Mike:	**00:01:46**	All right, the bills are paid
Richard:	**00:01:48**	He's back.
Michael:	**00:01:49**	How you doing, guys?
Richard:	**00:01:50**	Mike his back.
Mike:	**00:01:50**	Good. Good. Good to dig into some of the Mike's gray matter here. Yeah, for sure. Before we start, I just want to remind everybody that this is not investment advice of any kind and that if you're looking for investment advice, probably four dudes on a YouTube channel and a Friday afternoon, I don't know. You know, maybe rethink some things.
Adam:	**00:02:11**	I was going to ask Mike to do their compliance riff actually.
Michael:	**00:02:16**	How about FOMO actually.
Adam:	**00:02:17**	Yeah.
Mike:	**00:02:18**	It's all about the FOMO. The FOMO and the YOLO. All right. Well, that's …
Adam:	**00:02:23**	So, ladies and gentlemen, Mike Green. Mike, thanks so much…
Richard:	**00:02:26**	Yeah, I was trying to remember…
Adam:	**00:02:27**	…
Richard:	**00:02:28**	Yeah, what was the last time we had Mike on? It's been over a year I think.
Michael:	**00:02:33**	I think that's probably right. I mean, Adam was really generous in reaching out after some of my Bitcoin debates in particular and giving me the opportunity to just riff on life more broadly and express some of it in non-sound bite form. I think it's probably been at least a year since I sat down with Corey and you guys, because I know we were in the thick of the pandemic. Mike Philbrick was remarkably like unshaved and his hair hadn't been cut in a long time. For those who are listening in and missed the intro, his desire to dig into my gray matter takes on new meaning given he told us he was a fan of Jeffrey Dahmer before the show.
Mike:	**00:03:11**	They just keep coming. They just keep coming.
Michael:	**00:03:13**	Yeah.
Adam:	**00:03:15**	Mike, you'll be glad to know that the other Mike is actually trying to grow a ponytail, right?

Michael:	**00:03:23**	Oh, he's going for the Eddie Murphy royalty look, huh?
Adam:	**00:03:26**	Exactly.
Mike:	**00:03:27**	Yeah.
Richard:	**00:03:28**	Yeah. I'm glad that Jeffrey Dahmer comment made it to live. I thought that was going to be kept for the background commentary.
Adam:	**00:03:36**	To fair he said he's a fan of Dahmer, right. So, we could be generous and say he's a fan of the series, I guess, just to put things into context.
Mike:	**00:03:42**	I think I said I'm a Dahmer fan. Anyway, let's not go too deeply into any deeper meaning in that.
Michael:	**00:03:50**	No, wouldn't have had any meaning whatsoever if it hadn't been for the comment about dig into my gray matter. Which I've never been afraid on the podcast before, but a moment of fear entered.
Mike:	**00:03:58**	…
Richard:	**00:04:01**	Especially with that black screen.
Michael:	**00:04:03**	Yeah, that's right. There might be something hiding behind me. That's exactly correct.
Adam:	**00:04:07**	Black hole
Mike:	**00:04:07**	Well, a little American Psycho back there. Noted. If you're at Greeny's house and he brings out a plastic sheet and lays it out, just …
Michael:	**00:04:18**	Exactly. That's right. Me and Christian Bale. Speaking of …, I'm noticing that ReSolve has the same conference room that both Adam and Richard are in, but in one it has the ReSolve on the left wall and the other has ReSolve on the right wall.
Adam:	**00:04:35**	We're just on opposite sides of the room, can't you tell? We're actually behind each other's heads.
Richard:	**00:04:42**	I might … We got to do something about that, Adam. We got to switch that up.
Adam:	**00:04:49**	I know. I keep thinking the same thing and …
Michael:	**00:4:51**	All right. So, we're figuring out various ways to delay getting into interesting stuff, right?
Mike:	**00:04:56**	Let's get into it.

The Bizarro World Version

Adam:	**00:04:57**	Yeah. I was going to get your take, Mike, on -- unless you had something you were just dying to talk about. I was going to get your take, because I feel like this year has been the bizarro world version of the prior sort of 10 or 12 years. And I think that juxtaposition is an interesting place to start. Right? So, I thought it'd be kind of of fun to maybe get your take on how you characterize the market and economic environment from kind of like 2009 to call it into 2021. If you want, you can kind of end of 2019, pre-pandemic, and maybe the pandemic era is kind of its own regime. But maybe, let's take that, what did that look like? What were the drivers? What lessons did investors learn from that? And then let's juxtapose what we're currently facing on that experience. How does that sound like a good place to start?
Michael:	**00:05:52**	Sure, that sounds really reasonable. So, I mean, look, I agree with you that this year has felt like bizarro world in the context of what we've seen over the last decade. Right? And more to the point, I think the thing that I'm most distressed by this year, like what feels most bizarro to me, is the apparent glee that people have about an interventionist Fed when it's hiking rates, versus an interventionist Fed when it's cutting rates, right? And I genuinely struggle with this. I don't entirely understand why people who seem to be very much against an interventionist Fed, that seems to be working without a functioning model of how money interacts in the banking system, how the banking system itself interacts with the real economy, the financial markets interact with the real economy. I struggle with how they've suddenly become so enthusiastic and so deeply embraced this idea of well, obviously, this is the right thing to do. That to me, --**.** What's that?
Adam:	**00:06:56**	Can I offer a thesis?
Michael:	**00:06:58**	Sure, please.
Adam:	**00:06:59**	So, do you think that there's an increasing, and this cohort has increased over time, over the last decade, especially. But I would argue that this has been going on longer than just the last decade, but I definitely think it's accelerated, and taken to a new level. I think there's an increasing number of people who really felt left behind by the interventionist, *easy Fed*, right? The fact that the Fed had intervened since 2009, consistently to bail out speculators, to incentivize risky behavior or bad behavior, had amped up moral hazard. And in so doing, had left an increasing proportion of people out of the wealth generating functions of -- especially of the US economy. And one might argue other developed economies, more so through the housing channel than through the equity and bond channel, maybe.

But if there was a feeling that lower rates and rewarding risky behavior and all of those other dynamics that were -- that sort of went along with an interventionist Fed from the 2009 to 2021 period caused people to feel left out, maybe there's a feeling that finally we're unwinding some of those dynamics. And there's a possibility, without having to resort to the kind of nihilistic behavior that we observed, especially that sort of really ramped up in 2021, with the GameStop's and the and the crypto and the hyper speculation in the options markets, etc., without having to resort to those types of nihilistic behavior that this kind of dynamic now is equalizing the boat a little bit, right? And so let me just throw that out there and get your reaction on that as a potential source of explanation.

Michael: **00:09:13** So, I definitely think that there is an element that people want to believe that, right, that there is -- I might put it slightly deeper into the psyche and say that Americans, as a country, broadly embrace the German puritanical component of suffering for your sins, right. So, I think oddly, we tend to enjoy punishment more than we enjoy reward. We constantly feel with reward that there's going to be something coming on the other side. And I guess I would push back pretty hard against the idea of the excessive speculation having been squashed, particularly in the options space, as we're now seeing roughly 50% of all options transactions are now happening within less than a week to expiry options, right. These are functionally as I've described it in my Twitter feed and various other things, like this is okay, put it on black, right?

Richard: **00:10:14** Yeah, just as a side note, Cem Karsan was our guest last week, and he was speaking precisely to this point that the amount of options that have been traded by retail, and specifically in the run-up to their expiry has thrown such a curveball to market makers than it's added to the complexity of the dynamics that we see nowadays in the lack of signaling mechanism in the equity market.

Michael: **00:10:39** Yeah, no, I think that's exactly right. So, I think you guys know this, I write a newsletter for *Tier1 Alpha*, that is another one of the businesses I'm involved with on this dynamic of option theory. And we're talking exactly about this, right. So, we've started to develop some tools that allow us to think about this. But this phenomenon has emerged in such a novel form in such a short period of time that it has substantively changed the game in the same way that I would argue the meme stock behavior took short sellers by surprise. Right.

Now, I mean, we've always seen components of this type of speculation before but I pointed this out yesterday or on Tuesday I think it was with the Fed where -- on Wednesday, I'm sorry. Where if you had bought at the open a zero day to expiry call and then flipped it upon the release into a zero day to expiry put, you would have made something like 30 times your money over the course of the day, right. If on the other hand, you had actually transacted in those options for a two-day period, right, you would have lost money. So, I mean, it was just like absolute rank speculation, true path dependency, no real opportunity for meaningful investment framework. And yet all the dynamics that we know that individuals like Ben Eifert, and others have done such an excellent job, Cem, etc., have done such an excellent job of describing the need for the delta hedging and how this plays out in increasingly thin and illiquid markets. All of that is now basically been short circuited because zero day to expiry options are pure gamma, I mean, they're just pure gamma. They're either --

And just again, to define this, I've tried to help people think through these components. Remember, what gamma is, is the change in delta per unit of change in price, right. And so if you think about a zero day to expiry option, it has one of two states, alive or dead, right. And alive is one delta, dead, zero delta. And so every change that happens in that option is pure gamma, change in delta for change in price. There's very little time value component to it other than to just purely evaporating component etc. So, in every theoretical model we've ever had, the zero day to expiry option has been a sale. Now suddenly, it's a, you know, there's extraordinary temptation to carry it to expiry and we're seeing the exact same behavior by the way, that we saw in the meme stocks and the options associated with meme stocks, where the market makers are cranking the price of these up, right.

So, historically, a zero day to expiry option will carry an element of implied volatility that reflects some jump to default risk. But generally, if you're transacting within one week of expiry, those options are going to trade at a discount to the VIX, which in turn is going to trade at a discount to longer data that the vol surface tends to be upward sloping. Now we've got a vol surface that up into the last week, basically spikes, right. So, we're now carrying a significant premium in those last five days, in part because market makers know that they can extract it from individuals who are gambling, right? I mean, they don't actually care. They just want to try and make that 30 to one payout. Right?

Somebody made money on, you know, again, like I walked through this, somebody transacted, somebody made money, but it was actually not 30 to one, they made basically two to one on their money, sort of thing. It's like, guys, that's a terrible trade. If you're trading a one day option, and you make 2X your money over the, you know, and it's 50/50, like over the course of the year, you're going to lose all your money, right? You don't even need a year, right? I mean, I don't care what your betting frequency is or anything else, like that's just a bad trade. I almost will never enter into an option unless I have a reasonable expectation of payout on success of four to five to one, precisely because it has such a low -- a long option position, precisely because it has such low payout probability in terms of its maximum expression, right? So, I don't think we've actually killed the speculative component. If anything, I think we've amped up the nihilism where people are increasingly just saying something along the lines of, I'm happy to go down as long as everybody else gets hurt too.

End miniriff here

Adam: **00:15:08** Well, yeah. I mean, if you're feeling left out and you feel like there's no conceivable way that you can achieve the American dream through the income channel, the way that you perceive … Right, yeah. Then you can see how some would perceive that the gambling channel is kind of their only shot, right. And it's been enabled over the last couple of years, or amplified by orders of magnitude, by the fact that through fiscal stimulus, we've kind of firehose trillions of dollars directly into people's bank accounts. And so we got checking deposits still near record highs, right? I think there's still $1.7 trillion in excess savings in demand deposits.

Michael: **00:16:00** Let's just be very, very clear, though. That's all sitting in the pockets of Bill Gates and Ken Griffin at this point as compared to the median American, right? The median American is now empirically worse off than they were going into COVID. They have more debt …

Adam: **00:16:15** They are, sure, from a wealth standpoint, and from a … in real terms.

Michael: **00:16:23** Yeah, not just in real terms. I mean, like actual -- the actual nominal cash balances for the average American household are now below where they were at the start of the pandemic, forgetting inflationary components, which are somewhere in the neighborhood cumulatively around 20% for the flexible components of CPI, that adjust on your day to day purchases, right. So, people have unequivocally been put into a worse place. The unemployment rate for those with less than a college degree is now above what it was in January 2020. So, we're now actually starting to see a deterioration in the employment prospects for those who are not among the relative elite in our economy, you're starting to see -- …

Adam: **00:17:04** In May of 2020 we were near, we were pretty well in cycle lows in terms of unemployment rates for those typically underemployed cohorts, right? So, you're referencing, like you're working seeing a pretty strong labor market.

Michael: **00:17:20** Yes. But, right, that low was a relative high that had only begun to retreat from the extremely high levels of the 1980s and 1990s, towards the tail end of that cycle. And I could show a couple of charts around those dynamics. But in just the simplest terms, the demographic component of the baby boomers that drove the elevated unemployment in the 1960s, and 1970s, that need to absorb a large number of new entrants every single year, we were incapable of addressing through the growth of the economy, particularly with the restrictions that were placed on it by the Federal Reserve, that returned in a much smaller form with the millennials. Right.

So, we'd already been going through that, the dynamics of underemployment, the dynamics of people graduating with college degrees, and significant quantities of college debt, and then being unable to find jobs in their chosen field that allowed them to pay back their college student loans, for example. You know, that was a very real phenomenon, somewhere around 1%. It's a little bit less than that, about 0.9% per year unemployment increase, and the persistence of the higher levels of unemployment was simply tied to the entrance of the millennials into the labor force. That's now fully retreated, and it's in part why we're seeing this persistent low level of unemployment, right?

It looks much more like the 1950s in which I can flip that on its head and say the 2.6% unemployment rate or 3% unemployment rates that were common in the 1950s were largely a byproduct of women who had gone in the labor force saying okay, screw it. I can leave the labor force and you know, go live with my husband and raise 2.3 children, right?

Richard: 00:19:06 Which is why we still see record low participation rates in the economy. I guess that's the irony?

Michael: 00:19:12 The irony is that they know this. So, Lael Brainard pointed this out, and others have pointed this out. The demographically adjusted labor force participation rate is at its peak. Right? Like, if we adjust for the fact that you have lower labor force participation rate amongst those who are above the age of 55, we are absolutely at our peaks in terms of what we should expect for labor force participation rates.

Richard: 00:19:36 Yet the Fed is trying to give a veneer of fighting inequality with their current fight against inflation. They're trying to frame it in these terms.

Michael: 00:19:48 Well, to me, that's part of the bizarro world, right, because I go back to Jay Powell, and his entrance and Grant Williams, who I'm a huge fan of and a personal friend. But if you remember his original comment, *I liked the cut of his jib, r*ight? You know, this dynamic of this guy seems better than Ben. I think he could very well go down as the worst Fed Chair in history. Like this guy is really bad.

Adam: 00:20:15 Well, you also think Volcker was -- Volcker would be your second worst, or is he your worst?

Michael: 00:20:20 Volcker's still my worst. But the irony, of course, is that Jay Powell is now trying to be what he thinks Volker was. Right? Which, man, if you want a prescription for Mike Green thinking you're a terrible Fed chair, pick the guy I think is the worst, and then try to do it without the underlying conditions being the same. Congratulations, like you're actually setting up a real disaster here.

Adam: 00:20:46 Okay, I wasn't going to go here but… go ahead, Richard. You were on a thread.

Richard: **00:20:51** No, I just wanted to kind of follow up because when Mike was last year on Riffs, he talked about sort of his take on the 1970s inflation, which was not what the conventional wisdom suggested. It was the oil shocks, he went down the demographic route and he explained that. And nowadays, we hear this Milton Friedman truism that inflation is always an … and always and everywhere in monetary phenomenon. Which is true, but it doesn't really explain what the inflation is actually caused by. So, supply chain disruptions is the most beaten to death term these days. We obviously know that the fiscal outlays played a big role here. What are your thoughts? Do you have any sort of controversial takes on the current causes of inflation that are outside of the mainstream narrative that interplay between these two dynamics?

Michael: **00:21:44** Well, as you said, supply chain disruption is the most overused narrative, and I just want to push back for a second on the description of the 1970s. The oil shocks were a critical component of it. But what they did was they restricted supply. Right? So, roughly a third of US industrial production at the time relied on oil as its source of energy. As oil prices skyrocketed and as oil availability retreated, the use of things like diesel generators, etc., became uneconomic, and factories were unable to expand production under a cost umbrella that would allow them to be -- under a price umbrella that would allow them to be profitable, right? If you just think about it in easily accessible commodity terms, the cost curve shifted significantly. Those that used diesel as their underlying component in terms of input, were shifted out in the same way we're seeing for Germany right now with natural gas as an input. Right.

So, that component played a critical role. But the real issue in the 1960s and 1970s, was this extraordinary growth in the population and the labor force that required a continual expansion of the capital investment in order to keep the capital labor ratio somewhat constant or growing, which facilitates productivity. And the way that we dealt with that, in response to the Fed hiking interest rates was basically by importing all those goods and services. Right. So, the auto manufacturers in Detroit were unable to expand to meet the needs of the baby boomers. Remember, like this is the 1970s. Auto sales hit record levels, home sales, homebuilding hit record levels in the 1970s despite population being less than half of what it is today. Right.

So, that demand shock into the economy was very similar to what we had upon the reopening. And I think we have better models of what's happened this time around in World War One -- in the re-openings after World War One and the re-openings after World War Two in which we saw almost identical inflation dynamics, as we reopened the consumption economy right, the consumer economy. The economy was not set up to deliver three ply toilet paper; instead, it was set up to deliver the rough stuff that we shipped off to GIs, right. When we changed that around, we entered into a supply shock that meant that there was demand without it being able to meet -- be met by supply, prices expanded and then they retreated in relatively short order.

Mike:	**00:24:19**	Didn't we also have some price controls involved in there that were lifted and caused some inflationary spikes along the way?
Michael:	**00:24:26**	That was more in the early 1940s. So, a little bit less of that that happened at the tail end. But remember, just like what we had in 2021, right, the core fear as the GIs returned and the stimulus retreated from World War Two and even from World War One, was that we would go back into a recession, right, that we'd go back into the Great Depression. Now, the repaired balance sheets and everything else similar to what we experienced this time around, meant that that didn't occur and I'd broadly point out the balance sheets were actually in pretty darn good shape going into COVID, right. We'd had a period of elevated household savings, the savings rate was higher, people had paid down debt. They'd begun the process of increasing their debt by adding to homeownership rates, which again makes perfect sense as the millennials began to try to acquire homes. But the simple reality was that we short circuited all of that with the original sin of shutting down the economy. And doing so in a truly chaotic way that we just, like, I still don't think we have a reasonable explanation for why we behaved the way that we did.
Adam:	**00:25:36**	In lockdowns and stuff? Well, we probably don't need to debate that in retrospect.
Michael:	**00:25:40**	No, it's not worth debating. We chose to do it, right. Let's just be very clear. And then in reaction to that we did what every population in history has done. In reaction to a pandemic, people fled the cities and sought out single family homes. Right? And there was a very clear increase in the utility value of a single family home. Right. It went from a place in which you were spending basically 6:00 PM at night until 8:00 AM, in the morning, with your kids, we're home for a brief period of time, if you were lucky enough to get them home in time for dinner. They'd stay at your house and do homework at the kitchen table. You know, you and your wife would watch TV a little bit, and then you'd go to bed and you'd start the next day by going off to school, work, etc. We replaced that whole process with an environment in which we were locked into our homes. We had to educate our children there, we had to do our work from there, we had to find all of our entertainment from there, etc. That's a massive outward shift in the utility function of a home. And what should happen in response to that? Prices should go up, particularly in an environment in which supply is constrained. Right? Now, we're moving back in the opposite direction. People are going back to work. Children are back in school for the first time consistently, in 2022. Right? What

should have happened to home prices in 2022? What was already underway? They were slowing. The supply of homes under construction had grown significantly. We were facing a significant retreat, and then the Fed decided to shoot the housing market in its head. I mean, like this was completely unnecessary in my analysis.

Adam: **00:27:19**

Well, I think if you go back, Logan Mohtashami's got some really good data on housing supply. And the total housing supply, counting both sales of existing homes and new homes under development, had been in retreat for 10 or 12 years. And that trend hasn't even, you know, it hasn't accelerated to the downside, we just continue to sort of be, we're basically just manifesting or extending the exact same trend that's been in place since sort of 2015-2016. The private sector has just not demonstrated a willingness or capacity to build homes to satisfy demand for at least the last seven or eight years, even in the most favorable interest rate environment that anyone could ever wish for in terms of funding new developments.

So, I'm not sure that we can point to a slowdown in home building or higher interest rates, motivating home builders to shut in some development projects as being the causal factor in the lack of home supply. I mean, I think there's just a general failure of the private sector to deliver a sufficient number of homes to individuals, especially in places where people want to form new families. So, near urban centers that have the prospect of work that people want to pursue, right? So, I find it hard to -- we haven't even seen a material rollover. And we've certainly seen a rollover and turnover of homes. We've seen a slowdown in homebuilding. But you know, as far as I can see, home prices are still…

Michael: **00:29:19**

Yeah, what we've seen so far is a slowdown in housing starts. But houses under construction are still at their peak, because of the relatively slow process of building a home and the delays associated with supply chain disruptions that meant that toilets from Japan didn't make it to the United States, for example, right? But that's clearing -- …

Adam: **00:29:40**

Okay. But obviously that with lumber prices, then I mean, clearly there was a supply problem like a year and a half ago. But there's the basic building blocks for building new homes. I think it's hard to argue that there are major supply chain disruptions for the last 18 months or so, right?

Michael: **00:29:57**

18 months I would push back on. The last six months, I would definitely agree with you. 18 months ago, like it's easy to forget how long ago, 18 months is, right? So, we're in October or November, I guess actually. 18 months ago, basically, it's February of 2021, you were very much in the thick of housing going absolutely bananas. And I believe, that at that point, we had near the highest number, because I even remember writing about this at the time, we had near the highest

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number of homes under construction in basically the past 20 years. We actually were beginning to pass the levels of 2006 in terms of housing starts and the combined component of housing starts and slower development.

I would also -- I just think is really important, like we talked about a failure of the private sector. If you, and I had a Twitter thread that I put out on this, right, I highlighted this dynamic, right. The idea was that homes are really, really expensive. What we actually did was we made it, particularly in the aftermath of the global financial crisis, we made it really hard to get homes permitted and built. And as a result, the average size of a home rose much more rapidly than it did even in the 2005-2006 time period. Right? And so if you adjust on a per square foot basis, you don't really see a meaningful increase in home prices until the very teeth of the pandemic. The home price increase associated with a pandemic, that outward shift in the utility value, and I could pull up the chart and show it, but like, we're very much -- we were going into this with homes representing relative value on a price per square foot even if we're talk-- before we begin to talk about the dynamics of how much it costs us to finance them.

Adam: **00:31:49** The price per square foot thing seems like something that we could discuss further. But maybe I sort of -- let me drag it back up to kind of where I started, right? Because you're sort of taking issue, you're saying we got a hyper Volcker-ized Fed, under conditions that are actually much more challenging than Volcker faced at the time. And therefore, the consequences of this misguided approach are much larger now, which I think I'm fair in summarizing your perspective with that statement.

Michael: **00:32:30** Well, when you say it's much more difficult, I mean, under Volcker, at least, you could make the argument that inflation expectations were deeply entrenched, right? Again, I disagree with Volker's approach. I think the evidence is actually very clear that the methodology meant that he made inflation worse, rather than actually fixing inflation. If I looked elsewhere around the world, the demographic impacts meant that the inflation on a global basis peaked in 1979, as compared to 1981, as it did in the United States.

Adam: **00:33:05** Let me just -- because I was going somewhere with that, and that was sort of parenthetical. I just wanted to sort of set the stage. But would you say that the period from 2009 to 2020, or 2021, that we had healthy policies in place?

Michael: **00:33:23** Oh, God, I mean, when you define healthy policies, I just, I want to be really clear, like …

Adam: **00:33:29** Which is why I'm asking you to define them.

Michael: **00:33:32** Yeah. So, I think that we had, I think that we engaged in some necessary emergency policies, given our mistake of shutting the economy down in the early parts and through 2020. As we moved into the 2021 time period, it is very clear that we overstimulated the economy.

Adam: **00:33:52** No, but I mean, what about from 2000 to 2020 as well, right? Were the policies during that period healthy? I mean, and maybe not 2009, because now we've got the GFC there and I think we could all agree that extraordinary intervention was necessary at that point, right. But let's sort of say 2011, 2012 on. From 2011, 2012 on, was this a healthy policy environment?

Michael: **00:34:19** I don't think it was as unhealthy as everybody thinks. I do think that we were too quick to respond. I do think that we were too quick to decide to bail out the systems, respond with interest rate policy or balance sheet expansions and QE two, three, etc. And I think more importantly that we misused the opportunity. Right? So, you know, what I've been on record is saying very clearly is MMT is correct, in that it is descriptive of the system. But it is not at all *prescriptive*, meaning telling you what to do with the money that you can print. We oddly wasted the opportunity to make the end investments to improve our society so that we'd be better positioned coming out of this. Right?

Richard: **00:35:05** I think the point might be that monetary policy is not enough, right? The problem is that the blunt tools that Fed and other central banks have at their disposal only allows them to do so much. And the second order effects and second/third order effects of those policies create all these externalities that we're now coming to terms with. Right? I think perhaps what you're going with this is that fiscal policy and regulation and fighting NIMBYism, and all these other dynamics are the more appropriate approach from a regulatory and policy perspective.

Michael: **00:35:43** 100%. That is the correct interpretation. Right. And I would argue that if I'm complaining about monetary policy, between 2009 and 2020, it's largely about the fact that monetary policy enabled fiscal policy to not do anything. Right? We did the damnedest to try to make sure that no hard choices had to be made, until we got to a degree of societal friction, where it feels like we cannot make them.

Richard: **00:36:16** A powerful opioid that numbed everybody into inaction, I guess, is a …

Michael: **00:36:21** Reasonable statement.

Adam: **00:36:24** So, what type of environment motivates the type of action that we need, from a fiscal standpoint or from a policy standpoint? And how do we engineer an environment that produces that?

Michael: **00:36:42** Well, so I think this is one of the great ironies is that we had started to have these very real conversations, right. And so when you talk about the desire to harmonize and equalize components of the system. Tax policy, for example, being much more progressive and being much harder on billionaires than it is on individual working families, strikes me as a very logical part of that process. Now, the narrative takes various forms of, well, if you try to do that the billionaire's are just going to leave. Well, that's fine. Okay. If they really want to go to New Zealand, they really want to relocate to New Zealand or to various other places that absolutely should be their prerogative. But there should also be disadvantageous conditions under tax policy, if that's their choice. Right?

We should not allow corporations like Apple to decide that it is going to sell cheaply its IP into low tax regimes, and then claim that the majority of its revenues and profits derived from Ireland, right? Like, that's just absurd. We should not allow corporations like Apple to engage in clearly anti-competitive behavior with their employees in Silicon Valley, entering into non-solicitation agreements with other tech companies around their employees, that results in an incredible number of employees being underpaid, right, relative to their free market value. And a settlement for a company like Apple where they pay $600 million, which is functionally sofa change. Right? I mean, like, that's insane. It really is.

Adam: **00:38:25** So, let's say we're all in agreement on that, Mike. So, I think we'd all also be in agreement with the fact that passing the types of laws or regulations or rolling back the types of laws and regulations that are required to facilitate those types of solutions, are implausible in the current economic climate.

Michael: **00:38:49** I actually think that they're increasingly plausible as compared to implausible. I think the risk is that we actually have entered into an era of meanness in which somebody like Desantis, who I would functionally argue like, I just want to be really clear, like my biggest complaint against Desantis is not the same as my complaint against Trump. It's just he seems mean. Like, what a nasty guy to load up immigrants and ship them off somewhere, to make a point, right? I mean, those are individuals, those are human beings. Yes, I understand the point that he's making and his point is absolutely valid, but to use human beings to display that, that's just disgusting.

Adam: **00:39:31** Okay. But that whole populistic movement was in place before the pandemic and before the Fed started to implement these types of policies, right? I mean …

Michael: **00:39:45** Pandemics almost never change the direction ,or these types of events don't change the direction. They just magnify and bring forward, right. We were already moving towards work from home. I already worked from home. Right? We advanced these dynamics significantly. You know, massive online courses, the MOOCs etc., right? Those were already available, people were able to choose to do that. Zoom existed, etc. All we did was push this dynamic forward. So, we didn't actually change anything. And I would broadly argue that Desantis is just the fuller realization as much of the anger and frustration and desire to hurt people, that largely embodied Trump. Right? I think he's a far better individual than Trump is.

I just want to be really clear on that. But I'm not sure that the full expression of that anger and frustration and that sense of, *oh, we're going to make people pay or I'm going to show you*, it's not a helpful component in terms of drawing people back into discussion with each other.

Adam: **00:40:43** Agreed. So, then how are you getting to the conclusion that we're moving toward a more constructive political climate where we're going to be able to move some of those policies forward?

Michael: **00:40:59** Because I would actually broadly realize that I'm increasingly hearing that from both sides, right. People are increasingly saying I think AOC is ridiculous and I think Trump/Desantis' behavior is ridiculous. I don't have an empirical point that I can point to and say, …

Adam: **00:41:15** No, no, that's fair component.

Michael: **00:41:18.** But the sentiment feels like it's shifting back towards a recognition that somebody at some point needs to say, hey, wait a second, we all love our children, we all want to make sure that the best happens for them. Right? How do we actually engage in a constructive conversation so that we make that happen?

Adam: **00:41:41** Sure, but I think that the challenge is that -- certainly the perception is that policies that will make it easier for our children have the potential to make it harder for me, right. Like policies that make it easier for my children to own a home and form a family close to where I live in downtown San Francisco, or Oakland, or Manhattan or Boston or whatever, mean that maybe I will lose some rights, or I'll have to relinquish some of my NIMBY-ist perspectives. I may have to live with lower home prices or give back some of the lottery gains that I've had on my own home. There's a -- at least a perception of a bit of a zero sum dynamic at play, right? If the boomers, let's just say the boomers, I don't want to -- but let's say homeowners, homeowners have won the lottery over the last 20-30 years, right? If you owned a home and that's just accelerated over the last two or three, but also over the last five, etc. So, we could largely divide the population into those who've owned a home prior to kind of 2020 or 2015, and those who don't, and are looking to form households and start families near attractive urban centers. And so how do we reconcile that type of dynamic in a non-zero sum type of way?

Michael: **00:43:25** So, I think actually -- so again, I would suggest that increasingly, we're moving away from that. So, homeowners in San Francisco while recognizing that the theoretical price appreciation of their home is very high and would likely retreat somewhat in the event of additional construction, are increasingly saying, hey, wait a second, unless we attract young, vibrant families into San Francisco, San Francisco's going to be overrun by homeless people. Right? Nobody wants to live in San Francisco, especially the people who live there. Just as Paul Pelosi, right. Like, nobody actually wants to live there anymore.

Adam: **00:44:04** Except those who own multi-million dollar homes in greater San Francisco and I mean, obviously, they obviously …

Michael: **00:44:12** I'm going to push back on that. I actually increasingly would argue that those who are in those cities recognize that what they've established, unless they truly turn them into gated cities, right, and gated communities, they're facing increasingly third world conditions that mean that they can no longer enjoy the properties that they own.

Adam: **00:44:31** Okay. Well, let's take that forward and let's assume that's true. So, what type of policies might come to fruition then as people begin, and not just in San Francisco but in general, let's generalize this away from housing, what's -- Yeah.

Michael: **00:44:43** Right. So, you're already seeing this. This is part of the point that I would make, right. The recall of Chesa Boudin and replacement by a relative conservative in Jenkins. You're seeing this in Los Angeles where they're doing the same thing. Even Portland is talking about becoming Republican for God's sakes, right? Now, does Republican necessarily mean good? Absolutely not. Because we got crazy policies on both sides. I was just spending time complaining about the meanness associated with Desantis, right, and the broad recognition that this just cannot stand. We cannot actually have this type of behavior and expect to maintain coherence in our society. Right?

Richard: **00:45:22** So, I'm curious, Mike, do you really see a possibility with the current two-party system, where the primaries are often decided by the most extreme of the party candidates because they're catering to the base? You're not seeing perhaps with the stereotype argument now is that it's becoming more polarized. You're actually seeing something of a move to the middle from both sides?

Michael: **00:45:50** I do think you're starting to see that, I genuinely do. And I could be wrong on that. I hope I'm right, but I could be wrong. Like I just can't emphasize that enough, right. And I would broadly say that increasingly, everyone within both parties is recognizing that much of the behavior was performative. Right? Support for Trump and the dynamics of Trumpism and the enjoyment of Desantis' behavior, etc., feels like it's retreating. Feels like people are saying you know what, that was probably a little bit too much. Right?

Richard: **00:46:35** Let me follow up with -- The Economist is doing an interesting coverage of the upcoming midterms and talking about how elected officials in the states, particularly in red states, the more moderate Republicans are being replaced with the Trump candidates, and particularly the officials that would be validating elections are coming in with the narrative of the stolen election of 2020. And so the concern is that 2024 we're coming into an even larger crisis, because of the potential for an actual stealing of an election now to the other side. Have you been following these events at all? How does that square with your take?

Michael: **00:47:22** So, I would broadly argue, again, that like we tend to focus on the last war, right? So, effectively I would argue we're trying to construct a Maginot Line against something that I would argue is not going to actually be particularly an effective approach. I can't guarantee that because again, like this is a relatively hopeful observation in a morass of really bad policy making choices. And it's one of the reasons that I'm so frightened of the behavior of the Federal Reserve, because the clearly conventional wisdom is, *well, we're going to have a recession, but it's going to be really mild*. Right? Man, I struggle, like, that frightens me more than anything else, because recessions are inherently chaotic activities. Right? Things get restructured in ways that we can't predict. It could be the case, right? I can certainly see how that happens.

I can also see how we enter into an environment, in which there's an extraordinary degree of hysteresis. And the human capital skills that people have developed, are replaced by a significant diminution of that. Right? I mean, there is again, we're going into a recession with unemployment programs woefully unprepared, state finances woefully unprepared, household balance sheets at an extraordinary, for the majority of US households, in an extraordinarily weak framework. We're looking at things like credit card debt that is non-dischargeable. We're looking at a high probability that the Biden administration's attempt to eliminate student loan debt fails and suddenly people who thought that they had dropped $20,000 worth of debt find that not only do they have that $20,000 worth of debt, but it's now non-dischargeable …

Richard: **00:49:20** Interests are higher.

Michael: **00:49:21** … right? It's reset higher because of accumulated -- like, think about the potential that we're looking at here. And everyone's saying, boy if we just have a recession, then that's really going to hurt Ken Griffin. I guarantee you that Ken Griffin could care less.

Mike: **00:49:36** He's going to be fine.

Adam: **00:49:37** Well, Ken Griffin is an interesting example. Right? It's clearly hurting the oligarchs that are the primary shareholders of the FANGs, for example, right. Like, there's -- you're hurting …

Michael: **00:49:52** Wait a second. When you say it's clearly hurting, right, I mean, while Jack Dorsey may look like a homeless man. I have not yet seen him on a street corner collecting quarters.

Adam:	**00:50:01**	Agreed, agreed, impairing not devastating. But you know, it's definitely -- we're balancing some of those things. I guess my point is like, is your recommendation that we should have been -- we should continue with the same types of looser monetary policy that we embraced from, and again, notwithstanding 2009, but from the sort of 2012 to 2021 period, in the face of continued gridlock at the state political level, and the national political level that is unlikely to unleash the types of other policies that we need to see, in order to move in a more productive direction for the majority of Americans. It's one thing if there's some optimism, that some of the ossification that we're observing in terms of political decision making is becoming more productive. But I think in the short term, it's hard to argue that, right? So, if we can't count on government to make different decisions, then does the Fed really have a choice? Is it your recommendation that we should have continued with the same kinds of loose or stimulative monetary policies because we can't count on government to step in and do the right thing?
Michael:	**00:51:37**	Well, again, I think you're drawing a distinction between the Fed and government that is false. Right. It's the financing arm of the US government. So, to treat it as a separate political entity, I think is a false distinction. What you're really saying is should the Fed, an unelected body, sit by and pass judgment on the terrible policies that we have allowed to persist in our political system? And I don't see how they possibly have that authority.
Adam:	**00:52:12**	But they did that from 2012 to 2021, it's just in the opposite direction.
Michael:	**00:52:19**	Again, I'm not defending those choices, but two wrongs do not make a right. And the Fed decided, at any point in -- I mean, we actually saw this behavior, right? We saw what happened when the Fed repeatedly tried to hike interest rates, and then backed off because they were incapable of seeing the system through. Right? The persistence and the reliance on the dynamic of the Fed responding under any conditions got worse and worse, and worse and worse. All right. So, the easiest thing for the Fed to do is to say you know what, first thing we're going to do is cause no harm. We're going to adopt effectively, the Hippocratic Oath that says we're not going to actually try to change economic outcomes ourselves.
Adam:	**00:53:04**	But no, action from zero rates is an action.
Michael:	**00:53:08**	What's that?
Adam:	**00:53:09**	No action or just maintaining the status quo with extreme policy, is an action.
Michael:	**00:53:18**	Again, the dynamics of the extreme policy that were put in place in the pandemic, they absolutely should have withdrawn components of that. There was no reason to providing significant support to the housing market, once it was clear that the

pandemic emergency was in place. But remember what the Fed actually did, right? The Fed lowered interest rates by roughly 75 basis points, right, on mortgages, which while material, remember that if you're in a fixed rate, 30 year mortgage, you're still paying back the principal. So, all you're doing is reducing the interest component of it, gave or take on a $300,000 home, it takes your payment from roughly $2,700 a month to somewhere in the neighborhood of $2,400 a month. Yes, that's an improvement, but no, that is not driving a 30% increase in home prices. Right.

The second thing that the Fed does, is that when the Fed lowers interest rates, it facilitates a refinancing and liquification of savings from those who are already locked into paying $2,700 a month, allowing them to obtain an additional $300 a month in income. If they sell their home and they liquefy a component of the gains in capital gains component, bully for them, that's fantastic. But then they have to go out and find additional housing. Right? So, there's not really much of a trade that's underway there, unless you're willing to significantly take a step down and take cash out. And that's always going to happen in every cycle. Right?

So, the actual value that the Fed was able to bring into that process was in an environment in which unemployment spiked to 20% for a brief period of time and tremendous amounts of economic uncertainty existed, we facilitated the fleeing to the countryside that has accompanied every pandemic in history. Right? We had a choice. We could either say to people, no, you can't move anywhere, because no bank is going to finance you. Or we can say, you know what, we're going to step in, we're going to facilitate this transition. If you really want to get out, if you really want to have a place to educate your children, if you really want to have a place to work from home, we're going to actually make that possible for you.

And you actually see this in the purchase data, which had a very minor step up, in part because as Logan and others pointed out, there was simply a lack of available inventory that does show up in higher prices. People made bad choices around that, and there would have been a natural retreat from it, right. But to engage in a substantive and intentional punitive behavior in which you're then turning around and saying, okay, we're going to trap these people in their homes and their mortgages for an extended period of time and reduce the capacity of the economy to restructure itself by hiking interest rates, right, and reducing that capacity for a fundamental restructuring, strikes me as absurd policy in an environment in which you're trying to accomplish everything that you're saying.

Adam: **00:56:10** Okay, but that sounds like we're not going to resolve this in particular at the moment.

Michael: **00:56:17** Let's me flip it on it's head. Like what should the Fed have done from your standpoint?

Mike: **00:56:20** Yes, this is -- Yeah, I want that. Perfect.

Adam: **00:56:23** Well, I think in the context of a government is unable to make decisions and pass meaningful laws, I think something needs to be done to provide younger generations hope that they may be able to live some manifestation of the dream that they probably grew up having, right? The vision of life with family and etc., that they watched their parents have. In fact watched their parents have with that vastly greater effectiveness than even their parents probably anticipated, because of massive windfall gains on portfolios. And you've got millennials who are looking at home prices that are unachievable through the labor channel, portfolios, rates and equity yields at pretty well the lowest in any generation. So, expected return on invested capital near the lowest in a generation and wondering what to do. So…

Richard: **00:57:50** I think Mike's point, and which I agree, and Mike, you can correct me if I'm wrong, is that these outcomes that you're hoping for are not achieved by tighter monetary policy, particularly in this environment. And…

Adam: **00:58:05** I agree they're not but also they're not continuing to make the situation worse, which is what…

Richard: **00:58:12** The issue is that the Fed is perhaps not the avenue through which some of these policies should be enacted. Mike, I wonder if you might talk a little bit about -- …

Adam: **00:58:20** … the avenue to which these issues came about. And since no one else is willing or able to enact policies that might address the challenges, then can the Fed not be called upon to undo some of the errors of its own making?

Richard: **00:58:43** Yeah, but I wanted specifically to hear from Mike with regards to the current inflationary issue. The fact that we've had such … policy towards the energy industry in the US, and particularly, the shale industry's unwillingness to increase production, because they sense the hostility that continues to come from the Democratic Party and the ESG mantra that has permeated the zeitgeist to a meaningful degree in the last couple of years. So, I wonder if you might speak to that. Is that some of the -- one of the avenues that you think governments should be pursuing, like a change in that policy framework to allow the US who should be energy independent to actually realize that potential?

Michael: **00:59:33** Well, first, let's be really clear. The US is by and large energy independent on a net basis, right? We actually are energy independent. So, could we have even more and export even more and become a Saudi Arabia, etc.? Sure. And should we have an industrial policy that favors growth over stagnation? Like, you're basically asking me like should we behave like idiots or should we behave like sensible human beings? Right? You know my response to that is we should behave like sensible human beings. I do think that there is a very fundamental lie that we tell ourselves that the reason for the under investment in energy has been a function of ESG frameworks, right? That's just not true. We actually had massive expansion in fossil fuel production in the United States, to the point that we had a tremendous crash created in the 2016, 2017, 2018 time period. And negative prices, briefly at the opening of the pandemic, right, that created the conditions under which nobody was willing to finance energy companies. Right?

Now, David Einhorn is a great friend of mine, somebody I deeply, deeply respect. But remember, he was going around in 2015, 2016, highlighting the fact that the *Mother-fracker* was a cash burning exercise and that these shale drillers were never actually generating a return on cash. And subsequently has become very favorable about production under the current price regime. But like we did that ourselves, right. We generated terrible returns on invested capital to which investors understandably reacted by saying*, I don't want to put any more money into this space.* Right? Like, that …

Adam:	**01:01:18**	That's kind of the pre-ESG era, though, right? I mean, like, 2015, 2016, the ESG
Michael:	**01:01:23**	Like that's six years ago.
Richard:	**01:01:26**	It was the beginning. That was the beginning.
Adam:	**01:01:27**	We were just starting, right. But it's not like we were seeing massive divestment of energy companies by major sovereign wealth funds and major endowments in 2015, 2016 -- …
Richard:	**01:01:37**	The narrative wasn't …
Adam:	**01:01:38**	-- as we were in 2018, 2019.
Michael:	**01:01:41**	Again, in the 2018, 2019 time period, what were oil prices, right? We got oil prices up into the mid-70s, the fourth quarter of 2018. And by the end of the fourth quarter of 2018, they'd crashed into the 40s. Right? Like, was that a function of ESG? No, it wasn't a function of ESG. Right. It was a function of overproduction and terrible financing choices. Right. So, like we have to be honest with ourselves, if we're actually going to get this stuff done. Like, do I think ESG is garbage? Yes, I think ESG is by and large, is garbage. Right? I actually think the great irony about ESG is that it reinforces many of the components that I highlight with passive investing that it's completely absurd to think that these are passive entities that are not influencing market behavior. Right?

I mean, the wonderful thing that Larry Fink has actually done is he's exposed his market power. And now we're finally starting to see some traction in terms of concern on the growth of passive, from the antitrust perspective of the Democrats and from the ESG perspective of Republicans, right. They're getting fire from both sides, and they largely created it themselves. Right. So, like, I'm actually, in some ways, very deeply thrilled to watch some of this going on. But the idea that …

Adam: **01:02:55** Okay. So, let's pivot to that, Mike.

Michael: **01:02:57** What's that?

Adam: **01:02:58** Go ahead. Yeah. Sorry, finish your thought.

Michael: **01:03:00** No, no, no. Like, again, this is part of the reason why I'm kind of hopeful, is I'm starting to actually see some growing awareness around many of the issues that I've talked about for a very long time, that the capital allocation process in our economy is largely broken, because we've subsumed markets that are designed for capital allocation, and turn them into vehicles that are designed to provide a risk free retirement to our population. That's just a stupid use of capital markets, right? So, it falls under the terrible policy choices of everything else that we're talking about, right? We're not yet at the point that we're actually challenging that framework. We still talk about what should be the expected return of equities, or etc.

You know what the answer to that is? It depends. If we make terrible choices, it's going to be lower. If we make great choices, it's going to be higher. Right? Like, congratulations, good choices get rewarded. Like, Mike Green, brilliant podcast, here we go. I'm the smartest man alive. I just told you, make good choices, things turn out better. Right? That's the sum total of the advice I can offer for you. Right. So, we know that a lot of the stuff that we talk about is just like epic bullshit, right? That it's ESG, it's the fault of AOC that we don't have adequate oil and gas production, etc. Like, those are just not true statements. Right. They're just not true.

Adam: **01:04:18** Let's pivot to the passive theme, because I did want to explore that as well and get an update on where you are in your thinking. Has what we've observed this year, and the current environment in terms of flows, has that caused you to update anything? And I'd love to pull on the thread of what's going on at Blackrock. Because I'm not intimately familiar with what you're referring to there that has exposed the market power that Blackrock has and what some of the implications of that might be. So, let's pivot there.

Michael: **01:04:51** Sure. So, I think the most interesting thing that's happened in the passive framework on a year to date basis is that we have not yet seen the negative flows that everybody's worried about, myself especially right. We've continued to see positive inflows, particularly into the vehicles that are used for retirement, right. There's been some diminution, they're diminished, whatever, reduction, versus what we saw in 2021. Obviously, there's less cash available, there's less money going into the market. But most of that decrease has actually come from the single stock space as compared to and you know, the punting dynamic of you know, Dave Portnoy, etc. We've not really seen a meaningful deterioration yet in retirement savings, right, those that are coming from employment.

What we have seen is actually something else that you heard me talk about, which is the impact of systematic strategies that rebalance between equities and bonds. Right. And so I would argue that one of the things that the Fed didn't fully appreciate going in, and I would point out that almost all macro punters who made significant bets against rates actually made them in steepeners, right? Their bet was that inflation would cause the long end to rise, we're going to lose control of the long end, people would no longer want to buy 10-year and out, etc. Man that is 180 degrees from what actually happened. Right? The short end was raised by the Fed. And -- …

Adam: **01:06:20** Well, yeah, nobody believed that the Fed had a spine, right? Nobody believed that the Fed was going to step in and take a stand here. Right?

Michael: **01:06:26** Right. And through the miracle of duration exposure, you end up winning in a steepener if you've placed a similar nominal bet, right notional bet in terms of the long end versus the short end, because the selloff ultimately pays off in a meaningful way. If we go back a year ago, most macro funds had not yet seen that sell off to the point that they were in the money on their long end debt, they were losing money on the steepener. Now we're in a position where everybody looks like a genius for betting against rates, right? Even if they made the wrong bet in terms of the steepener framework.

The second component that I guess that I would highlight about that, that people tended to under appreciate was that the structure of bond indices created an extraordinary duration extension. Right? So, if you think about what happens when you cut interest rates, which bonds go up most? Long duration, low coupon bonds, they have the highest sensitivity to interest rates. They have a high coupon, right? I'm receiving more of my cash flows up front versus more my cash flows at the back, I have less sensitivity. So, as the Fed lowered interest rates, the bonds that were most responsive to this were things like the Austrian Century Bond, right? A 100-year bond that goes to 240, right? Well, at 240, it becomes two and a half times the weight in the index. Incremental flows into bond funds mean that you buy more and more and more of that. You extend the duration of the index, creating extraordinary interest rate sensitivity. And that's what we saw in government bond funds, that's what we saw in high yield. High yield went in with a duration, closer to eight versus its historical four and a half. Right? Investment grade went in with a duration, and I want to say it was probably close to 11, right, as compared to a historical somewhere in the six or seven, right.

So, we have this extraordinary duration extension and the Fed starts hiking interest rates, we get hammered in bonds. If I have a systematic allocation strategy that's supposed to be 60/40 bonds, and I get hammered in my bond portion, what do I have to do with my equities? Sell, right? I have to sell equities, buy bonds. Sell equities, buy bonds. Fed keeps hiking. What we've actually seen is global market cap of bonds has fallen off at almost exactly the same pace as global market cap of equities. Right? That's totally unprecedented, but again, makes perfect sense in the context of systematic strategies that automatically are continuously rebalancing. One of the best charts people can pull up for 2022 is the ratio between the total return of Vanguard's Total Market Index, you know, proxy this with the VTI ETF, versus their Total Bond Market Index, right, BND is the ticker there. It's unchanged, functionally unchanged for the year. It looks exactly like it was just rebalanced over and over and over again over the course of this year. Right?

I think this is one of the really key takeaways that people should have on a year-to-date basis. This has not been about recession. This is not about deteriorating earnings. This is not about Apple's iPhone sales didn't actually meet expectations or sold off significantly. None of that happened. S&P earnings are at a peak. They may begin to fall, right, but they have not yet begun to fall. Russell 2000 earnings are barely off at all. They peaked roughly in July. Right. But that's the cyclical aspect of our stock market. We have almost no evidence whatsoever of recessionary pricing in those indices.

Adam: **01:10:02** Yeah, Bridgewater's got, like a chart showing that if you just hold the discount rate constant with where we were at the beginning of the year that actually equity valuations are higher than they were in December 2021.

Michael: **01:10:15** Right. And again, I would just highlight that I don't think that's actually how it works. I don't think anybody actually does. Like, when was the last time and an analyst actually sat down with you was like, okay, well, let's increase the cost of equity for Microsoft and run our DCF under unchanged cash flow assumptions at higher levels of interest rate, and therefore, we should be selling Microsoft right? That's not the discussion that's going on. I have yet to hear anyone actually say that other than maybe …, right, and he would say the exact same thing. We've actually seen no meaningful expansion of the cost of equity in terms of a spread over bonds, right.

So, what we're actually doing in many ways, is we're accommodating systematic rebalancing of equities and bonds, by selling equities to accommodate much lower prices in bonds, reallocating it into bonds. Very similar to the experience that I went into 2000 as a value manager, where suddenly people who had not had religion about rebalancing their exposure between small cap value and the NASDAQ, suddenly became religious about it. Okay. Well, every quarter, we need to rebalance, because we don't want to be caught in the wrong position, right? So, as an outperforming small cap value manager, I was facing constant redemptions so that people could turn around and buy the NASDAQ and lose even more money, right. And by and large, that's what we've seen.

Adam: **01:11:35** Okay, so tie a bow on that. So, if I'm reading you correctly, I think you're saying that the losses in equities are primarily, or at least, partially a rebalancing effect, and don't really reflect changes in discount rates. So, it's not really a fundamental effect, it's more of a flows effect.

Michael: **01:11:58** I think that's right. And again, that would be the key takeaway that I would offer around this type of dynamic.

Richard: **01:12:06** But the discount rate effect is still there, even if that's not the reason why people are selling, it is reflective. What I think is interesting is that no one has really priced in an earnings recession into equities. And what are your thoughts there?

Michael: **01:12:21** We haven't had an earnings recession, let's be really clear, right? We have not had an earning …

Richard: **01:12:25** Well, the expectation of one.

Michael: **01:12:27** There's no evidence of that. There's no evidence that we are yet doing that. And in fact, if I look across my universe of high yield sensitive equities, right, those that need to refinance over the next two to three years, if interest rates stay at these levels, like they're just all bankrupt, right. They can't service their debt at these levels. Right? There was an incorrect chart that was put up by Liz Ann Sonders, saying the number of zombie companies that's falling defined as a three year average of EBIT to interest rate, well, that's a trailing number, right? If I use a forward number to reflect the current level of interest rate, I run a basket of about 100 names in the Russell 1000 that I treat as a junk basket, every single one of those companies is incapable of servicing debt at current levels. They just can't do it. High yield index is refinancing from 4% to 12%. Can't be done.

And that's actually, the Minsky framework is really important here. And it's one of the reasons why I would push so hard against what the Fed is doing, right? So, people forget what the Minsky framework actually is. The Minsky framework is that you have companies that are capable of operating at a level of interest rate, and companies that are incapable of operating at a level of interest rate. You can influence that through interest rates. Right? So, what we've lived through is a model where you cut interest rates, and households that had taken out a mortgage at 5%, are able to refinance at three and a half, increasing their liquidity, raising their monthly take home pay so that they can pay off other stuff, right? Same thing is true for corporations. I refinance from 5% to three and a half percent, I now have additional money that I can use to theoretically pay down debt, make investments, pay my employees, etc., continue as an ongoing concern. Right.

But if I flip that around, and then go from three and a half to five, right, the initial impact is functionally zero, right? Unless you happen to be trapped in an immediately adjustable rate mortgage, or an immediately adjustable rate debt issuance. It has no meaningful impact on your cash flow characteristics until you need to refinance. And then you face that same deterioration. And so there's a window of opportunity that I would argue that we exist in right now, where the hedged companies, the companies that are actually capable of servicing their debt, are not yet incapable of servicing it. But if we persist on this path, we're going to face an extraordinary restructuring of the American capital stack, both in terms of households because people that lose their jobs and ultimately have to sell their homes into this environment are going to face catastrophic circumstances, right.

And those companies that need to refinance, you're seeing this with Carnival Cruise Lines and others, they're slowly converting their capital stack. But if you convert that entire capital stack by staying here for an extended period of time, those companies are just gone. They're just gone, total change of ownership. And when that happens, it's not going to -- it's not like Carnival Cruise Lines is going to be auctioned off to the 10th percentile in terms of income distribution in the US, those assets are going to be sold to the wealthy.

Adam: 01:15:48 Okay. I mean, aside from the question of whether it's the Fed's job to sustain businesses that are operating at imprudent levels of operating or financial leverage, are you suggesting -- there's two ways to take your comments, right? Are you suggesting that the discount rate, the change in discount rate has not yet priced into equities, and therefore we have a substantial shift lower as equities reprice to higher discount rates? Or are you suggesting it's a complete myth that anybody ever discounts future cash flows as a way to value equities and it's purely just a relative basis relative to bonds, and based on the total amount of liquidity or savings in the economy? So, that's kind of -- well, let's take that question first.

Michael: 01:16:43 So, first, I would never say that it's a total myth of anything, right? So, everything that, it is absolutely true that somebody in Seth Klarman's shop is probably running a discounted cash flow analysis and saying, at these levels of interest rates, here's the opportunity that's created, or here's a likely catalyst. And by the way, I'm engaged in those conversations as well. I'm working with individuals who are starting to prepare to take advantage of a serious distress cycle that could potentially liberate significant quantities of capital similar to what happened with the savings and loan crisis. Right?

Now, the irony, of course, is that those that will be most adversely affected by that type of dynamic are those who are trapped in systematic strategies, like a Vanguard total bond fund, that has to sell on a ratings downgrade, no discussion, like is it what are the recoveries? Is this the keystone collateral? Is this the part of the capital stack that you want to be in? If it receives a rating downgrade, it is no longer eligible for inclusion in an IG graded fund, right? Get it out of here at whatever price, right? That's an incredible opportunity akin to the Resolution Trust Corp dumping valuable properties in the aftermath of the SNL, right. So, things like that will present themselves.

When you talk about the adjustment dynamics, I'll share my screen for one second. This is actually shared with me from an incredibly smart trader. Let me see if, I can --

Mike: 01:18:21 Yeah, Ani are you there?

Michael: 01:18:25 Share screen, there we go. Okay. All right. So, this is looking at the effective mortgage rate for homes in the United States, this is from Haver, right, obviously, … etc. versus Canada, which has adjustable rate mortgages. Right, like the US is the black line. We have yet to see any meaningful increase. Right? Canada on the other hand, man, that's going to be an interesting Christmas up north.

Adam: 01:19:02 Well, yeah.

Richard: 01:19:04 Canada doesn't have 30-year mortgages like the US does, so we can at most lock in our rates for five years. So, when I heard you guys are able to do that effectively, it was just a …

Mike: 01:19:20 The shocker too is that obviously the Canadians who are over leveraged in real estate piled into the variable rate in order to capture the lowest possible payment rate in a big way.

Adam: 01:19:31 They learned all the wrong lessons and many of them are going to learn the right lessons over the next five or 10 years.

Michael: 01:19:38 Wait a second though. What is the right lesson? Right? I mean, that…

Adam: 01:19:41 Well, should we be teaching everybody that unproductive wealth generation via capital appreciation of like, fixed homes, should be the dominant way that you generate wealth? Or should be rewarding labor productivity and …

Michael: **01:20:00** Wait a second, Adam. A second ago you were telling me that we should have policy that encourages the ability for people to buy homes, right? That they want to be able to participate in the system in the way that their forebears did.

Adam: **01:20:12** That's not it. I'm suggesting that we need home prices that reflect responsible levels of leverage and the consumer responsible level of the percentage of household capital, in order to crystallize that American dream. I'm not saying we should give everyone a home. I'm saying that everyone should have a shot at a home through labor income. And the existing pricing mechanisms don't enable that.

Michael: **01:20:40** So, when your great grandparents -- when your great grandparents came to Canada, did they move into downtown Toronto, which was filled with skyscrapers and pricey condos with gyms? Or did they scrape, you know, an existence out of a hut that was barely insulated against the Canadian winters? You know the answer to that.

Adam: **01:21:03** The latter, of course.

Mike: **01:21:05** Yeah, B tier city, often industrial, often workforce into it …

Michael: **01:21:1** You're saying city. They were farmers. I mean, the simple reality is, is like, go out, go anywhere in the United States, you'll find plenty of abandoned homesteads in which people were living in structures that are functionally like the tent cities that we have in Oakland and San Francisco and Toronto, right. Like, that was a standard of living that people were prepared to engage in. I do not think the pumpkin flavored latte mocha chinos were available then. And we're a reasonable distance away from those encampments, but that was actually home ownership back then. Right? To not recognize the dramatic improvement that is that accompanies urbanization is like disingenuous, genuinely disingenuous.

Mike: **01:21:55** Well, and I also think Canada represents a bit of policy that encouraged the speculation, right? That people upsized their home because it was their only tax, zero tax investment, right. Then they also fell into the funding of it. And through policy in Canada through thoughtful policy to try and allow homeownership, you have a household that now is extremely levered, and extremely expensive. So, it's not that the policies always worked.

Michael: **01:22:25** Let's be honest about what really happened in Canada. You also said to Chinese investors that were trying to park money away from China, guess what, we're not going to really check any of your data.

Adam: **01:22:37** What motivated that decision to allow that? What policy objective facilitated that decision?

Michael: **01:22:44** That is a question that I would ask you to answer instead of me.

Adam: **01:22:49** Well, I mean, if you want in a normal housing market that makes homes available to citizens, does it seem like a reasonable policy to open up home ownership to capital recycling from other jurisdictions and make Canada a safe haven for investment capital? Like, it just seems like, clearly the policy, in my mind, was you're appeasing voters by causing home prices to go up.

Michael: **01:23:19** Yeah. So, flip that on its head. If you hiked interest rates, right, and created broadly unstable conditions for the young who could no longer afford these homes, right? Nobody in Canada can afford these homes. Is anybody who was able to get their capital out of China now, fazed by these levels of interest rates? No, they're actually like, wow, this is fantastic. Thank you, I'm just going to pay cash.

Adam: **01:23:44** There are policies also under -- that have been in place now for the last five years, and they continue to ramp them up, that penalize capital movement into Canada for the purchase of homeownership, right? There's all kinds of tax disincentives, etc. They keep ramping those up. But they're doing it at a prudent rate so as to not shock the market, right? They're shocking the market already with rates.

Michael: **01:24:06** That's an astonishing thing that you just said. They're doing it at a prudent rate in order not to shock the market. So, we're going to do it at a prudent rate in order to accommodate the Chinese, but we're not going to do it at a prudent rate in order to accommodate young people who simply are trying to move out of the city and have children. That's what we're doing. We're going to be kinder to the Chinese than we are to our own citizens.

Adam: **01:24:31** Well, I'm not suggesting that the rate of rate rises is necessarily appropriate. I don't have strong views on that, it may be inappropriate. But directionally I think that we have spent too long rewarding the wrong kind of behavior. And I think we're moving at least in the right direction in this dimension to start to reward a different type of behavior. Or at least not continue to give future generations the impression that you can not concentrate on labor productivity, but instead just own a home and retire rich. I don't know whose … that was a weird statement.

Michael: **01:25:21** If you actually believe that that is going to occur based on our existing policy, then I'll be proven wrong. I would argue that the policies that we're setting in place right now are almost certain to enrich the already wealthy, far more effectively in the same way that Blackstone emerged with greater control of homeownership, because they had access to financing in an environment in which home prices fell, and everyone was willing to accommodate it. We're seeing absolutely no indications that they're willing to, that they have any intention of reversing them.

Adam: **01:25:56** Okay. And that's a fair point.

Michael:	**01:25:57**	Very first person who was going to have access to financing at low prices - Blackstone.
Mike:	**01:26:03**	Well, in a recession, generally, everyone's going to have less and less available financing. So, Mike, on your other chart, where the Canadian rates are rising and US rates are rising more slowly, what are your thoughts on sort of the -- you are in a bit of a freeze in the housing market for sort of upscaling homes. Is that going to have some impact in the US? Or like, the mobility, the inter mobility of the homes is something that is still impacted, is it not, in the US context?
Michael:	**01:26:37**	Help me understand what you mean by that.
Adam:	**01:26:39**	You're moving from like a smaller home to a slightly larger home, or moving up. Yeah.
Mike:	**01:26:44**	Yeah. So, doesn't the market sort of freeze, because you've got to refinance whatever -- I suppose you can carry some of your original mortgage over. But the …
Michael:	**01:26:51**	No, you can't. I mean…
Mike:	**01:26:53**	Oh, you have to refinance the whole thing.
Michael:	**01:26:**	Yeah. No, in the United States, the mortgage is tied to the property. So, if I sell the property, then I have to close out the existing mortgage. Right? So, yes, what you're describing is exactly what is going to transpire, that we've created a system of extraordinary stasis, right? That the system has functionally shut down and that further exacerbates the conditions under which people are unable to reinvent themselves by moving from low employment areas to high employment areas. Under the current model, a 3% mortgage becomes a generational endowment.
Mike:	**01:27:35**	Right. And so, maybe so, less tightening from the Fed, and more tax policy, was that …
Michael:	**01:27:46**	100%. Like, we know the answer to this, right? This is exactly the issue, right? And again, Adam is correct, we're doing a terrible job from our policymakers of making hard choices. Right? But we as financial investors should be leveling our ire at them and saying that's unacceptable, and what the Fed is doing is unacceptable. What we had was a condition under which they were failing to show leadership, and the Fed was at least kind of being accommodative to prevent a subsequent restructuring of society in an unelected framework. Now we're potentially facing a true Andrew Mellon, liquidate stocks, liquidate labor, etc.

Mike: **01:28:30** Right. And so is that a function of the of the very different objective functions of the fiscal policy driven by reelection and monetary policy having to adjust to that or have its primary mandates …

Michael: **01:28:48** Let's be very clear, monetary policy was being driven by a reelection cycle as well. It's just called appointment and it's for Powell. Right? So, he didn't want to behave in a fashion that would lead it to be perceived that he was anti-Biden. And so he held off until he was confirmed. Then suddenly he gets religion around inflation, once Biden says, hey, this inflation thing's really a problem. Right? And so he turns around, and he starts behaving in a way that allows him to pretend that he is a significantly shorter Paul Volcker.

Adam: **01:29:23** So, I guess, I think where Mike's trying to go is, like, what would have been the right path if we acknowledge that the government is not able to do the right thing or not willing to do the right thing, what was the right path, right? I mean, because I think we were all sort of, kind of in a way saying a similar thing, right, which is, this is not the best path, the way that the Fed is behaving is not the best path. The way that they behaved later in the pandemic exacerbated the issue. The way that they behaved prior to the pandemic from sort of 2012 on, also exacerbated the issue. They enabled a dysfunctional government because they stepped in instead of allowing the market to create crises that necessitated government decision making, right?

So, we've pushed all of this decision making out. Is there not an argument to be made, the Fed is now saying, we're no longer going to defer the kind of crisis that will force that kind of decision making? And if they hadn't taken this kind of policy stance that we would have just deferred those types of hard decisions indefinitely?

Michael: **01:30:44** So, whether that is true or not, I actually just want to emphasize what you're saying. You're saying that an unelected appointed body should have the right to express what it thinks is the right policy choices for fiscal legislators, and that it should be able to effectively force them to choose along the lines that the Fed thinks is correct.

Adam: **01:31:03** I don't. But they …

Michael: **01:31:06** But that is what you're saying, right?

Adam: **01:31:08** I'm saying they took steps before that short circuited that. Now they're recognizing whoops, and I'm not saying this is the motivation, I'm just saying, is it possible that recognizing whoops, we probably shouldn't have done that, because we had a bunch of missed opportunities, where we could have allowed the private sector to stand on its own feet or fall on its own, which would have forced some decision making and hard decisions by government, five years ago, 10 years ago, etc.

Now they're looking at it saying, we probably should have allowed those things to play out then. We didn't, we've gotten ourselves into an even more challenging situation now, and we're not going to repeat the same mistake again. We're simply going to normalize our balance sheet, we're going to normalize rates and allow the economy to stand on its own two feet, because, and allow the private sector to do what it does, so that we finally have that, an outcome that necessitates or motivates elected officials to make the decisions that they should have made five or 10 years ago, if the Fed hadn't intervened then.

Michael: **01:32:28** So, again, I find what you're saying logically inconsistent. Right? And I just want to emphasize this, right? You're saying what I wouldn't -- I would use a parenting analogy. You're saying to your child, I'm not going to tell you what to study in college, but if you don't study engineering I'm not paying.

Adam: **01:32:53** Well, you're saying, I'm going to take a hard-- let me flip that around. I'm a parent who said, I'm going to take a hard line during high school. You're going to study math and science, because you're going to be an engineer. And you know, for three or four years, you take a really hard line, they don't get to go to parties, they don't get to pursue their writing passion because they need to do math tutoring or whatever. They go off to school, they're now stifled because they're not able to manifest their own destiny. And the parents going, okay, you're right, I made a mistake. And now I'm going to let you make your own decisions and learn your own lessons and be your own adult.

Michael: **01:33:37** So, again, like obviously, given that, and by the way, this is what I did in parenting, right was tried to give as constructive criticism as I can when they're young, so that they make better choices on their own. Depending on the kid, that works very well for some and works very poorly for others. And I will also tell you, like**,** sure one of the funnier stories, you guys know because you follow me on Twitter. I have a son who's at the US Naval Academy, who's just -- he's a serious badass, absolutely fantastic. But when he was five years old, he and I were walking through Central Park, and he asked me, Dad, what's it like to be an actor?

And I pointed around Central Park, and I'm like, well, what I told him first is like, look, son, there are careers that are broad pyramids in terms of outcomes and very steep pyramids in terms of outcomes, right? If you're a very successful actor, you do extraordinarily well. But the minute you step down from the top tier, you basically are waiting tables, right? If you're a teacher, it's a very broad pyramid. The top person is not doing nearly as well as the best actor, but the worst teacher is doing significantly better than the worst actor, right? And I forget the exact analogies that I used, but I then used for acting, I'm like, acting is super steep. The very top actors are guys like George Clooney and others and Tom Cruise who make a billion dollars. And at the bottom of the tier are all the homeless people in Central Park, right?

And he told me about that 10 years later, he's like, yeah, you pretty much crushed my dreams of being an actor immediately, right, because I didn't want to be homeless in Central Park, right? And you can tell that to a five year old, and you can laugh about what an asshole you are afterwards, right. And I do, like, my son is a remarkably talented actor, I think he would have done great. But I'm really, really happy that he's studying math at the US Naval Academy instead of trying to cut his teeth as an actor, you know, bussing tables in New York City, right? He's made a series of choices that are much better, right? But you can do that when they're five and you can do that when they're 15. But if you go to your 18 year old or 19 year old, and after years of coddling them, you suddenly turn around and say, you know what, I'm really thrilled that you got into Harvard, but unless you study math, I'm not paying, right. After not having given any of those expectations, like you run a very real risk of creating far worse outcomes than you would have otherwise. Right? Now, again, there is no right answer, there can't be a right answer, because we don't know what the future is.

But I wanted to show another chart here very quickly. So, this is actually looking at this issue of homeownership rates. Right. And this white line here is, in the United States, and unfortunately, most of this data is only easily accessible to me, for the United States.

Adam: **01:36:39** That's fine.

Michael: **01:36:41** This is looking at the homeownership rates. The white line is the homeownership rate for those 35 to 44 years of age, right. In the United States -- first of all, that's relatively high in the United States versus almost any other society. And if I were to go back in time, that's even more true. So, in the United States in the 1950s and 60s, homeownership rates for those 35 were around 62%. By 2005, they'd climbed to 70%, with the ownership society and the subsidies for homeownership that had been created. And by 2015, following the global financial crisis, and the dramatic tightening of financial conditions that we created for credit standards that caused the FICO standards for mortgage applications to explode from their historical levels, to basically, you couldn't get a mortgage unless you had perfect credit, right, that number had fallen to 58%.

Now we're right back at 62 and a half percent, and by the way, here's the pandemic. Right. Here is what the Fed did. So, here is interest rates going into the pandemic. We managed to take them from 370 to a low of 290. Like this was accommodative. I'm not disputing that. This is absurd. Right? And the Fed seems to believe that it has symmetrical tools. It doesn't. The reason it doesn't is because there's something like $5 trillion worth of mortgages that were refinanced and sit in this price range. When I cut interest rates from here to here, all of the mortgages that had accumulated over this roughly seven year period, had the opportunity to refinance and create liquidity for the economy. That was a net positive contribution to both the economic circumstances around the pandemic and absolutely the inflationary conditions that we saw. Right? But if I cut this interest rate to here, 200 basis points as compared to the 70 that I did here, who refinances? Nobody.

Mike:	**01:38:50**	Nobody.
Adam:	**01:38:52**	Yeah, I mean, Mike Harris raises the point that I was going to raise, which is, I mean, if you cut interest rates to zero, then everyone gets to own a home. But no one actually owns the home, the bank owns the home and you just infinitely rent the home from the bank. Right? I mean, it's just this weird situation that if you cut rates to zero, then you're right, none of this makes any sense. And there's no, you're at the zero bound and everything. It's like trying to anticipate what happens in a black hole. Like, it's all of the rules of economics go out the window.
Michael:	**01:39:26**	Well and again, like people use language like that. If we lower interest rates to zero, everybody gets to own a home, but that's actually not true. Right? Because particularly when you have fixed rate mortgages, if I go from -- if I buy a home, to make my life simple for $240,000 or $300,000. And I have a 0% interest rate loan, I still have to make principal payments. I still …
Adam:	**01:39:51**	Not if you extend the amortization period to 100 years.
Mike:	**01:39:55**	Well, no, you got to …
Michael:	**01:39:56**	You've got to make principal payments. It's just 100 years.
Adam:	**01:39:59**	Yeah, that's fine. I'm just saying that like you can extend the term in such a way…
Michael:	**01:40:04**	That's part of the point, we didn't do that. We didn't extend it to 100 years. We kept it standard at 30. So, the actual degree of stimulus was really not that much. We didn't change the components. And in many ways, what we saw in 2003, 2004, 2005, with ARMs, negative amortization, all sorts of stuff like that, zero, interest only loans, etc., right, that was far more accommodative than what we did during the period of the pandemic. Right? Like, it's just not comparable. And again, I'm not defending the fact that the Fed didn't withdraw that accommodation. I think that Powell, in his venality, wanted to get reelected, like every other elected representative, except he's an appointed one. Right? I expect better in that situation. He has no real motivation, he's worth a couple 100 million bucks, he can behave better. He chose not to.

Adam:	**01:41:00**	So, if he'd started to raise rates in May or June of 2021…
Michael:	**01:41:05**	… mortgages, right? I mean, if the Fed does not agree to buy every single mortgage, because they're saying, okay, we want to re-interject some credit risk associated with mortgages, then mortgage spreads begin to rise relative to the broad financing rate, and you begin to impact the housing sector. Right? That's fine. I get it. That actually makes sense. And I'm not arguing that they shouldn't have done that. I'm actually arguing against the unique incompetence that is manifesting itself in hey, I want to be just like Paul Volcker, when I grow up. Well, one you can't be six seven, right? And two, Paul Volcker was a jerk. Right? So, let's be really simple. Congratulations, you want to be a miniature version, a mini me version of a jerk. So, like I just -- I find this whole thing absurd.
Richard:	**01:41:53**	Guys, I wonder if we might put a pin on the home ownership …
Michael:	**01:41:57**	Yeah, Richard is very sensible.
Richard:	**01:41:59**	-- conversation and the central bank bashing just for a moment, because I know that we're coming up on time. We're an hour 40 minutes in, but I did want to get Mike's thoughts on a bit of the geopolitical conversation, if we have a few more minutes. Because I haven't heard you talk about this in a while and I know that you follow the arena pretty closely. So, I wonder if you might share a few thoughts on what you're seeing currently with China and Taiwan, and what came out of the Party Congress that essentially enshrined Xi for life, and if you might comment a little bit as well, on the Russia/Ukraine and what your thoughts are there?
Michael:	**01:42:41**	Yeah. Okay, first, on Xi and the Party Congress. I think others have hit on this and said it remarkably well. One, terrible that he is effectively put all of his friends in charge. Right. So, this is the equivalent of Stalin basically stacking the deck and saying I'm never walking out here, right. And that is broadly been the direction that China has chosen to go since 2013, when they decided not to engage in a genuine reopening of the economy and a rejection of the Perestroika and Glasnost dynamics that they correctly pointed to and said, hey, wait, that led to the end of the CCP equivalent in Russia, right? Well, then you have no other choice that you're going to follow the J curve back to North Korea, right? Like you move to Stalinist Russia, if you don't go the path of Mikhail Gorbachev. Those are only two choices, there's only stability at the extremes. So, we knew that this was underway, this is simply a reinforcement of that. The second thing that was really important was the appointment of effectively a COVID czar that is not Xi, right. So, that was the sign in my view, and others have articulated this far better, that we were going to see them start to remove some of the restrictions. More importantly, the restrictions on people coming into the country, I would argue, than money and people getting out. Because the simple reality is once you started to lock down like that, you can't let people out, they're

not coming back. Right. You can have people come in, you can have them check their factories, you can have them say to their workers, boy, aren't you lucky that you get to continue to work. It's so bad outside. The recession is raging and Russia and Ukraine, etc. And if you want to continue to do business in China and you're smart, you're going to remain highly controlled in your communication with anyone inside China. You're certainly not going to go around and start throwing tomato soup at precious Chinese art, right?

So, you know, that dynamic is very straightforward. They'll let people in, they'll let the people that they let in out, but they're not letting anybody else out. This is not going to be Chinese tourists traveling all over the world, right? Again, my assessment, what I'm seeing. Now, on a positioning basis and the funds that I manage, I bought call options on emerging market indices to protect against this risk that this is going to occur. So far, that seems to be working out okay. And those had actually become cheaper, the implied volatility was below that of the S&P. Like, a lot of weird things had created conditions under which these seemed relatively attractive to me.

So, I just think that there's going to be a brief period of effectively honeymoon, where people say, oh, China's reopening, China's reopening, and that's true. You'll be allowed to go back to China. As a foreign investor, you'll be able to go check on your factory, you'll be able to go back and have your phone efficiently bugged, your laptop hacked into; all that sort of fun stuff that we take for granted when you travel to China. And some of that may make it back if you're completely naive about it. But China is not going to reopen in a pre-2013 or pre-2020 framework. It's basically, you can come here and do business, in the same way that you could go to Austria and transit across the Soviet border, and quote-unquote, do business in Russia, even when it was persona non grata on the world stage.

Adam: 01:46:07 Are you expecting an acceleration in GDP, or in industrial production or consumption in China though over the next couple of years with that on the line?

Michael: 01:46:16 If anything I would say it's the opposite, right? You basically have now fully declared that we're going to become a slave state, right. And if you're not able to leave, and you're not able to protest, and you're not able to say I don't want to do this, then the whole lie flat thing become somewhat ridiculous, and you start to enter into the Soviet era of we pretend to pay you, you pretend to work sort of stuff. And productivity will fall in China. There'll be an element of racial homogeneity that exists that allows them to persist for a longer period, perhaps, than you might have had in Russia. But functionally, we've just watched it close down again. Will it reopen under different leadership, you know, new management? I don't know. That's a story to worry about in the future. But that's my general read on this environment is that we're moving towards the regime of

Stalin and the characteristics of a closed front, particularly for those who are in the system and want to get out. They just can't, it's gone.

Adam: **01:47:11** So, how does that impact the global, you know, the whole globalization, de-globalization dynamic if you've got China, which we've spent the last 20 years outsourcing to cheap labor and outsourcing environmental externalities, etc., to China and China is going to slowly de-industrialize and/or lose productivity. We also know that they're going to lose population, just demographically.

Michael: **01:47:48** They've been losing pop-- I mean, they're finally …

Richard: **01:47:49** They lost 100 million in the census, they lost 100 million in their census. So, they just admitted that they over counted by 100, so not 1.4, it's 1.3. Maybe that goes out in the wash, because it's a rounding error at a billion but…

Michael: **01:48:01** But let's be really clear, 100 million is Japan, they lost Japan. Right? Like, that's hard to do. Like, I lose money on the sofa, and I can't really find it, and it's great. But like, we're not finding 100 million people. Right? So, like, that's a really, really big deal. You mentioned this dynamic of deindustrialization. When you enter into that regime, what does it do? Well, if I'm tearing down buildings anyway, guess what happens to the copper that was embedded in the wiring and those buildings? I no longer need to import it from elsewhere around the world. Right? People talk about the EV revolution and the dynamic that that has on copper, and 50% of the consumption of world's copper was going into Chinese infrastructure; residential, power production, etc. They're going to be liberating that and doing the opposite, and using it to create effectively hard currency that they can use to buy things that they really need from the rest of the world. Right?

Richard: **01:48:55** Including energy.

Michael: **01:48:57** Energy would be one of them, although they've managed to create a semi-captive source in Russia, they're basically trying to go back and forth on. Russia is a little harder because it feels less stable. Right? It doesn't have the characteristics of being able to shut down in the same way. And it has a more chaotic component to it than I would argue that China has. So, I guess I would just suspend, I don't really know what's going to happen to Russia right now. Right? It's very clear that they have become effectively a vassal state of China. Whether there's going to be an overthrow of Putin and a re-evaluation or a further move towards the right. You know, they're just not as good at locking their population down as the Chinese are, at least not now.

They may get better at it, but everything that China has going from it from that standpoint, right, I'm going to sound like a terrible human being for saying these things, but like racial homogeneity, right? If you're … Chinese, you're presumed to be Chinese, you're not allowed out of the country unless you have the appropriate papers from the communist government. Right? Russia continues to be a collection of people who look radically different from the extreme east to the west. Their ability to control those borders, their ability to control the out migration, the emigration, etc., far less convincing than I would argue than what you have. And ironically, I would argue the West is actually broadly helping them in that process. You know, but very difficult to know, I would just, again, I would, I would beg out of it and say, Russia is much more chaotic, much less predictable, and candidly, less relevant. Right?

Adam: **01:50:46** I guess, if you're China, and you perceive Russia to be a de facto vassal state, you don't really care if Russians flee. You'll move your own population in there and make more effective use of the resources and it makes it more attractive.

Richard: **01:51:00** It plays that China's …

Adam: **01:51:03** Yeah.

Richard: **01:51:04** Yeah. Mike I wanted…

Michael: **01:51:05** Yeah, go ahead. No, go ahead.

Richard: **01:51:09** I wanted to pull on a thread and get into the US is pushing China further down this path. And then particularly with the restrictions on exports on chip manufacturing and chip technology, do you see any analogy here with what the US did to Japan in the 1930s, which arguably precipitated the attack on Pearl Harbor, with the possibility of an invasion to Taiwan, given what we have done? Because they've been awfully quiet. I mean, obviously, they voiced their dissatisfaction with all this, but they haven't yet announced any sort of material retaliation from that move. And I'm wondering if this is sort of that calm before the storm, or if now that Xi has been anointed Emperor for life, it just gives him the right amount of clout and power plus the narrative, the backdrop that you see, the West is trying to push us down keeping us, the … dynamic. Do you see that dynamic at play here with regards to a possible conflict, a precipitation of that possible invasion?

Michael: **01:52:18** So, the quick answer to that is yes. And if anything, I would argue that the US -- What the US has, quote-unquote, accomplished in the last year and a half, if you really think about it, it's like, it's fairly mind-blowing. Right? We've managed to shut down China's advanced chip manufacturing industry, we've managed to pull all the employees of US and European companies and Japanese companies that are working on advanced chip technology in China and gotten them out. Right? We've created conditions under which they cannot return. We've functionally defeated Russia without putting a single soldier on the ground in Europe, right, by using outdated technology to blow up their even more outdated technology and techniques.

Now, that's rapidly modernizing. I just want to be clear, like the move towards drones is an escalation there, again, that I would put into the chaotic dynamic where it's much less clear, right? But if I'm looking at what the US has done, like, oh, my God, like we just showed the rest of the world in the same way -- you know, congratulations, China, you've got Russia, they're a vassal state. Japan and Europe are now completely vassal states to the United States. Right? Like, that's a pretty remarkable move. And I say that cognizant that, that sounds offensive, many of the things I do. Like, I always have to apologize because my wife gets really pissed at me. But the simple reality is, is it's a true statement, right? I mean, we are much more powerful in the United States than we were 12 months ago, relative to the rest of the world.

If anything, I would argue that we are baiting China and trying to get them to move, because we know that it's a mistake for them to move fast. And it works to our disadvantage if they increasingly enslave their population and move towards a German style model, where they re-militarize or aggressively militarize and say, you know what, we don't care if we lose 100 million people, we'll lose 100 million people to accomplish these objectives. By the way, we just lost 100 million people. Right? Like, see if we care. Right. So, like, the US is very cognizant of that risk, and that the US cannot tolerate losing a million people, much less 100 million people.

So, I would argue that we're effectively trying to bait China into moving faster and before they are prepared with actually, the great irony being, that there's -- if you just think about that apex, right, China effectively can militarize and try to respond. But it looks like that pyramid of being an actor in New York City, it's going to last about six months before they can no longer sustain it, and then it's going to start crashing down because their population can't handle it. And they're increasingly being shut off from the rest of the world and their ability to provide goods and services that the rest of the world values. Right?

Richard: **01:55:28** Not to mention the straits and the, geographically China is locked in such a way that it's actually quite easy to blockade access from oil tankers and other types of exports. And you can't really build the pipelines to the Russian Eastern oil productions in any reasonable timeframe. That would take what, a decade at least? So, it seems like …

Michael: **01:55:53** It's China and its war, right? So, recognize that, like, there's lots of things you can do when you decide that you're really committed to doing it, and you don't care about the loss of life and you don't, you know …

Mike: **01:56:06** We can accomplish great things if we just throw enough death and suffering at it.

Michael: **01:56:11** Yeah, no. And, I mean, Mike, unfortunately, that's true, right? I mean, if you really, like, stop worrying about the eiderdown duck, and say just screw it, just dynamite the whole thing, you're going to clear a lot of land, right, and you can do a lot of stuff. So, I'm not going to go so far as to say they can't actually come up with solutions. You know, necessity is the mother of invention, both here and there. But the faster we force them to move, we effectively have them in the chess term of zugzwang, right? Whatever they do is a deterioration of the existing system, the existing position.

You know, all of that effectively means that a theory that I have put forward and you know, it's similar to Peter Zeihan's, etc., like the US is by far the best position. The fear that I have, and it goes back to all the discussions we're having around terrible policy, etc., is that this is not the end of the American empire. It's the beginning of the American empire and the end of the American republic, right, that we're done having the conversations on what should we do? And how do we incorporate all the touchy feely stuff and make sure that people that have multiple pronouns can afford homes in, you know, various urban environments, right? And we just moved to like, nope. The only way you get a home is if you serve in the military. Right? That's a solution. Right? Why not …

Richard: **01:57:42** And it jives with Victor Schwetz's …

Michael: **01:57:46** By the way, if you go back and you look at my interview with Victor, I'm going to be doing another one in, I believe it's February on Simplify's channel. You know what I said very clearly is I hate this. I absolutely hate this, but everything I'm seeing suggests that you're correct. Right? And like, I'm sure the YouTube channel is going to light up. But like, just seriously think about it. What happens if the US government says, serve in the military, we'll give you a home? Right? I mean, in all seriousness, my son, they're giving a half million dollar education and at some point they're going to hand over a piece of equipment to them, that will cost more than you and I would ever make in our lives, probably more than Simplify currently manages and be like, yeah, you're a 24 year old kid, try not to blow it up too fast. Right?

Like, would they give them a $350,000 home? Why not? Right. That's what they did in Rome, they gave them tracts of land. Right. So, like, there's all sorts of things we can do to change the outcomes and steer it in a direction that ultimately we want, that feels deeply foreign and unsettling to how we're currently positioned

Richard: **01:59:01** Seems like the possibility to end on a positive note has flown out the window really …

Adam: **01:59:07** Hold on though, we can still give the people what they want. Right? So, let's at least finish on an investment theme, right. So…

Mike: **01:59:13** This wasn't what they wanted?

Adam:	**01:59:15**	Yeah. I think they probably did, but let's also give them the icing on the cake, right. So, what is the right approach from an investment standpoint here, you know, what's the best way to diversify or hedge the risks that we've been talking about and maximize opportunity in the current environment or over the next five or 10 years?
Michael:	**01:59:42**	Well, I mean, I'm going to leave you with just the very obvious answer that Bitcoin fixes this. That was a little joke.
Adam:	**01:59:51**	You don't have to be taken out of context and put all over Twitter …
Mike:	**01:59:55**	You're going to see that. You're going to see that.
Richard:	**01:59:56**	I know a couple of podcasters are going to use that clip.
Mike:	**02:00:00**	We've turned him, we've turned him.
Michael:	**02:00:02**	Yeah. Actually, one of the funnier things is you know, Nick Carter, who basically started my whole adventures in Bitcoin land has now flipped on Bitcoin and you know, he's inhabiting my DM and he's like man, I'm really sorry, I didn't realize what jerks these Bitcoin maximalist were. You know, so it's actually pretty funny that went back in that direction. You know, so look, a lot of people have forwarded me Russell Napier's stuff, and have highlighted this idea that, okay, Russell predicted higher inflation, and that this is the direction this is going to go, right. I just want to emphasize that that framework of financial repression has been broadly in place since roughly 2012, with low interest rate environments. And the confusing part has been low measured inflation, right.

Now, people have substituted all sorts of stuff that says oh, well, the inflation shows up in asset prices, etc. I don't actually think that's the case. I think that's largely a function of the passive dynamic. We've talked about that elsewhere, I don't want to spend any more time on revisiting it. But I broadly would argue that I think what is happening, and the path that we're heading down, forces us into Russell's world, right, because if the Federal Reserve can crank interest rates by 500 basis points in a year, and take basically 30% of the Russell 3000 and turn it from businesses that are capable of operating to businesses that are incapable of refinancing themselves, and continuing to operate in their current structure, there is no investment that can occur without blessing from the Emperor. Right? Like, that's really the conditions that we're setting up for.

And so in that framework, I would argue that people want to spend more and more time thinking about what are the priorities of the government? Not, do I agree with them or disagree with them? But how can I work alongside in a profiteer framework, enabling the Emperor to express more fully his point of view? Right. I don't know who that Emperor is going to be. It definitely is not

		Biden, he's a caretaker along the process. I doubt that is Desantis, although he has the requisite meanness to him. Right.
Richard:	**02:02:28**	Are you suggesting the Orange Man is back?
Michael:	**02:02:31**	Absolutely not. I think we will actually find that the Orange Man does not return. I certainly hope that that's the case. The wonderful thing about Nancy Pelosi and Donald Trump and Joe Biden and of all that is that they're mortal and they're going to die, so we don't have to put up with them that much longer. Right?
Mike:	**02:02:50**	Boy, they've been tough to kill.
Michael:	**02:02:51**	Yeah. Well there's been an attempt on Paul Pelosi's life. We've had an attempt on the various forms of leadership. We've seen Abe killed, right. Like, we're seeing the fourth turning type dynamics in action, right? You're seeing that it is no longer unacceptable to think legitimately that I can execute or assassinate the Emperor. And I think, unfortunately, we're going to see more of that. Right.
Adam:	**02:03:18**	So, big tech, do you think they're going to be then…
Michael:	**02:03:21**	I think big tech will ultimately be cowed. I think what you're seeing with Twitter is probably the first signs of that. Right.
Adam:	**02:03:28**	And also appropriated by the government increasingly, right, for the government's purposes.
Michael:	**02:03:34**	And there's parts of that that are good, right, and there's parts of that that are bad. You know, I think most of us are deeply uncomfortable with it. But again, that's part of Russell's point, and I would highlight that I don't actually think that Russell correctly diagnosed what transpired up to this point. But I do think that the actions that have taken place from Powell and others has effectively put the nail in the coffin on the idea to steal from Dan Ox, right, if you're not doing macro, macro is doing you. If you're not doing what the government wants you to do now, man, you have no certainty that you're going to be okay.
Richard:	**02:04:16**	Okay, we clearly did not -- …
Adam:	**02:04:187**	So, how does a global -- well, yeah, no, but I'm getting there. Like, how do you position for that, right? I mean, global cap weighted equities, still skew pretty heavily to tech, global issuance weighted bonds. You know, it seems to me that you're invoking a future environment that will be unkind to those weighting schemes or those types of portfolios. How should people diversify? You know, what are some other ways to think about the problem?

Michael: **02:04:55** Again, like I'm just going to push it back into the same underlying framework, right? I think broadly that Russell has it correct. We're talking about moving towards a more autocratic system, we're talking about moving towards a system more focused around national security and autarky. That means if you want to invest in Mountain Pass and have, or Greenland and have rare earths produced in the United States or on North American soil in a manner that facilitates the US national security interests, like that probably seems like a pretty reasonable place to be. If you can pull off what you know, Elon Musk and others have pulled off, which is favorable financing terms from the government that locks in a path of certainty that is far from clear, right?

But I actually tend to agree with you that it strikes me as far more likely that the Ministry of Truth is managed by Google, and cowed Google employees, than it's managed by Lockheed Martin. Right. And it's -- I've said this 50 million times, I don't know how else to say it. Like it deeply saddens me that that's the world that seems to be in front of us. Man, it does seem like that's the path we're going, right. And it's the natural evolution of something that you've heard me talk about everywhere else. Like, in all seriousness, while I'm painting a ugly picture and something that you really don't want to hear, where else are you going to go? You're going to go to Canada? Man, mortgages are 6% there.

Mike: **02:06:37** Canada's got lots of warts.

Michael: **02:06:40** Right? Are you going to go to New Zealand? New Zealand's a population of 5 million people. Right. And by the way, they were even more intrusive in their lockdowns. You're going to go to Brazil? That seems like a great choice.

Richard: **02:06:53** Hey, go easy on Brazil there.

Adam: **02:06:56** But just in general …

Michael: **02:06:57** Easy on Brazil, it's just like where are you actually going to go? There's nowhere left.

Adam: **02:07:03** Yeah, you want to favor industrials, you want to favor, you know, commodity producers in general, energy producers in general. Or maybe just broad commodities, because I mean, we keep seeing that governments are unwilling to allow commodity companies to enjoy so-called windfall profits. Right? So, while the underlying commodities may continue to do well, the companies that will be relied upon to extract them may not see a majority of the profit that would otherwise accrue, right. So, there's…

Michael: **02:07:43** Again, not a terrible model. And I would suggest, if I look at other places around the world, we're probably further down this path. Right? I mean, the nationalization that's occurred in places like Japan and Europe, etc., that is likely to take on much more explicit tones as we move forward. You know, one way of handling social policy is you say to the auto companies, you can't fire people. Right? Like, we did that for years and years and years, and we've forgotten how common that was in the early 1990s. I worked on the restructuring of PepsiCo, Spain. We did the whole analysis, and we're like, well, this is really easy. You've just got too many workers. And they're like, oh, yeah, they refuse to be fired. Right? So, you have to have a different solution.

Okay, wait a second. The problem is, you have too many workers, and they refuse to be fired, and the government will not allow you to fire them. So, how do we come up with a solution? Okay. Well, you just have to accept lower profitability. Right? And that is a method of transferring wealth to workers away from the bourgeoisie, right. So, that does seem like a reasonable path.

Adam:	**02:08:55**	On another show, we'll have to explore ways to move more power to labor in a productive way that doesn't require this kind of authoritative or authoritarian direction. But we're now at two hours and 10 minutes. And while I think we all could pick your brain for several more hours, we probably should let you go and enjoy your weekend and leave something …
Michael:	**02:09:21**	I appreciate that very much. My dogs just came running down to tell me that we've been on for two hours plus minutes. And … I'm thinking about you and your assertion that I make sound bites. So, this is a two-hour sound bite. There we go guys.
Mike:	**02:09:37**	I think actually, in the last call, the dog came down and pulled him away to go for a walk too.
Michael:	**02:09:41**	Yeah, that's the easiest way …
Adam:	**02:09:44**	… indicator that dog.
Richard:	**02:09:48**	You've been very generous with your time, really appreciate it.
Michael:	**02:09:50**	It's always fun hanging out with you guys. I'll talk to you later.
Adam:	**02:09:53**	Yes. For sure. Enjoy your weekend.