Our Outlook and the Threats We See to Portfolios, with Co-CIO Karen Karniol-Tambour

Speakers: Jim Haskell (Host), Karen Karniol-Tambour (Guest)
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Jim Haskell: I'm Jim Haskell, editor of the Bridgewater Daily Observations. We recently hosted our Q1 CIO call with co-CIO Karen Karniol-Tambour. Today, we're sharing an edited version of that call focused on our global outlook and how we're processing this new market reality as investors. In this observation, you'll hear Karen describe the very different world we now find ourselves in, the implications of the shift to the modern mercantilism paradigm, and the urgent threat it represents to current investment portfolios. In addition to the secular challenges, we also discuss the rising probability of a US recession and the constraints on the Federal Reserve to manage any growth downturn. The final part of the conversation touches on the heightened risk of investing in US dollar-denominated assets, the role gold seems to be playing as an alternative storehold of wealth, and of course artificial intelligence or AI. And so with that, let's get right into the CIO call starting with Karen sharing our outlook.

Karen Karniol-Tambour: Thank you, Jim. So let me jump in and talk about the environment. Let me kick it off by saying what I think is more or less obvious to every person listening to this call today, which is we are in a radically different economic and market environment than what came before. It is very different from the last 15 years where there's been an extraordinary set of returns for traditional assets, for equities, very different from the last 40 years where the backdrop was kind of a laissez-faire high globalization secular disinflation background, and for the last 80 years where there's been a very strong US-led international order. We're in a very different environment today, and there's no going back. We've named this new environment modern mercantilism. What we mean by modern mercantilism, I'll talk about more. But as we've now shifted from a transition into this new environment to really plunging head first to really being in it, that transition these last few weeks has been chaotic. It has happened in ways that have really increased uncertainty. When we look ahead, the next shoes to drop from the shift in environment are very clear, which is now this shift in environment is going to cascade through to real economic activity and to capital flows. It's become a major, an urgent threat to markets, the portfolios that people hold. So when you look at the next shoes to drop, we're looking at a policy-induced slowdown that is starting and is increasing the likelihood of a recession. We're looking at that happening in the context of a more constrained Federal Reserve, of rising inflationary pressures from these policies, and we're looking at rapidly changing capital flows that can move a lot faster than the actual trade flows and policies are trying to shift, which are really shifting very quickly the calculus of investing in the US economy and US dollar-denominated assets. Now while the last few weeks have been relatively tumultuous in markets, when you step back, pricing hasn't actually changed that much. What's priced into markets to occur going forward has not meaningfully shifted, certainly not in the context of the magnitude of shift in environment that we're in the middle of. That creates major opportunities, major opportunities to structure portfolios to be ready not for the environment that was, but for what's ahead of us. Now, we're simultaneously amid a once-in-a-generation technological disruption. That's been easier to ignore the last few weeks, but when we look back a decade from now, this will be one of the most important forces that define what's going to happen in the next decade or so because developments in AI and machine learning are going to interact with this environment, reinforcing some of its drivers, potentially giving some breathing room to others. We'll speak about that as well. So let me dive in and start with this meaningful shift in the market and economic environment that we're living through and say, look, this did not happen in a day. This is not the story of one policy, of one announcement where President Trump gets up and has liberation day tariffs. It is much bigger and broader than that. When you look at what we've been used to, whether it's on geopolitics, the government's broad approach to economic policy, the kind of Washington consensus we were living in, what globalization was like, the constraints on the Fed, the secular disinflation, in all these areas, there was really a period of transition here that was 5 to 10 years, depending on which area, where you started seeing things pop up and say, wait a minute, we're not so sure that the old environment works anymore. Rising signs globalization starts flattening out. The Fed starts having inflation constraints, starts having all sorts of targeted tariffs, more industrial policy, questions about the US role. Really, the only place the transition has been extremely sharp has really been asset returns. We had an exceptional run in financial assets, especially US equities. They really went from 2010 and pretty much continued unabated until pretty recently. So there, the shift in what financial markets feel like feels abrupt. But the background of that, the shift in environment, has been with us for some time. For us at Bridgewater, that's given us the time over the last five and ten years to be seeing these green shoots of a shift in environment, studying them, studying their cause-and-effect linkages, and preparing for the ultimate shift that's occurred. So what is this new environment? As all of you know, we've coined the term or called this environment modern mercantilism. What we mean by that is something pretty specific. It's that the state has a role, or is perceived to have a role, which is to do three things that can be interconnected. One is really accumulate national wealth. The state should worry about how much national wealth is accumulated. Second is pursuing geopolitical strength, and the third is economic self-sufficiency. You can see how trade deficits end up being kind of smack in the center of these things, right? Trade deficits are perceived as something to be avoided because they're perceived as a wealth transfer abroad, as something that diminishes self-sufficiency because by definition you're consuming something that you're not producing domestically. Depending on who you're importing it from can create meaningful security vulnerabilities depending on who that is. So something like very intense tariffs on China is kind of smack in the middle of the set of policies. It's also a set of goals that says that strategic sectors or national champions really need to be protected. We need to use things like industrial policy or opposing the sale of US steel in order to make sure that we have certain capabilities domestically, and that it's okay to use foreign policy that's transactional or even coercive to achieve these goals. So something, not close to day-to-day markets, like the Ukraine minerals ultimatum, is really something that should be understood as part of this whole mix of policies that brings together the set of goals and says we're going to pursue material wealth at the same time we pursue geopolitical issues and self-sufficiency, and we're going to do that using this much broader set of tools, and it's not just one policy, it is really the mix.

Jim Haskell: Now I want to interject here because I would say if I synthesize one of the main questions we get, is that there is a difference between the picture you're painting here, which is that this has been a buildup, and then maybe the catalyst has been the Trump presidency, right, but that Trump is more of a symptom of these growing forces that have been in play for some time, because the question we get is if President Trump can basically almost by executive order put these in place, can't he just go the other way too? Isn't this just sort of like a particularly temporary period that can go back into the bottle? The genie can go back into the bottle. So what say you to that kind of question?

Karen Karniol-Tambour: Well, I'll say there's three reasons why there's really no going back to where we came from, right? One is the long-term reason, which is there is a reason that there's been a buildup and a shift in this direction in this long period of transition, which is that there were discontents with the way that the system was working, and this modern mercantilism is coming out as an answer to discontent with the way that prior system was working, with looking at the US-led international order and seeing China rise, with looking at the rise in globalization and asking, wait a minute, are developed countries happy with what's happened to their manufacturing capability, their economic self-sufficiency. So whether or not it's this set of policies or a slightly different set of policies, you're going to see an attempt to find an answer to what's seen as discontent to the last paradigm. Then the next two reasons they're not going back are more specific to how it's been implemented, which is, look, it takes a lot of years to build up the trust to have the sort of US-led international order that we've had. It doesn't take a long time to destroy the trust. What's happened the last few months is that a lot of trust was very rapidly destroyed. It's very hard for any ally of the United States to look at this set of policies and not say, I should worry that any reliance I have on the United States could be weaponized against me, could be used against me in a coercive way. That kicks off a process of other countries saying, how do I become economically self-sufficient? How do I make sure that I can't be coerced? How do I make sure that I deal with the fact that the United States is not the kind of reliable trading partner and security partner that I thought it was? So even if Trump tomorrow came in and said, forget about it, I don't want to do any of these things, would you really go back to trusting that the United States is a reliable partner, or would you stay on a path to say, how do

I become less reliant? The last piece is that because it's been done so chaotically, because it's been hard to predict and shift in and out, you set open a process of uncertainty. I mean, you and I were joking about how when we planned this call, we were planning it just a couple of business days ago, we had no idea what trade policy would be by the time we did the call. That's a few business days. Imagine trying to be a business today, trying to think, what kind of factories am I going to do? What business line should I expand? It's extremely hard to make decisions with this type of uncertainty. So when you add up kind of the desire for a different economic system with the loss of trust in the United States as a reliable partner and then the massive uncertainty injected, I don't think it matters what Trump and his team does, that you can just go back and put the genie back in the bottle here.

[15:00]
Karen Karniol-Tambour: So let me keep going and talk about how this affects us as investors, which is that everything I talked about can sound a little bit almost academic, and at the end of the day, it's got to flow through to prices, to the economy for it to matter for us, and what we have really spent time doing as we've been transitioning and are going to keep of course spending time doing is thinking about how does this new environment literally cascade into the next shoes to drop, and that has to happen through money, through credit, through somebody having different sources of funds or uses of funds, buying or selling something differently than they did before, and effects on the big forces that drive the economy. When you think about this environment, we really do see it cascading through to affect every major force in the economy. Right? So if productivity is sort of the underlying force that pushes the economy forward, these mercantilist policies are a productivity drag by definition. You're saying I'm not going to produce based on where's most efficient, I want to be self-sufficient, I want to think about national security, etc. It might be offset by things like AI, but that's a productivity drag underlying everything. You're talking about a much more volatile short-term debt cycle. I just spoke about all the uncertainty that's been interjected. That's a lot more volatility in the business cycle and happening in a time where you don't have these deflationary forces anymore. So tougher for central banks to balance the volatility and be able to ease into it. From the perspective of long-term debts, we're going into this with kind of an ever-growing size of public debts in a lot of countries, and the temptation to move against this environment using fiscal policy, industrial policy, basically use public sector balance sheets, is going to be there and really question the limits of how far that can go, and the levers we're going to see used. If traditionally we had primarily interest rates, quantitative easing, a little bit of fiscal, there's a whole range of levers that get employed in this type of environment. Tariffs were not a common lever we were speaking about in the past. Now we're talking about tariffs, antitrust, lots of different industrial policy type of levers that can be used. So it's a very different environment. If we put these policies through the environment, the next shoes to drop become clear. It becomes clear what's coming ahead of us. When I add up what's coming ahead of us, it is particularly an urgent threat to markets and to the portfolios that people hold. So before jumping into those threats, I just want to take a second and step back on what's going on with global capital. What's going on with global capital going into this environment? So as I noted, we're coming out of a period of just a massive run in financial assets, most importantly a massive run in US equities and in

liquid assets. As naturally happens, the assets that do well get more and more capital because they go up in value, and people see that and want to be in them, bigger and bigger part of market cap. So we're starting at a place where global capital is extremely concentrated in equities and in the liquids. Falling growth is not great for global capital, makes all of its money in periods where growth is rising, loses money when growth is falling. It's worse if liquidity is also tightening, and you don't have a Federal Reserve that can flexibly ease into a growth problem. Equity bear markets were terrible for global capital 15 years ago, even worse today because so much money is moved to equities. All the money is made when equities go up. The concentration in the US is greater than ever, so performing well when the US is the underperformer is tough to do given the large size the US plays today. So you start with vulnerabilities, then you look at how these policies are flowing through, and every single one of these vulnerabilities is under urgent threat today from the shift in environment, starting with growth. So we're in a point today where we really expect a policy-induced slowdown, and there's a rising probability of a recession. As I mentioned, the chaotic implementation of this shift in environment is a major driver of this. These charts here, they really show an index that I think reflects what we've all experienced viscerally, which is this is a very uncertain environment, as uncertain as what it felt like at the height of COVID, where we didn't know what was coming next because changing every day, hard to make decisions, hard to find stability. When we go and put all of the policies today through our machine, thinking what are the cause-effect relationships, what's going to end up in the real economy, what you see here, and this is shown for the United States on top and not United States in the bottom, is that the uncertainty effect is actually a major part of the drag that we see on the environment. So this compares, this is the uncertainty effect, and over here is actually the direct effect of the tariffs. Now for the tariffs, we're using a probabilistic estimate, we don't know where they're going to land, I don't think anybody knows where they're going to land, but using the best of our abilities, we're saying here's what we think is likely going to be the damage to the economy from the tariffs in the United States. The uncertainty effect is at least as big, probably larger, even in a place like the United States. A little bit of extra pain from fiscal policy that is trying to cut back government spending, and you end up with a pretty meaningful drag on growth, and you see it flowing through. So since the election, United States coincident growth has already fallen a decent amount. Our forward estimate went from pretty much normal to very close to zero. That's a rising probability of a recession. When you look globally, this is not a US slowdown, this is going to be a global slowdown. Our forward growth estimate in other countries, about 0.4%. You have the same meaningful uncertainty effect hitting everywhere. Tariff effects are bigger in some countries, smaller in others. The biggest difference other countries, why they can be better off, is that in some places they have chosen to employ fiscal policy to offset these effects, and more countries might follow. So Germany is probably the best example of who's been front-footed, saying, we see all this, we don't need to live with this, we can go and change rules that were considered unchangeable in Germany, but go and create our own economic self-sufficiency, our own defense capabilities, our own infrastructure, and that's why you end up a little bit better. But this is a global growth slowdown that will hit portfolios and asset prices.

Jim Haskell: Now, when you get a global growth slowdown, the natural question is, what can the central banks do? How much can they step in? We're in an environment where the United States, in particular, the Fed, in particular, will have a harder time really being able to respond to this growth slowdown in a way that is nearly as proactive as they have been. When you look back at the great asset performance the last 20, 30, 40 years, the Fed's ability to very proactively step in, solve any problem before it got too big, sometimes go ahead of the problems even being there in ease, today the ability to do that is going to be restrained. You look at our leading inflation pressures, the United States has a meaningful impact from tariffs that's likely to hit, this is based on our probabilistic tariff reads, so it could be better, it could be worse, but very likely you're going to get something like a 4% to 4.5% type inflation set of prints that, even if the Fed looks at them and says these are probably short-term, these are probably one-off effects, to have the confidence to ease proactively into that is a different bar, when you have something this big flowing through. So even though we expect inflation to come back down, settle only a bit above the Fed's comfort level, that's a lot even in the face of deflationary cyclical weakness. There's not much priced in, the Fed is not priced in to do a lot on net, they'll probably do more than this, but it'll be tough, especially when you add in the fact that suddenly they're looking through a couple weeks that look almost like balance of payments crisis market action, right? Where when growth looks bad, when stocks are falling, you're actually getting rising bond yields and a falling dollar. That's sort of the ultimate Fed constraint and likely to give a little bit of pause as well. I want to stop on that for a second because this is the next big, if I look at all the questions that have been coming in over the last couple weeks, this is the other big component of it, that last week it felt, I remember back in the late 1990s, a series of crises through the emerging countries in Asia and then in Argentina and Brazil and so on, Russia and so on, and they were always marked by that balance of payments crisis, and it was, as you say, these correlated falls in assets. So last week, even today coming into this call, we have the dollar down significantly, we have equities under pressure, US equities under pressure, and bond yields which really aren't rallying, right, to be that diversifying asset. Then there are other assets we'll get into, like gold, which is ripping, right? I look at that and I'm like, it feels like a balance of payments crisis. Now, you mentioned that, do you believe we are right now in a balance of payments crisis, or are we on the edges of it where this could be a real constraint on the Fed? What's the exact point you're trying to make here?

Karen Karniol-Tambour: I think we're on the edges, I don't think there's a real constraint on the Fed yet. You're talking about a Fed that has not had to think like an emerging market central bank in decades, right? So it's going to take more pressure for the Fed to really say this is a major constraint on me. But it's a start of a warning sign. We'll talk about this more, but when you look at everything I spoke about in terms of the loss of trust in the United States, less reliable as a trading partner, as a security partner, it's very natural to see why people around the world are reassessing their exposure to the United States, and we expect that to continue. US assets are under tremendous risk. So if you're the Fed, what's happened so far, while it's been fast, is probably still tolerable. But there's clearly been a rise in the sort of risk premium being assessed on US assets and on treasuries in particular. So if you think about not the level of rates but kind of the yield curve or how much is being charged by the markets to hold a longer-term treasury relative to being shorter-term treasuries, that yield curve probably rose 50 basis points in two weeks. It's meaningful, but it's starting from a level where for many years there was virtually no risk premium in treasuries, it was considered a risk-free asset, you got almost nothing in return for parting with your money for a longer period of time. So some adjustment to some risk premium in treasuries could make a lot of sense and may not be at the realm where the Fed really feels constrained by this. That said, it could be just the beginning, and there's probably more of this ahead of us in terms of reassessing it. So it's at the outer edges of what's going to bother the Fed. But when you add that up with high inflation prints and with the fact that some of this cyclical weakness ahead of us is not a sure thing because we have this uncertainty. So the same way that businesses feel uncertainty, the Fed doesn't know for sure exactly what tariffs are going to hit and how. It's a very tough environment to be proactive and proactively ease and not worry about the effects of that. Now the contrast I would make is really other central banks, because other central banks will very likely lead this easing cycle because they are not facing this. So if you put yourself in the shoes of another central bank, and this kind of average of non-US developed countries, but across the board, it captures a lot of this, which is the tariff impact on inflation is very small, the cyclical weakness is much bigger, and they're actually seeing more deflationary effects from commodity prices, from their currencies. So you're looking at much more deflationary forces when inflation is not a huge problem, growth is slowing, and yet almost nothing is priced in. So this is a huge opportunity to basically look at these rates and say, this doesn't reflect a major slowdown, this doesn't reflect a major change in environment, and these central banks are not going to be looking at balance of payments type crises at pressures or meaningful inflation pressures. For them, easing is more of a no-brainer. Now that said, back to what investors are exposed to, investors are very materially exposed to US corporates. So in other places, an easier way of easing and less of a constraint around easing doesn't help investors as much. Particularly, let me talk about the exposure to US companies, because it's intuitive that growth slowing is not good for stocks, and in addition to that, the Fed not being able to ease is not good for US stocks. But US corporates are even greater risk than that. These are extremely international bodies that are very exposed to international cooperation kind of not going well. So if you look and we try to do all of our work on US corporates, really going bottoms up, company by company, understanding their circumstances, how they work, what's happening in there, when you add that up, you see that very little of what's going on in US corporates is making and selling things inside the United States. There is a large share, about 40%, that is sold in the United States but with lots of products and inputs from abroad, so very obviously sensitive to tariffs, but also sensitive to other ways of making it more difficult for these US companies to get all these inputs they need. Then another 40% are just sold abroad, and so these are very vulnerable to retaliation, and you've started to see some pretty, I'd say, creative retaliation happening across the countries that have been most targeted. So really attempts to say, how do I limit the market access specifically for US companies? How do I depreciate my currency? How do I reduce my purchase of US goods in a targeted way? Increase subsidies to my domestic producers, restrict US from importing the pieces that they need, as well as have regulatory actions that very literally target US companies or seize their local assets. So you see, Canadians don't want to sell US liquor, China's targeting specifically Google or specifically Micron, there is an effort to say these are very vulnerable entities, more vulnerable than just the economy. Then I would add the fact that most investors really do hold primarily US companies. The US is now 70 plus% of the global market cap in equities, and when you look at that, you end up quite vulnerable to the fact that all US assets are under exceptional risks. The risk to US assets are really coming from the fact that US assets have been bought by foreigners to a massive degree, and it's just the natural flip side of the trade deficit. So the same trade deficit that there's an attempt to close, the other side of it is that every time we buy more goods from abroad, people are buying our financial assets. What's happening today is that these attempts to close the trade deficits, they're not moving very quickly to actually shift US trade, there's a lot of volatility, a lot of questions, but you don't have actually US trade having closed and not having a deficit anymore. The capital can move a lot faster, this is what is starting to happen, this is why US assets are under such risk, because of how much faster capital can move than the trade. So if you look at what's built up since 2010, since 2015, it's not US adversaries like China and Russia that are buying the assets, in fact, China and Russia have been pretty much shifting out of the assets that they've held, mostly bonds, in response to what they felt was a weaponization of dollar holdings after Russia invaded Ukraine, but even before that, it is really traditional US allies, NATO members, Canada, Japan, Korea, traditional US allies that have been on a buying spree, buying massive amounts of US stocks, US bonds, and now they hold this big pile, and almost anyone that we speak to holds at least 50% in the United States. I mean, I've had multiple conversations where people say, I only hold 50% in the United States, I'm underallocated, the market cap is 70, 75, I'm underallocated, huge piles of US assets at a time where it's very reasonable to say, how much do I want that exposure to rise, how likely is it that that exposure would be weaponized in the future? So the potentially secular pressure to say, let's hold less of this, let's at least stop buying at the pace we were buying, puts tremendous risk on all US assets, on the dollar specifically, on US stocks at this point, because US is such a big part of market cap, you need to get 70 cents of every cross-border dollar to come into the United States just to keep kind of where we are at the end of the day, for an asset to move, someone actually has to buy or sell it, because they want to, so we really try to get in there and estimate buyers and sellers of every asset in the world, cross-border, within borders, so you have here kind of our structural estimates of these purchases coming down based on the uncertainty, the lack of trust in the United States, this could be exacerbated by the United States having worse growth outcomes and so on and so forth, but these would be structural pressures on US assets in the dollar.

[30:00]
Jim Haskell: So this gets to another area of focus, and that's been on the dollar itself. Now granted, a lot of these questions on the dollar have come in from clients outside the United States, because they have basically two issues. The first one is the fact that all of these US holdings in the last 15 years or so, it's been incredible, right, because they unusually, they had not only the rise in the asset, also the rise in the currency was like incredible total return, those two components working hand in hand, and the other thing they got strategically was they didn't have to really hedge the assets, because there's this, that the dollar was the biggest, most liquid currency, so even if you were sitting outside the United States, you could borrow in dollars, right, as a funding currency, and then when things got tight, when there was risk-off, you didn't have to

convert that into domestic currency loans, you would hoard it, right, you would save it until times were better, and that meant when the risky assets went down, in those periods when they went down, the dollar went up, so it's very diversifying. My question to you is on both fronts, right? Are we looking at the beginnings, or have we already experienced a material amount of, let's say, a secular dollar decline? If you're a foreigner, how should you think about the strategic hedging qualities, and should you be looking into that right now?

Karen Karniol-Tambour: It's a great question, I think it's a really excellent time to revisit currency posture, partly because currencies were just not moving that much, and so it seemed less relevant to be asking the question of what is my currency posture? In addition to that, just like you said, if you were outside the United States, you just benefited from holding dollars, they went up secularly. Now, I would say even before there was such an acceleration in modern mercantilism, such an acceleration, the last lack of trust in the United States, I would say you do not want to extrapolate going forward the dollar continuing to rise as part of how you're building your strategic exposures. Dollar has just gone through 15, 20 years of a big secular rise, you don't want to extrapolate that, so thinking about your neutral position, not assuming that you're going to earn something from the dollar was already true before this, and this just exacerbates the question of, hey, there's good reasons why you could get a slow secular decline in the dollar, as that revisiting it can happen at a slow pace, look at how slowly China has moved out of its dollar holdings, but that's a persistent pressure that'll be much bigger than China, because these are much bigger holdings. So I would definitely not extrapolate the dollar direction as being behind us or thinking it'll rise again. Then in terms of that more day-to-day relationship, right, there are good mechanical reasons that really go back to who are the players and how they behave, why, when you have a global risk-off day, you tend to have the dollar going up, meaning, when we really look at the buyers and sellers and how they're behaving, we understand what's driving that, it's not just a statistical correlation. I don't see a lot of reason for that to go away. That said, we haven't lived through a lot of periods that were kind of risk-off periods, they were concentrated in the United States, where in addition to general rising risk premiums, there was a view that specifically US risk premiums had to rise, and clearly much of what's been going on here is a view that there's a new risk premium you have to put on the United States, I mean, you look at the kind of conversations that are floating around, what if we did default on our debt, what if we tried to weaken the dollar, I mean, there's just lots in the air, you don't need a high probability of it to think that a higher risk premium is warranted on US dollars and dollar assets, and so when that is happening at the center of risk-off market action, in addition to those mechanical flows that create that relationship, you're going to get more pressures for the dollar to fall, so you can't rely that every global risk-off event will be dominated by that more mechanical relationship. I would also say that it's somewhat hard to take advantage of just the fact that it happens to be that on the same day one rises and one falls, so when you step back and think about what are your currency exposures, the most important question is what are the structural risks that you're taking over months and years, and probably not what's happening with your risk appetite really day-to-day. Let me step back about just what's happened in markets for a minute, because it has definitely been a dramatic couple weeks, and being a market participant, things are changing day-to-day, a lot of things are happening intraday, if you look at the US stock market, the two days after liberation day with stock market being down more than 10%, I mean that's probably some of the worst 48 hours since World War II or something, and then you had a very big rebound on the other side of that being paused, the currency markets, a shift from the yen at 155 to 145, certainly feels dramatic, we talked about a 50 basis points move in that yield curve slope in the United States, that's a lot to live through in a very short period of time in a time where that feels unexpected, but when you then just go and step back and look at these market moves in the context since 2010 or so, since this run we had in the last 15 years in assets, they are very small, the magnitude of what's actually occurred in pricing is very small relative to what I really believe is the magnitude of underlying tectonic shifts that are underway here, right, so if you look at the stock market, the US moved from 50 to almost 75% of world stock markets, what's happened recently is barely noticeable, the US has been outperforming every single country in the world massively, the last few weeks have felt like dramatic underperformance, but it barely undoes a couple months of this, and the bond yield, the moves feel large because we're not used to them happening on days like these, but the bond yield's kind of right in the range has been for a while, and the yield curve slope, it's certainly sharper than it was, and that was a fast move, but this is not a major risk premium yet, this is not anything like a steep yield curve, and in the currency markets, the run that the dollar has had just barely started to reverse, shown here versus the euro and yen in the recent moves, and so if you see how many shoes are left to drop, that what's happening in the policy environment is just starting to show up, is still ahead of us to really come into real economic activity, to really hit all the capital flows that are going to be reassessed and asking these questions, you see that the pricing has not moved much yet, which really creates a time for great opportunities.

Karen Karniol-Tambour: We also are living through this while simultaneously there is a once-in-a-generation technological disruption that's going on, and that has felt easier to ignore when you're getting intraday big shifts in policy, you're not getting necessarily as fast of a move here, but when you step back, even over a month, what's happening over a month and a few months in AI and machine learning is remarkable, and when you kind of look at where we are today, I would summarize it as, look, the intelligence is clearly here, the technology has already made leaps and bounds and proven that it is incredibly capable, we have not yet figured out what is the way that's going to make it really into the economy and upend the way the economy is working, what we know is that as that accelerates, this is going to really interact with the environment I spoke about, right, and so if you think about, I spoke about kind of what are the root causes of why we switched to modern mercantilism, what are the root causes of why we had, why did mercantilism really come up, it's issues like rising great power competition, clearly AI, machine learning, and be in the middle of that, and you already see that with things like deepseek, clearly that's only going to accelerate these great power tensions, number two, issues like stress about labor markets, really being upended and shifted through the years of globalization, this is clearly ahead of us with more of this with AI, at the same time, the pace and timing of when AI comes forward could also give us some breathing room to offset some of the impacts by being more productivity-enhancing when mercantilism is more productivity detracting, supporting growth and so on, as a market practitioner, the main point I would leave you with is that there is no certainty yet about where the winners and losers will be, right, but expectations are already sky-high, and so a lot of room for disappointment in the particular place, expectations are there, already very high expectations for capex from AI that will support the economy, I think they could go more than this, because companies that are not the AI leaders, not the Mag Seven, can wake up one day and realize, kind of in what my colleague Cos Greg Jensen called a Barnes & Noble moment, they can realize, wait a minute, we're under existential threat, our whole business model is not going to work if we don't invest in AI and start doing capex themselves, but already the leaders are expected to do a ton of capex, their earnings are already expected to skyrocket relative to anyone else's as a result of it, and then economy-wide, we had very slow productivity growth coming out of the great financial crisis for more than 10 years, and that really held back what the economy could deliver, we did a great job on productivity coming out of the recession, because coming out of recessions is really a time where productivity can accelerate, but if you kind of say, what's the productivity that's already expected to get a reasonable runway for growth that's non-inflationary, especially at a time where President Trump and his team are going to clamp down immigration, so you're not going to get tons of growth from just labor force growing, the number we would come to is pretty good, certainly much higher than it was in the great financial crisis, so a lot's already baked in the cake, and then in terms of markets winners and losers, if you look back at the internet boom, and you think, where do you think we are in that story, I think it's hard to argue we're well past, I don't know, call it 1998, which is a lot of promise, but the internet is not yet kind of where it is today with us all having phones, a lot of the winners today in markets that would have made you all this money from this revolution, I mean, Meta didn't even exist yet, Google didn't even exist yet at the time, so very hard to believe that we know who the winners are and that you'll be able to pick them today, some of them may not even exist yet today.

Jim Haskell: Great, so that was very comprehensive, and I think we'll now turn to the direct Q&A. Now again, you hit on this because going back to the first question I asked you, but this is an extension of that question that's just come through, you said, look, we're not going back, right, and that the other thing you said was these forces have been in play for a very long time, so with that said, let me ask you the direct question, do you expect the new modern mercantilism regime to continue even when the current government is no longer in power, what would create a reversal?

Karen Karniol-Tambour: Look, if you look at Trump one and then see what happened when the Biden administration came in, there were things that changed, and there were things that didn't change, but a lot of the core modern mercantilist ideas that came in from Trump one stayed in place, they had some slightly different implementations, and so there are a lot of things that could shift here, right, I think that a different government could easily come in and say, we're going to reduce the chaos, we're going to create more predictability, they may not like specific policies, if you look at the map of policy laid out, they could choose that a bunch of them are not good policies to pursue, they could be more selective in how to do them, but I think the broad direction of where we're going, the concerns that are kind of leading to these policies, is likely to stay in place, and that'll be very difficult for a new government to meaningfully rebuild the trust quickly, and so if you have four years where trust is destroyed, it gets very difficult to build that up in a day, and so some of the pressures that will be in the system, for example, reduce reliance on the United States, it takes a lot for somebody to say, you know what, now I trust the United States, I no longer want to be self-sufficient away from the United States, so you probably would need years of shifting away not just of specific policies but of a direction to rebuild some of that trust.

Jim Haskell: Next question, again along these lines, but now we turn to the capital side of this, could capital outflows from the US be offset by Trump strong-arming foreign companies to build factories in the US to create jobs, how would that net out for the economy and for asset returns?

Karen Karniol-Tambour: What's being asked here is definitely at the heart of what we are trying to be predicting, and so we are looking at the potential flows and saying, let's size each one of them, and that's changing and evolving, the biggest thing that's occurred is that the degree of uncertainty that's been interjected is going to make it very hard to have particularly short-term large flows to build factories, so if you just take those two types of flows and you say, well, how quickly could you decide, wait a minute, maybe I don't want lots more US exposure, I'm okay with my 50%, I'm okay with my 70%, I'm just going to hold off here, you can decide that in a second, you don't need to worry about a lot, versus a decision to go build a factory in the United States, there could be real pressure to do that, and in some cases, it may even make sense economically to do that, but that's going to be a much slower decision, and one that in my view has been radically stalled by the degree of uncertainty, and so the more there's predictability, the more businesses can say, that's a slam dunk, it's actually a good idea to go build a factory in the United States, because I know what the policy regime is going to be, and why that's the right economic decision under a certain tariff regime, the more that's under play, you might as well just pause, and so I think the paralysis on that type of decision is just likely to make it much slower, and even in the best of times, true FDI takes time, and capital flows can move a lot faster.

[43:45]
Jim Haskell: When we walked into this room today to have this conversation and this call, gold had broken through $3,300 an ounce, it was up almost two and a half% in the morning, and this has just been a continuous kind of climb up, so you're explaining the vulnerability of the dollar, you're explaining the outflows that could occur, even if foreign entities don't sell, just if they don't add, right, and of course, if they sold, that would accelerate the movement, so it looks like, and I just want you to comment on this, it looks like gold is the alternative storehold of wealth, it looks like, maybe not being hyperbolic here, is gold the world's new reserve currency, what's going on?

Karen Karniol-Tambour: Well, look, we definitely could not get through this call, especially with you moderating it, not touching on gold, right, and I do think when you look at everything I said, it's hard to not walk away from that and say, maybe I should hold some gold, right, I mean, you look at all these vulnerabilities, and it's just a natural thing to go and want more of when very few people have it, very few people have a big exposure to gold, well, we know that the gold market is small, it's nowhere near the size of the dollar market, and so if you look, coming out of Russia's invasion of Ukraine, when actors like China, most importantly, concluded that their dollar and euro holdings, importantly, could be weaponized against them, they moved meaningfully into gold, you barely saw any sign of that in the dollar or the euro, but you saw a huge price effect of that in gold, so it's a much smaller market where a much smaller number of players can decide, I'd like some more gold, in order to get a big price move, their flows out of the dollar could be totally washed out, there's lots of things going on, huge market, but in gold, they meaningfully drove the price up, so it makes a lot of sense that today some subset of players are looking at the world and saying, I don't have a lot of gold, this seems like the natural place to go given the tensions that are happening here, I should have some, they don't even have to make that decision in a huge amount, because it's a smaller market, and I think for a buyer of gold, that makes gold especially attractive, because it means that it has these properties of being able to protect against inflation and be a real source of wealth, while also having some degree of, it doesn't take a huge amount of geopolitical upheaval to convince the marginal next player that they should have a little more gold, and that player's ability to move the market, so very attractive, and most people are just underallocated.

Jim Haskell: Okay, we're at the top of the hour, so we'll end it after this question, you describe the Fed as being constrained, if they're less likely to ease than perhaps other central banks are, because the central banks don't have those same conflicting pressures, could that support the dollar and offset other structural pressures that you've described in the call?

Karen Karniol-Tambour: Look, absolutely, and it's part of the calculus, so if you think about net pressure on a currency, it's always going to be a mix of different pressures, this is going to be a piece, and if that's what's occurred, that'll be a piece of the pressure on the dollar, it'll be one of many flows, you're still going to have some of the structural flows I described, and we don't have certainty that the Fed will actually act in line with this, right, you could get a Fed that gets political pressure to ease, that eases anyway, that is still more proactive, and so when you weigh all the elements of pressure on the dollar, the dollar is not equally unattractive against every currency, it looks most unattractive against the yen, also against the euro, against other currencies, it is more matched, and so you have to sort of match all the different pressures that are going in the dollar, and this will be a piece of it that could materialize.

Jim Haskell: Great, well, Karen Karniol-Tambour, thank you so much for your time, looking forward to the next time we can do this, thanks so much.