Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Michael Pento
Pento Portfolio Strategies

Date Aired: October 8, 2023

Produced by:

Retirement Lifestyle Advocates
961 Four Mile Road, NW
Grand Rapids, MI 49544

Phone: (866) 921-3613
Email: info@plplanners.com
Website: www.RetirementLifestyleAdvocates.com

Dennis Tubbergen:

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. Joining me once again on today's program is returning guest, Mr. Michael Pento. Michael is the founder and president of Pento Portfolio Strategies. I would encourage you to learn more about his work at pentoport.com. He is also the host of the popular podcast titled The Midweek Reality Check, and you can learn more about the podcast at pentoport.com as well. Michael, welcome back to the program.

Michael Pento:

Pleasure to be on with you, Dennis. We have got a lot to talk about.

Dennis Tubbergen:

A lot going on, isn't there? So, let's start by talking about just the general health of the US economy, in your view. Are we in a recession?

Michael Pento:

Or lack thereof? Well, we were in a earnings recession. We had three quarters in a row where earnings declined. We were in a recession earlier this year. The Fed bailed out the recession. They held it in advance with its bank term funding program, printing $400 billion in two weeks. So, they monetized all that bank debt. That was bad, but that's only a loan for a year. It's a loan that has to be returned at par, and these assets have to go back to the banks supposedly at whatever they are, 50 cents on the dollar. In the case of commercial mortgage-backed securities, maybe even less. So, we haven't bailed out the banking system at all. We haven't canceled the recession. The recession is coming. It's been delayed because of Fed action, but it has not been abrogated.

Dennis Tubbergen:

So, Michael, when you bring up banking, I read an article, I think it was published by Reuters, that worldwide debt is now 305 trillion, which is more than triple than it was at the time of the financial crisis, and arguably the banking failures at that time were largely due to a lot of bad debt. Is it going to be a lot worse this time around?

Michael Pento:

Well, we have a triumvirate of asset bubbles, Dennis. So whenever before in the history of the United States have, we had bubbles in real estate, in the bond market, and in the stock market all at once, I mean, look at the Nasdaq in year 2000, that was the bubble. The bubble was in high tech internet stocks. That was it. There wasn't really a bubble in housing at all,

and there wasn't really a bubble in the bond market at that point. 2008 was a bubble in the housing market. Equities were elevated, but there wasn't really a bubble in the bond market. A small bubble, but nothing compared to what we had today.

Leading up to today, we had, globally, 17 trillion dollars of negative yielding debt. Now, the cost of money, or a yield on a bond, interest rates, are the most important signal in a market economy or in any economy. That is the cost of money is paramount when it comes to deciding the savings and investment dynamic, the value of assets, whether or not we have asset bubbles, the health of the middle class, the rate of inflation, it is the most important crucial linchpin for an economy, and that was falsified to the point where you got paid to borrow 17 trillion dollars.

The nucleus of this bubble was the bond bubble. That bond bubble engendered borrowing on a record scale. So, we have, as you pointed out, 33 trillion dollars in the national debt right now. 33 trillion dollars, record amount of debt. It's even a record as a percentage of GDP. 700 billion dollars a year is what it costs over that, is what the annual interest rate expense is. That 700 billion dollars, on its own, was a remarkable eye-popping deficit. That's just the interest now that we pay. Our deficits are now 2 trillion dollars a year, and that interest payment is 17% of the old revenue, and that's going to jump to 35% in the next couple of years as our debt is rolled over at much higher interest rates.

We're no longer paying... Two years ago, the 10-year was yielding 50 basis points. Now it's 4.8%. That debt is rolling over and the money that it costs to service that debt is skyrocketing. We're going to have 35% of all of our income going to pay just the interest. And then you have the fact that entitlement programs and interest payments will equal a hundred percent of all revenue by 2040, and it's going to be much sooner if we have a recession, and I'll just say not if, when we have a recession, because the economy is weakening quickly now.

This is the fourth quarter now of 2023. The economy is set to weaken swiftly, as you see interest expenses rolling over now or lapping much higher interest rates. It usually takes about 12 to 18 months before these interest rate hikes take effect. We are now there. Don't forget rates in March of 2022, interest rates were zero. So, we're now getting to the point where we're getting much higher interest rates, much higher payments on debt service. That trillion dollars in credit card debt, much higher rates. Auto loans through the roof. We even have a housing market now that's

completely frozen. If you look at mortgage demand, it's down to the same level it was in 1996, the demand for mortgages. This is a depression in housing activity, and prices are soon to follow.

Dennis Tubbergen:

Well, if you're just tuning in, I'm chatting today with Mr. Michael Pento. He is the founder and president of Pento Portfolio Strategies. He is the host of the popular podcast, the Midweek Reality Check. You can learn more about his work and the podcast pentoport.com. And Michael, I want to go back because you'd mentioned the cost of just servicing the US government debt. It seems to me, I recently read a stat that the US government is going to have to refinance 7.6 trillion dollars in debt in the next 12 months and then throw a 2 trillion-dollar deficit on top of that. We can round up and say that's 10 trillion dollars. The government's got to figure out how to finance at these higher interest rates. Is this going to all hit the fan here in the next 12 months?

Michael Pento:

Yes, it is. And who's going to buy that debt? Let's just talk about the dynamics behind the treasury market. I wrote a book in 2013 called the Coming Bond Market Collapse. It's here. We are seeing it right now. I said that eventually, these negative nominal and real interest rates, at that time, it wasn't nominal, but it was real interest rates that were negative, but we eventually got to negative nominal rates. I mean, they just told you, you could put your money in Europe. Hey, you put your money in the bank, you're going to get less than your principal back.

Negative nominal rates. That was the de facto practice from the ECB. So, we are seeing the implosion of the bond market, and it is my opinion that we're going to see interest rates go much higher in the next iteration of this. So, we're going to have a collapse of this phony economy, this debt-saturated economy, which will, on the other side of this, cause Jerome Powell to lower interest rates with reluctance, with reticence, because inflation was the linchpin that changed everything. We finally got inflation above 2%. It went from 2 to 20, Dennis. Okay? That is incredible to me, that you would have an inflation target that used to be zero, then it became two, you couldn't get to two because the economy couldn't function under 1.8%, don't you know? The American consumer cannot function if inflation's not two. It has to be two, not 1.8.

Then we got to 2 to 20, and that means that the next time we have a recession, and it is coming, as you just clearly stated, and I'm trying to

articulate, that the cost of servicing all this debt is coming to bite us in 2024. That the Fed is going to be reluctant to go back to zero with alacrity and quickly, will be reluctant to go back into QE from QT, because of that inflation. It's going to fetter his ability to return to easy monetary policies. He'll have to do it because I believe the bond market and the repo market is suffering from massive illiquidity right now. And I just want to go through why I believe that, if you don't mind. Just let me just enumerate.

Dennis Tubbergen:

Please do. Please do.

Michael Pento:

Okay, I'll quickly try to do that. So, what we have today, this is why we see rates spiking and bonds trading like micro-cap insolvent penny stocks. This is the way the bond market is trading. You blink your eyes, yields are up 5%, then they're down 7%, then are up 10%. The bond market is up 70 basis points in the last few weeks. That does not happen. It should not ever happen. But let's just go through the dynamics really quickly. So normally, you would have a stable bond market, but now you see a massive amount of selling from those entities that were once big buyers. China is selling, because they have to support their currency. Japan is selling its reserves, largest holder of treasuries, selling its reserves, buying the yen, selling treasuries and buying yen, selling the dollar, buying the yen to support the currency. Japan is also relaxing yield curve control. In other words, the 10 year note in Japan used to be zero to 25 basis points. Now it's 80 basis points. That's more competition for treasuries on a rate-of-change basis.

Then you have the Federal Reserve, which was a big buyer of bonds, holding these bonds on his balance sheet. The balance sheet went from 800 billion dollars to 9 trillion. There's a trillion dollars less in that Fed balance sheet. They're selling 85 billion dollars a month. So, we're finally seeing price discovery in bonds. The free market is now asked to tell the government what they think of inflation and what they think about its solvency condition. And the vote is no, it's a negative. It's a thumbs down. That's sending rates rising. That's the real reason. It's not because growth is booming. It's not even because inflation is booming. Inflation is rising now instead of being in a state of disinflation. But those are background, ancillary, marginal factors. The real factor, what I'm mentioning right now, the bond market illiquidity is causing rates to surge.

Then when you add in disinflation is turning to reflation, then you get a very nasty picture for the bond market. And while that's happening, and I am not

a Republican. I'm a libertarian. While this is happening, Joe Biden is walking picket lines, trying to get people, corporations, United Order Workers Union, to have wages rise because of the inflation that he helped cause. At the same time, Mr. Biden is canceling student loan debt. Who is that debt owed to, Dennis? It's owed to the government. It's owed to you and me. It is adding to the debt and deficit problem that we have.

So, we have dysfunctional government, we have chaos in the bond market, and we're going to see chaos in the equity market, because when you look at the equity market complex, I'm sorry I'm rambling here, but so many things that I have to get out to your audience. If you look at the valuation of equities, something called risk premium, which is the inverse of the PE ratio, the earnings yield of stocks compared to treasuries, there is zero compensation for taking the added risk to owning equities at this time.

Dennis Tubbergen:

Well, my guest today is Mr. Michael Pento. He is the founder and president of Pento Portfolio Strategies. He's the host of the Midweek Reality Check podcast. You can learn more at pentoport.com. I'll continue my conversation with Mr. Michael Pento when RLA Radio returns. Stay with us.

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. I have the pleasure of chatting today once again with returning guest, Mr. Michael Pento. Michael is the founder and president of Pento Portfolio Strategies. He is the host of the popular podcast, the Midweek Reality Check. You can learn more about his work at pentoport.com. And Michael, before we jump in and get your forecast here for stocks and real estate in this segment, share a little bit with the listeners about the philosophy that you have in this environment when it comes to managing assets.

Michael Pento:

Well, we're becoming much more defensive in the portfolio. We have been primarily defensive most of the year. We haven't had any shorts in the portfolio as of yet. We've been short junk bonds, which is working out well for us. We also have an anti-beta ETF, which has not been working out terribly terrific up until this point, but we expect that to change very soon. But we're vastly underweight. This is the key. We're vastly underweight equities. This is the fallacy of the buy and hold in 60-40 portfolio on Wall Street. If you held long duration bonds two years ago, guess what, Dennis? You are down 50% in your portfolio, five zero. I didn't misspeak. Five zero. You've lost half of your money.

So, if you're someone coming out of post-COVID, and you say, "You know what? I'm a retiree. I want to lock out. I want to lock in these long rates and they're not offering much at all, but I have to lock into some safety here. I have to buy treasuries. Maybe the price will go up and the yield will go down. I don't know. Maybe inflation will never show up or whatever your philosophy was at the time. You have lost half of your money.

Now when you add that into the last two years that the S&P 500 is down, yes, I said down, didn't misspeak. S&P 500 is down 12% from two years ago, since the start of 2022. You see a massive reverse wealth effect here happening. So, Pento Portfolio Strategies has been underweight equities, and we are about 65%, about two thirds of the portfolio has been in short-term treasuries, T-bills. That's where the yields are higher and they are not as affected by inflation, growth concerns, or selling from foreign investors. So, the Fed is almost done hiking rates. They maybe have one more left before this whole thing dissolves into complete chaos. And that's how we're invested right now.

After this interview is over, because my model is signaling to me that things are getting worse, statistically speaking, those high frequency components are starting to really start to roll over, I may start to increase my shorts, and it might happen today in the portfolio. That's how we are handling the situation. I'm telling you; I'll reiterate what I just said, the 60-40 portfolio has gotten investors decimated in the last two years, and that is not going to get any better. It's going to get much worse. Because on the other side of this is going to be a protracted period after this recession comes manifest, and stocks don't go down 12, they go down 30, 40, 50 percent. Then we're going to see, I believe, a protracted period of stagflation. And that has to be actively and accurately managed by an active portfolio manager.

Dennis Tubbergen:

Michael, you mentioned that you're certainly bearish on equities. I read a statistic that on average, over the long term, the ratio of corporate profits as a percentage of GDP is about 5 to 6 percent, and they're now at about 12%. Would you attribute all these elevated profits to just all this easy money the Fed has just literally thrown out there out of helicopters over the past eight, ten years?

Michael Pento:

Well, there's no doubt that capital has been favored over labor in the past few years, but now labor's making a big comeback, but you nailed it. What is happening to corporate profits is the same thing that happened to the

middle class of America. You see this massive bifurcation between the haves and the have-nots. You've eviscerated the middle class, and you've created an oligarchy of ultra rich people who invest in homes and equities, and the past 12, 14 years have gotten very wealthy, and those that are living paycheck-to-paycheck have been wiped out because most of their paycheck goes to inflation. They don't have multiple homes. Many of these people rent, and they're paying 35% of their income to food and shelter. They don't have a big portfolio either. So, they're in deep trouble. And that's one of the reasons why you see crime and dysfunction in these major US cities in the United States, and I think that gets worse, unfortunately.

We haven't even seen the recession yet, Dennis, but when it happens, I'm afraid it's going to get very ugly. Interest rate chaos is here right now, and it's getting much worse. It's true that businesses and consumers have termed out their debt, but the belief is that everything is fine, but there's a few problems with that. I'll quickly go through them. If nobody wants to buy a house, let's just say nobody wants to buy a house, because my mortgage is 3%, and if I sell, my mortgage is going to be 8%. So that may sound like, "Okay, well great. No one's paying the higher rate, so it doesn't..." I hear this from the perma-bulls on Wall Street. Drives me crazy.

Well, I don't have to pay that higher rate because I'm sitting in my house. Doesn't that also mean that the real estate market is frozen? And isn't there any value added to GDP when people transact on a house? Don't people then go to Home Depot and fix up the bathroom and change the drapes, order new appliances, paint the house? That's a lot of economic activity. It's frozen. The same concept as with the auto market. Consumers, maybe they're taking out less loans, so they're not buying as many cars. That doesn't mean that the economy's not affected negatively. As I said, mortgage demand is down from where it was to 1996 levels. The economy is sunk in that case.

Now, financial entities hold this debt at ultra-low interest rates, debt meaning corporate bonds, commercial mortgage-backed securities, mortgage-backed securities, treasuries. These entities are way underwater on this debt. Now, the Fed owns these bonds now, but come March, they're supposed to go back to these entities, at pennies on the dollar, a fraction of what they're worth. So, what we've created, I believe, is a bunch of zombie lending institutions. That's hurting the economy as well.

There's also a maturity wall coming. There's $1.8 trillion of corporate debt that needs to be refinanced between 2024 and 2025. That debt is going to

be refinanced at much higher interest rates. So, again, it's recession delayed, not canceled. We are going to have a terrible time in 2024 and 2025. Sometime in that timeframe, you'll have a vicious recession, very deep acute cutting recession. I think that will slowly bring Powell back to the ZIRP QE stance, in other words, looser monetary policy. It'll be with reticence, it'll be dragged back into it, but when the repo market and the credit markets freeze, he'll have no choice. Then on the other end of that, you're going to see stagflation like we've never seen before. All of the conditions of asset bubbles, evisceration of the middle class, bifurcation of the economy is going to get much worse.

Dennis Tubbergen:

So, Michael, you used the term stagflation a couple times here, and for our average listener that has money in a 401K, has money in an IRA, they're not familiar with what stagflation looks like, can you give them a definition of how that affects the average everyday person trying to just save money so they can retire someday?

Michael Pento:

Well, it's the worst of all conditions, really, when you think about it. It's inflation, which is rising. Interest rates that are higher than normally. They would be. So, you have that negative part of the spectrum. And then on top of that, there is no growth. We are either in a recession or a period of no growth. So, the economy isn't growing, but you have the added burden. I mean, at least, Dennis, at least during disinflation and recession, the healing process has begun. Asset prices fall, bond yields drop, borrowing conditions, financial conditions ease, and even though it's very painful in the short term, it leads to that healing process because you have a restructuring of the debt, defaulting on the debt. That doesn't happen in stagflation. So, it's something that could last a very long time.

Dennis Tubbergen:

So, Michael, in the time we have left, you mentioned you're looking for stocks to decline 30 to 50%. If I made a correct note, you can correct me if I'm wrong. What's your forecast for real estate?

Michael Pento:

Well, the real estate market is in terrible condition. Right now, it's being hidden in masse by the fact that the inventory is so low. Well, why is the inventory so low, you ask? Well, it's because people don't want to sell their house. They just don't want to sell their house and move and get a fat mortgage. But the problem that exists in real estate is mostly what I call a closet inventory. These are the companies like Blackstone, who bought

hundreds of thousands of units of single-family homes, not because it made sense in a normal market. It made sense because the Fed took rates, borrowing costs down to 0%, and they made the calculation, "Well, hey, if mortgage-backed securities are being bought with reckless abandon by the Fed, and mortgage rates are plunging, and home prices are being pushed higher, let's get into the rental business.

Now, what's going to happen is if the recession becomes manifest, and I believe, again, that it will become manifest in 2024, early 2024 at the latest, the first half of the next year at the latest, you're going to see the unemployment rate increase, and what happens when the unemployment rate increases? Then you're going to see, of course, rental income streams dry up, because people don't pay their rent when they don't have any job. Then you're going to have a calculation from all of these investors, which many metrics show that in the last few years, 20 to 25% of all single-family homes were bought by Wall Street and investors, and they're sitting, Dennis, they're on a massive gain. 43% increase in imputed gains, implied gains over the last two years.

So, if you own all of these homes on your balance sheet, or if you're an investor, individual investor, and you own five homes, you can only live in one at a time, four of them are up 43% or thereabouts, and they start to roll over and you're no longer getting that rental income, what would you do? You may put them on the market for sale. And if that happens, it sort of has a compounding effect where people say, "Oh my gosh, look, we better cash out now or we never will." That could flood the market with new homes, and that will cause prices to drop. They have to drop.

Dennis, home prices, nominally speaking, are in the stratosphere, the thermosphere. Prices are astronomically high. But they're even much higher than they were in 2006, the prior peak, in relation to incomes. We have the highest home price to income ratio on record, and home prices are the most unaffordable on record because interest rates are spiking. Again, if you have a 43% gain in your investment property, would you or would you not consider putting those homes on the market? That's what I'm afraid of. That's what I believe is going to happen once the labor market begins to crack, and that will cause home prices to drop. I don't know if they drop as much as 30%, but they could very well drop 20 to 25%, and I don't think that would surprise me at all.

Dennis Tubbergen:

Well, my guest today has been Mr. Michael Pento. He is the founder and president of Pento Portfolio Strategies, the host of the podcast, the Midwest... The Midweek Reality Check, excuse me. The website is pentoport.com. I'd encourage you to check it out. Michael, it is always a pleasure to catch up with you. I love to have you back down the road. I know the listeners really appreciate your perspective, as do I. Thank you.

Michael Pento:

Thank you again, Dennis.

Dennis Tubbergen:

We'll return after these words.