Rodrigo:	**00:01:45**	People thought that was a crazy idea when that was published in 2020, Vince.
Adam:	**00:01:52**	You know, I was just thinking maybe we're going to have to change that *it's been a great ride* language. I don't know. Like, people, maybe not …
Rodrigo:	**00:01:58**	But there is a threshold, isn't there?
Vincent:	**00:02:01**	Those meetings, that could not finish what I came out with that stagflation call in April 20. I've been personally insulted by clients.
Adam:	**00:02:13**	No doubt. I'm sure …
Richard:	**00:02:16**	Yeah, we also heard that we were out of our minds with that call. And I love the graphic with the whirlwind, the hurricane with the money flowing around. I think that's as powerful as it gets.
Adam:	**00:02:29**	That's right, powerful symbolism right there. Before we get started, please remember that this is for entertainment and educational purposes only. And you should not consider what we discuss today on today's podcast as advice. With that said, Vincent, welcome to the show. I have been really excited to have you on as I was mentioning, before we went live because we've been following your thesis very closely for the last 18 months or so. And it has increasingly sort of converged with the perspective and observations that we've been making, and that we've been preparing for, for many years. So, I think your framework for how to think about this problem in a sort of data driven way. So, what has inflation looked like historically? How persistent has it been under different conditions? What to expect? And what are the impacts on markets? I think that's a really timely and powerful framework for us to discuss today. So, welcome.
Rodrigo:	**00:03:38**	Yes.
Vincent:	**00:03:39**	Thank you.

Backgrounder

Rodrigo:	**00:03:40**	Vince, do tell us a little bit about your background. You know, we've heard it here before, but just before we begin the whole discussion and thesis and lots to dig into, why don't you give us a little bit about you?
Vincent:	**00:03:54**	Sure. So, I was born and raised in a small town in France. Initially, I think I was probably meant to do what you do when you have good grades in school in France, which is work for the government. And then I don't know, I just had a stroke of luck. I got a scholarship to go study in the US for grad school. That was shortly before 08, I guess 06 or something like that. At the time, I think if you could -- the test to work at an investment research firm or hedge fund was can

you open Excel, which I could barely do. So, I started at a small research firm out of Sausalito, not far from San Francisco. Worked through the whole 2008, 2011 sovereign debt crisis. That was really, I would say, my formative experience. And I think it really scars you, I mean, the first thing you see is middle markets dropping by, you know. In the case of international markets, sometimes more than 70%. That's really pretty deep.

And after that, I started Ned Davis Research, European product. So, I was out of Florida for five years. And then, about six, seven years ago, my current employer, StoneX, is a very large broker dealer with a big presence in Latin America. I started noticing that clients were really demanding kind of original third party research, didn't trust the banks. I said, well, let's try covering that in-house, let's start our own global macro product. So, that's what I've been doing for the past six years, and it's been a terrific ride really. It's a fun job. Like, markets are fantastic. I mean, it's always something new to learn, there's always some new idea to investigate and to have the freedom to be able to do that. And the ability to meet with people, such as yourselves or some other people on FinTwit, it's just very grateful for doing what I do.

Adam: **00:06:07** So, you had a calling into public service in France, you went to the US, were corrupted, driven into the private sector, for profit, the public service in France was deprived of your expertise and value add, and here you are today, in service to global hedge funds. I feel like that's …

Vincent: **00:06:28** Well, so you're making two assumptions here. One, that the French public service is a model of virtue and a paragon of honesty. And they are these people, for sure. But you know, on average, shall we say, people are the same everywhere. And really, as far as the clients we serve, it's mostly actually Latin American pension funds, and the farmers, producers. So, it's kind of fun, like boots on the ground. Our largest office is in Brazil, for example. And it's kind of, I don't know, I feel like it's more real when you see people who are trying to make a farm run and …

Rodrigo: **00:07:13** Yeah, I enjoyed that StoneX conference, a lot of my Latin American brethren. You just get to see a completely different side of financial markets, right, what they actually care about; the actual commodity hedgers, and produce-- hedging actual product and what they're really focused on, and there's some asset managers as well. But the way they think about inflation is very different than what an American advisor thinks about inflation, for obvious reasons. A lot of Argentines that we met there, thinking like, were like, do Americans not even think that it's possible to see any inflation, is that for real? And I'm like, that's a real thing.

Richard: **00:07:48** Well, the Argentine on the other end of the spectrum, right? They don't know what it's like to have benign inflation. They've had continuous high inflation for how many decades now?

Rodrigo: **00:07:59** Yeah, it's been pretty bad. Just before we continue it, nobody's complimented my fancy drink today.

Adam: **00:08:05** What are you doing?

Rodrigo: **00:08:07** I'm doing a gin tonic with a passion fruit sprinkling. It's like my new thing. I'm going to do only fancy drinks and refs going forward. And I encourage the rest of you to do it. I think, you know, we started there. And now we're drinking …

Richard: **00:08:26** To your benefit not to ask, Rod but since you had to bring it up.

Rodrigo: **00:08:30** No, no, no. This is -- I know, it seems a little fan - too fancy, but it's delicious. I highly recommend -- I'll put how I make it in the show notes for everybody.

Adam: **00:08:40** Well, that's good. We got markets in turmoil on CNBC and Rodrigo is talking about his fancy pink gin and tonic.

Rodrigo: **00:08:45** I know. We got to keep it light if we can, no?

Adam: **00:08:48** I hear you, that's true.

StoneX and Global Macro

Richard: **00:08:49** Pivoting slightly back to Vincent, walk us through your framework. What are you looking at? I know that StoneX has a big focus on commodities. But with regards to how your general framework for global macro understanding works, can you just walk us through the main variables that you're watching and how you thinking about global macro.

Vincent: **00:09:14** Sure. So, I mean, really, it's – for myself, because I work mostly with Latin pension funds and private banks in Switzerland. So, these are institutional investors who have the capacity to take some volatility and a five to 10 year investment horizon. So, the idea is not that you have like, the best rate for the end of the month, it's to really get the big, big trend that will matter for the next 10 years when the workers are going to come out and they will need the money that's in the fund, right? And I think historically at least the way I think about market, that is the, I would say the biggest driver of your long-term return is your asset allocation and getting these big calls right. And of course, you never get them perfectly right or you never buy the bottoms and at the top. But I do believe that there are these kind of long term secular trends that as a long term investor, you can capitalize on and effectively beat the market. So, that's what I focus on.

I think, and I'm sure we'll talk about it more, but we are at a pivotal moment. I know, it sounds cliché to say that, but a lot of the mega trends that have been going on for four years are inverting. This is why markets feel so scary. And so we are right now. But that means that for the next decade, you really have to start building portfolios differently than you had in the prior decades. When you back-test the strategy, you have to think what is it that I'm picking up? Am I picking up just the fact that interest rates have been going down for four years? Or am I you know, we became something different? So, I think -- initially, I kind of started as a quant, so I still keep some of that background. But I think over the years, I've developed quite a bit of skepticism, especially after working for the Davis Research where we did a lot of technical analysis, which I have a strong appreciation for, but there's also quite a bit of over-fitting and computing power is cheap now.

So, understanding the parameters in your model, understanding the period over which you tested your model, testing out of sample, all these ideas, I think, are essential to building your asset allocation. And then I made these my more French bureaucrat or diplomat for that matter, background, but I like also to think about history, culture, social attitudes, because I do think there is an element that, you know, almost like an animal spirit you cannot touch upon that matters, especially when we talk about inflation. Like inflation is a psychological phenomenon at the end of the day, and you cannot boil down to equation, you have to understand. And I think something like COVID, for example, has changes the social psyche; the way people relate to their jobs, the way they relate to their leisure, the way they relate to their homes. So, I try to bring that all in, and yeah, try to be on the right side of the trade. I feel now I mean, as we're talking before, like we're finally getting some vindication, but it can be difficult sometimes. I mean, you can feel like you're preaching in the desert.

Richard: **00:12:30** You've come to the right place. Vincent, this is where quant analysis meets essential thinking. Yeah, exactly.

The Inflation Side of the Equation

Adam: **00:12:38** One of the features that obviously has dominated so much mindshare, over the last 30-40 years, has been the growth side of the asset allocation equation, right? If you sort of think about asset allocation, as being motivated primarily by two dynamics, being inflation and growth and periodically, liquidity, investors haven't really needed to think about inflation or be concerned about inflation. For most of the last 40 years. It's been sort of a steadily either sort of benign disinflationary environment, punctuated by deflation on a couple of occasions in sort of 2000, 2003 and 2008. But otherwise, it's been mostly benign kind of disinflation. We're clearly in a time when investors are now paying more attention to the inflation side of the equation. So, what are you seeing and what were you seeing 18 months to two years ago, that were raising red flags for you on the inflation side? And then how have those dynamics that you were observing evolved to where we are today?

Vincent: **00:13:54** Yeah. So, let me start, because I had the information called before COVID. COVID, in some ways, actually solidified this viewing. As with many things, COVID just, you know, took an existing trend and shrank it, right. I feel we would still have this re-flation, we would not be at 8.5, we would probably be at four without COVID. So, let me start with a pre-COVID. I think it was really part of a different appreciation of the relation between demography and inflation. I think the consensus is basically Japan. We'll all go, Japanese as society's age, aggregate demand falls, and nominal growth falls and yields can only go lower, inflation can -- that was kind of the consensus. And really, to me, it's *a sample of one* type of thing.

You know, maybe you could throw some European countries in there, but I would argue there are other things that played a role in the European disinflationary experiments, things like presidential policy, things like fiscal policy. And I think the Japanese experience should not be extrapolated from. I think at some points, aging actually becomes inflationary, because it means your production function drops, you have fewer people producing and more people consuming. I mean, it's as if -- imagine if we told people there's going to be UBI and 30% of the labor force is going to go out and live on a UBI. Everybody said that's inflationary. Well, that is what's going to happen with baby boomers. So, there was that. There was also the --

To me, the main driver of the greatest inflation of the past 20 years, was what happened in Asia post 89; restarted with the two Chinese devaluation 93, 94 … divided by communities 70% just as the Tiananmen riots, collapse of the Soviet wall, the Chinese leadership realizes they have this massively expanding labor force, because there was a baby boom in the 70s in China just because of the one child policy. So, they had to find 20 million new jobs at the time, it was a very, very poor economy, poorer than most of Africa, with a very direct economic system. So, the only way they could do that was by becoming the manufacturing engine of the world, which they did. Special economic zone, Shenzhen, the reforms, all of that stuff. And a very deeply undervalued currency.

So, suddenly, you add close to 500 million workers in China overnight, and not coincidentally, three years later, we hear the term *Great Moderation* in the US for the first time. Now the Fed being the Fed, they claim credit for everything. So, I think at the time it was Greenspan say, oh, it's because our inflationary policy is so credible that you know, inflation has disappeared. No, it's not that hard. You only had to go to Walmart to understand what's going on. And then it dominoed right, with the East Asian financial crisis, first Thailand, then Indonesia, then South Korea, you see pretty much every single Asian currency dropped by 70-80%. And then these massive surpluses appearing across East Asia.

So, basically, what that meant is that half of the world, I would argue the most productive half of the world, was subsidizing the consumption of the other half. And with the surpluses that they were getting, they were reinvesting in the US, that was the savings glut that Bernanke talked about. So, you get low inflation, lower rates, negative correlation with stocks and bonds and a fantastic environment for asset allocators. All you have to do is 60-40, you made like 9% a year for basically four years. That era, to me, has ended. If you look at, you know, you had a demographic collapse in East Asia, the likes of which we've never seen, maybe even when Columbus arrived in America. Maybe it was the same.

But basically, you look at South Korea, Taiwan, you have one child per woman. So, populations, half every generation. So, this huge surplus of labor is no longer there. These economies no longer need cheap currencies, they no longer need current account surpluses. So, just as that old shock was deflationary, that new shock is going to be inflationary. As East Asian economy growth slows, so will export, so will surpluses, and we'll be faced with the reality of labor shortage supply chain issues, which I think would have happened, irrespective, with or without COVID.

Rodrigo: 00:18:16 So, that's interesting, because it is, especially the demographic argument. Right? There's two major arguments for deflation here. And one is technology, the other one is demographics, right. So, you kind of address the demographic argument, which is you're not going to have enough people out there producing the goods that we need. But the innovation or technology aspect might fill that gap, or even improve it. Right? So, how do you respond to that other major argument on the other side of this?

Vincent: 00:18:48 Yeah, I think it's the best argument against inflation, honestly. And I know it's fun to beat on Cathie Wood right now, and I've done my share of that. But I mean, I think she should be taken seriously, because that is -- yeah, I mean, the only way out, if there is one to me, is some sort of technological miracle. The one she would highlight like whatever, what's the expected return now?

Rodrigo: 00:19:16 Now, it just gets bigger and bigger from when she last announced.

Vincent: 00:19:17 But you need to make a case like that where we're going to have the squeeze on the production function, as labor and capital with a, I don't know, either residual or some sort of interaction term for technological progress. That needs to pick up the slack, if we want to maintain price stability. And I'm not a technology economist or productivity economist. It's a very complicated question. It just seems odd to me that it would just pick up, you know, I mean, I can see the squeeze in the -- L in the function. Maybe, maybe not. To me, it seems that COVID -- I know, there were these hopes, like, oh, COVID is going to unleash this great productivity boom. Hard to see why. I mean, if anything everything's more complicated. I mean, try boarding on a plane these days or I mean, life in general is harder with COVID. So, I see that actually as a negative for us moving forward.

Rodrigo: **00:20:23** Moving goods is just as difficult as moving human beings these days, for sure.

Adam: **00:20:28** Well, the other thing, like the big argument for technology being deflationary is automation, right? And I mean, we see this all the time, right, everywhere you go nowadays, companies are highly motivated to automate as many dimensions of the business as possible, especially as cost of labor has started to increase and availability of labor in many fields have started to be scarce. But then it begs the question, what happens to these displaced workers either nearing the end of their careers, who are unlikely going to be repackaged into software engineers or healthcare support workers, right? Maybe you're going to repackage truckers into orderlies. Right? It's not that there's no potential for some of this.

But most of it is hard and complicated. And at the low skill, just starting work stage, the typical laborer working at Starbucks or working at the grocery store, or what have you, when you go to the grocery store now, you check out your own groceries. There's a huge kerfuffle in Canada, right now, one of the main -- one of the big health food takeout places has started, they deployed a cashier that's now on a screen, and they video in from Guadeloupe. And so they don't need to hire somebody like a high cost person in Toronto to stand at the cash, they can check out at the counter using lower cost labor in Central America or Latin America, and then just go get the salad that they wanted on the shelf. Right? You know, so we're already sort of seeing this.

And the question becomes, well, that's fine. Certainly, we can automate away a wide variety of jobs. But then where are these people deriving their income from? And where is the demand coming from if nobody has jobs? So, unless we sort of reengineer society to support some of this displaced labor, then there's a pretty substantial demand gap that is, is building in the economy. So, that certainly is maybe deflationary in the short term, but it raises larger societal and political issues in the intermediate term.

Debt

Richard: **00:23:05** And aren't we forgetting the third leg of this, which is debt overhang? I mean, demographics, technology and excess debt. Excess debt is the one we haven't yet touched on, so Vincent, maybe you can touch upon that a little bit. And also add in the fact that Japan has all these issues, but we haven't yet seen that pickup in inflation that you have suggested that aging populations will eventually inflect towards?

Vincent: **00:23:31**

Yeah, yeah. No, good point. On the debt, I've been kind of in the MMT camp for a while that the debt problem is mostly a matter of writing down assets more than an actual threat. I mean, roughly speaking, I would say we had this big accumulation of private debts between 2000 to 2008. Real Estate in the US, some corporate debt in Europe, etc., emerging markets, dollar debt, whatever, then we got to a point where growth was not sufficient to support this debt accumulation in 2008. And in various ways, we ended up nationalizing it, transferring it from private balance sheet to public sector balance sheet. Now, in Europe, that gave us a sovereign debt crisis, because we forgot the next part of the planning, which is you move it to the -- In US, we couldn't get us on that crisis. Because you know, the US dollar is the reserve asset.

The next step, of course, once it's on the government balance sheet is you extinguish it with QE. So, until there's a gap in Europe between the time we nationalized the debt, and we started monetizing it, and that's when we had a sovereign debt crisis. But if we had done it, the two at the same time, we would have avoided it because as… and Japan, for example, never had any issue because the debt is effectively owned by the BOJ. I think they own close to 100% of GDP. Now when, for example, Japan, when the BOJ owns a … it's still pays the coupon, I mean, very low because…low, right. So, technically, that's money that flows from there, the Japanese treasury, to the Bank of Japan. But then by statute, the Bank of Japan has to turn over any profit it makes back to the Japanese treasury, or same thing between the Fed and US Treasury.

So, effectively that exists in the accounting entry. It's money goes from the right pocket to the left pocket back to the right. But I think when we speak about debt, we need to take away the part, the central bank balance sheets, because that represents, it's almost like the tonsil that you have in the bottom of the throat, like it's a legacy thing that doesn't serve any purpose. So, I view the world as much less indebted, the true debt load as much less. And I think that that decade of QE that was its purpose. So, if I were -- the way we'll deal with the debt, it's a long cycle, debt cycles are very long, right? We build debt for four years, then we nationalized it, then we monetized it, and the next step is we inflate it, and then we'll end up to a point, I think, by the end of the 2020s, one will have extraordinarily low debt to GDP ratio the same way it was after the 70s in the US, and then we can start the whole thing again.

Rodrigo: **00:26:11**

So, from what I'm understanding, I mean, US right now seems to have a much lower consumer debt than we did prior to 2008.

Vincent: **00:26:19**

Yes.

Rodrigo: **00:26:21**

This idea from a government perspective of one man's debt is another man's asset doesn't really matter, because it's the same government. So, that part of the debt can be, if they wanted to have a debt …. and so the combination of those two things, if that were to happen today, what we'd see is a much lower debt burden than what the headline tells us. I don't know …

Adam: **00:26:47** What's missing from that equation, are there's two other major sources of debt. One is corporate debt, and one is asset backed debt. And so Vincent, I'd love to hear your thoughts on how the corporate debt and the asset backed debt is managed through this cycle.

Vincent: **00:27:06** I think inflation is the only way to deal with it. I mean, unless we do the other way around, which would be you know, we have a great recession, and then everybody goes bankrupt. And then we have to nationalize everyone, which I don't think we should do. And that's the European path. And I think that's a very unpleasant path. You know, you end up with these low growth, extremely high asset prices, huge generational strife, I think inflation is a better way. And I think we're getting there. Yeah, people freak out now, because the -- what is it, the … spreads are close to 4% when inflation is at eight. I mean, you can still be a junk rated borrower and borrow at a negative real rate, which never happened in 100 years before.

So, I see inflation as the jubilee, you just inflate the top line so that you can service the debt. So, I think that applies to corporate. On the asset backed, I'm not as close to really give you -- I naively think there could be some problems, but I don't think I'm smart enough to really give you the how… but that's an area that would worry me.

Rodrigo: **00:28:11** Right. So, when we talk about this idea of inflating away debt, you also always talk about the difference in demographics, right? The younger generation who is very much indebted is going to be okay with inflation, right? They have this big student loan debt plus home debt, and they're just starting to make money, the labor costs are probably going to go up with inflation, hopefully, or enough that they can kind of muddle through it, but it's the generation that has all the savings that are going to end up paying for that negative real yield. And who's got more political power, is the question.

Vincent: **00:28:47** Yes. Correct. And that issue. So, let me go back a little bit on the generational analysis. To me, one of the most important … you can make is the ratio of the S&P 500 to the minimum wage in the US. And to me, that is a generational trade. So, that ratio has exploded, so I think in the late 70s, when the baby boomers were making it into the real world -- can you guys hear me?

Adam: **00:29:15** Yeah, perfectly.

Vincent: **00:29:15** Okay, good. Yeah. You could buy a share in the S&P 500 with two days of work. Today, you need to work for two months to get that same share. And the reason why I think of it as a generational trade is, think of it as human capital. This is financial capital. If we want to take a very narrow and unspiritual perspective of life, I would say that the goal of life, at least according to the Samuelson textbook, is to convert your human capital into financial capital, so that at the end of the day, when your human capital is depleted, you no longer work, you need someone to help you, you have the financial capital to hire the human capital to take care of you. Right?

If you think of the market, the young offer the human capital, the labor, which is really cheap and qualified, so that's how the minimum wage comes in. And then the old offer their financial capital in the form of pension or houses or financial assets, and they buy each other. Well, that ratio between the two has been multiplied by 10. So, the relative price of an hour of young people work and the money used by the old people has been divided by 10. To me, this is not a way -- I mean, you're creating so much stress, I mean, that social generational contract is the heart of the social contract; who gets what, which generation owns the asset, the debt. I mean, all of society revolves around these questions. And we're going one way for forty years, and we need to go the other way.

Now, the only way that I can think of to do that is through inflation. And with inflation, you effectively inflate the cost of labor, which we are seeing now. You see the highest gain for waiters, hospitality, low-end jobs that are disproportionately employing young people. So, you inflate the wage numerator, and then you deflate the denominator, which is the S&P 500, because rates go up. And then at some point you let the multiple play in, instead of having the S&P at -- what was it, close to five times sales at one point. You get back to more normal multiple, and then that restores the balance. Of course, it's extremely painful for the owners of financial capital.

Richard: **00:31:31** So, what you're saying is, despite the tough talk from central banks, this is exactly what they need. I mean, this is the argument that you hear from a lot of commentators that might be described as somewhat more cynic. I think you're making this argument in a more elegant way. But it's basically debt jubilee is too painful because one man's liability is another man's asset. You cannot break the banks, so you break the insurance companies. Can't grow your way out of the debt, at least not in the way that we're currently structured. So, the frog in the boiling pan is the easiest way and the least painful way, in your view.

Vincent: **00:32:05** I mean, inflation is a choice. Like today, Powell could stop inflation if he wanted, like the, was it, the Bank of Russia did that. Oh, I'm going to hike overnight the repo rate to 20%. He can stop, like we can stop right away. You know, if we're really serious about it, okay. Powell announces that. And then Yellen announces that the US government is going to pursue a fiscal surplus and pay down the debt for the next 10 years. Inflation goes tomorrow. So, the inflation that we have is an easy choice. And I would argue that the politics of choice are not going to change. If anything, they're going to go more and more in a way that's favorable to debtors as the millennial plus Gen Z become the dominant force on the political. I think the next election will be the first time that you'll have more millennial and Gen Z than you had … plus boomers.

Now, of course, the voting rates are not the same, like old people vote and young people don't, but eventually, the numbers will play out. I mean, death awaits for us all. And then that will accelerate that shift towards non-inflationary policies, which we even see that in social -- in surveys of social studies, where the young today lean much more left than -- it's not just the fact that young people are traditionally more left and old people more right. Like, even at the same age, boomers were more right than left. I mean, especially, I mean, Rodrigo, you're from Peru. I mean, you know what I'm talking about. You know, Chile, same story. You have all these ideas of MMT. And it's not just -- I don't think it's like Chavez, it's kind of something different. It's the generation that I think correctly thinks that it's been on the short end of the stick for 40 years, and wants to change and is slowly, slowly getting empowered.

Richard: **00:34:05** I totally agree…

Rodrigo: **00:34:05** Richard's a Brazilian just so you know, he's seen it worse than all of us.

Richard: **00:34:11** I totally agree with your latter point. But I just wanted to push back a little bit on this idea that the Fed could now, if they wanted, curtail inflation to a meaningful degree, at least in the timeframe that is relevant to investors. The idea that COVID accelerated a lot of the trends that you were seeing earlier and the issue is now with the availability of basic supplies. This notion of deglobalization, the US realizing that they can't rely on China for their pharmaceuticals and other critical supplies, and so they're going to have to re-shore those supplies back. That's going to be inflationary. The context now that we're seeing, the availability of grains and metals and energies because of the war in the Ukraine, so I wonder if you might comment on that. It seems like there's an important component, you might say there's core CPI that takes away food and energy prices. So, that might be a little bit more reasonable. But I wonder if we might contrast that with the view that the Fed does have the ability to curtail?

Vincent: **00:35:15** Yeah. No, thank you for pointing that out. I was being somewhat provocative here. I mean, the point, it exists. Like, you can destroy so much demand that at one point you can … Exactly.

Rodrigo: **00:35:31** Yeah, I mean, that you can raise rates to 8 percent to match the point of inflation. In Peru, after the grave hyperinflation of 89, the US government came in, put Fujimori in-ish. And then because we can't print our own, like, we just don't have the ability to interact with the world without kind of complying. There was a single day where the government decided to get rid of all their price controls. And they announced it, and the central -- the head of the Central Bank ended the discussion by saying, and may God save us all. And the next day grains went from like, whatever they were to 10X in a single day, caused a massive, like, very quick depression, riots everywhere. But then we were part of the global economy again, and Bob's your uncle, right? A lot of people call for that type of shock. Now, you should read up on it, it was brutal. And the guy ended it saying, and may God save us all, not the right move.

Adam: **00:36:30** Well, you can get it by engineering it or you can get it by just kicking the can until you have -- it emerges, whether you like it or not. So, you can have it in a controlled way, quasi-controlled way. Or you can have it in an uncontrolled way. And I think the argument is that we should take the short term pain with a limited amount of control rather than allow it to get out of control and then the dispersion of potential outcomes is much broader.

Richard: **00:37:01** I think the point I'm trying to make or that I was trying to make earlier is that a lot of this is outside of the control of governments and central banks. And a lot of the tectonic shifts that are happening right now in the geopolitical stage, I think, are bringing a lot of our assumptions to be questioned. And I think a lot of the things that we were holding for granted, can no longer be.

Vincent: **00:37:25** Yeah, if I may comment on your … Rich, so I think what you are telling is, even if, you know most of these are supply side issues, the Feds tool, in the words of Paul are blunt, and they can only address demand. The point I was making almost provocatively was like, well, you can always destroy as much demand as is required. But practically, that's not going to happen. And I kind of agree with you on, actually I 100% agree with you on all the factors you mentioned. And it brings me to an idea that I think we should consider. And I think what's missing from this week's press conference is there seem to be the implicit belief during the press conference that it's just about excess demand, like we ran ahead. In the US, we give too much money, too much stimulus. Now, demand is too hot, but you know, we're going to cool it down and when we do that demand is going to slow.

I think, especially coming from Europe, that one thing that we need to consider, and I'm pretty sure what's going to happen here as well, is that even if we slow demand we'll still have inflation, because of all the supply chain issues that you mentioned, commodity, de-global all that stuff. Like I mean, you see Europe did not overstimulate, like the US did. I mean, if anything, we kind of kept people where they would have been or even less. So, now with the ECB, you have … the Bank of England, I think, have announced today, like yeah, we're going to have a recession. And you know what, we're going to hike, boom, boom, boom, boom, boom, boom. That's not a conversation that I hear people worry about in the US. And I think they should, because maybe the Fed hikes and the QT and

		the gridlock in Congress is going to get rid of the excess public stimulus. But I think we ended up in a situation where growth has indeed slowed, but inflation hasn't slowed and I think that's the story for 2023.
Adam:	**00:39:18**	No, no. I think the reality is, if you actually want to moderate inflation to a material degree, you're going to need to engineer a deep global recession. And I agree that they don't have the stomach for it. And probably from a social, global-social outcomes standpoint, that's not… Even accounting for some of the outlier negative scenarios in an inflationary spiral type of world, engineering, a deep global recession will impact the poorest of the poor in a much more outsized way, and net-net is going to be a much more negative outcome from a social standpoint than some of the other alternatives.

MMT

		You mentioned MMT, and I just want to maybe pull a little bit on how you think about MMT. Maybe sort of define it for us, and maybe help us understand how some of the instruments of MMT might be useful in the current context.
Vincent:	**00:40:23**	Right. So, we have, how many hours do we have?
Adam:	**00:40:29**	As long as you want.
Rodrigo:	**00:40:30**	As many as you need.
Adam:	**00:40:31**	You're right down the fairway for us.
Vincent:	**00:40:34**	Well, I think at the core of MMT is kind of a distinction between currency issuers and currency users. And that we cannot use the same tools to analyze currency users such as ourselves to a currency issuer, such as the government and the naive rules of private accounting. Or you need to balance the book. If you run a deficit, sometimes you're going to have to pay, does not apply to the sovereign. And that *seigniorage*, which is the issuance of currency is a legitimate form of financing government, always has been, always will be. And I think from a historical perspective, it's very hard to argue against it or even from a functional, some people call it a functional monetary theory because this is how the world works. Like when the US, the government spends money does not go out first, ask, can you go through like a little TBL. Can you give me money for this TBL so that I can pay the teachers. No, he just credits the bank account of the person it pays and that money comes from the TGA, Treasury General Account at the Fed. So, if anything, taxes come after spending, it's kind of a -- it reverses the order, right. And, I mean, I don't think anyone can really seriously argue that they are wrong on how things …

Adam: **00:41:53**

No, no. There's a temptation, this always happens with conversations with MMT, where everyone feels like you need to actually define MMT, the functional definition of MMT. And it is important because most people actually don't have the background in that either, right. And it's and it's critical to understand that MMT allows government to spend without the constraint of taxation. The real constraint of spending is inflation or supply, the ability for the economy to produce goods and services to meet the demand that's available from the amount of money that the economy has produced, or wealth the economy, and demand the economy has produced.

So, absolutely, we need to get that out of the way. But there are policy implications too, that arise from the fact that the government is not constrained by taxation, but is rather constrained by inflation, that I think, is a more interesting topic for discussion. Right? I think, when people get angry about MMT, those are the things they get angry about, and not about the functional plumbing of the financials.

Vincent: **00:43:04**

Yeah. And especially now because we are hitting that limit, right? I mean, we kind of had this golden window, right, where because we had so much disinflationary forces in the economy because of what happened to bank lending, and yada, yada, like there was that space for fiscal resources that could be mobilized without being inflationary. And I've argued that it -- I mean, again, I come from Europe, I think Europe missed five years of free lunches there. But that era is over. I mean, I will say we spent that financials on COVID, on sending checks to people who didn't need it, and PPP loans that were abused by law firms, and all sort of …, we had that space and now we are getting the real concern about public spending, which is indeed, inflation and the supply.

And yes, now, I would -- I mean, to me, the past 10 years has been a real-life battle between these two competing monetary views and the MMT side has won. I mean, everything that MMT has predicted has happened. QE was not inflationary because we're doing fiscal austerity at the same time. So, it's fiscal that matters, not monetary. When you do not have an inflation constraint, you can increase deficits without creating any sort of issues. You do have a free lunch there. And then once you over-eat that free lunch, you have an inflationary hangover. I mean, this is pure MMT. The past 10 years has been a crash course in MMT for the world.

Richard: **00:44:37**

Yeah, I think it's indisputable that…

Adam: **00:44:37**

It's not that the quantity is the only culprit here, right? That it was the quantity of money that was, let's say, printed, right, through fiscal policy during COVID that has caused this inflation and it's not so much the quantity as it is the directions in which that money was spent, right? There were thoughtful ways that that money could have been spent in the economy. And there were the fire

		hose way that it was spent. And it was the fact that it wasn't spent thoughtfully, that is partly responsible for the inflation, along with all the other supply challenges as well.
Rodrigo:	**00:45:22**	So, just to define that, you mean, not thoughtful is putting money available to spend on *Beanie Boos* on Amazon. And thoughtful would have been infrastructure, education, something that pays off over time, like investing in your future that pays dividends and if one doesn't pay dividends, the other one does not.
Adam:	**00:45:37**	Medicare for all, revamping the education system, building a healthcare nursing reserve, infrastructure investment, technology investments, absolutely. There's just so many different areas that might have benefited from that spend.
Richard:	**00:45:53**	I think it's hard to dispute that MMT does a better job at explaining how the monetary system works than classical economics, because it addresses head on some of the main blind spots, but classical economics does, especially in understanding the flow of taxation and spending by the currency issuer, as you rightly pointed out. I think what makes a lot of people very worried is the policies that a lot of MMT proponents would espouse. And I think we're coming into this head now with a difficulty in seeing a future without fiscal spending, and the degree to which, MMT in the hands of populist governments might just bring the whole -- unravel the whole system, if you will, with the bringing us from high inflation to potentially even higher inflation, if you will.
Vincent:	**00:46:53**	So, there is an easy out to your point, which I'm not going to take, but it would be to say MMT is not preoccupied with policy prescription, it just describes how things work. Then the idea is the policy is implemented by democratically elected responsible leaders, and you can do with it what you will. So, you can't blame what's happening on MMT. It just describes the way the world is, doesn't tell you what to do with it. But I mean, I understand that the broader meaning of your question, and I kind of agree with it. That's kind of part of my case for inflation. It's almost like a *fourth turning* argument. I'm sure the book by Neil Howe and Strauss, where we have all these kind of generational political, social shifts, different attitudes. Again, I cannot think of any better country for that than Chile, or maybe Peru, to some extent, where …
Rodrigo:	**00:47:45**	It's happening for sure.
Vincent:	**00:47:47**	Yeah. Like, you could really see, like in Chile, the most -- it's the church, the army, the state, I mean, it's always been like that. And then suddenly you get this *summer of discontent*. You get this new constitution 20-year-old, like throwing everything but the kitchen sink at the Constitution. Wow, what happened? Like, I used to travel there quite often. And you just, three years, like, wow, completely different place. What happened here? And I think this is what we're

talking about. Now, as far as what would happen? I don't know, part of me, like in the case of Chile, for example, I think we could maybe go a little more.

Like, yeah, there's no reason why Chile should have the level of income inequality that it has with the wealth that it has. There are probably, I think, there is a middle path between where we've been and Hugo Chavez, and I hope that we can find that path. But it is certainly, at least in my opinion, where the world is going, as we have this generational turning, is going to bring more preference for social, more preference for the state, more preference for collective solution, less reliance on markets. I mean, you can see that even young generation today, for example with free speech. I mean, it's the water we will swim in.

Generational Shift

Rodrigo: **00:49:10** So, let's talk about the generational shift. And particularly about China, because up until I started reading your stuff, I was in the bandwagon of China being the next great superpower, right? That it was going to finally take over, internal consumption was going to replace exporting consumption. And why don't you tell us a little bit about how you see the demographic shifts in China, and what your perspective of the future China is, versus that narrative?

Vincent: **00:49:46** Well, I don't think the two are necessarily incompatible. I mean, I still think we can have a scenario. I mean, because I think Rodrigo and I, we kind of grew up I think in the same early 2000s, rise of the BRICs. And especially in the US, you guys were kind of shielded by the illusion of *the US is special*. But for foreigners, it was so clear to us that we were moving to a multipolar world, the emerging middle class, all that stuff. And yeah, I think, in the past 10 years, we've been -- had to rethink a lot of these assumptions, right? I mean, the Brazilian middle class, do they really exist, probably not. You know, China's *Double D* growth, is it real? Is it not, yada, yada.

And yeah, so the demography in China is basically starting in 81-82, you get the one child policy, and it was very, hardly implemented in cities, less in the countryside, but you go from four or five kids, a woman to one. I mean, this is something you cannot undo. And then even when they undid it in 2016, the birth rates are still close to one. And even places that didn't have the one child policy like Taiwan and South Korea, they did on their own, because of things like education, cost of housing. I mean, it's not just the government mandate. So, yeah, that is going to be a huge break on growth. But again, I would argue there is some room to grow, you know, they were growing at 7-8%. So, even if it slows to less, three or four, they're still somewhat better than the US. You can grow, as you were pointing out, the share of the consumption pie, which is less than 50% of GDP, it's ridiculous.

In the US, you have 80% of your GDP's domestic consumption. In China it's 50. So, just by increasing that share of the pie, you can have growth -- actually, for most of the GDP growth that we see in China, if it's surpluses, it means consumed by other people. Like, it's not real growth for them like, oh, wow, I'm great. We're growing at 10%. That means that the Americans are buying a lot of stuff at Walmart, that doesn't make you feel all that great, right? So, I think I still kind of remain in the camp, just because of the scale. I mean, China is 1.1-1.2 billion people, the US is 380, I mean, I think all they have to do is become half as rich as the Americans and it will be by far the largest economy in the world. So, I still think it's going to happen.

Richard: 00:52:28 How will they adapt to the demographic cliff, though, especially if you consider that much like Japan, China is somewhat of a closed society. You don't get a lot of influx, you don't have a lot of immigration coming in. Whereas in the US, you have a lot of immigration like it's what you hear, everybody wants to come into the US, everybody wants to migrate to the US. You don't hear a lot of people wanting to migrate to China or to Japan to a large extent. So, do you see this demographic replenishment, perhaps serving as a counterbalance to your view?

Vincent: 00:53:07 Yeah, I think that's historically been very correct. I mean, that's been really the -- I would argue the three advantages of the US status as a superpower are through this kind of amazing geography that it has, especially when compared to Europe, I mean they're not neighbored by Russia, Turkey and Africa. They have Canada and that's pretty big. They have big rivers and all of that stuff, right? And then they share the world reserve currency. And on top of that, they get this tranche of really of really smart, educated people who typically move when they're ready to work so you don't have to pay for their expense, right? They move at 25. And then quite often, they even retire in their own country. So, you're really squeezing -- it's like a tax on the rest of the world. And this is how empires work, by the way. I mean, empires extract wealth from the periphery, and they bring it to the center. And the US has done that since its foundation, really. And it's done that better than any other country in the world.

Now, I would say on the margin, I think the tolerance for immigration in the US is going down, or in the West in general, I mean, especially in Europe. So, the hope that we can outsource our demographic crisis to foreigners, I think is not possible also, because you have to let in a lot more. You know, as internal demographics degrade, you'd need to get like 2-3% of annual immigration and I think we've reached especially in Europe, I think we reached a breaking point. Like we -- I mean, I don't think it's racist to say that. I mean, people just don't want any more foreigners to come in Europe, even though the economy needs it. I mean, that was the whole debate around Merkel and getting the Syrian immigrants. I mean, Merkel was giving the view of the German establishment like the German manufacturing, it's like, okay, we need X million workers to keep the car production afloat. And then the population said no, we stop here.

Richard:	**00:55:06**	Right. In Europe, the immigrants tend not to be quite assimilated. You see this, particularly in France, and all the social convulsion that we've seen in France, whereas in the US, I think the Latino communities, which are a large influx of immigrants, tend to blend much better into the society. But I'm still thinking about how this contrasts with the two Asian superpowers, China and Japan and the lack of this immigration flow and how that will eventually lead China to grow old before it grows rich, and Japan to continue to age and continue to experience difficulties.
Vincent:	**00:55:53**	My impression of Japan is that, you know, they're kind of okay with this kind of managed economy. I don't know how long it can last but, you know, because your population is shrinking, even zero growth, you increase per capita income. And actually, if you look real cap -- real per capita income, because of the foreign population, the foreign inflation, Japan's performance has been very comparable to that of Germany, of Canada and the US over the past 20 years. So, when we say last decades, no, like living standards, I mean, Japan is still a very comfortable place to live. It's a very safe place to live. They have low – I mean it's not a -- if you do chart of nominal GDP, of course, it looks awful, especially with us, the fall of the yen lately, but … yes, per capita real, I think it's not -- I don't know if that's sustainable or not. I think we're kind of testing that now with this inflationary shock, we'll see what happens. But so far, I think that's been the case. As far as China, time will tell. China has been an empire before. China is a very diverse multi-ethnic country with, you know, already in rural China, hundreds of ethnic groups. And I would not necessarily write it off, as a -- you know, I mean, again, this is the path of empires. Empires attract from the periphery, squeeze in, and if China is to be a successful empire, it will have to do that.
Rodrigo:	**00:57:20**	So, speaking of …
Adam:	**00:57:20**	I want to shift into…
Rodrigo:	**00:57:22**	Go ahead.
Adam:	**00:57:23**	Okay. No, if you had a point on this one, go ahead, because I wanted to kind of shift.
Rodrigo:	**00:57:26**	No, I was going to shift as well.

The Nature of Inflationary Episodes

Adam:	**00:57:27**	Okay. Because what I've -- one of the things I've really admired about your analysis, Vince, is the empirical framework that you bring to bear and you have done a lot of really good work on the nature of inflationary episodes historically, and the circumstances under which they persist, or in which they're transitory. I think there's a general presumption in Neo-Keynesianism, and in the sort of broad economic literature that inflation is broadly self-correcting. And I think your analysis, maybe contravenes that and a lot of it, or in certain important ways. So, what did you conclude from your analysis of prior historical episodes? And what do you think that tells us about what we should expect in this current circumstance?
Vincent:	**00:58:23**	Yeah. So, one chart I've done, which I found fascinating, so I tried to download the biggest, widest database of information I could across every nation as far as I could. And the question was, I just want to plot the distribution of inflation versus say, a normal economic variable like real GDP growth, where you have the kind of log normal distribution, right. And one thing that struck me is that inflation is not normally or even not normally distributed. If you look at growth it's kind of this nice peek around 3-4%, tails on both sides, and nothing to see here. For inflation, it's got this very long tail and then the curve is where we are today is an anomaly, seven/eight, you usually don't stay there. So, two things can happen at seven/eight, either it's the kind of self-correcting high prices are the cure for high prices. Inflation, like you have a shock, oil prices go up things go out of whack and then a little bit the market does its thing, get more drilling and then falls back to price stability, or just an outcome that I think is absolutely not priced in by the swap market or the TIPS market is that it actually keeps accelerating because you get to the point where inflation becomes inflationary, right, the expectation channel. And I think the longer we stay at seven/eight, the more likely that that scenario happens because people start addressing their behavior, right. I mean, if -- I don't know, I give you a personal story, I'm …
Rodrigo:	**00:59:58**	I mean, would you push it to the screen?
Vincent:	**01:00:01**	Pardon me?
Rodrigo:	**01:00:02**	Sorry. I was just telling Ani to push to the screen because I have you, I'm having a few issues . Go ahead. Sorry.
Vincent:	**01:00:10**	Yeah, so that's okay. Perfect. That's the chart. Yeah. So, like, for example, now I need to change my car. I got a ... I'm like, I had been waiting looking at the used car CPI. No way that thing's up like 35. I'm not buying it now. And actually, it's not slowing down. So, for the past six months my own reaction to inflation was

like, I'm going to wait until it passes. And now it's been six months and I look at the Manheim whatever, like, I don't see any sign. So, I'm like, oh, I need to buy now fast. And that's a psychological shift that I think could happen at the societal level where people are like, no, I want to be paid, you know, you want to be paid faster, so the velocity of money starts picking up. And that's when you go in that, right there. Now, I'm not saying we're going to go there in the US. But I would say the probability of getting there is certainly not zero. And that probably is priced by exactly zero by the swap market at this point.

Adam: **01:01:08** And you did some studies on the conditional probability of inflation falling back to more normal levels once it sustains above a certain threshold for one or two quarters. Right? You want to walk us through what you found?

Vincent: **01:01:26** Yeah. So, you know, I started from the Fed's SEP Summary of Economic Projections, or fairy tale in normal words, where they tell us that -- so, how does it work? So, the Fed funds rate is going to rise to the neutral rate, which now we know is 2.5%, somewhere around that. And then inflation is going to flow from eight to three at the end of this year, and then gently converge to two, all of that while unemployment rate stays at 3.5%. I mean, I see no problem with that scenario. So, that's what the Fed is telling us. And by and large, this is what the market is pricing in, right? I mean, if you look at the swap market, the Fed is somewhat correct that this is -- it's credible in the way that the swap and the breakeven market reflect that. So I looked at how likely is it.

So, I was looking at countries where you had a historic price stability, a one-time spike, one year inflation rise above 7%. And then I looked at the next five years. So, the tiny bar, which I define as full success, is the Fed …, i.e. inflation falls back to 3%, and stays under 3%, for the next five years. That happened 1.4% of the time. This is what we all put in. I think some people would go with the next bar as well, right, partial success is we're under 3%, on average, but we have a couple spikes over 3%. But we don't go above seven, I would say that's where the market is, to be fair. Most people don't think inflation is going to fall below three, it's like 3.5, whatever, a couple years. And that's about, I don't know, it looks like it's about 8% of the time. So, between the two, you have 10% of the cases.

And then the two scenarios that the market is absolutely not pricing are 20 to 25% each, basically. One is inflation stays between five and 10% for the next five years, which would be where I am. And then there's the other one, the craziest one where no, actually inflation accelerates and averages more than 10% in the next five years. And that happened 25% of times historically. And that's something that's, you know, it's not nowhere, it's not in the tail, it's not in the price. It's nowhere.

Adam: **01:03:47** So, generic location is okay, for sure. Go ahead. Yeah.

Richard:	**01:03:51**	No, I was just going to ask how do those scenarios vary between countries that have historically had stronger currencies, which can perhaps attract more capital and can withstand a little bit more these oscillations versus Latin American, African, Asian countries that have historically dealt with balance of payment problems and other economic dynamics that eventually do lead to inflation getting out of hand?
Vincent:	**01:04:18**	Yep. That is that tail. I mean, that tail is Brazil in the 80s, Argentina and pretty much every single decade since …
Richard:	**01:04:27**	Zimbabwe, … Germany, so on.
Vincent:	**01:04:31**	Yeah, that is that tail, but, I mean, I don't really expect that. But to be devil's advocate, I mean, talk about balance of payment crisis, I mean, look at the latest trade balance for the US. I mean, again, the fact that the US issues the world reserve currency is indeed a game changer, but I would not completely rule it out.
Richard:	**01:04:54**	No, it's possible, given the weaponization of the dollar since what's happened with the sanctions imposed on Russia. Putting no moral or ethical considerations on what was done there, if you're a fiduciary for a central bank or a government treasury right now, you must be considering the risks that you're on the wrong side of any argument with the US in the future and that your reserves are rendered useless. And I'm sure all of these guys are having to consider diversifying away part of their cleanest dirty shirt that the US …
Adam:	**01:05:31**	That's the question. Where do they diversify, aside from real assets like gold and commodities, for example, where do these global treasuries diversify their reserves?
Richard:	**01:05:45**	Yeah, you can't really count on the euro, because by many accounts, the euro will not last more than five or 10 years. Even though I think the recent rallying together by the European Union and NATO to some extent, does seem like …
Adam:	**01:06:02**	No, no. Junker's Bundesbank was eviscerated as soon as the Germans said that they're going to deficit spend on military spending. And there's obviously lots of reconciliatory language and communications across Europe now where even Germany is getting behind the fiscal stimulus bus here and they're loosening their inflation constraints, right. So, I don't think, and certainly looking at the Euro/USD, the market certainly doesn't see the Euro as being a more stable place to store reserves. So, the Yen is failing, Renminbi is collapsing.
Richard:	**01:06:51**	And it's also a closed economy that doesn't have enough depth of its sovereign bond market to weather all those -- all that capital.

Rodrigo: 01:06:59

Yeah, you still have global liquidity, the fact that the US has some yield to their treasuries right now, right, another 50 basis point hike, like all these things, it's just going to be a tough thing to replace, at least in the short term. But …

Adam: 01:07:18

It's a strange phenomenon where I think it's right to be concerned about the value of the US dollar. But relative to all of the other currencies, it still looks relatively strong. Which brings up the question of why aren't we seeing more action in gold here? Is that something that you've got anything to add to?

Richard: 01:07:44

And other precious metals. Silver has collapsed as has platinum, as...

Vincent: 01:07:46

Has there been any single thing that's more disappointing than silver? I vomit silver. I don't know. I mean, yes, I'm disappointed by -- I mean, all I have to add is my pain. On gold, at least I would say it's kind of like a day like today, like whatever, like it's still holding up better. It's up for the year. It had a big -- I would argue that gold had its big move before the inflation came in. So, went up 30%. Then once inflation did come in we started worrying about… That's still how I -- gold, I can still rationalize myself in it and I still think it's right. Man, silver? I don't know. I mean you have like double digit nominal GDP growth, lack of investment everywhere. I mean, I don't, silver just likes to break horse. All the other industrial metals are taking up and it's a mix between industrial and precious, and it …

Adam: 01:08:49

Well, copper, I mean …

Rodrigo: 01:08:53

What does?

Adam: 01:08:54

Copper, copper continues to look like a vomiting camel.

Rodrigo: 01:09:02

Yeah. But Vince, I mean, when I see -- there's one chart that I keep on looking at that just validates this, that gold is correlated to real returns, right, to the real rates. And when rates were going on the way to negative, gold was going up. And then as rates have gone positive again, or getting above zero, again, gold has not done as well. I mean, it acted positively during some crisis moments.

Adam: 01:09:30

No, but real rates today are even more negative today than they were during QE. Right? Like, real rates are still massively negative. Like, the 10 year's at two.

Rodrigo: 01:09:42

They are but it's direction --

Adam: 01:09:45

And CPI is at eight.

Richard: 01:09:47

It's closer to three.

Rodrigo: 01:09:48

But still, I think your point is valid. Yeah. It's true, but I'm just saying like we're talking about what's happened to gold in the last quarter, last six months, last two years. If you match that against the change of positive to negative real rates, it's negatively correlated to that direction.

Adam: **01:10:10** You're breaking up a lot, Rod, I don't know if it's me. But…

Richard: **01:10:13** No, yeah, his internet is lacking.

Rodrigo: **01:10:17** All right, I'm going to ask one more question, and then I'm going to stop talking because I clearly suck with my internet. Vince, can we talk …

Similar Yet Different

Adam: **01:10:33** Yeah. I know where he's going. I'll say it for you. So, as we look at the current inflationary environment, obviously, we've had two major inflationary episodes in the last, well, in the post-World War II period, right. The first was coming out of the war, which was financial repression. And the Fed and central banks, keeping rates low and allowing inflation to run hot in order to devalue the debts that were accumulated during wartime, right. And then obviously, the 1970s, the Fed allowed rates to fluctuate. And so while we did have negative real rates on occasion, we also had very positive real rates. And so we had both high rates and high inflation and central banks were actively trying to moderate it. As you look at those two historical analogues, what are the similarities and differences that you could draw to the current episode?

Vincent: **01:11:36** So, good question. So, on the post-World War II inflation and financial repression, I think we're going to try that path. Right. That is the hope. I mean, this is the beautiful deleveraging, right? You don't worry about it for then the economy kind of fixes itself. And you kept the 10-year yield at whatever, point five back then, I can't remember. And after a decade, you've come clear of your World War II-Korean War debts. So, I think we're going to try that because that's the better one. I don't think it's going to work.

And the reason I don't think is going to work is I think what happened in the 50s, going back to our earlier conversation on productivity is, productivity just kicked in and took over. I mean, after World War II, we basically had 50% of labor force we're not using, which were woman. I mean, it started during World War II, right, … and all that. You could massively expand production function. Also African American communities with the desegregation, migration to the north. So, between 10-15% of disenfranchised communities and the woman, you could expand your production plus the US dollar becomes a world reserve currency. You switch from clearly being the global imperial power.

So, all of that was deflationary. So, I think that's what took care of the inflationary pressure and that's what allowed the experiment to be successful. I don't see how to repeat that -- I mean, we're going to try to repeat it because that's the best, that's the easiest. But I don't see how we're going to be successful, I don't see where you find 40% of the labor force just sitting around just like ready to come in. So, I think it's going to start looking like the 50s. And then it's going to devolve into the 70s and then we'll have these issues. Because I mean, the 70s, as you point out, we make fun of Burns, the Fed chairman at the time, like, oh, he was too slow. Well, look at the Fed funds versus the CPI? I mean, just like match, match, match, match, match. I mean …

Adam: **01:13:49** Yeah, yeah, they tracked it brilliantly. Yeah.

Vincent: **01:13:51** Real rates were actually positive for most of the 70s. And, yeah, it was -- I mean, think about that. I mean, think of where, you know, terminal rate, Powell told us it was two to 3%. I mean, think about bringing it to level inflation. 8.5. So, to me, that means more and more painful financial markets and more returns for things like commodities, things like momentum, things like CTAs, things like gold, eventually. I'm not going to say silver because I'm too sad about it. But yeah, I think this is really just the beginning.

Adam: **01:14:28** So, 1950s financial repression leading to …

Vincent: **01:14:33** One would see that it doesn't work like a brutal awakening. And the more you wait, the harder the awakening, right.

Adam: **01:14:45** So, what would the indicators be that would signal to you that this financial repression approach is maybe being more successful than you expect? And what would you be looking at to see the opposite things sort of spiraling in a different direction?

Vincent: **01:15:05** That's a good question. I mean, you need to see productivity pick up dramatically, which is always hard to measure, right? I mean, productivity is kind of one of these things. Like, it's like the Holy Ghost during Mass. I mean it's there, but no one sees it.

Adam: **01:15:20** It's the residual term after you account for all of the other things that you can count. Yeah.

Vincent: **01:15:23** That's right. And then I would even argue, can you really count GDP in an economy that's 50% service oriented? I mean, like when Netflix raises prices, is it inflation, or is it, you know, because the catalog is big? I mean, I have all these kind of essential questions that -- But anyway, I'm not going with that. So, yeah, miracle increase in productivity, and then also increasing in labor force participation, somehow you get this reserve army of workers that comes in, I just don't see where it's coming from. If anything, job report today, participation went down.

Richard:	**01:15:55**	It has been going down for the better part of, I guess, two decades. What do you attribute that to?
Vincent:	**01:16:02**	No, the craziest story yet is *prime age men*. Like, if you look at prime age men in the US four decades, you go from 98%. So, prime age is like 25 to 55, you know, to -- now it's less than Europe. Yeah, it's less than Europe now for prime age men. And to me, then you go back to the whole issues of opioids, of broken healthcare system, of …
Richard:	**01:16:28**	Disenfranchisement of a good chunk of the population.
Vincent:	**01:16:31**	Yeah. The country, the territory itself, treating 80% of the country as disposable, and telling them, yeah, just going to code and shut up. I mean, this is forty years of bad policies that come. And again, you add COVID on top of that, I mean, you have the obesity problem that's gotten worse, the mental health crisis has gotten worse. The drug problem has gotten worse. I really don't see, like to me, there's a physical deterioration in the workforce in the US that kind of puts a cap honestly on it, and its growth potential. Like, that's the biggest weakness that I can think of the US is the fact that it has an extraordinarily unhealthy population.
Richard:	**01:17:10**	Would you say that that also adds power to your view that in relative terms, China can still sort of surpass the US in economic terms, because you're seeing sort of this social malaise that keeps the US economy from reaching anywhere near its full potential?
Vincent:	**01:17:27**	I would think so. And another sort of, like I said, physical. I mean if you look 40% of US population is obese. And if you look at the portion, the job markets, where you have the tightest, are things that you need to be fit to do like waiters, hospitality, leisure, or even the trucker crisis is another example. The reason we can't hire truckers in the US is because this tests against marijuana, and yeah, most -- and it's very hard to find people who are clear of any drug for the past two weeks and are willing to be on the road for several weeks at a time without seeing their families. So, no, I think it's a major issue. And yeah, the US is, again, it's the product of -- I mean, we're getting a political term, but like, I think we had an opportunity with COVID, maybe, or even after the great financial crisis to kind of fix and redirect the system, and we didn't seize it.

Positioning Portfolios Today

Richard:	**01:18:29**	I want to be cognizant that we don't have you for an eternal amount of time here, and time being limited. We'd be remiss if we didn't ask you a little bit about how you're seeing the best opportunities to position portfolios. I mean, we've talked a lot about the big macro themes. I've heard you in the past, discussing hard assets, soft assets. What are the assets that you're currently seeing as the best opportunities? You've mentioned CTAs, as well. Those do seem to be

		becoming part of the conversation again, but there doesn't seem to be as much uptake, as perhaps one would imagine, given the current circumstances. So, I wonder if you might talk a little bit about asset location in this environment.
Rodrigo:	**01:19:13**	… he's levering silver right now. If it was good before, it's good now. Right?
Richard:	**01:19:19**	…
Vincent:	**01:19:23**	No, but jokes aside, I think an approach like the one that you guys have is it's only the beginning. You know, the 60/40 is dead. I mean, we see days like, stock market down 3% and then 10 year Treasury down three and a half percent. I mean, you look at the 60/40 for the year, I mean, it's down 10 because both bonds and stocks are down 10. So, clearly, you need to rethink your entire asset allocation. And clearly you need to broaden it to strategies that involve real assets, that involve commodities and that involve, I think, quant investing properly done, not just, you know, over optimizing back-tests over the past 20 years is going to be, you know, for the mid 70s CTAs perform very well, among others. So, I don't want to preach to the choir, but I think you guys have done tremendous work here. And again, it is just the beginning. As far as the short term, it's odd for it an inflation guy like me, but cash, when everything goes, the cash purchasing power in terms of assets is going up. In terms of stuff you can buy at the grocery store is going down, but I was a big LATAM bull. You know, I … that work really well in Brazilian real and Brazilian in general. Now we had a big move already. You know, 25, 27%.
Rodrigo:	**01:20:47**	Peru was one of your calls too, no?
Vincent:	**01:20:49**	Yeah, yes, yes. Yes. Yes. Yes.
Rodrigo:	**01:20:51**	And they're up for the year so, they were yesterday.
Vincent:	**01:20:54**	Yeah, one of the few, very, very few. Now, I'm almost starting to worry that, you know, if this accelerates, the dollar keeps strengthening, you get bad balance of payments issue like, yeah, I started worrying that we might get to this, like tail-end scenario, things getting really nasty this summer. And then even kind of like the LATAM commodity heavy, resource heavy is going to start suffering. I mean, I still would own that over Microsoft at 10X sales. But it could be that it gets so bumpy, that it's going to be very, very difficult.
Adam:	**01:21:34**	I want to parse that cash call a little bit because I think, and I could be wrong, but my sense is that your -- because your client base, you're often talking to clients in Latin America. And I haven't looked at Latin American interest rates, so I'm not sure but maybe in Latin America, they're allowing rates to rise

commensurate with rates of inflation, right? And so cash in that scenario probably makes some prudent sense. But I mean, clearly, if the developed markets' central banks are explicitly pursuing a policy of financial repression, where they're going to hold cash rates at 2%, and allow inflation to run at five to 10%, cash is one of the worst places that you can, you could park funds, like tactically.

Vincent: 01:22:23 Yeah, agree on both. Yeah, Latin America, that's one of the rare cases where Latin American central bankers have been smart. I mean, you look at the … it's close to 10% across -- I mean, before Powell even thought about thinking about inflation, or whatever the quote was you had like, four or five rate hikes across Colombia, Peru, Chile, Brazil, Mexico. So, they come into this crisis in a good spot. Current account balances are generally better. So, yeah, I that was part of the appeal. The currencies are very cheap. The commodities that they export have rallied massively.

So, you have all these tailwinds? I mean, to me, that was more a story for six months ago, like we are going through these tailwinds. But yeah, and then on your point, yeah, cash is clearly a short-term solution. Really, that reflects the lack of other options. I started to worry that -- my concern, I mean, talking about short market outlooks, the biggest concern I have right now is that kink in the Eurodollar curve, the expectation that we're going to have a dovish vote in from the Fed in 2023, to me, tells me that transitory is alive. Like it's like Voldemort, you can't say it, but it's still there.

Adam: 01:23:38 From an expectation standpoint, that's where the market is still pricing. Agreed.

Vincent: 01:23:42 Yes. If I'm right, you're going to need to keep that out. And once you keep that out, once you incorporate these higher for longer rates, in you discount models, I mean, especially given the duration of the US stock market, we have another leg down. My guess is that is going to happen in late August, September, October typically, when seasonality is bad, when you're going to have margin compression from earnings, you have this perfect storm that's building. And again, if we follow on 2008 analog, like we had the first 10% down, that's not where the real pain is. The real pain comes too fast.

Rodrigo: 01:24:17 You're right, there was a …

Adam: 01:24:19 Okay. So, that is what I was trying to get at. Totally, yes. So, that kink in the Eurodollar curve, which is indicating that the market is still pricing transitory inflation, when that kink goes away, that is suggestive that the market is now taking sustained inflation seriously. At that point, they will be pricing risk assets for much higher long-term rates for longer. And so that is a point at which, from a tactical standpoint, investors may start to be able to become at least tactically constructive on risk assets, because they will have been properly priced along

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the discount curve. Yeah, that makes a lot of sense to me. So, for you, looking at that kink, which is kind of at the, if I'm right, the 18 to two year range of the Eurodollar curve, right. So, watching that sort of range and seeing if that kink reverts to a more upward sloping, continuous function, that would be a constructive signal to start thinking about putting risk back on.

Vincent: **01:25:29** Yeah. After financial assets dropped by 15 or 20% more.

Rodrigo: **01:25:37** I mean, when you get there, that's the signal. But right now, it's not priced in, right, because it's all about not being priced in right now. That is not -- the way markets go down fully priced in, you may start seeing a more constructive economy.

Adam: **01:25:51** Now, what about the -- So, other path, to me, that's the most bullish, most constructive, that's the best case scenario. I think you agree, right, Vince, right? The worst case scenario is that the Fed pivots dovish too quickly, the Eurodollar curve inverts or goes back to normal and the slope goes way higher, and the market then begins to price in much higher levels of inflation for longer, the Fed pivots, risk assets get a tactical bid, maybe we get a multi-week rally, while inflation expectations also surge. And then the Fed needs to go into an even more aggressive pivot three to four months down the road to fight inflation rates that are twice as high and much further out the curve than are currently being priced. Is that a fair kind of worst case path to possibility?

Vincent: **01:26:49** I'd say maybe. Maybe we got a preview of that the past few days, right? I mean, the Fed, you know, takes 25 bips off the table, market rate is 3% and people wake up and like, hold on, what's going on? Yield curve steepens. I mean, that could have been a preview. I hope you're wrong. I hope that doesn't happen because yesterday was pretty bad. So, like what you're talking would be months like yesterday.

Richard: **01:27:16** Is this kink of the Euro dollar curve what explains this apparent contradiction between the dollar index which is now almost at 104 and US Treasuries and US equities falling. So, money is flowing into US dollar assets, but the classic US-based assets cannot catch a bid or haven't been catching a bid in the last few weeks. Is this where they're going to this year and a half to two year portion of the Eurodollar curve?

Vincent: **01:27:49** Yeah, that would be consistent with people wanting, you know, buying the dollar asset but keeping duration as short as possible, yeah, that would be the consistent explanation with what you see. And I can understand why people would do that

Richard: **01:28:04** How bad do you think the dollar index can get before we see some softening again? Because it seems like we were getting lower highs. It required a lower and lower high to become a pain threshold for investors. But all of a sudden we're now seeing it rally all the way back to 104.

Vincent: **01:28:31** So, you're triggering my old demons like something I hope I wouldn't fall into which is talking a bullish case for the euro, which I know never works. But yeah, I mean, you triggered me. I'm thinking that at some point the incentive for the Europeans and the Japanese are going to change. Once you have 30% PPII, *producer price import inflation*, and your currency is falling by like 10% a week, you are destroying your manufacturing base. Like, if we keep going that path, the German car manufacturers can't get their hands on the parts either. And these are economies that live from exports. So, at some point you'll see that shift and like okay we cannot go down that way anymore. We got to be serious about it.

And my impression especially, I like the Swiss franc. I think Switzerland because of all the reserves like they can set the value of currency wherever they want it to be. They have a trillion plus in reserve, 100,000 euros of reserves per capita. So, they can just -- okay. The moment they decide to be serious about inflation, they can do something. Or in Japan, they can just go to the … of control and fix the problem overnight. So, I hope that happens at some point. Because yeah, cost of inflation is going to be too painful and you have very powerful manufacturing lobbies in both Europe and Japan. I don't know. I always overestimate the economy competency of European policymakers.

For me, that point is now and this is when you need to like, okay, adopt a strong Euro policy. But Lagarde, she was a -- how do you call that, the coordinated swimmers, the one who do the, synchronized swimming. She was a French national and she's very good at it. I don't think that is the right skill for the job. So, I think the way she approaches monetary policy is the same as she does with synchronized swimming. So, eventually once enough -- other central banks have done it, she's going to do the right thing, but might take some time.

Adam: **01:30:44** Wow. Okay, that's a good.

Rodrigo: **01:30:46** Vince, amazing. We've been at it for an hour and a half now. Did not disappoint. Thank you so much for your time, man. That was amazing. Great masterclass in all things macro and inflation. Tell us, yeah, where people can find you.

Vincent: **01:31:03** Well, Twitter is the place where people find people. So, at Vincent, V-I-N-C-E-N-T Deluard, D-E-L-U-A-R-D. If you go to my fin tweet, there is a link where you can apply for a free trial of my research which is granted to everybody. So, I write a report a week, it's available for clients of StoneX. Just get in touch with your brokers and we'll figure out a way to get you on my list. If not, you can subscribe like the way you subscribe to Economist. Maybe DM me, that's probably the best way to go at it honestly, or follow the link. And yeah, that's it. It's been a pleasure

		to be with you. I was looking forward to this as well. I think you do terrific, terrific, terrific work. And things are going to get much, much easier and better for you in the next decade.
Richard:	**01:31:59**	Thank you so much for your time.
Rodrigo:	**01:32:00**	Everybody, knock on some wood.
Adam:	**01:32:02**	I also want to mention that we've got Andy Constan on the show next week. So, actually, I think it'll be a really nice segue from Vincent's work to Andy's work. We're going to talk about how the interaction between the Treasury issuance and the Fed quantitative tightening and the roll off of their balance sheet interacts for supply dynamics in terms of liquidity and demand for asset prices in the intermediate term, and obviously get his take on how to navigate what is obviously a really tricky macro environment with tactical trading. So, stay tuned for that. Vince, it's been a pleasure. Gentlemen. Thanks again, and have a great weekend.
Rodrigo:	**01:32:53**	Bye, thank you.
Vincent:	**01:32:54**	Ciao.
Rodrigo:	**01:32:55**	Queue the music.