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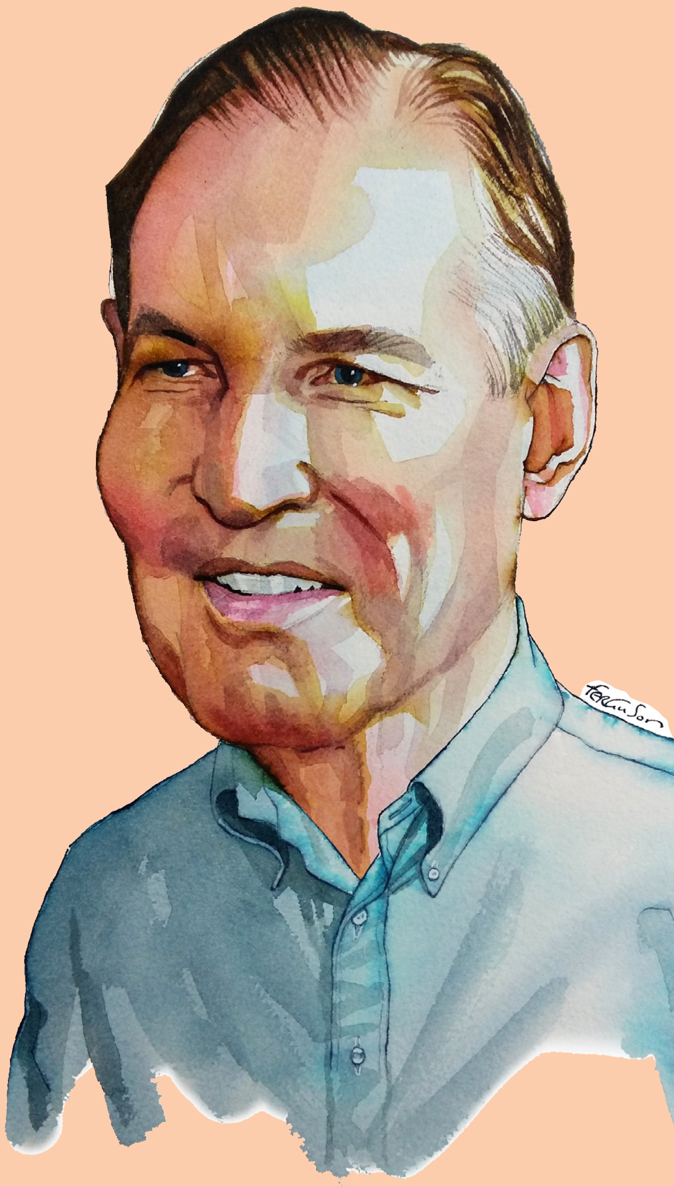
Life

Lunch with the FT Kiril Sokoloff

'There will have to be massive debt relief'



He has made a fortune from calling the big global shifts. Over Russian meatballs and rosé on a menu cooked by both the FT and our guest's private chef, the Wall Street strategist talks to *Rana Foroohar* about debt, lessons from losing his hearing — and his latest predictions for the world

My soufflé won't rise. It's hard not to see this as a metaphor. I'm making it for an FT Lunch with Kiril Sokoloff, an investment strategist who made his name by calling the big shifts in the world over several decades, from the growth of post-Tiananmen China to the rise of the tech sector in the mid-1990s. (His clients include Mukesh Ambani, Sam Zell and Raymond Kwok.)

Recently, he has been trying to make the financial elite see the dangers of seeking to solve the problems of debt with more debt. The topic is timelier than ever, given that central-bank balance sheets — already huge before Covid-19 — are headed into the stratosphere, as policymakers struggle to cope with the crisis, not to mention the popping of a debt bubble that grew for years before it. Like the Fed, I am trying to create froth. But it's not working.

"More whisking," advises Sokoloff's chef Ben Hall, who is quarantined with him in sunny Lyford Cay in the Bahamas. I myself am housebound in drizzly Brooklyn. Hall's head pops up on my computer screen. "You have to make peaks," he says, adjusting the camera to demonstrate the proper wrist action.

We may not have economic growth. Or restaurants. Or anything resembling the "medium peaks" that Hall's recipe calls for. But we can have lunch. And since everything now is virtual, this meal is too. That means I have to cook it myself, though we have agreed to enjoy over Skype the same menu, created by Hall.

It's not the first time we've dined together. A couple of years ago, I was a guest at Sokoloff's "camp" at the Adirondack League Club, a private nature preserve founded in 1890 as somewhere for industrialists and politicians to mingle in a pristine portion of upstate New York. This is the sort of place where the word camp involves not a tent but an elegant lakefront log cabin with picture-postcard views. We discussed what Sokoloff believed was a coming shift, the biggest of our lifetime, from "an era of wealth creation to one of wealth distribution". He argued that the balance of power between labour and capital would begin shifting towards the former, and all the market trends we had become used to — from rising equity prices to the trustworthiness of American sovereign debt — would be swept aside in a downturn that would eventually result in a new order.

He had already rejigged his portfolio in anticipation of this, going long on gold as a hedge against what he believed would be an erosion of the dollar's value in a world awash with central-bank money. What struck me more was that he'd stocked up on tradable goods and made sure that his truck had enough diesel to travel across the country without stopping. It was, as he put it in a newsletter, "unclear whether the cycle swing would be slow and incremental, or violent and extreme".

KIRIL SOKOLOFF'S LUNCH MENU
(As concocted by his chef in lockdown in the Bahamas, and simultaneously cooked by the FT in Brooklyn)

Roasted Brussels sprout and sun-dried tomato frittata

Russian-style meatballs

Wild rice with garden greens

Mocha-infused chocolate soufflé topped with fresh mint and light vanilla sauce

Whispering Angel rosé

Now that Covid-19 has triggered a market crash and recession that may hasten the shift to this new era, we've reconvened. We are having roasted Brussels sprout frittata, his family's recipe for Russian meatballs, wild rice with garden greens and a dark chocolate soufflé. I've tested the recipes in advance, truth be told, as part of a pre-lunch dinner served to my family. ("Can we eat like this every night?" my husband asks. Answer: no.) They are lovely — easy, fresh, healthy. Thankfully, I can still source the ingredients in my neighbourhood, albeit after a queue outside the Union Market grocery store with fellow masked shoppers. I think of Fed chair Jay Powell, and wonder if he has to wait for his groceries, too.

In preparation, I've been not only beating eggs but also reading Depression-era journalist Garet Garrett's 1932 book *A Bubble That Broke the World*, recommended to me by Sokoloff as a primer for our age, since it covers how central-bank actions contributed to the debt-driven run-up to the stock market crash of 1929 and the Great Depression.

I am also pondering a graphic he has sent me, charting the value of US equities between 1918 and 1932. The rise and the fall are frighteningly similar to the period from 2009 onwards. If history is a guide, stocks have further to go before they hit bottom. That's Sokoloff's view, anyway. Then as now, he says, "central bankers were pushing on a string", trying in vain to whip up a real economic recovery with monetary policy.

"The more debt you add [via monetary and even some fiscal policy], the more unproductive the debt becomes," says Sokoloff, who is now positioned at the dining table in front of his screen. It's not a popular view these days. Austerity is out, and MMT — the notion that a country that controls its own currency can print it freely to fund deficit spending without worry — is in. (MMT stands for "modern monetary theory" or "magic money tree", depending on your viewpoint.) But Sokoloff believes the stimulus programmes being launched in the US, Europe and many other parts of the world will very likely end in tears.

"I think we're at the beginning of a long-term period of deflation, falling prices and the loss of pricing power. The only way out of it will be to have a long period of austerity, and to get the US savings rate up dramatically." He points as an example to the US in the period during the second world war, when federal budget deficits were high, well over 20 per cent of GDP in some years (compared to what may be some 20 per cent-plus by the end of this year) but the personal savings rates of Americans were positively Chinese — as high as 25 per cent including income gains from the war and net exports, as opposed to 8 per cent or so before the Covid-19 crisis — boosted by wartime rationing.

While it's true that nobody is spending right now, it's painful to contemplate such a prolonged era of American austerity, which would surely cause both corporations and consumers to suffer in ways that none of us have experienced. Sokoloff, who is supportive of Joe Biden, is concerned about this. But since he is invested mainly in gold and gold mining stocks, he has not been personally hurt by the market downturn. The 72-year-old looks tanned and relaxed (he credits this to daily meditation), with the flattering light of the Caribbean sun pouring across the elegant bookshelf backing ground that has become standard in this strange era of nonstop teleconferencing.

Sokoloff's views, honed over a lifetime of reading history, are persuasive to me, a debt-phobic Midwestern child of immigrants who never understood why more people (not to mention companies) didn't save for a rainy day.

"When you get debt above 90 per cent [of GDP], you reduce economic growth by one-third. And the velocity of money declines," says Sokoloff, quoting from a recent interview in one of his newsletters with the economist Lacy Hunt, in which the two laid out their shared view on debt. "So, the productivity in that debt declines too. A dollar of debt used to get you 40 cents of growth. Now, with all this stimulus, it's about 25 per cent." And most probably going lower.

"Are we opening the wine?" he asks, smiling and holding up a bottle of the summertime classic Whispering Angel that he has suggested accompany our meal. Oh yes, I nod, grimly pondering how my own dollar assets might decline in the future he suggests. Real estate in prime cities such as New York is already plummeting, as Sokoloff had long predicted it would. I uncork my own bottle and am silently grateful for one of the advantages of WFH, which is that nobody can see how much you drink.

The rosé reminds me of the Hamptons, where a number of the readers of Sokoloff's trademark publication, "What I Learned This Week", have undoubtedly holed up to wait out the crisis. In a way, I've been waiting to do this Lunch for nearly 15 years, which is roughly how long I've followed Sokoloff's work.

He was first recommended to me by the late money manager Barton Biggs, with whom I used to chat frequently about investment ideas. Once, in the mid-2000s, when I was complaining to Biggs about the commoditisation of the media landscape thanks to online competition, he observed that he was paying more money than ever for the sharpest investment publications. I told him to send me something that he couldn't live without; what I received was a copy of WILTW, which Sokoloff publishes through his advisory firm 13D Global Strategy & Research.

There were no snazzy graphics or charts — visually, it looked rather like a college essay paper — but it read like a primer to every investment trend you wished you'd seen coming: the Asian financial crisis (Sokoloff says the building of the Petronas Towers was a key signal for him), the tip to a bull market in commodities in 1999, and so on.

He didn't get everything right (Sokoloff turned bearish on US equities too soon before the dotcom crash, and was overly focused on oil for years). But he was mostly right and took the long view. I remember in particular being struck by a piece that ran many years ago about the geopolitical implications of China cornering the market in rare earth minerals.

I was also struck by Sokoloff's literary sensibility. Every week, he would deliver to readers a half dozen or so prescient ideas — the dangers of Islamic fundamentalism two weeks before 9/11, a series on pandemics that began in 1998 — but also references to classical learning, interesting or obscure books he had read, even cultural trends (he has published pieces recently on the economic challenges and opportunities of loneliness, and why figurative painting is making a comeback).

When I tried to contact him about writing a guest piece for the news magazine I was working for at the time (an offer he declined), I discovered one reason why he was so well read: he had been slowly losing his hearing since his college years, and spent much of his time alone with books. "I was struggling to cope in a world that was becoming quieter and quieter," he says.

A cochlear implant eventually brought his hearing back to a manageable level. But the experience left him with a particular appreciation of why, as the philosopher Pascal put it, "all of humanity's problems stem from man's inability to sit quietly in a room alone". Unlike many financial types, Sokoloff tends to ignore high-speed media and the blizzard of big data and focuses instead on emotions and instinct, trying to pinpoint important anomalies that signal secular shifts across politics, economics, markets and history.

He is in touch with the 19th century and its lessons directly through the life of his father, an aristocratic Russian doctor who won election to the All Russian Constituent Assembly in the six-month interlude between the tsar and Lenin. The first day the assembly met, says Sokoloff, "Lenin hired these Latvian sailors and gave them a couple of bottles of vodka each and sent them up to the balconies, where they screamed and shouted so nothing could happen."

After a brief stint as part of the White Russian government, Sokoloff's father escaped to Prague, travelling through Paris and London, and settled in the US, where he married Sokoloff's mother, a piano prodigy who entered Radcliffe College at the age of 16 and, like his father, was the author of several history books. Her family lost much of their money in the 1929 crash. Being the child of elites who experienced class warfare and the Great Depression must surely have informed his somewhat apocalyptic views about today.

While his parents had more pedigree than wealth, "there was always money for travel, and for books", says Sokoloff, who correctly spotted the beginning of supply-side economics and the possibility of a bull run in all sorts of assets after hearing a speech that then former governor of California Ronald Reagan gave at the Republican National Convention in 1976, which prompted a long ovation from the crowd. "My uncle hauled me in front of his New Deal friends, saying, 'My nephew believes there is going to be a new era of capitalism in the US.' His friends said it was the most ridiculous thing they'd heard. But there was a special mood at the time. You could feel it."

Sokoloff, who has worked for himself as an investor and adviser since the 1970s following brief stints as a financial editor and investment banker, wrote a book on inflation with economist Gary Shilling, and started an Asian hedge fund and a mobile technology fund before shifting his full attention to writing his weekly newsletters. Clients tend to be erudite, long-game types — people such as George Soros (a tennis partner for many years; the two enjoy games in Sun Valley) or Biggs, who would read his copy on the train home to Connecticut, a glass of wine in hand.

A highlight of Sokoloff's report is the list of timely historical quotes, such as this one from Montagu Norman, governor of the Bank of England between 1920 and 1944, which ran in an issue last year analysing whether the Fed rate cut of 1921 might have fuelled the boom-bust cycle of the Roaring Twenties: "We achieved absolutely nothing . . . nothing that I did, and very little that old Ben [Strong, head of the NY Fed] did, internationally produced any good effect — or indeed any effect at all except that we collected money from a lot of poor devils and gave it over to the four winds."

> 'We're at the beginning of a long-term period of deflation, falling prices and the loss of pricing power'

Is that where we are headed today? Sokoloff says very probably, yes. In fact, even with the stimulus, "there will have to be massive debt relief on both principal and interest." Not that this is anything new; Sokoloff has been making comparisons between a previous debt-forgiving superpower — Julius Caesar and Rome — and the US for years.

As we wind down lunch, he mentions yet another book he's currently keen on, *The Fourth Turning*, written in 1997 by two American historians, William Strauss and Neil Howe. In it, they predicted that around the year 2005 a financial crisis would set off a major change in social mood and the political and economic order, raising questions of class, race, nation and empire. "This is turning out to be a very prophetic book," says Sokoloff, pouring vanilla cream over his chocolate soufflé.

Mine may not have risen, but it is delicious — dark and rich, with a kick of the instant coffee that is the secret ingredient. Still, pondering this coming era of austerity, I've lost my appetite. I decide to have fresh fruit instead. I have thus far avoided Covid-19. But, sadly, I'm battling the Covid-10: those extra pounds I've gained in quarantine.

Rana Foroohar is an FT columnist