Demetri Kofinas:	00:00	Today's episode of Hidden Forces is made possible by listeners like you. For more information about this week's episode or for easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you listen to the show on your Apple Podcast app remember, you can give us a review. Each review helps more people find the show and join our amazing community. And with that, please enjoy this week's episode.
Demetri Kofinas:	00:48	What's up everybody? Before I introduce today's guest, because this episode deals with investing, I want to make absolutely clear that nothing that I say here today can or should be viewed as financial advice. All opinions expressed by me and my guest are solely our own opinions. This conversation is for informational purposes only, and should not be relied upon as the basis for financial decisions.
Demetri Kofinas:	01:15	Now, with that out of the way, I want to introduce my guest, Eric Peters. Eric is the founder, CEO, and CIO of One River Asset Management, which manages five high conviction, absolute return, volatility oriented, and systematic trend strategies for institutional clients. He's also the author of the thoughtful Weekend Notes, an unorthodox take on markets, politics and policy that's widely read by investors, central bankers, and senior leaders within politics and policy. I've included excerpts from five of those notes in this week's rundown that I found particularly insightful and relevant to the current climate, and which inform much of today's conversation, which covers not only financial markets, but also many of the social, political, and geopolitical forces that are increasingly driving many of the outcomes that we're experiencing both as individuals, but also as market participants.
Demetri Kofinas:	02:21	I think one of the challenges that, speaking personally, I... and I imagine many other people... have in talking about or thinking about investing today is that it feels impossible to even attempt to separate policy and politics from markets and the economy. I mean, in principle, markets have always existed within national and supranational boundaries and borders and have always, with rare historical exceptions, had to navigate legal and regulatory frameworks. And I've spent most of my life feeling pretty comfortable that I could try and understand those markets, within those frameworks, and within a very stable set of assumptions. In other words, I never felt like I had to doubt whether or not an insolvent corporation would be allowed to go bankrupt. I mean, even that dilemma would not have occurred to me. The question would never have occurred to me. I never had to question the durability of the American-led international order, or the credibility of American political institutions.
Demetri Kofinas:	03:36	All of this feels like it's up for grabs today, and it makes investing, something that has always intimidated most people, that much more intimidating and confusing. So you're not alone if you feel confused. I certainly do. I think we're living through a period of radical uncertainty and a loss of faith in institutions and markets that we haven't seen for a hundred years. And the implications, not only for portfolios, but for us as individuals, for our lives and for our families, can feel daunting. So at the risk of belaboring the point, I think it's important to recognize how little we know, while at the same time having faith in our ability to learn about and understand the world better. Because we're all going to be navigating some very rough seas in the years ahead, which isn't news to anyone who's a regular listener of this show. It's why we've been covering these topics for over three years now. So without any further ado, let's get right into my conversation with CEO of One River Asset Management, Eric Peters.

Demetri Kofinas:	04:51	Eric, welcome to Hidden Forces.
Eric Peters:	04:54	Hey, thanks a lot Demetri. It's great to be here.
Demetri Kofinas:	04:56	So Eric, we spoke a bit before we started about your Weekend Notes and how much I've enjoyed reading them. You have such a wide ranging interest area. Maybe it would be best to start this conversation by asking you, what's been most on your mind during this time of not only great economic uncertainty, but also change and opportunity? What's been most on your mind these days?
Eric Peters:	05:22	What's most on my mind is an outspring of a lot of my study and really kind of a core fascination of mine that's grown over the course of my career. It started very early, in fact, but it's something that I've been fascinated by, which is the study of manias and human behavior. I'm not a deep equity fundamental analyst. I'm not someone who studies supply and demand and commodity markets. I'm definitely an economist by training, and I'd say a student of the markets. But I believe what overwhelms the movement in market prices is human psychology, and that it also drives our politics, and economics, and policy decisions that we make. And so, to me, for instance, to try to pin evaluation on a stock or a stock market, one approach is to try to study the actual earnings and your forecast for those. But best I can tell, equally if not more important than even forecasting those, is figuring out what's the multiple that's going to be placed on that market.
Eric Peters:	06:30	At any rate, I'm most interested in the psychology of markets, and mass psychology, and where that comes together in a super fascinating way is through manias. And so, my observation, and to a degree theory, is that we really don't understand mass human behavior. And where we get the greatest glimpse of that is in those extreme periods. But manias are extreme events in mass human psychology. And so, we can learn a lot about ourselves by studying those. And what's incredible to me is that we had a dot-com mania where very clearly there was substance to that enormous rally in equities, and the investments that we made that corresponded to that. There was some foundation to that. But we drove it to levels that were utterly absurd. And yet, in the midst of it, collectively we didn't really realize it, or almost by definition, it wouldn't have sustained. And you'd think that after such a mass mania that wasn't really simply limited to the US, it was more global, you would think that it would be virtually impossible to have another mania seven or eight years later, when we had the housing mania. And to me, that's an illustration that we really don't understand ourselves, in the sense that to have one mania follow so quickly from another one that went bust, you would think would be impossible if we had greater self-awareness as a group of people, but I think we really don't.
Eric Peters:	08:01	And so, what fascinates me about the period that we're in now is I think we have had a mania that has driven us to levels of inequality that were last seen in the late 1920s. And that mania, like every mania, is kind of hidden beneath the surface. And it was more of a mania of the financialization of not only the US economy, but in many respects the global economy. I think it was most pronounced here in the US, and we'll probably talk about that later. But there's been a mania there, but what I strongly believe is that after hitting such heights of inequality similar to what we hit in the late 1920s, it's a very complex process that gets you to such high levels of inequality. And yet, when that turns, I think

the process on the way down, the process toward greater equality, is equally an extremely complex process.

Eric Peters: 08:57

And so, when we look back at these various manias, they all seem like they're easy to understand once you pass through them. So, dot-com is kind of easy to understand and almost laugh at. The housing mania was easy to understand. I think a big mistake that we are making right now is that we collectively look back at the Great Depression, and we ascribe really rather simple reasons for why it happened. And as a result, we have drawn pretty strong conclusions around how to prevent something like that from happening again. But it was such a long time ago that I think we're extremely confident about the conclusions that we've drawn, and so we're crafting very aggressive policies to try to prevent a repeat of that. My concern is that we don't understand the complexity of that whole process, and by applying really quite strong but pretty simple solutions to it, that we miss the real complexity of it. And as a result, we end up with an outcome that's not our desired outcome. In other words, we're overly confident in our ability to prevent an outcome like that, and as a result, we get blindsided by kind of the complex mass hysteria that it appears to me we're entering into.

Eric Peters: 10:14

So, it looks to me like we're entering into our first, let's call it mania, that's a pessimistic one. We're accustomed to these bullish manias like dot-com. We're accustomed to a bullish mania like housing, or investing in the Asian tire economies back in the 90s. We haven't in our lifetime seen a bearish mania, but it appears to me that we're tipping into that right now, and if we don't pull ourselves out of that quickly, I think there'll be enormous impacts for society, and certainly markets, as well.

Demetri Kofinas: 10:46

So, like a psychological depression in your view?

Eric Peters: 10:50

I think we're in grave danger of that. It doesn't mean that that has to happen. So, as I speak with policy makers and people that advise senior political figures, I'm trying to raise this issue because I think it's super important for us to realize how dangerous a place we are right now. Look, we are 100% in a global depression that's actually worse than the Great Depression right now. There's no question about that. The only question is how quickly we emerge from it. And I think that there's a level of confidence that has almost tipped into arrogance that, through some aggressive policies out of the central bank and the treasury, that we can just bridge this gap and that we'll get to the other side, and we'll, largely speaking, be fine, and, I think, a number of financial asset markets that are really priced for that scenario.

Eric Peters: 11:41

That may be what happens, and wouldn't that be wonderful if it does. But I think the real risks are tilted very much in the other direction. And certainly the risk in terms of market pricing is tilted very extremely in the other direction, just given that asset prices are actually really quite high right now.

Demetri Kofinas: 11:58

Well, one of the things that you've alluded to a number of times in the Weekend Notes specifically is the risk that we will gin up, or politicians in the US will gin up, or we ourselves will get worked up to point our dissatisfaction outward on the world stage, towards some other country. How concerned are you about that? That the virus and the economic fallout will translate into both political turmoil in the country... I mean, you've also talked about the extent to which we're divided politically and socially, but also outward in terms of military conflict abroad?

Eric Peters: 12:41

Look. I love this country. I've lived in many places around the world. There're super special things about America. I mean, we're a force for great good. And I think we have quite devastating power, and sometimes it's misused. I think in any country it's important to, as a citizen, to be a check against kind of the misuse of nationalism to try to distract a country from some of its own problems. I think the issue that I see geopolitically right now, like all of this, it's super complex, right? But we had a unipolar world. We have a rising power, which is China. We've got Europe, which continues to largely be in a mess, which it's been in for arguably centuries. But in that situation, historically, it's often the case that there's a particular conflict.

Eric Peters: 13:34

Now, I think the risk here is that the US, in its response to this pandemic, its response has been an abject failure. I think that that's unequivocal. I'm trying to avoid any kind of distinct politics here. Look, the point that I'm making, really, is that if you look at the results of how this pandemic has hit the United States, anyone would conclude that we have failed in a colossal way. Meaning, our economy's shut down. We have 50,000 people who have died. We have yet to do comprehensive testing. I don't believe that the numbers coming out of China are accurate, but I think it's pretty safe to say that their lockdown was far more effective than ours, and they were able to contain it, at least to date, far better than we. South Korea, same. We'll see about some other countries. Germany certainly has done a far better job. And there've been some countries that haven't done a particularly good job, but I think the American psyche is used to feeling that, when push comes to shove, we win. And the reality is, that point has come, and we have really failed our own expectations of ourselves.

Eric Peters: 14:53

And so, the question is, what do we do as a nation? Are we self-reflective and say, "You know what? We've not made the appropriate investments in public health care, in emergency responses, in our ability to deal with pandemics." We can't claim that no one had any idea about this because we've had departments about it. Guys like Bill Gates has been warning about this forever. Our doctors tell us that this was an inevitability. And yet, we've come up short in every single way. With PPE, we've come up short. Testing has just been virtually criminally negligent.

Eric Peters: 15:23

And so, the question is, how do Americans deal with that? Do we turn inward and say, "You know what? We can do a better job. And let's pull together and fight this common enemy." Do we instead start fighting amongst ourselves? Or do we try to find a common enemy? And I think that's where we stand right now. I would love to think that we are self-reflective and simply improve as a country, and this is a great catalyst for us to advance in all kinds of ways as a society. That'd be wonderful to think. I guess I've just been through enough cycles to have a sense for how our collective reaction is going to be, and unfortunately, it's hard to be optimistic. I think that we will find a common enemy, and I think almost our best case scenario at this stage is that we have kind of a bitter argument within the country, and we resolve it internally. And by the way, I don't think that that's a great outcome. It's-

Demetri Kofinas: 16:15

What isn't a great outcome?

Eric Peters: 16:18 ... fighting amongst ourselves. It's just-

Demetri Kofinas: 16:19 Oh. We've been doing that for a while.

Eric Peters: 16:21 ... yeah. Well look, this is unambiguously the most divided this country has been in kind of our adult lifetime, and I'm 53. I think there've been various points in time where the country has been divided, but this is a pretty extreme level of division within the nation right now. And division comes along a whole bunch of lines. But as I said, the best outcome is that we're self-reflective, and we pull together, and we use this as a catalyst for really positive change. I just think that that's unlikely. I think our best case scenario is we argue bitterly internally here, and we figure out and kind of limp our way into a solution. But a worst case scenario is that what we attempt to do is distract our own division by finding an external enemy, and it's pretty clear that that enemy would be China. I think that's the one thing that has unified this nation in the last few years has been the view that China is a common threat in one way or another.

Demetri Kofinas: 17:22 Yeah. That's interesting. That's also kind of raised an interesting question which is why, beyond the sort of obvious reasons that people give for why we should enact trade barriers with China, put kind of limits on sharing intellectual property and things like this, why this is the one thing that's united people? I wonder if it's really driven from the political parties? I don't know to what extent, in other words, why the common front among people? Why do you think that is?

Eric Peters: 17:55 Like every conflict, there's some basis for it. And then, inevitably, fears magnify some of the differences that you have between people or nations. And China is a rising power. Americans are... post-Cold War, we've had a unipolar world, and China's the rising power. I think that they've risen through an enormous amount of hard work, through a very manipulated economy that has, just through sheer will, has lifted an enormous amount of people out of poverty. And they've used the size of that market to lure American companies into sharing technology to get access to that market. And in some cases, taking that technology, or kind of prying it away. And there's a basis for that.

Eric Peters: 18:42 And that's something that's frustrated corporate leaders for a long period of time, but they've been very quiet about it. I think, when I speak with my senior military contacts, they've been frustrated that China has increasingly become more and more... and this goes back over the last decade... they've just become increasingly assertive throughout their region. That's natural for a rising power. But nevertheless, it affects the balance of power. And when I speak with my senior military contacts, they've said we've effectively been at war with China. Not a hot war, but certainly other types of war.

Demetri Kofinas: 19:15 Or that they have certainly been at war with us.

Eric Peters: 19:18 Yes. And look, I mean, we're no angels when it comes to warfare. I'm sure it's gone both ways. But certainly, China's become more assertive militarily, and so I think there've been a number of different constituencies in the US that have been frustrated by the rise of China but have played along. I think Wall Street has made an enormous fortune facilitating a lot of the offshoring to China. We've built deep supply chains. And so, corporate America has at once been frustrated, but also complicit, in deepening their supply chains there. And that has come at the cost of hurting US labor in terms of their bargaining power.

Eric Peters: 20:00 And so, I think that all of this went on for a long period of time in kind of a slow drip fashion. But really, over the last three or four years it's come to a head, and literally, it's the one point that unifies Americans. And what's so interesting is, it's hard if you can imagine a point that could unify military leaders, politicians on both sides, workers in America, and the military. It's hard to do that, because different groups have different perspectives that are often at odds with one another. But this is something where everyone around the table has said, "Yes, China's a threat." At a minimum they're a rival, and at a maximum they're an enemy.

Eric Peters: 20:43 And I think the process to de-link from China has been underway for some period of time. It's accelerated in the last year, year and a half, and I think that's been part of a broader kind of trend toward deglobalization. I think this pandemic and the aftermath of this is just going to be devastating for the globalization. And so, this has clearly been a catalyst that is going to sever any good will between the US and China at this point. And I think economies will have to adjust to that in a very material way.

Demetri Kofinas: 21:18 Yeah. It feels like... and I think a lot of people feel this way, it's expressed in our politics... that the economy hasn't been working, certainly for most people. But in general, it feels like we haven't prioritized the right things. And it feels like where we are today, we're seeing a lot of conversations about how to prioritize certain national security objectives, or energy security, or food security. You see, for example, in places like the European Union, something we've talked about on this show, where agricultural policies have divested certain countries of their capacity to produce food, while others have grown their capacities. And it's left a lot of countries vulnerable when the system doesn't work at its most efficient. Right?

Demetri Kofinas: 22:05 We've tried to generate this really efficient global economy, and now it feels like it's starting to break apart. And we're seeing that both in supply chains. We're seeing that in terms of credit. I think you kind of explicitly made this point about the financialization of the economy. We've financialized our economy. We've relied on credit growth to fuel economic growth, and as the nominal debt burden has grown over the decades, interest rates have had to drop, and interest rates have gotten to zero. And now we're seeing governments, not just monetize through monetary policy, but increasingly we're going to see it, I imagine, through fiscal policy. And one of my biggest concerns through all of this has been the combination of the kind of fragile society we've built economically, the political discontent and disunity internally. And Americans have gotten conditioned, it seems, after 9/11, to expecting more and more the government to solve problems. And the government has proven itself increasingly inept at solving those problems. And I just worry that in this crisis, as everyone is looking towards the government to do something, that what we're going to get is more of the same, but much more of the same, which is more government, more authoritarianism, more surveillance, and less solution.

Demetri Kofinas: 23:30 And I worry when we go to lift these quarantines, for example, that people are going to find that there's going to be a resurgence of the virus. And that again, to this point about resiliency, I worry that we're not very resilient. And so, my biggest concern is that we're vulnerable to a demagogue. If not this president, then maybe some other president or some other administration, but that's my biggest concern. And in that context, I do worry about foreign wars.

Eric Peters:	24:03	Yeah. There's a lot there. What's fascinating to me is the notion of fragility and resilience. One of the things that has happened over the past 20 years, in particular, is that our corporate sector has really tried to optimize for the highest level of profit possible. And there's nothing wrong with that. If you just made that statement, you'd say, "Well, that's great." Okay? The question is, what are you willing to do in order to optimize profit? And I think if we're honest with ourselves, what we would say is that we have tried to build incredibly deep and kind of wide supply chains globally to try to eke out every last dollar of potential profit by accessing the world's cheapest labor, cheapest shipping, cheapest everything. So that's one of the things that we've done.
Eric Peters:	25:01	Another thing that we've done is we've essentially endorsed a central bank that has taken it upon themselves to smooth out every economic and market ripple to such a degree that it's given corporate leaders, who have been trying to optimize for the highest profit and the highest equity value, it's given them an illusion that we live in an extremely stable world. And it's a world that they're attempting to create. Because remember, corporations essentially run America. I mean, via the lobbyist channel, our large corporations really drive political decisions in this country. And so, government and big business is very closely aligned in this country, unlike in any other country.
Eric Peters:	25:48	And so, over this period of time, as the corporate sector, working really together with government and central bank, has smoothed the kind of market cycles and smoothed the economic cycles and smoothed, really, inflation, as well, there's been this great level of confidence that we can operate with very little redundancy in the system. And so, when you have very little redundancy, you've got highly complex global supply chains, and you have extremely leveraged corporate balance sheets that optimize for the highest possible stock price, the highest profit margins, et cetera. You can create for a period of time what appears to be a lot of prosperity. But the cost comes in that you have made the system extremely fragile. And that's kind of where we find ourselves right now. I think we have just realized, "Oh, my God. We have a system that is extremely exposed."
Eric Peters:	26:45	We now have, I would say, tens of millions, maybe there are a hundred million people in this country that know what a global supply chain is. I would tell you, a month and a half ago, if you said a global supply chain, no one would have any idea what you were talking about. But we're aware of that now because we don't have enough PPE equipment. We don't have enough medical compounds. We don't have enough X, Y, and Z. Our shelves are bare of paper products at the grocery store. These things are becoming obvious to people. It's part of their day-to-day life. And one of the reactions, to go back to the complexity of market cycles and mass human psychology, the complexity of the impact of such a huge portion of our citizenry realizing that we have an extremely optimized economy that has produced huge profits for a certain sliver of the population, but has now made us extremely vulnerable to any type of shock, surely that will have long lasting implications in terms of policy, terms of what our corporations are allowed to do, in terms of globalization, in terms of regulation, et cetera, et cetera.

Demetri Kofinas: 27:55

Yeah, it's a really interesting point. Right? Like this trade of redundancy for optimization. And we all kind of have known this. We've all felt like we are taking on risks in the way that we live that we're really not properly calculating on, sort of dependent on things remaining pretty much the same for a prolonged period of time in order for something really bad not to happen. But like you said, this is not a black swan event. A global pandemic is not the most shocking outcome in a world that's becoming increasingly urbanized, where we continue to see population growth, there's antibacterial resistance. There are many other risks, not just this.

Demetri Kofinas: 28:41

One of my concerns, and I wonder if you think about this, which is, our economy, the way we built our society, has been to make it more vulnerable. We get hit with this pandemic, and on top of that, there're all sorts of other things that can happen. You could get another hurricane that maybe runs up the East Coast. You could get a cyber-attack. You could get all sorts of other events. That's one of my other big concerns, which is that we're kind of hobbled, and then something else happens.

Eric Peters: 29:12

Sure. When you study market history, just going well back before our career time, you'll find that it's usually the case that bad things happen when bad things are happening, and good things happen when good things are happening. It's rare that a lot of good things are happening and then all of a sudden a really bad thing happens. It doesn't work that way. From a market perspective, the September 11th attack came in the midst of already a big bear market. And you have, in the kind of the global financial crisis, you discover that there's a Bernie Madoff fraud. It's just the nature of the way it seems the world works. It goes back to the mass human psychology I'm just fascinated by.

Eric Peters: 29:56

And look, a lot of that makes sense if you step back and think about it. There are, certainly geopolitically, but in all aspects of life, when there are vulnerabilities, there always are going to be people and nations and politicians who are opportunists. When you're weak, you're susceptible. And so that happens, but that's part of the cycle. And I would expect that we have some real surprises ahead. I don't know what form they'll take, but to your point, this was in no way a tail event. I mean, this is something that, it wasn't that we suspected it would happen. It was simply a matter of time until it happened. Why we didn't have a play book with ample national stockpiles to deal with something like this is, I think it's a reflection of our society's emphasis on maximizing profit over resiliency and redundancy in the system.

Eric Peters: 30:52

And so, that will be something that I can assure you will become a big part of the debate over the coming years is, what's the right level of emphasis that we place on efficiency and profitability relative to redundancy in the system? And that pendulum is undoubtedly going to swing back. Particularly now that we've actually had... This is our third major crisis. Think about that. In 20 years, this is our third major crisis, where every corporate CEO getting bailed out is an exaggeration, because, inevitably, in any particular crisis, there's certain firms that thrive, but many don't. But this is our third major crisis where the corporations are going to be bailed out in just extravagant ways.

Demetri Kofinas: 31:41

Yeah. The thing, also, is that we all know that some of these solutions need to come from government. And at the same time, we really don't have faith in government. And one of the examples is, we were talking about China. It feels difficult to criticize other countries that deserve criticism when we also are aware of how much we've failed ourselves. And 9/11 is such a good example of that, with respect to how we proceeded forward from that period and the mistakes that we made, and then again after 2008. It almost just kind of feels like we have to go through what we have to go through.

Demetri Kofinas: 32:23

And so, there are two, I guess, parallel conversations. One is the public conversation, and you hope to see the kind of changes that we need in order to move us forward as a society. And then there's also, like, what you can do as an individual, right? Which is kind of why I started the conversation the way that I did. Because although these are interesting conversations to have, and I have definitely had them on the show, it kind of gets to a point where you kind of ask yourself, "What can I do?" Like, as an individual, there's only so much that you can do. The real solutions have to come at the macro level. But as an individual, there's only so much you can contribute to the macro conversations or to the macro solutions, unless you're president of the United States. So how does an individual navigate this landscape? What do you advise your clients to do? Or what kind of conversations do you have with your friends, whether they work in this industry or not? How do you think about that?

Eric Peters: 33:24

Well, on a personal basis, I think it's an extremely important time to try to find at least one person that you can help. And if you have the means to help more than one, then that's wonderful. And that's the type of thing that we talk about just in our family. And I think if everyone has that conversation, it improves the sense of broader community, and that's really important to do. And I think I'm just so optimistic about the future just because I look at... we have four children, age 18 down to 10... and I look at them, and I'm so impressed by the young people that they're becoming, and their values, and their ability to think. They're developing more critical thought. They're serving. My son's heading into the US Naval Academy. My daughter, at age 16, is about to be approved as being an EMT and a volunteer in town, and my next son is on that path, too. And so, I look at them and I think about the world that they're going to be able to create, and I think it's just wonderful. Unfortunately, I think that we have a very difficult period to go through before they really get the chance to kind of play their hand. And that's, in many respects, the world that I, in my own small way, can influence.

Eric Peters: 34:47

So I think I'm fortunate to have developed a really good audience with my writing, and so I try to raise what I think are the important questions to be asking and thoughts to be having. That extends to discussions with policy makers and advisers to very senior political figures. And so, that is my own small way of contributing to the conversation, and just trying to make sure that I've done whatever I can to kind of put on people's radars the things that I think are most important to think about.

Eric Peters: 35:18

And then I have an obligation to my partners at my firm and our clients, certainly. And we're trying to do the best that we can to navigate through what I think has just been the first stage of a multi-year process. And I think this is going to be an extremely treacherous process for investors. And so, this goes back to another example of fragility in the system. The policies that we have employed for decades now have led to extremely low interest rates, as you've pointed out. And now that the fed has gone to a zero rate and has pressed 30 years all the way down to 115 or 120 basis points, essentially for an investor

		that needs to deliver a 7% or 7 1/2% return, which is most of the pension system in the United States of America, for that investor to be able to do that with a risk-free rate that's effectively zero all the way out to 30 years, is essentially, it's mathematically impossible at scale. It doesn't mean that one or two may not do that. And yet at scale, we know system wide we have an impossible situation.
Eric Peters:	36:27	And so, to the extent, just in my own life and with our clients, if we can help them think through really how to frame that problem, and then how to come up with reasonably creative solutions, unfortunately not scalable. In other words, I don't think you can solve the entire industry's problem, but I think you can solve the problem for some sector of the industry through some creative investment and active management. And that's what we focus on. You can only do what you can do.
Eric Peters:	37:00	And I think it's important that we look at the hand that we're dealt, and whatever we've developed and try to play that in as altruistic a way as possible, and help in our own way. And I think if we all do that then we're going to be better off for sure. It doesn't mean that we don't have a number of hard years ahead. I think inevitably we do. It's just the nature of a pendulum swinging the way that it's swung toward this extreme inequality, and that will swing back toward something more equal. That process is naturally tumultuous and painful, and hopefully we can avoid a major hot military conflict along the way. Obviously, I don't know whether we can or can't. I know that the risk is there, but I think along the way, if we can all do what we can do, then the outcome will be as best as it can be.
Demetri Kofinas:	37:44	You kind of alluded to this in terms of pension fund obligations, and the challenge, like, one of the big kind of themes of the last 10 years in particular... though I wouldn't say only the last 10 years, but as a sort of public theme... has been then search for yield and financial repression and the challenge to these traditional portfolios as they're constructed, stock-bond portfolios, to generate the type of return needed to hit those targets. But there's also the other side of this equation, which is the risk-adjusted nature of that portfolio, both from the perspective of what type of risk you've taken on in your search for yield, but also, I think, one of the fundamental assumptions that underlies investing today is that, as you get older, in order to take risk off, you go into bonds.
Demetri Kofinas:	38:41	But I think one of the things that we're seeing is that a lot of these correlations that have held for a period of time, may not necessarily hold going forward. And I wonder if we're heading into a period right now where a lot of those correlations are going to be rethought and reconsidered, and that's going to sort of be another dominant theme in the way that financial repression was for people. What do you think of that?
Eric Peters:	39:09	Well, because I think we're entering into a new period, I think that any investment portfolio or strategy, that its foundation is built upon this idea that correlations are going to remain stable, that yesterday's correlations are going to be the same as tomorrow's, essentially. Those strategies are going to come under a lot of stress. It's not to say they won't ever make money again, but I think even if they do make money, it will be episodic. It will be with a far worse sharp, and it'll probably be with less money.

Eric Peters: 39:44 By the way, that's an important thing, because what's happened over the last, certainly decade, but really kind of two decades, is that in this real search for yield, investors have done a whole range of things. They've engaged in riskier behaviors. Everyone read the book that said the only free lunch in investing is diversification. And so, investors went out and tried to find as wide an array of strategies that appeared to be diversified. And so, a whole new range of investment strategies were developed to provide more line items in a portfolio. And in a particularly benign market environment, they indeed appeared to be diversified. And they, generally speaking, made money. They were, in one form or another, different versions of the driving forces in markets, which is inequity return and a yield of some sort. But they're different forms of carry, different forms of insurance selling, vol selling. And so you ended up with an awful lot of line items in portfolios that acted in a particular way that people could model because those correlations were reasonably stable.

Eric Peters: 41:00 But if you enter into a new regime, and I'll explain why I think this is such a new regime in just a second, but those correlations inevitably are going to behave differently. It doesn't mean that they will consistently behave differently, but that they will periodically behave differently. And that just means investors have way more risk in their portfolios than they thought. And that's something that investors are going to have to contend with, and it's going to be a painful few years. Some of the largest investment firms in the industry over the past 10 years with the greatest flows, just colossal flows, have been those firms that are really kind of correlation machines that I think are dressed up to look like investment firms. It's not that they don't provide investment solutions, it's just that the investment solutions that they supply are really just kind of correlation-based portfolios and their big risk is if something changes.

Eric Peters: 41:51 So the question is what changes? And I would say that for as long as I have been investing, since the late 1980s, we have been in what I would consider to be a regime of monetary dominance. Meaning that monetary policy has dominated all other forms of policy. And so, if you could figure out what the central banks were doing, you by and large could be on the right side of markets. Not all the time, but most of the time. And the volatility events were things where maybe someone or some country got over-leveraged and they got in trouble, or that central banks internationally were moving at different speeds relative to the US, or even in opposition to the US. Those were the periods of volatility. But over the last decade, you've really gotten every central banker to operate using the fed model and the fed playbook, and they've all done the same thing, roughly speaking, at the same time to lesser or greater degrees. And so, we've lived in a world where policy has been extremely homogeneous because central bankers are kind of all the same.

Eric Peters: 42:58 But now that they've gotten to zero, and they have been literally screaming for the last year to year and a half for politicians to pick up the fiscal mantel and help support their aggressive monetary policy in lifting growth, lifting inflation, lifting capital investment, this crisis has provided the final catalyst that has given the politicians the green light to really spend money. So I'd say that we're in this transition period from monetary dominance to fiscal dominance. The interesting thing about fiscal dominance and fiscal policy is that it's not directed in a homogenous way. It's a heterogeneous policy in the sense that every politician is different. Every political party is different. Even within the United States, the fiscal policy that Trump will implement will naturally be different from the fiscal policy that Joe Biden or whoever else could potentially be president will implement. The difference in choices between Italy and Germany on fiscal are vast, and between China and Japan are vast.

Eric Peters: 44:01

So you have a whole bunch of different actors pulling a fiscal lever, and what we'll discover is that's very heterogeneous policy, and that will create, potentially, inflation and deflation in one country relative to another. It will mean certain sectors outperform other sectors based on political choices. And that's just a much more volatile world where correlations are naturally going to shift, given that we've shifted from this homogeneous policy dynamic which was just driven by monetary to something much more heterogeneous.

Demetri Kofinas: 44:35

So how do people protect themselves in such an environment, where there isn't a traditional risk-off asset? We've done episodes with guys like Christopher Cole, for example, and he talks about long volatility strategies, commodity trend following. What do you guys do at One River Management to give you, let's say, an advantage at this time that someone who's invested in a target date fund, for example, would not have access to? And then I suppose I could ask the sort of ridiculous question, which would be, what can someone who's not actually invested with an active manager like you be able to do? Which I always want to ask, but it almost feels like it's very difficult to have that type of conversation because the level of intelligence that guys like you deploy in the service of your clients is something that just very few people have. That kind of experience, as well. And it's challenging. But I'll put that forward.

Eric Peters: 45:37

Well, thanks for saying that. Look, we just manage money for large institutional clients, just to make that clear. I think to answer that question properly, I'd like to just step back for a second and say, what is the core problem, right? I'm always trying to think about, what is the essence of this problem? We've talked about different policy regimes and what not, but I think the essence of the problem that investors face, whether they're institutional or retail or somewhere in between, is the following, in my opinion. We have an abundance of capital relative to the need for that capital on a global basis. So some may argue that a lot of that capital has been created because central banks have just injected so much liquidity into the system. But I would say even in the absence of what the central banks have done, we have had decades of really uninterrupted growth and compounding of capital in a world that no longer seems to really need to make the huge capital investments in big steel factories and auto plants.

Eric Peters: 46:45

And if you look at the big investments that are being made, or have been made for the last decade, you look at some of these companies that have just become dominant firms in their industries. And a lot of them are super capital light, and you find a lot of those intact because they just don't need the same level of capital. So we have too much capital in the world that is held in the hands of people, generally speaking, that are older. They're obviously aging, and they're thinking about retirement, and they want a healthy return. And so, they've chased a limited number of opportunities. And the consequence on that is that the yield on those investments is driven lower because there's just too much capital chasing them.

Eric Peters: 47:26

And so, until we either decide that we're going to make much, much more aggressive capital investments as a society, and that may happen, by the way. A

Green New Deal, I would say, is the most obvious and optimistic possibility. But until we make those big capital investment decisions, and I think it probably needs to be made as a society, because we just looked at the last decade of what corporate CEOs have been prepared to do with easy access to capital. They've chosen to leverage their balance sheets to just buy their stock back. So these guys are not the guys that are going to make big capital decisions. It's going to happen from government if it happens at all.

Eric Peters: 48:05 Another way that capital could get destroyed and then lift the return that investors receive on their capital, is through taxation. Capital could get destroyed because the government just confiscates it in one way or another through higher taxes. And capital historically has been destroyed most efficiently through war, because in war you destroy capital investment that is made, and you take the capital stock of society down, or you spend a lot of money just even building bombs or bombers or whatever it is. And it's extremely destructive in terms of capital. And so, the consequence of that is you can come out of that and demand for capital is higher, and real rates become higher because a lot of stuff needs to be rebuilt.

Eric Peters: 48:47 So there are a range of things that might happen as we look forward that could restore the returns to capital. I think in the absence of those types of events or actions or investment activities that really increase the demand for capital, just societally, there're going to be very low returns to be made collectively in terms of investments. Now obviously, there are going to be some people who are really good investors and make a lot of money. But broadly speaking, there's just not a big return to be made because there's just too much capital and not enough demand for that.

Eric Peters: 49:20 So to me the question is, or that I ask myself, is okay, so what activities can we engage in that we think we're going to be paid for? And I never make any investment, and I never engage in any type of investment activity without... I don't want to say having a clear understanding, because these things are difficult to necessarily understand, but at least having a strong opinion for why I'm getting paid to do something. And when you look at a treasury bond, you go, "Okay, well, I'm going to buy a 30-year treasury bond and earn 1.2%. Why am I getting paid for that?" Or, "Why am I getting paid so little?" It's like, well, you're really not taking much risk. In a sense, you are. You're taking a risk of inflation or something like that, but you're going to get paid back.

Demetri Kofinas: 50:03 Right, but not default risk.

Eric Peters: 50:04 Yeah. Right. So we're in a world where you're really going to have to take risk to make money. And in our case, thankfully, we've developed skills and tools over lots of years, so we think that some of the activities that we engage in are profitable because we bring skill to the table. But for an investor who is really just kind of a passive investor who says, "Look, I've got my day job. I'm a lawyer. I'm a this. I'm a that. I don't really understand markets very well, but I want to make a lot of money," I think they're either going to get lucky and put their money in the right stock and just luck, but they're not going to really be able to have, certainly, in aggregate, a really healthy return on their money.

Eric Peters: 50:45 I think the people who make money are going to be people engaged in risky activities, and they're smart about that and risk-manage well. So again, those are the kind of things that we do. And we're very active in volatility markets. They're complex markets. We understand them very well. We measure the flows. We look for opportunities and distortions that are created by the activities of other people and try to take advantage of those and generate quite high sharp ratios. We look for opportunities to invest in markets where we think there's going to be a significant move and the volatility's underpriced. That's how we've delivered such strong returns this year. We see some amazing opportunities as we look out over the next couple years.

Eric Peters: 51:30 And then, you mentioned things like commodity trend. I think that what's interesting is trend is a strategy that bets on, really, just kind of continuation of price movements across a whole range of different markets globally, either up or down. So a trend strategy can make money in a bull market or a bear market, and that could be in oil prices, it could be in stock prices, it could be in bond prices, it could be in currency exchange rates.

Demetri Kofinas: 51:56 It doesn't have to just be commodities.

Eric Peters: 51:56 Yeah. Exactly. And so, we do run those strategies. What's interesting, and I think this is going to be really important for the next decade, is that the past decade for trend has been literally the worst decade of performance for that type of strategy in the last 120 years. The second worst decade was the 1960s, and the 1960s was followed by the 1970s. So the 1960s was a period of relative calm, low inflation, low interest rates, low unemployment. Many of the things that I think are quite analogous to what we have been in. But it was followed by a period of great tumult, which was the 1970s. It was an extremely difficult for any type of passive investor, but for active managers and for trend strategies, it was the best decade of the last 120 years.

Eric Peters: 52:47 So I suspect the trend, having just had its worst decade in the last 120 years, won't have its next worst decade, and that the trends that come out of it will be some of the big societal changes and policy regime shifts that I've described. I think there are reasons for that. But anyhow, I think if I were an individual investor, I would definitely have some money in trend. We don't offer those things in '40 Act funds, but they are available. Other managers do that in '40 Act funds. I would definitely have money in something like that, because you can make money in bull markets and bear markets.

Demetri Kofinas: 53:18 So actually, I'm going to ask you something, but we'll answer it in the overtime, which is, are there certain assets, for example, that perform better... not just strategies, but assets... that perform better in high volatility environments or the types of environments that we're going into? I also, I want to really continue this conversation about government investment and the Green New Deal and stuff like this, because again, the challenge this time around is just how little faith there seems to be in government when we need a government to function properly. And it's also interesting to compare this to the 1930s, because at that time, we had a very small government, right? We've got a much larger government today, so that's sort of an interesting difference, and I wonder how that would impact it.

Demetri Kofinas: 54:06 I also would love to talk about the dollar, and maybe gold, and maybe also the European Union, because you've made an interesting point about the appointment of Lagarde there. And I think Europe's in a really interesting place, because there're many things... I mean, it's very easy to be pessimistic on Europe, but there're also many forces that drive the continent together, historical reasons for the Union. And I wonder if there might be some creative solutions, maybe multi-tiered unions and stuff like this.

Demetri Kofinas: 54:35 For regular listeners, you know the drill. If you're new to the program, or if you haven't subscribed yet to our Audiophile, Autodidact, or Super Nerd tiers, head over to patreon.com/hiddenforces, or scroll down to the summary section of this week's episode and click on the link that sends you to the Hidden Forces Patreon page, where you can continue to listen to my conversation with Eric, including gaining access to the transcript of today's conversation, as well as to this week's rundown, which includes not only all of the usual research and information that I compile in preparation for these conversations, but also key excerpts from Eric's Weekend Notes going all the way back to the start of this year. I hope you guys will join us. Eric, stick around. We're going to move the second part of our conversation into the overtime.

Demetri Kofinas: 55:31 Today's episode of Hidden Forces was recorded in New York City. For more information about this week's episode, or if you want easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you want access to overtime segments, episode transcripts, and show rundowns full of links and detailed information related to each and every episode, check out our premium subscription, available through the Hidden Forces website, or through our Patreon page at patreon.com/hiddenforces. Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at hiddenforces.io. Join the conversation at Facebook, Twitter, and Instagram @hiddenforcespod or send me an email. As always, thanks for listening. We'll see you next week.