

Cycles, Crises, And the Currency of Change with Ray Dalio

>> Hi. I'm George Patterson, and it's an honor to introduce Ray Dalio. Ray really does not need an introduction, but I'll just be very brief and introduce Ray as the founder of the world's largest hedge fund and a phenomenal investor who's also recently delivered a number of interesting tomes. And I call them tomes because they're pretty the result of very in-depth research, which is very impressive. We're here today just to discuss a few questions about global cycles, which is really your area of expertise. So, Ray, today you spoke a lot about the next big cycle. And really, what do you think is the phenomenon today that people are misunderstanding or mischaracterizing that historians are going to be talking about in the future?

>> Well, the big cycle, I think people pay so much attention to the news every day that they lose sight of how things evolve, you know. Just like in our lives, we have a life cycle. There is a cycle, and the cycle is influenced by five big forces. And the first is a debt cycle. When debts rise relative to incomes, debt service payments squeeze out other spending. They become a supply and demand problem for debt, which is happening now, and that affects the value of money, because central banks come in and they make up the difference. They ease monetary policy. That's one part of the cycle. Next part of the cycle is that there is a political and social cycle of the -- naturally, as there grow wealth differences and values differences, there are conflicts between the left and the right, and those can become irreconcilable differences. And so you see that democracies in history sometimes -- Plato described it, it happened in the '30s -- that there become irreconcilable differences in a conflict. And so we're seeing that the nature of our democracy and our decision-making across political parties is changing.

The third is a geopolitical cycle. You know, the winner of the war creates the new world order, the rules and how it works. And then as its relative position changes, there's a conflict and there are comparable powers, and then there's a struggle in those. Those cycles all work together. Number four is that there is also, throughout history, nature is a big influence, and droughts, floods, and pandemics, and certainly climate change. And that is a big influence now. And then number five is always man's learning and technologies. And of course, that's a big force. And I think people don't understand how that evolution takes place. It's like looking at, you know, your own life, where are you in your life cycle, but there's a life cycle. So I think that's what's missing.

>> Okay. So it sounded like a lot of perspective on where we are and taking maybe a step back from looking at the trees to take the sea in the forest.

>> Yes. And you can see it in numbers and charts, like a doctor looking at the tests of a patient's health. You can see how debt service payments are squeezing out spending. You can see those things. And so, like doctors looking at that, I think that that perspective is being overlooked, and there's just the news of the day.

>> So we've heard a lot about cycles, and obviously, that's been a big focus. So, has there been any particular event that's maybe not as systemic that has really influenced your career since founding Bridgewater?

>> Well, the breakdown of the monetary system in 1971, I would say, is systemic, but it had a big effect. Because 1971, well, I traded markets since I was a kid, and when I -- '71 -- the summer of '71, was between college and going to graduate school. And I clerked on the floor of the New York Stock Exchange. And I went on the floor of the New York Stock Exchange after President Nixon said, "You're not going to get your money." I mean, basically, gold was money then, and there was a promise that you could take your paper money and turn it in for gold, and you couldn't. And so when I went on to the floor of the New York Stock Exchange, I thought there would be a crisis, and what there really was -- stock market went up a lot. And I didn't understand it, and as a result, I went back to history and studied it. And I found that in March 1933, the exact same thing happened with Roosevelt getting on the radio and saying the same thing, and it let me understand this. So that moment changed my perspective of history, because I could see that things that happened, but not in my lifetime, were important. And so, because I studied the '30s, I was able to anticipate the 2008 financial crisis. So we made a lot of money in the 2000 when most people lost, and so that moment really gave me a lesson about, you know, the importance of having that historical perspective. Like, I'm a practical guy who has to make bets, and so that perspective made me not just a theoretical historian, but finding real practical great benefits in it.

>> Yeah, I agree. Being practical and having to put money on the table gives you an entirely different perspective, where you also have to explain the performance to your partners and your clients.

>> Right.

>> So we've talked a lot about the dollar, and, you know, what are some of the signs of kind of like the weakness in the US dollar and the potential of the US dollar losing its status as a reserve currency. But what does it look like when that actually happens? What economic changes do we actually see when that trend accelerates?

>> Well, you're seeing it now. You have to keep in mind that gold is a currency. It's not just something you might buy, like a piece of real estate and so on. And so we have to think, what is our currency as a storehold of wealth, okay? And debt is the opposite side of that, okay? So what you're seeing right now is a deterioration in the debts storehold of wealth and a shifting from debt-denominated assets to gold by central banks. This isn't just speculators, but the world's major central banks and so on have been letting their holdings of debt assets go down, and then their buying of gold. The gold has now become a second reserve currency. So I think as we're watching these things happen, you have to think about real returns. In other words, not just nominal returns, what did it go up, but does it beat inflation after taxes? How do you make a return that's ahead of inflation after taxes? And then, from a portfolio construction, how do you create a balanced portfolio? And it's almost the equivalent that gold is like cash. When you start to think of it, it's almost like cash. Because when we're looking at the lens -- through the lens of a currency, we see that when we're doing that, that things go up and down in that currency. And we could lose sight of the fact that that perspective is lost, because in reality, it's the currency going up and down. So we've seen the currency value go down as we've seen these other assets, which are an alternative storehold of wealth, go up.

>> Interesting about gold. Now, in terms of debt, something I know you've also spoken about, and we've talked about just the snowballing of debt and how that can be kind of a self-fulfilling prophecy. Is there anything that can really be done to kind of halt that, particularly, in the United States, or to evolve that process?

>> Yes, but it's probably too late, and politics stands in the way.

I wrote a book called "How Countries Go Broke: The Big Cycle." And I wrote that mostly so that people could see the mechanics of it. And I gave the numbers. And we're in a situation now where, if -- but you have to stabilize these numbers, otherwise, the debt will build up. If there was a reduction in spending of about 4% of the budget, 4% of spending, and there was an increase in taxes of about 4%, there would be also a natural decrease in interest rates of a bit. And that would sort of stabilize things where we are. If we don't stabilize things where we are, then you're really crossing a threshold level because the debt compounds on itself. But politics stands in the way. I went, you know, down to Washington, speak to leaders of both parties, and they agree that this is -- we have to get the deficit down 3% of GDP or whatever. But they tell me that they can't because of politics. Because they say they have to make promises. And the promises are one of two, if not both. The promise is, "I will not raise your taxes and/or I will not cut your benefits." So that means you're going to keep going. And so politics is playing a very important role that's standing in the way of making that kind of adjustment, as what I would assess it to be as kind of at the last moment.

>> Interesting. Also on the subject of debt, when you look at developed economies and mature markets, are there any particular signs or signals that tell you when to get out or when to be more cautious about those markets?

>> Well, yes, you can see it. And then you start to see it in the market action, like you're seeing in the UK and France to some extent, and sometimes you see it here. When you have a bond, when there's an easing of monetary policy, in other words, lowering short rates and long rates don't go down or go up. And you see that the inflation hedge assets, such as gold and so on, rise. And that's like a market action that is reflecting the shifting of holding assets, debt assets, because they're not going to provide an adequate return. They're going to be monetized and so on to shift it to other assets as a storehold of wealth. So I keep an eye on that sort of market dynamic at that time. But very other symptoms like shortening the maturity of the debt. Shortening the maturity of the debt is a way of taking the supply that's on the longer end and lessening it and bring it to the shorter end. The problem with that is that then a lot more debt is mature. And then that means much more need to keep that down, which weakens the currency. But those are the types of symptoms that are typical.

>> Right. And when you also have a lot of short-term debt, you always have to be refunding it all the time, which gives you different dynamics in terms of risks, in terms of liquidity. Interesting. What about geopolitics?

How do you think about geopolitics playing into kind of global markets in this day and age? You know, we've been -- you know, I always think it's impossible for things to get crazier, and yet I'm always wrong in that they continue to get crazier in terms of the geopolitical situation. So, how do you think about that tying into your thinking about debt and countries?

>> Well, there's it in and of itself, but you can see all the symptoms of the cycle. The fact that you're talking about what you're talking about the geopolitics, at the same time as you're talking about what's going on in politics, at the same time as you're talking about what's going on in debt. You can see these interrelated big cycles take place. We understand what's going on. And so we're shifting the way the world works from what was called a multilateral world order, which began in 1945. The United States primarily determined that we should have a multilateral world order. That means the United Nations, the World Trade Organization, the World Court, the World Bank, the IMF, all of those organizations with representatives, and so on working that to a unilateral world order. In other words, more like a law of the jungle in which power matters, right? So now, we're having each country for their own and particularly that type of a conflict.

Now, that has implications. That have implications in terms of the lesser efficiencies that are operating in the systems when you have protectionism and you have disruptions. Of course, that makes the world economy less efficient. You also have to produce things at home, and that makes it less efficient. You have tariffs, of course, which are used also to bring in money for tax reasons. So you have a world economy that is happening and going through. And so you have wars now. Like you have a trade war. You have a technology war. You have a geopolitical war, in a sense. And those wars then also can cause military wars. So we're seeing more worries about that that are having an effect. Certainly, let's say Russia and Europe, for example, and what that means economically for them. They have to run budget -- they have to spend 5% on GDP, on defense, and those types of things. All of those are, you know, putting sand in the gears and also creating wars. Now, of course, if you had a more of a shooting war and you had that, then that's so much worse. We're going to cross the line. But yes, that's the nature of the geopolitical tape that take place at this part of the cycle.

>> Yeah. Interesting. I think the wars of tomorrow -- what's been amazing has been how much the war that we've seen between Russia and Ukraine has really been fought, not with traditional weapons, but, you know, with things like drone. You have to think that the next war will really be cyber warfare or purely electronic.

>> Always, every war is fought with a new technology.

>> Yeah.

>> And the classic ideal way of fighting a war secretly to develop your new technology, the way we did with the Manhattan Project, a nuclear weapon. And I think right now what's going on with quantum computing and AI and space wars and other types, that -- yeah, the new war will be fought with a new technology as it always has.

>> Yeah. And I think technology has also been very influential historically in terms of different mechanisms, different methods of conducting war.

>> That's right. Whoever wins the technology war will win it all. Yeah. They'll win not only the economic war, but they'll win it all.

>> Is there any risk in the current economy that you think people are overlooking that are just being -- that is being mispriced in the current cycle?

>> Well, I think the value of dollar-denominated debt is a pricing. I think private credit has very low credit spreads. And I don't think we're going to have a debt crisis there. I think they're just going to have terrible deterrence. It won't have a debt crisis because the terms are so --

-- liberal that the actual act of a default, you know, the mark to market, and that dynamic is much less likely there. But the credit spreads are so bad. I would say, generally speaking, the super scalers are expensive, and that the parts of the economy that are

using AI effectively or creating the platforms to use AI, that the power of the cost effectiveness of using AI and its impact on companies' earnings and so on will be great. I don't think enough attention is given to that relative to the super scalers.

>> Interesting.

And then, again, just maybe, you know, taking a step back, like beyond quantum computing, beyond AI, where do you see the next big trends that are really in the early stages today that will continue to grow over the next 50 years?

>> Well, 50 years.

I think it's tough to even think 10 years, but I think the advanced automation in space, in all kinds of thinking.

So it'll have a big impact on pharmaceuticals. It'll have a big impact on just that. Everything is going to have a huge impact on employment. I think we're going into a time war. I think it's not 50 years. I think it's five years.

>> In other words, I think when I take these factors, these five factors, and I look five to 10 years out, I think you're going to see a radically different world, like going through a time war. And we think we could know some things about it, and then we can't know other things about it. Let's say, like AI, it's one of those things. How it's used will have its bigger impact than, you know, it intrinsically. Like, is it used for war? Is it used for breaking security systems, quantum and AI together, breaking security systems? What is money? What is a storeholder wealth? All of those things, I think we're going to go through, like, that time warp over the next five years for all of those things.

>> Great. Thank you very much. It's been an honor to talk with you and get your insights on the current status of the world, as well as -- as well as, you know, what we might be seeing over the next few years. I like that analogy of a time warp, because I agree, it's a very interesting time, and we're going to be seeing a lot of technologies really make their mark in a very near term. So, Ray, thank you very much. My [inaudible] speak with you.

>> Thank you.

>> Thank you.

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