IN PRAISE OF PHILOSOPHY IN INVESTING, ON WHAT IT IS, A CRITIQUE OF HOW IT FUNCTIONS

Any framework or model of solving complex problems (such as life or markets) only becomes complete when it allows for escape clauses. The provision to look through the constraints of the framework, or the boundaries of it, is as important as the framework itself. This is because complexity in social systems, unlike physical ones, is not bound by some historical constraints or rules. Just a blind application of one's model would leave him standing utterly in shock at the reality that unfolds before him. History neither repeats, nor rhymes… it simply evolves.

Frameworks, however scientific and comprehensive, are tools useful to navigate such problems only in routine times. Each time one is presented with non-recurrent yet significant variation, his response shouldn't be surfing through the historical archetypes, but instead re-reasoning and re-thinking from the ground up.

Only philosophy, of all, provides for such a mechanism. Philosophy, to me, is an art of speculating on matters that are not settled. It's not empiricism, nor is it just opinions. I think of it as a kind of meta-framework to speculate on matters which don't presently lend themselves to clear cut solutions.

One possible way to do this is to get beyond the interiors of markets, of valuations and flows, of your firm's management chatter and the story that your fav bull gives you, time and time again. Not instead, but surely alongside, speculate on distant matters, of exteriors, of things which seem to have no impact on what RBI will do in next policy and where quarterly numbers will be but of things which will have significant ramifications on the evolution of the economy, political systems and markets- not immediately but imminently.

Read cultural and political history to build priors, know geo-politics and tech to update it, decipher psychology of both the madness and the wisdom of the crowd, look at markets through the interactions of bio-physical systems with monetarist ones. And never forget to learn how the idea of the world itself evolved, from Aristotle to Sartre. Not preaching, just reminding myself. This place is my diary, after all.

Empiricists, of this moment, crowd the markets, and we need more logicians. Far too many statisticians, where we need more philosophers. Too many detail & data folks out there- we need those who can abstract. I don't think truth is revealed through data analytics, it can only be verified by it at times. Truth finding is a speculative exercise, in the realm of imagination & creativity. I think it's too mischievous to build investing analog basis one or a set of data series.

Key message: Even while you formulate your investment framework – one that is adjacent to Warren Buffett or Soros, keep space to modulate it. Because all available investment framework is optimised for the past. And none that worked in the past insures success in the future. Lots of famous investors do disservice to routine investors by making investment framework appear cast in stone. One potential way to train mind is to speculate on many issues – not just that are adjacent to market but also distant but related to it

Philosophy of investing: Meta, Epistemology and aesthetics

Philosophy is interested in three major areas of knowledge. The first is metaphysics, which is

concerned with how the world of ideas deals with issues such as GOD, the afterlife, life's meaning, love, and responsibility. We can only speculate on such topics; as we have no idea what the restrictions or restraints are.

Another branch of philosophy- aesthetics - is concerned with beauty, morals with good and wrong, and politics. This one's obsession is with the form.

Finally, epistemology is the third and most important field of philosophy. It ponders on the knowledge of knowing, thinking frameworks, and how we think about thinking. <u>This one is concerned with what is knowable, how something may be known, and how to know that we are aware of it. This is mostly about our capacity to develop sufficient models to help us better deal with the world. This branch of philosophical study is concerned with method, road, model!</u>

I've asked this rhetorical question about what investing philosophy is and speculated on what it isn't many times in the past – to many investing team mates and leaders. Most leaders think of it through the framework of aesthetics, and the successful ones begin taking it as metaphysics.

<u>Success in investing is neither in the form nor in the realm of ideas. But, solely from the position of the philosophical tradition, I believe it is mostly about epistemology - a model of how your investing team thinks & mechanism or incentive structure that you devise to facilitate it.</u>

An investment philosophy is not an exact method for opportunity recognition, position size, or stop loss, but it is about how we think about these challenges. It's about how we build models to cope with each of these critical investing cogs. Because it exists outside of a certain investment methodology, it allows for reformation and rejigging of the approach. To that degree, it approaches the concept of intelligence itself, which is the ability to create a model of the world that lowers the distance between a set point and external obstacles.

So, when we talk about investment philosophy, we're talking about the intelligence to create a model that deals with the methods we use to act on information, techniques to determine if information is considered cohesive, diagnostic, and robust, resolving conflicts that arise given diverse data, and navigating troubled waters when uncertainty drives near-term reality in a direction we weren't expecting.

It's okay if it feels a little too intricate &....theoretical; perhaps a re-read is in order. In any case, when is a good practice born without a sound theory?

Key message: How you think – is the domain of epistemology- an important branch of philosophy. Do you argue on matters – from all sorts of angels, dismiss points which you believed in until yesterday – just because a new data has arrived to make old thesis incompatible, reflect on all parts of your knowledge – over and over again to ensure that there is coherence in what you believe in.

You will have to build a framework for yourself

I've never met anyone who minted significant alpha by copying someone else. No one. Many people I know have lost money after following someone. Really many.

Many people whom you and I admire for various reasons are poor investors even though they come from that very field. I've had the opportunity to get up close and personal with many such wonderful people. Nice, affable, intelligent, and skilled in many other areas except investing.

Someone who does not risk his own money, no matter how intelligent he is, cannot teach us at least one thing, namely investing! Like driving or playing – it's the thing to do. Not to know.

If you're serious, it's better to be an iconoclast than an ardent follower of any great. First principles. Your constraints are yours. Your philosophy is yours. That who invokes him from far-land is trying to sell you something - because it's an easy sell!

Investing is not a project of a blind watchmaker. It's of a person who is wide awake. It is a personal craft because it is swayed by one's mind, mood, and habitual swings.

Therefore,

Everything I write, including this, is my opinion. Truths that have been researched! But not those that have been revealed. Formed by personal experience. I admire a few. But follow none's prescription. That's why many of my views will be novel but at times, wrong.

And I write all of it for fun! Read everything I write to wander around in this reason-land, pour water on things you find poorly researched, and rejoice if it helps you rediscover what you already knew.

Key message: Even though its popular to believe in what greats such as Buffett or your favourite fund manager believes in – the only way to formulate a good investment framework is to train it on your own model of life – your environment & family, risk taking capabilities & fears, your reflexes and so on. Investment philosophy is a very personal ideal

On investment framework

I am listening to this Indian fund CIO talk about his inv framework and… he says that "I mix art and science in investing". Given that he refers to use of 'gut instinct' I am assuming he means of art as decision framework of intuiting. And I wonder - what is art and its role in investing?

Art is less empirical, more personal, less logical, at times irrational, not certainly universal. It's known to evoke emotions. Feelings. Art seems a subjective expression. What I like could be very different from what you do. We all get our soul mates basis that. Don't we?

And science? It is objective. Rational. Empirical. Universal. It believes in things that it can test repeatedly.

I speculate that art entails "an unexplained jump". To know and conclude without enough data (in the manner empiricists think). To weigh things not in accordance of established practices. It's still an algorithm but a very personal one. It's still a science but a personal one.

So what's the role of art in investing?

If you are following Buffett or whoever or have a solid investment framework- to do this or that - you are doing science. If you can write the whole of framework on paper. Then also.

But if you feel - something is not right with the promoter even though your rest of the team seems impressed. You aren't being irrational. Nor are you concluding without a reason. Just that you are weighing a 'trait' of the management or firm different from many others. You are likely using Art.

I once worked with someone who was very fussy about management teams who sounded too

sophisticated. He saw superficiality in it. His framework rejected such people. He was relying on 'Art'.

Then there was a CFO of a micro finance firm who would wear Hawai Chappal when he came to meet us. Just imagine western suit & chappal. Was he being artistic?

Key message: Most people underappreciate the unique and different views on an investment idea – even though they apply similar scientific methods to evaluate them. To that extent – investing is an art. A very personalised form of decision making which is overlaid on the science of it. As much one considers investing as science, it is an art too.

What is investing framework- Understanding what is not?

What is an investing framework? Is that the algorithm that tells you to go long or liquidate an asset or is it the process which harvests data and views which are available in the market place or is it simply the bureaucratic division of work, which ensures that no one can ever do anything discretionary?

There is nothing wrong in any of these yet one wonders whether investing framework is all about the documented or revealed truth that algorithms proclaim. I am yet to see that algo which hasn't done well when implemented in the past, the world that was and yet there is none that lives to its promise to the world that is and will be.

Then, there is an elaborate process of sifting and aggregation of prevalent views and infinite data, something that most portfolio managers practice, and proudly claim as their investing framework. The meetings where your team comes together to discuss this or that of nearly everything are both fun and helpful. I get that. But that itself can barely pass the muster of being an investing framework. It could at best be the hygiene of it. An up-keeper.

Finally, one often hears an investment process that entails layers and layers of filters, escalation metrics, approval mechanisms or some other forms of bureaucracy -before an investment is approved. it is true that bureaucracy does great to slow things down disallowing impromptu gratification that risk taking delivers to managers, yet its famously value neutral. It functions well to stabilize the system but does little to do anything which help managers pick winners or avoid losers. The value of bureaucracy is not in the wisdom that resides within it-its true value is simply in the mechanics of slowing things. The hope is that by the time bureaucracy turns around, bad ideas would have turned breathless anyways.

Then what on earth is investing framework of a portfolio manager or you? That you will figure soon, but for now, knowing what it is not, may itself be a good beginning.

Key message: Investment framework is neither an algorithm, nor the discipline of getting to decision, nor even the bureaucratic set up that each decision has to get approved of.

Is warren Buffett' the right investment framework

If you are growing up in US in 1930s, a market based economy that is mightiest of all, a hegemon protected from vast seas, doing half of the world GDP, has Milton Friedmans to celebrate its private sector and is at the tech frontier - Only if you could start with some riches, investing in a balance portfolio of US equity index and bonds, your money will make lots of return!

Then your friend gives you cheap leverage, that is 70% of your capital, at a cost which is 3% lower than sovereign. You are likely to become that mythical figure, who will be more famous than singers & cine stars. Many wannabes will flock to your city in search of that great investing framework, to listen to your stories of how you do it and reading your letters as religious text. You are no one else but-The Sage of Omaha!

How does he do it? He invests in firms with favourable and durable economic characteristics without getting bogged down by price volatility. His analog seems simple, to buy high quality firms, mostly of his country, at reasonable price. Firms which have done well for few years, ones which don't compete with too many firms, and who returns earnings to investors instead of retaining them and runs low leverage. You got the answer, this is called Investing Framework?

But wait, a simple balance portfolio would have delivered exactly the same return as that of The Sage. At less than three quarter of sharpe ratio- does that need invocation of the mystical powers or of improbable intelligence? The true magic of his excess returns seems to come from a clever use of low cost insurance leverage afterall.

Yet his investing framework seems decent. Can you use it as well? To answer that, we must ask a 'what if' question. What if he was born in 18th or 19th century of US or in 20th century of North Korea, Argentina or Germany. His returns would have been bad or ugly or just about okay. Therefore, was his investment outcome a product of the time that he lived his life in and the place he was born at. Seems like an ovarian lottery- he himself claims.

How can your investing framework be one which is time and space dependent? Because only history is a well-documented fact whereas future is messy & unknown. A good investing framework has to imbibe intelligence i.e. an ability to model the world, not of the past but of the probable future, not of a historical place but of the one you reside and invest in. There is no way for it to assume the exteriors, of the ones that Sage was gifted with.

The question that an investing framework has to solve ought to be both time and space neutral. It has to tell, in the times of tomorrow, of the place where we live – which asset will do the trick for you. In other words, it has to seek answers of what lies ahead - a 19th century of US or 20th century of Argentina or something else? The Sage doesn't answer that (heresy!). He pre-supposes 20th century of US.

Key message: This may sound sacrilegious – and at the face of it appears an attack on the idea that majority of investors believe in. I am simply trying to tell that your investment framework should be time and space independent. It should come up with decisions which are unique to the time and space constraints.

Stocks: Buy slow and sell fast

We are built to take forever to trust someone but a single instance of betrayal or disappointment can swiftly sever the fragile threads we worked so diligently to intertwine. Like a delicate sculpture that crumbles at the slightest touch, our trust is vulnerable and easily sabotaged.

Curiously, the reception of news follows a similar pattern. Good tidings, like a gentle breeze, require time to settle within our being. Yet, in stark contrast, negative news often strikes like a thunderbolt, resonating with immediate believability. Its potency is amplified, seeping effortlessly into the retreats of our minds, often eclipsing the positive aspects of reality.

How frequently do we experience a sense of euphoria and relief when our medical tests reveal no significant issues? The clean bill of health is looked at with suspicion. Yet, when faced with a single marker that deviates from the expected norm, our reaction is swift and laden with concern.

Good fund managers harvest this nature of ours in stock investing. They gradually scale their investments, gathering more information before significant position-sizing but exit rapidly when bad news emerges. Using this - they avoid two significant biases, overconfidence and sunk cost fallacy.

I once worked with a seasoned portfolio manager whose approach was rather straightforward: the moment negative news concerning a stock surfaced publicly, he swiftly abandoned it, without fretting over the impact cost. At first, this tactic struck me as unconvincing, as, at times he would sell stocks too cheap and too fast. But over the long run - it worked for him remarkably at the portfolio level. So much - that I actually believed that this was the key moat of his portfolio management style.

But here is a paradox. This reflex (buy slowly and sell fast) works in stock investing but not in asset allocation or market timing. Reversing it makes sense. And that's difficult to do because it means one has to act in contrast to a typical human reflex. Why & How? Think!

Key message: Position sizing in stocks must be calibrated to our biases. Given most of us get greedy fast and can't cut losses- even if data has emerged which negates our original thesis. We must work to overcome these biases while investing in stocks or bonds or any other financial security.

Why buy fast and sell slowly works for markets

… I argued in the previous essay why buying slowly and selling fast works for stocks. However, if you find yourself in the role of an asset allocator or a macro speculator, this reflex must be reversed. In a market panic, you must quickly seize the opportunity to buy into the chaos, going all-in as rapidly as possible. Conversely, a more gradual exit works when it comes to exiting your positions. This is an empirical truth, but let me indulge in some speculation on the why.

Rising markets are driven by an energy of good luck and exuberant investors, pushing them upwards. However, their ascent is gradual, with the peak occurring later. Conversely, anxious markets tend to quickly lose value, reaching a climax in a short span of time.

Have you ever taken note of the return distribution chart? Observe the weeks of extreme movements. You will notice that the cumulative movement of markets in times of 'major loss' outweighs that of 'major profit periods'. Most studies of higher moments are studies of significant losses.

For aggregate markets, two factors are at play. Firstly, most macro events are reversible thanks to super-quick policy interventions. However, because investors are inherently wired to exit all at once, even though policy support is inevitably on the horizon, markets experience precipitous falls. This is the reason, it makes sense to invest all at once, or more accurately, very quickly during times of market turmoil.

Exiting, however, is a different matter. Policymakers are slow to intervene during booming markets, which causes investors to exaggerate the underlying positive factors. So markets stray for longer. Therefore, the framework for exiting should be gradual, with markers based on policy or macro-related factors rather than solely on valuations. That's why I suggest buying valuation and selling macro. A less playful version of this statement would be to buy undervalued assets and sell when the policy setup turning unfavourable.

Wonder why it doesn't work for individual stocks. Unlike for aggregate markets, where most of the worst negative news is mean reverting, for individual stocks- the worst news tends to be persistent and un-reverting.

Also, note that the various participants in the stock market ecosystem, notably management teams, and brokers, tend to impede the dissemination of negative news while actively promoting positive one. That's the reason you are more likely to meet with a negative shock instead of a positive one. That's why - for my old colleague, the strategy of buying slowly and selling quickly worked so effectively.

PS
Want to be a macro speculator- next time when a macro thunderbolt arrives, the next 9-11, Left coalition govt, GFC, Policy paralysis, or Covid arrive, stay ready with your gun loaded- dial risk all at once-when valuation has nosedived. You will get two entry passes every decade. And when the policy is beginning to lean against the good times, start to unload it - slowly.

Key message: At stock level – you are more likely to meet duds, as 80% of them will not even deliver bond returns. So the idea of being cautious and buying slowly make sense – as I argued in the previous essay. But the same doesn't apply to stock markets which are inherently bullish. About 3/4th of the time, markets will be rising, and most falls are likely to be in short span of time. This set up requires asset allocators to dial up risk fast and exit slowly.

Investment process- sublime vs beauty

"We have got great investment process. Everything is meticulous mapped out. What happens when & when happens what - all planned"

That's beauty.

"My team has been through various challenges. Some catastrophes- I must say. But somehow we as a team grouped together to deal with them"

That's sublime.

Kant wrote that beautiful objects are characterised by sense of harmony, proportion and symmetry. Captivating landscape, well designed furniture, a well curated garden - all are beautiful.

Beautiful investment process is characterised by clarity and simplicity. Free from jargon.

Understandable. It delivers great risk management practices. It requires fund managers to adhere to predetermined guidelines. It requires clear reporting, timely updates.

Sublime recognises and evokes a sense of vastness. This night, try & look outside the window, as it pours so heavily (if you are in Mumbai). It may terrorise you first but thereafter, will come a sense of awe. Yes- here & now- you will be witnessing sublime!

Sublime entails risk taking, exploration. Sublime investment process is adaptable and agile. Dynamic. It entails responding to crisis - recognising it's uniqueness. It tailor- makes its path to solve problems. It delivers great risk taking practices. It communicates the fluidity of set ups.

What's a good investment process? It of course is a trade-off. It entails both. Yet- once you begin to observe investment professionals, a little more keenly - you recognise that they are optimising for one of them. What delivers? Who knows!

Key message: Investment process or framework may have both aesthetical as well as subliminal characteristics. Former is about the clarity of how our stock picking functions and latter is how dynamic & fluid it is. Both are necessary conditions of good investing. Invariably the latter is underplayed by many.

Buy valuation, sell macro framework

Here is a quick peek into my 'buy valuation and sell macro' framework. Draw a policy-valuation quadrant. Imagine two axes representing valuation and policies. You get four sections. Be overweight equities when valuations are inexpensive and policies are reflationary, and underweight when expensive valuations coincide with tight policies.

First on policy. I focus on three key ones: fiscal, tax, and monetary. Other policies of redistribution, trade and tariff also matter but these three matter a great deal more. Reflation means looser policies that support the expansion of the economy and profit. Tighter means?- you understand that.

Equities like looser fiscal policies, declining taxes, and lower real interest rates. Bonds tend to perform well under tighter fiscal policies, higher taxes, and higher real interest rates. Each variable needs to be contextualised with respect to history – as you notice - the terms 'looser' and 'higher' are not just relative to the recent past but also with regard to history.

Valuations? Valuation is a relative metric. For example, one would see Indian equities relative to their historical valuations (PE, PCF, PS), bonds, and international markets, particularly the US market. As an old bond guy - I am a fan of equity risk premium (equity yield –bond yield).

Many popular PMs like simple historic ratios, academics and some oldies, favor CAPE and market cap to GDP ratios. Each approach has its advantages, and the choice depends on which aspect of a market move you aim to capture. It is worth mentioning that CAPE or Buffett ratio has gained a reputation for being quite rigid and 'fundamentalist', while historical PE ratios have proven less effective at capturing significant macro & policy shifts.

So you notice the real trick here? This framework relies on valuation to enter equities but waits for the policies to turn restrictive before exiting. Incorporating policy into the equation helps in a few things, one it safeguards you from both entering and exiting too early, two, it takes into account the regimes, particularly which are induced by politics on issues such as inflation, financial repression, tax or redistribution policies. Instead of relying on the more famous 'growth and inflation quadrant', this

one explicitly acknowledges the importance of policies which are more adjacent to asset pricing than macro variables themselves. For these reasons, I think this framework may be more robust than the popular one, stemming from growth and inflation cycles.

Key message: This essay is a brief intro to how I look at position sizing in markets. I like to buy when valuations are very cheap and exit when macro – turns obstructive along with expensive markets. This framework allows me to dial up risk rapidly in distress and reduce the risk of major drawdowns in my portfolio.

How much to risk in equities

"Too many people want to send their kids to foreign universities, buy bigger homes – I tell them -Only equities can yield you enough to afford all these perks," someone who was building his wealth platform and managed money told me. Late 2021, it was.

"How do you get anyone to invest in equities for any specific purpose? Equity's outcome is inherently uncertain. The very good that it invariably produces results from this innate uncertainty. That uncertainty is irreducible – for an investor"? I asked him.

"I don't know. Equity is uncertain in the near term but isn't in the long term" He meant that time in the market will solve everything.

"Uncertainty is time-independent chief. e.g. there have been long periods when equities didn't deliver any return." I pushed back.

"Of course, there are these 1-2 years. But in the long term, it always delivers" He quickly pointed to a slide on how Indian markets had delivered good returns over the last 25 years.

"Financial history didn't begin in 2000, not even in 1980" was my retort to that. What i don't like about most market folks in here is how conveniently they ignore most of the fin history while talking about markets.

"Investors don't understand these complexities. As a matter of fact – they are underweight risk. So a simple idea is to promote more of it. Period!" He pretty much meant 'any coloured cat that catches mice'

"The fact that most investors earn significantly lower than markets underline the reality that investors are misplacing bets relative to their risk appetite – for both size and time" When I said this – he seemed perplexed because he really didn't see this as proof of my earlier claim.

I saw him on TV today. He is more famous these days. And is more vocal about the same ideas. Proving that our conversation made no difference. Not an unusual sight for me – in any case :)

PS

You may not bother about the philosophical underpinnings of my arguments given above, I will still say that may be useful for you:

The idea of betting on risky assets to attain a certain upgraded lifestyle is ill-conceived if not totally flawed. Wise investing may yield good returns but the outcome and resultant expenditure from the same shouldn't be pre-conceived, because doing so distracts one to size, bear and endure risks.

Equity investing arises from spare capital. One that is not mortgaged to your imminent liabilities or desired lifestyle.

Equity investing's fruits must be plucked only when regular income seizes to exist. Once an investor primes himself to dissociate his potential lifestyle from investing, he is likely to develop a longer-term view of the world, avoiding any FOMO and pursuing some form of disciplined or systematic investing.

On risk and what it is not. On measurements of it and the faults therein.

Risk' expression is not the volatility, the price swings around the mean but the very act of catastrophe itself. The act that can destroy you or cost you enormously. But we often measure risk in terms of variability of outcome. I think it's wrong. I will be happy if someone can share literature on this, if this quirk has already been explored by others. Here is a quick view of what i think of the risk of bond and equity...

To me, bonds are risky not because they jiggle once in a while, dancing to the tunes of central planners. They are risky because they may not bond with you on the date of maturity. Or they get stunted by inflation, which sometimes arrive because of mismanaged money policies but more often because we run out the things that our population demands. There are centuries when bonds deliver alright. And then decades when all the gains of centuries evaporate. They are risky, because they will rob you of your wealth so badly that your life's outcome is going to be significantly worse- if all your money was invested there. Especially when you are poor in that poor country. These cultures are trained to bet on something less ephemeral and more durable. That which glitters.

Equity is risky not just because a typical life time of a firm isn't significantly greater than a generation, but also, when your nation confronts the hard power of the hegemon, it's whole market' value may drop precipitously. Only once in a while, you realize that you are an economic colony of the big bully and your residual value, the market cap, is simply a function of the side that you take, for or against the bully. And then, for some or other reasons, your nation's economy decay for its population stop multiplying or its climate turns too harsh or its tech stop advancing. Equity is generally never ever for a poor, not even for low-middlers. That's the reason most never invest.

Design of almost all financial instruments, including equities is to perpetuate the status quo, not to bridge the gaps born of inequality. O kind hearted ones! - don't force equity investing unto poor because they won't be able to digest the left side of its distribution! But if you are rich, then risk expresses differently. You have nothing 'really' to lose. Infact, not taking risk is a risk then! Confused?

There is another twist here. Risk is often measured as if it is person neutral. It is not measured on the subject who is the recipient of its wrath but on some related object that we perceive as a marker of subject' response, e.g. risk of a financial instrument is seen as an objective metric of price variability, what it is instead is a subjective experience of an individual at the extreme value of the instrument. To a certain extent it's like pain, purely a subjective phenomenon with no scale to assess objectively. Word limit busted. Some other time, then.

Key message: Understanding risk not as volatility but as uncertainty makes more sense. There is a real possibility of many of the financial instruments to not deliver the expected risk premiums, and instead perform terribly affecting the asset allocators. So, beware of thinking that time itself will heal the wounds of volatility. Many times – it doesn't.

Risk-taking for 20-something:

Me: “You must risk it all, boy! Go for the high-stakes game, even if the odds of achieving extreme success are slim”

20-year-old-someone, (Chuckling): “How does that align with your preaching about being cautious with position sizing and all? It seems like you're doing one thing and preaching another”

Me: “hmmm…. Even if there are major gains in bets – one with riches or liabilities must play cautiously. The cost of losing a substantial part of his wealth can be painful enough to drive him cautious even though the bets could be greatly rewarding. Not true for young.”

Him: “But young have little to bet. Even though gains are great, they may be inconsequential”

Me: “The meta structure of society’s betting system values how much a man is willing to bet 'of himself' a great deal more than how much is he willing to bet. So in the grand wagers, a significant premium is placed on a man’s courage to stake his very self rather than the material amount he is prepared to gamble. Since Young has little to lose, he is, almost paradoxically, the most qualified to bet it all and win majestically in our system”

Him: “…..there's definitely a cost to failure. Time and energy wasted, isn't it?”

Me: “Even grand failure at that age is valuable because it fuels a profound understanding of risk-taking and the need to know when to stop. It helps him organically develop a framework for navigating risks. That is what makes him great at risk modulation in his adult life”

PS

And If you are 20-something. In markets. Bet it all. On the things that you like. It’s okay to lose spectacularly. Let your investing philosophy be built by felt experiences, not from the books of greats.

Key message: This essay is born of debates at home. For my 20-year-old boy – should he take up the plum job or risk it all to do something of his own. His mother won’t agree. But I have nonetheless persuaded him to risk it all.

How do you position size?

Little has been written about it by anyone - at least i haven't read beyond simple frameworks which suggest that you must scale equity in youth and debt as you age. But that's not very helpful for an active macro investor.

Here is my take looking at sizing through the lens of three distinct forms of set-ups

1. Discord set-up: Look for discord amongst major markets. Identify one that is obviously wrong. Bet on its correction. (e.g. it was easy to predict a sharp rally in US a year ago, bonds were discordant vs equities a quarter ago). These are most rewarding trades given that correction in the 'wrong side' of the discordant asset delivers significant returns. Scaling should be slow but sizing of the positions should be max as discord set up converts into the next one- the momentum set-up.

2. Momentum set-up: If all markets are homogenously pointing towards one or another regime, bet on momentum until economic reality seems insanely different or policy turns against, vs what markets are pricing. e.g. we may be in this regime – thus lower yields and weaker USD are decent trades for 2024. We could also weigh valuations to scale up/down position sizing in this set up, though remember- that valuation is a poor guide in near term.

3. Contra set-up: If all markets, homogeneously have started to distant themselves from economic reality- bet on the regime reversal. There is always a risk of committing to this trade too early. Be careful about timing here. This position in your portfolio must have strict stop losses. And until a discord develops- where at least one major asset starts to side with your view of economy, run leaner positions.

Key message: How much to risk depends not just upon how much can you risk but also – about how risky the markets are. You may choose to bet on momentum, be contra or simply look at discordant assets which don't fit well with rest of the narrative of the market. Bet sizing in each set up will be different. How much should it be – is a matter of discussion. Here, my attempt is to show you how you can look at markets in three distinct manners.

Popular but faulty position sizing strategy

Most popular dynamic position-sizing strategies underperform because the scaling happens as a response to past good performance. More profits I get - merrier I feel about the positions. More I bet on the same…

…this approach result in maximizing positions at the point of major reversals…

…thus, substantial percentage gains are realized on relatively small positions, while minor percentage losses erode value at the positions' peak. On net- resulting is bad outcomes.

Magic of SIP is to take this bias away. It's a performance neutral position sizing. So unless one has a position- sizing craft, SIP remains the best bet for the most.

Yours truly learnt this hard way!

My position sizing framework

- **Assets:** Increase surface area (at least include UST and SPX to it along with local assets - bonds, equity and credit)
- **Choice of security**: Median MF portfolios in small/mid and Index for Large/diversified for both US/India. Debt MFs for bonds. Arbitrage funds for cash.
- **Direction:** Buy cheap valuations with favourable policy set up, hold out expensive valuations and neutral policy (this is the most difficult part) and exit only when policy turns very tight. (Learnt from FI money management)
- **Speed:** Scale quickly and exit slowly (Learnt from experience of exiting early based on valuations)
- **Technique**: First trade in/out to test priors and then invest. (Learnt from RJ)

Why cash and diversification in portfolio

Excited me told my kid- "See, I stumbled upon this insight while watching this movie…

.... Perfection lies at the farthest point in the current environment where one has minimised the distance between set point and himself. Thus arrives the problem of survival of the fittest. Since environment itself keep changing - fittest win big but also always- lose big. Extreme success is a curse, therefore"

...and he goes like "Yea true. But this idea is nearly 150-year-old. Darwin?" And we went back to watch this new hyped- up movie.

"....the most adaptable necessarily are less fit in any environment than the fittest ones. The spare capacity that doesn't optimize things to the tee, grants an individual or organization the capacity to adapt" I thought & wondered this too has been said before?

Whatever. I think experienced portfolio managers know this too intimately. That's why there is always some cash in portfolios. Always diversification. Even if GOD told him about a specific asset' sure success- he would still limit the exposure. These ideas appear routine. But one only learns hard way- as yours truly did!

Key message: The one who succeeds the most is never the sole bet for a portfolio manager – even if he is forced to decide retroactively. Diversification and presence of cash – are part of a portfolio, not because he doesn't know enough about the likely successful bet but because no one can ever know enough.

Idea of new year as a concept in investing

Ever wondered why every society- in every part of the world- marks a day of new year? Not really because there is anything new. Time and physical realities are boringly continuous. Yet we all need a day to serve as a temporal landmark. A day to reflect. On good or bad. To introspect and adjust. But more than that- we need a clean slate. A fresh start. Because it is therapeutic.

New year is a CONCEPT. Not a reality. If you are managing money or portfolios - you may know its value!

Every now and then, your team will face losses. Sometimes so significant that pain will seem unbearable. Your reflex will be to feel gutted. To accuse something or someone. Mind clouded. This is a state of mind - that is a fertile ground to compound the mistakes. To get you to the point of no return.

In such set ups- tell yourself and your team that Tom is a fresh start- A new day. Accept the mistakes, forgive each other, and if possible, reshuffle the roles. All of it to ensure that Tom' decisions are unburdened of the past errors. After this night, it should look & feel like new ....like really New!

Professional investors understand that it's hard to not just exit losses, but also to move past the pain of past mistakes. Even after exiting positions, the scars remain.

To that extent, stop loss isn't a mechanical idea. We must find ways to regenerate our selves- unscarred of the wounds of the past. New year gives us a framework to imbibe that.

PS

Bholu used to question it as free pardon. I tried telling him many times that in investing-for the virtue

of being a 'continuous problem', the most important thing is not to be remorseful but to make adjustments after the catastrophe. Avoiding a mistake is foresight, but dealing with it is science. But he will be like 'hum nahi manenge'

Key message: The lesson of the failure is not in its remorse, but in its utility to change our reaction function – if the similar set up were to recur.

Equity vs bonds – type 2 vs 1 minimising

Equity bottom-up investing is concerned with minimizing Type 2 error. This is because, only around 5-10% of firms will yield nearly all returns over the next 10-30 years, just as it occurred in the previous three decades. About 80% of the current firms will either fail or yield returns lower than bonds. This skewed outcome forms the basis of the strategy to minimize Type 2 errors, emphasizing the mantra of "don't miss a big opportunity." Or "I shouldn't reject if it's not bad". It's about casting the net wide.

Bond, credit, and macro investing strategies are about minimizing Type 1 error. Such strategies underscore the principle of "lose less." Or put it simply "I shouldn't select if it's not really good". It's about narrowing the funnel.

So- in stock investing- type 2 error is in not implementing a good idea. Minimising it means- you could end up having a few ideas/stocks which aren't good enough. That's okay because losing a good idea will cost a lot more.

And in credit or bond investing - type 1 risk is the error of implementing a bad idea. That risk must be reduced.

PS1

There was no wolf, and villagers came running to help = they committed type 1 error.

There was a wolf, and villagers avoided the call for help= they committed type 2 error.

PS2

Our instinctive reactions to potential threats, such as spotting stripes and assuming it's a tiger or hearing a hiss and suspecting a snake is a type-1 risk minimising framework. Howsoever low the probability may be- we must gear up for "fight and flight" - is how it operates.

PS3

You shouldn't underwrite credit with T2 minimising framework or look for stocks with T1 minimising one.

Remember that T1 risk is an error of commission. And T2 is of omission.

In credit - make less mistakes even at the cost of losing good ideas. In equities - don't miss - even at the cost of having some bad apples.

PS4

Bholu is different. He is cynic. He swings from being a T1 to T2 minimiser- resulting in only risk with no return.

Key message: different asset classes requires one to choose between selection or rejection framework. How likely is the success of any random bet is the determinant of which framework shall we use for that asset.

Buy & hold strategy must meet four conditions & arguments against it

Buy and hold (B&H) strategy is a bad idea for a stock though it generally* works for a well-diversified stock portfolio. Here too - as always- conditions apply.

Once you acquaint yourself with long history and contextualize it with the reality of limited life, it becomes rather clear that buy & hold of anything, including a diversified portfolio or index - sometimes works & sometimes doesn't.

There are four conditions a country' market must meet to approve of holding forever (B&H) strategy. One, country' businesses must cater to growing population, two, they must reside in territories of either global or regional hegemon or in its protection, three, the country must have food & energy security, preferably self-sufficiency and four, if it's not at tech frontier then it should be integrated with the world to replicate first world's tech by trading off either its raw resources or cheap labour.

These conditions were met in many or rather most of the countries of the world since Second World War. That era is nearing an end.

As global order disintegrates with US turning inward, much of the rich & semi rich world begins to depopulate, race for regional hegemonies intensifies and the climactic and geo-political constraints on dense-energy sources begin to appear, you are better placed to be suspicious of B&H strategy. There are alternates to It. Look for them.

When things don't compute, Index.

It is okay to believe that most social science problems are un-computable and therefore the best solution may simply be 'indexing the answers'. Market is one such problem and no wonder why indexing is so popular. For the uninitiated, Indexing is all about believing in the view of the aggregate. Sheep index when they herd, birds do when they fly continents and we do when we invest.

The problem begins when a paradox of disbelief in ability to decipher macro trend come along with a fanatic trust in one's ability to dissect the micro. 'We can't know inflation's trend but can very well assess the 'intentions' of the management'- is claimed- Practitioners know that former is a computational problem and the latter isn't or is less so.

Macro's key computational dimension comes from a fact that many idiosyncratic factors of its ingredients cancel out and what remains is a composite' direction which is often secular only punctured by active human intervention or some less frequent but random mishaps. Micro has no such science backing it. Your well intentioned and focused edible oil producing promoter may choose to run airports and the one who was handling your phone calls may want to become solar energy behemoth. Human beings do strange things. At individual level, they are un-computable. At macro level, their behaviour is forecastable.

So when ‘few things don’t compute’ – Index :). Don’t jump to a conclusion that more complex ones do.

Key message: One must not obsess over selecting winner or betting uniquely all the times. It’s rare to know a little more than the market. Thus market itself is a refuge when there is no particularly sharp insight we have vis a vis markets. I have seen far too many people failing to appreciate this part of investing and burn fingers given their obsession of doing something unique.

Stop loss: The biggest trick to succeed in markets

You just missed the turn, one which would take you to your friend’s place. Going straight would take longer. You pause, drag your bike back. What did you do? You stopped the loss!

You leave for vacation and you are told that your kid has developed some infection- you are agitated as hotel and flights are booked. Yet, you know you must go back else it could be costlier for the family. You return. You pressed stopped loss.

We make friends and then realize some are not really good, join firms only to recognize within a few months that something simply does not feel right. What shall we do? Press stop loss!

It’s called a stop loss because you are limiting the loss. But you are realizing the losses nonetheless, losing an opportunity to regain, allowing the good side of life to take charge and your kid to recover. There is always a possibility that ‘not such a good friend’ and ‘a bad firm’ turn out to be rather good in long term. Once you stop that relationship or exit the firm or cancel the flight tickets, that possibility seizes to exist. And our mind is a funny place. It loves what it chooses. Its pained to see its choice get reversed. Howsoever clever you may be and whatsoever be the evidence of wrong that you are committed to, there is an enormous inertia to accept the mistakes and reverse the decisions. Most firms that you love, will be bankrupt in your lifetime, not because of the wrong decisions that they took, as no one is prescient, but because they floated along the wrong for long enough. Most famed leaders would go down the same path. So will be many popular investors of today.

And I think, this is the single most important trick of a successful life, but who am I to sermonize on such matters, so I will limit my claim to the domain of markets. There is no way for anyone to do well in markets, unless he has learnt the tricks of exiting loss making bets – in some rule based manner. There are no ideological biases of markets, no place or asset that is predestined to do well and no men who are omniscient. Every one, place or people, firm or markets do well and then stop doing well. One has to develop a framework of exiting positions that have strayed too far for one's comfort.

Stop loss can’t be basis feelings of an investor because it only gets triggered when losses have gone too far. Nor can it be basis evolving views which are formed basis just in time narratives. Its rules have to be pre-set, even before the position is taken. The mechanics of it- has to be basis individual’s capacity to take losses and historic volatility of the assets.

And remember, it’s not a pleasant exercise. It is a rather painful one, that will fill you will both shame and remorsefulness. Often, you will tease yourself of buffoonery of exiting things or positions that eventually recovered. Yet there is no way to survive markets without stop losses. No way.

PS
Something wasn’t right that day. Our fav singer KK knew it. Wish he had pressed the stop loss.

Key message: Stop loss is the single most important marker of investing success. One who has deployed decent module of stop loss – will be able to take risk better. The only successful alternate to stop loss is being omniscient.

Surface area increase

"You make yourself widely known and famous because you increase your chances of getting lucky in some way you can't predict in advance. One point of fame is to simply increase your surface area exposure to lucky accidents." said one of my intellectual hero, Sutherland.

"When you read biographies of people who've done great work, it's remarkable how much luck is involved. They discover what to work on as a result of a chance meeting, or by reading a book they happen to pick up. So you need to make yourself a big target for luck, and the way to do that is to be curious. Try lots of things, meet lots of people, read lots of books, ask lots of questions." Wrote Paul Graham. Few say such wise things.

Upon reflection, a cyclical investor found himself pondering on the following thought: "in order to outdo the market, one must cast his net wide. Know many 'fields' & play various 'games'. Sometimes bonds, sometimes equities. At times the US market & some other times India. Sometimes risk free, at other times risky bonds. Sometimes, inert for long, while at other times, quick & active. Only by making the playground bigger & tool kit diverse, one meets opportunities more often and can aim at bigger spoils"

Key message: Even though- far too many investors are focused on just one asset – either bond or equity or real estate, the best way to do well is to know all of them well. All asset classes are cyclical – their risk premiums oscillate, moving from one extreme to another. Just a decent understanding of all assets will help you dial up the ones which offer the best risk premiums. One trick ponies don't work well.

What Should You Track in macro?

The abundance of data on the US economy, coupled with many good analysts tracking it, simplifies our job of observing prevailing views and deducing accurate insights about US markets. However, make sure you don't get swamped by the minutiae of US macro details, especially if your primary objective is to grasp the broader picture (and not to optimize US assets). Conserve your analytical bandwidth for other key areas, most importantly China.

China's data is as important as the US's, particularly for driving global growth, influencing commodity prices, and affecting emerging market currencies. Yet, the scarcity of good analysts and the dominance of propaganda often lead to a one-sided perspective on China. So be cautious of the noise in this space. Watch what its policymakers do instead of what they say. East Asia tends to precede China in economic trends and offers more reliable data, so you may choose to infer China's macroeconomic conditions through that lens. Its currency is a more reliable short-term marker of both local policy and macro conditions. Loan growth is a good medium-term marker of growth impulse. Its equity markets are less reliable, and bonds are somewhat better.

And now India. It perhaps has the highest number of equity strategists and analysts (on a per-unit market cap basis). This makes the analysis of Indian stocks rich, dependable, and plentifully available. But due to limited good economic data and the RBI's policy of intervening in currency markets to subdue volatility and extreme valuation, our currency inferences must rely on global macro setups. In the case of bonds, for similar reasons, plugging in the RBI reaction function and US bonds get us reasonable results. Most good Indian economists tend to be bond-focused instead of currency-

focused. Hopefully, this will change as Indian heft rises in international markets, and foreigners become more dominant in local rate markets.

Europe and many other parts of the world economy, while significant to the global economy, don't offer novel insights. They, barring political or geopolitical events, generally echo the dynamics of the US or China.

Most cyclical investors can limit their exposure to just two geographies: US bonds/US tech/S&P 500 and Indian equity/bonds. If you have more bandwidth, then perhaps look for distressed valuations in Europe, China, or Japan. Generally, it's a good idea to limit exposures to these to the extent of 10-15%.

If you are looking to build a career in Indian markets, choose credit over equity, currency over bonds, buy-side over sell-side, and market over economics. The value of an opportunity for a new entrant is based on market size deflated by the number of people already doing that business. There are too many equity strategists and analysts in India. Too few in currency, credit and bonds.

But what if you are passionate about equity as a 20-year-old? Well, it mostly doesn't matter. All markets are equally fun!

Key Message
For multi-asset investors or asset allocators, it's crucial to focus on the broader picture and key areas like China and India, while also being aware of the noise and limitations in available data. Prioritize your analytical efforts to track meaningful indicators and diversify your exposure wisely.

Some formulas that will help you forecast growth of India and other economies

1. Long term growth = labour growth + its past growth* (10-20 years of growth)

*Best is to look at per worker output growth

2. Medium term growth = long term growth + balance sheet cycle (leverage or deleverage cycle of private balance sheets)

3. Short term growth = Medium term growth, business cycle (up/down), crude cycle (only for India), policy cycle (fiscal/ Monetary - tightening/loosening), and some random variables (war, pandemic, crisis in other major economies)

PS

In demography - the key thing to track is labour population growth over next 10-20 years.

Long term = next 10-15 years
Medium term = next 3-5 years
Short term = 1-3 years

All of these formulas have errors. But for markets - you can ignore them.

Also you will notice that these formulas will never catch break outs (1991 India) and break downs

(2022 Russia, 2012 Greece). But such breaks are rare and should be responded with a market framework (stop loss/stop out).

Key message: This is a very simple framework of how to calculate the growth of our country. For short, medium and long term.

Global downside and upside risks

Factors such as expensive energy resulting from climate change policies and underinvestment, a declining working-age population in the most productive economies, a disintegrating global order, protectionist policies, and reshoring all suggest that global real interest rates will be higher in the coming decade, even as growth slows down. This implies that a significant amount of TINA (There Is No Alternative) money will likely flow into bonds, easing the FOMO (Fear of Missing Out) felt by many investors. Consequently, returns over the next decade are expected to be lower than those achieved by investors in the previous decade.

Regarding demographics, the top four economic regions, which represent 60% of world consumption (US, Europe, China, and Japan), are expected to see their working-age population decrease by approximately 20% over the next 30 years. This demographic group is the most significant in terms of consumption and earnings. As there will be fewer babies and more elderly people, the structure of these economies will change. Healthcare costs will rise, while housing, auto, and education spending will decline, resulting in slower growth. Keep these trends in mind when making long-term asset allocation decisions.

The upside risks to the global economy could stem from two distinct areas: a breakthrough in energy technology and progress towards Artificial General Intelligence (AGI). These upside risks have never been as plausible as they are today. It's interesting to note that both significant upside and downside risks are present in the current environment, which supports the idea that timing the market and developing strategies to do so could be advantageous for investors.

10 macro rules

1. If a country imposes 20% tariffs on all imported things: local currency will appreciate by 20% (Trump tariff plan). Most surprising thing = tariffs don't matter much to current account (2017 US exp)

2. Govt increase the fiscal deficit or oil collapses or non-mortgage credit surge = profits of corporate will surge (2020-23 whole world ex China)

3. Credit growth accelerates Or debt to GDP rises sharply: Property prices will rise (India 2000s due to credit, India 2010-14 debt to GDP), CAD will rise, currency will depreciate (doesn't apply to USD though)

4. Household reduce buying houses= corporate are forced to absorb these savings, resulting in major M&A, buy backs and trophy assets at crazy valuations, growth slows, current account bloats (Japan 1980s)

5. Household don't buy houses+ corporate don't absorb these savings = savings leak to rest of the

world, current account surplus rises, less activity at home, consumption slows (Japan 1990, China 2020s)

6. UPA fiscal policy template is western. NDA' Chinese or East Asian. Fiscal stimulus UPA styled (2009-10 = inflation, rural income growth, property boom), NDA styled (2001-03, 2020-22 = low-inflation, boom in fin savings, listless real estate). Former entailed income transfer, duty cuts, MSP increase and the latter, infra spend, supply side (PLI)

7. QE = less inflation, more inequality, tech outperformance (2010s US). Fiscal expansion by way of direct transfers (2020s) = more inflation, less inequality.

8. Three USD/UST regimes: tight dollar, high UST (2022) is the worst for all fin assets, weak USD, lower UST (2019 pivot) is great for fin assets, tight dollar and lower UST, US markets do better than all other markets (2010s).

9. Inflation is more likely a fiscal phenomenon than a monetary one. India inflation is a function of MSP, crude and fiscal deficit (more with revenue deficit)

10. If your country' inflation is going to skyrocket (Venezuela or Turkey) - assets which will preserve your buying power= Dollar > real estate > stocks > local currency cash > bonds

Key message: These are some rules that work. They are born of my experience and my reading of markets over past 2 dozen years. Many won't agree. But let us debate on them at least!

Macro indicators that work

Do economic indicators work? It is true that economic growth slowdown or acceleration is the most reliable way to predict the markets. But very few macroeconomic indicators help us with it, Some such are:

US = housing permits, auto sales, ISM mfg
China = Total social financing, auto sales, PPI
India: Auto sales (PVs, not two-wheelers), NONG imports & WPI (less reliable)
Global = exports of East Asians (Taiwan, Sk)

The above list appears too short, isn't it? Because we all are used to long macro decks with 100s of variables. The fact is that many core indicators such as IIP, PMI services, CPI, core industry, taxes etc. tend to be erratic, coincidental, or cluttered with noise. They may help in building higher confidence in our thesis but rarely help in detecting the turn of a cycle. They may be of great help to policymakers or industry. But if the objective is to solve markets - many of them don't yield much.

Many economists create composites of indicators. But there is a danger in doing so. Each cycle is different and aggregating the variables removes the possibility of weighing such variables depending on the uniqueness of a cycle. Of the available ones, OECD CLI works somewhat better.

What gets the cycle' turn is the behaviour of discretionary & and high-value consumable sales, such as auto and housing, which are not close to saturation in terms of ownership. Unilever or Dabur volume data, firms' wage data, train passenger traffic data etc. won't get you that!

If you have been reading this blog, you know that I like 'market indicators' more than 'economic ones'.

The markets which are adjacent to 'real economic variables' get us better insight. Why? Because they do a dynamic weighing of many variables. Something that routine dashboards or static composites fail to do....

....e.g. we are better served relying on short bonds to predict inflation, long bonds to predict long-term real growth, currencies & and HK equity to gauge global fin conditions, crude to deduce geopolitical risk, 'copper to gold' ratio + shape of yield curve + 'internals of stock market' to assess global growth, 3m CP/Bill spread for local fin conditions … and so on. This list is long and I have written about it in the past.

Key message: There are so many economic indicators. If you are not in business of watching each data keenly – just know the important ones. But also know that markets are better predictors of other markets. How does one use the market to forecast the market? The trick lies in viewing the "target market" as the outcome and all other markets as the variable inputs. While it may sound somewhat simplistic, trust me, this works better than being overwhelmed by reds and greens of macro-economic dashboards.

A few macro set-ups or analogues

Inflation: Even though equity is a inflation pass through assets, higher inflation hurts because it leads to higher rents, land and resource prices, wages. So moderate inflation is best for equity. In India – that number is 5-7%. Not 4%. In US, 3+ inflation is corrosive for equity returns. Inflation @ 2-3% is the best environment for multiples. Above 4% inflation hurts consumer, and real demand plunges. Bad for earnings that is. Health care, RE and energy do well in inflationary regimes. Financials do okay. Bonds are the worst assets to own then.

Deflation: Hiking rates are generally enough to cure inflation. But cutting rates is not adequate for deflation (Japan, Europe). Bonds love deflation. Even though Gold is seen as inflation protection, its zero coupon becomes a charm. Equity is the worst asset class to own in deflation.

US recession: stocks peak 6m ahead of recession. On average. USD strengthens into recession. Global growth slows. US recession first works on periphery – KOSPI, EM index, Equal weigh index, US micro caps. Asia exports, Sweden industrial output and global manufacturing (PMI, IP) weaken. On average SPX fall by 35% odd into US recession (7-8 times in last 50 years). Bonds are the best asset to own before recession. Commodities are the worst.

Wars: War is bad for country which is going into war. But neutral to most other countries – unless a country imports a lot of raw materials. War is good for USD. Generally, benefits US. Most get whipsawed into war trades. So best is to either ignore it or have strict stop losses while you mount your trades. Oil is an insider of a war.

Housing price boom: everything does well into housing boom (2004-07 US, 2006-13 India, 2008-20 China), CAD expands (China is an exception), eventually paves way for very weak

economy and poor macro. Housing boom is policy's nightmare – everyone loves it but it's after effects are very bad and difficult to cure.

Policy: Fiscal and monetary policies tend to oscillate - a subdued inflation paves way for higher fiscal deficits and low real rates (1960s US, 2010-21 US monetary policy, 2009-13 India fiscal policy). Loose policies leads to more CAD, more inflation and eventually a lot of macro-distress in the country. Equities love loose fiscal policies. Bonds hate it.

Productivity boom: It always feels like one in booming markets, is almost is never like one. So rare (once in 100 years thing) it is that its best to ignore it.

Commodity cycles: 15-20 years of busts and then 10 years of boom. Commodities offer no risk premium. Booming commodities favour resource rich EMs. Coincides with weak USD, so favour equities too. Since commodity prices are mostly about today's demand and supply, they don't price future well – and thus end up going to extremes (lows and highs). Extremely high prices pave way for equity and bond busts, and extremely low ones – for booms.

HOW DO WE PRICE US RECESSIONS IN MARKETS?

Do the earnings of corporations ever fall? Yes, they do. The S&P 500 has seen earnings fall 13 times in the last five decades.

Do recessions cause earnings to fall? Yes. All recessions cause earnings to decline.

How much do earnings fall in recessions? It depends. The lowest declines were in 1970 and 1982, at 8-10%. The highest declines were in 2008 and 2001, at 31% and 46%.

And on average? Earnings fall by 21% in recessions, on average.

What are the S&P 500 earnings and estimates? The S&P 500 earned $218 in 2022. The analyst estimate for 2024 is close to $245.

If there were to be a recession:

Valuation: The market is trading at 19x 2024 expected earnings.
Valuation (if recession): 23.5x 2024 earnings (earnings will likely be $196, with an average fall of 20% applied).
Historic valuation of the S&P 500: 17x expected earnings.
Therefore, what exactly is the market pricing? No recession and four rate cuts in 2024.

Possible? Yes.
Probable? No.
If there will be a recession sometime in 2024? High probability.

Year	YOY Earnings Growth	Recession
1970	-9.67%	Yes
1975	-17.54%	Yes
1982	-8.96%	Yes
1983	-3.84%	No
1985	-6.89%	No
1986	-7.97%	No
1990	-6.87%	Yes
1991	-14.79%	Yes
2001	-30.79%	Yes
2007	-5.91%	Yes
2008	-40.02%	Yes
2015	-13.50%	No
2020	-14.92%	Yes

How does market pick key variables in a dashboard?

It seems to me that markets run dashboard of many variables but it only attends to or react to ones which cross certain strike prices e.g. Only when crude bursts above $80, bonds begin to take notice & only at $90+, equities shudder. Markets wait for a full month in early 2020's to react even after its evident to many of us that Covid was a malaise the world would have to deal with. I have always been perplexed about this mechanism because folklores of market's infinite intelligence don't tally with these episodes of rather late or lazy reaction functions.

Here is my speculation about this. Since markets need to bother about too many variables, they have inability to pay ATTENTION to any specific one, all the times, even though it may eventually drive a regime change. Criticality of a variable is noticed & reacted to, only when it's value crosses certain level. This is fair since most variable functions should simply be assumed as oscillators and its best for Mr Market to ignore them for most of the times.

That's exactly how a human attention system also works. We don't attend to every data hitting our sensory system. It's only when something is awkward which we can't model, our attention system forces us to take notice of. You can imagine yourself driving car perfectly well without noticing any one, humming some song or having an intimate conversation without having to pay any attention to anything on the road. Not that you don't 'know' of what's happening on the road, it's just that to drive, the cognition or being aware isn't required until something untoward is noticed by you or more specifically, your perception system.

Most market theories suggest that Mr Market has a method which continuously updates its models relating to all variables. I dare say that it may not be true. I think market work exactly like human minds (or cognition). Ignoring most data points until some of them assume criticality.

I still need to develop on this idea but if my speculation is true, then the utility of this is as follows: If one is able to identify an important variable which will bring about regime change or get a break in momentum, he is best served by acting linearly to the variable's movement, modulating risk with it without waiting for the strike price that will trigger market reaction.

Problem of dashboard approach

The problem with a dashboard approach, both in businesses and markets, is that it automatically assigns equal weights to each variable that its populated with. The 'reality' is that almost all regime changes are driven by a single dominant variable that eventually reflect in many others, albeit with a lag. Markets and customer biases

change much before changes appear widespread and are readily picked up on the dashboard—therefore making the dashboard void of any utility.

Net net, to win markets or businesses, we must get that dominant variable right. One's dashboard is not an algorithm to deduce from, instead it's a bouquet of variables to choose from.

KEY MACRO RISKS FOR THE MEDIUM TO LONG TERM

I have written about the disintegrating global order in the past and its dampening effect on both growth and risk appetite. Unlike the post-World War order, when the world has been unipolar, the current setup increasingly resembles the 18th and 19th centuries. Some of this is being expressed today. Don't think of it as one-off events. More and more of such stories will come your way over the next many years. (Strongly recommend reading Zeihan's Disunited Nations and Mearsheimer's work on structured realism.)

The world has moved from a liberal order where trade and markets dominated politics to the dominance of structured realism. In this new reality, mercantilist setups rise, most games are zero-sum, regional hegemons seek rents from neighbouring countries, defense budgets rise, and nationalism dominates.

If you are a macro investor, you must train your risk models to the reality of climate change (which dampens dense energy supply, leading to high crude prices) and the disintegration of the US-led order (resulting in a mercantilist world characterized by low trade, reshoring, low capital flows, and low growth). Even if you are that famous breed of 'we only pick stocks,' be aware of the changing conditions in which your great business resides.

All of this does not mean you don't dial in/out risk. The routine cyclical nature of growth and policy should still drive your risk on/off decisions, but exterior conditions should be considered before taking very long-term calls. It's best to avoid doing that. Buy equity when liquidation is in play and sell when complacency sets in, macro conditions worsen, and magical stories are needed to support market levels.

Key message: The shift from a liberal world order to structured realism presents significant risks for the global economy, affecting growth, trade, and capital flows. Macro investors must adapt their risk models to account for climate change and the new geopolitical landscape. Regular cyclical trends should guide short-term decisions, while long-term calls should be approached with caution.

Rules of Money

Only commercial banks and central banks are licensed to do 'credit creation.' Always remember that credit creates deposits because, even if we know it, we don't tend to use this simple idea.

Non-banks, such as mutual funds or NBFCs, can't create new money. They can only broker credit transactions (they are risk transferors).

It never makes sense to worry about where banks will get deposits to lend. They will always get them because they create them! Also, it's almost never a concern whether the government will be able to raise money to fund its fiscal deficit.

The Cash Reserve Ratio (CRR) is not a constraining factor for credit anywhere in the world. Banks lobby against it because it doesn't earn anything for them. High CRRs are a way to achieve financial repression, with better optics than both inflation and YCC.

Even capital is not an effective constraint for banks because, in good times, banks can raise plenty. In bad times, they don't raise as much as they should (due to dilution at low PB multiples). For financiers, raising capital should be a market timing exercise, not a business timing one.

The real constraint for banks is their sentiment about themselves and the economy (not capital or CRR). That sentiment is reflected in their lending standards.

Tight monetary policy leads to tight lending standards with some lag. Then there is a 6-12-month lag between lending standards and credit growth. Thus, the rates that are operational today have nothing to do with the rates prevalent today.

It's better practice to watch M3 instead of bank credit growth. M3 gives you a better idea of money's thrust for growth or inflation, as it combines both credit and fiscal thrust. (M3 is the reason India's inflation didn't misbehave as much in the last 2 years).

Commercial papers (not bank lending) provide growth capital to non-bank financiers. Since non-bank lending tends to be more cyclical, the CP market is full of insights—not just about the mood of the NBFCs/MFs but also about the economy.

The lender of last resort (RBI) effectively has a monopoly in lending. Every bank must comply with its directives, and the banking system cannot act against its desires. So, if the RBI wants a slowdown in PLs, banks will comply—regardless of their own views.

And a bonus rule: UPI transactions are an indicator of that indicator only. They may tell something someday but tell nothing right now.

WHY BIG GLOBAL RISK CAPITAL WON'T COME TO EMs NOW

All emerging markets (EMs) face the same fate: becoming autarkic, kleptocratic (no use of market then), or socialistic (transferor state, so rent-seeker from businesses). Only a very few grow to become developed markets (DMs). Growing is a hard problem!

Over the past decade, investors have been reminded of this reality. The DM/EM convergence project has slowed, if not stalled. Misty eyes are now waking up to the reality of a sparring world and antagonistic trade. Developed world capital now has a lot less affinity for the charm of liberalism and globalism. Their masters are placing geo-strategy ahead of labour arbitrage.

Onlookers see this as a tightening Fed problem. Those in the know see it as history being rerun.

In this dark EM world, India is a rather bright spot, still traversing a narrow lane of growth and convergence. It hasn't yet taken the socialistic, kleptocratic, or autarkic turn. But it's still a narrow

lane, not a highway, and “yet” remains an operative word there. Assuming it as the only possible outcome may be patriotic, but don’t expect hardnosed capital to ignore other possibilities.

Peak risk appetite is behind us, not ahead. What lies ahead is trickles, just trickles!

Key message: The convergence of emerging markets with developed markets has slowed, and global risk capital is now wary due to geopolitical tensions and shifting priorities. While India remains a hopeful exception, the path to growth is narrow, and the future inflow of risk capital will be limited and cautious.

Terminal Growth

Since Buddha and Mahavir were giving sermons in and around Benares, up until the 1700s, global per capita income likely remained the same. Zero growth for 2,000 years. That means growth is rare. Very rare.

Since the dawn of the 18th century, we've seen a sprint in economic growth. The catalysts? Industrialization and the advent of affordable fossil fuels. Income grew by 1% per annum in most advanced economies. Did you just think, "that’s all"?

Post-World War II, economic growth didn't just walk; it soared. The world grew at 2%. Lesson so far: growth is hard and rare. 2% is a gold standard in the near term. 1% in the medium term. And over the very long term? One has to be pessimistic.

Argentina, once a top-ten global economy and a rival to the United States, has been in a serial crisis. Today, its per capita income is only about 10% of the US, and its economy is less than 5% the size of the US. This serves as a reminder that unpredictable events can shape a nation's fate.

Once flourishing economies like Iran, Greece, and Russia turn decadent, while others like Japan, which came close to surpassing the US in the late 1980s, abruptly cease their growth. It makes us ponder if a comparable destiny awaits the birthplace of modern civilization, Europe. Here in the US, bookstores are filled with numerous books arguing for the end of its hegemony.

Some poor countries, which undertake reforms, build their hard and soft infrastructure, and engage with the rest of the world see their growth faster than developed countries. The extent of growing faster than the US is called the convergence rate. Korea converges at 4% since the 1950s. China at 2%. India at 1%. Since the 1980s, China converges at 4% and India at 2%. Most African countries don’t even converge.

The convergence slows dramatically when poor countries become middle-income ones. Some countries begin to slow at a per capita income of USD 2,000, some at 7,000, and most below 12,000. From 1960 to 2010, just 15 out of 101 countries escaped this trap.

Net net, let's reconsider those long-term projections. Such things have been said before.

Key Message: Growth is historically rare and difficult to sustain. While economic booms can occur, many nations experience stagnation or decline over long periods of time, highlighting the complexity

and unpredictability of long-term economic projections. So beware of projecting secular growth for any country or corporate.

Understanding Financial repression

Financial repression is a mechanism of depressing interest rates in anticipation of emergent high inflation. In an alternate setup, which experiences unanticipated high inflation, depressing real rates, authorities may actively talk up the rates to re-anchor inflation, even at the cost of a sharp slowdown. This scenario is not called financial repression.

Financial repression is an ex-ante framework and can't be assessed ex-post.

Investors, not the storytellers, often misinterpret financial repression as a realized real rate. It isn't. It's the anticipated low real rate that frames financial repression.

Since long rates are generally determined by investors (not central banks), there is no way to cheat investors for long. At best, what can be tried is to suppress real rates in a brief window. Investors should recall that high real rates persisted in the 90s even though 80s inflation subsided dramatically in the ensuing decade. What was happening? Investors were overcharging in that decade because the memory of 80s inflation was still fresh.

Key message: Far too often – analysts argue that governments around the world, given fiscal dominance, will practice financial repression. That is about forcing interest rates lower than where they ought to be. As I argue here – just having high inflation isn't a sufficient condition to call the regime repressive. It is repressive – when it forces instruments such as high CRR or SLR on markets or does monetisation of most of the government bonds. Fin repression is not an automatic choice with the policy maker. It is a critical and difficult political decision. There are significant parts of the population (rich and elderly) who are severely worse off due to financial repression. Political calculus has to get their buy in – before implementing such a strategy.

UNDERSTANDING THAT IT'S NOT RETAIL BUT THE RICH WHO MATTER TO MARKETS

The top 10%, the rich, make about half of the total global income but represent only a quarter of total consumption. So they save a lot. Almost all global savings belong to them.

The rest (the next 90%) consume more than their income. They borrow every year, and the rich lend to them—not directly, but through banks. Corporations act as veils for the rich's savings. The rich impersonalize themselves through corporate entities, which limits their liabilities and makes asset ownership efficient.

Since the rest are heavily indebted, dissaving every year, and becoming reluctant to borrow excessively after a point, demand falls short of supply. So the government steps in to spend. Almost all governments spend more than they earn, and the rich lend to them. Thus, the rich save while the rest and the government borrow.

The rich already own 76% of all assets. Because they save every year, this number increases by about 1% annually. In the long run, everything will be owned by the rich—initially by the top 10%, then most by the top 1%, and eventually, just one person will own almost everything. That's Kurzweil's singularity at work in the economy.

This is how the current economic machine operates. It's not a story; we are living it. If you believe otherwise, you've taken the blue pill.

So every time you think of market gyrations, ebbing and rising flows, buying and selling of assets, falling and rising asset prices, and allocation, think of what the rich are doing. Only the rich matter. What the 90% think or do with their savings has little impact on market movements. They are footnotes. When sleek brokers and billionaire investors make retail the champions of this or that cycle, there is a design to that claim, but not much truth.

Key message: Market movements and asset prices are predominantly driven by the actions of the rich, who control the majority of global savings and assets. The 90% have little impact on markets, making them mere footnotes in the economic and market narratives.

India is the same, the narrative has changed

I recently met a white dude from afar—an old acquaintance. I've been seeing him for more than a decade. Always sceptical he was, 'You guys are too many' he would giggle, his favourite cribs for India being terrible inequality, boundless traffic, and inadequate infra. More fascinating were his thoughts on how we, the Indians, were bombastic about our future and state of affairs. I would often tell him that India was doing well in many areas. And more importantly, I will highlight that India was only a USD 2k per capita economy and therefore he shouldn't judge it by the west's standards. Never convinced, he would gently push me into discussing our business.

Then covid struck. His meetings went Zoom. He turned further bearish on India ~ How will your country deal with such a catastrophe? I would mischievously send him many WhatsApp messages and clips of my own interviews- on why India had a great future and perhaps a golden decade ahead of it. To match his pessimism, I wonder if I was turning a bit hyperbolic then.

Anyways. Nearly after 3 years, I bumped into him, and he seemed a changed man. Excited that India had built great digital and physical infrastructure, had enterprising people and west had no choice but to build a coalition with India- he professed a great future for our country.

I came back home and like any analyst – opened my excel sheets again – to check if I had missed something critical. Like, seriously! Unlike the grand narrators, a risk-taker is a lot more uncertain about his views.

As I stared at Madisson's data set, I was reminded that since independence India's per capita has grown at 1% faster than the US. This is called the convergence rate. Since 1990, the convergence has been much higher at 2.5%. It is true that some important reforms have been undertaken by India over the past few years. But, they pale in contrast to the impact of LPG (Liberalisation, Privatisation, and Globalisation) reforms of the 1990s and early 2000s on our economy, which changed India from backwaters to a fairly industrialised and capitalist country. Since then, per capita income has grown at a handsome 6% annual rate for over three decades. We now have a much larger economy. The low-hanging fruits have all been picked. What lies ahead is the weight of a larger economy, driving slower growth rather than acceleration. The only good news is that we will begin the journey of convergence with China – the first time ever in the past 30 years. Not because we are growing faster – but because China is slowing faster!

Key message: Though current bullishness seems headier than what we saw in the 2007s, it's an impact of a strong narrative instead of strong data. The Mumbai elites have built a great coalition with New Delhi ones in building this narrative. Old wine, in more or less the same bottle, is just being marketed better. But markets will be arbiters of truth in the long run.

India vs US convergence

At what rate is India's GDP converging vis a vis US = 2%
At what rate have they been converging since 1980 = 2.5%
But at what rate did we converge in 2000-10 = 10%

So when I say 2% = the Indian GDP is growing 2% faster than the US.

The biggest myth perpetuated by New Delhi (political types) & Mumbai elites (market types) is that we are accelerating vis a vis frontier economy (the US). Nope. Both China and India are rapidly slowing in convergence. And that is our (not of China- as much) biggest headache.

Key message: The convergence with US has slowed over past decade. This is a terrible news. But also from market standpoint – the whole argument that now is the birth of India story – is a fallacious one.

China is not in shambles

In India, it's common to hear the myth of "China is in shambles" which a fellow panelist reiterated in yesterday's TV interview.

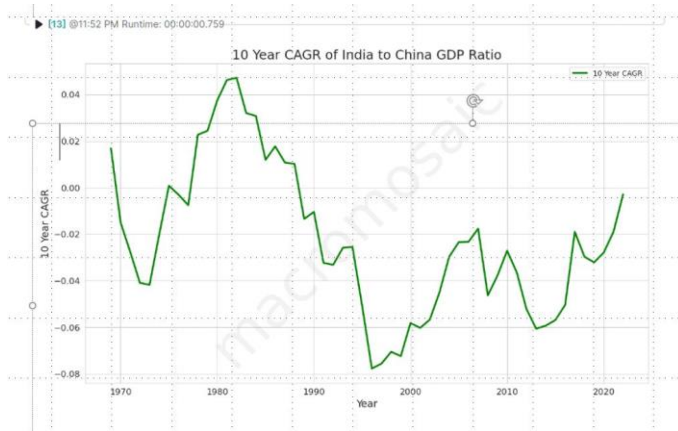
Has it?

Bad news: Even last 10 years - when China has slowed remarkably - it grew somewhat faster than us.

Good news: It is very likely that India will grow somewhat faster than China. Demographics will equal a nearly 1% drag on their GDP growth vis-à-vis ours over the next 3 decades. Western ghettoization will hurt it too. Plus, the odds of an upper middle-income country converging with a frontier economy are very low (historically speaking). But this is my "view". No empirical evidence of convergence yet.

Did we ever grow faster than China? Yes. In the 80s.

The chart = It's the growth differential between India and China's GDP (in USD) on a rolling 10-year basis. You will notice that in the mid-90s, China was growing at nearly 8% FASTER, and then until 2015, it was growing nearly 4% faster. Now growing as fast. The last data point is for 2023 - I have taken 3.75 trillion for India and 19.37 trillion for China.



Key message: It's unbelievable how the popular perception can yield to desire instead of hard facts. Over years – I have tried to defend my position that it is too complacent of us to believe that China will self-destroy. They deserve for what they have done, and we better be threatened if we don't do well.

On credit growth

Me: Bhai, what is the likely bank credit growth over the next 12-24m?
Banking analyst: 15-16%

Me: On what basis?
Banking analyst: Pointing at the Red and Blue lines of the attached chart = look at 1-2 year credit growth.

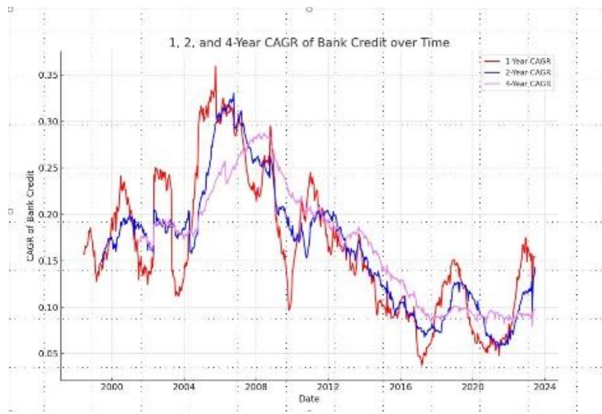
Me: But that's the un-doing of the Covid slowdown in credit. And I point at the PINK line. the Four-year credit growth remains at 10%. That's the peak of credit growth in the last decade.
Banking analyst: Why? 2018 was strong.

Me: 2018 YOY was strong because of NBFC replacement. Overall credit was the same. Again look at 4 years CAGR of 2018 (that's a look through of Demon/GST then)
Banking Analyst: Banking b/s are strong sirji. So credit will be faster. The 2010s were supply-side issues due to NPAs.

Me: India never had many supply-side issues on credit in the 2010s. It's a big misconception. In fact, the 2010s were boom years as financiers figured a way to lend to retail. That thing un-existed before.
Banking Analyst: Sir, ab toh aap kuch alag hi cheeez bole rahe ho!
Me: The majority of credits were cheaper* in the 2010s than in the 2000s (on average). Home loans, personal loans as well as industrial loans.

Banking Analyst: What do you think the next 1-2 year credit growth will be at?
Me: 10% or thereabouts.

*cheaper = relative to benchmarks



Key message: I want you to know what will be our credit growth – if that's an important assumption in your assessment of banking stocks or general markets, consider 10% is the answer. Of course- there will be times when it will be higher or lower. But for long term – its best to assume that credit growth will be close to nominal GDP growth.

SPECULATIVE ESSAYS ON MACRO……….

These essays explore a range of macroeconomic issues, including growth, taxation, and biophysical constraints, reflecting my personal views. Given the speculative nature of these topics, it's important to acknowledge that many knowledgeable individuals may hold opposing perspectives. I term these essays "speculative" because they delve into areas where definitive scientific proof is often elusive.

Future of Finance

Imagine a future where Aadhar serves as your account number, and your mobile functions as your branch with a direct link to the Reserve Bank of India (RBI). Every new-born automatically receives an account under this system.

When you secure a job, your employer pays directly into this account. You receive and make payments through UPI on your mobile. Any idle funds in your account are automatically invested in 14-day Treasury bills through RBI Retail Direct. Additionally, you can purchase 10-year bonds with a simple swipe on your mobile, effectively managing your savings and investments without involving banks.

This poses a challenge to banks as they must compete with a genuinely risk-free product for deposits. It signals an end to the era of financial repression where banks could leverage deposits at lower rates. This shift is advantageous for consumers but poses challenges for traditional banking institutions.

Moving to credit, traditionally a core function of banks, involves evaluating an individual's identity (Aadhar number), financial history (CIBIL score), income, and collateral. As more assets and income records are digitized and tokenized, credit underwriting is set to become almost entirely mechanized within the next decade. Standardized algorithms will assess creditworthiness based on income, payment history, and collateral provided through account aggregators. Even for businesses, factors like GST filings, tax records, and ongoing credit assessments will drive lending decisions. While this process is somewhat in place today, it will become more efficient and automated.

Looking ahead, if banking's credit function can be streamlined into an app powered by data processors, one might question the necessity of banks themselves. China's experiment with CBDCs offers insights into this potential future. While this may sound dystopian, it underscores that in such a scenario, a bank could essentially function as a utility, combining data processing capabilities with the authority to create money granted by the RBI. This would diminish the influence and discretion historically wielded by bankers in both public and market spheres.

Already observed in developed nations, this trend towards utility banking should also manifest in India. Future generations may find it curious that bankers once held significant power and influence.

Key Message: The future of finance is likely to see a transformation where traditional banking roles diminish, replaced by efficient, automated systems that democratize access to financial services while reducing the influence of individual bankers and financial institutions.

Bananas vs. Banana Shakes: The COMPLEXITY OF GDP CALCULATIONS

Me & 14-year kid. At a grocery store. Discussing the GDP of a banana vs juice.

I: Why don't you have a fresh banana instead of a cold-pressed banana shake? It's healthier for you.

Kid reasoned: And it's also cheaper for you, Papa. ☺

I: That's true too.

Kid: But how about GDP? You bring up GDP in every conversation. ☺

I: Well, when it comes to GDP, the packaged fruit juice will be more valuable.

Kid: Why? Banana is more nutritious, so shouldn't it be more valuable?

I: Hmmm, the juice offers some other benefits that we humans value a lot more. Not always. But at times.

Kid: Like what? Food is after all for just nutrition & calories.

I: We value the convenience of being able to pick up a bottle from anywhere, even in places where bananas don't grow. We also value the convenience of having it available even when it's not banana season. Additionally, the juice tastes better when it's cold, and we have a preference for that. There's also the standardization factor - you're likely to get the same product every time. With bananas, you can't always be sure....

Kid (interrupted): Come on, I picked up a good, ripened banana. How hard is it to know that it's good?

I: You know about bananas, but can you tell if oranges are good? Look at that heap of oranges over there.

Kid: Hmm, no, I can't. But how can we determine the 'extra' value of juice over a banana? There is some give & take there- so it seems.

I: There's no sure-fire way to know. The best method is to rely on prices. The fact that people are willing to pay 10 times more for a juice suggests that they consider it more valuable.

Kid: That seems crazy. We should ideally value nutrition and freshness more.

I: That's true, but GDP isn't perfect. It's a statistical measure of the value we humans create. At its core, it assumes that we value "more good" over "less good" in a rationale manner- pricing accordingly.

I followed up with a Q: Anyways, can you imagine a country or a place where a fresh banana would be more valuable than a banana shake?

Kid: I guess in a place where it's difficult to grow or transport fresh bananas. Where people value its freshness & nutrition more. Like Antarctica, maybe?

I smiled. He was thrilled because he cracked the code. I didn't want to bring up other complexities, as it would deflate his excitement.

But while I write this- I wonder if this value business has been fully subverted in our civilisation. What if we value the juice just because it's promoted so aggressively? Vs poor Banana- who has no one to promote its story.

And why should one ever buy cold pressed juice at 10x price if fresh banana is being sold alongside. His question, I think, should have invoked more thoughtful response vs what I did. The hubris of know-it-all & habit of tell-it-fast, I guess.

Key message: I am trying to convey how GDP is calculated. At times – the way value add is calculated doesn't seem fair.

GDP measures what we care about – so it will always grow!

What if we transit into a civilisation that is a well-nourished, thriving in towering skyscrapers, and all that we care about is the production of best poetry, prose, love, aesthetics & beauty, and speculative thoughts

that explains the true nature of reality.

And we stop caring about being an ever larger specie. Pursuit of materially luxuries- of grander mansions, speedier transports fade away. And fade does our idea of eternal life!

In that world, our economy' size might break free from reliance on physical resources. Neither crude, nor food, or any physical resource will limit our growth! To this extent, the idea of limit to growth is ill-conceived. Economist friends?

"GDP is a funny concept…. It measures what we have a fancy for. "Considering the consideration…that our considerations keep changing, our GDP growth may never take a pause" Guess, who would have said this?

Key message: Here again – I bring out the nuance of GDP calculation. It is what we wish to measure. Therefore – take all the distant past GDP with a pinch of salt.

The Real Value of Free Time: Exploring GDP, Productivity, and Human Flourishing

As King Vikramaditya continues his quest to bring Betal back to the sage, he is presented with yet another of Betal's clever tales. This time, the story revolves around three hardworking farmers who each labour ten hours a day to provide their own sustenance. One day, they are all miraculously blessed with an endless supply of cooked food. With their newfound abundance of free time, the first farmer cultivates a beautiful garden around his home, which soon attracts bees, birds, and even peacocks, creating a haven of pure bliss. The second farmer spends his days singing love songs, while the third farmer listens to these songs, visits the garden, and indulges in his favourite pastime – sleeping, which yields him longer life than the other two.

Betal poses a question to King Vikramaditya, accompanied by the well-known conditions. Remember them?

"Whose farmer's GDP (income) grew the most?"

Betal also gave him some reference points. A famous portfolio manager recently claimed in a popular podcast, "GPT is a 10x technology. Knowledge workers will become 10x more productive, which will likely cause US GDP to skyrocket!" Similarly, an ever-optimistic Indian strategist recently stated in a report, "India's digitization is a powerful force that will propel our growth to new heights."

Vikramaditya said "Growth arises when improved productivity generates more free time, which can then be directed towards new endeavours and the creation of additional goods or services. In a word when all work will be done by robots and all humans will be busy eating, drinking and merry. The world GDP will be the same as today (if our calculations of GDP don't change)"

"If the next delivery service will begin to deliver everything in 1 min – it will make no difference unless we have something to do in the spared 9 or 29 minutes! Productivity growth is 'just' an enabler to do something else" He continued. "Since we don't count age, leisure and sleep time as GDP. We will continue to have the same GDP even though we may have considerably more free time"

Betal smiled. He likely flew back to the tree! Notwithstanding the unresolved Solow's paradox, most economists will think that his head would have burst into thousand pieces.

PS

The productivity is about relieving time and effort of human being – that in turn can be put to use in other chores. Many have argued why the big boom on social media hasn't led to any productivity. Great tech consumed more time – instead of less.

To relax, cultivate art or grow aesthetics of the environment are better alternatives that the world should ready itself for instead of Huxley's chemically induced happiness. Just in case. That point is far though. I know. For our country, very ---- very far!

Infra is useful to stimulate growth – but only until a point:

It is a tale of two villages. Each produced different fruits. One cultivated mango and another banana. They could both produce far more than they could consume. However, there was no link between these two cities. No road. Tons of fruits were thrown away every year. Wasted.

Once, a wise man from one village came up with an idea. 'What if we construct a road between two villages? Our people will be able to trade mangoes for bananas'

He convinced its farmers to pave road. This meant that some of its farmers had to labour on road instead of planting trees. That little extra work did the magic. When the road got ready - its farmers got a market to sell their mangoes and buy bananas in exchange for them. Everyone was super happy. They had more fruits. Village' GDP grew!

The people of his village were impressed. Building a road seemed to have done so much good. Everyone, in the village started to push him to plan for one more road. He was circumspect but villagers went ahead building it.

What do you think happened then? Did it boost the villager's prosperity further? Did its GDP grow?

Key message: Use this simple model to think of infra-building and its role in GDP. There is a reason why many countries don't do as well despite building China like infra.

Consider for a moment that the only thing that humans consumed in that village was fruits. Once you have this model right - you can expand to include many other things.

People who built the road were paid. And what did they do with that money? - they bought mangoes as well as bananas.

BIOPHYSICAL CONSTRAINTS AND LIMITS TO GROWTH

Economics is called a dismal science because it used to have a secularly pessimistic outlook. Ricardo, a famous economist of 19th century, thought of land as a key resource of production. Since land is scarce, he concluded that land lords would extract all the rent pushing everyone else to subsistence wages. A feudal society was inevitable, he thought, whose population growth was supposed to stagnate under Malthusian framework.

He was wrong. Thinking of land as the most important resource was a mistake. Transition to fossil fuel transformed our society. It endowed us with more power. We built machines which worked tirelessly using that fuel. Imagination, creativity paved way for a technological society. Humans sailed far and wide. Tilled more land,

transported stuff from one place to another. We grew. An average Englishman, since Ricardo days about 200 years ago, is 24X richer today (1.6%pa)

Hard lessons were learnt. Never bet against human ingenuity was the new credo. Economics shed its dismal characteristics.

About 5 decades ago, Meadows wrote 'Limits to growth' and tried to revive the tradition of dismal-ity! Ricardian questions were asked yet again, how could finite planet support infinite growth. Simple models showed that we were growing too fast for the planet and that in, not too distant a future, much before we run out of our resources, we may run out of atmospheric space to grow. If we don't mend our ways, a catastrophe will ensue. Population will decline. We will have to deindustrialize - he argued.

But these ideas remained popular only with a small group of people ~ a club of Rome. Meadow was right but we didn't care much. Our civilization isn't sentient. Who really will sacrifice a marshmallow for a promise of two to someone a century out?

Growth continued.

Cut to the present era, most economists have turned from being techo-pessimist to being hyper-optimists. Nothing contrasts the turn of the tables as much as Cathie Woods, once a practitioner of dismal science, who ceaselessly talks of hyper growth in future. Last she was heard cheering for the latest advances in AI that could bring about 50% GDP growth. Really? How? But anyways.

What's in all of this for a betting man? This idea of limit to growth attracts me, not because 20k Scientists are giving a dire warning, of untold amount of human misery in future. It attracts, because elephant is already in the room. Heat waves, sudden downpours, flash floods are all part of the warm climate's wreckage. We have no option but to impose steep Carbon taxes, make fuel expensive, and introduce carbon tariffs. Don't look at this energy cycle, rising crude, food and coal prices as just another wave of booms and busts. Yes, there are usual arguments of wars and under-investments for the cyclical boom. But there is more meat to it. Being a little bit dismal-ist will help.

Key message: Climate risk is a looming threat, not necessarily immediate but capable of manifesting abruptly in the future. The purpose here is not to incite fear, but to highlight that numerous risks, like climate change, are currently being overlooked by the market. While these risks are not certain, their potential realization could have significant consequences for risky assets. Awareness of these risks is crucial as their impact could be profound if they materialize.

Indian rich think that they are middle class

Dad "we had limited means …. Luxury was beyond our grasp"

Me "but you had stable banking job in 70s. And had a car in mid 90s."

Dad "oh come on, it was a Maruti 800. That's a poor man' car. Not a symbol of wealth"

Me "less than half a % of Indian population had car then. That placed you amongst super rich"

Most Indian who call themselves as middle class are rich! Not because they own fancy cars, do destination weddings, and live in mansions, but because they own Maruti Brezza, do gala weddings in nearby hotel, and reside in well-equipped multi storied complexes.

‘Class’ is relative.

Oil math

“Anyone who knows school level maths know that oil prices don’t matter to GDP…”

An equity strategist told me & my team. In a phone conversation. Sometime in 2015. Just after oil had crashed. We were trying to test our hypothesis that low oil price would mean higher GDP for India.

“Why won’t it matter?” One of my team’ soft spoken fund manager asked.

“Because it will be absorbed by fiscal cushion” he said.

“How exactly? That seems so intuitive that we import oil from rest of the world. As long as it remains un-substitutable, higher price will dampen our output and Vice versa” I asked.

“No. Our GDP is calculated in INR. If higher prices are subsidised by Government or if lower prices are absorbed by higher taxes, it will make no difference to our output” was his retort.

“But the fiscal support and withdrawals aren’t discretionary. An additional real support can only come when there is a slack in the economy. And be removed if economy is at full capacity” my colleague said.

“Oil price works through price effect in local economy. If it is supported, price doesn’t matter. Period” he was curt. Unable to bear with us- so it seemed.

“So you are saying, if oil price becomes zero, our GDP won’t go up” I asked.

“This is childish…. ” he wasn’t happy with my question.

“Well, that’s how we test ideas, isn’t it? By stressing them to extreme. To the furthest” I said.

“One needs to read school textbook again to understand how GDP calculations work. Remember 2003-07. Oil moved from 20 to 100. Did it hurt our output then too” He was rude.

“That’s because- our exports grew as fast. CAD remained stable in that period” I said.

“Anyways” and he ended the conversation.

Just remembered this conversation as I saw his post on Chat GPT & stuff… he has done very well!

Key message: Oil matters a lot to GDP. If Oil prices drop – that’s effectively is reduction in the transfer of income to rest of the world.

On public debt

Engaging Dialogue with a Respected Mentor. He spanked me on my position on public debt. Paraphrasing here.

He: So fiscal deficit doesn’t matter?
I: I said only inflation is a binding constraint. Not debt itself.

He: And you mean high fiscal deficit in itself is not correlated with inflation?

I: Hmm... I am assuming that fiscal will adjust to the evolution of inflation. If it's expectedly rising- the deficit spending can be reduced.

He: Works in theory. Sit in Delhi or DC and you realize that it's not possible.
I: Then what about Japan?

He: Japan is a basket case.
I: But real interest rates have fallen thru the last 3 decades across OECD. Even though the public debt has risen to unprecedented levels, empirically - high debt has led to lower real rates, supporting even higher public debt.

He: True. But they are rising now.
I: I too think they may - due to re-shoring. But there will be a cycle before that force grips the system fully.

He: you are being a trader here. We are trying to solve it but at diff time scales. There are only two policy choices. Inflate away the debt by "inflation tax" or Reduce expenses. Since the latter can't happen- ready yourself for unexpected inflation bouts or financial repression (not paying any interest on bank reserves or yield caps)
I: There is one more method. Get young people to migrate to your country.

He: Ah, how's that?
I: Young productive adults suppress inflation. And increase output. Thus adds to the savings of the country.

He: That's an interesting thought. Or make more babies?
I: Haan. That's a long-term solution. The quick fix is to get a skilled workforce from India.

Key message: This conversation was born off my arguments somewhere that the only constraint to public debt is inflation. Far too many people have argued against public debt in west – arguing that collapse was inevitable due to rising public debt. My point has been that not running high public debt may yield deflation – that is far more devastating outcome for many of these western countries and even China now. So as long as there is no inflation – there is no limit to public debt.

On paying taxes

The 31st July thing is coming—some deadline - something to do with taxes. Dad sent the tax sheet. It's the first time I actually looked at the taxes being paid. Because until very recently – most income was from salary. The joke about a salaried guy is that he feels he is getting X but experiences only 0.6x after all the taxes. For a businessman, tax is an expense. For salaried guys, it's something to do with Form16!

It was certainly not a pleasant sight, and so, with a determination to seek answers, I decided to dial someone in FinMin. NS picked up.

"Madam," I started, "you had mentioned that the super-rich taxes would be revoked on the 75th anniversary of India. The 77th is fast approaching."

"I brought it down na. From 43% to 39%. You see; I need to balance my budget. India requires a build-up of social infra. I am counting on you to fund it" NS said.

"But 40% is still very high, no?"

"Well. Rich have to pay to build this country. You were in the US for a few weeks. Didn't you notice your clients paying a similar amount?" NS asked.

“They do pay. But of ~40% taxes, an American will get social security after 65. He will also get Medicare. So ballpark 15-20% of taxes that one pays are returned to him. That means real taxes maybe just 30% for Richie Rich there!” I responded.

"Ah, you see," NS retorted, "taxes are unavoidable, and historically, the tax rates were much higher. Back in the early 70s, the marginal tax rate was actually over 90%. Even as recently as 1990, it was around 56%."

“But this is not all. There is GST. Exorbitant fuel taxes. Sin taxes. Property taxes. The list is endless” I was hoping against hope.

“Read Arth-Shastra. There was sales tax then too. Also, tax on buying properties. Tolls (Vanikpath). Ferry charges. Profit from land (Sita). Even Import duty at 20%. At least we don’t charge Yatra-vetana, the then tax on pilgrimage. And yes- there was a sin tax then too. 5% on all liquor sold” She chuckled.

Kautilya jumped into the conversation. These days he is ever observant given how often he is invoked by the tax department. “See, I told Chandra that taxes should be just. 1/6th is what I asked him to charge from farmers. You folks charge a lot more today. Also, I told him that if the king failed to protect citizens – they should stop paying taxes and even demand the refund of taxes*”

“You see madam? Now try a refund here” i said.

“In any case – your original point on high taxes on the rich– let’s ask Kautilya only,” NS said.

“Yes- the affluent have to pay higher. That’s what makes the system just. I wrote it in my treatise” Kautilya said.

NS smiled. I realise that I must pay taxes to build our country. But I still feel what I feel. This is the Trolley problem of life. I guess.

Key message: Here I want to bring out this idea that we all pay taxes (just half a percent of population) – but is there a fair deal that we have with state? I go to ArthShastra to argue what a King is supposed to deliver to tax paying citizens.

End of CHEAP OIL IS OUR BIGGEST DREAD

I considered what might halt our secular march. What, if anything, will put a halt to our growth? Many believe it has to do with conflicts. I think it might have to do with the end of cheap oil.

I tried to give Colour to that ominous future! Not inevitable. But a risk.

Dried rigs. Broken car. Sea boiling. Lands fried.

Extravagant life of US

Far away. In the new world. Life is extravagant, nature' spoils are plentiful, abundance is way of being.

A janitor earns an annual income of USD30k in here. That's almost an Indian income of 7 Lakh per annum. And yes- that is after adjusting for lower cost of living in India. (PPP terms)

A supermarket attendant commands a little more than janitor, while an electrician pulls in double the amount. A driver's earnings are thrice over. Do you know that, the threshold for the top ten percentile of income in India stands at 3 lakhs? And a median Indian earns less than 1 lakh per annum.

There are certainly several macro and historical explanations for this disparity. I know you know them. But from the vantage point of the Indian janitor, driver, or electrician, these explanations may not hold satisfactory answers to the deeper meta-physical question of 'why'. If at all - they ever ask it.

Most of the whys never have answers. I mean there are superficial ones. But never real. Never convincing enough.

Key message: I am trying to convey that the stark difference I observe between an Indian and American. I take a philosophical approach of asking a why question on behalf of a low payee job in India but realise that such why questions have no answers.

CONTEXTUALIZING FRIVOLOUS JOBS IN THE RISE OF A SERVICE ECONOMY

Imagine a country whose people only consume car travel and food, and nothing else. This country's people do only three jobs: making cars, driving cars, and cooking food. Since making cars is a technical and skilled job, only a few do it. Since all the people have to travel, the owners of the cars employ drivers to ferry people around. Those who don't know how to make cars become drivers. The drivers earn much less than the car-makers. Both the car-makers and drivers are busy and don't have time to cook food. So the remaining people cook food. They earn even less than the drivers. But everyone is employed, gets to travel, and eat. The country is happy!

Then, one of the car-makers has a breakthrough. He makes a better car. No one wants to drive or sit in any other car now. So the other car-makers are forced to become drivers or cooks. A few years later, an autonomous car is invented, driving all the drivers out of business. Since there is no job left in the country, a new job is invented—cheerleaders. People begin to get paid small amounts to hail the car-maker and chant his name for a few hours every day. The country remains fully employed, but it is less happy now.

P.S.
Meanwhile, one smart guy, though he doesn't know how to make a car, develops a trick to keep an account of everything. Initially, he does it himself by keeping a physical ledger; later, he develops some software to do it. This unique talent helps him make more money than the drivers and cooks. The country celebrates it as the rise of the service economy!

Key message: The rise of a service economy often includes the creation of seemingly frivolous jobs, maintaining full employment but potentially reducing overall happiness as traditional roles are replaced by less fulfilling ones.

How economy functions: looking at it through wedding economy

Imagine a wedding economy. A simple one.

People come together, make and eat food. Each family is self-sufficient to finish a wedding. Hypothetically- it requires just one product from outside. A decorative bulb.

You can see how many different types of jobs are created in this economy. Someone makes the bulb. Someone helps people display it in weddings. Some are about relaying messages about the bulb's requirements, others about transporting it to its destination, and still others about testing it.

Since everyone wants to rent the bulb in their family weddings but not everyone gets a job to manufacture, deliver or display it, so to earn some dimes to rent bulb, many other jobs begin to develop in this 'wedding economy'

Some people start offering services like making funny faces at weddings, while others show off their gymnastics. But the gist is that everyone is selling TIME in order to obtain resources to buy or rent the bulb as needed.

A few step forward to organise the "TIME sellers" to negotiate better wages or life for themselves. Some accomplish this through instilling fear of the punishment in the afterlife, while others make threats to punish people in this life if ordinary people transgressed. These individuals enlist men to deliver the messages to all nooks and crannies of the city. Just a select handful learn the art of arbitrating. And a few others hone their bookkeeping skills.

Craftspeople, inventors, transporters, bookkeepers, funny-facers, entertainers, and other professionals - the 'TIME sellers' - will all fare ok. But in a modern system—the TIME aggregators—win the biggest prize. They come in three varieties: politicians, businessmen, and godmen. Do you notice around you that once a system is sufficiently complex- the most lucrative work is about aggregating people?

This is a simple frame through which you may like to see the modern economy, its work, and its winners & losers. More on it - some other day.

PS1
On a wedding day of a cousin. As it is for most people in our country, a gentleman sold his life' TIME to make his kid' wedding a grand spectacle. A big politician around is behaving as if …because he has the trick few have.

PS2
You may think what was the point of having a Bulb in this story? It was about telling that while the bulb is the only requirement - many jobs develop around and beyond it.

Replace bulbs with any product of modern life. And run this thought experiment. See how complex the web of jobs is hilt around it.

Bookkeepers are bankers. Funny facers are comedians. And so on. And so on.

Key message: This is my attempt to explain how economy functions. With an example of a wedding economy.

Investing for 1000-year horizon

If you were to invest in a nation with a thousand-year horizon, which would be your choice? You'd likely consider a country with some prosperous history, one that has withstood ups and downs without major internal turmoil, maintained its integrity even in defeat, and has cultural strengths to endure the uncertain future.

The U.S. might seem too young, Europe has experienced numerous devastating conflicts, and Africa has a history of ethnic strife without achieving any significant prosperity ever. This leaves us with India and China as primary candidates. However, considering China's current challenges, and the fact that it has tendencies to burn its boats- India emerges as a safer option. A couple of unique feature of India are diversity, reflex of non-violence and resolving problems through debates.

First on diversity. With over 800 languages, diverse cuisines, and all major religions, its cultural and ethnic variety makes it the most diversified place in the world. As a portfolio manager – I am not celebrating India's diversity as some culture virtue but simply seeing it as an instrument to achieve adaptability to 100s of existential challenges each country will face over next 1000 years. A diverse one stands a better chance to

survive them.

India's history of minimal internal revolts has protected the wealth of its citizens, irrespective of regime changes. The belief in diverse outcomes as a natural part of human existence - is the reason a wonderful co-existence of richest of rich and poorest of poor can live in vicinity. Come to Mumbai to see it in full glare!

Compared to regions like Europe, West Asia, and Africa, historically, India's lower incidence of ethnic or religious conflict casualties reflects a societal preference for non-violent resolutions.

India has a history of addressing major cultural and societal issues through dialogue and reasoning, rather than through force. All our movements of past 3 millennia's, where masters (Buddha, Mahavir, Shankara, Gandhi etc) sought to influence both state and society, exemplify this. Again – a delight for a portfolio manager who is assured that the country will solve many problems not but eliminating one group or another – but by convincing each other.

Our reflex is not to go to war – yields us a reduced risk of it. Again-
a simple rule of investing is to avoid countries which go to wars – because
losers of wars wipe out the wealth of a nation.

PS1
You may find diversity - a reason of noise in the way we evolve, lack of conflict - a reason for inequality and not going to war - a reason of long years of enslavement. It is above my pay grade to solve society's good. Simply solving portfolio here.

PS2
Happy Diwali to all of you! May you all be well! May your money turn into capital!

Conversation on inequality

This is a conversation with RCD (Rich cynic dude) on various aspects of wealth distribution.

"You are placing more importance on consumption than on investments. The 'banker' was probably correct when he said that giving money to the poor will lead to consumption while giving it to the rich will result in them starting a new factory. For output of an economy - it makes no difference if money is used in consumption or investments"
"Just that money with poor is more likely to get spent, either on investments or consumption."

"If the rich don't invest, the money will end up somewhere else, right? It doesn't really matter who spends it in the end."
"Money never ends up anywhere. It keeps moving. From one to another. And in that process keeps getting created. A system that facilitates a quicker use of money- has more money. My point is that when the money reaches the poor – it makes more of itself. When it reaches rich, it makes less of itself"

"How more of itself?"
"Because the poor is likely to spend so it will quickly get spent on things. The very things that we all produce. Say we all buy more chocolates. That means more cocoa will be grown. The mechanism of growing more coca is the mechanism of having more money" (To be clear we were talking of real money. That which has the power to demand goods. Money represents an IOU against present or future production.)

“So it’s the production of more cocoa that creates more money right? That’s what rich do. All the demand for more chocolates will mean no extra money if there isn’t more supply of chocolates. It seems like chicken and egg. It can be argued from both sides. But you yourself state that the creation of money is actually supply side”

“True. The supply side alone can create new money. The skill, resources and energy have to come together to make new goods/services to create more money in the system. But in absence of demand – the supply will have no incentive to exploit all of these”

“So what exactly can the rich do with the money when they don’t use it to build a factory?”

“The wealthy can lend to the poor or Govt, relying on their future earnings or taxes as collateral. This lending typically occurs through banks or by purchasing government bonds. However, both type of borrowers faces constraints: the poor due to their limited repayment capacity and the government due to self-imposed borrowing limits, such as fiscal deficit constraints. When the wealthy have more money to lend than the poor and the government is willing to borrow, interest rates must be reduced to accommodate the excess funds. Eventually, a point may be reached where lenders accept the prospect of receiving less in the future, resulting in negative interest rates. Eg It is a common misconception that Europe's negative rates were solely a result of the European Central Bank's actions. In reality, the negative rates emerged because only at those levels could the financial system efficiently accommodate the savings of the wealth”

“Then what happened? Where did the inflation come from in the last two years?”

“Excess savings in the system is a fraction of total money. Only so much that clears at -1%. Post Covid, Governments injected an additional 20% excess demand into those economies. This shocked the system, and caused demand to surpass supply, resulting in inflation that was significantly higher than anticipated. Saving glut gave into deficit glut. Consequently, a financial system that was previously clearing savings at a -1% real interest rate now struggles to do so even at a 2% real rate”

“Anyways – what proof do you have that ‘more money’ in the hands of rich means slower economies?”

“More money in the hands of the rich make societies more unequal. There are studies that show that too much inequality slows the growth” (Studies such as that of Berg/Ostry, Dollar/Kray, Knowels)

“But by your logic, given that more money was given to poor, economies should be doing well”

“Precisely. That’s why despite giving a big rate shock to the system along with great wealth destruction, US continues to do so well. Even Europe, which experienced a major energy shock, has done much better than what people expected”

“So the lesson from the crisis is to do more of doles”

“Most people think that the lesson from the past crisis is that fiscal expansion shouldn’t have happened. Given the major inflation surprise. But the fact is that countries which did max fiscal response ended up doing much better than more conservative ones. A major policy tightening hasn’t resulted in any major slowdown in these economies. Effectively- it worked as a debt jubilee or major fiscal transfer. I think economies such as US as bright future ahead. Can’t say the same thing for poor countries….”

From here on – the conversation took a different turn. Both of us disagreed on what should be done to do the inequality. My points appeared left-leaning to him and – nothing provokes a fund manager more than such arguments. He found my ideas were inspired by Marx. I thought it wasn’t so.

"I don't agree with your argument, but in any case, this is your solution to inequality – to do more fiscal spending?"
"To be honest, I'm not sure either. But I see two tools getting deployed, one is financial repression, that is to depress real rates by yield caps and the second is inheritance tax. Low real rates have been on full display for the past decade. It seems increasingly likely that a significant inheritance tax will be introduced. It's a flaw in capitalism that we allow one generation's large savings to be passed on to the next."

"You must be drunk on Marx!"
"Not really. Capitalism is all about profit maximization, while inheritance is rooted in kinship. Inheritance doesn't necessarily serve the goal of profit maximization, and this conflict between the two is something that needs to be addressed. These two concepts are strange bedfellows, and I'm not sure how long they can coexist."

"How is this different from the Marxist system?"
"Well, in capitalism, the market determines the price of goods and services, including the price of commodities such as bread or butter, as well as the price of ideas or talents. On the other hand, in the Marxist system, there is no market for wages or capital. Everything is centrally planned. However, in capitalism, the existence of kinship poses a challenge, as it can interfere with the proper discovery of prices for ideas, skills, and wages. Mr Ambani's kid can fund Campacola even though it may not be the best thing to do for capital. There is a very little market constraint on this decision"

"But capitalism works so beautifully only because of the incentive structure"
"Yes. The payoff is inverted U. It fails when it coincides with kinship taken to the extreme. Now we are back to the inequality debate"

"And your idea is to give this capital to whom?"
"Let it go to the most competent individuals. Just think about it - wouldn't our country be much better off if a billionaire's large percentage of capital was inherited by the most competent kids, rather than their own children?"

"What's wrong in Mr Ambani's kid or some PE guy to give money to these most competent ones"
"Well. The ability to take risks goes up when there is not much to lose. It's the same argument of equity vs debt. A firm with more equity will be more confident taking on newer risks than the ones which is funded by debt. Similarly – a person with a lot of money will find it easier to fund risky ventures. To be sure- Amabani' kid may be good too – just that he may not be the most competent one to burn $10bn."

"How do we know – who is the most competent one?"
"Well, we have 'not so perfect' but yet reasonable metrics to select these folks. Society already does it. The competitive exams, KRA and assessments in corporate are such ways to do it"

"Anyways, my dream is to provide my children with a better life. If you take that away from me, I won't even bother working."
"I understand your perspective. That's why ultimately, capitalism and kinship need to reach a compromise. Perhaps your children could still inherit a decent amount of capital that would place them among the top X% of the country. In US – up to $11mn gift doesn't attract tax. "

"Why can't the country find other ways to fund the best? Why target the wealth of the rich?" "The true wealth of a nation lies in the know-how of its people. Among them, some individuals are exceptionally skilled in advancing the country's frontiers – by continually improving their craft. These exceptional individuals include top engineers, scientists, doctors, farmers, construction workers, entrepreneurs, and others. Many self-made wealthy individuals emerge from this pool of talent only.

Is this wealth or capital unlimited? No. Such highly skilled individuals are a limited resource for any country. It will not be an overstatement that such people are the only binding constraint of a nation's development. The country has to maximize the use of this capital. The decision to take is – to let inherited rich kid have the power of 'right to allocate capital' or give it to most talented ones"

"Right to allocate capital – what is that?"
"The right to undertake risk. This we discussed"

"Okay, I'm not sure."
"Well, I'll write it down then."

"You never do."
"Okay, I'll make sure to do it this time"

I had used some terms and studies – today morning I thought I should clarify what I meant by it. Not sure it will satisfy him – but this is my first attempt to clarify what I was saying.

What is the capital of a country?

The resources and assets utilised to produce commodities and services are referred to as capital. In economics, the term "capital" can refer to both physical capitals—such as buildings, machinery, and equipment—and financial capital—such as cash, stocks, and bonds.

The other way to think of capital is through a metric of know-how. Not just of engineers, doctors, scientists, economists, portfolio managers, farmers and construction workers, but also of policy, planning, philosophers, and lawyers. In some sense capital is what transforms a raw resource into a useful commodity. A farmer covers land, water and a wheat seed into 50 seeds. That very craft is capital. To be sure, land, geography, energy and other resources are also capital. But they are considered as given. Really can't change. And to that extent –only human know how is what I am considering as capital in this conversation. Thankfully – that is what is a key determinant of nation's success in modern times.

What does it mean when we say that someone owns $100bn worth of shares of a firm, is it capital OR is it wealth?

That $100bn is wealth of him. This in itself is not capital but is a right to allocate it. If Mukesh Amabai chooses to deploy all the profits of RIL to build a space ship – he can do it because he owns the firm. Since he has control of what a million workers do, he can ask them to do anything by deploying his wealth. That which has earned.

But what exactly can wealth do?

It allows you to risk it. Even if Ambani kids lose half of the money they put in campa cola venture, their life style won't be worse off. Can an bright kid from IISC do it, giving all his time to a whim and not face real consequences. So wealth allows a person to risk but because it is passed on from one generation to another, it may give right to deploy it to people who are not the most capable ones.

Does inequality matter?

Money serves as a claim on present or future output. If rich get it, they are less likely to use it to consume resources. Instead, they will invest in the production of more resources by employing talent (or capital) to increase output. Conversely, when money is given to the poor, their unmet demands will drive them to consume a larger portion of it. This consumption will encourage the rich to produce even more, offering better wages to motivate workers and engaging with skilled individuals to create more efficient and innovative goods and services. The result is an increase in profits for the rich.

Consider this: if there is an unemployed individual, when is he more likely to find employment? When the rich make more money, or when the poor do? The rich, when making more money, have no incentive to produce if there is no demand from the poor. It is important to consider the role of incentives in this context. If profits are eliminated and all money is distributed as wages, the absence of profit incentives may discourage risk-taking and innovation. This lack of incentives could lead to stagnation in the economy, making society poorer overall.
Interestingly, this dynamic reveals that profit maximization does not occur through wage minimization. As profits as a percentage of GDP fall and wages rise, overall profits are likely to grow faster. This phenomenon can be better understood by examining a feudal economy. If one individual possesses all the money (or resources), the economy will likely experience slower growth. Therefore, profit maximization is achieved when reasonable wages are distributed, enabling a more equitable distribution of wealth and resources.

In conclusion, the distribution of money between the rich and the poor has a significant impact on economic growth. By understanding the dynamics of consumption and production, it becomes evident that a more equitable distribution of wealth and resources can lead to a healthier economy and higher overall profits. The solution lies in finding an optimal balance between profit and wages. No one can precisely identify this point, as it can only be observed ex post. The recent decline in growth across developed countries and research suggests that the balance may have swung too far in favour of profit. As a result, societies may now be beginning to course correct.

Studies of the effect of inequality?

In industrialised nations, higher levels of income inequality are linked to slower medium-term economic development. Per a 2014 study IMF. It says that inequality has a detrimental effect on investment and the accumulation of human capital. Also leads to political instability and social discontent.

In particular, in nations with already high levels of inequality, rising inequality has a detrimental effect on economic growth, OECD's 2015 study concluded. High levels of inequality, it argued, can limit access to credit and other financial services, discourage investment in education and training, and reduce social mobility.

In emerging nations, reducing inequality can result in more consistent and inclusive economic growth, according to a 2016 World Bank study. Per it, larger investments in human capital, higher levels of production, and more stable political systems can result from more equitable allocation of assets and resources.

According to a 2018 analysis by the Institute for Policy Studies, the United States' excessive levels of wealth disparity are impeding stability and economic growth. According to the study, excessive levels of wealth concentration can have a detrimental influence on economic growth by reducing consumer spending, limiting company investment, and undermining social cohesiveness.

What is the solution to inequality?

The consensus in the world is to build a better welfare system to tackle it, with free education, universal healthcare and stronger labour protection. Europe has been able to do it better than the US and within Europe, Nordic countries do even better (measured in terms of HDI). So the answer to inequality is – unfortunately – a bigger government. That as such sits at odds with capitalism. The only important observation is that countries such as the US which relied more heavily on private health care and education system seem to do worse in most human development indicators than its European counterparts.

If the solution to inequality is bigger government – it will have to mean higher taxes. Many countries have been successful in implementing progressive taxation better. Yet- given the role of r>g (earning on capital is generally greater than growth of the country), inequality has tended to get higher pretty much across the world over time.

Over the past few years – given the dominant role of capital gains, particularly in stocks – case of increasing some form of wealth tax has been made. The privileged status of long-term capital gain tax wasn't always so. For instance, in the US, it used to be equal to ordinary income in the 1910s, was increased substantially after world war 2 and only after 1969, a process to bring it down started, only to be reversed in 1986 when it was made taxable as ordinary income. The recent period of low long-term taxes has been in place since 1997.

is inheritance in conflict with capitalism?

Capitalism, primarily understood as the private ownership of assets, leads to the price discovery of both capital and commodities. Despite its imperfections, capitalism has been embraced for its capacity to improve people's lives, spur economic growth, and address a wide range of societal issues more effectively than any other system.

Inheritance is a feature of human society, that enables the accumulation and transfer of wealth from one generation to another. This mechanism can be seen as an incentive for individuals to work hard and amass wealth, knowing that their children and grandchildren will benefit from their efforts. Consequently, removing this incentive structure could potentially dampen the entrepreneurial spirit and hinder economic growth.

However, inheritance can lead to the concentration of wealth and power among a small number of families. This can result in social inequality and limited economic mobility, which could ultimately undermine the core objectives of capitalism.

Thus, while inheritance is not fundamentally at odds with capitalism, its potential to exacerbate inequality and restrict economic mobility should be acknowledged and addressed. A balance must be struck between preserving incentives for wealth creation and preventing excessive wealth concentration to maintain a healthy capitalist system.

To tackle inequality, the consensus is shifting towards the implementation of some form of wealth tax such as inheritance taxes. As previously explained, this strategy is considered far superior to taxing existing enterprises, which could dampen society's risk appetite. Inheritance taxes might affect the wealthy, but they are less likely to hinder the overall economic growth of society.

I must clarify my personal stance on this matter. As an individual, I would vote against any proposal to tax inheritance, as I too would want my children to benefit from my earnings. I am not an altruist. However, as an observer of the global economy and politics, I cannot ignore the ongoing shift towards taxing the wealthy, particularly through inheritance taxes. The movement has already begun, and it is essential to consider its implications for the future of capitalism and economic equality.

How does it all matter to investors?

It matters if capital gain taxes will rise, the risk premiums of equities will have to rise to ensure that investors get adequately compensated for the risk they take. Over past few decades, policy support and lower taxes have caused demanded risk premiums to drop. Any reversal of such policies will mean that they go up again.

But for now, its important to realise that, at least in India – the demanded risk premium for equity should drop given that bonds have become extraordinarily expensive because of the change in taxes for bond funds and MLDs.

HOW TO TRACK POLICIES?

How to listen to policy makers

First a joke and a little lesson in interpreting policymakers.

A German journalist - working in the erstwhile USSR tells his companions, well aware that all of his correspondence would be inspected by Russian censors --"Let's develop a code: if a letter you will receive from me is written in regular blue ink, it is true; if it is written in red ink, it is false,"

After a month, his newspaper head office gets the first letter from him, written in blue ink: "Everything is lovely here: stores are full, food is plentiful, apartments are huge and nicely heated, movie theatres play Western films...the only thing unavailable is red ink."

Hmm... in the absence of red ink, the letter writer still manages to get the truth about the conditions of life in the USSR past the censors.

An ordinary investor may be listening to & reading these policymakers every day across media platforms. How does he discern what is 'really' true given that much of what they may be saying could simply be pushing the government's own narrative?

Contrary to what you may think of them - they are very clever and intelligent. And self-respecting too. Despite a lot of constraints, they leave clues of 'red ink'. In metaphors or abstracts. That's where truth is densely poured into. Whenever election season is upon us, look for red ink :)

How belief functions in markets: Santa Clause's analogy

If you ask a parent if she believes in Santa clause, she would say- of course no. Yet she pretends to believe in it because that keeps the excitement amongst children. So nice of her!

Then ask a child. And he too would say - 'I know I know, Santa doesn't exist. But I pretend so that I don't hurt my parents. They work so hard to make me believe in Santa and the presents'

The paradox is that both sides don't believe in it yet the Belief continues to function. (Quoting Zizek here). Amazing- we are- not just that truth doesn't matter, knowing it in itself is inconsequential to the functioning of our belief- howsoever over false.

If you played truth or dare with RBI gov and asked if he believed in local monetary policy anchoring inflation? He would smile. Then ask a market participant, if he believed in it. He too would smile. But the belief functions nonetheless. We hear monetary policy religiously. React to it. And a journo asks this questions after every policy - without fail- what is the target real-rate in India :)

The truth is that EM central banks have little control on growth and inflation of their country. Exteriors decide it. The only thing that they must strive to deliver is -financial stability.

FED'S EFFECT ON EVERYTHING IS A MATTER OF FAITH, NOT REASON

At the home of the great scientist Niels Bohr, sometime in the early 1900s, this really happened. Seeing a horseshoe on his door, an old tradition, his friend slyly claimed that he didn't believe in the superstition that it brought luck and was disgusted that such a great scientist had faith in it.

To this, Bohr retorted: "I also do not believe in it—I have it there because I was told that it works even if one does not believe in it." ☺

One can use this allegory to defend their faith in the Fed's tightening effect on the INR, equities, or IGBs, even when presented with disparate data claiming it's irrelevant.

They may say, as I do: "I also actually don't believe that Fed action is consequential for the Nifty, INR, or rates, but I still act as if it is, and it works even if one doesn't believe in it."

Key message: The allegory of Niels Bohr's horseshoe illustrates how belief in the impact of the Fed's actions on financial markets can persist, even when faced with contradictory data, because acting as if it matters often proves effective regardless of personal belief.

WHAT IS A FED PUT?

Ever wondered what a 'Fed put' is? It is not an autonomous function but one that is conditionally activated when the prior condition of low inflation is met.

Additionally, it's a rather recent phenomenon, as one rarely finds mention of 'stock markets' in FOMC meetings until the late 80s. It was only in the 90s that Greenspan introduced 'positive asymmetry' by arguing that the Fed would do nothing to prick the stock bubble but would come to mop the floor soon after the bust. Thus, the Fed put was born!
`
The 'Fed put' functionality operates through negative bond/stock correlation, i.e., bonds rally when stocks fall, making the stock market fall a self-limiting one. Again, this isn't a historical truth but simply a revelation of the past three decades.

The big question is if the Put is still operational, especially when the condition precedent of low inflation isn't in place. As I have argued over the past few months, in current conditions, the reverse of the 'Fed put' may be in place, which entails 'hawkish surprise' to markets. Surprise is a policy instrument that the Fed has systematically undermined since the GFC. It's time to bring it back.

P.S.
Surprise is not such a novelty to Indian bond guys. How agonizing those Friday evenings were when Dr. Reddy would surprisingly announce some kind of hike, and frenetic weekend sell-offs would follow. Powell may do a Reddy!

Key message: The 'Fed put' refers to the Federal Reserve's tendency to support markets during downturns, conditional on low inflation. It is not an explicit attempt to save equity markets – as is often described by many participants. It's a mechanism through in their effort to save the main street wall-street benefits.

Federal Reserve Rate Hike Cycle and Market Signals

There is a notable signal in the Federal Reserve's actions with respect to equity returns. Firstly, equities tend to deliver better returns during a rate-cutting cycle than during a rate hike cycle, indicating that the Fed's actions do matter for equity performance. Secondly, there is limited value in assessing the 10-year bond yield in relation to the Fed's actions. Bond yields typically peak about a month and a half before the last rate hike. Given that the Federal Open Market Committee (FOMC) meets approximately every 45 days, bond yields do not provide a timely indicator of the Fed's actions.

it is crucial to remember that the shape of the yield curve provides more value than the absolute level or movement of bond yields. An inverted yield curve, particularly the 2-year/10-year or 2-year/5-year spreads, can be decent indicators of the end of a Fed rate hike cycle.

Conversation with a banker: How does Fed or CB policy work:

"So Fed has started to pump money again. Inflating asset prices. Wonder what will happen to extreme inequality" He quipped.
"Fed policy is more likely an effect of an underlying force, not an instrument of it" I said.

“Is it? Greenspan brought rates down to near zero as a response to the dotcom bust – didn’t he? It was a mistake as the US certainly didn’t require such low rates. Thereafter, Bernanke & Yellen kept doing QE. ” He said.
“Well. It was a likely mistake but not to the extent it is given the credit of. Though a much bigger mistake was to ignore the incentive structure of bankers, letting securitisation grow rampantly, allowing banks to lever as much. Our team Dr Reddy & co was a lot more circumspect about it. And correctly so" I said.

"Hmmm. This is interesting. I thought the effect on QE and low rates is well documented. QE forced people to invest in equities making them more expensive" He was playful. Sort of showing off, that he knew it all.
“Well. Yes, and no. There is some effect of QE on asset markets but one, it's debatable and two, its magnitude is small. Also, it’s a misconception that QE/low rates led to major asset rebalancing towards equity. 2 decades ago, equity was 60% of the total market cap & and today it's 40%. Most don’t realise that equity is a significantly lower part of savings today than it was then” I said.

"Hmm. And low rates certainly caused inequality. Didn't it?" He asked.
“How so? One can argue that inequality is the cause of lower rates – not the other way around. There is some solid research, arguing that increases in top income earner's share account for about half of the decline in the "natural rate of interest" (since the 80s)” I said. I thought he would ask the source of this claim but he didn’t. That saved me given how bad I am at remembering names and references.

"If the rich make a lot of money - what is the impact on growth," he asked.
“Likely that the 'saving glut of the rich' has caused lower demand (lower investments)" I responded.

“I don’t get it. If the rich have more money - they should build more factories. That should mean more growth!” He asked curiously.
"Not true. A large amount of 'physical investment' happens in household building houses and buying washing machines and cars. Since the wealthy prefer to invest in financial instruments vs physical ones, the demand for bonds rises and not of things, and that drives real rates lower, exasperating wealth inequality further" I said.

Okay......He moved on to more pertinent points - How will I make his firm a lot more valuable? There too, the answer was to simply implement what he thought was obvious :)

Key message: All of what you are told and believe in isn't as obvious as you think it is. This idea that most central bank pumping money is the reason why markets have done is only half true. One of my arguments over years has been that as societies become more unequal, the real rates drop. Does it not surprise you that world is overweight bonds today vs equities, relative to 2 decades ago.

History of India policy choices

Over the last 40 years, macro observers have watched Indian policy go from too lax to too restrictive. The remarkable thing is that both fiscal and monetary policies tend to change the reflex at the same time. This implies that the monetary policy decisions, at least their leanings are crafted in New Delhi rather than Mumbai. Furthermore, overly loose policies often result in some type of crisis, as occurred in the early 1990s and 2010s, and subsequent consensus changes to operate excessively tight policies neglecting the requirements of the business cycle.

The permissive policies of the 1980s (Rajiv/VPS & Malhotra) culminated in the BOP crisis of the early 1990s, which gave way to a relatively restrictive policy regime in the 1990s (Rao, Rangrajan). The 2000s had appropriate policy regimes (Vajpayee/MMS, Jalan/Reddy) - Loose and tight basis the requirement of the business cycle. That lasted only until the GFC when our administration had the opportunity to conduct an extremely lax policy (Pranad da & Subba). That resulted in significant inflation and CAD in the next few years, putting India into the club of fragile five - a mini 1992 arrived and the climax was reached in 2013 when the RBI had to execute a U-turn by hiking rates by 3% and offering attractive rates to foreigners to raise dollar deposits. Following that, we pursued stringent policies, even in the midst of the banking crisis, pushing for a reduced fiscal deficit and higher real rates (Modi 1.0 & Rajan).

We might be in that situation again when policy leanings are changing. Running a near9% budget deficit despite a 3%+ current account deficit, not allowing the currency to devalue considerably enough to take some steam off our imports, and, until recently, not allowing rates to move higher through active guidance and interventions. All of these are the markers of the changed framework. It was not too long ago when a deputy governor reprimanded bond dealers for not pricing long bonds higher. And do you still remember the 4% inflation target, 2% real rate, 3% fiscal deficit and whatnot? If we are letting loose the fiscal and monetary policies - bonds are going to have a rough ride. They will certainly rise and fall with business cycles but won't compensate adequately for inflation. That's why my advice is to avoid long bonds until the next government formation in 2024, even though the business cycle demands a change in that view.

The good news is that negative BOP shock has resulted in extremely tight liquidity. That brought you splendidly high short-term rates. Relish them. Lock your money for 1-3 years. You will likely get good real returns - a rather infrequent outcome for Indians.

PS1
Tight policy regimes result in low non-performing loans, slow credit expansion, low inflation, reasonable fixed income and lowly equities return. The opposite happens in a loose policy regime.

PS2
Policy = fiscal (deficit) + monetary (real rates)

Key message: This gives a tour of India' macro policy and how it has tended to run pro-cyclical policy. One of the thing I like about Modi Govt is that it has changed that a bit. One of the reason – why India's macro has improved over past few years is because we did act somewhat counter-cyclically.

Regulators are countercyclical

Regulators are like parents.

Lenient when markets are in distress. Stern in good times.

To remind - in times of exuberance- the need of restraint.

To slow. Because fast paced financial systems sow seeds of future stress.

We are witnessing peak hawkishness of regulators in India. Job at hand is to derisk.

Their memo is served to the system-even though the action is directed towards a select few.

Don't we show anger at one kid but our gaze shifts to another .. as if to say "take note" :)

Knowing RBI governors

I've had the privilege to know, meet, and operate under six RBI govs. All extraordinarily intelligent. Here's an analytical appraisal of whose regimes intersected with my career:

Jalan: He was our Greenspan. His goal was to convince markets to move rates lower. Successful he was in getting bond yields move from 12ish% to 5%. So convincing he was - that some lenders offered 10-20 year fixed rate mortgages at 7% in 2003-04. We will never see those rates again. He was the governor during "the first big credit bust" in India when NPAs skyrocketed after AFC, 1998 sanctions and slowdown. He managed it well and deserves more credit than most give him. His mistake- The last 50bp cut in 2003 was not needed. He should have re-built the capacity of DFIs.

Reddy: wise, just, and nearly universally admired. Tightened monetary policy appropriately – though the 2008' 50bp rate hike was perhaps a mistake. His caution against exotic financial derivatives served India well. Yet, he was not without fault; his decision to cap reverse repo absorption was a lapse, quickly corrected. He should have been more assertive in curbing the rapid bank credit growth (25% cagr) between 2003-2007. Allowing PSU banks to do project finance (what DFIs used to do earlier) was a regulatory oversight.

Rajan: Asset Quality Review (AQR) was a great move—bringing the errors to light. Yet, in that delicate period when banks wobbled, he maintained high policy rates—a misstep. Could have been more forthcoming in regulating NBFCs. Was a charm. Made his office more open and conversational. Changing his views on liquidity (after 2015) showed his flexibility. Paved the way for inflation targeting. Lost public favor when he leaned too politically. Broke a tradition in India.

Subba: Was a thorough gentleman. Brought transparent communication and more engagement to RBI. Laid a foundation of inflation targeting. Fought with political masters to secure independence. His biggest error lay in thinking the Indian Rupee could control local inflation—a hubristic mistake that likely led to the currency crisis in 2013.

Urjit Patel: Went back to Reddy's style of communication. Terse, witty and hawkish. Made ~4% inflation target more serious than it had to be. His distinct belief in the separation of the RBI's roles in monetary policy and bank regulation 'could have been' his lasting legacy. His stern "don't do business" policy for sick banks was the best gift. History will be kinder to him.

SKD: Pragmatist who knows the limitations of India's economic data. Brought common sense back to managing monetary policy. His management of the Covid time was exemplary. Was shrewd in managing bond yields during 2021. Avoided moral hazard of bailouts (2018). Leaned against inflating bond bubble (demon) and potential bust (2021). His oversight? The current system has sapped the vitality out of NBFCs and small banks. He must lean against the oligopolistic practices of big boys!

Key message: This is short biography of RBI governors. Knowing will it help you understand how each governor has a unique perspective on variety of issues and his response could be different. Knowing RBI governor's perspective is one of the most important task of a macro watcher.

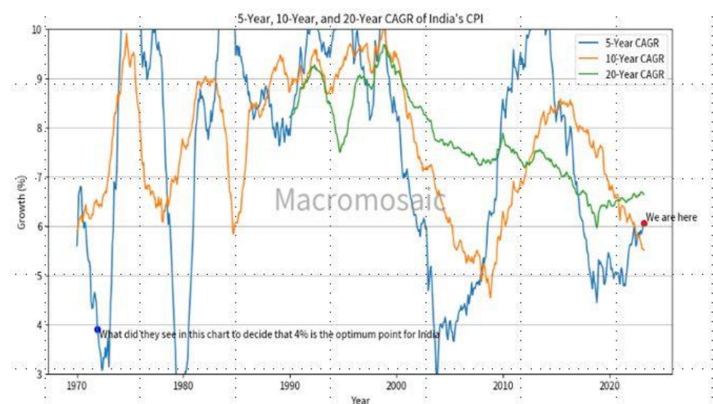
Important historical conversations at RBI and FED

1996. At Fed.
"Let's target zero inflation. But let us not tell anyone about it" Greenspan said to his comrades. That era's bankers believed that secrecy was part of their tool kit:)
"A little inflation lowers unemployment too – as it facilitates adjustment in relative pay. No one likes nominal pay cuts" Yellen.
"So what rate of inflation is good then?" GS
"2% seems decent" Yellen
"Ok done. Let's disperse" GS

2013. At RBI.
"Let's target inflation. Of the hundred reforms that I wrote about- this one is very critical. Q is what is the right level of inflation for India?" RR
"DMs are at 2%. Let's target 4%" UP
"Seems like a decent number. Let's get some econometrics to back this, okay?" RR
"Done" UP

2021 London (I picked it up from the Markus Academy interview. Though I think he talked about it in his book "The End of Alchemy")
"We don't know why and how we got 2% inflation year after year for the past 20 years. It was a surprise to us at BOE" Mervyn King.

2015. Mumbai (RBI Conf room)
"There is nothing in our CPI chart that suggest that we will ever get to 4% (see chart). Our structure of Inflation is such that only a collapse in commodities (mostly crude) gets us near 4%. But given that we don't allow crude prices to be passed on –what we get is less volatile but floored CPI at 5% in the best case" I handed over a research paper (my team had put this together) to RR. Primarily arguing for liquidity easing but also being careful with inflation targeting.



Key message: Do you notice how these targets come into being? Casual conversations yield them. 1996 conversation actually happened. 2013 one is my imagination - but I can bet on it. A good policymaker is one who knows it and speaks as if these single-target variables exist and acts as if they don't. Take

ShaktiKanti Das or Reddy for instance. As such I want investors to know that much of the policy architecture is lot more fluid that what they think it is. So the assumptions in pricing assets cannot that current policy regime will continue. Of the million sources of volatility in markets – one is the policy changes which are born of pragmatism. Though they are given an impression of inevitability.

ON DEMOGRAPHICS

Indian demography and general demography rules

1. Rural India is Japan now: Indian rural population is declining now. Early 2000s - population used to grow at 1cr every year. This year - it will probably decline by 10-20Lakhs. Urban population is growing at 1cr+ every year. This means if your village is not adjacent to an urban center - poor prospects ahead for your shop there, and your land there.

2. Our peak demographic dividend is behind us: 1980- every year our working age population will grow by 2.5%. 20 year ago- 2.2%, 10 years ago 1.9%, now 1.1%, and in next 10 years at .6%. So semi-skilled and unskilled labor cost in India will get relatively expensive. This also means the super cheap services (help, drivers) in India is going to get more and more expensive.

4. India will slowdown, not accelerate: Because of working age population is going to be slowing rapidly - growth in India is likely to decelerate, not accelerate over medium term. Demography alone can chop off 1-1.5% growth over next 25 years vs past 25 years. Of-course productivity can bear the burden. But that bit is difficult to call. Also - there is nothing that we know today which suggests that India can accelerate from what we have achieved over past 25 years. (Our per-worker output has grown at 6% every year over past 25 years- i use it as a measure of productivity and growth)

5. Even India will be China: China working age population used to grow every year at 1%+ until 2008. Now it degrows at 25bps. The only difference with China is - that it will take 40 years instead of 15. Our elderly population is 10% of working age. It will continue to crawl up to 20% where China is today. Slowly- but will get there.

6. Peak population is approaching faster than most assume: Indian TFR (per woman - children) is likely to get to 1 odd over next 30 years (Official estimate = 1.3, but it's speeding faster than what most officials assume). It means many better per-capita infra. But if you are selling cheap toys - contraction or stagnation ahead. Remember @1 TFR, every generation, say in 20-30 years, population begins to halve.

Demographics Rules (more like my beliefs)
1. working age population is key driver of growth.
2. Dependency is key driver of public debt.
3. If more children are the reason of dependency, it drives inflation. If more oldies are the reason - it drives deflation.
4. Peak earning happens in 50s - whereas peak spending happens in 30s.

5. Peak house/housing equipment buying happens in 30s. Peak financial savings happen in 40snd and 50s.
6. Lower TFR leads to better educational outcomes leading to better technological society.
7. Ageing society tends to be more conservative- in its cultural and political choices.
8 Demography is a key driver of flows into asset classes. It transitions from a fridge/car to house to stocks to Fixed Deposits.
9. Urbanization is the key cause of demographic decline (TFR).
10. Demographic decline is generally irreversible. (Israel an exception)

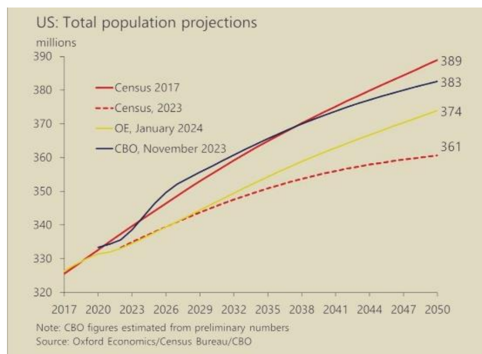
Covid' durable effect

Many years out- when history is written of Covid' impact on our society .. the most 'durable effect' will be seen as lower birth rate & lower migration.

= lower population vs what was projected* 5-7 years ago.

= lower growth than what was projected (less babies today = less growth 20 years out)

*Compare census 2017 vs 2023.



HOW DEMOGRAPHICS AFFECT ECONOMIES ~THINKING THROUGH A PRISM OF A FAMILY

You marry. Both your parents and spouse are working, so there's lots of income. A few years later, kids arrive and routine expenses begin to rise. Soon after, cars and houses are bought on debt. This is peak GDP (income), peak expense of the family. EMIs don't hurt you since all of you are earning. Debt to GDP of the family is not high.

Two decades later, parents are out of jobs and require a lot of care. Some need surgery; others have various diseases. Kids are pursuing higher education and are still dependent. Suddenly, earning members have halved. Expenditure also drops, but income falls a lot more. Debt to GDP looks very high now. Since your house is still quite valuable, Debt < Wealth.

Two more decades pass. It's just the two of you now. Both old and retired, with no income. Lots of healthcare needs. Savings deplete. This is now a no-GDP family. Debt to GDP has no meaning now. The bank is told to sell the house to recover the debt after the two of you are gone. But since your

neighbour knows that your bank will sell your house to recover the loan, the value of the house depletes.

Your kids are in some distant place. One refuses to marry; the other has just one kid.

The world, just a decade ago, was that new family. It had 65% of the population in the productive age (15-64 years). Now it's fast entering the second stage: fewer babies, more elderly, and rapidly rising debt. Germany, Japan, and South Korea have already been in the second stage for the past few years. The world has 20 years to get there; India has a little more time. But all of us will soon get there. This is the single most important variable to assess future growth, debt, inflation, rates, and asset prices!

Recalculate.

Key message: The global demographic shift towards an aging population and declining birth rates is the most critical factor in predicting future economic growth, debt, inflation, interest rates, and asset prices. As Elon musk and many others argue – that may our biggest headache of the future. Especially of developed world, Latinos and east Asia.

WARS, GEO-POLITICS AND POLITICS

Disintegrating world order and implications

I have long argued that a world without the US as a policeman is likely to be dramatically more fractured and violent (Zeihan). It will trade less and war more, and that outcome increasingly looks inevitable. Its repercussions are many.

I have never sided with Steve Pinker's argument of the better angels of our nature, that we have stabilized at a higher plateau of peace and prosperity. Not just statistically (Taleb) but also behaviourally—I never agreed with his hypothesis. We are a violent species. We will always fight for territories, and every subsequent fight will be bloodier and deadlier. Pinker will lose all his public bets.

So far, so good with my framework. But here is to admit a mistake in it. I have often criticized India's model of economic development that we have pursued since independence. Instead of focusing on the comparative advantage of labour (Ricardo), we pursued a path of investing in higher education to get close to the tech frontier. This resulted in the inadequate/slow industrialization of our nation. I thought Bangladesh and Vietnam got this right (Panagaria) while we got it wrong.

But what's happening in Eurasia is helping me rewrite my rules. I think many will be doing the same.

I now realize that the sovereignty of a nation and the welfare of her people may have a trade-off—not always, but at times. India, too, had a choice when it made the tryst with her destiny. It could have said NO to IITs, world-class IT firms, the nuclear bomb, and BrahMos missiles capable of threatening Beijing, and instead have had lots of clothes manufacturing (Bangladesh) and cellular assembly units (Vietnam). The result would have made her people better off, but I suspect her sovereignty would have been at risk. Such a state would have been a client or a vassal state at the mercy of the bully next door. So, thanking our leaders here, we took the right decisions then!

Until we reach a utopia of Vasudhaiva Kutumbakam (which will never happen), it's important to secure sovereignty even though it comes at the cost of the general welfare of our people! One could have been forgiven for overlooking this realism in the post-Berlin Wall decades. Not anymore.

Quick implications: every country realizes this now. A new arms race is about to begin. A world that rearms, reshapes its supply chain, secures its essential commodities, and renews its energy sources will have sustained pressure on the cost of money and risk premiums. This world's politics wouldn't be based on the promise of Acche Din. It will be based on thwarting bure ones.

Nietzsche will reincarnate, woke ideas will give way to the aesthetics of the music of marching soldiers' boots! Trump will be tweeting in 2024, not on how high the SPX is, but on how fast his hypersonic are. We will also have our Manoj Kumar 2.0.

It is time to reread the greats who recorded the early 20th-century mishaps and miscalculations. And then—recalculate.

Key message: The current geopolitical landscape, marked by rising tensions and conflicts, underscores the importance of securing sovereignty even at the cost of immediate economic benefits. This realism is driving nations towards rearming, reshoring supply chains, and securing essential commodities, leading to sustained economic pressures. As a result, future politics will prioritize national security over economic prosperity, heralding a shift away from ideals of global cooperation towards a more militarized and protectionist world order.

How to solve wars?

My framework involves four parts: Who are the actors, What do they want, Is it a major and durable conflict, and is the war oil sensitive?

First a few simple rules: Only a major war = higher oil, High oil = weak INR and higher bonds. If oil is going up due to the supply side = high VIX in eq.

Now the framework for the current war in the Middle East:

'Who are the actors': Only if point 4 and 5 are high probabilities, do we bother about such conflicts for markets.

1. Its oppressed (Hamas) against the oppressor (Israel) set up? 100%
2. But there are other parties involved (most importantly Iran) 75%
3. Will it spread in other countries of the region – Lebanon, and Iraq? 50%
4. Will the US/China, or both be involved in this in a proxied manner, direct manner? 75%, 0%
5. Is this war likely to affect the oil supply? 100% but mildly.

The 'Who wants what' metric is to build an incentive structure of main actors given that you will hear a lot of propaganda from both sides. Better to use a 'Realist' framework to assess the 'war incentives' of different parties. Try mitigating your own biases by temporarily adopting opposing political stances.

1. What does Hamas want? More freedom
2. What does Israel want? Revenge
3. What does the US want? Low oil prices in the short term. Israel/Saudi friendship in medium-term

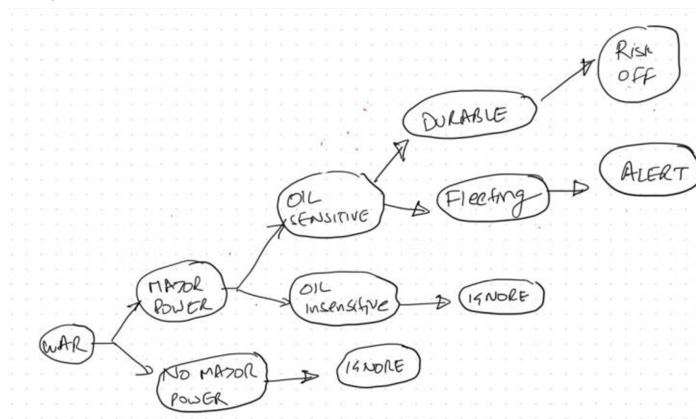
4. What does China want? The US to get distracted in one more war
5. What does Russia want? Wants Trump to win (so high oil prices), and the US to get distracted
6. And what does Iran want? Abraham's alliance doesn't take shape in the short term, being nuclear and hegemonic in the region in the long run.
7. What does Saudi want? Serious security guarantee from the US

"Is it a major war? Durable?" metric:

1. China, the US and Russia are likely to get involved in a proxy war, thus its a major conflict but with lower risk than the Ukraine war (since Russia was involved directly in it)
2. Also, given the objective of the war (Eliminating difficult-to-trace Hamas force for Israel and complete freedom for Hamas) – this war is likely to be DURABLE

The OIL PRICE metric helps me assess if the war is likely to cause an oil price shock.

1. Risk to shipping: 20% of oil is transported by strait of Hormuz. But because Iran, China and Russia may be together in this war – the risk of disruption is not very high (basis incentives)
2. Risk of Iran sanction: Since China has been importing from Iran in spite of sanctions and Saudis should be able to release 1-2mbpd in case of a supply shock, the risk of significant supply cuts is LOW.
3. Risk of low inventory: Coz of low inventory levels (due to SPR release)- risk of moderate price shock -HIGH



PS1
I am no expert in such matters. Nor am I giving my view on markets. Just giving a framework to navigate. Inspired by Tetlock's SF.

Some clarifications:

Crude effect = mild effect (10-50% jump in price, many small wars), strong (50%+, 1970s oil embargo, 1990s gulf war, 2022 Ukraine war)

Durable effect of crude = more than 1 year. More importantly recurrent.

Actors in wars = direct and indirect role in war (in this war, Hamas, Israel, Saudi, Iran, US, Russi, China)

Major powers in the world = US, China, Russia. If they are involved, the conflict becomes durable.

Realist (foreign policy) framework = zero sum power game amongst nation states. No idealism. Mearsheimer styled.

Key message: of the many macro variables that we must solve, one is war. I know war is a tragedy for all. But we have to still solve markets! Our job it is. This bit just one framework to solve a war for markets.

Dials on Political Macro

The freebie culture, known as "Revadi," has gained its own momentum. In Tamil Nadu, it began in 1967 and has continued since.

For the first time since 1990, we have two divergent policy offerings. The consensus on economic policies has broken.

The opposition offers an aggressive social safety net.

The future policy direction is revealed not by what the incumbent defends, but by what the opposition popularly suggests.

The constituencies of the market, the rich, and the incumbent are worse off in the setup created by the alternative policy.

Those who have not participated in the growth are better off in such a setup.

For markets - what matters in an election isn't about -who is the next ruler, but the degree of which the emerging perspective on 'economic and industrial policy' is distant form the prevalent one.

The democratic process doesn't yield a binary outocme, rather it unveils a spectrum of possibilities in terms of policies.

Even when the incumbent retains power, if alternate policy gains significant support, the resulting policy landscape is significantly altered.

Indian polity is leaning left again!

Politics and markets (Oct23)

"India grows at night when the government sleeps. This country is a tale of private success and public failure. It is governed by a very weak and ineffective state. We need a strong state" wrote someone who was once a board member of a firm I worked with. Back in 2012. (paraphrasing)

It was a paradox because in his work that was published in the early 2000s – he argued that "India had a lost generation during 1966-90" But that was the time of a strong state, wasn't it? I once asked him.
****

Today morning – a political commentator on a WhatsApp group said – "that Indian election outcomes are irrelevant to markets. They will do well irrespective of the government"

I replied to him "There is a clear distinction between two sides, the current party favours industrial policy, national champions and formalisation, state-funded infra, lower MSP and lower taxes" and "the other side

is likely more laisse faire in its economic policy, lifting MSPs as it may be seen as an instrument of income transfer to rural folks and back off from corporate tax cuts" The difference between the two sides is more today than ever. And these differences are material ones for markets.
****

In another conversation today, a businessman was too jittery to even think of an adverse outcome for the current government “India has done well only because of this strong government. Else we would have been significantly worse off”. He wrote to me.

And I replied “India will do well irrespective of the government. Your business will do well irrespective of the election outcome. So ignore it"
****

Election results matter little to the economy. Matters a lot to the markets. So if you are a fund manager - better build a template to navigate this uncertainty. Because it matters!

Conversation with RCD on political outcome

Rich & Cynic Dude (RCD) "Very disappointed with political results!"

Me "Why? This is such a phenomenal outcome. A win-win-win for out nation, economy and culture"

Rich dude (RCD) "I don't agree but in any case - we require major reforms to grow fast. This fractured mandate won't allow the govt to do anything substantial"

Me "Quite the contrary. We desperately needed a Policy-Light environment. Where nothing dramatic is done incrementally. Too many policy interventions in policy lead to uncertainty- driving growth lower, at least in near term. Lots of good has been done over past few years – it’s a time to sit back and enjoy the ride. I think the current mandate delivers it"

RCD "So you are status-quoist. You don't agree that reforms bring more growth?"

Me "Reform is the pain that present must take for better future. In long run -they yield. In short term - reforms do the opposite. Slow growth. India needs govt-do-nothing-much set up to get good growth in this cycle. Small little reforms can continue over next few years. But it’s time to harvest, not to dig. "

RCD "This is woo-doo stuff. We need to solve delays in judicial resolutions. RERA must be implemented across country. ONOP, UCC... But you won’t get that! Will you not agree that we need better infra?"

Me "Govt - in near term can only influence the growth outcome by fiscal policies. And the rule of fiscal policies is simple. Be counter-cyclical. Spend more when economy is slow. Less when its fast"

RCD "Don't we need to improve our ranking in logistics, defence, and high tech manufacturing. A strong govt is needed for it"

Me "Sure. But there is little or no influence of these on near term growth. Also, the current form of Govt or perhaps any government is good enough to secure better outcomes even in these areas."

RCD "Did you say any govt? Come on.. "

Profit pool of an economy

Had a spar with a friend on what the profit pool of an economy is, how it can be measured, how it is different from the profits of its firms and how tech influences the profit pool. Laying out my side for a critique:

Profit for an economy is different from profit of firms. Latter is a part of it. Typically, 1/3rd of the total profit of an economy accrues to corporations (8-10% of GDP). The remaining goes to households (~15% of GDP).

Most of the corporate profit is the profit of elites. Corporations are veiled structures to house the wealth of the rich.

For an economy – what it saves is its profit. Like good firms make a lot of profit - strong economies save a lot. Since savings of an economy equals investment - strong economies invest a lot. To observe the profit of the economy - we must observe the investments in it.

Think of it intuitively - the profit of an economy is 'excess production'. More than what is consumed in a country.

The excess production is generally of capital goods. Goods that will be of use in future. Capital goods are consumer goods in a fridge - ones that will be used tom.

The profit of a country/economy is divided between corporations and households. There are times when the profit of a nation rises but corporations' don't (China 2000s), other times, profits of corporations rise dramatically even when the profit of a nation doesn't (US 2010s, India 2020s)

Such a divergence is generally not sustainable in capitalistic economies. However, all these mechanics fail in socialistic ones.

New tech rarely creates a new profit pool. It typically cannibalises someone else's profit pool.

Also, in aggregate - profits don't necessarily rise because of technology, they simply get transferred (from malls to Amazon, from TV to Google)

The end beneficiaries of the Internet or rail or electric grids are those who use the tech as opposed to owners or builders of the tech. The same can be said for infra also. Rarely infra firms make significant money. The users do.

Key message: Of many things that are super-important for a macro watcher, one is to speculate on the aggregate profits of the firms. Here- I argue about the profit pool of the economy, and as it is the case with the firm which can be described as doing well, the same applies to economy. One which is investing a lot – is likely doing very well.

Why governments obsess over inflation

Desire of every popularly elected govt is to have both low inflation and low rates. But yearning of low inflation trumps by wide margin.

There is a reason why every Govt obsess over inflation. Have you ever heard of someone thanking PM for a good job? Good is quickly attributed to one' own merit. But everytime one buys more expensive grocery, petrol and shampoo, it's seen as govt' failure. Growth is seen as individual' project, Inflation

govt'.

Low Rates is a second order populism- but high inflation is first order catastrophe for a popular govt. One it has no will to bear anyhow.

Yet, despite it being so critical to its popularity, the conundrum is that no govt and it's money officers ever see inflation coming. That's the trick. If govt sees it coming- it never arrives. Inflation is always and everywhere a miscalculation of Govt & it's money officers. Once again & yet again.

Key message: It is often so that people think Government' key mandate is to get growth higher. I think it's to keep inflation low – is invariably what most government obsess over. A family sees high inflation as Govt failure, whereas, better job is seen as personal success.

Rules of Power

The thing about power is - it is only benign when its distributed. When it swings in favour of one -just one - what you get is unpredictability.

In the context of businesses, if the power-keeper is moral - the rents are sucked out. If its immoral - rents are re-distributed basis the loyalties- whose judge is the keeper, not the loyal subject.

It could be good for the system. For its people. But markets are not about system's good.

it could be just for most. But not for profits of businesses. Seen China?

I am reading this news on capping of air-fares. Its good. I am happy. But how about you -the owner of that airline?

Or banks? Of cement business? of Commercial vehicle? hmmm?

Why do we all hate short selling?

This phenomenon is not an Indian one. All societies hate short-selling. This has to do with the deep-rooted belief that participating in someone else's success is all right but benefiting from one's failure is seen as petty and sometimes criminal. Growth and optimism are seen as virtuous. Let all boats be lifted remains the key idea of policy leanings as well. Pessimism is seen as zero-sum.

This idea is used by 'gamers' to lean on the bullish side. They have the moral support of society. No other place is more apparent than in corporate life. People are trained to speak up. Irrespective of set-up and asks, the answer is: Kaam Ho Jayega!

Key message: Societies tend to view growth and optimism as virtuous. This cultural bias supports bullish perspectives and influences corporate and policy attitudes, encouraging a positive, "can-do" approach despite challenges. This invariably makes the set up asymmetric: bullish narratives - even though they are wrong - are encouraged and cheered, the bearish ones are shooed away.

Geo-political calculus in USD

Thinking of the USD move over the past many quarters as a mere expression of rate or growth differential and ignoring the geo-political calculus of 'the land of liberty' to checkmate the rising and ever-threatening middle kingdom has been a fool's errand.

Those in the know of it, have known that Powell's policy is two-faced, as its primary motive may be to indulge in an economic war that its country must have to avoid a bloody one. After all, why will the shrewd new world-ers will miss an opportunity to drum up the stress, when its arch-rival appears in revulsion, locking the country to achieve reincarnation of The Xi? This tape has run before, long before most of us were born!

Key message: Here, in this brief essay I want to emphasise that US uses its policy to not just achieve its desired economic outcome but also a geo-political outcome. US has done it with many other countries in the past – most notably in Japan in 90s.

US's Playbook: Burning the Boats of EMs?

The US is that naughty but superpower maniac, whose inflation has to be brought down at any cost—that's what its rulers seem to have decided. As they debate many options to achieve it, some may be thinking of tightening rates, slowing the economy, and perhaps embracing a mild recession. Only that, orthodoxy argues, could tame inflation. Yet others, the wicked ones, may be thinking of burning the boats of emerging markets (EMs) and thereby squeezing global demand for commodities and consumer goods. That will certainly bring down pricing pressures in the world.

The best way to squeeze EM demand is to deflate asset prices, limit USD supply, and tighten financial conditions in as many ways as possible. What wrong did we do, we may ask? How can the US afford to inflict pain on us to solve its domestic inflation problem? They can, and they will. Bear in mind that the poor has always been collateral to the rich's discretion, seen as a matter of no consequence, a trivia.

Slowing our and many other EM economies is a trick that the Fed may deploy to get US inflation down. It seems immoral but likely true. This is not inevitable—of course, nothing is in geopolitics.

Key message: Here again – I argue, how US uses its currency and rates to effect demand in the world and achieve the outcome it seeks for its local economy. This will help you understand the privilege that US has – of having a world reserve currency. The US may deploy strategies that inflict economic pain on emerging markets to control its domestic inflation. This approach underscores the harsh reality that global financial stability can often hinge on the decisions of powerful nations, with emerging markets bearing the collateral damage.

EVOLUTION OF CURRENCIES IN A DE-GLOBALISING WORLD

One of our government officials said recently that we should rather build oil reserves instead of buying US bonds. Putin, too, offered investment advice to all countries, suggesting they buy real assets like land, oil, and commodities instead of unreliable Western bonds, which can be confiscated.

But if your country buys land or oil instead of US bonds, it simply pushes the problem to another country selling these real assets. You can buy land in Madagascar, but Madagascar will have to do something with these dollars! So it doesn't fundamentally solve the problem of 'what to do with surplus.'

Why can't central banks buy other countries' bonds? Each central bank looks for a credible country's bonds—one whose borders are secure, military is mighty, tech is advanced, economy is large and vibrant, and one that is Atmanirbhar (self-reliant) in food and energy. No wonder everyone wants to buy US bonds only!

But a more fundamental question is, why does any country run a current account surplus—which is actually the origin of the problem? The way the global economic system works is that most countries want to buy an 'insurance policy' for rainy days. They do so by saving. And every time a country saves, its policy indulges in consumer repression. Had it not chosen to save, its people would buy a lot more imported goods, thereby balancing trade accounts.

That 'saved' money goes to the safest haven. The reason why the US runs a current account deficit isn't because its people are particularly spendthrift, but because it simply accommodates the precautionary savings of other countries.

Herein lies the true solution to de-dollarizing reserves: getting rid of surpluses themselves. If you are China and don't trust Western governments because you fear similar treatment to what Russia received, the only real solution is to reprice your currency higher. This means giving more consuming power to your consumers. If the CNY were to appreciate by 20%, many more Chinese would buy imported luxury goods and travel to Rome and Venice, resulting in a balanced current account. Problem solved!

Key message: The evolution of currencies in a de-globalizing world hinges on addressing current account surpluses and deficits. Countries like China will need to appreciate their currencies to balance trade, while deficit countries will face depreciation, leading to a less accommodative global trade environment. This is an opposite take on China currency – which is often argued as one which has to weaken dramatically to heal Chinese economy.

Dollar wrecking ball is an expression of US's strength

People initially read USD strength as cyclical story and now being forced to read it as flight to safety (recessionary) one. It is both and yet there is more fuel in this stove which is gas-lighting many currencies.

The dollar wrecking ball is an expression of US' exceptional strength of the post Covid world, coz It's economy stands alone in the world- fully recovered & now overheated. Plus it is the only large economic block boasting of energy & food self-sufficiency.

But more than that, inductive reasoning suggests that tight crude/USD combination may destroy its peer competitor (rerun of what happened a few decades ago to another competitor then) that no military superiority can achieve. Crude & currencies are the lethal weapons of destruction.

Since Forcing an offset on China for a low level equilibrium or simply put, destroying it is the sole geo-strategic goal of US, I like see many of its moves thru that lens. Including the war in Russia and US' role in that.

Key message: This I had written in July2022. In response to USD rise. I argued then – and the same applies almost all the time, that when USD rises, it's like a wrecking ball. An incumbent hegemonic power does everything to destroy its peer competitor even though such policy inflicts some cost on itself.

Why the USD behaves contrary to what many think.

The US can be hopelessly rogue (2021 stimulus), wrong (2021-22 inflation), or repressive (2013-21). Its financiers may screw up (2008), and the government may get its policies horribly wrong (COVID-19 vaccines). Yet, in all such conditions, it is rewarded with a strengthening currency.

In case our or any other country makes such mistakes... you can imagine the consequences. All countries run out of dollars once in a while—except the US. Paradoxically, when the US is struggling, outsiders scramble for USD, leading to its surge.

The US is the only country in the world that doesn't have to worry about any trade-off in responding to a crisis. It can cut rates and increase the fiscal deficit with no consequence on its external financial stability.

The privilege of the USD as the global currency is that the US gets the perks of having a free capital account and independent monetary policy without any downside of currency instability-induced balance sheet risk. It's a Mundell-Fleming perk, typical of a rich kid whose sins are absolved and whose smallest good deeds are cheered by all. Can you relate?

... Brace yourselves for another unexpected rise of the US dollar. As for an investment/trading framework, remember the following:

- The sufficient condition for a USD rise is a "problem anywhere," including in the US. The USD is the universal financial conditions index.
- No bull market in non-US equities is long-lasting or secular if it coincides with a strong USD. However, this is not a constraint for US equities, which can rally even amidst a rising USD.

Key Message: The USD often strengthens in response to global uncertainties, including issues within the US, due to its unique position in the global financial system. This dynamic underscores the USD's role as a universal financial conditions index and highlights the resilience of US equities in the face of a strong dollar.