PLACE YOUR TRADES

KEY TAKEAWAYS

Special Guests: Tavi Costa and Bill Fleckenstein

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CHIGRL'S KEY TAKEAWAYS

Bill Fleckenstein:

1. On Jerome Powell.

He hiked rates rather aggressively while not understanding the consequences of their policies. People tend to give him credit for what he has done but don't but fail to focus on the mistakes that led to the actions. He does not believe that they will turn out successful at conquering inflation but that doesn't mean we won't see lower inflation rates for a while. People talk of Powell's power, but he has not really been tested. He was able to raise rates without much breaking. The banking industry started to have problems because of all the fixed income they bought when rates were at zero. He has shown that he will move if something goes wrong. He believes that now that inflation has stopped ratcheting up aggressively due to the base effect, if we start to see weakness or a problem, he will start to cut. The market has gotten ahead of that outcome as people are beginning to buy fixed income prospectively thinking it will do well when that happens. Bill believes he is going to have a prolonged inflation problem.

2. On rate cuts and the Fed's stance.

They are speculating on what they think is the certainty of a recession, and the fact that inflation is under control, therefore they bid bonds to a place that implies these rate cuts.

3. On Yellen.

She has been skewing things towards bills because there are ready buyers for bills versus longer term paper. He believes that she will do "whatever it takes" to try to keep rates from going higher next year. He does not believe that Powell is that pliable and if there is any kind of catalyst or reason for him to want to ease, it will be Janet's job to try to monkey with things the best she can.

4. On the BOJ and Yen.

Japan has indicated that they are going to let yield curve control go away. They have moved the bands and have hinted that it will end. They have also indicated a potential hiking cycle. The big surprise of 2024 will be that the Bank of Japan begins an actual rate hiking cycle, which he doesn't believe people are prepared for. He believes this would trigger a fair amount of repatriation of capital home to Japan which would upset those carry traders that are funding their speculative trades in Yen, so it would have the potential to have a big impact on the FX market with the Yen rallying. He believes it would be another headwind for treasuries in the US. Some people believe that this impact would be "the end of the world", but he doesn't believe that would be the case.

5. On China and the property sector.

He doesn't trust any of their data, therefore he tries not to have too much of an opinion on the topic.

6. On the US markets.

The passive bid is this: In corporate America, there there are these target date funds and they have a certain amount of equities and a certain amount of fixed income depending on your age, and that money gets shipped to Black Rock and Vanguard and is run almost exclusively these days in a passive form which is whats taking all of the incremental market share, somewhere around 50% of daily activity. Robots have begun to be a part of these decision making processes making it mechanical and has nothing to do with any particular views in an attempt to create a lower cost way to mimic the market. There is a massive amount of money that is in the option

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oriented world which amplifies things and moves individual securities disproportionately relative to the news. This creates certain risks but they also create a certain amount of automatic pilotness to the process. We need a certain amount of contraction or lack of growth in the employment process to start to move that bid in a way that matters. This presents a big risk to the downside as it will be just as indiscriminate in selling as it has been in buying.

7. On US financial conditions and why we are seeing divergence.

He believes part of it is that there are these passive flows that have still been there and he would argue that if they were not there, the market would have already weakened. There have been enough signs of recession in certain industries that the market would have started down already. Part of it has been the passive bid and these option flows that have helped hold the market together.

8. Final thoughts.

The risks factors he discussed that are below the surface are things to keep on your radar as it is crucial to understand the longevity for future investments. There will be big opportunities in some of these commodities, particularly silver and gold, and it is important to be sensitive to the idea that it is finally starting to work and look up in the future..

Tavi Costa:

1. On whether he is in the hard, soft, or no landing camp and the yield curve inversion.

He is in the hard landing camp and has been there for a while. He doesn't believe that a lot of the profusion of macro indicators today, pointing to a recession, are going to be different this time. We are entering a phase now where labor markets are showing some serious signs of deterioration. We see this with job openings and the collapse of that index and when you look at the amount of government jobs relative to the overall job openings, which is increasing compared to private companies is a sign of a recession. The unemployment rate is crossing its two year moving average which is a signal that has also predicted recessions in the past and marks the beginning of the deterioration in labor markets. The number of unemployed people for over 15 weeks or longer is on the rise as well. These things indicate the weakening of the labor market. Things are really changing from a capital spending perspective and we are shifting towards technology being the most capital intensive sector of the economy, changing the cyclicality of those companies. The reason why we have not seen a recession quite yet could be due to the delay of monetary conditions and the normal lagging effects of that. As we see the effects of interest rates begin to rise we will see the real impact of liquidity.

2. What is the catalyst for the complacency concerning volatility?

The euphoria of AI has had a big impact on this. Secondly, there was a negative sentiment in 2022 which caused people to be off-footed in terms of positioning creating the rally we see today. His view on inflation is similar to others in that he believes that we are facing many structural problems which have to do with what he calls "pillars of inflation". Those being, the reckless amount of fiscal spending, the deglobalization issues, and the chronic underinvestment in natural resources. He believes labor costs and deglobalization are going to create further implications for companies to make money. A deceleration of growth is happening and we are seeing that in labor markets and manufacturing.

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3. On the chart he posted on US stocks having an exorbitant valuation compared to global equities.

The chart reflects the unsustainable valuations we have of US businesses relative to other parts of the world. Some people might find the short side very compelling but he feels that the long side of resource abundant economies is even more interesting to him.

4. On the green transition and the underperformance of renewable minerals and metals.

It has mostly to do with the misallocation of capital in the natural resources space. The lack of understanding in these markets is shocking. Focusing on projects that can be adequately developed is crucial. The lack of geologists in the industry has an impact on the lack of understanding.

5. On bringing mining back to North America with the permitting issues we see.

He believes that there are incredible opportunities for projects in North America to be developed over time. What is interesting about this market is that you have premium evaluations of projects that are in North America relative to other parts of the world. The premium is normal and how markets are prioritizing jurisdiction risks. It makes sense, but with changing prioritization as we enter the cycle, he believes that the speed of getting projects started in North America takes much longer than it would in South America making it difficult to advance desired projects in the north. He believes that the premium of jurisdiction risks are going to be squeezed.

6. On Gold.

It takes time to see some of these big changes reflected in the markets. Gold has been performing very well, much better than other assets, and has been changing the way in which it behaves relative to bonds or tips markets. A lot of things that used to be highly correlated with gold have been changing in the past 12-24 months. Gold held up very well throughout the steep hiking cycle. He believes gold prices are going to trade much higher 10 years from now.

7. On Silver.

It trades very erratically. Silver is a great opportunity and is one of those things that encompasses a lot of different parts of macro imbalances and opportunities, meaning that it is a monetary metal and performs well during inflation. It is a part of the Green Revolution and as it becomes higher in prices, it will continue to become more of a monetary metal relative to industrial metal similar to gold. It is extremely difficult to find primary silver assets today through discovery.

8. Final Thoughts.

There are pockets of volatilities in the market that are very cheap right now and he believes we are back to the old days of macro where volatility of BFX will be reestablished in a way where interest rates stay higher than usual. There will be opportunities for delagging of currencies and other issues. He believes that the cost of capital being higher will change the dynamic of how we value assets. The second thing to be aware of is valuing emerging markets, particularly Brazilian equities. He feels as though it is a forgotten part of the market but should be watched.