What Makes a Great Macro Fund Manager? With Scott Bessent, CEO & Founder of Key Square Capital Management

Simon Brewer
If you were a key player on the George Soros team that in 1992 helped the Quantum Fund make a billion dollars shorting the pound ahead of the UK's withdrawal from the ERM, are acknowledged as a significant thinker, a highly respected macro hedge fund manager, have taught financial history as an adjunct professor at Yale, and a recognised philanthropist, you might know that our guest today is Scott Bessent. Scott's firm Key Square has as his firm's mantra, 'We study history, we observe the present, and try to imagine the future.' And that's what I hope we all do today. So, Scott, you're over from the US, we're recording here in London, and I have a list of macro and market topics I'm itching to ask and our listeners will be reaching to hear. So welcome to the Money Maze Podcast.

Scott Bessent
Thanks, Simon. I think our compliance department wants to say this is all my opinion, not investment advice for your viewing listening audience. So, I'm looking forward to this.

Simon Brewer
There's been a lot of press around Elon Musk's father's influence on his career, and you told me that your father had one of the largest collections of science fiction books in your part of the US and used to sit and discuss them when you were a child, so much so you said that you could point out the Alpha Centauri constellation before you knew where Chicago was. How did that make you perceive the world?

Scott Bessent
Yeah, it was incredible. So, the largest science fiction collection in South Carolina, not a high bar, but my dad loved to talk about it. And we would sit, look at the stars, try to imagine things, are there people on other planets? If you can believe it, one of our neighbours had a proper observatory telescope. It's just this imagination that there could be something different and it could be on a different planet, or in macro investing, it's regime change, which is I think why I gravitated to it. You need a good imagination.

Simon Brewer
We're going to talk about some of those skills required for your specific part of the business. But you also said your father was a boom-bust real estate investor and his rollercoaster fortunes made you focused on risk management, watching furniture being carried out of a house that your family has owned for 200 years will focus one's mind on not blowing up. Now, of course, some folks would bet that against such a mercurial backdrop, you would be a risk-averse academic or you would avoid investments. But of course, that hasn't been the case and we're going to unpack that. But how did you earn your first dollar?

Scott Bessent
I earned my first dollar putting out the chairs on the beach for lifeguards and hoping one day to be a lifeguard. But I would say I'm a competitive backgammon player. So in backgammon, with a doubling dice, there's something called PRAT, P-R-A-T, and it stands for positioning, racing, and threat. So do you double? If you have two out of the three, you double. So I tend to be more focused on the threat.

Simon Brewer
That is absolutely what we're going to talk about in detail. But you chose Yale, I'm always intrigued. We've had lots of people from different backgrounds. Why Yale?

Scott Bessent
I think I wanted to get out of the South. It was a medium-sized city in New Haven, near New York, but not New York, and a great reputation. Yale had a host of distinguished alumni from South Carolina. Before the Civil War, Charleston had the second or third most students at Yale. So there was a big South Carolina tradition. I didn't know what I wanted to do. Do I want to be a journalist? Do I want to be a computer scientist? Keep in mind, this was 1980 that the computer science department had just switched over from cards, which I think probably 80% of the people being part of this can't imagine, to the mainframes. I was back and forth between quantitative and qualitative and Yale was a good mix.

Simon Brewer
Now, I understand that you actually did get your first job as a securities analyst for the investment firm of a Saudi Arabian family.

Scott Bessent
My first job was actually with George Soros' old partner, Jim Rogers. It was a summer internship. When I look back at it, I'm not even sure you could put this on a bulletin board now, but it was 'Analysts Wanted – Do spreadsheets, make lunch and you can sleep on the sofa if you don't have a place to live', and I didn't have a place to live! So you can imagine 107th Broadway in 1982 in New York City was quite spicy. It was an incredible experience. Jim is one of the great researchers. I could see how he and George Soros were this incredible pair. With Jim's research and then George's market instincts, it was an incredible combination.

Simon Brewer
Do you then work as a securities analyst after that?

Scott Bessent
I did a training program at Brown Brothers, and then I went to work for this Saudi family. Again, counterintuitive, but South Carolina and Saudi Arabia had a long history. The governor of South Carolina had been US ambassador to Saudi Arabia, and this family was incredible. They're one of the most prominent families still. The father came I think to the US in the early '60s, saw New York, and unlike most Saudis of his day, he didn't want to meet movie stars, he didn't want to do this, he wanted to meet CEOs. And he was generating this incredible cash flow from servicing all the Aramco employees and he just kept reinvesting it into US companies. And he got right in at the bottom 1975 and had the ride of a lifetime. They are the most understated, hardworking Middle Eastern family. I'm still very close to them, and the next generation is taking over, and it's incredible to watch their work ethic.

Simon Brewer
So you end up running, when you go back to work with George Soros, you run the London office for eight years, you work with Stan Druckenmiller, and we'll talk a little bit about mentors later on. And you obviously had some very high-profile successes. And then you set up your own firm, Key Square, and that's when we're going to start talking about the markets. But just a bit of reference for our listener community, some will be very familiar with global macro, some less. But if you were to describe global macro at its very essence, how would you describe it?

Scott Bessent
You are observing the world, you're observing markets, you're observing what you think should happen, and you're observing what is happening. It's good and bad that you can look around the world and you're looking for

mispricings, you are looking for policy errors, you're looking for political changes. So basically, you are looking for change on the margin and you want to see what the market is giving you? What is the market giving you, what's the opportunity set? Because you might think you have a great idea, you might think you split an atom, and then it turns out everyone else believes it. A good example would be October 2016. I didn't think Donald Trump was going to win, but I thought he could win. No one else thought he could win. I actually had a big bet with one of my neighbours in the Bahamas who's quite a prominent currency speculator on that.

Simon Brewer
So you launched Key Square. It was one of the largest hedge fund launches ever. I think George Soros was a $2 billion anchor investor and I think you had $4.5 billion within six months. Key Square, I have learned as I have done my research, is from a chess sequence. I'm not a chess player, I'm not a backgammon player, but you say that it doesn't take long for a beginner of chess to learn that the end game is the most difficult and complicated part of the game despite there being less pieces on the board. So help the non-chess players in the audience here understand. You would have given a lot of thought to that name. Why?

Scott Bessent
Sure. So a lot of what we're doing, back to your question on what is global macro, that you can have these big trends, and you can either be part of the trend, you can ride the momentum. George Soros' theory of reflexivity is really a momentum strategy if it's really going up by more, and at the turn is when you can really make a lot of money. With key square, it's when there are just two kings, several pawns, and there is one square you can move to, and you win. If you think about the financial markets, many times, there is one investment you can do and you win, whether it was John Paulson with this CDO-CDS in 2008, whether it was Stan Druckenmiller shorting the pound, again and again, you see these things and we try to keep things very simple. We have a few positions. Where are we going to and what is the key square?

Simon Brewer
So you're continually looking for that position that will enable you to win with the least risk. We have information overload. How do you separate noise from signal?

Scott Bessent
So I actually don't have a Bloomberg. The former mayor doesn't like for me to say this in interviews. I have an incredible trading desk. For me, there is no information value in watching things turn yellow or red constantly. We have a lot of respect for the markets. I look at 270 charts every night. We're not a think tank. You're just looking for either things that are changing, anomalies, or what you think is clearly a mistake, or that something that's maybe unsustainable, and then you identify why now - is that unsustainability going to break?

Simon Brewer
As we think about, and the industry likes to talk about micro and macro, you have written we don't have an edge in predicting nonfarm payrolls, but you can learn a lot from what corporates are saying about wages, hiring and CapEx. The cynic would say, well, so can everyone. So what is it that you think you do or use with that information that gives you an advantage?

Scott Bessent
I think what's different is one of the few good things about being 61 is I have a lot of data. So I've been doing this a long time. And if I look back, in terms of asset classes, foreign exchange has been our biggest dollar winner since I started doing macro in '92, followed by equities. And I think that when we're talking to a company, we aren't necessarily trying to get an edge on the company, we're trying to get an edge on the economy. Everyone's trying to predict the Microsoft earnings or everyone's trying to figure out the FedEx earnings. I'm trying to figure

out what is the FedEx wage round or what is the UPS wage round if it bleeds into a FedEx wage round, then tell me about a wage price spiral in the US. So it's the same information, we just have a different use case.

Simon Brewer
So this comes back to your earlier point about macro investors almost need to have a flexible imagination.

Scott Bessent
We're on a podcast. These didn't exist three to five years ago when you think about how many jobs there are that didn't exist. We were just talking about what will our sons do. His job probably doesn't exist, but you've just got to train them well for how it does exist.

Simon Brewer
I remember a great macro thinker, David Roche, Morgan Stanley's strategist coming in after the Berlin Wall had fallen and the consensus was rates rise, this is awful, and he was unequivocal that you just go and buy German equities. He saw the unification beyond the rising cost of capital, and of course, it was for a while then absolute home run trade. We might talk about Germany's more troubled situation later on.

Scott Bessent
And again, things are counterintuitive. You just said it was a home run trade and then it was a terrible trade because there was the impetus or the demand shock from rebuilding the east. So that's a shock, probably a policy mistake that led to a great deal of inflation. And then the Bundesbank pulled back the liquidity which set off a chain reaction collapse in European equities, which is actually how I ended up in the Soros London office. The Bundesbank actually put me here. The then manager had a very large position in what you would call a reunification play, which worked well for a bit. Then when the Bundesbank decided we are the Bundesbank, we don't like inflation, and they started hiking rates aggressively, the shares collapsed. There was a management change in London. Sequencing is very important in macro. Sequencing is right now, and maybe we'll talk about it later, there is clearly a slow-motion de-dollarisation going on. But could the initial stages be a dollar rally because companies, countries are paying back their dollar debt? So there's a dollar thirst before there's a dollar boycott.

Simon Brewer
You can't see my sheet of questions, but as we move to investment themes, number one is de-dollarisation. So you already jumped in there. So how do you think about taking that idea which I guess many people would say isn't controversial that the dollar loses not its hegemony, it’s relative status? How do you think about the journey ahead and how do you think about as an investor, when is the right time to build your positions?

Scott Bessent
We look for stress in the system. We just did a three-day off-site here in London and I came away thinking, we have these meta-long arc ideas and the real challenge here is, as you just said, we're to implement them as actionable market ideas. There are things happening on the margin, this Shanghai Gold Exchange, very interesting. We see India and China being able to pay for oil, which is the ultimate commodity, via rupees and RMB. So you've now moved the US out of the way. And I'll tell you, a real wake-up call for me was last December. We were doing a call with one of our consultants, a much older fellow, great thinker, and French. And he said I was used to, okay, the US has sanctioned Venezuela, the US has sanctioned Russia, US has sanctioned Iran. And he said, it is untenable that the US can extend its foreign policy to the French government via the dollar, and just this huge multibillion-dollar fine on BNP is going to make a US ally want to think of a new way of doing business. This new term, the Global South, that wants out of the dollar system. Very interesting if French Republic wants out of the dollar system.

Simon Brewer
Yes. And the seizing Russia's reserves has probably only accelerated that.

Scott Bessent
They haven't been seized. I'm told they're frozen. My inclination is they will disappear.

Simon Brewer
All this debt swirling around the system. One as an investor should be thinking about the presentation of purchasing power almost above all, and therefore, currencies has always been a relative game. And I sometimes get some criticism from my partner Will Campion about the fact that I'm a long-term believer in gold and a distruster of the central banks. You have written about gold and have painted a scenario if we get into this monetisation of debt. Am I jumping ahead?

Scott Bessent
Gold is not a fiat currency. There's a limited amount. It is recognised as a store of value. And you are seeing that you can keep gold in your vault. You can move it back. I am adamantly anti-Russian, but the mistake the Russians made was the Russians got onto war footing in terms of their foreign exchange reserves but they moved out of dollars into euros. And they never believed that the Europeans would have the wherewithal, the inclination to follow the Americans. If the Russians had moved entirely into gold, price would be higher, but they would have all their reserves in Moscow. So I think a lot [about] who knows whether China is moving on to war footing vis-à-vis Taiwan, the Chinese PBOC is the largest buyer of gold now. Again, back to imagination, could we imagine some kind of a RMB that is exchangeable into gold maybe at a premium?

Simon Brewer
I don't disagree with any of that, which is probably why I find myself constantly rolling my eyes when people mention Bitcoin.

Scott Bessent
Gold can be a risk-off and a risk-on asset. Bitcoin is a risk-on asset.

Simon Brewer
Plot that chart of Bitcoin against Tesla up until recently, it had a correlation that was almost perfectly 1.

Scott Bessent
As someone who spends a lot of time in The Bahamas, one is sceptical about some aspects of crypto and getting it back.

Simon Brewer
Enough said. Let us talk about Japan. You have had rich pickings there in the past, you've been writing about it again. I'm going to quote you when you say the Bank of Japan will be the final central bank to exit from ultra-loose monetary policy and that global ramifications will be profound. Now, as I follow these currencies, I did run the charts the other day. I think that Japan's purchasing power parity is the most extreme ever witnessed. So that's either the elastic has been stretched or it's the first of these collapsing currencies courtesy of its debt. How are you thinking about Japan, number one, and how are you planning and playing the three legs of that stool which is the FX, the bond market, and the equity market?

Scott Bessent

A little history. I went to Japan first time in 1990/91, spent 90 days at the Okura Hotel. It was a then incredible price of $500 a night. The Okura Hotel, they've just remodelled it, but it's still about $500 a night. We're sitting here in London. I'm not sure I can get a shed for $500 a night! Japan, if we rewind to 2011, it's easy to remember 3/11/11, the terrible Fukushima incident. Japan looked completely hapless, the yen strengthened, they'd been through a series of prime ministers. And they had this gigantic current account because after the collapse of the bubble, I'll go back in '91, the Nikkei peaked and then just kept dribbling down for 20 years. And we were just the opposite then. So the yen was 78 to 82 and it was on PPP, which we use as a gauge. Trading currencies off PPP, you lose all your money because currencies can stay cheap or expensive longer than you can stay solvent. But it was the most expensive currency in the world. We come back around summer of 2012, China was starting to rattle the sabre over the Senkaku Islands. The Japanese were feeling set upon. The Obama administration had basically shown up and said not so much, you're not relevant anymore, and the Japanese panicked. One of our consultants called and said, oh, there's this fellow named Abe, he used to be the prime minister, he's going to come back. He's got this program, and at the time, it was called 3, 3 and 3, then he changed it 2, 2 and 2; 2% inflation, 2 years, 2% inflation, 2% growth. And back to imagination, no one believed he could do it. So we had a theory and then it turned out that there were all these seats opening up on the Bank of Japan, including the chairmanship. So you had a cheap currency and the potential political will to change that. Off the bottom in October, the yen was trading 78 to 82. By the spring of 2013, what we call Abenomics had taken place. A new chairman of the Bank of Japan, a new governor of the Bank of Japan. Governor Kuroda put in the big boom, went to ultra-loose monetary policy. And I remember George Soros and I went up to Yale and visited one of the architects of Abenomics. We had lunch with him and on the way back, George said, 'Do you think this is going to work?' And I said, 'I have no idea, but it's going to be the market ride of a lifetime.' And it has been, it's been incredible. So we're going to 78 on the yen. When I walked in this morning, it was approximately 148.20. I think it peaked at 152.70, and now they have the opposite problem. They were in deflation. Now no one could have imagined that Japan could have an inflationary spiral. And since 1991, you call it the Malaise, but Japan has actually done an incredible smoothing operation and they've just added more debt. They've actually had turns of statistically measured recession. They've only had very few down quarters because they just spent so much government money. They had a huge amount of real estate debt. The government then took it on and now they monetize the debt. And now they're seeing real inflation, both imported globally, and for the first time, wage inflation. I think that they are running a high-pressure economy. To get back to your question on the three asset classes, my guess is that the Nikkei and the TOPIX are going to break through the all-time high. They're part of Abenomics. There's ultra-loose monetary policy, but there's this incredible sea change in Japanese corporate behaviour. So that's back to observing. Companies used to keep a lot of cash on the balance sheet. My friend Jim Grant actually had a Japan fund that was based on the old Ben Graham net cash position. It's a good idea, but in a way, the most dangerous thing is a Japanese company with a lot of cash because they'll do something crazy with it. They have this incredible manufacturing ability and they are less good in financial transactions. So now we're seeing excellent return on capital. The Abe administration put in minimum returns or you get delisted from Tokyo Stock Exchange. I think over the next few years that probably, Tokyo will do the best of any major market. The other thing that's happened too is you're seeing this reshoring in Japan. The semiconductor industry, I was talking to someone, there is a university down toward Okinawa, and Taiwan Semi is hiring every graduate this year, and they're doubling their salaries. Again, Japan in terms of offshoring, the US changing supply chains, Japan's a key component. On the currency, there's a new governor, Governor Ueda. I've met with him many times. I think he's an incredible thinker. For an academic, he loves markets. When I was at his office at the University of Tokyo, there was a Bloomberg, unlike my office, pulsing in the background. And I think he's realised that they've been successful in getting them out of deflation. And I think we've got to have a lot of imagination. So Japan is in NIRP right now, negative interest rate policy. If you have this huge pile of savings and savers who have got nothing on them, if you need to raise rates to 1% or if you do raise rates to 1% to stop inflation, strengthen the currency, could you really end up with something that picks up a lot of strength because Japanese are huge savers. So now you're handing them extra cash. It's almost like a helicopter drop into their bank accounts. And I think no one's imagining what that could look like in six or nine months. One of the things we think about a lot is policymakers are people. Jerome Powell reads what the New York Times writes about him. Ben Bernanke wrote a book, it sounded like he was the head of SEAL Team Six, 'The Courage to Act' or something. I think Governor Ueda will understand that Prime Minister Abe was assassinated, the legacy of Abenomics, they don't want it to end up with a financial bust either in Japan or globally. So I think they will move to quell inflation early.

Simon Brewer
I remember working with Barton Biggs and one of my most successful PA trades was buying the dollar against the yen when the yen was so strong and so I've been itching to put that trade on, but right now, the market has just played the advantage of higher US interest rates and shorter the yen. What will be the trigger for you to get really long the yen?

Scott Bessent
So it would be twofold. One, I would say that there is a position because I perceive we've had a change of personnel with Governor Ueda. He has started hinting that there is going to be a policy change and we are observing from Japanese corporates a pattern of price increases that if you hadn't raised prices for 20 years, you start out at 2 or 3%. Now they're raising prices 8 to 12%. It'll be a one-two combination because it'll be a combination of Japan is coming out on this side. And then with the US, yesterday, we just took out two interest rate cuts for next year, clarified a hike for this year. My guess is you see some kind of back to currencies being relative. You see a big relative change in expectations that the Fed has maybe finally slowed the economy, which was difficult given the amount of government spending. But the Bank of Japan is just beginning a cycle. So the Fed, we'll see. Have they gone a step too far? They are closer to the end than the beginning, and the Bank of Japan is just at the beginning of the cycle. So we want to see both legs to have a full position. Again, the market is giving a lot here. Very few people are interested in owning the yen. If you look at the CTA, their commitment to short yen, quite large.

Simon Brewer
Back to the future, here we are talking about Japan and most people aren't. Everyone's been talking about China. Let's just pause and look at China. What are their fiscal and monetary options? You said that we're seeing the end of a multi-decade leverage cycle in China. How are you thinking about China as an investor?

Scott Bessent
Not Chinese New Year 2023 but 2022, I was invited to a very nice dinner in New York. Everyone had followed China for a long time so you can imagine the early '22, people still very constructive on China. And I had a long-term secular down view based both on economics gravity, because somehow everyone thought China is so big, they have this closed capital account. If it were any other country, it already would have exploded but the view that gravity would win. And then I also had the view that when party Chairman Xi came in, he's a different kind of cat. And this very unusual capitalist-communist blend that had taken China out of the dark ages and into the modern world was over. Now we've seen they've gone to more of command-and-control economy. So at this dinner, I told everyone at the table, I said, you can have China, I will take India and Japan, let's reconvene in five years. I think it's this Leninist model versus the Japanese democratic model and then the Indian, very loud, democratic model. I think you can avoid China and I think that they can have a cyclical balance here within the secular down. They have some very difficult policy decisions to make. They've starved the consumer or starved households in favour of manufacturing and doing the rebalancing is very painful. You have a lot of vested interest, especially at the state and local level, and you've got to move it over to the households. States are not going to sell off assets willingly, but it's got to be done. Then you have the whole Taiwan question. That is we try not to play fort and predict these things, but I think we have to imagine. Our mutual friend Niall Ferguson wrote

a very good piece last week, and it had two parts to it. One was, are the US and China in mutually assured financial destruction? In game theory, an escalating tit for tat is one of the worst patterns. The US kneecaps Chinese tech growth by high-end semiconductor ban, and then Chinese government starts getting a little squishy about Apple, maybe government officials can't have them, maybe there's been a security breach. If we see that financial tit for tat, that's a market event. Taiwan has elections in January. The leading separatist candidate is doing quite well. He's pretty aggressive. We'll see what US policy is. I think we have until the election to see but we'll see how President Xi responds. We're concerned China has been sucking in oil imports. If you were going to go on to war footing, you would need energy, you would need food, and then you would probably sell your treasuries.

Simon Brewer
So before we leave China, I have this micro-macro question, which is if you were a bottom-up investor, you'd look at Alibaba or Tencent and you'd say, world class companies operating with great profitability and trajectories. I'm so drawn to them. Does the macro investor go, I don't care because the geopolitical risk and uncertainty is too profound?

Scott Bessent
I think there are two things here. One, are you a tactical investor, and these things can be very interesting, or are you an endowment long-term investor? At that point, everyone always asks me what is risk, and I say probability and severity. If you think about those positions, what is the probability that you're going to have 100% loss? It is not zero, that you walk in one day and you have just had a Russia and a Ukraine event and the stocks went to zero, or you're not allowed to own them anymore. So I see your point that we are getting to, if I just look at a chart, because I was looking at the chart of the KWEB, which is the China internet index, it looks like it could go down 10% and maybe up 50%. But there's probably a 20% chance you can go down 100% when you think about it in terms of outcomes. So for tactical investors, very interesting. For an endowment, a pension fund, a sovereign wealth fund, probably less interesting.

Simon Brewer
Very well put. Now, as we talked about military conflict, here we have this Ukraine situation. It was General Petraeus who was on the show in January who said, 'All wars end in a conversation.' The next step becomes a rebuild of Ukraine, potentially of a scale that we haven't seen. How are you thinking about exploring that theme?

Scott Bessent
For us, framing a problem is the most important thing. And if we're losing money, I usually think our framing is incorrect. In terms of framing the scenario you just outlined, I think I don't have to worry about that yet because there's an 80% probability Donald Trump is the Republican candidate. Is there a 40% probability that he wins the general election? If you are Vladimir Putin, and former President Trump has said, I am going to end the war in 24 hours, you're not settling. So November 5th, 2024, is when the talking probably starts. Trump wins, it comes in January 20th, there's a conversation. Biden or the Democratic candidate wins again, I'm not in this for 24 more months. This is a meat grinder. I'm going to run out of prisoners from Vladivostok. When you game out the potential paths, I think no conversation starts until November 5th. We always focus on signposts. Again, I think that you don't have to have a conversation. You can have lots of observations, but I don't have to have a conversation on what China might do in Taiwan until I'm confident. But I think the Taiwanese election of January 17th is DPP, which is the anti-unification party wins, then you got to start thinking, could this turn kinetic? My guess is it's more of a blockade. But the Ukraine tragedy, there will be an incredible rebuild. It will be something back to the fall of the Berlin Wall.

Simon Brewer

I look back at my own investing career starting in the mid '80s, and if there's been a persistent mistake, it's trying to be too early. And what you're saying is that you need maybe a convergence of the fundamentals and also the technicals.

Scott Bessent
I always tell everyone who works with me, we're not a think tank, we're a money management firm. Bruce Kovner has this great saying, an investor who doesn't look at technicals is like a doctor without a stethoscope. Even Barton loved technicals. The mind of the market, I don't think I'm smarter than the market and I certainly don't think I have more liquidity than the market, but there are a lot of signals.

Simon Brewer
Which of course leads us, well, it may not of course, it's going to lead me to talk about AI. Now, you've written about how AI can impact productivity. You've also talked about how regulation could help or hinder countries, I'm thinking the US juxtaposed with Europe in that regard. How are you thinking about what AI does and how do you think it will influence your positioning?

Scott Bessent
My guess is it is business out two or three years that we're already starting to see it. I was on a Zoom with one of the most prominent tech overlords. And for those of us on the Zoom, he did a trip around the world and he said China will never let AI meaningfully enter the private sector because they will be convinced that maybe Jack Ma with AI could take down the CCP. So you will not get this private sector productivity enhancement in China. He was of the view that Europe was already starting to regulate it away, and unfortunately, the UK seems to be following the European model. And the US, as we tend to do in the US, he said was the wild, wild west and it could be incredible productivity gains for the US if we don't blow ourselves up. You're starting to see the use case for this. My guess is the big winners, just like with the Internet, no one knew Google was founded in '98, appeared in the early 2000s, so a three or five-year lag. Facebook, Amazon, those companies don't exist yet. My guess is the super scalers who are trying to get onto this, Microsoft, Google, Amazon, Oracle, Meta, are going to be spending a lot of CapEx, they may or may not be the big winners. The big winners could actually be US corporates who are able to get these big productivity gains. You could imagine two or three years out this big cut in employment in maybe white-collar employment, back office. We had a summer intern 20-year-old and he is a Chat GPT Plus native. It was incredible the things he could do for $35 a month.

Simon Brewer
In short, would you say that AI has extraordinary possibilities but huge dispersion in how governments respond around the world, and as an investor, you're watching closely?

Scott Bessent
That's a fantastic summary. And if I think about what is today's business with AI, I would think these hyper scalers. If you come back to the sucking liquidity out of the system, the hyper scalers are the most cash rich companies in the US. And I think Apple would probably be the biggest sovereign wealth fund after Norway. I think I left them off the hyper scalar list. The hyper scalers are probably going to spend between $500 billion and $1 trillion on the data centres for AI. This is an arms race. What happens when they start spending the cash rather than accumulating it? What happens when Apple is selling IG credit to have bricks mortars and Nvidia chips near a power facility in Nebraska? This is just another model change in terms of the savings glut actually getting pushed into the real economy.

Simon Brewer

Which of course brings us to this question I have in front of me, which was summarising today's climate. And you've written a lot about this savings glut. We all know about the cumulative levels of debt. We all read the history books and know that inflating our way out is one of the roots. But summarising today, it's a paradigm shift. It's a changed order. Is that fair?

Scott Bessent
We've had 40 years of disinflation, now we're going the other way. I started university in 1980, started in the investment business in 1984. For my entire adult life, capital has gotten treated better to the detriment of labour. Thatcher came in in '79, Reagan came in in '80, and then life just kept getting better for owners of capital, NAFTA, WTO. We can come back to this AI because I would say, for the US or for the developed world, my hope would be that if there is an AI employment displacement, that we would handle it better than we did with the manufacturing displacement, that we don't end up with a Luddite revolution. It is a model change. I believe you said you were born in '63. I was born in '62. The baby boom bulge is about 54 to 56. So in the US, very good things happen to you when you turn 65 in terms of government benefits, so security, federal health care. And my team thinks that one of the things that happened under the cover of COVID, and everyone's blaming it on COVID, and I think it did accelerate it like COVID did everything. But I think under the cover of COVID, the baby boom bulge turned 65. So they were always going to leave, and that got accelerated during the pandemic. So we've got this incredible labour shortage. I think that someone in my office told me this week, there are a thousand pilots at United Airlines who are going to make over $1 million this year. I was actually getting a UPS package when the UPS labour strike was settled I congratulated the fellow and he said, oh, yeah, my wife has already spent it. You're seeing this UAW strike on all those. And my sense is that the American people are behind the strikers, which is the first time in my working career that the public is with them. So anyway, that was a long way of saying we're going to see a very natural shift back from an overshoot in the amount of the profits going to capital and it's got to come back to labour.

Simon Brewer
And a reaction to executive hyper-pay and some bad behaviour.

Scott Bessent
Terrible behaviour. And this leader of the UAW is quite charismatic but he's making the point - we only want the same increase that the CEO of Ford got. We just want what you get. Why did you get it? Again, on the other hand, what's the future for those workers?

Simon Brewer
So when we think about the portfolio that you run, and we'll talk a little bit about your fund in a minute, you've got this sourcing of ideas and then the positioning. I think your former colleague Jim Rogers said about risk, you've got to look down before you look up. And Michael Mauboussin, who I'm interviewing this afternoon at the London quality group conference, had this number. I don't know if he's right, that when you were all at Soros, the success rate was only around 30%. But your position sizing must have been outstanding because you made such great returns. Is that true and how do you think about the position sizing and the managing of that risk?

Scott Bessent
I'm glad you mentioned Michael because he was chairman for many years at this incredible organisation called the Santa Fe Institute and the way they think about systems. When you say, what is macro, macro is thinking about systems. Can the system accelerate? Could the system break down? And I think the 30% is low. That might have been a number that George Soros said about himself one time. For American baseball, probably the most famous player in history is Babe Ruth, homerun king, strikeout king. So in macro, it's how much do you make

when you're right, how much do you lose when you're wrong. And back to either I think I told you that even though our firm name is based on a chess move, I actually think investing is much more like cards or backgammon. You don't know what the dealer's going to give you or you don't know what the dice are going to give you. Chess, everything's on the board. Does your opponent make a mistake? I remember being at the Santa Fe Institute conference and one of the speakers was talking about what confidence ratio do you need to get to to increase your position. So in theory, if you can get to 51%, then you should keep getting bigger and bigger. I would say that my philosophy, certainly Stan Druckenmiller's philosophy, he's incredible in thinking about asymmetry, is, what's the market given me? What's my upside, downside, and how should I size that? That's what most people missed on the sterling exit from the ERM was we could keep pushing the Bank of England up against the band, they would only push us back to the other side of the band. And there was a chance that maybe the band would break. If I think about in 2012, the yen was, as you said, the most overvalued currency in the world, and the Bank of Japan was doing the worst-kept secret of stealth intervention at about 78. If I was shorting the yen at 80, I could lose 20 points. And if my imagination wasn’t right, I'd lose two big figures. But if my imagination was right, I could make 20 or 30. It's adding when you get information, adding when things break down.

Simon Brewer
Now, this may not be true, but I was told that when you and Stanley Druckenmiller presented the case for shorting the pound to George Soros, his initial reaction was one of what appeared to be dismay, but it was only because you weren't suggesting doing enough.

Scott Bessent
Yeah. You have to remember, especially in the '70s, even into the '80s, markets trended much more. So if you read ‘The Alchemy of Finance’, Plaza Accord happens, the currencies move 7%, but George is adding a 300% position because they're going to keep going. If you have a great idea, it can never be big enough. I've found, I think his quote is it's like shooting fish in a barrel. I think that there’s a change in market structure. Either the fish can shoot back or the metal ties holding the barrel together have gotten bigger and the bullet can bounce back and hit you. You’ve got to be much more adept and much more attentive to the other players.

Simon Brewer
Let's just talk about Key Square, your fund. I believe you had a very good year last year, I think about 30% last year. You obviously have these high conviction macro views you express. You're open to new investors. Who are the sort of partners that you most likely to welcome?

Scott Bessent
We like having a very iterative relationship, I do think, for whatever reason, you tend to get these paradigm shifts, investment changes every 10 years, and they centre around the decade. And I think we're in the midst of one now. I don't know what the dominant theme is going to be for the rest of the 2020s, but I know it's not going to be what it was in the teens. It's also very helpful to hear people's incentives, what they're thinking, what they're leaning towards.

Simon Brewer
So you refer to Stan Druckenmiller very nicely as the greatest investor of our lifetime. Most of us have had mentors along the way who have been extremely important. It just so happens that we were talking about David Darst, who was important to me at Morgan Stanley, and David Roche, in fact, from a distance, Barton Biggs. But what was it that Stan Druckenmiller that you most valued?

Scott Bessent

There's something called superstar syndrome, that Michael Jordan probably couldn't teach us how to play basketball, Roger Federer is probably not the greatest tennis coach, but being able to sit- I'm not sure if Stan could explain why he always does what he does, but being able to sit next to him and watch him and have the dialogue with him, he's just incredible. There's a great trader, I said earlier, the combination of George Soros and Jim Rogers was incredible because of Jim's analytics and then George's trading instincts. Stan is that in one person, and his risk management is incredible. He's never had a down year. It's humbling. The bad part about sitting next to him is that I'm a basketball fan. I go back and look, and if I look at the Chicago Bulls, they were all better. Scottie Pippen, Horace Grant, they were all better for playing with Michael Jordan.

Simon Brewer
I'll have to ask you since we're on the subject of Soros, what was it then that George Soros gave you in that capacity as somebody who was junior initially?

Scott Bessent
I would say the best trade George ever did was hiring Stan. I would tell people, working with George was good at two different times. One on December 31st when the cheque came, and then the other, you always had to be ready, especially when I came back as CIO. I had to have my thoughts organised. And George would probe for the weak spot in your argument. 'Okay, you believe this on the yen, what about this? Oh, I spoke to so and so, he says that. Good Lord, why do we own X billion dollars of Argentinian bonds? I just spoke to my friend Joe Stiglitz, he got back from meeting the new Macri government, and he thinks it will never work. Again, I don't know if it's going to work the years out, but I think the bonds are going to go up 30%.' But I always had to have my thoughts organised, which a lot of people say to me, why don't you just manage your own money? And I find the discipline of having other people's money and having to have my thoughts organised is very helpful as opposed to just I'm intuiting this, I believe this, it'll eventually work out.

Simon Brewer
Discipline is accountability and it's putting yourself in front of an audience who will be rightly judgmental. Moving on to some final closing questions, I'd like to just touch on philanthropy. You've been extremely generous. I understand you donated the Bessent Library to Yale in honour of your father, you sponsor a number of students from less privileged backgrounds. You're a very analytical person, how do you think about prioritising charitable gifts?

Scott Bessent
I'm a big believer in if we believe the system works, which I do, then we have to bring people into the system and convince them that it works. Because when it stops working for everyone, it gets to be a problem. When I lived in Miami, our church went and helped people with their tax returns. And it was incredible to be able to show someone you're getting a refund or with these kids - I'm very active in Harlem Children's Zone and I taught at Yale. So I have that cohort of kids and they're getting Rhodes Scholars, their PhDs and MIT, they're working in the Council of Economic Advisers in the White House. And then I have Harlem Children's Zone and they have just as interesting paths, but it's can I help them go in as a commissioned officer in the army? One of them just had a terrible semester and no one in his family has ever gone to college. Can you help them reboot? Again, it comes down to my worry in the US is education. If you think about the maybe five income quintiles, US used to be you were able to move up and down and a lot of it was education. And if you don't have the education, then the system is not going to work.

Simon Brewer
Staying with education, you and I had an exchange a few weeks back, and we just interviewed Sir Anthony Seldon, who I think was as inspiring and enlightening on the subject of education as anybody that we've spoken

to. I think when we had that conversation, you, and I may be not quoting you correctly, but you said you would be reluctant to hire an undergraduate from Harvard. Was that right?

Scott Bessent
It's 100% correct, and it's not a Yale bias. We're just finding these days that the real go-getters are- look, I think in life, it's probably good to have a little bit of a chip on your shoulder, maybe you didn't get into Harvard. But you are number 1, number 2, number 10 in your university, and people haven't told you you're special your whole life or you've failed at something. And I'm finding that these Harvard kids are quite coddled. I'm going to make up the number, but I think I'm right in order of magnitude, I think 82% of the undergraduates graduate with some kind of an honour. It's a participation medal and they are very difficult for them to take constructive criticism.

Simon Brewer
Great. That is important and we've noted it in the context of a lot of privately educated British students wanting to go to the US and the brain drain that's happening because of some of these other dynamics about rebalancing in the UK.

Scott Bessent
I think that is a huge mistake for the UK. Once you get some hyper-bright young person in Boston or Silicon Valley or Nashville often and they don't come back, then UK is in real trouble.

Simon Brewer
I agree. So that's a different subject for another sub-podcast. But you mentioned setbacks. You've had some investment setbacks along the way. How have you responded and how have you taken lessons from them?

Scott Bessent
You can't personalise it. You try to learn from it. Again, I think having seen my father's up-down, up-down, you always try to manage the magnitude. You want to be able to come back, you want to be able to dust yourself off. Other than Stan Druckenmiller, people lose money. There are good times, there are bad times. I use a lot of data. I had a fallow period. Again, the only good thing about being 61 is I have a lot of data, and I went back and I could see that I tend to have kind of market-based investments and idiosyncratic investments. And maybe there weren't as many market-based opportunities so the idiosyncratic have gotten too big. And then a couple of them went wrong, it wasn’t catastrophic, but it was just a hit against the P&L. And then I realised, okay, there's nothing to do over here. You're probably pushing out the sails a little too much here. Better just to keep everything muted if there's nothing to do.

Simon Brewer
Okay, the final five. What's your most important daily habit?

Scott Bessent
Imagining the day. I was at Hong Kong Airport, I had nothing to read on the plane. I picked up this book on Buddhism and it had, I don't know, 50 meditations you're supposed to do every day which I think added up to more than 24 hours. I felt the most important thing was imagine the day you want to have, you're going to have - what do you have to deal with today? And also great money managers, I'm not necessarily putting myself in this, but my observation is everyone has a plan that if this happens, I'll do that, if this happens, so it's, okay, here's what a good day would look like.

Simon Brewer

How do you seek refuge from the information overload and manage to relax?

Scott Bessent
Saturday is sacred. I try to put my devices away, try to spend it with family, exercise, and then by Sunday afternoon, start up again. My secret weapon even since university has always been starting the week on Sunday afternoon, starting 1, 2 o'clock, maybe working till 8, 9, 10, and then you have a jump on the week, but that's because Saturday has been sacred.

Simon Brewer
A jump on the week and you've got to jump on the competition as well, one can argue, if you're doing it correctly.

Scott Bessent
Again, you've had this incredible regenerative thing on Saturdays. So Saturday is my secret weapon.

Simon Brewer
How have you found navigating the world of finance being an openly gay man?

Scott Bessent
I think I was very fortunate in terms of - and maybe that's why I gravitated to money management, not sales, not investment banking, not management - at the end of the day, the numbers are the numbers, data is data. You can have narratives around the performance, around the data. In general, people don't care. Maybe they're pulling for you, maybe they're pulling against you, but it's performance.

Simon Brewer
Metaphorically, what is the peak that you have still to scale?

Scott Bessent
I think I've made a difference in philanthropy, I think I've made a difference in education, somewhat in the investment business. But in terms of maybe policymakers listening to some of the advice that I have, in terms of we're running these incredible deficits in the US, debt is high everywhere, is the artist Marcel Duchamp who was also a philosopher. He said, "if there's no solution, there's no problem." And I think we're going to have to acknowledge that there's a problem in the US, but globally, and I'd like to be part of that solution in terms of figuring out what is a fair, equitable, and the best way to get to the other side of this.

Simon Brewer
So Scott, my gosh, we could have gone on. I think I'm going to be asking you to have a reappearance next year because there's so much that needs to be covered and the world is moving rapidly. And some of these big themes, I think, might unfold in front of us and trouble investors who have been used to, shall we say, a more comfortable paradigm. I'm going to take away two specific observations you've made today. One is you define risk as I haven't heard it defined before, which is it is assessing both probability and severity. And what it is that makes a good or better macro investor is focusing on those signposts but understanding when and how they are evolving and coming along before they influence the position sizing. So I just want to say, Scott, fantastic for being here today. Thank you very much indeed.

Scott Bessent
Good. Thanks, Simon.

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