Louis-Vincent Gave: What Just Happened?

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Erik: Joining me now is Gavekal co-founder, Louis-Vincent Gave. Louis, any other guest but you, it's so easy to do an August interview. You talk to the guest off the air. It's like, okay, dog days of summer. Nothing happened in the market, nothing to talk about. Let's make something up. We don't have to do that this week, do we? And you know, when the VIX hit 60 on Monday, my first reaction was to look at the calendar, and I thought to myself, wait a minute, I'd have thought we didn't have Louis Gave until tomorrow, because it seems like every time you and I talk, something crazy happens in the market.

Louis: That's right. Thanks for having me on. It's always a pleasure to chat. You probably remember this, but you and I were taping an interview the day the WTI went negative. So with that in mind, I think what I'm going to start doing now is, each time I do a MacroVoices interview, maybe I'll start buying calls on the VIX and, you know, way, way, way out of the money calls and puts on a bunch of asset classes the week or two before we're slated to talk, because it does seem that there's an uncanny coincidence where each time we're talking, things seem to be melting down.

Erik: Dude, I've already got plans to launch an ETF where basically the strategy is, we know we have inside information. Our producer knows when Louis Gave is on the schedule. We're buying structured, you know, hedge instruments, the Friday before we get you on the show, dude. Anyway…

Louis: It's the only rational thing to do.

Erik: Well, let's start with what just happened. Because some people say it was all about the Yen carry trade unwind. Some people say it was all about the jobs report. Other people say, no, no, those are just small catalysts, and it was all waiting to happen anyway. What just happened in the market? What should we make of it? How do we interpret it?

Louis: Look, I think we were coming into the summer with a few prices that were really out of whack. And you know, we wrote a lot of pieces saying, look, the Yen is absolutely ridiculous. I know you and I had this conversation in the past about how stupid the Yen valuations have gotten and another completely stupid valuation was basically anything and everything linked to AI. Now, whether the two were linked, whether one was funding the other, perhaps, perhaps not. But what ends up happening is, when things get too crazy, too out of whack every now and then, they roll over. And if you go back to say, March 2000 when you had the dot com boom and then bust, etc., you know what? What was the real trigger for all of a sudden, you know, the whole internet space imploding. Now, you could say, well, you know, the Fed had raised interest rates from 5.5% to 6%, etc. But sometimes when valuations get too crazy, they roll over and that's where we are today.

Now, I think from there the question is, okay, things have rolled over, we've had a correction. What's the NASDAQ down 12% or something from its high, something like that? But is this a correction, or is this the start of a bear market? And if it's the start of a bear market, what kind of bear market? Is it one of those minus 20? Slash 25 or is it one of those slash minus 50? I think these are the questions that we're confronting today. I have my view, but it's a view, and it could well be wrong. But my view is, I think we have started a bear market. I tend to believe that, because everywhere around me, I see examples of capital living being misallocated, on a grand scale. I've written a bunch of pieces trying to highlight what John Kenneth Galbraith would call the bezzle. I don't know if you're familiar with that term, but Galbraith would highlight that in bull markets, what happens is that capital gets wasted and actually gets consumed, and the people who provided the capital don't realize that their capital is being wasted. So, think of Madoff as a typical bezzle, right? You got all the rich Europeans giving money to Madoff. And Madoff was consuming that capital. He was either passing it on to other folks, but he was also buying Rolexes for himself and houses in Palm Beach and meanwhile, the guys who had the money at Madoff thought the money is still there, and so they were going to San Tropez and to St. Moritz, and they were having great holidays and buying yachts. But meanwhile, the money had disappeared. And of course, once that realization happens, you get a dual negative impact. No longer is Madoff, no longer buying a mansion in Palm Beach, but at the same time, your rich European is no longer going to a holiday in San Tropez. And so I think you've had a massive examples of bezzles, especially in the US, over the past five or six years, through VC funds, through private equity funds, through real estate funds, number of which are reporting to clients, yeah, yeah, don't worry. You know you're holdings are worth plus 15% a year, and they've been up 15% a year every year for the past five years. And as the economy rolls over, they'll realize very quickly that actually, not only these gains haven't been there, but perhaps the capital itself has been destroyed.

Erik: Louis, you mentioned that there were a number of assets that were overpriced, the obvious one being the AI bubble. How should we think about this bear market? Is it mostly an AI unwind where, you know, the biggest thing that you want to short now is going to be Nvidia? Or is it more the case that that part of it already popped and now it's going to be the contagion into other sectors that we need to worry about?

Louis: Like, that's the all important question, and for what it's worth, my starting point when I look at asset prices is that assets can have value for one of two reasons, either because they're scarce, i.e. a gold bar, a vintage Ferrari, a bottle of Petrus, or a mansion on the peak in Hong Kong. What gives these assets value is their scarcity factor. Or, assets are perceived to be efficient. They're a source of future cash flows. And usually, most of the time, people spend most of their resources investing in assets that generate future cash flows. Now, I think what's happened with AI is that the expectations for future cash flows got blown out way out of proportion, and the excitement really stopped corresponding to reality. And then in the past, really two, three months, we've had a reality check. We've had pretty much every big tech company, whether Alphabet, whether Facebook, whether Microsoft, all come out and said, hey guys, yeah, we did spend tens, if not hundreds of billions on AI. Yes, we did think that this would generate returns very quickly. Actually, it turns out that we're not quite sure when we're going to see the returns from this, or if we're going to see any returns at all. But if we're going to see returns, it's going to be further out into the future. Now, this has basically been the message coming out of the AI space, where really quickly, from six months ago, oh my god, AI is going to completely change the world, to we're not quite sure how we're going to make money with this. And so, the bear market, I think we're seeing that is starting to unleash is linked to this very notion of, oh, hold on, we've put all this money in efficiency assets on the premise that we get huge productivity gains very, very quickly. Turns out, actually, we may not get these productivity gains very quickly. Therefore, we need to reprice all these assets.

And now, as this unfolds, and I think this has started to unfold, obviously, everybody starts clamoring for a Fed rate cut, right? Everybody's like, Oh, my God, things are terrible. We're not going to get the returns on our investments in AI that we thought we would. That's obviously the Fed's fault. So the Fed should cut 50 basis points, 75 basis points, 125 basis points. In fact, it should have done so already, and the Fed needs to cut right here right now. But if the Fed cuts right here right now, concretely, that's not going to make the past investments you made in AI more productive. It's not. It's not going to all of a sudden boost the cash flows at Microsoft or at Alphabet. What it might do is actually, all of a sudden, make the scarcity assets more valuable. Remember, there's two kinds of assets, the efficiency assets and the scarcity assets. So as the Fed starts cutting, to answer your question, do you go back into Nvidia? Or do you think, hold on, if the Fed starts cutting, we're now in a different cycle, one where the US dollar probably goes down and where, because people don't want to own Nvidia anymore, because the returns over the next 10 years or 5 years aren't going to be what I thought they were six months ago, I want to own the scarcity assets. Maybe I want to own, I don't know, a gold bar, or a Ferrari, a vintage Ferrari, or whatever else. So that, for me is, the big question is, again, first, if you think of your decision tree, have we started a proper bear market? Yes or No? I think yes. The second question is, have we started? Will this lead to a Fed cutting cycle? And I think yes, because each time you have a bear market, you get a Fed cutting cycle. Let's not kid ourselves here. And you know, with that, does that mean that, oh, great, I go back to buying US growth stocks. Or does that mean that with this new Fed cutting cycle, we actually have a new investment cycle with new assets that start to do well in here? I'll go back to what one of my oldest clients always says is, look, bear markets are there for a reason, and it's to return capital to its rightful owners. And the idea is, as you start a bear market, usually, you have a rotation, and the past winners are seldom the new winners, especially if the past winners drove to really silly valuations. So I do think we're planting, with this bear market, we're planting the seeds for the next bull market, and it'll be our job to figure out what it is.

Erik: No, I definitely agree with you, Louis, that because of this market action, it's likely that the Fed is going to be more inclined to consider a cut rather than a hike as their next move. But hang on a second. I think we went, from last Thursday to Tuesday, by the way, for our listeners, we are recording on Tuesday, which in this market, a lot could happen in the two days before you hear this. So this is Tuesday morning we're recording, folks. It seems to me that we've gone, in just a few days to new market expectations in terms of what SOFR futures are pricing, of like four or five cuts this calendar year. Recent history teaches us that every time the market suddenly thinks there's going to be five cuts this year. That is a very important signal that everybody's going to think that for a little while, but it never seems to really materialize to five cuts. Or maybe it does now, because you're saying this is a real bear market, as opposed to just a little correction. So how should we think about this expectation the market now has that there's four or five cuts coming?

Louis: Look, I don't think we'll get five cuts. Let me come out and say it. The Fed moves much slower. It's also gone out of its way to try to prove that it is data dependent. And you know, the data isn't great in the US, but it's not like five cuts bad either. The fact that the NASDAQ is down 12% isn't enough of an event, and it's still up, whatever it is, what is it up for the year? It's still up like 10% for the year, or something. It's nowhere near this bad that the Fed needs to, all of a sudden, empty the cupboard, get the fire hose out and drain all the liquidity. Because, by the way, if it does this, if it turns around, let's say tomorrow, Jay Powell comes out and says, we're cutting and we're going to cut a bunch. So don't worry, we're here. Then at what price does the Yen go? I think the Yen goes to 120 if that happens, which is one of the problems we're dealing with. So to the extent that a Fed cut amplifies the rapid de-leveraging in the Yen carry trade, maybe it could make things worse, rather than better. I also think a very aggressive Fed, and I think the Fed has to know this, will a very aggressive fed from here on out, in terms of cutting, would mean that gold would go through the roof. And again, you'd have this amplified rotation from the growth stocks that have driven the markets and into scarcity assets of all kinds, which is probably not what the Fed wants to generate today. Or let me put it to you this way, you know, if the Fed cuts five times between now and year end, imagine that you're the Chinese entrepreneur sitting on the other side of that 100 billion monthly trade surplus that China has, and that's so far what you've done with all the dollars that you earn. Again, 100 billion dollars a month is a lot of money, with all these dollars that you earn, what you've typically done is you've gone out and bought Microsoft, and you bought Apple and you bought Alphabet because A, they were going up. B, your local economy was doing nothing. C, they're very liquid. So you can always change your mind later, and it wasn't just you, the Swiss National Bank was doing the same thing. Japanese insurance companies and banks were obviously doing the same thing, et cetera. So now the Fed comes out and says, hey, you know what? I'm going to trash the dollar. I'm going to cut interest rate by five times, and I'm just going to let the dollar tank. Then all of a sudden, it's like, well, alright, fine. I don't want to own Microsoft anymore. I want to own a gold bar. I don't want to own Apple anymore. Maybe, you know, if you're Chinese, you think, well, maybe I'm just as better off owning Alibaba or Tencent at a fourth or the fifth or a 10th of the valuation, and all of a sudden, the money, instead of being recycled in the US, stays at home. So all this to say that we may reach, have reached a point in the cycle where massive rate cuts might not be that useful. So I think whatever the Fed does is going to be very, very gradual. I think you and I talked about this when we last chatted six months ago. So I've always thought the Fed would cut just before the election, and I still think they will cut in September, but they'll probably cut and say, hey, alright, here's a little bit of help. We're showing that we're here, but don't expect too much. So, if really the market is expecting five cuts, I think the market's going to be disappointed.

Erik: I want to go a little deeper on the US dollar, but before we go there, let's start with your intermediate to long term outlook on inflation. Because obviously, if you're a secular inflationist or deflationist, that's going to affect how you interpret the dollar view.

Louis: Yeah, look, I think you and I have had this conversation many times over the years. You know, I've been a secular inflationist, I remain one. I think when I look at most OECD countries today, all running budget deficits of 3% to 7% of GDP, while the global economy has been humming along. It reflects the fact that none of these countries can no longer afford the welfare state that they promised their citizens. Now the reality is, you know, you look at France, you look at US, you look at Canada, all these countries, the math on the welfare state started to deteriorate badly around 20 years ago, and they thought, you know what? And this for purely demographic reasons, people aged instead of dying at 65 like they used to, they started to die at 80, 85, all along, medical costs were rising, and so the way most of these countries dealt with this unfortunate reality was to say, you know what, we're going to bring in a bunch of immigrants. We're going to bring a bunch of 20 to 30 year olds, and then the math will work again. It turns out that unfortunately, a 20 year old guy coming out of Senegal or Algeria actually doesn't have the same productivity for a number of reasons, as a 20 year old guy coming out of the French educational system. And it's just an unfortunate reality, but that is the case. And so, as it's turned out, the immigration, instead of making the evening things out for the various welfare states of the West, has actually made the balance worse. It's increased the costs, and now it's also increased the social tensions, as we're now seeing in the UK, as we're seeing in France. So, all this to say that when you look at the budgetary situation of pretty much any Western country, there is no exit but inflation. I mean, you could say, well, the other exit would be to default on the debt, but defaulting on the debt is so costly, so politically suicidal, that really, inflation is the path of least resistance. So, yeah, I am an inflationista. I look at the US, and I think, here we have the US with full employment, economy humming along, and you get budget deficits of 7% of GDP. Now, you know that if there's a recession, that's going to go to 11%, 12%, 13% of GDP. How can that not be inflationary?

Erik: Well, I couldn't agree more, but let's touch on that recession point a little bit more. Because, if we get into a recession, although I'm totally with you on the secular inflation call, isn't it true that a recession tends to at least put inflation on hold and maybe create a false signal to validate to those who thought that the inflation was transitory, that, hey, look, I see it really did come down. And of course, that sets expectations, and it takes a while for it to come back. So, I'm assuming that if you think this is a significant bear market, that there's likely a US recession coming, so I guess please confirm your view on that. And if so, does that mean that even though you and I can see the inflation, that maybe it's kind of put on hold for a while?

Louis: So, I think that's a super, super important question. And look, I think you can imagine several scenarios looking forward. The first scenario is you could say, okay, you get a bear market, a bear market that's concentrated on all the things that were super, super popular up until recently, and where valuations got to be way too stretched. And yeah, the Fed cuts, and yeah, the US dollar weakens some and we have, frankly, a scenario that is not that different from what we had in 2000, 2001, where US economy does slow, but then the weaker dollar allows other parts of the world to grow. It allows emerging markets to grow faster. And on this, I think one of the oddities of the world that we live in is, that if you compare the situation today relative to situation in 2000, in 2000 US was a huge part of global GDP, but it was only about 45% of global equity markets. Today, the US is 70% of global equity markets, but it's a much smaller part of global GDP, because over the past 25 years, China has grown massively, and India has grown massively, and Latin America has grown, etc. So why couldn't we have a scenario somewhat similar to the 2000, 2001? Now, back then, the US was avoiding a recession, the economy was slowing down, and things weren't looking great. Even as the rest of the world was picking up, 9/11 through everything, of course, with 9/11 the US did experience a recession. But even with 9/11, the US recession back then was actually decently shallow, and the US bounced back decently quickly, so that to me, to be honest, that's more my scenario today. Okay, yes, we have a slowdown in the US, perhaps a mild recession, perhaps not. But thanks to the weaker dollar, rest of the world, hums along, you get a big rotation. And you know, the world doesn't fall apart. And in that environment, weak dollar, EM is doing better, most likely that helps boost commodity prices higher. You get higher oil, you get higher metals, you get higher food prices, and all this together with that backdrop, it's hard to see inflation falling very much.

Erik: Louis, you mentioned precious metals a couple of times, let's go a little bit deeper on that. Sounds like you're definitely bullish on gold. Where do you see it going? Is there a risk that we need to think about? Because certainly, the fundamentals, I think should be positive for gold right now, given what's going on. But what we're seeing is, gold got dragged down 100 bucks in the last few days, along with everything else. I see it as, you know, people who have to sell, sell what they can, not what they want to and that's why gold got dragged down. Is that the right way to look at it? And is that over? Is it uphill from here? How should we think about precious metals generally, and gold in specific?

Louis: I was about to say that the old story, that the only thing that goes up in a market crash is correlations. And you know, you look at gold back in 2008, it took a big dip and then rebounded strongly. In fact, I would say that these kinds of events are, it's a great opportunity for people who do have capital to buy back gold. The reality is, gold is in a structural bull market. You know, it makes a new high, it consolidates a little bit, and then it goes out and makes a new high again, and the structural bull market reflects many realities of the world that we live in. It's partly to geopolitical tensions, partly the fact that a lot of wealth is being created in parts of the world, whether China, India, Indonesia, etc., where perhaps people don't really trust either their banking system or their government. And that historically, if you don't trust either your banks or your government, gold is the obvious choice for you to store your wealth. So for all these reasons, yeah, I have been bullish gold. I've argued over the years that gold is really a play on emerging markets. And I remain very bullish emerging markets. So it's very hard, I think, to be bullish emerging markets and not be bullish gold.

Now, against that, you could say, okay, what's the negative scenario for gold? How would gold fail? One way gold could fail, of course, is if the Fed turns around in September and says, hey, things are fine, I'm not cutting, and sends the US dollar higher. That'd be one possible scenario. But, if the Fed goes there, yeah, you take a hit in September, October, but I don't think the Fed will be able to stay on that stance for very long. So then, it just becomes a question of timing. What's the other bear scenario for gold? You could say, well, a bear scenario would be India or China imploding, and all the local owners of gold there having to basically flood the market to buy food and pay their bills. And you know, while I think you could have said that argument about China a few years back, the reality is that, yes, China has slowed a lot, no doubt, but it has not imploded. Far from it. You've had a massive asset price adjustment, stocks went down two thirds. Real estate went down by a third. You had the balance sheet contraction. But all this is more behind us now. And in fact, one of the very interesting developments for me in this current market pullback that we're going through, is that this must be the first risk off event in the past five years or so, where the Renminbi rose instead of a fall. It's also a big risk off event where Chinese stocks broadly did nothing, even as the Nikkei imploded and even as the KOSPI imploded and then the NASDAQ imploded, Chinese stocks, basically, they hummed along. And that brings me to perhaps a side point on gold. But if you think that a lot of the buying on gold, of physical gold in the world takes place in China and it takes place in India, think of Xi Jinping for a second. If you're Xi Jinping, you want to de-dollarize global trade. The US has tried to take you down, or you feel like the US has tried to take you down. You feel like you're under attack from the US. You desperately want to de-dollarize your trade. What's the easiest way to de-dollarize global trade? I think it's to ensure that gold keeps going up. And so that everybody around the world starts to say, you know what, I really shouldn't be in US Treasuries, I should be in gold. That'd be a much better trade, whether you're managing the Thai central bank reserves or the Indonesian central bank reserves or the South Korean Central bank reserves. And so, I highlight this because if you're Xi Jinping and you feel like the US has been attacking you, attacking you, attacking you, for the for the past few years, and now, all of a sudden, the US starts to feel a little bit wobbly. It starts to feel, you know, the NASDAQ is rolling over. It's no longer all about the Mag Seven. It's no longer all about Nvidia. And is this the moment that you start tightening the screws? Is this the moment where you start bidding up gold and saying, hey, I've got a bid at 2500, I got one at 2600, I got one at 3000, what would you do if you were him?

Erik: Louis, I just want to make sure that I understand your point correctly. Your hypothesis is that China may be intentionally buying gold for its own reserves, obviously, but as part of a strategy to intentionally foment an outcome where the whole world says, boy, look at this structural gold bull market. It makes so much more sense for central banks and other big institutional holders to replace their US Treasury holdings with gold because it's a better strategic asset. You're saying, essentially, they may be mounting a campaign to manipulate price, in order to bring more attention into this market for the purpose of, essentially a form of economic warfare to defend against what they perceive as aggression from the United States.

Louis: So, I'm not saying that this is happening, but what I would say is this, is that we're all the fruits of our own experiences. Now, if you're Xi Jinping, you're part of that generation that was sent out to the countryside during the Great Proletarian Cultural Revolution, you were sent off in the middle of nowhere with not a single book to read except Mao's Little Red Book. Now, you probably never read Mao's Little Red Book, but it's actually, it's not a great treatise on philosophy. It's really a how to do guerrilla warfare book, because Mao was actually a terrific guerrilla warfare leader. He beat the Japanese, he beat the nationalists who were funded by the United States and had all the equipment. He was obviously not a good guy at all, but he was a great guerrilla warfare leader. And you know, one of the great quotes that's often cited of the Little Red Book is, when the enemy attacks, we retreat. When the enemy rests, we harass. When the enemy retreats, we pursue. Now, imagine you're Xi Jinping, and you spend your entire youth with nothing but that, and your formative years with nothing but that. And if you think, okay, the US is out to get me. Do I take the US head on? No, I fight a guerrilla warfare against the US. When the US attacks, I retreat, and when the US retreats, I pursue. So the big question is, when you look at US politics today, when you look at the starting shift in financial markets, is this not the time where China starts to pursue. And how do you pursue? For me, the most obvious one is you crank up the gold price.

Erik: Okay, let's also cover industrial base metals, particularly copper. We saw a really strong rally in copper. Everybody thought, okay, it's this energy transition rally that's on because copper is so essential to electrifying the economy, then it started to blow off. We were holding the 200-day moving average, just barely, and took it out as a result of the last few days. Where are we headed from here? Is this part of the structural bear market that you're talking about? Are we headed much lower in copper before it's over?

Louis: So it's actually interesting, right? Because copper, if you look back, really started to puke before everything else. It started to puke before the Yen. It started to puke before the NASDAQ. So, to some extent, copper, once again, was a great leading indicator. Now, to answer your question, I don't want to make like a Jesuit priest and answer your question with another question. But I think at this stage, when you look at copper, you have to ask yourself, the question is, okay, do I believe we're entering into a big, bad global recession or not? If you believe, and I don't believe, but if you believe we're heading into a big, bad global recession, then why would you own copper? Right? You know you're going to get a lot less construction in the US, you're going to get a lot less construction in China. It's all going to go to the dogs. So, but if like me, you think, well, actually, they are trying to stimulate growth in China. You do have an emerging market boom unfolding in Indonesia and across the Middle East, if you think of all these things, then you have to see the current dip as a buying opportunity. So that's where I stand. But again, if you're of the view that, no, the global economy has become so financialized that a US bear market really is going to trigger a cataclysm of collapsing consumption, of collapsing capital spending, then, if that's your view, and I'm not poo pooing the view, I'm just saying, like it's a perfectly rational view. If that's your view, then yeah, there's not much point in buying copper, that's for sure.

Erik: While we're on metals, I want to hit you up with what I'm going to call the uranium conundrum. And that conundrum is this, I am absolutely convinced, Louis, that the fundamentals have never looked better for uranium, and therefore, indirectly, for uranium mining shares. And the reasons for that we've gone into in other episodes, but very briefly, the demand is knowable. You know how many reactors there are, you know how many new ones are being built. You know what the available supply is. You know that the world is getting more constrained. A lot of it comes from Kazakhstan. There's just so many reasons to be bullish here. But hang on, this sector has seen, not an AI like bubble, but boy, it's really been up a lot. And equities are equities. And it's also a very, very heavy retail participation sector, because for people who are running institutional money and have to worry about ESG scores and so forth, you know, it's nuclear, it's mining, it doesn't really tick their boxes. So, most of these uranium mining companies are almost entirely retail held, and those are the people that tend to panic in bear markets. So, on one hand, I don't think the fundamentals have ever been better. On the other hand, I know who owns these things. I know they're people that are prone to panicking, and I see the same concerns that you see in terms of where we might be headed with the broader market. And frankly, I can't figure out how to hedge it, because even if you think, well, okay, the risk is to the S&P, the broader market. So you hedge the S&P. The thing is, I think because of that retail participation, uranium shares could be down even harder than the S&P, so I don't see an efficient way to hedge it. I don't know what to do. I don't want to let go of it, but I'm a little concerned, because I am very much overweight uranium. What do you think?

Louis: So, I feel your pain. It's because I'm in the same boat, so I definitely feel your pain. So like…

Erik: Are you in the same boat? Long uranium? Or just…

Louis: Long uranium, and feeling the squeeze. Now, I would say that if you look at the big sell-off we've had in recent days, surely that's got to be some of the retail coming out, right? You would imagine that a lot of these producers have gotten absolutely smoked in the past few sessions, so that that might now be behind us. Then you're left, I think, with the quandary, when you look at the uranium miners, is it going to be like the gold miners? You know, where, if you look at the past five, six years, gold has done great, and gold miners have done nothing. And number of reasons, but the simplest reasons why gold miners struggle is that they spend all this money on exploration. They spend all this money on production, but actually finding gold has gotten really, really hard, and extracting gold has gotten really, really hard. And perhaps it's the same story for uranium, right? It's the spot price of uranium goes up, but production of it pretty challenging, and it takes a long time to get the mine up and running. And finding geologists, as you and I have discussed in the past, is now impossible. Finding people who want to go work in northern Canada, or work in Kazakhstan is pretty tough in a tight labor market when people would rather be in Austin, Texas or in New York City. So, for number of reasons, miners should be making money hand over fist, provided they can get the stuff out of the ground. But getting the stuff out of the ground is, whether you look at Gold, whether you look at Silver, whether you look at Copper, whether you look at uranium, it's just tougher and tougher and tougher.

Erik: You know, there's a scenario that I can't decide if it's a big deal or not, which is, I really won't be that surprised if in the next few years, the geopolitical tensions escalate to the point that somebody detonates just one of the smallest yield tactical nukes, in order to make a point, so to speak. I really hope it doesn't come to that.

Louis: This could happen. I was going to say, this could happen as soon as next week, when you look at the saber-rattling going on in the middle, exactly.

Erik: So, obviously, if we had a Fukushima sized nuclear power plant accident, that would put a huge, huge cloud over the uranium market. Would a tactical nuke detonation make everybody freak out about nuclear energy again? I mean, it wasn't rational last time. So, you can't really apply logic. How do you decide what size risk that is? Because, I think, if you're as overweight as I am on uranium shares, you ought to at least think about whether or not that's a big deal, and I can't decide,

Louis: See, I think that's such an important point you just made, because the reality is that there is no logical thinking around uranium, mostly because of it first appear in our collective consciousness with Hiroshima and Nagasaki. Before that, nobody knew anything about nuclear. It really wasn't a point of discussion. Now, we've had a couple accidents. There's been Chernobyl. There's been Fukushima. And think of the panic that this triggered in markets, that this triggered in the media. I mean, go back to the HBO show that they did on Chernobyl, which is really frankly ridiculous about how the guys who had been exposed to Uranium needed to be contained because they would be contagious, etc., etc. So in our collective consciousness, there's this thing, this belief, oh, uranium is so dangerous, nuclear is so dangerous, etc. When the reality, of course, is that, there's hundreds of people who die every year on oil rigs down coal mines, or 10s of 1000s who die on coal mines around the world. There's people who die every year falling off windmills that they're being repaired. The reality is that nuclear is by far the safest. If you look at the total number of casualties, relative to the energy produced, it's not even close how safe it is. It's so much safer than anything else we've ever used for energy. But in the public consciousness, you ask 100 people on the street, and 99 will tell you nuclear is the most dangerous, even though it's the safest. And yes, to your point, you have a nuclear event, you'll go from 99 to 100 everybody will say, and it will set it back. So that's a risk.

Erik: Let's broaden out the energy discussion and talk about what's happening with the oil market and where it's headed. You know, there's now, although I think in the big picture longer term, we're going to have a really serious spare capacity problem. We don't have a spare capacity problem right now. OPEC is withholding about 4 million barrels per day off the market. So, I suppose, an escalation with Russia that took Russia totally offline would change everything. But, short of really major geopolitical escalations, right now, we've got enough. But, boy, really major geopolitical escalations are not out of the question with what's going on in the world. So how do we think about this?

Louis: Well, first, I would say OPEC *says* they're holding back 4 million barrels per day. And we don't want to go down the rabbit hole of how much capacity does Saudi Arabia really have, you know, OPEC says they're holding back, withholding 4 million barrels per day. I'm skeptical on that, number one. Number two, you look at the past 30 years outside of massive global economic meltdowns, like 2008 and, of course, COVID, global demand grows by about a million to a million and a half barrels per day every year, and that's not coming out of Europe. That growth and demand, it's not coming out of US. You know, for the past 30 years, all that growth and demand has come out of emerging markets. Now, with that in mind, you know what's the biggest trend in emerging markets right now? And I think you and I have discussed this in the past, but what nobody saw coming, and one of the biggest macro trends for me of the past few years, is how China has become the biggest auto exporter in the world from nowhere. From nowhere, four years ago, China is now the biggest auto exporter, not because of cars it's selling into the US or Europe, but because of cars it's selling into Indonesia, into Pakistan. China is selling sub $10,000 ICE vehicles, you know, internal combustion engine vehicles all across the emerging markets. And it's not electric cars. They're ICE cars, because that's what emerging markets can afford. And in any event, most people in emerging markets don't have a powerful grid enough for cars, etc. So, I guess the point I'm making is that we have had been used to growth in oil demand being a million, a million and a half barrels per day coming up over emerging markets. And this was when everybody in Indonesia, everybody in India, everybody in Colombia was going around either on a bicycle or, at most, a moped. And what's happening is that all those guys who were driving mopeds are now buying cars. Not only that, they're buying cars and then next year, their cousins buying a car, and the following year, their niece is buying a car. So are we going to stay in a world in which China is now exporting millions of vehicles every month around the world?? Are we going to stay at a steady million, million and a half growth in demand, or could we conceptually move to two, two and a half million in demand? And if we do, then that spare capacity that you mentioned is going to get absorbed much, much faster than anybody expects.

Erik: Louis, let's go back to the nuclear conversation and tie it into what you were just saying about China. Because, if there's any theme that I think is the absolute most important one that there is, in not just in macro, but for the sake of knowing where the future of the world is headed, everything that I've learned in the last couple of years about advanced nuclear technology leads me to two primary conclusions. Number one, US policy has screwed this up so badly that it's really hard to see how we're going to get back on track, although they're finally starting to talk a good story, the advanced reactor certifications that Jennifer Granholm talks about. She has no idea what she's talking about. I mean, that's what they need to do, but they're not really doing it the way they're pretending to. China, on the other hand, is at least 15 years ahead. China's not fantasizing about Molten Salt Reactors. They're building them. They've already built them. They've already announced their intentions to build a container ship fleet that is powered nuclear, powered by molten salt cooled thorium fueled reactors. Exactly the right technology, in my opinion, that we should be focusing on globally for energy transition. The only people that are doing anything with it is China. The only people that are developing a thorium rather than uranium nuclear fuel supply chain is China. And what I see is a very, very clear trend which is going to elevate China economically and therefore militarily eventually, because of their energy superiority and the fact that they're already in industrial powerhouse, not this year, not next year, not in five years, but over the next 25 years, I see China becoming basically invincible and exceeding the United States economic and military capabilities dramatically within 25 years. And it's not some secret conspiracy that's hidden behind anything. It's all in plain view. China's not hiding anything. When I try to emphasize this, people either get mad at me and say, why are you down on China? Well, I'm not down on China. China's doing exactly the right thing for the

Chinese people. I applaud them for their leadership in nuclear energy. But Louis, something our generation knows, and I think a lot of newer generations seem to have forgotten, is the world is a competitive place. If we don't compete to have the same energy capacity in the West that China is already building their planned and under construction nuclear plants in the next 10 years, is like more than half the size of the entire US fleet. This is just so clear as to what's happening. Nobody's talking about it. Nobody's worried about it. I think it leads us to a very different world. And I'm not saying China's bad. I'm saying we should get our shit together. Nobody's listening.

Louis: Look, I love the points you make, because it goes back to so many of the themes that I've harped on about in my letters over the years. But I typically start off with the idea that economic activity is energy transformed. That, you look at most GDP, economic activity is extremely, extremely energy intensive. So that's the first idea. A second idea is that every country, every businessman, every industrialist, every entrepreneur, really has to deal with four things. He's got the cost of labor, huge cost for most people, you've got your cost of capital, you've got your cost of government. And the cost of government can come in many ways. There's the taxes, but there's also the regulation, and then you've got your cost of energy, and it's the interaction of these four things, cost of labor, cost of capital, cost of government, cost of energy, that make you competitive or not. Now, the reality is that, most people look at the boom in the US of the past 15 years and say, well, you know, the US, we're smarter, we're better. US exceptionalism, American exceptionalism. And you know, we've got the best tech sector, etc. I've argued time and again that what the US has had over the past 15 years is the benefits, the massive benefits of the shale revolution. The fact that the US could get natural gas a fifth of the price of the rest of the world was such a boon, such a tailwind for the US economy. It allowed for a stronger dollar, it allowed for an improvement in a trade balance. It allowed for low inflation, and the Fed to keep the cost of capital very low for a long time. So now, not to belabor your point, but if we look at the next 10 years, the next 15 years, who's going to have that cheap cost of energy? Now, you could say, well, it'll still be the US, because of shale, because the US has a deregulated energy industry. If you basically think the next 10,15 years are going to be still be all about carbon, then probably the US remains the winner. If it's all about carbon, the US remains the winner because the US has a lot of carbon, whether coal, natural gas, oil, the US has a lot of it. But also the US has very entrepreneurial energy sector, wildcatters, and people, you give them a dime, they immediately start digging a well. So, the US has that in a way that very few countries do. But if you think, no, the future of energy is not carbon, both for political reasons, but also simply because of cost reasons, because the scale efficiencies from carbon actually are nowhere near as good as the scale efficiencies that you get from nuclear, from solar or from wind. Now, if you think the future is wind, I don't, to be very clear, if you think the future is wind, then you might be bullish Germany, because they're a clear wind winner, wind leader. But if you think that the future is either solar and or nuclear. And for what it's worth, I do think that, then those two industries are today, completely dominated by China. And yes, to your point, they're 10, 15 years ahead, and it's hard to see them give up that lead in the future. So, I think people underestimate how China has leapfrogged us over the past 10 years in so many industries. It's leapfrogged us in the manufacturing of cars. It's leapfrogged us in the matching manufacturing of solar panels. It's leapfrogged us in the, and when I say us, I mean the Western world. It's leapfrogged us in the manufacturing of nuclear plants, and that this has now sown the seeds for comparative advantages in China for probably the next decade.

Erik: Louis, I want to close with a cultural question, because you are a Frenchman who has lived in Hong Kong. I'm an American who's lived in Hong Kong. And something I find interesting is when I express my view to other Americans, which is that I think China is better than we are at long term planning. I think that China has a very clear long term energy plan. They understand everything you just said a minute ago about why the economy is really energy transformed. I think that they understand exactly that. They already have enough thorium to run the entire world indefinitely. They have enough uranium to breed that thorium into U-233, they are already building that supply chain. They're already building the advanced reactors. But I think culturally, there's more to it, which is, I think, that the Chinese government and the Chinese people see themselves exactly the way their country is named in their language, zhong guo, central nation. And I think a lot of people misinterpret that. They call it the Middle Kingdom. What I think it means is the Chinese culture sees itself as basically the center of the universe. We're in charge of everything, because we are the Chinese. That's the way, as they say it, it's always been for 4000 years, and this last 200-250 years of industrial revolution in the West, being in charge of things that's like a very unfortunate mistake in the long term history line that's about to be corrected through what I think is a brilliantly crafted Chinese energy policy. Now, I wouldn't get through that little monolog with most of my American friends before eyes are rolling, you're a nut case to think that, that's what the Chinese people actually think, that they're supposed to be the leaders of the world. These are people, Louis, who've been to Chinese restaurants, but haven't lived for years as you and I have in Hong Kong. My counter to them is kind of like, okay, I don't know what else to say, but try living there. Get a sense of what the culture is really about. You've lived there a lot longer than I have. Am I crazy to say these things?

Louis: No, you're not. But I look at it a little bit differently. I'm sure you know the story of, you know the two young fish swimming in the ocean, crossing the old fish, and the old fish says, hey guys, how's the water? And the two young fish say, you know what, what's he talking about? What does he mean water? I think if you live in the US, you've never had to worry about energy. You were awash in it, or at least you, you have been for the past 20 years. In case you didn't have it, you had a powerful enough army to send around the world to make sure that you would get it. So all this to say, if you were in the US, you never had to worry about energy. You never really needed an energy policy, it was there. It was one of those things you could take for granted, just like the young fish can take the water for granted. Now, I think what makes China fairly unique today, not just right now, in its position in the world, but frankly, in its position of over 5000 years of history is that, if you look back at the history of the past 5000 years, there's lots of examples of empires that rise and empires that collapse, Mesopotamia, Persia, Rome, Cartage, you name it. Empires rise and fall, and it's the pattern of history. So what makes China quite unique, and today, is that China was once a great, mighty empire. And to your point, they did see themselves as the central nation. And you know, when the Westerners first showed up, when the Brits, it was really the Brits in the 18th century, they show up to say, hey, we want to trade more. Would you look at all these things we can bring? They look at it and they say, well, this is gadgets. We really have no interest. You know, when the great fleet went around the world in 1421, you know, it was 300 ships. They went all the way down the coast of Africa, all across the Middle East, all across India, some people believe they even went across the Pacific. Anyway, they came back and said, yeah, there's really nothing interesting in the rest of the world. And they burned the fleet down, whatever. We're so, so much more advanced than everybody else. Everybody else is kind of a waste of time. That was the perception. So when the foreigners came in and invaded them, and excuse my French, but basically, bitch slapped him around, they couldn't compute. It was a huge disillusion for them.

But what makes China very unique is that it's an empire that rose, that was very powerful, that collapsed in a spectacular fashion. You know, living in China between 1860 and 1975 was probably living in one of the most miserable places on Earth. Famines, civil wars, warlords, and that's if you were a man, if you were a woman, it was even worse, bound feet, et cetera. It was just a really rough place to live. And having tasted that very bitter taste of utmost defeat, et cetera, you now have, of course, a leadership, now that they've come back up and really being the first empire in the history of humanity that picked itself off the floor, dusted itself off and came back up. Having done this, there's, of course, a lot of thinking of we can never go back to what it used to be. Now, unlike the US, China does not have the natural resources. It does have some oil. It does have some natural gas, but not nearly enough for 1.2 billion people aspiring to consume at a high level. And so, China has no choice but to embrace technology. You know, technology is the necessity, is the mother of all inventions. China has no choice but to go down the technology route, to deal with its energy needs. It has to embrace nuclear. It has to embrace solar, because it doesn't have, again, the luxury that the United States has, of being a very well endowed in terms of commodities country. And so, this is why you look at China today and China now graduates more engineers every year than there are engineers in the United States. China is just, it has no choice. It has no choice because A, it feels like foreigners want to take it down, just like it did last time around, when China rose, China was cruising along, doing well, and then foreigners came in and tore it apart. So they do have this in their collective memory. And so when foreigners come in and say, you can't do this, you need to do that. We're going to take you down. We're going to prevent you from growing. We're going to prevent you from having the semiconductors that you need. Very quickly they think, okay, it's semiconductors today. It's going to be energy tomorrow or food tomorrow. So again, necessity is the mother of all inventions. Given the deep historical trauma that China went through 1860 to 1975, they have no choice but to plan, but to innovate, but to move forward.

Erik: Louis, I can't thank you enough as always for a terrific interview, I always enjoy our talks, despite the fact that you cause market dislocations every time we schedule you.

Louis: That's me, that’s my fault.

Erik: Before I let you go though, just tell our listeners, I can’t imagine who's not familiar with Gavekal, but you guys are an institutional, boutique, institutional advisory firm. Tell us more about it.

Louis: absolutely. Thanks again for having me. I always enjoy our chats. We're a bit of an odd firm. We do different things. We do produce research for institutions, and people who are interested in that should probably just look at our website, gavekal.com. We do have an institutional money management arm run out of Hong Kong, mostly running Asian strategies, Asian fixed income, Asian equities. We recently actually launched a Latin America debt fixed income strategy. And then we have a private wealth arm, and then joint venture in the US with Evergreen Gavekal, so people can look at that website if they're American or Gavekal Wealth if they're not American. So, two separate entities there. So yeah, we really do three things: private wealth, institutional money management and then institutional research.

Erik: Patrick Ceresna, Nick Galarnyk and I will be back as MacroVoices continues right here at macrovoices.com.