

# BEHIND THE MARKETS PODCAST: A DISCUSSION WITH WARREN PIES FROM 3FOURTEEN RESEARCH

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This week, Warren Pies, Founder and Strategist at 3Fourteen Research, joined regular host Jeremy Schwartz, Global CIO at WisdomTree, on the *Behind the Markets* podcast.

## Introduction and Background

It was interesting to start by hearing a bit about Warren's background. He started out as an attorney and then transitioned to market research at Ned Davis Research. His focus there was predominantly on commodities and real assets, and he left after Ned Davis Research wanted to stop focusing on commodities coverage. He started 3Fourteen Research about a year ago.

## Who Is 3Fourteen Research

3Fourteen takes a more advanced, quantitative approach to building different models. The firm's high level asset allocation view is that the next 25 years in the markets will look very different from the 25 years that we have just experienced. Investors were well served by the 60/40 equities/fixed income approach for the past 25 years—but this may not work as well in the coming period.

## What Is the Model Telling Us Today?

Warren discussed one of 3Fourteen's key models, which includes 17 different assets. The drivers of the model include:

1. Trend
2. [Correlation](#)
3. [Volatility](#)

The current positioning is taking a very clear stance on short [duration](#). One way this can be seen is that the longer-term Treasury bond exposure is only about 1%. Equity exposure is roughly neutral, at about 40%, but within this exposure the model has shifted more toward [small caps](#) and the [value](#) factor. The main shift was out of bonds and into real assets—notably, real estate, [bitcoin](#) and gold are at the highest levels seen in the model since the pandemic began.

## Notable Research with Big Implications for Equities vs. Bonds

Warren cited a piece that 3Fourteen put out looking at the relationship in terms of returns for stocks versus bonds. He took the 100 worst days from the last 25 years, based on equity returns, and saw that bond returns were positive on 83 of these days—a great ratio of success as a possible hedge. If one did the same exercise, but looked instead at the 25 years prior to 1998 during the same type of days—the worst 100 for equity returns—bonds only had positive returns on 35 of them.

Two simple variables account for a lot of the movement of stocks and bonds: economic growth and [inflation](#). Over the past 25 years, inflation was largely removed from being a real concern for investors. There was a huge trend toward globalization which led to much lower inflation, particularly in durable goods. Cheaper durable goods prices effectively pulled the [Consumer Price Index](#) lower over this time, improving the prospects for bond returns generally.

## What Are Some of the Best Hedges if People Are Concerned with Inflation?

Warren thinks that oil will merit special consideration as an inflation hedge in the coming years. He cited how we have seen the “shale revolution” since about 2014, driving prices lower. However, going forward there hasn't been much further capital investment in oil, and yet the demand for oil is expected to keep rising in the coming years. After the

supply and demand balance normalizes in the next six to nine months, Warren's view is that the focus will eventually start to recognize that green energy is great, but oil demand shrinking to zero is not in the immediate future, even if the mix of how people get energy is evolving more and more toward cleaner sources.

### What about Gold & Crypto?

3Fourteen also looks into at gold and crypto. Toward the end of the discussion, Warren discussed his view that bitcoin has been taking investor fund flows away from gold. Warren believes that bitcoin has a great use case for wealthy individuals stuck in closed economies, who want to take their wealth to countries with strong property rights, like the United States. Bitcoin has been rising, and so has the dollar, and this is one possible explanation, at least in part.

You can listen to the full episode below.

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## **DEFINITIONS**

**Correlation** : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;.

**Duration** : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

**Small caps** : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

**Bitcoin (the currency)** : A digital currency (also called a cryptocurrency) created in 2009, which is operated by a decentralized authority as opposed to a traditional central bank or monetary authority.

**Inflation** : Characterized by rising price levels.

**Consumer Price Index (CPI)** : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.