Viktor Shvets: From Central Banks to Asset Classes to Geopolitics & More

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Erik: Joining me now is Victor Shvets, global head of desk strategy for Macquarie Capital. Viktor, it's great to get you back on the show. So much we've got to talk about. Let's start with the Federal Reserve and for that matter, we can expand the conversation to central banks generally. Have they become political? Heavens no, it could never happen in the United States, and have they committed a policy error?

Viktor: Well, thank you very much for having me. It's always an interesting question, are central banks political? It's like asking, is any human institution political or not? For the answer, they're all political in some form. It's all about the degree of independence that you get, but nobody is truly non-political. So, I don't think Federal Reserve or any other central banks are purely technocratic institutions. However, in terms of whether they made a policy error or not, that's an interesting question. Because, to my mind, the inflation, or the problem of inflation was over and done with probably sometime in earlier 2023. That's when I published that team transitory has won, and team transitory was right all along, any inflation after that, pretty much globally, was really anomalies, either statistical anomalies or methodological anomalies, but the underlying inflationary pulse arising out of COVID was pretty much over in 2023. So, the question is, by waiting all the way into '24, whether central banks have committed a policy error by keeping interest rates above neutral rates. To my mind, they have committed a policy error, but the consequences are not as significant as they used to be.

One of the things I keep emphasizing is that we live in the world of excess surplus capital. We've got abundance of capital, not a constraint shortage of capital. Now, that's quite unique. It only occurred in the last 15, 20 years, and it's been increasing ever since, primarily because money supply has been growing so much faster than nominal GDP. And the difference between the two is this excess capital we have, it's very hard to compute, but on a global basis, I think we have at least $500 to $800 trillion of capital, which means anywhere from 5 to 10 times GDP. So, when you have excess capital, prices don't work as well because there is excess of that commodity, rather than a shortage. Now that helps if you commit a policy error, if you keep rates too high, but there is too much capital moving around, that cushions the real economy.

The second thing we have that we never had before is really instantaneous risk repricing. You know, Federal Reserve makes one announcement, the answer is automatically on a screen within a split second, so you immediately know where there is a problem. And the third thing we have, once again, we didn't have it before, really, is ability of central banks to roll out new policies on a whim incredibly fast. Think of it this way. Federal Reserve, it took them almost a year to become comfortable with QE. It took them at least a month to understand that we need an emergency repo facility back in 2019, but in 2023 it just took 72 hours in order to create a brand new facility to rescue Silicon Valley Bank and essentially end the regional banking crisis. So, if you have too much capital, which we do, in other words, there is no shortage of capital if you have instantaneous repricing of risk, and if you have policies that are designed for specific problems and can't be rolled out incredibly fast, how can you commit a policy error? And more importantly, if you have committed a policy error, you can unwind it incredibly fast, pretty much in a split second, without really damaging the underlying economy so much. Now, I'm not saying that if you decided that inflation is a real problem, and you want to keep, say, policy rates at 5.5%, when neutral rates in the US are closer to 3%- 3.5%, if you keep basis points up for a long period of time, eventually you're going to crash the economy. But why would you do that? If inflation is not really a problem and is unlikely to be a problem as you go forward?

So to answer your question, are central banks political? I think every human institution in some form is political. Number two, have they kept the interest rates, whether Federal Reserve or ECB, too high? The answer is yes, they have. Have they committed a policy error? Yes. Is it going to lead to recession or extremely negative outcomes, either in terms of bankruptcies or bad debts or consumer spending? The answer, no, we're going to end up with a slower growth. We're going to end 3%-3.5%. In the case of eurozone, it's going to be a more like 1.5%-2% lower rates. And we're going to get more liquidity. And if you think of liquidity, if you look at federal reserve balance sheet, they're down to about $3.2- $3.3 trillion in Treasury securities. If you think of reverse repo, they're down to only about $300 billion. They need to continue to unwind the idea of QT, and, in fact, go beyond that and start injecting liquidity. So, my view in the next 18 months, slow growth, but no recession, lower rates and more liquidity. So from an asset classes point of view, and asset prices point of view, what is there not to like? It's almost like a goldilock.

Erik: Speaking of asset classes, let's talk about the yen carry trade debacle, which was the huge, huge story of a few weeks ago, oh my gosh, the world, you know, sky is falling. Then maybe a week later, it seems like everybody forgot about it. Was that the BOJ just reversing policy? Or what happened there? And should we still be concerned?

Viktor: Well, you should always be concerned with a major player like BOJ or Japan changes policy. It always has some impact. But again, if you take my idea of abundance of capital, not shortage of capital, Japan doesn't play quite exactly the same role. So, if you take my view of $500-$800 trillion of capital, Japan, with a $3 trillion of net international investments, roughly a trillion dollars of lending is important, just like Petrodollar is important, but they're not as critical as they used to be 15, 20, 25 years ago, because there were many other sources of liquidity around the world. We are now adding more and more securities for every asset that we have. We used to have one to one, then it was two to one, then it was four to one, then five to one. All of those securities can be leveraged. So, when the Japanese yen debacle started, my critical question to ask was, do I see contagion? In other words, there's plenty of capital out there for everybody and for everything, but sometimes people get petrified. And they get petrified because incremental liquidity gets withdrawn, and when they get petrified, they stop multiplying liquidity. Banks stop providing overnights to other banks, other entities, stop multiplying hedge funds or family offices, stop multiplying liquidity. And so, the question in those dates, in that week, was, really, do you see contagion? And the answer is, none. If you think of overnight spreads, if you think of the old TED spreads, which is commercial spreads. If you think of high yield market, whether it's CCC or BB or single B, if you think of basis swaps, which is basically what you pay to swap your currency, no matter where I looked, I really didn't see any contagion. So long as contagion did not occur, so long as people did not get petrified, and therefore, so long as they didn't stop the liquidity train, then it's just what I call the heart palpitation, it's not a coronary attack. It only becomes coronary attack, or a heart attack if actually, you do see contagion. And a final thing to say about yen carry trade, as I said, yes, Japan is important, but less important than it used to be. But if, in fact, this equilibration, or this synchronization of monetary policy between the US and Japan were to go deeper, it's almost inevitable, BoJ and Federal Reserve will intervene. Now a lot of people say, Viktor, how do you know that something bad is not going to happen? We are looking at the banks, we are looking at the corporates, but a lot of that money goes into family offices, they go into private capital, they go into places that are not as visible as other banks or corporates are. How do you know that we will not wake up tomorrow, and one of them was on the wrong side of that transaction? Well, I don't know if it is possible, but all I'm saying, just like a Silicon Valley Bank, a solution, if it's systemic, a solution will come across. So, my view of yen trade was, it's a heart palpitation. It is not a heart attack. It's not a coronary, unless and until we actually find contagion. As I said, it was not back on that week or two weeks. It's not there today.

Erik: Viktor, there seems to be a global trend that I'm noticing, and I don't know if it's related or not, so I'd like to ask you to comment. Around, I'll call it extreme politics, whether it be something like in the UK, you've now got threats being made by the director of the police, I forget the gentleman's name, saying that even social media posts posted in other countries, criticizing UK Government policy could lead to extradition requests. In the United States, you've got an extreme political situation with an election underway where the incumbent candidate has not made any position statement whatsoever, there's been a huge amount of contention around that. In France, you've got the arrest of Pavel Durov, and a lot of it seems like growing discontentment within the French system. Is this stuff all related? What's going on here? What's driving it?

Viktor: Well, it's a good question. And actually, in my latest book that I published, *The Twilight Before the Storm*, I tried to answer this question, why are people polarized? Why are societies so polarized? Why politics cannot revert back to being a collegial, problem solving institutions, why society and politics place so much emphasis on purity and so much emphasis on destruction of the house, rather than the compromises which inevitably are required if you were to govern? And the answer to me is what I call Fujiwara effect, which is a merger and reinforcement of several hurricanes. Now the first hurricane to me is the information age, which are picking up speed and have been picking up speed since 1990s that basically disintermediates both labor and capital. The second hurricane is what we've discussed a second ago, and that's financialization, that we now live in a world of abundance of capital, not in a world of scarcity of capital. And financialization reinforces technological progression, because what you're seeing is that if you are highly financialized, liquidity has to keep on growing forever. If it does, then there is more and more capital available to try out various technologies. So, technology is a human spirit, but the speed with which it propagates depends on availability of the cost of capital. And so, one of the things financialization ensures that it's actually there, and so you have this intertwining or reinforcement of those two hurricanes. It's been made even worse by sort of neoliberal policies that we have pursued, which included globalization, fairly destructive in some ways, globalization, it included climate change, it included many other things.

So as a result of this Fujiwara effect, or a merger of technology, financialization and neoliberal policies, people within the countries start moving in different directions, at different speeds, and races and national minorities or ethnic groups start moving in different direction, different speeds. When that happens, inevitably, domestic polarization increases, and then the countries themselves start moving in different direction, at different speeds. That leads you to geopolitical problems that we have. And so, to me, that's the heart of the matter, merger of financialization and technology that is driving all of those polarization issues. But one of the good things, by the way, that's why I compared our period to 1930s rather than a more conventional comparison by everybody, to 1970s. But the good news, if you think of Brothers of Italy, if you think of RN in France, if you think of PVV, even at extremes, things like AFD in Germany, what we've seen so far is that if the electorate, the people are not yet mad enough, are not yet crazy enough, are not yet angry enough to magnify the extremes, in order to be allowed to govern those countries had to eject their worst ideas. So, Brothers of Italy no longer talking about exiting EU, exiting Europe, taxing banks, cutting welfare payments. They essentially become social conservatives, but in an economic sense, they're much closer to, same thing pretty much happened in Iran, in France, if you think of the United States, Republican and Democrats are moving in a similar direction. So Republican Party injecting Project 2025, they're not talking about entitlements, or try not to, or procreation rights. In other words, they're trying to move a little bit to the center and so, as Democrats who are no longer talking about oil and fracking, as much as you would have expected Democrats to do. So it's good news, because the more the electorate forces those parties to reject their worst ideas, the closer the economic policies actually are going to be. And why is it critical? Because that's where your central banks come in and everybody else. The further the policy are apart, the greater volatility that central banks will be facing and the greater problems what the monetary fiscal policy is actually likely to be. So there is a good news in it at this stage, the electorate is not yet mad enough or angry enough.

Erik: Okay, now I really want to key in on when you said, not yet. I noticed the inflection in your voice on the word “yet” was quite telling, suggesting that it's coming. But at the same time, you, just a minute ago, said that a lot of these policies were kind of moving back to center as the worst ideas have been rejected, so is your outlook that things are calming down or things are about to get worse? What was the “not yet” part?

Viktor: Oh, it depends. It depends on the policies we pursue. And again, if I go to my writings and the latest book, basically what I'm saying, there are policies that you can design in order to lower the pressures. When I compare it to 1930s, I was saying, look, in 1930s the choice was not between freedom and slavery. The choice was how much freedom do I need to sacrifice, in order to avoid the most extreme outcomes? And in 1930s, the choice was between communism, fascism and constrained democracy. All of them tried to address the same problem, inequalities, lack of opportunities, lack of possessions, whatever. It's exactly the same problem. And all of them, whether you were communist or a fascist in those days, or whether you were New Deal liberal, it doesn't matter. In all cases, it was all about the government. So, whether you're a communist, expanding the government, whether you’re Taft expanding the government, whether you're Franklin Delano Roosevelt expanding the government, the government was the answer. The only question was, extent to which the government should spread, extent to which its influence should spread, how much free space should be left for people, for private markets, for private businesses. That was the difference. So, the communists said, no free space, we're getting rid of property rights. We're getting rid of discussion, no debate, no politics. Okay, that's one answer, but we're promising you fairness, although that wasn't true, but that's what they promised. If you think of fascists, they said, okay, you can keep your property, but we will determine what we're going to do with it. And by the way, we're getting rid of all the politics along the way. And again, we promise you more fair environment and maybe even longer term, faster growth. The genius, in many ways, of FDR is that he found the middle ground. Yes, some freedoms were lost. Yes, new agencies came up. Yes, the government reach had increased, but political rights were preserved. Most of the freedoms were preserved. Private sector in private space was preserved.

We're kind of facing that same environment. The sort of labels might be different. We're no longer talking about fascists, the communists. But the idea is the same, how do we essentially reestablish society? How do we stabilize societies? What will be the role of government in those societies? You know, in 1937, they published this book, *Planned Societies: Yesterday, Today, Tomorrow*. And contributions were from Joseph Stalin, from Benito Mussolini, from New Deal economists, from American sociologists. And the interesting thing, when you read it, all of them agreed that liberal free market philosophy was led to devastating outcomes. And all of them agreed that the government rule will increase. The only difference between Joseph Stalin or Benito Mussolini or New Deal guys was a degree, extent to which, so the question then becomes, as we go forward, the government tentacles are expanding. The government influence is already expanding and has been for a considerable period of time. Societies are already becoming more conservative, just like they were in 1950s with UN American Activities and the rest of it, so societies are becoming more conservative. Societies are now penalizing more aggressively any behavior that is outside acceptable norms, much more so than societies did 10, 15, 20 years ago, so we're already moving in that direction. So the question is, how far do we need to move for societies to stabilize? Because if societies stabilize, then the “yet” is not going to come through, and we actually will land straight from 1930s into 1950s and bypass 1940s along the way.

Erik: Let's move on to geopolitics, starting with the Gaza-Israel-Iran conflict. Feels like things are heating up. Israel made some statements this week suggesting they're not about to back down anytime soon on their attacks, and there's been some more fighting. Where is this headed? What is the likely outcome?

Viktor: The way I look at it, there is what I call "the Ring of Fire" around the world. And you guarantee that over the next 5, 10 years, there will be earthquakes along that line of fire. Where does it run? It runs through the bloodlands of Belarus, Ukraine. It goes into Balkans. It runs through the Middle East and Central Asia, then it goes up to Himalayas, then it comes down to South China Sea in Taiwan, and finally, it goes up to Korea. That's where the conflicts will arise. The only question is whether it's Hamas, Iran, Israel, whether it's Serbia, whether it's Ukraine, whether it's Taiwan, whether it's India, China and Himalayas, the only question is, will it be a hot war or a cold war? So some kind of conflicts are inevitable. The question is one of severity, either economically, socially, politically. Because if you think of a hot war, where major protagonists confronting each other, that's devastating, because that's where the death rates are at least 200, 300 per 100,000 people. You find military spending goes up to 20%, 40%, 50% of GDP, massive shifts and fiscal spending, massive destruction of GDP. If, however, you have a cold war that is fought mostly by proxies, mostly on the localized levels, not between the major protagonists, the numbers are much lower. So, if you think of military spending, instead of 20%, 40%, 50% of GDP, tends to be 5% or 6%. Instead of killing 200, 300 people per 100,000, it tends to be more like 5 or 6. Instead of destroying 30%, 40% of GDP globally, it only limited to certain areas. And then, of course, there was a period of peace dividend from 1990 until, call it around 2010, when defense spending was less than 2% globally, you find deaths in conflicts were less than 1 per 100,000.

So we're already somewhere between the Cold War in a peace dividend. So if you think of defense spending globally, we're now spending more on defense than on research and development. For example, US is now spending 3.5%-3.7% of GDP on defense, if you think of deaths in conflict, to already up to about 3 per 100,000 from less than 1. So we're somewhere in between. Are we going to keep on drifting towards the Cold War, era of 1950s, 1970s? I think the answer is yes. Is it going to be a hot conflict like World War II or the Great War? Right now, it seems highly unlikely. So when people say, my God, we've got Houthis, we got Hamas, but we always had that. If you think of '50s and '60s, how much of that stuff was going on, it just so happened that between 1990 and 2010, people didn't see it. But now we're returning to normality, much more conflicts globally, far more turbulent than it used to be in the past, in the recent past. Now the key, of course, is whether it displaces globally demand and supply curves for goods, labor and services and capital. Now, if the answer is no, and in the Cold War of 1956 is the answer was no, it's very unpleasant, and horrible tragedies that are occurring. But from a global economic point of view, it actually does not make a significant difference. And so, to me, when I look at all of those tragedies that are occurring, I basically say return back to normal international relations. That the previous 30 years was abnormal, but it doesn't mean that it necessarily significantly dislocates, as I said, either the global flows or the global trade or even labor, goods or services markets.

Erik: I'm very curious about your comment to the effect that a cold war was not likely to lead to a hot war escalation. It seems to me, as we bring the Russia-Ukraine conflict into this, and I'll just remind our listeners you were born in Kyiv, Ukraine, so you probably have some strong perspective on this. It seems to me like the conflict has just entered. I'll call it a new chapter, the push of the Ukrainians into the Kursk Region. You know, now we've got an offensive with German tanks rolling into Russian territory for the first time since World War II. There's been a lot of talk that suggests maybe this is going to be what provokes Vladimir Putin to escalate substantially in terms of his attacks, and it seems like that's happening. So how do we reconcile that this doesn't lead to a hot war, with the fact that it feels to me like the Russia-Ukraine conflict is heating up pretty quickly.

Viktor: Yeah. I mean, the risk out there, no question about it. Lots of people who say, well, Russia and Ukraine need to negotiate. The problem is, there is no basis for negotiation. What Russia wants, Ukraine can never willingly concede, and what Ukraine wants, Russia will never accept. So, you need to wait to a point that both of them, either of them, or both of them, are exhausted and at a deadlock. Now, what Ukrainians have done is basically took the leave of, you know, from Israeli wars, for example, in 1967 and 1973 by changing the game and aggressively attacking. Now, could it lead to much more complex warfare? The answer is yes. But one of the things we've learned in the Suez War in the Middle East wars of 1960s, 1970s, one of the things we remember from Budapest, Hungary, in 1956, from Berlin Wall in 1961, from Berlin airlift in 1940s, from all of those conflicts that we have experienced, and every time there was a view that this could lead to something horrible, by and large, it didn't. And the reason it didn't is that nobody was prepared to use the ultimate weapons, which in those days and even today. And the reason nobody was prepared to do that, because that's the end, that's the end of your country if you're actually going to do it. And so, even Joseph Stalin was reluctant to do it. If you think of Mao, he was reluctant to do it, and remember, they were not shrinking violence, either Mao or Joseph Stalin. So to me, when people say that, I just don't buy it, historically, that's not the way it played out. What we're seeing is a chessboard with Ukraine, courageously, in my view, and wisely changing the dynamics on a battle. Because I said, everybody who talks about negotiations, they just don't understand that Ukraine is fighting for its identity, as it had for about 500, 600 years, against Russians, against Poles, against Lithuanians. And the idea that Russia had of itself is not confined to Russian borders. So if you think of Russian identity, Russian language, Russian ethnicity, it has no relationship to the Russian borders or borders of Russian Federation itself. So, you've got this irreconcilable difference that Russia views itself differently. And I think Zbigniew Brzezinski was absolutely right to say that without Ukraine, Russia can never be an empire, but *with* Ukraine, it automatically becomes one. And he said it back in the early ‘90s. At the same time, actually quite presciently, he was arguing that probably the worst geopolitical outcome to happen in the future will be the coalition of grievances between Russia, China and Iran. And if you think about it, that was uttered in 1990s when nobody was thinking about that. So, he was right on that, too. So to answer your question, yes, it's a risk. It's a horrible thing that’s happening, but I can't see a basis for negotiations, because it is about the stall and the nature of the countries which you can't negotiate. The only thing you can do is either both sides get exhausted or somehow find at least a temporary compromise, but not a resolution.

Erik: Viktor, with respect to the impact of these conflicts on markets, of course, people think first about the oil market. What I'm hearing in terms of chatter this week among oil traders is kind of a dichotomy between two very opposite views. One is, look, OPEC's got so much spare capacity, they're kind of threatening to terminate their cuts and resume producing previous levels, which would, of course, suggest lower prices, potentially substantially lower oil prices to come. And that is counterbalanced by the fact that these geopolitical escalations keep getting more significant. People are getting more and more concerned about a big upward spike in oil prices. So, is it one or both of those things, or both at once, until one happens on top of the other? How do we make sense of the energy markets from here?

Viktor: I think all of those things are possible, but if you try to be rational about what's likely to happen, to me, and I'm not an oil specialist, but to me, couple of things come to mind. Number one, remember how people are worried about oil and gas, and what's going to happen? Europe is going to freeze because Russia, they're not taking Russian gas and they're not taking Russian oil. It's just remarkable how, in the space of just less than a year, the trade got redirected. So, in other words, Russian oil and gas are still coming onto the market, but it's coming into different countries. It's coming in different means. Some of it is legal, some of it is not legal, but it's circulating somewhere. So, the idea that oil or gas prices will go up because Russia is out of the system was categorically wrong. Then you have a question that we're not actually short of oil. I mean, we've got plenty of oil, plenty of gas. It's just we're not using it the way we could be, and some countries are not pumping it the way they could be, which means it all comes down to demand. So, if there's plenty of debt, commodity is theoretically available, it comes down to demand. And so, one of the things I've been highlighting is that we're globally living in a twilight, meaning we have no recessions, but we have no strong recoveries. If you don't have a recession, there is nothing to recover from, right? Say, we're leaving in a twilight, no bad debts, no horrible stuff, but the growth rates globally tend to get shallower and shallower and shallower. So if you go back a decade or two ago, global growth rates and market prices would have been 4%-4.5%, then it was 3.5%, then it was 3%. Today, we're barely traveling at about 2.5%-2.7% and that applies to 2024, that will apply to ‘25 in my view, it won't be that much different in 2026. So when you are living in a twilight, no collapses, no recoveries, no bad stuff, but no good stuff, you don't actually have a considerable push in terms of demand for oil and other commodities.

And the third thing I highlight is China. In my view, China will never again support global growth rates. It will never again support a global commodity complex. And the reason for that is simple, that current leadership of China fully understands that four cycles that they have done since 2008 have resulted in massive explosion of debt. They've gone from less than $5 trillion to $65 trillion, it resulted in a significant decline in efficiency of capital utilization. They now need $10 of investment for every dollar of GDP, whereas previously, they needed more like $3. It resulted in lower ROE’s, return on equities, it used to be, you know, for corporate, 20%, now it's more like 9%. And so, they fully understand that they can't do another cycle the way they did over the previous 15 years or so. And so, if you don't have a significant reliance on capital intensive stimuli, whether it's infrastructure, whether it's real estate, then you're not going to provide the support for commodities, whether it's iron ore, whether it's copper, whether it's oil.

To me, just answering your oil question, I basically say number one, we've managed to redirect Russia incredibly effectively, as I said, some legal, some illegal, but it's still done. Secondly, we have plenty of stuff to go on. Thirdly, global growth rates are contained in a relatively narrow range, which means demand doesn't really jump. And the final point is China, and the way China consumes commodity is unlikely to be anything like what we saw in the previous 15 years. And by the way, there is no other country in the world today that is able to replace China or step into China's shoes. That probably will be true for at least 10 years, if not longer.

Erik: Let's broaden the conversation beyond energy to commodities generally. I noticed copper, in particular, the counter trend rally. And copper stalled and failed right on the 50-day moving average, and we ended up trading well below the 200-day moving average, but rallying back up now, just as we're speaking on Tuesday afternoon, once again, right on the 50-day moving average, which is where the early July rally failed. Are we about to fail again? Or has Dr copper begun to stage a real recovery here?

Viktor: Well, I'm not a commodity specialist. I'm not going to put specific prices. That's other people's job. But the way, again, I look at it is, in the case of copper, there is actually long term underlying demand. Unless we have a much more effective energy conduit than copper, and maybe we're going to invent something, who knows, in the next 5, 10 years, but unless we find something else, copper actually has a long term demand, unlike oil, for example, or coal, which are really industrial AG assets, I describe them as modern day equivalent of tobacco. We’re addicted, but it is tobacco. Copper is not. And so Copper has a long term line of sight, just like lithium has, just like rare earth has, just like nickel has, but it doesn't mean that it's a smooth ride, because what also is important is, number one, economic growth rates, particularly China. Number two, what is important is how we use it. In other words, how much technology can get to a stage that we're using less of it compared to what we're doing today. That in many ways, what happened to nickel over the last sort of 18 months, 2 years. And the third area is supply. How quickly is supply actually comes along? Not that long ago, we were talking about massive shortage of supply of lithium that seems like it reversed itself reasonably quickly. So, my idea, when I look at commodities, that I'm not a commodity specialist, is to say I would be a rich man if every time I got a dime when people said we're running out of commodities, because every time we haven't, either we found something else or we found a lot of it. Alternatively, we've used technology differently in order to use that commodity more efficiently.

Erik: Let's move on to the US stock market. A lot of people have suggested maybe we're seeing the beginnings of a double top here. We're within about 80 points at least, as we're speaking on Tuesday afternoon. I'm looking at $5,643 on the September E Mini futures contract. That's about 80 points below the July top. Are we going to take out that top to new highs, or is this maybe a double top that's about to reverse lower?

Viktor: Well, it could, in the short term, reverse. I mean, the way I look at the US is to say, if I think of earnings per share estimates on the corporate side, US analysts are putting just a little bit too much gross in my view, for 2025 and 2026. They're looking at about 14%, 15% EPS growth rates. That's too high. If, in fact, the global growth rates were about 2.5%, and if the US were to full in nominal GDP gross returns from five to maybe four or less, generating that 15% is not going to be easy. It should really be in high single digits, rather than in a lot of mid double digits. So that's your potential negative, that you actually get less growth coming through. But on the positive side, risk free rates are going to be lower. As I said early on, the neutral rates in the US, in my view, in real terms, are less than 1%. So that means, in nominal terms, they're somewhere around 3%, 3.5%. That's 200 basis points less than where Federal Reserve actually is today, as we speak. So, risk free rates will be low. That leaves you with a risk premia, equity risk premia to decide what the value will be. Now, equity risk premia today in the US is incredibly low. Even if you adjust for inflation, it's only about 3%. If you don't adjust for inflation, it's like less than 1%, that means it's the lowest since dotcom, only during dotcom period, equity risk premium in the United States was lower than that. So, there is no capacity to lower risk premium any further. So the question is, extent to which risk premium might actually jump. Now, to me, it will only jump if you have cataclysmic electoral outcomes, like one of the worst potential electoral outcomes will be inconclusive and disputed elections that could create massive problems. So the question is, will electoral outcomes do this.

The other way to look at it is to say, if the underlying economies were much, much weaker than what we expect, I don't think that's likely to happen, but that's your risk, and risk premia, clearly, is going to go up. The third area is, really, if you look at it, it's a question of technology and growth styles, because the SPX is much more weight by growth styles than any other index. So the question that comes back is, is technology overvalued? Now, I happen to believe it's the case. The answer is, no, it isn't. But you can debate whether 30 times it is overvalued, it is undervalued. In my view, everything is valued very highly. I mean, even the value in cyclical styles in the US are trading at 16 times forward, very seldom they trade it at that sort of a level. So long as my view on the technology is right, so long as electoral outcomes are not extreme, an economy slows, but there is no recession, probably risk premium will stay fairly flat.

Now, that basically means that the SPX should be range bound. That has been my view for the last 12 months that lower EPS will be compensated by lower risk-free rate, with equity risk premium remaining relatively flat now. So far, SPX performed better than I thought it would, and the earnings, to be fair, were actually better than I was anticipating. So to me, I'm still in the game, saying, I can't see why SPX will jump to 6000 or 6500, and I can see why it should be range bound somewhere in low to mid five, I can see that. Now, if you take that view, then the question becomes one of rotation of styles. In other words, what will win and what would lose. Now, so long as you don't have strong cyclicality, and so long as you don't have bankruptcies and disasters, there is no need for defensives, because there is nothing to defend against, because there are no disasters. On the other hand, because cyclicality is weak, there is not enough there for cyclicals in value. So, I'm still coming back to sort of the middle ground, which is a quality, sustainable growth, growth thematics, they are more expensive. It's true, any of those styles will be, on average, about 25 times forward. But the ROE's are usually, or return on equity, usually over 30%, cash flow generation is very high, and the balance sheets are good. So I'm still ending up sort of in the same position by arguing that there is no reason for US market to sell off, limited reason for it to accelerate massively or de-accelerate. But there is a lot of reasons to argue that you might have rotation of styles depending on what people's views are, on cyclicality, on growth, on recession and on problems, opportunities that will arise. If I relied on all the bad stuff and relied on all the good stuff as well, then I'm sort of left in the middle.

Erik: Viktor, I can't thank you enough for a terrific interview, but before I let you go, please tell our listeners how they can contact you and follow your work, but particularly about your book, because I think it really relates to a lot of the topics that we've discussed today.

Viktor: Yes, thank you for having me. And yeah, absolutely. The book is called *The Twilight Before the Storm: From the Fractured 1930s to Today's Crisis Culture*, how to avoid a world on fire and it basically discusses some of the topics we discussed during this conversation. In other words, I think 1930s is the most comparable period to us. And so, the book asked the question, are we destined to live through disasters of 1940s or can we just go from 1930s straight into 1950s and ‘60s, which was not a bad era, even though it wasn't liberal by any stretch, and was quite constrained. Or to put it the other way, the choice in 1930s was not between liberty, freedom and slavery. It was about the extent to which you're going to lose your liberty in order to stabilize your society. And the book also refers to specific policies that people will consider, whether it's industrial policies, whether it's funding of R&D and education, whether it's universal basic income, whether it's how you're going to fund the governments, whether it's a Marshall Plan for less developed countries to make sure that immigration does not become an absolute disastrous issue for all the countries. Because one of the ways to look at it is, if we might be facing immigration wave larger than either the third, fifth century barbarians in the Roman Empire, or 13th, 15th century Mongols and Turks into Russia, Greece and Turkey, how do we make sure that the immigration doesn't become a calamity for us? And you can get it from Amazon. In terms of my strategy work, I am a part of Macquarie Group, and clearly, if you are Macquarie Bank customer, then you will be getting that as well.

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