Mike Green: What The Market Is Not Discounting

May 29th, 2025

Erik: Joining me now is Mike Green, Chief Strategist and Portfolio Manager for Simplify Asset Management. Mike, it's great to get you back on the show. It's been way too long. I want to start with something that you've been talking and writing about lately, which is, when you have the scope and level of change in government that we're seeing under the Trump administration, not only does that change the economy, but it also brings into question the metrics that we use for measuring the economy. Tell me what's going on in your assessment. Is the market correctly discounting what the real economic effects of Trump policy are? Or, is Trump policy actually interfering with the way we measure these things to the point that we're losing track?

Mike: Well, I think it's a combination of the two. And I don't think it's unique to the Trump administration, although I do think the disruption that is underway in the Trump administration will play a role as we roll forward. Your listeners who have heard me talk before know that my primary area of research, my primary focus is on the market structure impacts of the growth of passive investing. And what that leads you to understand or believe is that the market is being inflated by our style of investing. You put money into a passive index fund, it allocates very large sums of capital to the largest companies. Those companies are highly inelastic in their price response, meaning small changes in supplier demand can cause significant price change. You can think about it as a multiplier, right? So, the traditional thought process behind something like the Efficient Market Hypothesis is that a dollar into the market has very little impact on security prices because it's really an information exchange. You're saying I have a strong view about X, but somebody on the other side of the trade has an equally strong view that X is not true, or they have their own reasons for selling. And so, the net impact of flows into the market under the EMH are very, very small. We now know that is not true. The academic research that has emerged in the past decade, starting with Ralph Koijen and extending to his work with Xavier Gabaix called the Inelastic Market Hypothesis (IMH), identified that stocks are highly inelastic. And in fact, what we're seeing is somewhere in the neighborhood of about $7 to $8 worth of market cap created for every dollar that flows into the markets. That suggests that the EMH is misspecified about 800 to 1. That research has now gone further, augmented by an individual named Valentin Haddad at UCLA, who has looked at the market cap impact of that. And I've done a lot of work with Valentin at this point. And what we're finding is that for many of the largest stocks, the NVIDIA's, the Apple's, et cetera, of the world, that inelasticity is an order of magnitude higher there.

So, we're seeing between $75 and $100 of market cap created for each dollar that flows into the market. As long as people have jobs and are contributing to 401Ks and their retirement flows

continue to be positive, and that's been augmented by policy choices like Secure Act 1 and Secure Act 2 that have increased participation and increased employer contributions, that means that the market isn't really pricing anything anymore. What it's really doing is reflecting those flows. And Trump's policies, while they've interjected uncertainty—uncertainty doesn't mean fire the workers you desperately tried to obtain over the last five years—we basically have businesses in a holding pattern where they're starting the process of thinking about firing people. You just saw Facebook introduce performance metrics, et cetera, and the objective being to move to a GE type model where they lay off the bottom 10% of performers on a continual upgrading basis. That's telling you that the uncertainty is likely to morph into some form of increase in unemployment. We see this in employee uncertainty indices. 'Jobs hard to find' are getting higher relative to 'jobs plentiful,' fear of losing your job is starting to rise. All of those are telling you that we're looking at a scenario in which unemployment could begin to rise fairly significantly. And if that happens, then those flows can change. But in the meantime, we're used to thinking about markets as discounting mechanisms, and we ask ourselves, what is priced in? If the market is going higher, it must be good, things are about to occur. The market is discounting something positive in the future. I just don't think that's true. I think that it really reflects the fact that companies have not yet laid off the employees despite the fact that we're seeing significant weakness and demand.

Erik: I want to clarify and better understand the basic premise of what you're saying. You started with the Efficient Market Hypothesis and other thinking was that $1 coming into the market was only going to make the difference of $1 worth of market cap. You're saying it's more like about 8 to 1. Are you saying something has changed since the days when the Efficient Markets Hypothesis was first posited and it doesn't work the way it used to? Or are you saying it's always been this way and they just had it wrong before?

Mike: So, it's a mixture of the two. It definitely has changed. So again, this is the work of Valentin Haddad and also Marco Sammon, who is at Harvard. What we're finding is, is that as companies get larger in market capitalization, their need to be included in the index rises. So, if you think about it, in the concept of substitution effects, if I'm buying the S&P500, I don't really care whether I buy United Airlines or American Airlines. They're both 0.002% of the index. They have no meaningful impact on performance. And candidly, I can buy one or the other. It doesn't matter. I could buy two times as much one. It's not really going to matter in any meaningful way. And for that matter, I could even leave them out. But I can't do that with Apple. I can't do that with NVIDIA. I can't do that with Microsoft. I have to buy those at whatever price they're offered to me. And as a result, those large stocks actually have much lower elasticity, or higher inelasticity, than the smaller stocks do. And so, the impact of this is to actually increase that multiplier over time, as we get a more and more concentrated index, which, in and of itself is a byproduct of this effect. So indexing is driving concentration. Concentration is driving inelasticity. Inelasticity means, as long as money is coming in, prices will react more and more favorably. What looks like a booming economy in the stock market is really just a stagnant labor force.

Erik: Mike, let's talk about what the effects of this are. You're saying, basically, that there's kind of a new regime in the marketplace that's changing the way that we make decisions. What will the knock-on effects of that be?

Mike: Well, I think that there's a couple of things. One is, as I mentioned, end demand is weak. We know this in part because commodity prices, in gold terms, are not rising. That's telling you that the demand for money is exceeding the demand for industrial materials. If we were watching a booming economy, you would typically see the opposite effect, right? And we see this on gold. We see it in iron ore, we see it in copper, we see it in nickel, we see it in softs, et cetera. That suggests that the economy is significantly weaker than we would expect. With that said, the tariffs that are being introduced will absolutely cause some portions of our consumption basket to rise in price, because the government has effectively introduced the sales tax. When we saw this in Japan in 2014, it caused prices to rise instantaneously, in many situations, by nearly the 10% increase in sales tax, because you are actually artificially driving up the cost side of the equation, reducing the supply of goods and services in that framework, and that then translates to higher prices. So, we will see higher prices in some areas, particularly areas like electronics, in which the costs are going to go up to the end consumer in a meaningful way.

What's different this time around, versus, say, 2021, is that we don't have a giant stimulus occurring on in line with this. So, there's not the consumption boom that's happening or the demand side of the equation that's happening alongside the supply restriction. That means that we'll see prices increase in those areas where consumers have no real choice because it's sourced from China or it's sourced from Europe. But in other areas, it means that they're going to have to economize and reduce their consumption. And the most obvious one of those is in the housing market, which people fantasize is an inelastic market. It's one that people can't replace, right? If you need a house, you need a house. But that's really only true in periods in which employment is growing rapidly. So people need to relocate to where their new job is or where the population is growing very, very rapidly, either in terms of individual households, because you suddenly discovered that your roommates were toxic and could kill you in a COVID type framework, or as we saw in the 1970s where there was simply huge growth in population that required that increase, that makes it much harder. But in today's world, we're seeing something different. We're starting to see household size begin to rise. That means that young people are staying with their parents longer. It means that adult children are moving back home to be with their aged parents, to help them care for their aging parents, or to help them care for their young children, because the cost of childcare services have risen dramatically. Perversely, you can create an incredible amount of elasticity in the housing market simply by doubling up, increasing people per household, and that takes time. There's a slow response to it, but we're starting to see that, and now we see metrics like the Cleveland New Tenant Rent Index falling significantly. This is being validated in other private sector metrics. We just saw housing prices fall for the first time in the past four years in the S&P Shiller indices, the core Shiller indices. This is telling you that that largest portion of the inflation basket shelter is actually meaningfully under pressure, and we're likely to see that offset a significant fraction of

the inflation that we will see on the goods side of products that are imported from places like China.

Erik: Mike, I have an utterly simplistic and unsophisticated view of what's going on here, and it's very simple. It goes like this: finance guys like you and I, and most of our listeners get it and understand that tariffs inherently pose an inflation risk. But I think the average American citizen, the average Joe Q Public, hasn't really figured it out yet. They don't understand that what a tariff is, is a gigantic sales tax that is assessed and paid by American citizens on the hope that foreign suppliers of goods, in order to maintain a level selling price will reduce the cost of their exports in order to compensate for that massive new tax that's being charged. I don't think most people have any idea that that's what's on the table, other than finance people who study this stuff. And I think that when that sinks in, if you think inflation expectations are high now? Just wait. Am I on to something?

Mike: Well, I just want to make sure that I understand what you're saying. So, you're saying we're introducing a giant tax, and then you're saying that you think inflation expectations will rise further because of that tax, or you think that they will?

Erik: I think that inflation expectations will rise even further, because I don't think that current inflation expectations, as high as they are, have fully contemplated what's really about to happen here. And this depends, if we end up with tariffs were all a bluffing, negotiating game, and we don't have any tariffs. Well, that would reverse it, but assuming that we really are intending to rely on tariffs as a revenue production mechanism, that means that revenue, it's coming from someplace, it's got to come out of someplace else. So, either Americans pay more for their foreign products, or foreign sellers of exports reduce their prices in order to offset that tax, it's got to be one or the other. And I don't think people have figured that out yet.

Mike: Well, I think it's a combination of both. But I think part of what I would argue is, is that inflation expectations, first, we have to be very careful in terms of what we're defining. So, the headlines are filled with the Michigan Survey of Consumer Expectations that shows Democrats thinking that inflation is going to rise 12%, Republicans thinking inflation is going to be less than 2%. And there's been some retreat of those Republicans moving slightly higher as the headlines basically wear people down. I'll be honest with you, I actually think that inflation expectations is proxied by those types of metrics, are hopelessly corrupted by both a change in methodology and the increasing tribalism of the response. If I look at market-based metrics, things like a 5y5y forward inflation swap, those are actually falling, right? So, what that's telling you is, is that the market is pricing inflation in the second half of the next decade, is actually being lower than they were at the start of these discussions. You know, it's possible that that rises because we have terrible policy, and we make all sorts of bad choices, and we seem uniquely suited to doing that. If that's your belief, then TIPS as an investment opportunity are significant. But the metrics that we're getting on the surveys, I actually think, are really screwed up by this tribal dynamic. And then the other thing, and I put a tweet out on this, in which I jokingly pointed out the old New Yorker cartoon on the internet. Nobody knows you're a dog. I rephrased it as on the internet, nobody knows you're DOGE, but what we saw was a change in methodology, where we moved

from telephone based surveys to online surveys, and once we removed that human filter, the inflation expectations just went nutty. The variance of inflation expectations are no longer filtering out the extreme views, where somebody says, I think inflation is going to be 100% for the next couple of years. That was very hard to do in a telephone survey, because you'd hang up with somebody like that. There's another interesting thing that seems to be happening, which is an increasing number of surveys seem to be answered by LLMs, by ChatGPT equivalents, and the ChatGPT equivalents will search for the answers to these surveys by using the popular press and the written materials. And so, we've constructed a narrative that prices are going to unmoor themselves, and the surveys are increasingly reflecting that even as market-based measures of it suggests the exact opposite.

Erik: So let's get your assessment, your outlook for inflation for the next several years, and how it relates to consensus.

Mike: Well, what I would argue is, is that we are likely to see the impact of that tax increase that you're referring to, right? Anytime you tax something, you are going to get less of it. The way you get less of it is because the price has effectively gone up relative to other goods or services. And so we'll likely see a reduction in economic activity, as you would expect with a tax and there's multiple taxes, while people have focused on the expansionary nature of the Trump administration passing the 'Big, beautiful tax bill' that basically extends the Trump tax cuts. So, in other words, extends the status quo, but is scored on a baseline as very expansionary, because it's taking tax cuts that would have expired and extending them out. So, it looks on a baseline like a very big stimulus, but it's not, really, right? And the money that it is taking away, it's taking away money from income supports, things like SNAP, or nutrition supports, or welfare that are flowing to households that spend a large fraction of it, and it's increasing the flows to people who have lots of income and lots of assets, who basically have a very low propensity to spend. So, it's actually a fairly contractionary policy. My hunch is, is that we will actually find, as we did in the 1930s, that the impact of tariffs is to be deflationary by slowing economic activity.

Erik: Mike, I want to introduce AI into this, because as we change the world to depend more and more on AI, I'm going to make the argument that it's too late to stop or shut down AI. In other words, we're at the point, or we're well past the point where, for military reasons, if there was any effort to, you know, we're going to shut down AI globally, there would be several military interests, including the United States, would say, yeah, but we're going to do it anyway behind closed doors, because we need to get a leg up on everybody else, or else they would do the same thing to us. That logic guarantees that AI cannot be stopped. Now, given that, to what extent do you think that AI is really going to immediately help us? Or could there be kind of a tax on the economy from the sense that we've got to pay for AI and all of the development, and particularly the burden it's going to place on our energy infrastructure. That's all coming no matter what, we can't stop it. What's that going to mean for the economy?

Mike: Well, yes, there will be investment that's required in energy. And if you look at areas that you and I have talked enthusiastically about in the past, things like nuclear, and by the way, my son, who is in the US Navy, is going nuclear subs and off to nuclear power school in another

year. So, I'm a firm believer in this, both in terms of human capital and physical capital. You know, the nuclear power indices are up nearly 100% on a year to day basis. Uranium has not performed in quite the same way, in part because it was the only mechanism that was really available for people to invest for a long period of time. So, I'd argue people bid up uranium in expectation of what does actually appear to be a very real need. I think we have to be very cognizant that while the increase in supply is necessary and that will require capital investment, and that can help power the economy, energy is a very small fraction of overall economic activity. And in fact, the investment in energy infrastructure is likely to be significantly less than much of the contribution that's coming to GDP through things like intellectual property, which is a purely imputed metric that I think is very overstated in terms of its impact. So again, the work in productivity studies and analysis is pretty straightforward. If AI is going to radically lower the costs or improve productivity and services, what you're actually doing is what I call productizing services. And we've been through this before, right? We used to call them washing machines because they replaced washer women, right? Women who, literally, their job was to come around and wash people's laundry, because it was a time consuming task that ideally you'd outsource to an Irish immigrant. We replaced those with physical machines. The first people to actually benefit from that were actually the housekeepers who went out and bought vacuum cleaners, or who bought washing machines that they then used to expand their business, centralizing it in laundry centers, what we call now dry cleaners, et cetera. Those used to be actual laundry centers, where you would have higher productivity. What that does is it lowers it as a fraction of your purchasing basket, improving the access to it for more and more people. And so, AI is likely to be a hugely deflationary force in the services area, which makes up 75% of the US economy.

Erik: Mike, let's go a little bit further on AI. I've drawn an analogy before to the early stages of the internet, where, in the beginning, everybody was excited. They knew correctly, they correctly understood the internet was going to be a big deal, so they just started buying anything with .com in its name, with absolutely no understanding of what they're buying. I've made the argument that a lot of people buying AI related stocks have been doing the same thing. They don't really know, you know, the fact that NVIDIA just makes the chips and doesn't actually make the AI that runs on the chips. Most people buying NVIDIA stock don't even know that. They just know it's the play on AI, it's the thing to buy. Is that the way you see it? And what could the implications be if that's true?

Mike: I think the internet, the early days of the internet, and more accurately, what I would describe is the build out of the infrastructure of the internet. That's the fiber optic, it is the subsea cables. It is the internet providers and the switching equipment and the data centers, et cetera, that were also built in that time period, is a very apt analogy. What people often forget about what happened in that time period was that you actually saw an extraordinary build out under economic expectations that you would be able to continue to price the Internet services at a high level, in a manner that's not dissimilar to what we're seeing for AI today. But what actually changed was the technology around things like switching and amplifying, which meant that we didn't need anywhere near as much fiber as we actually put in the ground. Even today, roughly 25 years after the dot-com cycle collapsed, we're still using significantly less than half of the

fiber that we actually laid at that point. The introduction of wave multiplexing, which allows you to send different colored lights basically down a fiber optic so they don't interfere with each other, because wave theory meant that you could dramatically expand the quantity of data that was transmitted. Likewise, the introduction of amplifiers meant that you needed far less equipment put in place, you could send a signal much further. The way this manifested itself is in the late 1990s, we were paying the equivalent of $800 per megabyte. That was actually the number that was used by global crossing when they were building their investor presentations about what the opportunity set looked like. I think today, we're down to about 32 cents per megabyte. And an analogy in AI is the move from the training period to the exploitation period. We're still very much in the build out. We're discovering what these machines are capable of doing, but once we actually cross a threshold, most AI will satisfice at human levels of intelligence, right? And candidly, relatively low levels of human intelligence, because many people in services that are doing the sort of routine jobs, like call center work, et cetera, that are very likely to be the first to be automated, they're not the people that came out of MIT, to be very straightforward. And as a result, once we cross that threshold, we radically lower the cost. Further innovation basically means that becomes super easy to do, and as a result, the costs are likely to become incredibly deflationary in the AI space as well. I would guess that the cost per token, which is effectively the equivalent of a megabyte type analysis, is going to collapse over the next 5 to 10 years, and we'll discover that we have ubiquitous AI. Now, that may create its own interesting challenges, right? But the actual impact of it doesn't strike me as possibly inflationary.

Erik: Let's bring all of this AI talk back to the equity markets and passive investing and so forth, assimilating all the various different things that we've talked about. Give us your outlook for equity markets and an update on the role that passive is going to play in terms of influencing them.

Mike: Well, the critical component that I would emphasize is that as long as people have jobs, and as long as our policy is you're going to contribute to a 401K, by default, you're going to contribute to retirement. And we've created a liability bias through what's called Qualified Default Investment Alternatives (QDIA), which is what causes you to open up your 401K, your new job and see you have basic 10 choices of investments, all of which are various forms of Vanguard target date funds. As long as that maintains itself, we are likely to see equity prices inflated by the mechanisms that I saw before. The issue is, if I'm correct in my analysis of the ultimate impact of AI, that it's going to cause disruption, and ultimately, companies try to lay people off as the demand does not expand enough to offset the improvement in productivity. That will ultimately prove to be negative to equity prices as those flows potentially begin to reverse as baby boomers head into retirement. That's finally here, and as fewer people have high value jobs that are creating or driving, effectively, an increase in contribution to financial assets, you could see that reverse itself quite sharply. I think that's not at all priced into markets right now. It's a key risk that I've been emphasizing, and unfortunately, I think the uncertainty that's being created right now could very well prove to be that straw that breaks the camel's back. But against that, I would argue that the neglect that has occurred in the fixed income market in the same manner that we saw during the dot-com cycle, when TIPS got to 4% real

yields, that was an extraordinary return relative to what you could expect from equities going forward. Almost everything we see, whether it's a Shiller PE or equivalent, would suggest something very similar exists out there in the future. And the 2.8% real yield that you can pick up in a 30-year Treasury or 30-year TIP, that's going to be an interest, you know, that would be a very hard number to beat in the equity markets. And so, I'm encouraging people to recognize that the fixed income markets simultaneously suffer neglect under these models, and they don't have the same propensity for Ponzi type dynamics, where the price you sell it to the next person is your primary source of return. Fixed Income ultimately pulls towards par. Your return is your coupon plus the return of your capital that is much less susceptible to the types of passive distortion that occurs in the equity markets. And so, I think that people should really be very closely evaluating. Do they want to actually increase their exposure to bonds? One of my favorite examples of that right now is Harvard Management Company, which is, as you know, being called to task for its high allocation of things like private equity and venture capital, with Bill Ackman calling out that those are highly likely to be mismarked. I'm actually doing some work on this right now. You know, Harvard has 5% of their assets in bonds. 5% of their assets in bonds. That gives you some idea of how neglected this asset class actually is at this point.

Erik: Let's go a little bit further on real rates and what they mean, because I would argue that we always know what a nominal rate means, but the real rate is only as accurate as the inflation number that you plug in to calculate it. Are we calculating inflation accurately? Are the real rate indications that we're seeing now truthful, or are they just a reflection of misanalyzed statistics? And in either case, what are they telling us? What's the outlook?

Mike: So, I think this is actually really an important one. And I encourage people to check out the Substack that I wrote on this. You can find my Substack at, yesigiveafig.com, you know, we're seeing metrics like trueflation, which was the darling of the inflationista set, in the 2021 time period, when it correctly highlighted that inflation was running much higher than government numbers were printing. The primary reason for that was the owner's equivalent rent component, and the way rent is calculated in the CPI, it's intentionally designed as a slow lagging indicator that you can almost think of as like a three-year moving average, that metric was slow to respond. Trueflation recognized it quickly. Trueflation has pulled back down, and now, of course, we're introducing another disruption that is likely to cause some of those inflation metrics to rise, something like trueflation is starting to show that we're starting to see a little bit of inflationary impact there, but trueflation does not have the negative impact of that. OER now falling back towards Earth, it's already happened in their indices, and so I don't think the government numbers are actually that far off. I fully recognize that it doesn't feel like that. And people, when they hear inflation retreat, often are talking about the absolute level of the price level as compared to the change in prices. Egg prices are high. There's no question about it, right? The price of many of the products that we buy at the grocery store have been increased, whether that's a function of monetary policy or whether that is a function of market power, is really up for debate. And my hunch is, is that what we're actually seeing is the evidence of market power that has been created. There are two separate sources of that. It can be the market power from increased consolidation that has occurred through private equity, or through M&A activity in the United States is very strong evidence that we are an increasingly

monopolized and monopsonized economy where there are fewer employers and there are fewer sellers of goods and services that are able to extract higher margins and greater prices. But that's not inflation, that's market power. And so, you can see this, I encourage people to go check out your Amazon listings for monitors. US listed monitors from Dell or from US brands or name brands like Sony etc., are already reflecting much higher prices, while Chinese imports are actually incredibly cheap. I just picked up a 34-inch monitor for my daughter who's getting her new apartment, and it was 150 bucks for a 4k, 34-inch monitor. That's insanely cheap.

Erik: Mike, let's tie all of this into monetary policy. President Trump says that Jay Powell ought to be fired for his failure to cut interest rates more aggressively. Jay Powell has almost alluded to thinking he needs to go the other direction, although I don't know that he's said that directly. What should be happening here? Where should we be headed with monetary policy, and why?

Mike: Well, the idea that, I mean first, let's call out Powell's disingenuousness, right? So, the Fed itself in 2018, as they evaluated the tariffs, made very clear in their research that it should be ignored for purposes of monetary policy. If anything, you should look through it to the economic implications of it, the bizarreness of saying, hey, let's increase taxes, and therefore let's increase interest rates as well. That's absurd, right? Like, you know that that is not correct, but because it's tied to quote-unquote “prices,” and we imagine that every increase in price is an inflationary activity. The Fed is kind of on pause in this framework. Again, for me, that means they're keeping interest rates at too high of a level for too long, which is creating an incipient credit cycle, which we're just now discovering how advanced it is.

Erik: Does that mean that it's finally time to go long bonds here?

Mike: I lean in that direction. But, I've been wrong about this in part because, you know, Jay Powell very much thinks that the increase in prices means that they have uncertainty in terms of the economy. To me, that's absurd, right? You don't raise taxes and then say, oh, look, taxes went up, therefore we should increase interest rates. This is the equivalent of tacking on a value added tax, right? Or a sales tax. It would be absurd to penalize the market with less stimulus or with contractionary policy in an environment in which you've already introduced contractionary tax policy, but I don't get a vote on the Federal Reserve. And Jay Powell also has significant political objections to the Trump administration, and candidly, I think that he's probably quite happy to sit where he is right now. Does that mean that bonds can't rally? It means they are limited, right? If the cash yield is at 4.5%, you don't have a lot of incentive to go out and make a bet that those rates are going to be cut, until you start to see material representation of the weakness in the economy in the traditional data sets. And that's another area, unfortunately, where I think a lot of the changes that we made to try to adjust and accommodate in the post GFC era are now candidly coming back and biting us and creating a lot of data that makes absolutely no sense whatsoever.

Erik: Mike, let's talk about a part of the market that you are extremely familiar with, which is high yield, you run Simplify’s high yield fund. That ticker symbol is CDX. Why would a guy like you, who's expressed a fair amount of, I don't know, conservatism or criticism that bull markets

might be out of control, why would a guy like you be investing in high yield? It seems like I'm missing a little bit, or maybe I don't understand what the investment rationale is.

Mike: So that's a great point. What we do that is unique within CDX is, we actually hedge the credit exposure. So, we have a proprietary index that we use, an equity long-short overlay that is designed to replicate credit spreads and do so at very low to even negative costs. It takes advantage of a theoretical framework called the Merton model of capital structure, which says that, look, an equity is effectively a call option that sits over and above the claims of creditors to the company, right? So, it's the residual that's left over by constructing an index that is long, high quality, companies that never really need to tap capital markets, and short companies that continually tap capital markets, these would be serial refinancers, companies that are losing money, etc. What we're actually doing is effectively isolating the hitting the capital market or needing to tap capital markets factor. And so, by overlaying that with a high yield exposure, we're able to hedge out the credit spreads. That's the unique thing about high yield as it relates to other fixed income, is when the economic conditions weaken, you see a credit response that impairs high yield. If you're able to take out that credit response and neutralize that, you can actually feel very comfortable investing in the space. If I'm wrong, and the economy is going to be totally fine, then high yield is going to do great, and my hedge is not going to hurt me too badly. I'll modestly underperform my benchmark, but significantly outperform treasuries. On the flip side of the equation, if I'm correct that there's an incipient credit cycle, my hedging allows me to actually reallocate capital at much more attractive prices while I've protected my investors from those credit spread widening. I would encourage you, when you look at the product, run it against an equivalent product like HYG, and make sure you're looking at the total return components, you can see the outperformance that is created during credit cycles that just continually accumulates. And so, over the history of the product, we've had roughly 12 separate mini cycles of credit, spread widening and tightening. During periods of credit spread widening, we add about 300 basis points versus the benchmark. During periods of credit spread tightening, we give back about 100 basis points about performance. The net impact of that is just to accumulate to outperformance over time, which is really the signature I'm always looking for in a market.

Erik: Well, Mike, I can't thank you enough for another terrific interview. But before I let you go, tell us a little bit more about what you do at Simplify Asset Management, where people can follow your work. And again, the ticker symbol, please confirm, is CDX for the high yield fund.

Mike: Yep, that is the right ticker. At Simplify, I'm the chief strategist and portfolio manager. I was one of the early members of the firm. Simplify itself is actually an outgrowth from a regulatory change that was introduced in September of 2020, it's called the derivative rule alongside a rule change in 2019 that occurred, called the ETF rule—very exciting titles we have here—the ETF rule made it much easier to create new ETFs. It reduced the comment period, and then the derivative rule actually established the guidelines that allow you to do complex strategies, like the overlays that I provide within CDX, basically bringing hedge fund-like strategies to the ETF space. Now, both of these have actually been behind the explosion in ETFs that we've seen, and have, in many cases, been used to create very aggressive products.

I'll be honest with you, I'm a worrier, right? I like to actually present things in a way that reduces risk while potentially increasing return. And that's really what we've tried to achieve with CDX, exposure to the high yield universe, without necessarily the risk associated with credit. That is the primary issue that you face within high yield. And it is really important to understand that that has been created. Now, those components created the opportunity to take my hedge fund background and transition it over into the ETF space, which is a much more tax efficient and low-cost manner for the traditional investor to access these types of markets. Simplify has grown from about $200 million when I joined in early 2021 to today, we are around $7 billion with approximately 25 different strategies offering exposures, about 40% of which are going to be in the fixed income space. Another 20% of that is going to be in various managed futures. I know you've spoken with Charlie McElligott in the past about our managed future strategy, CTA, those types of strategies really are powering the growth of the business. We are slowly making our way as we get those three-year track records into the Morningstar five-star ratings and the distribution into retail accounts that we had hoped to accomplish when we identified the opportunity, and so I've been really pleased to see how the firm has grown. We're really happy when we can help investors build their portfolios in ways that we think could be quite beneficial to them over the long haul.

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