The Case for Greenflation

"In the twenty first century, when it comes to major central banks tightening policy by raising interest rates, it is never a foregone conclusion. Whenever there is a hint of doubt, always favor the dovish option."
– Jones Trading's Chief Market Strategist and author of *The Closing Print*, Mike O'Rourke

---

Introduction

In this week's *EVA,* we are running a special podcast edition of David Hay's recent interview on MacroVoices with hedge fund manager, Erik Townsend. The conversation shines the spotlight on a phrase coined by Dave, "Greenflation", but also touches on stocks, precious metals, and more. For time-pressed *EVA* recipients, below is a summary of Dave's key comments, basically an abbreviated transcript. (Note: some of the following text has been revised by him for clarity and he also has expanded on several of his key themes.)

The Case for Greenflation by David Hay

- In my view, Greenflation is hugely important and plays a significant role in the debate about whether inflation is transitory or it's much more enduring. Frankly, based on the Fed's (not so great) forecasting record, and the fact they're saying inflation is transitory, it's probably not.

- Greenflation is based on the reality that policies in the West have evolved to the point that we are in a great green energy transition. It's the first time in human history we're moving from more efficient fuel sources to less efficient fuel sources. And, we're trying to accomplish this daunting task on an, arguably, overly ambitious timeframe.

- Many energy companies are offering great free cash flow yields, and I contend it's a very good space to be invested in for years to come. The futures on oil also look very attractive based on the extremely tight supply of the commodity. Due to ESG, along with Wall Street pressures not to explore for oil and gas, the usual increased supply response (like new drilling) to higher prices isn't happening.

- When it comes to the broader stock market, we've found that multi-year breakouts (or range expansion) to be an extremely valuable technical indicator. You can currently see this breakout occurring in the Japanese stock market, which recently made a 28-year high. This methodology also can be applied to things like inflation and the labor market. It's almost like fractals in geometry and nature—a pattern that repeats across many aspects of life.

- I believe the Fed is not doing QE like many think – we are in a full-blown MMT (Modern Monetary Theory) environment. Not only has the US government spent $1.2 billion ($14 trillion total) every hour since Covid-19 started, creating a $6 trillion cumulative deficit over that period, the Fed has been buying most of the debt, directly and indirectly, with its Magical Money Machine. This is full-blown debt monetization and is classic MMT. The Federal Reserve appears to have printed itself into a very tight corner.

- When you look historically at the relationship between stocks and inflation, most stocks struggle when you go from low inflation to rising inflation – even though we haven't seen that yet this year in the S&P 500. If you use the 1970's as a template, the stock market did very poorly in a similar environment but hard asset-based stocks (or scarce assets) did very well.

- During the next serious market sell-off, I believe the Fed is going to print money to buy stocks just like they rescued the bond market by announcing in March of 2020 that it was buying corporate bonds with money it fabricated. This instantly turned the bear market back then into a raging bull; it also fulfilled one of my wildest predictions from as far back as 2017. The reality is the Fed only needed to buy a relatively small amount of corporate bonds. The same is likely to be true with stocks.

- Bonds are clearly no longer performing their role as a risk-mitigator – they are actually becoming a risk-elevator. I believe the traditional 60/40 equity-to-bond portfolio model, that was a champion for decades, is obsolete. Inflation means that typically most stocks and nearly all bonds go down together, as they did in the 1970s.

- It appears to me the most way to effectively trade bitcoin is via chart-based technical analysis and buying into extreme selling panics. I believe there is a major shakeout on the horizon with the majority of cryptocurrencies – it's the classic speculative asset class. When the mania ends, as they always do, this area is likely to get nuked. At that point, Bitcoin will be an interesting opportunity.

- Though it may be a jagged ride up, I do think gold is probably headed much higher. In particular, gold mining stocks provide a very solid bang for your buck, plus you get the dividend kicker. Almost every foreign central bank has been aggressive accumulators of gold, and I think they're on the right track.

- The big question for me over the next 12-24 months is whether the global economy is in an inflationary boom or an inflationary bust. I believe we are in an environment similar to post-WWII when the private sector of the economy was shut down during the war effort and came out of it with lots of savings. This led to an economic boom during the late 1940s into the 1950's but it also came with a pretty heavy dose of inflation. Bondholders were clobbered during that timeframe on an after-inflation basis and that largely continued until the early 1980s.

- There is quite a fallacy around the inflation is transitory narrative. We're seeing that wages are very sticky and the cost of rents has been relatively low. Companies like Amazon and Whole Food are also hiring tens of thousands of people, which indicates upward pressure on wages. Strikes with generous comp settlements are spreading. I think the Fed is going to look back and lament that they characterized this as a time of transitory inflation. Rents are beginning to soar and energy has obviously done so already (and is likely to continue marching jaggedly higher). These trends are likely to persist into 2022, if not beyond.

Image not found or type unknown

David Hay
Co-Chief Investment Officer
To contact Dave, email:
dhay@evergreengavekal.com