Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Dr. A. Gary Shilling
A. Gary Shilling & Company

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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 Dr. A. Gary Shilling. Longtime listeners will recognize Gary as a longtime Forbes columnist. He is the founder and president of A. Gary Shilling & Company. He is also the publisher of the Insight Newsletter, which is a monthly newsletter that is more like a magazine filled with a lot of terrific information. If you'd like to learn more about his newsletter or get a free copy, you can go to (888)-346-7444, which is his office phone. (888)-346-7444. And Gary, we'd be glad to share with you a complimentary copy of the newsletter. And Gary, welcome back to the program.

Gary Shilling:

Glad to be back with you, Dennis, as usual.

Dennis Tubbergen:

Well, Gary, let's just jump in here, give our listeners your assessment as to the health of the US economy.

Gary Shilling:

Well, that's a very good question because you can read that two ways. If you look at what a lot of people are concentrating on, they're looking at employment, which is weakening, but it hasn't fallen apart. They're looking at stocks which seem to just keep going up regardless of what happens.

They're looking at enthusiasm, they're looking at investors that think we're in for a soft landing, that the recession is simply a thing of the past or it never happened. And then you can turn it around and look at the normal leading indicators, the inverted yield curve, leading indicators. And, of course, you look at what the Federal Reserve is doing and what the Fed is doing now is in the past has always led to a recession. And so, you really have a very interesting dichotomy here. And of course, what's fascinating about this is that a lot of investors simply think that the Fed doesn't matter.

Now, I'll bet on the Fed any day, and I think the Fed under Chairman Powell is particularly zealous to bring inflation down to their 2% target. It's come down, but it's about 3%. And in the service area, which they're particularly concerned that it's running at about 4%. So, you've really got a battle of investors versus the Fed and say, I'll bet on the Fed.

Dennis Tubbergen:

So, Gary, let's just take that a step further. Where do you think the Fed is in the tightening process here? And did you see more rate increases this year, or do you think we've seen the top here?

Gary Shilling:

I think we've got more rate increases. The Fed would ... Obviously, they like to back off. They don't go out to deliberately precipitate a recession, but their concern is inflation. And they worry that if they back off prematurely, then as we've seen in the past the 1970s, were certainly a case in point that then all hell breaks loose. And then they've really got to kill things to convince investors that they have teeth. So, I think they really want to make sure that they kill inflation.

So, I don't think they're through raising rates. And, of course, as long as investors are pushing up, particularly stocks, the Fed I think is determined to really say, no, we're going to deal with this, and until you believe that we are ... you're really just going to have to suffer the consequences.

Dennis Tubbergen:

So, Gary, when you take a look at just the general health of the economy, I made a note here that credit card debt now for consumers has topped a trillion dollars for the first time. And the US economy, as we've discussed in the past is very dependent upon consumer spending. Isn't the American consumer at this point pretty strapped? And what's your take there?

Gary Shilling:

It's a very interesting dichotomy, Dennis, because if you look at all the extra saving that was built up because of the stimulus back the COVID years, there was a tremendous amount of money that was pumped into the economy by the administration and Congress and also by the Federal Reserve. And that really pushed up savings. And there's still a fair amount of that around. But at the same time, as you point out, we're seeing credit card debt a trillion dollars. We're seeing people who are borrowing because they really have no choice. And with credit card rates around 20%, obviously, they're pretty desperate. So, I think you've got a real dichotomy that yes, there's still a lot of cash out there, but it's not in the hands of everybody. It's not evenly distributed, and that's what makes things difficult to analyze.

But I think that the big runup in credit card debt is telling us that a lot of people are really strapped. And, of course, we've got an event coming up here in October when students have to start repaying debt. And that, as you

know, was a result of the Supreme Court decision, which really negated what the administration wanted to do. So, you've got a situation there where you've already ... excuse me, you've got a lot of people with serious debt, and it's going to get even more severe this fall.

Dennis Tubbergen:

Well, if you're just tuning in, I'm chatting today with Dr. A. Gary Shilling. His website is agaryshilling.com. He is also the publisher of the Insight Newsletter, and you can get a free copy by calling his office (888)-346-7444.

And Gary, how impactful is the student loan moratorium expiring to use those terms, how impactful is that going to be on the overall economy in your view?

Gary Shilling:

Again, it makes a great deal of difference. A lot of the debt is run up by graduate students, by people who have good jobs, who do have the ability to service the debt. But there are a lot of people, and we don't really have a good handle on the numbers as to who's in what camp, but there obviously a lot of people out there who do not have the resources to service that debt. And what it means is that they're going to have to cut back on their spending tremendously. And as you probably know, federal student debt is not subject to bankruptcy. You can't go bankrupt to get rid of federal student debt, a lot of debt, you can. Credit cards and so on, but you can't do that. It's not legal with federally funded student debt, which is the vast majority of it. So, you've got a lot of people there who are really stressed.

Dennis Tubbergen:

Well, and Gary, along those same lines, I recently read that adjusting for inflation and taxes, the income of US consumers since April of 2020, since the COVID years as you say, has fallen more than 9%. Do you agree with that? And do you think that trend is going to reverse?

Gary Shilling:

Well, we have had lately ... I mean, you had a long period there when wage increases, we're simply not keeping up with inflation. Now what's happened in the last four or five months is that inflation has come down. And so even though the rate of increase in wages has not picked up, still it means that for the last four or five months that people have had actually positive real wages, real meaning inflation-adjusted. But that does not mean that they're back in high clover. It means that they're not racking up a lot more

problems than they had before, but there still are a lot of difficulties from the past.

Dennis Tubbergen:

Well, Gary, let's shift gears a minute and talk about stocks. Before we started to record this interview, we chatted a bit, and I think I made the comment that stocks certainly aren't reacting the way one might expect when you look at just the fundamental data. Give us your assessment as to the major US stock market indices. And I know when we talked before, I think it's been about five months or so, you were not really bullish on stocks. So, what's your forecast, and have you changed your mind?

Gary Shilling:

No, I think stocks are still very vulnerable. They had a big run. I don't think it is supported by what you call the fundamentals by earnings growth, by economic expansion, by income. But the way I've put this, and I've been saying this for about 30 years, markets can remain irrational a lot longer than I can remain solvent. And you simply have to ... My approach to this is you simply got to be on the sidelines. You just say, hey, I just don't want to be involved. I don't believe it's valid. I think we're going to see some very big corrections stocks. Last year, early in the year, they declined about 20%. I'm looking at the S&P 500 index. Then you had a rally. It got back to within about five or 10% of its all-time peak lately, it's been a little sloppy, but I think we could have from here a 30% decline in the S&P 500.

And that would be in keeping with my earlier forecast that the peak to trough decline would probably run about 40%. The first half of that last year was really the Fed tightening and pushing up interest rates. The second half, which I think we're getting into now, is the effects of weak corporate profits, weak corporate sales. And that means that stocks in relative to earnings, not only reported earnings, but future earnings are very expensive.

Dennis Tubbergen:

Well, I am chatting today with Dr. A. Gary Shilling. He is the founder and president of A. Gary Shilling company. You can learn more about his work at agaryshilling.com. Gary also publishes Insight Newsletter, which is a terrific publication. He would be glad to share a complimentary copy with our listeners. To get your free copy, give his office a call at (888)-346-7444. The number again is 888-346-7444, and I will return after these words and continue my conversation with Dr. A. Gary Shilling.

I'm Dennis Tubbergen, and you're listening to RLA Radio. I have the pleasure of chatting once again today with returning guests, Dr. A. Gary Shilling. Gary is the publisher of Insight Newsletter, which is really more of a magazine every month that provides you current economic data and Gary's forecast. He has been uncannily accurate through the years, and he's happy to share a free copy of that newsletter with you. If you'd like to get it, call the office, (888) 346-7444. That is Gary's office at (888)-346-7444.

So, Gary, as we concluded the last segment, you were forecasting that perhaps we could see a decline of up to another 30% here in the S&P 500. When you look at certain sectors of the market, we've certainly seen, for example, oil prices now start to rebound. Is there any sectors of the S&P that you might be bullish on?

Gary Shilling:

Not really, Dennis. Matter of fact, one of the things that we've looked at and reported on in our monthly newsletter many times over the years is the 10 components of the S&P 500 index. And they published 10 components, a consumer staples, consumer discretionary spending, energy. You go down the list, there are 10 major sectors. And if you look at past bear markets associated with recessions, and I think that's what we're looking at here, you've never had any of those that actually rose.

Now, some of them have done better than others. And the ones that you would expect, the so-called defensive spots, utilities, consumer staples tend to hold up better, but they have never actually risen. In other words, you may lose less money if you're in these defensive stocks, but the odds of making money, at least if you buy the broad segments, it just has not happened historically.

Dennis Tubbergen:

So, Gary, I want to go back to you mentioned a stock decline associated with a recession. And the first segment you talked about the inverted yield curve. Has there ever been an inverted yield curve that did not lead to a recession?

Gary Shilling:

No, not really. No, I don't think you have. Not in the post-World War II era. Every time you've had an inverted yield curve, you've gotten a recession. Now, the timing can vary all over the lot. It can be anywhere from a month or two to maybe six months or a year later. But when you get an inverted yield curve, historically, you've always had a recession.

Dennis Tubbergen:

So, assuming we are going to have a recession here, how deep do you think it might be?

Gary Shilling:

Well, I don't see any reason why it's going to be deeper than normal. And the average recession in the post-World War II period takes real inflation adjusted GDP down by about 3%, 3% doesn't sound like a lot, but when you're in an economy which is geared to growth, and, of course 3% and the total means that some sectors are a lot weaker. Housing, we've already seen. Very much very sensitive to interest rates, and that's declined a lot more than 3%. And some of these interest-rates-sensitive areas, consumer durable goods, things that are postponable, tend to do a lot worse. But on average, the economy peak-to- trough declines about 3%. And I don't see any reason why it would be more than that. Now, if you go back to the Great Recession, the one that we had a decade ago, there you had four and a half percent real GDP decline peak to trough. That was a very, very serious one, and that was led by the collapse in subprime mortgages. You had huge, huge speculation.

A lot of people were involved, and you've had speculation. This time, it's been mainly in the crypto area and others, but it was never as widespread or as severe as it was in housing. Back in the days when people could borrow on houses and literally put nothing down and were assured, they never have to put a nickel in because the house would appreciate so much they could refinance and take money out before the first mortgage payment was due, I mean, it was a wonderful free lunch era, never, never land. The Tooth Fairy had arrived. We don't have anything that severe right now. So, I don't think we're going to have anything more than a normal recession. But we have had a lot of speculation.

We've seen some of it come unglued. You're well aware that early this year we had a bank, Silicon Valley Bank was a standout where they really got nailed because they had this huge inflow of deposits. All these people from these Silicon Valley deals, these venture capital deals, and they put it in ... the deposits, they put in treasury obligations, nice, safe and sound treasuries.

Well, what happened was when the Fed raised interest rates, the value of those treasuries declined. Now, they don't have to mark them to market normally, but deposits started to flow out, so they had to market them to market as they sold those treasuries. And that was the demise of Silicon

Valley Bank and a couple of others. So you did have some imbalances there, and you never know what's going to come out of the woodwork, but I can't see anything right now that's going to rival what we saw in terms of the subprime mortgage collapse 10 years ago.

Dennis Tubbergen:

Well, Gary, you mentioned Silicon Valley Bank, and then of course there was Signature Bank and First Republic. Recently we had Kansas Heartland Tri-State, a regional bank closed by FDIC. Do you think these banking issues are going to continue, and if so, to what extent do you think it'll kind of be a canary in a coal mine, if you will, that we are headed for recession?

Gary Shilling:

Yeah, it is, Dennis. I mean, it's not a run on the banks in the 1930 sense because the Fed, the FDIC, the other regulators have basically bailed them out. In other words, they guaranteed all the deposits in those banks. Silicon Valley Bank, Signature Bank, et cetera. But that doesn't mean you don't get the effects of that. And what are the effects? The effects are that the banks are very, very scared. They don't want to lend. And, of course, depositors, even though their deposits I think are safe, I think they'll get bailed out regardless. They have pulled out money from banks and they put it into money market funds, into treasury, securities. So, you've had a decline in bank assets, the deposits, and you've had a bank decline in their liabilities. Loans. They don't want to loan money, they're scared. So, you really had a very similar fact to the run on the bank. I call it the slow motion run on the banks, which is silly there. And as you point out, this continues. So, you do have these effects.

Dennis Tubbergen:

Gary, you mentioned housing, and I'd love to get your forecast on housing, but I wanted to get your take on this. It seems that these artificially low interest rates, and you had a lot of people refinance, and there's a lot of people out there that have 30-year mortgages that even sub 3%, but certainly, low 3%. Aren't those people kind of in housing jail and didn't the Fed maybe inadvertently shrink the housing market and ... as housing slows, this is a problem of the Fed's making?

Gary Shilling:

Well, in a sense it is because the Fed raised interest rates. And now they did after the Great Recession, 2008 financial crisis, they did something they've never done before. They favored housing. They did that by buying mortgage-backed securities. Normally, they just buy treasuries to support the economy and let the chips fall where they may. But that was the first

time ever, as far as I know, where they supported a specific sector, housing, by buying mortgage-backed securities. But they have since then been selling them off. And I don't think that they have any desire to step back in and support the housing market if the world fell apart. You never know what they're going to do. But I think unless you got very, very severe situations, and it would take something like the collapse in the subprime mortgages that we have, and I don't see anything on the horizon that's likely to match that.

So, I'd rather suspect that we won't see the Fed doing much to bail out housing. And as you point out what's happening, you got a lot of people who have very low interest rate mortgages that they got during the post-financial-crisis years, and that means that they don't want to sell their houses and buy other houses. You've had very low turnover in existing housing because then they'd have to take out another mortgage at a much higher rate. So you've had very little turnover in existing housing. It means that the strength in housing has been in new housing and builders have been active there, but still new housing is only 15 or 20% of the total. Normally, the rest is trading in existing housing. So, the overall effect has been a fairly subdued housing sector.

Dennis Tubbergen:

So, what is your forecast for housing moving ahead, Gary?

Gary Shilling:

I don't think it's going to be exuberant. I don't think it's going to collapse. I think it's going to be a fairly mundane sector from here on. I mean, there's always the argument that we don't have enough housing and so on and so forth, but hey, there's never enough Mercedes-Benz around. I wouldn't mind having one, or Rolls-Royce. That's not a valid question. I mean, sure, if things were cheap enough, well, they say if wishes were horses, beggars would ride. It was a very old saying. And I don't think, it's not a logical statement to say, that there's a shortage of housing. Yeah, there's a shortage of housing at what people want to pay, but we're really the most over-housed country in the world. When you look at the square footage of housing per occupant, we're very smart. You got a lot of rooms relative to the number of people and what happens, you get rentals which absorb the difference.

And people simply don't form families. I mean, to form a household, you have to move into a separate dwelling unit. That's the way it's defined. A household is one or more people occupying a separate dwelling unit. That's

the government's definition. Well, if people don't feel they can afford a house, they just don't move in together. And of course, a lot of people are operating without the benefit of clergy these days. So I don't know that that's really bothering him a great deal. Very different than when I was young and you were younger, but that seems to be the style.

Dennis Tubbergen:

Yeah. Well, we're going to have to leave it there. My guest today has been Dr. A. Gary Shilling. The website is agaryshilling.com. You can get a free copy of Gary's Insight newsletter. I'd encourage you to do that. Give his office a call at (888)-346-7444 and just request a copy of the Insight newsletter.

Gary, always a pleasure to catch up with you. Appreciate the update. Love to have you back down the road. Thank you for joining us.

Gary Shilling:

I look forward to the next encounter. Dennis, thanks a lot.

Dennis Tubbergen:

We will return after these words.