

Demetri Kofinas: 00:00 What's up, everybody? My name is Demetri Kofinas, and you're listening to Hidden Forces, a podcast that inspires investors, entrepreneurs, and everyday citizens to challenge consensus narratives and learn how to think critically about the systems of power shaping our world.

00:19 My guest on this episode of Hidden Forces is Lawrence McDonald, the founder of The Bear Traps Report, and the author of a recently published book about the risks and investment opportunities present in today's radically reshaped economy titled, *How to Listen When Markets Speak*.

00:35 In today's conversation, Larry and I discuss how social media and the gamification of investing have amplified behavioral biases and added fuel to the AI boom, crypto, and other tertiary corners of the market. We then zoom out to examine how the macro environment itself has changed since the COVID-19 pandemic and how the government's response to both the GFC and the COVID crisis have sent investors scrambling for new frameworks to help them understand the role played by government in the economy, and how to position themselves and their client's portfolios for a radically different world than the one that we learned about in our financial textbooks and macroeconomics courses. We also explore the dark side of passive investing, the extreme concentration in a handful of AI-linked mega caps, the risk to markets of more capricious government trade policies, and why Larry believes that one of the most underappreciated opportunities sets in AI lies not at the intersection of semiconductors and the AI companies themselves, but in the physical energy and delivery infrastructure needed to power them.

01:39 If you want access to our premium feed, which provides you with subscriber-only content, as well as transcripts and intelligence reports for conversations like this one, go to hiddenforces.io/subscribe, where you can also learn how to join in on the conversation by becoming a member of the Hidden Forces Genius community. Genius members have access to bi-monthly Q&A calls with guests, discounted access to third-party research and analysis, and in-person events like our intimate dinners and weekend retreats. And if you still have questions, feel free to send an email to info@hiddenforces.io, and I, or someone from our team, will get right back to you.

02:18 Lastly, because this conversation deals with investing, nothing we say on this podcast can or should be viewed as financial advice. All opinions expressed by me and my guests are solely our own opinions and should not be relied upon as the basis for financial decisions.

02:35 And with that, please enjoy this timely and valuable conversation with my guest, Lawrence McDonald.

02:45 Larry McDonald, welcome to Hidden Forces.

Lawrence McDonald: 02:49 It's great to be with you guys. I've heard a lot about the platform. Congratulations.

Demetri Kofinas: 02:54 Thanks, Larry. That makes us sound like we're a bigger deal than we are, calling us a platform. I like that. I'm going to start referring to this as a platform instead of a program. So, you've been on my radar for a very long time, but it was one

of our genius members who was at a recent private gathering of yours down in Panama who suggested to me that I reach out and have you on the show, and I've heard great things about your network and the types of people that you have access to interact with.

03:17 So, I'm very excited to speak with you today. Why don't we start with your background? How did you get started in finance, and how long have you been working on the research side of the business?

Lawrence McDonald: 03:28 Well, I started off on the retail side of the business in the '90s, and we were fortunate enough we created a website in the '90s. I wanted to diversify away from the retail financial advisor setting. And so, we created Convertbond.com, we sold it to Morgan Stanley in October of '99, probably the best trade of my life, because if we didn't sell the website at that point, we probably would never have sold it because it was right before the crash.

03:59 And then, I went to Lehman Brothers, and I was on the deck of a Titanic as we're heading toward that iceberg. And this was the largest bankruptcy in the history of financial markets. It was like a really almost a \$790 billion failure, and I was fortunate enough to write the inside story about the collapse of Lehman Brothers. It became a New York Times bestseller. It's now published in 12 languages, and we've done about 140 speeches in 16 countries talking about the crisis. We built up this incredible network of mentors.

04:39 So, we run a Bloomberg chat behind me with hedge funds, mutual funds, pension funds, the most sophisticated investors in the world, and we democratize that information in our new book, How to Listen When Markets Speak.

Demetri Kofinas: 04:55 This wasn't a question that I had, so I've got lots of questions here. I don't know how familiar you are with the show, Larry, but I'm pretty well-prepared. But oftentimes, I come up with questions in the middle of an interview, and here's one that I wasn't initially prepared to ask, but just hearing you answer this, so you sold your first research business in the late '90s. You were at Lehman. You've amassed this very large and influential network of people that you advise and work with, and you've been publishing letters and books for decades.

05:22 How do you avoid not getting caught up in your own bubble or your own echo chamber, where you're so focused on putting out research notes and thought pieces that you neglect to really sit back and reflect on what's going on in the world and in markets that you may not have readily available answers to?

Lawrence McDonald: 05:40 Well, I mean, to me, when I was in the '90s, I was a financial advisor, it really disgusted me how uneven the playing field is. In other words, I would see research and I'd find out years later that the institutional investors would get the research first and the financial advisors would get picked over research, and it really infuriated me.

06:04 So, I've just had this mission to democratize information. I want to even that playing field between the average investor, the family office, the wealth manager, and the high, high institutional investor. And I think that the internet, Twitter has accelerated this to my benefit, and it's just been a lifelong mission

because as a financial advisor in the '90s, every day I was at work, and you would just realize that you were getting second - third hand information in terms of research.

- Demetri Kofinas:** 06:39 Do you feel like people's financial acumen has improved or worsened in the course of your career?
- Lawrence McDonald:** 06:44 Oh, it's dramatically improved. Yeah, it's dramatically improved. But one of the problems I see, one of the things that I think is an opportunity for people listening to us right now, is because of the democratizing of information, the rate of change, speed of transfer of information, the capitulation on sell-offs is much more spectacular, and it creates opportunities.
- 07:08 In the old days, like in the '90s or even 2000s, a stock would sell off over time, but today, everyone's getting the stop loss at the same moment. Everyone on Twitter is basically doing the same thing, whereas they're buying breakouts. And when that channel changes, everyone's puking out. That's why if you look at this year, Chipotle, Lululemon, the Target, the tax loss opportunities this year are so spectacular because everyone has puked out a lot of these really fantastic companies that are 50, 60, 70% off.
- Demetri Kofinas:** 07:48 Does that suggest that social media and the hijacking of people's limbic systems who spend too much time on the internet have amplified some of the more deleterious behavioral biases of investors, and that this has actually increased the challenges associated with portfolio management today, and therefore, also created opportunities for those investors who are better able to govern their passions, so to speak?
- Lawrence McDonald:** 08:12 A 100%. Just look at Robinhood, look at the way what they've done with Bitcoin and crypto is just so sick. These eight cryptocurrencies outside of Bitcoin that have lost investors \$210 billion from the highs, \$210 billion, the Solanas of the world. We can go through the coins, but we wrote about this this weekend and the little guy, because of technology information transfer, because a lot of these websites, these broker-dealers allow you to buy crypto on leverage, and the inexperienced investor gets flushed out.
- 08:54 And I'm telling right now, and I know this firsthand from investors, that in our network, a lot of times, the stop losses are pretty well known within the financial ecosystem. And as we've seen in Bitcoin, and not just Bitcoin, but more so the tertiary coins in recent months, especially the last 30 days, you're talking about people getting flushed out, stopped out because what sellers will do, they'll create a capitulation, they'll sell into that. They want to knock out those stops. They want to force that capitulation and buy on the cheap.
- 09:27 And the Michael Sailors of the world and these clowns on the internet that talk about long-term track records for Bitcoin or any kind of crypto, it's complete garbage because when asset classes drop 50 to 90%, four or five times in a decade, long-term track records are absolute garbage meaningless. They mean nothing because the little guy is getting stomped out, knocked out, and selling in the hole.

09:59 That's why you see spectacular volume with crypto on the hole and nobody's calling these guys out. Bitcoin's long-term track record means nothing because people have been getting stopped down on Bitcoin and shitcoins for much of the last five to seven years.

Demetri Kofinas: 10:14 So, in other words, the bottom of the pyramid, which has less liquidity, which is most people, can't sustain those drawdowns, so they also amplify the wealth discrepancies and disparities in society.

Lawrence McDonald: 10:25 A 100%, 100%, because you know what? The sales pitch is, "Oh, I'm going to buy and hold Bitcoin, I don't need it," or "I'm going to buy and hold crypto," and that's what people do. Young people psychologically condition themselves into a lie, because what happens is when you say that, all of a sudden, you have an asset that goes down 80%, 70%, it stays there for a year and a half, two years, the testosterone's flowing through a young person's body, especially men, and you want to buy the house.

10:57 There's a line in our book, JP Morgan 1907, he said, "There's nothing in this world which will sell violently, distort a man's judgment more than the sight of his neighbor getting rich. In other words, you're in crypto for the long haul, it drops 70%, stays there for a year and a half, two years, you see someone making money on Tesla, or you want to buy that house, or you want to buy that car, and guess what? You sell, and that's what happens, and that's the reality of crypto. It's reality of Bitcoin.

Demetri Kofinas: 11:31 Yeah, I mean, I think even though we've made a lot of progress in sort of democratizing knowledge about behavioral science in the last two decades, I still think it's the most under-appreciated part of investing.

Lawrence McDonald: 11:42 I agree.

Demetri Kofinas: 11:43 So, let's pivot to some of your recent notes. In your most recent one, your Washington pressure point note... By the way, how many notes do you publish a week or a month? What different categories? What are the different names? How many of those do you have?

Lawrence McDonald: 11:55 Sure. We recap the institutional chat. So, remember that's the conversation between hedge funds, mutual funds, and pension funds. We recap that overnight, Monday through Friday, and then we recap it once a week with the turning point. Maybe someone doesn't need the information every day.

12:13 The Washington pressure points came out within the last year, and it has to do with the point in our book around the financing of the debt low, that \$37 trillion debt hole, 38 trillion, and how much has to be financed. And those bond sales and what we call bond vigilantes that have appeared several times in the last year, we're trying to make sure retail investors don't get body slammed by the bond market.

Demetri Kofinas: 12:41 Would you also agree that understanding government and the relationship between government and the private sector is more important today than it's been at any other point in your career?

Lawrence McDonald: 12:50 Oh my God, yeah, because I mean, essentially interest on the debt is one to 1 to 1.1 trillion, and interest rates have gone up into a massive... There's a scene in the book, 40% of all dollars ever created or done so between 2020 and '21 with Trump and to Biden. So, 40 to 41% of all dollars ever created in the history of the United States were created in that little period.

13:21 And so, that's created, there's a really good line too, this is a better line to help you understand, the fiscal and monetary response to Lehman Brothers, which was the greatest financial crisis of all time, was \$4 trillion. The fiscal and monetary response to COVID, the regional bank crisis of 2023, and then juicing the fiscal spending into the election of '24, that was 16 trillion. And so, that's why, like you said, that public policy in markets is much more intertwined today.

Demetri Kofinas: 13:57 So, this is somewhat of a meta question, Larry, because you wrote in one of your most recent notes that your clients have been requesting a comprehensive one-stop shop that will provide them with information about treasury issuance and stuff like the reverse repo facility and the treasury general account, which is basically the government's bank account along with stuff like commercial bank reserves and the fiscal budget and the financing path of Washington, as well as what you call real liquidity.

14:27 And my question is, what is the deeper question or set of questions that you think your clients and readers or your research are really asking you for when they say that they want A "one-stop shop" that includes all of this information related to the government's finances and the interaction of its balance sheet with the broader economy?

14:48 Because I feel like many podcast listeners in particular who seem to express interest in whether the TGA is drawn down or whether we're seeing inflows into the RRP, are really grappling with a deeper question or set of questions about the government's role in the economy, and they're looking to develop a new understanding and a new framework for thinking about how the economy and markets operate today. Does that resonate with you?

Lawrence McDonald: 15:19 Well, if you think of the annual deficits are in recent years between 6 and 8% annually, that's in Washington. And you can call it modern monetary theory, you can call it whatever you want, but both Democrats and Republicans have chose to go down this road of much more, this is World War II-type spending. I mean, you look back through the '90s and the 2000s, the annual deficits were 1 to 3% worst case. And now, we're in this 6 to 8% for the last three, four years.

15:56 So, the amount of treasuries you have to sell to fund that, and then you have in the world less buyers than we had, we're getting far less help from China. We've taken sanctions, we've hit countries over the head, and with all kinds of sanctions the last 10 years, 20 years, Democrats and Republicans, and then we confiscated Russian private capital after the tragedy in the Ukraine, \$300 billion. And then, we had the trade war.

16:25 So, the amount of foreign buyers of treasuries relative to previous decades we're getting a lot less help. And that means we need to sell more bonds; we need more help from our trading partners. And that's why, to your point, and you're spot on, the zeitgeist is like investors now around the world are much

more careful about analyzing this problem because it's a little banana republic like we're walking down that path, and if we don't have enough buyers of the paper, then we're going to have a big, big bond crisis.

17:00 And people have been talking about this for a couple of years and hasn't emerged. The Treasury Department has done a number of things. They've got some tricks up their sleeve, which they've been executing with.

Demetri Kofinas: 17:10 So, you mentioned this term real liquidity when listing out things that your clients and readers are looking for information on. Michael Howell of Crossborder Capital, who's been on the show as well, also puts brackets around the term liquidity and has developed his own gauge of global liquidity that takes into account more than just the traditional monetary aggregates. What is it that you mean when you say real liquidity?

Lawrence McDonald: 17:36 Well, there's the academic version that's M2 money supply, or then you take the RRP, and that's the reverse repo facility, or the TGA, the Treasury general account. If the Treasury general account is going up and up and up and up, and that means that's the Treasury's checking account, that means they're taking in tax receipts and they're not spending it for whatever reason, whether it be the government shutdown, that's pulling liquidity out of the market.

18:02 But when we were in San Francisco this summer, a client really opened my eyes to what a lot of sophisticated investors are actually measuring liquidity in a different way, and this was a hedge fund manager that manages money from one of the largest families, a tech family in the valley.

18:20 And I guess, the best way to measure liquidity, I think, and this is his thoughts, and looking back, we have a model that tracks it this way, if you look at tertiary assets versus established, so you look at Bitcoin for example versus Solana, so that's established versus Solana is more tertiary or Avalanche or any one of these what we call the shitcoins, or you just look at the NASDAQ versus Bitcoin, so something's going on.

18:48 When the rate of change of Bitcoin or tertiary assets accelerates and starts to underperform established, think about meme stocks, profitless stocks, or the most shorted stocks, stocks that are really speculative, that what a company is a really speculative, and let's just say it has a \$10 billion market cap and no sales, at some point, that stock almost becomes a bit like a shitcoin, right? So, what a lot of professional investors are doing today to measure liquidity is they're looking across 17 of these verticals.

19:22 Look at digital asset treasury stocks like MicroStrategy. All of a sudden, this group of hot equities, which was dramatically outperforming for a long time, is now underperforming. Same thing with meme stocks, look at ARK stocks in recent months. So yeah, so there's different ways to measure liquidity. There's the traditional academic way, and then there's the real day-to-day way in the market.

Demetri Kofinas: 19:48 So, I feel like 2008 was this watershed moment that at least within my own circles, created two types of people: those who when faced with their own failed forecasts responded by rethinking their assumptions and improving their,

or seeking to improve their understanding of the world, and those who doubled down on their preexisting models despite their failures, because throwing them out is starting over is just hard, and I feel like the same thing has happened after COVID.

20:18 All this interest in the fiscal side of the balance sheet and how the government interacts with the private sector is a result of the fiscal interventions during COVID and the failure, in particular, of higher interest rates to contract the economy. Would you agree with that? And have you experienced the demand from your readers for information that helps them understand these forces and how to think about the government's role in the economy post-COVID?

Lawrence McDonald: 20:43 You're spot on. I mean, so Lehman goes down at 2008, President Obama kicked butt in the election, won a big landslide. But then in 2010, he lost the most seats in the House since the 1920s. And what happened was we went into this period where we were doing all this fiscal and monetary coming out of Lehman, and the monetary was through what we call quantitative easing, and a lot of that was staying on the central bank balance sheets and the bank balance sheets, and we can talk about that.

21:16 But at the same time, the fiscal lever got chopped off by the loss in the house from the Democrats, and we had this two-year period, three-year, really four or five-year period of gridlock where we took the deficit from say, 1.1, 1.2 trillion, and because republicans and Democrats were not agreeing on spending, that deficit went from annually 1.1 trillion down to a little bit, I think a little bit less than 400 billion. So, it was a massive fiscal austerity period. They called it the Tea Party.

21:51 This created this real incredible backdrop of what we call deflation, disinflation, and the portfolio construction for that changed dramatically. In other words, if you're long-duration equities like software companies or Mag Seven or whatever kind of stocks, they do really well, especially software companies in a certain deflationary world.

22:16 So, let's just say you have 10 years of cash cashflow, right? So, you've got a software company that pays a billion dollars of cash flow over 10 years. If you have certain deflation, that billion dollars of cash flow is worth a lot, lot more. But then COVID comes along, supply chains are stressed, and all of a sudden Republicans and Democrats are like, "Oh, those jobs over in emerging markets that we sent to China and Vietnam, where do we want to bring those back?"

22:45 So, all of this inflation pressures that never really didn't exist in the previous decade have exploded to the surface. Like I said, that fiscal and monetary response was enormous, 16 trillion, and that's created this fiscal/much higher inflation regime, higher interest rates, higher inflation, that is killing consumer confidence, university mission consumer confidence, and all kinds of consumer confidence indicators are trading below Lehman 2008 levels with the stock market at all-time highs. That tells you that people are really stressed in the middle class.

Demetri Kofinas: 23:24 Okay, so how do you square that, and what does that imply about the way that our economy works today and the relationship between the economy and financial markets?

Lawrence McDonald: 23:34 It's really ugly. And if you look at Chipotle's earnings or if you look at this K-shaped economy, I really don't like that term because people don't really understand what it is, but think of the letter K, you've got one group, look at Expedia or-

Demetri Kofinas: 23:47 The haves and the have-nots.

Lawrence McDonald: 23:49 Yes, yes. So, let's look at the have and the have-nots. So, look at Expedia and Airbnb's earnings that came out in the last three weeks. I mean, if you listen to those calls, you think they were in this raging bull market, right? But then, you look at the restaurants and not just Chipotle, we calculated there's like 20 restaurants that are down more than 20%. Domino's Pizza, crushed. Chipotle, and if you look at the comments that are coming from the CEOs, they're talking about young people, middle-class people, that people just can't afford that type of lifestyle anymore.

24:23 And you could see it in certain companies and you could see it in certain sectors, but then again, the wealthy upper class that's now getting a lot more interest on their checking account, oh, by the way, imagine if you had 5 million bucks in a money market fund, you were getting 1% a year, now you're getting four and a half, 4%, so you had a 300% pay raise. Those people are out spending much more money on travel, and that's why you're seeing this Expedia/Airbnb upside. And then, you're seeing restaurants and some regional banks and some REITs, commercial real estate investment trust, off a lot, really a lot of pain there.

Demetri Kofinas: 25:04 So, I do want to circle back to that, but let's talk a little bit about the government shutdowns for talking about the government and the fiscal side. And we just got news last week that the government shutdown is technically over, though I know that that's not, it doesn't work sort of one-to-one; there are some lagging effects as a result of what has occurred over the last several weeks, especially.

25:25 What are some of the lasting effects of the shutdown in your view? And to what degree have investors and policymakers been handicapped, especially by the delay in the release of government data?

Lawrence McDonald: 25:37 So, there's one important thing, and we did some really good research on this with clients behind me, but the first week of a shutdown means almost nothing because the paychecks haven't really been stopped yet. But once you go past that second, third week, there's an exponential destruction that, and we calculated the amount of paychecks across the military or across different parts of the government that were on hold for those, because we went at five weeks, so, the fourth and fifth week, the economic destruction was probably 20 times what the first week was.

26:13 And if that's why the White House, and I think Congress panicked, that they knew if they went on a couple more weeks, we would go into a real hard landing or a recession. And so, that's your first thing. So, the data is now still isn't out. I

think we're going to get the jobs numbers this week, the inflation data. So, a lot of the data is now in this mystery meat category because the government's been shut down. So, these are the short-term effects.

26:38 So, the data's going to get really bad. That's why if you look at the bond market, you look at oil, you got a big move down in yields, that's telling you that the market is pricing in some type of hard or some bad economic data, same thing with oil, it's telling you that. But other than that, the government shutdown impact will dissipate over the next six months. It doesn't have long-lasting implications, but it has definitely short, nasty ones.

Demetri Kofinas: 27:05 And while I don't mean to understate the impact of the shutdown, it doesn't come close to the impact of this administration in the way that it has conducted policy, the uncertainty it's generated, the corruption, the rapid loss of support for the president among some members of his base. I mean, how do you think about that, Larry?

27:28 When you look at what's going on, like Marjorie Taylor Greene, for example, has come out openly against Donald Trump. He's beginning to lose support also in some of his important he influencers on social media. There's a bit of a mutiny. We're seeing the early stages of a mutiny in the MAGA coalition. How does someone like you try to get his arms around those kinds of political indicators that are not easily quantifiable, but which can have an enormous, disproportionately enormous impact on markets?

Lawrence McDonald: 27:58 I've been hearing about this social unrest revolution for a long time, the whole ice thing. We haven't seen any evidence of it in terms of impact on the markets yet, but it's something that's in the conversation with institutional investors all the time. Trump's approval rating, really low. A lot of times, presidents run into this, and especially in the second, third year.

Demetri Kofinas: 28:23 Yeah, but he's going for broke, Larry. He's going for broke. He's not listening to his own base.

Lawrence McDonald: 28:29 Yeah, well, you could say, I mean, Biden was intellectually intoxicated, right? He's a vegetable. So, they're both in, there's... The one thing I don't buy into Trump's bad, Biden's good, but listen, they both have huge flaws. And the way the country was run under the Democrats was screwed up in a lot of ways. And the way it's run under the Trump and Republicans, it's screwed up in a lot of ways, to your point, to have that revolution within the party.

Demetri Kofinas: 28:57 Yeah, I mean, fair enough. Though there is a difference. Certainly, the flavor is different, but also, I think the difference between Trump, one of the key differences is that we've moved from a phase of covert corruption where if you're caught "red-handed," it's a problem for you; whereas today, it's all happening out in the open. And I think that's especially challenging because there's been a lag. After Trump came into office, the-

Lawrence McDonald: 29:27 You're not talking about Nancy Pelosi's trading?

Demetri Kofinas: 29:29 Yeah, but everyone already knows that.

Lawrence McDonald: 29:32 Hold on. That's not out in the open.

Demetri Kofinas: 29:34 No, no, because she denies it.

Lawrence McDonald: 29:35 I mean, literally has-

Demetri Kofinas: 29:35 No, because she denies it, Larry. She denies it.

Lawrence McDonald: 29:38 No, but no, it's 100% return.

Demetri Kofinas: 29:39 Trump doesn't deny it.

Lawrence McDonald: 29:40 Her returns relative to her pay as out in the open. She should not have that net worth with that kind of pay.

Demetri Kofinas: 29:48 Sure. But she denies it, though.

Lawrence McDonald: 29:49 It's pure math.

Demetri Kofinas: 29:49 I hear you. I hear you. The difference is, my point is she denies it.

Lawrence McDonald: 29:53 Well, you're telling me Don Jr. and the Trump boys --

Demetri Kofinas: 29:55 Donald Trump openly embraced it with their coins and their shit pumps and all that crap. They've basically said, "We're going to take what is already going on, the corrupt Nancy Pelosi, the Obamas with their estates in Nantucket or whatever they are, and we're going to take it to the next level. We're going to go full Banana Republic. We're going to out Argentina, Argentina.

30:15 And so, I think besides all the other ways in which that's bad, I think it's also beginning to filter through to the MAGA base where you're beginning to see some of the big MAGA supporters start to break with the president, and I think that is a problem. I mean, the center of the story is, for whatever reason, is the "Epstein list." There's no actual Epstein list, but it's a heuristic for the people that have benefited from whatever it was that Jeffrey Epstein was running his whatever you want to call it.

30:47 But my point is that I feel like we might've been able to get through this administration without as many hiccups if he didn't lose support from his base. What seems to be happening is that he's losing that support, and that could mean a big change coming up at the midterms. And that is my point about trying to wrap your arms around this unquantifiable risk to markets that's coming from the political side. And again, so much more is coming from the political side, Larry, whether it's fiscal expansion or whether it is political volatility because we have not addressed the deeper fundamental economic challenges post-2008.

Lawrence McDonald: 31:24 Yeah, this crypto thing by the White House, it was a real bad thing to do because if you look at that's, like I said, the tertiary coins, just eight of them have lost 210 billion off the local high, so that's from 2021 to now. So, you can never really quite know where the high was because some of the highs on the coins

were recent. Some of the highs on the coins were '21, but that's \$210 billion of wealth destruction that's affected a lot of voters.

31:54 And you can say that whole GENIUS Act and the whole, there's some good parts of the GENIUS Act, which I think are going to be phenomenal for global payments, but the way the White House embraced some of these tertiary coins, that really bad part of the cycle is, yeah, it's going to leave a big stain. I'm not defending that at all.

Demetri Kofinas: 32:16 No, I think for many of us, it was obvious that Trump's North Star was not right sizing the financial system or addressing corruption in Washington. It seems that it's really about what benefits him and his group, and again, in a much more open way, it's just a significant change in degree. And I think that is unnerving for investors who understand it, and I think it undermines investor confidence.

32:40 And so much to your point, I mean, you talked about this earlier about the capital account surplus of the United States runs and its need for foreign capital in order to sustain the value of the dollar, sustain moderately high yields on treasuries. And so, much of that is it's not petrodollars, it's confidence in the American legal system, in property rights, in the strength of American Empire.

33:04 And I think the risk that, I think you're sort of touching on here, when your investors reach out to you or your clients reach out to you looking for a one-stop shop to understand the role that Washington is playing in all of this, I think there's a lot of anxiety around a potential discontinuous change in the role of the United States internationally, what that means for the dollar, what that means for interest rates, for the deficit, for these asset markets that are at all-time highs.

33:31 I mean, it's a scary environment, which is why I led with some questions about what people are asking you because it feels like folks like you and I are who people come to for continuing financial education or when their models for understanding of the world and financial markets no longer work, and they're trying to interpret that information about the world that's coming at them in real time.

33:51 There are some other things that we haven't touched on, like the decision for a new Fed chair. I mean, you'll have to remind me when that date is, when Trump has to make that decision about who's going to replace Chairman Powell. There's also the Supreme Court ruling that we're waiting on regarding the president's tariff authority, and of course, there is the Fed rate decision coming up in December. Where do you rank these in terms of importance, and what should investors be paying attention to here?

Lawrence McDonald: 34:17 Well, I would say the Fed share thing has been out there, and they're narrowing it, narrowing it, narrowing it. So, that's pretty much a known, known, it's Hasset and down to, I think Waller is out in the picture now, and I would say if it's Hasset, one of the clients made a point this weekend.

34:37 And so, what we do is we have a conversation in the Bloomberg terminal and on Discord, and a number of clients have said that Hasset is kind of, you think about the Central Bank of Turkey and Aragon and the control that he has over

the central bank, or if you think of the view is that the Hasset Fed share seat from a global institutional investor and say Canada, is much less trusting of that Fed share White House relationship. It's a step toward the Banana Republic direction in terms of just too cozy relationship.

35:20 So, I think that the market could be underestimating that. In other words, that could create some long-end, the 30-year, if Hasset is put at the seat, the 30-year could really sell off. I think in terms of this whole tariff, tax revenue thing, if the Supreme Court dances around it, it's not a big deal. But if they create a really stern decision on, because you could say, and I completely agree with this, there is a White House abuse of power in the Brazil situation.

35:55 Say you like Bolsonaro, you don't like Lula, and therefore you're going to defend Bolsonaro through tariff. The White House should not be going down those types of roads. And I can see the Supreme Court's definitely going to push back on executive branch abuses and the power abuses, and both Republicans and Democrat administrations. We've gone through this where the War Powers Act of push, and there's all different times throughout history, the executive branch gets aggressive, and I think there's no question there, we're very aggressive here.

36:25 But there's some wiggle room in there for them to be narrow and go after some tax revenues. But if it was more broad, then all of a sudden, we're going to have a huge, I think it's like \$300 billion of assumed tax revenues that we're getting from tariffs, and if that was to cut down to like 75, once again, that would create a nasty shock in the bond market.

Demetri Kofinas: 36:47 I have a question about that because yes, I understand that causal mechanism, but also, couldn't it also be seen as dollar positive for the same reason that has its appointment would be seen as negative for the dollar and for the treasury market, because it's the United States legal system asserting itself, drawing a line in the sand saying thus far, no further executive?

Lawrence McDonald: 37:07 Yeah, so if it was, I see what you're saying. Yeah, so if it was narrow and it wiped out a lot of tax revenue, it could be a dollar positive.

Demetri Kofinas: 37:16 Maybe not in the short term, but maybe in the long term?

Lawrence McDonald: 37:18 Well, no, you're right, but higher yields would be a dollar positive too.

Demetri Kofinas: 37:22 Well, depending on why they're going up, I suppose.

Lawrence McDonald: 37:24 Yeah, especially if they go up in the... But if they go up the 5-year to 10-year, all of a sudden our paper yields more than the rest of the world relatively. Yeah, that brings in money. People buy bonds, so that brings in demand for dollars.

Demetri Kofinas: 37:36 So, what do you think determines which of those paths we end up on? Are you able to determine it just based off the Supreme Court's decision? Is that what we're waiting for, or what's the sequence here that we should be paying attention to as investors?

Lawrence McDonald: 37:49 Well, when you saw the minutes, there are these oral arguments. The oral arguments came out last Monday, Tuesday; the probability of Trump losing went up a lot. So, the oral arguments point towards some type of, if you look in the betting sites, if you look at the markets, what's weird is the markets, even though the betting sites are telling us that the probability of Trump losing went up, the markets haven't really reacted to it the way they should.

Demetri Kofinas: 38:16 Why?

Lawrence McDonald: 38:17 I think it's because it's just people are just, there's so much noise around it, and there's not a lot of clarity as to how narrow they get, and we are at risk on bull market. That's pretty, you got a lot of people buying dips, and the most incredible thing to me in my whole career is right before COVID or right before Lehman Brothers.

38:36 It's like the February of 2020, with all the evidence in the world that COVID was accelerating all through Asia and Europe, the market was going straight up every single day from February 10th to February 25th. It was just ignoring, encroaching really hardcore evidence of a potential problem. So, bull markets can get really stupid like that.

Demetri Kofinas: 39:03 Do you feel like complacency is a word that describes the zeitgeist today, not just in markets, but generally in a way that we haven't seen before in our lives?

Lawrence McDonald: 39:15 Well, complacency, to me, it's always the same, but today with options and zero day options, and we call single-day, zero day, it's created a much more wacky level of complacency. But at the end of the day, all it means is that you get a bunch of monkey speculators that are just buying dips, and what they're doing is they're buying breakouts, and every time the market pulls back, they are buying because it's worked over and over again. And the longer it works, the more and more junkies it brings into the trade.

Demetri Kofinas: 39:46 And you know what it is, Larry? I mean, just thinking about this, this concept of complacency, it feels like in our society in general, I mean, to your point about as long as it keeps working, we've forgotten why it works. We've forgotten how things work, why they work to begin with, how they got there, whether we're talking about bridges and tunnels and infrastructure, whether we're talking about the rules-based liberal order and what got us here.

40:08 We are just almost like the inheritors of a great fortune, and we have now just gotten to the place where we take it for granted, and I worry about the nature of change in those dynamics when the dynamic flips and how discontinuous it is. And again, I feel like this is what so many of us, at least those of us who are interested in these topics and explore them intellectually, this is what so many of us are worried about, like it's deep down.

40:37 I think even for mainstream audiences, I think it explains some of the appeal of zombie movies. I mean, there's always a perpetual appeal for these types of end of the world films and sort of artwork, but I do feel like people understand on some level that things are unsustainable and that there's a sort of inertia that's keeping the ball moving, but that at some point, things are going to start to fall apart, and I don't think it's clear either.

41:03 I mean, even for me on exactly how to navigate that situation, I feel like it's going to require a day-to-day, week-to-week, month-to-month assessment as we go through it, because in part, government is going to play such a huge role in that situation. I mean, do you think about that at all?

41:20 Again, this is not a question I had, I have so many questions that are in this outline, but how do you think about how government and governments in the West especially, are going to have to respond over time to the underlying structural problems that we've been talking about here, the deficit debt, the need to reshore, reindustrialize, all the level of capital expenditures that need to occur? I mean, how do you think about that as an investor?

Lawrence McDonald: 41:48 Well, Demetri, one of the things that you can use your platform, to me, there's this structural, horrific thing going on. We call it the dark side of passive investing. In other words, if you think of the top two stocks in the S&P 500, in the '90s, the top two stocks were maybe 6th, 7% of the S&P. Even 2000s, the top two stocks from maybe 7, 8% of the S&P 500.

42:18 Today, the top two stocks are close to 16% of the index. And so, what's happened is complacency and passive money, in other words, once passive investing, all passive means is if you think active management means somebody's running the money, buying stocks and bonds, and they're picking the stocks, that's active. Passive means you just own the index.

42:42 And what's happened is there's this complacency around, oh, the index always beats everyone. Okay, hedge funds can't outperform the index; all this moronic, idiotic, I mean, it's like Jonestown cult of people saying the same thing over and over again. And for a lot of years, that thinking was right.

43:00 The problem is it's now at a point where if you have a million, say you're 80 years old, the oldest boomer is now returning 80, right? They controlled almost 80 trillion of wealth, and say you're 75, 80 years old, you had a million dollars in the stock market in the S&P 500, that's \$160,000. It's in two AI stocks. Microsoft at 14 times sales, which is two to three standard deviations greater than the 30-year mean, and Nvidia at 31 times sales, which is again, two to three standard deviations greater than the 20-year mean or average.

43:43 And so, this is something where the regulators will cry, there'll be House hearings. This is going to be like you watch because at some point, passive investing is evil because what if the top two stocks were 25% of the S&P? There's going to be hearings, going to be all this controversy because we got way too overweighted. There's no regulatory reaction now, and there won't be until somebody gets a lot of people get really, really hurt and nobody's talking about this, and it's just a travesty, I think.

Demetri Kofinas: 44:14 That's super scary. I mean, Mike Green has been on the show talking about it for many years. I know David Einhorn also has been. So, it is definitely something that people have been ringing alarm bells about, but it's got a force of its own. It's like a giant death star.

Lawrence McDonald: 44:28 But remember, Demetri, five years ago, the top two stocks in the S&P were maybe 9%, 10%. So, in recent years, it's gone to 16. And yeah, it's much worse

now than it was 5, 6, 10 years ago, and it's getting worse and worse. The other crazy thing is all this money's in passive, State Street, Vanguard, BlackRock, those shares are not for sale unless there's a crash or a sell-off. And so, what happens is people just know that all the shares are locked up, and if companies going buy back.

Demetri Kofinas: 45:06

It's like crypto.

Lawrence McDonald: 45:07

Yeah, well, so Walmart's trading at 40 times earnings because they're high weighting in the S&P. Target's trading at 12 times earnings. So, you could say Walmart's a better company, all the baloney, right? Sure, that's true. But it's never been that the spread between those two companies was normally maybe, okay, maybe Walmart had a PE of say, 18, and Target had a PE of 12. Okay, that's fine. But 40 times earning versus 12, these types of distortions have ruined the market.

Demetri Kofinas: 45:41

So, I have a bunch of questions for you about the Fed, Fed policy, the dual mandate, what's the concerns about inflation versus job market data, but honestly, how much does any of this really matter? How much does the Fed and short-term interest rates really matter today when compared to all the other things we've talked about?

Lawrence McDonald: 45:59

You know what? The Fed thing is worth less and less and less because 10 years ago, it was the only game in town. Like I said, we had that vicious austerity between 2010, 2020, where they took the deficit from 1.2 trillion a year down to 400 billion, and it was a Tea Party and whatever the Fed did, it was secular sass stagnation, and the Fed policy meant a lot more.

46:27

Now, with the fiscal stuff and reshoring and all these inflationary impulses that are just oozing through the economy with all this fiscal, I mean, think about the Fed raising interest rates for keeping them here with the amount of fiscal that both Biden and Trump have done, is literally shooting a squirt gun at a fire. I mean, there's just way too much fiscal relative to what the Fed's trying to do to slow down inflation.

Demetri Kofinas: 46:57

So, you said that the dollar, because of a sharp drop in foreign exchange volatility, is regaining its appeal as one of the world's most attractive assets for the carry trade, where investors borrow and lower-yielding currencies such as the Japanese Yen or Swiss Franc, and then reinvest that money to higher-yielding dollar assets. What explains the drop in dollar foreign exchange volatility, and what is the causal relationship between the government shutdown and that volatility?

Lawrence McDonald: 47:24

Okay, so government shutdown creates demand for bonds. It lowers bond volatility, and so the bond volatility has become way down. In terms of foreign exchange volatility, it has a lot more to do with tariffs and this crash that we have, the dollar. So, in the book, we make a really hardcore determination around a bearish view on the dollar, but the move from the dollar from 2020 to now, if you look at the rate of change, it's been one of the most severe we've ever seen.

47:57 And so, that is creating this dynamic where the dollar was extremely oversold, when we had the tariff debates or tariff fight, a lot of foreign investors moved away from the dollar. This created a lot of dollar volatility. The thing is, we're coming out of that, and so that's the biggest driver of really stabilizing the dollar.

Demetri Kofinas: 48:16 So, you think we're on the verge of a period of prolonged dollar strengthening? How do you think about that?

Lawrence McDonald: 48:22 No, no, no. What we are trying to say there in the note is that the rate of change in the dollar move in 2022 to now has been one of the most severe sell-offs that we've had, and the fact that things have stabilized around, we're getting much more clarity around trade. The trade uncertainty in April for the dollar was spectacular.

48:46 I mean, there were some weeks in April where the dollar was down, stocks were down, and bonds were down. That's something you only see in emerging market countries. And so, that freaked out a lot of people. The certainty around or the knowledge of what tariffs are going to look like is creating a bounce in the dollar, but it's just a bounce within a bear market. It's just coming out of an extreme oversold level.

Demetri Kofinas: 49:09 So, what is the return of this dynamic or return of carry into the dollar? Tell us about the broader risk appetite.

Lawrence McDonald: 49:15 Well, the carry trade's been out there for a long time, and there were periods where it gets popular again, periods where it breaks down. It started to break down in April with the volatility in the market. But in terms of the carry trade per se, I don't have any strong views there. It's the trade that comes back and forth with countries like Japan, where people can borrow money there for almost nothing and put money in our bonds or put money in US corporate bonds and make a spread, and then try to hedge out the currency risk.

49:50 The one thing I would say is that the long-duration bonds in Japan and France, in the UK, have been in a much higher regime. This is one of the things that's driving money toward hard assets is that anybody in the long duration assets in the US, Japan, UK, France is losing money since 2022, and every day, every week, every month, the people are losing that kind of money, it's pushing money into hard assets and other types of assets besides duration.

Demetri Kofinas: 50:23 So, last question for you, Larry. We've talked a lot today about the risks. We've talked about all sorts of ways in which our economy, our political economy, is screwed up. What are the opportunities in your view for investors, especially those that maybe people aren't really paying attention to?

Lawrence McDonald: 50:39 Well, the one thing is this whole year-end tax loss selling thing, where in years where the S&P's up a decent amount, and there's a big divergence between winners and losers, there's a lot of stocks right now that have been dramatically underperforming the market a lot, like big famous household names, the Lulus, the Chipotles, the Targets.

51:03 So, to me, that's one of the big opportunities that we talk about. But the biggest of all is the AI power play. Everyone is in the chips. This is the dumbest trade in the world. It's the most overbought, it's the most concentrated. Everyone's in Micron, Nvidia, and the amount of wealth that's in the chip side is idiotic relative to the power and the social bottlenecks. I call it social and power bottlenecks.

51:35 These billionaires are putting these data centers in some of the wrong places in the United States, counties in the United States, there's all kinds of protests because you're going to rent...Billionaires in Silicon Valley are flexing their muscles with the spending around data centers and investment trillions of dollars.

51:53 It's distorting the cost of electricity around the country, and it's creating power bottlenecks, social inequality bottlenecks, protests. And so, the execution of this, everyone should really sell and take down exposure to the chips and build exposure to natural gas, coal, nuclear power, uranium, things that are going to actually power this data center power reticence.

Demetri Kofinas: 52:25 Larry, it was great having an opportunity to speak with you, man. Thank you so much for coming on the show. Do me a favor, give out your website for people who may want to follow your research, and let us know also, do you use Twitter regularly? What are some of the ways in which people can follow you and keep up with your work?

Lawrence McDonald: 52:39 Thank you, Demetri. It's How to Listen When Markets Speak, in the top. It's been in the top 5 or 10 on Amazon all month, all year, and then at Convertbond on Twitter. And if anybody wants a copy of our latest reports, it's info@thebeartrapsreport.com.

Demetri Kofinas: 52:57 Awesome, Larry. And anyone who is interested in accessing our subscriber-only content, including the transcript and intelligence report for this conversation and other episodes, or if you're interested in joining our GENIUS community and having the opportunity to ask these questions directly to Larry and other podcast guests on our live Q&As or in-person at our various dinners, weekend retreats, and other in-person events that we host all over the world, you can do that at hiddenforces.io/subscribe. Larry, thank you again for coming on the show. It was great speaking with you.

Lawrence McDonald: 53:31 Thanks, Demetri.

Demetri Kofinas: 53:33 If you enjoyed listening to today's episode and want to join in on the conversation by becoming a member of the Hidden Forces Genius community, which includes Q&A calls with guests, access to special research and analysis, in-person events, and dinners, you can do that at hiddenforces.io/subscribe. And if you still have questions, feel free to send an email to info@hiddenforces.io, and I or someone from our team will get right back to you.

54:03 Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at hiddenforces.io. You can follow me on Twitter @kofinas, and you can email me at info@hiddenforces.io. As always, thanks for listening. We'll see you next time.