

Q&A

An Interview With Felix Zulauf, Private Investor
and Publisher, Zulauf Consulting Newsletter

The View From Europe

By LAUREN R. RUBLIN



Photograph by SCANDERBEG+SAUER

Felix Zulauf retired from the *Barron's* Roundtable in 2017 after 30 years' service, and has given up managing other people's money. But no one who knows him would ever call Felix retiring. To the contrary, from his perch in Baar, Switzerland, he continues to follow macroeconomic trends, sharing his invariably thoughtful observations and often-bracing opinions with clients of Zulauf Consulting, a research firm catering to institutional investors.

He also pens a biweekly newsletter packed with insights on geopolitics, policy, markets, and investible assets, and hosts a quarterly webinar.

There's a lot to observe these days, from China's muscular rise to Europe's shaky union, not to mention the global meltdown in bond yields and buildup in public debt. Nor do the prospects for stocks, commodities, and Bitcoin escape Felix's gimlet eye. He touches on all of these topics in the edited interview that follows. *Barron's* has supplied the names of specific exchange-traded funds that reflect his current investment themes.

**“Whenever there is a selloff [in gold],
I snap up some gold-mining stocks.”** Felix Zulauf

Barron's: As you wrote recently, Felix, we're living through the sorts of things we've only read about in history books—a pandemic for one, and unconventional policies designed to deal with the fallout. We'll survive the pandemic, but how will we exit this era of chronically low interest rates?

I don't think we can. Once you start debasing your currency and inflating your financial system constantly and chronically, you can't stop. If you do, you risk a deflationary accident. The problem today is that the world doesn't have enough growth. Demographics are one cause; annual population growth in the U.S. is about half a percentage point, and declining. It is near zero percent in Europe, and declining. It is zero in China, and declining, and negative in Japan. Economic growth equals population growth plus productivity growth, and productivity growth trends are also declining because policies being applied in many parts of the

world are creating more zombie companies. The U.S. economy is destined to grow by probably less than 2% a year on a long-term trend basis, and Europe, by less than 1%. But our system is built on growth.

How so?

We need to grow to service our debts, cover our pension costs, and so forth. The central banks have been trying to create growth since the financial crisis of 2008-09 by pumping liquidity into the global economy. But it got stuck in the financial system and didn't make it to Main Street. Now, the authorities have turned to fiscal expansion. Governments around the world are talking about investing massive amounts of money in infrastructure, particularly to deal with climate change. In this way, they hope to create enough demand to elevate economic growth rates.

It will work for a very short time. Coming out of a crisis, there is usually pent-up demand. All the spending

might lift growth by 4% or 5% for a few quarters, but afterward, growth will ebb again unless the fiscal push increases.

What are the likely consequences of all this spending?

The government share of the economy will continue to rise. The more government is involved in the economy, the less productive and efficient the economy becomes. If productivity falls, prosperity declines. An ever-larger percentage of the population falls into poverty or near-poverty, and society takes on a bigger role in caring for those people. We are slipping into planned economies and greater socialism. In the long term, it is the wrong recipe.

Much of Europe might disagree.

I expect the Biden administration to take the U.S. toward the European model. Under normal circumstances, it is difficult for Europe to generate 1% annual growth. Asia is different because

it is one generational cycle behind the West. The population is very hungry.

Longer term, the current economic framework will lead to social conflict, played out against the background of a conflict of a hegemon in relative decline—the U.S.—and a new power that is rising and self-confident: China. Those sorts of conflicts usually start with trade, as this one did, but they could lead to military conflict.

You have called the European monetary union the biggest mistake of the century. Why?

The political elite favors European integration, and the Germans, under Chancellor Angela Merkel, have caved in to the French. The European Union architecture is French; it is centralized. The German architecture is decentralized. Imbalances exist within the EU because some economies are more competitive than others. To rebalance the imbalances, the EU has weakened the stronger members; it hasn't strengthened the weaker members.

Europe will continue to integrate, and economic growth and prosperity will continue to decline. Far in the future, there will be a major revolt of the people against the elites. Don't count on Europe to launch any big growth agenda. It won't work.

What's ahead for the U.S. economy?

If the U.S. launches a big infrastructure program, the economy will enjoy strong growth for a number of quarters. Inflation could also surprise on the upside, but whether that will be a secular change, we don't yet know. The U.S. could see a 3% jump in prices this year, due to a weakening dollar and rising import costs. Asian exporters are raising prices for the first time in 20 years, which is a major change. You're seeing price hikes in electronic components. Commodity prices are also rising. That will flow into the consumer price index sooner or later.

The bond market won't be happy. I expect the 10-year Treasury yield to

1.50%
Bond Market Revolt

Zulauf sees bond yields rising as inflation ticks up.

Near-term forecast for 10-year Treasury yields, which are now around 1.3%

rise to the 1.50% area. Then we'll see whether it reaches 2% later this year or early next year. [Bond prices move inversely to yields.] As yields rise, the valuations of growth stocks could fall. Later this year, perhaps from late summer onward, growth stocks will be in high-risk territory. The U.S. stock market could have a temporary correction in March, caused by a rise in yields. If that correction is shallow, the chance of a late-summer buying climax in the big growth stocks is high. If the correction is deeper, a cyclical top for these stocks will be postponed into the first half of 2022. But monetary policy won't be tightened, and economic growth won't collapse. Thus, we don't have the classic factors that usually create a bear market.

What are the most and least attractive investments today?

The least-attractive assets are long-term bonds, with the caveat that inflation and interest rates could stay low for years. But even then, bonds wouldn't yield a high return. The most attractive assets are long-duration assets: the shares of companies that can achieve sales and earnings growth even in difficult economic and political environments, and real assets. Growth stocks are highly valued, but if bond yields and inflation stay low for the next five years, these stocks will do well.

Where are you putting your money?

I invest in themes. I like the agriculture theme. Jim Rogers said years ago at a *Barron's* Roundtable that farmers were aging, and there weren't new farmers taking their place. We have fewer farms in the world today, and they have to produce more, for more people. There are shortages everywhere, and climate events are affecting harvests and causing prices to

spike. [**Invesco DB Agriculture**, ticker: DBA, tracks agricultural-products prices.]

I am also quite bullish on oil. The U.S. dollar probably has about 30% downside over the next five years. That is bullish for commodities in general, which are traded in U.S. dollars. I could see West Texas Intermediate, the U.S. benchmark crude, trading at \$100 a barrel in four years, because the Biden administration's policies are against drilling for new oil. [**United States Oil** fund (USO) tracks WTI prices. **Energy Select Sector SPDR** (XLE) holds big oil stocks.]

Are you investing actively in Asia?

Yes, through futures and ETFs. I am long Japan, Taiwan, and Korea. Taiwan and Korea are my favorite markets because of their technology tilt. [**iShares MSCI Taiwan** (EWT) and **iShares MSCI South Korea** (EWY) offer exposure to these markets.]

I have some reservations about

China. The Chinese didn't overdo it on fiscal spending, and while they aren't tightening monetary policy, they are tightening the reins a bit. Therefore, the Chinese stock market might underperform other Asian markets for a while.

What appeals to you in the U.S.?

I own some of the FAANG stocks [large tech stocks such as **Facebook** (FB), **Apple** (AAPL), and **Amazon.com** (AMZN)] and ETFs, although I started to reduce my positions earlier this year because I thought a correction would come in February. If it comes in March or April, I may increase my positions on a trading basis.

Gold is dead money this year, but I like it longer term because of the crazy policy moves we're making. Millennials are buying Bitcoin instead of gold. Whenever there is a selloff [in gold], I snap up some gold-mining stocks, as they are cheap long-term options on the gold price. The GDX [**VanEck Vectors Gold Miners**] should do well over the next few years.

What do you make of Bitcoin?

I don't believe that Bitcoin will ever make it as money used in daily payments. It is too complicated, the price is too volatile, and "mining" it requires too much energy. But as long as people think of Bitcoin as a safe store of value, the price could go higher, and it could become a mania. At the peak of the tulip-bulb mania [in the 1630s], the most expensive tulip bulb cost as much as a house. That suggests Bitcoin could reach \$1 million someday. But tulip bulbs trade today at only \$10 a dozen.

Thanks, Felix. 

FOR MORE INFORMATION ON RESEARCH AND SERVICES
PLEASE CONTACT:



info@felixzulauf.com
www.felixzulauf.com
(212) 452-3115