Anatomy of the US Dollar End Game Part 4 of 5

Hosted by Erik Townsend and starring Jeffrey Snider, Mark Yusko and Luke Gromen
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Luke: If you were moving in that direction you'd expect to see things like – you would need the new reserve asset, you would need that to move to the right people, right? A big problem a lot of gold investors make – gold bugs, however you want to call it – is everyone wants to think of gold as actually like a market asset. It is not. It is a political asset. And so –

Jeff: And it's concentrated in very few hands. It's not distributed widely.

Luke: Exactly, right? So if you were going to resolve this issue the way I described, the way the World Bank hinted at, the way the IMF talked about, you would expect to start to see things like gold flowing to those nations. If that's going to be a new reserve asset, then the United States needs to have a lot. The Europeans need to have a lot – and when I say the Europeans, the Germans need to have a lot.

And what have the Germans been doing? They've been asking for their gold back, haven't they? You would need the Chinese to have a whole lot. And how do you do that? One way to do it is you make sure the price of gold doesn't move in dollars, because Americans don't buy something that's not rising – it's cultural. Chinese buy more. Indians buy more when it falls. Americans, they won't buy something that's not moving in price.

In addition to these very powerful institutions, Western institutions advocating for these things, you're seeing actual movement since they advocated for them of things that would support that. Now, again, is gold it? Is it gold going into the SDR? Is it SDRs getting revalued much higher and that filters through to gold? I don't know. But it has to be a neutral settlement asset to fix the system.

And – to your point, Jeff, of we don't know how big it is – that just tells you how big it's eventually got to be. Like, you know, what we've been saying is gold is the credit default swap trade of this cycle.

Jeff: Right.

Luke: Like it's going to be thousand, thousand, thousand, 1,200 thousand, people playing with the paper back and forth Europe. And then you're going to wake up one day and it's going to be like 13 thousand, have a good day. And physical only, by the way.

Because if you look at, the GLD, there's all this language – hey, sorry, we can cash settle you, we'll cash settle you, you know – It'll be like CDS, right? If Goldman's long paper gold when it happens, everyone long paper gold is going to get paid. If Goldman and the systemically important banks are short gold when it happens, anyone who owns paper gold ain't gonna get paid.

Mark: Well, that's a problem for JP Morgan, isn't it, since they're short theoretically two times the world's gold production.

Luke: Theoretically. The way I think it'll really work if something like this happens we'll wake up and JP Morgan and Goldman will be like, hey, in this room we have all this physical gold over here, we never knew we had it –

Jeff: Let me throw out an example which actually I think is kind of similar but not quite. The United States, some of the United States officials are trying to revalue the interest rate swap market. Because they have lots of problems with LIBOR – and we can get into LIBOR's issues – and so they decided they're just going to switch to the US Treasury repo rate, which has its own set of problems too.

But the way that they're proceeding is that they know that they can't just do this tomorrow. This is something that they're not even going to discuss until 2020. It's not something you could just show up on any given Sunday and say, okay, we used LIBOR yesterday, we're going to use the repo rate today. It's something that, because of the way the markets work – again, it gets back to institutional inertia – you can't just violently change something over a short period of time and expect it not to be disruptive.

Luke: Oh, it will be disruptive, but – look at the last major currency transition we had with the dollar, in the petrodollar. There's a great book called *Century of War* by William Engdahl. He does the groundwork where the price of oil was raised 400% in six months. And the cover given was a war. And if you go – he has transcripts of conversations with the Shah of Iran at the time where they asked him, why are you raising the price of oil from $4 to $11 overnight? And he said, I don't know. Go talk to Henry Kissinger.

Jeff: Exactly.

Luke: So, is it a big change? Absolutely, it's a big change. But we're not talking about interest rates and financial contracts of every single consumer loan out there –

Jeff: No, but we are. If we change the reserve currency, don't think for a second that doesn't change how global banking works. It's a much bigger task than just saying, okay, well, China's going to start revaluating oil into CNY or gold or whatever else. It changes everything. To change the reserve currency, even to say that the dollar's going to be a co-reserve with RMB or something else, that changes everything. And I think that's one of the things that's holding everything back.

Luke: No, all you're doing is changing the ratio of oil to gold. And then you let the market do the rest. The markets will take care of the rest. Think about that. So let's say – let's run through it.

You have 1,000 barrels an ounce now. We wake up tomorrow and gold's 1,000 barrels an ounce. So what does that imply for gold, for oil – you can choose. Let's pretend that oil stays at $50 and gold's at $50,000. What do we do? The first thing we do is we go out and we buy oil. Oil's going higher.

Jeff: Yeah, but how? How? You're getting into the mechanics of something like a gold price rule. How does the price of gold or how does the price of oil be rigged at that point?

Luke: Oh, they can make gold do whatever they want. They've been doing it.

Jeff: Seriously, how do you keep a commodity price on a global market at a particular price?

Luke: If you look at the gold/oil ratio over a long period of time, it's been remarkably steady. You just have to reset that. What we're talking about is a – what has backed the dollar for 50 years? Oil, right? All we're talking about is devaluing the real currency here. Everybody thinks the value of the petrodollar is in the dollar. It's not. It's in the petro.

Jeff: Right. Devalue it and you're doing something. You're changing the entire underlying assumptions of the system as it is today.

Luke: No, you're just doing a big currency devaluation. That's all.

Jeff: Exactly. And that's not some small thing.

Luke: No, but it is exactly how it worked in '74. Nixon came on and said, that's it, have a good day. And then, you know, we're six-months timeframe, OPEC went from $2.50 a barrel to $11. You go back to 1933, how did the Depression end? FDR walked in and said, hey, yesterday gold was $20, now it's $35, have a good day. The dollar's down 65%.

Jeff: But that was after all the damage had been done. I mean, he walked in at '33 and the US economy was decimated. It's not like he just fixed everything.

Luke: I totally agree. And 65,000 Americans died of opioid overdoses last year. That's more than Vietnam, Iraq – we're there.

Jeff: No, I agree. Again, we're on the same page there. It's how do we get from A to B – I don't think it's as simple as saying we're going to just devalue the dollar tomorrow. And we're going to start rewriting all our contracts in different terms.

Luke: Why do you have to rewrite –

Jeff: You can't do that. You've changed the value of the liabilities under – that support everything.

Luke: There's no change to those liabilities. Why would you have to rewrite any of those contracts?

Jeff: There are. Because if you went tomorrow to a gold standard –

Luke: It's not a gold standard, it's not a gold standard –

Jeff: Everything would have to be revalued to the ability of those institutions to be able to acquire gold.

Luke: No, no. This is not a gold standard. This is not a gold standard. This is simply creating a neutral reserve asset.

Jeff: Same thing. Again, you're changing the value of all the liabilities that are currently denominated in dollars.

Luke: Yeah, you're writing them down – "sorry, you lose".

Jeff: You can't just write down the value of all of these assets and liabilities that underpin the entire global banking system in one fell swoop without bankrupting the whole damned system. I think that's the – I mean, look, we have this slow drip of erosion here which is bad. You point out the opioid crisis, which is a valid criticism. The system doesn't work. But changing everything at one fell swoop might make it worse.

Luke: It'll make it way better, because, again, what would you need to rewrite under my scenario? Because, again, it's not – you don't have to own gold. Gold is just $50,000. This is not all the banks need to own X amount of reserves in gold –

Erik: Let's back up before we even get – because I don't understand the premise of your supposition, Luke. You're saying, what if the Saudis announced tomorrow that the new price of oil is 1,000 barrels per ounce of gold. Why in the world would they even consider doing that when today they can sell the oil for $55 and take the $55,000 and buy 42 or 43 ounces of gold?

Why in the world would Saudi ever do that? I don't understand the premise of what you're trying to say.

Luke: There's two reasons. (#1) because up until about two years ago, they would have gotten a visit from the US Marine Corps, number one, for doing that. After Russia – remember we were going to get Assad and Russia said no you're not? And we said yes we are. And the Russians said no you're not.

I think that was very enlightening to a lot of people around this country, or around the world. For the first time ever, the Saudi king just went to Moscow. Russia proved that when they say "no you're not" they can back it up. So I think (a) that changes it.

More importantly, Saudis – the market would immediately shut down, right? That's effectively what you're talking about here. It's not been in their interest as long as they are getting real value for their oil through the dollar system – and they have. This system has worked. To be clear, this system worked great for them.

Where the system breaks down is where it gets to, hey, you pump your oil for me and I will give you Treasuries that are yielding negative 2 on a real basis. Again, Saudi faces the same problem that Russia does. Which is on this system Saudi will pump all their oil, and they will have a bunch of paper and that paper will be worthless. And that is not a place you're going to want to be when all the oil's gone and you're sitting on a pile of worthless paper yielding zero.

Erik: If they really wanted to do this, considering that at $55 oil prices that's about 23 barrels of oil per ounce of gold. Why in the world would they even consider a number like 1,000? Why wouldn't they say, from now on we don't want dollars anymore, we want 25 barrels of oil per ounce of gold? A little bit of a discount off the current price.

How'd you get from 25 to 1,000?

Luke: There's two reasons. (#1) it's not an economic thing. And this is what I meant – a lot of market guys, why not just put the bid higher? It's a political question. It's the modern-day version of going to the Shah of Iran and saying, why did you raise oil prices from $3 to $11? And the answer was: go talk to Henry Kissinger, I don't know. The answer was they needed to make oil big enough to back the dollar under the petrodollar system.

Same thing here.

The secondary answer is we look at gold as $1,200 or whatever the digits say on our screen. If you look at the value of gold – people in the East look at the value of gold. They understand the value of gold better than Americans do.

And what I mean by that is, in 1980 – under the Bretton Woods system, through most of the petrodollar system, the market value of the United States' official gold as a percentage of US foreign-held Treasuries outstanding ranged from 20% to 130%. So forever. And that was as recently as 1989, maybe 1991 after the wall came down.

US official gold still was, at market prices, 20% of our foreign-held outstanding debt. That percentage is now 4%. And so, people understand that. Not in the United States, but Easterners understand what's happened to the real value of the dollar in real money, in gold terms. The question is not is it 25 or is it 26 or 28?

The real number is, where it's fairly valued, is multiples from here. Gold would have to rise five X just to get to the bottom of the hundred-year range. It would have to rise 30 X just to get to where it was in 1980 when there was actually a dollar crisis.

So (a) it's a political decision, not a monetary decision. And you would need to make gold or SDRs – or gold and SDRs – big enough to settle trade as a reserve asset. And (#2) everyone knows gold is – again, people who aren't in America understand that gold is wildly undervalued relative to the US's debt position, relative to the hundred-year history.

It's a big political change. You would still be – your dollar contracts, you'd still be paying dollar contracts. It's just that those dollars would buy you a lot less oil and a lot less gold. And if you do that, you're going to start changing trade flows. Look, the US dollar collapsed against oil from 2000 to 2008. From 2009 to 2016 the US trade deficit in oil collapsed. We started producing a lot more.

Is there anybody who thinks that devaluation of the dollar against oil was a bad thing?

Erik: Well, you still haven't explained if – what you're doing is bypassing the dollar, that's obviously going to alienate the United States. Why in the world would Saudi Arabia consider doing such a thing when they can't possibly face the United States on a military level.

Luke: Because they're being forced to by Russia and China. Because, basically, that's where it gets back to why has it taken so long to – Look, China's driving the boat here.

Jeff: Yeah but that isn't exactly a great way to convince the world to come on to your side. And I think it speaks again to the difficulties in trying to do something like this. There is no consensus.

I agree with you, Luke, to a certain extent, that Russia and China are trying to do something. I just think that they're very limited in the capacity for them to be able to carry out this thing and that's what's taking so long. Is that RMB is an alternative to the dollar, for a lot of reasons. And I think a lot of it has to do with the economic risk of China.

Luke: Oh, it's not. It's absolutely not. Oh, it's absolutely not. There's no question. And that's where the gold comes in too. Nobody trusts the renminbi, no one's going to hold the renminbi. They're going to pay in renminbi, if you want to, or you can pay in dollars if you want to. But in renminbi, I can show up in Shanghai, or I can show up in Hong Kong, or I can show up in Dubai, and I'll convert those renminbi into gold.

And the gold will float in price. And, by the way, China learned from the United States' mistakes. The United States made two mistakes with the Bretton Woods gold standard: (#1) they fixed the price, and (#2) they actually agreed to let US gold settle the stuff.

The Chinese have rectified both. They're not promising you that the yuan they pay you for your oil is going to get you X amount of gold. It floats, number one.

(#2) Gold in mainland China can't leave mainland China. So if it can't leave mainland China, then when Russia shows up with renminbi in, say, Hong Kong and says I want gold, where's the gold come from? Gold comes from UK, gold comes from US.

It's very, very elegant. Basically, the act of showing up with renminbi from selling oil to the Chinese and having any of it converted into gold begins to put irreversible pressure on the dollar through the gold link. Through the physical gold link.

Because now you've got three choices. If Russia shows up in Hong Kong and says I want gold for my renminbi, then there's three choices there.

(#1) yes, here's your gold and we're going to let the price – you bidding for gold with renminbi drive the price up in dollar terms, which is a devaluation of the dollar.

(#2) we're going to let you have the gold, but we're not going to let the price of gold rise in dollars when it moves from the US to Hong Kong, we're just going to give you the physical gold and we're going to increase the paper leverage, and so the price doesn't move.

Or option (#3) is no, you can't have the gold. And, again, the no you can't have the gold, that's a point where China and Russia say, okay, that's a default, we're free-structuring our own system.

And that type of thing has some of the same drastic implications. But the point is you look at the flows of how this is set up. It's extraordinarily elegant when matched with what's going on with the US fiscal side – it's just a slow-squeezing noose.

Mark: I think at the end of the day, because the big thing is we're coming back to, you know, gold – so many people think of gold the wrong way. They think of it as a commodity, but it's the one thing that is both a commodity and a currency.

Luke: Yeah, it's a 0%-yielding bond of infinite duration.

Mark: And if it is viewed as the ultimate currency – and what's really amazing, over the last 25 years it's outperformed every other currency on the planet. And it's not by a little bit. It's by a wide margin. So it's the one thing that isn't racing to the bottom.

And whether it's been held down artificially or not, which I actually agree it has, it's still held up better than any other currency on the planet made of paper. So, as we think about this next step in the dollar, and kind of bringing this back to our mission here – which is dollar up, dollar down, dollar sideways, dollar losing its hegemonic status. It's clearly on that path whether it's displaced by the ultimate currency, gold, or this other currency, the renminbi – that we could probably talk about for another four-five hours, but we've probably got to get to the end of this presentation.

Luke: Yeah, and I think it's important. The dollar is not going to be replaced by gold. Gold is going to be a reference point for the dollar. Gold is going to be a reference point for the renminbi. And what you end up doing is you end up going back – the way the world's economy worked for thousands of years, was a balance of payments–centric system.

In other words, the guy with the biggest trade surplus and the guy with the biggest reserve balance had the best currency. And for the last 45 years we've had this perversity where the guy with the worst trade balance and the guy with the lowest amount of reserves has the best currency.

And we're at the end of the useful life of that. And all this will do is rebalance that through that neutral settlement. (Again, when I say gold, you should also hear gold, or SDRs, or SDRs in gold.) But what it implies is that the dollar has to collapse against SDRs/gold. The yuan has to rise against SDRs/gold. The Euro has to rise against SDRs/gold. The yen has to rise against SDRs/gold. And the pound probably has to fall against SDRs/gold.

And how they net out against each other, we can have a discussion. But the gist of it is through that SDR/gold link that will be enforced by the value of oil that that SDR/gold gets you, because through each nation's balance of payments you will have moved the global economic system, still using the same currencies, still able to use all the same contracts, back towards the balance of payments–centric currency system that the world used for basically all of mankind's history up until the last 46 years.

Mark: Agreed.

Erik: Luke, I think we left off on Slide 9. Why don't we get back into your slide deck?

Luke: Absolutely. So the net of it is – you can see, you know, the narrative was that the dollar shortage got worse purely because oil fell. But what was interesting (you can see on Slide 9), as a result of the actions that were starting to be taken, vis-à-vis non-dollar oil pricing – a number of different oil producers were already seeing dollar shortages with oil still in the $95 to $100 per barrel range in late third quarter 2014.

I think, importantly, if you go to Slide 10 and 11, US investors have largely ignored all of the preceding geopolitical moves by China and Russia. But US officials began sounding the alarm in 2Q14. There was – Charles Duelfer is a guy who spent over 25 years in national securities agencies, government, policy development. He was big in rebuilding Iraq.

And he said look at the world, or even just the US, from the position of China. What makes the US a superpower? It's not our military. It's not our nukes. What really gives us leverage is the dollar.

In the last financial crisis, we escaped largely by printing money. Other countries can't get away with that without causing massive inflation. The former Chief of Staff to US Secretary of State Colin Powell gave a speech late 2014. He said essentially the same thing. Gold's being moved in sort of unique concentrated and secret ways.

Bejing and Moscow are doing it and what they're trying to do is get around the dollar. The supposed strengthening of the dollar is really a false impression. They want to use Putin and others' petrodollars, oil power, petro-yuan etc., to effectively create a run on the dollar in a similar manner in which Dwight Eisenhower did to the British in the IMF back in the '50s.

You know, it's really fascinating, what he's really talking about. As we go to Slide 13, jumping ahead a couple, what China, what Russia, and what these American officials are all referring to is, if you look at the US international investment position as a percent of GDP, this has never been inflationary to the US.

US deficits have never mattered. But it has been inflationary to Russia and China and the rest of the world. It's only because of the dollar's reserve status.

So then the question becomes: What happens to the US if global central banks stop financing that net international investment deficit? And the answer, as seen here on what we call this "death spiral" – I don't love the phrase because I think it's too hyperbolic, but I can't come up with a better one.

But the gist of it is you get a slower US economy, foreign central banks aren't lending to the US anymore so the private sector has to fund it, this drives LIBOR up, this drives the dollar up, the private sector is crowded out, that then slows the US economy, which then drives a drop in tax receipts. And you wash/rinse/repeat until either the US nominally defaults, until the dollar is massively devalued, or until the Fed implements helicopter money.

Okay, that's a what-if. Well, if you go to Slide 15, the what-if began happening in 3Q14. Deficits began to matter again for the first time for the US in 70+ years.

No one investing today was even alive the last time US deficits mattered.

Once this happened, we started writing about it. And what we wrote last fall was that, once global central bank FX reserve growth – you know, basically once global central banks stopped sterilizing dollar deficits – the US had three options.

They either had to raise rates, regardless of what the US economy was doing to try to force foreign capital back into Treasuries. They could accelerate efforts to try to force banks, pensions, money market funds to buy Treasuries. And also push costs of their biggest expenses like health care onto US citizens. Or the Fed could step up and just buy the whole – finance the whole deficit.

If you go to Slide 17, 35 years, you can see Option 1: Fed must raise rates regardless of what the economy's doing to try to drive capital into Treasuries. First time in 35 years the Fed was raising rates into a collapse in the growth rate of US tax receipts. Why are they doing that?

Option 2 on Slide 18 – US government accelerates its efforts to force banks, pensions, money market funds, to buy Treasuries and also force health care costs onto consumers.

Go to Slide 19. You can see banks buying has been totally overwhelming Chinese and Japanese selling of Treasuries beginning in 2013.

Oh, and Jeff did a great job of highlighting how the Chinese began scrambling in 2013–2014. The US has been scrambling since 2014 as well in its own right, is what this shows.

You can see very different behavior on Slide 20. Back to 2008, any time LIBOR rose, the Fed supplied liquidity. They used swap lines QE2, swap lines QE3. All of a sudden in 3Q14 LIBOR starts rising and the Fed decides they're going to chase a rise in LIBOR with rate hikes. Why the different behavior?

Option 2 again. You can see, as Americans have to actually pay for their own health care instead of it being financed, essentially, by global central banks stockpiling Treasuries, you see substantial inflation rates in health care plans in the United States.

Now as they were implemented, if you go to Slide 22 – Option 1, Option 2 – they drove a massive short squeeze in the dollar that began in 3Q14. I mean, you saw the dollar rising a bit, but it really took off like a scalded cat in 3Q14.

Option 1, Option 2, the US scrambling – it can all work, and it did work. But it only works until the moment when the strong dollar and the rising LIBOR begin to choke off the US government's tax receipts. And that's when the "death spiral" (shown earlier) will begin to accelerate. And that moment began in 3Q16. As you see on this chart, US deficit rose for the first time since the Recession in 3Q16.

You go to Slide 23, a troubling symptom of the accelerating "death spiral" is that US federal deficit is acting as if the US is in the depths of a recession, despite being the peak of the economic cycle. You can see fiscal '17 – normally when you have a second straight year of an increasing US federal deficit outright and as a percent of GDP, you're at the bottom of the cycle. Last time it happened, the second year was fiscal '09. The time before that, the second year was fiscal '02. The time before that was fiscal '91. But it's happening at the peak.

Another troubling symptom of the accelerating "death spiral" – I thought this quote by Lacy Hunt & Van Hoisington last month was tremendous – "deterioration in the budget deficit of this magnitude is unprecedented in a late-stage business cycle expansion." We've never seen this before.

And the problem is that, suddenly, for the first time in at least 20 years, an everything bubble isn't enough to drive sufficient tax receipts. You know, you look at the dot com bubble, trailing 12-month tax receipts up 12%. Housing bubble trailing 12-months up 15%. Shale bubble trailing 12-months up 13%.

Everything bubble and they're down? Are you kidding me? Like, it shouldn't be happening.

And no one's paying attention to it.

I mentioned this in a couple of presentations. If you go to Slide 26, historically, once tax receipts drop, the US on a year-over-year basis steps have been taken very quickly to weaken the dollar.

And this, to me, is one of the key timing mechanisms, I think – you can see the short arrow shows you where it went down to about a down 3%. That's sort of a random number I picked. And then the big arrow that follows is the weakening of the dollar. It's an inverted dollar. And it's, same as last time, it basically hit that point and shortly thereafter, nearly tick for tick with the weakening dollar, tax receipts improved.

Slide 27, Treasury issuance is going to have to increase enormously in coming years, while foreign central banks aren't stockpiling Treasuries anymore. In theory, this sets up a serious Treasury supply/demand mismatch where yields should increase, should be dollar positive. It should exacerbate the dollar shortage.

The challenge, though, is that – we're saying, look, it's not different this time, because the last time the US's fiscal situation was this desperate –

Look at November 1941, renewed deflationary forces ten years into a secular debt deflation. It's an easy trade. You buy ten-year Treasuries, you buy dollars, lower yields are coming. And then the Japanese bomb Pearl Harbor and you have a backup in yields 50 basis points. And then the Fed says, hey, we're going to buy every ten-year Treasury you issue at 2.5%.

And you go to Slide 29. You say, how'd that work out? Well, the good news is, if you owned Treasuries you didn't lose any money. You can see right there, the blue line over those nine years, you ended up, whatever, that's $1,000, the price of the movement of $1,000 over that course of time. The bad news is that you lost 85% of your money against the S&P and you lost 75% of your money against US CPI.

It is not different this time. In World War II, what the Fed did was they controlled the price of money and they let go of the quantity of money. It appears to our eyes that global central banks have been effectively doing the same thing today, as you can see on Slide 30.

On Slide 31, ever since that 3Q14 timeframe, the hand of God has refused to let the ten-year Treasury go over 2.6%. Maybe it's Keyser Söze . But, boy, every time it gets near 2.6%, something happens, weaker economic data? Just whoof, it doesn't get over there. To us it's starting to resemble what happened in 1942 to 1951.

And the bottom line for us is: The dollar shortage is real, it's positive for the dollar – until it's not. Our case is that the evidence increasingly suggests that the dollar shortage got intense over three years ago, but that we're not getting into the "until it's not" part of this movie.

The US needs to either get China and Russia to stop doing what they're doing; the US has to weaken the dollar to increase tax receipts; or the dollar has to have its reserve status ended on the US's terms.

What's interesting, again, to kind of tie in back to the geopolitical side – if you go to Slide 33 – Putin's talking about this calculus. He refers to the US massive government debt as a mine in slow motion – that's the "death spiral".

Are they going to devalue the debt in the future? Nobody knows.

The IMF and BIS are talking about that the dollar needs to be weaker. And, of course, timing.

Slide 35, I think, really speaks to timing. Recently, arguably the most respected central banker of his generation made what I felt was a stunning admission and then abruptly resigned. For a guy of Fischer's caliber to say that the US is losing its status as the world's hegemonic power – in the FT – that's not something central bankers say. They just don't. Especially one of his caliber, his experience.

And then, like, three weeks later he resigned. And then of course we've had Dudley leave since, we've had Yellen – she just resigned yesterday from any other positions after Trump replaced her.

If you go to Slide 36, Fischer had experience of this. He lived in Northern Rhodesia, which was a UK protectorate when they lost their – sort of the coup de gras was applied to the UK's reserve status as it faded out. You can see on a real basis, the pound was a one-way trade.

If you go to Slide 37, you can see what it implied for UK retail prices, which is that just up and to the right at a 45 degree angle – inflation, inflation, inflation, inflation. And the question is, if we're right, how do you (and this speaks to my point before) how do you sell dollars?

The IMF said the US looks like an emerging market. They said it eight years ago. How do you get out of the dollar like you would get out of Argentine pesos? The only thing big enough to take dollars is the US market.

And so, to us, it's super-interesting that Trump gets elected and look what happens. You have a clear breakout on a 25-year chart of the S&P over TLT. This is the oh my God, they're going to print it all, get me out of debt, they're going to run the World War II playbook again. They're going to inflate the heck out of this.

I also think you're starting to see FX markets beginning to pick this up. The dollar no longer seems a sure thing in the age of Trump (Slide 39) in the New York Times.

Couldn't the US go to war against Russia and China to stop what amounts to an act of economic war against the US? Absolutely they could. But Americans haven't funded their own wars in 70 years. They don't remember what that entails. And that is extraordinarily inflationary.

And so our bottom line is that, all else equal, the Eurodollar system as structured suffers from a significant shortage. I totally agree with Jeff's conclusion there. All else equal should drive significantly higher dollar.

But we don't think all else is equal. We think there is this unacknowledged hot currency war going on that's putting intense pressure on the already poor fiscal position of the US government and highly financialized economy.

It really comes down to one thing in terms of the dollar. You've got the Euro, you've got the yuan, you've got the dollar. Which do you think is going to hit the wall first? And our reading of the tealeaves is that the dollar's going to hit the wall first.

I would lastly go to Slide 46. I do think it's interesting – if we think about the Eurodollar system, not in terms of incipient dollar shortage, but instead as a measure of the amount of base money that must eventually be created to avoid a Treasury default. Then you start thinking about – flip the logic in your head, and I think this chart is totally apropos of what that implies.

Unless we think the US will be allowed to nominally default, this is what stocks have to do. I'm not saying they've got to go up 5 X in a year, but they've got to go up a lot, generally pretty consistently. I'm not saying you can't have corrections like Venezuela had from 40K to 30K for a cup of coffee on its way to 100K.

But this is an EM phenomena. And the US has been transitioning for 15 years to emerging market status. So I'm not sure that it's different.

Erik: I'd love to hear Jeff's reaction particularly to the point you make on Slide 32 where you say the US dollar shortage – and you agree, there's a shortage there as Jeff has described – is a positive for the dollar "until it's not". And you think that we're at the point where it becomes not.

Jeff, do you agree with the premise that at some point the shortage stops being a positive for the dollar? And how do you feel about whether or not now is the time that it's not anymore?

Jeff: I agree with Luke – the "until it's not" part is actually the part that we really need to focus on. That's really the point here. I don't necessarily believe that it's a binary option. I think there's a whole range of things that could happen. A few of them maybe even positive.

If Janet Yellen ever got her head out of her ass for more than a few minutes, maybe there was a possibility that we could have had a Bretton Wood II type of conference where China, Russia, the Saudis, everybody could have sat down at a table and said, this thing just doesn't work and we need to design a system that does.

And that's still, I guess, a possibility, depending on how long the Eurodollar system continues limping along as it does. And I agree with Luke there, and Mark too, that the clock is ticking here. We're already at least a decade into it. And I think Luke is very – go back to even before 2007. Because some of the economic consequences of the Eurodollar system, especially for the United States in the middle 2000s, were not good.

And so for a lot of places, including the US, and I would include Europe too, the clock has been running for more than a decade. So it does make me worried about how much time is left for this thing.

I mean, let's say we go through these up and down cycles but what happens if we get into a fourth down cycle? Maybe that's the one that breaks it. Maybe that's where Russia and China say, okay, that's it, we've taken as much as we possibly can and we need to do something else.

I think what gives me pause in believing in that scenario is what we talked about before, that I don't think it's an easy thing to do to just replace the dollar, or even just parts of the dollar system, overnight. There's a lot of infrastructure and logistics that need to take place.

I'll give you an example. Cross-currency basis swaps in 2015 and 2016 (and again recently) have been trading at very negative premiums, to almost imply a dollar shortage. So if you're short, say, negative 40 basis points in premium against the Japanese yen, and all of a sudden tomorrow we're going to start revaluing all oil contracts (or even just Chinese oil contracts) in gold or RMB or whatever else that it might be, what happens to the value of that basis swap?

The value of the basis swap is going to go positive. Their premium's going to go positive. Which is going to decimate the American bank on the other side supplying the dollars. Because the value of that contract if they've extended it to a Japanese bank is going to fall through the floor.

And there's not just a few of these out there. There are trillions upon trillions of these contracts out there that would have to be rewritten, revalued, re-liabilitied (if that's even a word; it is to me), that would all have to be done under whatever – any, the smallest minute change to the reserve system.

Because the way the reserve system – it's more than just values of currencies. It's more than just politics. It's logistics. It's how things actually get done. How do we actually trade goods between Brazil and China, for example? There's a dollar in between there. And there's a dollar infrastructure in there.

Luke: There should be capital underlying those contracts, right? There should be a winner and a loser, right? Like, at the end of the day –

Jeff: There's none. That's the problem.

Luke: So they're just spec–

Mark: That's fascinating.

Luke: So there's no capital underlying these?

Jeff: There's nothing. The Eurodollar system is non-reservable for that reason. Because capital slowed it down. To actually have to count physical Federal Reserve notes or bars of gold – those are restrictions that the Eurodollar system didn't want.

That's one of the reasons why it started out in the '50s and the early '60s as sort of a hidden system. Because the bankers who were trading in those, particularly merchant banks engaged in global trade, didn't want authorities to find out that they were doing all of this ledger money behavior. Because it would slow it down.

And eventually what happened was central banks said, you know what, this is a damned good idea, we're going to participate in it too. And so it evolved over time, especially in the '80s and '90s, into more of a derivative system with nothing underlying. It was assumed that that didn't matter. Until 2007.

So there is no actual capital in these flows. I'm a bank in Brazil, you're a bank in China, we both have computer screens that are linked by a network, and if your numbers come up as the same as what my numbers say, we're good. Something happens. That's all it is. It's a ledger system.

Luke: It gets into the notional question, right? I mean, it says that there's $800 trillion notional, but the net is only some ludicrously low number, right? In theory, the basis swap that I would get my face ripped off on one side, I have something offsetting on the other side, as I'm on the right side of that trade.

Jeff: Yes. Exactly. And that's the issue. But is there? If you change the system – this again is what happened in 2007–2008. A lot of those funding trades everybody thought were netted out properly. In fact they had all sorts of complex math to make sure that it was.

Except that it wasn't. Because the math is always flawed too. You kind of adopt mathematically and quantitatively to the real world that has tail risk.

Luke: Oh for sure. And your point on Bretton Woods is fascinating, right, because the Bretton Woods II. Because –

Jeff: Okay, so a devaluation of this type would be a tail risk.

Luke: If you recall, what was the alternative option at Bretton Woods II? Ironically it was John Maynard Keynes wanted the bancor. He wanted a neutral reserve settlement asset that floated against all currencies. That's all I'm talking about.

Jeff: Yeah, exactly.

Luke: That's all I'm talking about. Gold or SDRs is the bancor.

And if you think about it that way, at some level – I look at some of the netting of derivatives that have taken place over the last ten years and some of the theory putting them on exchanges or what have you. I've talked to derivative guys who are, like, my life is boring because of the regulations we've put in place for some of this stuff.

You don't know what the problems is. To your point, you don't know what the problem is. I don't have a lot of sympathy if you're not hedging your book right, but it's difficult to know on all these things. And the managements have no idea, from what I've been told.

Jeff: Don't forget, too, hedging, how the risk system works and the derivative system works is there's only a handful of players. It's incestuous.

In other words, JP Morgan's laying off risk to Deutsche Bank, who's laying off risk to Morgan Stanley, who's laying off risk to JP Morgan. That was one of the problems in 2007-2008, and again in 2014.

One of the reasons why the dollar problem was so severe was that, once those guys started cutting back in their dollar business, there was no place to lay off risk. Because they *are* the dollar business. So if you impair one you impair them all. I think that's a big problem –

Again, I agree with you the system needs to change. It needs to transition. If we could ever figure out how to get to point B, that's a very happy day for everybody. The whole world. It's a great day.

I'm just concerned about how we get from A to B, and I think there's a non-trivial chance that in trying to get from A to B in some of these other – let's try a different kind of reserve system – it actually makes it worse. As impossible as that may seem, given how bad the last ten years has been, it can actually get worse.

Luke: I guess my point is that I think Russia, China, Iran, India (to a lesser extent), Japan, South Korea, a number of – they're moving in the Bretton Woods II direction without us now. I think that's what's happening. And when you hear these, we're being left out. And you can see by the actions – I think we talked about it before.

When we went to QE whatever in 2012, China's like, that's it, we're done here. Give us the gold. And that's when you really started to see some of the sanctions and some of the other – The authorities have been talking about it for –

You had Zhou in 2009.

You had the World Bank in 2010.

You had the IMF in 2011.

You had the Iranians sanctioned in 2012 by the US, kicked out of SWIFT for trying to price oil in non-dollars.

2013 was when the Chinese said "give us the gold and we're out of here, we're not stuck on FX reserves anymore".

2014 you had the Holy Grail deal between Russia and China, they started pricing oil in non-dollars.

3Q14 they announce it, they begin to force the Saudis to not have to cut production.

2015 you have the Chinese scrambling to devaluate.

I look at the whole timeline and go, it's been happening. It's just people aren't noticing, because they happen so far between each other. And, a lot of times, we think of each thing as a disparate problem when, to me, I think it's more serial than people –

Jeff: I was just going to ask, Luke, earlier this year, back in June, the Chinese announced that they were buying Treasuries again. And according to the tick data they did. They bought something like $150 billion across seven months from February to August.

How do you account for that?

Luke: I think it's definitely a non-sequitur. I would say two things. I would say (1) I guess the Occam's razor explanation is that, after they put in some sort of capital controls, whenever that was, late last year, early this year, and it was simply back to currency management.

The more tin foil hat, if you will – but I don't think it's *that* tin foil hat – is look when they started buying it. Pretty much the moment Trump got elected, they started buying again.

And so to me I look at that and go, is it possible – like it is a matter of national security for them to get this done. If you read what they say, the odds of them going back to the dollar system, they don't want to do it.

And so, if I'm Chinese, and I've got a guy in office who's finally going to do what I've wanted done, devalue the dollar, end this dollar system – do I continue to just dump and run Treasuries down and stick it to him? Or do I, basically, be a good global citizen and keep the whole thing together?

Because at this point, if you've got a guy who's going to work with you, the worst thing that can happen is some sort of fire somewhere that then further delays progress on this front. Because that's all they've done since '08. It's been – really since '99 – it's been fire, fire, fire, fire, fire.

So you can't have a fire. Is it possible China's basically doing what makes sense? Again, in the long – not even long run, but just –

It's interesting. Trump got elected, Trump met the next week with Henry Kissinger, like two weeks after that Kissinger was meeting with the Chinese in an official capacity for the US government. He had been meeting with Putin earlier – there are a lot of meetings around then, and the timing of Chinese buying of Treasuries, again, after whatever it was, three plus years selling, coinciding with Trump's election.

The other thing, too, is they stopped buying gold too. At least they stopped reporting it. Their official gold reserves in terms of tonnage stopped rising in, basically, the month after Trump got elected. And US exports of oil to China exploded. We went from, basically, exporting nothing to exporting like half a million barrels a day to China.

Erik: Gentlemen, we could probably go on for several more hours discussing the nuances of all the slides in each deck. But at this point I'd like to pull this whole thing together into the bigger picture.

We originally set out to discuss the bull versus bear case for the US dollar. But I think what we've discovered is that all four of us actually agree that the dollar's hegemony over the global financial system is in the slow process of ending.

It sounds like we all agree that there has been a dollar shortage, which Jeff attributes to the breakdown in the Eurodollar system. Luke makes the excellent point that that shortage is positive for the dollar – until one day when it stops being positive.

And probably the only thing that we don't really agree on necessarily is whether that day has already arrived. I think everybody's willing to acknowledge either possibility, despite having our own leanings.

So what I'd like to do now is come back to the big picture and ask each of you to describe how you see the age of dollar hegemony ending. Specifically, how is this thing going to go down? How long will it take? And what's the big picture going to look like after the dust settles?

I'll start with my own views and then ask each of you for yours.

Something I've learned about human nature is that when we talk about really big changes, like whether the dollar is going to remain the world's reserve currency, most people get stuck in one of two incorrect views.

The first and most common is denial. If you ask most people in finance, they'll tell you the dollar will always remain the dominant currency because it's always been the dominant currency. Now, of course that's not true. It's only been the dominant currency for 73 years. But that's more than all of our lifetimes. Most people just don't register that.

What I've noticed is that when you get a person out of that – and I say this having fallen victim to it myself – when you pull a person out of that denial and they recognize, finally, that the dollar does have to lose its dominance in the global financial system – Robert Triffin was right. He was just 60 years early.

All of a sudden they seem to switch from thinking that's impossible to thinking it's imminent. And to me it's most important that we stress this is not imminent. It's not going to happen overnight.

The dollar's hegemony over the financial system – look at what happened to the British pound sterling. It was dethroned as the dominant global currency, but it took a couple of decades for that process to occur. And it still exists today as one of the most important currencies that we have.

I think the dollar is going to exist long after it falls from its current place of hegemony. None of this is going to happen overnight. The dollar is very unlikely to crash and lose all its value the way so many doomsday bloggers have predicted.

I think instead that it's almost certain, though, to gradually and slowly fall from prominence the way the British pound sterling did. What will change, though – and it will change in a really, really big way – is the United States will no longer reap the so-called exorbitant privilege of being able to get away with unlimited deficit spending almost without consequence. And we'll come back to that later.

Now, with regard to how long this will take, I don't think any of us really knows. But if I had to hazard an educated guess, I'm going to defer to Neil Howe's work on longwave business cycles. I think the dollar's loss of hegemony is probably the big event of the present fourth turning cycle.

So if I invoke the lessons of prior fourth turnings, this should all be over by about 2030. The worst of the crisis will probably come between 2022 and 2028. And that would be my guess as to when things get really ugly for the US government as it realizes that it can no longer get away with spending beyond its means thanks to exorbitant privilege.

As to what the picture looks like after the dust settles, clearly we're all guessing here. But my guess would be a global state-sponsored cryptocurrency that becomes the new global reserve currency.

We already know the People's Bank of China is hiring blockchain engineers to design the digital RMB. I don't whether they'll succeed or not, but my strong belief is that China understands this picture very well. I think they're vying for their digital RMB to become the new global reserve currency. It doesn't mean they'll win that title. But I definitely predict that they're going to try to, and I think they see this picture every bit as clearly as we do.

I think the dollar's future is going to mirror the evolution of the pound sterling. It'll always exist and it will probably always remain the national currency of the United States. What will change dramatically, though, is that immunities that the dollar enjoyed during its tenure as the global reserve currency will no longer apply. And as a result, I think a US Treasury bond crisis – and I do mean crisis – by the mid-2020s is a very strong possibility.

So that's my take.

Mark Yusko, let's go to your views next. How does this thing go down? How long does it take? And what does the picture look like after the dust settles?

Mark: Erik, I think you make a number of really important points, many of which I agree with. In terms of timing, it's very interesting that you cited Neil Howe's work on the fourth turning in terms of the actual dates.

I use a similar focus and philosophy in thinking about long-term demographic shifts from a different person, Harry Dent. Some people like Harry, some people don't. I think his first book, *The Great Boom Ahead* was one of the great investment books of all time. And it laid out this process that was going to occur because of demographics.

And ultimately, I think demographics drive everything. People do certain things from age 25 to 45. They do different things from age 45 to 65. And very different things from age 65 to 85.

And what's happened in the US is very predictable up through the global financial crisis in 2008, which Harry talked about in his book in 1993. And it's interesting that he used the same date, 2022, as the turn from when we start to see the echo boomers start to age into that 45 to 65-year-old group, which is where you get high productivity, you get more growth.

And it's going to take some time until we get there. So I clearly see the timing lining up with that being the bottom or the turn.

In terms of the dollar losing its status as *the* world's reserve currency, I think it's already begun. I think that process does take decades. Now whether it takes three decades, like the pound sterling did from '13 to '44, I'll say a little bit less.

So, again, I think your timing of 2030 is not off the table. I think China has already become *a* world reserve currency by becoming part of the SDR. I think they have their sights firmly set on being *the* world reserve currency.

I love your construct of it being a digital currency. Now I will use digital there intentionally, versus crypto. Because I think what makes crypto crypto, what makes bitcoin bitcoin, and what makes bitcoin so exciting, is that it is different than fiat currency in that it has limited supply. It's more of a pure store-of-value gold substitute.

Whereas I think a digital currency has a lot of advantages over paper currency. And I think you've seen some of the advantages with what's gone on in India and their Aadhaar project. But we can talk more about that in later times.

If I think about the steps along the process, I think we're already there. I think we're in a race to the bottom in the developed world because of the Killer Ds – bad demographics, too much debt, and deflation. And so I think you're going to continue to see the yen continue to spiral down and the dollar and the Euro have to fight their way down in that race to the bottom – competitive devaluations.

And one of the most important things that I think, of the last four or five years, is the PBOC stating very clearly that they were not going to play in this competitive devaluation game. And that what they were looking for was for the renminbi or the yuan to be a stable source of value that central banks and other financial institutions would be comfortable holding. And I think that's the big change.

I think one of the semantics issues here – I think Jeff brought it up at the beginning – is sometimes dollar strength, what people perceive as dollar strength, is really not. It's just weakness of other things. And I think from 2011 to 2016 emerging market currencies – because of the commodity implosion – were very weak. And that weakness appeared as dollar strength. I actually don't think it really was dollar strength per se, but just relative weakness of these other currencies.

So as we think about currencies, one of the challenges of any currency discussion is you always have to say relative to something else. What is it we're talking about with the dollar? Are we talking about it relative to the Euro? I have a different view of the dollar/Euro than I do of the dollar/yen. Or the dollar/renminbi. Or the dollar/bolivar. Or something else.

So as we sit here today I think we're headed for a slow unwind of dollar hegemony. I think we are seeing the leadership shift from the West to the East. I think Eurasia will continue to be an important player in this going forward. What role will Putin and Russia have in this is yet to be seen. What role the Middle East has in this remains to be seen.

But I do think China is taking a very strong leadership role. And because of that I think the dollar will continue on its downward slope as we de-dollarize and we move away from petrodollars to a different system.

Erik: Fantastic. Jeff Snider. What's your take? What's this going to look like? How does it go down? How long does it take? And what does it look like after the dust settles?

Jeff: I have no idea.

Erik: The most honest answer yet.

Jeff: It's very easy to sit here and say, hey, there's something wrong. And it's very difficult to say, well, how does this something wrong actually work out in the end? And the reason I say that is I don't think we're far enough along in the process to really have a good idea of how it ends.

And that's kind of a weird thing to say because it's been – as Luke pointed out – nearly two decades here. And in some cases it's been 1/2 a century that this Eurodollar system has been running amok throughout the world.

And it's interesting, Erik, that you bring up Robert Triffin. Because Robert Triffin's view on global liquidity shifted in the 1970s. He went from Triffin's paradox in 1960 to, by 1979, talking about the Eurodollar system.

In October 1979 he said: My major thesis is that neither stable nor floating exchange rates can function satisfactorily in the absence of any international control and restraints over the fantastic explosion of international liquidity provided to the market by monetary authorities and the commercial banking system.

He was talking about the Eurodollar system. That, free from the gold standard in 1971 at the end of Bretton Woods, this explosion in international liquidity completely changed the game. And so when we look at the transformation, or the possible transformation, that's taking place today, we have the same kind of a problem in that there is nothing else out there that can supply that kind of liquidity to allow for an alternate system to take its place.

And what I mean by that is a couple of different things. Going back to what I said earlier about the Bank for International Settlements finally looking into the offshore footnotes of various banking accounting statement, and finding $13–$14 trillion in offshore currency swaps and other kinds of derivatives that they didn't know existed.

And, again, these are offshore, they're all denominated in dollars, and what that $13–$14 trillion in hidden footnote dollars actually does is provide the basis and liquidity for the Eurodollar system to actually function.

And so, what I mean by the fact that I don't think there's a ready alternative available to simply switch from Eurodollars to something else, what I mean by that is there is no infrastructure in place. And I agree with Luke and Mark that China, especially, and emerging markets and various other places want to get out of this thing.

Because it doesn't work for anybody. But it really doesn't work for places lie China and Brazil and the rest of the emerging markets. But to get from A to B I don't think is a very easy thing to do. And it's especially difficult when nobody in the West will even admit that there's a problem.

And so, without being able to see how there could be an alternate method of providing this massive amount of necessary liquidity, I still think we're just too early in the process to really know how it could end.

And there's a whole range of ways in which it could. Some of them would be – as we talked about before – quite positive. Luke makes the point that when we get to that point B, that's a vey happy day. And I agree with that. I think once we get this currency system solved there's a lot of good things that can happen.

It's just getting from A to B, which is extremely difficult. And it's fraught with a lot of dangers, and I think it's fraught with a lot of dangers that aren't visible. To use a term coined by Donald Rumsfeld, a lot of unknown unknowns here.

Because, again, this Eurodollar system is so large, and so qualitatively expansive, we don't even know what's out there. We still haven't even mapped the whole thing yet. So it's an enormous challenge and I think we're still stuck early in the process.

Erik: Fantastic. Luke Gromen, you get the last on this one. How does this go down? How long does it take? And what does it look like after the dust settles?

Luke: I agree it won't happen overnight. But, as Jeff alluded to – the preponderance of the evidence suggests we're 10 years or 18 years or 50 years into this, depending on how you measure. The EU began planning to move away from the dollar in the late 1960s. The Euro launched in 1999. The Eurodollar system – to Jeff's point – irrevocably broke in 2007 and it's been operating on an ad hoc patchwork basis since then.

I agree with you, Erik, that the dollar as a currency will likely always be here, like the pound.

But it's important, I think – even in the case of the pound, there was an event where loss of hegemonic status finally became obvious to everybody. In the pound's case, after World War II, once the US-centric institutions went live (the IMF and the World Bank who at their core were designed to help accelerate and enforce US dollar hegemony), the pound became a one-way trade down on a real basis in the next 50 years, pretty much without pause.

And we have that in our slide deck, Slide 36. And the flip side is retail prices on a real basis were a one-way trade up in pound terms. In other words, massive, massive secular inflation. Decade after decade after decade.

And that's at a time where US investors are hyper-focused on strong dollar, deflation, at a time where China is setting up – and is years into setting up – competing institutions to the World Bank and IMF that enforced and accelerated the dollar's hegemony.

I also think it's important to note that these events tend to be little by little and then all at once. It was interesting, last week we saw a perfect example with what happened to Venezuela and sovereign CDS spread?

In March of 2017 – it's not like this was that long ago – Bloomberg was reporting that Venezuelan teachers and doctors were being forced to turn to prostitution for food money. At that point Venezuelan CDS were 3,000 basis points.

May of 2017 Bloomberg reports women and children are starving in Venezuela. Venezuelan sovereign CDS 3,000 basis points.

They start bleeding up June, July, August, September, October. By October they're at about 5,000. So a pretty big move. And it's been choppy on the way up. All of a sudden, boom, 15,000 basis points. Up 5x from May when people were starving to death, 5x from March when people were turning to prostitution for food.

So the bottom line to me is these things tend to go little by little and then all at once. And we've been in the little by little portion of the dollar's hegemony for 10 years or 18 years or 50 years, depending on how you look at it.

And so, to me, a more binary change in the dollar's reserve status is really now an any given Sunday type of phenomenon. And in my opinion, the reaction to the last meaningful selloff we had in risk assets, which was election night 2016, is a huge clue. The DOW was down 1,000 point for six whole hours. The tenuous fiscal position of the US government and reliance on capital gains for funding means that any risk-off will have to be dealt with rapidly and aggressively as it was on election night.

I guess lastly in terms of there's no means of providing liquidity, I strongly disagree there. It's interesting Ken Rogoff who's a former IMF and Fed guy, wrote a fascinating paper in May of 2016. You can Google it, the name of the paper was "Emerging Markets Should Go for the Gold".

In it he says if emerging markets were to bid for gold with FX reserves, because gold has no limit on the price, they could eliminate the global dollar shortage by bidding for gold with FX reserves. $12 trillion in FX reserves out there in total. There's about $100 billion a year in gold produced.

So to me that was a big clue on the ultimate endgame of where this goes. And, like I said, I think we’re in late innings. I’ll pause there.

Erik: So I think we all agree that the dollar’s hegemony over the global financial system is ending, but slowly. And we agree it’s not going to happen overnight. So my next question is, what are the most important consequences of this change going to be? And I don’t mean just on financial markets, but also society as a whole. Particularly in the United States.

I’m going to start again with my own opinions to set the context. And then I’m going to ask each of you to chime in.

I think the biggest implication is going to be that politicians have been conditioned for decades to believe that deficits don’t matter. And, in fairness, in some regards it has been absolutely true for decades. That you could get away with running massive budget deficits without immediate consequences being felt.

My prediction is that no amount of logic and reason is going to change their mindset. You’re not going to tell them, hey, look, we’re living through the resolution of Triffin’s dilemma. Its a different game now. You can’t continue this.

They’re going to just roll their eyes. Academics have been warning them for generations that they shouldn’t be doing all this deficit spending. And they know from experience that they do it and they get away with it. So I think they’re going to ignore all the warnings and continue to attempt to create an even greater unserviceable debt load. History has proven to them that they could get away with it and I think they’re going to be up for a very rude awakening.

I don’t think the loss of dollar reserve status or any other amount of warning is going to change the behavior of Washington DC. This time, though, there will be dire consequences and they won’t be decades off. The US Treasury market will back up. And, at first rising, Treasury yields will be heralded as evidence that the US economy is doing great and it doesn’t matter that we don’t have reserve currency status and so forth.

What most people will miss, though, is that US Treasury yields will be increasing even as the dollar is still depreciating relative to other currencies. In other words, the normal macroeconomic function of interest rate differentials attracting international capital flows will have broken down, but most people won’t notice.

Eventually there’s going to be a government funding crisis, I predict. I can’t tell you when that’s going to happen. But I’m willing to predict what’s not going to happen. What’s not going to happen is politicians are not going to recognize and admit that these are problems of our own making, as a result of decades of reckless deficit spending.

Instead there will be scapegoats. Probably foreigners. The government won’t be able to finance its continuing operation without raising taxes to levels that would cripple the economy. The situation will be met with denial by government bureaucrats.

And I think it's going to escalate the class warfare that we're already seeing in the United States today. The masses will demand that that the rich be taxed punitively to resolve the crisis. The rich will correctly point out that even doing that doesn't really solve the problem. But politicians are still going to be attracted to populist appeal. And doing whatever they can to persuade the masses that they're doing something about the problem.

The result could very well involve a financial crisis bigger than 2008, or even bigger than the Great Depression, in which the country struggles to come to terms with financing its government without the benefit of exorbitant privilege.

My prediction is that this is all going to lead to a social divide of epic proportions. And I think that what we're seeing already today in the United States, with Antifa versus the Trump supporters, the Charlottesville events, the mass shootings around the country, escalating racial tensions, Dallas police shootings.

All these things, I fear, could be just the beginning of a divide that's only going to worsen and escalate through the mid-2020s. I don't think it leads to an actual civil war in the sense of clearly-defined sides fighting with one another in conventional warfare. But I fear that it could lead to further acts of violence, even acts of domestic terrorism.

And this could get to the point – we've already seen the beginnings of this – where people in government are so completely dismayed by the party in power that they are actually disloyal to the government and giving confidential government documents to anti-government protesters or something. And I think you've seen people who are in the government now that are not loyal to President Trump starting to behave in these ways.

And I fear that those things could get worse.

So I think it leads to a divided society where people with one political view are literally afraid to associate with people of the opposite view. Because the escalating number of acts of aggression and violence motivated by political affiliation become so strong.

So I fear that the modern corollary of the race riots of the 1960s could be the class riots of the 2020s. And I think that we're seeing the beginnings of it, unfortunately. And, believe me, I so badly want to be proven wrong about this. But those are the kind of outcomes that I fear.

I intentionally took a very polarized statement here. Guys, set me straight.

If I'm crazy to think that the economic situation that we're talking about could bring about this degree of social change, please speak up and tell me I'm crazy. Because I would like to be proven crazy on these things.

Jeff, what's your take?

Jeff: I don't think you're crazy. Again, I don't think we're far enough along in the process to figure out exactly which way it goes. But, historically speaking, these types of periods where the economy is in prolonged stagnation at best, and depression at worst, do not end well.

We're talking more than just financial and economic things, we're talking about political upheaval, social upheaval, exactly the kind of things that you're talking about, Erik, and those are all possible if these things don't get fixed.

So my concern, what I'm looking for, is the sequence of events. Yes, the debt does matter, the economy does matter, and the currency system does matter. But which one gets fixed first? Or which one gets forced to be fixed first?

And I think the reason that politicians aren't necessarily focusing on the debt isn't that they don't realize it's a problem – and maybe I'm giving politicians way too much credit here. But they are, I think, overall somewhat unrealistic about the fact that there is a lot of debt – not just here but almost everywhere. And we shouldn't focus on the debt just in the United States. China has a massive debt problem too, as does Japan and Europe.

And so I think what really matters is the sequence of how these things play out. If the debt is the first thing that needs to get fixed, because it's no longer tenable, then I think that's what unleashes the worst possible consequences.

In a more hopeful scenario, we fix the currency system first, before the debt needs to be solved, which fixes the economy, which then makes the debt transition that much less violent and paradigm-shifting, I guess is a good way to put it. So I think there's opportunity here to get things right.

The question is whether or not we have the people in place to do it. And that's where I think we get pessimistic.

Again, I keep going back to the fact that the Chinese and all the political systems in Asia and throughout the emerging markets realize that there's a massive problem. Whereas in Europe and the United States, you won't get anybody to admit that there's even something like a problem.

So there's a schism there that needs to be dealt with too. And it's a huge impediment towards getting the sequence of events right so that we can actually have a decent outcome here.

I think that's the important part. What comes first? Does the debt need to be solved immediately? And if that's the case, then – which I think is Luke's scenario – then, yeah, that's a pretty bad day for everybody. Let's get the sequence of events correct and maybe try to avoid all the really bad stuff.

Erik: Luke Gromen, what's your take? Am I crazy to think that these economic changes could lead to the degree of social change that I fear?

Luke: No I don't think you're crazy, and I agree with your point that you're already seeing a lot of these effects.

I'm located out in Cleveland, Ohio, flyover country, which has been ground zero for the petrodollar system – so we're 45 years into this movie and it really accelerated after NAFTA. And it really accelerated – really accelerated – after the Dinar entered the WTO in 2001.

So, at the very least, we're 15 to 20 years into this out here. But I think, more importantly in terms of how imminent is it, you've had Brexit, you've had Trump, you've had Le Pen (even though she didn't win it was close), you've had AfD in Germany. Real living standards have been falling, particularly in the West, but in Anglo-American markets in particular for 18 plus years.

And history's very clear on this. Once living standards fall enough on a real basis, at some point you reach a tipping point. And once that tipping point of populism is reached, it's not good for the real value of currencies and sovereign debts.

And the reality is that we haven't seen something like this in the US populist front in at least 50 years, since the 1960s, and arguably – Ray Dalio has a great chart showing that Western populism is at its highest level since the '30s. I don't think anyone doesn't know that the reality is that the election last year in the US should have been Trump versus Sanders. And our case has been continuously, if you don't like Trump, wait till you see who the people elect next.

The strong dollar and this Eurodollar system, that's not working anymore for 24 out of the 25 biggest US metropolitan areas. 24 out of 25 of the biggest US MSAs cannot afford the average priced new car on their median income financed traditionally. The only one that can is Washington, which means the only one this dollar system is working for anymore is Washington.

My translation of that, in terms of when do we hit a tipping point, I think Americans are going to keep electing politicians that promise to weaken the dollar like Trump did. Until they get one that actually does.

And I think it's important to note that two of the last three major dollar devaluations were done unilaterally on a binary basis by a US president. With FDR overnight in 1933, Nixon overnight in 1971.

I think deficits are already beginning to matter again. I think people are already in denial about it. They started mattering three years ago. You saw the initial symptoms of it with deficits starting to matter, which is, ironically, a rising dollar. Rising LIBOR.

In my opinion you're starting to see the symptoms of the next crisis as a result of it. You're seeing parabolic asset class rises, but Federal tax receipts were only running – I think the US has been on the clock for a funding problem for three years.

I think few people in the US see it. But it's – as I talk to people it's much more clear to those investors willing to look at the US as an emerging market, Which makes sense, given a lot of the factors we're – you're talking about Erik – in terms of some of the strife. Look, these are hallmarks of emerging markets, not of a developed economy.

I'll pause there.

Erik: Well, I'll qualify my own comments as well, after hearing you and Jeff talk. I'm not predicting some zombie apocalypse starts tomorrow. What I'm unfortunately predicting is things that we've already seen in the United States will probably continue to get worse.

And the type of thing I'm talking about is Charlottesville, Dallas police shootings, just huge anger that people who are – the Antifa versus the Make America Great Again crowd can't even politely speak to one another. And resort to violence. I'm afraid of those things getting worse.

Mark Yusko, please tell me I'm crazy and it's not as bad as I think.

Mark: It's not as bad as you think today. We are certainly headed for a worse environment in the future, should we stay on the same path that we're on today. And it's entirely predictable as Luke was saying.

We have the data. We can go back to the 1930s, and we can see when we had the most divided government in history, up until today. We can see when we had the greatest income inequality up until today. And we can see exactly what happened in terms of the nationalistic rhetoric and the forced repatriation of 500,000 Mexicans – some of them American citizens – physically marched back to Mexico. Hundreds of miles on foot. That actually happened. In America.

We know what happened with Smoot-Hawley and trying to go rogue and force a trade war, and what that did to American exports drying up 38%. Because it turns out that other countries fight back. Surprise, surprise.

So I think the bigger challenge today is what happens when – because it's not if – when the entitlements that people have promised themselves in the form of electing government officials that give them things that they want, when those promises get broken?

Because they're going to get broken.

I worked for the great state of North Carolina for seven years. And, theoretically, when I turn 62 – which used to sound like a long time; now it doesn't sound like that far – when I turn 62, I get lifetime medical benefits for free.

Now there's no chance I'm going to collect on that benefit. It's just never going to happen, because North Carolina doesn't have the money. So they're going to have to come up with a way and say, well, I know we promised it to you, but you didn't work 20 years like everybody else, so you don't get it.

And, fortunately, touch wood, I can afford that. So I won't probably fight that hard. But I think there are a lot of people who don't have that luxury and are going to be really, really unhappy when they start cutting back their pensions or their health care benefits.

So I think we are on the verge of some really dark times, should this hegemonic state and this ability to constantly live on deficit spending and increasing debt suddenly causes an increase in income inequality and an increase in the haves and the have nots.

You've seen just massive transfer of wealth from the middle class and lower class to the upper class in the last decade and a half. I mean, just massive. And that, at some point, comes out in the polls. And I think this year was the first time. I love the point that – imagine who they'll elect the next time. It could be really scary.

I guess the only positive I take away from this part of the conversation is, the numbers are relatively small. The marginalized are, at this point, still relatively small. We don't have a massive poverty problem.

Although the one thing that we do have that I think gets underreported and not talked about enough – I think I have this number right – 44 million people on the SNAP food stamp program. And that's the equivalent of soup kitchens and breadlines in the Great Depression. In fact it's bigger. And worse.

So we do have these scary things. I heard once that 10% of Walmart's revenues come in a 15-minute period, the first day of every month. From 12:01 midnight, on the 1st, to 12:15 when everybody checks out – because their EBT card recharges. And then they don't have any money for the rest of the month.

I think we are at a very scary juncture, and the dollar continuing to decline, I think, is going to take us to a place where we can't handle the outcomes that are going to occur. And I would not be surprised to see some of the things that you talked about, Erik, in terms of increased violent acts and increased confrontations and conflict.

Scary as that sounds, I don't think it's unreasonable.

Erik: Well, I have never wanted more to be proven completely wrong. I really hope that the country comes together and works together to work through our problems as a team.

And maybe we'll see a resurgence of community spirit that takes us in that direction. But I fear that it could get really ugly.

I have several more questions for all of you. First, I'd like to talk about what signposts we should be looking for along the way as the dollar endgame unfolds, and then finally, I want to ask each of you how one manages their investments through an event like this.

But unfortunately, we're out of time for today's episode, so all these topics will have to wait for the fifth and final part of this series, which will air in our regularly scheduled Thursday evening podcast on January 4th. Folks, please tune back in then, as you're not going to want to miss the final chapter of this fascinating series.