HH1 [00:00:12]

Lynn it is a spectacular pleasure to be to be with you today on behalf of the real vision crew who have again with their immense generosity thrown the universe at us and put us together.

LA [00:00:32]

We're going to keep it kind of rapid because I've got a plane to catch as I'm going back to London. And so, I think we're going to try and rap this up in 60 minutes. But let's kind of play games and pretend it's an episode of billions. Oh no...

HH [00:00:48]

Sometimes I get pumped when I see things cross the Twitter tape and I start writing and with great respect to Luke Gromen, because I do use him like my own personal punch bag. He brings out a rage in me but it's a good rage because he's pushing me. And I always regard you two as being part of the same fight club.

Which is to say that I respect the hard work and the endeavour of both of you. And it's incredible how much I think we agree and yet sometimes it tends to be just perhaps emphasis which separates us. But it's in those tiny little details sometimes that it makes all the difference. So, I hope to explore all of that.

It used to be with me and my guys, that they would try put people in front of me because I never saw anyone, I'd be like yeah you know that I prefer to listen to music. I read books...why have endless debates where no one listens to each other's argument but here we are again...

HH [00:01:47]

But every now and again, and indeed back in 2007 I had the opportunity to meet that Deutsche Bank trader Greg Lippmann, with the mortgage-backed trade. And it's like the first meeting was catastrophic. The second was mediocre and the third was revelatory. So, these things do work sometimes. So, any way let's role play.

If you may, indulge me, and let's pretend that I'm a hedge fund manager again and you're one of these free spirits that is out there having ideas and you've got your own thing and your own attitude. So, bring it on Lyn.

LA [00:02:27]

Yeah sure. So, you know I think this is really a good conversation to have. I've seen that you've been active on Twitter lately. You're also putting out YouTube content. So, what's got you amped up lately and brought out the animal spirits within you? For example, in the conversation with Luke or just more generally?

HH [00:02:45]

I mean there's a general point which is my car crash re-awakening this year. Having spent two or more years after the closure of my hedge fund which I ran for 15 years. I'm going to publish a film I made in London recently. And it's gonna be awkward and I'm gonna need to send out a few tweets by way of explanation and it's me trying to tell a bit of my back story but I feel it's going to come across more like a hedge fund rap. But it does detail a little of where I came from... the feeling of not belonging to a tribe...of taking my own responsibility to see things...of getting the vibe that something's coming down the railroad track... that there's this danger or indeed opportunity approaching.

HH [00:03:42]

But whatever it is, it's still way off. And the challenge at the very beginning was to convince others of the imminent prospects to make or to lose money. I have to say I struggled for the best part of a decade to convince people to step aside from that rail track and I'm sure many people know my story. I met with Crispin Odey and you know the game... we called it misbehaving. But it was having the curiosity to see things, to see things differently. But using essentially the technology of the 16th or 17th century via the bar charts and technical charts from Japanese rice traders and as everyone knows, as they say in show business, the rest is history.

[00:04:26]

But this year, and especially with this film, I kind of want to say that I feel stronger being shorn of the hedge fund. It's such a weight to carry around and one of the things I've noticed, and I bitch about everyone, so, what's my bitch about you? I hear sometimes you, and I get it, and you're entitled to do it...And

Raoul does it, my God! Do I bitch about him? These ~~are~~ fantasy portfolios where you all say, "hey last month I was up seven point-six-three percent on my paper portfolio". Those things kind of enrage me because there's nothing like the white fury of being responsible, and the loneliness of that responsibility, for managing other people's money.

But what I'm finding is that shorn of that responsibility that I can enjoy myself more and still hopefully be relevant and help people engage in complexity. Maybe this imaginary paper performance is what's facilitating and helping you with some of your inspired calls but for me it's so much baggage to carry around and we're just better thinkers not having that, for me at least. And again, some of the rage when I come back at people like Luke, it's just the pretence at what we're all trying to do. We haven't visited the future. We're all guessing. And so, I don't like it when it's portrayed as science. And that's why there is a method to my madness, I would rather present myself as being a bit kooky because I think that's a more honest portrayal of having this preposterous notion that you can see something in the future. And so, to return to your question, this this year I felt that I still had a voice...

HH [00:06:07]

I'm kind of proud of some of the threads that I put together... proud that I—could do a thread and get people engaged with it.

LA [00:06:15]

Sure yeah. No, I think it's certainly important for people to analyse things in terms of probabilities rather than certainties because there's always one of those situations where you might have 7 big variables involved in what the direction of a specific asset class is going to be. And you could get six-out-of-seven right. And there's one thing you're not understanding about the seventh variable or something totally unexpected happens and things change.

I think that's why it's better to focus on probabilities and I think that's what some of the best investors out there do. So, I can imagine that managing a fund would be extraordinarily stressful. I mean that's well known in the industry and you know huge rewards but also just massive burdens that come along with that. And so one thing I've kind of focused on is marrying my enjoyment of writing with the research aspect of that.

So, as you know I manage model portfolios but they're real money portfolios rather than paper portfolios; it’s my own money. But I have the advantage of putting them out there for clients.

LA [00:07:23]

Clients can choose to use the research that accommodates their own goals. And so, there's somewhat of a less stressful approach there and that allows for ~~it~~ in some ways more freedom of expression to write these big articles and kind of express my view in a way so that people can interpret it however they choose.

I know you've been focusing heavily, and I know some of the intersections on Twitter for example have really focused on international trade. And what's going to happen with the dollar. Who is responsible for some of the mercantilist policies that are out there? Do you want to elaborate a little bit on that and how you're thinking about some of the things that have amped you up lately as it pertains to trade?

HH [00:08:17]

Sure. The rest of the world has always bitched about the US. The US leads from the front. So, it is understandable that there can be envy and that the big guy, the one that everyone talks bad things about behind his back, Samson-style, that such countries always receive a raw deal. But there's a saying in markets that when those that know something the best...that when they come to love it the least... Well, that's when there are real opportunities to trade. And I feel a little bit like that with the respect to dollars today. Not as a best opportunity trade idea. Trading a G7 currency pair is lame. All I'm saying is that you expect a non-U.S. audience to kind of be derogatory towards US foreign policy and U.S. monetary policy and the footprint that it leaves behind on the rest of the world. But when I hear that same refrain from US citizens. From those who are supposed to love it the most but seem to love the least..? Well goddamn it!

And so, our absent friend, Luke Gromen, I only mention him because he flags me in his tweets. I get notifications when he’s on the tape, he baits me...and I am way too sensitive. But. I think it's kind of black and white. That you've got big fascist regimes called China and Russia at one end of the spectrum and America at the other. And that at both extremes they're getting somethings right and somethings wrong. If we want to use this term mercantilism, China is simply the latest foreign sovereign to adopt mercantilism. It's a well-trodden path. It can be a tortuous path: during the last hundred and fifty years of course, it came to prominence first with the Kaiser's Germany, the second adopter of the Industrial Revolution. Being number one, the UK was of course a trailblazer. But as number two adopter you can skip a lot of the pain and reach your objectives quicker. And so, we saw that Germany at the end of the 19th century began to quickly, if not supplant the UK, certainly narrow the gap. And then we got this crazy and pointless First World War.

So hidden, and huge, latent dangers are always lurking in the background but i never like to engage in those kinds of geo-political prophesies of wars and what like. Markets are hard enough...

But before China was the Great Mercantilist, we had the perceived miracle of Japan, and before that the U.S.S.R. So, China, and all those that came before; they're using a policy that requires a willing host. The USA is that willing host. The US is willing to receive the surplus savings of the rest of the world; it is essentially a dumping ground for the sequestration of other global citizens wealth by their central planners. I'm being a bit pejorative. These are savings which come almost entirely from a fascist diktackt. That there is a conscious decision by bureaucrats to redistribute wealth from their citizens. It's a game of chess and the sequestration of private wealth that I am talking about is essential to controlling and almost preventing market forces and the upwards appreciation that foreign currency markets and the rules of economics demand.

That foreign exchange markets can clearly see the imperative for the Yuan to trade higher versus the dollar and equalize and bring more into balance the terms of trade. Except something that could materialise over the course of 2 to 3 years, the Chinese would prefer that it happen less quickly, more like 10 to 15 years, if at all. That is a decision which robs Chinese citizens of their purchasing power, what I call their latent and meritous wealth. Consider that big ticket high value-added items produced in the US like Boeing aircraft could be at least 10 to 15 percent cheaper to a Chinese citizen if the currency could move in that direction more quickly. Look at Hong Kong, its currency rate is hardly changed over 25 years...and the wealth gets directed instead into domestic assets like the stock and property markets. Wealth, or billions, for the few Party insiders rather than hundreds of dollars of wealth for the many and industrious citizens; I find it revolting.

Mercantilists control the level of their exchange rates via the management of their FX reserves. Chinese exporters have very little need or use for U.S. dollars in their daily activities. These dollars get swept up by SAFE, the Chinese state's FX reserve manager And I would say the mistake that people make is to think of these reserve managers as hedge funds or regular investment portfolio managers. They're not! They're not there to make a commercial return. They're there to make a sovereign return; to meet the goals and the ambitions of the bureaucrats at the very centre of their political system. To make billionaires of Party elites...

And that's what takes us into this vexed and complicated world of the dollar and the role of these reserve managers. I think in preserving the status quo which is a dollar that never weakens enough to restore equity to the unskilled pool of displaced American steel plant workers. And therefore, in doing so it creates, I want to use the word almost insatiable appetite for dollar assets, like US Treasuries, from the rest of the world. But insatiable must be cautioned, it's only insatiable if the circumstances are correct. Should the dollar break key chart levels, like it's doing today, and looks as though it's going over the cliff and set to depreciate rapidly, then these huge FX reserve managers of mercantilist nations are pre-programmed to buy US liquid dollar assets. I guess we are going to see soon.

But Lyn I know you you're out there with a lot of the same thoughts but perhaps with a nuance which is different from mine. Is that something that you can expand upon?

LA [00:14:01]

Yes, I agree with virtually all of that. I think that's a phenomenal summary of it. I focus instead on the structural forces behind your thesis.

You mention that many Americans are increasingly critical of the current monetary system. And I think that's in large part because there have been huge winners like us that work in technology or finance or government. However, those accumulated trade deficits of the USA, accumulated over several decades, they've really hurt a large portion of middle America. And so that's why we're seeing rising populism both in the US and elsewhere and there's increasing signs that the system that's been structured for the past 50 years, what we call the petrodollar system, that it is beginning to unravel.

This is not just problematic for the rest of world but also problematic to the United States. And so, one of the things I focus on when it comes to mercantilist nations is that they're partially incentivized by the current system to act in the manner that you just described - I give them a partial pass - because the whole purpose of the petrodollar system is that the US tries to enforce its hegemony in a sense that all global energy pricing occurs in dollars and so all nations need dollars. And so, there's this constant demand for the dollar and in order to have that system function we must have a tremendous amount of dollars in the system. And so that's kind of the retooled version of the Triffin Dilemma that he proposed when noting the flaw in the Bretton Woods system. And that's kind of come back to roost here in the petrodollar system as well today.

HH [00:15:37]

That's great. Let's stop there for a moment. There's a lot there that I want to disagree with.

LA [00:15:42]

Sure...

HH [00:15:45]

But it's just...it's nuances. Yeah... When I listen to what you just said, or if I read it in a tweet, I could get really enraged because there's this sense of pejorative bully boy implication. I don't buy it, that anyone is compelled against their will to use dollars. If there is a compulsion, it is a commercial best practice compulsion. I don't think there's going to be a warship off your coastline if you dare not obey the hegemon, launch a nuclear arms program and almost certainly... But rather it is networking effects or the economic benefits which tend to override all other factors.

I think the flaw in the Bretton Woods system is that it was an effete gold standard in disguise, or should I say in drag? That it still required that credit be anchored to something that could not move. And the lesson that certainly I take, and I believe the Federal Reserve also, when I think of their mea-culpa at the 91st birthday party of Milton Friedman, when they famously declared that they'd got it wrong and had been culpable in the events that led up to the Great Depression, was again this notion of rigidity versus flexibility. There was such a rigid anchor that the system just broke with devastating consequences back then. That if you don't have fluidity in things, if you can't flex with these great economic storms, then you end up playing chance with the powers of entropy

HH [00:17:29]

Bretton Woods II, the modern era after the closure of the Gold Window back in 1971, is better, much better in my opinion! There I've said it! Right. And what people neglect very much is the Eurodollar market that Jeff Snyder, and anyone that's reading my tweets will know that I attend Jeff's Eurodollar university with Emile, and i think they do a brilliant job throwing light onto that market, this invisible web of offshore banks who accept dollar deposits, what you call petrodollars.

And you're quite right because of course at the same time as the closure of the US dollar gold window we had the oil embargo from our Arabian friends and the price of oil rocketed to ten bucks And so, these Bedouin tribal nations in the middle of nowhere received dollars and those dollars went on deposit not physically within the United States of America but within banks from Paris to Brussels to Timbuktu and they were therefore able to use the reserve fractional reserve system of lending to create vast flows of new dollar credits. That's where the term petrodollar comes from – a happenstance that we had this oil embargo shortly after the gold window closed.

And it allows you to use this as a pretext to likening it to warship diplomacy. We are the hegemon and you've got to use dollars or else. And I would say. No one's compelling you to use dollars. Just look at Australia... I mean look at Australia as an example. Why the Fxxx would I want the Chinese Yuan, which itself has tied itself inextricably to the US dollar, or why on earth would I prefer to receive Vladimir's rocky roubles for my bounty of raw materials? Why would I want Russian pieces of paper? Or euros – a currency invented in our lifetime??? I want dollars. So again, I don't see any hegemonic misbehaviour in that dynamic.

LA [00:19:40]

So, if you go back to the beginning, the system was founded with an agreement between the U.S. and the Saudis. Intentional choices were taken at the beginning and you reap what you sow.

But I agree that from there on that network effects played a very large role. So, once it starts happening globally then you start having global financing happening. So, we have all that dollar denominated debt that a lot of us like to talk about outside of the country. And so, it does become a network effect. There are still occasionally military actions or sanctions that are used to enforce that. You know dictators that end up pricing their oil in something other than dollars generally have a track record of being taken out. In the next couple of years and then their country goes back to pricing oil in dollars. And if for example one of the things that if you look at modern hot spots for example the Nord Stream II hot spot being only the latest one with the U.S. layering sanctions on sanctions on the fact that Russia is building that pipeline in Germany and so on one hand, we have this increased populist and political incentive to try to narrow the US trade deficit but on the other hand we're still trying to enforce some degree of dollar-only energy pricing out there.

Now there are signs that the network effect is beginning to fray. So, for example if you look at trade between Russia and Europe or Russia and China over the past two, three, four years it is beginning to de-dollarize. So, we're starting to see partially it's going up in euros. So even between China and Russia there the trade, the percentage of their trade, it's happening in Euros is increasing. And we're also seeing that of course being Russia and Europe. But then in addition we're seeing some increase in their local currencies as well. So, what we're seeing is some degree of decentralization where the dollar still plays an important role in global energy markets. But we are starting to see some alternate payment systems around the margins. And so, we basically have had multiple decades in a row of you know just accumulated trade deficits for the United States. They have tools that they can end this at any time but instead they've kind of perpetuated the system.

HH [00:21:50]

What are these tools available to the US to stop incurring trade deficits?

LA [00:21:52]

Well for example they engage in some of the same mercantilist process of other countries like they can for example move their currency lower whenever they wish. And they just do.

HH [00:22:01]

That's my principal point - that the hegemon is toiling from the actions of the mercantilists - America had the brute strength of

Samson until they gave him a haircut and he lost his superpower. The U.S. is in a bind in a world where everyone has a fiat currency...in a world where everyone is Switzerland. The US cannot devalue because if I print a trillion dollars to lower the value of the dollar well, we all have these metaphorical iPhones storing infinite dollar like fiat paper currencies – previously money or banknote creation was physically limited to print machines and wheelbarrows but today...? Boom one trillion dollars! Boom two trillion dollars of foreign fiat equivalent. Boom! Three trillion dollars. I'm at market, bid only to buy US dollars...you can't push the dollar down in an environment where you have infinite foreign printing presses; you can't, it's just not possible.

LA [00:23:11]

Well, we saw that it's possible this year. But I mean they can easily continue some of the same policies that they have been this year now but there's also alternative things that they haven't done at all. So, for example the United States has not employed any of the same tactics that Switzerland is, so Switzerland does is they print a ton of money they buy foreign assets they keep building their reserves. They're one of their arguably the most egregious currency manipulator out there. And the United States at any time could use similar tactics but chooses not to.

Instead, the US maintains the smallest global reserves including gold as a percentage of GDP of virtually any country out there. And that's been because being the axiom of the system we are the global reserve currency we've chosen not to engage in basically printing money buying gold buying foreign currency bonds and building any sort of exchange reserves other than something like 2 percent of GDP. But the U.S. if they wanted to engage in that currency war strategy could do so easily – so far, they have had no desire to choose so

HH [00:24:23]

U.S. GDP versus Switzerland must be 15 times the size of the Swiss economy I'm guessing but whatever it is (27x) the Swiss can print as much if not more money as the United States.

I think we should appreciate that the U.S. has shown the wisdom not to pursue trade conflict with its neighbours. It seems to me, prior to Trump, that it stood alone in that regard.

LA [00:24:59]

Well until recently you saw for example under the Trump administration there was a renewed effort to try to narrow the trade gap. And you know it was unsuccessful because they didn't get to the root cause of it. They didn't employ a lot of the tools they could have. And they focused more on that on the tariff angle.

HH [00:25:20]

Let me throw a hard question back at you because when you talk of the petrodollar currency system of the last 50 years, and in trade finance it is supposedly impossible for a country to perpetually run a trade deficit, the U.S. has done it for the last 50 years, that’s not forever but it's kind of stretching things, and you are alarmed at these populist uprisings that brought us Brexit and Trump, but tell me this... what part of the system has failed? What is the defect that you want to fix?

Before you answer, here’s my take. People in the Midwest, people in the UK and let's generalize and say that a large subsector of that enraged population are unskilled labour pools, and the fact of the last 30 years is that the breaking down of some of these fascist imposed global boundaries brought on a billion plus new unskilled people to the global jobs market. And so, there's a kind of inevitability whereby if you decide that it's just not satisfactory that someone should live on a dollar a day let's say for the peasant in China twenty-five years ago. And you want to bring them closer to Kansas then something or someone's got to pay for it. The person that pays for it is the person that chose to be unskilled. And I don't think that's breakage or some demonic hegemon spoiler. I think the $ system has had to deal with it. But without a doubt there have been losers, but I sense that you think there's a much deeper more malign defect.

LA [00:27:57]

Well, I think it's more that the system has essentially run its course...

And so, I if I were to describe a defect, I believe it goes back to the intentional emphasis on US policy promoting most global energy being priced in dollars and that that could have made sense decades ago but just makes less sense now. And so, we are starting to see that change we're starting to see multi-currency energy deals we're starting to see alternative payment system develop and technology makes that easier.

HH [00:28:27]

Why does the pricing of oil in dollars change anything!? That just makes my blood boil! Who gives a royal fxxx about petrodollars? Who cares about oil? I mean we're not going to be using oil in the damn future. Who cares? How would you solve the disenfranchisement of unskilled labour by changing the dynamics of how you price a barrel of crude oil? It's absurd.

LA[00:28:53]

Well one is because that would over time allow for devaluation of the dollar and so it goes back to this thing where we have...

HH [00:29:01]

Sorry but how does it achieve that?

I cannot think of any direct channel whereby you make it easier for the dollar to devalue by changing the transactional currency of barrels of oil...

LA

I discussed where it can happen. We agreed that the Chinese currency has a long-term tendency to want to appreciate, in order to close that trade gap. And so, but of course all these mercantilist nations to varying degrees of pushing back on that free-market dynamic. Now China decided to push back on it less back in like 2013 or so but we still have countries like Switzerland that are much smaller but are still aggressively going along that route.

Speaker 1 [00:29:34]

I disagree.

China made no pushback. Let me rephrase that. China experimented for a year or so with the notion of allowing their currency to move a little bit higher v’s the dollar.

Because I think you guys are part of a gang that see the world that way, I want to reiterate my point that mercantilist FX reserve managers are drones or cyborgs. They have no subtlety about what they're doing. Dollars go into their system and they recycle those dollars into foreign reserve assets, principally US treasuries to maintain a smooth controlled glide path that allows for only the most benign appreciation of their currencies.No incremental dollars entering their system means no additional US Treasury purchases by SAFE.

LA 00:30:24]

It changed in 2013. So, for example China holds less treasuries now than they held seven years ago, and they announced back then that accumulating treasuries was no longer in their best interest. And that instead they've launched the Silk Road Initiative. And so instead of continuing a cycle of taking all their dollar surpluses and putting them into Treasuries they started putting them into dollar loans for an infrastructure projects mostly around the developed and developing world. So, it's Eurasia, Africa, Latin America and East Europe.

HH [00:30:52]

That’s just Propaganda. Okay. China is to quote my great wonderful friend Michael Pettis, China is a volatility machine.

Tell me this? Who suffered the greatest pain from The Great Depression? It was inflicted on supposedly the strongest member. And who was the strongest member back then? Of course, it was the US, which was the mercantilist of that time, running huge surpluses. But who went down hardest when you took incremental demand out of the system? It was the mercantilist that absolutely withered dramatically. Because they have nothing internally to support themselves when the economic tide turns and that’s why you need an emergency slush fund to bail yourself out.

So as a reserve manager you can talk with bouquets of flowers about expanding your Asian Silk Road to Europe etc. But this is all about having reserves that you know 100pc that you will have to call upon, that you will have to turn them back into your local cash to bail out the morons, and that’s not aimed at the Chinese, but is a global refrain about the foibles of banking and cycles, because at some point in terms of credit there's going to be another credit accident and when it blows up a good reserve manager stands there and it's like BOOM! Sell my Treasuries BOOM! I got my local currency cash back and BOOM! I've just solved the domestic internal credit difficulties of my banking system. A bad reserve manager goes, “oh gee, I've got a trillion dollars invested in illiquid Vietnam railroad bonds...” I mean this is the PBoC’s China and it’s not only a volatility machine, but it spews out plumes of propaganda that you guys swallow hook line and sinker to such an extent that I believe your tweets should carry an advisory message.

LA [00:32:35]

I prefer focusing on numbers more so than narratives. So basically, they pointed out back then that they're no longer willing to buy treasuries and therefore what we saw was they stopped committing to treasuries and instead they dramatically ramped up dollar funding finance for infrastructure around the world

HH [00:32:57]

OK as the numbers person, can you describe for me the course of the current account surplus for China since 2013? Let me tell you what you find. You find that the global trade system began to lose demand. That their surplus to GDP fell to zero.

You discover that there was a huge credit bubble created by the Eurodollar offshore dollar market that for 10 years or more was throwing off and creating money and it was all being directed into the nirvana of China. This thing that was going to supplant and take over the world. And so, you could get financing for container ships you could get financing for any commodity you could get financing for agricultural land you could get financing... And all that new credit backed dollar flow headed into China. This dark web of dollars creates more dollars gratefully received by Chinese exporters, the coffers of the Chinese reserve manager swell, and they buy treasuries. But when our system goes oh gosh I may have got that wrong. And we climax with China reaching 17 % of global GDP. Japan got to 15, Russia got to about the same figure. So, China pushed it out by two percentage points, but it still slowed thereafter. And so, the banking system goes, Oh bugger, we've just made a mistake again. And it stops throwing and transporting money to the Chinese credit system. What happens is their external surpluses retreat. In terms of the Chinese, less dollar creation means less external surpluses which means less dollars to sweep up from the domestic system to buy dollar treasury bonds. They are the ultimate slaves to the rhythm of our private sector whims, to our private commercial bank dollar generation. But boy! Can they spin a good yarn about choosing instead to invest in their Silk Road instead of buy treasuries!

LA [00:34:41]

China must balance both their reserve requirements with their insatiable demand for commodities and so it’s in their interest to basically secure commodity rights around the world. And so that's been one of their incentives because they had this big demographic problem. And so that's why they've shifted more and more towards trying to have their infrastructure around the country rather than relying truly on what's inside the country. And so, it's always a challenging thing for any emerging market to thread that needle from shifting to an export driven nation to a consumption driven nation. You know it's that it's that trap that a lot of countries fall into. And so, China is currently rounding that turn like a race car. And so, the question is are they going to flip off the rails or are they going to stay the course and shift to more of a consumption-based model. In that process instead of just reinvest their surpluses into Treasuries they've basically emphasized the purchase of hard assets around the world right.

HH [00:35:41]

Why do they need more hard assets Lyn? In the first decade of this century, they used more steel and concrete than the United States did in 100 years why do they need yet more?

LA

Well mainly they want commodity exposure because China is a big importer of commodities and so...

HH

?

Commodities could be as cheap as chips to the Chinese if the allowed their currency to break its peg to the US dollar and allowed markets to push it higher to levels whereby they didn't have that comparative advantage domestically. Why not pursue that policy?

The danger with this hard asset policy is that the sovereign ends up mired in places like Mozambique buying a stranded coal asset in the centre of the country, stranded because the economics of pulling it out of there and getting it to the coastline, of building railroads through mountains and all the rest of it is a 20-to-30-year project in an environment where the local sovereign administration is going to change several times and they're going to default most likely. So, it requires you to become imperialists and to say I don't care about your domestic regulations. I'm doing this and I will take this coal out of your country come what may. I mean that's scary gunboat imperialistic policy from a fascist nation; we should be constraining them to their national borders and not welcoming them to spread their lack of civil freedoms into new continents.

So, I don't know how safe this policy is at the geopolitical level is, I don't know the wisdom of embarking on the procurement of yet more commodities is given how much they've already consumed and the inevitability that their GDP growth rates are declining. China doesn't need to import or secure more commodities it needs to get over the serfdom, it needs to overcome the fascist dictate that says you as a citizen are not allowed to make your own decisions the way we are in the West, they need a stronger currency rate to lessen their dependency or to cheapen their lust for commodities.

LA [00:37:16]

Well, I've always in favour of freedom. So, I wouldn't argue with that. I'd love to see them trying to open more and become freer. I'm just talking about the strategy of their current approach.

HH [00:37:26]

You seem to think this current approach is valid and so by implication you must believe that they should be willing to allow their currency to rise more rapidly, that they should not be in control of its ascent. If you believe that they attribute a value to treasuries and a negative value at that vis-a-vis other hard assets, then again you fall into the trap of comparing China to an investment advisor.

LA [00:38:20]

Yeah, I agree that they don't operate it like a for-profit fund manager. So, what we can go by is what they state, by what they state their intentions to be and then more specifically what the numbers start doing after they state their intentions. So, when they say it's no longer here to buy Treasuries and then they stop buying treasuries and then they start buying other things we can explore what that reason is. And so, for example you mentioned that they don't need commodities anymore when one thing to keep in mind is that their oil consumption per capita for example is still far lower than the United States. And because they have like four times as many people and so as they transition to more of a middle-income country, they still have a big appetite for energy and general gas or oil if China is to become a middle-income country.

HH [00:39:09]

Can China become a middle-income country?

Because what have we done in 25 years? We've raised per capita GDP in China...I'm not sure I want to say that over twenty-five years we've taken per capita GDP up from a thousand dollars to fifteen thousand dollars, or thereabouts. Correct?

LA [00:39:26]

That's directionally correct. Yes.

HH [00:39:28]

OK. OK. And we agree that consequently we have displaced millions of millions I mean hundreds of millions of folks outside of China unskilled folks because of the additional competition in the labour market and the ruptures that we've seen from Brexit to Trump and rumblings of further populist movements, I want to ask how we can take China from 17 percent of global GDP to 25 or 30 percent without further global and political disenfranchisement?

LA [00:40:13]

Well so I looked up for a quick it's about ten thousand per capita. And so, one thing I'd ask you in the context of disenfranchisement as China has become this big Mercantilist Nation is why if you look at Japan's trade balance they're still balanced. Europe's trade balance they're still balanced. So, a lot of that disenfranchisement has come from United States specifically rather than pulling it all from you know throughout the developed world. And so, I think that's why it's important to focus on specific policy choices that America, the United States is doing differently, as it relates to the global monetary system or fiscal policy or geopolitical policy compared to Europe and Japan.

HH [00:41:06]

Described like that the. U.S. is a bright shiny beacon. Because what is the difference? The difference is that Europe, let's focus on Europe, it has state sponsored coercion of its citizens. They use trade embargoes. Trump was trying to copy a lot of the European model. You just can't import the quantity of items you might desire as a free global citizen – for example, you can't import American cars into the UK or into Europe. And likewise, it's the same restriction for Chinese autos. Quotas are ubiquitous. They ensure that all cars in Europe trade at a particular price. Buying an automobile in Europe is 50 percent more expensive than it is in the US. So again, you see that as a citizen I'm a punch bag for high minded centrist bureaucrats.

If they didn't interfere in my life, my money would go for further, I would be wealthier. But bureaucrats in Brussels, so ok they're not fascist, but bureaucrats in Brussels decide that it's better that we continue to make crappy French cars. Right. And I'm not to be trusted. Give me an extra three or four thousand dollars and I might spend it on other things or as I see fit but I'm not to be trusted. So, the U.S. is the only nation that has shown the wisdom and the belief in the ordinary person - the US model says it is for you the citizen to decide. And so, I put it back to you, why do you extol this model of bureaucrats meddling?

LA

I'm not in favour.

HH

But that's the principal difference. That's why the US, and yes, I know all of you folk who are in the process of tweeting to say that the US government in Washington is in cahoots with big corporations and they both sold out middle America, but your talk is cheap – in the real world you must make imperfect decisions. We, you, me, brave Chines policymakers, the global unskilled labour force, all of us, we brought China from a thousand to ten thousand dollars per head in GDP. By allowing those Chinese people to enter the global markets and it worked because the US stood out by refusing to put quotas on products coming into the United States.

And so, whilst you were displaced as a low skilled member of the community, at least whatever you were paid, and I know it was a relative pittance, but at least everything became cheap in terms of what you wanted to buy. Now there's nothing perfect about that; those seeking perfection are fantasists. But the alternative model is found in Europe where we pay for unskilled or semi-skilled labour to make crappy French or Italian cars to be sold to a captive domestic consumer at a price which is 1.5x the global market price - is that better? If the US had pursued that model, I assure you that China's prosperity leap would have been less spectacular, and millions of peasants would still be locked into a cycle of unending grim poverty. is that better? I just think the libertarian in me says I want to burn that European system down and I don't think populism has ended with Trump and I think Europe will still have a say in where populism goes next.

LA [00:44:02]

Yeah, I think I know. I also favour the free market approach. That's why I think in the next decade we're going to see increasing you know alternate payment channels around the Swift system around the dollar system as it relates to global energy and going back to the US for a second.

It depends on who benefited. Right? So, we talked about some of the downsides for example of being in Europe but in the United States the median citizen not the average but the median citizen in the middle. You know that the representative of the middle person has less wealth than the average Japanese citizen or the European citizen. We're also...the United States is ranked near the bottom of developed countries for social mobility. So whatever kind of social status you're born into plays a larger role in where you end up in United States compared to Europe and Japan which goes against the narrative or grain of this mythic American Dream concept.

HH [00:44:52]

I tell you I don't see lines outside the Japanese Embassy, I don't see people going I want a slice of that action. Their set-up really feels meritocratic versus home-town USA...hmm...not convinced. I'm sure you can find figures supporting anything but I'm an observationist, an anthropologist, I choose to dine in busy restaurants. I like popular movies and culture; I believe that crowds impart knowledge. The Rolling Stone made songs about Los Angeles and they didn't make songs about Brussels; exiled on Main Street not Oxford Street...

HH [00:45:12]

My hedge fund colleagues, and I are always in wonder and astonishment whenever your gang bring up the oil price as the principal determinant in your rage against the present monetary or dollar standard. The oil market is unquestionably large - bigger than all other commodity markets combined - but that still represents about $1.7 trillion dollars of physical a year versus global gdp of more than $90 trillion and sure the number is bigger when accounting for futures and derivatives but again nothing like the Treasury market or the S&P.

But we'll let that be. I respect differences. I think we could go on and on and on about the past and how we got here. But the future demands that we offer some prognosis as to what policy makers should be doing. I want to suggest several things to you and then you can do vice versa.

[00:45:42]

So, for me the principal problem of the world is we keep adding debt and the incremental debt seems to be dysfunctional because it is not adding to GDP which is to say that debt to GDP ratios keep rising. You've got to think that that's making us vulnerable. So, any solution would be a solution that boosts global GDP without needing additional debt. So, if I was to keep within the boundaries of our conversation, I believe that there is a readymade solution which would be too lower the dollar. And this is where we agree - the dollar should be falling.

The D X Y, the Dixie index, people sometimes prefer trade weighted but they all come out roughly the same, the DXY is trading in the low 90s and a big move which would be outside the normal volatility bands and would indicate official intervention would be if it were to trade at 80 if not 75 if not 70 and at those levels you would have enriched the consumers, the individuals of countries like Germany, China and all the other mercantilists.

And with that I think you'd have boosted their wealth and I believe that they would spend that bounty and on spending they would propel GDP global higher and not necessarily with the need to add debt.

Voilà, a solution...

HH [00:47:24]

I've suggested that it is very hard for the US to unilaterally weaken the dollar. Since with these digital infinite printing presses, from Switzerland to wherever else, you can summon up enough FX orders to buy dollars to thwart any downwards movement. And so, I've come back to the notion that there is no choice, in a world where mercantilists insist on buying U.S. Treasuries and to disenfranchise the western unskilled labour force, but to charge them for this exorbitant privilege. I'm not suggesting a US treasury intervention but rather I am prophesising that market economics in the fullness of time and in their infinite wisdom will see the need for U.S. Treasuries to trade with a big negative yield and I'm not talking 20 basis points but more like 200 to 300 basis points. And I see a lot of cute justice in that proposition, but I also see it as the only means available when the centre, when Samson, is being held hostage to the infinite printing presses of Switzerland et all.

What say you, Lyn?

LA [00:48:39]

Yeah, I think I think a lot of these forces are going to play out naturally, so I think as we go forward several years my base case is probably to see a weaker dollar, but I do think that there is a possibility in the next three to six months we have the winter flu season, and we haven't the vaccines out yet. And so, we could see more solvency issues and in that time period. So, I don't I have a strong view in the shorter term. But I think once you get into later 2021 / 2022 that the vaccines are hopefully effective, that international trade opens more but the US is still running these larger fiscal deficits as a percentage of GDP than most of the rest of the developed world. We also of course have that current account deficit, so we have a much larger twin deficit. So, I do think we're going to see a weaker dollar regardless of what policymakers do.

And so, if they were to implement policy choices that further improve that. I think that they can rearrange taxes. So, for example they could cut payroll taxes to make U.S. labour more competitive at the cost of some other less effective areas. And so, I really think they could kick-off with a more industrial centric policy if they ever wanted to have some of those jobs come back. And so, because we've really doubled down on technology and finance over the past several decades which has benefited the few at the expense of the many, that going forward I think we're going to see more and more populism until some of these imbalances start to work themselves out. And I think with regards to the problems of the dollar policy, they're working themselves out gradually as the world becomes a little bit more decentralized with its payment systems and based on all the joint, coordinated fiscal & monetary policy that I see happening that the US policymakers can either kind of adapt to that or keep pushing back against it. And I think there will be really kind of good trading opportunities around that t

HH[00:50:41]

Gee...i got to go put more coconut oil in my coffee.

I'm becoming exhausted. Many things have happened in the last 10, 15, 20 years but if f I look at the Dollar Index, it's just a noisy line that goes nowhere except back and forward, sometimes persuading participants that real change is immanent only to reverse and mean revert every ten or so years and that would be my best guess moving forward unless policy makers or the markets decide to take matters into their own hands and push destiny. Failing that I would see the future of the dollar being a continuation of that same noisy and toxic trend - a trend that fuels populism.

HH [00:51:04]

Lyn, are you seeing something different? You're saying that you can see the Dollar Index in 2021 / 22 trading at 80?

LA [00:51:15]

I think so. If you look back over the past 50 years there have been three big dollar cycles, so we had the peak in the 80s then the decline, then the peak in the late 90s and then the decline in the 2000s and recently we've had a peak up since late 2014 early 2015 when we've been in a strong dollar environment.

But now that the Fed has shifted more towards dovish policy, they stopped tapering and launched more QE, they have interest rates at the zero bound, they haven't gone negative yet. So, and combined with the very large fiscal deficits I do think we're going to see probably the next down leg in that in that dollar cycle. So, another kind of downward move. Like what we had in the early 2000s or in the late 1980s. Now the one in the 80s was more designed around multilateralism and the Plaza Accord, the 2000s cycle was mostly due to a shift in all sorts of monetary and fiscal policy that was happening at the time. And so, I kind of view it more like the early

2000s dollar decline and then going from there I think that process can take several years to play out. I think we're going to see more and more decentralized payment systems. And so, I do think that relationship could change more structurally.

HH [00:52:32]

So basically, you've just described to me all the Fed policies currently and of course they are pursuing all the same monetary and fiscal policies as every other central bank in the world today. So, my come back to you is that the Fed's actions should be kind of irrelevant vis-a-vis where the dollar trades...because they aren't an outlier. Now, I want to propose that they become deviant but that’s not what I hear in your summary.

You're still working on a huge breaking of the dollar system...so again you said several things...these dollar cycles...the dollar rises when global commercial banks stop printing dollars and the 2014 datapoint corroborates that nicely with essentially the greatest era of commercial bank credit creation of dollar creation closing its operations out of fear of past miscalculations

So, in my mind, the only way the dollar would fall appreciably is with the advent of the reverse situation - should the Fed come out fighting and ditch its neutral monetary policy and challenge market forces to create an environment where global banks once more wish to be risk seekers and create dollar credit. Then we could see a dollar decline that would benefit the world.

HH[00:53:33]

And arguably that's the Fed's role. People keep challenging me about whether I do or don’t believe in the wisdom of market forces. For the record, I'm all-in favour. So, why have a Federal Reserve? The role of the Fed Reserve as I see it is to periodically push beyond where the market is; to provoke a market reaction. To ask questions. Sometimes market forces cancel themselves out and become dominated by inertia.

The Fed keeps claiming it wants to create inflation. Previously it could just talk its book wizard of oz style but that’s failing. Now I am the greatest believer in market forces but for the Fed to be true to its word it must challenge the market. The free market is setting nominal rates at zero. So, to change the course of history and pursue its number one ambition of installing an uptick in inflation the Fed should be setting its policy rates way below zero.

If you accept the need for central banks...and that’s a big if...but you do need a central bank which is courageous enough to either go way below or way above the market or natural interest rate like Volcker in the late 1970s. You can’t have your cake and eat it with a vanilla or beige monetary policy and a radical mission. Instead, we just sit here trapped in a modest depression that radicalises ordinary folk into wishing to burn our system down.

LA [00:55:02]

So, what you're looking for is like an inverse Volcker moment to jack interest rates negative. I think one thing that we need to consider is the cost of doing that. I think if they were to go sharply negative and do this big shock to the system, I do think you'd see a weaker dollar. I think you'd see foreigners reducing their Treasury holdings to that point because they're paying in a negative nominal yield but in addition that would disrupt the U.S. banking system and that would further inflate some of these asset bubbles that have that have benefited those of us at the top of the income spectrum and disenfranchised so many.

HH1 [00:55:41]

When you're challenging the status quo the easiest thing to do is to list all the disadvantages of radical change. The inertia is intense. That's why people very rarely challenge the status quo, that’s why we need heroes. Someone to push back at these chinless wonders that game the system in their own favour. I think I am right in saying that dollar denominated FX reserve assets account for 63 or 64 percent of all global reserve assets. So, someone's playing a game, someone is deciding to overweight dollars. And therefore, to my mind that makes them a legitimate

target. Let’s return our firepower on them; see how they like that. Dollar reserve assets should be around 20% of the total not 64%; so, cease and desist or pay for your nuisance...let’s fight back for the disenfranchised.

If Treasuries had a minus three hundred basis point handle I still...I don't think these mercantilist reserve managers would dump Treasuries. Even if they did, I would see that as a victory. Rates could quickly return to zero and we would have lowered the dollar to more competitive levels. We can always coerce domestic US financial institutions to buy these certificates of confiscation, we’re already doing that through the pursuit of macro prudent regulations.

HH [00:56:37]

Now maybe you come back at me and say yeah, they would buy gold and other dollar assets...and I accept that at the margin that would happen, and those asset prices would zoom even higher. But again, at the heart of a reserve manager calculation is liquidity; it's the knowledge that you will be fired or worse sent to prison etc if there is a great global crisis, and you are the reserve manager that kind of because you were dissatisfied with the minus 3 yield you sacrificed liquidity and went searching for yield. Good luck with that. If you can’t sell a hundred yards in the morning session you are in the wrong asset and your bureaucrat chiefs back at base camp aren’t going to be best placed. That's the different dynamics at play here which people tend to neglect.

LA [00:57:24]

So, one thing that they can shift over time just by not buying anymore Treasuries. A country like Russia did dump Treasuries. You can have a situation like China where they say we're not going to dump our treasuries but we're not gonna buy anymore either. That's the more gradual option that they do. And then also I know you push back but this gets back to global energy pricing because if a country knows that most of its obligations are in dollars so if all the commodities that they import energy based and non-energy based are mostly priced in dollars then it makes sense for them to have a very large dollar allocation in their reserves. However, as we see more and more development of payment systems in other currencies then you can see more of a diversification within those reserves because it matches their import and their commodity consumption profile.

HH [00:58:16]

Gee...you did just say Russia dumped its US Treasuries??? I do find these are fascinating James Bond conversations when people say things like that... Russia dumped US Treasuries...yeah, right. Me? I live a very simple life not really giving a damn about the loony tune policies of a rogue nation like Russia. I don't think their purported or actual decisions can move my curiosity needle.

Regardless, this has been wonderful. I have as the viewers may have noted, wilted very rapidly under your constant refrain of petrodollars, new non-dollar payments systems and the oil, oil everywhere in your understanding of the global monetary order or maybe it's just that my attention has begun contemplating my immanent 15-hour journey to London.

I’m going to London to buy a Christmas tree.

I think we set off at a fantastic pace and I want to thank you for being more than up for kind of getting down there and not taking my bait, not being rattled by my hostility to your ideas. I think there's more gas in the tank for what should happen next. I think we can have another great session. So, I think to have that opportunity that I want to end here and rush to the airport...

LA [00:59:12]

Yeah. Thanks so much for the conversation and you know I hope you have a safe flight and I know travel can be brutal so best of luck going through that.