Eric Peters: US/EU/China, Competitive Outlook

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Erik: Joining me now is Eric Peters, CIO of One River Asset Management and also of Coinbase Asset Management. Eric, it's great to get you back on the show. Let's start by talking about the US dollar. What's going on here in terms of Fed policy, big picture? It seems like everybody thought the Fed should not wait until this close to the election to start easing, because that would create the appearance of them becoming political. Seems like they have hit across that Rubicon. They sure do appear political. What is happening? What should we expect? And where do you see things headed for the dollar from here?

Eric Peters: Well, for starters, great to be back. It's been a while, actually, as we were chatting pregame here, it's been a little while, really nice to be back. Boy, you know the Fed being political is, I think the Fed is naturally political, given that the chairman is appointed. Question is, how removed are their decisions from the political calendar and process? And I think they've got a very difficult job here. They were well behind the curve for a long time. They had thought inflation would be transitory. They actually changed that tune and raised rates at a pretty unprecedented pace relative to history, and now we're sitting here with quite high real rates. Prime rates are extraordinarily high on a real basis, when you look back historically, which is where many businesses borrow, and I think that they've really been praying that we get lower inflation here, and a bit of softness in inflation, just so they can try to bring that rate back down. And, hopefully create a "soft landing." I don't think it's extremely political. I think there are all sorts of other political manipulations that lead up to the election. The budget deficit this year has gone up 25% roughly, relative to last year coming to the election. So, I think that's probably a more powerful force than what the Fed can do, just briefly before the election.

Erik: Eric, let's talk about the big picture of just the macro situation in the world between the US, the European Union, and China. We've got, obviously, new geopolitical tensions with China that are changing the relationship there. Where is this all headed?

Eric Peters: I think we're starting to really see some of the reverberations from this new phase of de-globalization. Some people call it re-globalization at this stage, kind of just changing trade relationships. But, however you term it, I think the world is beginning to look, really, quite different from a trade and kind of an economic zone perspective. And I wrote a few weeks ago about just some of the vast divergences that are opening up. And I think you see it happening economically, where China's economy is significantly weak. Their long-term interest rates have hit all-time lows. China's somewhat in a world of its own. Economically right now, Europe is really struggling. Europe is super stagnant. And I think what happened in Europe is, Europe was built, and this is an exaggeration, but was built around the German economy, which was more or less organized to take cheap Russian gas and productize it in all sorts of different manufactured goods ways and then export those. And that model is in the process of, more or less imploding. And then there's the US, which the US, for all of our faults and massive deficits and many things that inevitably are unsustainable, but for all of those things, the US has outperformed dramatically. And so, I mean, some of the stats that I was looking at, which are kind of mind-boggling, just looking back from, say, the peak of 2007, just to pick a material market peak. On real terms, your stocks are down 30% from there. They're about unchanged on a nominal basis, but inflation adjusted, taking out dividends are down 30%, they're down 50% from the 2000 highs. And if you look at that relative to the US, S&P 500 is up 60% from 2007 highs on a real basis, and up over 100% from 2000. So, there's just been dramatic outperformance by both the economy, but also equity markets. And then it's almost laughable to look at those stats as they apply to China.

Erik: Going back to the US dollar, I've long held the view that the reason that the dollar is the world's global reserve currency is simply that there is no viable alternative. And I've long argued that there are a lot of people around the world that are motivated to create such an alternative. Hence the BRICS currency block and so forth. You're in a kind of interesting position, because you're both a macro guy, but you also are, having had the digital side of your business acquired by Coinbase, you're also very much in the digital currency business. So where do you see all of this ultimately being headed? Are we headed toward the dollar maintaining its role as reserve currency? If not, is it a digital currency that threatens the stranglehold or monopoly that the dollar has on reserve currency status? And if so, is that a CBDC or just something like Bitcoin have a chance?

Eric Peters: It’s really interesting, Erik. For starters, I don't think Bitcoin has a chance to, in the near future, the foreseeable future, let's say, just over the next 10 years, become a meaningful global currency. I think it's doing a wonderful job of becoming a decentralized form of digital gold. And I think that there could be things built on top of the Bitcoin network that make it much more interesting and more valuable than simply gold. So, I think Bitcoin is a very interesting story, but I don't see it unseating the dollar. What I do see is a really interesting opportunity that's opening up for digital currency, and I think that that will take the form of various forms of digital fiat. And currently, the US dollar is the dominant digital fiat currency in the world. So, if you look at all of the private sector stable coins, which is essentially a fiat digital manifestation of a fiat currency, the dollar absolutely dominates that. But I think the Chinese are looking at this and saying, there's a technological revolution happening here in crypto, and maybe we have a chance to export the RMB through these new digital rails. And anytime there's a technological revolution, you should expect volatility. And so, I think some of the countries and economic blocs that would like to see the US dollar unseated, or at least see the US dollar be less dominant than it currently is, are trying to use this technological innovation to unseat the dollar. I actually think the US was quite far behind a year ago. I think we're still behind from a regulatory standpoint, and yet, I think that Washington, due to a lot of advocacy by players in this industry, has started to realize that actually, if the US can provide some clarity around these technologies, it's possible that the US dollar will be distributed globally in a tokenized form. So not necessarily a CBDC, but a private sector stablecoin, is I suspect what will happen, and the US dollar could become that much more dominant in this new technological revolution. And I think that's definitely in the US' best interest. And I think that Washington is starting to see that. So I think it's probably pretty exciting for the dollar.

Erik: So let me just make sure I understand this. Your view is that the reason the dollar is likely to continue to have the monopoly that it's had for many years on reserve currency status is that it is about to be supplemented by a private label stablecoin, which won't compete with it, will just basically provide a linked mechanism, a tokenized mechanism that is tied directly to the value of the dollar. You think that the prevalence of that digital mechanism will actually prolong, or potentially extend the life of the dollar as the world's global reserve currency?

Eric Peters: I think, if well executed, and well executed means the private sector and also the regulators, I think if well executed, that is very likely to be the case. I think there are other reasons for dollar dominance, which are all the obvious ones that have led to dollar dominance for such a long period of time, and those don't just disappear overnight. I don't see a great alternative to the dollar out there. And I don't think, practically speaking, cryptocurrency is going to take over the world anytime soon, but I think stablecoins probably will, and that's the opportunity for the dollar. So yes, I think that that could be the case.

Erik: Eric, why do you think specifically that stablecoins are going to play such an important role when other people might have argued that, in new tokens, whether it be Bitcoin or Ethereum or whatever, that are their own currency, or where it's at, you're saying it's more likely to be stablecoin tokens that are tied to an existing fiat currency. Is that because of the prevalence or the recognition of the fiat currency, or is that for other reasons?

Eric Peters: I think it's mostly through recognition of the fiat currencies, and because governments will accept that. So, an issue that you have, for instance, just with Bitcoin, if you were to think about it as something that would take over the dollar on a global basis, you know your Bitcoin holdings are taxed. So, if the price of Bitcoin goes up, if you own some Bitcoin and it goes up and you sell it, you have to pay taxes on that. And I think that creates all sorts of frictions, just on a practical basis for the use of Bitcoin at scale to be used for payments. And what you observe with Bitcoin is, it's not really used for payments. Some people use it for payments, but it's really used more or less for a store of value at this stage. And I think there are all sorts of reasons for that, but one of them as well, is just how it's treated from tax perspective. So, I think you'll see countries around the world that have monetary regimes that are highly inflationary, where Bitcoin gets used, but probably dollar stablecoin as well. So depending on the preferences of the people in those currencies, they may use Bitcoin, they may use Ethereum, they may use any number of things. But I suspect you'll see wide scale adoption of dollar stablecoin, and by the way, once you have people adopt that, then they have crypto wallets, and they will probably turn to Bitcoin for some of this, the real store of value and even appreciation. So the adoption of stablecoins, I think, will be very positive for cryptocurrencies, is kind of a broad matter,

Erik: Okay, and you think that the reason that the stablecoins will be adopted is because more actors in the conventional financial system will see the need for it? Or, what is the driver that gets us onto the stablecoin demand?

Eric Peters: Yeah, they'll see the need for it, the ability to transact and move money around the world instantaneously at virtually no cost, has been enabled by these technologies. And so, throughout the long history of finance, it has been inevitable that when a new technology comes around that makes things faster, cheaper, more secure, they get adopted. And so, there have been certainly regulatory headwinds that have slowed the adoption of this, but it is coming.

Erik: Let's go back to the inflation outlook globally and just talk about where all this is headed. Because it seems like central bankers have been engaged in this round of policy that has felt to me like it's all about, you know, thankfully, that quick scare we had with inflation is over and behind us now, so let's shake it off, walk away from it and be glad that it's all over. I'm not so persuaded that it's all over. I think that we probably do have a persistent inflation problem. Would you agree? And do you think that central bankers are becoming too complacent about inflation?

Eric Peters: I think that it's hard to call inflation a problem when it's a choice. I think the US has made a choice by and large, to debase the currency, kind of unburden ourselves from the debts that we're incurring through trying to boost nominal GDP as much as possible. And there are all sorts of ways of doing that, but I think that the US has more or less made a choice that it wants higher inflation, that said inflation clearly got out of control post-COVID and became a political issue. And so, at the moment, inflation has been coming down, and politicians talk about how they think inflation is not a good thing. But if you look out at the fiscal plans of the US right now, we're running a 7% deficit this year with what appears to be pretty good growth. Certainly, that's what Powell had to say at the press conference. He's cutting rates to maintain what he says is a pretty good economy, or quite a good economy, but we're running a 7% deficit. If you look at the CBO projections for next year at 6.5%, then it goes down by 2027 to 5.5%, and then it starts rising again. So, by 2034, I think the CBO projections are, we're back to 6.9 some percent budget deficits. These are just mind-boggling numbers. So, I think you've seen a political choice, and it's probably actually a reasonable choice for the US to make at this stage, but made a choice that, look, we've got a lot of people retiring. We've got a lot of baby boomers. We've got a lot of things to build. I think we got ourselves economically into a place where we felt very exposed to China and other trading partners, but perhaps adversaries, certainly competitors around the world that we don't want to exposure to. And there's a lot of investment that we've determined that we need to make back here in the US, while also paying for all these retirees and rebuilding productive capacity here. All this can take a lot of money, not to mention this green transition. So, the US has made that choice. I think it's like, we're going to spend a lot of money, or we're not going to get ourselves out of that by creating some type of austerity or low inflation. So I don't want to say, pretend that we want low inflation and then just trick people into having higher inflation, and I don't think there's one person who has made this decision. I just think the body politic has looked at the configuration of economic challenges and opportunities that we have and said, all right, we're going to spend a lot of money, and if the cost of that is higher inflation and or a weaker dollar, which is more or less one in the same, then so be it. And so, I don't think it's a problem. I think it's a choice.

Erik: Eric, I want to come back to our earlier conversation about the US versus the European Union versus China. Let's talk a little bit more about where all of this is headed in the next few years, because obviously, we've got a lot of talk now about expectations of growing geopolitical tension between the US and China. How does that change the balance of global trade? How does that change, potentially, Europe's role in that balance? What are the various manifestations of how this can unfold?

Eric Peters: So I think what's unfolding here is, it's just fascinating when I reflect back on my career, and I started in in ’89, I think it's really been characterized by pretty well. It's ongoing, deepening economic integration between all these zones, competition between the US and Europe, always. And then the rise of China, particularly post 2000, and now what appears to me is that we're really separating these three economic zones out in very material ways. And so, when you look at couple weeks ago, two weeks ago, Draghi released this EU Competitiveness Report, and it was utterly scathing and to the point that he called for 800 billion euros, essentially fiscal stimulus, to try to re-boost European competitiveness. That's 4.7% of GDP. That’s just mind-boggling numbers. So, I think that you're seeing real economic stagnation in Europe, in an environment where the world's becoming less safe and less friendly amongst these different trading blocs. And so, China has, I think, economically hurt itself in all sorts of ways as it tries to deleverage somewhat, but it's been compounded by the US being really aggressive as we have headed into this. You know, it's really kind of a Cold War with technology and AI and so, China is becoming increasingly isolated and economically less dynamic. Europe is stagnating markedly, and the US, again, I mentioned the US for all its faults a little while ago, the US is doing all sorts of things, including running massive budget deficits that are clearly unsustainable. But when you look at the economic dynamism of the US, if you just look at the top 25, just to use the equity market as a reflection of economic dynamism, if you look at the top 25 stocks in the world from a market cap perspective, they're all US stocks, except for there's one Danish company, that’s it. Europe has one. China has one, It’s Tencent. The Saudis have Saudi Aramco. Does Japan have one? No. Taiwan has one, TSMC. So almost all of the top 25 companies in the world are US companies at this stage. And so I think that the competitive dynamics between these three economic zones are going to define the global economy for certainly, for the next decade, that's why I think it's so interesting. I'm curious how you look at that.

Erik: Well, Eric, I've been a secular inflationist for a long time, and I don't profess to know how to get the timing right, but I'm convinced that more inflation is coming. And in general, I think that the market is likely to be caught unprepared for that secular inflation as it eventually takes hold on the economy. I just have no idea how long it's going to take before that starts to happen. Let's move on now to energy markets. We saw a huge sell-off in crude oil all the way down to low 65 handle last week. Then it seems like there was a big recovery. And then just on Monday, the day that we're speaking, we've seen a little bit of sell-off there. Where do you think energy markets are headed?

Eric Peters: We don't trade a ton of energy. So, I'm not a like a micro fundamentalist when it comes to energy markets. What I would say, there are interesting dynamics in energy right now, particularly electricity. But just stepping back, when I look at US oil and energy production, I think as we think about how these different economic blocs are competing with one another, meaning the US versus Europe versus China, energy is one of our clear strengths. And so, US energy production from 2016 to 2020, went from 9 million barrels a day to 12 million. And then, under Biden, Biden actually continued Trump's policies, and more or less in terms of accommodating greater energy production. And production, the US went from 12 million to 13 million. Nat gas in the 2016 to 2020 period, increased by 25% US production and up another 15% under Biden. So, this has given the US, economically speaking, a substantial advantage, and certainly versus Europe, given the issues that it has had with the Russia Ukraine war and China itself. China has been rushing to create renewable energy sources to sustain its economy, because it doesn't have very much fossil fuel. So I think we're seeing, again, we talked a little bit about US equity markets reflecting much more dynamic and robust economy relative to these other economic areas. And I think you can see the same thing manifest in energy supplies, energy markets. I suspect that the US is going to kind of continue down that path, and that, I would say, just feeds into the interesting dynamic in electricity. So, this AI boom has created just a massive bid for electricity and for power. And I suspect that, just recently, Microsoft has come out and appears to be funding a reopening of the of one of the Three Mile Island reactors that was shuttered in 2019, so that doesn't sound like picking the lowest hanging fruit. So, I think it is a reflection of the demand for energy. These big companies are desperate for electricity, and when you're going and restarting nuclear reactors, it suggests to me that there's probably not a lot of electricity to go around. That just seems like a very expensive proposition. So, I think there's going to be massive demand globally for energy, and the US is going to continue to have a major advantage there. And you know, Europe faces this massive headwind.

Erik: The rumor is that that deal with Microsoft was negotiated at $100 per megawatt hour of electrical consumption. That is a very expensive cost of electricity to be contracting long term. So, if that's going to set a precedent, I think that there's lots of opportunity for people to build out more nuclear capacity in order to fulfill the demand that's going to exist in coming years.

Eric Peters: I agree, all sorts of capacity. I think this is something that likely sustains the US economy. There's just an awful lot of infrastructure that needs to be built out. Some of it has been subsidized to a degree by the Inflation Reduction Act. Some of it by just this corporate move to re-shore production, bring closer to home and sustaining all of it will be relatively cheap energy here, but then converting that to electricity will create need for a big build out here too.

Erik: Let's translate this macro outlook that we've been discussing to some more specific market outlooks. S&P 500 has been, just continues to break to new all-time highs every week. It feels like, should we expect that to continue through the rest of the election season?

Eric Peters: It sure feels that way right now, doesn't it? I think the Fed, 50 basis point rate cut at all-time highs and the equity market is really something to behold.

Erik: Was that a policy error?

Eric Peters: I don't know. You know, what I find so interesting and fun about markets right now is, I think the level of uncertainty is just extraordinarily high. Because, if you just look at where we are with the economy, with the equity market, and you closed your eyes, if you told me that the promise of AI will manifest over the next five years, even if it's in a bumpy way, and the equity market is seeing above what might be some of the bumps along that path, and is painting a picture of a world that where productivity is significantly increased, which, incidentally, would allow US budget deficits to decline to something more normal, as opposed to something that's relatively obscene right now. If you told me that, I could get my head around the equity market being, as expensive as it is, being fairly reasonable. But if you told me that AI is overhyped and that some of the ways that it's going to be used are going to actually be detrimental to the economy via the political process, meaning that AI is used to just further divide the population and harm the country through the political process, and that the promise of AI is, even if it is wonderful, it's not going to manifest for 5 or 10 years. And we're not going to have good visibility into that. You could look at the equity market right now as forming just a major, major top and you could see this recent cut potentially being a policy error, but I don't know. But what I think we have to recognize, and from Powell's press conference, I think Powell, Powell doesn't know. None of these guys know. And we've gone from, we've left the world where central banks have successfully, kind of pretended that they have the levers and the dials and know what's going on in the economy, and kind of can move it at their whim, like we kind of left that world post COVID, the mistakes that central banks have made have been magnificent, really. And what they're hoping to do right now is get us back into a place where we think, okay, they know what's happening. They've got this under control, and they're going to land this economy softly, whatever that means. But I think that the reality is that they don't know what the future holds. This has been such a unique cycle, and this new arrival of AI, makes the future look so uncertain. So, I wouldn't say that it's a policy, or I just think we're going to see, I think that these guys are feeling their way across the riverbed. They can't really see what they're stepping on. And the potential for big mistake is very clearly there, but we'll have to see how it manifests. The stock market's saying right now that it's fine.

Erik: Let’s talk about commodities next. We’re in a new commodity super cycle, and what's your outlook for commodities and the dollar?

Eric Peters: I suspect, Erik, that we're getting closer to some type of Chinese economic stimulus, just because the economic and the market performance there is just so poor, like with the COVID lockdowns, you didn't really understand, why XI was so strict, and it felt like he wasn't going to change his mind. And then all of a sudden, over a very short number of days, he completely changed policy. I think we're probably getting closer to some type of Chinese stimulus. I don't think it'll be a commodity led stimulus, you know, not a big building boom. It'll be something else. But I think commodities have priced in a very, very weak China at this stage. So

I think there's more upside than downside to commodities in here. It could be part of the dollar story as well. So, I do think that the US, I think the Fed, is going to start lowering rates in a material way. Obviously, what the Fed thinks they're going to do and what the market thinks the Fed is going to do are two different things, but I think we're going to start seeing material rate cuts out of the US here, and you know that that should overall weigh on the dollar. I think that the big dollar move, though, is not going to be just because of rate cuts, the big down move in the dollar, which I do think will come, that's going to be led by a concern about debt sustainability in the US.

You asked about policy error. If you were to see the Fed cutting rates persistently, and we were to see the market fall out of love with this AI story, and people worried that, oh my god, we're not going to get a great productivity boom out of AI, there was a lot of hype and a lot of promise, but light on the delivery. If we were to see that type of environment, I think that's when you could start worrying about US stagnation, and you could get people leaving the dollar in a material way. That's where you get a big dollar decline. That's where you get the kind of the stagnation or stagflation type economic environment. That's the real downside for the market right now. But I think it would largely be led by a rate hike, equity markets rolling over, economy being particularly weak, and concerns that the deficit in that environment is just going to explode. If we're 7% right now, and we actually have a material recession, and you see that number go up to 12% or something with no real hope for to come back down. That's when the dollar gets smoked. We're clearly not there. But, that's the type of setup I would see for a weak dollar. And I think that would be a big, big trade. So that's the thing to keep on your radar.

Erik: Okay, if we're keeping that on the radar, are we keeping it on the radar for a long precious metals trade, or for some other kind of trade?

Eric Peters: I think precious metals would do incredibly well there, and it's interesting that they're doing as they are right now, even with an economy that's doing pretty well. I think digital assets, certainly, Bitcoin and Ethereum do extremely well there. Bitcoin is up, I don't know, 100%, 130%, 140% over the last 12 months. So, these markets, these forward-looking inflation markets like Bitcoin and gold are suggesting that there is inflation around the corner. I think that we're right at the tail end of the first wave of this inflationary cycle. So, the inflationary cycle we were calling for it, in kind of 2018, 2019, and then 2020 hit. And ultimately, we all know that really took off then. And when you look historically at inflation, it moves in waves, and the inflation itself tends to be very volatile. So, we had the big up. We've now had a significant normalization, and now we have a rate cut cycle with running huge deficits. So, I think that we're in for, inflation stabilizes in here and starts heading higher for a bunch of the reasons that we talked about with supply constraints and investment demand and infrastructure build out, et cetera. But if you compound that with a weak dollar, that's when you see really explosive moves in metals and in digital assets as well.

Erik: Well. Eric, I can't thank you enough for another terrific interview. Before I let you go, I want to give our listeners a little bit of an update, because I don't think that Coinbase had acquired your digital arm yet last time we spoke, give us a little bit of perspective on what's going on with your company. You've changed your role a little bit. What do people need to know and how can people follow your work?

Eric Peters: So, as you probably recall, we entered the digital markets in November 2020, with what at the time was the largest institutional allocation to the space. We, roughly speaking, tripled that investment, returned that capital, but in the process, built out a digital asset manager called One River Digital Asset Management, and continued to build that company. Coinbase acquired that about a year and a half ago, in its entirety, and I thankfully have been able to remain the CEO and CIO of One River, where I have two terrific deputy CIOs. And also, I'm the CEO, CIO of Coinbase Asset Management now, where I also have just a fantastic deputy CIO. So I straddle both firms, which, as a macro investor, is a wonderful place to be, because I do think that crypto and traditional macro are converging around this big currency trade that we probably have ahead. But it's also a new technology play as well. So you were talking about CBDCs and private sector stablecoin and monetary policy, macro and all these things are really connected. So it's been a fascinating two seats to be in, I should say.

Erik: Patrick Ceresna and I will be back as MacroVoices continues right after this.