Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Michael Pento
Pento Portfolio Strategies

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Dennis Tubbergen:

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. Joining me once again on today's program is returning guests, Mr. Michael Pento. Longtime listeners will recognize Michael as the founder and president of Pento Portfolio Strategies. He is also the host of the popular podcast, the Midweek Reality Check. You can learn more about both Pento Portfolio Strategies and the Midweek Reality Check Podcast by visiting pentoport.com. Hey Michael, welcome back to the program and thanks for joining us.

Michael Pento:

Hey, great to be with you, Dennis. Good timing.

Dennis Tubbergen:

Yeah, so let's talk a little bit about, there's so much to talk about, but let's start with what's going on in banking. First, we had Silicon Valley Bank, Signature Bank, now First Republic. Bank stocks were down again this week because there's a few more banks on the ropes. How bad does this get?

Michael Pento:

Well, unfortunately, because of the megalomaniac morons that run the Federal Reserve, this is just getting started. I just put out a commentary on my website. You guys could go there and look at it yourself. The problem in the banking system is pretty simple. So, in the last 10 years, so 10 out of the last 14 years since May of 2010, the effective Fed funds rate where it is today, which is 5.1%, is above where 30 year fixed mortgage rates were. So, when you think about 30-year fixed mortgage rates. They hit a low of 2.65% in 2021, but they've been well below 5% for 10 of the last 14 years, all the way back to May of 2010. So, these bank assets are yielding very, very low-income streams to banks. Yet you can go out right now and get over 5% on a risk-free ultra short-term treasury note.

No liquidity risks, no duration risks, nothing. Over 5%, Dennis. So, here's the calculation many people have made, I know I have made this calculation. They said to their local bankers, "Can I receive more than 0.05% on my liquid deposits with you? I mean, I could get a little higher if I do CDs, but I'm talking about liquid money markets. What can I get?" And they say, "No, I'm not giving you anything because I have plenty of excess reserves that the Federal Reserve gave me post COVID. I don't need your deposit." So, I said, and everybody else seems to be saying the same thing, taking their money and walking away with it and saying, "Thank you very much. I'll take my deposit out of your bank and I'll go put it at a money market mutual fund or a brokerage firm, or go to treasurydirect.gov, buy myself some short-term treasuries." Risk-free, no duration risk, no credit risk, and get 500 more basis points than I'm getting in a bank and everybody's doing it.

Now, that's just one problem in the banking system that's removing reserves from the banking system. By the way, banks need reserves to max liquidity requirements and Basel III requirements. But don't forget about the ongoing QT program, which was temporarily interrupted because of the BTFP program that the Federal Reserve launched, but the QT program removes reserves from the banking system. So, the next part of this vicious cycle is we're going to see the recession become manifest, which has yet to hit, and we're going to see more of bank assets come under duress, like commercial real estate, collateralized loan obligations, junk bonds.

We haven't seen any stress in the banking system or shadow banking system yet because of the recession. But their credit card loans, their auto loans, student loans, if anybody's paying them anymore, supposed to be pretty soon. They're all coming under pressure, and that is going to severely hurt the banking system. Right now, it's just becoming manifest in the regional banks because people say, "Well, I don't want to have a deposit at my regional bank because I want to have my deposit with JP Morgan." Tell me, Dennis, why would I accept 0% of my deposits at JP Morgan if I'm not going to accept them at Pack West? It doesn't make a darn bit of sense.

Dennis Tubbergen:

So, Michael, it seems that the Fed has agreed to backstop all these banks, make all these depositors whole, which they pretty much have to. My research shows the deposit insurance reserve fund is 0.6% of insured deposits. Doesn't this just force the Fed right back into to more QE?

Michael Pento:

Sure. Well, first of all, there's no money in any of these bank reserve systems. There's no money in there, Dennis, you know that. There's no money in the social security system. It's just a promise to sell debt to fund these institutions. So, if the FDIC was called upon to bail out every insolvent bank, the FDIC is insolvent and the government of the United States is insolvent, you understand that? I'm sure. But listen, the KRE is the regional bank ETF. That particular index is down almost 45% since February of this year. What does that tell you? I mean, you're talking about being down almost 50% in a matter of a couple of months, in the value of the entire regional banking index. So, to answer your question, the only way out of this, and I'm going to put quotes, you're on radio, you can't see me with my fingers going quote, the only way out of this is for the Fed to cut interest rates back to a point that brings treasury prices up and yields down.

But since a lot of what's troubling these banks in the case of some of these brokerage institutions, is they own a lot of long duration treasury bonds. What do you think is going to happen to the rate of inflation if the Fed returns to QE in ZIRP, like I'm quite sure they're going to be forced to do reluctantly in the near future. Well, the long end of the bond market's going to go haywire. Prices are going to crash, and yields are going to go much higher because who is going to be dumb enough to believe that the Fed actually has the ability to fight inflation, if Powell were to pivot at this point?

Dennis Tubbergen:

So, Michael, this may mean that we have to have more inflation, but ultimately all this debt has to lead to deflation, and we've had this conversation before. What's your forecast, as far as, are we going to see inflation near term, deflation, long term stagflation? How do you see this affecting the economy?

Michael Pento:

Well, you've touched upon the reason why I have an inflation, deflation and economic cycle model. So, my model predicted that we'd first have inflation in 2022, which is what we did. We had breakout inflation. Why was that inflation engendered, Dennis? I still hear, even today, "We had a supply shock." I mean, what the heck are you talking about? A supply shock. What we had was a Federal Reserve shock and an insane government that locked down people because of a virus. The entire country was locked down, the whole world was locked down and couldn't produce anything. Yet they were given trillions of dollars to go out and spend. So, in the case of the Federal Reserve, $4.5 trillion was monetized of the $6 trillion of helicopter money coming from the treasury, and there were no goods and services to purchase.

There were supply chain bottlenecks because people couldn't make things, and yet they had all of this phony money thrown at them. That's the whole story. It wasn't just a supply chain issue. Okay. So that's why we had inflation in 2022. I then predicted that we would have disinflation in the latter half of 22, and in 23, which is what we have right now, inflation has gone from 9.1% down to 5% on the headline CPI. The next step is, a very salient risk of deflation, falling prices, not the falling rate of change of prices, falling prices due to the fact we have crashing money supply growth.

Due to the fact that banks are tightening lending standards at the fastest rate in history, due to the fact that banks are going out of business now. And that's where we have a debt-based monetary system. And when banks can't make loans and they can't, money supply shrinks. So, we're going to have a shrinking money supply. We're going to have a credit crisis. This is a very salient risk, and that has always led to deflation and depression. Now, after that truncated period of time where we have crises in the money markets, I expect Powell to then reluctantly panic, go back to ZIRP, go back to QE, and then you're going to see inflation run intractable, I believe for a very long time.

Dennis Tubbergen:

Well, and Michael, certainly when you look at the M2 money supply, which is contracting, that certainly seems to back up what you're saying. And given that when you have a contracting money supply, then you have an ever-increasing need for more currency, both in the public sector and the private sector. I agree with you. I don't think there can be any other choice. And how bad does inflation get this next time around?

Michael Pento:

If I'm correct and I don't get paid, you can't make money jumping ahead of cycles. So, in the investing cycle right now, what you need to know is we have disinflation and recession. That's how you should be invested. When my model lets me know and informs me that things are changing, i.e., the Fed and treasury have liquified the banking system, then I can make a logical change in my investment strategy to hedge towards intractable inflation and stagflation. Now, you asked me to pontificate, and by the way, how high that inflation runs is something that's not as concerning to me in the short term as getting the direction right, because your assets will make money hopefully based upon that rate of change of inflation.

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But back to what the exact answer I want to give you is inflation went to 9.1% headline CPI, and at that time, we still had many people had complete faith in Jerome Powell that he would be able to handle the inflation crisis, and he put his reputation online saying, "Hey, I am going to raise interest rates. I'm going to drain my balance sheet and I'm going to bring inflation down." So far, he's doing that, and inflation rates are coming down. However, if he is forced to panic now, it will be a tacit admission that he can never really get a handle on inflation without destroying the economy. So, I think inflation can go well into the double digits, higher than ever before imagined in this country if he does exactly that.

Dennis Tubbergen:

Well, my guest today is Mr. Michael Pento. The website is pentoport.com. You can learn about Michael's Pento Portfolio Strategies there as well as the Midweek Reality Check Podcast. Again, the website, pentoport.com. I'll continue my conversation with Michael Pento when RLA Radio returns, stay with us.

I'm Dennis Tubbergen. You're listening to RLA radio. I'm chatting today with Mr. Michael Pento. He is the founder and president of Pento Portfolio Strategies. You can learn more about his work as well as the Midweek Reality Check Podcast that he hosts at pentoport.com.

Michael, prior to the break, we were talking about the fact that we have disinflation now and then at some point in the future, you're forecasting more inflation. Seems like that will exacerbate this move we're seeing around the globe away from the US dollar. What's your take on that particular topic?

Michael Pento:

Well, short term, I mean we've been long the dollar for about almost two years now. We sold half of it about six months ago, don't quote me exactly on the time, but we did very well on that trade, don't do very well on every trade, but we did very well on that trade when everybody else was negative of the dollar. And I still get a lot of feedback negatively like, "Hey, the dollar's losing ground, it's going to be losing its world reserve currency status." And I understand that. I've been ahead of that curve. I've written about it for years. The dollar is definitely going to lose its world's reserve currency status. That's a long-protracted process. But right now, why we still hold half of our dollar position is because during times of global recessions and global banking crises, the dollar is seen as a safe haven.

Now, I think it might be seen less so as a safe haven this time around, but still I think treasuries and the dollar will offer a significant haven for investors simply because there's too much dollar denominated debt around the world. And when you're an emerging market and we have a recession emerge and you have to pay back a loan that's in dollars and they're in short supply, you have to sell your currency and buy dollars to pay back that loan in a panic. And this is what's going to happen again, happens all the time, Dennis, but this again is something very short-lived. I believe firmly that when Powell does make any kind of pivot to lowering interest rates, it's going to be the end of the dollars hegemony and dominance as a world's reserve currency status for many years to come. Does that mean it's going away completely?

Absolutely not. I mean, look at the competition for the dollar. Is the dollar going to lose ground to the Euro, to the Yen? It can't lose ground to the Yuan. The Yuan is a closed currency system, so it'll lose some of its dominance as the world's reserve currency, and it will lose value against other fiat currencies. But in the short term, it's still a buy, and I'm most concentrated on what's going to happen between now and the next three months, and I'm moderately bullish on the dollar solely because of the stress in the global economic system.

Dennis Tubbergen:

So, Michael, moving ahead here over the next three months or so, talk a little bit about investments on which you're bullish.

Michael Pento:

Well, I'm bullish on bonds. Last time I was on your program, I think I made a pretty good case of owning the highest quality treasuries, which is again, a fantastic trade. Bond proxies like utilities are also a very good place to hide. Low beta stocks over high beta stocks, in other words, If you still own the high volatile tech sector, which has had a pretty decent year so far, I would run as fast as you can from that sector. Dollar, we do own some of the dollars I just mentioned, we just talked about. Gold is at a 15 to 17% weighting in my portfolio. That's 300 basis points below my max. So I'm just about as bullish on gold as you could possibly be at this moment that includes physical gold and the miners.

Dennis Tubbergen:

Michael, would you be as bullish on silver as you are gold, and why or why not?

Michael Pento:

The answer is, I'm bullish on silver. I'm not as bullish on silver as gold. If you look at historically, silver does about half as good as gold over time. Silver is a monetary metal. It's a hybrid, its monetary metal, and it is also a base metal. So during times of a global slowdown, it tends to do a good job as gold as a hedge for your portfolio. So, I would own some silver, but I would definitely own more gold than the silver.

Dennis Tubbergen:

Michael, let's talk a little bit about the forecast, rather for the broad stock market the rest of this year, take the US major indices like the S&P 500 or the Dow.

Michael Pento:

Well, I don't give forecasts for the Dow in points. The forecast is for much slower prices. We have a debt ceiling confrontation going on right now. It has to be resolved in the next few weeks. History is clear that it's going to get resolved. This time it's much more difficult than ever before. I believe that Speaker McCarthy is not going to be able to put that vote to the floor unless there's significant spending cuts. So, if he's going to put a vote to the floor without significant spending cuts to raise the debt ceiling, Matt Gaetz is going to get him out of there and he'll lose his speaker gavel. So, it's a very, very difficult, fragile coalition. He's got to bring over those very ultra-conservatives, and thank God, we have them, the Freedom Caucus there in the Republican Party in the house. But maybe the debt ceiling does get raised, maybe it doesn't, but the last time this happened in 2011, the Dow and the S&P lost a significant percentage of their value.

So short term, that's just one of the things I'm looking at. Of course, having four banks fail, four banks have failed this year, and the banks that failed, aren't insignificant. They're the second, third, and fourth largest bank failures in history. So, they're big banks that are failing even though they're regional banks at this point. I would think that given the scenarios and the issues that I just talked about, and this is not a price target, this is just a valuation comment that the S&P, which is currently trading at north of 4,000, should go down to 3000.

So that's a 25% hit on the S&P 500 just to reach about fair value based on total market cap of equities to GDP and usually in bear markets, valuations just don't go to normal, they shoot below the average by a lot. So, 25 30% down from here would not surprise me at all, and it's all predicated on what exactly Powell does and when does he do it. So, when will Powell intervene? It was easier, Dennis, for Powell to intervene in 2019. Remember in 2019, we had a repo market crisis. The Fed was raising rates, stopped cutting rates in 2018, and then we had a repo crisis in 2019 because of the ongoing QT program that was occurring back then, and Powell started cutting rates in 2019 before anybody heard of the disease, COVID-19.

So, it was easier for him to do that, Dennis, because inflation was quiescent, but he cannot do that now. He knows that inflation was running amuck and intractable just a few months ago. He started raising rates in March 22. He was buying mortgage-backed securities in the first part of 2022. So, he knows that if he were to start cutting rates, now he knows the inflation battle that he's going to have is going to be one that's going to be lost, and he's not yet ready to give up that fight. He's not ready to take that battle on, I should say. So, it's going to take a very severe banking crisis, one where a completely clogged money market where you can't flow commercial paper, junk bonds are in free fall. You can't issue any new debt. That's the kind of thing I'm thinking.

Or how about this, Dennis? How about a couple of these pension plans run into trouble, private equity firms run into problems? These are things I think is going to happen. They might happen faster than you think, and that'll bring Powell to the table. It'll force him to the table because in the end, inflation's important, but either he claims it's job number one, even though he has no idea what causes it or how to tackle it or handle it adequately. He claims inflation is his number one issue before employment, before anything else. But in reality, his number one directive is to make sure banks can survive and function well. That's his number one directive. And when they stop functioning, when the money markets clog, guess what? It's back to QE in ZIRP.

Dennis Tubbergen:

Michael, in the time we have left, I was just reading that I believe there's about $3 trillion of outstanding commercial real estate debt, and I think about half of that is going to have to get refinanced over the next couple years, and that debt has largely adjustable interest rates. Isn't this going to be a huge economic headwind for real estate and for the banking sector over the next couple years?

Michael Pento:

A hundred percent. Commercial real estate is maybe the new ground zero of a banking crisis, but it's going to be just part of the whole devolution of the system. Don't forget, we have credit card loans, auto loans, student loans are going to have to start being repaid. We have junk bonds in the banking system. The shadow banking system is replete with collateralized loan obligations, which are highly leveraged loans to businesses that couldn't even access the credit markets. All of these things are going to devolve, and we haven't even seen the unemployment rate tick up yet. In other words, we haven't even seen the start of the recession. We just maybe see the fringes. Maybe the outer bands of the hurricane are buffeting the coast right now, so to speak. But wait until you start seeing vacancy rates shoot up for commercial real estate.

Not only commercial real estate, but private real estate, you have a lot of homes, single family homes, about 20 to 25% of single-family homes that were purchased over the past few years were done by Wall Street and investors. That investment makes a lot of sense. When you have a renter who has a job who's making huge payments, huge income streams to the owner, but when the home prices start to fall and your renter doesn't pay you any longer because he lost his job, what do you think the value of that mortgage-backed security, that private mortgage-backed security is going to be? These are all the assets, CRE, private mortgage-backed security, CLOs, junk bonds, private equity, pension plans. All of those troubles have yet to begin, and they're right around the corner.

Dennis Tubbergen:

Well, my guest today has been Mr. Michael Pento. He is the founder and president of Pento Portfolio Strategies. He is the host of the Midweek Reality Check Podcast. You can learn more about both at pentoport.com. Michael, it is always a pleasure to catch up with you. Appreciate you taking the time to join us on today's program and would love to have you back down the road.

Michael Pento:

Anytime, Dennis. Thank you.

Dennis Tubbergen:

We will return after these words.