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THE "YOU MAY NOT KNOW REPORT"

A PUBLICATION OF RETIREMENT LIFESTYLE ADVOCATES

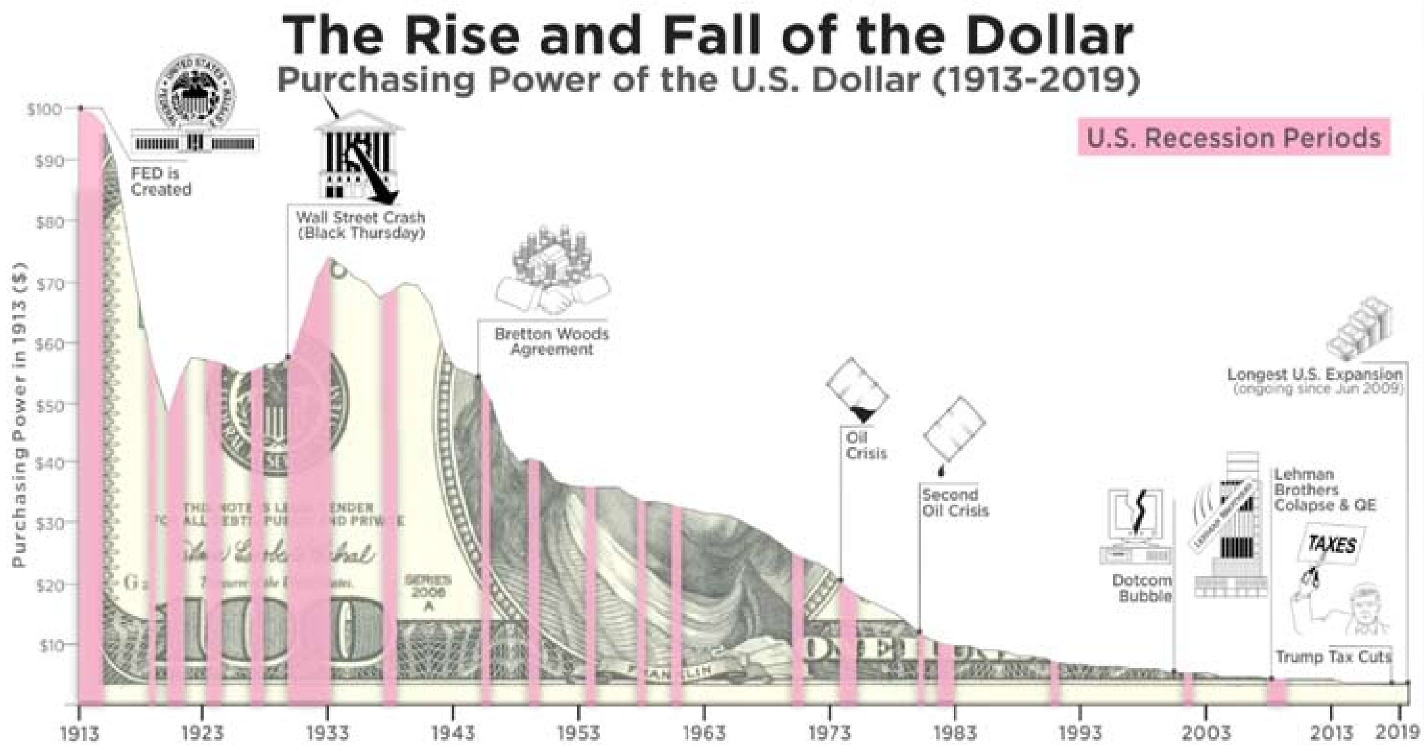
"60 Minutes" Features An Interview with Federal Reserve Chair Powell

The Chairman of the Federal Reserve, the central bank of the United States appeared on the television show, "60 Minutes" last month.

For new readers of this report, the Federal Reserve is a private group of bankers that has controlled US monetary policy since the Federal Reserve Act was passed in 1913. Many Americans falsely believe that the Fed is a government agency – it is not.

Since the Fed has been in charge of US monetary policy, the US Dollar has been on a what could only be described as a long, painfully slow death spiral. The devaluation of the US Dollar has taken place consistently no matter the political party in charge at the time.

This chart illustrates this devaluation nicely:[1]



Notice that the US Dollar has lost most all its purchasing power as the Fed has been managing monetary policy.

Fed policies have been tough on savers and investors. And, these policies are becoming more extreme by the day. Perhaps that's why Mr. Powell elected to do a mini media tour?

During the interview, Mr. Powell was asked if the Fed simply flooded the system with money. Mr. Powel replied affirmatively.

Then a follow up question was asked, where did the money come from?

Mr. Powell's answer was interesting, "We print it digitally. So, as a central bank, we have the ability to create money digitally. And we do that by buying Treasury bills or bonds or other government-guaranteed securities. And that actually increases the money supply." [2]

While the Fed Chair's admission that money is being created out of thin air was refreshing, the reality is part of that statement is only partially true presently.

The Federal Reserve is printing money digitally to buy government-guaranteed securities but is also printing money digitally to loan to the US Treasury. The US Treasury is then using the newly created money to buy private corporate debt. The Fed is also printing money digitally to buy low quality "junk" bonds.

The CARES Act passed in response to COVID-19 changed the rules about what the Fed could do with newly created money. The legislation made it legal for the US Treasury to borrow newly created money from the Fed in order to buy corporate bonds through the use of Special Purpose Vehicles or SPV's.

The Fed however is buying junk bonds directly which seems to be a clear violation of the Federal Reserve Act.

Mr. Powell made it clear that the Federal Reserve was far from done with money creation when he stated, "I will say that we're not out of ammunition by a long shot. No, there is really no limit as to what we can do with these lending programs."

Unfortunately, history teaches us that this statement made by Mr. Powell is totally untrue. Money printing does have a limit.

Excessive money creation eventually leads to a currency failure. Money printing works only until the populace loses confidence in the currency. Once confidence is lost and those holding the currency elect to exchange the currency for any other asset that is not currency, inflation or hyperinflation kicks in.

What About these Deflationary Forces?

Interestingly, while monster levels of money printing is inflationary, mammoth debt levels are deflationary.

As long-term readers of the "You May Not Know Report" are aware, the way money is created has evolved over time. We call this the currency-money cycle.

After World War II, the US Dollar was made the world reserve currency since the United States agreed to back the US Dollar with gold at the rate of $35 per ounce.

That meant any foreign holder of US Dollars could exchange their dollars for gold.

Due to excessive money creation in the 1960's, the US Dollar's convertibility to gold ended in 1971. Since that time, money has been loaned into existence. That makes money debt.

When the dollar was directly backed by gold, money was an asset. Thirty-five US Dollars was a claim ticket for an ounce of gold.

Beginning in 1971, when the US Dollar was no longer backed by gold, money became debt. Banks could create new money by making loans.

Here's an example to make the point clearer.

ABC Bank, a hypothetical bank, has deposits of $10 million. The initial balance sheet of ABC Bank looks like this:

Assets		Liabilities + Net Worth	
Reserves	$1,000,000	Deposits	$10,000,000

The Federal Reserve, which makes the rules for banks, requires that banks hold 10% of deposits in reserve. In this example, ABC Bank would reserve $1,000,000 but would be free to loan $9,000,000.

Let's say that Jim's Manufacturing Company borrows $9 million from ABC Bank. ABC Bank will charge Jim's Manufacturing Company interest on the loan. This will allow the bank to pay interest to depositors and earn a profit.

ABC Bank's revised balance sheet looks like this:

Assets		Liabilities + Net Worth	
Reserves	$1,000,000	Deposits	$10,000,000
Loan	$9,000,000		

When Jim, the President of Jim's Manufacturing, walks out of the bank with his $9 million loan, the banker does not let him walk out of the bank with cash. Instead, Jim walks out of the bank with a cashier's check for $9 million.

Jim takes the $9 million cashier's check and deposits it into his business checking account over at XYZ National Bank.

XYZ National Bank has its deposits rise by $9 million and also sees its reserves rise by $9 million. A simple version of XYZ National's balance sheet might look like this:

Assets		Liabilities + Net Worth	
Reserves	$9,000,000	Deposits	$9,000,000

XYZ National is now free to loan out 90% of the deposit, maintaining $900,000 in reserves.

When Jim makes his deposit into his checking account at XYZ National, the money supply increases. Prior to ABC Bank making the loan to Jim, the total money supply was $10 million. After Jim's loan proceeds are deposited, the money supply has risen to $19 million.

Now, let's assume that XYZ National Bank makes an $8.1 million loan to Sarah's Automobile dealership. XYZ National's revised balance sheet looks like this:

Assets		**Liabilities + Net Worth**	
Reserves	$900,000	Deposits	$9,000,000
Loan	$8,100,000		

Sarah doesn't walk out of XYZ Bank with cash. Instead she receives her loan proceeds in the form of a cashier's check which she deposits into her business checking account at Secure Bank.

Following the examples above, the money supply has now expanded to $27.1 million.

This process continues until the $10 million expands to $100 million.

Up until the financial crisis a little more than a decade ago, if the Federal Reserve wanted to increase the money supply, the central bank would reduce interest rates. Lower interest rates encourage borrowing and borrowing means money creation.

Money creation happens as long as people and businesses borrow. Under this system money is debt and debt cannot be infinite. Debt can only expand as long as income expands too.

The truth about debt is that servicing debt, making interest and principle payments, consumes future production. Here is another example to help to make the point.

You go to the car dealership and buy a car. You have cash in the bank and opt to use that cash to make the car purchase. You are spending prior production to buy the car. In order to have the cash in the bank, you had to go to work, earn money and save some of your earnings.

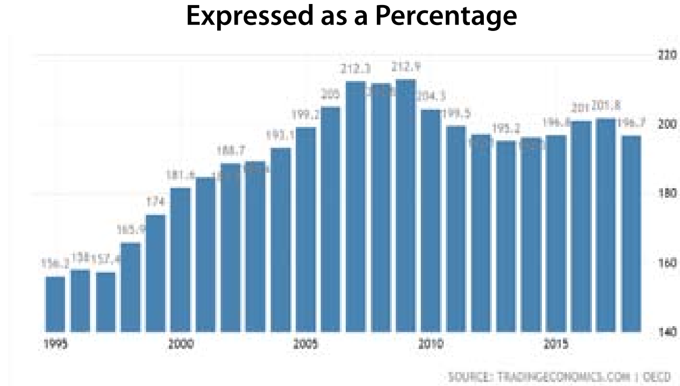
Your neighbor goes to the same car dealership and buys a car but instead of paying cash for the car, your neighbor elects to make payments. That consumes future production. In order to make the future car payments, your neighbor has to go to work, earn money and with some of that earned money make the payments on the car. That consumes future production.

The reason that debt can't be infinite is that future production is not infinite. Once enough of future production is consumed by debt, further debt accumulation and future money creation is not possible.

From 2007 through 2009 private sector debt as a percentage of economic output (total gross domestic product) reached an all-time high.

The chart illustrates:

US Private Sector Debt to Gross Domestic Product Expressed as a Percentage



Despite the fact that the Federal Reserve dropped interest rates to zero, borrowing didn't ensue.

Debt was too high.

Borrowers were not adding debt (creating money) they were defaulting.

When defaults on debt occur, money disappears from the financial system. That means the money supply contracts.

During the recession from 2007 to 2009 private sector debt was about 212% of total US economic output.

The Federal Reserve had two choices. Go through a deflationary period that would have been painful for some years as debt was purged from the system, or, print money which, as we wrote at the time, would only delay the ultimate economic pain.

That economic pain is now here, and the forces of deflation will likely emerge. To some extent they have already.

According to "Market Watch",[3] used car prices fell more than 12% in April from the prior year. That's a huge decline and is deflationary. This from the piece (emphasis added):

> *Much of the buzz stems from a recent report from the Industry Insights team at Cox Automotive, the parent company of Kelley Blue Book and KBB.com. On April 15, Cox released a special midmonth measure of the Manheim Used Vehicle Value Index (MUVVI). Manheim is the world's largest wholesale auction chain where dealers buy preowned vehicles.* ***The analytics team had never released data midmonth but did it because prices were dropping fast.***
>
> *No surprise: In mid-April,* ***wholesale used-vehicle prices had tanked – down approximately 12% from year–ago levels****. That is a big move for the MUVVI; the word "historic" was used to describe the drop. The fall–off in value was driven mostly by a lack of demand and few buyers. Not many dealers are interested in acquiring new inventory when there is a lack of consumer demand and a need to conserve cash. With little wholesale demand, prices fell quickly.*

Another deflationary symptom: retail landlords are sending out thousands default notices to their tenants who are unable to pay rent. This from "Bloomberg" (emphasis added):[4]

> ***Retail landlords are sending out thousands of default notices to tenants****, a situation that could tip already ailing retailers into bankruptcy or total collapse.*
>
> *Department stores, restaurants, apparel merchants and specialty chains have been getting the notices as property owners who've gone unpaid for as long as three months lose patience, according to people with knowledge of the matter and court filings.*

Many retailers have filed for bankruptcy protection already in 2020 including The Shurman Retail Group (Papyrus), Lucky's Market, Earth Fare, Noah's Event Venue, Pier One, Art Van Furniture, Modell's Sporting Goods, Food First Global Restaurants, True Religion, J Crew, Neiman Marcus, Stage Stores, Garden Fresh Restaurants and JC Penney.

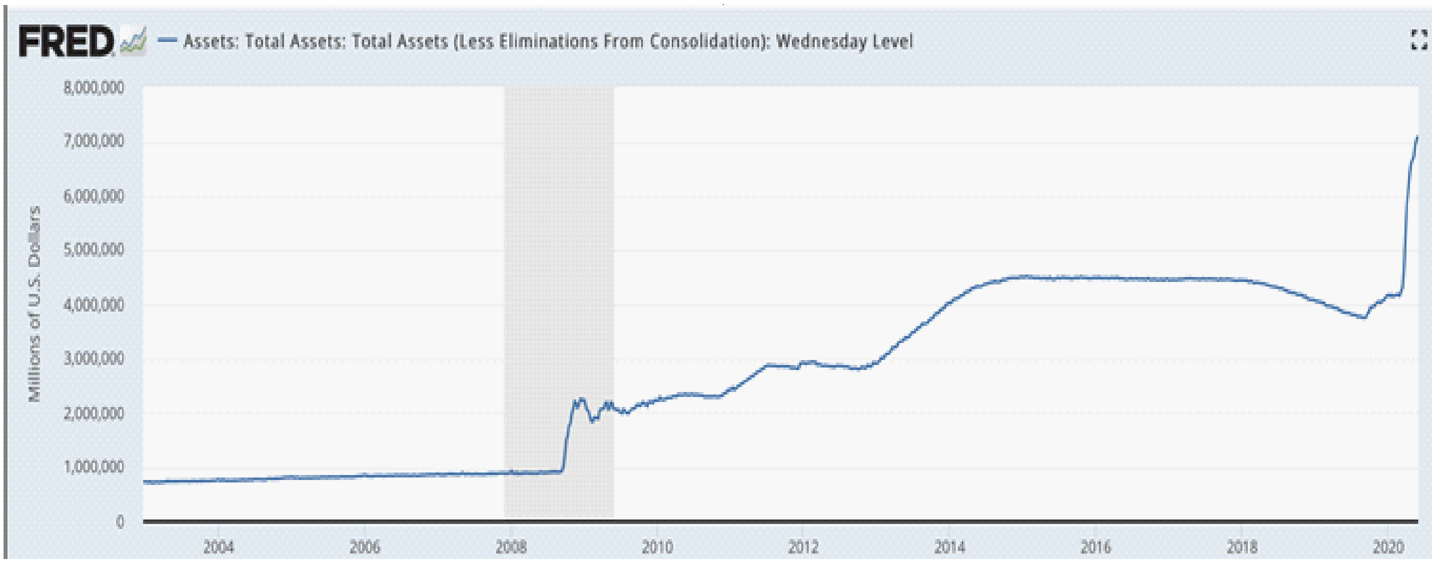
In bankruptcies, debt goes unpaid and that means money disappears from the financial system.

May headline unemployment will likely be 27% or 28% according to John Williams of Shadow Stats. Record unemployment levels are deflationary.

With all these deflationary forces at work and with interest rates near zero, the Fed is creating unprecedented amounts of new money. That is undoubtedly inflationary.

As of May 27, 2020, the Fed's balance sheet had risen to $7.15 trillion.[5]

This chart from the St. Louis Federal Reserve Bank illustrates:



That means Chairman Powell and his colleagues have digitally printed about $3.5 trillion already this year. While that is not quite double, it is very close.

At this point, our best forecast is that we will see deflation for a period of time and then inflation should the money printing continue. This forecast is consistent with the long-term forecast made in the "New Retirement Rules" book 5 years ago; only now it's here.

The best approach in our view remains the two-bucket approach to managing money. Deflation could prove to be hard on traditional investments like stocks. Having some of your invested assets (at least the amount needed for income) in a safe place makes sense. And, having other assets that can act as a deflation hedge down to road will also be important.

Will the Fed Now Print to Try to Bail Out the States?

It's no surprise that the COVID-19 lockdowns and economic restraints have been very damaging to the economy. And, when the economy tanks, tax revenues plummet.

During the month of April, at the Federal level, tax revenues were about $242 billion while expenditures were about $1 trillion.[6]

Year-to-date, through April tax receipts were down 54% year-to-year while government expenditures rose 161%.

Most all of this spending has been monetized by the Federal Reserve's digital money creation to quote Mr. Powell. And, despite the huge quantities of new money created, it seems that the Fed is now poised to ramp up its money creation activities to help bailout states and other municipalities.

This from Bloomberg[7] on May 15 (emphasis added):

> *The Federal* ***Reserve took another step toward launching an emergency lending program for state and local governments****, publishing an online document on Friday for would-be borrowers.*
>
> *The so-called notice-of-interest document is for eligible issuers in the municipal debt market "to express interest in selling notes to the special purpose vehicle" set up as part of the program, the New York Fed said on its website. "Filling out the notice of interest is the initial step for an eligible issuer to provide eligibility*

information to the SPV for review."

Budgets of state and local governments have come under serious strain as stay-at-home orders have shuttered entire sectors and tax revenues have dried up. ***The Fed facility offers to purchase securities from state and local issuers with maturities of up to three years to help temporarily fund the shortfalls****, though a bipartisan group of senators is calling for the Fed to buy longer-term debt as well.*

Democrats and Republicans are also debating direct aid for states and municipalities as part of another round of fiscal relief.

Within a couple months, look for states and municipalities to be getting freshly printed money from the Fed.

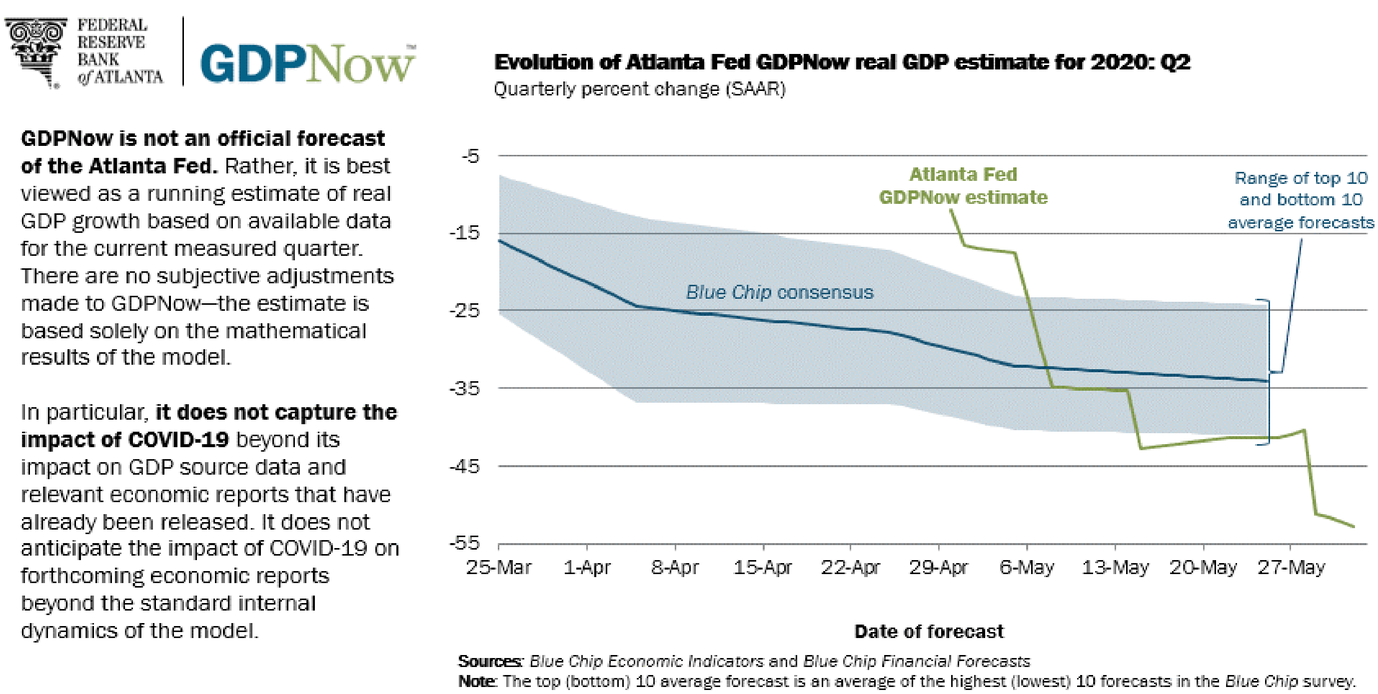
New Fed Economic Prediction Confirms Initial Prediction

Many of you undoubtedly remember the dire forecast of St. Louis Federal Reserve President James Bullard in March. Mr. Bullard suggested that unemployment could rise to 30% and the economic hit to the economy in the second quarter could be an unprecedented 50%.

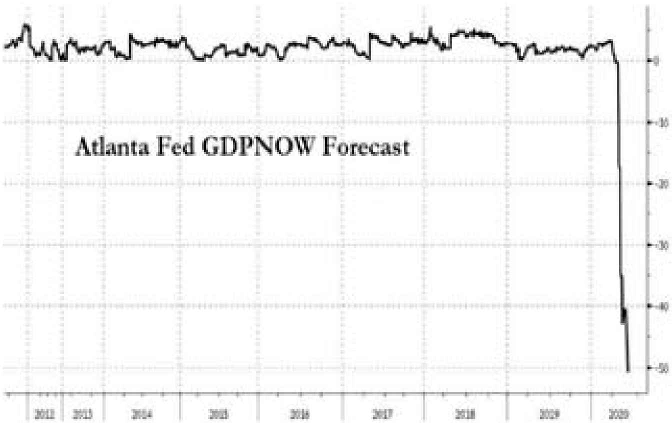
The comments at least contributed to the stock market's collapse. But now, the Atlanta Federal Reserve Bank is confirming that Mr. Bullard's initial thoughts may be on target.

On May 29, 2020 the GDPNow calculator estimates that second quarter GDP growth will be -51.2%.[8] Should that be the final number, it would be a new record.

The chart illustrates and explains:



Here is the actual forecast on a chart with historical precedent:



We are of the view that a decline of this magnitude will not allow for the "v-shaped" recovery that so many are hoping for.

There has simply been too much economic destruction done.

In our view the big hit will happen in the second quarter with further, smaller declines in the third and fourth quarters.

We also remain of the opinion that stocks are extremely overvalued and a further, steeper decline remains the most likely outcome.

Schiff: Nearly Half of Small Businessowners Expected to Close Down Permanently

We have long been skeptical as to the health of the US economy and have stated so often in this publication over the past several years.

That is not an indictment of any current or prior politician or policy; rather it has been a sharp criticism of Federal Reserve policies which were creating what we perceived to be an artificial economy.

Peter Schiff recently commented on this[9] (emphasis added):

The economy was booming. The stock market was setting records. Then coronavirus came along and governments shut things down to minimize the pandemic. That led to massive layoffs and a nasty recession. But once states open up, things will spring back to life and the economy will go back to being great again.

That's the mainstream narrative. But it's not based on reality.

In truth, ***the economy was a Fed-induced bubble before the pandemic. The central bank has managed to reinflate the stock market bubble despite the economic destruction, but it is nothing but a Fed-induced sugar high.*** *And the economy won't likely rebound quickly, even after things open up.*


Photo courtesy of Gage Skidmore

There are all kinds of reasons to doubt the quick economic recovery narrative. We've reported on the number of over-leveraged zombie companies, skyrocketing household debt, the battered labor market, and a potential cash-flow crisis even after the economy gets moving.

Now we have another sign of long-term economic trouble. ***A survey conducted by financial services company Azlo found that nearly half of small business owners think they will eventually have to close their businesses for good.***

Forty-seven percent of the small business owners surveyed said they anticipate shutting down, and 41% said they are looking for full-time work elsewhere.

This is on top of the small businesses that have already shut down and will never reopen.

The survey also asked questions about the Paycheck Protection Program (PPP) instituted through the CARES Act. The results were less than stellar, as Newsweek *reports.*

Less than half of participants—38 percent—involved in Azlo's recent survey applied for PPP loans. Of those who did apply, 37% said the program was slow to distribute funds and 20% described the process as 'painful,' the company reported."

It's absurd to think the economy is going to come roaring back when nearly half of small business owners expect to shut down. Small businesses employ 58.9 million Americans, making up 47.5% of the country's total employee workforce.

Fed Nominee Floats Gold Backed Crypto-Currency Idea

In 2017, when Bitcoin made news by having its price blow past $2,500 per ounce, we stated that there were some inherent problems with Bitcoin as a currency alternative, the principle problem being price volatility.

In order for a currency to gain widespread and near universal acceptance, it needs to be stable. A consumer doesn't want to hold a currency to use at a later date if there is a good chance of the purchasing power of that currency falling.

While we still feel that way about many cryptocurrencies, with the large amounts of fiat currency being digitally created, we now consider Bitcoin and other crypto-currencies to be speculative investments that more aggressive investors might consider for a small part of their portfolios. Although, we are still bigger fans of silver and gold and expect that should inflation emerge in earnest down the road (after what looks like a period of deflation) these precious metals will perform in an historically predictable manner.

Should inflation turn to hyperinflation, then owning gold and silver will be essential for financial survival,

Judy Shelton is a current nominee for the Federal Reserve Board. She is a controversial nominee to be sure as she has advocated for a return to the gold standard or some variation thereof.

The resistance of politicians to approve a nominee who wants to see a more restrained approach to money creation is understandable. Under a gold-exchange monetary system, paper currency creation is limited or tied to the level of gold in reserve. Under a gold-exchange system, spending is also restrained.

Call us old-fashioned, but since our clients and friends are savers and investors, we are 100% in favor of such a monetary system.

Ms. Shelton recently offered her views[10] on how a system based on gold might work in a recent interview (emphasis added).

"I don't see it so much as returning [to the gold standard], more like 'back to the future.' ***I think that what a gold standard***

> ***stands for is monetary discipline for its own sake. Money is supposed to be a unit of account, a reliable measure and a dependable store of value. It really shouldn't be subject to who's the chairman of the Federal Reserve."***

This from the article[10] reporting on Ms. Shelton's thoughts (emphasis added):

> *According to Shelton, **a "futuristic" vision of the gold standard may involve a digital currency component.** She said that **central banks are "not serving the private sector in providing that reliable unit of account** [...] under the gold standard, you did have that stability, and I think that's what's missing [...] it could be used in a very 'cryptocurrency way.'"*
>
> *Engaging with the emerging sector of digital currencies is not wholly new for Shelton, who has previously advocated for a digital dollar's potential in helping to "preserve the primacy" of the U.S. currency worldwide.*
>
> *For Shelton, **the U.S. needs a "reset" away from the "distortions" of the Fed over the past half-century. She has previously argued that the Federal Reserve's current mandate flies in the face of a market-led society.***
>
> ***Central bank activism, for Shelton, hinders the ability of the market to function free from centrally planned overreach**. Here she overlaps with proponents of Bitcoin (BTC) who argue that blockchain technology can ensure that the currency will remain immune to any single entity's attempts to "manipulate" its value.*
>
> *Shelton might well be sympathetic to advocates of digital scarcity who claim that Bitcoin can induce a deflationary monetary policy by serving as a reserve currency with a finite supply.*
>
> ***Yet she has also said that she is open to an approach where the Fed would target a dollar price for gold "by linking the supply of money and credit to gold".***

Ms. Shelton's nomination is currently stalled.

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You can also visit that site to listen to the podcast version of the Retirement Lifestyle Advocates radio program on which host, Dennis Tubbergen, interviews financial and economic experts to get their perspectives and opinions.

Feel free to pass this additional resources on to anyone who might appreciate them in these unprecedented times.

If you have a question or comment about anything in this publication, feel free to give the office a call. Our office phone is **1-866-921-3613**. Our office phone is answered 8 to 5 Monday through Thursday, and 8 to Noon on Friday.

Best wishes to you and yours.

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