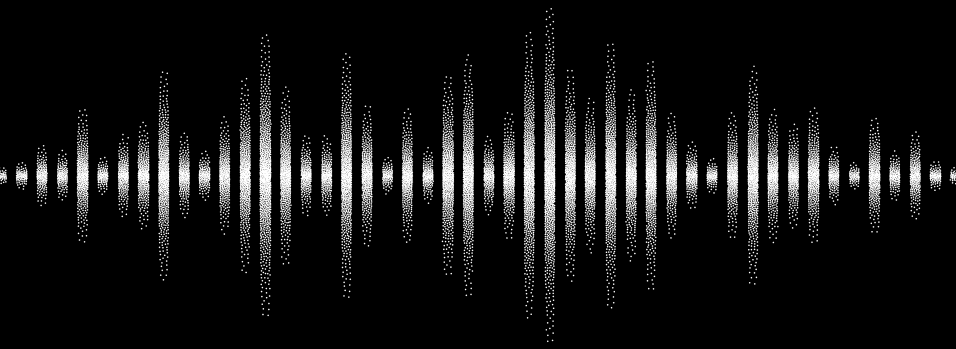
'Any investor with skin in the game needs to buy this book'
NIALL FERGUSON

HOW TO LISTEN WHEN MARKETS SPEAK



RISKS, MYTHS AND INVESTMENT OPPORTUNITIES IN A RADICALLY RESHAPED ECONOMY

LAWRENCE G. McDONALD
New York Times bestselling author
WITH JAMES PATRICK ROBINSON

Acclaim for *How to Listen When Markets Speak*

'As soon as I finished *How to Listen When Markets Speak*, I took a long, hard look at my portfolio. Any investor with skin in the game needs to buy this book.' Niall Ferguson, Harvard historian and author of *The Ascent of Money and Doom*

'*How to Listen When Markets Speak* makes gutsy predictions about seismic shifts in the global economy, advises readers on how to prepare for those shifts, and anticipates trends in almost every asset class while sharing important signals that can give investors an edge in the volatile years to come.' Gregory Zuckerman, author of *The Man Who Solved the Market*

'McDonald's provocative, passionate and sometimes prophetic insights are always worth pondering, even (or especially) when you disagree. His latest book offers strong riposte to the tech hype, bull-market euphoria, and wishful thinking about a soft landing. It is a thought-provoking work at a time when the global zeitgeist is changing in profound ways.' Gillian Tett, columnist for the *Financial Times,* provost at King's College, and author of *Anthro-Vision*

'I can't tell you how much I learned from *How to Listen When Markets Speak*. The historical perspectives and insights are something every investor needs to know. Buy this book.' Mark Cuban, founder of Cost Plus Drugs and former owner of the Dallas Mavericks

'Larry McDonald's deep knowledge, experience, and insights have been invaluable in shaping my investment strategies, and *How to Listen When Markets Speak* is no different. It will sit on the edge of my desk, ready to refer back to frequently. I highly recommended it to anyone keen to protect their wealth in tumultuous times.' Raoul Pal, CEO and co-founder of Real Vision

'*How to Listen When Markets Speak* is a consistently compelling contribution to today's debate on the future of financial markets and a challenge to assumptions that have outlived their value.' Ian Bremmer, political scientist and president of the Eurasia Group

Copyrighted Material

www.penguin.co.uk

ALSO BY LAWRENCE G. MCDONALD

A Colossal Failure of Common Sense

Copyrighted Material

How to Listen When Markets Speak

Risks, Myths and Investment Opportunities in a Radically Reshaped Economy



Lawrence G. McDonald
with James Patrick Robinson



Copyrighted Material

PENGUIN BOOKS

TRANSWORLD PUBLISHERS
Penguin Random House, One Embassy Gardens,
8 Viaduct Gardens, London SW11 7BW
www.penguin.co.uk

Transworld is part of the Penguin Random House group of companies
whose addresses can be found at global.penguinrandomhouse.com



Penguin
Random House
UK

First published in Great Britain in 2024 by Torva
an imprint of Transworld Publishers
Penguin paperback edition published 2025
This edition published by arrangement with Currency, an imprint of the
Crown Publishing Group, a division of Penguin Random House LLC.

Copyright © Lawrence G. McDonald and James P. Robinson 2024

Lawrence G. McDonald and James P. Robinson have asserted their
right under the Copyright, Designs and Patents Act 1988 to be
identified as the authors of this work.

Every effort has been made to obtain the necessary permissions with
reference to copyright material, both illustrative and quoted. We apologize
for any omissions in this respect and will be pleased to make the
appropriate acknowledgements in any future edition.

A CIP catalogue record for this book
is available from the British Library.

ISBN
9781804995983

Text design by Ralph Fowler
Charts by Robbert van Batenburg

Printed and bound in Great Britain by Clays Ltd, Elcograf S.p.A.

The authorized representative in the EEA is Penguin Random House Ireland,
Morrison Chambers, 32 Nassau Street, Dublin D02 YH68.

Penguin Random House values and supports copyright. Copyright fuels creativity,
encourages diverse voices, promotes freedom of expression and supports a vibrant culture.
Thank you for purchasing an authorized edition of this book and for respecting intellectual
property laws by not reproducing, scanning or distributing any part of it by any means
without permission. You are supporting authors and enabling Penguin Random House to
continue to publish books for everyone. No part of this book may be used or reproduced
in any manner for the purpose of training artificial intelligence technologies or systems.
In accordance with Article 4(3) of the DSM Directive 2019/790, Penguin Random House
expressly reserves this work from the text and data mining exception.

Penguin Random House is committed to a sustainable future
for our business, our readers and our planet. This book is made
from Forest Stewardship Council® certified paper.



Copyrighted Material

To Anabela, Gabriella, and Marcus,
and to Dad, my mentor for decades.
Without his guidance this book
wouldn't have been possible.

Copyrighted Material

Copyrighted Material

CONTENTS

Author's Note ix
Foreword xi
Introduction xv

1. The End of an Era 3
2. America Crosses the Rubicon 22
3. The Dazzling Obamas—and the Dying of the Light 43
4. The New Washington Consensus 59
5. Fossil Fuels Paving the Way to the Green Meadow 84
6. The Dark Side of Passive Investing 117
7. The Psychology of Bubbles and the Mania of Crypto 140
8. The Decline of the U.S. Dollar 166
9. Cold, Hard Assets—the Portfolio for the Next Decade 197

Acknowledgments 227
Notes 231
Index 235

Copyrighted Material

Copyrighted Material

AUTHOR'S NOTE

This book is the result of fifteen years spent roaming the hallways of global finance. When Lehman Brothers failed, I thought I had lost everything. Like a bird thrown out of the nest, I had to reinvent myself. On that long, sometimes lonely road, publishing the inside story of Lehman's collapse and giving lectures on the economy throughout the world, I somehow amassed a team of brilliant minds who became my brain trust in the coming years. Blessed with good friends and great mentors, I leaned heavily on their wisdom to write this book. For each person who shared their macro lens on markets and allowed me to see with great clarity the ebb and flow of international money, I remain eternally grateful. It is to you that I owe this book.

Copyrighted Material

Copyrighted Material

FOREWORD

NIALL FERGUSON

In *How to Listen When Markets Speak,* Larry McDonald prophesies "a new era of persistent inflation, an escalation in global conflict, a multipolar world teaming up against the United States, the horror of a weakening dollar, a series of sovereign debt crises, and a thundering of capital out of financial assets into hard assets," not to mention "catastrophic shortages of natural resources."

There is always an audience for prophets of doom, as I pointed out in a book of my own—*Doom: The Politics of Catastrophe*—and doommongers have prophesied thousands of the last zero ends of the world. But Larry McDonald is in a different category. The author of the definitive insider's account of the fall of Lehman Brothers, *A Colossal Failure of Common Sense,* he has a remarkable ear for financial markets, the result of decades of Wall Street conversations, going all the way back to the stock market crash of 1987. The message of his new book is not that the world's about to end, but that the global economy is going through a paradigm shift. The markets are already telling us that. You just have to have your ear to the ground, the way McDonald does. Or maybe that should be "your ear to the trading floor."

The trouble with Wall Street chatter is that the ratio of noise to signal is pretty high. To try to strip out the noise, McDonald has developed a model of financial risk based on twenty-one systemic risk indicators, including the corporate default rate, stock market short-interest ratios, and investor sentiment surveys. Since 2010, when he founded *The Bear Traps Report,* he has been one of my favorite channels of communication with that talkative and moody individual known as Mr. Market.

The key thesis of *How to Listen When Markets Speak* is one with which I heartily agree. The end of the Cold War in the late 1980s and early 1990s ushered in a generational financial boom that has lasted close to forty years, albeit a boom punctuated by numerous crises. The principal drivers of the boom were globalization and the integration of Asian labor and

Copyrighted Material

savings—not forgetting talent—into an increasingly borderless financial system that successfully harnessed the innovations in information technology emanating from Silicon Valley. These powerful forces drove down inflation from the heights of the 1970s to the low point of 2009.

But that era is now over. What ended it? The prime suspects are central bankers, who grew increasingly reckless in their efforts to stave off crises (notably in 1998, 2001, 2008 to 2009, and 2020) by cutting interest rates and then buying bonds and other financial assets ("quantitative easing"), massively expanding their balance sheets. These measures, McDonald argues, acted as a volatility suppressant, encouraging structural shifts in financial markets in favor of exchange-traded funds, passive investment, and short-volatility strategies. At the same time, China's admission to the World Trade Organization and its securing of permanent normal trade relations with the United States in 2001 ensured a sustained hollowing out of U.S. manufacturing capacity, with all its social and political consequences. Third, fiscal policy—beginning with the Global War on Terror and culminating in the Biden administration's various industrial policy measures—has driven the U.S. federal debt to a height relative to GDP that is unprecedented since World War II. Fourth, the political backlash against globalization has produced a new protectionist (and anti-China) bipartisan consensus in Washington. Finally, the global campaign to discourage investment in "fossil fuels" in favor of "renewables" is leading to an unintended energy crisis.

McDonald's conclusions are bold:

The great migration of capital, moving from growth stocks into value stocks, has only just begun. We are in the first inning. And as every rally in the growth space fails, it will bring more disappointment to those investors who are still searching for the promised land. One day they will grudgingly pack their bags and walk into the value sector. They will see the rally happening in gold, silver, platinum, and palladium.

In other words, the inter–Cold War era of disinflation is over. Inflation is not returning to 2 percent or lower. The dollar is destined for a period of weakness. And investors would be well advised to ditch tech stocks and invest in precious metals, not to mention copper, lithium, cobalt, graphite, and uranium, all of which will be in short supply relative to the ambitious demands of the "energy transition."

Copyrighted Material

Some might say that this makes too little allowance for the likely ben-

efits of further technological innovation (think artificial intelligence) or the potential comeback of secular stagnation as demographics and debt dynamics slow down growth. But McDonald's case for the financial equivalent of a "Fourth Turning" is strengthened by some star witnesses, including such legendary investors as David Tepper, David Einhorn, and Charlie Munger. Interviews with these luminaries, as well as with less-well-known members of McDonald's Wall Street network, are a key part of what distinguishes *How to Listen When Markets Speak* from other books on contemporary finance, most of which ought to be titled *How to Stay Awake While I Pontificate.* McDonald's humility is a rare thing in the financial world. To his credit, he has never forgotten that he started out "as a pork chop salesman along the Cape Cod Canal."

I can't pretend to know the financial future. Back in 2008, my book *The Ascent of Money* did a pretty good job of foreseeing the global financial crisis, but subsequent events caught me out more than once and taught me the valuable lesson that to anticipate markets you really do need to listen before you talk. That's why I became a regular reader of *The Bear Traps Report*. It's why I recommend Larry McDonald's new book. And it's why, as soon as I'd finished it, the first thing I did was take a long, hard look at my own portfolio. I predict most readers will do the same.

Copyrighted Material

Copyrighted Material

INTRODUCTION

A Banquet of Consequences

Sooner or later everyone sits down to a banquet of consequences.
—COMMONLY ATTRIBUTED TO ROBERT LOUIS STEVENSON

For most of the last three decades, since the end of the Cold War, America has basked in an unprecedented era of peace and prosperity. Increased international trade, reduced interstate conflict, and a global dollar reserve currency generated newfound wealth and a disinflationary environment. The whole world feasted on relatively cheap and abundant commodities.

These times of plenty enabled irrational thinking and hubristic behavior by those with money and power, and insulated them from the consequences. On four major occasions—1998, 2001, 2008, and 2020—the Fed and Congress used the tools at their disposal to hand Wall Street a lifeline. They bailed out rotten market participants and heedlessly injected cash into the system to kick-start the economy. As a result, the government now owes $33 trillion in debt after years of spending wildly beyond its means, the Fed has bought more than $8.5 trillion in bonds, and financial assets have cycled through bubble after bubble.

As the 2020s arrived, America reached a tipping point. Financial markets and the real-world economy were sent reeling by the COVID-19 pandemic. Russia's war against Ukraine, which has already cost an immeasurable number of lives, interrupted crucial oil and gas supply lines,

Copyrighted Material

fueling a global inflationary crisis and sending many countries into recessions. After a bull run the year before, 2022 saw a $9 trillion loss of wealth as technology stocks and crypto crashed.

This offers just a taste of what's to come and marks the very beginning of the seismic shift in the performance of financial assets. The economic world as we know it—and the rules that govern it—are over. In the coming decade, we'll witness a new era of persistent inflation, an escalation in global conflict, a multipolar world teaming up against the United States, the horror of a weakening dollar, a series of sovereign debt crises, and a thundering of capital out of financial assets into hard assets.

The entire planet is also soon to experience catastrophic shortages of natural resources. From Europe's Climate Target Plan to the many pieces of Biden's original Build Back Better plan, developed countries are steaming full speed ahead toward carbon neutrality, but without the adequate raw materials to manufacture the solar panels, wind turbines, and electric motors they'll need. And as the developing world grows richer, demand for oil and other fossil fuels will skyrocket, accelerated by population growth. Competition for critical commodities will be fierce.

To make matters worse, America's economy is skewed to an almost unimaginable degree, which will intensify any economic dislocation. Policymakers have intervened in financial markets so much that they've irrecoverably damaged the price-discovery mechanism. Stocks, bonds, real estate, commodities, and other assets are riddled with imbalances, leaving millions of 401(k)s and IRAs at risk. Capital across the economy has been allocated according to what's been true over the past three decades, not the new paradigms that will define the next decade. Tens of trillions of dollars have been shoveled into passive investing vehicles like exchange-traded funds (ETFs), with little consideration as to how that might distort valuations and buying behavior. In stocks, quantitative trading has massively compounded the colossal distortion of market risk. Now imagine a world that is constantly short of energy supplies, where crises and crashes regularly rock financial markets but where the Fed and Congress are unable to do anything to help. This sea change will challenge existing financial thinking and force a rebalancing of epic proportions toward new sectors.

Copyrighted Material

But, however grim the economic outlook, this story is not about gloom and doom. Investors are not helpless pawns facing inevitable losses. My

goal is not to scare you but to prepare you—to light a path through and around the coming upheaval. The stakes are sky-high, and the opportunities are even higher. A decade from now, investors who positioned their portfolios ahead of the seismic shifts in global markets—who capitalized on the first-mover advantage—will be the envy of Wall Street. Meanwhile, investors who still chase the last decade's darlings, pressured by the fear of missing out and trapped in a rearview-mirror mentality, will yearn for a do-over.

I've spent practically my entire career on Wall Street, riding the ups and downs of the past thirty years. In the late 1990s, I co-founded Convertbond.com, a website that provided news, valuation, terms, and analysis tools about convertible securities. After that, I moved to Lehman Brothers, where I became one of the most profitable traders in high-yield, distressed debt, and convertible securities.

My first book, *A Colossal Failure of Common Sense,* chronicled the fateful mistakes and hubris that led to Lehman's collapse. Rather than keeping his ear to the ground, our former chairman "secluded himself in palatial offices on the thirty-first floor, far away from the action, nursing ambitions of unfettered growth."

The parallels with our current moment are eerie.

Lehman gave me a real-world education in market risk. Watching the cleverest minds on Wall Street succumb to irredeemable logic, heading directly for the biggest subprime iceberg ever seen, left me forever changed. After the crisis, as the words "if only" slammed repeatedly into my brain, I poured my energy into learning how to detect early signals of economic danger and opportunity. Twenty-one systemic risk indicators—many of which mainstream financial models overlook—emerged from my analysis, giving me a razor-sharp gauge for assessing the health of an economy. Finally ready to get back into the action, though as an independent agent no longer beholden to the big banks, I founded *The Bear Traps Report,* a macroeconomic financial research platform that draws on those indicators to help hedge funds, family offices, asset managers, and investors navigate an increasingly risky world and build crisis-proof portfolios.

And that's exactly what this book will do for you. First we'll trace the origins of our current economic order, replaying the events, decisions, and economic conditions that created a thirty-year bull market. It's an epic tale of reckless optimism, maddening groupthink, and naïve policy.

Copyrighted Material

Although some of this history will be familiar to readers of finance books, we'll approach it as a study of cause and effect. Few investors know how to connect the dots among past, present, and future, and those who can will gain a powerful edge.

Then we'll map out the twists and turns of the road ahead. Though most people alive today grew up alongside a historic rise in financial wealth and are accustomed to relentless asset appreciation, those macro conditions will soon be a distant memory—and much of the "financial wealth" we have accumulated will prove illusory.

In the second half of the book, we'll outline new rules of investing in a radically reshaped economic landscape, including strategies for resisting reactionary narratives and detecting bearish and bullish trends a beat ahead of the crowds. Along the way, you'll sit down with some of the greatest traders and investors of the past decade, including Charlie Munger, David Tepper, and David Einhorn, getting a front-row seat to the smartest professional money trades in today's markets.

The markets are speaking loudly and clearly; we just need to have ears to listen. On the journey ahead, we'll explore the following:

- How the peaceful afterglow of the Cold War's end laid the foundations for an era of disinflation that defined the following thirty years and your investment portfolio.
- Why a sustained era of high interest rates will make the shuddering $33 trillion debt on the U.S. balance sheet impossible to finance, pushing interest payments on the national debt from $580 billion in 2021 to $1.4 trillion in 2024 (more than the government currently spends on defense or Medicare), and how a monumental $200 trillion of unfunded liabilities will increase the risk of a catastrophic default.
- How outsourcing since the 1990s further depressed inflation and facilitated America's now-crushing government indebtedness—and presents you with one of the most compelling investment opportunities in a generation.
- Why countries like Russia, China, and Saudi Arabia are taking steps to transition away from using the U.S. dollar as a reserve currency, further hurting our country's ability to finance its tre-

Copyrighted Material

mendous debts, wreaking havoc on financial markets, and potentially forcing us to slash Social Security, Medicare, and military spending—and how investors can capitalize on the coming era of a weak dollar.

- How inflation is fueling a surge in the power of labor, like that of the 1960s to 1970s, with unions scoring historic wins that ultimately make inflation "stickier," and what this could mean for your portfolio.
- How the West's war on oil and gas, underinvestment in fossil fuels and energy infrastructure, and estranged relationships with Russia and Saudi Arabia will lift the base price of energy—and everything else—to a higher level, and how to get in front of this moneymaking trend.
- How global population growth and mounting demand from the green revolution will contribute to catastrophic shortages of natural resources, and why hard assets, including green transition minerals like lithium and cobalt, will outperform growth stocks, U.S. Treasuries, and passive investment strategies in the coming years.
- How the crypto sales pitch around escaping the centralized, state-controlled financial system relied on a bet that central banks would suppress rates and inject liquidity forever, and how, given its detachment from hard assets, crypto may even be more sensitive to Fed action than stocks or bonds.
- How algorithmic trading fomented a colossal distortion of market risk: a ticking time bomb that periodically leads to extreme spikes in volatility and triggers abrupt market crashes.
- How passive investing and the vehicles intended to democratize finance have fueled bubbles and ideological skew by large market participants, and how America's 401(k) and retirement plans have been hijacked by fourteen stocks.

Copyrighted Material

- Why the classic 60 percent stock/40 percent bond portfolio—revered as the foundational guidepost for many investors—is

dead, and why the forward thinking should embrace a more commodity- and cash-heavy approach to portfolio construction.

We're about to witness a historic multitrillion-dollar migration of capital—one that ushers in a new class of winners and losers. If you have skin in the market, this story is happening to you.

Historians William Strauss and Neil Howe famously argued that modern history moves in cycles, with four distinct phases, or "turnings." Each typically lasts fifteen to twenty-five years, meaning the whole cycle neatly coincides with the average life span of a human being. The First Turning is "the High," followed by "the Awakening," followed by "the Unraveling," followed by "the Crisis." Our current cycle began with the High of the post–World War II economic boom and ended with JFK's assassination in 1963. The Awakening produced the rise of a new counterculture, with the civil rights, antiwar, and women's movements gaining traction. The third turning arrived under Reagan in the mid-1980s and was defined both by economic expansion and a new wave of culture wars, political polarization, and slowly weakening institutions. The Unraveling was a particularly long era. But prosperity eventually breeds complacency, and now the United States must face the Fourth Turning—the Crisis—a period of creative destruction in which the slate is wiped clean and old institutions are replaced with new ones.

But before looking forward, we must look back. Our story begins in the back seat of a presidential motorcade in the early 1980s.

Copyrighted Material

How to Listen When Markets Speak

Copyrighted Material

Copyrighted Material

1

The End of an Era

It was the afternoon of March 8, 1983. A tropical breeze swept across endless acres of citrus orchards and into Orlando, fluttering the flags on the limousine pulling up in front of the Sheraton Twin Towers. Immaculate as ever, in a navy suit offset by a white linen pocket square, President Ronald W. Reagan was led to a podium where he delivered a speech that would be remembered for decades. In it, he called the USSR an "evil empire" and took steps to shore up NATO's nuclear deterrent to counteract the Soviet Union's.

The United States and the Soviet Union were already in an arms race that would peak three years after Reagan stepped up to that podium. The Cold War had started in 1947. By 1975, a red line had been carved right down the northern hemisphere, dividing East from West, with the East protected by a Soviet military of 5.5 million men and about twenty thousand nuclear missiles. In the next ten years the number of missiles would double. It was nothing short of a standoff, a display of muscle flexing on the grandest scale, neither camp daring to open a line of communication.

Despite that muscular display, the Soviet Union's economy was in tough shape. The nation spanned fifteen republics, eleven time zones, and a swath of land 6,800 miles wide—from Kaliningrad in the west all the way to a desperately cold spit of land on the Chukchi Sea known as Uelen. But landmass rarely equals wealth, happiness, or opportunity. For the Soviets, it didn't even promise a hot meal. Corruption, the absence of a free market, and a costly proxy war in the Hindu Kush, where the mujahideen were covertly supported by the Pentagon and the Saudis, severely hampered the economy. Images of breadlines and empty supermarket shelves were often seen in Western newspapers.

Copyrighted Material

Reagan's "rhetorical rearmament" achieved its intended effect of rattling his adversary. By 1985, the Soviets had amassed a total of 39,000 nuclear missiles, with close to 6,000 aimed directly at the United States. America met this threat by stockpiling over 21,000 warheads. The world was one technical fault away from total annihilation.

The big man in the White House knew that the USSR could easily buckle under a disillusioned military and an educated populace living in near squalor, with little chance of a better life. Then came the 1986 nuclear accident at Chernobyl and the Politburo's decision to stall the public announcement for two days. Even then, its twenty-second televised statement was vague, assuring listeners that authorities were handling the situation. The surge of radiation poisoning, of course, was not under control. And while the Politburo avoided addressing this new public health crisis, Mikhail Gorbachev, the new general secretary of the Soviet Communist Party and de facto leader of the country, pored over the reports of death, injury, and ruination: across great tracts of land, lives, homes, and even entire towns were torn apart. He wrote afterward that his conscience could no longer be involved with nuclear arms.

Later that same year, a black motorcade snaked through the middle of Reykjavik, Iceland, stopping at a whitewashed building known as Hofdi House. It was a blustery, sodden morning, the skies platinum above the bank of photographers in waiting. Gorbachev, in a knee-length cashmere overcoat, trotted up the steps to be greeted by President Reagan.

Reagan looked at Gorbachev for a beat, at a man born and raised in Soviet Russia under the most hard-line communist rulers: men like Josef Stalin, Nikita Khrushchev, and Leonid Brezhnev (whose eighteen-year reign was defined by economic stagnation). And here was Gorbachev, an educated man standing before the president of the United States, against every possible communist belief. He may have been only five feet nine inches tall, but history would remember him as a giant of democracy. Gorbachev was there to discuss a nuclear arms reduction, for which he would later be given a Nobel Peace Prize. Reagan smiled at him in that classic cowboy way, and the two men shook hands as if they were already friends, the whole world watching. For the USSR, this was a giant step toward dissolution.

Copyrighted Material

The concept of hope has been one of the most potent forces in the history of mankind.

That simple emotion has been responsible for more victories against the odds than any machine or weapon. It's how the Greeks, desperately outnumbered, defeated ten thousand Persian soldiers in 490 B.C. on the plain of Marathon. It's how Winston Churchill rallied Great Britain and its allies to fight the tyranny of Nazi Germany. And it's how, in the last year of the 1980s, half a million citizens of East Germany staged a mass protest along the perimeter of the Berlin Wall, turning their backs on the bankrupt state. On the night of November 9, 1989, the concrete divider separating East and West Germany was finally torn down.

The Soviet Union was in free fall by late 1991. Despite Gorbachev's hopes for radical liberalization, piecemeal reforms couldn't save an economic system founded on centralized control. On Christmas Day, the bright red flag flying above the Kremlin, with its yellow hammer and sickle representing the solidarity between industrial proletarians and farmworkers, was lowered for the last time. Gorbachev abolished the Communist Party of the Soviet Union and then resigned as president of the USSR.

The collapse of the Soviet Union became the great representation of global peace that settled like a blanket on international trade and free markets throughout the world. The bitter tensions that had plagued geopolitics since the start of the Cold War had finally been extinguished.

But what does the fall of the Soviet Union in the 1990s have to do with your portfolio in the 2020s?

Everything!

Because the collapse of the USSR helped shift the world from a multipolar to a unipolar order, one that revolved around a single dominant player. Backed by an outrageously robust economy and an overwhelming military force, the United States could crush challengers like ants. Under this new world order, a massive, interconnected system of global trade and security blossomed. Countries that took advantage of it prospered. Global trade went from less than $5 trillion in 1990 to $28 trillion in 2022, contributing to an increase in global GDP from $20.7 trillion to $100 trillion.

The unipolar world order entailed many different things across many domains—for instance, reducing the urgency of maintaining large stand-

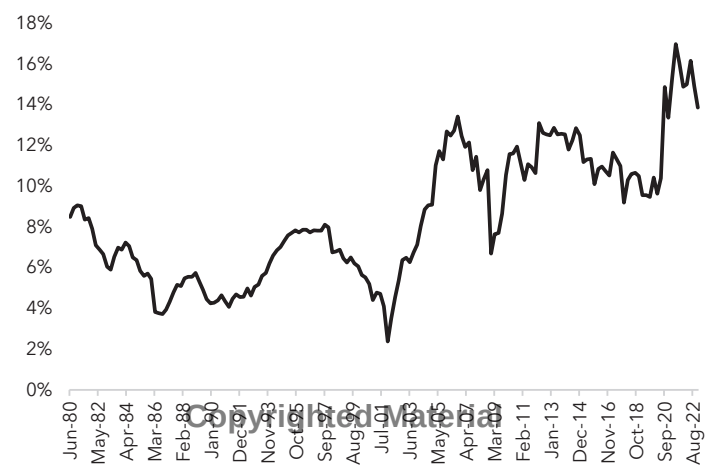
Copyrighted Material

ing armies—but for investors, its most crucial effect was its unprecedented disinflationary power. The surging supply of everything from raw materials (sourced from Russia) to finished goods and cheap labor (sourced from Asia, and especially China) stamped out inflation in Europe and the United States until 2021. Inflation went from 7 percent in the 1970s to 3 percent in the 1990s to 1.7 percent in the 2010s.

This allowed the U.S. Treasury bond yield, also known as the risk-free rate—the fixed rate of return on government Treasuries, which are considered to be zero risk because they are backed by the U.S. taxpayer—to decline from 15 percent in 1981 to less than 1 percent in the 2010s. Declining Treasury yields make fixed-income investments like government bonds less attractive and push investors toward riskier asset classes in search of higher returns. Price-to-earnings (PE) multiples—a measure of how much investors are willing to pay per dollar of company earnings, reflecting general market sentiment—expand when the risk-free rate goes down. Sure enough, the S&P 500's PE ratio went from 7x in the early 1980s to 30x in the late 1990s and in 2021.

This disinflation was one of the most important contributors to the epic bull market in risk assets. Profit margins exploded as financial

S&P Corporate Profit Margin



Copyrighted Material