MACRO Voices

with hosts Erik Townsend and Patrick Ceresna

Darius Dale: Are You Positioned For The Melt-Up?

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Erik: Joining me now is 42 Macro founder Darius Dale. As always, Darius has prepared a fantastic slide deck to accompany today's interview. Registered users will find the download link in your Research Roundup email. If you don't have a Research Roundup email, it means you're not registered yet at macrovoices.com. Just go to the homepage macrovoices.com, look for the red button above Darius' picture that says, *looking for the downloads*. Darius, it's great to get you back on the show. It's been way too long. I want to start with the market outlook and just what's going on so many people are really saying this has gone too far. I don't know if you caught Lyn Alden last week saying, run your portfolio hot. I think you're more in Lyn's camp. Give us the outlook on what's going on with the market. Where do we stand?

Darius: I appreciate you having me back on. I'm really grateful when anytime I can be in the same camp as someone as brilliant as Lyn Alden, that's always a good sign. I have tremendous amount of respect for her, and I agree, we've been pounding the table on our paradigm C view since late April, early May, specifically early May in terms of how resoundingly bullish we've been on risk assets, and we continue to see a tremendous amount of structural upside over the long term as a function of our paradigm C theme. Just kind of really quickly, highlighting a chart that can sort of explain why both Lyn and I think the economy is being ran hot, if you go to slide 44 in our slide deck. And by the way, we have our usual customary slide deck for you guys as well, so listeners will be able to access that if they sign up for your Research Roundup email.

Anyway, getting back into slide 44 where we show in this chart, are a collection of major economies through the lens of their sovereign fiscal balance to GDP ratio, their current account balance to GDP ratio. And then we sum those figures to come up with a twin balance. So, if you look at the US, which are the blue, the dark blue lines in each panel, the US is running a record non-war, non-recession, budget deficit, and has been for an extended period of time. You know, really throughout the Biden administration, in terms of this lurching forward into fiscal dominance, that really began back in 2020 with COVID. We essentially stayed there since part of that that's been a driver of our current account deficit, a really swelling minus 4.6% of GDP. And so now, the US is sort of running these persistent twin deficits, somewhere in the 11% to 12% range. And in the 11% to 12% range, we are on par with an economy like Brazil or Argentina or Türkiye. These are types of economies that you tend to see dramatic currency declines, dramatic asset price appreciation, and ultimately, a tremendous amount of political unrest, if you will, as a function of the income and wealth inequality that tends to perpetuate.

Erik: Well, Darius, I have a strong feeling that both you and Lyn are right, and that concerns me, oddly enough, because that's not where I'm positioned. I'm actually probably more hedged with more bearish exposure on than I've had in years. And the reason, I'd like to run past you, because I think you and Lyn both have the macro call right here. What I see is an exogenous risk, and I wish I knew a more efficient way to hedge it, but I think it's been proven now that President Trump and Secretary Bessent are not concerned about collateral damage in financial markets, and one of the signals that I thought was particularly important was the way that they just whipsawed copper up and down. We might, you know, tariff coppers up 50% almost on speculation, front running. Oh, we're not going to tariff copper because it's a source material that we need to support American business, we would never tariff copper. Crash, probably the biggest down day in copper in years, then we're through the roof on the 50% copper tariff, which is diametrically opposed to what Trump was saying a month earlier. So, it seems to me that they have really big policy initiatives that they're intending. They're not done yet, and they're not afraid to break things along the way. Now, I suppose there's just as many right tail risks as there are left tail risks in that, right? But the ones that I have to hedge against because of where my other risk exposure is the left tail risks. So, for that reason, I'm way over hedged, and maybe I shouldn't be. What do you think?

Darius: Well, that's a great question, Erik. And I'll say is, I think, if you take a short to medium term time horizon, which is sort of one to three months in harvest management nomenclature, I think you're sort of appropriate to be at least somewhat hedged, because it's very likely that we see the section 232 tariffs, which have somewhat been forgotten about by market participants, as well as the increased aggression by the Trump administration with respect to trade policy negotiations. Those things are likely to get worse over that time horizon, and so it's very likely you see at the bare minimum, 5% to 8% pullback, let's say in the S&P. You can extrapolate what that means for other asset classes on a beta adjusted basis. But from my perspective, when you take a look into the medium to long term, that's a time horizon of 3 to 12 plus months, and our risk management nomenclature. We think Paradigm C is here to stay and is likely to result in dramatic upside for risk assets and also the economy as well. Essentially, what we're arguing for is that, hey, even though there are these tenets of policy, like tariffs trade, the general kind of chaotic nature with which the administration is negotiating trade policy, even if there's a tremendous amount of policy uncertainty stemming from that, we would argue that policy uncertainty is going to be resolved on a net positive basis, net positive for growth, net positive for asset markets, and ultimately, net positive for investors that are participating in our Paradigm C theme.

So, one final thing I'll say on this is, I hear you on the administration's boldness with regards to it seems like they're increasingly less willing to respond to markets and market signals in terms of how aggressive they are being on trade policy. However, I would say they, actually, the biggest pivot came back on April 9, if you recall when President Trump pit punted on the Liberation Day tariffs, and if you go to slide 43, slide 43 tells you exactly why they punted and why we're likely to remain in this Paradigm C framework for an extended period of time. We're talking at least through the November 2026 midterms, and perhaps even longer than that, if the Republicans win. So, on this chart, on slide 43, we show the US' net international investment position. As you can see, we're at a $26 trillion deficit, which has more than doubled in the past five years. And so now the US' net international investment deficit to GDP ratio is somewhere on the order of 90%, and it's a fourth global GDP. And so, what that essentially means is that there's been, the US economy has sort of Hoover vacuumed a tremendous amount of the world's capital in recent and over the past, let's call it 15 years, with a tremendous amount of that coming in the last five years. And as a function of that, if you skip ahead to slide 45 and 46, on slide 45, we show the average 10yr nominal yield and MSCI equity index earnings yield, to give you an indication of what the relative cost of capital is for these economies. And as you can see, the US, with this twin deficit ratio of about 12% and its net international investment, the GDP ratio of about 90% which is about a fourth of global GDP, is capitalizing itself as if it were a creditor economy, an international investment surplus creditor economy. You know, we're down there, kind of around 4% which is right in line with Japan, which is one of the world's largest surplus economies. It's actually below Eurozone and China, which are the two of the three largest surplus net international investment surplus economies. And so, what we saw in throughout March and especially throughout early April, in our opinion, forced the administration to transition from what we were calling paradigm B, which is a dramatic fiscal retrenchment, which would ultimately narrow the current account surplus or narrow the current account deficit, and ultimately take us into a new paradigm, much less inflationary paradigm. And they pivoted to paradigm C because they were ultimately concerned about the persistence of the Sell America trade, which was shown on slide 46. Those persistent capital outflows that we saw, remember, we saw several indications of stocks down, dollar down, the bonds down, which has never really happened, seldom happened in anyone's career in this industry. We saw several indications of that. And what that was a signal to both us and the administration, was that, this sort of hard line approach to policy making, in terms of transitioning from paradigm A, which is Biden's economy, to paradigm, what would have been paradigm B, was actually contributing to a elevated risk of a durable loss of US exceptionalism, which, in our view, would have contributed to a debt spiral. This chart, we show federal interest payments to GDP. We're up at 4% now. That's a three sigma move relative to the trailing 25 years. And ultimately, we're headed back towards potentially all-time highs of this ratio, partially as a function of higher interest rates, but also obviously as a function of the increase in the deficits that we've seen in this fiscal dominance regime. And so, if they were going to go full bore into it, the risk of going full bore in toward which we saw on the tape several times throughout April was a durable loss of US exceptionalism and this debt spiral risk, and you don't want to get into a debts problem, because it's incredibly hard to get out. So, in our view, we think we're very insulated as investors to from that outcome, that more bearish outcome, that was paradigm B, and why we think they pivoted to paradigm C in April 9th.

Erik: Paradigm Charlie, what is it?

Darius: Let me take you through it. So if you go to slide 22, where we show labor share of national income and capital share of national income, to me, this has always been one of the most important charts in macro, and has been for over a decade now. This chart shows the increasing share of income that is essentially being siphoned away from household balance sheets to corporate balance sheets as a function of a variety of policies. But I would say globalization, the disparate taxation of labor versus capital income, or these are all types of structural forces that have contributed to this kind of very awkward dichotomy, if you will. So, at 52% labor share of national income, we're down about 500 basis points from the long run mean prior 2000, that represents an annual transfer of about $1.5 trillion from US workers to US asset owners, which is roughly about a 14%-15% annual loss of income for the median US household. And so ultimately, the output of that is, if you look at slide 24, that dynamic sort of contributed to this very K shaped US economy that we're now all living in, and all participating in, from a political volatility perspective. So, this chart on slide 24, we show various quintiles of the five quintiles share of household income. And as you can see, unless you're in the top 20% from a household income perspective, you lost income on a relative basis to that, to that upper cohort of households over the past, let's call it 40-50 years, as partially, as a function of everything we talked about on slide 22. So in our view, we think President Trump was elected to fix this. If you go to slide 36 where you show the Electoral College map spanning with red from sea to shining sea. To us, last fall, that was a pretty clear indication that, hey, consumers and businesses on the bottom part of that K, they don't appreciate the crippling income and wealth inequality. They did not appreciate the 40-year high in inflation that was engineered by the fiscal largesse and monetary largesse of the Biden administration, and ultimately, they didn't appreciate the historic crowding out of those medium to bottom and medium households and small to medium sized enterprises that was a function of all that fiscal largesse. This is why we think that America essentially gave the Trump administration such an aggressive mandate to try to fix this, which is why we thought they were going to pivot us from paradigm Alpha to paradigm Bravo. And the problem with pivoting us to paradigm Bravo, as we talked about a few slides ago, was the rest of the world wasn't having it. They are our creditors. You know, net 90% of our GDP is worth of our assets, they own a net 90% of our GDP worth of assets, and so that the Trump administration is essentially not playing nice in the sandbox. Essentially, you know, risk that durable loss of US exceptionalism and a potential debt spiral as the dollar declines, bonds decline, interest rates go higher, the deficit blows out, rinse and repeat, and so that was the risk. And ultimately, that's why we think they've adopted this paradigm Charlie theme.

If you want to say about, okay, what is paradigm Charlie? Well, paradigm Charlie is a situation where they were going to try to cut their way out of the US' sovereign fiscal indebtedness. Obviously, one of the most indebted economies in the world, particularly when you look at it relative to our domestic liquidity stock, I think we're somewhere close to 117% of our domestic liquidity in terms of our sovereign debt. That compares to about 30%, 40%, 50% for our peer economies like Japan, China, eurozone, etc. And so, we're kind of about to launch in terms of how much debt we have and relative to our own domestic ability to capitalize that debt. And so, now we're essentially in a scenario where we're going to try to outrun the debt. You know, you and I've talked about fourth turning and nauseam on this program. And for those who may be a little bit unfamiliar, they can definitely reference our previous interviews or some of our published research on our paywall. But one of the key takeaways from that, there are several key takeaways from that research that we performed in terms of doing the empirical deep dive on fourth turning from economic and market perspective. But one of those key determinations was that, hey, when you get to this level of sovereign indebtedness, and it's partially driven by this sort of K shaped economy, in terms of the demand for populism in the economy, and ultimately, response from fiscal policy makers, when you get to this level of indebtedness, you really only have three ways out as a sovereign. You can try to cut your way out, which was paradigm Bravo, or you could try to grow your way out, which is paradigm Charlie, and then paradigm Delta, which is paradigm D, will be, they'll print their way out. We're ultimately headed towards, they're going to try to print their way out of the mess. But then, in our opinion, we think we have to spend at least a couple of years in paradigm C, paradigm Charlie, of them trying to grow their way out of the debt. And so, I think investors need to start investing with the expectation that, hey, everything you're hearing about tariffs, which are being over represented relative to trade, share of the US economy, relative to good share of US consumer spending, you know, tariffs are being overrepresented, but what's being underrepresented? All the different factors that are putting together this paradigm C theme that's going to allow, or at least on a transitory basis, allow the US economy to sort of outgrow the debt for a short period of time. They're ultimately going to fail at this, but at least you don't want to short that as an investor from this starting point.

Erik: How do we reconcile this question of the massive, massive national debt and growing deficits and so forth? The problem I have is, everybody's made this argument before, and they were right when they made it before. When we said, when Ross Perot said in 1992 that the US national debt was not sustainable, he was right, but it is sustainable longer than almost anybody imagines possible, before it all falls apart. Then it usually falls apart faster than anybody believes possible. I keep feeling like we're closer to that moment where, all of a sudden, acceleration, where it's falling apart quickly. But how do you gauge that? How do you quantify it, and really know when we're there and we're not just going through another round of, “let's talk and sound responsible, talking about fiscal responsibility.” In reality, this problem has been talked about for decades and hasn't really materialized.

Darius: Yeah, that's a great question, Erik. And so, I will say, the way we risk managers think about market risk is a little bit different than how I would say a politician or maybe even a novice investor would think about market risk. You know, the stock of the debt is irrelevant. As we've seen with Japan, your debt can literally grow to the moon. What matters to a risk manager, and what matters from market timing perspective, is the supply and demand of the debt securities. To me, that is what matters and why this is now an acute risk, financial market risk, as opposed to a, I don't know, political talking point, is a function of those geopolitically driven supply demand balance that we identified in the treasury market a few years ago, in the context of our investing during regime framework. I'll throw a few statistics out there at you really quickly when you think about, okay, who owns US debt? If you go to slide 88, where we show foreign creditors own about 32% total of US debt. That's about $9 trillion with the securities on its way to 10. But the problem is, it's on its way to 10 not fast enough. And now we're starting to see structural forces in the content that are all fourth turning style forces that are, you're really starting to kind of erode that former demand for US Treasury securities at a time where we're actually accelerating the growth rate of those securities. So, the supply going up, demand going down at the margins, and ultimately, it's causing a rift that ultimately will require durable, Fed yield curve control to fix. We're not there yet. We're not in the paradigm D, Delta phase of this.

We're still in the paradigm C, growth phase of this. But ultimately that that paradigm D print phase is coming in the coming years, in our view.

Let’s think about three structural forces that are all causing the US Treasury market to grow from a risk perspective. So, number one would be the re-militarization of Europe. If you look at the NATO defense spending pledges, both in Germany, but also across all of NATO, they're trying to take NATO defense spending from 2% to 5% of GDP. Now, I'm guessing by the time we get to 2035, they're not going to be at 5% of GDP, much like many of the economies aren't at 2% now, but we know the delta is higher. And ultimately, what that represents is a durable capital call home from our European creditors that now have to finance their own sovereign debt markets in terms of the expansion of the defense spending and the increase in infrastructure spending and all this stuff, requires debt that they need to now capitalize, as opposed to capitalizing our own treasury bond market. So that's number one. Number two is Japan's policy normalization. One of the most under-talked about risks in all of global macro is the fact that Japan has durably escaped deflation, and has for several years now, and so ultimately what that means is Japan's monetary policy normalization is likely to remain ongoing for the foreseeable future. They're already guiding to it remaining ongoing for the foreseeable future, if you look at the latest DOJ guidance. And then finally, number three is China's strategic decoupling from the US. Notice I didn't say the US’ strategic decoupling from China. I'm saying China is now actively accelerating its own strategic decoupling from the US. For example, if you look at the share of exports to the US from China, it's now down at 12% from a peak of about 20%. We're almost double that about 20 years ago. So that's a big, big structural force. And if you want to look at US imports from China, we're now down at 7% of total from a peak of 24% back in 2015. So there's been this massive shift in terms of our three largest creditor economies, in terms of the capitalized in the treasury bond market, they're now either, durably need their own capital to come home, they don't owe, they don't need to buy treasuries at the same rate. In terms of, in China's case, in Europe's case, their cap, they're essentially having a capital call home. And in Japan's case, they have enough capital restruction that's going to limit the cross-currency basis that they pick up from perspective of capitalizing the US Treasury market. In fact, if you subtract the cost of hedging dollars from the perspective of European and Japanese investors, you're essentially relative to staying home in their own domestic bond markets, you're essentially losing by over 100 basis points relative to just staying home and capitalizing their own bond market. So, this is a relatively new dynamic in global financial markets that is likely to be ongoing in the context of the secular dollar bear market that we continue to call for.

So, going back to where you started, the question, it's not about the stock of debt or the growth of the debt, or the size of the budget deficit, or who's got this politicized talking point about this or that. Who cares? I could care less about that. We could talk about that stuff forever in it. But what matters is the supply and demand imbalance for these securities and global financial markets. And one final thing I'll say is, one of the reasons this has become more of an acute risk over the past couple of years since, let's call it late 2021, is the fact that the share of price insensitive buyers in the treasury market has declined considerably, and they've been replaced by price sensitive buyers. So, if you look at the kind of the Fed's share of Treasury debt, they've declined from about high 20s to 15%, if you look at a foreign central bank share of Treasury debt, they declined from, let's call it 40% in 2008 to about 14% now. Commercial bank share of US Treasury debt peaked at somewhere around 35% in the early 2000s, it's now only 16%. And so, the residual of that is the private, non-bank sector. It's us. It's us, the investors, our investor class, we now own 56% of marketable Treasury securities, and that is up 2000 basis points since the end of 2021. And so, we've replaced all these price insensitive buyers with price sensitive buyers. At the same time, this geopolitically driven supply demand imbalance in the treasury bond market is accelerating from a structural force perspective, and all these structural forces in terms of decoupling, remilitarizing, and elevated inflation in Japan's case, these are all things you should be expecting as an investor, in a fourth turning and something we've been guiding our clients to anticipating for the past couple of years.

Erik: Okay, Darius, as I assimilate this whole paradigm evolution theory of yours, it seems to me like what you're saying is, basically, right now, we're moving into paradigm C. Paradigm Charlie, is entirely about grow our way out of this. Okay, you and I both know what that means is a whole lot of pro-growth policy, which is going to be bullish for financial markets. Lots of good reasons for listeners to take heed of your and Lyn Alden's advice to run their portfolios hot. But you've also described that where it's inevitably headed is toward a future, hasn't happened yet, transition from paradigm Charlie to paradigm Delta, which is where we go from "grow our way out" to "print our way out." And I would say that economic history teaches us that is an incredibly perilous moment where you don't want to be overweight equities. You want to be very, very hitched. Therefore, I'm concluding the most important thing out of all this is, what are the signs of the transition from C to D, from Charlie to Delta?

Darius: Great question. To me, I think the transition is going to come from a political standpoint. So, let's really quickly touch on some of the levers that the administration is are likely to pull, to try to exhaust all the options that are available, options that they have, to try to help us grow our way out. So, let's jump to slide 51, where we show the impact from a budget deficit standpoint of the "one big, ugly bill." So, you can see here in this analysis from our friends at the Committee for Responsible Federal Budget, the impact the fiscal impulse from the "one big, ugly bill," is front loaded and the savings are back loaded. So, what you're going to see is peak positive fiscal impulse over the next two years. In fact, you're already starting to get some positive fiscal impulse in here in terms of the retroactiveness of some of the provisions and the tax cuts that are, some of the provisions that were rolled over from the prior tax cuts and Jobs Act, and some of the new provisions from the "one big, ugly bill," like no tax on tips and increase deduction for seniors. So, a lot of that stuff's already starting to pour in from a fiscal relief standpoint here in 2025. But the biggest, the peak pistol impulse, will come over the next couple of years. So, you definitely don't want to fight that as a bear. Paradigm Charlie also features this, the monetary largesse that we observed on paradigm Alpha. On the third panel, we show the Florida Fed funds rate that's currently at three and a quarter. And then the bottom panel shows the floor Fed funds rate minus the 2yr TIPS break even rate. And for those who may be unfamiliar, the floor Fed funds rate is just the minimum value on the overnight index swaps curve out two years. And so that's essentially where the market is pricing in the Fed's policy rate to get to, from a rate cutting cycle perspective over the next two years. And then we showed

that on a real basis in the bottom panel, as you can see, since the start of the year, we've essentially cut the floor Fed funds rate by 100 basis points since the start of the year. And ultimately, by the end of this process, we think that's going to be a negative, a durably negative number, obviously. Let's make it headline news today. We're recording here on July 16, as Kevin Hassett now being frontman, the front runner for replacing Jay Powell at the Fed. Our clients can attest to this. I laughed out loud in one of our recent Around the Horn videos, just kind of thinking about how preposterously hilariously dovish Kevin Hassett would be as a Fed chair. And ultimately, I think that's coming to a theater near you, because forcing incremental monetary largesse upon the economy is one such way. It's a lever that the administration can and likely will pull to try to engineer an economic boom, however fleeting it may be. If you look at slide 53, deregulation is a big lever that there can and will pull, particularly financial sector deregulation. Don't forget, they put this man, Paul Atkins, back at the top of the SEC. Paul Atkins was the guy who was running the SEC when Chuck
Prince said you got to keep dancing if the music's playing. Paul Atkins was the DJ playing the music ahead of the housing crisis, the financial crisis, the global financial crisis. And so, they put this man back atop the SEC. And so, we know the music is going to get turned on. From a financial sector deregulation standpoint, we've already seen elements of this. They're going to relax the supplementary leverage ratio by the end of the year, by, let's call it, 150 basis points. They've already neutered the Consumer Financial Protection Bureau. Wells Fargo, which effectively committed a crime in December, was let out a penalty box weeks later when the Trump administration took office. And so, we're already seeing evidence of financial sector deregulation, and it's already started to show up in credit growth.

If you look at the top panel on this chart, on slide 53, commercial bank loans and leases are now compounding at 6.6% on a 3-month annualized basis. It's the first time, and have been for the past in that, roughly in that range for the past month and a half. It's almost three months. This last three months of credit growth is the fastest three months of credit growth we've seen since the first quarter of 2023, just prior to the regional banking crisis. So, we're now kind of coming out of what had been a very depressed period of credit growth of the United States. So, we now have this upside risk to the business cycle that's a function of levering of the private sector balance sheet, which has been very de-levered since it started to de-lever, back in 2008. Paradigm C also features some really stronger critical industries. As we show here on slide 54, construction spending, particularly non-residential, residential, which is the second and third panels in this chart, non-residential construction spending is currently compounding at -2.5% on 3-month annualized basis. It's not going to stay down there if they're going to reassure at all, right? Like, we have, what was it like, $10 trillion of capital commitments, at least secured capital commitments from President Trump and everyone that's kissed the ring in the last six months? Now, we know that's all fake. It's a phony fluff. But at some point, some of that dollars are going to start to build some factories here in the US. So, we know this number is going to go up. We know that they are targeting recovery in the housing market, explicitly, Scott Bessent has confirmed this. So housing, residential construction, which is compounding at -8.5% on a 3-month annualized basis, you know that's not going to stay negative either. So, you have credit growth that is now accelerating to an above trend rate, building, the building of factories and structures that are likely to accelerate. You also have the acceleration in residential construction that's probably going to be a function of deregulating the housing sector. You also have AI, the continued infrastructure investment associated with AI, both on data center build out and powering those data centers. So, you have a lot of levers that are going to get pulled, both by the Administration, also by the private sector over the next let's call it 1 to 2, perhaps even 3 to 4 years, in terms of trying to grow our way out of this debt problem. Again, it's not going to work, but they're going to continually, increasingly pull those levers and try to get it to work in one of those levers, and I'll shut up, one of those levers that they're going to pull, in our opinion, is ultimately, maintaining this very dovish net financing policy that we've seen out of the Treasury.

So, if you skip to slide 56, what we're showing this chart is the weighted average maturity of total marketable Treasury debt. It's about six years. And then we show on the second, third, fourth panels is the percentage of marketable Treasury debt returning in the next year. Returning in the next year, the next two years, in the next three years. If you look at the percentage of marketable Treasury debt returning in the next 12 months, so you can assume those are mostly T bills, that's about 31%. It peaked at 48% in early 1980s. So we think that number is going to be on a structural rise, because there's going to be no tolerance for issuing and taking down a tremendous amount of bonds in an economy that's being ran hot from a fiscal, monetary largesse perspective. There's also going to be not a lot of demand for bonds in the context of replacing a bunch of price insensitive buyers with a bunch of price sensitive buyers in the treasury market. And it's ultimately not going to be a lot of demand for bonds as a function of that geopolitically driven supply demand imbalance that we identified years ago in terms of Europe's real remilitarization, Japan's policy normalization, and China, strategic decoupling. So they're going to jam us with a lot of T bills. And one of the reasons we know that the administration, and going back to our second or first question there, one of the one thing that gives us a tremendous amount of confidence in our paradigm Charlie view— and the durability and ultimate upside risk to both the economy and asset markets over the long term— is the fact that Treasury Secretary Scott Bessent, whom I've known for years, former client, he spent almost 18 months just lambasting our fellow Janet Yellen's dovish net financing policy in terms of her concentrating issuance in the bill market. The second he got into the seat, he said, oh no, no wait. I think I'm going to keep this policy. And as most recently as a couple of weeks ago, he was on Face The Nation essentially saying, no, no, the time to term out our debt had passed already. And so ultimately, in our opinion, that was a very clear signal that in this paradigm C, try to outgrow, you're outrun the growth of the deficit, and try to grow your way out of the Cisco malaise. This in debt, sovereign indebtedness, they're very unwilling to upset the apple cart, to copy and paste policy that you spent the previous 12 to 18 months just criticizing and ridiculing, and in our opinion, is a very clear signal that these guys don't want to do anything to dramatically upset the apple cart. So, investors should be taking that as a clear signal. Ignore President Trump's ridiculous trade tariff tweets, just understand that their ultimate goal is to boom the economy. And if they're successful with that, and they likely will be successful with that on a transitory basis, let's call it 1 to 2, perhaps 3 to 4 years, if they're successful at that, consensus is not positioned for that. I don't even think consensus understands half of that, and in terms of the myopic focus on tariffs when I look at the media. But the reality is paradigm is easier to stay in our view, and ultimately, that represents a tremendous amount of upside risk and asset markets from those types of risk assets.

Erik: Darius, I want to go a little bit deeper on the Fed, both because you brought that up and because it's super relevant all the things you're talking about, it's going to be the Fed's policy making that's going to decide a lot of these things. Okay. Hang on a second. We're dealing now really with completely new territory. Does the President of the United States have the authority to fire the head of the Federal Reserve, an organization which is theoretically not even part of the government, and which was created specifically to be independent from the government so that the President would not be able to interfere with monetary policy? It's clearly an affront to that. So, everybody's talking about who the person would be. It seems to me that the more important question is, are we likely, through the political process to allow this apparent fait accompli that the President has the authority to fire the Fed chair?

Darius: That's an excellent question, Erik. And I really think you have to, one, believe in the fourth turning, and two, understand the implications of a fourth turning upon the economy and asset markets, as our clients do here at 42 macro, to really have what I would consider to be a satisfactory answer to that question. So, at face value, no, this is just one of many presidents in the last 100 plus years that have jawboned the Fed and have taken great criticism to the acting Fed chair. But the reality is, we are in a fourth turning. And what happens in fourth turnings is the distribution of probable policy outcomes widens tremendously as a function of the, among other things, social discontent and political volatility. So, we have someone who believes [inaudible] to usher in a new paradigm for a new regime, for how the US economy works and how it functions on the global scale. And so ultimately, you have a man who is very clearly proven he has a limited amount of respect for the established rule of law. He has a tremendous amount of respect for his own rules of law. And ultimately, we are probably going to see some form of political and/or congressional influence, and if not legislated, that could potentially change how the Fed operates. I mean, you got Kevin Hassett essentially rubber stamping, everything Donald Trump is saying with respect to Fed policy. And then you have Kevin Marsh was essentially, switched up from being a complete hawk because he wants the job. Couple months ago, very hawkish, now he's very dovish, he's calling for a complete overhaul of the institution in terms of cleaning house. All the PhD economists that worked there cleaning house with the Fed board, or Fed Governor board. I mean, this is, this is fourth turning style stuff. You have to understand that in a fourth turning, the distribution of probable policy, economic and market outcomes is significantly wider than it is when you're not in a fourth turning. And so, all those structural forces that are ripping and pulling the economy and policy and society apart at the seams, the Fed is not separate and dependent from that. The Fed is also part of that. And so ultimately, we expect some material change to how the Fed operates in the coming years as a function of these fourth turning type policy dynamics.

So, if you look at slide 57, this chart, we show, top panel shows December-25 Fed Funds Futures yield, 10yr nominal Treasury on the US Dollar Index. The second panel shows, the blue line is the December-26 Fed Funds Futures yield. And then the bottom panel is the OIS-derived Fed Funds made out 5 years, you can see that there's been a big divergence between the dollar and short rate and long rate pricing in the past few months. And so, in our opinion, we think the currency markets are already starting to sniff out the fact that the Fed may, you know, its independence and or how it operates from a dollar credibility, or inflation buying credibility standpoint is going to get challenged, perhaps aggressively, in the coming years. And so ultimately, we think as investors, you have to take the under or take the over on rate cuts. Take the under on the level, the terminal of the floor Fed funds rate. We'll show that on slide 69, where in the second panel, the Fed's dot plot, which was hawkish, supervised in the most recent SCP summary of economic projections, now, is only forecasting one rate cut in 2026. This is after them projecting two rate cuts here in 2025, and that's wrong, in our opinion. In our opinion, I think by the end of 2026, you got to assume there's got to be probably, there's likely to be double that from a rate policy, rate cutting perspective. And so ultimately, we think the markets are starting to sniff that out. If you look at what the Fed Fund Futures are pricing, they're essentially pricing two and a half rate cuts next year, as opposed to only one. And that's a big change from where we were a few months ago. And so, we think the market is starting to come around to our view that whatever you think about Fed policy and the durability of the legacy institutions about regarding the Fed, and in and around the Fed, you have to assume that that they're going to get changed. Fourth turnings are where institutions go to die. Fed independence can die in this fourth turning. The Fed itself could die in this fourth turning. Heck, the country, United States of America, can die in this fourth turning. That's how big the stakes are. And for anyone who thinks I sound heretical about that, go back and read my former colleague and one of my mentors, Neil Howe's two books on this subject matter, and then review our investing during a fourth turning regime analysis presentation. If you consume those three materials and still think I sound heretical, that's on you.

Erik: Okay, Darius, but I just want to pull this together and get a sense of the timing and how we navigate this future that you're describing. Because, what I'm hearing you say is, we should expect a fantastically bullish market environment as a result of a whole bunch of grow-our-way-out of a problem that can't be grown out of kind of policies until they figure out that it can't be grown out of, at which point it turns into a print-your-way-out situation, which is probably also a market crash situation. So, it's fabulously bullish until the shit hits the fan, and then it's really ugly, if I'm hearing you correctly. What's the timing? Are we talking years, months, quarters? I mean, there's a pivot there, some point where you want to go from max long to max short. Is that quarters away, years away?

Darius: From a fundamental standpoint, I think it's at least, I think we have at least until November of 2026, on this paradigm Charlie theme, paradigm C theme. Beyond that, it's hard to forecast, because we may get some adverse outcomes from an election standpoint that help that sort of limit what the administration can continue to do to kind of pump the economy from a fiscal largesse perspective. So that, you know, I think it's TBD, but I think we have, at least until the midterm elections, and perhaps even beyond that, in terms of the persistency of fiscal largesse and perhaps the deepening of monetary largesse. So in our opinion, I think it's TBD, but the most important thing, I would say just take away is, if you go to slide 157, and we can end on this, 157-158, one of the key takeaways from our investing doing a fourth turning regime analysis is that asset markets tend to appreciate faster in a fourth turning regime than they do in first, second and third turnings. We found that that was a statistical finding that we determined, but what they depreciate faster, with more volatility. So, they have the bigger up moves, but also bigger down moves, and also the frequency of the market cycles themselves actually speeds up. And isn't that exactly what we've experienced in the past, let's call it a decade or so. Every year since 2015, we've had an entry year crash of 20% in absolute terms, the market has either gone up 20% entry year or gone down 20% entry year, every year in the past 10 years. I mean, that's insane. And that's exactly what we would have, that's exactly what we did forecast continuation of going back when we introduced that analysis. And so, I think I would, it would sound, I would have to have an unusual amount of hubris to tell you exactly when paradigm C is going to end. You know, given that we're only a few months, and I think I reserve the right to do my job as an institutional macro risk manager for our clients over the next, you know, it's called 1-3 years, and try to determine that. And so that's why I'll end on slide 158, we you don't have to live in fear of not knowing when paradigm C is going to end. You don't have to live in fear of knowing, not knowing, when the thing that caused this paradigm C to end. That will be very painful for most investors, that will ultimately require the paradigm ushering in a paradigm, you don't have to live in fear of that. You can just dispassionately execute our KISS and Dr. Mo signals along the way, which keep you on the right side of market risk. I don't have to forecast when that occurs, I just have to refresh the model. On the day that it's starting to occur, send a signal to our clients and say, hey, take down risks. We're about to go into the valley between paradigm C and paradigm D, and ultimately, those same exact signals will help our clients come out of the valley and buy the lows and really position themselves for paradigm D. And so, I don't know when that's going to happen, but I know exactly what I'll be doing between now and then and throughout. It's the same exact thing that I do every single day, six days a week for our clients here [42 Macro].

Erik: Well, I'm not going to stop on page 158, you'll like where I'm going next, though, which is slides 9 through 11. For many of our listeners who are very well familiar with your approach, I asked Darius not to go through the process they use at 42 Macro in full detail on every one of these interviews, because it would be too much, and a lot of us have heard it before. But for any new listeners, you're definitely going to want to check out this process. This is a very, what would I describe it as, a very methodical and systematic approach to macro. Darius, very briefly, give the quick overview of what you do at 42 Macro, what is in that 9 through 11. And for people who want the full version of it, how do they contact you to find out more about what you offer?

Darius: We are systematic investors here at [42 Macro]. I know we spent most of this conversation talking about our fundamental research views, because that seems to get the audience's attention. But the reality is, we don't use any of our fundamental research, which I think is some of the best in the world. Many of our institutional clients agree. We don't use any of that fundamental research to manage risk and financial markets. We use our KISS, fulfill the construction process for retail investors, and we take those same exact volatility targeting and dynamic position sizing signals and push those to institutional investors via our discretionary risk management overlay, aka Dr. Mo, that's on slide 12. And so, you can sort of quickly see on slide 10, sort of the summer statistics of what it feels like to be an investor participating in our KISS system. It's a very simple system. You have the long stocks, gold, Bitcoin, or cash, at any given time. And what we ultimately found out is that based on our fourth turning regime analysis, based on our fundamental research, and ultimately based on market signals that we've accumulated throughout the years, stocks, gold and Bitcoin, are the three best asset classes to take advantage of the cuts of policy responses that we tend to see in fourth turnings. So, I highly recommend investors check that out. Review the summary statistics on slide 10. I'd say the highlight is you essentially, it's a 250% upside capture ratio relative to 60/40 with only a 50% downside capture ratio. So, I can't think of a better solution to help retail clients, retail investors, retire on time and comfortably. You can see the output of our current KISS allocations on slide 11. We're currently fully invested, and have been for a while. KISS came into the year maximum gold. And obviously that's been a great call, or not a great call not a good call by me, great call by the system, Bitcoin, has started buying back Bitcoin in mid-April, and started buying stocks back in late April. So, we've captured a tremendous amount of the upside we've seen since the lows of April, much more so than I that would say the average investor. And this is coming off of KISS having effectively risk managed the crash that we fundamentally called for coming into this year. So, really proud of the system, really proud of our clients for partnering with us, for engineering better results in their portfolios that they may otherwise have without us. So, Eric, I just want to say thank you for having me on the show. You're doing a great service for the world, my friend. I've learned a tremendous amount from you and your guests that you featured on the show over the past decade plus, and I'm just really grateful and humbled to be a contributor.

Erik: It's always a pleasure to have you on, my friend. Patrick Ceresna, and I will be back as MacroVoices continues right here, at macrovoices.com.