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How *a* World-Class Money Manager Sizes Up America's Predicament

By Stanley Druckenmiller

The United States is likely to end up the loser.

I've been in the financial markets as some kind of chief investment officer since 1978. And the current market scenario is about the wildest cocktail I've ever seen in terms of trying to figure out a roadmap. Just to frame things a little, the 2020 economic downturn was five times as large as the average-sized recession since World War II, but this latest recession occurred in only 25 percent of the time. More bizarrely, last year while eleven million people were unemployed, we had the largest increase in personal income in twenty years. That's because of the massive policy response.

The 2020 CARES Act added trillions of dollars in fiscal stimulus to the U.S. economy. How big was it? In three months, we increased the deficit more than resulted from the last five recessions combined. And those were big ones—1973–1975, 1982, the early 1990s, the dotcom bust, and then of course the great financial crisis of 2007–2008. If you added the increase in the deficit during all those five periods and combined them, we increased the deficit in the United States more in three months in 2020 than we did during the cumulative total.

In six weeks during 2020, the Federal Reserve bought more Treasury bonds than it did in ten years under Ben Bernanke and Janet Yellen when people like me were screaming about how excessive quantitative easing was during that period.

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The United States *vs.* China

Long-term, I think Asia is going to be an outperformer, their equity market versus the United States and especially their currency market. Again, China has done virtually no quantitative easing during the last two years, while our QE-to-GDP ratio has jumped something like 14 percent. Their real yields are higher than ours. They continue to run a current account surplus. Global net investment into China actually exceeded investment into the United States for the first time ever. This is the beginning, not the end, of the trend.

—S. Druckenmiller

Corporate borrowing, which almost always goes down in a recession as corporations re-liquefy and had already gone from $6 trillion to $10 trillion because of the Fed's virtually free money going into the period, actually went up $400 billion. Just for perspective, corporate borrowing went down $500 billion during the great financial crisis. And obviously, all this stimulus has flowed into financial markets, into commodities, and into financial interest instruments. It's sort of a bizarre background as we continue into 2021.

The juxtaposition of the various policy responses from the United States and other Western economies with their Asian counterparts including China is breathtaking. Since 2018, M2 in the United States has grown 25 percent more than nominal GDP—a 25 percent increase in liquidity. In China, the M2-to-nominal GDP ratio is where it was three years ago. China hasn't borrowed anything from their future.

We've had a massive liquidity input, and frankly, very low investment. The economy's been running primarily on transfer payments and Fed stimulus. And we've done a horrific job with the virus.

The Chinese, and basically Asia in general, have pretty much defeated the virus. They haven't borrowed from their future.

So the backdrop as the East and West emerge from the pandemic slowdown could not be more different. But it also could not be more exciting if you're a macro investor, because there is the other big force in the equation, which is vaccines. And it's possible, in fact probable, that all this stimulus is still going to be in place, and frankly increasing, just when we unleash the biggest increase in pent-up demand globally we've had since the 1920s, which could make the world look extremely different than it looks today.

As a money manager, currently my overriding theme is inflation relative to what policymakers think. But because of the policymaker response, which could vary based on the vaccine and how they respond to various metrics, I've found it better to have a matrix. Basically, to play potential inflation, I have a short Treasury position, primarily at the long end. Because the Fed could drive me crazy and not allow the market to drive rate rises to come to fruition, I also have a large position in commodities. The longer the Fed tries to keep rates suppressed so they have stimulus in the pipeline, the more I win on my commodities. The quicker they respond, the quicker I might have a problem with my commodities but win on my Treasuries. And then because of the juxtaposition of our policy response versus that of Asia, I have a very, very short dollar position.

As for predicting the future of tech stocks, including the mega cap tech or cloud names, it's a tough call. If we get, say, 4–5 percent inflation in the United States a couple of years out and bond yields rise precipitously, the result would be very negative historically for growth stocks relative to other stocks.

On the other hand, I think the comparisons with 2000 are ridiculous. We had a double whammy back then. We not only had the raging mania overvaluation, but the earnings were about to end because those companies that were growing rapidly then were all about building the internet itself. I didn't see this coming at the time, but the internet had already been built. Imagine companies selling railroad ties just as the Union Pacific had crossed the United States and was done building track.

I do think the combination of valuation and challenged bond markets could certainly put growth stocks in a very challenging environment over the next five years,

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certainly relative to what they've been, which is not saying a lot. As for the cloud, I'd say we're in the third or fourth inning in terms of its expansion. We're definitely not in the ninth inning, and if anything, the companies I talk to are actually speeding up the transition. They know they're going to competitively die if they fall behind this digital transformation.

Within tech itself, the FAANGs, or let's just talk about, say, Amazon, Microsoft, that brand, they've actually been big underperformers over the last two or three months. It's like the market has rotated into forty-times-sales tech companies or into radioactive reopening stocks. And if you actually looked at the Amazons, the Microsofts, and the Googles of the world, they're not overvalued, they're GARP names, and they're currently out of favor. And if the Fed continues to push the envelope in terms of friendliness, I'm not really too worried about those stocks. If anything, I would think they could keep going somewhat.

When I look at how much the United States has borrowed from its future, and when I look at how Asia has responded to the pandemic, I just think the Asian economies including China are the big winners coming out of Covid. Even within specific areas like tech, Intel's thrown in the towel. Asia owns Foundry. They own memory. They're ahead on robotics. Over the next five years or so, Asia looks a lot better to me than the United States because at some point we've got to pay the piper in terms of productivity, in terms of higher rates, and in terms of a lower dollar for all these transfer payments we've made during the last nine months and it looks like we're going to continue to make. I'm quite constructive on a number of stock names in Taiwan and Korea and China.

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I don't know about the next few months. But long-term, I think Asia is going to be an outperformer, their equity market versus the United States and especially their currency market. Again, China has done virtually no quantitative easing during the last two years, while our QE-to-GDP ratio has jumped something like 14 percent. Their real yields are higher than ours. They continue to run a current account surplus. Global net investment into China actually exceeded investment into the United States for the first time ever. This is the beginning, not the end, of the trend.

I'm worried about the future of American capitalism. The reason I'm worried is that we haven't really engaged in capitalism for quite some time. The central bank has bastardized the most important price in the world, which is the cost of money, particularly at the long end of the Treasury market. We have crony capitalism, as you know. But even in the best days of capitalism, it's always had a stain in the United States.

I grew up believing in the meritocracy theory about pulling yourself up by your bootstraps. We are a meritocracy by and large, but there is a sub-sector of our society that is pretty much in a caste system. And we have neighborhoods in our country, lots of them, where millions of kids just don't have the opportunity to pull themselves up by their bootstraps and work hard. This is something we need to address, which is why I'm not sure the events of last summer were such a bad thing.

People need to be woken up to the fact that the American Dream—and it's a great thing in the greatest country on Earth—doesn't exist for a significant number of kids no matter how hard they work. ◆