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12/22/23 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. January 1, 1990. Investing $100 in the S&P 500 at 339.97 would be worth more than $2,600 today, doing nothing more than keeping your hands in your pockets and reinvesting dividends. An annualized return of more than 10%. Owning bonds was the same story. It gets even better. The 1990s had a tough start to the decade. Back then, policy thought recessions were a good thing, a cleansing tool, a necessary outcome to make sure inflation demons never returned.

2. Breaking things was a sign policy was working. Regional bank failures, emerging market defaults, and the demise of Bankers Trust, an institution that provided the very first President of the Federal Reserve Bank of New York – all acceptable collateral damage in the name of macro discipline. But it also made for relaxed investors once inflation was back in the genie bottle. You really didn't need to work all that hard when "trees grow" was the theme of the day.

3. Leadership matters. Fed Chair Greenspan began to run an experiment of sorts in the second half of the 1990s. He had a hunch the United States was experiencing "the wonders of a new economy" where productivity would let growth run stronger without inflation. So instead of tightening with the aim of a cleansing recession, Greenspan held policy rates largely unchanged from 1996 to 1998. The economy boomed, and inflation fell. The "new economy" was a reality.

4. Leadership really matters. Jerome Powell's first strategic address was in August 2018, in the stunning Jackson Hole. To avoid 1970s-style inflation, the Fed would need to steer clear of academic issues like "equilibrium" concepts of unemployment and interest rates. Calibrating policy to models on what the economy ought to be led policymakers to run inflation hot. Instead, Powell preferred the "hunch policy" style of the Greenspan era, leaning on pragmatism.

5. Does that make Powell's 2023 a repeat of Greenspan's 1995? The experiment is being run to be sure. Like 1995, the Fed raised rates quickly over a short period, slowing activity and containing inflation. And to curb economic weakness, rate cuts followed shortly thereafter. Soft landings were not a policy path back then – Greenspan made it a reality. In Feb 1999, the TIME Magazine cover featured Greenspan, Summers, and Rubin, elevating policy to rock-star status. (Larry on the skins for sure.)

6. Bond markets see the parallel. Figure 1 illustrates short-term interest rate expectations from the time of the last rate hike in Feb 1995 and July 2023. The starting point is similar. But the market expectation is vastly different. In 1995, investors were conditioned to believe that central banks wanted a recession. Now, investors see policy hunting for the soft landing. Two years after the final hike, rates were expected to be 8% in 1995; now, they're projected to fall to 3%.

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7. Expectations make all the difference. That investors expect policy to calibrate to the 1990s makes it an implausible outcome. Clues are there. Gold and oil prices were cratering back then. US value stocks traded at 10-times forward earnings and growth companies at 15-times, valuations reserved for downturns. Investors were bracing for a crash landing. When it wasn't realized, a sling-shot effect led a capital surge into growth. The Dotcom Bubble was born.

8. Today's potential bubble? Scarcity. Just as tech was poking its head in the early 1990s to explode into the dotcom bubble, less sexy capacity constraints are what matter now. Power. Chips. Ships. The stuff that makes an economy go vroom and was taken for granted because poor countries were desperate to integrate into rich ones by providing cheap capacity. The pandemic exposed the limitations of capacity, and global wars have reinforced them.

9. Take fossil fuels. Headlines tell us fossils are destined to be dinosaurs. Yet, world demand for liquid oil products marches forward with another 2% increase this year to a record 102 million barrels per day, which will rise another 1-2 million next year. Capital spending budgets are constrained, well below pre-COVID levels with growth in low-carbon areas. Demand for fossils will be rationed by limited supply and rising prices – shove over dotcom, scarcity is moving in.

10. Scarcity may be the theme of the century, not just the cycle. It's the antithesis of the capacity-rich 1990s that dulled inflation and fueled valuations for everything else. That's being flipped on its head now. It's just not the focus of investors, intent to pray on the trivial parallels to the 1990s that conveniently fit a consensus growth-portfolio mindset. Lower inflation and lower rates underpinning consensus portfolios are on a collision course with capacity constraints.

11. Crypto asset markets are sending early warning signals. Bitcoin. That's where scarcity value lives most happily in crypto. Not scarcity by way of algorithm. Scarcity of real resources. Power. Chips. Ships. Bitcoin is the crypto asset whose valuation, creation, and administration depend on the state of real resources. It's the marriage of physical and social sciences. And judging by Bitcoin's outperformance, the crypto crowd wisely sees this isn't the 1990s at all.

12. Like scarcity in any market, demand will be rationed by price. It's the demand side that has the most interesting potential next year and beyond. As crypto assets enter the regulatory mainstream, it is not just the linear entry of crypto into portfolios but the surge in use cases tied to efficiency layers like Solana that can deliver throughput to the mainstream. It is demand that reveals scarcity – and that is crypto's convexity.

13. Where's the scarcity premium in your portfolio?

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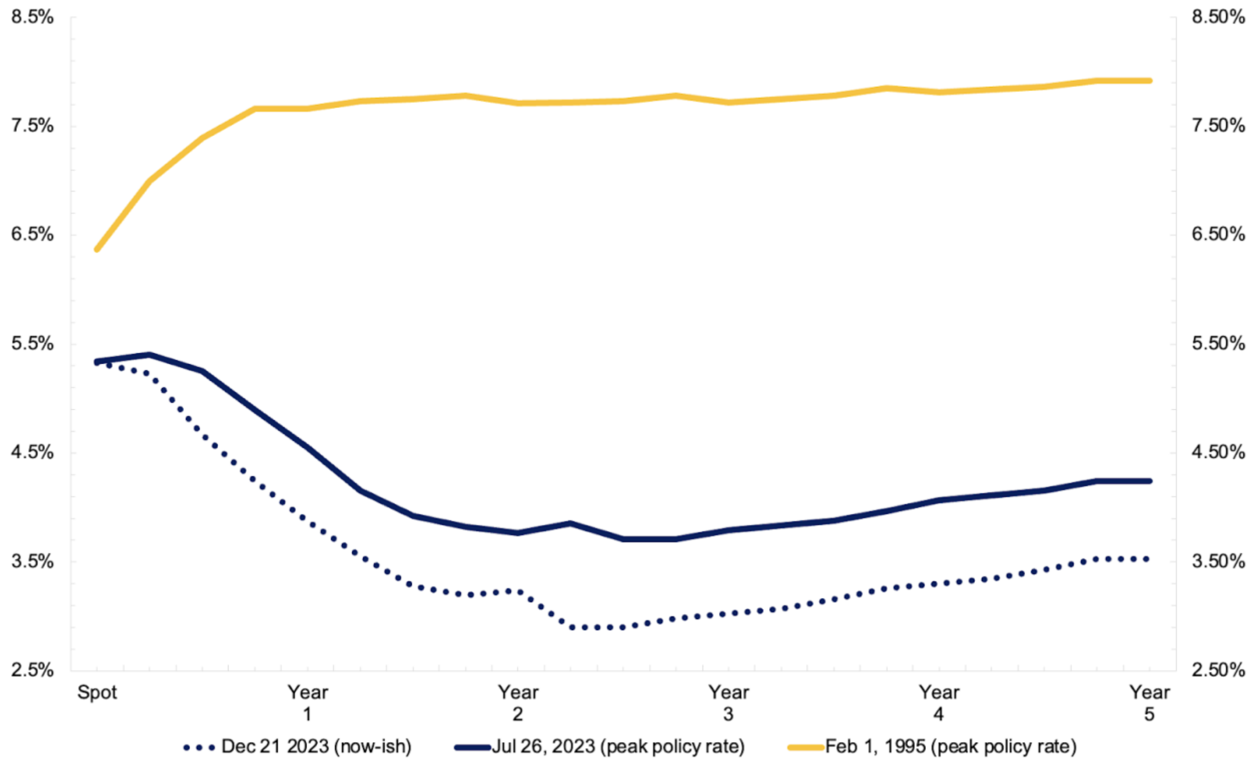
Figure 1: Short-Term Interest Rate Futures. Party Like It's 1995… but it's not.



Source: Bloomberg LP. CBAM Calculations. X-axis is the policy rate implied by market futures. 1995 Eurodollar futures are used, subtracting the spread between spot 3-month LIBOR underlying Eurodollar futures and the effective policy rate.

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