We're going through events that, probably no investor below 75 has gone through –

- We're going through the end of the peace dividend – some people call it World War 3 or the start of new cold war. War is always and has always been inflationary, whether a Hot War or a Cold War. Every meaningful economy is increasing its defense spending; whether in Europe, in China, in Russia, in the US. And military spending is fundamentally unproductive spending. It like spending money on a bunch of things, high priced items that you hope you never use. So that's a first dramatic shift.
- The second massive shift is, most countries are going through a very important demographic transition. Most countries are aging and aging fast. The big pools of excess labor in the world that used to be China, India, Mexico, places where women would have 2, 3, 4, 5 children per women now have less than two children per women. We no longer have somebody like China adding an additional 20 million workers to the workforce every year.
- The story of the past 250 years is fundamentally a story of humanity, always moving to more efficient methods of producing energy. You start with coal, move to whale oil, to oil, then to natural gas, to nuclear. And for the past 10- 15 years, we've decided, let's move away from all this and move towards more inefficient energies – wind, solar etc. In doing so, there's a tremendous economic economy cost and economic cost means lower living standards. And that's another big uncertainty out there.
- We have started a structural shift in the global monetary system by cutting off the biggest commodity exporter, namely Russia from the US dollar system. We are now seeing deals for oil, deals for iron ore, deals for coal being done in Renminbi, Rupees, Thai Baht. That adds a lot a lot of uncertainty in the world that we live in.
- Asides there is cyclical stuff. We have the Fed that is tightening, while on the fiscal side in the US, they're still running massive budget deficits. The second biggest economy in the world that had been locked down for three years that is reopening. Markets are talking about Xi pivot, China recapitalizing the local authorities to get local infrastructure spending again, getting rid of the red lines on real estate lending etc.

Given all the forces above, what the Fed does actually matters less and less. The Fed is tightening but, meanwhile, inflation stayed strong and growth in the US is actually not as bad. So, against all this uncertainty, one needs to be very modest.

(Louis Gavekal via Macro Voices)

You have to look at the markets and say what messages am I getting from the markets today?

- Bonds are done for. We're now entering a second year where US Treasuries are losing money and emerging markets bonds are outperforming OECD government bonds.
- Energy stocks are volatile, but they continue to do pretty well in spite of an energy price that has remained stubbornly low; which is a mystery.
- Gold has been disappointing; but, it's massively outperformed US Treasuries over past couple of years. Despite DXY up by 15% and short-term rates moving from 0% to 5%; gold has held up its position. You have a shrinking money supply in the US now. So, it is doing its broad job, sort of holding its value in the face of a challenging environment.

But, are the markets adequately pricing the assets, particularly Gold for uncertainty and shock events?

There are two kinds of crises in markets - You have exogenous shocks and endogenous shocks. Exogenous shocks are like COVID crisis that comes out of nowhere or say World War 1. And then you have the endogenous problems. Demographics is an endogenous problem, it's something that evolves over time. Energy transition is an endogenous problem, again something that evolves over time. Shift in the monetary system is also an endogenous shock that moves over time. Market participants tend to position themselves for endogenous problems and not exogenous problems.

Practically no one is positioning themselves for World War 3. Its like what's the point of positioning yourself because if it happens, well, you will probably dead anyway. And if it doesn't happen, you've wasted capital, trying to protect yourself from it. And if exogenous events do happen people expect Fed to step in. It's like, markets fall 30%, get the change in policy, change in monetary policy, change in fiscal policy etc. That's why people aren't loading up into gold. People are slowly positioning themselves for the endogenous shock; but, nobody's positioning themselves for the World War 3.

What's coming next? Where to look now?

First casualty in war is truth. During war, propaganda efforts go through the roof, etc. And having all that not clouded your own judgment is extremely challenging. The only winners in a war are the people who stay out of the war. And wars again destroy capital, destroy people, either because they kill them, or they leave them mentally damaged or physically damaged.

(Louis Gavekal via Macro Voices)

So, the best thing you can do in a war is, see who is not participating & that's where to invest. And today, in this conflict between Russia and the Western world, most of the emerging markets are staying away. So, this is why emerging market bonds are outperforming, emerging markets Ex-China equities are outperforming. Every time USD went up, every time the Fed raised interest rates, every time oil prices went up, or energy prices went up, markets like India or Indonesia would hit the wall. Indonesia has always been the redheaded stepchild of markets, whenever something bad happens, they are the first one to get hit. Last year, global equities down 20%. Indonesian equities up, Indonesian Bonds flat. In essence, let's just invest in places that aren't involved in the war – Chile, Brazil, Indonesia or South Korea. Only way you could preserve capital in World War 2 was investing in Switzerland/Sweden because they stayed out of it, or investing in Latin America back then.

Whats happening to Energy markets especially after China re-opening?

Most market participants expected energy markets to rally massively post China re-opening; but, this hasn't happened. Reality is, today in China, you're still have about 300 flights a day. Pre-COVID you had 1300 flights. The reason for that is, they lost a lot of pilots, lots of pilots lost their licenses because they didn't fly enough hours during COVID. So, they've run out of pilots, you got to retrain pilots. Another issue, in terms of traveling, at least abroad is most Chinese People's passports have expired during COVID and couldn't get new passports during COVID. May be that's a delayed effect, but if it doesn't happen in the next three to four months, we'll have to consider the situation.

A second possible option to explain what's happening in energy is the energy market of today is very different. Russia is selling oil off market, no longer in US dollars, to China, to India, for very long-term contracts, at big discounts. Interesting question is if the rest of the world pays, let's say, $75- $80 for their oil, but China and India, get to pay $50 or $55 for their oil, and that too in their local currency, then what happens to the price of oil or to their local currency? It means that these currencies, if they get to buy oil at 30% discount, then it means that these currencies are 30% cheap. So, over coming years either oil prices adjust higher or Asian currencies adjust higher.

How is the globalization shaping up?

We are living in a world that's deglobalizing, but not in the way people think. When people think of deglobalization, they think of the Nike supply chain or the Apple supply chain. But if you look at China's exports to the US; in 2020, it was 30 bn a month, today, it's 50 bn a month. So there's still tons of trade flowing.

(Louis Gavekal via Macro Voices)

Real deglobalization is occurring in terms of financial flows. That's the important deglobalization. It's the fact that US pension funds are now being told by US government, they should not invest in China. You have Chinese institutions that now think maybe US Treasuries are not as safe. And again, the big difference is the US runs twin deficits of 10% of GDP and China doesn't. So the marginal savings in the world are happening in places like Saudi Arabia, Kuwait, UAE and China.

Recession in 2023?

Where in the world are we talking about this recession, because in Asia, there's no recession, Chinese growth is re-accelerating. This is a huge massive shift that people haven't adjusted their portfolios to. Four or five months ago, everybody thought that growth in China could be negative or 1 - 2%. And now all of a sudden, it's probably going to be 5.5 - 6%. And when China does well, emerging markets do well. And when China does well, Japan tends to do well, so does South Korea. Europe comes along for the ride, because at this point, Europe is just a leveraged play on emerging markets. Europe basically sources most of its growth from emerging markets.

You're really left with the big question of the US. The US which is the one major economy that will not benefit from China's rebound.

Can we see a recession in the US?

US has high interest rates, but whom does that impact? That impacts all private equity guys, commercial real estate lenders etc. But most of the consumers are still not feeling the impact. 99% of Americans today have a mortgage rates that is lower than the current mortgage rates. Lot of people are paying 3-3.5% on their mortgage loans. Growth in the US isn't going to be great, but it's not going to be that bad.

(Louis Gavekal via Macro Voices)

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