GLOBAL MACRO UPDATE

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What the *WSJ* Gets Wrong About China, with Louis Gave

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Ed D'Agostino:

Few people have a better understanding of global investment markets than Louis Gave, CEO and co-founder of Gavekal Research. He spent decades in Hong Kong building his research firm, and he oversees the firm's money management business. He is always one of the most popular speakers at our annual Strategic Investment Conference.

Today, Louis and I discuss US government debt. Does it finally matter? We'll also get into US-China relations and Louis's top investment ideas.

If you haven't already, please subscribe to our YouTube channel. We're so close to 20,000 subscribers, and I'd like for you to join us in the conversation. Now, let's catch up with Louis Gave.

Louis, my friend, it's always good to see you. First thing I want to ask you about is are we finally at the point in the United States where debt is actually starting to matter?

Louis Gave:

It's that old Ben Stein rule, right? If things can't go on, they won't. Look, great to be here, Ed. I always love catching up with you. Thanks a lot for having me.

I think that's the right question. I think this is undeniably the most important question right now. I think if you look at the past month, the TLT is down, what, something like 9% or something—the long-dated US ETF—frankly on fairly low news. Right? It's not like we've had the Feds say anything. It's not like we have a political crisis in the US. We've had the debt ceiling thing pass, what was it, back in March, I think, on basically no news whatsoever.

In fact, inflation data looks like it's been softer and rolling over. Growth hasn't been that strong. All of a sudden, out of the blue, US Treasuries, at the long end, puke out 9%. And this is the single most important asset class in the world, the deepest, most liquid market. And is it pricing in higher inflation? I don't think so. Is it pricing in much stronger growth? I also don't think so. So, what is it pricing in? Is it pricing in the fact that the fiscal situation in the US is getting too stressed?

And here, I'll just throw a couple numbers your way, going back to this Ben Stein rule. If you look at the US, the US is roughly 4% of the global population. The US budget deficit today is 40% of the world's budget deficits. So you add up all the world's budget deficits together, the US is 40%. And if you add up all of the world's current account deficits, so you take all the countries that have current account deficits, the US is now 60% of the world's current account deficits.

So 4% of the world's population makes 40% of the world's budget deficit, 60% of the world's current account deficit, which means that... Concretely, what does that mean?

That means that to keep the show on the road, the US has to attract, year in, year out, roughly between half and two-thirds of the world's marginal increase in savings. If that money, between roughly... Let's say two-thirds of the world's savings don't float to the US every year. Then you're either going to have a problem with the debt or a problem with the US dollar.

And maybe we're there. Maybe that's where we are now, where the US fiscal situation has been such where it's like, "You know what? We're going to pile in a trillion and a half of additional debts every year while our interest costs rise by 300 or 400 billion dollars additional every year." The numbers just start getting too big. It's too big for the foreigners to fund, it's too big for US private savers to fund, and it's too big for even the US commercial banks to fund. Or at least, it's too big for them to fund with an inverted yield curve because why would US commercial banks run out and buy the long end of the yield curve when the yield curve is that inverted?

So now, what strikes me is that all this was very visible six or nine months ago, which is why I think when we last talked, I said, "I'll be like Saint Thomas. I'll believe QT when I see it." Genuinely, I was looking at these numbers, and I thought, "No way can the Fed back off because if you do, you're going to get a funding crisis in the US at some point."

But the Fed did back off. I was wrong. The Fed did back off, and now, bond yields are creeping up. And they're creeping up, of course, for the government. But actually, perhaps the bigger story, even bigger than TLT, is the mortgages. Long-dated mortgages in the US are now 7.5%. And I think they're at what, they're like a 20-year high. They're at levels we haven't seen since 2002.

So yeah, you look at this, and you think, "Okay. Maybe this isn't a problem because a bunch of people locked in low mortgage rates when mortgage rates were low."

But guess who didn't lock in their mortgage rates? Guess who didn't lock in their low-interest rates? The US government. And this was what makes this cycle so odd is corporates locked in the low interest rates, individuals locked in the low interest rates, and the government believed its own propaganda that interest rates would stay low forever and dramatically shorten the duration of their debt.

So it's actually the government that is seeing the interest costs go through the roof. So logically, in this part of the cycle, the government should be tightening its belt, but it's doubling down. So it's a very odd cycle, very odd cycle.

Ed D'Agostino:

Well, the other thing that I caught you comment on is inflation in the US and how the government can't really be taking inflation that seriously if, at a time when we've got historically low unemployment numbers—times are relatively great—and yet we're running these huge deficits. It makes no sense.

Louis Gave:

No. Look, hand on my heart, if, three years ago, you'd have told me, "Hey Louis, in 2023, the US government will be running budget deficits of 8% of GDP, and at the same time, the US will have full employment," I would've thought you wore tin hats in bed. I would've thought you were ready for the loony bin. But yet, here we are. Here we are, to your point, which does beg the question, "Well, what happens if and when the US hits a recession?" Because you know that each time there's a recession, the budget deficit deteriorates by 3% or 4% of GDP.

So we're at eight today. If tomorrow there's a recession—I'm not saying there is going to be a recession, I'm just saying *if* there is a recession, then you move to what, 11%–12% budget deficit? Then that means that all of a sudden, you're 50% or 60% of the world's budget deficits, that you have to suck in even more of the world's savings just to keep the show on the road, at a time when, already given the current numbers, you can't.

So the big problem is, at the next recession, who steps up to fund the increase in the budget deficit? And I think we all know the answer. There's only one guy in town who can do it, and he's speaking right now in Jackson Hole. There's only one guy who can do this. It's Jay Powell. So at this point, the only question becomes, "All right. When does the Fed throw in the towel and stop pretending that they're not going to fund the big increase in the US budget deficit?"

Because deep down, look, do you think central banks have two mandates or three mandates? If you think their mandates are price stability and employment, then you think the Fed doesn't do anything. I tend to think they have three mandates: price stability, employment, and financial market stability. And they've shown time and time again that financial market stability actually, in a crisis, it trumps the other two. The only question mark is, when does this happen? And once it happens, how much does the US dollar fold?

Ed D'Agostino:

Well, if the Fed steps in again, I mean, we're coming off of a period where—

Louis Gave:

When the Fed steps in again.

Ed D'Agostino:

Okay. So, when the Fed steps in again, they're going to be stepping in at a time where they've already let— Since its peak... I have a chart here. We peaked at just a hair under $9 trillion on the Fed's balance sheet. Just a hair. Maybe $100 billion, but what's $100 billion among friends? And they've let about $800 billion burn off, which is a humongous number. But when you look at it on the chart, it's just a little blip because the total stack of their balance sheet is so huge. How much do you think they can let burn off before they have to hit the pause button? Unfair question, I admit.

Louis Gave:

No, no. I don't know, but it seems to me that we're in go time right now. Again, mortgage rates of 7.5%. How high do you think they can go? Do you think they can go to eight? Yeah, maybe. Do you think they can go to nine? I think you start seeing problems. I think you've already started to see the weaker banks go by the wayside. Can you have many more banks go by the wayside?

Actually, I just dropped off my son in college, and he didn't have a US bank account. So we went to open him a bank account when I dropped him off, and we opened one with Chase. And out of curiosity, I said, "Oh, what's the interest on the savings rates?" And it was like 0.05%.

Ed D'Agostino:

No.

Louis Gave:

Not 5%, like 0.05%. The big money banks, your Chase, your Bank of Americas, et cetera, they still haven't raised their interest rates. So they're still sitting pretty, actually, those guys. I mean, if you can get deposits at zero and lend it out to the government at five, you're laughing. But of course, the more interest rates rise, at this point, why isn't every American just buying a mortgage bond at seven and a half instead of keeping money in a savings deposit, right? So how much more can it go? I would say, look, again, long bond yields have just gone down... I mean, TLT has just gone down 9% in a month on no news.

Ed D'Agostino:

Shocking.

Louis Gave:

Yeah. To me, this is telling me... And once again, TLT has gone down twice as much as the S&P 500. So once again, long bonds are doing precisely the opposite of what they're supposed to do. When you lose 5% on your S&P 500, you would hope that your long bonds would be up to a three and cushion the shock. You don't expect them to be dug down twice as much. So I think we're in go time now. The meltdown we're starting to see in long-dated bonds, that's the story. That's the story of the summer.

You wouldn't know it looking at the media. We've now had two covers back-to-back of *The Economist* start telling us about Chinese implosion. It's "China imploding." After six weeks of "Ukraine is winning every day," we now get six weeks of "China is imploding every day."

At some point, the media narrative will shift and be like, "Hold on. 7.5% mortgage rates are starting to dish out the pain."

But it's funny, we live in a world where media latches onto a narrative, keeps running with it for six weeks, and then moves on to the next thing. I think that the "China's imploding" narrative, which was the one prevalent for the next six weeks, is starting to run out of steam. The next one will be, "Hold on. These higher interest rates are starting to cause some real pain."

Ed D'Agostino:

Yeah. Everything that we just talked about gets very little coverage in financial media, let alone broader media. And yet, you're right. Every day, it's "China's on the edge of a precipice. China's got a debt explosion happening."

Louis Gave:

Meanwhile, on this—

Ed D'Agostino:

Go ahead.

Louis Gave:

... since I brought it up, but you picked it up, so I'll keep running with it. Funny story. If you look at Chinese bank shares over the past 12 months, they're basically flat. They're up marginally. They're up like 3% or 4%. If you look at US bank shares over the past 12 months, they're down 20%. So you're like, "Okay. I'm supposed to worry about..."

China is having this EM systemic crisis, but its bank shares are outperforming US banks. Its bank shares are outperforming US Treasuries.

What do you call an emerging market systemic crisis in which the local debt markets, the local stock markets, and the local bank shares all outperform US Treasuries by more than double digits? I think you can call it one of two things. You can call it either unprecedented—because it would be—or you can call it inexistent. You choose. But everybody is banging on about how China is going through this crisis. Iron ore prices are up 50% since late October. The LVMH share price is close to all-time highs.

It's like, all of the things you would look for in the market, if *The Economist* cover was correct, you can't see it. You can't find it. The Chinese stock markets have not been great. They haven't been, but they're still up between 10% and 20% from late October when China reopened. So it's not great. It's been disappointing. Don't get me wrong. It's disappointing, but it's not a systemic crisis. Let's keep the hyperbole in check.

Ed D'Agostino:

You wrote about what is under pressure in China right now, and it's essentially high-yield debt.

Louis Gave:

Yup.

Ed D'Agostino:

High-yield debt is under pressure.

Louis Gave:

But it's been for two years. High-yield debt—

Ed D'Agostino:

Yeah. And who owns that?

Louis Gave:

Yeah, yeah.

Ed D'Agostino:

Who owns those debts?

Louis Gave:

The high-yield debt market is broken. But to your point, high-yield debt market is all property developers that have issued a lot of debt. And remember, the government hates them, so they don't really want to bail those guys out. And that debt's been bought by foreign hedge funds, which the government also hates. And then it's like, I feel like I'm in a bizarro world, where you have editorials in *The Wall Street Journal* that are basically berating—*The Wall Street Journal*—the most red-blooded press of red-blooded capitalists telling the Chinese Communist government they need to intervene more in the economy.

Ed D'Agostino:

It is bizarre.

Louis Gave:

It's like, "I've taken crazy pills."

Ed D'Agostino:

Yes.

Louis Gave:

This is like the world turned up upside down. We're all berating... Same again with *The Economist* the past two weeks. It's like editorials... *The Economist* is supposed to be the classically liberal, laissez-faire *Economist* telling the Chinese government, "You need to intervene to bail out the property developers." It's like, "Why? My financial system is not imploding because property developer loans amount to 6% of total developer loans in China. So yes, it's a problem. Yes, it's going to lead to weaker growth, but my banks are not imploding. And if banks aren't imploding, you don't have a systemic crisis."

Ed D'Agostino:

It's truly shocking how normalized bailouts have become in this country.

Louis Gave:

I think it's part of that. I think all this is a legacy of 2008. I think we all have PTSD from 2008. So we see, "Oh my God, Chinese property prices are down 10% to 20%. Oh my God, property developers are going bust. Oh my God, some financial intermediaries are in trouble. I've seen this movie before. This is going to be terrible. Run for the bunkers, get the hard hats, and shelter in place."

But between January 2007 and July 15, 2008—or two months before Lehman went bust—American bank shares were down 60%. I think bank shares are often the best leading indicators of problems. European bank shares puked the year before the European crisis. US bank shares, as I just mentioned, puked. Again, in the past 12 months, Chinese bank shares are essentially flat.

And then it's not that it's awesome business, and you should go out to rush and buy them. That's not what I'm saying. I'm just saying the Chinese bank shares aren't announcing EM crisis. Neither is the iron ore price. Neither is the share price of LVMH. Neither is the Chinese government bond market. Neither is the Chinese stock market. So aside from the cover of *The Wall Street Journal* and *The Economist*, you struggle to see where the China crisis is.

Ed D'Agostino:

Can we talk a little bit about US-China relations?

Louis Gave:

Sure.

Ed D'Agostino:

Because boy, it sure does feel tense, and it feels like anything and everything that can be "weaponized," weaponized in quotes, is being weaponized. It feels very hot. How do you see this playing out? Is this temporary? Is this permanent? Are we decoupling completely?

Louis Gave:

Look, it's permanent. And here, I think part of the disconnect is, if you ask any American what's the biggest comparative advantage of the United States, Americans will say, "Well, we have the world's best universities," or "We have the rule of law," or "We have some of the world's best managers," and any number of things, which happen to be true, of course.

Now, ask any foreigner what's the biggest comparative advantage of the United States, going back to this 4% of the population running 60% of the world's current account deficit and 40% of the world's budget deficit, they'll say, "The US has the US dollar." The US has the world's reserve currency, which allows it to do things like run 60% of the world's current account deficits and attract all of the world's savings.

Now, starting 10 years ago, China deliberately went gunning for that comparative advantage of the United States. China came out and said, "Look..." And I've talked about this many times at the Mauldin SICs. This has been a key feature of my thinking for the past 10 years. I've done presentation after presentation on this. I've written books on this.

When China came out 10 years ago and said, "We want to de-dollarize our trade. We want to make the renminbi a trading currency. We want to make the RMB bond market a global reference," that was a direct attack to the US. Yeah. So no wonder the US latches back, right? China is trying to undermine the one thing that makes the US truly exceptional. Now, I know in American minds, many things make the US exceptional, but in foreign minds, that's it. That's what makes the US truly exceptional.

And so, we're in the middle of this fight. Now, the one thing I would say is, if I was the US and I knew I was in this fight, I knew China was coming to try to undermine me, et cetera, running budget deficits of 8% of GDP while running full employment would not be the way I'd go about this fight. I would start to say, "Okay. I'm under attack. I've got to clean house. I got to basically do what Clinton did in the late '90s, run budget surpluses and run a much tighter ship, make my currency actually deeply attractive to foreigners."

When was the last time you heard a US policymaker talk about the strong dollar policy? That was like a 1990s thing. You haven't heard about that for a while. So that battle is on. Now, that battle, it's been the big story of the past 10 years. In my eyes, it's going to be an even bigger story for the next 10 years, partly because de-dollarization is not an event; it's a process. It's something that happens very, very slowly, but it is unfolding.

The fact that you now have five of the world's top eight producers of oil in the world that have signed up to the BRICS agreements, where the stated aim is to de-dollarize commodity trade, should be ringing all sorts of alarm bells. The fact that Saudi, Egypt, UAE, et cetera, just signed up for this, that should be a sign. So, again, it's a process. It's not an event; it's a process, and we are in this process. So yeah, the US and China are in this clash.

Now, along this process, there's ebbs and flows. And I think things got pretty bad lately with the whole shooting of the balloon, the whole China not picking up Biden's phone calls, et cetera. Things are now better, and things are now better, and they will likely be better for the near term because you have an APEC summit coming up in November in California. And the reality is both Biden and Xi need that summit to go well, simply for pure domestic political reasons.

And so, I think between now and November, as you come into the APEC summit, all of a sudden, the diplomats are back to talking with each other. All of a sudden, there are high-end delegations. You had Yellen come to Beijing. You had Kerry come to Beijing. You saw Kissinger come to Beijing. So it seems like both, through front channels and back channels, things are a bit better. My guess is try to make nice till the APEC summit. Then, after that, you move into an electoral year in the US, where probably nothing much happens anyway.

Then, after that, you have also two big events. The first really important event in the relationship is the Taiwanese election coming up in late January. And here, you have a candidate that's very pro-independence against a candidate that's very pro-let's-get-together-with-China. Now, if the pro-independence government, pro-independence candidate wins, that's a real problem. That's a real problem, especially during an election year in the US, where the China-bashing always ratchets up a little bit. So that could create lots of tension there.

If the KMT candidate wins, then China relaxes a lot. And in fact, instead of rattling the cage, Taiwan will make overtures to China, and China will open the checkbook. They'll shower the KMT candidates with gifts, with a basically pretty clear view of, "Look at what happens when you play nice." And the first thing the KMT candidate will do is he'll ask the 300 Marines that the US recently sent to China to go home, and that will be a huge sigh of relief in China because that's a huge red line for China, to have foreign troops sitting in Taiwan. Huge red line.

Yeah. So in terms of the timeline, November, you've got the APEC summits. I think we play nice until then. Then everybody's on pause and waits for the Taiwanese election. And if the KMT guy wins, then I think China is a nonissue till after the election.

Ed D'Agostino:

We've been following at Mauldin Economics the reshoring, friendshoring, nearshoring trend—critical manufacturing being brought back to US shores with the CHIPS Act, huge investments in silicon wafer plants, fabs being built in the US. What is your view on trade between the two? I feel like this reshoring trend is pretty unstoppable, but it really is going to hinge on automation.

I don't think you can make the same products for the same price on US soil that you could in Taiwan or anywhere in Asia, really. You follow robotics and automation closely. You've been involved in an ETF around the topic. Where are we at in terms of the evolution of robotics and the shortage of chips to fuel that growth?

Louis Gave:

Look, we've had a shortage of chips, and we've also had a shortage of workers, right? I mean, pretty much everywhere you care to look. So no, look, I think the tailwinds for automation remains great. Now, to your point, I think the big buzzword of recent years has been deglobalization, which I think is a complete misnomer. We shouldn't call it deglobalization. We should call it de-Sinicization. And it's not exactly the same thing because what you have is factories leaving China, but it doesn't mean that they move to Cleveland or to Duluth.

Instead, they move to Mexico. They move to Indonesia. They move to Vietnam. So the US says, "Well, we don't feel comfortable having our production in a communist country, so let's move to Vietnam." And practically, that's what's happening. The reality is that there are two ways to look at this, two ways to look at the whole, "Hmm, I don't feel that comfortable about China anymore."

The first way is to say there are a number of countries that are winning big time from this: Indonesia, Vietnam, Mexico, countries in emerging markets. And this, you already see very clearly in the numbers. You look at Mexican exports to the US surging, Vietnamese exports to the US surging. Now, our big line on this was that a lot of these factories leaving were probably going to leave anyway—at least to places like Vietnam or Indonesia because of higher labor costs, et cetera—and that it was mostly lower value-added stuff. So it was sort of like crumbs falling off of China's table.

Now, if you're Vietnam, you can feast on these crumbs. If you're Indonesia, you can feast on these crumbs. But the mix of China's exports as a result has shifted dramatically in the past 10 years. When we think of Chinese exports in the West, I think we still think of tennis shoes and cotton underwear. Meanwhile, China is now the biggest automobile exporter in the world, from nowhere five years ago. China now exports more cars than either South Korea, Japan, or Germany. Few people realize this, but there you have it. Broadly, the same story in earth-moving equipment, telecom switches, et cetera.

So you've had to move up the value chain, that's been tremendous, and you pass on all the lower value-added stuff, the textiles, the shoes, the toys, the furniture, to other countries. So that's your first trend. The second trend is the one you highlight: the robotics. And here, I think the US does have a tremendous comparative advantage relative to the rest of the Western world. So the US has a cost of energy that's a fraction of anybody else's.

And so, here, if what you're doing is quite energy-intensive, if you're in chemical products, if you're in any one of any energy-intensive... And a lot of stuff that requires a lot of robotics is energy-intensive, then the US actually does make sense, potentially. So you're seeing as well some of that. And then I think there's a third part to the whole de-Sinicization, which is China produces stuff that we've let China produce. Think of the other rare earths, but also the low-end semiconductors, et cetera. We've let China produce that either because it was polluting, because it was low value-added, or because China was very competitive. And now, all of a sudden, we no longer feel comfortable doing this.

And even though it makes no economic sense for us to bring it back into the West, we're going to do that. And so, now, all of a sudden, you have big investments for rare earths and mines in Australia or in Canada or even in the US because, geo-strategically, it just makes more sense.

But some of the stuff that's being done today, like building semiconductor plants in Arizona, I think that makes no sense. I mean, I think that's just capital waste. And TSMC is doing it, and they keep saying, "This is stupid," like every chance they get.

They're doing it because the US is making them do it, and they're doing it because the US is giving them money for them to do it. But building semiconductor plants requires lots of water in one of the driest parts of the US. Yeah, it's boneheaded. But politically, it was decided that it should be Arizona because that's a purple state, and it's completely boneheaded. Completely boneheaded. So just sheer capital waste.

Meanwhile, you could say, "I could see why you wouldn't want to see my conductor plants in Taiwan because I could get invaded by China," although I don't think it will. But conceptually, I could see, "Okay, we don't want that." But then put them in South Korea, put them in Japan, where there's a long expertise in doing this kind of work. And you can do it maybe not as efficiently as in Taiwan, but almost, as opposed to building from scratch in Arizona. Just stupid.

Ed D'Agostino:

There definitely seems to be strong, strong political will and massive amounts of dollars going in that direction, though, so it's hard to deny that—

Louis Gave:

Oh, yeah. Well, for sure.

Ed D'Agostino:

—from an investment perspective.

Louis Gave:

No, no, for sure. And then it comes back to this. The US, in the past 20 years, has gone from, what was it, five or six trillion in debt to $32.5 today, $35 by January 2025, and probably before. So let's call it almost a $30 trillion increase in debt.

What do you have to show for this money?

If I was American—and I'm not—if I was American, I would say, "Hold on. We've just loaded 30 trillion in debt over the past generation. Where's the Hoover Dam that we've built? Where's the Tennessee Valley Authority? Where's the high-speed rail links? Where's the Interstate Highway System? What did we get for this 30 trillion in debt?"

And the reality is, what you get is either pet political projects like, "Let's put fabs in Arizona." So you get that. Obviously, you get wars, and what you get is increasing transfer payments because you look at the US, Social Security, Medicare, and Medicaid, plus interest payments are basically almost equal today to tax receipts. So that's before you've paid anybody's salaries, before you've maintained any roads, before you've done any of these things. That's how you end up with a budget deficit of 8% of GDP.

And so, the big problem is, I have nothing against debt, but when you pile on the debt, it's got to be for productive stuff. If you're a company, you pile on debt because you're building a factory. If you're an individual, you pile on debt because you're getting a mortgage. If what you're doing is running up the credit card debt to fund your current spending, that's much more problematic.

And that's where the US is today, going back to how we started. Have we reached a point now where the US annual increase in debt requires roughly two-thirds of the world's global savings to fund it—the annual increase in savings—that we reached the point where the train starts going off the rails?

Ed D'Agostino:

And what scares me the most about this situation, Louis, you could probably count on one hand the number of congressmen and women who understand this. We have a disproportionate number of lawyers. So they understand law, and that's great, and legislation, but they don't think they really understand the effects. And was it Grant Williams who said, "Just because something bad hasn't happened, doesn't mean it can't happen"?

Louis Gave:

Probably. That sounds very Grant-like, and I fully agree with that, by the way. Is it that they don't understand? I was recently told that because the US economy is not looking great, Raytheon and Lockheed have had to fire 30 congressmen. So I think it's more of the latter. I'm a firm believer of "if people are paid to not see a problem, they're not going to see it."

And when you look at the cost of political campaigns in the US... Look, we're ramping up toward another presidential election. Both parties are going to spend around $1 billion just on the presidential election. People don't spend a billion—they don't give millions of dollars without expecting some kind of payback. I don't think so.

Nobody gives $1 billion to Joe Biden or to Donald Trump because they think he's a terrific guy, such a lovely guy, such a terrific human being, that they really want to see him in a position of power because how can you not love either Joe Biden or Donald Trump? They're just such awesome individuals that I have to give them a big chunk of my savings. I don't think it works that way.

Ed D'Agostino:

Let's end on a happy note.

Louis Gave:

Yes. Sorry.

Ed D'Agostino:

Give me a couple of ideas, if you'd be so kind—

Louis Gave:

Yeah, of course.

Ed D'Agostino:

—of just areas that you're interested in right now, like maybe commodities. Do you feel like commodities are still a good opportunity? What do you like?

Louis Gave:

Yeah. So I've liked commodities for a while, and I remain a very firm buyer of commodities, partly because, look, I think if you're a capital allocator, what's your comparative advantage? Why do you get rewarded? Your value-add is to bring capital. Now, my own bias is to think, "Well, if I bring capital today to Microsoft, they're going to tell me, 'Get in line. Everybody wants to give me capital.'" I'm better off bringing capital to people who have been starved of capital, people who haven't had it.

Now, the commodity sector has been starved of capital for the past 10 years. Meanwhile, we all need commodities, and we probably need commodities more than we ever have. I think that there was this big hope for a few years that, "Oh, you know what? Basically, with magic mirrors and windmills, we're going to be able to bypass our need for energy. We're going to bypass our need for commodities, et cetera." And it turns out to have been a pipe dream. We've spent $4 trillion in alternative energy over the past 20 years. And for that, we've managed to move from 83% carbon down to 81% carbon.

This is one of the grossest misallocations of capital on record. And we haven't paid the piper for this yet, and the way we'll pay the piper is through higher commodity prices. So I still think that the risk-reward in commodities is an extremely, extremely attractive one. And there are many, many ways, of course, to express that, whether it's through metals, whether it's through... So I think that's one key theme.

I think another key theme out there is that for roughly 15–20 years, the working class—and by that, I mean the blue-collar class—in Western countries kept seeing their income squeeze year in, year out. So if you were working in an office with a laptop and a cell phone, you were doing great. If you were living in New York, if you're living in San Francisco, your income kept growing. The interest rates kept coming down. Your real disposable income, your assets kept going up in price. Everything was awesome.

And that cycle is now over, and you're seeing it every day. Right? Right now, you've got the UAW strike. You've got UPS workers making $170,000 and farmers making a whole lot more money than they used to. Oil rig workers are making a ton more money. Oil companies can't get enough oil rig workers. They can't get enough truck drivers. So these guys, all of a sudden, are making proper money, and their consumption patterns are very different than your laptop class in New York and San Francisco.

They're not going to buy avocado toast. They're going to buy a snowmobile or a pickup truck or a boat. And by the way, those things are flying, RVs, all these things. And I don't think it's a one-year thing. I think we've trained an entire generation to look down on manual labor. We've told an entire generation, "If you don't go to college, you'll be a nobody, and nobody will respect you."

And so, for the love of money, you can't find a plumber, and you can't find a carpenter, and you can't find a truck driver, and that's not going to get fixed immediately. It's going to have to be a cultural shift. And in the meantime, these guys are making money. So you want to own anything these guys want to buy because that's a 10-year tailwind.

I think another story for me is I love the fact that *The Economist* runs two covers back-to-back on China imploding. I love it. I can today buy Alibaba at the same price as when it IPO'ed, and its sales are 11 to 12 times bigger than when it IPO'ed. Yeah. It's like the price-to-sale of Alibaba has just gone down 90%. Love this. Now, it's basically trading at valuations where either this thing goes bust and is a zero, or you should fill your boots with it. And I like that kind of risk-return profile, I must admit. And it might not go up in the next year, but in the next five, this is for sure a must-own.

And it's not just Alibaba. I own BYD, the biggest electric car company in the world in terms of production, not in terms of market cap. That's Tesla, of course. Yeah. BYD now sells the BYD Seagull. It's a small hatchback. Think of a Honda Civic. It's a hatchback, full electric, 220-mile radius, 11,000 US dollars. Like that? How can anybody compete with that car? The answer is they can't. They just started selling them in Australia. They sold 10,000 in the first 24 hours, and then that was it. That's all they had. Like the first 10,000, gone, boom. So now they've got to send another 10,000 because, at that price point, you can put it on your credit card almost.

Ed D'Agostino:

Right.

Louis Gave:

So, there's lots of exciting things going on. But perhaps the most exciting thing of them all, the one that the Western world is missing, is the one I talked about at the SIC, is the fact that due to geopolitical developments, both the Ukraine-Russia war and the Iran-Saudi Arabia peace deal, you have an outpouring of infrastructure spending on an axis that basically goes from Istanbul to Jakarta that is simply unprecedented, pipelines, roads, railroads being built, because commodities that used to go west from Russia towards Europe now have to go south and east. So that requires commodities.

Commodities, funnily enough, they are now priced in local currency. So there is no constraint to the infrastructure spending because before, you were constrained by your ability to get access to dollars. Now you're just constrained by your own ability to print the money to buy the commodities from Russia, whether you're India, whether you're Indonesia, whether you're Brazil, whether you're China, of course.

So I look at emerging markets, and there are three massive, massive trends. The first is the de-dollarization of the commodity trade means that the constraint to infrastructure spending is basically being removed. The second is de-Sinicization, factories moving from China to everywhere else in the emerging markets. And the third is the unfolding commodity bull market because, for all the bearishness out there, as I mentioned earlier, iron ore prices are grinding higher. Copper is not falling apart. Energy prices are grinding higher.

And so, you put all these three things together. And historically, again, when commodity prices rose, countries like India would blow up. Countries like China would slow down. But now that they price it in their own currencies, now that you can buy the oil in renminbi, the oil price no longer matters if you're China. It's like, "Yeah. Print the renminbi. Give me more oil." So it's a dramatic shift that I don't think has been reflected in people's portfolios yet. So tons and tons of opportunities, lots of places.

Ed D'Agostino:

If you want to hear more about energy from one of my favorite energy analysts, check out this conversation with Jan Stuart of Piper Sandler.
