Bridgewater®

Daily Observations

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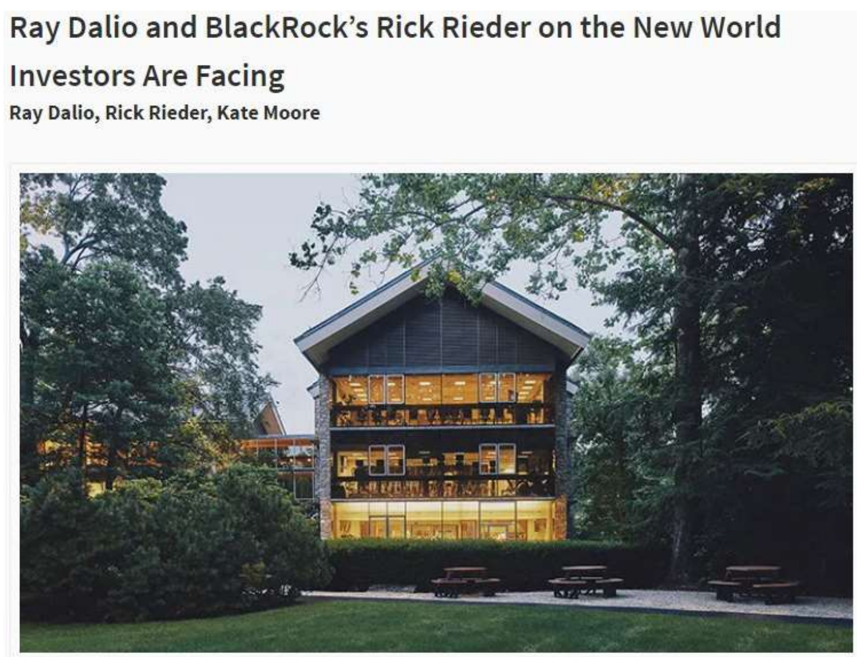
Ray Dalio
Rick Rieder
Kate Moore

Ray Dalio and BlackRock's Rick Rieder on the New World Investors Are Facing

Discussing the massive changes to the economy, monetary policy, and geopolitics that have played out since the onset of the COVID-19 pandemic, and what they mean for investors.

Listen to the Podcast

Late last month, Bridgewater founder Ray Dalio joined the BlackRock Future Forum for a wide-ranging discussion on how to invest in a world that has been transformed since the start of the COVID-19 pandemic. Ray is joined by Rick Rieder, BlackRock's CIO of Global Fixed Income, and by Head of Thematic Strategy Kate Moore, who moderates their discussion. Rick and Ray talk through the massive changes to the economy, monetary policy, and geopolitics that have played out since the onset of COVID, and the lessons investors can learn from history to prepare them for the most important dynamics in the current environment. They also discuss their contrasting perspectives on inflation, their thoughts on investing in China, and how technology may transform the economy in the coming years. We hope you enjoy the discussion.



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A full transcript is included in today's *Observations*.

TRANSCRIPT
Ray Dalio and BlackRock's Rick Rieder on the New World Investors Are Facing

Note: This transcript has been edited for readability.

ZACH BUCHWALD
Now, to start us off, I'll pass the mic to Kate Moore. Thanks again for joining us today. And now, over to you, Kate.

KATE MOORE
Thank you, Zach. This is a particularly interesting moment in the economy and markets. And I can't think of two better people than Rick and Ray to help us think through this inflection point in monetary policy, fiscal policy, geopolitics, and sustainability. Eighteen months after the start of the pandemic, liquidity remains high. The labor market is tight, and consumers are in great health. Companies are also flush with cash, and corporate margins are at or close to all-time highs. And yet we also have concerns around the duration of supply chain disruptions and what will happen with rising energy costs, what the impact is going to be on inflation for both businesses and individuals.

So, I'm excited to be sharing this conversation with Rick and Ray, two titans of the investment world, who combined have a staggering 75 years of investment experience. Incredibly impressive. You both managed portfolios through the crash of 1987, the tech bubble, the great financial crisis, the taper tantrum in 2013, and now have made it through in one piece over the course of the pandemic. I think we can all agree that the past year and a half has been difficult at best.

Chapter 1: Understanding the New World Investors Are Facing

Rick discusses how the COVID pandemic has ushered in dramatic changes to the economic and geopolitical environment that raise new challenges for investors.

KATE MOORE
So, Rick, I'm going to start with you just quickly here to set the stage for markets. I'd love if you could reflect on why today's investment backdrop is different than past market events and, specifically, how you're thinking about balancing risk, how do you think about building resiliency in a portfolio, and where we go from here. So, Rick, over to you.

RICK RIEDER
Thanks, Kate, and thanks to all for doing this. When it comes to investing today or thinking about the investment backdrop, I mean, you can't get around—we just went through what has been the most epic event, arguably, in the history of markets in terms of this health crisis. And I think the impact that that is going to have and the way it's going to change the nature of commerce going forward—technology, travel, supply chain dynamics, how you balance and how the world balances long-term versus short-term investment dynamics, things like energy, commodities, etc. So, first consideration is, how do you think about the new world on the back side of what is an extraordinary, historic healthcare event?

Second point I would make is that the usage of fiscal and monetary policy to bridge to the other side of this epidemic has been pretty extraordinary and beyond anything I've ever seen, certainly, in the investment universe. I would say generally well-designed, flexible, more than adequate, in order to minimize social and economic disruption. And you think about the backdrop of when you pull monetary and fiscal together, not just in the US, but globally—I mean, you pressed into the system immense amounts of liquidity. But just to put a couple of these numbers in the backdrop into perspective, today versus 20 years ago—20 years ago there was less than $3 trillion of liquidity in the system—in dollar equivalents, 6% of GDP. It's now $40 trillion or just under 50% of GDP.

So, first thing, from an investment point of view, that liquidity is completely different. And then, how do you invest? And now, you think about you're probably on the back side of that. And then finally, to wrap up, I'll pass it to Ray for his better, bigger-picture thoughts than mine, I would throw out: how do you think about global and political tensions on the back side of what I just described? Supply-chain breakages, the dynamics around how do you think about your domestic trade, how do you think about your domestic ecosystem, which I think you'll see some stress based on, you know, how have you operated internationally over the last few decades? So, big consideration, I think, is going to be how do you think about political tension, and how do you think about sovereign or regional dynamics? Maybe a bit more profound and different than we've seen over the last couple of decades. So, with that, I'll pass it to Ray for his big-picture thoughts on these things.

Chapter 2: Applying the Lessons of History to Today

Ray discusses the importance of using history to understand today's economy and talks through the three most important dynamics he's seeing in the current environment.

KATE MOORE

Well, Rick, thank you so much for framing that. Ray, you've talked a lot about the key to imagining the future in looking beyond just the lessons of one lifetime or the lifetime that we've all lived. So, maybe can you expand a little bit upon that and what you think the biggest forces are and what history we should be paying attention to, to better understand our present?

RAY DALIO

Well, I think Rick did a good job of describing the big forces. I look at it this way—I learned a lesson in 1971 when there was the first dollar devaluation. The stock market went up a lot, and I thought it was going to go down a lot in 1971, because it was the first devaluation in my lifetime. And that got me in the habit of looking at history to figuring I need to understand those things that happened even before my lifetime, because that same devaluation happened on March 5, 1933, by Roosevelt. So, I like to look at history. By being able to study the Great Depression, it was that which allowed us to do well in the 2008 financial crisis.

So, there were three big things that didn't happen in my lifetime before that happened in recent years that required me to study the last 500 years of history to gain perspective. And I found these things happened over and over again. And the first is the hitting of zero interest rates, requiring the creation of a lot of debt—to send out those checks—and the monetization of that debt and how that passes through the system. I'm like a mechanic. I follow the flows. And when you make those purchases, it passes through the system. And as Rick mentioned, that has had a transformative effect and will be part of our future. Last time you have to go back to see that was 1933, and it happened many times before and has a big effect on the value of money, the value of money, because we talk about assets. But what's the value of money?

The second force is the gaps—the sizes of the wealth and income gaps and the political gaps. And with that, the conflicts that we're having internally, when I look at a lot of statistics, is the greatest since 1900. And that has an interactive effect with how the checks are going out and so on. So, a big, big issue is that internal conflict and how that will be dealt with—through tax policy, through even antagonism, through the political system, as we start to think about how will the elections go or even any of those aspects. And that's just the United States. The world is encountering that.

And the third great influence that didn't happen in my lifetime before but happened many times before was the rise of a great power to challenge the existing great power and the existing world order. In other words, the rise of China to challenge the United States in trade, technology, capital markets, geopolitically, and conceivably military. That factor is also entering into those.

And then, of course, when I studied history, I studied that acts of nature have had a bigger effect on the world than wars, than depressions, and so on. They've killed more people than wars, and that includes pandemics, floods, and droughts. And so, I didn't pay as much attention to those because pandemics are one of those things that come along regularly, like the giant storm that comes along regularly. But we forget about it because it doesn't happen in our lifetime. So, I've started to think about not only pandemics but floods and so on in light of climate change. So, Rick and I, I think, are agreeing. He may phrase it differently. But history tells us a lot about the mechanics of today. And so, those are the subjects I think we're all interested in.

Chapter 3: Where Is Inflation Going from Here?

First, Rick gives his thoughts on inflation, estimating that it will peak soon and then return to normal levels. Then Ray describes his own contrasting views and why he is more concerned about persistently high inflation than Rick.

KATE MOORE

Ray, that was fascinating. I love thinking about periods of history that we all need to study to have a better understanding of today. And particularly, my attention was caught by that comment you made around the great power shift with China challenging the US. I want to bring this back, actually, to monetary policy for a moment, though, and give this to Rick. What do you think is the biggest story in the market? Is it inflation and the adjustment of monetary policy? And how should investors be positioning portfolios and reacting to the dynamics and policy in inflation right now?

RICK RIEDER

So, I think inflation is a tricky thing in terms of, what are we talking about when we talk about inflation? How do you measure it? How do you think about the impact on different areas? Listen, I think if you had to generalize inflation over the coming months, maybe the next couple of years, I think we're talking about inflation that's going to run in the high twos type of inflation. You know, our estimate is that core PCE is going to go, over the next few months, to about 3.5%, peaking in around December, maybe close to 4%. But then we think it's going to decline to below 2% by around the middle of next year. There are some things that are going to be with us for, I think, a longer period of time. I think higher labor costs are going to be with us for a long time. Quite frankly, I think we're going through the strongest job market in history, literally in history. I was studying this in terms of the demand for jobs, and depending on the metrics you use, whether it's quits to layoffs, whether it's JOLTS job openings, I think we're in the strongest job market in history. I think you're going to see persistent wage inflation take place.

By the way, I also think there's a cultural evolution at play around a movement of the spoils going from capital to labor that suggests that we are going to be in a dynamic where you have higher wages that will lead to—in areas where you have pricing power—where you're going to see is a bit more inflation, which I actually think is going to reduce growth in some areas. You're seeing it in houses today; you're seeing it in some of the consumer durables. A lot of the inflation is coming from the supply side of the equation. The central banks modulate the demand side. So, what do they do with the supply side? Do the central banks hike? Well, it's hard to hike if actually you're denigrating growth from higher prices. So, what do you do in portfolios? I think investment in things like real estate are going to be durable. I think investments in and around some parts of the commodity infrastructure makes some sense going forward, some inflation protection. And then, real rates have been artificially low for an extended period of time. I think you could see a bit of upward pressure on real rates as central banks around the world, in varying degrees, start to try to address some of that inflation.

So, I do think inflation is one of the couple of big subjects and big things and risks and opportunities, quite frankly, to think about today. I would say the other one is China, but I'm going to stop, because I think Ray is going to—I think China, as Ray was describing earlier, is a shift of regional concentration of growth and politics, etc., is maybe the biggest thing we're going to face in the coming years.

KATE MOORE

Rick, you were just stealing my thunder there for a moment because I was going to turn to Ray in a moment here to talk more about his point on China and to dig into some of his thoughts around China's ascendancy, the challenge in terms of power. But Ray, I also wanted to frame this to say the regulatory and policy environment in China looks different right now, very different than in other parts of the world. And in the near term, Chinese growth looks a little bit weaker. Does this matter? And maybe if you could build out your thoughts on the China point—geopolitics and growth in markets—that would be very helpful.

RAY DALIO

I'd love to do that, but before I do, can I offer some thoughts on inflation and the question that you asked? I'm much more concerned about inflation than Rick is, I think. Inflation is the value of money. If you look at where we are in terms of liquidity, the savings rates, and so on, and you look at where real interest rates are, this is the most important thing I think investors should pay attention to, which is they look at nominal rates, and they measure their well-being in their local currency. I think you have to be careful. I think looking at real interest rates and looking at the returns that you're going to get in investments relative to the inflation rate is the most important. And the amount of liquidity and savings that exist, the savings, the net worth has risen because so much money has been put out without any liabilities. The Federal Reserve has taken the liability side of that. And now everybody's got so much more money, and they're not going to reel that in significantly because if they did, they would cause a downturn. Imagine if we had a downturn. Now, imagine the political consequences. Imagine all of that.

So what you have is a situation where there's an unlimited amount of money around; people have never had so much money, and they have interest rates, which are negative real interest rates. History has shown you cannot run for a sustainable period of time without accelerating inflation and paying for it, spending a lot more than you are earning, and creating that with money and credit.

So, investors need to pay attention to, what are the real returns? And of course, as that money goes through the system, what it does is it first starts in bonds, and then it goes through all the way down the risk level. And it bids up the asset classes, all asset classes, and bids up stocks, which lowers their future expected returns. And so, the Federal Reserve cannot make a significant tightening. I imagine at some point that they will make some sort of a tightening, but they're very late on this tightening by any measure. So, I think that paying attention to the real rates, and I think this can be much more chronic. And there is also this tax element, which is this change in wealth. That's an issue, too.

Chapter 4: How Should Investors Think About China?

Ray and Rick give their thoughts on investing in China and the key considerations for investors.

RAY DALIO

As far as the China element goes, in terms of what's going on in China, I've been very lucky to, since 1984, go to China. I went to China because of the interest, and it's been enthralling. First 20 years, I didn't go for making money because there was no money in China really to make, but it brought me in contact with the system and the people and so on. I was lucky enough to be actually able to help them in some ways to develop the financial system, which brought me an intimacy. I would say the important thing to understand is that these are very smart, practical people. That would be the headline. And since I've been there, per capita income has increased by 26 times. The market has become a much more market economy. So, the capital markets become the second-largest capital markets there; people have become billionaires, and so on. And they understand, like Deng Xiaoping said when he was asked about capitalism, and he said, "It doesn't matter whether it's a white cat or a black cat, just as long as it catches mice," and he said, "It's glorious to be rich." And what they're in is a phase of that, what they call common prosperity. And we're wrestling with common prosperity. And I don't know who's against common prosperity, but you also have a different way of approaching things, top-down versus bottom-up.

One of the leaders of China described to me, he said, "The United States is a country of individuals and individualism, and it values that." And so, it's a bottom-up type of country. In China, it's an extension of the parent. It's like a strict parent—it's top-down and it's collective. There are other factors that are going on simultaneously, which include the control of data. Who is going to control data? Data is power, particularly in AI. So, you're getting the movement for the government there to control the data. In the United States, we're struggling with the question of who does control the data and so on. That's what's going on.

Also, when you hear communism or you hear Marxism, there's a knee-jerk reaction from people who are not used to that to understand what that means, and that has to do with common prosperity. In any case, what I would say is, I think that there's an exaggerated reaction to the things that are going on. We could talk about the particulars. There's an exaggerated reaction to those. The assets are cheap. And just basically, you have to say they are a competitor, an effective competitor in the world. And we are operating in an environment where diversification is a very important thing in this largely bipolar world, because when we look at it, we look at American risks, we look at Chinese risks, we look at risks around the country, around the world. And that type of diversification, I think is important.

KATE MOORE
Well, thanks very much, Ray. That gave us a lot to think about. You made two points in there that I'd love for Rick to expand on. Number one, Ray, you mentioned that you thought Chinese assets are cheap, especially after the recent sell-off. So, Rick, I'm going to ask you to speak to that. And the second point you made, which I know is something that we care a lot about at BlackRock, is thinking about portfolio diversification and the importance that Chinese assets play for a diversified portfolio. So, Rick, talk to us about how you're thinking about investing in China at this point in the near term and over the medium term.

RICK RIEDER
I think China is, arguably, the biggest opportunity and one of the biggest risks to how the world plays out, both inflation, growth, fiscal, political pressures, etc. But I think putting some backdrop to it to understand where we're coming from, and I think Ray described this right—20 years ago, China was a trillion-dollar economy. It is now a $17 trillion equivalent economy. It's now 73% of the size of the US. And so, the discussion about should people be investing in China, not investing in China? I think it's going to be challenging to say, gosh, I'm just going to avoid investing in that part of the world for diversification or otherwise.

And so, what I try to think about is, so what do you do with that today in 2021, leading into 2022. Today, China is less than 4% of the ACWI and 7% of the global ag on the fixed income side. So, today, you can have a discussion and say, you know what, those are small parts of the index or your benchmark or what your investment opportunity set is, and I'm not going to do much there, and I'll wait and see how things develop. But I just want to give you one good stat that I think is critical. If you're thinking about big cap in the world today, there are 72 big-cap companies in the US; there's three in China. So, you're thinking about, gosh, the ACWI and what am I doing in big cap? Maybe I have some investment in some of those big cap names, but they're not that many of them today.

However, when you think about unicorns, there are 234 unicorns that came out of the US over the last couple of years, 125 out of China. If you add that up, the US is 48% of the globe, China's 26%, so meaning there's some exciting companies and interesting companies coming out of China. And that's where I think you start to take some risks. You think about where you are in the capital stack, where I have some convexity to the upside. I think there's some exciting things coming out of China. So you say, gosh, there's some exciting investments, bottom of the stack. I think the rates market—if you look at where real rates are in China and some different policy that Ray was describing, the amount of liquidity that's been pumped into the system, the easy policy, I would say maybe a bit more deliberate. So, can you have rates exposure in China? I think so. And that managing the currency around that, which is not always easy, is critical. And then credit—listen, I think you're building some opportunities in the credit markets that have manifest themselves over the past few weeks that require immense amounts of work and dissection. But I think there's some opportunities there to actually look at some of the credit markets.

Chapter 5: How Will Tech Transform Our Economy?

Ray and Rick discuss their thoughts on technology and how it's likely to disrupt and change our economy and industries going forward.

KATE MOORE
I love that. That's awesome, Rick. Thinking about China, one of the other things, Ray, that you said in regard to China is that data is power, and that is one of the reasons why the government has been exerting the influence that it has. And I want to tie that idea into one of the other major themes you outlined at the beginning, which is around the digital revolution. So, over the last 18 months, we've seen an acceleration in technology trends and technology adoption. I'd love, Ray, if you could talk about where you think we go from here and how will technology transform or disrupt our existing systems and institutions.

RAY DALIO
One of the great things of studying the last 500 years is that I could see the depressions, the wars, all of those types of things, and then I could see the evolution. So, in charts that show real GDP per capita, life expectancy, and so on, you plot a chart of that, and everything that we're talking about—the wars, the depressions, and all of those—

barely show up. They look like little blips along this line of upward-rising living standards and so on, which comes from humanity's inventiveness and the technologies that they're developing.

Now, the issue is we see these cycles very up close. In history, 10 years is a very minor blip, and it barely shows up. In our lifetimes, it's just the most important thing that can kill us. So, you see that, but you see it in the form of, like, the wonderful vaccination discoveries and so on. And so, when I look at that, I think that we're now in an era to have more revolutionary technology development than ever before—and more disruption—because of the fact that the learning, the intelligence does not apply to a single area. It implies to all learning and all developments. And because of that, thinking better and using that data together, hopefully intelligently. There are risks to it too. But with that comes the greatest power to make the greatest revolutions we can see.

I think that when I look at investments, some of them are in the technology development of that. Of course, those are the obvious ones, and they can be quite expensive. And one tends to pay attention to the prices as well. Not just good investments, good companies, but good companies can be bad investments and bad companies can be good investments. You have to pay attention to the price. But also, those that are taking advantage of those technologies to transform the businesses, those that are quickest to do that and create revolutionary change. I think that that's one of the most important things. That's also one of the areas China is very, very important.

There are only really two big technology centers, and that's the United States and China. But to be able to realize that those revolutionary changes are through the technology will matter.

KATE MOORE
Great. Thanks so much, Ray. And, Rick, I want to bring this over to you. A famous element of your market commentaries for years and years now, it seems, has been on the power of technology, and you've highlighted many transformational technologies, and you have been out front on a number of brands and a number of disruptors. So, I would love for you to talk a little bit about how you think about the technology-investing landscape at this point and react at all to some of Ray's comments.

RICK RIEDER
Well, I think Ray hit it. I mean, I didn't know we were both going to talk about this dynamic around data. But I have to say, I think you're now going to take internet development, mobility, and now data. And so, maybe I'll take a little bit of a twist on what Ray was saying. But I think your ability to actually move data, transmit it, assimilate it, process it, analyze it, are going to change everything we do. There are a couple of areas I'm super excited about. One, I think, healthcare, which Ray touched on. Understanding the human genome—you can actually take DNA—and I think someone told me there are 22,000 genes in the body, and it's actually just a software program. And if we can actually analyze that DNA construct, if you think about it—like Ray said, I'm thinking of how quickly we got the vaccine.

Once you understood the genetic makeup of what COVID-19 was, all of a sudden you could go and run that software program. I think you're going to see discovery over the next five years in and around healthcare—because data, robotic surgery, diagnostics—that I think is truly extraordinary. The other part of it, which I think people are scratching the surface on that gets a lot of media attention, is space. How do you get data from space, not just in GPS technology, which is one of the great technologies, I think, of our time. But how does that change agriculture, logistics, mining, disaster recovery? And I think you're going to see discoveries of space, maybe manufacturing—Jeff Bezos talked about manufacturing using solar in space, obviously, where you get 100% of the time in sunlight. Well, I think this ability to take this into space and move this data is incredible.

I'll say one last thing on investment management. We are scratching at the surface of what other industries, I think, have done and the ability to use AI, to use data simulation, to use efficient correlations and diversification, and build data into your modeling of economic conditions. Pretty exciting point in time. And I think five years from now, people are going to look back and say this is the most exciting time to invest in new companies, new businesses, but also actually hopefully put money to work efficiently. So, I'll leave it there, Kate.

KATE MOORE
Awesome, Rick. As we're thinking about data and talking about data, I was reminded of the quote that, "If you don't pay for the product, then you are the product." Your data is valuable, but I love those other themes, Rick, that you mentioned around healthcare and space and where we're going to be able to really see some incredibly interesting innovations over the quarters and years to come.

So, with that, I just want to give a major thank you to both Rick and Ray for incredible insights and for sharing their perspectives today. I think this was a really fantastic session, and I loved being a part of that. And with that, I'm going to turn it back over to you, Zach.

ZACH BUCHWALD
All right. Thanks, Kate. And let me thank you as well. It's not easy to wrangle those guys. And that conversation was pretty brilliant.