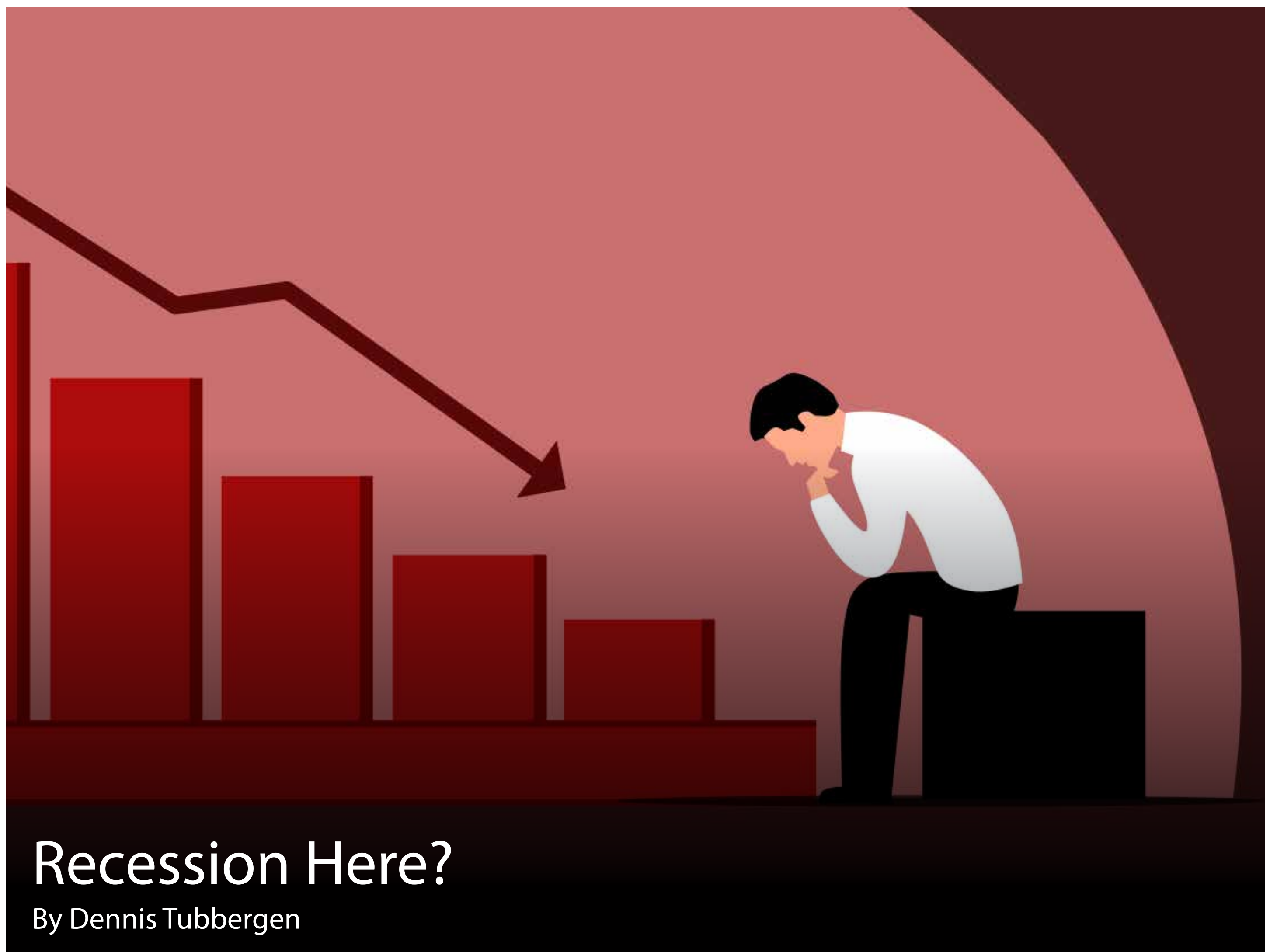
THE "YOU MAY NOT KNOW REPORT"

A PUBLICATION OF RETIREMENT LIFESTYLE ADVOCATES



Recession Here?

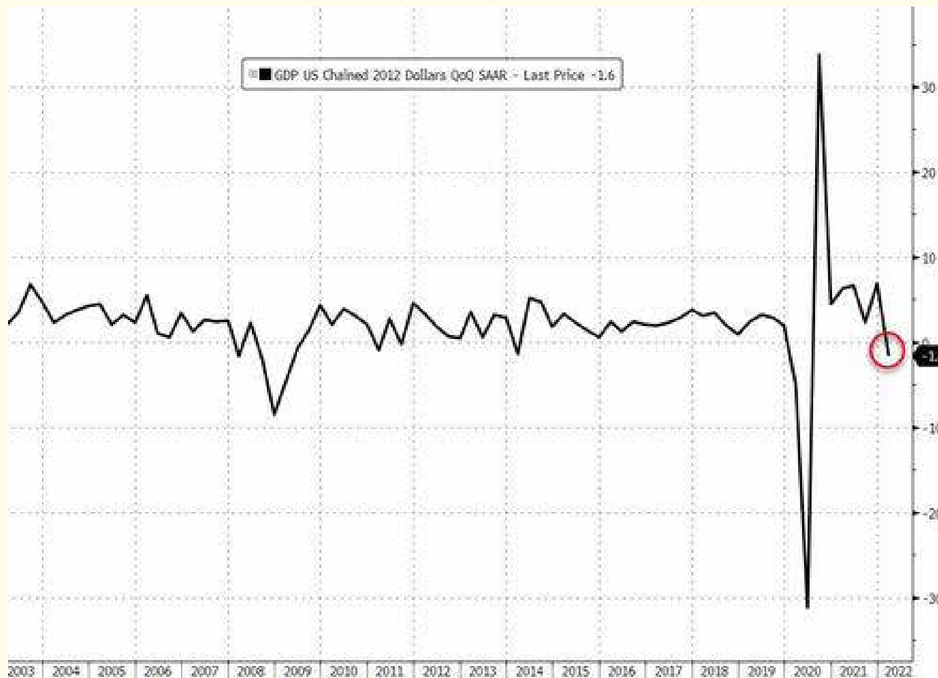
By Dennis Tubbergen

As I have noted previously, recessions arrive before they are officially recognized. Economic data is reported and then revised multiple times before there is consensus on the real state of the economy.

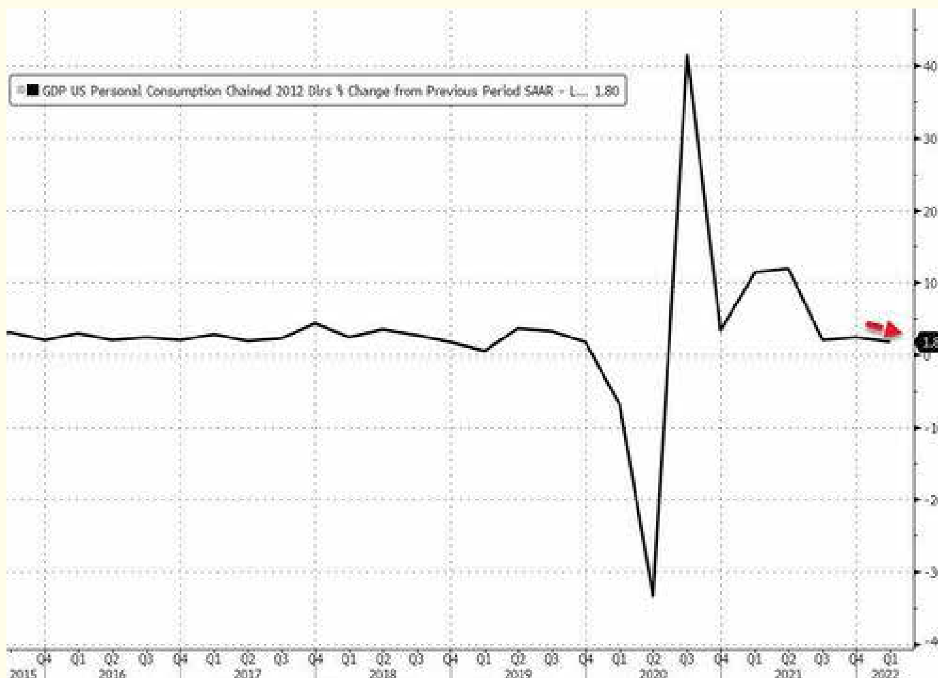
In the first quarter of this year, on the RLA Radio program and in the newsletters we publish, I noted that it was my belief that the U.S. economy was in recession. Seems that now the economic data is being revised, that may indeed be the case. This[1] from "Zero Hedge":

The third look at Q1 GDP appears to confirm the worsening picture of the US economy that is now evident in sentiment surveys nationwide.

Growth was revised even lower to -1.6% Annualized QoQ (from -1.5%)...



Personal Consumption growth collapsed from +3.1% to just +1.8% - weakest since the COVID lockdown collapse...



And finally, inflation - GDP Price Index - rose from +8.1% to +8.2% - the highest since June 1981...

So - stagflation it is... not exactly what The Fed wants to see.

Moving ahead, I expect that we will see persistent inflation in consumer essentials, continued economic contraction and declining asset values specifically in the broad stock market and in real estate.

Today's economy is totally artificial, dependent on currency creation and helicopter money to maintain the illusion of economic health. Now that interest rates have risen very modestly and since government stimulus payments have been spent, economic reality is setting in.

The Federal Reserve has two choices at this juncture in my view. One, continue to tighten by raising interest rates in which case a deep recession will be the result. Or, two, reverse course and let the dollar fall farther to attempt to maintain the illusion of economic health.

Ultimately, I believe the Fed will opt for choice two resulting in continued stagflation.

As noted, this will likely be bad news for the broad stock market. As noted in past issues of the "You May Not Know Report", one of most common stock valuation indicators, "The Buffet Indicator", has been telling us that stocks are very overvalued for a very long time.

For new readers, The Buffet Indicator measures the total value of all stocks and compares that value to the Gross Domestic Product, or economic output of the United States.

As the economy contracts, stock values must fall as well to keep the ratio in current balance. Since stocks remain overvalued, it is my opinion that stocks will need to fall farther than the economy contracts on a percentage basis.

That seems to be what is happening at the present time.

Fundamentally speaking, stock values are driven by earnings. While talking about price to earnings ratios has fallen out of vogue of late, this ratio is still one of the best fundamental measures of stock valuation.

If you're not familiar with the price to earnings ratio, it is a ratio that is constructed by taking the price of a stock per share and dividing by the earnings per share. For example, if a stock is selling for $15 per share and the earnings per share are $1, then the price to earnings ratio is 15.

In other words, an investor contemplating a purchase of the stock for $15 per share could expect to get a return on investment of $1 per share.

If earnings per share rise, one could reasonably expect the share price of the stock to increase as well. On the other hand, if earnings per share falls, one might expect that the stock price per share would fall as well.

Lance Roberts commented in a recent "Market Watch" op-ed piece[2]:

Big increases in borrowing costs will erode company profits as the economy slows. Expect the bear market to stick around longer.

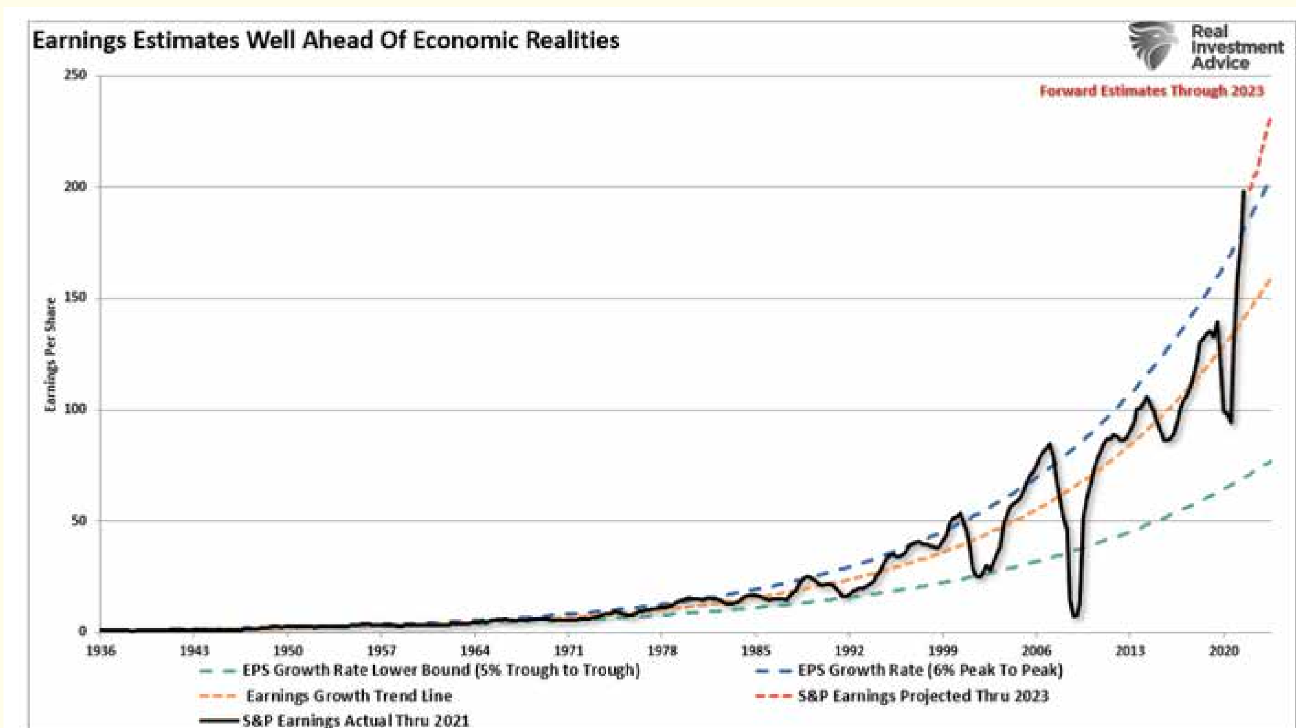
An earnings recession is coming as the Federal Reserve raises interest rates, which in itself accelerates an economic recession. That should be no surprise given earnings are derived from economic activity.

However, despite the economy already showing signs of weakness, inflation running at the highest level in 40 years and the Fed moving aggressively to tighten monetary policy, Wall Street analysts continue to suggest strong profit margins and rising earnings into 2023.

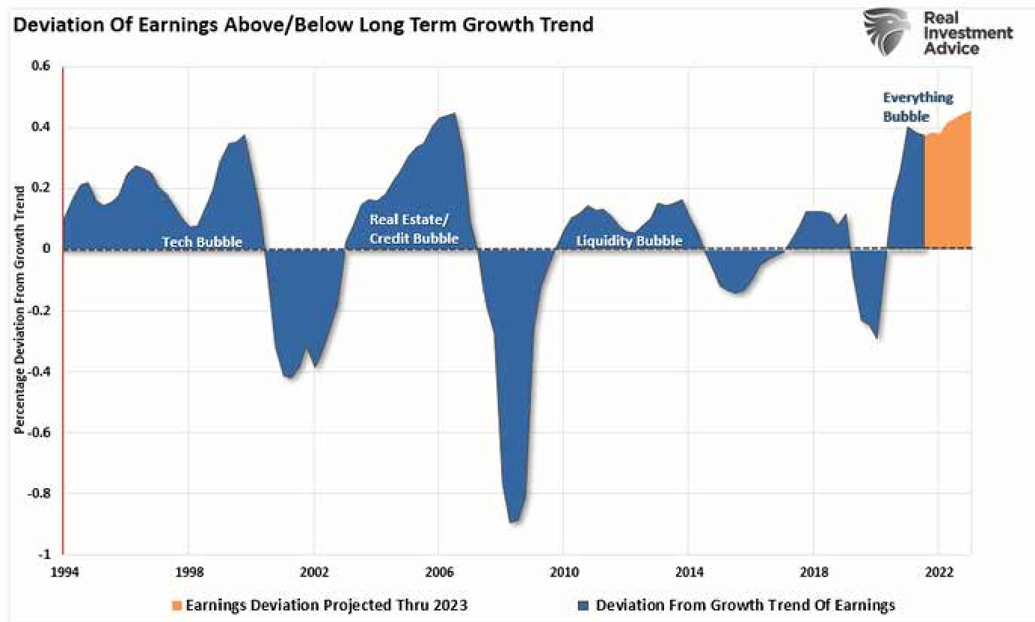
The Fed on Wednesday raised interest rates by 75 basis points, the biggest increase since the mid-1990s, to curb inflation. The central bank indicated it would keep lifting rates, a strategy that will inevitably hurt the economy and the jobs market.

For the purposes of this article, we are defining an earnings recession as a period in which corporate earnings, or profits, are below the year-earlier level for two consecutive quarters. Using this measure, there have been 19 earnings recessions since 1948, with at least three instances in the past 10 years.

Over the long term, the economy grows at about 6%. Therefore, earnings growth also runs at roughly 6% on a peak-to-peak basis. But analysts suggest that earnings growth into 2023 will run well above the historical growth rate despite forecasts of much slower economic activity.



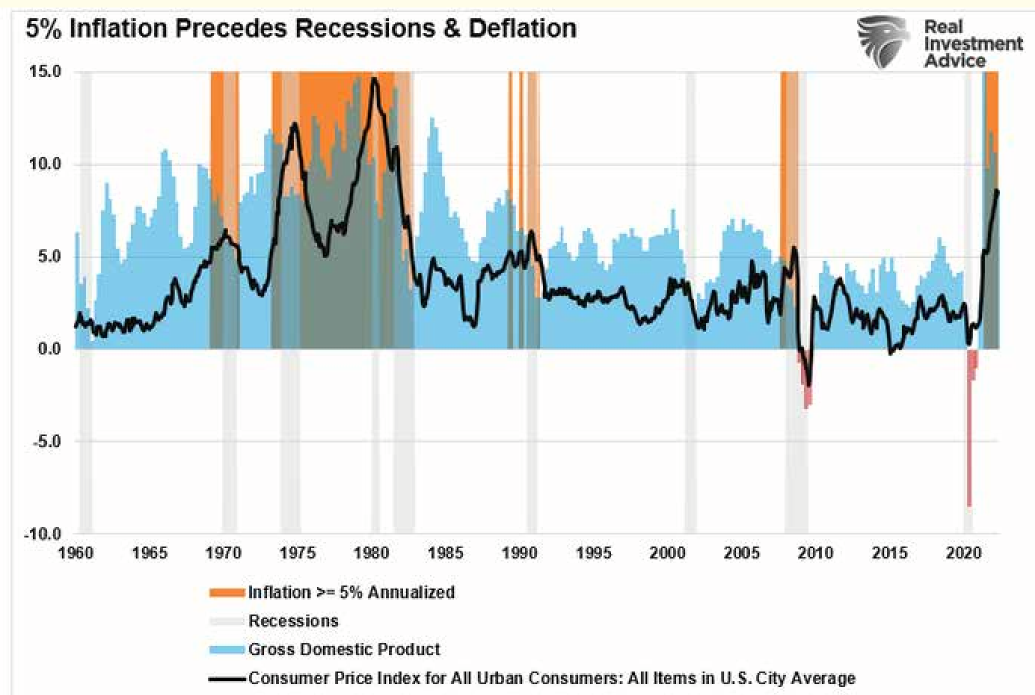
To put that into perspective, analysts' estimates are currently at the most significant deviation above that 6% earnings growth trend.



The only two previous periods with similar deviations are the 2008-2009 financial crisis and the dot-com bubble that burst in 2000.

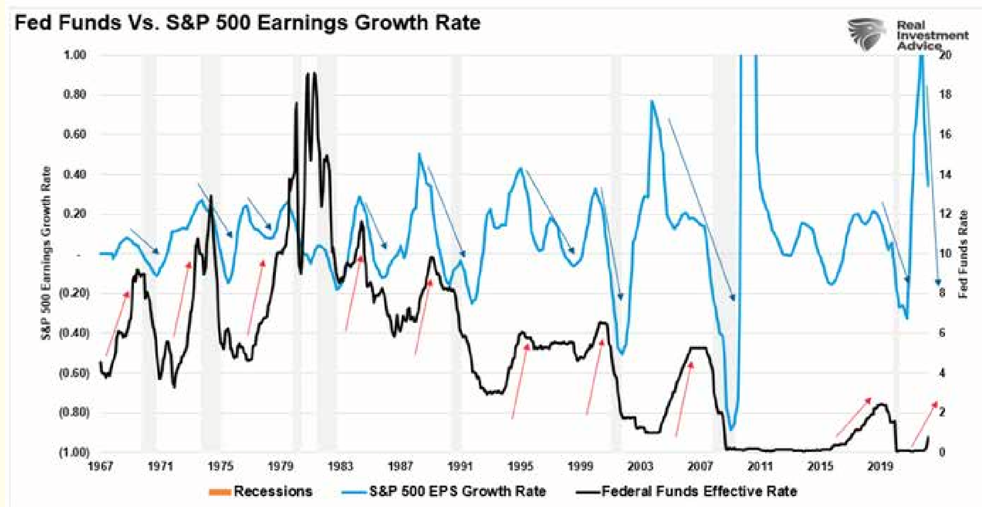
While Wall Street analysts currently remain exuberant about earnings growth, an economic reversion resulting from tighter monetary policy will lead to an earnings recession.

As noted, with inflation already running at 40-year highs, the risk of an economic recession has risen markedly in 2022. Historically, when inflation rises by more than 5% annually, an economic contraction has followed.

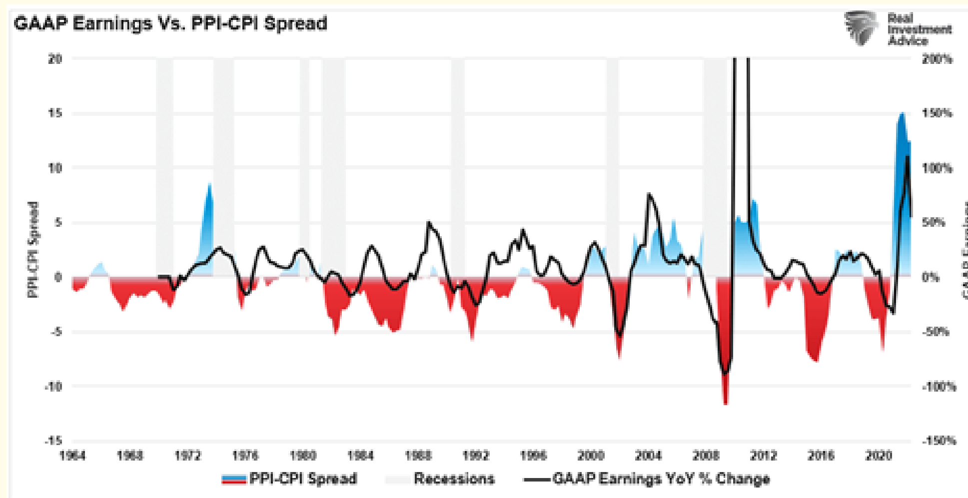


As shown, "high prices cure high prices" by slowing economic demand. However, as the Fed hikes rates to slow economic growth, thereby reducing inflation, they risk pushing the economy into a contraction. Given consumers' dependence on low rates to support economic growth, the risk of a policy mistake is elevated.

Of course, since earnings are highly correlated to economic growth, earnings don't survive rate hikes. As the arrows below show, Fed rate increases consistently lead to earnings recessions.



The Fed is in a difficult position. Producer prices, as shown below, have risen substantially faster than consumer prices have. That suggests companies are absorbing input costs that they can't pass on to consumers. Eventually, the absorption of higher costs impairs profitability and reduces earnings.



When the inflation spread rises enough to impair profitability, corporations take defensive measures to reduce costs (layoffs, cost cuts, automation.) As job losses increase, consumers contract spending, which pushes the economy towards a recession.

The economy slows even faster if the Fed hikes rates to slow inflation. While no one currently expects an earnings recession, few tailwinds are supporting economic growth. The combination of geopolitical events and Fed policy will make continued growth even more challenging.

Central Bank of Zimbabwe Embraces Gold

The Country of Zimbabwe, riddled with bouts of high inflation over nearly the past two decades is now turning to gold as a solution. This[3] from Schiff Gold:

> *The Reserve Bank of Zimbabwe plans to issue gold coins as a way for investors in the country to store value as inflation runs rampant in the economy.*
>
> *The United States isn't the only country battling rapidly rising prices. The inflation rate in Zimbabwe spiked from 132% in May to 191.6% in June, and the Zimbabwean currency is quickly devaluing against other global currencies, particularly the US dollar.*
>
> *Enter gold.*
>
> *On Monday, Reserve Bank of Zimbabwe, John Mangudya, announced the new gold coins would be minted by Fidelity Gold Refineries (Private) Limited and available to the public through normal banking institutions.*
>
> *"The Reserve Bank of Zimbabwe's Monetary Policy Committee (MPC) resolved to introduce gold coins into the market as an instrument that will enable investors to store value."*
>
> *The central bank owns Fidelity Gold Refineries (Private) Limited. It operates as the only gold-buying and refining entity in the southern African country. The RBZ has not announced a timeline for the introduction of the coins.*
>
> *Batanai Matsika heads research for Morgan & Co, a Zimbabwean brokerage firm. In an interview with Al Jazeera, he called the introduction of the gold coins a 'welcome development' in a market starved of options to hedge against inflation.*

Here is a quote from Mr. Matsika:

> *"For a long time, the market did not have many investment options and this is a new asset class. The thinking was inspired by the need to come up with an instrument that addresses the inflation problems in the economy where purchasing power has been eroded. From*

what we are gathering, this is going to be a store of value."

Matsika went on to say the fundamentals of gold help it hedge against inflation and geopolitical risk, and that gold coins would open the gold market to 'ordinary investors."

Typical of central bankers, the RBZ is trying to solve a problem it created. The country has labored under an inflationary monetary policy for decades. According to 'Al Jazeera', the bank worsened the problem by printing even more new money, reversing gains made in the past two years. Inflation decreased from a peak of 800% in 2020 to 60% in January this year.

Ironically, Zimbabwean investors have turned to the US Dollar as a store of value. The dollar has its own inflationary problem, but as the world reserve currency, the greenback is the cleanest dirty shirt in the laundry. One US Dollar sells on the Zimbabwean black market for 650 Zimbabwean dollars.

The availability of gold coins will likely ease pressure on the US Dollar in the country. After all, gold is a better long-term store of value than another fiat currency. It has no counter-party risk and it cannot be created out of thin air by central banks.

This move by the central bank of Zimbabwe fits in with what the next big worldwide currency move will be, in my view – a move to link a currency to gold.

We are seeing more and more movement in that direction this year. Another good reason to own physical precious metals in your portfolio.

The Big Four

One of the analysts that I follow is Matthew Piepenburg. Mr. Piepenburg recently wrote a piece in which he concluded that as ugly as 2022 has been for the markets, there is more pain coming.

I agree.

Piepenburg offers many solid reasons for reaching this conclusion in his piece.[4] I am sharing excerpts here, but I would encourage you to read the entire piece at the link furnished below.

For well over a year before fantasy-pushers and politicized, central-bank mouth pieces like Powell and Yellen were preaching "transitory inflation," or hinting that "we may never see another financial crisis in our lifetime," we've been patiently and bluntly (rather than "gloomily") warning investors of the "Big Four."

That is, we saw an: 1) inevitable liquidity crisis which would take our 2) zombie bond markets to the floor, yields (and hence interest rates) to new highs and 3) debt-soaked nations and markets tanking dangerously south into 4) the dark days of stagflation.

In short, by calmly tracking empirical data and cyclical debt patterns, one does not have to be a market timer, tarot-reader or broken watch of "doom and gloom" to warn of an unavoidable credit, equity, inflation and currency crisis, all of which lead to levels of increasing political and social crisis and ultimately extreme control from the top down.

Such are the currents of history and the tides/fates of broke(n) regimes.

And that is precisely where we are today—no longer warning of a pending convergence of crises, but already well into a market disaster within the worst macro-economic setting (compliments of cornered "central planners") that I have ever experienced in my post-dot.com career.

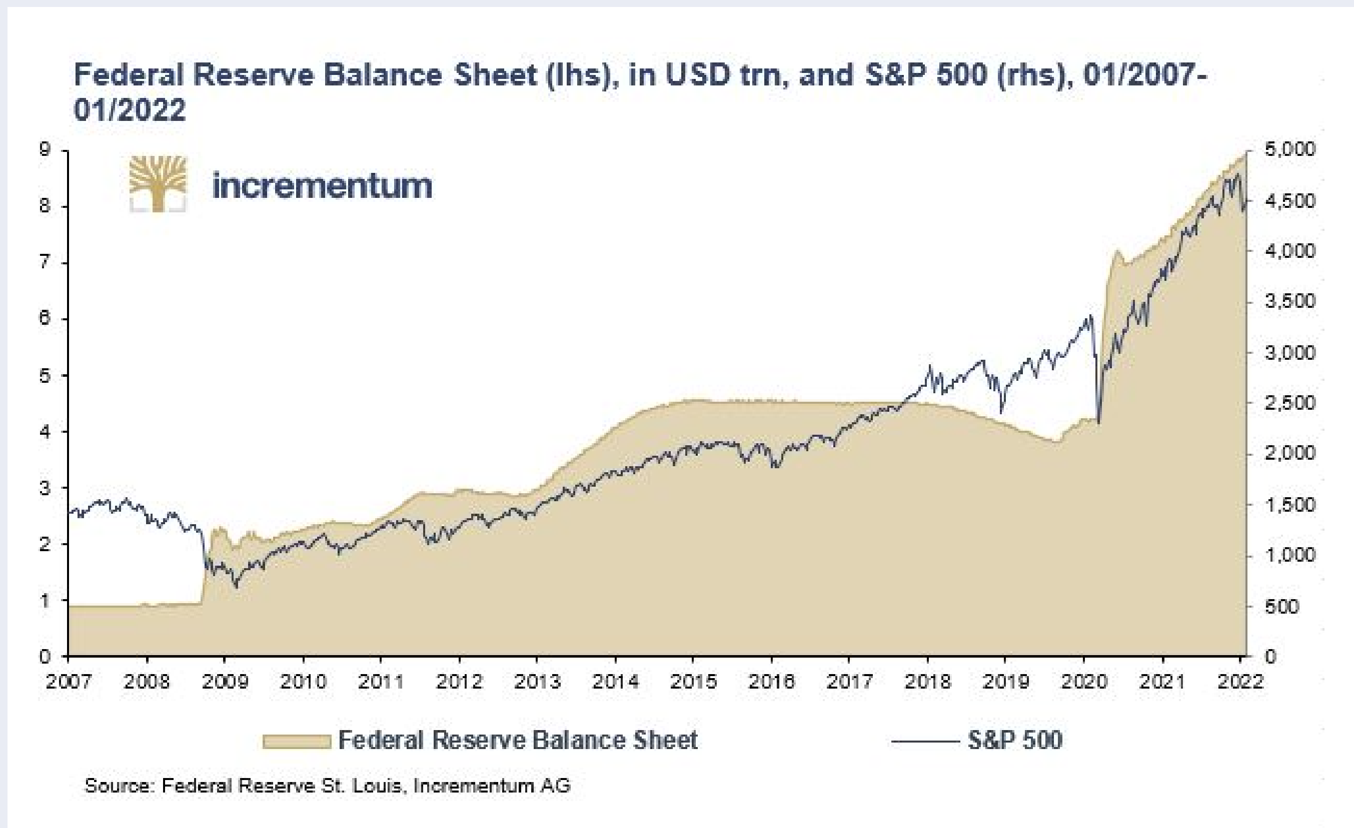
But sadly, and I do mean sadly, the worst is yet to come.

As always, facts rather than sensationalism confirm such hard conclusions, and hence we turn now to some equally hard facts behind this market disaster.

For well over a decade, the post-2008 central bankers of the world have been selling the intoxicating elixir (i.e., lie) that a debt crisis can be solved with more debt, which is then paid for with mouse-click money.

Investors drank this elixir with abandon as markets ripped to unprecedented highs on an inflationary wave of money printed out of thin air by a central bank near you.

In case you still don't know what such "correlation" looks like, see below:



But as we've warned in interview after interview and report after report, the only thing mouse-click money does is make markets drunker rather than immune from a fatal hangover and market disaster.

For years, such free money from the global central banks ($35T and counting) has merely postponed rather than outlawed the hangover, but as we are seeing below, the hangover, and puking, has already begun in a stock, credit or currency market disaster near you.

Why?

Because the money (i.e., "liquidity") that makes this drunken fantasy go round is drying up (or "tightening") as the debt levels are piling up.

That is, years and years of issuing IOU's (i.e., sovereign bonds) has made those IOU's less attractive, and the solution-myth of creating money out of thin air to pay for those IOUs is becoming less believable as inflation rises like a killer shark from beneath the feet of our money printers.

As we've warned, the UST is experiencing a liquidity problem.

Demand for Uncle Sam's bar tab (IOU's) is tanking month, after month, after month.

As a result, the price of those bonds is falling and hence their yields (and our interest rates) are rising, creating massive levels of pain in an already debt-saturated world where rising rates kill drunken credit parties (i.e., markets).

Toward this end, Wall Street is seeing a dangerous rise in what the fancy lads call "omit days," which basically means days wherein inter-dealer liquidity for UST's is simply not available.

Such omit days are screaming signs of "uh-oh" which go un-noticed by 99.99% of the consensus-think financial advisors selling traditional stocks and bonds for a fee.

As the repo warnings (as well as our written warnings) have made clear since September of 2019, when liquidity in the credit markets tightens, the entire risk asset bubble (stocks, bonds and property) starts to cough, wheeze and then choke to death.

Unfortunately, the extraordinary levels of global debt in general, and US public debt in particular, means there's simply no way to avoid more choking to come.

As all debt-soaked nations or regimes since the days of ancient Rome remind us , once debt levels exceed income levels by 100% or more, the only option left is to "inflate away" that debt by debasing (i.e., expanding/diluting) the currency—which is the very definition of inflation.

And that inflation is only just beginning…

July 2022 Special Report

Five Investing Myths and Mistakes and How to Potentially Avoid Them

This month only, we are making available a free report titled, "Five Investing Myths and Mistakes and How to Potentially Avoid Them".

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:

- Five mistakes investors can make in a down market
- Strategies for the current environment
- An updated forecast based on the latest data

This report is available for the month of July only.

Time Deposit Rates

At the time of publication, these rates were valid:

Term	Rate
1-Year	1.50%
2-Year	2.50%
5-Year	4.25%

Call the office for details at
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Resources to Help You Stay Informed

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

The weekly "Portfolio Watch" newsletter. 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

1. https://www.zerohedge.com/economics/us-q1-gdp-revisions-scream-stagflation
2. https://www.marketwatch.com/story/the-fed-is-aggressively-raising-interest-rates-an-earnings-recession-comes-next-11655327367
3. https://schiffgold.com/key-gold-news/zimbabwe-central-bank-to-offer-gold-coins-as-inflation-ravages-the-country/
4. https://goldswitzerland.com/the-2022-market-disaster-more-pain-to-come/