

Erik: Joining me now is [Forest for the Trees founder](#), Luke Gromen. Luke we're recording this on Monday afternoon. That's only three days before our listeners will hear it, there could have been two or three wars between now and then at the rate things are going. Why don't we start with a recap of your understanding and.

Perception of the current situation with the Iran conflict and what it means to markets. And listeners, obviously please understand that we have to record in advance of airing this. The news flow is coming pretty fast, so it may have changed by the time you hear this.

Luke: Fast and furious indeed. Now, thanks for having me on again, Eric. I appreciate it. For me, I think this is simultaneously. At the moment, both the easiest and the hardest macro event to trade in quite some time. And the reason I say that is it's the easiest because it's a one factor market, in my opinion. Is Hormuz Open or is Hormuz closed?

And as long as it's still closed, we are accelerating nonlinearly toward a really bad outcome. And if it reopens, then we can start looking at secondary and tertiary explanations, outcomes Etc As things stand now. You know Hormuz when this war started, it was supposed to be a weekend and then maybe a week, and then maybe a couple weeks, and then a month, and it was supposed to be open quickly and when it started, my worst case scenario was that this could end up being a US Suez 1956 moment and now seven weeks in hor moves is still closed. Supply chain issues are just now really starting to stack up. Whether you look at social unrest over fuel in Ireland, you look at, I thought interesting data point today. Toto, the Japanese toiletry maker or toilet maker had to new orders for raw material.

The stock down percent today. So I think the base case now for me is that this is a US Suez 1956 moment where, until Hormuz reopens I think supply chains are gonna keep getting worse exponentially from here. I think we still have at some point that's gonna matter even more to sovereign bond markets, particularly in the West.

You're already seeing Japanese bond yields. The US has had, I think two or three different Trump tacos once the tenure has hit 4.4%. A couple weeks ago, we had three straight really sloppy auctions. So there's some noise in there that is being managed as well. And at the same time as all this is going on I'm just astonished still how complacent that consensus appears to be about these supply chains and bonds.

Number one, but then number two, how complacent consensus is about the fact that this is not just existential for Iran and for Israel and for the US but it's existential for China and Russia too. And so every analysis I see practically it seems that sooner or later we're just gonna beat up and we're down the Iranians.

And maybe that's true. It's probably true. None of these analyses I see are factoring in that this is existential for China and it's existential for Russia. And what does that mean? And people say they can't do anything. China supplies our military China's factories back the S&P500, essentially.

There's a lot they can do. I think where this is all headed is forcing the US into a choice. So what does Suez 1956 mean For us, I think it means we're forced to pull back. Or we're forced to print money into an oil spike to contain the bond market. Or we let rates rise in a recession, in an oil spike and let the economy take the hit, which is not really an option, but it's for very long.

At least it's an option in the very short run, conceivably. But, so I guess just overall. I've been doing this 30 years in investment research and I've only seen two other times like this that I can recall, and the first is in 4Q07, where I was in a former seat and I was seeing, we were doing bottoms up fundamental equity research at Cleveland Research and I was seeing the US economy and financial system collapse in real time.

And yet the equity markets hit an all time record on the S&P in the fourth quarter of oh seven. And it also reminds me of 1Q20 when, obviously with COVID. And quite honestly I didn't think COVID was a big a deal initially, and I was wrong about that. But the same way markets were just blissfully.

Complacent. And then Tom Hanks said he had COVID and then they shut things down and the markets absolutely, had a fit. The view I'm I've had, and the view I'm sticking with Hormuz is all that matters and every day that it stays closed is it brings us closer to a nonlinear break in supply chains.

And my view has been that's not gonna be good for markets if slash when that happens. And I just, that's why I highlighted that Japanese toilet maker today, down 7% on the day like. If they had gone up 7% or up 10% on announcing that they couldn't make anything anymore, 'cause the supply chains, I'd probably would've have to say, all right maybe I'm just not getting this, but the fact that individual names are getting crushed on supply chain problems I think means that if this continues, the market's gonna get crushed probably sooner rather than later.

It just feels like a Wiley Coyote moment.

Erik: Let's go a little deeper on that issue of consensus, complacency. I have a theory I'd like to run past you, which is I think it's as simple as the people in finance who are not physical crude oil market traders just don't understand the logistics lag effect, and trust me, the among professional physical market.

Crude to oil traders. There's no complacency crisis there. They're scared shitless. And I think what people don't understand is the last tanker to transit successfully on February 28th before all of this stuff started. That hor is oil will arrive at its destination next week. That's how long it takes for oil that's flowing through the Strait of Hormuz to get to where it's going.

So there hasn't been any supply. There's been speculation, obviously about this is a big deal and what could be coming, but the actual disruption of supply hasn't even started yet. It seems to me like it sets the stage if we saw some kind of resolution in the next week or so. Fingers crossed.

It really sets the stage for the market to breathe this huge sigh of relief where all the people who don't understand the physical logistics say, okay, that's over. Wow, glad we got through that. And they don't realize that there's like this six week complete stoppage of flow of crude oil. Into the whole rest of the world.

That's going to happen no matter what. And you don't just take the, let's say we resolve this and we open the strait completely and totally next week. You don't just call up the captains of those vccs and say, Hey, engage your warp drive and, get to Asia in a week instead of a month and a half.

It still takes more than a month to get there. It seems to me like that's a setup, if I'm right about that for the market to really have kind of a final blow off of complacency and then a, oh shit, this is reality. What do you think?

Luke: I think that makes perfect sense. I've seen that in conference calls where, someone asked me on a conference call, and this was probably six days into this, and they said, okay, what do you think?

And this should be over another week. I said, another week. Are you kidding me? Based on what I was hearing was, what I said is, I said, my base case is we're gonna be, we're gonna get to at least mid April. I said, and that, that kind of stuned them, I said but. I would actually be risking, your portfolio for Hormuz is still closed on the 4th of July or for mid-May, late, or mid-May to mid-June.

And it looked like their face, looked like I jumped through the screen, kicked their coffee into their lap, and then, just shock them. And their response was you understand, you're saying if that happens, like hundreds of millions of people could starve to death, right? I said, I know exactly what I'm saying.

This is why I'm so worked up. that people in finance are just hey, just, hit, control P and. We'll print oil or, we'll, the oil will be where it needs to be and the sulfur will be where it needs to be and the fertilizer will be where it needs to be.

'cause oh, by the way, on fertilizer as I'm sure Eric, we're on the clock for a growing season. Like you're not gonna be throwing fertilizer down in June or July. It's too late at that point in, in the Northern Hemisphere for a lot of places. So I think it's that. And then I also think too, there is.

We are in, generously, we're in fog of war, not generously. We are being subjected to very good propaganda and control of the message, which is to say from day one, I was getting very credible rumblings that this war was a going to last longer than we thought, and b, it was not going as well as we were advertised as we were being told.

And. When I started hearing that, it was probably 3, 4, 5 weeks ago, and last week and a half, we've had in the Wall Street Journal the news come out that the US Embassy at Riyadh not only was hit way harder than we had admitted, but that the Iranians were so accurate that they didn't just hit the embassy.

They picked out the very part of the embassy where the CIA office was and destroyed it. They were so accurate. I hear credible rumblings that much of the CIA evacuated much the Middle East, early in this war, not a peep from. And so I had heard that relatively early on. Then you hear things like fifth Fleet at Bahrain again.

Heard that it got hit very hard relatively early on, that our air defense stuff wasn't as good as we were being told our air defense missiles and the Iranians were far more accurate than we expected and that the Russians were helping target and the Russians helping Target came out relatively early on.

And then again, last week we had an article saying that 1500 people at the head, the home of the US. Fifth fleet in Bahrain were evacuated so quickly. They couldn't, at first, they weren't even gonna let them take pets and they finally let 'em take pets. But it's basically grab your pet, grab a bag, grab your toothbrush, and go.

And they evacuated them back to the US. I'd heard about that three, four weeks ago. And so it's publicly reported now. And my point here is that. Between the physical constraints and the lagged effect of that, that people in that world are seeing. And then just this, you would never gather, hey, the Iranians, and to be clear, I'm not hearing the Iranians are winning. That's not my point I'm hearing they're getting beaten up tactically very badly. And I'm also hearing that they are doing some very damaging things to our infrastructure and bases in a way that absolutely point to this being a much longer than we thought, which I was hearing three, four weeks ago, five weeks ago, and b.

Like the whole dynamic of weed are just, there've been all kinds of reasons why Hormuz isn't closed. Like when you tell people on the ground in the Middle East MOUs isn't closed because they don't want to, and it's ship insurance and all this stuff. Like they laugh at you and they're like, that's stupid.

The reason it's closed it's cause no wants to get blown up. And, We've seen sort of the proof in that of, hey, not only did they get by our air defenses, but they hit, they hit our embassy and they hit the part of the embassy where the CIA a was not where the families were. They hit the fifth fleet base at Bahrain is very beat up.

I hear. If they're getting through those things, which presumably had pretty good air defense, like by all accounts, sailing a ship through the strait of Hormuz is like. Shooting fish in a barrel for that kind of stuff. When you pair that with what what you're hearing in the physical world, what the physical world's okay.

The war we have not even seen the shortfall yet. And then the guys in the defense world are going, this is gonna last longer than we think, and it's gonna, if we really do this the wrong way, it's gonna be bloodier than we think. Then you start saying, okay. I'm not, still not optimistic.

It's gonna be open in a week, in two weeks, in a month. I like, to me, I think it's very possible this thing's still closed on the 4th of July. And if that, like nobody's position for that at all. So I think between your point of, Hey, we've not even seen the lag effects and look, I don't, it's, is it my base case?

It's still closed on 4th of July. No, but is it, my base case is still closed in a month. Yes. And you and I both know what that implies for the second half of the year for supply chains. It's a disaster.

Erik: Let's talk about some of those knock on effects now and how they're going to affect the economy and what it's gonna mean in terms of trades and markets.

Let's suppose you're right that the fertilizer shortage that's already occurring is gonna mean that farmers don't. Plant 'cause it's planting season now or it's coming up on planting season. Depending on, on, what latitude you're at. If they're not able to use as much fertilizer as they would like to, or they can't get the fertilizer they need or whatever it means, crop yields this year are not going to be as strong as they've been in past years.

We won't see those effects hit the real economy until after the harvest season, but it means six to 12 months down the road there's a very significant food inflation effect there potentially, if you're right, that it's at least another month. That's going to cause the backwardation to steepen even further.

And we're going to get to where, the people who need the diesel fuel most urgently, especially in Asia, Australia, the hardest geographies. We're gonna be looking at double, triple prices that creates. An inflation shock wave that potentially becomes self-reinforcing and changes behaviors because as we know as our listeners know the study of inflation says that once it gets going, consumer behavior changes.

As people know that things, the prices are going up, they start hoarding and, that just exacerbates the problem. Are we headed into some of those feedback loops that are, are they avoidable at this point? And if they're not avoidable, where's that gonna leave us a year from now in terms of inflation bond yields and so forth?

Luke: I think you absolutely nailed it. I'll simplify I'll use a stark, but I think straightforward. Simplification of it, which is, our world and data put out a chart data is 2015, but it shows world population of seven and a half billion. And then it shows world population supported without synthetic fertilizers.

So to be clear, this is what population would go to if we didn't have synthetic nitrogen fertilizers via the the Haber Bosch process and. World population in 2015 with fertilizers, seven and a half billion world population without synthetic nitrogen fertilizers in 2015, 3.9 billion. That's the dynamic we're talking about.

And so it, there's a, obviously it isn't a, we've not been completely cut off, but it is a margin. Everything happens on the margin and on the margin. Yields are gonna fall, supplies are gonna fall. Supplies down demand for food is constant.

And if anything, it's probably up here. You saw the Trump administration take the E 15 limits off of ethanol.

So I don't know if anyone's blending higher levels, but conceivably they could, which will chew up more of the corn crop here in the US and further reduce any sort of you know Tighten global corn, markets. Yeah, you're looking at a situation where later this year you're gonna be looking at starvation across, in parts of the, in the poorest parts of the global south, possibly quite bad a humanitarian crisis.

You're gonna see food inflation that is pretty pronounced across. The richer countries and that then gets into important implications for obviously for politics. You can if food inflation and gas inflation is short soaring, you can certainly short the it's probably a good idea to short the incumbent.

So you'd be talking about a blue wave probably in midterms this year. But from a market's perspective. Mar that's, we're gonna be talking about a spike in inflation bond yields already at problematic levels and not able to go much higher without creating market feedback issues.

I had thought that number was 4.6% of 4.8% on the US 10Y treasury yield. Last three weeks, four weeks have shown me at least that. Bessent and Trump seemed to think that number's 4.4% because every time it breaks 4.4%, like the war goes away for a couple days and some sort of positive announcement.

Or the last week or a week and a half ago, Bessent did the single biggest treasury buyback in a single day in history at \$15 billion. So clearly four point percent, 4.5% in a tenure is a bogey they're watching for. And we're at what, 4.32 today? You get more food inflation, it's gonna wanna go through that 4.4% on the upside, like a hot knife through butter, which if it did, would then create, okay, this decision point again, do we let.

Stocks really tank and the dollar really rip, which is gonna create a dollar debt spiral of, higher yields, higher dollar, lower stocks, lower receipts, higher deficits higher issuance, higher yields, higher dollar lower stocks until we crash into the ground at, 500 miles an hour.

Or do they come in into a food spike and an oil spike and print money to cap yields, which I think is what they would do, which will only make the problem worse. Yeah, it is a, it's a huge issue. And again, if they fixed it today, it's gonna be a huge issue. And I don't think they're gonna fix it today.

And I don't think they're gonna fix it for another month at least. And that makes it a huge issue. And if it goes the 4th of July, which I think is, 10, 20% chance. Holy cow. Like you we really are talking about looking at the possibility, one of the worst humanitarian crises in my lifetime.

And then you get into, from the financial standpoint of, all right, you're gonna have food riots all over the global south. You're going to have political instability, you're going to have bond problems. And that's, it's just, it's not a good environment for risk taking, for investing. It's a good environment to, own cash.

Own gold and go to the beach and have a, ha, have a drink because it's gonna be, it's gonna be a tough environment.

Erik: Based on the things that you're saying and that we both agree on, governments would need to get very heavily involved in coming to the rescue. If you have a humanitarian crisis where people are literally starving to death, obviously governments have to step in and do something to help.

California's already announced an intention to suspend its gasoline tax in order to help people through this crisis. Okay I support all those things, but wait a minute. If all of the governments around the world. World have to subsidize a whole bunch of things. Doesn't that dramatically exacerbate a government debt crisis that you and I both agree is already, you've famously made the comment that government deficits and excessive debt don't matter.

Until they do, then they matter a lot. I thought we were getting close to that matter a lot moment already before this all hit the stage. Now we're talking about events that it seems to me are necessarily going to force governments to step in and subsidize a whole bunch of things with a whole bunch of money that they don't have

Luke: a hundred percent.

That's that really awkward. Moment of you gonna print money into a food and oil spike, are you gonna, how are you gonna, and some governments have other options, right? Depending on the government. For example, Chi Japan's probably one of the first that is already right there, teetering on the edge of a bond market problem.

If, you know something we've been repeatedly highlighting declines is if you look at, for the past six to nine months, if you look at. The 10 year US treasury

yield minus the 10 year JGB Japanese government bond yield. And then you compare that to the the yen against the dollar. You can see that those two have been very tightly correlated up until about six or eight months ago.

They've diverged massively with and so what that's telling you is the Japanese government bond yield is getting higher and higher relative to the treasury bond. But Instead of that strengthening the Yen, it's weakening the Yen against the dollar. And that's emerging market price action. Like people are watching that with great curiosity in the developed markets going we've never seen this before.

And everybody in the emerging markets is doing like the Leonardo DiCaprio meme, right? Where you agree with the beer in their hand on the sofa pointing at the tv. I recognize that's I know what that is and that's the market saying. Higher yields are not gonna strengthen your currency, Japan, they're gonna weaken it because we know you can't afford a higher yield and you're gonna have to print it.

So you know, Japan's already dancing along the edge. But Japan has some has an option that say the US doesn't have and that Britain doesn't have and Europe has less of, which is, Japanese have this massively positive net international investment position, which is just.

Japan's piggy bank, all of the years that Japan's been running massive trade and current account surpluses, they've invested a lot of 'em into dollar assets and they've got trillions of dollars in dollar assets. And if this hits Japan, something Japan can do something Korea can do, something Germany can do to a lesser extent.

And parts of Europe is, do we print the money or do we not print the money and we just sell treasury bonds and sell us dollar assets that we've saved up for a rainy day. They're gonna sell the bonds, they're gonna sell the stocks. And that's where, people say there's this view that.

The plan of what Trump is doing is he's an agent of chaos and he is just gonna create chaos, and that's gonna be an opportunity. And it's not it's going to blow up his own bond market because people aren't gonna hold treasury bonds and certainly not gonna buy more of them. They don't have enough food if they don't have enough energy.

Treasury bonds and stocks are below food and energy on Maslow's hierarchy of needs. And you know the countries that have been running surpluses for a long

time, they have some leeway to sell dollar assets, and the world in total owns \$70 trillion in dollar assets. Gross \$27 trillion in dollar assets net, and they'll sell every one of 'em to get food.

Get food and energy in the same way that you or I would sell everything we own to feed our children or feed our loved ones. The world will break down, now the poorer countries that are barely have not really run current account surpluses like. They're gonna have to print money, and it's only gonna make it worse.

The Americans are only are gonna have to print money. The Brits are gonna have to print money because us is a Twin Deficit Nation. Brits are a twin deficit nation. Turkey is a twin deficit nation. These places are gonna have to print money to buy food and it, it will be orders of difference, right?

Rather be in the US than in Turkey, rather be in the US than Britain. But it's all gonna be highly inflationary. Yeah I agree. It is very problematic.

Erik: You mentioned gold a minute ago. Let's come back to that. 'cause this has been really fascinating. At the beginning of this crisis in February, gold was acting in its traditional role as a geopolitical risk hitch.

The bombs drop gold goes up along with oil. Then on March 2nd, everything changed and we got this inverse relationship where its bombs drop, oil goes up, gold goes down, presumably because the market was sensing that oil driven inflation signal was going to tie the fed's hands and pretty much rule out any possibility of a rate cut.

It started to look like gold was maybe starting to go back to its its historic behavior over the last week or two. But then Monday we saw, eh, muted recovery on gold. But as, and just think about this, Monday was a day, first. Over the weekend there was supposed to be this big peace talk and everything would be worked out that failed.

We didn't get to a peaceful resolution to the the crisis in Iran. And The S&P breaks out to the upside through. Its a hundred day moving average in reaction to that news, but gold, which had been suppressed because of the, the Iran crisis and the perception that it was gonna create this inflation signal.

It's not breaking out to new highs. It's struggling. What gives here,

Luke: I think your explanation for why Gold got hit initially was exactly right.

And, there were a lot of tourists in gold at those prior price levels and so there was some fuel for it to head lower when there were concerns about higher rates. And people were complacent initially about stocks, and then people were like, oh my gosh, this actually is a big deal.

And they hit stocks. And so people have been out of off sides for, for a lot of these moves. So a lot of people who got, for the first week, oil didn't really move that much and then it moved a lot and then, then it came back. So it, a lot of people have been off sides both ways on oil, and a lot of people have been off sides both ways on gold.

A lot of people had been, hey, I'm, okay, markets don't care about, the stock market doesn't care about this. And then the next week you cared about it a lot. And so people had to position by the time everyone repositioned and then it started going the other way. And so I feel like there's a lot of that still going on.

In the context of the broader context of investors, have had 30 plus years going back to 1990, 35 years. So everybody in a senior seat today has gotten paid for buying. When the bonds start falling and, once the bonds drop, you buy stocks and you sell oil, and you sell gold.

You don't need, and they've not revisited their priors. This thing was supposed to be over three, four weeks ago. It ain't, and it's not it's not getting better. Now, I also I'll that's my Occam's razor explanation. I think there is, look in, there's in, there's a, an old saw, there's no atheists and foxholes and in wartime there's no such thing as free markets.

And so these markets make no mistake, are being managed. And I'm not gonna say that they managed gold. I think look, gold was due for a selloff. And I think that's the reason gold sold off. Now you had three really ugly auctions, including in a two year treasury auction. You should never have a bad two year treasury auction ever.

And it was a really ugly one. I think it was three weeks ago, followed by an ugly five, and I think an ugly seven or ugly 10, I can't remember what, but they were all ugly. And then literally five days later, we get, this huge treasury buyback program. And again, is it new liquidity? Not technically, but if you're putting in bills and taking out notes or duration, like it's, it's a management it's a manipulation.

And it like that is what it is. Because the reality is if, the reality is the, is bestin and Trump are not going to let the bond market. And the stock market beat

them. And so the release valve is gonna have to be something else. They're not gonna let the price of oil beat them. The former commander in chief of the Iranian the IRGC came out like a week and a half in and said, listen, our plan is simple.

They were planning on a very short stay. We can see that from their logistics. All we're gonna do is we're gonna hang in here and we are going to create a financial crisis like Hormuz stays closed, the world economy is gonna collapse. That is not a guess. That is a mathematical, physical certainty. We can debate how long it'll take Hormuz to stay closed for it collapse, but it stays closed long enough.

The world economy will absolutely 100% collapse. That's their plan is, Hey, let's keep Hormuz closed. And we'll collapse the global economy and we'll see if Trump wants to continue to be a warmonger. His word's not mine we'll drive oil up a whole bunch. So I, I think part of what's going on here is you're getting the military guys like, hey, some of what they're doing over there with these airstrikes are shaping operations.

I think Besson and his team are doing shaping operations in the market, which is. If people want to take yields to a bad level, they shape those people wanna run away with oil. They shape those, they, they there's I think it's a very challenging environment as a result of that because again, that there is zero chance, in my opinion, that Trump and Bessent are going to allow the US to lose because of free markets.

They have absolutely have the firepower, the means mode of an opportunity to do these things. And I would just, people don't wanna make, might think I'm crazy, but I would just point you to the blatant front running in the oil markets, which I'm sure you saw, right? Somebody, on the 24th of March, somebody front ran on \$500 million in notional on shorting oil ahead of Trump's tweet.

And then last week somebody front ran the ceasefire \$950 million in notional, that's. Big boy positions who's getting the heads up, right? Why is these are not clean markets. These are not exactly the these are not your, these are not our fathers or our grandfather's markets of, Hey, this is just supply demand and there's no political impetus here.

There's a huge political impetus in these markets.

Erik: Let's talk about how this inflation signal plays out, because at first glance it seems just overwhelmingly clear that if you have an oil crisis, the oil prices

have to go dramatically up. That's a huge driver of inflation. Food prices. If you have crop yields diminished as a result of a lack of fertilizer, that is.

A huge driver of inflation. But wait a minute, Luke, you said just a minute ago that it is an absolute certainty that the entire global economy crashes and stops if this thing goes too far. Wait a minute. That's deflationary, right? At what point does the inflation signal go the other way?

Luke: Yeah, it's a great question because it isn't a very short run. You're exactly right, which is to say that once these oil prices get too high as a deflationary impulse. Now if you have right now, the new fiscal numbers just came out for the us It's through it's halfway through the year, right?

So we're six months in through March. I ran the math on Friday. If you look at US true interest expense, which is entitlements plus gross interest, or actually in this case, net interest. Plus Veterans Affairs through March, which is six months of the fiscal year, we're at 102% of receipts. In other words, the interest and interest like obligations of the federal government are 102% of the receipts.

And it's, it is this tricky dynamic where there is a pass through inflationary impulse of commodities. On the one hand, which all else equal raises inflation expectations, there is a deflationary impulse from the recessionary aspect of higher of an oil price spike and commodity price spike, which takes away slows growth, takes away discretionary spending, Etc.

And then there's this, you know that it tho both of those two factors get layered onto the dynamic, which is if you have a recessionary deflationary impulse, you're going to send your receipts well below your interest and your entitlements. And then you're in real sim. Another very simple decision market, which is the US government going to print money to pay for interest and entitlements?

Or is the United States government going to default and miss a payment on entitlements and interest? And I think there is zero chance. They do the latter. I think they're gonna print the money now, to be clear. Until they do. That's gonna be a market we can get dollar up rates up everything else down. And we've seen a number of those markets since 2019.

And so there's this very. Sensitive. Okay. Inflationary impulse of higher commodities, higher oil, deflationary, impulse of those things, and then a deflationary impulse of those things. Hitting receipts, which are going to create

dollar up rates up, slow things down. But then it also is going to raise the question of.

Are they gonna print money? Are they gonna default on treasury bonds and entitlements? And of course, they're never gonna do those things. And there's, there is nothing that is more inflationary in the long run than a government who needs to print the money just to pay the interest on their existing debt and obligations.

So that's the sort of when I let off by saying it's both the easiest market and the hardest market at the same time, it's the easiest. It's is hor moves closed? Yes or no? Okay. That's pretty easy. The hard part. Okay, when is it inflationary? When is it not inflationary? Are they, how long are they gonna let people twist in the wind until they print the interest and the entitlements?

How much is the US and other governments involved in markets, whether that be subsidizing food or, if you're long oil, what, if Trump comes out, you're long oil, you're feeling good, bombs are dropping. Trump comes out and goes, Hey, I'm thinking about doing export controls on oil. Ah, now oil's gonna go limit down.

What? Like it's. It is very simple and very complex. I personally, for me, I put it in what, my friend Lynn our friend Lynn Alden calls it the too hard camp, right? Just too hard. So for me, it's too hard to try to trade the very short run. I feel very confident that an oil spike and a food spike will drive a slowdown, if not a recession.

Particularly when married with higher rates and the disruption from supply chains, and I'm not trying to bet on, on exactly when they're gonna pivot. I feel very strongly it's gonna create an air pocket and I feel very strongly that Air Pocket will send receipts below their interest and their entitlements.

And I feel very strongly that we ultimately, due to them having to print money probably into a commodity spike,

That's the sequencing. I see. And in the short run, I'm just sitting in cash and bullying mostly because. It's just too hard to try to, it's too hard to try to nimbly work my way through that. I'd rather just wait, maybe give up some upside and wait for the, okay. They're having to do QE and they're they'll do it, whatever, they won't call it QE. Probably they'll call it reserve management purchases or, food purchases to help the poor or some BS.

It'll, with the masses. So at any rate, that's, I'm rambling now, but that's you're right that it's this yin and yang to inflation, deflation in the context of the fiscal situation.

Erik: Let's come back to my favorite Luke Roman quote, which you've been saying for more than a decade now, which is government deficits don't matter until they do, and then they matter a whole lot.

It seems to me like when you talk about market complacency, the complacency we have in the United States is everybody is just always assumed. Look the US dollar is the world's global reserve currency. There's always gonna be a market for us treasuries. Always there. There's a special privilege, the exorbitant privilege that the US government has.

They're always able to print the money. They're always able to go into further debt. They're not going to have a fiscal crisis or runaway interest rates because they got too indebted because they're immune to it, thanks to being the world's reserve currency. Hang on a second. Didn't we just see most of Europe completely unwilling to support the US in this Iran debacle?

Aren't we seeing changes where around the world? A lot of central banks are a lot less inclined to really focus on US treasuries as their primary reserve asset. Are we headed toward a US fiscal crisis that, everybody was too complacent to see coming

Luke: in a word? Yes. And you can see it, it's been slow motion.

People say, look, foreign demand for treasuries at all time highs, which is true. When you break that down, what that actually looks is well. Foreign central banks who once upon a time were the one of, if not the biggest holder. They haven't bought any new treasury since 2014 on net.

They're actually down slightly. Japan's bought a little bit more. The UK's bought a bunch more, which is primarily investors and hedge funds. And then, you look at where the biggest marginal buyer is in foreign, fed did a white paper in October of 25 that pointed out that 37% of the net issuance of US treasury notes and bonds.

Belly the curve and duration 37% in net issuance over the last four years has been the Cayman Islands. Which is heavily US hedge funds. It's this treasury basis trade and where you're buying cash bonds and you're shortened futures on insane amounts of leverage.

And yes, nominally foreign demand is absolutely at highs. That's correct. The makeup of it has been, we've gone from financing with very patient foreign insurers and pensions and central banks to. Highly levered hedge funds who sell treasuries when risk goes off, which is why treasuries, when you look at the correlations, have become risk off at risk, off risk on assets.

They've stopped acting. Even in this crisis, the weekend we, the bomb started flying around. I was having a discussion with someone on X. They're like, oh, 10 year yields are going way lower. I'm like, sold to you. They aren't going lower. They're going way higher.

Sure enough, right? We're up 50 basis points, give or take from, in seven weeks from where they started this war at, I don't know that they ever traded down at all from 3.94 on the tenure. So we have the foreign demand is nominally better, but it is lower quality, low, less patient creditors.

And in the meantime, the biggest marginal buyers have been, besides. Hedge funds in the Caymans have been us the Fed itself and US banks as well. And so people say when's it gonna start? And you go, when's it gonna start? Since Central Banks stopped buying treasuries and started buying gold.

Long-term treasury bond futures priced in gold are down 90% since 2014. And it's like the dream trade for a macro, the sharp ratio on it's beautiful. It's like up and to the right at a 45 degree angle if you look at it as gold over treasuries. But it is a one-way trade long gold short treasuries has just been an absolute beautiful, very minimal drawdowns, very minimal volatility.

So I think we're already there, but in terms of it going critical. That's the part to me that I just think the administration and a lot of investors were just super complacent on, or just out to lunch on, which is there's this view that the Chinese have no move, and I think that's totally wrong.

I think they just need to squeeze supply chains a little, get inflation going. And

The bond market will do the rest, and if the bond market doesn't wanna do the rest. Point being that if. They don't let inflation print the real number or they cap yields or whatever they do, then, real inflation's gonna show up politically no matter what. Because Trump and vesting can say, Hey, inflation's only three and a half, and if it's actually seven or eight, they're gonna be, they're gonna be spending the next two years of their lives dealing with impeachment hearings for Trump for the last two years because he'll lose the House and the Senate.

One way or another. China has a way to force this dynamic in terms of cost on the bond market. And so yeah, I think it is, that's where I think it is going to further accelerate. There's nothing more inflationary than war. So if you already had a very delicately balanced situation and here too, I would just point back to what we talked about earlier, which is this net international investment position dynamic.

Look, Japan needs oil, they need food other places that own a lot of dollar assets, including treasuries. They need food, they need energy. They're gonna sell those things. And so your net supplies of treasuries. May potentially rise dramatically, US deficits, especially if we have a recession, foreigners selling.

Your biggest marginal buyers have been levered hedge funds and, when volatility goes up in equities or anywhere else, they're gonna sell treasuries, not buy them. Yeah it is a, it is an accelerant without a doubt to the stresses we've been talking about for some time in the sovereign bond market&Particularly western sovereign bond markets.

Erik: Let's talk about where the trades are. I appreciate you said this is, too hard to trade in the very short term. As we start to get through this and see a light at the end of the tunnel, where are the trades gonna be? It seems to me that the food, if you look for things that have not been priced yet, that are certain to be coming.

Food inflation seems to me like a certainty. So how do you play that? Is there a curve steeper here in the bond market? That makes sense. What else? Where might the trades be when it is time to start trading this?

Luke: I think there's a lot here in, in secular, food inflation. There's even things like, grocery store comps will accelerate, it's nominal, but there's leverage there.

'cause it's a high fixed cost model, right? So grocery stores should do well in a higher. Food inflation environment. I would think for me, the cleanest fundamental plays are things around energy and uranium and domestic electrical infrastructure and the industrial selling into that. You've got bottlenecks there already.

You've got an impetus to reshore. So I think every, and anything in electrical infrastructure and nuclear and even oil, ENP, those things all seem very well positioned. I think I still really like gold. I think gold as well. I think there's gonna be a time for Bitcoin, coming up here probably next.

I dunno, a few months later this year I still, I'm watching Bitcoin as a trades still with IGV, the software ETF, and, there's maybe a sign of a divergence in the last week we'll see IG v's broken down again, but then Bitcoin didn't. But I think Bitcoin's gonna follow it lower again if I'm correct about the, the supply chain whoosh down.

So I think all of these things, when you get to the other side of. What I think is this supply chain problem that is going to get very acute and a moment of brief, moment of panic in the grand scheme of things. On the other side of that, I think these types of names will do quite well.

Erik: Luke, I can't thank you enough for a terrific interview. Before I let you go, your firm Forest for the Trees, which is fftt-llc.com has really become one of the most respected boutique investment research firms really in existence. Tell us a little bit more about what you do and what people can expect to find when they go to fftt-llc.com.

Luke: Thank you for that, Eric. I appreciate you. You've played a big role in that and I've always been very appreciative of all the support you've given us over the years. What we do is we aggregate a large amount of publicly available data points in a unique manner, trying to identify developing economic bottlenecks for our clients and and identifying different sectors to that are more attractive and less attractive for investment.

Really appreciate that.

Erik: Folks, be sure to stay tuned as Rory Johnston, founder of commoditycontext.com will be joining us next for an update on the Iran crisis and the logistics of oil in and out of the straight of Hormuz.