Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Ed Butowsky
Chapwood Investments LLC

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Retirement Lifestyle Advocates
961 Four Mile Road, NW
Grand Rapids, MI 49544

Phone: (866) 921-3613
Email: info@plplanners.com
Website: www.RetirementLifestyleAdvocates.com

Dennis Tubbergen:

This is the Retirement Lifestyle Advocates Radio Program. I'm your host, Dennis Tubbergen. I'm chatting today with returning guest, Mr. Ed Butowsky. Some of you who are long-time listeners may remember Ed as the founder of the Chapwood Index, and he's also the author of the book Wealth Mismanagement, which is available on Amazon. Ed, welcome back to the program.

Ed Butowsky:

Well, thanks for having me again, Dennis.

Dennis Tubbergen:

Ed, let's just start, if we could, for our listeners that maybe are not familiar with the Chapwood Index, can you explain what it is?

Ed Butowsky:

Sure. The index was created as the result of a conversation I had with a gentleman named John Williams. John Williams has a phenomenal website called Shadowstats, and he does great work in terms of calculating what the true inflation rate is when you take away the manipulation that the government has put in since 1983. They changed the way they calculated the CPI. They used to have 1,700 items that they calculated every single month. When the inflation rate got to 13%, the government changed the way they calculated it so it quickly went from 13% down to 3% the next year. In 1994, under the Boskin Commission, who was a professor at Stanford, he was entrusted by the government to come up with a new way to calculate the CPI. Every time they've done this, and they continue to do it, they make that number seem lower.

Ed Butowsky:

So I asked John Williams, I said that every city has its own unique cost of living increase. Why don't you do something with that? He said, well, he didn't have the time to do it, so I decided that I would do it. So I created ... I took the 50 major cities in the United States and calculated the items that people use most often and had people literally going into the stores every single quarter and calculating the exact increase in the prices. Then it got too much work, so I did it twice a year. Now, recently, sadly, because of COVID, I've had to hold back on updating the numbers, but the numbers were very much in line with what John Williams had found, but I do mine city by city.

Dennis Tubbergen:

Well, it's interesting because John Williams has been a frequent guest here on the program as well. He was on in the second week of June, and he is forecasting that we'll likely have a hyper inflationary outcome here. So, well, let me just ask, Ed, going into COVID, so this would be early 2020, maybe 2019, give our listeners a bit of an idea as to what the real inflation rate was based on your research with the Chapwood Index.

Ed Butowsky:

You have to remember, when we talk about inflation, we're talking about cost-of-living increase. We're not talking about the cost of living. Because cost of living, people can get comfortable with, but it's the increase that destroys people's lives. What I was seeing in the west coast and a lot of the cities in California, including Seattle and Portland, I was seeing double digit inflation of numbers up to about 12% per year. Chicago was 11%. New York was 11%. Philadelphia was 12%. These major cities are seeing cost of living increases mainly because of the tax policies that are ingrained in those cities. That's why you have a difference between that and Taos, New Mexico.

Ed Butowsky:

Even Dallas, where I reside, was up 9.2% year over year. So it has a lot to do with what the tax implications are, not just for the city itself, but also for products that come into the city. Cost to do business on the road, for instance, even taxes, tolls, everything trickles down to the end investor or the end-user. That's sad, but that's what the real numbers are. So when the government was sitting there saying that inflation was 1.5%, well, the true cost of living increase, if you were in Long Beach, was 12%. So you were losing 10.5% purchasing power year after year.

Dennis Tubbergen:

Well, Ed, when you stop and think about that, let's just use the 12% number. I think John Williams estimates now that if we were to calculate the inflation rate, the way they did pre 1980, I think it was in the 70s that then Fed chair, Arthur Burns, as a result of food and fuel prices going up, said, "We need to take those out of the mix because it's OPEC's fault and it's the drought. It's not our policies." There's been a lot of changes made through the years, but when you take a look at a 12% inflation rate and then take a look at how artificially low interest rates have been held, that creates a real problem for people that want to retire and maybe invest more conservatively. Like a lot of people who are retired, not only want to do, but perhaps should do. So what would you say to those people?

Ed Butowsky:

Education is always the key, because if I was to turn to somebody without having any knowledge and tell them that they should be buying senior rate floating notes, they would look at me with a sideways look because they wouldn't understand what I was talking about. But to me, that is an alternative to regular bonds. Right now, there's only four that trade on the stock market that are AAA rated. A lot of people don't know that. That's Microsoft, and my goodness, Singapore Telephone, and there was one other. I can't remember.

Dennis Tubbergen:

I think it's Johnson... Johnson & Johnson might be in there.

Ed Butowsky:

It could be Johnson & Johnson.

Dennis Tubbergen:

Maybe Walmart, but yeah.

Ed Butowsky:

No, Walmart was not.

Dennis Tubbergen:

Oh really?

Note: The four companies with AAA Bond Ratings:

Automatic Data Processing (ADP)
Johnson & Johnson (JNJ)
Miscrosoft (MSFT)
Exxon Mobil (XOM)

Ed Butowsky:

But when you get to the education part and people say, well, I want AAA rated bonds, they're getting the 0.2% on that, and AA rated bonds, they're getting 1%, and singly rated bonds are getting 1.5%. So there's education to learn about alternative ways because the need for income is always going to be there. But how people derive that income has to change based on where the artificially low interest rates are right now.

Dennis Tubbergen:

Ed, given that we're seeing inflation emerge a bit more in earnest, and given that pre COVID, you were seeing 10 to 12% actual increases in the cost of living, where would you estimate that the real inflation rate or cost of living increase has gone in the last year?

Ed Butowsky:

It's scary to think just how high the cost-of-living increase is. If you notice, I avoid saying the CPI because of this manipulation. But I would say that across the board, we're probably looking at 15% cost of living increase when you look at gas and taxes and food. I mean, everybody can see just how much food has gone up. I went the other day to Costco to buy some steaks. I got six steaks and they were $120, and these were rib-eyes. My wife said, "Well, this is normal," and I thought, my goodness, we've got to stop eating this. I mean, it's just ridiculous how high everything is, and if wages don't increase to compensate for it, we're going to have ourselves a real problem in this country.

Dennis Tubbergen:

Ed, you mentioned that wages do need to increase to allow people just to meet their daily living expenses. It seems that that's not what's happening. It seems that we have stagflation. It seems that we have economic contraction. We have really, to some extent, more stagnant wages, especially at the lower end of the pay scale and yet we have this inflation. Now, would you agree with that? Then secondly, in your view, how do you think it ends?

Ed Butowsky:

Well, I'm happy, you said the word stagflation because that's revisiting from many, many years ago. But that's actually what we do have with the exception of high unemployment, which some people will argue we still have a lot of jobs out there that need to be filled. But if you look at inflation is rising and cost of living, and income is down, what you have to have is an increase in wages. Now people are arguing about minimum wage, which I don't believe really plays a huge role in the overall economy. There's a lot of cities and a lot of states that are increasing minimum wage and that's not making a big change. I mean, you're looking at, if you were working $10 an hour, making $10 an hour at 40 hour week, you were making $400.

Ed Butowsky:

If you increase that to 15, you're making $600. Well, I mean, that's not going to change your life, and it's not going to increase the amount of money into the system that's being used. So how this thing ends is going to be really just an ugly scenario where we're going to see hyperinflation. We're going to see people who just can't make ends meet. You're going to see real estate prices continue to soar and products continue to go up in price. But we're not going to have wages there to compensate for it unless you're a one percenter.

Dennis Tubbergen:

Well, certainly Ed, when you, when you take a look at the 1%, the 1% have done quite well over the last year. Yet I recently read an article that reported that one in four Americans now are the lower quarter of the earnings segment of society, I have to use that term, is now having difficulty making ends meet. Then we've got rent moratoriums, which were extended through the end of July. We're talking here approaching mid-July now. That's going to be, I believe, a big headwind moving ahead.

Ed Butowsky:

Well, it should be. I don't know how many people have taken advantage of the rent moratorium, but if I was in an apartment and I was offered the opportunity to have a rent moratorium, I would take it. I think a lot of people probably have. So again, it's just, I don't know how many different ways we can say how ugly it could be and it's going to be, but we're absolutely in an unprecedented situation. That we're going to see rising costs and less money in people's pockets, which is ... Ultimately, what that should cause is prices to come down, but you're not going to see that because commodity prices have risen so much.

Dennis Tubbergen:

Well, my guest today is Mr. Ed Butowsky. He is the founder of the Chapwood Index. The website is chapwoodindex.org. He is also the author of Wealth Mismanagement. I'll continue my conversation with Ed when RLA Radio returns. Stay with us.

Dennis Tubbergen:

I'm Dennis Tubbergen. You are listening to RLA Radio. My guest today is Mr. Ed Butowsky. Ed is the founder of the Chapwood Index. He is also the author of Wealth Mismanagement and Ed, we talked about the fact that cost of living will likely continue to go up. To what extent do you believe that is attributable to the Fed easy money policies? We've got money creation taking place at the rate of about $120 billion a month. Interest rates are still near zero. Is that what's driving all this?

Ed Butowsky:

Well, you can't ignore how high M2 is, which is a way of looking at the money supply and the amount of money that's out there. The perfect definition of inflation is too much money chasing too few products. With the supply chain messed up from COVID, you have to imagine that it's very difficult to get your hands on a lot of products. So therefore, the prices have gone up. Fed policy has definitely played a role in this. It didn't happen in a vacuum. It happened because of lots of different reasons, but one of them is the amount of money the Fed is printing, and that money has gotten into the economy as evidenced by M2.

Ed Butowsky:

So you have a tremendous amount of inflationary pressures that have been basically designed by the Fed, and the Fed isn't recognizing that. They believe that it's transitory. The way you combat inflation is to raise interest rates, and they're not willing to do that. Although I've heard from some people, just like anybody else has heard, that they might raise the Fed funds rate and the discount policy by a quarter of a point before the end of the year, but that's not going to squelch inflation at all.

Dennis Tubbergen:

Ed, when you look at what happened, for example, back when Paul Volcker raised interest rates, I think the Fed funds rate went to almost 20% as I recall, that certainly subdued inflation, but it also created, at least temporarily, a very difficult economic environment. So I think any way you slice this, would you agree that we're in for some tough few years here?

Ed Butowsky:

Yeah, no question about it. Then it shocks me how many people continue to pile money into the stock market, not recognizing the lofty valuation of the stock market. The stock market is priced high because the 10-year treasury is so low. But if the 10-year treasury rises, that's going to put a stretch or a strain, I should say, on valuations on the stock market. So seeing 20% on the Fed funds rate would be shocking, I mean, given that we're at zero right now. But seeing 5% on the Fed funds rate is not something out of the question over the next couple of years.

Dennis Tubbergen:

Well Ed, I think the other elephant in the room is that, in 1980, when Paul Volcker raised interest rates, the Fed funds rate to nearly 20%, the US government had about a trillion dollars in debt. We're nearly 30 times that today. So if interest rates do come up and the federal government is forced to finance really a level of debt that's insurmountable, it can't be paid. If they're forced to try to finance that at 5% or 6%, doesn't that create an even bigger problem?

Ed Butowsky:

That's exactly why you're probably going to continue to see rates low. You have to really question if the government is selling those bonds. They print money and they create debt and you have to wonder, are they really selling it to other countries or are they just selling it to themselves and then not paying the interest on them? But if in fact they are selling them to other countries, what country in their right mind is going to continue to buy our bonds when they're paying 0.2%? I mean, whoever it is, whatever country that is needs a new financial advisor, because it's just a horrible way of managing your money, and how long can that last? So at some point, rates are going to have to rise. You look at the credit quality. I mean, a lot of people don't realize that our country's debt is rated, we're rated about 14th in terms of our ability to pay on our debt.

Ed Butowsky:

That number has gotten lower, meaning higher number over the last couple of years. It used to be we were ranked 9th. So at some point, when our quality of our ability to pay on our debt goes down, the reverse happens, meaning that interest rates rise. So at some point, if we get to 5% and we have 20, well, we'll call it $30 trillion, that means we have 1.5%, or $1.5 trillion goes to just pay interest. We bring in about 4 trillion in tax revenue a year. So we're really at a really dicey part of, I would say, that's about 30% of what we bring in would go to pay interest on our debt alone. That's scary.

Dennis Tubbergen:

Yeah, and, Ed, I think when you talk about John Williams and you referenced your work with him and conversations with him in the first segment, I think that's why he's predicting a hyper inflationary outcome, as is Alasdair McLeod. They're saying this could happen sooner rather than later for the reasons that you just articulated. Would you agree?

Ed Butowsky:

Yeah. Well, those gentlemen are a lot smarter than I am. I learned from them, but I would have to say that there's really no reason for that not to happen unless there is some sort of ... Some people say, well, why don't we just tell everybody to forgive our debt and just let it ... just erase it? I can't imagine that that's ever going to happen. So I don't see any other alternative but to see hyperinflation.

Dennis Tubbergen:

So Ed, let's talk a little bit about your book and talk a little bit about what advice you might give our listeners. Explain to the listeners the motivation behind your book, Wealth Mismanagement.

Ed Butowsky:

Well, I was in the industry. I grew up at Morgan Stanley and for many, many years, I would sit there and sell the mutual funds and sell the different products that Morgan Stanley had presented and did very well. I was one of their top producers in the country. Only when I left Morgan Stanley and I got with a gentleman at Wharton did I really learn about wealth management. I sat in on a couple of institutional meetings. Meetings where he would have with groups that were very large endowments and foundations, and there was a whole different language that was spoken. It had to do with sharp ratios and regression analysis, and all these other terms that I never got when I was at Morgan Stanley. So I quickly became a student of investing and realized that the majority of the portfolios that retail investors are given by their brokers are inefficient. Meaning they're taking too much risk for the expected rate of return, and the rate of return, oftentimes, people don't know what rate of return they need to make because they don't factor in the cost of living increase.

Ed Butowsky:

So I created eight metrics that I highlight in the book about how to evaluate a portfolio, and realizing that what I ended up doing was really going after people in my industry, but not because, I didn't like them. It was because the whole industry is one where people are not trained properly on how to evaluate a portfolio, and it's not their fault. It's the firm's fault for not understanding portfolio management. So Wealth Mismanagement starts off with how I got to where I was or where I am now, and it highlights exactly how you should evaluate a portfolio. I created the CHIP score, which stands for Chapwood Investment Portfolio score. It's a way for ... Anybody can go there to my website, Chapwoodinvestments.com, and pull down the CHIP score and fill out the information and find out what their score is.

Ed Butowsky:

Because it always bothered me, Dennis, that there wasn't a way to score portfolios. That people chose financial advisors based on a friend's recommendation and/or the name of a firm, but that's not how you should choose a portfolio or a financial advisor. You should get in writing what their recommendations are, and then be able to study and analyze the probability of a loss in the next 12 months based on what they recommended to you, the amount of money at risk in the next 12 months. I created a term called

Variance Drag Phantom Tax, which has to do with how much ... what your standard deviation is relative to your historical rate of return. Your standard deviation should be 80% or less than your historical rate of return. Those are some of the nuggets out of my book that I would love for anybody to go in and get and give me their input on it.

Dennis Tubbergen:

Well, Ed, given what you just stated, and in the first segment you alluded to the fact that stock valuations are really at nosebleed levels, to use that term. I think using the Buffett Indicator market capitalization to gross domestic product, we've got valuations now that are about a third higher than they were at the peak of the tech stock bubble. What's your view for traditional asset classes moving ahead, which are often stocks and bonds, or stock funds and bond funds?

Ed Butowsky:

Yeah, well, I see the stock market currently 31% over valued based on historical value, based on where interest rates are and where earnings expectations are. So you have the stock market that should be selling at a PE of 17 selling at 26 right now, and that is just not sustainable. So what has to happen is earnings either have to increase, which they're not going to dramatically, or prices have to come down. But at some point, there'll be a reversion back to the mean. Bond prices are ... One of the worst investments you can make right now is in a long-dated fixed income bond. Anybody who has those should be selling them and taking their profits right now and reinvesting them in something like a senior rate floating note, or a business development company, or preferreds.

Ed Butowsky:

That's how you can get really nice income. Even muni bonds are not something I would recommend because they are interest rate sensitive. If you buy a long-dated one, you're going to get really hurt badly. You just have to look at 1994 to reflect on rising interest rates and what that did to fixed income. It really destroyed it.

Dennis Tubbergen:

Well, the clock says we're going to have to stop there. My guest today is Mr. Ed Butowsky. He is the founder of the Chapwood Index. The website is chapwoodindex.org. And his book that we've been chatting about is Wealth Mismanagement, available on Amazon. Ed, a pleasure to catch up with you again. Keep up the good work. We look forward to an updated Chapwood Index, and we'd love to have you back down the road.

Ed Butowsky:
Thank you very much, Dennis.

Dennis Tubbergen:
We'll return after these words.