**Mike:** **00:02:12** How we doing?

**Darius:** **00:02:13** What's up, Mike?

**Mike:** **99:02:14** That was some crazy reverberation going. I don't know what our sound crew's doing but they're -- the hamster is not working hard enough. Are you hearing that? I don't know.

**Darius:** **00:02:25** Yeah. Do love the info graphics, man. That's good ad, got to pay the bills. How are you doing, dude? It's good to see you.

**Mike:** **00:02:30** Good to see you bro. Just, I'm here in Baton Rouge getting ready for the LSU/Old Miss game tomorrow. Getting my spirit on and chatting a little macro with the *macro meister* himself, 42. So, I'm looking forward to --

**Darius:** **00:02:43** Thank you, man. I appreciate you for having me on. I'm excited for you, man. …, so you're going to have a good weekend. I'm damn sure of that.

**Mike:** **00:02:52** We're going to have like a tailgate party with 100 people. So, I can't wait. We're going to keep this to an hour so we can go get started.

**Darius:** **00:02:58** Oh, dude, 30 minutes. I do not want to be the reason you are being held back from beer, cold beer on a Friday afternoon in Bayou, man. Come on.

## The 42 Macro Take

**Mike:** **00:03:07** Well, let's pitter patter and get after. So, Richard may join us. I know he's having a few computer issues. But so yeah, let's get caught up on the macro scene. What are you seeing out there? Give us a little bit of landscape of what 42 Macro's seeing. We got all kinds of upheaval in the bond market? What do we got, global growth, and then we got the long end of the bond curve giving us higher yields. I don't know. It's all very confusing. Help us.

**Darius:** **00:03:35** Yeah. So, this is -- So, macro's back and macro's back with a vengeance. You know, every sort of let's call it, I don't know, throughout the duration of my career, I started this business in 2009 after college. And you know, I'd say probably like every three, three and a half years, there's a problem. You know, sometimes it's longer, sometimes it's shorter. And this is one of the bigger problems. In fact, if you look at the, kind of the year to date returns of the cumulative peak to trough drawdowns we're seeing in fixed income and equity securities on a simultaneous basis, you know, this is one of the worst bear markets ever. You know, if you look about the cumulative destruction of capital, across the sort of total aggregate portfolio. And we're not even including the likely drawdown we may see in housing prices here in the US on a nationwide basis over the next 12 to 18 months.

So, this is nasty, it's nasty stuff. We know what's driving it. It's the Fed's reaction function to inflation. And so as investors in terms of thinking about where our next pivots are, how to put money to work, where to preserve capital, where to start deploying capital, it's really about understanding the timing of the Fed pivot, the nature of the Fed pivot. And then I would argue a secondary consideration to that is where are we in the growth cycle when that occurs, because that will have pretty significant implications on sector and style factor dispersion in equity and credit markets, significant implications on the sector dispersion in the fixed income markets, and how much sort of general risk tolerance investors are going to want to allocate.

**Mike:** **00:05:04** Yeah, yeah. What do you think of the sort of, I guess over the last day or so there's been this, there's a rumor of a pivot now. Right? So, it's like almost as though -- Hey, Richie.

**Darius:** **00:05:18** Hey, Rich. What's up, buddy?

**Richard:** **00:05:19** Hey, guys. Sorry. I'm late.

**Darius:** **00:05:21** No worries. Good to see you.

**Mike:** **00:05:23** No worries.

**Richard:** **00:05:23** Darius, welcome back. Sorry, Mike, you were about to ask something. Go ahead.

**Mike:** **00:05:29** Well, yeah, I just -- Darius just mentioned the pivot, global growth versus inflation. I think there's so many ways to go with this. I think one of the biggest things maybe Darius you can elaborate on is how the inflation regime may have changed, and its structural implications for the other asset prices? Like, I actually think that at the highest level is something that's kind of misunderstood. The reason that you're getting correlations between fixed income and growth assets now, and that's quite unique. Like, you have to go back to sort of pre-1990 to get bonds and stocks correlating.

So, we've got this combined drawdown in these two asset classes that for 30 years have been very non-correlated. And maybe you could touch on a little bit of the inflationary dynamics and how it sort of causes that structurally. And help, and help people sort of understand that this is truly a regime change, it's different. It's not *buy the fucking dip* anymore. Like this is a slightly different set of circumstances. You have to be careful with the BTFD of the crowd now. Right? I don't know. I'm just trying to help.

**Darius:** **00:06:41** Yeah, absolutely. So, one of my favorite jokes -- Ani, if you can pull up my slide deck here. So, one of my favorite jokes out before I even get into the inflation is we swapped the girlfriends here year to date. So, we went from, like dating our friend, Tina, she has all the rage, she's the hot girl on the block and now, we have to dump Tina. And now there's Tara, and there's a reasonable alternative to -- there is no alternative and that reasonable alternative now is cash, the yield that we're seeing on cash.

So, this chart shows, the blue line is the sort of the three month -- the 12 month T Bill yield at sort of, I think, where are we at here, most recent price at 4.47%. We got the S&P 500s next 12 month dividend yield. And as you can see, we're now 268 basis points north of that. I mean, you have to go back to when I was in I want to say sixth grade maybe or something like that. Oh no, I think it was in eighth grade the last time we had T Bill yields significantly higher than the S&P yield. So, there is a reasonable alternative. And part of the reason there's a reasonable alternative is the Fed's response to inflation. You know, you ask a question about regime change, and why stocks and bonds are now correlated after spending most of the previous 30 years inversely correlated and really been the foundational aspects of 60-40, risk parity, etc.

And the real driver of that is you get -- there's a couple of things. One, we're in a higher inflation regime, and we can talk about all the different drivers of inflation regime separately, but just kind of the key takeaways on this transition, this regime change is, higher inflation tends to beget higher inflation volatility. The blue line in this chart just shows headline CPI data going all the way back to 1881, from my former professor at Yale University here, Bob Shiller. And what you tend to see is high inflation regimes tend to correspond to higher levels of inflation volatility. This red line shows the percentile of the trailing five year volatility, realized volatility of headline CPI.

And so when you look at that further, you tend to want -- you can sort of explore the data in several different sort of categories. But one thing we looked at and did the research on is try to understand, hey, what does the higher inflation volatility mean? Well, we typically see higher volatility in both nominal and real economic growth. And what we're showing here in this chart as a proxy for both nominal and real growth, are just the mean percentiles of the five year volatility of nominal earnings growth and real earnings growth on the right. As you can see, it's a pretty linear step function, increase higher if you go from the first quartile to the fourth quartile in inflation volatility in terms of the relationship to earnings volatility.

And so part of the reason you know, good to kind of land the boat on the plane or land the plane on the tarmac here, part of the reason we're seeing so much volatility in fixed income markets, because we're transitioning from something that looks like this, from an economic standpoint, a nominal growth standpoint, a real growth standpoint, the two most important variables for pricing fixed income securities, to something that looks more like this in terms of the kind of volatility we're going to see with inflation and growth.

And so ultimately, the bond market is having a really difficult time. This is 10 year Treasury term premia. The bond market's having a difficult time trying to ascertain, one, what is the fundamental price of a fixed income security in this different regime where we're probably going to have more structural inflation. And I also happen to think, which is a loaded statement, we can unpack this later. I also happen to think we're going to have a Fed acquiesce to more structural inflation at some point later in the next couple of years. And so as a function of that there's all this sort of consternation going on across global sovereign debt markets associated with repricing all that different volatility and the changes in the Fed's reaction function of that, but also consternation associated with just the general uncertainty that those are kind of big things there.

**Mike:** **00:10:31** What are you seeing for the sort of long-term settling out on this inflation rate? Do you think they can even get to a target of two? Or do you think that that's more three, four and a half, and yield is going to be a little higher than that a little longer?

**Darius:** **00:10:44** Yeah, no. So, we've built a pretty sophisticated dynamic factor model. We've been talking about this all year, really since February, which is if you look at some of the core drivers of core inflation in terms of projecting the underlying mean of the time series, things like automation, globalization, or rather deglobalization at this point; the rise in public debt, monopsony power, wealth, wages, all that stuff, the things that have contributed to persistent disinflation over the last 30 to 40 years, all those things are -- not all, but many of those things are moving in reverse. And the key takeaway is when you sort of run the analysis, our model is projecting a range of about 70 to 120 basis points more in terms of the underlying mean of core PCE

Now, that doesn't sound like a lot, but what it effectively means is, we're going to go from something that's just inside of two, to just inside of three. And this is before we factor in any sort of incremental commodity price, inflation, potential dollar depreciation, the other side of whatever Fed pivot we're likely to get over the medium term. And so all that stuff is going to be additional sort of, let's call it additional impetus to the underlying mean of inflation to transpose itself higher. And so I happen to think that it's going to be very difficult for the Fed to get inflation, to stick inflation persistently in and around two. I think three is going to become the new two, as it relates to core inflation here in the US, unless they really want to sacrifice kind of the economy, to kind of achieve what is, will increasingly, in my opinion, become kind of an outdated political objective.

**Richard:** **00:12:19** But didn't the Fed change their framework, Darius? Remind me, I'm trying to remember if this was right before COVID or right after COVID. But they went from an av-- they moved towards an average inflation target, right? It's never really a target. It's not an explicit target. But implicitly, there's a band of comfort that used to be 2% a year, and then they move towards something that was average. And I don't know if they specified the number of years that they were averaging out. But it sounded like they were trying to buy themselves some room in order to allow for some more inflation volatility, if you will. Wouldn't this sort of give them a little bit more leeway given what you just described?

**Darius:** **00:13:00** Yes and no. So, we're well past the threshold of leeway, right? Like, going from two to four and saying it's transitory, that's the leeway. Going from four to nine, is well beyond the point of leeway and it's obviously an issue, both politically and also to the broader economy and to capital markets. And so the problem with having a 2% average inflation target in a world where inflation is three, is that you're never going to get to the below two, to meet your average, right? And at some point the Fed has to acknowledge the fact that the economy has changed, and we have things like deglobalization and rising competition for resources, etc., breaking apart of supply chains from a global perspective to a regional perspective. All this stuff is contributing to that.

So, the Fed -- and by the way, Jay Powell has been one of the thought leaders in the global financial or global central banker community about acknowledging all this stuff changing in real time. And so ultimately going back to the pivot that they made, you highlighted Richard in August of 2020, to basically they wanted to have more inflation to quote-unquote, let the economy run hot, to allow for the maximum -- the achievement of what it was a new kind of characterization of their employment mandate, which is maximum… and inclusive, right. It's basically let the economy run hot so we can make sure that more disaffected groups who have historically sort of been kind of late to the party in various economic cycles with, you know, getting wage increases, jobs, etc.. They accomplished that, and they accomplished that in spades. And this is kind of where we are here with an economy that's very clearly overheating from a labor market perspective.

**Richard:** **00:14:44** Now we're hearing from a lot of people in the global macro space that the Fed is making a mistake, that they're using inflation which is, you know, PCE or CPI, whichever one you choose. They're backward looking indicators and that there are ample signs that the economy is starting to keel over at -- that they're eventually going to be forced to pivot. But now they tend to step into this corner where they have to continue to talk tough. Now, I wonder if you might, I kind of did a summary of that argument that we've heard. I wonder if you might *steel man* that argument as to perhaps why your current thesis could be wrong, but then say why your current thesis is still the correct way to think about where we're going right now?

**Darius:** **00:15:31** I'm not sure if I follow, like your steel man thesis. What's the basis for that?

**Richard:** **00:15:35** No, I wonder if you can explain why these people are referring to the current framework for the Fed as wrong. Right? The fact that they're tightening into a recession is what they're describing. So, if you might be able to steel man that version of the argument, and we'll come back to your side of the argument and kind of tell us --

**Darius:** **00:15:59** Yeah. So, I mean, look, we're never going to -- There's no right answer to this question. Right? This is a real philosophical question on whether you believe the Fed should be intervening in markets and the economy, and at what intervals, when should they be intervening? It's whether they should be and when should they be? We don't particularly care to answer those kinds of questions, because they tend not to be relevant to making and saving money in financial markets, which is all I care about, all we care about at 42 Macro. The real question is, why is the Fed doing what it's doing? And the Fed, in our opinion, is doing what it's doing because the fiscal authority, aided by the Fed, did what it did in 2020 and 2021.

There's a reason the US core inflation dynamics on a three month annualized basis, pick your statistic, one of my favorites is median inflation or median CPI, as a kind of a mix of all the noise associated with airline tickets, used cars, all that stuff. You know, we're still compounding at 7%, three month annualized. You know, there's a reason -- Europe's not doing that. So, what happened in 2020 and 2021 just from a key headline takeaway perspective is, we dumped six and a half trillion dollars into the US economy that was roughly around $15 trillion at the time, if you look at on average and smooth basis. And this is from the fiscal authority, which again, was being capitalized by the monetary authority. We didn't have to pay for that. We didn't have to pay for that, all that debt issuance. The Fed was paying for the debt issuance.

So, we monetized basically, two thirds or not two thirds, a third of our economy, in the course of you know, let's call it 24 months, 18-24 months and we're all sitting here wondering why we have so much inflation. Not only do we have a lot of inflation, we have an excess of inflation relative to the rest of the world. You know, we looked at this, if you look at the spread between our inflation relative to the rest of the world inflation, it's in the 95th percentile through, I want to say though, it's dated through August, right, going back 50 years. There's a reason that spread is in the 95th percentile, because we overcooked the goose, we overcooked the turkey. And now the Fed's dealing with it. Now they brought up the broom and the mop and they're dealing with it.

**Mike:** **00:18:06** And I mean, the tightening of liquidity conditions. Are you seeing any signs of growth? So, when we think about the recessionary impacts or the growth impacts that the tightening liquidity is having the increase in rates going into quantitative tightening, the housing market, like global growth looks shitty, any kind of forward looking indicators look kind of crappy. The yield curve inversion across the curve, the 10s/3s, the last holdout is the one thing that is always the thing that identifies the recession. I guess labor might be the only thing that's saying that growth is hanging in there. How are you seeing the growth side of the equation now, right?

So, we've talked about inflation, we've talked about the new regime, we've talked about increase in volatility, we should expect, we should probably think that assets need to have some kind of further discount so we get more returns in the future for the risk we're taking. Now on the growth side, are you seeing any sort of sprouts, green sprouts yet? Is the rate of change on the downside slowing? How are you seeing the growth side of the equation? I can't find much positive other than maybe the labor market. But what are you seeing?

**Darius:** **00:19:20** Mike, Mike, Mike, the economy is booming, booming**,** from coincident and lagging indicators perspective.

**Mike:** **00:19:28** Well, yeah, coincident and lagging.

**Darius:** **00:19:31** Yes, coincident and lagging indicators. The economy is booming in a way that I have not observed in my career. You know, that's just a few charts on that. And so I think we can all agree that the leading indicator is headed south, you know, just start with a couple, one of our favorite leading indicators is looking at the speed of the change in real interest rates. So, the blue line in this upper panel just shows the real 10 year Treasury yield relative to the red line, which is the manufacturing PMI, and the middle panel just shows the real 10 year Treasury yield on a three month -- on three years Z-score basis.

And as you, what you can see in this chart is every time we hit a two sigma rise trailing three year basis in this, we tend to have a massive slowdown in the economy, just using the manufacturing PMI as a proxy. It's the same when you look at it from a mortgage rate perspective, it's the same when you look at it from the perspective of corporate borrowing costs. So, whenever we have these three sigma, or two to three sigma shocks to the upside in interest rates, we will have an economic slowdown. You could set your clock to that from an economic perspective. So, we know the economy is headed lower on a prospective basis. And that's very much consistent with our GRID model forecasts that are calling for persistent disinflation or deflation, which is where growth and inflation slow simultaneously.

Going back to the coincident and lagging indicators, which the Fed are focused on, this is the issue. As asset market participants, we need to accept the fact that, hey, look, the Fed, whether you agree with it or not, it doesn't matter if we agree with it or not, as investors, the Fed has chosen to not look at models and not guide -- base their policy on the model projections because their models are so wrong last year that you could argue maybe many of them are broken. And so now they're looking at coincident and lagging indicators to affirm or disconfirm their core beliefs about sort of the economy.

And so when you look at the coincident and lagging indicators, they'll start, slide 7, where we just show retail sales, industrial production, and then nominal real GDP. When you look at these things on a three month annualized rate of change basis, we're still growing above trend in all these statistics. 3.8% retail sales control, slowing, obviously, everything's slowing. That's not what's being debated here, it's whether or not it's still very robust and very strong. So, we're very much slowing. But industrial production actually re-accelerated. I'm not sure if that had anything to do with the hurricane or not. But we're still well above trend there, obviously well above trend from nominal GDP perspective, and actually well and quite above trend, from a real GDP perspective.

And so that's the one thing I call out is that it's not just the labor market, the labor market itself is obviously booming. We saw that on slide 15, where all these different measures of the labor market, whether you look at private payrolls, relative to the trend, pre-COVID trend, hourly earnings relative to the pre-COVID trend, weekly hours not really moving. But you productize all those three things, you wind up with aggregate labor income that's just inside of 8%. Like these are crazy numbers. I mean, I know they're just bars on a page, but like, the US labor market, private sector aggregate labor income, that's all you me, and everybody who works in the private sector, our income is growing at 8% on a three month annualized basis. Months -

**Richard:** **00:22:42** Are these real or nominal?

**Darius:** **00:22:45** This is nominal. Yeah, this is nominal.

**Richard:** **00:22:47** These are nominal numbers?

**Darius:** **00:22:48** Yeah, absolutely.

**Mike:** **00:22:53** But what are the forward looking indicators saying? What are the things that, like, isn't that where the problem is? Or I guess, so this is …

**Darius:** **00:23:03** Well, we as investors have to focus on forward looking indicators to establish positions, right. But if you're trying to time the Fed pivot, your assessment, my assessment on forward looking indicators is moot. It's irrelevant. The Fed is going to wait to find data, clear, convincing evidence that they need to pivot.

**Mike:** **00:23:21** Right. So, likely the pivot, although the last couple of days, or the last day of rhetoric has been interesting, like this sort of people have, I don't even know what they're glomming on to. Because I think all the rhetoric before that is like, we're not pivoting, we're just going to tighten this thing into the ground. So, I guess the next question is, what are the assets that we favor? How do we attack this? You know, positioning, generally is smaller, I guess, right? Is it time to go fishing? This is *the time to go fishing market*, make it smaller, hold more cash? No? What's the answer?

**Darius:** 00:24:02

No, no. So, yeah -- I mean, you've heard me say this a long time now, which is, cash is king and it's an increasingly *king-er* as interest rates continue to rise on the short end of the curve. We're going to continue to see a step function increase higher in interest rates, and that's only going to make cash more king relative to other assets. And this is something I've been trying to coach investors on over the last couple of weeks on Fin Twit, this concept about positioning for OpEx rallies and things like that. Yeah, that stuff definitely works from a short term tactical perspective.

But the deeper you go into a bear market with interest rates at four and 5% and on the short end of the curve, the less likely it is that investors are going to be willing to take those kinds of risks. Right? And that to me is like a big boogeyman out there, because this retail mentality is still very much in animal spirits mode. When do I buy, when Lambo? When's the pivot? Everyone wants to make money right now, and bear markets typically don't end when everyone wants to make money. Bear markets typically end when everyone is concerned about their nest egg, and they're trying to preserve capital. And so I still think we got quite a ways to go to the downside in terms of this process.

**Richard:** 00:25:13

Yeah, there's no doubt that there's been a conditioning in the last 10 to 12 years of *buy the dip*. And that's really the Fed's got your back kind of narrative. Which if we're to believe anything that's been said by the Fed in the last few years, and according to your kind of main scenario here, this is not going to happen. And so buy the dip is going to get you fired as an advisor or broke as an investor. You mentioned something I think I saw over Twitter, you said the 60/40 portfolio is going to become the new 60/30/10. What is 10 in your asset allocation?

**Darius:** 00:25:48

So, the 10 would be -- well, one, let me start by saying we don't we don't manage assets on a 60/40 basis, or even a 60/30/10 basis. I'm more making a broader comment about the kind of the investment advisor industry. But the 10 very clearly has to be sort of alternatives, physical and digital commodities, things like Bitcoin, etc., real estate. You know, pull up a chart of asset class performance in the 70s and it's pretty clear, where you should have been allocated. I mean, it's things like gold did really well, as well, back in that duration.

Now, this is not the 70s. This is not the 70s. But the reason I'm making these comments is because we're coming from a very kind of asymmetric point, both in terms of the price of the US dollar, and in terms of sort of the relative allocation across kind of the mean investor balance sheet, with respect to things that are, tend to be positively correlated with dollar strength. Everyone's got sort of a lot of bonds in their portfolio, they've got a lot of -- I mean, we can see this in our data that we track from a balance sheet perspective. People got a chock full of bonds, they're chock full of US instead of international emerging markets, and they're chock full of mega caps, instead of small caps, they're chock full of growth instead of value.

All those positions are wrong on a structural basis in a regime where there's 50% more inflation, and the Fed is largely going to, in our opinion, they're going to be forced to acquiesce to it. Otherwise, they're going to have to deal with a lot of much more sort of what I would consider to be aggressive political consequences for trying to get to two. I don't think they're going to have the political cover to go from three to two. I think it's going to stop. I think that the Paul Volcker, and kind of the conjuring of the image of the ghost of Paul Volcker, I think that stops, that's done. Unemployment rates, the difference is going from three, five on the U three to five, as opposed to going from five to seven or eight. That Paul Volcker crap stops real quickly.

But again, by the way, just real quick, before we move on, we're not there yet. The discussion amongst investors is about Fed pivot, when this, when that. We have a lot of flowing to do yet.

**Mike:** **00:28:03** It's a lot of hope. It's *Hopium*. Let's get the pivot. Let's get the bounce back. Let's get the V bottom again. Oh, we've done the correction, let's get back …

**Darius:** **00:28:11** …recession. Why the hell would these people pivot?

**Mike:** **00:28:14** Agreed, agreed. So, when do we think that we can start to creep some duration into the bond portfolio and have it be worthwhile, right? So, cash is king at the moment because we're still adjusting to this liquidity shock, this tightening, this increasing rate. We're still waiting for the growth shock to manifest a little bit. And we're not seeing any kind of bond response that's sort of more typical of the previous 30 years, minus the last nine months. And so when do you think we're going to get to a point where bonds are going to offer the longer end of the curve, the duration is going to offer enough enticement to start to think about incorporating that into the portfolio in order for, I don't know if there's a deflationary response that comes of this down the road, if we kill growth that much that we get into that stagflation or actually that disinflation with the inflation side of it, where everyone's running back to the 30 year, in order to preserve money. When do we start to incorporate some duration into the portfolio do you think?

**Darius:** **00:29:21** My favorite question and I think we've done a great job of making sure our clients haven't pissed away their life savings with buying bonds and every dip lower. You know, we made a few mistakes on the long side of the bonds rate this year, namely in March and -- no, pretty much March I think it was the only real mistake, major mistake. But in answering the bond question, the duration question specifically, to me comes from two questions. One is, is the growth outlook really evolving in a really materially adverse way that will catalyze investors to really start to price in material change and -- material inflection policy, not just a pause, but more importantly, rate cuts, etc., etc. We're not there yet. You know, Ani, if you could throw this chart up, there's a couple of charts I'll use to answer this question.

But on the domestic side of the equation, the bond market does not yet believe that an actual recession is the modal outcome. And the reason I say that is we have not seen the inversion that you typically see in the three month 10 year yield curve ahead of recession. I mean, this thing has 100% track record in predicting recession. And from my perspective, the researcher's perspective, I think Campbell already wrote a great paper on this in the 80s. And the conclusion still holds true, which is this is the countdown clock to actual recession. And so the lack of inversion here tells me that the bond market itself is really not that concerned about growth yet.

Now it will. This thing was 12 basis points from inverting when I updated this chart the other day. It's going to invert, and once it inverts persistently, not just like, ticks a basis point below zero. Once it inverts persistently, it'll start to send signals to investors, lenders, people in capital markets, business owners to start doing things and behaving differently. And then voila, 12-18 months later, you wind up in a recession. I think a lot of investors were wrong-footed in June, and I would put ourselves in this camp in thinking that a recession was going to be more imminent, like, let's call it end of 2022, early 2023.

And what we've learned throughout the summer, at least what we at 42 Macro has learned throughout the summer by sequencing all the data and reacting and observing all these trends is that the economy coincident to lagging indicators booming, it's going to be a while before we get into an actual recession. So, that's one part of the answer to your question, Mike, which is we got to wait for the bond market to get concerned about growth, before duration is legitimate -- before we can find the real floor to the price of long duration securities.

The other side of the answer to your question comes from abroad, which is the inflation shock, really, and the response to the inflation shock from a policy perspective in Europe. You know, what we're showing you in this chart, showing the red line up here is the CITI Eurozone inflation surprise index. So, it measures kind of the deviation and surprises when inflation data reports are higher, means you tend to have more surprise, more shock value relative to the US inflation surprise index, which is blue. And as you can see their inflation problem, from a surprise perspective, from a shocking perspective is much bigger than ours.

And as a function of that, we're seeing a three to four sigma rise on a trailing three year basis in 10 year German bund yields that are contributing to the rise that we're seeing in 10 year treasury yields and abroad. Fixed income markets are very global in nature. You know, it's not like stocks where there's a real significant home bias. Investors in fixed income markets are going where there's the best rate of return on a risk adjusted and financing basis, in terms of the all in cost of capital. And so this is having a significant impact on the bond markets globally.

You know, I want to say this week alone, we've seen Germany authorize a 200 billion Euro package to finance or to help finance their sort of fight against energy, price inflation in terms of what's providing subsidies for consumers. I think that's somewhere around 5% of German GDP. France with another 100 billion dollar package, that's like a 3% of French GDP. So, there's a lot more supply coming online from a European bond perspective. And not only is that supply coming online in terms of the expansionary fiscal policy, we're seeing contractionary monetary policy over there as well.

**Mike:** **00:33:32** It's amazing. It's amazing.

**Darius:** **00:33:34** It's causing problems in global fixed income markets. Who the hell needs to buy these securities? No one needs them.

## The European Energy Crisis

**Richard:** **00:33:43** Well, financial repression is eventually what this leads to. It's the idea of forcing some of your financial companies and whether it's insurance companies or what we've experienced in the 1940s, in previous bouts of debt overhang in history. But what I wanted to pull on the thread that you mentioned there, which is I think it's the biggest issue today, which is the energy crisis in Europe. The US has been using the strategic petroleum reserves to some extent, I think, to some degree in the run up to the midterm elections. There's a very political angle to all this. So, I wonder how much more they're willing to deplete the SPR after the …

**Darius:** **00:34:27** 15 million barrels this week.

**Richard:** **00:34:29** Yeah, exactly. And now they're saying that they might extend that even further. So, there's a big question there. But to some extent, the whole dynamic that we're seeing in the bond market in the US and in Europe is very much predicated on the price of energy and it's gone haywire in Europe. The US has this escape valve. But if we do keep rising rates and trying to affect demand which is essentially what they're trying to do, oil prices and natural gas prices are still going to be oscillating depending on these other variables, right? You have geopolitical risks, you have the lack of investment in the space, you have ESG kind of dominating the expenditure of CapEx towards energy. So, to what extent could this affect your thesis, the energy prices, both in Europe and in the US?

**Darius:** **00:35:29**

Well, I mean, I think it's a factor. I wouldn't want to sort of put -- so, the reason I say it's a factor is because a lot of the inflation we're observing in the US economy has very little to do with energy at all. In fact, if you look at headline CPI, energy inflation is tracking down 40% on a three month annualized basis. We're at minus 45% and we're still dealing with 6, 7, 8, 9%, core inflation pressure, whether you look at core goods, or sorry, core CPI, core services, shelter services, less rental shelter. So, to me, it's, I think energy is a big factor structurally longer term, in terms of this energy transition, and the kind of energy insecurity that it seems like we're walking ourselves into by feuding with Saudis, obviously, beefing with Russia and China. But these things aren't going to go away.

And so understanding that these things aren't going to go away, in my opinion, is an issue for the bond market in terms of the thesis, right? It's an issue because it ultimately means that policymakers, because we're in this fourth turning era, where inequality is really driving populism from a political response perspective, you're going to continue to see policymakers opt for kind of the green button. The red button is shut it all off, destroy the economy, get inflation down, which the Fed is trying to do, but the green button in Brussels and in DC, which is well, it's actually just spend more money and help the consumers deal with this problem, which obviously makes the problem worse, over the longer term.

So, going back to tying this all back to the decisions you should be making as an investor in your portfolio, again, I keep saying this, like, I don't understand why so many investors have been in a rush to buy fixed income securities. I mean, we dipped our toe in summertime. I think we bought the EDV, or something like that was like the 30 year treasury, had a nice little trade on it to the upside, and then was like, you know, I think this is over. We saw that September CPR print, and it just was like, no, it's going to be a long time, not a long time, sorry, not time in x-axis terms. But more, if we could potentially still be a decent ways away for the market finding a clearing price for a lot of these global sovereign debt securities.

You know, just the reality is, I think that we all understand going back to that structural inflation model, whether you have a very sophisticated model like that or not, we all understand that there's going to be more inflation on a go forward basis than the kind of regime we've exited. And so I think just finding a clearing price for that is still kind of the key driver of financial markets right now, which is why we can't find …

**Mike:** **00:38:05**

Then you get into some perversion of that with the potential for those who are defending their currencies, potentially dumping more bonds in order to do, if you think about the Chinese and the Japanese sort of issues, there's buy and sell decisions that might not be influenced by the current yield that could cause -- wreak some havoc with yields. And I think the other thing that's really interesting with this re-shoring, that I'm very uncertain of is, as you r-shore and take all the steps that are being taken by the US to sort of go from sort of cheap and cheerful, just-in-time inventory channels and whatnot, supply chains to more redundancy, more reliability, higher cost on-shored, that actually is bullish for employment, pretty significantly.

And I wonder if we don't get into that sort of precise weirdness from the 70s, where wage inflation is uncontrollable to some degree. Which is a really difficult trap to get out of if you're sitting in the US and you're continuing to have very low unemployment rates, very high demand for employment, and very high costs of labor. You know, that can lead to a lot of issues that are -- it's an interesting spiral.

**Darius:** **00:39:41** To me, it's like the biggest risk out there, which is -- well, I don't know if it's the biggest risk out there because I think the Fed understands the risk better than the average person I interact with on these subject matters. Because I keep hearing from folks saying like, look, the supply -- the issue to this inflation problem is more supply, more energy, more re-shore, all the -- more supply. You know, don't -- it's not -- they shouldn't be taking a weed-whacker to demand. They should be helping us increase supply. And I say sure, yeah, that'd be great if the unemployment rate wasn't already at 3.5%.

Who's going to drill oil in a fully employed America? This is the issue. This is why you have cycles. This is why inflation, if you look about it from a GRID regime perspective, is always the peak of the cycle. You have inflation because you're running up against capacity constraints, and the only way to ameliorate those capacity restraints isn't to come lick your finger out of here and play Hocus Pocus, Fin Twit war and the more supply. It's no, we need to reallocate resources in the economy. And the only way to do that is with one of these red bars. These red bars are very, they're very necessary in the capitalist society.

And so if we don't have some program or plan in place to import a bunch of labor through immigration, which very clearly, that's not going to be anything solved on that front in a long period of time, could be quite a while there. We're going to have to see an uptick in unemployment, we're going to have to see a capital reallocation, and those things need to happen. They need to occur in order for us to get that incremental supply to get out of this inflation mess. If we just try to stick around in a three and a half percent unemployment rate indefinitely, we're not going to -- none of these problems are going to get solved. And so unfortunately, I think investors think about this the wrong way, which is trying to find the easy way out. Guess what? When inflation is at 9%, 7, 8, 9% on a core basis, there are no easy ways out. We already had the easy. The easy was getting here. 2020 to 2021, if you didn't make money then too bad, sorry.

**Mike:** **00:41:46** I think there's an interesting argument too for like a lot of automation and a lot of -- this is kind of a longer term thing like this is a five, over the next five, seven years. I think we're going to see the way we interact with a lot of services change in that we're going to adopt automation, because we're going to need to proportion the labor force. We're going to need to put jobs where we actually need humans and where we can automate, whether that's through AI or robot automation, or the service industry, less interaction with human contact, more like you press the button and you get your stuff. I think there's a, you know, longer term that has to happen. We just don't have the humans.

**Darius:** **00:42:30** It absolutely has to happen, if you consider the decline in workforce, working age population in places like China, some of these large kind of global manufacturing hubs. If you also consider the fact that we've had a structural downshift in our labor force participation rate that it accelerated in the COVID era. It's already been trending lower since 2000 basically. It's actually accelerating the COVID era. One thing I'd say on automation is that we're actually moving in the wrong direction. You know, automation is one of the factors that we use in this structure inflation model, and how we proxy automation because there's no real statistic out there.

We look at the consumption of fixed capital, relative to the total dollars amounts that we're spending on employee compensation. And we're actually going down in terms of CapEx, relative to employee compensation. So, it's actually contributing a positive kind of factor to the overall inflation model. So, we need to reverse this trend, this is something that's kind of really started in the mid --right around 2014-2015. And it's showing up in the labor data. One thing I call out and flag on the labor side is, we're at an all-time high in terms of the private sector, employee compensation index, which is the broadest measure of wages and salaries and benefits in the US economy. Unfortunately, data only goes back to 2001. But at 5.5%, we're 300 basis points higher than where we trended at pre-COVID. You know, I don't know how we go back to that level.

Again, I just don't know how we go back to that level in the context of 100 basis point decline in the labor force, participation rate, 100 plus basis point decline in the employment population ratio, and not really improving anymore. You know, I think a lot of people really left the labor force for a variety of different reasons. Elderly people don't want to die on the job with COVID. You know, people probably moved to cheaper localities, low tax states, they don't need to make as much. You know, you don't need two income households, going to one single income households, etc.

There's all these different reasons. And maybe people just decided, you know, work less, who knows. That's also a legitimate reason as well. Like, just the economy is running out of resources, both domestically and globally. And as a function of running out of resources, we're having a regime shift higher in terms of inflation, and we all have to deal with it. And the reason we all have to deal with this is because the bond market has to deal with it. The bond market still has not figured out what the right price for a 10 or 30 year Treasury yield is.

**Richard:** **00:44:53** So, I wanted to take a step back and go from US to global, hinging on what you're saying. And one of the reasons, one of the factors that has probably driven oil prices down to a meaningful degree has been the rolling lockdowns in China and China's zero COVID policy. So, that demand hasn't been in the market now for several months. How concerned are you when they do --

There's some speculation that once Xi is anointed Emperor for life, or whatever the title is going to be that they're likely to relax that to some degree. Or even if that's not the variable, once they do start to relax that that demand starts to come back online and the SPR starts to get depleted to a point where they're no longer willing to keep prices at the pump as down at the cost of the strategic reserve. How concerned are you with the Fed's ability to continue to fight inflation with the blunt tool of monetary policy?

**Darius:** **00:45:53** So, fighting inflation with a blunt tool like monetary policy is not the best outcome. The best outcome is a combination of monetary policy, fiscal policy, consumer changes and behavioral changes. But that's not how this works, right? We don't get optimal outcomes all the time. In fact, we rarely get optimal outcomes. We just have to deal with it as investors. It's not our job to say what should be the best thing. It's our job to just position for what's going to happen, figure out what's going to happen and position for it. So, to me, that's -- I tend not -- if you can tell, I tend not to entertain too many what if debates. I focus on the what is and how that's going to change so I can make money. Like, to me that's where we need to be, that's where we need to reside, as investors.

Going back to China, I'll be the first person to tell you, and I'll be the first in what should be a very long line of people to say, we have no freaking clue what the Chinese authorities are going to do on zero COVID. You know, this is a policy that's being kind of orchestrated by what is effectively a czar, increasingly becoming a czar, and we don't have any insights and clues as to what he's going to do. All we can do is read the tea leaves on how increasingly tough they're cracking down, which I would argue they actually are. There's riot police and I want to say Chengdu and Shenzhen, trying to prevent people from kind of violating zero COVID. And so that's as recently as last week. So like, to me, it doesn't look like they're doing anything different on zero COVID anytime soon, but I have no basis to know.

What I know is that if they do something different, we need to react to that as investors and I would suspect we'd start to see that kind of the whisper, at the bare minimum, the whispers of that show up in the data in terms of Chinese energy imports, etc. You know, Chinese imports of kind of raw commodities that would kind of coincide with more economic activity. We haven't really seen that yet, nor have we seen it in the prices of these assets. So, I have a reasonable degree of confidence that we're still in the status quo, but again, who knows, nobody knows what the Chinese Communist Party is going to do. We all pretend like we know and we spend all day on, not we, but people spend all day on Fin Twit opining about these things. But the reality is they don't know any more than they know what President Biden is going to do tomorrow.

## Models

**Richard:** **00:48:02** That's fair enough. So, moving from the realm of speculation to leading indicators and using the BOJ as probably the leading central bank, they were the first ones to implement QE, they are now the first ones to implement yield curve control. But Europe was actually quite quick to follow for reasons that we've already touched on here briefly. So, the Bank of England has done it, the European Central Bank has done it to some degree. The BOJ market has kind of started to display unhealthy signs for bond investors. One worries that Europe would be next. How concerned are you where this leads to the health and the structure of sovereign debt markets?

**Darius:** **00:48:46** Oh, concern would be the wrong word because I really don't care. They're all numbers on a page. But the one thing I'll say is, these policymakers have a choice, right? You know, one thing that, we have three different models that we use to identify and understand -- to understand currency markets, to figure out what the variables are that are driving currency so that we can make better trades, to inform ourselves to make better trades in currency. So, one, you can think about it from the balance of payments perspective, which is how we look at that, it's just the change in the current account balance relative to the change in nominal effective exchange rate.

The second framework would be kind of the -- kind of more core, what is money, what is trust kind of a framework. And we look at that in terms of the deviation from trend in terms of the sovereign budget balance as a percent of GDP, again, relative to the changes in the nominal effective exchange rate. And then we look at kind of monetary policy divergences, kind of the real interest rate differentials, if you will, that's kind of the thing that most people think about, but these other two factors that tend to be pretty meaningful factors at different times as well. Right now this model, kind of the monetary policy divergence model is explaining currency market movement better than all the other two models.

And so that tells me that if Europe continues to opt for what it seems like kind of, I don't know, using the monetary authority's balance sheet to capitalize incremental fiscal kind of support for the economy, they'll couch it however they need to couch it from this is a shock. We're just responding to the shock. However they couch it is irrelevant. What matters is the supply and demand of sovereign debt in this globally coordinated system. And the reality is, if we start to see those fiscal authorities really start to flex their balance sheets in a material way to acquiesce -- to the monetary authorities to acquiesce to the fiscal authorities in these jurisdictions, we're going to see those currencies get smoked. We're going to see the inflation problem in those jurisdictions continue to fester and continue to be an issue.

Now obviously, on a year over year rate of change basis, inflation is going to come down everywhere in the world, we know that. Our models are forecasting that, our GRID models. We project this for 35 different economies, in terms of the rate of change of growth, rate of change of inflation, and what that means from an economic regime signaling standpoint. So, the whole world is in a sea of blue, and the sea of blue means that both growth and inflation are slowing simultaneously. That's where you're in this particular quadrant there. Now, that doesn't mean that inflation is going to go to a level that is politically palatable, or acceptable from the perspective of the central banker's inflation targets.

So, you know, kind of going back to answer your question, Richard, it's a choice. We don't know how they're going to choose. But based on the tea leaves, based on the incremental evidence we got this week, and what we got from Bank of England or not from England, throughout this most recent month, which is that's probably where we're headed. Which is Europe is going to continue to be easier, both fiscally and monetarily, relative to the US, which ultimately translates to more dollar strength, and more of everything you've seen on your screens year to date.

**Richard:** **00:51:51** Yeah. Well, especially with quantitative tightening, right? They show no signs of easing up on QT. Right? They're both raising interest rates and offloading the Fed's balance sheet to a meaningful degree. If they had to pivot, which one of those do you think would go first?

**Darius:** **00:52:11** Who?

**Richard:** **00:52:13** Would they interrupt QT and perhaps start buying bonds again? Or would they pause and perhaps signal a reduction in interest rates?

**Darius:** **00:52:22** Yeah, it strikes me that based on, you know, Powell has been pretty clear about understanding the history around monetary policy tightening cycles. And you kind of look at what Volcker had to do in the 70s and 80s, which is basically get real interest rates on a realized basis. Realize real yields, which are yields across the Treasury curve, higher than reported inflation using core inflation or core CPI, or core PCE rather, as the as inflation adjustment here. So, we're still quite a ways away on that front.

And so it's my belief that the Fed, understanding the lessons and telling us, consistently telling us that they understand the lessons of the 70s, I think they're going to be very reluctant. I mean, way more reluctant than what's currently priced in the Eurodollar markets, etc., etc., to cut interest rates, I think that we're going to have to see some substantial economic pain for them to cut interest rates. I think the likelihood that they expand the balance sheet to address what they will probably couch as market functioning or liquidity issues in the treasury market, is likely to be the first policy move.

Now, they're not going to be hiking interest rates. If and when they do that, they will very much likely have been in a stable interest rate regime from, at that particular time, in that particular juncture. But again, it's, I think, the concept of cutting interest rates, one, cutting them at all, but certainly cutting them at a material degree is something that we as investors need to just get out of our heads from now until at least the end of next year. And I take great offense to the current pricing in the Eurodollar market, which still thinks the Fed is going to cut rates next year, 25 basis points. That's 25 basis points of market risk to every investor in the world right now because I don't think they are. In fact, it's very unlikely that they do.

## Something Needs to Break

**Richard:** **00:54:13** So, could you see them kind of deploying this hybrid, okay, we're not going to stop our interest rate hike. We might maybe take a pause. But could you see them interrupting QT if there are signs that something is meaningfully breaking? Because the issue is if you do see any meaningful break in, whether it's the repo market or the functioning of bond markets and capital markets to a larger extent that has spillover implications to the economy, obviously. So, would you see them perhaps pausing QT maybe even outright reversing it for a brief stint if they were to see any signs, and what might those signs have to be?

**Darius:** **00:54:56** The number one obvious sign is that you, me, everyone watching this has lost a shit ton more money for lack of a better word, right? They're not going to pivot from their policy and help make us richer unless something really breaks. You don't want to be long for the break. And this is the, you know, I've been kind of answering questions like this all year from retail investors, etc. Like, when buy? It's the when buy, when buy the dip, when the pivot. It's like these people are only going to pivot after all hell breaks loose. So, you don't want to be long for the all hell break loose part. Right? That's how you lose your entire life savings. We've seen this movie many times before.

In terms of the bond market and I've been going back and forth with a client on this, I have great discussions this week with him on this. You know, the term premia are rising, and they've risen pretty meaningfully in recent months. We've gone from basically minus 80 basis points to minus 33 basis points on the 10 year in terms of term premia, but we're still negative. Like, the bond market is not broken. The bond market is just repricing because there's been a change in policy rate expectations. There's been a change in inflation expectations. And there's been a rise, a higher premium assigned to inflation volatility. Like the bond market is going down in price for very legitimate supply and demand fundamental reasons. It's not breaking, it's just repricing according to the changes in the economy, and the changes in policy associated with those changes in the economy.

If the bond market was breaking, you'd see something that looks like this, which is a big spike in term premium. You know, we saw that in March 2020. We saw that obviously, in 2008 when all hell broke loose then. That's not happening right now. Now once that happens, I would expect to see something like hey, look, 95 billion a month of QT is too much. Maybe we dialed it down, maybe we just hold the balance sheet flat. Maybe our estimate of reserves in the system, like the minimum requirement level of reserves is too high or too low. Maybe we need to rise that higher and stop quantitative tightening. I could see all that happening. But guess what? If all that happens, it's going to be after term premia spike and real interest rates spike and the market pukes. Like, you don't want to be long for that process. Get this -- not you guys, but I'm just trying to help the audience. People need to understand that the Fed is not going to pivot until you lose a shit ton of money. Understand that. So, don't be long before they pivot.

**Mike:** **00:57:18** Yeah, you don't want to be long the pivot. The pivot was a catastrophic event. Right? So, why do you want to be sitting there long, wait till that pivot comes. Wait it till …

**Darius:** **00:57:30** Wait till they pivot.

**Richard:** **00:57:32** Markets stop panicking when central banks start panicking. So, the pivot is the central bank starting to panic. I'm just curious, Mike, before you shift gears. So, within the $95 billion a month of QT, I think there's 60 in treasuries, which I'm assuming is being absorbed by the primary dealers. Who's absorbing the other 35 billion in the mortgage assets?

**Darius:** **00:57:56** Oh, I mean, the capital markets. So, when the Fed …

**Richard:** **00:58:00** Are market participants buying those?

**Darius:** **00:58:03** Obviously not. The public charter mortgage rates …

**Richard:** **00:58:08** That's what I'm saying. It seems like that might be the breakage point sooner than many people expect.

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| **Darius:** | **00:58:15** | So, why don't we -- No offense, Richard, but why do we keep using the word break? They're trying to break things. They're not -- break is not, we keep, not we, but the narrative out there is the Fed is going to break something. The Fed is trying to break something. They want to break stuff because inflation is too high. We can't keep talking about breaking things like it's an accident, and therefore they're going to pivot and they're not going to do a thing. |
| **Mike:** | **0058:41** | It's their intention. |
| **Darius:** | **00:58:43** | It's their intention. Let me -- two very important slides here in this deck, and now I'm fired up. |
| **Mike:** | **00:58:51** | We got him triggered, man, we got him triggered. |
| **Darius:** | **00:58:52** | Oh no, you didn't trigger me but it's very clearly something that's been a bee in my bonnet all year because I keep having these conversations with different investors on Twitter. The Fed is forecasting a 180 basis point decline in the core PCE, year over year rate of change of core PCE, by the end of next year. So, that's relative to the most recent data, that's 16 months away. We've never seen a 180 basis point decline in core PCE on a 16 month time horizon without an actual recession, without one of these red bars.<br><br>The Fed, going back to this chart here, is forecasting unemployment rate to be at 4.4% by the end of next year. That's a 90 basis point rise from where we are in September. We have never seen a 90 basis point rise over a 15 month interval in the unemployment rate that does not correspond to a recession. So, riddle me this. Is the Federal Reserve implicitly signaling a recession? I happen to think they are. They're not going to come out and use the R word because all hell would break loose if they did, but I think they are. I think they know we need a recession to get this inflation problem under control. So, if they're implicitly signaling a recession, why would they respond to a recession? Why would they panic when the recession happens? They know what's coming. They're causing it. They're the ones who are causing it. It's the -- |
| **Richard:** | **01:00:11** | Powell all but said so in the Q&A following the last meeting. |
| **Darius:** | **01:00:19** | Yeah. It's again, investors must reorient their thought process around the Fed reaction function. They are trying to break things in the economy. They're trying to break things in the financial markets. They want you, Mike, Richard, everyone watching, me included to be poor, so that we can keep that $9 trillion of cash that's sitting on household balance sheets where it is, in checking accounts and money market funds. They don't want it in the CPI index, they don't want it in the core PCE index. They want to keep that money where it is. And until we all understand that as investors, we're going to be impatient and in a hurry to buy the dip. And I just, I fear, we haven't seen the worst of this bear market, and |

people are going to buy the dip way too early with these kind of wacky theories on something broke, therefore, the Fed's going to pivot, and I guarantee you, people are going to lose a lot of money on that.

## What Do We Do Now?

**Mike:** **01:01:13** I love it. So, we've kept you for an hour and we said, we're going to be an hour today. So, let's keep them wanting more. So, as a final thought, shit's going to break, there's no rush. There's a reason we've got four plus percent rates of return on holding cash. They want us to hold cash because the world is trying to encourage us to be a little bit more conservative. Maybe we should heed that. So, for the typical sort of more long-only investor, what are some thoughts? And then maybe long/short investor, what are your thoughts to kind of close? We've talked a lot about a lot of stuff. What do we do now? What are some of the things around the edges that you would be able to share to people who aren't your members? Because if you want to know everything that DD's doing, buck up and frickin' sign up and get the real deal. If you're just trying to get around the edges some ideas of what to do, then we're just going to give you a little bit. DD give them a little bit around the edges, not too much. Make them want to get on the subscription.

**Darius:** **01:02:17** Yeah, Ani, if you can pull this up. I'll give them everything but the actual exposure.

**Mike:** **01:02:25** There you go.

**Darius:** **01:02:27** So, I mean we're sitting here, we're net short equity, credit commodity exposure, in terms of the aggregate portfolio construction. We're sitting here with about 55% of our assets in fixed income, FX and vol. And trust me, there is no duration in that. We're not riding this bear -- we're not buying the dip all the way down to the lows and bond prices, all that. Most of that is in very short-term a debt instruments because again, we're finally staying the yield on our cash. We got about 17 and a half percent cash there waiting to dip our toes in. But again, we're not in a hurry. You know, one thing I will say is, we've done -- I mean, I think we've done as much research on understanding kind of the reaction function of the market to things like Fed pivots, etc., historically and understanding just kind of the bear market dynamics in general.

A couple stats I'll throw out at you, there has been 17 bear markets over the last 100 years, kind of starting with the Act One of the Great Depression. The median decline in these bear markets is minus 28%. The median decline in the last three months is minus 19%. So, effectively, two thirds of the declines you get in these bear markets comes into people puking the lows. We have obviously not puked the lows, we've not seen enough fixed curve backwardation. We've not seen a lot of different things. You know, if you look at our cross asset correction risk indicator that's on slide 140, we still haven't seen this type of capitulation you typically see at these capitulatory lows, which tells us that it's likely still ahead of us, because every bear market tends to capitulate to the downside towards the end of the process. That's still ahead of us. So, we can't be in a hurry to say, well don't let the cash burn a hole in your wallet.

Let the specter of losing more money, burn a hole in your wallet. It's okay to sit there and clip coupons at three to 4% on the short end of the Treasury curve until you get more clarity around some of these dynamics. And this brings me back to a conversation we're having earlier. One thing we haven't talked about yet, and I think we should save it for the next show, which is, it's not just about the Fed pivot. Because what you buy, I would agree ,you do want to buy when the Fed pivots. In fact, bear markets tend to bottom roughly one month after the Fed pivot on the median basis. Inflationary bear markets actually tend to take a little bit longer. They tend to bottom three months on a median basis after those Fed pivots, but that's neither here nor there.

What you buy has everything to do with where we are in the growth cycle at that particular point in time. Are you going high beta? Are you going international? Are you going, you know, sort of cyclicals, or are you going duration? Are you going low beta? You going mega cap, you going US? You know that to me, that answers that question. It really depends on the timing of that pivot because again, we're not quite towards the bottom of the growth cycle. You know, if you look at, sorry, the growth cycle in the US specifically, we're tracking around the bottom sometime, kind of mid to Q3 of next year, if you will. And so if we pivot here, you get … play defense. We pivot here, you're going to play offense. So, to me, I think that's …

**Mike:** 01:05:27 So, it's a little bit of disinflationary growth, maybe versus inflationary growth in those sort of sectors that you might influence exposures, geographically sectors within the S&P 500 and those types of things would have that impact. Yeah.

**Darius:** 01:05:43 Yeah, absolutely. So, we know what you should be doing based on where we are today. But this could change. This could be Goldilocks by the time they pivot, if they pivot well into next year, right? And so let's not assume that we know what to buy. We know that we will need to be buying and taking up our exposure to risk when they pivot. But what we buy when we take our exposure to risk really comes down to what GRID regime will we be from a risk reward perspective, in terms of that particular interval, so we'll check back on it. Definitely come check us out at 42 Macro

**Mike:** 01:06:14 Classic. Yeah, for sure. 42 Macro and Darius Dale, and it's been great having you here. I think on that note, too, you think about the bottom of the market in 2001-2-3 that was inflationary, right? You wanted to buy Canada, Australia, Chile, that type of thing. And then you look at the bottom in 08, 09 it was much more of that disinflationary growth. You wanted to buy NASDAQ, you wanted to buy those tech stocks. And that's what you're sort of alluding to is they are different regimes that are going to make different areas that are structurally inclined, once there is a pivot. And we don't actually know what those regimes are yet. So, let's wait and see what they are, get more information and watch for it. And then when it happens stay tuned, we'll be back.

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|---|---|---|
| **Darius:** | **01:07:00** | 100%, man. Mike, Richard. |
| **Richard:** | **01:07:02** | Darius, where can people find you? You want to leave your Twitter handle and all other handles that are noteworthy? |
| **Darius:** | **01:07:09** | Yeah, absolutely. So, come check us out of 42 Macro. I mean, we do obviously institutional research for everybody. That's kind of our model, institution with macro risk management for everyone. So, depends on where -- who cares where you are on the … I think everybody needs good macro research and a good macro process. I don't think we do research. I think we sell process more than anything. 42MacroDDale my Twitter handle, for those of you who don't follow, come check us out. We appreciate you. |
| **Mike:** | **01:07:33** | Yeah. Appreciate you too, DD. |
| **Richard:** | **01:07:34** | Thanks for joining us today. Yeah, appreciate it. |
| **Mike:** | **01:07:37** | Have a great weekend. |
| **Richard:** | **01:07:38** | Have a great weekend. |
| **Darius:** | **01:07:39** | We know Mike's going to have a good weekend. |
| **Mike:** | **01:07:40** | Yeah. Whohoo. |
| **Darius:** | **01:07:43** | See you guys. Cheers. |
| **Mike:** | **01:07:44** | Queue the music. |
| **Richard:** | **01:07:35** | Cheers. Thanks. |