Chanticleer

This Wall Street legend will be out of stocks by Christmas

Stanley Druckenmiller misread the V-shaped recovery, but the refusal of central banks to retreat from loose monetary policy has him considering an exit from equities.

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Stanley Druckenmiller, the much admired hedge fund manager who famously helped George Soros "break" the British pound in the early 1990s, has a simple message for investors patting themselves on the back for the way they've navigated markets in the last 12 months.

"A monkey could make money in this market."

The billionaire told CNBC on Tuesday night (AEST) that his family office, Duquesne Capital, had delivered a 42 per cent return in 2020 and was up 17 per cent so far this year; six outside money managers he uses have done much better than him, he said.

Hedge fund legend Stanley Druckenmiller says the Fed needs to change its stance now the economic reality has changed. **Bloomberg**

But it is the reason that Druckenmiller and indeed so many other monkeys – sorry, investors – have done so well in the last 12 months that has him worried.

Moves by the Federal Reserve to stimulate the economy were appropriate at the start of the pandemic, Druckenmiller says, and have worked well. Last year, he described the prospect of a V-shaped recovery as “a fantasy” and sat out of the sharemarket in April and May, when the incredible rally in equities was just getting started.

"I couldn't have been more wrong," he happily admits.

But he cannot understand why the Fed and other central banks haven't changed their policy settings as economies have rebounded.

"The black hole didn't occur – that's wonderful, and we're all happy. But we're still acting like we're in a black hole. In fact, the economy has accelerated," Druckenmiller says, using the US economy as his example.

Gross domestic product has normalised, retail sales have surged above pre-COVID-19 levels, and the jobs market has rebounded.

I can't find any period in history where monetary and fiscal policy was this out of step with the economic circumstances. Not one.

— Stanley Druckenmiller

But as Druckenmiller wrote in a piece in *The Wall Street Journal* with colleague Christian Broda, Fed chairman Jerome Powell is determined to keep "emergency settings after the emergency has passed".

"The Fed is telling markets that the first hike will happen in 32 months - 2½ years later than normal," the two wrote.

"In addition, the Fed continues to buy $US40 billion ($51.2 billion) a month in mortgages even as housing is clearly running out of supply. And the central bank still isn't even thinking about ending $US120 billion a month of bond purchases."

On top of that, the Biden administration has just launched the biggest fiscal stimulus program in history. Of the $US850 billion transferred from the US government to the private sector, Druckenmiller says $US575 billion came after retail sales had returned to trend levels.

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"I can't find any period in history where monetary and fiscal policy was this out of step with the economic circumstances. Not one," Druckenmiller says.

"I just think it's totally inappropriate."

Inflation is the elephant in the room

Raising interest rates now would hurt, Druckenmiller concedes. But it won't hurt as much as raising them in three years, when he argues the bubble will have been further inflated.

While tensions between China and the rest of the world over Taiwan could be the thing that pops the bubble, "the most probable, and the elephant in the room, is that inflation becomes so obvious that the Fed has to move".

"The longer they wait to move, the bigger the bubble and the bigger the reaction."

Druckenmiller's comments add to growing market jitters about rising inflation and the potential reaction of central banks to it.

Global sharemarkets shuddered on Tuesday night, with the S&P 500 index down 1.1 per cent, the FTSE down 2.5 per cent, the DAX off 1.8 per cent and the CAC off 1.9 per cent.

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It's simply impossible to ignore the big surges in the prices of different commodities as the global recovery rolls on – iron ore and copper of course, but also timber, oil and even some soft commodities. Corn is up 50 per cent this year and wheat and soyabeans have also pushed higher.

Druckenmiller sees several implications for the Fed's inaction. The first, and perhaps the most obvious given the way inflation jitters washed through markets on Tuesday night, is in equities.

"I have no doubt – none whatsoever – that we are in a raging mania in all assets. I also have no doubt that I have no clue when that's going to end," he says.

He's still long equities, but says "we're not nearly as long as we were four, five month ago", with many of Duquesne Capital's relative bets shifting to commodities, interest rates and currencies.

"I will be surprised if we're not out of the stockmarket by the end of the year," he says bluntly.

New global currency could be crypto

Druckenmiller has also predicted the US dollar could lose its status as the world's reserve currency if the Fed continues to add to America's debt at the current rate and interest rates eventually rise, making interest repayments difficult.

He says that using the Congressional Budget Office's long-term average rate for US

10-year Treasuries of 4.9 per cent – which of course seems a zillion miles from

today's rate settings – the US government would need to spend 30 per cent of GDP on interest payments alone.

He argues that the dollar's safe haven status is already being questioned; when markets crashed in March last year, Druckenmiller says foreign investors withdrew $1 trillion from the US bond market and outflows from foreign investors have increased.

The reason the US dollar hasn't fallen, he says, is because the big pandemic winners were US tech giants, so flows of foreign capital into US shares have supported the currency.

But if the rotation to value continues, Druckenmiller wonders if America's growth-oriented markets could take a hit – putting pressure on the dollar.

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The new global reserve currency could be a crypto one, Druckenmiller says, while stressing it's likely this currency is yet to be invented and is unlikely to come from the current crop of cryptocurrencies.

"Five, six years ago I said crypto was a solution in search of a problem. The problem has been clearly identified. It is Jerome Powell and the rest of the world's central bankers. There's a lack of trust," he says.

Druckenmiller's warning on inflation and loose monetary policy are certainly attractive in a world where you only need to go to a shopping centre to see the stock shortages that will logically flow through to higher prices.

But at the same time, the Federal Reserve and the Reserve Bank of Australia – and indeed the Biden administration and the Coalition government in Tuesday's federal budget – have made it clear that they are taking a very humanistic approach to monetary and fiscal policy settings.

The burden of this pandemic crisis has clearly not been borne by billionaires such as Druckenmiller, but by low income workers who were the first to lose their jobs and in some cases are yet to regain them.

The argument goes that supporting these people must be the focus of monetary and fiscal stimulus. And that means keeping the taps open and waiting to see actual inflation before you act – and perhaps even tolerating a bit more inflation than in past economic cycles.

It's a reasonable argument, but Druckenmiller is right when he says history shows it's not without risk.

The problem with running hot is that you can get burnt.

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