Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
Market-Ticker.org

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Dennis Tubbergen:

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. Joining me on today's program is Mr. Karl Denninger. Longtime listeners will recognize Karl as a returning guest. He is the commentator and the proprietor, I guess that's the right word to use, at market-ticker.org. That's market-ticker.org. He is a prolific commentator. I've followed his work for many years and would encourage you to do the same. Karl, welcome back to the program and thank you for joining us.

Karl Denninger:

Well, thank you very much.

Dennis Tubbergen:

Karl, we were talking a bit before we started recording today that we have had an inverted yield curve for a bit over a year. Can you explain to the listeners a bit, first of all, what that is, and then in your view, what does that mean?

Karl Denninger:

Sure. Well, the premise is that time has value. So, if you want to borrow money, it should cost you a higher interest rate to borrow that money for a longer period of time. And that's just because nobody can ever have today back. It doesn't matter what you do. It doesn't matter how rich you are, there's no way to do that. So as a result, the value of time should always mean that the cost of borrowing money for a longer period is more expensive.

When the curve inverts, what that means is that the short-term cost of borrowing is higher than the long-term cost. And what this says is that the bond market believes that economic conditions will be nastier tomorrow than they are today. Why? Because, well, rates will go down. That's basically what the market is expecting to happen. Why would rates go down? Well, rates will go down because people are losing their jobs and there's a recession.

And then the other thing that could make rates go down would be if Congress was to ever balance their budget, which is about as likely as Jesus showing up at my doorstep in the morning, but those are the drivers. And so it's normally what happens when there's a recession on the way is that the curve inverts and then it goes back to positive, but it's rather rare for the curve to stay inverted like this for this length of time. The last time that we had a positive curve was around September, the end of September of last year, and it started to decline, and it went into negative territory in the middle of October, and it's been there since. That's October 22. Okay? So, it's been over a year now, and that length of time is extraordinary. It looked like we were possibly headed towards the curve going back positive about a month ago, and that has turned out to not be true.

Dennis Tubbergen:

So, Karl, when you look at the economy in your view, do you think we're in recession now?

Karl Denninger:

Yes, but the question is how you define that. Okay? Because if you take a look at, for example, the retail sales report, the last one that came out, the advancement in retail sales over a year ago values everywhere except in out stores. In other words, Amazon. Okay? Online. Everywhere else was negative in inflation adjusted dollars because the Marts report, which is what it's called, is not in inflation adjusted dollars, it's in gross amounts spent. So, you have to subtract back out of that whatever the inflation rate is, and even using the government's claimed inflation rate, which is fanciful nonsense, those values were negative. The one exception was, again, in the online marketplaces, which have been growing in terms of dollar value for a very long time.

So, if that was to ever go negative in inflation adjusted terms, I think we'd be in a depression, not a recession at this point, but that's what that data says. And when you look at that, then you have to look at things like the GDP report and say, well, how do you get a positive GDP report in real terms, which they claim is in fact the case when it's... Marts, that's retail sales, that's actual sales to actual people. I don't know how you argue with those numbers. That's the number that rang on the cash register.

Dennis Tubbergen:

Karl, you also talked about the fact that the US government having a balanced budget could make rates fall. I certainly agree with the likelihood of that happening, and we really don't need to look a lot further than the most recent US government bond auction. That was a dismal failure. It seems that the US and the US dollar are continuing to lose favor around the world.

Karl Denninger:

Well, that's an interesting situation because if you look at the actual data on the dollar, the dollar is not losing favor, if you want to look at it from a standpoint of where it actually is. Where have we been? Where are we going? Well, the DXY, which is a trade weighted dollar index, is still well over 100, so 102-ish, and it's been trading in that general area for the last quite some time. It did go up as far as 115, close to 115 back in 2022. But it by no stretch of the imagination is collapsing.

And to put some context on this, back at the time of the Great Financial Crisis and the crash, it traded down around 70, okay? That's a huge difference. We're nowhere near there, but what is happening is that the ability to hide inflation, which our government takes great advantage of through the advancement of trade. In other words, if you start with a trillion dollars worth of trade in a year and you go to 1.5 trillion, during the time that those goods and services are in transit, somebody has to be holding money because the guy who made the thing wants to get paid, and the guy who is buying the thing has to pay, and that cash has to be sequestered somewhere. Well, that has all been done in dollars, and as that expands, that gives you a temporary $500 billion worth of deficit spending that doesn't result in inflation.

Congress has gotten drunk on this, and so has the American consumer. The idea that you should be able to get a 3% mortgage is absolutely ludicrous. In a zero-inflation environment, yes, perhaps. But in a 2% inflation environment, which is what the Fed says is their preferred, your 30-year mortgage rate should be about six.

Dennis Tubbergen:

I'm chatting today with Mr. Karl Denninger. He is a prolific commentator. You can read his work at market-ticker.org. I'd encourage you to do that. And Karl, when you take a look at some of the other economic data, I think housing sales are now equal to 2010. They have fallen off, not a surprise, with higher interest rates. The used car index, the Manheim used car index down, there's a lot of signs that we may be seeing the beginning of this debt starting to unwind, this deflation. Do you agree with that assessment?

Karl Denninger:

Yeah, there's an awful lot of happy face stuff going on, particularly in real estate, but the market is essentially locked right now because so many people took out 2%, two and a half percent mortgages during the pandemic.

And if you could refinance into that, in a lot of cases people did. And then you had a large number of people that thought that remote work was never going to go away, and they moved to cheaper places to try to arbitrage a job in California, for example, where they were getting paid substantially more money because the cost of living is higher.

So, we, "Let's move to Arkansas and we're going to be working on Zoom for the rest of our natural lives." Well, that hasn't worked out so well, and so they're stuck. But there's a problem with that, and that is that as people get into a situation where they can't access any more credit, but they've built up this idea that they should be able to spend more than they make, and the inflationary consequences start to catch up with them, they get forced into refinancing at terms that they don't want, and that is going to start to force sales.

I don't see a lot of evidence of it yet, but it's coming. And then you have the Airbnb craze in a lot of places, including where I live, and now I'm seeing an awful lot of listings of stuff that was started during the pandemic years. They're now being completed, and these developers seem to think that they're going to be getting them at the fill rates and pricing that was going on when Tennessee was wide open for business and all the states around us were locked down, and therefore we had three times the demand of everybody else. Well, that's not true anymore. And so, the booking rates and the pricing has collapsed. That's going to lead to some problems for those people that overpaid for these things in the first place.

Dennis Tubbergen:

Well, Karl, when you look at... You mentioned credit too. There are some signs that we're nearing the end of the road there, at least in my view. Credit card debt is at all-time highs. Delinquencies are now rising. The consumer out there has gone through all of the savings for the most part that they accumulated during the pandemic when all the easy money was floating around. I think I read that personal savings have gone from $2 trillion to $190 billion. Isn't this day of reckoning, isn't it really imminent at this point?

Karl Denninger:

Oh yeah, I think it is. The credit card debt issue is very real, and what I'm seeing in a lot of places, and it's spotty, it's not everywhere yet, but I'm seeing a lot of slowdowns in that area. We had the Black Friday flyers that came around and Bass Pro that ate Cabela's. Tried to get in front of everybody by starting their sales on Monday morning at seven o'clock instead of on Friday. Well, I went over there on Monday morning at seven o'clock and there were three of us in the store.

Dennis Tubbergen:

Wow.

Karl Denninger:

And so, when you're outnumbered better than two to one by staff members, that's a problem. Okay? So yeah, there were cars all over the place here, but I don't know about bags. And as I've tried to explain to people before, when it comes to holiday sales in particular, you can look at all the traffic in the mall you want, it doesn't matter. How many people have bags in their hand? That's what counts.

Dennis Tubbergen:

Well, I'm chatting today with Mr. Karl Denninger. His blog can be read at market-ticker.org. And the good news is I've got one more segment to chat with Karl, so stay with us. We'll be back after these words.

I'm Dennis Tubbergen, your host. You are listening to RLA Radio, and I have the pleasure of chatting once again today with Mr. Karl Denninger. You can read Karl's work at market-ticker.org. I'd encourage you to do that. The website again, market-ticker.org.

Karl, another statistic just to pick up where we left off in the last segment that really makes me wonder what the Fed's policy will be moving ahead, is that I believe the US government has more than $7 trillion in debt that's got to be refinanced over the next year. And a lot of that debt now is being carried at very, very low interest rates, say less than 1%. And when you take a look at the rate now at which that'll be refinanced, it's five plus percent. So, what impact do you think that has on first US government finances and then secondly, the overall economy?

Karl Denninger:

Well, it's a very serious issue for the federal government because there are people saying that the government will not be able to fund its spending. That's not true. The bonds will sell. The question is at what price? And back, for those of us that are old enough to remember it, when Clinton was president, he originally wanted to do what ultimately ended up being Obamacare essentially, when it was Hillary's proposal. And he also wanted to spend a great deal of money in deficit. And the bond market started to have somewhat of a hissy fit about this. And he got rather impolitely told that, "Well, you can pass whatever you want. However, if the interest rates skyrocket, there's going to be a serious problem." And the primary dealers, which are the large banks; they do have an agreement that they will buy the debt, but that agreement does not specify at what price.

And so that's the problem that you run into here with this is that as this occurs, the government is going to eventually, and I think Powell will eventually have to go to Congress and have to go to Biden's administration and tell him, "Look, you were warned about this by Ben Bernanke during the Great Financial Crisis that they were doing QE and they were doing these things, but it had a use by date and that you could get away with this for a while. And Bernanke actually put about a 10-year time window on this and said, "This is about how far we can go with it before it comes apart in your face, and we're kind of there. So, you folks are out of rope on this, and you need to cut it out. And if you don't, we cannot shield you from what the market is going to do to borrowing costs," and that's going to hit everything in the economy because it's not just limited to government debt.

Everything else gets priced off of that. Why would you loan a business or a person money at 5% if you can get it at 6% or 7% and it's 100% safe, but for a revolution? And then of course, nobody cares anything about money at all. So why would you make a private loan if you could give it to the US Treasury at 7%? Well, you would not do it for less than 7%. You'd demand more than that. And so, when that sort of thing backs up, it all filters through everything else. It goes into car prices, car loans, mortgages, credit cards, everything, and all areas of the economy because how many businesses have an operating line of credit? They're a revolver, and that's what they're running on most of their time as well.

Dennis Tubbergen:

And Karl, I think the other thing that is really going to be a headwind moving ahead is banks are starting to really pull back and credit is tightening. Doesn't this all have to hit the fan, to use that term, next year sometime?

Karl Denninger:

Yeah, I think it does. And in the late 80s and the early 90s, there were a couple of these little shocks, if you will, that were nowhere near as bad as the kind of thing that I think is likely to come here. They were tremendous opportunities for me. It was part of the reason that I was able to do what I did with my internet firm because we were able to take advantage of other people's distress, but I also knew people that ended up on the wrong side of that. And one of them was a friend of mine who had a small manufacturing outfit, nicely profitable. He had an operating line of credit. The bank called it, he couldn't replace it. It literally put him out of business. And this was not a firm that was operating at a loss, but he had to have that operating line in order to be able to... Because people don't pay instantly, and you have to be able to finance your inventory until you make your stuff, and you sell it. And he could not replace that line, and it literally tanked his company.

So that kind of thing I think is going to start. The other thing that's going to happen with people that have HELOCs and other open lines of credit is that they're going to get slammed down to the open balance, and you're going to start to see that happen with credit cards as well. That's especially nasty if it happens with credit cards because it whacks your utilization, and that's a big part of your credit score. So, if you go from using 10% of your credit to all of a sudden using 60% because the bank turns your line down to whatever your open balance is, that could easily take 50 points off your score in a day.

Dennis Tubbergen:

So, Karl, when we look at this with rising interest rates, obviously there are a lot of IRA owners, a lot of 401(k) investors that invest in the traditional 60/40 portfolio of 60% stocks, 40% bonds. If you're in bond funds in a climate of rising interest rates as we already know, that is a surefire way to lose money, and certainly stocks here have not made it back to the highs they saw at the end of 2021. So what's your forecast, given everything we've talked about here for that traditional 60/40 investment portfolio?

Karl Denninger:

Well, remember, if you're in bonds and you're actually buying Treasuries, you don't lose principle. Where you lose money is in bond funds because of the redemptions. So, the person that has a two-year bond that they bought a couple of years ago and is going to mature, they could buy one today, it would pay a much higher rate of interest, but they're not out of any capital. They're forced to sit on it. Where you end up taking a capital loss is if you have to sell the position early. And if you're in a fund, that happens because people get out of there, and as they do.

Dennis Tubbergen:

Exactly. That's what I was talking about. Most people in an IRA and 401(k) invest in funds.

Karl Denninger:

Right. And if you're in a bond fund, yeah, that's really serious, but a lot of that damage has already happened, right? You take a look at the domestic bond funds that are out there, and good Lord, some of those have lost 30%, 40% of value over the last year. So that damage has already been taken. And then the other thing that you're likely to see though is I think you're going to see... As the tightening of credit gets into corporates, you're going to see PEs come in massively. And as a result, that means prices are going to go down and probably a lot. So, I would not be at all surprised if sometime in the next year or so we see a 30 or even larger percent drawdown in all the indices.

Dennis Tubbergen:

So, Karl, what would somebody do now if they've got money in an IRA or a 401(k) in your view? What asset class do you like, if any?

Karl Denninger:

Well, right now, you're getting paid 5% plus five, five and a half, just being in short-term Treasuries. What's the problem with that? Is it as good as inflation? No, but it beats losing a third of your money.

Dennis Tubbergen:

For sure. So, let's talk a little on the time we have left, let's talk a little politics. Dangerous subject obviously, but looking ahead to 2024 being an election year, at this point, how do you see things playing out on a national level?

Karl Denninger:

Well, I don't know. It's very difficult because we have perhaps the two most unlikeable obvious front-runners. Biden, of course, is obviously the presumptive Democratic nominee. There's a lot of murmuring going on that the Democratic Party is going to try to find a way between the Convention and the General Election to force him out, which would allow them to name a replacement. You're not entitled to another vote at a primary level. The party internal machinery would be the one to make that decision, which would be really interesting if that was to happen. Obviously, if it happens before the Convention, then the dynamics are different.

The other problem you have is that you've got a couple of people that are making serious noises about a real no BS third-party attempt, and Manchin's, one of them, and the other one is RFK. Now, neither of them is likely to have any reasonable possibility of winning. However, they skew the outcome dramatically, much like what happened with Perot. And both of those people are quite capable of drawing significant percentage of the vote. This is not like a Libertarian candidate's going to pull 1%. It's not going to work that way. It's going to be something significant.

And then on the Republican side, the obvious expectation is that Trump is going to be the nominee. However, Trump has something like 90 pending federal felony charges against him. Who knows how that plays out? So there's a lot of balls in the air right now. It'd be easy to try to handicap this if you are reasonably sure it's going to be Trump versus Biden. I think Biden loses, but there's so many balls in the air in terms of who's actually going to be on the ticket come next November. I don't even know that we can reasonably guess for that.

I wouldn't be surprised to see Gavin Newsom end up on the Democratic side of the ticket at all, but I think he loses in the General if they're crazy enough to do that.

Dennis Tubbergen:

Well, and particularly if we see a lot of these economic inevitabilities that we've been discussing on today's program play out. If that happens to happen... Happens to play out rather before the November election, that certainly is going to skew or sway a lot of people's opinions as well.

Karl Denninger:

Oh, yeah. Look at the possibility with all these migrants that have come into the United States over the last couple of years, and then the situation in San Francisco with people defecating in the middle of the street, and all of a sudden it magically goes away because the Chinese President shows up for a Convention and they shuffled it off. When you put Newsom on the ticket and then have the economic picture darkened substantially, unemployment starts to spike, and everybody looks at the migrant situation and where all that money's going and goes, "Hey, wait a minute. This clown out here was responsible for an awful lot of that in California. Do I want that guy in the left seat at a national level?" That's the kind of thing.

It's a wild card. It's very difficult to know how that all plays out, but I would say that the probability is quite high, and economic dislocations always hurt the incumbent. You look at what happened back in 2008. It wasn't just that a lot of people didn't like Hillary. It was also that Lehman Brothers blew up and the housing market exploded.

Dennis Tubbergen:

Yeah. Well, the clock says, Karl, we're going to have to leave it there. My guest today has been Mr. Karl Denninger. His website is market-ticker.org. The website again, market-ticker.org. I'd encourage you to check it out. Karl, always get terrific feedback when you're on the program. Appreciate you joining us today, and love to have you back after the first of the year for an update.

Karl Denninger:

Sounds good to me.

Dennis Tubbergen:

We will return after these words.