Darius Dale: No Difference Between Trump & Harris

October 31st, 2024

Erik: Joining me now is 42 Macro founder, Darius Dale. Darius, as always, has prepared a fantastic slide deck to accompany this interview. It is the full slide deck which is normally sent out to Darius' paying subscribers. Accordingly, we do need to redact some of those pages, otherwise those paying subscribers would throw a fit. So, you'll notice that only the slides that we discuss in this interview will be visible in the slide deck that you can download. If you want the whole deck, you'll have to follow up with Darius at 42macro.com. Darius, great to have you back on the show. Obviously, first topic's got to be, we're recording on Tuesday, seven days before election day in the United States. What should we think about that as investors?

Darius: Appreciate you having me, Erik, thanks again for thanks for the opportunity, my friend. So obviously, the markets are starting to run away. The probability of a Republican controlled government, as you see here on slide 85 of our latest Macro Scouting Report, we show the Polymarket odds. Now, we all know the Polymarket is manipulated by a few whales, but those whales are choosing to manipulate the market in favor of Donald Trump and a Republican sweep. So Republican sweep for a reason, likely for data driven reasons based on polling, based on early voting results. And so, it's really clear, and from our perspective, that the asset markets both factor leadership within the stock market and also the broader rates and currencies markets are really moving in the direction of the implications of Donald Trump's policies.

Erik: Okay, so let's talk about the headline, the click bait. I'll admit you actually said to me off the air before we recorded, it doesn't matter which candidate wins, because they're basically the same. I'm pretty sure that, from a social perspective, a lot of Americans don't see the candidates as the same. What did you mean by that statement?

Darius: Well, the reason I say that is because we are in a fourth turning, Erik, as you know, you well know you've had my former colleague and one of my mentors Neil Howe on the show, we're big believers in his research. From a geopolitical standpoint, we ourselves here at 42 Macro have done a big, deep dive empirical study on what happens to the economy, respective policy and asset markets, and also geopolitics, from the perspective of a fourth turning so that we can help our clients navigate this otherwise tumultuous period as investors. And one of the key takeaways from a fiscal policy perspective, as we highlight on slide 78 is, if you look at, if you study the evolution of critical fiscal policy time series, like the fiscal balance to GDP ratio, sovereign debt to GDP ratio, interest expense to GDP ratio, what we notice is that there are consistent and dramatic deltas that we tend to observe in fourth turnings as a function of the

fourth turning itself. Most notably, we tend to see a sharp deterioration in sovereign fiscal balance to GDP ratio, particularly as we get later and later in the fourth turning and a Sharpe as a function of that, obviously a Sharpe acceleration in the sovereign debt to GDP ratio. So those two dynamics are going to happen irrespective of which party controls Congress or which party takes the White House. And part of the reason for that, if you look at slide 81, Erik, more populism is the highest probability outcome, because we understand that the social contract here in the US is broken. If you look at this chart here, the blue line shows labor share of national income, the red line shows corporation share of national income, and both have deviated substantially from their longer term trends. If you look at labor share of national income, it averaged about 56% of gross domestic income from 1960 all the way through 2000, whereas it's currently at 52%. If you look at the corporate profits as a share of domestic income, it averaged about 9% versus the 13% an all-time high, that it's currently at an all-time low in terms of labor share currently. And so, if you think about that 400 basis point delta from those averages, that roughly accounts to about $1.2 trillion per annum as it relates to lost income from the private sector, in terms of the private sector employee and debt being siphoned into the coffers of corporate America, guys like Elon Musk. This is a regressive transfer that, in our opinion, was a function of a series of policies, most notably, China's entering to the WTO in 2001 and Mexico's empty entry into NAFTA. And so, we understand that this populism that is fueling the rise of populism on both sides of the aisle is likely to culminate in an explosive growth in federal debt as we progress deeper into this fourth turning and that's why the headline is, it doesn't matter who wins the election, we're going to wind up with significantly more sovereign debt, and US sovereign debt as a function of that.

If you look at slide 82, we see that Democrats have historically practiced socialism for the poor and Republicans have historically practiced socialism for the rich. And either way, both parties love piling on debt to socialize the income of their constituents. And I would argue, not only is the Republican Party historically practice socialism for the rich, you now have Donald Trump also practicing socialism for the poor. And so, in this chart here, we show government social benefits divided by household income. That's just been up and to the right for decades and decades, from a low of 6% in 1960 to the current 18% share. Currently, if you look at the effective corporate tax rate, the lower panel, that has been declining down into the right for decades, peaked out at around 43% in 1970 and it's currently only 11% total. And so, if you think about the spread between those two lines is the accumulation of public sector debt here in the United States. And ultimately that's going to be a problem from our perspective, because we ultimately realize that we're already having this sort of bipartisan surge of populist fiscal policy before the actual fourth turning takes place.

I'll share you with you one final slide here before we move on. If you look at US fiscal policy and fourth turnings historically, what we found is that the change in the sovereign debt to GDP sovereign fiscal balance to GDP ratio on slide 88, you see that in the Civil War fourth turning, we saw the start to trough change in the US sovereign fiscal balance, the GDP ratio was -950 basis points. So, the budget deficit got wider by 950 basis points. In the World War II fourth turning, we essentially, the budget deficit got wider by almost 28 percentage points. And right now ,we're wider by 11 percentage points, a little bit over, almost 12 percentage points

currently, and this is before the actual major existential fourth turning crisis occurs. And that's obviously terrifying in the context of the start to peak change in sovereign debt to GDP ratio that we've already accumulated in this current fourth turning. If you look at the Civil War fourth turning, the sovereign debt to GDP ratio rose 27 percentage points, in the World War II fourth turning it rose over 100 percentage points, and currently we're up about, 69 percentage points. And again, this is before the actual fourth turning crisis occurs. So, I can't stress this enough, the US is already on a profligate fiscal path that is getting increasingly dangerous as a function of the fourth turning, but also as a function of the wave of populist fiscal policy that we continue to see from both sides of the aisle.

Erik: Okay, Darius, I get it. I totally agree with you that there is a growing trend of populism. I also agree with you that more sovereign debt for the reasons that you state is likely. I think the chart 88 definitely makes a very compelling argument that we're in the middle of a fourth turning, which is defined as a 25-year period of not-so-happy history. I'm also a huge fan of Neil Howe's work. I named a company Fourth Turning Capital Management, I believe in the theory so much. So, needless to say, we're on the same page there. And I think the fact that the big heavy part of fourth turnings happens right kind of in the ninth inning of the fourth turning, so to speak, and we're not there yet, is a really prescient message.

But hang on a second, Darius, I don't think that this election is really about a Democrat versus Republican partisan election the way most people have interpreted it, because there's plenty of Republicans that are much more establishment wing. There's plenty of Democrats, although many of them are defecting from the Democrat party now, who have much more of a populist view. But I see this election as really the populist side represented by Donald Trump versus the establishment elite, you know, historical control of Washington, represented by Vice President Harris. So, it seems to me that although I agree with you that there's a trend in the economy that's very much moving towards populism, the policy intentions of these two presidential candidates in terms of what they've said about, or at least what historically the Biden administration, the Biden-Harris Administration, has done historically, since Vice President Biden [Harris] hasn't said that much about her actual intentions, I'm assuming it's the same as it's been. If you look at that versus former President Trump's intentions, they're really kind of polar opposites, at least in their rhetoric and what they say. Can you really make the claim that it doesn't matter?

Darius: Absolutely, I will and I won't even make the claim. I'll let the Committee for Responsible Federal Budget make the claim, which, in my opinion, based on our research here at 42 Macro, this is the bipartisan think tank down in DC as it relates to accurately forecasting the impact of policy upon the budget deficit. If you go to slide 87 where we show their analysis that evaluates the various proposals that each candidate has made on the campaign trail, all the way through September 30 of this year, their analysis shows Kamala Harris's proposals as accumulating roughly about an additional $3.5 trillion in US sovereign debt over the 10-year projection period relative to the baseline. If you add up all the various proposals from an income and spending perspective from the Trump campaign, it's about plus $7.5 trillion. The chart on the right in this side shows the ultimate impact of those policies, from the perspective of the US

debt to GDP ratio. Current law, which currently has the US, the Tax Cuts and Jobs Act, the Trump tax cuts, expiring at the end of 2025, still has the US debt to GDP ratio accelerating to 125% in 10 years' time. If you add on Harris's policy proposals, the US debt to GDP ratio accelerates to 133% in 10 years' time, and ultimately, US, Donald Trump's proposals are likely to cause about 142% debt to GDP ratio in roughly 10 years' time. And again, I can't stress this enough, these numbers are coming from the Committee for Responsible Federal Budget. It's like the sleepiest white glove institution in DC. You got the former head of the CBO, the former head of the Senate budgeting process, Republican former head of the house budgeting process. As a Democrat, it's literally the most bipartisan, sleepy think tank down in DC. So, I think you do have to take these estimates at face value in terms of what both candidates are promising.

And Erik, you made a point that I do want to unpack and push back on a little bit in the context of the Trump, representing the populist wing of the Republican Party, and Kamala Harris, sort of representing the kind of old guard establishment elite down in DC. In our opinion, we slightly disagree with that. If you look at slide 83, so we went back and we did a deep dive empirical study on the growth of sovereign debt and the monetization of sovereign debt under various presidential administrations, and I was shocked by the conclusions, genuinely shocked by the conclusions, because what the conclusions of the data suggests is that, in the post-war era, Republican administrations have outpaced Democrat administrations when it comes to burdening the country with debt. So, the rhetoric in this country around which party is responsible for our profligate fiscal trajectory is wrong. I mean, quite frankly, I think it's just lazy and misguided. So, if you look at the cumulative growth of US public debt during US presidential administrations in the post-war era, after year one, Democrat presidents have presided over, signed into law, 6% public debt growth versus 5% for Republican presidents. After year two, it's 10% versus 12% respectively. After year three, it's 22% versus 21% respectively. And then after year four, the Democrat median is 26% versus the Republican median is 39%, and even if you exclude year four from the Trump presidency, which I argue you should based on the COVID experience, that the Republican median is still plus 36%, 1000 basis points higher than the Democrat median in the post-war US economy. So, there is a real risk of a US fiscal crisis. In our opinion, we don't think Republican tax cuts are big enough discussion topic out there as it relates to, you know, discussion amongst investor consensus.

If you look at slide 84, we all know the Democrats spend too much. I don't think anybody can disagree with that, but we need, I'm trying to use my platform to create a better discussion globally. In global sovereign debt markets, we have some very big fixed income clients out there, and they know who they are. I want to create a very different discussion about which party is responsible for the debt, because the key takeaway is, they're both very much responsible for accumulating debt. If you look at the chart on the right here, on slide 84, where we show the cumulative growth of US public debt during those presidential administrations, six of the top eight in the post-war US economy are Republican presidents, six of the top eight. And so into my opinion, I think investors need to be aware that, even though Donald Trump represents the now populist wing of the re-energized Republican Party, we also need to represent, understand the fact that he wasn't the only reason we got here from this perspective

and the ultimate risk of a US fiscal crisis, that we continue to see elevated risk of here in this fourth turning.

Erik: Darius, I agree emphatically with everything that you just said, especially the ingredients being in place for a US fiscal crisis, too much debt, it's not sustainable. It can't last forever. Things that can't last forever don't. Okay, I'm on board, we're on the same religion. But hang on, I agreed completely with presidential candidate Ross Perot back in 1992 when he said a US national debt of $5 trillion is unsustainable, I think he was right. But guess what? We've gotten away with it for so long that most people have just gotten to the point where they roll their eyes and say another guy must be a libertarian talking about fiscal crisis because of too much debt. The debt doesn't matter for a big country the size of the United States. It's been proven by decades and decades of guys like Ross Perot being wrong. Why wouldn't someone conclude that you're wrong, too, right now, what's different about now that this unsustainable debt really does lead to the fiscal crisis that so many people have predicted for so many years?

Darius: Great question. Excellent question. And to me, it's all about the timing and sequencing, sequencing of catalysts. What's different about now, relative to historical episodes of too much US sovereign debt is the starting point with respect to US Dollar hegemony. If you go to slide 49, where we show the US dollar share of global totals in terms of foreign exchange reserves being 60%, cross border bank lending at 60%, international debt securities at 70%, trade invoicing at 79%, foreign exchange transactions at 88%, and stable coin backing at 99%, the world is grossly exposed to the US dollar and the US dollar hegemony in a way that it no longer wants to be. Obviously, last week we had the BRICS summit in Russia, where the stated objective, as a function of the stated objective in the conclusion of the summit was, we want out of this system. Obviously, there aren't any real viable alternatives to move out of the system en masse, but we do know that the system is broken from the perspective of a lot of our peer and adversary economies, and that they're going to be looking increasingly for viable alternatives over the long term. And so, the key takeaway from our research in this discussion today, Erik, is not to just sound the alarm bell on a US fiscal crisis. I think we're already in the slow-motion fiscal crisis, as evidenced by some of the dynamics in the bond market that we'll hit on shortly, but not to sound the alarm bell on the US fiscal crisis, to me, it's the sound the alarm bell on how the Fed is going to be forced to deal with this.

And so that transitions out to our secondary topic. If you go to slide 94, again, citing the deep dive empirical study that we did on the fourth turning. If you guys want to see the deep studies, about 50 or 60 slides of hard hitting factual data, with data going back to 1800s for every time series, to understand exactly how these dynamics have evolved in previous fourth turning episodes, which are generally 80-100 years apart. So it's obviously not like we have a ton of data, but we have at least a couple cycles to analyze. And here on slide 94, what we find is that, the key fourth turning monetary policy risks are a whole lot of financial repression, Erik, and a whole lot of monetary debasement, and ultimately that's likely to cause a significant acceleration in money supply that ultimately inflates the value of financial assets. So, if you look at slide 99, we have a strong belief that investors should expect incremental financial repression, because banks have ample capacity to lend to the Treasury market. If you go back and you look at

commercial banks, treasury and agency security portfolios, they're roughly about 18% of total bank assets currently. You got to go all the way back to as high as roughly 50% of total bank assets at the height of the last fourth turning so we know that the regulators, the Fed and other international regulators, are going to financially press banks into holding more treasuries. They're very likely to keep the policy rates significantly below what are likely to be elevated rates of inflation, as we progress deeper and deeper into this fourth turning.

We also see, on slide 102, that investors should expect monetary debasement, because the private sector, which has been increasingly called upon to capitalize the US government will demand higher yields to capitalize Uncle Sam. So, in this chart, we show the Fed's Treasury holdings as a share of the total marketable Treasury debt outstanding. That's the blue line. It's been declining for a couple of years now at only 16%, and the red line shows commercial banks Treasury holdings have been declining for a couple of years with bottom essentially in 2023, and it's been grinding higher since at about 15% of the total. The black line shows foreign official Treasury holding, so foreign central banks. Their share has been declining since 2008, now only at 14% and so the residual of that, the rest of it, is the global private sector. Our share has increased from 36% in late 2021 of the marketable Treasury market to 54% currently, and in our opinion, this unadulterated, unabated rise in the share of US public sector financing that has been forced upon, foisted upon the global private sector, has really caused a big rally in bond yields and a big backup in real interest rates across the curve, not just here in the US, but globally. And so, the key takeaway is, this, from a perspective of where our starting point of the deterioration, we already have observed in the terms of the US public sector balance sheet that is likely to accelerate dramatically, ie., the deterioration is likely to accelerate dramatically. We recognize that there's only one institution in the world with the balance sheet large enough to capitalize the US public sector debt in a fourth turning, and that's the Fed. That's the blue line on this chart here, on slide 102, we understand that the red line is going to be forced up as a function of regulation. We got Basel IV coming in next year, that's essentially going to change the risk weightings and force the banks incrementally out of the credit markets and incrementally into sovereign debt markets. That's another form of financial oppression. But ultimately, we realize that there will come a time, and probably multiple times over the next 5 to 10 years, where the Fed has to dramatically accelerate the growth of its balance sheet to capitalize the US sovereign debt, the US sovereign fiscal situation, if not in a perpetual manner, if we start to see yields run away from us.

And the final thing I'll say on this topic is, if they don't do it, the alternative is a collapse in the Treasury market, a collapse in the global repo market, a collapse as a function of that in the global financial markets, and ultimately, a collapse in the global economy. And it's our view that these, you know, academic wonks, the Federal Reserve, the ECB, the Bank of England, et cetera, et cetera, et cetera, they don't want collapse. They want to be credited with saving this and bailing out the system. So, if you look at slide 103, the key takeaway of this slide is that we're all frogs being boiled alive in a pot of monetary debasement and financial repression, due to this fourth turning style fiscal dominance that is going to accelerate as we progress over the next 5 to 10 years. So in this chart, we show in the top panel, 10-year Treasury term premia. That’s roughly 22 basis points wide currently, essentially no term premia is historically averaged

at about 150 basis points. So, if you go back and you add that 150 basis points of missing term premia from the bond market on the 10Y tenor as a function, in our opinion, of the asymmetrically double reaction function that we've observed out of the Fed over the past 10 plus years. You go back and add that term premia back to the bond market, you're talking about a 10Y Treasury yield that's closer to 6%, than it is closer to 4%. You're talking about a 10Y TIPS break even rate that's closer to 4% as opposed to the current 2.3%, and you're also talking about a positively sloped 10Y Treasury, a 3M10YR Treasury yield curve at about 122 basis points wide versus the minus 26 basis points that we currently have. So because of the asymmetrically dovish reaction function that we're already observing here in this fourth turning, the bond market is already exhibiting signs of financial repression, and it's likely to get worse and worse over the long term, which also means, as investors, we need to figure out a way to protect ourselves against that. Because, in my opinion, this is the key structural risk of our time.

Erik: Okay, I got it at the 35,000 ft, high level view. Let's come down to the 10,000 ft level and talk about some of the major macro drivers, macro backdrop issues. Got to start with inflation, and I'll tell you, Darius, I've been fascinated by the way people are interpreting current data, because, as you know, for several years now, I have held the view that the secular disinflation that began in the 1980s is over, that we're in a new period of secular inflation that is likely to last for at least a decade, and probably more. You know, in the post COVID era, there was this whole team transitory debate and, they had their view, I had my view. We disagreed and said, we'll see how it works out. Those guys are all taking a victory lap now. They're all saying, ha ha, told you so, it was transitory, I was right, you got it wrong. And I'm saying, really, that's how you're interpreting the data? How do you see it, Darius?

Darius: That's a great question, Erik, and I appreciate you teeing that up, because I think you and I share similar views on inflation and have for quite a while. So, if you go to slide 7, where we show our Fundamental Research Summary, these are a chronological list of our active themes that we maintain in these Monthly Macro Scouting Reports for our clients here, at 42 Macro. The first theme, which we authored in January of 2022, is our sticky inflation theme. And the key takeaway there is that we don't have any confidence that inflation is going to return durably to the Fed's state at 2% and de facto 2.5% targets in the absence of a recession. In fact, our model has inflation starting to bottom here in Q4 and meandering higher over the course of the next year. So, in our opinion, that could cause some problems in asset markets, but is unlikely to cause problems in asset markets until the Fed decides to downgrade the labor market and its reaction function, which it may not and may not want to for several months, if not even several quarters. So, Erik, I think one way we could, sort of, we can do like a rapid fire or each of these four themes? I'll hit on the theme, give you a couple charts, and then we can return to this slide to unpack each of the other themes with one or two charts. Does that make sense?

Erik: Makes sense to me.

Darius: Awesome. So, with respect to sticky inflation, let's go to slide 67, where we show inflation is the most lagging indicator of the business cycle and is unlikely to durably return a

trend absent a recession. So we did a, you know, I guess we're getting increasingly famous for doing deep dive empirical studies. One thing I found is that there's a lot of myth out there from the perspective of what people think about macro, and there's not a lot of factual data. So, what we do here at 42 Macro is really get our hands dirty, roll up our sleeves, to really, truly understand the empirics, the statistical properties of all the time series that we and other investors are focused on. And the reality is, there is a real cadence to the business cycle. It's called the business cycle for a reason. It doesn't just pop out of nowhere. We don't just drop into and out of recession every other week. There's a reason why the bears have been so wrong on this recession view for so long, is because we have not had the dynamics in the business cycle, the persistent leading in areas of the business cycle have never aligned themselves in a way that suggests a recession was going to be a high probability event on a short-term time horizon. But we'll unpack that in our resilience economy theme.

Let's get back to inflation. So, in this chart here on slide 67, we show the median trailing 10Y Delta-Adjusted Z-score in months before and after a recession begins in both of these charts. And so essentially, what it is, it's the median path that each of these cycles takes in and around a recession. And so, what we found is that, you go back and you study the 12 post-war business cycles that we have in the US economy, where you actually have robust data to analyze. What we find is that policy gets restrictive right around 15 months ahead of a recession, then the corporate profit cycle breaks down right around a year ahead of a recession, then liquidity breaks down right around three quarters ahead of a recession, then growth and the stock market breaks down simultaneously right around two quarters of a recession, employment breaks down right when the recession starts. Credit breaks down a quarter after that, and then finally, four to five quarters after a recession starts, you get inflation breaking down below trend on a durable basis. You can see it a little bit clearer in the chart on the right here on slide 67, where we show growth breaking down again two quarters ahead of a recession, headline inflation and core inflation breaking down about 12 to 15 months or four to five quarters after a recession starts. So clearly, if we don't have the persistent leadimg indicators of the business cycle aligned in a way that suggests a recession is a high probability outcome on a short term time horizon, then we should not be expecting a durable breakdown in inflation anytime soon as a function of that. In fact, if you look at slide 74 where we show some of the leading indicators of inflation, if you look at Core PPI, Core PPI actually bottomed at 2% last year. That's important, because obviously, if you want a mean of 2% from a policy perspective, you can't bottom it 2% and start to re accelerate higher from that like we currently are, in terms of the blue line on slide 74 and it's actually starting to, you're starting to see signs of an elevated bottoming process in Core CPI and Core PCE, which are the red line and the black lines in this chart. So to me, I think investors need to be very aware that inflation may not do what the Fed is expecting it to do and what other investors are currently expecting it to do, as evidenced by Bloomberg consensus.

And now finally, I'll shut up on this inflation topic, if you look at slide 37 where we show our grid model for the United States, we maintain this grid model for every major country in the world. Our views on growth have been consistent for 2+ years now on the context of resilience US economy theme which will dovetail into next, growth has been surprising to the upside, it's likely

to continue surprising to the upside. But as it relates to inflation, with just the chart on the bottom right, we have inflation bottoming here in Q4, and again, starting to meander higher over the medium-term, throughout the duration of our next 12 month forecast horizon. Now, again, we do not necessarily think that's going to cause problems in asset markets until the Fed starts getting concerned about it again, which may not occur for several months, several quarters, if not several years, who knows? It's the Fed, that has an asymmetrically dovish reaction function, and they may very well want to maintain that.

Erik: Let's move on to your second major theme, which was resilient US economy.

Darius: We offered this theme back in September of 2022, we maintain high conviction in that. And the key takeaway is that the US economy remains resilient for a variety of factors. I'd say the most important factors as it relates to the resilience of the US economy, we have historically strong household sector balance sheet. We've been covering the West Village Montauk effect, which is the elevated stock of savings as a function of the fiscal largesse and monetary largesse that we've seen in the post-COVID era is causing a decline in the flow of savings, which means households are now, because they have so much more money on their balance sheet, are spending more money into the economy on a flow basis. So that continues to dominate. We continue to see elevated sort of income disparity in the US economy, whereby the cohorts that account for the most amount of consumer spending in the US economy are doing quite well from the effect of asset price inflation, home price inflation, etc., etc. The corporate sector balance sheet is quite robust as well, that there's no change there. We've limited exposure to the policy rate in terms of the immunization that we've seen in the private sector from the policy, the level of the policy rate. And then we have very limited exposure to the volatile manufacturing sector. The manufacturing sector, which is only 10% of GDP, versus a peak of 28% back in 1953, and the manufacturing shares is only 14% of non-farm payrolls versus a peak of 44% back in 1943. If you take those numbers and understand that the manufacturing sector is only accounted for a median 98% of net job losses in the 12 post-war US recessions, you have to understand that, because we have such little exposure to this, from an economic standpoint, it's highly unlikely that we have a cyclical downturn in the economy, because the cyclical part of the economy is such a smaller share of the economy.

And so, one final thing I'll say on this, the limited probability of a recession over the medium term, you go to slide 26, where we show that similar analysis that we were talking about going back to slide 67, but we're showing this on the perspective of growth. So, the chart on the left again is how the each of these cycles have historically evolved in and around recession. The chart on the right now shows the actual current data for each cycle, and what we typically find is, we talked about this, policy breaks down over a year ahead of recession, followed by profits, followed by liquidity, followed by growth, followed by stocks. Right now, the only thing that is consistent with, signaling a leading indicator for a recession, is the fact that policy is "restrictive" right now. And you can make a case that it may not be, just given the limited exposure to the level of policy rate that we were reserving in this business cycle. We don't have corporate profit cycle breaking down, we don't have liquidity breaking down, we don't have growth breaking down, we don't have stocks breaking down. So why in the world would investors expect a

recession to occur any point in time over the medium-term time horizon? Our answer to that is, you shouldn't. And ultimately, going back to slide 37, investors should expect US growth to continue generally and persistently, surprising to the upside over the medium-term. So that's been where we've been for over two years now, and we expect to continue to be right on that view of the medium-term.

Erik: Darius, the next high conviction call, which you made back in November of 2023, was that Fed Chairman Jay Powell wants a soft landing.

Darius: Yes, he does. In our opinion, this is one of the least understood dynamics, but most important dynamics as it relates to how financial markets are operating at the current junction have been since early November of last year, when we authored the theme. So, if you go to slide 24, a lot of investors spend way too much time listening to each of these different Fed heads talks and chirp you know, it's like a cacophony of words. But the reality is, the only person you really need to listen to as it relates to the forward outlook for Fed policies is Chairman Jay Powell. And Chairman Jay Powell is very consistent, and has been all year about his desire to implement a soft landing in the US economy. Recall that back in 2022, he wanted pain. In 2023 he said, we have some progress here. And then in Jackson Hole in 2024, it was very clear, very obvious. In fact, I'll read a few quotes from his most recent commentary at The National Association of Business Economics.

“Our goal all along has been to restore price stability without the kind of painful rise in unemployment that has frequently accompanied efforts to bring down high inflation. While the task is not complete, we've made a good deal of progress toward that outcome.”

And then further, Powell said, “The path to a more neutral policy setting is not on a preset course, but the reality is, it certainly does feel like it's on a preset course in the context of the Fed's estimates for the neutral rate.” Powell goes on further to say, “we do not believe that we need to see a further cooling in labor market conditions to achieve 2% inflation.” And to me, that's such an important statement, because it ultimately means that the labor market itself is sacrosanct in the Fed's reaction function, we would argue the Treasury market is the most important dynamic driving the Fed's reaction function. But they're not going to come out and tell you that because that's not their congressional mandate. The Congressional mandate is price stability and maximum employment. So, they're going to say whatever they have to say in order to maintain credibility in the eyes of policymakers and in the eyes of investors. If you go to slide 75, part of the reason we see the Fed's asymmetrically dovish reaction function persisting is the fact that the Fed's estimate for neutral is all the way down at 3%, right? So obviously, the dot plot gets updated every quarter, they survey all the 20 something, I want to say 16 to 20-ish policy makers on the FOMC what their estimates are neutral, and the median estimate, and not only median, but the central tendency of the estimate, is clustered around 3%. Well, that has meaningful implications, because the current policy rate is currently up at 5%. So right now, instead of looking at the resiliency of the economy that we've been calling for since September of 2022, or the stickiness of inflation that we've been calling for since January of 2022, they are looking at their estimates of neutral in determining where they want the policy rate to go and

how fast they wanted to get it there. So, in this chart, we show that the dot plot, the blue bars in each of these panels for '24, '25, '26 and the longer run projections. The red line is the current Fed Funds future yields for December '24, '25, '26 and '27, the black line shows what the Fed's pricing in for each of those years. So right now, the Fed's dot plot is currently forecasting another two rate cuts for 2024, so obviously, in November, December of this year. Another four rate cuts in 2025, another two rate cuts in 2026, before they ultimately reach their neutral policy setting. So obviously, it's a gradual approach to getting to neutral. But the key takeaway is that this is a Federal Reserve, that despite having above trend, GDP growth above trend, real final sales growth above trend, inflation is already cutting the policy rate and is guiding the rate cuts. And oh, by the way, going back to June, already revised its balance sheet policy to get incrementally dovish as well. So, we've been here since November 2023, we ultimately understand that historically, the Fed has maintained an asymmetrically dovish reaction function throughout the entirety of the historical fourth turnings. Obviously, the Fed's only been around for the most recent fourth turning, but throughout that fourth turning, particularly in the 1940s, the Fed had an asymmetrically dovish reaction function that ultimately amounted to a significant amount of financial oppression and monetary debasement and explosive growth in the money supply, which ultimately was incredibly bullish, structurally bullish with things like stocks and gold. So, investors need to be aware of that. That's the environment that they're operating in, from a US monetary policy perspective. And as we talked about, on slide 49, the US monetary policy really, really matters to the rest of the world.

Erik: Going back to page 7, the last three topics we just discussed, sticky inflation, resilient US economy and Jay wants a soft landing, were all high conviction calls. You've also got a medium conviction call, which you just made last month, which is, here comes the liquidity.

Darius: That is correct, my friend. And so, this theme, here comes liquidity, is a combination of the theme that we've had that we were early on in terms of China's liquidity impulse, obviously accelerating massively in September. We've been calling for that since December of last year. But the additional layer of that is what we see as likely, an incredibly robust liquidity impulse from the US in the first part of next year that will be supplemental to what we're observing out of China and other economies around the world. So, if you go to slide 42 ,where we show our global liquidity monitor, Erik, if you kind of scroll over across the top of the columns, you can see liquidity proxy there for each of these economies, the trends in the respective liquidity proxy. And for those who may be new, we track global liquidity, and we track liquidity in every major economy in the world through the lens of our liquidity proxy, the 42 Macro liquidity proxy. So, on a global basis, that's the aggregated global central bank balance sheet from all the major economies in the world, all of their broad money supply aggregated, and their FX reserves minus gold aggregated. And then we layer on a bond market volatility overlay to simulate the impact of the repo market upon liquidity dynamics. And what we find is that, if you look at the liquidity proxies for each of these major countries that feed into the global liquidity proxy, you have Australian liquidity currently trending higher. You have Canadian liquidity currently trending higher. You have Chinese liquidity currently trending higher and set to massively accelerate in the coming months, you have Eurozone liquidity currently trending higher, you have Indian liquidity currently trending higher, you have Japanese liquidity currently trending higher. You

have Swiss liquidity currently trending higher. You have UK liquidity currently trending higher, and you have US liquidity now recently inflecting into a positive trend. So, every major economy in the world has its liquidity proxy accelerating currently. And so, investors need to be aware of that as an investor, and that's likely to actually accelerate from there. So obviously it's one thing to say liquidity is going up and liquidity is going down. I think every Jim O'Rourke on Twitter can tell you that. What they cannot tell you is, where is it headed over the medium term, and that's what you need to do math to figure that out. So on slide 43, we found, based on our analysis, that what actually leads global liquidity over the medium term is stocks, it's crypto, it's the US dollar, it's FX volatility, it's interest rates, it's fixed income volatility, it's growth, inflation, unemployment.

And if you look at slide 44, the aggregation of these key leading indicators of global liquidity, currently signal a significant increase in global liquidity over the medium-term. So investors need to be aware of that based on the movement of these time series, the volatility of the YoY rates of change of these time series, the current movement of those time series, based on their historical correlations, suggests that global liquidity is going to catch up in a material fashion over the medium-term. So again, we're already currently accelerating in global liquidity terms, with a broad based acceleration across most of these economies, most of the major economies in the world that contribute to our global liquidity proxy. And that's likely to accelerate over the medium-term. Obviously, China being a big driver of that. So that's the global liquidity proportion. We believe that US liquidity is likely to accelerate significantly as well in the coming months. So if you jump to slide 57, where we unpack the most recent, the Q3 QRA, the quarterly refunding announcement out of the US Treasury, the outlook for US liquidity is mildly positive. For Q4, we're talking about $175 billion decline in privately held net marketable borrowing. In Q4, we're talking about $150 billion decline in the treasury general comp balance here in Q4, currently projected by the by the Treasury. So those things are quite positive from the set of US liquidity.

But where I'm most concerned about US liquidity, from the perspective of being a bull, is the outlook for liquidity in Q1. So, we got the part one of the US Q4 quarterly refunding announcement on Monday this week, we'll get part two tomorrow on Wednesday, and what we find is that, the Treasury is expecting to incrementally crowd out the private sector and drain US liquidity in Q1? That's on slide 58 where we show the projections for Q1 with a privately held net marketable borrowing estimate of $823 billion is $277 billion relative to what it is in Q4 and then the Treasury General Account balance for Q1 is $150 billion higher than it is for Q4. Well, wait a minute. I just said the outlook for US liquidity is about to get wildly positive in Q1 and the reason for that is, they're not going to be able to do what they are put on the screen here, on slide 58, they will run directly into a debt ceiling, the lapse, the expiring debt ceiling moratorium on January 1, that's on slide 59. So on January 1, so the debt ceiling moratorium that was enacted in June of 2023, ends on January 1 of 2025. On January 2 of 2025, the US Treasury will no longer have borrowing authority, which ultimately means, if you look at slide 60, they're going to have to spend down that roughly $700 billion of Treasury General Account in the first few months of 2025 as we deal with another debt selling, you know, bipartisan debt selling brinksmanship episode. These things are only going to get more and more partisan and more

and more brinksmanship-y, for lack of a better word, as we progress deeper in the fourth turning and the rate of growth of US sovereign debts and deficits starts to meaningfully accelerate. So, if you look at the last two debt selling episodes, Erik, the Treasury spend down in the 2021 debt selling was $805 billion in a span of three and a half months. The Treasury spend down in the 2023 debt selling brinksmanship negotiation period, was about $560 billion worth of spend down. So that's about a mean of roughly just shy of $700 billion which Janet Yellen, being the dutiful student of economic financial market history that she is, and obviously being the one who presided over these two GJ spend down episodes, she understands that I need about $700 billion to get through the members of Senate, of which you need 60 votes in the Senate to legislate a debt selling increase to get through their bickering for the first few months of 2025. And so ultimately, that means that it's a very positive dynamic from US liquidity as well. So, we have global liquidity currently accelerating. It's expected to accelerate meaningfully over the medium-term, as a function of it catching up to where the leading indicators of global liquidity, as determined by our math suggested should be, and then ultimately, we're going to get on top of that roughly $700 billion of spend down by the TGA as a function of debt selling brinksmanship in the first part of next year. So, when you go back to slide 7, Erik, and you go look at our fundamental research themes and kind of just say them out loud in order, you have sticky inflation, resilient US economy, Jay wants a soft landing, here comes the liquidity. Most of that stuff is positive, and the three, the last three are positive, the one that is negative doesn't really matter yet, because the Fed doesn't care about inflation right now. They may be forced to care about inflation at some point to save face and for credibility sake, to maintain some credibility and inflation pricing in the bond market. But ultimately, we don't see that dynamic as a near-term risk. We see that dynamic as probably a risk that we have to deal with as investors, starting in Q2 of next year, particularly on the other side of that TGA spend down, where US liquidity could start to get really onerous. So, we're expecting a global refinancing air pocket to develop some time in 2025 and that should have some negative implications for asset markets, as evidenced by slide 40. But ultimately, we think the next, let’s call it four to five months, five to six months, should be quite positive. It should continue to be quite positive for risk assets and for things like gold.

Erik: I want to come back to some of the asset classes that you mentioned in just a minute, but let's just stay on liquidity, because obviously it's so important, what makes markets go up and down is when people buy and sell stuff, not macroeconomics. So, the availability of the money to buy and sell stuff is really what matters at the end of the day. I want to push back just a little bit, though, and come back to this election theme, because I get what you're saying, you got to do the math. I very much appreciate how data driven you are and the depth and just incredible quality of your analysis. But look, this is not your average presidential election. The views are so extreme that President Trump's strongest critics are literally out on the public stage predicting that there will be internment camps, World War II style, where the Biden supporters or Harris supporters will be locked up and re-educated, and President Trump is going to declare martial law. And there's people on the other side of this who are saying, look, Vice President Harris is so incompetent that she's going to lead us into a Global Thermonuclear War, and then botch the handling of that so badly that the whole world is vaporized. People really believe these extreme views, and I think that does carry over into investor sentiment. I see lots of people who

are normally very data driven, whose own personal politics are very much influencing their market views. Doesn't that mean that when somebody finds out next week that their candidate didn't win, that the consequence is there's going to be, you know, half of the investors are, to the extent that their politics influence their view, are going to conclude that the sky is falling, the world's coming to an end, and that's going to maybe take some of that liquidity out of the system?

Darius: 100%. But I think that's already been positioned for to a reasonable degree. If you look at the volatility risk premium, things like the stock US equity market, or things like the US Treasury market, right now, investors are positioned for all hell breaking loose on the other side of the election. So clearly, the risk, from my perspective, is upside risk as a function of those Vanna flows and those Charm flows decaying from those options decaying, and even if you did have all hell break loose, from a political perspective, we still think you've got to buy that dip in the context of those themes that we continue to go back to on slide 7. In our opinion, the election, the noise around the election and how people will feel about their candidate losing, and may even take to the streets as a function of their candidate losing, to me, that's the tree. The forest is the fact that the US economy remains resilient and is likely to continue surprising economic consensus expectations to the upside over the medium-term. The forest is the fact that the most important institution and person in the world want to engineer a soft landing in the US economy, and are maintaining an asymmetrically dovish reaction function, not just to achieve that objective, but also to help capitalize the US government in an era of explosive growth in sovereign debt. And finally, the forest is the fact that US global liquidity is currently trending higher, is expected to accelerate markedly in the coming months, and US liquidity is probably going to accelerate markedly, starting in the first quarter of next year. So, I would be buying that dip from a fundamental research perspective, and if we're wrong on that fundamental research view, then guess what, Erik, we've been talking for what, 45 minutes, 50 minutes, 0% accumulative, zero of those words has anything to do with the recommendations we make to our clients in terms of managing risk in their portfolio. 100% of the recommendations that we make to our clients are a function of our systematic trend following processes. The most cogent evidence of that process is on slide 14, where we show our market regime backtest. So, I may have mentioned this a few times ago, Erik, on the program, but we now cast the market regime. I think the best thing we do for investors is help them listen to the market and respond to what the market is trying to price in. And so in sort of 42 Macro nomenclature, that just means we nowcast the market regime, and then we provide them exact, specific recommendations on exactly how to position for those market regimes for the duration of the market regime, of which there are usually two to three meaningful payments per year. So, you're talking about three to four months of on average, in terms of the market regime, is persisting. On slide 14, when we show our market regime backtest for stocks, for crypto, we have this maintained for every asset class and sub asset class in the world. But just as a key takeaway, the S&P500, 97% of the S&P500 return since January of 1997, has come since when our market regime nowcasting process has indicated we're in a risk-on regime, ie., Goldilocks or reflation, only 3% of the S&P500 cumulative performance since January of 1998 has come when our market regime nowcasting process has indicated we're in a risk-off regime. So, if all you did was listen to 42 Macro research say risk-on or risk-off, you would do a lot better as an

investor. I guarantee you, if you look at the crypto market, the performance is even more extreme. 109% of the Bitcoin's cumulative performance since the inception of the asset class has come when our market regime nowcasting process has indicated we're in a risk-on market regime, versus minus 9% has come when we're in a risk-off market regime. So our market regime nowcasting process trades Bitcoin better than it trades itself. And so the key takeaway is, Erik, if we're wrong on these fundamental, these bullish fundamental research views, then our systematic processes, most notably our KISS portfolio construction process, that's slide 10, and our discretionary risk management overlay, which we use to help institutional investors stay on the right side of market risk, those processes will rotate us out of a risk-on market regime into a risk-off market regime. And as a function of that, take down our exposure to the various asset classes that we feature in our KISS portfolio construction process, and it'll change the proper trade recommendations, on slide 12, associated with the various factors within the equity, fixed income and global macro markets are.

Erik: Well, that's a perfect setup, because now I want to come back to gold. Boy, everything we've been talking about got to be just super bullish for gold. But at the same time, I really want to talk about what your indicators are telling you, in terms of trend following signals and so forth, because on almost any technical analysis level, in almost all time frames, gold is already flashing overbought to extreme overbought. It's very hard for a technical analyst to justify adding to a gold position here, as much as I think the fundamentals continue to keep getting better for the precious metals. How do you reconcile that? What should somebody who feels like they're under allocated to gold do here? I keep waiting for deeper dips in order to add to my position, and the deeper dips don't seem to be coming.

Darius: Well, this is an error. That's a great question, Erik, because we are in an era where both the cyclical, macro dynamics in the economy and the structural backdrop from a fiscal, monetary perspective, are combining to produce good outcomes in the gold price. This is arguably the best environment for gold in my career, outside of 2011. So in our opinion, we think gold, there's this meaningful upside in gold over the medium-term if we're proven to be right on those views and rewarded by that, rewarded by the markets for those views. So, the reason we have confidence in maintaining a maximum position in gold right now, as indicated on slide 11, in our case, before construction process, and just as an aside, let me before I even finish unpack that thought, our KISS-able construction process, we use this to help our retail investor clients stay on the right side of market risk, which is complicated nomenclature for just basically saying retiring on time and comfortably. We use this through ETF process to keep them invested in bull markets and ultimately on the sideline in bear markets, and gold is a core feature of that process. Gold right now is at max, it's 100% of its maximum exposure of 30% as a function of the top down and bottom-up risk management overlays that we show on slide 9. And I'll make sure all these slides are free to review in the presentation. So going back to gold, gold is currently bullish from the perspective of our Volatility Adjusted Momentum signal. Which is a core feature of the bottom-up risk management over up risk management overlay there on slide 9. Historically, 89% of gold's positive performance has come when our VAM signal has been bullish on gold. So if all you did was just be long gold, when 42 Macro says it's bullish VAMS, you make 89% of the total return you could possibly make in price of bullion. And so

that's why we have a lot of confidence in maintaining the position until the market vis-à-vis our VAM signal, or vis-à-vis our market regime nowcasting process tells us to do something different on gold. If you're an institutional investor and you're listening to this conversation, turn to slide 12 in our discretionary risk management overlay. You look at the bottom right, you see Gold LONG:MAX position. It has been some version of a long max position for the better part of a year now, our discretion risk management overlay pivoted 42 Macro clients to the long side of gold back in October of 2023, and has maintained either long half or long max position, primarily a long max position since then. And so obviously, gold's up 35%, 40% since then, and we see continued upside from here as a context of those fundamental research views. But again, if we're wrong in those fundamental research views, our risk management systems, which are trend following in nature, will cause, Descript Dr. Mo here, and KISS, going back to slide 11, to take down risk appropriately enough, with plenty enough time to avoid the worst of a deep correction or crash. And we're super proud of that.

Erik: Darius, we have been teasing our audience for this whole interview with your partially redacted slide deck. This is a working process that you evolve, keep updating this. How often do your paying subscribers get the update to this entire slide deck? What do you send them in between those updates? And for anybody who is interested in your paid service, both on the retail side and on the institutional side. where do they go to find out more about it?

Darius: You're too kind, Erik. I appreciate it as always, the opportunity to come connect with your audience. I've learned a tremendous amount from listening to every MacroVoices episodes for the past 5, 6, 7, years. So I just want to say thank you for everything that you've done for institutional finance, my friend. If investors want to learn more about…let me answer the first question, which is, how often do these presentations updated? We update this presentation every month right after the jobs report, and then we accompany this presentation with sort of about an hour, hour and 15-minute long webcast. Obviously, the presentation isn't the same every month. Obviously, the research will evolve between months. But the generally speaking, this comes out every month, right after the jobs report. Then throughout the month, every day, we write our lead off morning note, which is our Bayesian inference process that connects us from the prior Monthly Macro Scouting Report to the next Monthly Macro Scouting Report. And then every week, on Saturday, we have a sort of a semi deep dive that's sort of an amalgamation of that week's lead off morning notes that comes, accompanied with roughly 45-minute webcast, we'll be talking through the charts. So it's a very robust process. It's a Bayesian inference process. You know, we liken ourselves to, this is what you would see if you were sitting on a desk, trading desk at a global macro hedge fund. They're just not making the charts as pretty, and they're just not selling it to the public. And so we wanted to do what we can to democratize this kind of research, not just so that our retail investor clients can see what it is that we do, but so that hedge funds and family offices that don't have the kind of budgets like some of our big clients do, can actually access this kind of material as well. So, definitely come check us out if you've been impressed, 42macro.com. If you've been partially impressed and aren't quite ready to keep the tires on 42 Macro research, go to 42macro.com/the-macro-class, you can take our three part macro course where we walk through exactly how we derive a lot of these institutional processes and what to focus on as an investor, how to forecast the business

cycle, how to forecast the liquidity cycle, what types of indicators should you be looking for that are actually actionable and accurate across market cycles in terms of making the saving money in financial markets. So definitely, highly recommend everyone check that that course out. I don't care if you're a PM, a CIO, or a regular retail investor, you're going to learn a lot from that course.

Erik: Well, congratulations on a terrific year, my friend. I know you've made some terrific calls. Patrick Ceresna and I will be back as MacroVoices continues right here, at macrovoices.com.