Secular Versus Cyclical: Notes from SIC 2015

By John Mauldin | May 16, 2015

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The consensus I'm hearing and reading from the 500+ attendees at the recent Strategic Investment Conference is that this was the best ever. It was certainly intense, with more divergent views presented this year than at previous conferences. Plus, the range of topics was rather dramatic. This year I was able to listen to all but one of the presentations, and I want to share with you my notes and takeaway thoughts. (In addition to my own notes as a source for this letter, my associate Pat Watson sent me his notes, as well as links to a summary by attendees Chris Bailey and my good friend Steve Blumenthal. I borrow freely.)

I put a great deal of effort into planning the speaking lineup for my conference. It is routinely called the best macroeconomic investing conference in the country each year, and I have to humbly agree. It takes work to make it that way. Last fall, when I began to consider my lineup for this year's conference, one of the big questions on my mind and the minds of nearly everyone I was speaking to was Federal Reserve policy, so I specifically looked for a few new speakers who could address that concern. The topic of what the Fed would do and what the effects would be was a running theme throughout the conference. That concern is mirrored in the following quote from Stan Druckenmiller. (I think I'll try to get him to come to the conference next year.)

> Earnings don't move the overall market; it's the Federal Reserve board. And whatever you do, focus on the central banks and focus on the movement of liquidity. Most people in the market are looking for earnings and conventional measures. It's liquidity that moves markets.

Note: In a departure from tradition, cosponsor Altegris Investments has agreed to allow me to share one video of a conference speaker per week for the next few months. The videos are in production, and I hope to be able to bring you the first one next week. Now let's look at my notes.

SIC 2015: Speaker Notes

First up was David Rosenberg. Rosie has been my leadoff hitter for a number of years and is a crowd favorite. Never in all these years has he failed to bring a new presentation. My associate Tony Sagami, along with a number of other attendees, thought that Rosie's presentation was the best of the conference. It was certainly one of the most bullish. David was consigned to the permabear camp for many years, but he actually turned bullish at my conference about four years ago, which was pretty good timing.

He called the current economic expansion "The Rodney Dangerfield Expansion," since it gets no respect. The economy is tepid, in large part due to the shrinkage of the working-age population. Baby Boomers didn't have enough sex, and Millennials are delaying parenthood. There are not enough people to buy houses and consumer goods. (Pat Watson quipped: "I think the Boomer generation had plenty of sex. The problem is it was the non-procreative kind. FDA approved "the pill" in 1960, and birth rates plummeted soon afterward.")

Nonetheless, at 70 months so far, the weakest post-World War II recovery is still the sixth-longest expansion since the Civil War and deserves more respect.

Rosie contends that interest rate hikes won't necessarily hurt stocks. The last time the Fed hiked was June 2006, and it took 18 more months before the market started to crack. He offered this slide:

	Average (months)	Median (months)
Peak in S&P 500		
After first rate hike	38	40
After last rate hike	11	12
Recession		
After first rate hike	44	35
After last rate hike	17	8

Note:
Source: Federal Reserve Board, National Bureau for Economic Research, Haver Analyitcs, Gluskin Sheff

He predicts the Fed rate hike will not bring an end to the economic expansion or bull market. It is when the Fed tightens too much that they invert the yield curve and recessions start. All the "bad stuff" happens after the last Fed rate hike in a cycle. This expansion will end, too, but may not be over until 2018, Rosie says. On the profits recession: if you strip energy out of the S&P 500, profits are actually up. Energy earnings are down 64%. Central banks are gobbling up the Treasury supply. Note the drop in marketable Treasury securities outstanding from $2 trillion to $700 billion.

S&P 500 earnings ex-energy look fine. Therefore stocks are not as expensive as you think. Real bond yields are negative; bonds are overvalued. (Bonds being overvalued was a theme sounded by multiple speakers at the conference.)

Inflation is running close to 2.5%. There is more inflation beneath the surface than meets the eye. Real yields are negative. Institutions have to buy T-bonds. You don't – risk-reward is not in your favor. Bonds today are strictly for speculators. Coupons no longer provide any downside protection. Rosenberg offers his strong conviction: equities will be the best-returning asset class; stocks will outperform bonds.

Credit Sucks

Next up was Peter Briger of Fortress Investment Group, one of the largest private credit funds in the world. He had one of the better lines of the conference, which I just have to note. (Remember, he's been embedded in the credit world for decades.) "Credit sucks," he quipped. He's not interested in any long credit assets. He said this about 20 times in different ways. You get the idea that he really hates credit now.

"Don't buy anything with a CUSIP." There are opportunities, but they aren't easily available to the public. The credit assets you can actually trade do not have a sufficient liquidity premium to justify their risk. We will have great opportunities in a high-default environment when the financial system is on its ass. It's coming but not here yet. He would love to short German bunds, but trading mechanics make that very hard.

His remarks struck me as being part and parcel of a theme that has begun to show up a great deal recently in conversations and in my reading: there is an accelerating dropoff in the liquidity of fixed-income markets. There are several explanations for this, not the least of which is that the new regulations that resulted from Dodd-Frank have forced banks to pull back from providing liquidity and taking risks with capital. Bond funds promise daily liquidity; but in an exit, when herd mentality kicks in, there will simply be no liquidity for those funds; and pricing will go out the window. I was having lunch with an investment advisor today (who was at the conference), and a theme of our conversation was that bonds have to be considered risky. He is actually reducing exposure to bonds in his conservative portfolios.

Which brings us to the presentation of Dr. Lacy Hunt. Lacy is still recommending to his clients that they be invested in long-dated zero-coupon bonds, which his funds over at Hoisington

Asset Management utilize. Lacy (along with Gary Shilling, who followed up with Lucy in the Q&A session) has been recommending long bond positions for 30 years. He does not feel the bond bull market is over. I want to cover some of the ideas he presented and then talk about how both Lacy and Rosie can be right.

Characteristics of Over-Indebted Economies

Lacy is clearly in the deflation camp. Let's see if I can summarize his conclusions about over-indebted economies:

1. Temporary economic growth spurts can't be sustained.
2. Weak demand caused by payment obligations creates structural downturns.
3. Productivity falls without inflation.
4. Monetary policy is ineffective.
5. Inflation falls dramatically.
6. T-bonds fall to extremely low levels.

Nominal GDP is the best indicator to judge over-indebtedness. Per capita GDP shows standard of living growth averaged 1.9% from 1790–1990 but only 1.0% from 2000–2014. The real indicator and culprit for the weakness is public plus private debt as a percentage of GDP. Currency devaluations don't help, because they simply steal growth from others, who then retaliate.

Tendencies of over-indebted economies:

1. High debt tends to be a global phenomenon.
2. Rolling currency devaluations get thwarted by the Nash equilibrium.
3. Currency changes deliver no net gain, only a transitory benefit.
4. Currency devaluations reinforce global disinflationary conditions.
5. The only cure is a significant multi-year savings boom OR austerity.

Austerity is either self-imposed, forced by external demands, or naturally evolves through fortuitous circumstances.

Secular Versus Cyclical

Next week I'm going to be conducting a little "debate" with our new associate at Mauldin Economics, Jawad Mian, who is expecting a return of inflation, which doesn't exactly sound like one of my themes. He's going to present his case, and then I will present mine. A few of our mutual readers have wondered how we can have such different views. The answer is actually in our time frames. I'm not really a trader as such and tend to look out over a longer horizon. Jawad comes from a hedge fund background and is quite focused on the current period. (You can see Jawad's latest letter here – we have made it available for free.)

Lacy has a secular view of interest-rate dynamics, while many of the other conference speakers (but not all) were far more interested in what is going to happen over the next few months and quarters. It is important to understand the time frame of the speakers as well as to understand your own time frame and personality. If you have a long-term investment plan but a short-term mentality, you are not going to be able to stick to your plan. Let me say that there is absolutely nothing wrong with having a shorter-term view of the world if you have a plan that works in that perspective. Trading is a lot harder than it looks, like some of those crazy stunts that are done on TV right after the host looks into the camera and warns the viewing audience, “Don’t try this at home, boys and girls.” Then again, it can be tough to sit through cyclical ups and downs when they are going against you.

Everything That’s Obvious Is Wrong

Lacy was followed by one of my favorite economic commentators, Jim Bianco. His speech consisted of four themes, which I will summarize:

“Everything that’s obvious is wrong.” The earnings game is rigged by Wall Street: companies almost always beat expectations because they keep changing the expectations to match their realities. Jim is worried about the stock market but not afraid of a crash, as in, he doesn’t think one is likely. QE is the problem, not the solution. The Fed thinks it has a third mandate for “market stability.” Therefore it spends all its time trying to make sure Wall Street doesn’t get upset. He had an interesting chart showing that crude oil prices and world growth expectations track closely.

Paul McCulley was up next. He was perhaps the most unrepentant Keynesian to present at the conference, where he has been a mainstay for 11 straight years. This is the first time in a very long time that he had absolutely no facial hair. He was almost hard to recognize. He summarized some of his previous correct predictions. Most notably, 2008 was a Minsky Moment (I believe he coined the term), which is a liquidity trap – a period when the private sector has too much debt, which fuels a bubble. The dot-com bubble wasn’t debt-financed, so it popped quickly and was over. The housing bubble was worse because it was debt-based as well as based in illiquid assets.

When a debt-fueled bubble collapses, you get a recession. Monetary policy is ineffective in such recessions. Debt is too large relative to asset value. Private-sector debt generally creates tax revenue, making it easier to justify government stimulus (there we disagree). Fiscal stimulus is the right answer. Austerity is the wrong answer.

Louis-Vincent Gave flew in from Hong Kong to present his rather bullish view, not of the US stock market but of China.

“Money managers are paid to adapt, not to forecast,” he told us. Peak oil was hogwash, so why did it take so long for the oil price to collapse? The oil boom had all the elements of a traditional bubble. Now it has burst. Why? His answer is China. There is a new, ruthless ruler, Xi

Jinping. Xi's deal with Putin shifted the dynamic, putting China in the driver's seat. The China-driven commodity bubble was a "good" one since capital markets financed it, but it still led to the present deflationary shock. Asia was the biggest commodity consumer, so now it is the biggest beneficiary of lower prices.

Louis believes there is a huge change coming, with China pressuring the IMF to add the renminbi to the basket of four currencies (USD, euro, UK pound sterling, and Japanese yen) that make up the special drawing rights. He thinks they will probably get their wish at the November 2015 IMF meeting. This will let other central banks hold RMB, which they will do because it has a much higher yield than the alternative currencies (the four listed above). The result would be the lifting of Chinese capital controls and a sharp increase in China's weighting in world equity indices, forcing everyone to buy. The current China rally is front-running the entire world.

Louis is also bullish on Europe. Everything is lining up well, he says. He thinks the reflation plan will work. He does say to underweight the US. Valuations in the States are too high; P/E expansion can't continue. More than one third of S&P 500 earnings come from abroad, and dollar strength is killing them.

His broad conclusions? We are still in a deflationary period. The emerging market/developed world dichotomy no longer matters. Asia is in a broad bull market that will continue. Europe is in the sweet spot – a must-seize opportunity.

He did point out some potential risk factors: Russia, Eurozone upheaval, and a US bear market.

Peter Diamandis was our keynote dinner speaker on Thursday, and he really wowed the crowd. He spoke for almost an hour; the Q&A session was an additional hour; and literally nobody was leaving. We had some very special guests for the Q&A session, and I'm looking forward to being able to post that session if Peter will allow it. Peter is a true Renaissance man. He is an engineer and a physician and an entrepreneur best known for founding the X Prize Foundation. His book *Abundance* is a must-read. He is the ultimate optimist. He is the cofounder, along with Ray Kurzweil, of Singularity University. I have attended their 10-day executive course and highly recommend it.

To Peter, the media is a drug pusher, and their drug of choice is negative news, not the real world. The reason for this is that negative new sells. It appeals to that part of our human brain called the amygdala. Taking the opposite tack, he sees plenty of evidence for continued abundance: increases in global incomes, lifespans, and food production, and a decline of violence. He talks and writes about disruptive technologies – those technologies that will literally change the landscape of business.

The next morning former Fed governor Larry Meyer took the stage. Federal Reserve policy goals are simple – the dual mandate. Unlike many of the other speakers, Larry thinks the hurdles to a rate hike are very low, which he thinks will happen in the September FOMC meeting. The Fed doesn't need rising inflation or wages to hike, they just want inflation not to be falling. The challenge for us and for the Fed is to extract a signal from all the noise.

Meyer thinks we will be at full employment by September. If not for the oil shock, PCE inflation would be around 1.6%. In the Q&A, I asked him why the Fed fixates on 2% inflation. Why not 0%, 1%, 5%? Larry said the 2% target gives the Fed a cushion to cut rates if it wants to. Monetary policy at the zero bound is not an effective tool.

Grant Williams and Raoul Pal then did a tag-team session presenting what I thought was one of the most interesting ideas of the conference. A monsoon is a wind that blows through South Asia. It brings rain and once blew ships along ancient spice routes. Raoul and Grant presented a long-term forecast about what they call the monsoon region: South Asia and parts of the Mideast, East Africa, and Southern Africa, which they believe will be the next major growth region of the world.

The monsoon region has significant metal/mineral wealth, oil, fertile soil, and a young population. Demographics are on its side. The region is much younger than other areas of the world, with fewer old people to support. They referred to two McKinsey consumer growth studies, on "City 600" and "Emerging 440," which emphasize this region. Grant and Raoul see opportunities everywhere:

> Ethiopia – gangbuster growth, cotton resources, could replace Bangladesh as an apparel manufacturing center.
>
> Iran – high literacy rate, educated population, no debt (since it has been locked out of markets so long), and low P/E multiples because everyone shuns it. At some point the past will be shed, and the typically outward-looking Persians will turn their nation back into the trading mecca it has traditionally been.
>
> India – with a huge population and, finally, a leader (Modi) who seemingly gets what needs to be done, is simply the giant of the region.
>
> Morocco – bridges MENA with Europe and is the gateway to Algeria's resource riches. I thought this was a very interesting idea, and I may just need to go to Morocco for myself. Marrakesh, anyone?

Bond guru Jeffrey Gundlach spoke next and titled his speech "To Raise or Not to Raise?" His slides showed that June 2014 was a key turning point. Lots of things changed around that time: the dollar, Europe, oil, and the Fed.

"When will negative rates change behavior?" he asked. Yields are negative due to lack of supply – there is no net issuance anywhere in the developed world. Fed funds futures indicate no hike in June, and Gundlach agrees. In contrast with Larry Meyer, he thinks there will be no rate hike this year and the Fed will let the economy "run a little hot." The US dollar will stay strong, in a 10-year uptrend, with commodities generally weak, except that Gundlach said he likes gold. I wasn't doing the Q&A for that session or I would have asked why he is bullish on gold and the dollar at the same time. Bullish on gold in terms of euro/USD unity I can understand.

He points out that cross-border CPI comparisons fail because of differing methodologies. In concert with Lacy, he says that nominal GDP is a great indicator of long rates. CPI is a squishy and arbitrary statistic, but it isn't rigged.

With this next thought from Jeff I'm in total agreement: bond markets will fall gradually, then suddenly. Rates are already rising. Gundlach is still defensive on bonds and thinks too many investors are embracing them. High-yield will get cheaper after the first Fed tightening. He says he will stay out for now and buy HY later when it's cheaper.

"Everything you know about high-yield bonds is wrong," he said. He likened all of us to summer insects – we never seen high-yield in a ***major*** tightening cycle because the last one was already past when Milken invented HY. Current default rates are deceptive – he expects big problems when issuers have to roll over at higher rates. Going from 5% to 14% will kill some companies. (Briger mentioned something that goes along with this idea as well.) He expects the biggest problems for high-yield to be in the 2019-2022 period.

On a separate note, he thinks the federal budget deficit problem will return, but there is one glimmer of hope: household formation is picking up, which should help tax revenue.

Stephanie Pomboy was our next speaker, and she gave one of the more entertaining presentations of the conference. When we make it available, you really want to set aside some time to watch it. And I guess it was good that she was entertaining, because she was definitely the most bearish of our speakers. She thinks economic growth will stay low and that the consumer is still not back. The Fed will not tighten this year and may even launch QE4.

What would trigger a recession? She thinks it's a function of whether the stock market sees a sharp correction. In that she agrees with me, as I have wondered sometimes over the past year (in this letter) whether we might see a reversal of the usual bear market pattern: normally we see a recession coming, and then the stock market rolls over. Could it be that this time the market will roll over for reasons outside of the US economy and that will trigger a recession in the US? It's just a question, but it seems to be on Stephanie's mind as well. And, of course, she likes gold.

My friend George Friedman was our lunch speaker, and he was in rare form. It's been a few years since we've had him at the conference, but he is always a crowd favorite. He has just completed an excellent book on Europe called *Flashpoints: the Emerging Crisis in Europe*. In *Flashpoints* he talks about the frictions in Europe and why they won't go away anytime soon. The problems are as much cultural as economic or political. George started out talking about the process of creating jobs in Europe and described the regulatory nightmare that is the European Union. "You don't hire employees in Europe; you adopt them."

The regulatory regime in Europe prevents entrepreneurialism. There will never be a Google in Europe.

The Enlightenment was real, George reminded us, but it didn't eliminate war. Rather, it intensified war as ever-greater technologies made war even more destructive. He took us back to pre-World War I, when books were being written about how Europe had become too civilized for war. I've talked about how European bond markets, almost until the very first WWI engagement between France and Germany, discounted the possibility of war.

George asserts that PIIGS bonds won't be repaid in any conventional sense. The only question is how long they can paper over the problems and stave off political upheaval. He cautioned us to stop thinking of Europe as a single entity, because it isn't one.

In the Q&A period he was asked about Russia. He believes that Putin has become a figurehead for the oligarchs. He sees potentially bigger danger ahead when the country starts to fall apart in the 2020s but still has nuclear warheads. This thought provoked a low groan from the audience. Russia – the crisis that keeps on giving. (I will have an afternoon get together and then dinner with George and wife Meredith next Friday here in Dallas, and I am really looking forward to grilling him on a few topics.)

Next, we stayed with our geopolitical theme, and Ian Bremmer gave one of the best presentations of the conference in terms of simple delivery and keeping the crowd focused.

You could summarize his view as, "The geopolitical situation is bad."

- The US is no longer helping allies as in the past. The US is not becoming isolationist – more like "unilateral."
- Transatlantic relations are the worst in 30 years. As an example, the Netherlands hired Huawei to rebuild its internet backbone, showing that they are keeping their options open.
- Russia is declining, but Ukraine has been a big domestic success for Putin. His 80%+ approval ratings are real. We underestimate Russian resiliency. Sanctions will backfire and leave Putin with a desire to punish the US. Kerry didn't exactly come back from the latest summit with any positive developments. Ian expects more Russian military probes and "accidents" around the NATO periphery. Putin is very dangerous: back him into a corner, and he *will* jump out and bite you.
- China rising – a 30-year trend. It's the only country with a coherent global strategy. He worries about long-term Chinese stability but thinks we should be OK for another 5-10 years.
- "Globalization is proceeding. Americanization is not." That is one that made me think.
- The Cuban government survived 30 years of sanctions but will not survive 3 years of Starbucks. Once you give people a taste of what could be, they are going to want it.
- He sees India becoming more assertive and is rather positive on India. Beijing is trying

to counter with its New Silk Road initiative.

What could change his forecast? Three possibilities…

- China overplays its hand
- Middle East war – likely Saudi vs. Iran
- Iran nuclear pact implementation problems

During a free-fire question-and-answer session he gave us the following bullet points:

- Saudi reforms are over with the recent changes at the top. Their FX reserves won't last forever.
- Russia's and Iran's cyberwar capacities are danger points.
- He is optimistic on Brazil as SOEs reform.
- The US will earn a geopolitical risk premium, but only because everywhere else looks even worse. The main US problem: our allies don't trust us. The Asian Infrastructure Investment Bank proves it.
- The US is in real danger of losing currency reserve status unless we counter China soon.

DDD: Buy the Dax, Hedge It in the Dollar, and Be Done

For the last five years that I've been following David Zervos, the chief market strategist for Jefferies, he has developed a theme for investing in the following year. He is on an uncannily good roll. All the themes have been built around the concept of investing in the era of QE. In his conference presentation he explained that he felt the US is now too complicated, but we know what happens with QE, so let's go where we are seeing QE: Europe. The simple way to structure the trade is to buy the Dax, but in dollar terms, so you hedge the euro in the dollar and you are done – call it a day. So far that has been a good trade for the year.

My good friend Kyle Bass was our Friday night dinner speaker. He asked me to keep his presentation private, although he did share it with the attendees. He has agreed to let me write about his concept of shareholder activism in the hopefully not too distant future. I feel comfortable sharing that he touched on the progress he is making in challenging what he believes is out-of-control manipulation by the pharmaceutical industry in regards to patent protection. Did you know that it is actually illegal for Medicare to negotiate drug prices? I didn't. Blame both Bush and Obama and a very powerful lobby. How do you get it written into law that the federal government has to pay whatever price you want? I guess by spending billions in lobbying fees. He mentioned that the US could save $300-$700 billion per year over 10 years if we paid the same prices Canada now pays for the very same drugs. Even more if we paid what Norway pays. Talk about a way to balance the budget!

Saturday morning we started off with Michael Pettis, who is not as bullish on China as Louis Gave is. Pettis is a Beijing-based economic theorist and financial strategist. He is a professor of finance at Guanghua School of Management at Peking University in Beijing. He was founder and co-owner of punk-rock nightclub D22 in Beijing, which closed in January 2012. He produces records for a lot of very innovative Chinese groups, so I guess you could say he is an economic rock star. He has one of the most eclectic and fascinating minds of anybody I've ever conversed with. He is also deeply embedded in the Chinese culture and government thinking. When Michael Pettis speaks, you need to listen. It is a little hard to summarize his fascinating lecture in a few paragraphs, but I will try.

China has seen many recent innovations, but there is a lot of confusion surrounding them. The Chinese government has three goals: slow down credit growth, keep the employment rate high, and repair the national balance sheet and simplify the debt structure. (Note: Chinese government-backed debt has risen precipitously in the last 14 years and even faster in the last 7. It is simply an unsustainable trend, and the Chinese government knows it.)

There is a need to restructure China's financial system to keep debt within servicing capacity. (Note: we saw the beginning of that restructuring this week as the Chinese government began allowing local governments to issue low-interest long-term bonds to substitute for bank debt. The beginning tranche is rather small compared to the size of the debt, but I think this process will be repeated continuously. I wonder what creative financing we will see for the massive corporate debt, which is over four times larger.)

It is politically difficult to impose reforms, but the Chinese must bring investment down and consumption up. That means shifting money away from tycoons and to more productive uses, which will be resisted by the people who are currently benefiting, which means, the hierarchy of the Communist Party. He gave us a little insight into Chinese culture, countering some myths by noting that "Confucians don't save." There is actually a need to increase the savings rate. Financial repression acts as a tax and is a killer for the economy.

CPI is not a good inflation proxy in China – use the GDP deflator instead. Capital is cheap, so companies use too much of it, which creates a great deal of nonproductive spending. Michael thinks China can sustain 3-4% annual growth IF everything goes perfectly. The world is not prepared for a Chinese economy that grows at only 3%. He points out that metal commodities are screwed, but food commodities should do well, as even at 3% growth the demand for more protein and food in general will increase.

The Failure of the Central Banking System

It is hard to say what my "favorite" presentation was, as there were so many excellent ones, but Bill White's would certainly be on a very short list. He was the former chief economist at the Bank for International Settlements and is now the chairman of the Economic Development and Review Committee at the OECD in Paris.

Bill may not be as familiar to some of my readers as he is to me, but he is one of my economic heroes. A little history: Bill predicted the financial crisis of 2007–2010 before 2007's subprime mortgage meltdown. As early as 1996 he was one of the critics of Alan Greenspan's theory of the role of monetary policy. He challenged the former Federal Reserve chairman's view that central bankers can't effectively relieve the causes of asset bubbles. On Aug. 28, 2003, White made his argument directly to Greenspan at the Kansas City Fed's annual meeting in Jackson Hole, Wyoming. White recommended to "raise interest rates when credit expands too fast and force banks to build up cash cushions in fat times to use in lean years." Greenspan was unconvinced that this would work and said, "There has never been an instance, of which I'm aware, that leaning against the wind was successfully done." If you're not willing to take a little political heat, which clearly Greenspan wasn't, then we may never know whether that would work. However, I disagree with Greenspan: I think that Volcker leaned quite successfully. Yes, there were recessions, so you might not see that as successful, but I think the long-term positive results of Volcker's moves are evident.

That is the problem with having a monetary policy that is influenced by the political temperament and decisions of a small group of people. What happens is that people look around for scapegoats when a recession comes along, and they will point to a central bank that wasn't as accommodative as they would have liked and blame the bank, rather than simply understanding that the business cycle is what it is. Bill White is my favorite central banker.

Central bank models, he told us, are artificial machines. His best quote was, "The basic problem with central banks: they think they know how the economy works." Their models are built to be gamed and always assume a return to equilibrium. But there is no equilibrium – you are where you are. The problem with equilibrium models is that they don't reflect reality.

An economy is like a forest ecosystem, not a machine. We are on a very bad path – debt is unsustainable. Notice the environment since the 2008 crisis: the Eurozone crisis is a limited variant on a global crisis; fiscal and regulatory restraint is not helpful; and monetary policy is the only game in town and is not effective.

Does White expect better days ahead? The IMF and OECD expect modest expansion – but they have very poor forecasting records. Why should demand suddenly strengthen?
Is low inflation really so great?

Looking around the world, Bill thinks that Abenomics could backfire. Can China adapt to a new growth model? Can the Eurozone sustain confidence? Political problems are everywhere (which Friedman and Bremmer highlighted!). It is much easier in today's world for a crisis to spread worldwide because we have increasingly complex systems with far more linkages and rising correlations.

OECD simulations indicate global fragility. Rising rates still threaten fiscal reform.
Bill was very critical of the seemingly single-minded focus on monetary policy. Monetary policy hasn't delivered, and more of the same won't help. He offers three endgames:

- Endgame 1: global recession, policy and long rates stay low, debt deflation, more aggressive monetary policy and hyperinflation in some countries. Japan is very vulnerable in this scenario.
- End game 2: Rapid growth with an orderly exit from debt. Rates rise, inflation under control, debt-servicing problems diminish.
- End game 3: Rapid growth with a disorderly exit: long rates rise sharply, a rush to exit

from all risk assets, capital outflows from emerging markets, inflation expectations rise sharply, debt service problems increase, inflation fears fueled by fiscal dominance.

In the Q&A session Bill and I talked about the nature of current economic thinking and why it is inadequate. Independently, we're both beginning to look at a new way to understand markets called Complexity Economics. It has several sources, but the current center of gravity is the Santa Fe Institute in Santa Fe, NM. I may be "forced" to go spend some time in Santa Fe, burrowing into this new way to look at economics. It is significantly more complex, as you might imagine, than equilibrium models are; and it will therefore be even harder to create models that actually work, but it is certainly a place to start. By the way, the whole theory of complexity and complexity mathematics is reshaping a number of intellectual areas besides economics. Stay tuned.

Thinking over what I heard some 10 days ago, the questions that I wish I had asked many of the presenters center around the potential of a liquidity crisis should another event occur along the lines of what happened in the US in 2008 or in Europe in 2010. Because of the new regulations, especially Dodd-Frank, there are those who are beginning to suggest that the current situation might even be worse than in 2007. Can you see the irony? The very regulations that were supposed to prevent the next crisis will be at the root of it instead. There's a lot to ponder.

As I mentioned above, I hope we can start to give you a link to a different conference presentation every week. And for those of you who are wondering about the next conference, mark your calendars for May 24-27, 2016. I will make sure you get an early chance to register next year. And as a final thought on conference design, the Strategic Investment Conference has always been a place for networking. Next year, we're going to add some pizazz to the networking potential. It turns out there's an app for that. You are not going to want to miss what will be the best macroeconomic AND networking conference of 2016.

If you want to see other people's notes on the conference you can go to Chris Bailey's excellent conference notes, grouped by macro theme. Here are links: Day 1, Day 2, Day 3.

And my good friend Steve Blumenthal (who noted that we have been friends for over 15 years now – wow, where did the time go?) also wrote up his thoughts from Day 1 and Day 2.

Raleigh, Atlanta, and lots of NYC, the Boonies in New Hampshire, and Vermont

I am on my way to North Carolina as I finish this letter, first to spend some time with friends (some of my more religiously inclined readers may remember Bob Mumford, who is a friend, true mentor, and long-time counselor, now retired in the Raleigh area), then to speak for the Investment Institute in Raleigh, and then to participate in a Galectin Therapeutics board meeting in Atlanta. I'm going to New York the first week of June, where I will participate in the closing bell at the NYSE (and hopefully catch up with Art Cashin and the Friends of Fermentation afterward) and have a few special dinners before flying up to New Hampshire with Gary Shilling, where we will be speaking with a number of friends at a private retreat in the boonies. From their description it sounds like a slice of heaven! I will then somehow get to Stowe, Vermont, to meet with my partners at Mauldin Economics.

Then Jack Rivkin has just about convinced me to spend a month in NYC starting in mid-June to work on a new process out of Europe that is geared to helping you increase your focus and concentration, which is something I desperately need. Jack swears it works. It doesn't take much time each day, and I have always wanted to spend some time in NYC just getting into the feel of the city. That means I will need to find a two-bedroom apartment to rent for a month. I know the usual places to go hunting for one but thought I would see what my readers might be able to point me to. Drop my keeper/associate Mary@2000wave.com a note if you have an idea or a spare Park Avenue penthouse suite.

My daughter Melissa did her cancer therapy with no real side effects, and a few days later she went in, and they checked and gave her an all-clear report. Dad is happy.

OK, I confess. Sometimes I just get on planes and go where my staff tells me to go. I trust Mary and Shannon to have all the details in my calendar. I really should pay more attention in advance, but I guess it is part of that focus and concentration thing I need help on. Anyway, I agreed to speak at this Raleigh conference because Mark Yusko (of Morgan Creek, who is based in the area) asked me. They want me to speak on the future and impact of technology. I just this second looked at who else is speaking and found out a bunch of my friends are speaking there. It has been too long since I have seen Dennis Gartman, although we talk over the phone a lot. Raoul Pal and Kyle Bass, who were at my conference, will be there, too. I can't remember the last time I was with Don Lindsey of Strategas. My only real problem with listening to Mark is that I want to give him all the money in my checking account when he finishes. The list of attendees is impressive; this will be fun.

It is time to hit the send button. Next week I will be joined here by our newest editor, Jawad Mian, as we debate cyclical versus secular trends. In the meantime, call or go see an old friend or two and catch up this week. I will be doing just that.

Your thinking about the future a lot lately analyst,

John Mauldin

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