



## ***Tian Yang: A Whiff of Reflation?***

**Erik:** Joining me now is [Variant Perception](#), CEO, Tian Yang as usual, Tian provided not just one, but two slide decks to download. In association with this week's podcast, registered users will find the download links in your research roundup email. If you don't have a research roundup email, just go to our homepage, [macrovoices.com](http://macrovoices.com).

Click the red button above Tian's picture that says, looking for the downloads. Tian, it's great to have you back on. Before we get started, we should say probably that we are recording this. On Tuesday morning, a couple of days before it will air. This is a week when quite a lot has happened since Friday.

Needless to say, we're back to President Trump throwing the market some unexpected tape bombs. What's your take on Friday's action? What could happen between now and when this airs on Thursday? And after that, why don't we dive into your leading indicator watch, which is the first of your two slide decks.

**Tian:** Yeah. Thanks. Thanks, Eric. Great to be back. Obviously there's a lot of uncertainty, but I think the biggest picture remains that the Chinese and the US are ultimately talking, right? So compared to when Trump first returned to office compared to Liberation Day, I think there's a lot more established channels of communication.

I think the Chinese response has actually been a lot more measured. The market's obviously a bit worried about the risk of escalation, but compared to a hundred percent tariffs, like China's responded with very targeted measures, I wouldn't even be surprised if they maybe gave Trump a warning before they announced it.

So overall it feels like there's a bit of posturing, ahead of the meeting in the past kind of. Few weeks and months, you can see China getting prepared for that. Strategically lowering their imports of like American

agricultural products so they have something to give Trump for the meeting coming up.

So I, I would say I'm heartened by how measure the Chinese have been in response to this. So that kind of suggests this isn't really the kind of tip for attack, extreme escalation we saw back in April. This is ultimately, I think, gonna be a bit more contained.

**Erik:** I certainly hope that you are correct about that. Let's move into a whiff of Reflation, which is the title of your G3 Leading Indicator Watch this month.

**Tian:** In terms of the big picture, six month outlook, we essentially think this is a setup for a potentially reflationary environment. Our macro risk indicators has gone from, when we last spoke a bit more neutral towards more kind of risk on territory in the last few months.

Essentially what we see right now is a synchronized global easing cycle amongst all the major central banks. Pretty good improving liquidity conditions, credit creation driven by the private sector, and our US growth allies have been pretty resilient all year. Whilst we're starting to see the first signs of Europe lead indicators recovering and China becoming less bad.

So overall, that's a pretty decent macro. Set up, at the same time we think the Fed cut in September potentially is a cut into a non recessionary environment. So historically there's been a couple of these examples in 84' 95', and you can also count the September, 2024 cut last year. And the key takeaway is that, the fed cut ends up being an insurance cut, puts a bottom under growth, and ultimately growth and inflation.

Hold up and obviously that broadly leans into the idea that potentially yields and dollar find the bottom and actually squeeze a bit higher. So that's the biggest kind of, three to six months ahead roadmap we have right now. And that's broadly how we're thinking about it.

I obviously understand concerns around AI bubbles and those things, but I would almost phrase it like. That's a valuation problem in some pockets of the market maybe, but at least on our leading in cases, we don't think there's necessarily a huge macro problem right now.

**Erik:** John, let's dive into your leading indicators starting on page three.

**Tian:** Like I mentioned, our main US growth value is still pretty stable, around 2% annualized growth rate. This is pretty much in the ballpark of where most high frequency coincident measures of US growth is. The Fed weekly as we show here. Annualized 2.3, 2.4%. If you strip out the volatile components of GDP now you get at the core underlying private sector part that's now a 2.5% annualized growth.

And, other high frequency data like, TSA travel restaurant booking, so forth, credit card spend. Most things are fine right now. We were characterize as Allis, leading indicators are resilient and constant growth is also resilient.

**Erik:** You're describing an analog to 2002 through 2003 on page four.

What's the connection there?

**Tian:** Yeah. So I think one of the big outliers, or points of concern right now is clearly the US labor market. So there's a lot of concerns on is the US labor market weakness a sign of recession? Why is it that retail sales have held up and, the economy's held up yet the job market so weak.

So we essentially had a look at when was the last time you had this kind of a setup. And so it's very interesting to note the last time we had. Hiring be this weak, but retail sales holdups and start to even accelerate was actually in the 2002 2003 period, which was essentially characterized as a jobless economic recovery and there's a lot of analogs.

In addition to the retail sales divergence, you also had a similar kind of. Bottoming and acceleration in capital. Good spending back then against the backdrop of weak hiring. So again, you can see the analogies to today with ai CapEx but weak jobs and the liquidity context is also very comparable.

So again, you've got the weak label market, but back then, by 2002 and three, you have a pretty synchronized global easing cycle amongst the major central banks. You have the surging global excess liquidity coming out a period of cheap energy prices, right? As we show here with the kind of drawdown in the, in crude oil prices as well.

So all those things actually suggests, this is more of a setup heading into a recovery rather than on the precipice of a recession. The major structural caveat is obviously to note that. Back then it was after China joining the WTO in 2001. So that was a pretty structural offshoring of US manufacturing jobs.

And obviously that is something that isn't gonna be happening today. So ultimately that kind of suggests there's less of a structural reason why the job market is gonna remain. We like back then, there's some underlying signs for the US labor market is decent. For example, prime age participation rate is, has recovered back to a pretty healthy level.

Ultimately, we would think this is more likely a setup heading into recovery, and if there's a recovery eventually that will result in the turnaround, the labor market, again, just like we saw in 02' 03'

**Erik:** I can't help but react to the headline on page five. Recession is unlikely if everyone dissaves, and financial conditions are loose.

So as long as everybody spends beyond their means into easy money, everything's gonna be fine.

**Tian:** Yeah, the way we think about recessions is ultimately. These are like phase shifts, right? Where you go from a pretty normal cyclical behavior in economy towards the sudden shift when the hard economic data and the soft kind of financial market data start deteriorating.

At the same time. The real reason to worry about recessions is those times when you know financial assets start selling off, which then leads to kind of precautionary behavior. Households maybe save more, but as a result, earnings start falling, companies lay off more workers and these vicious cycles are formed.

And I think that window of vulnerability was actually a bit more elevated. If you think back to May and June when equity markets had drawn

down, there was a bit more signs of financial market stress. And obviously the economic data was distorting. The difference today is that.

Some of the things we measure here, like real M1, the top left chart here has returned to growth. So our real narrow money growth real narrow money is growing. We obviously still have a pretty big absolute fiscal deficit. The US household savings rate had been rising but it start has started actually rolling over again.

So again, households are continuing to, keep a low savings rate. And obviously financial assets are still near all time highs, right? Know, obviously it's been a couple of days since the Trump tweet. So this is not to say that there's no risk per se. Our US recession model risk is around 30%.

So low-ish, but not zero. The reason it's low is 'cause the US housing and labor but the key thing that would make it jump higher is that ultimately the time to worry is when, say s and p draws down five to 10%. Then you get a bad job print, right? That's the time when these feedback loops could potentially start and both deteriorate at the same time.

And it gets a lot more concerning about the phase shift to recession. As of right now, that isn't really the case. We can see how the, how this China, US trade war escalation plays out, but I think that's the key point I wanna make on this.

**Erik:** John, moving on to page six, it looks like you're anticipating the potential for an inventory rebuilding cycle.

**Tian:** Yeah. Again, on that theme of are we more likely heading to a slowdown or recovery? There's some typical signs you actually see going into recovery right now. So on the consumer side, one of the things we're showing here is that the bank. Bank's willingness to make consumer loans has actually been improving.

And historically, this leads the US kind of credit delinquency rates for consumers. So again, this will be a sign that delinquency rates have peaked in the us. Equally, if you look at US discretionary retail sales. Which we define as those, big ticket items, furniture, home furnishing, electronics closing and the like.

Again, that's had a pretty tarry couple of years and been forming a base and has actually already returned to growth. So again, something you see more out of a slowdown there heading into one on the wholesale side. If you look at durable goods wholesale. Revenues that's actually started to accelerate even as inventory growth remains tap.

So again, something you see more out of a slowdown than heading into one. And finally, within the ISM survey is this very interesting sub-component called customer inventories. And that's something where you can see the red line, the bottom right chart there. It's actually low and has been falling.

So IE. Within the ISM survey, people reporting that their customers have low inventories and have falling inventories. So again, these are more signs of the potential for recovery than not. Overall, we get that the labor market looks a bit weak, but you're not getting that much confirmation elsewhere.

**Erik:** Moving on to page seven, let's take a look at inflation pressures.

**Tian:** Yeah, so I think the headline on inflation is that we're going to be above target for a while, but the risk of a second wave remains relatively low for now. And I think ultimately probably around 3% annualized inflation in terms of the key data to keep an eye on.

One thing we're tracking very closely is actually PPI and import prices, which is the top right chart here. So you can see PPI for both goods and services are settling in just below 3%. This is obviously a measure of how much pass through pressure that will ultimately need to be on consumer prices.

And equally import prices are a reflection of our. Kind of foreign supplies ultimately eating the tariffs, which the answer is no right now. So I think we're a little bit at a point where, yeah, there'll be some moderate pass through pressure on the inflation front. But, PPI is not surging factors like, cheap energy prices and the like of likely helped there as well.

And ultimately what determines the ability to pass through price increases is actually lower income consumers, right? Which we know have been struggling a lot more. The rate to pass through would tend to be more moderate. In general, you can think about the top 20% of

consumers as driving growth and the bottom 20% health is being important for how much inflation pass through there is.

So right now it looks like there's some moderate, input, cost, pressure to pass through in general but it'll be passed through at a more moderate rate.

**Erik:** Let's move on to China on page eight.

**Tian:** I think what's very interesting in China, the price action has obviously been pretty reflatting so far.

We show here that Chinese small caps have been surging relative to large caps. Chinese 10Y yields are finally bottom and started to tick up and you're actually seeing the very first signs of things going from terrible to slightly less terrible. The bottom chart that showing a essentially employment PMI survey for China, private sector one, and it has gone from kind of very depression like levels and started to recover.

So broadly speaking, we would say that China overall. It doesn't look as bad as it's been. And at the same time, leading indicators of in, of both growth and inflation have bottom and started to recover. So overall we're heading into kind of the the fourth planning now. There's a lot more of talk about the, the Chinese authorities need to do some more for the consumption side.

So yeah, I would say macro tailwinds are still there for China. And obviously I'm making an assumption that Trump and Xi will ultimately meet and, try and announce a win for each other. Within that context, the macro seller looks okay, economy going from bad to slightly less bad.

Liquidities tailwinds are good, and asset prices broadly are on board with the kind of recovery story.

**Erik:** Let's move on to the Euro zone on page 10.

**Tian:** Yeah. On Euro specifically, what's very interesting is that, Europe structural problems are well known, right from the political dysfunction to, elevated energy prices.

We show here on page 10, the bottom there's a lot of problems, but what's very interesting is that we're actually seeing a bit of a recovery in our lead indicators and some of the underlying data for the first time in a very long time. Essentially, over the past three, three to four years, you're really starting to see in more kind of coordinated recovery in, in the German data, so for example, the German IFO expectations minus current conditions.

That differential is actually turning positive now for the first time in a very long time. We see that on the top right chart down on slide 10 the percentage German manufacturing industries where production expectations are improving. Again that's recovered to more than half. So we potentially have a little bit of a cyclical rebound coming in Europe.

Again, I think the structural problems are real, so the magnitude might not be there, but you're finally seeing this come through, on, on the back of some of the excitement around German and fiscal as well.

**Erik:** John, let's touch on slide 11, consensus two, optimistic on disinflation.

**Tian:** Yeah. So on Europe, I think it's worth pointing out that the market there used to be obviously was a bit further ahead of the of the US into getting their rate cuts in and policy rates being taken out to 2%.

I would say the consensus is fairly relaxed on European inflation risks. But it's interesting to note that our estimate of our star in Europe, I either, the neutral policy rate, the real neutral policy rate is actually 1.8, which is a bit towards the higher end, I would say, consensus of where ECB is.

So that would actually suggest that the neutral nominal policy rate right now is more closer to 3%. Rather than two. So we suspect that if anything ECB policy is actually towards slightly more stimulatory. Territory. The market is obviously focused on the France risk.

Right now it's trying to price some cuts in, but if you look at the bulk of the arrival curve we got on the bottom right there. Ultimately there are now hikes discounted for 2026, 2027, and it's hard to price a lot more in for next year. So given the ECB is ready for the cuts in, given the very first signs of some of those cyclical lead indicator recoveries the risk reward probably actually favors a, slightly more reflation in Europe and positioning for that.

**Erik:** Tian, I wanted to start there with the leading indicators because that's what variant perception is best known for. You also sent us a second PDF titled Macro Snapshot October 2nd. Tell us what that deck is about and go ahead and dive in.

**Tian:** Yeah, so that's more the investment implications in terms of trade ideas or asset allocation.

Obviously, using our lead indicators for kind of months, obviously a lot. The elements we already touched on. So maybe the key things that we wanna highlight here is if we go to like slide six and seven, that's probably the most important, and then we can talk about commodities as well.

So I think right now, one of the concerns that even if. There isn't necessary as obvious signs of macro problems. Clearly there's some concerns around the lack of risk premium in asset classes, right? Whether you look at credit spreads or US large cap equities. So it's natural to be a bit concerned about have we fully discounted this relatively benign macro outlook.

And, the way we think you can deal with it is that we have two very tangible signposts to watch. For a sign that a correction may be playing out. And in fact, obviously we put this on October 2nd. We actually had a kind of a hedging signal October 8th, which was fortuitous timing. But but essentially that, there's two things to, to think about.

The first is, joint periods like this. What we want to be very focused on is how cross asset volatility and just credit and credit linked are trading in general normally. When a, a correction potentially starts what you observe. Is that all volatility across asset classes start to take up from the lows and all different measures of credit start to deteriorate.

The key is the kind of breadth of it and the simultaneous nature of it, rather than the magnitude. So if they're all deteriorating the same time, that tends to be more reflective, the beginning of a broader de-risking. And so that's one of the key things to keep an eye on. And then we're starting to see inklings of that a little bit.

So that's just a very market behavioral stuff. We formalize it into the kind of VP correction signal. We have various versions of kind of tactical hedging signals right now. So it does make sense to keep some tactical

hedges for the month of October. This is. The bulk of earning season, we have the fed at the end of the month.

And we also obviously have the Trump meeting end of the month as well. So there's quite a lot of catalyst. That likely means that imply vol will remain bid, so you're a lot less, less likely to bleed as much as normal. So that's the overall thinking there on the tactical piece of the portfolio in terms of the cyclical roadmap and the signpost to watch for.

One of the key worries right now is that the fed cuts may become interpreted by the market's political as reflecting Trump's desire for more cuts to lower interest expenses. And that works and works until it doesn't. We just don't know when. But the sign from the market will be that at one of these upcoming fed cuts, it's possible we see the yield curve, have a sharp bear steepening in response to one of the cuts.

And that will be, a market based sign that okay, we've hit the limit here and then, they probably need to pull back a little bit. So I think that's something I'm watching for very closely. I don't know when, it could be even October Fed cut, the market has that reaction, but obviously it could be January or whenever it's.

And I think that's just something to bear in mind that I think we have this pretty decent macro goldilock setup until the fed over does it and cuts too much, and then the inflation fears pick up and then timely all these things matter again. So those are like the two tangible things right now to watch for.

**Erik:** Let's touch on semiconductors on page seven.

**Tian:** Yeah. So obviously in the talk of the town, AI bubble. Mental energy is being spent on this already, again, we're not gonna pretend to be like the AI experts, but we do have some general frameworks. We used to think about this the key one being our capital cycle framework.

And so ultimately on our capital cycle framework, what it tries to do is it tries to understand CapEx and R&D spend, what the marginal operational ROIC is for that spend, and ultimately how that translates into profit. But we do it across the entire aggregated profit pool. So what's been, what is more interesting to us is that on our capital cycle models is actually software that has been relatively weak within tech.

Semis have actually seen improving capital cycle, while hardware has been deteriorating slowly, but software is the weakest. Despite all the, I think it's understandable a lot of the concerns around, dot com, repeat dark fiber or the rail build out, like a lot of those things are valid.

But timing wise, typically the sequence would expect to see is that, we need to see the marginal operational RIC start to come off a bit, and then the capital cycle score will deteriorate a lot. So far, only one of the pieces are in place, which is essentially the surge in CapEx. But for a lot of the AI centric stuff for the profit a whole the kind of marginal returns are still significantly higher than the weighted average cost of capital.

Obviously these things will shift as assumptions around useful life depreciation schedules, vendor financing. All these things will eventually show up in how, the weighted average cost of capital is calculated. But it's just worth highlighting a high level that, at least right now, the industry is covering the cost of capital is actually profitable.

And so it may be a little bit early to be worrying about the surge in CapEx.

**Erik:** Let's touch on commodities on page 11.

**Tian:** So I think the last thing that I think is very interesting is that we have a pretty unambiguously bullish commodity set up with our models as well. The demand supply and balance models are suggesting quite strongly for commodity recovery cyclically, and obviously structurally the backdrop should be pretty favorable, where we are moving to a more, a world of great power competition, right?

Supply chains, commodities are being used and weaponized. In geopolitics and you have not just cyclical recovery, but also more price and sensitive industrial policy driven or politically driven demand potential as well. So it's a pretty good setup for commodities in general now that gold prices, in real terms of surge back towards the 1970s, 1980s high the, it's really about whether the other things can start to catch up.

As we show on the top right hand chart here, so broadly, I think, overall for the complex we think the upside is still very good. The laggards probably gonna be oil this time just 'cause of, OPEC and supply and

obviously some of the political imperatives around, keeping inflation contained.

But I think industrial commodities and the the catcher potentials is very good and ultimately obviously we'll get recovery in in oil as well.

**Erik:** John for the last few minutes, let's zoom out to this big picture that everybody's trying to figure out. Seems like just last Friday, China was absolutely evil and was the end of the world and then all of a sudden they're best friends again.

Is this just a part of the Donald Trump approach to diplomacy and what should we expect next?

**Tian:** Yeah, so I think the biggest picture here is actually something we laid out all the way back in 2022 when we wrote a kind of pretty big thematic report on the coming CapEx supercycle, the end of the invisible hand essentially the end of free market driven, let's say Fair Globe, globalization, right?

And I think this is the biggest context. For that, basically the US and the Chinese systems are moving from a focus on profit and efficiency towards the need for resilience. But, efficiency can, the flip side of resilience essentially inefficiency, right? You're gonna duplicate supply chains, you're gonna stock power more inventories you're gonna change how resources are allocated.

And so I still think that's what is really going on and having to manage that process. At the same time, there's, with the great power dynamics kicking in here, there's obviously a lot of, lessons from history we can learn. So I think for me, the a very useful context to think about is actually more the, US period would be World War II into like the fifties with FDR and essentially the arsenal of democracy kind of analogy.

So what that ultimately means is that when you have very important. National policy imperatives. You need to start thinking about the government's balance sheet and the private sector balance sheet is just one thing, one national balance sheet. So in FDR example I cited, that was like getting, the private sector to build your tanks and planes and to fuel the war effort, right?

And then later on coordinating between private and public sector in the Cold War, and this is essentially the playbook China has taken for. Quite a while in terms of how China coordinates their private sector with government policy to drive a lot of, industrial policy imperatives, national policy imperatives.

So I think that's the biggest picture context that we're just moving towards a world that, both countries wanna emphasize resilience, supply chain resilience. And this idea of to compete you a.

Broadly speaking, like most of the marginal news we see it leads into that story, right? All year long. So I think that's the, where ultimately both sides wanna end up and then they just have to manage the transition in the middle, right? And this is where I think there's a realization that leverage is becoming.

In my opinion, at least a bit more balanced. So I think the US probably does not have as strong a leverage as the US or in terms of tech sanctions on China, right? The rapid pace of Chinese tech development I think has probably surprised the US side. And equally, I think the us I might have underestimated kind of short term, rare earth choke point, again, in the long term, rare earth doesn't matter, right? Rare earths are not that rare. It's abundant. You just have to be able to refine it. But in the short term, obviously China has the refining capacity and so they need to play that card while they can. So I would say that's where, because the leverage is a bit more balanced, heading into kind of the Trump sheet meeting that they can obviously try and position.

But ultimately I think, as I mentioned right at the beginning of this. Meeting the structural direction is set, right? Both countries know they need to build a resilience from each other and just to, prioritize domestic, national needs, but they don't want to have such a dramatic kind of divorce.

That the short term pains too much. And so that's why all these communication channels have been established, since Liberation Day. And they're gonna, and they're likely talking. And so I think you'll just keep getting these nominal wins that both sides can announce to that domestic audience avoid the worst of the disruption.

Ultimately the trend is really towards, trying to build up essentially economic nationalism and resilience in terms of supply chains and manufacturing.

**Erik:** Tian as always, I can't thank you enough for a terrific interview. Before I let you go, tell us a little bit more about the work that you do at Variant Perception.

What services are on offer for our institutional investors and where people can follow your work?

**Tian:** Yeah. Thanks for having me on as usual. [Variantperception.com](https://variantperception.com). We can share a link for some of your listeners as well if they're interested in getting some more materials or to have some access to our portal.

But essentially, we focus on building. Investment models, right? Modeling the economy, modeling asset classes, modeling market behaviors and modeling long-term structural capital cycles. And then from those models, we will find outliers or interesting investment themes, contextualize those in terms of the news and price, action and flag ideas.

**Erik:** Patrick's Ceresna and I will be back as Macro Voices continues right here at [macrovoices.com](https://macrovoices.com).