Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

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Pento Portfolio Strategies

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Dennis Tubbergen:

Welcome back to RLA Radio. I am your host, Dennis Tubbergen. Joining me once again on today's program is returning guest Mr. Michael Pento. You've undoubtedly seen Michael as a frequent commentator on many television programs as well as many radio shows. Very happy to have him back. His website is pentoport.com. He is also the host of the very popular podcast, the Midweek Reality Check. Michael, it is always a pleasure to catch up with you. Thanks for coming back today.

Michael Pento:

Pleasure, Dennis, as ever.

Dennis Tubbergen:

So, Michael, going into... Or I should say, we're recording this on Tuesday, August 6th. This will air in just a few days. But no shortage of excitement as far as stock markets are concerned, big drops in the market. How do you see it? Is this the beginning of or a preview of things to come or what's your forecast?

Michael Pento:

Well, I think it is a preview of things to come. I don't think it's necessarily that we're going over the Niagara Falls with the barrel right now. This is more of what happened lately is Japanese Nikkei Dow down 12% in one night. That is a manifestation of the unwind of the Yen carry trade. And the Yen carry trade, just give you just a brief description of it, people were borrowing in Yen at 0% interest rates for 15 years. It was just a ridiculous central bank, Bank of Japan, BOJ repression run wild. In other words, what happened was in Japan, they had so much debt outstanding that if the central bank didn't buy all of it, interest rates would spike, and the country would be rendered into a depression. That's where they are now in Japan.

So, the Central bank was buying everything, and that wasn't really a bad outcome right away because post-COVID, every central bank on the planet was basically at 0%. So, Japan had a 0% interest rate, massive interest rate repression when they were just joining the rest of the world. But the rest of the world ended that ZERP regime, and they moved interest rates, for example, in the United States to 5.25 to 5.5%. And when your interest rates are 5.5% in the United States, and you could buy a treasury bill and earn that risk-free in an overnight short-term treasury, you do that.

What you do is you borrow Yen at no cost, 0%, and you park that money in a U.S. treasury or in U.S. stocks or in U.S. commodities or for that matter, stocks and equities and bond markets around the globe. And then what happens is you make the interest rate spread between zero and 5%, for example. And then also you get paid on the currency because the currency was depreciating, the Yen was depreciating, so the dollar is appreciating you're getting 5% and you're making money in the currency trade as well. So, it was a really big liquidity boom for markets, a huge source of liquidity. And that all turned around this week when the BOJ raised rates for the second time. And they raised rates all the way, Dennis, to one quarter of 1%.

And that huge increase in interest rates and that above negative nominal rate caused to many people's surprise an unwind of the carry trade, which means that you have to sell your treasuries, you have to sell your stocks, you have to sell your commodities, you have to sell your Bitcoin and you have to sell your dollars after you do that, and then you have to buy back the Yen that you were short. And that's what happened. That's why the Yen surged after being down 40% in the last few years. The Yen surged in value and that caused an air pocket in stocks. But here's what you really need to know, Dennis and your audience, the Yen carry trade was one source of liquidity that is now gone, and it's one source of liquidity that's joining other sources of liquidity that are now gone. For example, you just mentioned Fed funds rate went from zero to 5.3%.

That's a real Fed funds rate north of 2%, and it's been that way for a year. A major source of liquidity in the market now. Feds balance sheet has been shrinking for the better portion of a year and a half, two to two years. Now we're down from a $9 trillion balance sheet all the way down to $7.1 trillion. So, it's the rate of change that matters in investing. So that's another source of liquidity that's gone. You also have the inverted yield curve, that's a source of liquidity, banks tightening lending standards, another source of liquidity gone. And then the reverse repo facility, which was once two and a half trillion. Now it's only 300 billion dollars. So, all of the fuel that was boosting asset prices to astronomical levels, and I mean real estate, I mean equities, I mean credit, all those things, all that monetary fuel that was boosting those asset bubbles has now gone in to reverse.

So, it's a matter of time before the real collapse happens, and it won't be an episodic truncated sojourn into hysterical mania like we saw in the last few days. It's going to be something very protracted. It's going to last a long time, and all the Feds can do is go back to zero and QE. And we all know what happens when they do that. It's called intractable inflation.

Dennis Tubbergen:

So, Michael, what does the Fed do here? They're signaling a rate cut in September. Is there an emergency meeting in light of these circumstances to say, wait a minute, we've got to do the only thing we know how to do, we've got to go back to easy money?

Michael Pento:

I'm laughing, but I actually should vomit. You know what I find disgusting? I actually find it disgusting that somewhere along the line, the Federal Reserve, the Treasury, government, powers that be decided that since we don't have a currency that's linked to anything, it's just confetti, we can just print it ad nauseam and at will, we don't need to be fettered by the strictures of any kind of monetary metal like oh, we could just print money. So why do we need to have a recession? Why do we need to have a bear market in stocks? We'll just print everything away. What a Eureka. This is like Einstein 2.0, E equals MC squared. Let's just print every problem away, every hiccup in the stock market and every hiccup in the economy. Well now you have major, major just deformations that are formed. For instance, home prices to income ratios are at all-time record high.

And you see homeownership is unaffordable in this country anymore. Well, what's the right thing to do, Dennis, when that happens? Home prices should fall. And I see the morons on Wall Street and even some of these really well-recommended and highly esteemed gurus like this individual from the Wharton Business School with first name is Jeremy saying, we need an emergency rate cut. We need to emergency just bail out Wall Street right now. Well, you have already destroyed the middle class of this country. Middle class of this country can't afford food, and they can't afford shelter and they can't afford medical care. And you want to now panic to bail out Wall Street because they had a bad week? Shame on you, Mr. Jeremy.

Dennis Tubbergen:

So, Michael, it seems that a lot of smart money certainly saw this coming, and we've talked in the past that the market's been overvalued for a very long time. I thought it was interesting that Mr. Buffett, Warren Buffett who doesn't make many mistakes investing, unloaded about half his Apple stock as Apple was running up. He's sitting on, what, 230 billion dollars in cash now, an all-time high. Where do you see the market ultimately going here? Just say from now to the rest of the year, understanding there's an election, understanding Fed may try to intervene. What is Michael Pento's forecast?

Michael Pento:

Well, my forecast is that I think that we are... This is how I analyze markets. I look at the second derivative of inflation, and clearly, we're now back into disinflation. And I look at the context between the second derivative of inflation, deflation, that dynamic in the context of how healthy the economy is, and clearly the economy is sick and getting sicker. So, I think we're in sector two now, in my five sector investment spectrum, which is disinflation. Sector one is deflation when prices actually fall, which is actually very bad news for stocks. It's very bad news for the economy in the short term, but it's exactly what the economy and markets need to heal. It's part of the healing process. Now, will the Fed allow that to happen? I don't think they will. I think they're going to resort back into ZERP and back into QE.

But my forecast is to go back, in the short term we will go back into deflation. We will go into recession. The Fed will be reticent to cut rates because they know where this is leading. They know it's going to happen when they go back. The market will understand that the Fed is unable to ever provide investors with a real interest rate, a real positive interest rate, impossible. So, interest rates will be negative. Asset bubbles will soar, the middle class will be hollowed out. The top 1% will get richer and richer, has been the trend, and most of Americans will be relegated to penury. But that's okay because the elites on Wall Street, all they care about is the health of investment banks, banking system, and the stock price.

Dennis Tubbergen:

Well, my guest today is Mr. Michael Pento. He is the founder of Pento Portfolio Strategies. And Michael, we've got about a minute and a half left in this segment. Would you like to talk a little bit about your work?

Michael Pento:

Well, I put out a podcast called the Midweek Reality Check every week. It's available for $50 a year. It has a five-week free trial if you don't want to invest $50. And it gives you the salient economic data of the week and the absolute independent and valuable and important interpretation of that data so you understand where we are in the investment spectrum between deflation and stagflation and the context of growth there within. And then if you have a hundred thousand dollars to invest in you're a U.S. citizen, I'll actually invest your money myself in that strategy called the inflation, deflation and economic cycle strategy.

Dennis Tubbergen:

All right, well you can learn more at pentoport.com and the good news is I'll have Michael back for one more segment at RLA Radio. Stay with us.

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. I'm chatting today with the founder of Pento Portfolio Strategies, Mr. Michael Pento. He's also the host of the very popular podcast, the Midweek Reality Check. And Michael, you mentioned that we are in what you said I believe was sector two, disinflation, versus sector one, which is deflation. And we've talked in the past about just a massive levels of debt that exist both in the private sector and on the balance sheet of just about every government around the world. Isn't significant and severe deflation like we saw in the 1930s, isn't that at some point inevitable?

Michael Pento:

Well, I think both things are inevitable. I think the natural gravitational forces out there are deflation. Think about what we just talked about in the first segment was home prices. The home prices are this elevated. They're much higher than they were in nominal terms, even in 2006. Home prices are up 50%, Dennis, in the last four years. A home which just sits there and deteriorates slowly into the ground and taxes go up and maintenance costs go up and insurance goes up. That house is up 50% in the last four years. The natural gravitational forces would say home prices need to fall about 40% to bring them back to historical normal mean. If you look at asset prices, they were close to 200% total market cap of equity to GDP. Now they're about 185%. They should be closer to 100%. That's fully valued.

So, in reality, the stock market should drop about 40 to 45% from here. But if that happens, there wouldn't be a solvent pension plan or bank or shadow bank in the nation or maybe even in the planet. So, what's going to happen is you're going to get both dynamics. You're going to get inflation. We just came off in 2022, we had record high inflation in the summer of '22. Record high inflation in this country, never before seen close to 20% in reality. I know it was 9.1% according to the hedonically and substitutionally bastardized CPI

Personal consumption expenditure price index. I get that. But even there it showed up at 9%. But in reality, people go, hey, what did my cost of rent go up? What did my insurance do? What did my taxes do? What did the cost of eggs and milk and cheese and bread and bacon do? These are the things that went up 20% per annum two years in a row. So, we had that inflation. Now the monetary fuel has been cut off, the helicopter money is gone, and now we're going to have a crash because that's where the market wants to take things. It wants you to be able to buy stocks at a fair value. It wants you to buy a house at a fair value.

If left alone that's where they would go. But I doubt the Fed can do that because I just said it would bankrupt the financial system. When the Fed really gets nervous is when money markets don't function. You can't float commercial paper; you can't float a junk bond. 40% of the Russell 2000 is unprofitable and 50% plus of all small job creation comes from small companies. They're unprofitable now in the good times, supposedly good times. What happens when we have a recession? You're going to see mass layoffs, money market funds freeze, and the Fed will have nothing else to do but reliquefy the markets by massive QE and another explosion in their balance sheet. And here we go again off to the races. So, if you don't understand the dynamics of how to invest between deflation, disinflation, stasis reflation and stagflation or intractable inflation, then you're going to always be chasing your tail in this market.

Dennis Tubbergen:

Michael, do you think the Fed can be successful in going back to the only page left in the playbook and trying to reflate everything? As you stated, real estate's overvalued, the stock markets overvalued. Isn't it inevitable to use that term again, that these financial markets do have to crash and reset at some point? At what point will the Fed not be able to do what they've done to this point?

Michael Pento:

I have a very good answer for that, and I've thought about it a lot. Normally when the Fed, normally being since 1987 on, what the Fed does is they come in and they engage in something called interest rate repression. So, the salve or the healing process, the remediation process of a recession is to say, we have asset prices crashing because debt levels have become too onerous and asset bubbles are bursting. They became too big to support anymore. They start to crash. And what do they do is bring down interest rates by printing money, which is antithetical. Printing money is inflationary, but that inflation is pushed into the bond market first and then bond prices rise, the yields fall and okay, well home prices become more affordable because mortgages go from say 8% to say 2% or 3%, and that makes the bubble grow again and makes everything fine.

That's the playbook that they've used because long-term interest rates came down when the Fed started to cut short-term rates and print money. And the answer to your question is, what if the Fed comes in this time, starts to print a tremendous amount of money, trillions of dollars, which that's what they did in the past. The Fed's balance sheet went from 700 billion to $9 trillion since 2008. So, they will do it again, I'm afraid. But what if this time they do it instead of interest rates falling, prices of bonds crash. And the reason why they would, the odds are higher this time that bonds would crash, Dennis, is because we are an insolvent nation. That's a new phenomenon. We are now insolvent. Our assets lines liabilities are negative if you include the unfunded liabilities, and we have trillion-dollar deficits already to start from. So, the supply of bonds, in my calculation, the deficit would be between five and $6 trillion as the recession becomes manifest.

So, you have a supply tsunami. And then you add to that insolvent condition and supply constraints, you add to that the fact that we have inflation that just came off the boil at a record high level. So, if insolvency and inflation are your salient issues, and then you start to pursue this ZERP and QE and helicopter money, again, the odds are much higher that you'll get interest rates rise on the long end of the yield curve. And if that happens, you'll get no relief in the housing market and you'll get no relief from the stock market because interest rates will be soaring. And that's when reality hits and that means it just blows up anyway.

Dennis Tubbergen:

So, Michael, do you see that as an outcome potentially in this next cycle of the Fed going back to easy money?

Michael Pento:

Yeah, I see it as a salient and likely risk. The odds are, I can't give you the exact odds, 71%, I can't do that. I don't know. But I do know that what has changed this time around is every other time before this, when the Fed was entering this debt monetization scheme, deflation or disinflation or quiescence in inflation was the salient issue. And now it's not. Now we're at 3% inflation and heading higher if they start, I believe the inflation will head higher if they start to cut rates again and start doing this debt monetization scheme. And like I said, before, we have never seen the debt and deficits high in this country. So, you're starting at 35 trillion dollars in debt. You're starting at 125% debt to GDP. You're starting at a trillion dollars in interest payments on the debt. That's your starting point. So that risks are very high this time around that you'll see interest rates not respond the way they have done in the past.

Dennis Tubbergen:

Mike, we have time for just one more quick topic of conversation here. If you take government deficit spending out of the equation, it seems to me that we might already be in a technical recession, and the only thing keeping us out of recession is the government's spending a lot of money that they don't have and throwing it out into the economy. Now you're seeing signs. Corporate bankruptcies are up significantly, I think at the highest level in 14 years, more chain stores closing more locations. It seems like the recession might be here.

Michael Pento:

Yeah, I'm an outlier on this. I've been in the Congress of Market Strategies for decades. I don't think government spending does anything but destroy productivity. Deficit spending can work for a year or so, but deficit spending the way we've done actually destroys productivity and creates inflation. That's the long-term effect of deficit spending. So, count me down as someone who doesn't believe you can save the economy just by just issuing debt. In fact, every time the deficits have exploded, it's been during a recession. So, I don't think there's anything that they can do to save us.

The real issue is that the middle class has been eviscerated because of the inflation that has been inflicted upon them over the past four years. That is the real issue. And debt. We have a massive credit bubble, a massive housing bubble, and an enormous equity bubble existing concurrently. And now that the monetary fuel has been cut off, reality is starting to hit. So, look for weekends and days like we had this past week where you see Bitcoin drop $10,000 a unit and you see the Nikkei Dow losing 12%, the Nasdaq down 10% in just a couple of weeks. Look for more of that and in a more protracted and intense scenario.

Dennis Tubbergen:

Well, the clock says we're going to have to leave it there. My guest today has been Mr. Michael Pento. He is the founder of Pento Portfolio Strategies and the host of the wildly popular podcast, the Midweek Reality Check. You can learn more at pentoport.com. That's P-E-N-T-O-P-O-R-T.com. Michael, thanks for joining us today. Love to have you back down the road and appreciate again your time.

Michael Pento:

Looking forward to it, Dennis.

Dennis Tubbergen:

We'll return after these words.