THE GRANT WILLIAMS PODCAST

THE END GAME: EPISODE 14

Paul Singer, Elliott Investment Management

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The Grant Williams Podcast, including The End Game, *The Super Terrific Happy Hour* and *The Narrative Game* represents the Copper Tier of [grant-williams.com] and serves as a prelude to *Things That Make You Go Hmmm…*, Grant's monthly newsletter which, over the past decade has become one of the most widely-read financial publications in the world.

Blending history, humour and keen financial insight, Grant dissects the financial landscape with thought-provoking commentary—taking readers in unexpected directions and opening up investment avenues away from the beaten path which stimulate the kind of original thinking so lacking in today's financial media.

Drawing on Grant's extraordinary network of experts around the world, *Things That Make You Go Hmmm…* weaves together a tapestry of insight and information, folding in a series of under-the-radar stories and perspectives, to give subscribers an important edge in a fast-changing world.

Copper Tier subscribers can find out what the fuss is all about by upgrading to our Silver Tier!

Grant and Bill Fleckenstein welcome Paul Singer, Founder, President, Co-Chief Executive Officer, and Co-Chief Investment Officer of Elliott Investment Management L.P. to The End Game.

Among the topics covered in this extremely rare and endlessly fascinating conversation are Paul's thoughts on the importance of understanding markets are little more than mass experiments in psychology, the fallacy of 'sitting passively', the creation of value for clients and the corner into which the Fed and other central banks have painted themselves.

He explains why central banks are trapped and why holding long-term bonds is a 'senseless, speculative trade'.

Grant Williams:
Before we get going, here's the bit where I remind you that nothing we discuss during The End Game should be considered as investment advice. This conversation is for informational and hopefully entertainment purposes only. So while we hope you find it both informative and entertaining, please do your own research or speak to a financial advisor before putting a dime of your money into these crazy markets. And now on with the show.

Grant Williams:
Not quite. Before we begin this edition of the end game, I have an announcement to make regarding the future of this podcast. Beginning February 1, the Grant Williams podcast will become part of the copper membership tier of my new website, Grant-williams.com. The copper tier will include every future episode of *The End Game*, *The Super Terrific Happy Hour* and *The Narrative Game*, as well as access to a series of special one-on-one conversations I'll be having with a group of extraordinary people throughout the rest of this year.

Grant Williams:
And that will begin with my dear friend and mentor Anthony Deden of Edelweiss Holdings. Now at the website, grant-williams.com you'll also find a Silver Tier, which in addition to access to *The Grant Williams Podcast*, will include a year subscription to my monthly newsletter, *Things That Make You Go Hmmm*... But you can find out more about all that by simply visiting the site. Again, that's grant-williams.com. And I thank you all for listening. Now, on with the show.

Grant Williams:
Welcome, everybody to another edition of *The End Game*, a very special edition of *The End Game* one that Bill and I have both been extremely excited about having the opportunity to do. And when I say the name Bill of course, I'm talking about my co-host, Bill Fleckenstein. Bill, how rude of me not to introduce you first. How are you mate?

Bill Fleckenstein:
That's okay. I won't be offended, Grant. Thank you very much.

Grant Williams:
You're safely down in the desert in California in the sunshine.

Bill Fleckenstein:
Yes, yes. Where the weather's much nicer than it is in Seattle.

Grant Williams:
Yeah, right. Tennis, you playing tennis?

Bill Fleckenstein:
As much as I can. Yes.

Grant Williams:
Atta boy. You don't have to wear a mask when you play tennis, I suppose.

Bill Fleckenstein:
No. When they first let the pressure off last year, they wanted everyone to play tennis outside with masks on. But anyway, that's another story.

Grant Williams:
Some sense at last, anyway. Well, our guest today, as people will have seen, because they'll be tuning in to listen to him, is the one and only Paul Singer. Which I think you and I are both equally excited about having the chance to talk to Paul.

Bill Fleckenstein:
Yes. And I think that for people that don't know Paul's records, I think they started running money in '77, around there sometime.

Grant Williams:
Late 70s, yeah.

Bill Fleckenstein:
So he's seen a lot and managed their money through a lot of different cycles. And the amazing thing is that they've done it through so many, what normal people would look at as saying complicated, complicated topics where there's so many different outcomes, you have to have really, really tremendous analysis and all that. So I think some people who may be listening may not know of the intellectual and market-savvy man, and organization that he built that is about to share some information with them or his thoughts with them.

Grant Williams:
There's a good reason for that. Paul keeps a very low profile, which is I think why we're so excited to have a chance to talk to him today. And as you say, Bill, I mean, he's done just an extraordinary job of stewarding

capital through so many different market environments.

Bill Fleckenstein:
And not an odd lot, I might add. I'm pretty sure they're managing north of $40 billion, something like that. So I think that's another thing that a lot of people don't appreciate how difficult it is to actually manage large, I mean, really large pools of capital and manage the risk of the same time. It's mind-numbingly complicated. So, I mean, anyway, another reason why I have so much respect for him.

Grant Williams:
Having a chance to pick Paul's brain about how he sees the world today is a great opportunity. So I think we shouldn't waste any more time with you and me blabbing around, we should actually chat to Paul, what do you think?

Bill Fleckenstein:
Let's do it.

Grant Williams:
Paul it's such a great opportunity to speak to you. Bill, and I've been putting this podcast series together called *The End Game*. And actually our very first guest, the very first thing they said was, "Well, of course there *is* no end game," and he was absolutely right. What we think we're trying to figure out is what the transition looks like from here to whatever comes next. And I think a big part of that kind of leads into the first question, this whole era of central bank money printing, which feels like it may kick into overdrive now.

Grant Williams:
I think Bill has been looking for some time to understand whether the bond market is ultimately the catalyst for the end of this or perhaps there's some other crisis looming that everybody's missing. And we've used Japan as the model, but no one seems to be able to give us a sensible breakdown of how Japan might ultimately fall over. So we'd love to kick off by just getting your thoughts on that.

Paul Singer:
I think you just asked like four questions in there.

Grant Williams:
I did. Let's simplify into just this era of central bank money printing. How does it end, do you think? And is there a specific catalyst that you're focused on that may be the end of it?

Paul Singer:
Well, I respect the way you framed the question, but it's really not a question of how it can end is, there's a lot of path dependency here. Over a long period of time central bank control or purported control of the global economy and financial system and the difference with which fiscal authorities and investors have given to central bankers has just step by step and episode by episode just gotten more pervasive.

Paul Singer:
In the response to 2008, this ZIRP, zero interest rate policy, this quantitative easing, this emergency policy,

which was certainly needed in the immediate aftermath of the crisis, the central banks allowed the crisis to develop by not really understanding the risks. But once the crisis did develop, of course, you need to radically reduce interest rates and some asset buying during the crisis period was certainly sort of playbook, crash playbook and appropriate. But what happened after that, nine years of crisis techniques, long after the crisis was finished, was extremely dangerous.

Paul Singer:
And I think the central banks came to enjoy their role of being Samson holding up the global financial system and economy. And they weren't punished by consumer price inflation, they didn't understand that this asset price inflation, which had a secondary or tertiary positive effect on growth and employment. But they didn't understand that was a form of inflation, that that's where the free money and the money printing went. And so they didn't at all take into account that they were exacerbating the inequality that became a populist political theme.

Paul Singer:
And so this whole period of 2010, let's call it, to 2019 just built and built, A, this confidence in the central bankers, B, the central bank balance sheets, which pre-COVID what was it up to? $17 trillion of assets, including, in the case of Japan, and the Swiss National Bank hundreds of billions of dollars of stocks. The Japanese central bank, even a couple of years ago, was a 10% or more shareholder in several hundred of the top Japanese stocks. So you have this gradual build up and these small attempts by the United States, by the Fed to start to normalize financial conditions, which led to the 4.5 trillion dollar balance sheet of the Fed to go down to like 3.7 or 3.8. And allow the 0% interest rates to go up to 2.25, 2.5.

Paul Singer:
Now, as we know, toward the end of 2018, the 2.25, 2.5 percent, the last 25 basis point rise seemed to be the catalyst for a 20% downturn in global stocks. So they panicked, the President of the United States blamed this 20% downturn, which is not a crash. I mean, it was an abrupt downturn, on the Fed. The President told the Fed the interest rate should be zero. Why should Europe be quote "Ahead of the United States," close quotes, reducing interest rates. And so what that showed me and other practitioners was, the Fed was trapped, the central bankers were trapped, they couldn't normalize. A lousy 2.5 percent short term rate, caused this, or seemed to be the catalyst for this 20% downturn.

Paul Singer:
If you fast forward to early 2020, pre-COVID, what you find is everyone was back to zero interest rates or below. Everyone meaning the central banks. And, again, this, let's call it $17 trillion, still on the central bank balance sheets. I made the point that this was not a good condition to be in, pending, or in advance of, the next adverse market conditions from whatever direction they could come in. So here you have, starting in February, this 36% drawdown in the US stock market, in a straight line as a result of the developing COVID situation, and the policy response.

Paul Singer:
And so all of a sudden, in a very short period of time, the $17 trillion has gone to something like $24, $25 trillion spending deficits have gone through the roof, the interest rates basically everywhere, except for China, policy rates, are zero or below. And what bonds are relying on is some combination of the following. I think there's a very widespread belief on the part of investors that inflation is, as the central banks say, it

is really hard to generate. They think, "Wow, if only we could get to 2%. And it's so dangerous being under 2%." They think it's dangerous.

Paul Singer:
And they think it's so dangerous, that they switched from, "Let's get to 2%." To "Let's average 2% over a period of time." Now we're getting into the nitty gritty of the danger here and the problem and what happens next, and then next after next. Because let's average 2%, when you're coming from under 2%, it has the following characteristics. Inflation, what period are you averaging? Are you averaging two years, five years, 10 years of consumer price inflation?

Paul Singer:
And so when inflation gets to be 2.25, or 2.5 on a few monthly readings, or 2.75, do they really mean that they are going to stand by and start congratulating or high fiving each other because they finally generated the inflation? The reason I'm asking it that way is because how do you distinguish inflation readings of 2.5 percent annualized or 2.75 or 3, how do you distinguish that as merely creating this arithmetical average, which is completely arbitrary. How do you distinguish that from a situation in which, after 13 years, and counting, of the most radical policy of the developed world in history, from inflation breaking out.

Paul Singer:
If you look at the inflation of the 1960s, and 70s, inflation came in the mid to late 1960s, from basically very low levels, they didn't see it coming. They, meaning the policymakers, the central bankers, and when it came, they thought it was temporary, and one off, and one thing leads to another. So we know about the oil embargo of 1973, which took oil prices up three or four times. So wages, prices, guns and butter, the Great Society, the Vietnam War, and increases in the money supply, all combined. But once inflation lifted off, it just kept on going.

Paul Singer:
And so from 1, 1.5, 2, in 1968, I believe it was something like three or four. Labor unions had more power back then. A lot more power than they do today. We'll talk about tomorrow in a while. But once they generate some inflation, bondholders today and investors and policymakers I believe, universally believe, that it's not the case that inflation if it pokes above 2, or 2ish, they don't think that that's an accelerating point or a point of escape velocity. They will think, "Oh, it's fine. It's great. We've gotten some inflation, we're no longer in danger of inadequate inflation."

Paul Singer:
But because of the radical monetary policy, which has been going on for such a long time, without consumer price liftoff, let's just call it. Because of that I think policymakers and investors don't really have that in their minds as possibilities. And so it's not necessarily the case, in my view, that the financial world in the economic world will respond to the latest burst of radical monetary and fiscal policy the same way as it did from 2010 to 2019.

Paul Singer:
Another way of saying what I just said is, I think there's a really good chance, given the determination to spend trillions and trillions more on COVID relief, and stimulus, whatever you want to call it, to guarantee, quote, unquote, which is ridiculous, these super low interest rates for the next three years, and to keep

verbally boxing themselves in. I think there's a really good chance of a tremendous surprise and a surprise in the relatively near future. What would that surprise be? Some combination of actual consumer price inflation bursting out and keeping on going. That would be a stunning development to central bankers.

Paul Singer:
And the reason it would be stunning is because they will be sitting back and watching the first burst of 2.5 and 3% inflation. But if it keeps going, what I regard as their smug assumptions regarding what's actually radical monetary policy will start to be challenged. And once they realize that their theories, which had no theoretical or empirical basis, by the way, that their theories were wrong, or could possibly be wrong, and inflation is not coming down. But wage pressures are coming in for a variety of reasons, supply chain issues are on the horizon from just in time. Hasn't COVID made a tremendous change in the mentality of governments, and corporations from just in time? Isn't it going to start being just in case? Isn't the last 20 years worth of corporate decision making that says, "Where's the cheapest, most reliable stuff? Oh, okay, China, and five other places?" That's no longer going to be the sole discussion around the table.

Paul Singer:
It's going to be, okay, what about national security? What about national economic security? What about political policies aimed at bringing supply chains of all kinds of stuff closer to home, not just America and America first or whatever, but a generalized global understanding that just in time, let's buy the cheapest, and reliable, by the standards of the new history, will be changing. So, I said, some combination of that, or currency movements generating inflation, I think is highly likely.

Paul Singer:
It's very difficult, given that economists don't have a good history of predicting inflation, turning points in inflation, the reasons why inflation exists or doesn't exist, the reasons why these emerging market countries with policies very similar to those that are undertaken now in the developed world, that some of these emerging market countries are generating through excessive spending and money printing, really staggering amounts of inflation. So I think when we're talking about the end game, in terms of central bank policy, I think we're at the beginning of a path dependent and complicated set of processes in which the first thing that may happen may be some growth in inflation in these different areas that we've been talking about, combined with more of what we've been seeing in the bond markets in recent days, really, of some kind of response to the anticipation of the spending and the increased deficits that seem to be on the horizon.

Paul Singer:
And once that lights up into somewhat higher inflationary numbers there could be a wage pressures, there could be from the expected increase in labor power under the new American government. So I think there can be something analogous to the wage-price spiral and all I can say about any attempt to quantify it or date it, I think it's kind of doomed because it depends what happens after those pressures and those price rises start to happen. For example, I think it's been senseless for people to be continuing to own long term bonds at these crazy yields. In Europe, the 30-year swap got to minus 40 basis points. And I believe today, it's basically, zero, it's plus two basis points or something. 30-year swap.

Paul Singer:
And in America, the 30-year government bond is 1.6% or 1.7%. It doesn't make sense, even with current

inflation, to hold those instruments. No institution can meet their goals by owning those bonds, they're no longer a hedge against equity portfolios. They are speculative instruments. When you buy something with no yield, where you can only make money if the yield goes from zero to the minus five or minus 10. You're engaged in speculation, you're not engaged in investing.

Paul Singer:
And when you're doing that, at the same time that because of the same forces, stocks are priced toward the very top end of the historical range. And the signs of speculation are every bit as, let's just call them vivid, as the most speculative episodes in modern financial market history. What do you have? And part of the question was, will the bond market be the catalyst or something like that. We can see already that the bond market seems to be anticipating some increase in inflation. But markets can and frequently do try to get ahead of what they anticipate.

Paul Singer:
And so it's not necessarily the case that the bond market will just gradually readjust to gradual increases in inflation. If I'm correct, that there's a deep seated belief, a kind of a rigid belief, that real inflation in the 1970s style is impossible, or really not something that you should really put in your risk matrix. Then the realization, if I'm right, that that's incorrect, that actually, all of this, this lavish monetary and fiscal policy is going to likely lead to significant inflation, then bonds could have a very significant and abrupt and intense price readjustment. I'm not talking about 15%. But a price readjustment to yields of three or four for the 30 year or the 10 year in America, would cause quite a ruckus. Cause quite a ruckus, including in the stock market, as the stock market realizes perhaps, that things have changed and the Fed is not necessarily going to be protecting every investor stocks and bonds against loss.

Bill Fleckenstein:
Paul, when you lay that case out, and it seems so logical, and the facts are on your side behind all the argument and bullet points. I'm sort of amazed that with other smart people in the world why so little credence is given to the consequences of that outcome? I would have thought, given the investment environment I've lived through since the early 80s that if you would have told people that the central bank is trapped, and the policy consequences were quite severe, I wouldn't have guessed that the response would be to buy as much beta as possible. Do you think it's because nothing, quote unquote, bad has happened against the central banks as you said at the beginning of your answer? Did you think that's what's made people sort of blind to this outcome? Is it just the financial equivalent of muscle memory? Or does it doesn't even matter to speculate as to why?

Paul Singer:
I mean, this is an interesting discussion in a lot of respects. But I think if there's one thing that I would say is the most useful thing I can respond to these elements, it's best to think about financial markets as examples of mass human behavior, rather than anything scientific or modelable. Because financial markets contain numbers, lots of numbers and prices, and marks to market everything. It's easy to misunderstand them as actual physical phenomena. And people who are engaged in quantitative trading and investing do seem to make money by some process related to computers spitting out numbers and orders.

Paul Singer:
But if you think of investing and trading as examples of mass human behavior, then what you said a

couple of moments ago is exactly right. It's, how are people conditioned, it's not logical to think that 0% interest rates can persist and not result in a crack. It's not logical that people can walk into the office or their computer today, and pay an $800 billion enterprise value at more than 1,000 times earnings and the earnings are fake anyway.

Paul Singer:
But they do it because either others around them are doing it or because they think, and basically, they're wrong about this, that they will be able to get out before the others get out. Or some combination of those things. So I gave up. I mean, I've been investing for a long time, like yourself. And I gave up a long time ago trying to base my investment management activities, on the concept that markets and investors and traders are rational.

Paul Singer:
Because people try to be rational, and people think that they're rational, but quite frequently, they're not. And there's hardly a better example of that today than cryptocurrencies. To tell me that something that's constructed as a computer program, where you engage in some process of sitting there in front of your computer and after some period of time and the expenditure of a bunch of electricity, a message appears on your screen that you've actually created something, that's ridiculous. It's nothing.

Paul Singer:
Gold is not nothing, gold is something. Gold has uses, gold is hard. You'll hurt your teeth if you bite a gold coin. But cryptocurrencies, I have smart people sending me articles that read to me like some Babylonian religious text, if I could translate it. If cryptocurrencies are a code. And then people say, "Well, but the central banks are creating digital currencies." I say, "What are you talking about? All currencies created by central banks are digital currencies? What do you mean they're going to print more and they're going to put a sign on the computer that says these are digital dollars. Those are not digital dollars. What do you mean they're not digital dollars, my bank account is on the computer."

Paul Singer:
So people have been lulled into a variety of beliefs. And one of the main beliefs and I think it's very, very dangerous is to trust the central banks, and to trust that this radical monetary policy will not end in tears. Now, I admit I just used the word end. And previously, I said, there's no end. It's just path dependent. And this leads to that. And that leads to the other. I have a hard time thinking about what happens when inflation gets rolling, I would recommend to anyone listening to this podcast, to do some reading about the great inflations of the last 100 years.

Paul Singer:
I think the thing that's most interesting about the great inflations is once they get underway, and well before it's thousands of percent a day or a week, once they get underway, central banks get trapped in the sense that they know that if they diminish or end the money printing, or whatever the technological equivalent of money printing is at that time, the next thing that will happen instantly is a crash, a financial crash, a deep recession or depression. And so that's what I mean by trapped. I think central bank policy around the world has been something that has stored up this false confidence, has stored up, let's call it the ammunition for a future crash. And if the overall performance of the global economy and stocks and bonds in the next two or three or four years does not match or look like the performance in 2010 through

'19, it's probably because real inflation, real crack in global bond markets, and probably a crack in global stock markets is to blame.

Grant Williams:
Paul, can I ask, there's a couple of things in there, I'd love to ask you about. Because you talked about how market participants have become conditioned to certain outcomes. And we've talked about how the Federal Reserve haven't been punished so in their own way they've also become accustomed to the outcome, the outcome being their success at every turn whenever they try and fight any kind of small downturn. But I think the scenario you laid out so eloquently suggests, particularly within the context of your supposition that rates go to 3% or 4% is a major problem, that none of this can now be allowed to happen. Which suggests that yield curve control will be at some point essential. And with everybody kind of conditioned to getting the same outcome, does that actually give the central bank's more latitude because everybody is going to suffer if regular market forces, particularly inflation reassert themselves? And so does everybody buy into this and sits passively while yield curve control, for example, is instituted?

Paul Singer:
You know, it's very interesting, the way you framed the question, because there's no such thing as sitting passively. You're describing a set of actions and pressures, let's use that physical metaphor for a second. That have to go somewhere. So let's say inflation sort of breaks out a little breakout, little breakout, it's not 5, 6, 7. It's 2.5, it's 3 it's 3.25, whatever it is for a few months. So, you've posited, and it's reasonable to pause it because that's the working assumption, you've posited that somewhere between the current 1.5% yield on the US 30 year or something like that, the Fed's going to step in, yield curve control. Okay.

Paul Singer:
But by stepping in, with inflation at the 3 level and pointing to the sky... By the way, the five year inflation swap this morning was 220. Now, I admit that there's little liquidity in those kinds of instruments, but that's up from like 120, just a few months ago. So they step in with yield curve control, and where does the pressure go, it may go in the exchange value of the dollar, the dollar may fall. Or if it's a simultaneous set of actions by the major central banks of the world the major currencies may fall against gold, silver commodities, real estate, and so the notion that they can control everything seems fanciful to me.

Paul Singer:
And I think they'll run out of flexibility when they realize this, that's why I framed the 2010s, 2009-10 to 2019, as this period that they got away with something, they engaged in something experimental and radical, and it only had good effects. It held things up. You didn't need the legislature's creating excellent, intelligent pro-growth policies, because the central banks did it all. Well, now, you have these extra elements. There's no shyness, there's no austerity that's going to happen anywhere in the world in the developed world. So you've got the spending, you've got this insane, modern monetary theory, which basically says, "Well there's this inflation thing. And that's sort of a control... Or not a control a guardrail. You don't want to cause inflation."

Paul Singer:
But if you print your own currency, you don't have to worry about taxes, you don't have to worry about deficits. You don't have to worry about default, you can spend whatever you want. Now, I think that's the road to perdition. I just think that's the road to destruction. And that destruction would come if inflation

really lit up. It's very interesting that the markets seem to think that inflation and a bad economy are sort of incompatible. It's really not true. And that many of the great inflation's are at a time when there's economic dysfunction, malfunction, under-performance, which is attempted to be overcome by the spending and the money printing. So on the face of it, that's where the developed world is headed now,

Bill Fleckenstein:
Paul, when you talk about your framework for looking at financial markets as being more sort of psychology and emotion as opposed to math problems, if I can restate it that way. And you talk about how, if inflation, once inflation gets started, how difficult it is to stop. And I can remember that from the 70s as well. Does the psychology, psychological component matter in the getting started have it? Or do you think it has to kind of get started before psychology starts to really change? I mean, people are so ingrained to think that all of this works, and they've got all the rationalizations worked out as to why inflation can't possibly get started, even given the policies that are being pursued. I was just kind of curious if, after you noted the unpredictability of how it kind of gets going. How crucial is psychology in terms of psychology changing at the start of the process? If that's a fair way to think about it.

Paul Singer:
It's the ballgame. It's the whole ball of wax. Let me answer it by reference to one of the key tenets of central bank policy and practitioners thinking about central bank policy. Because the arithmetic is compelling, the combination of actual debt plus entitlements in the developed world, which to me, are the functional equivalent of debt, are unpayable. They're absolutely unpayable. The arithmetic is clear. And when I say unpayable, I'm not talking about the nominal currency, I'm talking about purchasing power. You will not get, in your Social Security, Medicare, Medicaid and the government bonds, the value that you put in plus a rate of return on that value. Okay. That's easy.

Paul Singer:
So what practitioners and economists say is, "Well, there's a variety of ways to deal with this. One is default. Great. The other is inflating your way out of it. Inflating your way out of it." And one of these central bankers, I think, was Evans a couple of days ago literally said something like, "Well, if inflation went 3%," which I giggled when I read this for a couple of reasons. One of them is the way he said that it was like, "Wow, I'm going to name a crazy number, 3%." Read the quote. So he says, "If inflation went to 3%, it wouldn't be a bad thing." Okay.

Paul Singer:
So, this is pathetic, okay, it wouldn't be a bad thing. Here's the problem. The reason the statement, "We can inflate our way out of it is preposterous," is exactly what your question was. It's investor psychology. Investors lose confidence in central bankers, the dollar and or bonds and or the ability to control inflation, you can paint pictures, you can imagine scenarios, and they're not trivial scenarios. If that happens, they will front run or attempt to front run the inflation.

Paul Singer:
How do you do that? You do that by selling down the bonds. What is the Fed going to own all bonds? The way the central bankers have gotten away with this for 13 years is Mario Draghi will do whatever it takes. Well, you stand up there, and you're fierce enough and you beat your chest, and you look strong enough and you start growling. People say, "Wow, they'll do whatever it takes." So you don't have to do anything.

Okay, so that's part of policy. If people actually lose confidence in money, I think it's going to be an interesting fight. Let's call it a fair fight between investors trying to get out, and governments, at least at the beginning, helping them to get out by holding up the prices.

Paul Singer:
But to answer your question very precisely the reason I said it's a ballgame is that confidence, and investor and citizen psychology is the key. And that's what policymakers have been relying on. And they don't really... They seem to think that it's infinite, that the confidence is infinite. And that the damage they can do to the reality of the currency, the forward rate of return, that investors just will either be fooled or placid in the face of it. It's really stunning to me. As simple as, how could investors today, and we have a lot of institutional investors. How can they sit around their tables, and maintain their positions in stocks and bonds at today's prices? And say, "Oh, we are aiming at a 7% annual return on our investment pool?" Where is that 7% investment return from today's prices going to be coming from. The bond side, the arithmetic is just really, really simple. On the stock side, I don't understand why more people don't say, "Wow, the bull market is at a place where the forward rate of return historically, is kind of low. It's not 7% or 8% a year, it's maybe 4% or 5% for the next 10 years. So how are we going to prepare the buildings? How are we going to do what we need to do?"

Grant Williams:
Paul is funny, a good friend of mine who's an RIA wrote a piece to his clients recently, and the piece was entitled Take Profits. This was at the beginning of the year. And he had a bunch of emails both internally and externally from people saying that was an alarmist headline for a piece. And it kind of got me thinking take profits used to be called investment advice. And now take profits has become too alarmist. And I think that speaks of everything you've just talked about here that people are fully invested, we're in that stage of the mania, where confidence is so high, that nothing can go wrong.

Grant Williams:
And earlier, you mentioned how the central bankers didn't seem to understand that this asset price inflation that we're talking about now, was a form of inflation. So they clapped themselves in the back and said that there was no inflation from their policies. Is it that simple that they don't understand that or do they understand it? And they're hoping nobody else understands it? Because I go back and forth between the two. And I really don't know the answer to that.

Paul Singer:
I'm pretty sure they don't understand it. And I'll give you some supportive evidence in a moment. Let's go back to 2005-6, roughly 2005-6. They don't understand it because the financial system and the financial innovations, derivatives and all kinds of complicated securities have gone way ahead of economic and financial theory. There are no models and real experience to understand what happens when from zero in 1970 or '75, that 1,000 trillion dollars notional of a variety of different kinds of derivatives have erupted in like 40 or 45 or 50 years.

Paul Singer:
And so, I said I'd offer some evidence, as you may know, you can obtain the minutes of fed meetings, all fed meetings, going back years. And so, people have published some of what went on in fed meetings in 2005, '6, '7. And what you can see clearly, because now we can see it in hindsight, but what you can see

clearly is they had no idea of what the CDOs, CDO squared subprime CTOs, that tying together of people in these tight webs of derivatives, where the BBB tranches of mortgage securitizations were used, particular trenches were use dozens and dozens of times, to construct securitizations and securitizations of securitizations, where the BBB was magically, because it was married to 50 BBBs from different pools magically turned into 85%, AAA.

Paul Singer:
The central bankers had no idea what was going on the ground, in the financial system on the structuring desks. And by the way, neither did as we now know, and we knew back then, but anyone can know it now. The risk departments of the major financial institutions of the world didn't have a clue either. And so the answer is that the complexity of the financial system went way beyond and is way beyond the understanding of central bankers, and they're just playing at thinking of this area as a science.

Paul Singer:
It has elements of science, but they don't understand why markets can go down 20% and up to 25% in like two months, that's December 2018. Down 36% in a straight line, up 67% in a straight line, that's February, March 2020, and the rest of 2020. And so you need some kind of explanation of why correlation and herding is clearly in recent years, more powerful, more abrupt, more intense, than in the past. And, to me, the answer is derivatives. Samethink, groupthink, and when people change their minds in one direction or another, there's just so much tightness both in the structures in their portfolios, in the leverage in the system, both overt leverage and through the derivatives markets. And I think central bankers, they don't even know how to catch up.

Grant Williams:
Paul, something obviously, you have great amount of experience in is distressed sovereign debt. And yet here we find ourselves in a world where three year Greek bonds have a negative yield. And I kind of go backwards and forwards with whether this is the end of an entire business model, or it's one of the greatest opportunities of a lifetime for someone like you.how do you kind of look at that word and weigh it up?

Paul Singer:
Well, I'm not going to answer the question just with reference to sovereign debt. The yield on Greek sovereign debt or Italian sovereign debt or any other sovereign debt is subject to a lot of forces. Including the consolidation, let's call it or attempted consolidation of Europe. But I think the more interesting part of the question to me is, what do you do with deep valuation aberrations? And I think in this environment, it's very, very hard.

Paul Singer:
We've had in house spirited discussions, let's just call it about European yields. And I'm not talking about Greece, I'm talking about the Euro swap or [inaudible 00:50:02], or can we declare zero yield for a 30 years euro swap a currency that some consider potentially a junk currency? Can we declare that an extreme? And can we trade it? Well a while ago, here it is at zero or plus two today, basis points for 30 years swap, it's quite a thing to do with your money. And at one point at the bottom I don't know a year ago, something, it was minus 40. Minus 40 basis points for 30 years. I mean, wow. Wow.

Paul Singer:
I lived through the worst trade in my history in 2008, where I was long, Japanese inflation linked bonds against Japanese non-inflation linked bonds. And I put that position on at an implied deflation rate of 2.5 percent per year. At the bottom, after I'd lost more money that I thought I could possibly lose in any trade they were trading at minus 4.5 percent per year.

Paul Singer:
Now, at a time like that, at a price like that the answer to the question, what did you do is based on two things. Did I have the emotional staying power? That was a tough time, the last few months of 2008. I stuck with that trade and it came obviously all the way back. But I think that modern markets, I mean, if there's anything useful, I can say, I think investors in the more humble, even more humble than in the past, and you always have to be humble, really humble to survive for a long time in the trading and investing in markets. But I think it's getting more difficult to dig your heels in from an overvaluation or an undervaluation standpoint.

Grant Williams:
Paul, what's more important to ride that trade out? Do you think what's more important, is it experience or tenure, because there'll be a lot of people who put that trade on in. And obviously, face values, as you said, it just made so much sense. But so many people would be stopped out by their customers, once it got to the extremes it reached, is it tenure? Or is it your experience? How do you mentally manage something like that?

Paul Singer:
Well, let me just say that, and I think it is a very interesting point. The way it got to 4.5%, is that most people that were in the trade, it was a popular trade. Most people were stopped out. They were stopped out by the predatory investment banks. I'm not going to name them. Okay.

Grant Williams:
You don't have to, we know who they are.

Paul Singer:
Or by their customers, or by their psychology. So your question was about the psychology of it. It's a much longer topic, but I don't like rigid trading rules for myself. Flexibility versus rigidity, let's call it, have to be individually assessed. There are times when you make a mistake, you think it's a mistake, or it might be a mistake, you've got to get out. And there's no magic to the difference between that. And it may be a mistake, but I don't think it's a mistake. And I'm going to stick with it. And sometimes you're right, and sometimes you're wrong, but I can't think of magic tools. Guys, I'm unfortunately going to have to bail. Do you have enough here.

Bill Fleckenstein:
Yeah, I think we should do Paul. I mean, all your points were so spectacular. I'm sure you could have lots more, but I think that was really great.

Grant Williams:
Yeah, we're grateful for the time you've given us, Paul. Thank you so much. It's hugely appreciated.

Paul Singer:
Thanks so much, guys. This was fun. I hope it was useful. Take care.

Grant Williams:
Well, Bill, it's an hour of Paul Singer's time and get the chance to listen to him speak for an hour. What a gift that was, for me personally, that was just fantastic. I enjoyed every single word of that.

Bill Fleckenstein:
I did too and what I would, I think, like to point out is a lot of what he said comes from experience in periods that I think a lot of people who are listening may have only read about in a textbook or somebody told them a story. And what I've noticed is that things that happened in the 70s, 80s, and even to some degree in the 90s, a lot of today's investors and speculators don't have much of an appreciation for, and it's easy to say to anything that sounds negative to whatever your current thesis is, "That doesn't matter. That's old news, whatever."

Bill Fleckenstein:
And I would really encourage people, if Paul said something that you don't really agree with or find uncomfortable, maybe you listen to it again, because there's a lot of what he said that I know to be true. And it's easy in these periods to think none of that matters. But when he sketched out the case for how the walls are kind of closing in on the central banks and people that are partying because of them. I mean, the walls are closing in all around. We don't know how much farther they have to go to matter. But I think there was so much that could be useful and help people avoid what bad outcomes that might be coming our way down the road. He made so many great points that I think most everyone should listen to it a couple of times.

Grant Williams:
Yeah. And I would say something Paul said quite early there about, he just very casually mentioned about reading about the great inflations. And that's something that not a lot of people have done, because it just hasn't been relevant for 40 years. But there are two books in particular that for me, did an extraordinary job of helping me understand how these things happen. One is *The Dying of Money* by Jens O Parssons, P-A-R-S-S-O-N-S, if I'm right. And the other one is, *When Money Dies*, there's a theme here, by Adam Fergusson.

Grant Williams:
And each of those just does an extraordinary job of explaining what happens during great inflations. What starts them how the mindset changes, and the and the actual manifestation of that loss of confidence that Paul talked about. And both, as I said, do a fabulous job of... They read like thrillers, in many cases, but they're very real. And they're very important to understand just how these things can happen.

Bill Fleckenstein:
I'm sorry, I was just going to say that... No, no, but the psychological component, which he felt was a big deal, is something that I recall. I was old enough to experience the inflation in some sort of a way that mattered. I was still really young. And when I see people today that say it can't happen because of bank loans and all these things. Those things that has been true, but the psychological component is such a big variable. Because it's hard to model that right. You can't tease that out of the data. If you were there you know

what it was. And I think that's maybe the most important point that he made, that when that starts to shift, and when people lose confidence in psychology starts to shift. It takes draconian measures to get it back. And it took 20% interest rates in 1980.

Grant Williams:
And also, it flips so quickly as well. Once that confidence goes, once the mindset shifts, it's too late. If you miss the shift in mindset, you're too late.

Bill Fleckenstein:
Because what do they do? Like he's pointed out, they get inflation starts to print north of twos, and then they rationalize and they bring out your yield curve control. Well, at some point, people are going to see they're just pouring gasoline on a lit fire. And they're totally trapped. And he didn't mention Hammerstein by name, but that was the conundrum the Germans face. They knew they couldn't stop printing or things would collapse. And so they were caught and they took the easier path, what they thought was the easier path, but it turned out to be the much more disastrous path. So the road ahead-

Grant Williams:
The thing that frightened me the most I think about what Paul said is his belief that central bankers don't understand that asset price inflation...

Bill Fleckenstein:
Sorry. When I did the research for my book. I was only able to get the minutes, because, I should know this. But it's either a five year or seven year lag. I always want to say one it's the opposite.

Grant Williams:
I think it's five.

Bill Fleckenstein:
It's the other one, but anyway, doesn't matter. So when I was doing the research on my book in late '07, I think I couldn't get minutes much past about 2000. So I knew for a fact and I have quotes in the book about what they... I'll never forget, there was one meeting where Mike Prell who was slightly skeptical talks about this is like the South Sea bubble, I think it was Red Hat that went public. I don't remember which one. And nobody said a word.

Bill Fleckenstein:
So after reading it, I knew they didn't understand anything. And I haven't gone back to read from the real estate period, bubble period, but he just told us, and it doesn't surprise me. So I've felt since, I don't know, for the last 15 years that they had no idea. If they had any idea, they could not pursue these policies. The only way you can pursue them is if you don't think anything bad can happen because of them, or you think you can stop anything bad immediately. Like they talk about stopping inflation, raising rates, well, they're already trapped, they couldn't exit QE. They think they're really going to be able to fight the inflation that they want once it gets rolling. Of course not.

Grant Williams:
But it's this idea, see, I understand why they would just ignore the fact that they're creating what they're

creating, because it's too painful to stop it and turn the other way. I get that. But if they really don't understand if they can't join this incredibly short series of dots, not just to asset price inflation, but to wealth inequality. If they genuinely don't understand these things, that terrifies me. I just figured they were being disingenuous, because they have to be at this point, because they can't admit this stuff.

Bill Fleckenstein:
No, you give them too much credit. You give them too much credit, I'm sorry to say.

Grant Williams:
Wow.

Bill Fleckenstein:
And all one has to do is spend some time with the actual transcripts. It's all in there, you'll read them and you'll learn the personalities of different people. And you'll just see how epically clueless they are. And it is scary. And if you take his conversation, go read some of those minutes come to the conclusion that they don't know what they're doing. It's even scarier. What's amazing to me is there's a lot of smart guys on wall street that understand what Paul said, and know the Fed doesn't know what it's doing. I know there's a lot of people that don't know that. What I can't understand why there's not more skepticism, maybe it's sort of like the functional equivalent of social media today. You stand up, say anything too negative they try to cancel you.

Grant Williams:
I think it's Stockholm syndrome. Your career, your bonus depends on them being right.

Bill Fleckenstein:
Perhaps, perhaps, perhaps it's that simple. But anyway.

Grant Williams:
All right. Well, listen, all the remains is to thank you for listening. Thank you for that. Please, if you get a moment to take a second to write reviews on the iTunes store, that really helps. You can follow Fleck on Twitter should you wish to do so. You'll find him @fleckcap, right.

Bill Fleckenstein:
Yes, sir.

Grant Williams:
Yes, sir. And you can find me @ttmygh. That's all for now, we'll be back with another End Game, who knows when but soon, thanks for listening.

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