is how has technology now entered the services sector? Because the narrative everyone over the last 30-40 years has been that technology has really disrupted the manufacturing sector. It's allowed globalization, offshoring, and all of that type of stuff. But the service sector has been relatively untouched by technology in terms of automation. But I think during the pandemic, what's happened is that lots of service jobs have been automated. So, for example, I'm sure you see this in Canada and North America, but in the UK, when you go to a supermarket store, they have self-checkouts. That was already the case before the pandemic, but now everything is self-checkouts. If you go to a food place, like a sandwich place, increasingly in London now they're self-checkout tills, they're getting rid of the staff. So, you get your sandwich, you just put it on the scanner, and then you walk out. So, you need less staff for that.

In terms of food delivery services, what's happening now is that in the past, you'd order from a, you'd use a delivery service and the restaurant on the high street would cook the food and a moped would then deliver it to your house. Now what's happening is those same restaurants now are using what's called *Dark Kitchens* in industrial estates to cook the food under the same brand name, so they no longer need to have that restaurant or kitchen in expensive high streets, now you deliver food remotely. I have a startup so I've been hiring people and I've be hiring people remotely. In the past, I would have just hired people in London and in New York because I'm in the finance sector, very expensive. Now, most of my staff aren't from London or New York, and they don't want to move to London and New York. The salary cost goes lower, because your labor market's broader.

So, suddenly, it flattens out the labor market. So, suddenly the mobility now, it's gone into the digital space where, okay, I need somebody who's a computer programmer, or I need an accountant. In the past, you'd go to an accountant in your city. Now you don't need to. You can do it over Zoom, they could be based in a much cheaper cost center. So, I think we're only now starting to see the impacts of this and this is really disinflationary. I mean, so in essence here, what this is doing is it's basically saying that, we thought physical geography was some kind of constraint on the labor market. But now because of Zoom, and like what we're doing here, suddenly, it allows, especially service sector jobs, you can suddenly open it all up. And I think that's something where we aren't quite -- we aren't quite sure the full consequence is of that.

So, for me, the technology impact on services, and the lost generation are two kind of outcomes of the pandemic that aren't discussed enough that we kind of all know intuitively, and policymakers aren't talking about these things because obviously, they're putting fires out all the time. But from a structural perspective, these are the things that are going to have profound impacts on all of our lives.

Positioning Strategies

Mike: 00:56:41

And you mentioned this sort of mega trend is something that you've been keenly focused on in the service sector, sort of dislocation, if you will. What are some of the ways that you're suggesting people position themselves? Like, is there particular stocks that you're suggesting? Is there particular areas or segments of the market that you could share with everyone? So, I know you go through your framework, mega trends, cyclical trends, and then how do we -- Okay, now we've got an idea, how do we manifest it through actual positions, and I'm wondering if you can share it. If it's proprietary, that's fine too.

Bilal: 00:57:17

Yeah. I mean, the challenge with this is that many of these mega trends kind of link to very fashionable mega trends as well. So, part of the whole flattening of the labor market, the service sector tech play is the technology platform play, Zoom and Microsoft and all these sorts of things. So, there's a tech element to it, which is already well priced and overpriced for lots of other reasons, not just that. So, I think it's hard to play it in that direction. But what it does, the way you can play it is through taking the view that inflation will be structurally low, after this all. So all the people that are kind of looking for a return to a 70 style, like a decade of inflation, for me, that's a way of playing it, to say actually no, we aren't going to have a decade of inflation, because we're going through the structural sort of change.

So, you always want to kind of fade the regime change people. We definitely do have inflation now and it will last maybe for the rest of this year, if not longer, maybe next year. But in the end, if long term inflation starts to take off, I'd fade that in the DM world. But I do think where there is value is EM, in the sense that technology will open up the EM side, places like India, for example, which already have quite a vibrant service sector. And they are kind of thinking about their long term goals. It kind of opens up EM in a way that wasn't the case before. So, countries with fairly well-educated labor forces, especially at sort of the top tier, those economies will do particularly well, and EM is just trading really poorly. And so that could be a way to play this.

Mike: 00:59:08

Is there any chance that the push to automation, actually, I mean, in order to automate, you need software, but you also need the machines and mechanics, and oftentimes, some of the more rare inputs to that from a commodities perspective. Does that drive that commodity bull run a little bit longer or?

Bilal: 00:59:27

Yeah, yeah. No, that's a good point. I should also mention that. I mean, just to kind of put this into historical context, it feels to me now, it reminds me a lot of the early 2000s where --I remember in the 90s it was all that dot-com tech stocks, and everything like that. And so it really felt like we had left the physical world. It was all -- everything was on screens and the internet, information superhighway and all of this type of stuff that we were talking about in the 90s. Then suddenly the dot-com crash happened in the early 2000s and 2000, and we had the rise of China, as its middle class grew, and suddenly commodity prices just went off the charts because China was basically, had to, like use all the world's commodities to build its roads. And so suddenly, the 2000s it was all about nuts and bolts and oil and commodities. So, we went from the digital realm back to the physical world, realizing there are constraints to the physicality, there's a physicality to the world.

And so for the next 10 years, you had the super cycle. So, I think there's something similar going on now, where we've come up this period of like tech this, tech that, and we've forgotten the physicality of the world. And obviously, we're seeing that now with supply chain issues. But all of this tells you that there's limits on -- there's constraints on all of this automation production. Energy transition, as well is a classic one where that's going to require a huge investment like, proper physical infrastructure investment, which will require all of these inputs. So no, I do agree. I think commodities are likely to have -- continue to have a really sort of strong run from here, even from current levels.

Policy Blunders and Recessions

Richard: 01:01:12

To press pause for a second on the forward looking part of the conversation, which I'm sure we'll return to, but I wanted to pull on the thread that we were discussing earlier. And I heard you on a recent podcast with one of your researchers, Dominique, and she was saying how she puts it at 50% of her base case is now that in the next 12 months, we're going to have some form of recession. So, I wonder if you might speak to some of the leading indicators and some of the parameters that she's looking at to make that type of assertion. And with that in mind, the whole conversation about tightening, does that sort of suggest that Powell and team might just be walking into yet another policy blunder?

Bilal: 01:01:54

No, that's a good question. Yeah. I mean, first of all, thematically yeah, I think, for me, as a market's person I always like to think about the next big theme and that's hence this conversation with Dominique and our team. So, last, like a year or two, it's been inflation, everyone's been talking about inflation, inflation, inflation. And even today, inflation is the big topic. But for me, the story is really recession, that that's the next iteration of this all. If you just fast forward everything, the next move has to be a recession and the question is just timing, and how soon will that happen. And so I think, for me, the inflation story is really, there's a huge amount of ink has been spilled on inflation. So, I feel like every side of the argument of inflation is well known. But the recession story isn't well-known. So, for me, the thing I'm just focusing on intensively this year is recession, recession, recession, and trying to understand how a recession could happen.

Now, to start with, if you just look historically, like over the last 30-40 years, you find this interesting phenomena, that whenever you have a Fed tightening cycle and rising oil prices, almost always you get a recession. Whether it was coincidental or not, that happens. So, 2007, oil shock, Fed was tightening and then you had the recession. 1990, the same thing happened. 70s, it happened numerous times as well. Because what you're doing there is that if the Fed's raising rates, that's tightening policy. Just costs go up in different ways. It's just harder to get things done. And oil is a big input cost, effectively it's like a tax. So, we have a double whammy now. And from the start of the year, if anything, everything's accelerated. The Feds becoming even more hawkish, and oil prices are going up even more so. So, the background I think, is very conducive to some kind of recessionary dynamics.

Then in terms of the specifics, the key thing for me if we take the US as the example, because Europe is probably easier to see a case of a recession for Europe, because it's not energy independent. But the US is the more interesting one. The key things for the US have been we had this big binge in goods consumption in the US. Everyone, you had in one or two years, you had the same amount of goods consumption growth than you had in the previous 10 years. So, a massive swing to one side. That's starting to fall now. And so the idea was that the service side will pick up the slack, it will really start to pick up and it hasn't. It's recovering but not dramatically so. So, that tells you that there's something -- the other part of the engine isn't working that well.

So, that's kind of a bit weaker. Why is that overall? It's partly I think, to do with this, things we were talking about, about the labor market that's a bit weaker than we think. But fundamentally if real wages are falling, that's a problem. It's just harder to get things moving. Then on top of that, if you look at the inventory cycle in the US, there was a big inventory buildup in Q4 of last year. So, basically companies have been basically building up their stocks, because they had low inventory before, so they had to build up the inventory plus, they were worried that they couldn't get stock so they double ordered everything. So, we've had this inventory cycle. And when you have that often, that takes away growth from the future because you're building up all the inventory now.

And then the other side of this is the fiscal side that we had -- last year or two, we've had this huge fiscal stimulus in the US, but this year, we aren't going to have anything. And so the net effect of that is you have a negative fiscal impulse. You go from fiscal stimulus to nothing, That leads to drag on growth. And then with midterms coming up, it's unlikely that anything is going to happen. And after midterms, the Congress will probably flip. And so no new fiscal will happen. So, you a get negative fiscal impulse, you get the oil shock, you get negative real income. So, all of this is basically pushing the US closer and closer to a recession. So, that's kind of the general direction, where we're kind of going in. Now, timing wise, what you need to see to time - so this tells us, this tells me that in the next year or two, there's a very high probability of a recession.

Now fine tuning the timing, the best things to look at are probably, you need to see the PMI numbers start come down. So, when that starts to fall much more sharply, that usually gives you a good sign that recession is imminent, i.e. in next few months. And then you need to see jobless claims really start to pick up again. So, for me, payrolls, jobless claims, and the ISM PMIs are the indicators you look at to fine tune the timing. So, the background for me is high chance of recession in the next year or two, and then fine tuning it, you look at these other indicators to fine tune it all. And in the case of the Fed, I think the Fed is kind of running into a blunder here in the sense that they're going to have to over tighten then they suddenly realize the economy's kind of slowing down sharply. And then at that point, they'll have to decide to pivot back to dovishness, which I'm sure they probably would end up doing or continue to hike to really wring out any inflation in the economy.

Adam: 01:07:03 So, help sort of reconcile this recession view over the next year, year and a half with again, this resiliency in equities, right. I mean, I feel like we've got a recessionary tailwind, we've got supply constraints on the inflation side, both in terms of the fact that China is still struggling with the pandemic, they're still on a zero COVID policy, they're still shutting down entire provinces and ports, at the same time, as we're getting four to 5 million barrels of oil coming offline, sometime in the next few weeks out of Russia. All the other secondary and tertiary impacts of the war. And yet, we still have this US equity markets within five or 6% of all-time highs, like something has to give here.

Bilal: 01:08:01

Yeah, yeah. No, absolutely. I mean, you're right there. I mean, the first thing I would say is that Chinese stocks have been trading pretty poorly, and rest of the world stocks in general have generally been trading poorly. Now, in terms of the relationship between stocks and recessions, typically stocks tend to weaken much closer to the point of the recession. So, there is a timing issue here, where rates markets tend to, just because of the nature of rates market, they tend to be much more forward looking. And stocks tend to almost like look at the next quarter. So, it matters whether the recession is in the next three months, or if it's Q1 next year. And if we're saying it's Q1 next year, it's too far away for stocks to really kind of be affected by that.

That said, if there is a recession, kind of on the horizon, to me, it tells me at the very least stocks should trade sideways, in general. Which they kind of in some broad sense they have. Especially, for the US, what I like to look at is the Russell 2000, rather than the S&P, because I think the Russell reflects the economy much better, because the S&P has the tech companies in there, which are kind of global, and they're kind of a tech play, and they're not sort of linked to the economy directly. And so the Russell …

Adam: 01:09:13

They should be even more vulnerable, right, given that the derive so much more of their revenue from outside the US and the rest of the world is much more vulnerable to all of the -- first of all, you got the whole dynamic of when the US catches cold the rest of the world catch the flu, which is typically what happens. And the fact that all of these other countries are much more impacted by either major commodity price rises and/or just proximity to the war and conflict and other types of frictions.

Bilal: 01:09:47

Yeah, yeah. I mean, I think it depends on the types of international companies in the US that we're looking at. So, I would say like US manufacturing companies or certain banks and so on, they would for sure be impacted by slowdown in the rest of the world. For tech companies, it's a bit trickier because if you look at the behavior of tech companies or the mega tech companies, they sometimes behave cyclically. But sometimes they behave like utilities as well, because they have attractive like dividends or buyback schemes and such. So, there's this kind of safe haven dynamic that you have within big tech, that makes it a bit more tough to kind of have the read through into the cycle.

Adam: 01:10:28

I think that's certainly the perception. I mean, I agree. I think big tech is being utilized here by global investors as a safe haven trade and I'm personally skeptical.

Bilal: 01:10:38

Yeah. Yeah. And it's a fair point and a point well taken, and it would be sort of vulnerable. I mean, I do think that the risk for big tech, for me, would be if we see this -- the way big tech isn't responding to higher rates. I think that's interesting. You know, it should reflect because if the argument is big tech gives you the yields, if interest rates are going up, then suddenly it doesn't give you the yields, and so it should be repriced lower. So, I think there's that. I think recently, I think the reason S&P has done well is that US, number one, is outside of the conflict zone, so US gets that benefit. The US earnings have been relatively strong as well throughout this whole period. And then also, there is this is kind of the reopening dynamic that also, to some extent, supports US stocks as well.

But I agree. I mean, I think it's really a question or matter of time before we see another down move in equities. We did see somewhat of a down move in equities. But then the bounce was quite strong recently. I mean, to be honest, I've been surprised about how quickly markets have shrugged off the war risk premia. I was kind of, we're going into this war and suddenly, the reversal's happened. And then I was stunned how quickly that's happened. And so …

Richard: 01:11:57 It's like the cleanest dirty shirt.

Bilal: 01:12:01 Yeah, I think there's that as well. And I think also, there's been a lot of position unwinding, bar shocks, margin calls. There's all sorts of weird stuff going on in markets right now. And so when that happens, it makes me cautious about reading too much into the price of something. Because it could just be some big position unwind, some quarter end rebalancing, some fund has blown up or something or …

Adam: 01:12:29 That's a really important point to remember through all this for sure.

Positioning Global Macro Views

Richard: 01:12:33 Yeah, I think this is something that we have touched upon on several episodes and in conversations internally, the idea that the price discovery is more and more skewed by the particular circumstances of market microstructures. And what's happening in certain sectors of the markets and big players unwinding or putting on positions and how that affects the signaling mechanism that the price of an asset might offer. So, as you're painting this global macro picture, and you have touched on this, to some extent, but I wonder if you might give us not investment advice, but sort of a general framework or a general positioning, how you're expressing some of these global macro views across asset classes.

Bilal: 01:13:21 Yeah, absolutely. Yeah. So, I kind of have this kind of almost sounds counterintuitive, but in my view, when you're in this kind of unstable inflationary environment, central banks hiking, stagflation, that whole mix, my bias is actually to be overweight cash in that environment. And so many people say you shouldn't go long cash, because in real terms, your cash goes away. But my point is that it doesn't lose your money in nominal terms. And the risk is that if you have money in bonds and equities, there's a high chance that you could make losses on your capital in nominal terms. And so to me in a year like this, where there's lot of uncertainty about what regime you're in, there's lots of geopolitics. It's all about survival, almost. So, the first rule of investment is survive, don't get wiped out.

Mike: 01:14:12 Yeah. Return of your capital, not return on your capital.

Bilal: 01:14:15 So, for me, that's the overarching mantra, is that. And so one is to be overweight cash, underweight equities and underweight bonds. So, if I had a choice between bonds, equities and cash, I'd pick cash. Now, the only thing I'd be willing to go long in is commodities because I do think that we're in this environment where everything geopolitics and supply chain all of this type of stuff just points to higher commodities. Which commodities? I think you just have a basket of commodities because there's a strong case for metals, energy, wheat, fertilizer; everything's kind of affected in some way. So, overall, that's kind of my basic answer. Keep it simple. Pretty much stay away from bonds and equities, be long cash, which also gives you optionality as well. So, for after big drops in other asset classes, you can use that cash and buy something, and long commodities.

I also, and we haven't talked about this so far, I'd also be small on crypto as well. Now part of that is a structural view that I think crypto is slowly becoming an accepted asset class. But also, I think there's some interesting features about crypto that provides some diversification. Because from a portfolio perspective, what you want is diversification. So, equities, bonds, commodities and so on. So, the question is, what is the diversification that crypto brings you? And for me, like at the fundamental level, the diversification it brings you is diversification of institutional exposure. So, if you imagine if you're holding dollar-based assets, you're exposed to the US regulatory financial legal system. Euros, it's a European system. Renminbi, it's the Chinese system, Rupee, it's an Indian system. And crypto is independent of any country. By its very nature, it's decentralized, permissionless, internet-based, and so you're exposing yourself to kind of a neutral institution.

Adam: 01:16:19 Can I press pause on that?

Mike: 01:16:21 The different ecosystems.

Bilal: 01:16:21 Sure.

Adam: 01:16:21 Because I kind of feel like, I don't know. Just, where are all the people that are going to be spending these crypto, this crypto wealth going to live. Because I mean, are they going to live on a convoy in the middle of the Pacific? Because otherwise, they are eventually going to be subject to the regulatory environment that -- in which they're resident, right? All of the other things that matter in their life, right, the things that they're going to consume, the assets that they're going to own etc. Right? So, I'm not sure that decentralizing the transactions necessarily allows people to disengage from the regulatory environment in which they're situated.

Bilal: 01:17:00 Yeah. No, that's a fair point. I mean, there still is -- I mean, that the key point of regulation is really the on-ramp process of where you go from dollars into the crypto world. Once you're in the crypto world, that area's much more harder to regulate. Because if you transact from one wallet to another on a decentralized exchange, no one can stop you doing that. That's just going to happen. And that can't be kind of captured.

Mike: 01:17:33 You also have self-sovereignty. If you hold assets in a dollar-based or Renminbi-based, you are subject to the sovereignty of that jurisdiction. And just as in a whole bunch of truckers in Canada learned, for simply protesting, you can have all of your assets seized, without question.

Bilal: 01:17:55 Yeah. So, that's kind of one side of it, that once you're inside the crypto world, no regulation can stop you from transacting with somebody else. And they can't take that money away from you once you're inside it. It's basically who are the gatekeepers who allow you in. So, that's one thing. Now, aside from that, what's the use case of crypto is the other point. So, let's say everything's kind of fine and stuff. One basic use case is that, say, something like Bitcoin, if that is a scarce asset where you could guarantee ownership of that scarce asset, and there's limited supply, then it's no different from gold, it's just that it's on the internet rather than gold. So, whatever the investment case is for gold, you can make the same case for Bitcoin. It's just in the digital realm. It's a scarce supply, it can't be increased. So, for Bitcoin specifically, you have that use case.

Outside of that, the other use case then is when you start to go into the other types of cryptocurrencies, like Ethereum, which are programmable. So, within there, you can basically start to create all sorts of additional crypto based features, which have use cases. So, one is the whole decentralized finance where you can basically start lending and borrowing and things like that. So, you've created a little mini financial industry on Ethereum, just like there's a financial instrument in the real world, you created one than the decentralized world.

Then there's the whole NFT metaverse side where you can start to buy and sell items within games, which is you know, which is the whole digital economy. So, to the extent that video games is an industry, then there's a crypto version of that as well. And the blockchain allows you to do certain things that you couldn't do before. So, you suddenly start to create all of these additional new kinds of like virtual economies, you could say.

Richard: 01:19:48

I like this framework and the thesis behind the bullish view on crypto. But I wonder if we might bring it back a step and say, you have a background in currencies. So, we've talked about a little bit about the dollar. I don't know if you feel that it too is the cleanest dirty shirt. And I wanted to frame this in the context of the recent sanctions that have been enacted and the idea now that assets in the treasury is going to be seized. And so what that does for the dollar reserve currency, also the petrodollar system coming undone if in fact, Saudi Arabia starts to fully cater to the east, particularly to China. And so the Pax Americana was already on its way out to some extent, or everybody could kind of see the writing on the wall. But now that seems to have been precipitated by recent events. So, I wonder if you might contextualize gold, currencies and crypto in sort of this relative game of currencies.

Bilal: 01:20:54

Yeah, absolutely. You know, I would kind of make a distinction between the price of the dollar right now, the ups and downs of the dollar, and whether the dollar is the dominant currency in the world. So, for example, the dollar has been the dominant currency, since pretty much you could say the First World War, definitely since the Second World War. And over that period of time, so since the Second World War, the dollar has gone up for 10 years, it's gone down for 10 years, gone up for 10 years, gone down for 10 years, gone up. I mean, it's followed this long term cycle. And during that entire period, the dollar was the top dog. So, we kind of have to separate out whether the dollar is strong today or not from the dollar being the dominant currency.

So, what do we mean by dominant currency? What we mean by dominant currency is that it's the most used currency when it comes to global trade that people, if they have to pick a currency, they pick the dollar, whether it's a commodity, a petrodollar trade, related trade. Whether it's if you invoice an importer/exporter, you'll pick dollars. If you're dealing in a non-US country, they won't pick Euros, they pick dollars. Reserve managers, central banks, which currency do they hold? Do they hold the dollar or do they hold another currency. Then financial transactions, what's the dominant currency in financial transactions, which is the most transactions in the world, is in financial. And what we've seen is over the last 10-15 years, the dollar is becoming more and more and more dominant. So, today the dollar is more dominant than it's ever been, in terms of the use in everything. So, it kind of sounds odd, but it's used more than ever before.

And so, in order for the dollar to be toppled, you need a couple of things to happen. One is, the key thing for me is, who can replace the dollar in the financial system, in financial markets? So, for example, with interest rate swaps, bonds, equities, the trading of everything in the world, who are the alternatives? It can't be crypto, it can't be gold, they're too small. They're minor players. It's either the Euro or the Renminbi. They're the only two players that matter, because Euro's a big enough economy. But what Euro has shown after the Russia thing is that Europe is subordinate to the US in some ways, that Europe will just basically follow whatever the US says, so Europe isn't really going to push this that much. So, China's really the alternative. So, the question then is, does the rest of the world want to hold Chinese Renminbi, and that's not clear to me.

Richard: 01:23:31 And does China have the capacity? I mean, one of the benefits of the US dollar is the depth of financial instruments on which you can park these dollars. So, the depth of the Chinese sovereign bond market, the threat of capital controls. All this suggests that the US continues to be the cleanest dirty shirt, because -- and when push comes to shove…

Bilal: 01:23:53 Yeah, absolutely. So, that's kind of my view. And China, in some ways, if you look at what they're doing, they aren't necessarily trying to replace the dollar on the global stage. What they're doing is they're doing strategic bilateral agreements. So, they've recently did an agreement with Indonesia where all their trade will be in Renminbi, all the trade between China and Indonesia will be in Renminbi now, not in dollars. Previously, it was in dollars, they then had to sell dollars to buy Renminbi. Malaysia, the same. They're trying to do that with Saudi. But even if they do it with Saudi, it still doesn't mean that the world will want to hold Renminbi. It's just that particular trade transaction that's between China…

Mike: 01:24:32 The funny thing there is that those are both pegged to the US dollar.

Bilal: 01:24:36 Yeah, yeah, exactly. Yeah.

Mike: 01:24:38 So, like, why -- Sure. Do whatever you want. It's still pegged to the US dollar.

Bilal: 01:24:41 Yeah. I mean, the real test is, will a non-Chinese country want to do a trade with Saudi in Renminbi or not? Or would they say I want it in dollars? So, it's always about the third country. That's the point about the US. So, if you look at the size of the biggest economies in the world, so Europe is one of the biggest economies, they favor the dollar over the Renminbi for sure. Brazil, who are they going to pick the dollar? India, for sure not the Renminbi, they're going to pick the dollar, Japan, the dollar. So, when you start to kind of get to the nuts and bolts, it's not clear.

Mike: 01:25:18 What about the idea of a basket, which has been sort of bandied about and is kind of now percolating up a little bit, again, with a basket of currencies and commodities and things like that, is that …

Adam: 01:25:30 Yeah, sort of, I mean, the Bancor idea proposed by…

Bilal:	01:25:35	Yeah, Bancor idea. Well, I think we have to sort of separate two things out where what you have seen already is that a country like China now doesn't manage its currency against the dollar, it manages it against the basket. Singapore does that as well, India does that as well. And their reserves reflect that basket. So, that's kind of happened at that level, but then when you look at global financial markets, if you're trading in equities or whatever, you don't buy a basket of currencies, you buy a dollar and then the dollar becomes something, use the dollar to buy treasuries or equities, or you sell the dollar to buy a Euro-asset. So, it's hard to use that basket. Now, the Bancor system was almost like what Keynes said was, you kind of almost set up a parallel FX market, which clears everyone's current accounts with this Bancor credits. So, that's much more revolutionary in some ways, because that's basically saying that you have some kind of rules of engagement around *trade balances have been balanced* or reach some levels, and then the Bancor currency will be the mechanism through which you do that. So, that has some kind of underlying framework for current accounts to kind of be balanced between countries. So, we're far, far away from that. The US won't agree to do that, the Chinese won't agree to do that, Europeans won't agree to do that. Nobody would …
Mike:	01:26:59	It's the best idea no one will do.
Bilal:	01:27:00	Yeah, the best idea nobody will do. And so that allows… And this goes to a deeper point, which is that why is the US the kind of the dominant currency that's used everywhere? And if you think about it, what it kind of goes back to is the fact that the US is the largest consumer in the world. Even the Chinese don't have really a big consumer base yet. It has consumption, but it still relies on exports to the US and rest of the world. Now, everybody's been telling the Chinese that they have to reduce the power of the production side, and boost consumption. But they haven't done that for lots of different reasons. And so in the end, everyone ends up having to trade with the US consumer through, either directly or indirectly. And so ultimately, if you want to use up the dollar, you need to have another economy that becomes a big consumer for the world so that everybody has to interact with that entity.
Adam:	01:27:55	But don't you think that's in the best interest of the United States? I mean, one of the arguments that I find most compelling, and I fully credit Luke Grumman with seeding this for me, but one of the things I find most compelling is that perhaps the dollar system no longer best serves the interests of the United States. Because what it's effectively done over the last 30-40 years is it's hollowed out the entire manufacturing base of the United States. And what we've seen in the last, at least the last couple of years, is this onshoring wave. And it's the Feds and the states, setting aggressive incentives and policies to bring manufacturing back

on shore. I wonder if it still serves the US to have the rest of the world do all of the manufacturing and for the US to simply send them bits of paper.

In a world where the US wants to see other countries come online and bring online their developed consumer base, so that the US can actually have an industrial sector; if that ends up being a sustained policy of the US, the US itself may have an incentive to undermine the global dollar system and put in place a broader system backed by some other collateral framework.

Bilal: 01:29:26 No, that's a fair point. And actually, there's an interesting historical precedent to all of this, which is that before the dollar, the pound was the dominant currency. And if you look at what led to the pound giving up its dominant status, which was just after the First World War, it was the decision of the UK. The UK devalued and moved off the gold standard. So, the UK actively said, we're giving this up, because it's just too much of a burden for us. So, what history tells you is …

Richard: 01:29:54 It was imposed in the UK because they couldn't foot the bill for WW1, right? So, at the end of the day, it was their active decision because they had no choice, to some extent.

Adam: 01:30:05 Well, no, they did have a choice, but it would have led to decades of austerity, of massive recession…

Richard: 01:30:12 Yeah. Well, so recession…

Adam: 01:30:15 It was a politically expedient solution.

Bilal: 01:30:16 Yeah. Yeah. So, I mean, they basically destroyed all sorts of alliances and allowed them to not suffer as much of a Great Depression as other countries did at the time. But what that tells you and the reason for bringing this up is that it's not so much the challenger that displaces the dominant currency, it's the dominant currency itself that decides on a course of action to end it. Now, what's the cost of the dollar being the dominant currency? I think, unlike the gold standard period, where that if you're the top dog, there's a deflationary bias to being the top currency.

Now, by being in a free-floating world, the bias is financial inflation, that's what tends to happen. Because what happens with the dollar being the reserve currency is that it allows the US to keep interest rates lower than they would normally be if the dollar wasn't the dominant currency. Because the rest of the world needs to hold treasuries as collateral. There's always this dollar shortage and scarcity, collateral scarcity, always. There's always excess demand for treasuries. No matter what the US does, there's always excess demand for treasuries, which always keeps down the US interest rates. So, if you keep down interest rates in the US, then that leads to all sorts of bubbles, and financial engineering and all of these sorts of things.

Richard: 01:31:34 And tech stocks will never drop.

Bilal: 01:31:35 And tech stocks never drop. And so that's a consequence of this. And also, by doing this, you also say that, if you want to be the top currency, you can't have any capital controls, that companies and everybody can move things around to really globalize everything then, as Adam has just said that means that, okay, cheaper manufacturing offshore, you just do that. So, that's the cost of having the dollar. Now, I think it does make some sense to scale that back and to pivot the other way. But I think it's going to be really hard for the US to do that, because all the interests are the other way. You know, for all the talk of backlash against the establishment, in the end, the establishment doesn't want this to change. You know, it's the financial centers are super, super powerful tech companies, like the low interest rates, big companies want to be able to locate not only their manufacturing plants offshore, but also their balance sheets. They like to sort of put it in all sorts of offshore centers to minimize their tax bills, and so on. So, there's lots of interests to keep the system as it is.

Adam: 01:32:49 Yeah, I mean, I'm sympathetic to the view that ultimately, the political policy direction at the margin is beholden to the preferences of the median voter. And certainly the policies of the last 30 or 40 years, have most benefited and continued to most benefit the largest voter blocks, which is the older Gen X's, but mostly the boomers. Right? And as we move from that regime, to a regime where the median voter is dominated by those in younger Gen X, millennials and Gen Z, then they may have very different preferences. And they may be looking at the policies of the last 40 years and saying we're now priced out of everything that our parents wanted so badly. And that allowed them to make a life and that are preventing us to recreate the life that our parents lead. And they may seek to unwind that, and politically, it may become feasible at that stage. Now, I'm not suggesting that that's a 2024 issue. It may be a 2028 issue. Right? But I think at least the potential for this is on the horizon in a way that we haven't seen in the last 30 or 40 years.

Richard: 01:34:20 Yeah, this does go back to the generational component that Bilal has mentioned a couple of times that I think that we keep coming back to. And I think obviously, this is a topic that we could spend hours on particularly when it pertains to US dominance. I mean, the US's ability to bring on fresh blood, the immigration policies of the US allow them to replenish their labor pool, whereas the Chinese labor pool is getting old before it becomes wealthy, and the same could be said about Russia to a much larger extent and Europe as well, and their inability to integrate their immigrants to their countries. I mean, the UK aside, but that's a big problem in France and Germany. So, I think the demographic component of all that we've been talking about cannot be overstated.

Bilal: 01:35:20 Yeah, yep. Yeah, absolutely.

Challenging Recent Themes

Richard: 01:35:23 Bilal, you've been very generous with your time. I think we're coming up on time now. Before we wrap up, I did want to ask you, as a fellow podcaster, and with the benefit of speaking to so many interesting minds, what are some of the themes that you've been exposed to more recently or views that you've been exposed to more recently that have challenged your previous understanding on certain topics? And what have been some of the topics where your views have shifted meaningfully after conversation with guests and their vantage point?

Bilal: 01:36:01 Yeah. No, that's a good question. I would say one thing has been probably on crypto. I was very, very skeptical on crypto until I started to have some guests, especially guests who were from the traditional finance world. So, I had one guest, Tanya Reef, who used to work at Alphadyne, and a number of other high profile hedge funds. So, she's from the macro world, and having a conversation with her was very helpful to kind of see some of the aspects of crypto, which I was kind of neglecting. I was so focused on some of the negative aspects that I wasn't really uncritically looking at crypto. So, I think that's one that has been helpful.

The other one was the -- I've had some conversations with some around risk management where I've tended to not focus on the value of cash in portfolios, because I've always been in financial markets for so long it's always more, I don't know, you always get pushed into doing something. There's hyperactivity. And so I've had a number of podcast guests who've just said that actually, sometimes cash is an attractive asset to hold. So, that's something that forced me to think a lot more about cash as an asset class and is cash undervalued or not? And this has led to me to kind of do some new research in this area about okay, if everything's overvalued, the everything bubble, what's undervalued on the other side, and so there's probably cash, is probably on the other side.

Richard: 01:37:40 Diego Pereira brings this point as well, he uses that framework as well.

Bilal: 01:37:46 Yeah, yeah. I actually used to work with Diego at JPMorgan about 20 years ago, so I know Diego. So, that's probably another one. And on topics like inflation, I don't think I've learned a huge amount necessarily, because the arguments on both sides are so well-known, that you just end up kind of debating timing depending on where you stand. I would say that some of the conversations I've had on the podcast about the politics of the Fed had been quite useful because I tend to underweight the politics side of the Fed. I kind of view them as

		technocrats. And that's, through those conversations, I realized actually I need to put a bit more weight on the politics that affect the Fed. Like Powell, who's not as strong a personality from a policymaking perspective as a Yellen, Bernanke, or Greenspan, who had very strong sort credentials and knew kind of how the world worked. Powell is kind of more of a politician in some ways. And so he's reacting to that, so that's another one. And then finally, I've had one or two podcasts with some Russian specialists … I have to admit, I wasn't an expert in Russia-Ukraine. So, that allowed me to understand some of the dynamics of Russia and Ukraine, which I didn't quite appreciate before. So, that was a gap in my knowledge set.
Mike:	01:39:14	Fantastic.
Richard:	01:39:16	And so before we wrap up, where can people find you, tell us all the details …
Bilal:	01:39:21	Yeah, absolutely. Yeah. So, you can just go to macrohive.com. That's where all of my and the team's research goes there. You can just subscribe, put your email in, there's a free newsletter, there's a paid option as well. On Twitter, it's Macro Hive, or my Twitter handle, Bilal_Hafeez123, @Bilal_Hafeez123. That's my Twitter handle. So, yeah, just macrohive.com is the easiest place to go to.
Mike:	01:39:52	All right. Thank you. Make sure everybody who's listening, yeah, Like and Share, smash that Like button, share it with your friends and helps us get great guests like Bilal on the chat macro for an hour and a half. Really appreciate it, Bilal.
Richard:	01:40:04	Yeah. Thank you very much.
Bilal:	01:40:04	Great speaking to you guys. Thanks a lot.
Richard:	01:40:06	Have a great weekend all. Cue the music.
Adam:	01:40:08	Thank you. See ya.