Transcript: Lakshman Achuthan: Smooth Reflation Sailing (For Now...)

Featuring: Lakshman Achuthan and Ed Harrison

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Synopsis: Lakshman Achuthan, COO and co-founder of ECRI, joins Real Vision managing editor Ed Harrison to share his outlook on economic growth, inflation, and markets. Achuthan charts his way through the next 12 months, pointing out how the bulk of ECRI indicators suggest that reflation is indeed, just as many foresee, here. Achuthan disaggregates "the reflation trade" into the U.S. business cycle upturn, the spike in future inflation gauges, and a pick-up in global industrial growth, predicting that these three forces will for the near-term persist, albeit with the potential for some "storm clouds on the horizon." Harrison asks Achuthan about the dangers and timescales of these storm clouds, and then the two interpret economic data ranging from jobless claims to shipping numbers to industrial production. Lastly, Achuthan shares his view on interest rates and volatility in the equity and credit markets. Key learnings: Reflation is here and will continue. In most of the economic data he tracks, Achuthan sees an expected pick-up in growth and inflation. Nonetheless, looking at longer-leading indicators, there are "storm clouds on the horizon" for these variables.

Video Link:

https://www.realvision.com/shows/the-interview/videos/lakshman-achuthan-smooth-reflation-sailing-for-now

ED HARRISON: Welcome to Real Vision. I'm Ed Harrison, and I have the great pleasure of talking to ECRI co-founder Lakshman Achuthan. Lakshman, good to talk to you–

LAKSHMAN ACHUTHAN: Really good to talk with you too– it's been a while.

ED HARRISON: It has. Actually, I was wondering if it's been so long that it was in studio where we spoke last, or if we did this whole Skype thing. Because you have a stunning background there, which is very positive.

LAKSHMAN ACHUTHAN: Oh yeah, I think it was. Yeah, it was way back in the before times, when we were in person– just before.

ED HARRISON: [INAUDIBLE] I think we should make that a habit here to talk about the before and after. I'm going to take that as a cue for how we're going to talk about things. And Lakshman, I want to start it off, actually, because literally right before we got on, I was telling you that I want to talk about what ECRI does, because even though, every time you've been on Real Vision, you've said what you guys do, I think it's really important to highlight how your process is important in terms of understanding the business cycle and how that applies to the economy and markets.

LAKSHMAN ACHUTHAN: Thank you. Thank you. So very big picture, what we're offering, what we can talk about is, I think, in a very fundamental basis different than other macro forecasters. We're looking at monitoring the business cycle primarily, but actually, many, many cycles– inflation cycles and other ones– and coming at it with without using models.

And so that's actually saying a lot, because many macro forecasters are using models which rely on some form of linear relationships over a long period of time. So we're not doing that. I'm not against them, but for the purpose of managing the risk around an inflection point in the cycle, it's not a great tool.

A better tool is our very good leading indicators of cycle turning points, and so that's where I've spent all my time. That's what ECRI does. We study cycles, and we try to forecast recessions and recoveries, and we try to forecast the switch between accelerating growth and decelerating growth.

We try to forecast when the pace of inflation is going to accelerate or decelerate. Now, if you do those things for large economies around the world, you start to get– it's not all simple. There's a lot of cross-currents. There's a lot of interesting patterns that are popping up. There are times, in particular, around turning points, when our process, almost on a systematic basis, is going to diverge from the consensus, which is more model-driven or extrapolative.

And that's a really interesting time, if you can step away from the crowd there. And that's basically what we're doing is trying to manage that cycle risk. So a good example would have been last year in April. Understanding the cycle dynamics, looking at some indicators, we came to the conclusion in early April that, as crazy as it was, it was over, and that we were going to have a short recession– wasn't going to be one that was going to linger.

And in that context, that directional, cyclical context, a stock price upturn made pretty good sense, and we explained that at that time. And in the aftermath of that, you lots of people have said lots of things. And we certainly observe, along with everyone, the outsized policy response.

We've seen so many of these– oh my gosh, I've never seen anything like that. Look at this. Look at that. It could be physical. It could be monetary. It could be something else with the epidemiology. And part of what's come along with that, which maybe we could talk about today, is this idea that with rates crushed a la Japan or something.

They're just crushed. They're pushed to the floor. What the heck does that mean? And there has been variations on, maybe macro isn't that important anymore. And on that score, it's possible. I have to say it's possible, macro, but when we do the– when we kick the tires and we look at it, actually, we conclude that it might be more important than ever. And so that's where we're ending up.

ED HARRISON: Good. That is a great lead in, the death of macro and how macro is more important than ever. And Lakshman, let me say that, I think it was maybe a year and a half ago, I spoke to a woman [INAUDIBLE] who does these dynamics stochastic model– nowcasting people call it.

A lot of people think of her as one of the founders of this whole nowcasting phenomena. And what she told me is that those nowcasts have a very limited horizon, over which they can forecast. So when you're nowcasting, as the Richmond Fed, or the Atlanta Fed, the New York Fed do, you're doing it over very limited time horizon.

One of the things that I think stands out is not just that you are talking about the cyclical turns, but you can also talk about time horizons that we are not able to observe in a nowcast. So in this conversation, I want to get to that, actually.

LAKSHMAN ACHUTHAN: 100%– right. So the way that I would map our work to what you just observed about the models and the nowcasting– and also, I'd throw in, to a degree, not all, but a lot of big data. It's very exciting, and it really does help improve the nowcasting– but on this question of forecasting, not so much.

In our world, nowcasting is coincident data, coincident indicators– tells us, where are we right now? What's going on outside the window? And right now we're in an upswing. That's good. I think we have pretty high conviction we're in that.

And then the question is, what's the risk of a turn? We have to look at forward-looking, leading indicators, drivers of whatever cycle we're talking about. And there are a few, but in this case, let's stick with growth. Are there indications of the acceleration and growth peaking and turning down?

And for the United States, not yet– so far, so good. I think we're on track, despite– it's not that I don't see the headlines, I don't see some of the negative numbers that are out there. I get it. But is there a shift in the direction of the cycle here and now? No.

That's what the forward data gives us– some conviction that it's not yet. It will come. Trees don't grow to the sky. It's going to happen, just not here and now.

ED HARRISON: Interesting– now, let me start the conversation off with the observation about what people are thinking about in the market, and how you can tell us how the economy going forward is going to affect that. I think, going back to April of 2000, when you were saying, yes, we saw that this is going to be a short recession, and therefore, that's positive and that's going to have a reflationary impact for the economy that's bullish for shares people bound.

And here we are, nine months later, and that's actually true. So this reflation trade that, generally speaking, people talked about as part of the reopening in the summer, continued, and went forward, and actually picked up steam in the post-election period– particularly when we got the vaccine, because the vaccine basically said to us, even if there is a temporary downturn or a softening of growth, it's only going to be temporary because that's a limited window.

The vaccine's on the other side of that. So reflation is what you got to think. That's the mantra going forward. The tunnel that people are talking about– it's manageable, especially through fiscal and monetary stimulus. Talk to me about what you're seeing in the context of that particular narrative.

LAKSHMAN ACHUTHAN: Again, I talk about what I know, which is cycles, and I have some conviction about– around that subject. So that's certainly part of my view. I also am very aware of the bulk of the market narrative, and you described some of that.

And there's been lots of wiggles in between last April and now. And what strikes me is that the business cycle, I think, is pretty darn powerful. So one component here of the conviction is we have an end of recession the beginning of a recovery. And typically, the first year of recovery is related to the depths of the recession, and so there is some, quote, unquote, "payback" that you get– regardless of the events, mind you.

This is cycle dynamics. And that lasts for about the– maybe up to a year. Then there's a second cycle here. I said many cycles. So the second cycle that's kicking in is a global industrial growth upturn. There aren't a lot of global cycles, and this is one, and it's very real.

And many large economies participate in that industrial supply chain in various ways, and the US is no exception. And then there's another cycle, which is the separate inflation cycle. And so we have an inflation cycle upturn, which is not to be confused– and it often is– with the business cycle.

So we have a business cycle or a US economic cycle upturn, we have a global industrial growth upturn, and we have a separate US inflation cycle upturn. That's what, I think, has come to be known as the reflation trade.

And I think what happens is that the reality is that all these cycles are turning to the upside, and people who are trying to explain that– you need stories around it. And so it was this stimulus, or it was that fading of the infection, or if it was this positive other development.

And we see them all, and I'm not saying those stories have no merit, but I kind of think you're playing catch-up, and nowcasting, and pontificating around trying to explain what's happening. And for my money, I'm going to look at these leading indicators, which gave me some pretty darn good correct conviction to the upside.

So when I run into a negative shock– stimulus wasn't what the market had hoped, something happened with the election– these are real things. I'm not saying they don't carry some import, but they're not as strong as the cycle. Cycle's stronger. That's my point.

And so even today, we could worry about this or that, and we should. I'm not saying don't. But if you want to relax a little bit and not be too entirely freaked out by the news, you can look at the cycle, and the reflation trade is still on. The business cycle is still moving to the upside. The inflation cycle is still moving to the upside. So those things remain intact for now.

ED HARRISON: Yeah– very interesting. Now, my takeaway from what you're saying is that, just to use a metaphor, we have a aircraft carrier-sized ship in terms of the economy, or in terms of these cycles, and to move those things in any way, shape, or form externally, you're going to have to have some very powerful forces.

LAKSHMAN ACHUTHAN: Yes. And you and I have chatted about this in some previous interviews. If– I'm totally speculating now– leading indicators turn down, at a certain point, a window of vulnerability opens up. It's like the defense perimeter has been breached, and you can get tagged by a negative event– where otherwise, when leading indicators from the cycles go into the upside or the leading indicators remain to the upside, you got a pretty darn good immune system going.

And you can take what otherwise may be a real heavy-duty hit and shake it off. And for the time being, that's fully intact. And I think, going back– you mentioned the DSG models– and the Fed walked away from its attempt at forecasting inflation. That's a whole other discussion.

But in doing that, you kind give way, and you're like, what the heck am I going to do? I'm going to have to follow events, because I can't follow some theory on where things are headed. And what I'm actually saying is, yeah, you can.

There's cycle theory. It's pretty darn good. It's stood the test of time. And not only did it nail this one– it's nailed, if we want to look back to 2018, 2016, really big inflation and rate moves– which also underscore that I don't think bond market volatility is gone. But those events were really well-mapped by this approach, which is not a DSG model approach. It doesn't mean you have to give up and just follow events.

ED HARRISON: I want to go to some of the events that are happening right now that people are concerned about. And so that will give us a little context to put this in. So the events that people are concerned about are basically that– so we've gotten to the vaccine, but now we're entering the winter.

And the winter is a period where you're going to see a lot more infections, and there are going to be lockdowns, and those lockdowns are going to be severe– not as severe as they were 10 months ago, but certainly relatively severe. For example, the British government just said that all travel quarters are suspended indefinitely.

They suspended these travel quarters over concerns about this new variant, B117, that's in the UK and that's causing most of the infections. And so people are saying to themselves, this is a clear and present danger globally– so we can talk about that– but also potentially for the United States as well, and it's going to have an impact on the inflation cycle as well. But what are your thoughts about that in terms of the data that you're seeing, in terms of the leading economic indicators?

LAKSHMAN ACHUTHAN: Look, it's real. I don't want to, in any way, belittle the human side of this, both with people who are on the front line and people who are being impacted personally by what's going on with the virus. But it's not going to change the direction of the aircraft carrier, to go back to our earlier metaphor.

The cycle is still to the upside. Look, the recovery began early last summer, let's say– somewhere in there. And a whole bunch of bad stuff was still happening. And we came right into a bunch of bad stuff. We're in the midst of it right now.

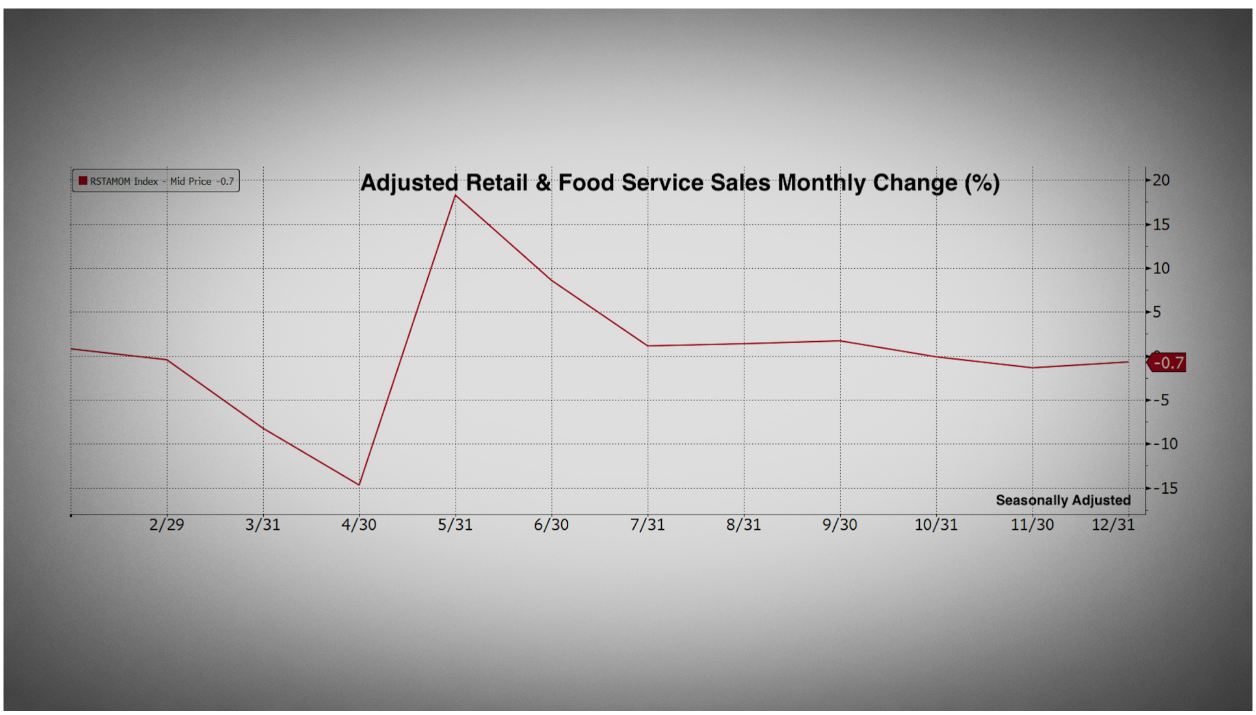
But you could see that the economy itself is growing. The primary foundation of this growth has been on the good side, and that's where it intersects with what you're describing, where the things that you can buy, and get delivered, and things that you can build, like residential homes– that stuff is hot. It's very strong.

And the consumers who have money to spend, which are the higher-end consumers– higher earners. That's your K-shaped recovery– so those consumers who are responsible for the bulk of consumer spending have redirected their spending from services toward goods and housing for– I'm oversimplifying, but that's basically what's going on.

And that's not over. That could just happen some more. That's going to happen some more. So if you look at claims, yeah, they're up, because forward-facing front-line service stuff is taking it on the chin. You look at sales– the same type of stuff is not– retail sales– same type of stuff is not going to do that well.

On the other hand, you take a look at industrial production or manufacturing industrial production– it's coming in way over consensus.


U.S. Initial Jobless Claims
Seasonally Adjusted
Mid Price 965.0
High on 03/27/20 6867.0
Average 852.8
Low on 01/31/20 201.0
7000
6000
5000
4000
3000
2000
965.0
0
Mar
Jun
Sep
Dec
Mar
Jun
Sep
Dec
2019
2020


RSTAMOM Index - Mid Price -0.7
Adjusted Retail & Food Service Sales Monthly Change (%)
20
15
10
5
-0.7
-5
-10
-15
Seasonally Adjusted
2/29
3/31
4/30
5/31
6/30
7/31
8/31
9/30
10/31
11/30
12/31

You look at all the shipping stuff all over the place– they're all off the charts, because people are buying stuff, and that's still happening. So the economy isn't tanking here. There are pieces of it that are exposed, that are taking it really hard, but it doesn't change the direction of that aircraft carrier– at least not yet.

ED HARRISON: So now, that's the US, and we're going to come back to that to a certain degree, but you did make a statement earlier that that's actually not reflective of the global economy, per se. What are you seeing there? And when I say not reflective of the global economy, number one, we have the global manufacturing upturn, which you said was still intact. But what about this whole outcome just from a purely economic perspective in Europe or in Asia?

LAKSHMAN ACHUTHAN: Everybody's not created exactly equal, but the general trend remains to the upside, so– we track industrial materials prices, industrial– sensitive industrial materials prices– so not precious metals and not soft commodities, but your lumber, and your metal– primary metals, and your energies, and things like that.

Those are at over decade highs. If you look at the stuff– which we do– which isn't easily tradable, it's near all-time highs in the growth rate, so it's kind of on fire. That's not over. So that's still happening, and underpinning many economies globally.

Now, trees don't grow to the sky. That will change. We're watching. Any time we have an upturn, we got to watch for the downturn. I'm just saying it's not here right now. And we do have to keep a close eye on the horizon for signs of that starting to turn.

If you have really hard shutdowns, you're going to have activity go down. There's no way around that. It's almost happening by definition. The question is if it becomes a cyclical event, in our mind, meaning something that is going to spread across all industries and persist.

And on that final score, the persisting score– is any shutdown or partial shutdown going to really persist? I'm not sure anyone's saying that at this point. I don't know that. And I there's quite a bit of resistance to doing that, in many cases. So in that sense, it's not adding up to a fresh cyclical downturn. You could have interruptions and restarts.

ED HARRISON: It's an interesting point. Let's examine that for a second. We saw the ADP number. We saw the jobs number. We also saw the jobs claims numbers that you just talked about. Let's say that we have those numbers and a month or two, maybe three months worth of numbers like that lead to a deceleration in growth in the United States. That's not necessarily a recession.

LAKSHMAN ACHUTHAN: No. First off, that's not a recession. And just to be clear, I'm not talking about a recession at all. There's just no recession in sight. Deceleration in growth, I think, is very important. I think there's some issues there, because when we have decelerations in growth– a cyclical deceleration in growth– I think that's an extremely important moment to see in advance.

And I would hope to see it a lot sooner than it's in the next month or two, by the way, using leading indexes. The reason I'm very sensitive to those is because that is where major corrections occur. When you are inside of a cyclical downturn in economic growth, now you're near rocky shoals.

You can get a major equity market correction, and we can get into yields, and valuations, and all of the– net present value of stuff and all that. But regardless of all, that, this is something I would take extremely seriously. It's not happening now, and I don't think it's on the near horizon either, notwithstanding the scenario you're describing, because number one, our leading indexes are pointing to the upside.

And they are fully exposed to issues around employment, and future employment, and much more. And when you come back to the composition of what's going on in this recovery– and the overuse kind of K-shape, but it's a quick shorthand– we can see lingering and backing and filling on weakness in jobs, at the same time that consumption is holding up, because roughly half of consumers are making up the bulk of the consumption.

And if they are able to work remotely, if they do own a home, if they have some exposure to equities, it's hard to say it, but they're not hurting actually that much, relative to the other cohort, which doesn't own the asset that's inflating and does have to go out and try– where there's not a lot of demand for an experiential– to earn an experiential wage.

And so that's where something that is really a mess, a train wreck, in some sense– this whole part of the economy isn't really running that well– at the same time that stuff is going to the upside. One other thing that can help explain that– feels like cognitive dissonance, practically– is that the cyclicality– and this is a double-edged sword– the cyclicality of the manufacturing, and goods, and even residential construction sector is on the order of six times larger than the services.

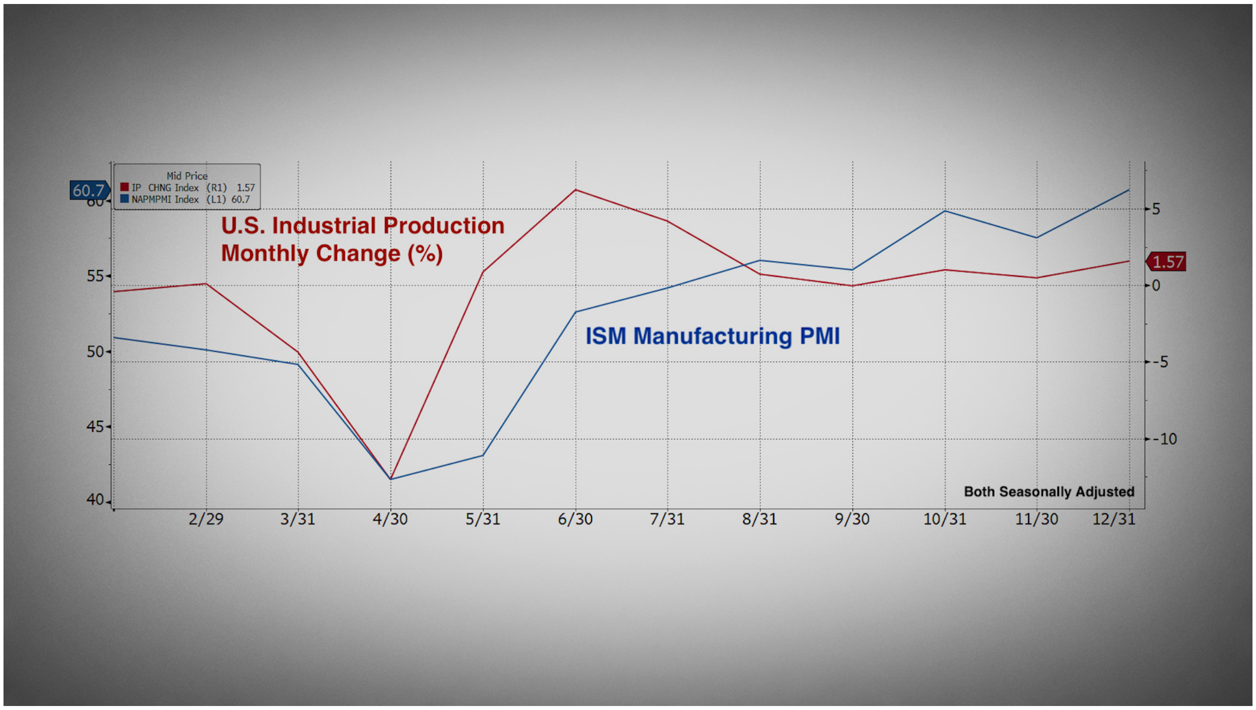
So feels great on the upside, but this, again, I want to– I don't know when it is, but at that next downturn, it works both ways– and so, again, pushing back on the idea that maybe macro isn't that important. Oh my gosh– I think, actually, when you have lower volatility like this in the overall economy, and growth has generally slowed over decades, boy, oh boy, you got to get these right.

ED HARRISON: Yes– 100%. And good that you mentioned that– we have to make that pivot to the death of macro. Let me go a little bit further. Two things– first, I want to talk about retail sales.

Then I want to talk about commodities, because we really haven't– we've given a bit of short shrift to the inflation side of things in terms of your cycles, but the retail sales number– when people see retail sales, they think consumption, but the reality is that retail sales are a subcomponent of overall consumption. When you're thinking about leading economic indicators, what do you make of the numbers for retail sales that have come out, which have been relatively negative?

LAKSHMAN ACHUTHAN: You're right. The true measure is a broader– much broader manufacturing and trade sales, really big, big transactional sales numbers, as opposed to retail sales are a little tighter. But what I make of it is that the virus is having an impact. You can't buy the services that you want. You see that in this quick– relatively quickly available data– the impact of that.

However, at the same time, you see that the good stuff is still solid– didn't go anywhere. In fact, it's stronger than expected. If you flip over and look at industrial production, manufacturing goods, and things like that, those kind of things are holding up. So the overall picture remains consistent with what the leading indexes had suggested, which is that the turns not here yet.



And that's the question we're always asking. Is the turn here yet? Just to be clear, all this data is kind of fuzzy. Market data is real. Survey data is, depending on the survey, pretty good. And then the government data is– they're doing their best, honestly, but it's a big thing to count and estimate, and it's fuzzy stuff.

And there's a lot of noise in there. And so the leading indicator of the cycle is trying to– what is that underlying persistent move inside of the noise? And the answer right now, as far as I can tell– everything I'm looking at is still to the upside, despite the back and forth.

ED HARRISON: Right. And right before we came on, I tweeted out that you had said that not only is this true, but quote, "commodities continue to rip to the upside in line with our spring 2020 call. As the chart suggests, no near-term downturn, but longer-term leading indexes hint at storm clouds on the horizon."

OK, so two or three things here– first and foremost, we're going to use this is making transition to thinking about prices and inflation. But also, I want to hear what you mean when you say no near-term downturn, which we've talked about so far, but storm clouds on the horizon.

LAKSHMAN ACHUTHAN: Sure. So ever since my mentor helped to develop the original indicators, leading indexes– that's back in the '50s, '60s– so what has been going on is developing– advancing that knowledge. So you have coincident data and leading data at cycle turning points. These are not models. This is things that do certain things at peaks and troughs.

So those are your original buckets. Every human being wants to see farther ahead, and so on and so forth, so we're looking at long leading indicators. And we have some very long leading indicators for global industrial growth. Again, that's the only really solid global economic cycle.

And we can get into why, but I'm just asserting that for the moment. And on that score, we have some very long leading indicators, like the median lead can be about a year. I got to tell you, that is next-generation stuff. It's really far in the future.

But the leads can vary– sometimes a longer lead, sometimes a little shorter. So we need to see shorter leading indicators– which have a more stable lead over the target, which is global industrial growth– beginning to smell the inflection point, the peak. They haven't done that.

And an example of even shorter leading indicators than our short leading indicators would be the PMIs or– and/or the commodity price chart that I tweeted out, which is going to the moon right now. And so those are short leading indicators. The market focuses on the PMIs quite a bit.

The ECRI industrial price index is– has a different characteristic, in that it's daily. It's more frequently available. And so when we're looking there, there's nothing there at all. When we look at our short leading indexes, which are not shown, but which we're tracking– not there, no downturn yet.

When we look at the really long ones, yeah, there's storm clouds there. There's something there. So I would not set it and forget it for the year 2021. I think you got to stay engaged and open. There's some time to make hay still, but storm clouds on the horizon– you got to pay attention.

ED HARRISON: And what sort of time frame are you talking about in terms of the storm clouds? When can that– those clouds manifest as an actual rain?

LAKSHMAN ACHUTHAN: I would expect sometime this year. I just don't know how soon.

ED HARRISON: Right.

LAKSHMAN ACHUTHAN: I got to watch those short leading indicators to see if it's a quarter out or so. I don't really see that. We don't see that just yet. And to be clear, I'm talking global industrial growth cycle. That's very different than the US–

ED HARRISON: Right. How much does China influence that cycle, by the way?

LAKSHMAN ACHUTHAN: Look, they're important, but so are we, and so are– Europe is a big industrial exporter as well. And even though we don't have a lot of people working in the industrial sector, relatively speaking disservices our output there is pretty darn good.

So it's all about the output, the actual industrial production growth. China's big. There's no doubt about it. China's OK. They're not falling apart. Our cycle indicators there are OK. They're OK.

ED HARRISON: So going back to this– the price index supplement that you were tweeting about, what does that say to you about prices? And in particular, I ask that because with the PPI that came out, and it showed some inflation, but not a whole lot of inflation– whereas commodities have been ripping to the upside on supply constraints.

How much do you think this leads into pent-up inflation that should have some impact on inflation expectations?

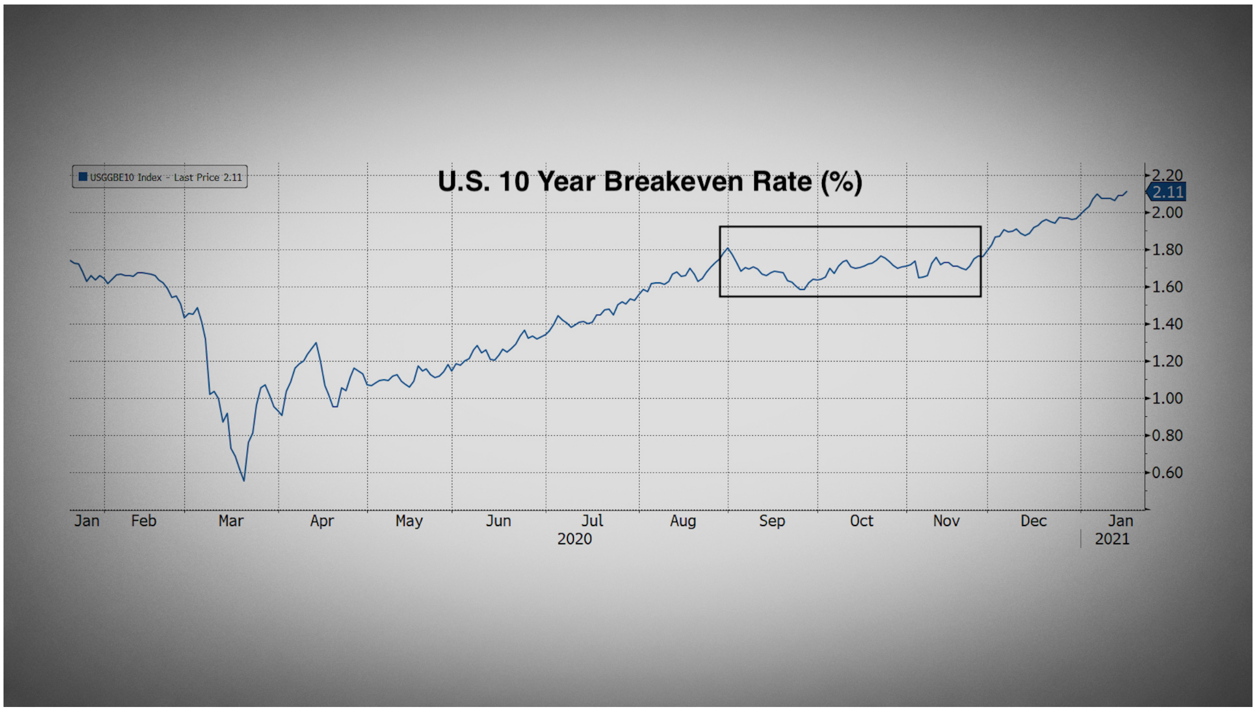
LAKSHMAN ACHUTHAN: Great question– look, I think inflation's very– it's a cyclical thing, first and foremost. It is very loosely related to the economic cycle, and so therefore, having separate indicators for inflation cycle turning points, I think, is really important. It's served us extremely well.

And I've been watching those real time since 1990, so I got a pretty good feel for them. Commodity price inflation feeds into that cycle, so it's one of many drivers of the inflation cycle. Our future inflation gauge, as I mentioned, turned up last summer, and inflation also bottomed around then.

This is in line with that. But the future inflation gauge is speaking to, is it cyclical? Is it going to be pronounced, pervasive, and persistent, relative to past inflation cycles? So the emphatic, really clear answer is yes.

Last week, we updated that through the end of 2020, and it hit a 13-year high. So this is not so much about magnitude. It's very much about direction. There's no peak in the increase in the pace of inflation in sight. And the future inflation gauge looks ahead a couple of quarters, maybe a little further than that.

You know– you guys are watching this– that expectations kind of went flat in the fall. All the events stuff, right, it kind of squashed, or whatever was going on– and it kind of squashed expectations. But boy, oh boy, the [INAUDIBLE] just saw straight through that.



PPI, CPI, PCE, all these– the GDP deflator– these are all coincident measures of inflation. And there's going to be some base effect thing where last year was lower, and so it's going to look higher. None of that is part of our process. We just walk past all that.

We're looking at the cyclical turning points in inflation, not about what happened 12 months ago to inflation. That's not part of our analysis. And the directional call remains up. This future inflation gauge has really performed unbelievably. I'm really proud of it, to tell you the truth. So if you remember, following the 2015– this is ancient history– I'm sorry.

ED HARRISON: You were about to talk about the oil shock.

LAKSHMAN ACHUTHAN: Yeah. So '15, '16, which is a big decline in industrial growth, actually– and it brought about all the secular stagnation stuff, low growth, low inflation. It cemented this narrative that really pushed yields and expectations down to record lows back then in 2016.

And expectations are super low, but the future inflation gauge turned up. Then the same gauge right now that's at a 13-year high turned up in the summer of '16. And remember, that comes before the presidential election, so this isn't about Trump getting elected, or tax cuts, or anything like that.

This is just a clean cycle move. Again, I'm talking about this cyclical, pronounced, pervasive, and persistent directional changes really overriding events. I think events come in. There are nice narratives around cycles, but I think the cycle– you can't confuse. They're not equal.

All our indicators were super strong into '16 and all that. Now, fast forward– you'll remember then, in '18, boy, oh boy, the bond market was dead. It was dead man walking. Everybody was saying bonds are done. And especially the tax cuts, and this, and that– and all those bond kings and everybody pounding the table– 4%, 5%, even 6% 10-year yields.

And lo and behold, we don't control this, we just monitor it, but the future inflation gauge turned down in '18. And so we're sitting here saying, whoa, everybody's looking that way. The inflation cycle is going to surprise you and go the other way.

And of course, you remember this– you got Powell talking about hikes at the end of '18, and then finally the pivot and all that stuff. So this thing, even in recent memory, has a really good track record of beating, essentially, the bond market. And right now, it's pointing to the upside at the same time the growth is pointing to the upside.

You obviously have to deal with events, if the market is bringing that narrative. And you got to know what the market narrative is. But I think then, having consumed that and understanding that, knowing where the cycle is going is perhaps more important.

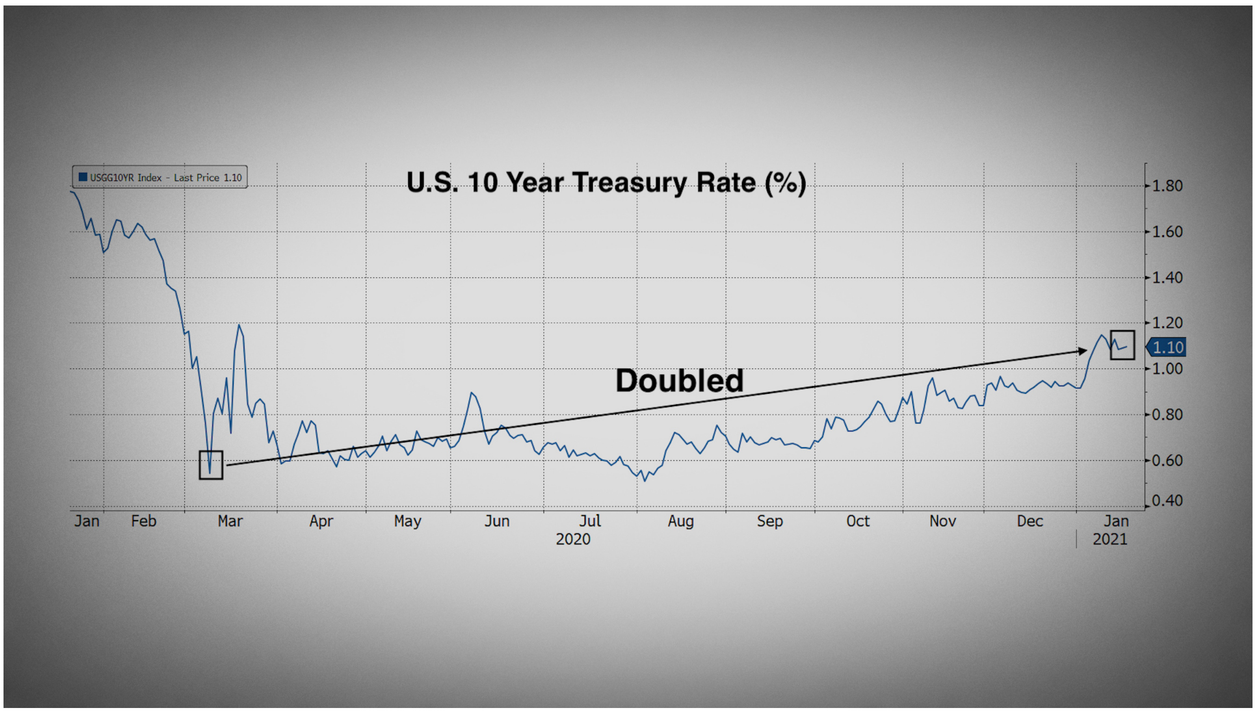
ED HARRISON: We can go to the death of macro here and do that via bonds, because basically what you have just said is, if you're thinking about nominal GDP growth, you have upside potential both in terms of real growth and in terms of inflation. And ultimately, if you're thinking about that from a bond market perspective, that should mean a steepening yield curve, which, to a certain degree, starting at the beginning of the year, we've seen. Potentially, if what you're saying is true, then that steepening could continue.

LAKSHMAN ACHUTHAN: Yeah. And I think, just before we go forward, I would say all that stuff that I'm saying about the cyclical view isn't new. This stuff is from monitoring the cycle data is actually old. And now the market has really bought into the narrative of it and is running with it. And I'm agreeing it's not over. That's all. That's all the cycle stuff is saying.

The whole death of macro stuff– OK, so yields get crushed really fast with this last recession to extremes, all that net present value of the market gets pulled forward, supporting valuations and any company that has a really good story about earning money down the line. So there's a ton of the tech companies, or Tesla– these are all future earners. You've got to discount that stuff. Boom– it goes up.

That's kind of a one-time deal. That's not an ongoing deal, I don't think, of pulling forward the future earnings. And so then you've got another hunk of your portfolio maybe sitting in bonds, which isn't really earning that much, and you say, that's the kind of– oh my gosh, my earnings expectations– to paraphrase Larry Fink– are really low– the BlackRock– head of BlackRock's, who's been talking for years about our potential earnings are pretty darn low– 100% agree.

But you come back to the story we were just telling, we were describing about inflation cycles and bonds. Yields have basically doubled off the low over the last little bit. That's pretty volatile. And I don't think people realize quite how volatile these rates are actually getting.



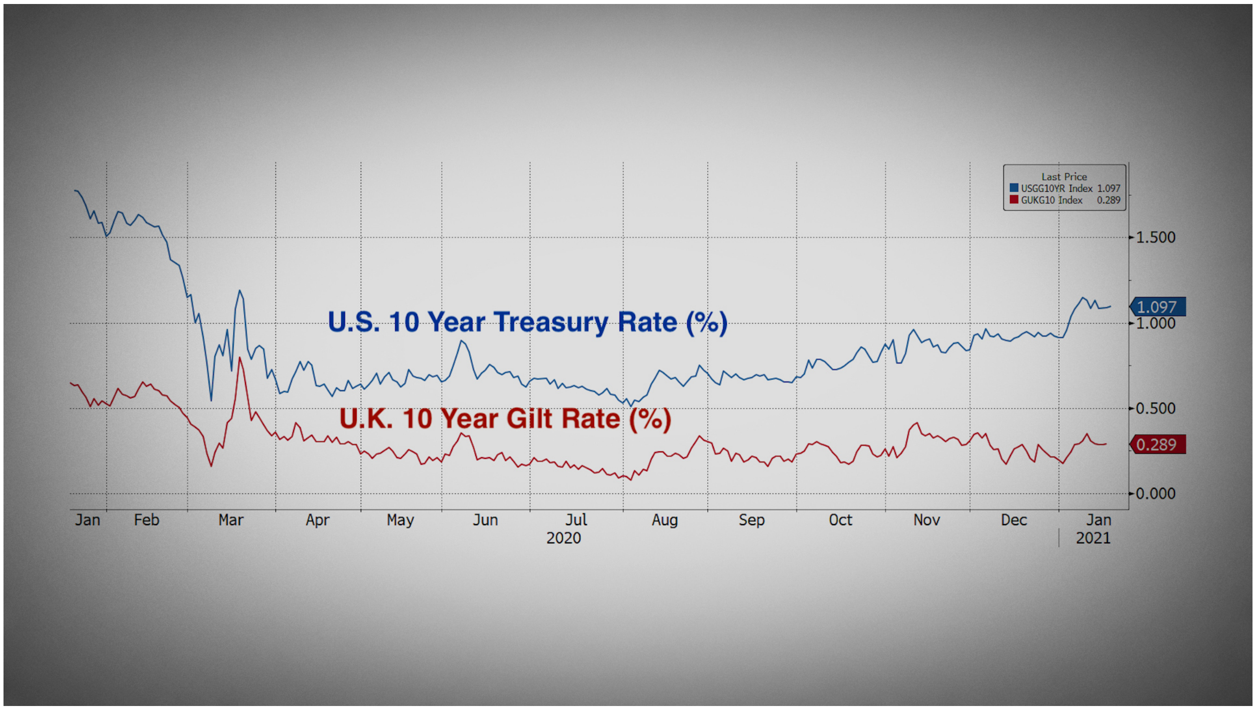
When they're low, any cycle turn like that is a big deal, and then that impacts other markets as well. And we know that bond yields are closely linked to business economic cycles and inflation cycles. Those are the key building blocks of your nominal yield.

So that tells us that there's a lot of opportunity in that volatility. These markets are not going to be calm going forward. Equity, volatility's is a little lower than it was decades ago. Bond market volatility is higher. Commodity price volatility is higher.

Those things are increasing, not decreasing. And that really challenges the idea that maybe macro doesn't matter that much anymore. I think, to the contrary, macro matters more.

ED HARRISON: Well, let me ask you this, because as you say that, the thing that is vexing me with regard to this is I'm looking at fiat currency issuing countries, ones that have the largest degrees of freedom that are closest to one another– the US and the UK. And with rates pinned at 0 at the lower bound on the short end, the UK 10-year is trading today at 28.6 basis points, whereas the US 10-year's trading at 109 basis points– 109.2 basis points.

That's a massive differential, especially in a world in which the British pound is increasing to 52-week highs versus the US dollar.



Those scenarios don't match. Something from a macro perspective is out of whack, especially in a world in which leading indicators are saying nominal GDP growth will go up potentially because of both real GDP growth and inflation in the United States.

You would think that would mean that, OK, yes, I get the bond part of that– 1.09 versus 28.6 in the UK. Maybe the UK isn't as good on that level. But then you have the currency side not matching out. Something from a macro perspective is going on there. Is there something in what you're seeing that can help explain those disconnects?

LAKSHMAN ACHUTHAN: On FX first, I think the vol, as you're describing– volatility– is here, and I wouldn't at all be surprised if it became more extreme. I agree with you that those differentials aren't currently in line.

ED HARRISON: 28.6 to 109.2– that's massive. And you think about the US and the UK as largely similar– deficit countries from a fiscal perspective, deficit countries from current account perspective, ultimate degrees of freedom in terms of fiat currency issuing. The UK just got out of the EU. There's nothing to constrain them. How is it possible that there's that massive a difference between those curves? What is the UK doing that the US is not doing?

LAKSHMAN ACHUTHAN: Predicting foreign exchange rates is a tough thing to do, as you know– and explaining them. I think that the cycle differentials are part of the puzzle, and cannot be ultimately ignored, but they can probably be ignored for a while for longer than we could stay solvent. So you have to respect that.

The one thing about the UK, as you know, also is that that's the– it's relatively undervalued through this whole debacle. And everybody else inflated, and they didn't really quite move as much, and so maybe there's some after effects of that that are in play here. I certainly don't put anything past some of the central banks and what they're doing.

I don't exactly know what they're up to there. I think that they are mucking around, and I'm not sure they know exactly what they're doing. But ultimately, I think the differential in growth and inflation will make sense in some of these fiat currencies.

We're in a really weird spot. We've all watched Japan do what it did. And then we're saying, oh, OK, Europe tried to do a little bit of it, but they've had to have their Hamiltonian moment to get all– a universal bond together. And I don't know exactly where that's going to go.

What's the US going to do? The reflation trade me bail out a little bit temporarily. It's cyclical. It's not a structural fix, by any means. And where does all that end up? I can't predict where inflation is going longer term. I think there's a lot of structural headwinds for inflation to really lift off because of ultimately lower long-term trend growth.

But I can't tell you for sure it's not going to somehow start to lift a bit beyond the cycle. And those things need to be considered. If we even go back to Japan, which is kind of at the vanguard of all this stuff, I think the Nikkei is up massively now on their business cycle recovery.

It's probably better than it's been in decades at this point. And that's after they've done all kinds of stuff mucking around in their market. I certainly don't think the US can do what Japan did literally, and while we're in the reflation trade, we don't even have to think about it.

They're going to be jawboning a little bit on being less dovish. But all of this is going to come home to roost when the next cycle downturn happens. That's when that action is going to be really dramatic. So you had asked a question– when is that? What is a time frame when you start to see the first fraying of the first cycle peaks? And my best guess is later this year.

ED HARRISON: Let me introduce this concept, in terms of the death of macro. So one of the takeaways from what you just said that I find interesting is that the next cyclical downturn will be meaningful. I would say that the next cyclical downturn from a macro matters perspective being meaningful– that is a very important point to make.

And in the context of the question I was asking before about the US and the UK, I think that that's also going to matter because, from my perspective, the similarities between the countries and their trajectories from a growth perspective, and also from a monetary and fiscal policy perspective, are similar enough that the gap between their respective curves– their government bond curves has to close.

Whether that's closing with the UK moving to the upside or the US moving to the downside, I don't know, but to me, it's compelling to think that, if business cycles–

LAKSHMAN ACHUTHAN: You mean with our yields going up to catch up with theirs?

ED HARRISON: With their yields going up to catch up with ours or with ours flattening to catch down to theirs– and so I think that it's compelling to me that this cycle turn will be very important in terms of making that convergence happen.

LAKSHMAN ACHUTHAN: An aspect– I'm just going to assert it here– of our indicators is that they are comparable across borders. That's all another discussion. So with that, we could look at the relative strength of leading– of the growth upturn, the inflation upturn here, and maybe in some other countries. And the US upturn is stronger.

ED HARRISON: Right, yes.

LAKSHMAN ACHUTHAN: This is one of the stronger ones, so that does support– if the Fed is stepping on the short end– they keep saying that they've been doing it, they want to do it– I take them at their word– then it's a steepener. And that's not over. So that's part of what to watch for here. I know it's backed off a little bit in recent days or whatever, but I don't think that that– from a cyclical point of view, nothing has fundamentally changed there.

ED HARRISON: Well, with that inconclusive point on the UK, I think we're going to have to end there because this is definitely going to be continued. I have a lot of thoughts in this.

LAKSHMAN ACHUTHAN: Yeah. No, it's great. I love the discussion.

ED HARRISON: Yeah, we'll have to discuss that a little bit more, because I just opened up a whole can of worms that I really do want to get to. We have to have a reop of this conversation in terms of a Real Vision Live, if that's something that you're interested in.

LAKSHMAN ACHUTHAN: 100%, 100%– I love talking about this. I think macro does matter. I want to get everybody some information on cycles, and I love talking with you, so let's do it.

ED HARRISON: Excellent– thank you very much, and looking forward to that conversation.

LAKSHMAN ACHUTHAN: All right.