Economics in Orbit

By John Mauldin | May 29, 2020

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The history of humanity, at least as taught in most schools, is really about two seemingly opposite forces: human innovation and human conflict. The same intelligence that lets us accomplish great things also sets us against each other. But sometimes, we rise above it.

Last week I saw on Twitter (where you should follow me, by the way. Seriously. I am really getting into late night Twitter as my relaxing/learning/commenting time, something I never expected), someone saying the COVID-19 pandemic may be the single most "global" event in human history. It's happening almost everywhere, to almost everyone, at about the same time. That idea made me look for other examples.

The 1969 moon landing came to mind instantly. Yes, the astronauts were American but it was about humanity: "One giant leap for mankind." People around the world experienced it together, as best as the day's technology and politics allowed. For a moment, at least, other conflicts faded away.

Now in 2020, we badly need another such moment. The pandemic may be global but it's not pleasant or unifying. So I, for one, looked forward to Wednesday's SpaceX rocket launch. Not only because it was going to be our country's first manned launch in years, but the first time a private company sent humans into space.

I grew up reading science fiction novels in which such scenes were common. SpaceX had to scrub the launch due to bad weather, but they will try again Saturday. We will see what was once science fiction actually happen again. And not just happen, but happen in the middle of this otherwise awful time.

To me, this is a metaphor of renewal. Great things can emerge from the ashes. We will get through this, and we will have a better world. I know it will be hard to understand from reading this letter, but I am strangely optimistic and looking forward to the future, uncertain as it may be.

Today I'll share some more insights from the Virtual Strategic Investment Conference. Frankly, I could go on for weeks like this, but this is going to be my last letter on the SIC. We had so much expertise and wisdom beamed in from all over the world. I'll give you a few more highlights and then offer my own personal takeaway.

Fireside Chat

Last Tuesday we started with a kind of fireside (virtual) chat, moderated by me, between my favorite Irish and Scottish thinkers, both dear friends who dearly love to tweak each other. On the Irish side was David McWilliams and representing Scotland, Niall Ferguson. They are both economists. David is more of a central banker type and Niall is an economic historian.

We began by looking at the present pandemic historically. We know of 60 or so worldwide infections. Measured by the number of deaths (so far), this one isn't in the top 10. But economically speaking, it already rivals the Great Depression of the 1930s.

Niall believes the US response to the coronavirus has turned a mid-sized pandemic into a catastrophe. Unlike war, which is typically inflationary because it stimulates demand, pandemics suppress demand. In his view, the economy will be slow to return as lockdowns end, leaving the world in a generally deflationary environment.

David pointed to another consequence: The pandemic quickly redefined the kind of policies we will accept. Ideas that just months ago sounded radical now seem reasonable. That means we can expect more radical responses as this crisis continues, and even more in future crises.

(By the way, both George Friedman and Neil Howe expressed the same opinion, stated differently, as David.)

We moved on to discussing debt. David observed debt is unsustainable without a level of growth which now looks out of reach, so we will certainly have a problem. Niall agreed but doesn't expect the US or Europe to move toward debt forgiveness or mutualization. He thinks we will simply turn Japanese and have central banks buy the debt with excess bank reserves, so it would not be inflationary. David wasn't convinced this is possible, given big social differences between the US and Japan.

We talked a little about the US election, from their perspectives as foreigners. Niall posited an interesting scenario in which the stay-home orders and business closures become campaign issues. Generally, Democrats favor more stringent controls while Republicans want to get back to normal (though there are certainly exceptions).

Niall said one of the divides will be “the party of the lockdown versus the party of open up.” Never mind whether that is reality. It’s a political talking point. And depending on what the virus does, it could favor either party at this point. We have never seen anything like this so it’s guesswork to say what would happen.

This saddens me. The pandemic and the virus shouldn’t be political issues. But I think Niall is right; politicians will use the situation if they think it will help score points. And since this election will likely be decided by a relatively small number of marginal votes in a handful of swing states, we will see a number of issues, including the virus, used as political fodder. It will not be one of America’s prouder moments.

Rapid Fire

Next up was Mark Yusko with one of his trademark slide presentations. This one was 235, yes, 235 slides, all important and fascinating. He blasted through them at an astonishing pace. You have to see it to believe it.

Pro Tip: Watch Yusko’s presentation, which will frustrate you because he goes through the slides so fast. But absorb his general ideas, then go back and look at his slide deck independently. Then read the transcript. There is actually a lot of gold in his presentation, sometimes literally, as he is a big gold fan (versus fiat currencies).

The “10 Potential Surprises” in Mark’s title weren’t predictions, as such. He describes them as variant perceptions, out-of-consensus ideas he thinks have a better than 50% chance of occurring this year. But there’s also a reasonable chance they won’t.

I can’t even begin to capture Mark’s lightning-fast style but here’s a quick outline with my parenthetical comments.

- #1: Interest rates continue to fall, go negative globally, and defy the “rates must rise” crowd. Best trade: Chinese long bonds. (Other presenters mentioned not only China but other foreign bonds as well. Norway comes to mind.)

- #2: Killer Ds: Demographics, Debt, and Deflation. Think they have been vanquished? Not. Central bank debt creates the illusion of growth, not the real thing. (Mark agrees with Lacy Hunt that excessive debt inevitably slows growth. Lower growth leads to lower earnings which leads to lower stock prices. We are in what he feels is at least a deep recession, with the potential to be a depression.)

- #3: Passive Investments Will Get Slaughtered. Stocks are 90% overvalued, which means they need a 50% decline. Multiple expansion was responsible for all of 2019 stock gains. We are still 18 months from the economic and market bottom. (Note: This was not a conference consensus opinion. Leon Cooperman and Doug Kass, among others, mentioned stocks they were buying. That being said, I agree with Mark in that passive index investments will not be where you want to be. The 2020s will favor active management once again.)

- #4: Make Volatility Great Again. 2019 was the longest-ever streak of low volatility. Stocks losses were outlawed. Buy the VIX (VXX) to protect yourself.

- #5: Wars Have No Winners. In a race-to-the-bottom currency war, everyone loses. Gold is the world’s best currency now. We are at war, so swap paper for gold. The US dollar will probably break down, as the Fed actively tries to weaken it. (While I think the dollar will go lower, I certainly would not use the words “breaking down.” Against what? Maybe gold. But I buy gold as central bank insurance, not as an investment. Though I do agree with Mark that it is probably time to buy a little more “gold” insurance.)

- #6: All’s Shale That Ends Shale. The Saudis are trying to put US shale producers out of business. US oil production falls to around 9 million barrels per day. (Again, that may be true for a while. Having grown up around the oil patch and crazy wildcatters, I am not sure how long it will last. Oil is increasingly a technology play as getting it out of the ground becomes less expensive. Ditto for natural gas.)

- #7: Abe-san Needs a Bigger Pump. Japan is the best money printer in the world, yet it suffers deflation and not inflation. Japan economic indicators are falling. They must devalue the yen.

- #8: Draghi Goes Out with a Bang. The ECB has tried everything and it hasn't worked so of course they will get even crazier. (Christine Lagarde starts screaming for more cowbell and the EU Commission responds with €750 billion stimulus fund. Watch that number rise.)

- #9: China Playing Go. China and emerging markets are where the growth is now. Invest in China as Asian consumers will become half of global consumption. China is integrating with the world, and it will win the trade war. In China you get twice the growth at half the price. (Color me a tad skeptical. First off, nobody wins a trade war. I agree emerging markets will be where the growth is, overall. But the US will have growth opportunities. Europe will have smaller but still significant numbers. Again, if you want to play in this world, you're going to need managers familiar with the local markets and not just buy indexes. Paying for that expertise is no different than paying a dentist to work on your teeth. It will be money well spent.)

- #10: Remember the Golden Rule (He who has the gold makes the rules). Real assets are better than paper assets over the long term. Every currency throughout history has gone to zero. Gold will continue to surge. Gold in Chinese Yuan may be the trade of the century. Gold and silver miners are super cheap—juniors even cheaper. The new "FANG" are all gold stocks.

  (Talking about every currency in history going to zero brings "survivor bias" to mind. Certainly the Swiss franc is not going to zero, nor the Norwegian kroner or numerous other currencies still hanging around after centuries. Yes, the dollar has depreciated, but numerous investments have far outperformed gold on whatever basis you want to judge. Again, gold is central bank insurance. And while we probably need more of that insurance in these times, that still doesn't make it an investment. (And to be fair to Mark, I don't think that he would suggest gold is his number-one investment. He has too many companies on his list. I call it insurance and he calls it a position. Same difference.)

- #11: Bonus. Bitcoin is the scarcest asset in the world. Buy Bitcoin. It is uncorrelated to all other assets. Put 5% into Bitcoin.

Fireworks Show

We wrapped up Thursday with a closing panel, ably moderated by Karen Harris and featuring David Bahnsen, Louis Gave, Mark Yusko, and your humble analyst. Fireworks went off almost from the first minute.

Karen began by asking us to imagine, one year from now, what one thing will we look back on and wish we had understood. The answers:

- Louis Gave: We have seen the low in oil and a high for the US dollar.

- Mark Yusko: Every interest rate on the planet will go negative. (I am not sure what he means by that. If he's talking in real inflation-adjusted terms, then I can understand. But there are numerous countries that will go nowhere near actual negative rates.)

- David Bahnsen: The Fed will avoid negative rates and less-leveraged companies will have been good buys.

Next year we will see who was right.

Karen next asked what I was taking away from the conference as a whole. I described what I call the "Rocky Mountain Recovery," with peaks of different sizes rising above the plains. We will need to aim carefully, and will probably do better buying the best entrepreneurs instead of looking at companies. I'm optimistic we will get a coronavirus vaccine fairly soon, speeding along recovery, but then we will be back to the same problems we had before.

Louis Gave took issue with me on entrepreneurship. As he sees it, the interventions and bailouts are teaching small entrepreneurs they are at government's mercy and may be better off working for large companies (that will get bailed out) or the government itself. He thinks we will come out of this with a much bigger government footprint than before.

Then we turned to China. As noted above, Yusko thinks China is winning the trade war and the US will never regain its lead. He thinks the Cold War rhetoric is "dumb" and disinvesting from China "idiotic." In his view, Trump trade policies are as bad as the 1930s Smoot-Hawley tariffs and we are now on the edge of doing it again.

David Bahnsen disagreed. He believes Trump is only jawboning and won't actually make good on his trade threats. He expects more trade with China, not less, to the benefit of both countries.

(Note this conversation happened before Beijing's latest move against Hong Kong and the developing US response.)

We wrapped up with a haunting idea from Louis Gave. Referring to current US policy, he asked what happens when you cut yourself off from the world? Among other things, foreigners lose interest in buying your debt. He expects the world to break into three economic zones, centered around the US, Europe, and China, and within them the self-funding countries to gain an advantage. Where that leaves the US is unclear, but it may not be good.

Again, you can still be part of the SIC with our Virtual Pass.

Some Final Thoughts

Let me list just a few of the things that have come across my desk in the last few days that now have special poignancy.

Barry Ritholtz did an interview with Jon Taffer, who hosts a reality TV show called *Bar Rescue*. Since I don't watch TV, I had never heard of him. Turns out lots of my friends have. Barry is simply a brilliant, gifted interviewer and Taffer is an expert on bars and restaurants.

Essentially, he lays out the simple business realities of owning a bar or restaurant. These are not typically high-margin businesses. The bar is often the profit center for restaurants that have active bars. Now social distancing rules simply prohibit a functioning bar in the way we know it.

Taffer thinks that 30 to 40% of the restaurants in the US will not make it. He also points out that the PPP small business aid program helps with payroll and rent, but many will also need cash to restock food and beverage inventory.

I encourage you to read the hard numbers and then think about it. Many ancillary companies depend on working restaurants. I think Taffer is right and that means (optimistically) another 3 to 4 million jobs lost. They'll come back eventually after entrepreneurs raise money and start over in a new world. But in the meantime…?

Then think about all the other businesses in similar circumstances. Hotel and travel and tourism? Small industries like Chucky Cheese and all the businesses designed for kids' entertainment for birthdays and so forth? Wedding venues? Luxury spas? No social distancing there. Scores of small industries are going to be devastated. Will they come back? Yes. But when and who will be doing it and where will the money come from?

This week's Federal Reserve Beige Book reported the problems employers are having enticing workers back when they are making more on unemployment than they did while working. I have no easy answer because there are none. These are the unintended consequences of good intentions.

Yesterday an article from Harvard professor Lawrence Katz crossed my desk. He was trying to be optimistic, pointing out that 78% of unemployed workers are in the "temporary layoff" category. Quoting from the interview:

> The good news is that economic recoveries are typically faster when a larger share of the unemployed are on temporary layoffs. On the other hand, my past work with Bruce Meyer has shown that unemployed individuals who initially view themselves as being on temporary layoff but who don't get recalled to their previous job (i.e., end up being permanently displaced if their previous employer goes out of business or permanently closes their unit) end up experiencing the longest jobless spells and largest earnings losses.
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> A major worry is that many (especially small and medium-sized) businesses are at risk of not surviving an extended pandemic downturn. Thus, a substantial share of those currently on temporary layoff are likely to become permanent job losers.

Neil Howe does a daily demographic newswire. Quoting from yesterday's:

> One study published last year, which followed college graduates who entered the labor market after the 2008 financial crisis, found that by 2018 those who had begun working in 2010 and 2011 had a lower employment rate than people at the same age who graduated before the recession hit. What's more, those who were working earned less. The author, Jesse Rothstein, contends that the slow speed at which this cohort's employment rates have recovered suggests that they will continue to feel the effects for "decades to come."
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> Another recent study focused on Americans who entered the labor market during the early 1980s recession—that is, late-wave Boomers and early-wave Xers. The researchers followed the trajectory of college graduates as well as high school graduates and dropouts through midlife. Not only did all of these groups earn less in midlife than those born just before and after, but they were also less likely to be married, more likely to be divorced, and less likely to have children. In addition, they had increases in mortality that began in their 30s and further worsened through age 50, which were driven by heart disease, lung cancer, liver failure, and drug overdoses—Case and Eaton's "deaths of despair." These researchers found that while the initial gap in earnings did fade over 10 to 15 years, it reopened when people reached their late 30s and stayed negative until age 50.

Scars from the Great Depression

This all brings to mind the scars that our parents and grandparents felt from the Great Depression. It led to what we now call the Greatest Generation. But the Greatest Generation came out of the roaring '20s, and then lived through the Great Depression.

I don't think the current recession/depression will last anywhere near as long as the Great Depression, but I do expect it to scar this generation just as much. That is both depressing and hopeful, because in the end it gave us a leap into the future.

This is truly going to be the Rocky Mountain Recovery. Some sectors will boom, others struggle in the valleys before rising. There will be no V's or U's or swooshes or other simplistic metaphors. It will have exhilarating moments but also hard work and struggles. We will all need to help those who struggle. This is beyond what government can do. It will depend on what we do as individuals.

If you can, find a few people to personally invest your money, time, and resources in. Help them get back on their feet. To my fellow Boomers and entrepreneurs: Take some time and mentor a few people to help get the country going again. Do it in your own backyard in whatever ways you can.

Given the economic, geopolitical, political, wealth, and income disparity climates, not to mention racial tensions, it's easy to despair right now. Don't. And for God's sake, recognize that in addition to COVID-19, the leading world poverty and hunger authorities tell us that between droughts and locusts and economic woes, millions of people around the world face starvation in the next few months. We have to remember them and help.

I know it sounds like a lot. And you can't do everything. But you can do what you can do.

I started this letter talking about the SpaceX rocket launch. The astronauts it carries into orbit will have an entirely different perspective. We discussed the world in pieces, as if China and the US and Europe are far apart. But from space, they aren't far apart at all. Astronauts see all three within the same hour. They get the ultimate macro view.

We truly are one globe of humanity. If only we could all get that same view. Someday, we will. And maybe sooner than you think.

Time to hit the send button and wish you a great week!

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