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THE "YOU MAY NOT KNOW REPORT"

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Making Sense of Nonsense

By Dennis Tubbergen

Does the current economy and the state of the financial markets presently seem artificial or non-sensical to you?

Stocks are more overvalued than at any point in history.

Housing prices just made a 30-Year high.

Money creation worldwide is continuing at a feverish pace.

Gold and silver markets have seen prices pull back.

Yields on long-term US Government debt remain at extremely low levels despite the fact that the US Government is a fiscal train wreck.

Does any of this make sense?

This month, in the "You May Not Know Report", I will attempt to help you sort this all out and, more importantly, show you what you may consider in your own, personal, financial situation.

Housing

In almost every market nationally, housing prices have now exceeded their highs prior to the last real estate market collapse.

Chart 1 (page 2, top) from the St. Louis Federal Reserve illustrates.[1]

***Chart 1:** St. Louis Federal Reserve*

A quick look at the chart has one concluding that US National Home prices are now more than 30% higher than they were at the prior peak in housing. In my view, there is emerging evidence that housing prices may now be experiencing a 'blow off top'. A blow off top is a technical term that describes a huge upward price move as prices peak and then reverse.

Notice how similar the price trajectories are from 2004 through 2006 and over the last two years.

A recent article[2] published by "The Street" noted that year-over-year, housing price increased more than 14% on average. This from the article (emphasis added):

> *Get Report and other homebuilders rose Tuesday after the S&P CoreLogic Case-Shiller Index found* ***that home prices rose more than 14% on annual basis in April****, the highest reading in more than 30 years.*
>
> *Phoenix, San Diego, and Seattle reported the highest year-over-year gains among the 20 cities in April,*
>
> *Phoenix led the way with a 22.3% year-over-year price increase, followed by San Diego with a 21.6% increase and Seattle with a 20.2% increase.*
>
> ***The 10-City Composite annual increase came in at 14.4%, up from 12.9% in the previous month. The 20-City Composite posted a 14.9% year-over-year gain, up from 13.4% in the previous month.***
>
> *All 20 cities reported higher price increases in the year ending April compared with the year ending March.*
>
> *"April's performance was truly extraordinary," Craig Lazzara, managing director and global head of index investment strategy at S&P DJI, said in a statement. "The 14.6% gain in the National Composite* ***is literally the highest reading in more than 30 years of S&P CoreLogic Case-Shiller data.****"*

There may now be evidence that the housing market is beginning to slow, and prices may be getting ready to reverse. Mortgage applications are now at the lowest level seen in more than one year. This from Fox[3] (emphasis added):

> ***Mortgage applications fell last week to***

numbers not seen for well more than a year, with both purchases and refinances taking a hit.

The Mortgage Bankers Association, which tracks the data, attributed the declines to a compilation of factors, including rising inflation and buyers being priced out of the market.

"Mortgage application volume fell to the lowest level in almost a year and a half, with declines in both refinance and purchase applications," MBA Senior Vice President and Chief Economist Mike Fratantoni said in a statement. "Mortgage rates were volatile last week, as investors tried to gauge upcoming moves by the Federal Reserve amidst several divergent signals, including rising inflation, mixed job market data, strong consumer spending, and a supply-constrained housing market that has led to rapid home-growth."

"Purchase applications for conventional loans declined last week to the lowest level since last May," Fratantoni continued, adding, ***"The average loan size for total purchase applications increased, indicating that first-time homebuyers, who typically get smaller loans, are likely getting squeezed out of the market due to the lack of entry-level homes for sale."***

There is an old market adage that the best cure for low prices is low prices. The opposite is also true – the best cure for high prices is high prices.

In my view, as I have stated many times in the pages of this report, housing is in an extreme bubble. The eternal truth about bubbles is that they cannot exist without easy credit.

Easy credit or easy money is bubble fuel.

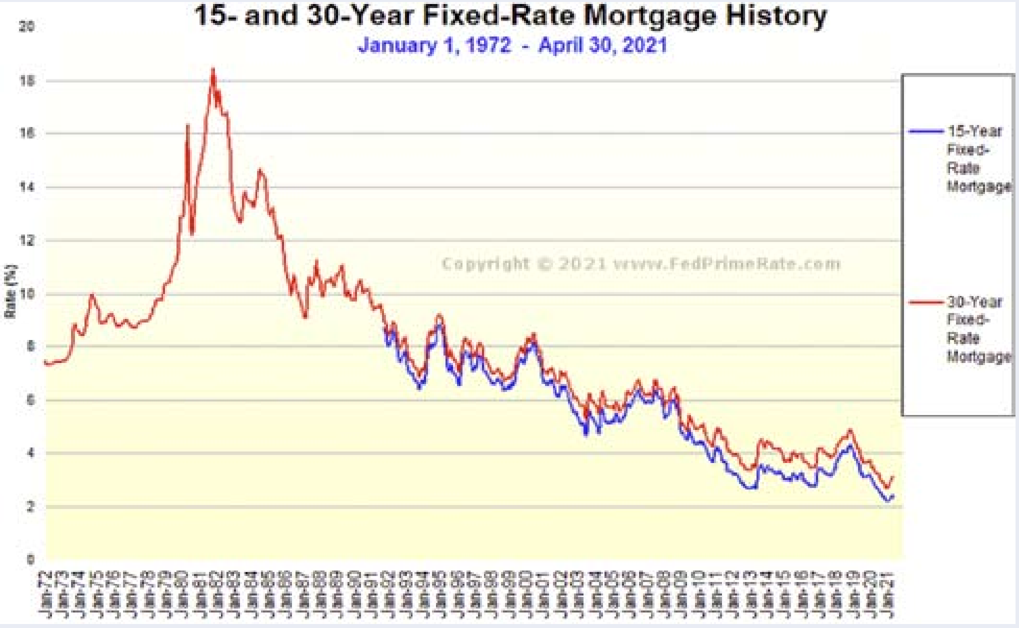
The Chart 2 (below) illustrates interest rates on both a 15-year and 30-year mortgage.[4]

Note from the chart that the interest rate on a 30-year mortgage dropped to just below 3% recently while during the prior housing bubble interest rates fell to about 5.5% at their lowest point.

Let's compare payments on a 30-year mortgage with a balance of $300,000 with an interest rate of 5.5% versus an interest rate of 2.75%.

Chart 2:

15- and 30-Year Fixed-Rate Mortgage History



With a 5.5% interest rate, the payments on a 30-Year mortgage are $1703.37 each month. At 2.75%, the payments are $1224.72 per month. That's a difference of $478.65 each month.

Many lenders use the 28% rule to determine how much house a potential buyer can afford. The 28% rule simply states that a home buyer should not spend more than 28% of gross income on a mortgage payment.

Working the mortgage payment numbers in reverse, at a 2.75% interest rate, a borrower could qualify for a $300,000 mortgage with annual gross income of slightly more than $52,000. However, if interest rates are 5.5%, annual gross income of slightly more than $73,000 is required to qualify for the same mortgage.

That's a meaningful difference in income. When mortgage interest rates are 5.5% rather than 2.75%, annual gross income needs to be 40% more to qualify for the mortgage.

This simple comparison demonstrates how many more borrowers could qualify for a mortgage with interest rates at much lower levels.

Interestingly, a huge housing bubble built and then burst with mortgage interest rates in 2004 and 2005 at nearly twice the level of recent mortgage interest rates.

It's a solid argument that the bubble is bigger this time.

Stocks

I think the evidence is clear that stocks are also in a bubble and for many of the same reasons as housing.

Stock valuations as measured by one of the most widely used indicators, market capitalization to gross domestic product, concludes that stocks are more overvalued than at any time in history.

If you're not familiar with this indicator, sometimes referred to as the "Buffet Indicator" since Warren Buffet mentioned it as one of his favorite measures of stock valuations, it is simply the total value of all stocks divided by the economic output of the United States.

Chart 3 (page 5, top) from Advisor Perspectives illustrates the current level of this indicator as of June 2021.[5]

Notice from the chart that the current level of this indicator is approximately 209%. That means the total market capitalization of stocks is more than twice the current level of economic output.

To put these current valuation levels in perspective, prior to the tech stock bubble bursting in 2000, this indicator was at 159% meaning the total market value of stocks was about one and a half times economic output.

In other words, stocks are now about 30% MORE expensive than in calendar year 2000 prior to the stock market crash of 2000 to 2002!

It's valid to make the case that stocks are in a bigger bubble today than two decades ago.

It is for this reason, I favor hedged stock portfolios and looking at specific market sectors when investing.

As I noted when examining the housing market which I believe is in a debt fueled bubble, the bubble in stocks has been driven largely by easy money and easy credit.

Chart 4 (page 5, middle) shows the level of margin loans that exist. If you aren't familiar with margin loans, a margin loan is a loan that is taken from a lender using a securities portfolio, usually a stock portfolio, as collateral. The loan proceeds are then used to buy more stocks.

Current margin loan rules allow a borrower to leverage 50% of the borrower's portfolio to buy more stock. This 50% rule can lead to more debt being created as a portfolio's value increases.

For example, an investor with a $1 million portfolio can borrow $500,000 to buy more stock.

Assuming the stock purchased with the loan appreciates in price, more money can be borrowed with the only requirement being that at least 50% equity is maintained in the account.

Assuming the account appreciates to $2 million, the allowable level of a margin loan can be $1 million. As the portfolio's value increases, more loans can be taken and more stocks purchased.

However, should the value of the portfolio decline, the borrower may need to sell securities to maintain the required 50% equity level. Large levels of margin debt can lead to dramatic declines as selling to maintain required account equity can exacerbate a market decline.

Note from the chart that levels of margin debt were at about $500 billion in February of 2020. At the present time, margin debt levels are pushing $900 billion. That's roughly an 80% increase in margin debt levels in less than 1 ½ years!

That's strong evidence that stocks are in a debt driven bubble.

Chart 3: *The Buffet Indicator*

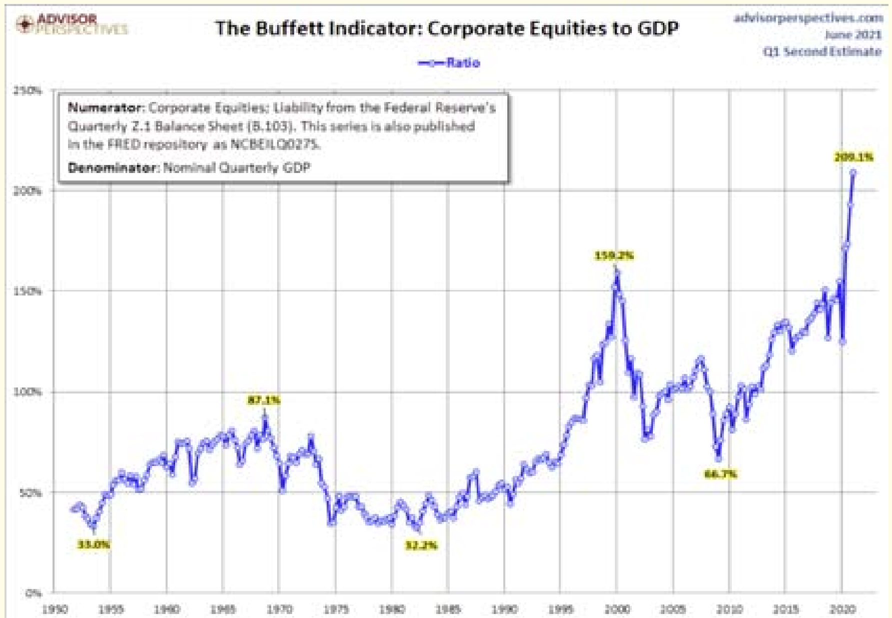


Chart 4: *Margin Loans on Securities*

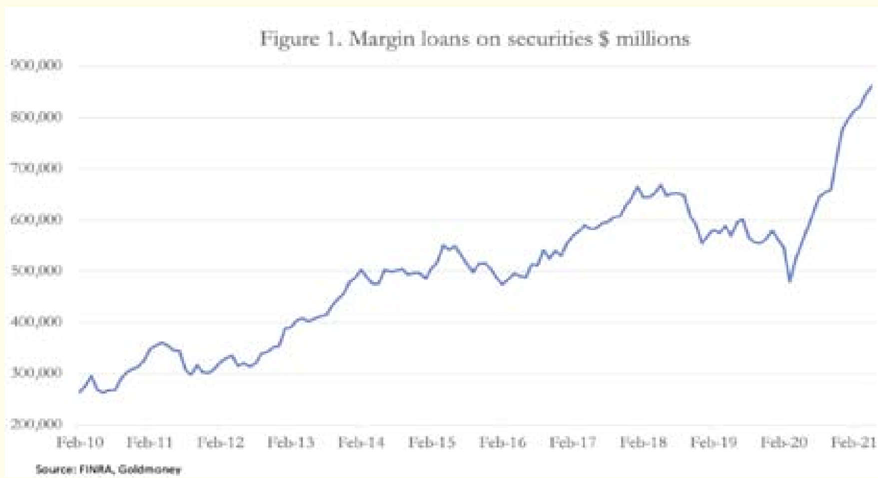


Chart 5: *Shiller PE Ration*

When analyzing stock price to earnings ratios, one also concludes that stocks are tremendously overvalued here. Chart 5 (page 5, bottom) illustrates the current price to earnings ratio of the S&P 500. Observe that using this metric, stocks are more overvalued than prior to the market crash at the onset of the Great Depression.

U.S. Government Bonds

It's fairly obvious that this is an artificial market as well. Examining the history of the yield on a 30-Year US Treasury Bond and contrasting that interest rate history with US debt levels combined with underfunded liabilities, one sees a pattern that is non-sensical.

First, let's look at the yield on the 30-Year US Treasury Bond.

Chart 6 (below) illustrates that the yield on the 30-Year US Treasury Bond has fallen from more than 6% at the turn of the century to about 2% presently. That's a decline in yield or an increase in the value of bonds of around 65% to 70%.

During that same time frame, the official national debt of the United States has risen from approximately $5.6 trillion at the end of fiscal year 2000[6] to about $28.5 trillion at the present time.

To make this a reasonable comparison, one needs to look at debt in the context of income. As noted above, lenders are concerned with the percentage of income a debt payment will consume rather than the actual amount of the debt payment.

Chart 7 (page 7, bottom) shows the debt of the United States as a percentage of economic output or Gross Domestic Product.

As one can see on the chart, in calendar year 2000, the national debt was about 50% of gross domestic product. Today it is at an all-time, record high of 135%.

The average ratio of debt to gross domestic product in US history going back to 1790 is 35%. In calendar year 2000, the debt to GDP level was about 40% over the historic average. Today, the debt to GDP level is more than 285% higher than that historic average!

Yet, during that same time frame, bonds have

Chart 6: *30-Year US Treasury Bond Yield*

rallied and interest rates have fallen. In a normal situation, one would conclude that declining interest rates would indicate a better credit risk. In other words, the more credit worthy the borrower, the less investment risk that exists. That means a lender may be willing to loan at a low interest rate.

A quick look at the numbers indicates that is definitely not the case with the US Government. To use traditional lending terms, the debt-to-income ratio of the US Government has risen from 50% to 285% as interest rates have literally plummeted.

Non-sensical isn't it?

So, the next obvious question is, why has this occurred?

One major contributing factor is that the Federal Reserve, the central bank of the United States, controlled by private banking interests, has been buying $80 billion per month of US Treasuries. If you're a new reader of the "You May Not Know Report", it's important for you to understand the that the Fed simply creates the money to make these bond purchases.

This artificially created demand by the Fed has, in my view, kept interest rates artificially low. This excerpt from an article[7] published by "The Wall Street Journal" explains (emphasis added):

> *The Fed has been buying $80 billion in Treasury bonds and $40 billion in mortgage bonds each month since last year and it isn't clear when that will stop. The central bank used the purchases to calm unsettled financial markets at the start of the pandemic. The purchases have, however, reverted to what they were during the financial crisis: a stimulus tool to complement the Fed's near-zero interest rate stance.*
>
> ***<u>The Fed's asset buying is aimed at lowering long-term bond yields from where they otherwise would have been,</u>*** *which in turn makes overall financial conditions more supportive of growth. The challenge for Fed policy makers and others is a lack of clear understanding in what a given level of buying does to asset levels.*

Chicago Fed leader Charles Evans said Wednesday that asset buying works in several different ways. But he said one of the key benefits is that

Chart 7:
National Debt as a Portion of U.S. Economy, 1790-2020

it signals how committed the Fed is to helping the economy recover.

> *"By continuing to do asset purchases, we're demonstrating we're in it to win, we're going to keep going, and we're, by golly, going to be achieving our, in this case, 2% on average inflation objective," Mr. Evans said.*

It should be noted that this article was published in early May of this year. Since that time, it's become more apparent that the Fed has exceeded the 2% annual inflation target mentioned in the article by Mr. Evans.

The obvious question is, if the Fed stops or slows it's purchases of US Treasuries, who picks up the slack given that government spending at the Federal level is now literally off the charts?

The answer is not clear. At this time, without the Fed, there are probably not enough eager buyers of US Treasuries to cover the government's deficit. It is for this reason that I believe the Fed's "taper talk" is just talk for the time being.

Precious Metals

Over the long term, precious metals have been the beneficiary of money creation. In this month's issue, we have used the time frame of 2000 to the present for reference. Not surprisingly, when looking at the performance of precious metals, the nonsense begins to make more sense.

In calendar year 2000, gold was selling for about $250 per ounce. Today, as this issue goes to print, an ounce of gold sells for about $1800 per ounce. That's an increase of more than 700%!

In calendar year 2000, an ounce of silver sold for a bit more than $4.50. Today, as I write this the spot price of an ounce of silver is about $26.50, an increase of almost 600%!

As the money creation continues as I believe it will, I expect that precious metals will be the beneficiary.

Depending on your own, personal financial situation, you could own up to 20% of your portfolio in precious metals. A brief word of warning though, buy the right form of metals and buy physical metals.

Over the past year, there has been a growing disparity between the spot price of gold and silver and the price one actually pays for the physical metal. Rick Harrison, of the hit reality television show "Pawn Stars" was recently interviewed and discussed this price disparity.[8] (Link to the interview in the Sources section below) (emphasis added):

> *Supply disruptions that began during the outbreak of COVID still linger and **continue to cause shortages of physical silver deliveries, driving premiums up, according to Rick Harrison, owner of the Gold & Silver Pawn Shop as featured in the hit reality TV show "Pawn Stars". "It's very hard to keep any bullion in stock and the bullion I do have I'm selling them for $4, $5 over spot when it comes to silver. It's very difficult to get. Physical silver is a very hard thing to find right now.** I know a lot of people in this business…physical delivery is very hard right now," Harrison told Michelle Makori, editor-in-chief of Kitco News.*

The reality is the paper price of gold and silver can be somewhat controlled. A recent article[9] by Craig Hemke explains using three days in May as an example. Here is an excerpt:

> *Here is your most recent example of this tried-and-true, Bank price manipulation technique.*

Over the last three days—Thursday, May 6; Friday, May 7; Monday, May 10—some of the most fundamentally bullish news of the year hit the COMEX gold market. Inflation is soaring. Real interest rates are plunging. Wages are increasing and stagflation is pending. All of this combined to surge Speculator interest in COMEX gold. Hedge funds, institutions, and traders all sought COMEX gold price exposure, and price rose $55 over those three days.

But that doesn't tell the whole story.

Over those same three days, the market-making Banks created and added a total of 45,858 new COMEX gold contracts. *The deep-pocketed Banks took the short side of these contracts and sold them to the aforementioned Speculators, who took the long side of the trade.*

So let's first stop here and ponder just how far price might have risen without these additional contracts diluting the available supply. Yes, a $55 rally is nice, but how far might price have risen if sellers of existing contracts were needed to be found in order to meet the Spec demand? $105? $155? It's impossible to say.

But next let's think about the scam and fraud of all this. The Banks created "gold" from nothing and sold it to Speculators who bought this "gold" by only putting 15% down (margin). No physical gold ever changed hands, and no physical gold entered the COMEX warehouses as collateral for the new shorts. Instead it's just one side making a bet against the other, and one side has monopolistic control of the "market" and the too-big-to-fail deep pockets needed to guard against margin calls.

The result is what we've seen literally hundreds of times before. Price spikes. The Banks control the rally through new contract issuance, and total open interest rises. Price is capped. Buying exhaustion follows. Banks initiate a price raid. Price plunges as jittery Specs begin to liquidate. Banks use Spec selling to buy back and cover the shorts they had created on the run up, and total open interest declines.

Making Sense of Nonsense

I will conclude this month where I began. While there are many other markets that could be analyzed, space prohibits such an exercise. So I'll summarize and offer some thoughts for you to consider moving ahead.

Given the large level of money creation by the Fed and the wide availability of easy, cheap credit, I believe we now find ourselves in an 'everything bubble' with no good way out.

An economic soft landing is, in my view, impossible.

There are two possible economic outcomes here in my opinion.

One, since current debt levels are simply monstrous, should the Fed begin to taper, or slow the rate of money creation while raising interest rates, the everything bubble bursts. Asset prices reset. As noted in this issue, stocks and real estate seem poised for such an outcome.

Interestingly, if interest rates are increased to get inflation under control, bond prices decline.

Two, the Fed continues with the increasingly hard to believe narrative that inflation is transitory and maintains its easy money policies. This outcome likely sees intensifying inflation that stops when the political pressure is sufficient enough to force the Fed to reverse course. This political pressure is already building as many Americans are now finding it to be increasingly difficult to put food on the table and maintain shelter. Continued easy money policies and higher price inflation will see increasing numbers of Americans dealing with the difficulty of meeting their basic living expenses.

Once this political pressure reaches a boiling point, the Fed may reverse easy money policies at which point the reset described above will follow.

The other, less likely outcome is that the Fed continues to ignore inflation and there is a currency crisis. This triggers the reset as well.

In my view, the evidence is clear. The everything bubble will have to burst.

The 'how' the everything bubble bursts is dependent on Fed policy.

If you're a client of our company or a long-term reader of the "You May Not Know Report", you know that we have long advocated the "Revenue Sourcing" approach to managing assets as described in the book by the same name.

This approach has you dividing your assets into two 'buckets'.

One bucket has you investing in assets that are stable and won't be affected when the everything bubble bursts. The other bucket is allocated to be used as an inflation hedge and for other contingencies.

If you'd like to discuss this approach further, feel free to give our office a call at 1-866-921-3613.

Time Deposit Rates

At the time of publication, these rates were valid:

1-Year	1.00%
2-Year	1.75%
5-Year	2.85%

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

FREE – Essential Reports Group

If you have not yet adopted the two-bucket approach to managing retirement assets, we'd like to invite you to discover more. You can order our Essential Reports group provided at no cost and no further, future obligation.

Your Essential Reports Group may show you:

- The best way to maximize your Social Security benefits even if you are already collecting Social Security
- How to reduce taxes on your IRA, 401(k) or other retirement account. As we discussed in this issue, as tax policy may dramatically change in the near future and become less favorable, taking steps now to understand how to possibly minimize taxes has never been more important.
- What your current fee level is in your portfolio and what your historical drawdown risk might be. Understanding this information may help you avoid participating in the next market crash.

To prepare these reports for you, we need only get some generic, non-personal information from you. We never ask for personal information, nor should you ever share that information with anyone. To request your reports, visit www.MyEssentialReports.com.

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The app will get you access to our weekly "Headline Roundup" Webinar, the podcast versions of the RLA radio program and our weekly newsletter.

You can also participate in the "Headline Roundup" webinar live on Mondays at Noon Eastern time.

If you know of someone who might appreciate getting this information during these challenging times, feel free to have them download the free app as well.

If you have questions when downloading the app or would like assistance, feel free to call the office. 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.

Sources

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