



Recently **Vallum Capital** hosted **Louis - Vincent Gave**, founding partner and CEO of **Gavekal Research**, for an insightful conversation on global developments.

HOST:

Manish Bhandari (manish.bhandari@vallum.in) is the Founder and CEO of Vallum Capital Advisors. He has more than two decades of experience in the Indian Capital Markets. Prior to founding Vallum Capital, he has worked as a VP & Portfolio Manager (Equities) with ING Management in India for six years and as a sell side research analyst for five years.

GUEST SPEAKER:

Louis - Vincent Gave, founding partner and CEO of **Gavekal Research**, a Macroeconomic research firm which is a well-known authority in the field of Investing & Macroeconomics. He has written seven books, the latest being *Avoiding the Punch; Investing in Uncertain Times* which reviews how to build a portfolio at a time of rising geo-strategic strife, and when very low-interest rates and stretched valuations. Louis is the non-executive chairman of Robo global LLC and sits on the visiting board of Trinity College of Duke University.

EXCERPT OF THE TRANSCRIPT OF THE DISCUSSION.

Manish Bhandari

Hi team members, I am very glad to welcome **Louis - Vincent Gave**. I follow Louis, regularly and have benefited from his advice on important turning points during global macro developments. I also had the good fortune of meeting Charles during my visit to Paris and gained insights from his decades of experience in the investing field.

Louis thanks for joining us today. Do you agree that India is set for economic expansion because of the sweeping changes made by the Indian government over the last few years?

Louis - Vincent Gave

I would say that there are a lot of exciting things happening in India. Let me draw your attention: each time you had a rising oil price and a rising U.S. dollar, India entered some kind of a balance of payment crisis or balance of payment tensions. The rupee would fall, the cost of capital would go up, the equity market would go down, capital spending would freeze, and India would do this cycle after cycle well. We've just had a big increase in the price of energy and of all commodities along with a big increase in the price of the U.S. dollar and **India has held up fine** and I think one of the main reason India has held up fine, of course we all know, is that something new is happening in the cycle and that is **India can now buy oil in its own currency from Iran and Russia**. This is a game-changer for India. The real constraints to India's growth have never been people, you have a lot of educated people, you have a growing middle class, a growing number of university students, the constraints have always been around energy. So to the extent that this constraint is now being dealt with, thanks in part to, geopolitical changes which have benefitted India. So that's on the economic side. Suddenly, the sort of regular shock that you used to get every seven to 10 years dissipates. When it comes to markets, I think for the next probably 6 to 9 months a big hurdle for India is going to be the China re-opening. It's all going to be about China for the next 6 to 9 months. Let's admit, India for the past few years has benefited massively from being sort of the only game in emerging markets, right, because you can't invest in Russia, you can't invest in China due to zero covid, political problems in Latin America, India was a sort of source of stability and was a good

story for every emerging market and APAC. They all love Indian equities because that was a good place to hide and the fact that now suddenly people need to invest in China, that means that money will be coming out of India and going to China. So for the next 6 to 9 months that's a big hurdle for the Indian equity market per se, that doesn't mean the correlation between equities and economic growth is loose. At best, while equities might struggle for the next 6 to 9 months, the Indian economy is likely to be fine.

The reality is we've started in emerging bull markets led mostly by China's rebound. You're going to see a lot of new capital allocated to emerging markets. Growth on the equity side on the bond side, India will get its share. Now within emerging markets, I think you'll do less well than China for the next 6 to 9 months. Going back to your point on a 10-year view, the story on India is a good one. The government is doing broadly a lot. Part of the story in India is there's still a lot of low-hanging fruits, right, if we put in the infrastructure, if we get constant electricity, if we build the road, if we build the airport. Just like it happened in China, you get inherent productivity gains, right. It's just going to be at a slower pace than China because no one can do it at the same pace as China. It's like comparing yourself to Usain Bolt running. Of course, nobody's going to be assessed as Usain Bolt, but you shouldn't hold yourself up to that standard.

Manish Bhandari

China has stolen a lot of limelight in the last two decades due to its stellar economic growth. Last year we have witnessed the property bubble burst and the ghost towns. We have witnessed government-led stimulus in the Year 2008 and 2014-15. What is the big picture which will drive China over the next two years and how that is going to be different from the last two cycles?

Louis- Vincent Gave

So, the first one I make in China is that we now have the Chinese economy reopening, right, and this is a movie we've seen time and time again. It's like a James Bond movie, always with the same script but a different location. So now if the location is China, you're going to see the pent-up demand, you're going to see the tide in labor markets as everybody tries to hire workers back. So that's the first point. So, growth for the next few quarters is going to be strong. I think it's going to be particularly strong because, let's face

it, the Chinese government have messed up badly in the past two years. With COVID lockdowns they've managed to piss off everybody in China. If you were a COVID skeptic, if you thought this is just the flu you should just get on with it, you're really angry that you lost your life in the lock down and if you're like inclined to be very worried about COVID, then you're likely you think, oh well, the government didn't vaccinate people, it didn't buy enough Paxil, it didn't plan for enough hospital beds, it opened too quickly etc... So, it's managed to piss off both sides of the arc on this COVID issue and I highlight this because this means that the government now needs a win. **It has pissed off everybody and it needs to change the topic of conversation away from it. The discussion on Weibo or on WeChat to be about something else than covid.** The simplest thing to do now is to get a boom going again and so that's why they have removed the three red lines on property (*1. Their liabilities shouldn't be more than 70% of assets, 2. Net debt shouldn't exceed equity. 3. Cash must be at least equal to short-term borrowings.*) and recapped the local authorities and basically told them to do infrastructure spending. The Chinese government is back to pressing every button and pulling every lever to get growth going again and so that's going to be the main story for the next 9 to 12 months. Investors are completely under-estimating the extent of the Chinese rebound for the very reason you highlight it and are still in the frame of mind of old Chinese real estate bubble and banking sectors troubles. Having said this, I don't think we're going to see a massive new real estate cycle in China for the next 9 to 12 months. What you're going to see is all the mothball projects being restarted, which is why copper, Nickel, zinc, and iron ore prices are going up. You have all the demands for the metals and various commodities, so you get the rebound there. The property developers have managed to survive and have spent the past three or four years thinking they were going to go bust and in that respect they're a little bit like shale producers in the US and you remember like all the oil producers in the US spent most of 2016/17/18/19 thinking I'm going to go bust. So, by the time they got access to capital again they didn't dig any new wells, they just returned capital to bondholders and returned capital to the shareholders. I think of the Chinese property developers and if it's not the property developers themselves that are going to be shot, it's going to be the investors themselves, I mean the purchasers of real estate, because the way real estate is funded in China is foremost through customer deposits, right. If you're a property developer, I will come to you. I want an apartment. I put 20% or 30% down and you promise me that in three years I'll have an apartment. Now, I've spent the past

three or four years petrified that you were going to go bust and destroy my life savings in the process. Fortunately, now you're surviving and you're going to complete the apartment but I as a real estate purchaser have gone through such trauma, for the past two or three years, that I'm unlikely to do it again, at least for a while. So, I think for all these reasons right now, the Chinese Government is, really trying to get things going again. We'll get a few quarters of very strong growth **but that's not going to kick off a new super cycle.**

Manish Bhandari

So, Louis, whatever you have mentioned now, how will it affect Yuan?

Louis- Vincent Gave

I think you're going to see massive appreciation of yuan. Here's my big quandary; I want to take you back to the early 2000s when the US current account deficit exploded. It went from roughly USD 25 billion a quarter to USD 200 billion a quarter at its peak. Now, the US current account deficit is USD 100 billion a quarter. It means that the U.S. consumer pushes a lot of money abroad. Since the start of COVID, the US current account deficit has moved from roughly a USD 100 billion a quarter to USD 280 billion. Never it's been this big, never has the US consumer pushed that many dollars abroad to the rest of the world. **Amazingly, while the US current account deficit absolutely surged, reserves held at the Fed for foreign central banks shrank and we've lived in a world where, clearly, we didn't have enough dollars, right,** as the price of USD was always shooting up. How can you have the US pushing almost US 300 billion dollars a quarter to the rest of the world and the rest of the world saying, hey, that's not enough dollar for us. We need more dollars. This does not make sense, right. If the US is pushing ever more dollars abroad why then they disappear into some kind of a black hole. Now when something doesn't make sense in the system my gut reaction is that maybe somebody in China is cheating. Let me explain - When you look at the massive deterioration in US current account deficit, officially, it didn't take place against China. If you look at the current account, Chinese current account surplus with the US is USD 100 billion in the quarter but that during COVID Chinese trade with the US was higher. Exports moved from roughly USD 35 billion to USD 50 billion a month because, all through covid, China was the only part of the world that was still producing. All the electronics, masks, medicine, everything. I highlight this

because my contention is simple. ***My contention is that most Chinese entrepreneurs when they sell stuff abroad, maintain two sets of books. There's the money they bring home and there's the money they keep in offshore accounts in the BI in Hong Kong and Macau, Cayman, you name it. This is the money that rich Chinese people use to buy houses in Vancouver buy LVMH handbags. This matters because Foreign Currencies held in Hong Kong banks have never reached this high.*** They have been this high through COVID and basically increased by 1.5 trillion Hong Kong dollars, roughly USD 200 billion dollars, which is enormous. It's enormous, especially when one considers that over the same period Hong Kong lost 260,000 people and the people that left Hong Kong were mostly rich people, expats, lawyers, doctors who were either worried about the political situation or simply tired of the COVID. With that you would have expected bank deposits to collapse, instead they're at record highs. Highlighting the fact that today, in Hong Kong, **I can get a mortgage at roughly 3%, which is less than the 12-month US T-bills rate. I mean, this has never happened in Hong Kong's history.** Hong Kong is a peg with the dollar, so this illustrates the amount of excess cash that the Hong Kong banks have today. So, my contention is simple: the reality is that your typical Chinese entrepreneur for the past three years has done nothing but go to work and go home. Now, with zero covid restriction, the liquidity dam of all this money that was sort of stuck because Chinese citizens were in lockdown, is now being unleashed onto the global markets. Hence, the US dollar has been going down and most asset prices have been going up with all that money starting to get recycled again **is very bearish for USD. So now, I'm quite bullish on Yuan on the back of this.**

Manish Bhandari

You spoke about the money which is going to float from Chinese people to the global markets. Does the rebound of European markets from October onwards, is also a reflection of a China trade?

Louis- Vincent Gave

Absolutely, especially when you look at what's rebounding in Europe, right. It's all the luxury goods, the tourism, the autos and also the banks. I think the main story for the next couple of quarters is China is going to have double digit number. I mean everybody who's reopened has done it at double digit nominal GDP. Why would China be any different. So

China's going to get double digit nominal GDP growth and then who benefits from that? Obviously, China, and so you buy the Chinese Markets, but a lot of people don't want to buy the Chinese markets for political reasons, for ESG reasons or because they sold them three months ago when they were running around saying China is un-investable, so it's hard to come back around and buy them back now that they're 40% higher and so you look around the world you think **who benefits from China's reopening. So, the obvious one is the rest of Asia, it's Korea, Japan** but the **rest of Europe** is well plugged in to Chinese growth, right. I think that's a big part behind the European rebound and the 2nd part behind the European rebound is that six months ago most people feared that Europe was going to face a massive energy crisis. Now, Europe got lucky because they got good weather. They've had winter in Europe that was unseasonably warm and that was 15 degrees Celsius on Christmas Day in Berlin, it's never been 15 Celsius on Christmas Day.

Manish Bhandari

Sure, one additional question, on decline of U.S. dollar and rise of the yuan as an alternative currency? Would you subscribe to the DXY going to reset at 85 or around in this cycle, faster than anticipated?

Louis- Vincent Gave

I do. I very much do. Backdrop to this is that the US wanted to punish Russia for invading Ukraine, but I think the US forgot how important Russia was. Russia is the world's largest exporter of commodities and the main reason most countries whether **India, China save U.S. dollars is to buy commodities**. So, when the US took the decision to cut Russia off the USD, they made them the single biggest commodity exporter and non-US dollar country. China and or India, are looking at this, mulling, in disbelief that the US is doing this. Napoleon used to say that when your enemy makes a mistake, you don't interrupt them. **China, and India see the US make this massive mistake of putting Russia off the USD system**, I'm not going to interrupt the US here, I'm going to let them go ahead and make this mistake and benefit from it. Look, in the world in which you can now buy commodities in your own currency and provided you're a big enough country like India, China, Brazil, Thailand, and Indonesia, it really reduces the need to sit in US dollars. **I mean, why do people save in US Dollar? To settle trade, mostly commodity trade and to settle and to buy weapons from the US because the US has the best weapons.**

Here again, I think that the Ukraine war is showing us that warfare has changed significantly. It's no longer about having hundreds and millions of high value systems or jets that cost \$100 million as much as it is about having thousands of drones that cost 10s of thousands of dollars, right. I mean, this is the main lesson of this war - Drones can take down the Makarov that was the biggest ship in Russia. You're better off having 1,000 drones and sending them on a target even if only 20% come back, doesn't matter. You haven't lost human lives. So, warfare has changed and we're now finding out that the marginal weapons providers like Turkey, Iran and Taiwan are redefining the game. They're the guys who produce the cheaper arms. That's a dramatic shift. So, the main **reasons to earn to save U.S. dollars are disappearing in front of our eyes.**

Manish Bhandari

Yeah, we learned the lesson about the changing nature of war during Armenia and Azerbaijan conflict few years back. I have another thing in mind which you have spoken about in your writings about the rising price of energy. However, the green hydrogen is going to swamp the world, talked about in China, India, and Europe. Isn't this contradictory with each other?

Louis- Vincent Gave

Yeah, I think it's all a question of timing. Hydrogen looks very exciting. Japan has also been at the forefront of a lot of hydrogen research but betting on a shortage of energy for the long term never works because of human ingenuity. We come up with new things at each critical juncture. In the 1970s, we came up with nuclear power. I mean, we knew nuclear already, but we really deployed it on large scale. France moved from practically nothing to within a decade, 75% nuclear as percentage of total electricity generated. So, while France was making all these nuclear investments in the 1970s, which were then allowed of course, was a contributor to oil rolling over in the 1980s, we still had two big energy crises in the period and so my fear is that over the very near term, and here I mean **the next 18 months, we have a very tight energy situation.** We have a tight energy situation because the US strategic petroleum reserves are, for all intents and purposes, empty. The war in Ukraine is still going on and with that are the sanctions on Russia. So, Russia's ability to continue producing as much as it has, I think, will come under stress on the other side of this winter and then we have China reopening and China reopening is

going to be an increase in demand of 1,500,000-2,000,000 barrels per day and it's not obvious to me where that increase comes from in the world. As of now, we're seeing the price of metals just absolutely shoot up. I think that a similar scenario on energy could easily be achievable and so that's why one of my big beliefs for the past few years has been: If we get a global recession, **if the system breaks, it's more likely to be because of high energy prices. So, I've argued incessantly that energy is the ultimate edge.** You need exposure to energy because that's the weakness in the system today because of **under investment in the energy space.** Now, granted, if you want to go past 2-3-4 years, then you can get excited every morning when, you hear you can get nuclear, you can get excited about hydrogen. There are things unfolding we're not like just saying. So, for example, if you're in India today the Indian markets held up well, the Indian Rupees held up well, the Indian bond markets held up well, but does it still do that if oil goes \$200/barrel? So that's why I think owning energy names if only as a hedge against that scenario. That makes a lot of sense.

Manish Bhandari

I want to know your observation on climate change. We have witnessed mild winter in Europe than anticipated. Keeping this in mind, is there a pattern in the climate change - floods, hurricanes, and trillions of dollars of calamity claims/losses, which has been taken by the various providers, insurers, banks, and the human life casualty. **A milder winters and harsher summers,** and this is a pattern one could play on.

Louis- Vincent Gave

Look, I'm not a specialist on this. Now I think when it comes to the big, to the floods and the casualties, unfortunately, and the destruction of properties, some of that is linked to the fact that where the **global population is growing, we build properties in parts, places that before we didn't build.** Today everybody wants to have a waterfront house because it's nice, but in the past, there was a reason you didn't have a waterfront house is that when the hurricane came you didn't have a house anymore. I think that is somewhat part of the issue. When it comes to climate change, historically, the climate always changes, right. If we go in history there are cycles and some of it is linked to human activity, some of it is linked to sun flares. In the 1800s and sorry the 1700s that, the Seine, the main Paris River tended to always freeze and then in the 1800s it never froze and in

1900s it froze again. It was, maybe it is, climate change. Maybe it's a new trend. Maybe the trend will change tomorrow. Predicting or investing based on what you think the weather will do next year, that's called farming – a terrible business.

Manish Bhandari

I appreciate. My discussion can never be complete without picking up your brains about one of my favorite countries; Japan. It has given Yield control shock; we are not able to decipher this shock. With our limited understanding, it's difficult for us to really fathom the whole impact of Japan yield curve control.

Louis- Vincent Gave

In Japan, the Central bank is trying to sort of clean up another mess but sort of clean up the structure before handing it over. I think there's an acknowledgement by the BOJ that we've now moved to inflationary environment and that maintaining yield curve controls at extremely low levels, 0% interest rates throughout the curve just doesn't work. I think there the Central Bank is trying to sort of sweep things and get it cleaned a little bit before handing over to the new landlord. I think there's a real risk there. I mean, we've already seen it, I've seen it again big time. We've seen big shifts in the Japanese yield but that's probably only just starting. The reality is **now I don't think short term yields go up that much in Japan but at the long-term curve the capacity of the Japanese government to sort of allow for a steepening of the yield curve is high if you look at the term structure of the Japanese debt, a lot of it is long dated.** So, the government, as long as the short end of the yield curve stays really low, they can roll over whatever debt comes due at the short end. It doesn't need to create a funding crisis but at the long end you let bills go and all of sudden banks are in a good position and make decent money through the yield curve. I mean, that's what's unfolding and the only reason that they're doing it too violently is because they don't want the yen to shoot up too brutally and basically crush all the big Japanese exporters. So, they're giving the Japanese exporters sort of leeway and time to hedge their books. For the rest of the world, the impact is that Japanese private savers start putting trading cap and that's a big deal. It's a big deal because Japanese private capital is heavy in the Brazilian bond market, the Indonesian, the European, so as they bring money home, who's going to be on the other side as they

sell Italian bonds or French bonds. It's not obvious to me who's going to be on the other side.

Manish Bhandari

FAANGs are subject of our obsession. Assuming there is a recession in the US. Market is betting that there will be a cut in the interest rates. So do you see a situation where the rebounds in the FAANG can happen over a period and lot of us could get would be caught unaware. What would be your view in case that we are not caught off guarded?

Louis- Vincent Gave

If you're playing recession bingo, you got all the signs for the US recession, right. You've got the inverted yield curve, falling eyes, falling leading indicators and now let's say this openly but we have the second largest economy (China) in the world that's about to rebound like crazy. In my career, every time the Chinese economy has rebounded strongly, take 2008 as an example or 2014/2015 or even 2002/2003, the message was obvious by watching **Li Keqiang Index**. This index is basically a 1/3rd rail cargo, 1/3rd electricity consumption and 1/3rd bank loans. **This turns out to be a pretty good index to follow the Chinese Economy**. As this Index goes through the roof, when you see that over the next six months, are you really going to see a global recession? Are you really going to see a US recession? **To me that seems unlikely**. The fact that its re-bounce has a big impact, but to answer your question, most of the people sitting around and I've had this question so many times - when does the Fed cut rates so I can buy Facebook. Again, to me, this makes as much sense as sitting around in Tokyo in 1992, saying when does the BoJ cut rates so that I can buy industrial Bank of Japan or Fuji. This ship has sailed the bubble of the past 10 years. **The myth that software eats the world bubble and you got to be in US tech etc. That has now imploded. And I, tend to think that China's reopening is going to be quite inflationary for the world. So, I don't think the Fed rushes to cut rates anyway** but even if I'm wrong on that and the Fed rushes to cut rates, it doesn't mean I am in a rush to buy things. I know that in Japan through the 1990s you had two 50% bull markets, but you need to be pretty good to trade those and the reality is bear markets are there for a reason. **It is to transition from one group of stocks to the next**, but the question is **what comes next and for me the new bull market is already unfolding, it's unfolding in Emerging Markets**. The fact is that in the end,

Indonesia, Brazil, Mexico, Colombia, Chile, all these markets massively outperformed last year amidst a massive Chinese lockdown. We saw a strong U.S. dollar, weak global equity markets. So how often in your career have you seen emerging markets massively outperform amidst the bear markets. To me that's a strong signal, they outperformed on the equity side and also outperformed on the bond side. Lastly, Chinese Internet stocks like Alibaba, Tencent, etc... used to be correlated to US tech stocks and then they stopped being correlated. Firstly, because Chinese stocks collapsed while US stocks still went up and then U.S. Stocks collapsed, and now Chinese stocks are rebounding. So, you could have a similar situation in India, that it's not an iron rule that they need to be correlated.

Manish Bhandari

You were involved in, the robo advisory and ETF based robo advisories. I am inquisitive to know that what is it all about and how you are trading the world through the robo advisory. And if something we could learn about it.

Louis- Vincent Gave

I've always been fascinated by robotics and back in 2011 or 2012 I wrote a book called Too Different for Comforts and mostly about how the rise in robotics is going to change our world, etc... and on the back of that a friend of mine said that we should create a robotics team and build an ETF around these ideas and so we did that. I'm one of the largest shareholders and a global advisor. That grew to about three billion dollars it was a commercial success and during Tik Tok Boom, Robotics went along with it. So, we had some wonderful years of mess of up performance, and it has struggled in the past. In the past couple of years, performance has been coming back partly because in a world in which labor is clearly a shortage in a lot of countries robotics is an obvious solution. As I look at robotic stocks, a lot of the big ones are in Japan, some are in Germany, in Sweden, Switzerland, the earnings of these companies had massively beaten expectations and they upgraded their outlook. **I'm quite confident that the macro backdrop is becoming very favorable to robotic songs.**

Manish Bhandari

What are the top 3 themes you will be in for next half a decade? I'm not interested in what happens in next quarter, but maybe around two to five years. Structural themes which

would, which are based on the underpinning of the structural changes happening in the global economy.

Louis- Vincent Gave

I'm sorry, I might give you more than three. Just maybe four or five. **The first one is a structural weakness in the US dollar.** I think we've seen a top in the US dollar and from here on out the US dollar being lower so that'd be my number one. My second one is that **inflation is here to stay.** We've moved into an inflationary environment and in an inflationary environment, diversifying your equity risk becomes more complicated. It's not just a question of buying bonds anymore. So that'd be my second theme for the next five years. Another theme for the next three years is that we remain **energy-constrained and that basically whoever has access to cheap energy wins** and today the ones who have access to cheap energy are basically anybody who's **willing to trade with Russia and anybody who's willing to burn coal**, and that happens to be the most emerging markets. Most emerging markets are happy to burn coal, and most of them are happy to trade with Russia. So that'd be third important theme for me, which leads me to my fourth one which is going to be the theme for the next decade. **That is emerging markets outperformance**, and this outperformance of emerging markets is its new bull markets. The new Bull Markets will be centered around emerging markets and they'll be consumption, capital spending in emerging markets. Within developed markets, themes like **robotics in Japan or luxury goods in Europe** will do well.

Manish Bhandari

Thanks, Louis, for an insightful journey in global macro-economic environment. Looking forward to meeting you in Mumbai. Kindly convey my regards to Charles.

Louis- Vincent Gave

Thank you much.

Disclaimer: All copyrights to this material vests with Vallum Capital Advisors Pvt. Ltd. No part of this material either in part or shall be copied, reprinted, reproduced, sold, distributed, or transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise, or stored in any retrieval system of any nature without the permission of Vallum Capital Advisors Pvt. Ltd. and any such violation would entail initiation of suitable legal proceedings.

Vallum Capital Advisors Private Limited is a SEBI Registered Portfolio Manager (Regd. No. INP000007650) based out of Mumbai, advising Institutional, Family Offices and HNIs on Equities and Asset Allocations.