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# THE "YOU MAY NOT KNOW REPORT"

## A PUBLICATION OF RETIREMENT LIFESTYLE ADVOCATES

# Is the Federal Reserve Tightening into a Recession?

By Dennis Tubbergen

As this issue of the "You May Not Know Report" is being assembled, the Federal Reserve, the central bank of the United States, has continued to raise interest rates to attempt to get rampant inflation under control. The stated goal of the Fed is to get inflation back to the bank's target of 2%.

The central bank raised interest rates to 3.25% at the latest meeting of the Fed. In my view, these moves by the Fed are more form over substance and they will not accomplish the objective of getting inflation back to the Fed's stated target.

Instead, the Fed's actions will likely catalyze a deeper recession that has been inevitable due to debt levels that exist both in the private sector and in the public sector. From my study of history, I've reached the conclusion that when debt levels reach a point that they are unsustainable, deflation and recession become unavoidable.

Since the beginning of the year, I've made the case that we are in recession. The first two quarters of 2022 saw economic contraction, meeting the textbook definition of a recession. I would expect similar data to be reported for the third quarter of this year.

So where do we go from here economically speaking and what should you be doing?

It's my view that we will continue down the stagflationary path on which we now find ourselves. Stagflation is defined as inflation coupled with economic contraction or recession.

Let's begin by discussing why the Fed's actions to date are unlikely to tame the inflation monster. Simply put, to get inflation under control, interest rates need to be positive on a real basis.

In other words, interest rates need to be higher than the inflation rate. If the inflation rate is higher than interest rates, spending is incentivized, in other words, since saving money will result in savings losing purchasing power, it makes more sense to spend money rather than save it.

Let's look at a hypothetical example using current conditions. This[1] from Yahoo Finance (emphasis added):

> *Yields on 10-year U.S. Treasury notes reversed sharply lower after touching the highest since October 2008 as the Bank of England said it would carry out temporary purchases of long-dated UK bonds to help restore order to the market.*
>
> ***<u>The benchmark US 10-year yield was little changed at 3.945% after earlier climbing to 4.015%.</u>*** *But Treasuries remain headed for their biggest annual loss since least 1973, with a Bloomberg gauge of the debt slumping 14% this year. UK 30-year borrowing costs slumped as much as 72 basis points to 4.26%, having surged to the highest since 1998 before the BOE signaled its intention.*
>
> *Still, an index of US sovereign securities extended its worst year since at least the 1970s after St. Louis Federal Reserve President James Bullard warned the central bank has to keep raising interest rates to retain its credibility. US debt has also been under pressure recently due to speculation the sliding yen will compel Japan to conduct more intervention, potentially funded by Treasuries sales.*
>
> *Poor liquidity as central banks trim their balance sheets and rising volatility may be exacerbating the financial turmoil. The Fed accelerated the unwinding of its balance sheet this month in what's known as quantitative tightening, while the Bank of England said its bond selling plans will be pushed back to the end of October, having originally intended to begin sales next week.*
>
> *"Market liquidity has dried up, so selling can easily accelerate in one direction, especially as there are plenty of investors who are ready to cut losses," said Eiichiro Tani, chief strategist at Daiwa Securities Co. in Tokyo.* ***"The central banks' quantitative tightening is having a significant impact over market liquidity."***

Investing in a 10-Year US Treasury Note will give an investor an annual yield of about 4%. The official inflation rate is over 8%. Doing some rough, back of the napkin math, one would lose about 4% annually in purchasing power annually by investing in a 10-Year US Treasury Note.

In 1980, Federal Reserve Chair, Paul Volcker, increased interest rates to nearly 20%. Inflation was brought under control as a result. The charts below[2] show the year-over-year inflation rate and the federal Funds rate, which is the interest rate set by the Federal Reserve. The charts are formatted to show the year, then the year-over-year inflation rate, then the Fed Funds rate.

When reviewing the charts, it's important to remember that the methodology used to calculate the official inflation rate changed in 1980 and 1990. The result of these changes was to make the officially reported inflation rate look more favorable.

Economist John Williams of www.ShadowStats.com estimates that the reported inflation rate would be about 16%-17% if the 1980 based calculation method was used.

| YEAR | INFLATION RATE YOY | FED FUNDS RATE |
|---|---|---|
| 1969 | 6.20% | 9.00% |
| 1970 | 5.60% | 5.00% |
| 1971 | 3.30% | 5.00% |
| 1972 | 3.40% | 5.75% |
| 1973 | 8.70% | 9.00% |
| 1974 | 12.30% | 8.00% |
| 1975 | 6.90% | 4.75% |
| 1976 | 4.90% | 4.75% |
| 1977 | 6.70% | 6.50% |
| 1978 | 9.00% | 10.00% |
| 1979 | 13.30% | 12.00% |
| 1980 | 12.50% | 18.00% |
| 1981 | 8.90% | 12.00% |
| 1982 | 3.80% | 8.50% |
| 1983 | 3.80% | 9.25% |
| 1984 | 3.90% | 8.25% |
| 1985 | 3.80% | 7.75% |
| 1986 | 1.10% | 6.00% |
| 1987 | 4.40% | 6.75% |
| 1988 | 4.40% | 9.75% |
| 1989 | 4.60% | 8.25% |
| 1990 | 6.10% | 7.00% |
| 1991 | 3.10% | 4.00% |
| 1992 | 2.90% | 3.00% |
| 1993 | 2.70% | 3.00% |
| 1994 | 2.70% | 5.50% |
| 1995 | 2.50% | 5.50% |

| YEAR | INFLATION RATE YOY | FED FUNDS RATE |
|---|---|---|
| 1996 | 3.30% | 5.25% |
| 1997 | 1.70% | 5.50% |
| 1998 | 1.60% | 4.75% |
| 1999 | 2.70% | 5.50% |
| 2000 | 3.40% | 6.50% |
| 2001 | 1.60% | 1.75% |
| 2002 | 2.40% | 1.25% |
| 2003 | 1.90% | 1.00% |
| 2004 | 3.30% | 2.25% |
| 2005 | 3.40% | 4.25% |
| 2006 | 2.50% | 5.25% |
| 2007 | 4.10% | 4.25% |
| 2008 | 0.10% | 0.25% |
| 2009 | 2.70% | 0.25% |
| 2010 | 1.50% | 0.25% |
| 2011 | 3.00% | 0.25% |
| 2012 | 1.70% | 0.25% |
| 2013 | 1.50% | 0.25% |
| 2014 | 0.80% | 0.25% |
| 2015 | 0.70% | 0.50% |
| 2016 | 2.10% | 0.75% |
| 2017 | 2.10% | 1.50% |
| 2018 | 1.90% | 2.50% |
| 2019 | 2.30% | 1.75% |
| 2020 | 1.40% | 0.25% |
| 2021 | 7.00% | 0.25% |
| 2022 | 8.30% | 3.25% |

Taking a look at the 2022 numbers, one finds that the official year-over-year inflation rate exceeds the current interest rate by 5%. (This slightly contradicts my back of the napkin math from above due to the numbers being reported at different times.

In 1980, the Fed Funds interest rate exceeded the official inflation rate by 5.5%.

Using Mr. Williams estimate of the inflation rate, the current interest rate lags the real inflation rate by more than 12%! That, in a nutshell, is why I believe we will have inflation in consumer prices for longer than many analysts are predicting.

The Fed, in my view, is powerless to get this inflation back to 2%. If we assume that Mr. Williams' estimate of the inflation rate is correct, the Fed Funds rate would need to be increased to more than 17% - that's 14% higher than the current interest rate set by the Fed.

Given that debt levels in the economy are at extreme levels, an increase in interest rates of this magnitude would bankrupt the economy and the US Government.

Let's look briefly at government debt to make the point. Current US Government debt is officially at about $31 trillion. At a 4% interest rate, the cost to service the interest on the debt is about $1.2 trillion. At 17%, the cost to service the interest on the debt would be about $5.2

trillion, which is more than total US tax revenues. That alone is the reason the Fed can't raise interest rates to a level that would get inflation back to the Fed's 2% target.

Ironically, the Fed's sudden resolve to control inflation by increasing interest rates is moving the country deeper into recession. While it is too early to report on the 3rd quarter Gross Domestic Product numbers, it is now 'official' that the first two quarters of the year saw the economy contract. This[3] from "Townhall":

> *The third and final estimate for U.S. GDP in the second quarter was released on Thursday morning, showing that the economy with -0.6 negative growth:*
>
> > *The "third" estimate of GDP released today is based on more complete source data than were available for the "second" estimate issued last month. In the second estimate, the decrease in real GDP was also 0.6 percent. The update primarily reflected an upward revision to consumer spending that was offset by a downward revision to exports. Imports, which are a subtraction in the calculation of GDP, were revised down.*
>
> *This week's report matches the second estimate for Q2 GDP released* in August of *-0.6, ending the quarter slightly better than the first Q2 estimate released in July that showed a -0.9 percent contraction in the U.S. economy.*
>
> *Thursday's final report for Q2 GDP showing negative growth — following the reported -1.6 percent contraction in Q1 — means that the definition of a recession — two consecutive quarters of negative GDP growth — has been confirmed, again.*
>
> *While the Biden administration insists that the U.S. is not in a recession by pointing to misleading indicators — such as the labor market — that are expected to buckle under the pressure of inflation and Federal Reserve interest rate hikes, there's no sign that relief for Americans and the larger economy are coming soon.*
>
> *The Fed continues raising its key interest rate target, aggressively but still not strongly enough, in attempts to bring inflation that's running at more than eight percent down to just two percent. The Fed's consecutive 75 basis point increases have failed to force down inflation so far, meaning more (and potentially bigger) increases lie ahead before the end of 2022.*
>
> *Those increases, aimed at slowing the economy to a crawl to reduce inflation, are sure to make things worse — as Fed Chairman Jerome Powell himself has said. "Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance," Powell said last month, actions that will "bring some pain to households and businesses."*
>
> *Meanwhile, the final Q2 GDP report also brought updated numbers for PCE inflation — the Fed's preferred indicator of inflation — and surprise, surprise, it showed that prices continued to rise, albeit in the rearview mirror:*
>
> > *The **price index for gross domestic purchases** increased 8.5 percent in the second quarter (table 4), an upward revision of 0.1 percentage point from the previous estimate. **The personal consumption expenditures (PCE) price index** increased 7.3 percent, an upward revision of 0.2 percentage*

*point. Excluding food and energy, the PCE price index increased 4.7 percent, an upward revision of 0.3 percentage point.*

*Fresh PCE data will be released Friday showing a more recent picture of inflation, but the numbers released Thursday show that the Fed's previous interest rate hikes did not move the inflation needle down in the second quarter while Americans continued to suffer from the decrease in real wages that rising prices cause.*

If inflation cannot be brought under control unless interest rates are increased to levels that will bankrupt much of the economy, we have to conclude that inflation will not be brought under control. As the economy moves into a deeper recession, I expect that the fed will reverse course and once again 'support' the economy via lower interest rates and more currency creation.

These efforts will ultimately have to fail. The real problem in the economy is excessive debt. Currency creation only exacerbates the problem. Since today's currency is debt, currency creation simply makes the ultimate problem worse.

Egon von Greyerz of Matterhorn Capital had this[4] to say on the topic recently:

*The current stock market crash has the potential to extend to a 30% fall in the next few weeks on the way to a 90% fall in coming years.*

*That the Dark Years would be coming has been clear to me for many years. The Dark Years are the very unpleasant antidote to a fake monetary and financial system which was doomed to fail the day it was created in 1913 when the Fed was founded.*

*Thomas Jefferson must be turning in his grave, as he foresaw over 200 years ago what will happen next.*

*The Fed is controlled by private banks and exists for their benefit solely. The fact that the Fed has an official raison d'être to control inflation and maintain full employment is just to please the politicians.*

*The Fed was always intended for the benefit of the bankers since the day it was conceived in 1910 on Jekyll Island.*

*The illusion that the Fed can control inflation and employment is total nonsense. It has as little credibility as if they would control the temperature of earth.*

*In my working lifetime of over 50 years, I have seen official US inflation go from 5% to 15%, down to negative and now 9%. For over 10 years the Fed tried to get inflation up to 2% but failed.* ***And now it is 9% and rising and they will have ZERO chance to get it down to 2% for years.***

***So the Fed has failed abysmally to control inflation. And just as Jefferson said, inflation will lead to Hyperinflation before the monetary system collapses into a deflationary depression.***

In my book "New Retirement Rules", I wrote about Mr. Jefferson's prediction. Jefferson said if the American people ever allow private bankers to control the issue of the currency, the economy would be destroyed first by inflation, then by deflation.

We are now on that path.

# Housing Update

Last month, in the "You May Not Know Report", I suggested that the housing market decline had begun.  While stocks have been reacting negatively to the shrinking economy since the beginning of the year, real estate had not yet followed suit.

I suggested that this was changing.  This is what I wrote last month in the September issue of the "You May Not Know Report":

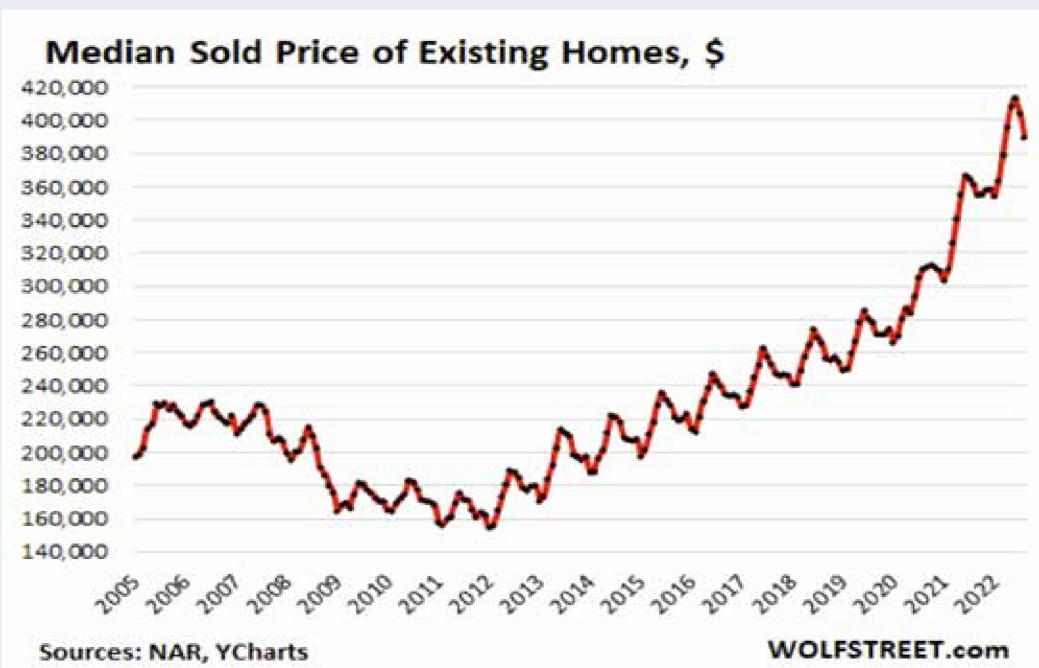
*As I write this slightly past the middle of August, I believe that the stock market bubble is in the process of unwinding and housing now seems poised to follow suit.*

I then offered an excerpt from a "Zero Hedge" article to help make my point:

*Another month, another plunge in housing.*

*Hot on the heels of the latest catastrophic homebuilder sentiment print and plunging single-family starts and permits, analysts expected existing home sales to accelerate their recent decline with a 4.9% MoM drop in July They were right in direction but severely wrong in magnitude as existing home sales tumbled 5.9% MoM in June.*

*That is the 6h straight month of existing home*



*sales declines - the longest stretch since 2013 - pulling home sales down a stunning 20.2% YoY.*

This month, the housing numbers continued to deteriorate, perhaps more evidence that the recession is here?

This is from a "Portfolio watch" weekly e-newsletter that I did in September. (If you're not reading the "Portfolio Watch" newsletter, visit **www.RetirementLifestyleAdvocates.com**. The newsletter is free and posted on the site with our other resources.)

Wolf Richter gathered some data this past week on the current state of the real estate market[5]:

*In July and through mid-August, mortgage rates fell sharply from the 6%-range in mid-June, on the widely propagated fantasy of a Fed "pivot" on rate hikes. By mid-August, the average 30-year fixed mortgage rate was down to 5%. Yesterday, they were at 6.47%. But the brief interlude of dropping mortgage rates slowed down the decline in home sales – sales declined again in August from July but at a slower rate – with Realtors in mid-August talking about the market waking back up.*

*But prices backed off for the second month in a row, and in a big way, amid widespread price reductions, and that also helped getting some deals done.*

*The median price of existing single-family houses, condos, and co-ops whose sales closed in August dropped a hefty 3.5% in August from July, the largest month-to-month percentage drop since January 2016, after the 2.4% drop in the prior month, to $389,500, according to the National Association of Realtors. While there is some seasonality involved, the percentage drop was much bigger than normal in August, whittling down the year-over-year price increase to 7.7%, down from the 25% year-over-year increases last summer (data via YCharts)*

*Sales of existing houses, condos, and co-ops across the US dipped a smidgen from July, after the 5.9% plunge in the prior month, to a seasonally adjusted annual rate of sales of 4.80 million homes, roughly level with lockdown-June 2020, according to the National Association of Realtors in its report. This was the seventh month in a row of month-to-month declines.*

*Beyond the lockdown months, it was the lowest sales rate since 2014, and down by 29% from October 2020 (historic data via YCharts).*

*Sales of single-family houses dropped by 0.9% in August from July, and by 19% year-over-year, to a seasonally adjusted annual rate of 4.28 million houses.*

*Sales of condos and co-ops rose 4% from July, to 520,000 seasonally adjusted annual rate, down 25% year-over-year.*

*Compared to August last year, sales fell by 20%, the 13th month in a row of year-over-year declines, based on the seasonally adjusted annual rate of sales.*

*Sales volume has been low because potential sellers are clinging to their aspirational prices of yesteryear, when mortgage rates were 3%, and many would rather keep the home off the market or pull it off the market than sell for less, for as long as they can. But price reductions have now taken off by sellers who want to sell.*

More signs of emerging deflation.


# Stock Update

In the February 2022 Special Report, I noted that stocks were poised to begin a decline. Here are a couple of excerpts from the February Special Report (which many of you probably have):

## EXCERPT ONE:

*For now, let's run with the price to earnings valuation.*

*The chart on this page illustrates the Shiller price to earnings ratio which is inflation adjusted.*

*Notice that at the market bottom at the time of the financial crisis, the Shiller PE ratio fell to about 15.*

*At the present time, the ratio is pushing 40. That is a level that exceeds the level of about 30 in 1929 by nearly 30%!*

## EXCERPT TWO:

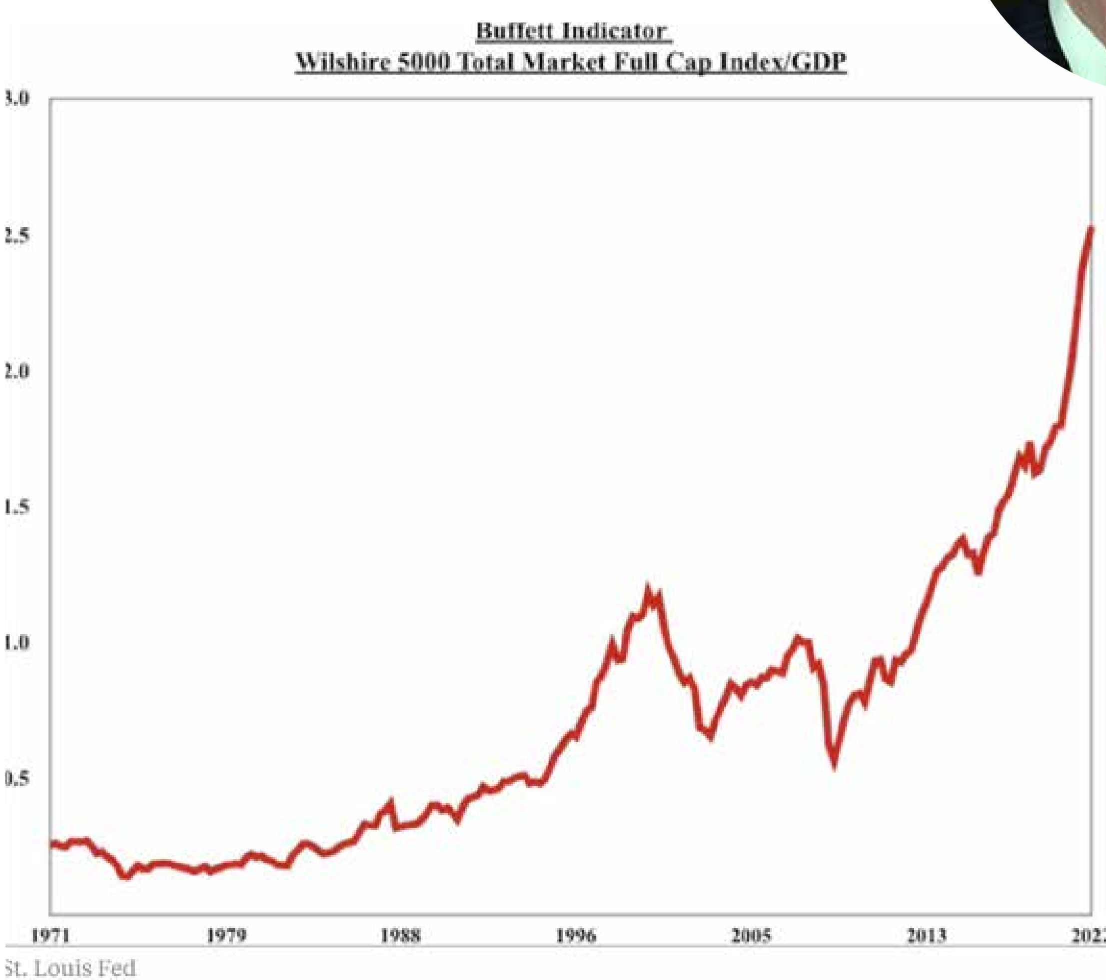
*There is another 'big picture' stock valuation tool that is often used to look at stock valuations. It is now colloquially known as the Buffet Indicator after the billionaire investor, Warren Buffet suggested it was his favorite stock market valuation tool in a televised interview.*

*This indicator is more formally known as the "Market Capitalization to Gross Domestic Product" indicator. It is constructed by taking the total value of stocks and dividing by Gross Domestic Product (total economic output).*

*The chart below illustrates the current status of "The Buffet Indicator".*

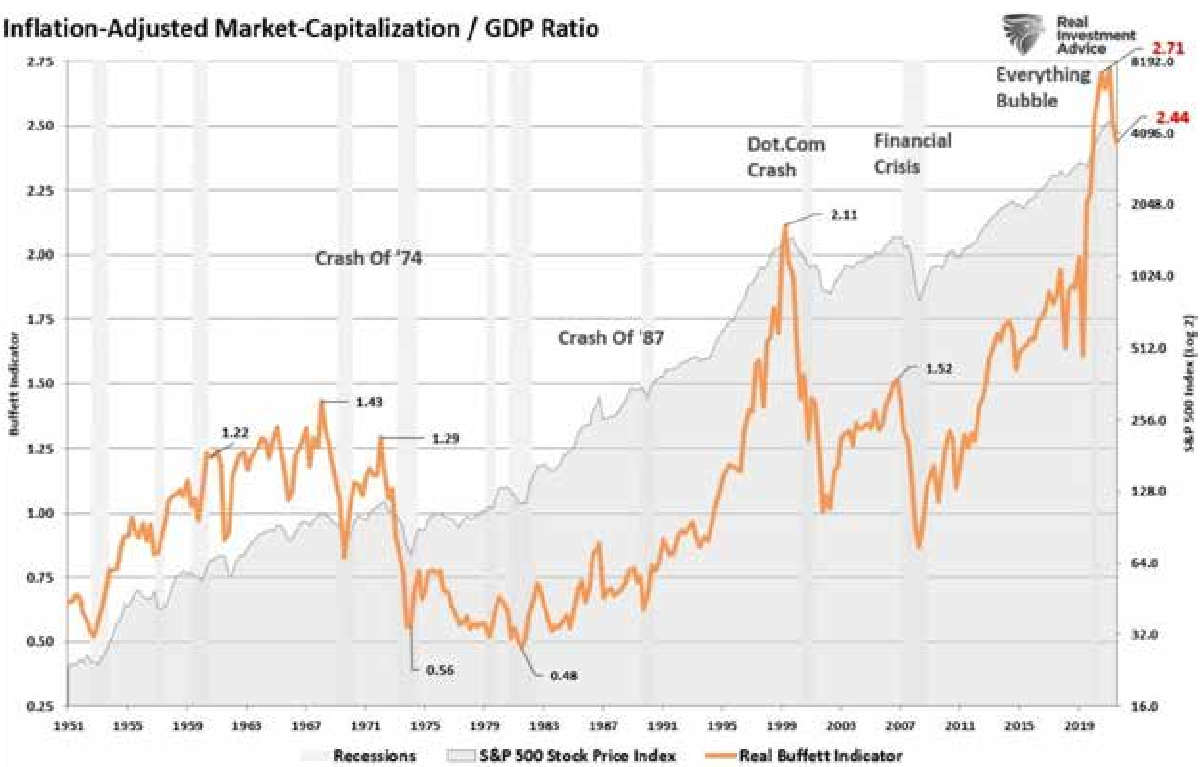
*The chart covers a time frame of just over 50 years. Notice that the indicator is now, far and away, higher than it has been at any point in the last 50 years.*

Since that report was published, stocks have begun their decline.



Here is a weekly price chart of an exchange traded fund that tracks the price action of the Standard and Poor's 500.


Notice that since the February Special report was published, stocks have declined more than 20%. Moving ahead, I expect more downside in stocks. Keep in mind that stocks rarely move straight up or straight down but instead follow a pattern of lower highs and lower lows as seen on the weekly price chart published here.




Notice the Buffet Indictor is still extremely elevated. With GDP contracting, I expect more downside in stocks.

*October 2022 Special Report*

# Anatomy of a Recession: Strategies for the Current Economy

This month only, we are making available a free report titled, "Anatomy of a Recession: Strategies for the Current Economy".

To request your complimentary copy this month only, return one of the postage-paid reply cards included with this month's newsletter. You'll notice that we've included three reply cards with this month's newsletter; we've done that so you can request a copy of this report for anyone you know that might find this information helpful.

In this month's special report, you will discover the different types of recessions, what causes them as well as strategies to consider in your personal situation.

This report is available for the month of October only.


## Time Deposit Rates

At the time of publication, these rates were valid:

| | |
|---|---|
| 1-Year | 1.80% |
| 2-Year | 3.00% |
| 5-Year | 4.55% |

Call the office for details at
1-866-921-3613

## Resources to Help You Stay Informed

All these resources are available at the Retirement Lifestyle Advocates website: www.RetirementLifestyleAdvocates.com.

As previously mentioned in this month's "You May Not Know Report", the weekly "Portfolio Watch" newsletter is available on the Retirement Lifestyle Advocates website. Each week, I give you an update as to where we are economically speaking and in the financial markets and where we are going based on my analysis.

The weekly "Headline Roundup" webinar. Replays are available on the website. "Headline Roundup" happens every Monday live at Noon Eastern Time. To get an invite to the live event, give the office a call at **1-866-921-3613**.

The weekly "RLA Radio" show and podcast.

We also have the RLA app available. All these resources are also available on the app.

You can download the YOURRLA app for free by visiting the app store (either Google or Apple) and searching under YOURRLA.

If you have questions when downloading the app or would like assistance, feel free to call the office. Our office phone is answered 8 to 5 Monday through Thursday and 8 to Noon on Friday.

## Sources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