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 am your host, Dennis Tubbergen. Joining me once again on today's program is returning guest, Mr. Karl Denninger. Karl is a prolific author. His work can be found at market-ticker.org, and I would encourage you on the right-hand side of the main page to click on the link, click "what the media does not want read". He has a lot of information from a lot of very well sourced places. Karl, welcome back to the program.

Karl Denninger:

Thank you very much for having me on.

Dennis Tubbergen:

I always enjoy talking to you, so let's just jump in, Karl. We're recording this on October 4th, about four days before it actually airs. Markets are reacting pretty positively. How do you read this?

Karl Denninger:

Well, this latest spike brings back to mind the sorts of things that happened in 2008. If you remember, back in 2008 the government decided that they were going to ban shorting financial stocks. Doing this caused a furious rally, which ended up not holding of course.

What produced the more durable rally that we saw off the bottom of course was when Congress turned around and told FASB, which is the Financial Regulatory Board, that they had to either legalize lying about asset values or they were going to pass legislation to do it themselves.

So, there you had a 10 plus year ramp job that came about as a result of fraud, and essentially that's what happened here. We had rumors flying around a few days ago that Credit Suisse, along with apparently a number of other organizations and pension funds in particular in Great Britain, had been writing levered interest rate swaps. You just have to shake your head at that sort of thing, okay?

At the terminal end of a 40-year trend, when interest rates are near zero, swaps are always a speculative instrument. To do so with leverage is even more so. To allow a bank which has its fiduciary responsibility to every person in the nation because their deposits are backed by public insurance to engage in speculative behavior is crazy. Anybody that does that ought to go to prison.

The finance ministers and such within the government and regulatory apparatus that allow that should all go to jail and their families should all be thrown into the street, living in a refrigerator box under a freeway overpass, because in the end what that basically does, it says that you can steal money through people through these instruments and when it goes bad somebody else is going to have to pay for it. You don't get charged for it, somebody else has to.

But there were rumors that Credit Suisse was in a great deal of trouble, and so were a bunch of pension funds over in England, so the Bank of England came out with an announcement that it was basically going to do both QE and QT at the same time, which of course is impossible. This also came on the back of another statement that the British government was going to cut taxes into an inflationary spike. Now that's crazy too, okay?

So, you had those things happen. That produced the first level of the rape job. Then people believed it. We got a huge move up in the market, and then on the back of that we got the Jobs Report, which is job openings. That's way down, which implies, of course, that companies are laying off and are pulling off the market, if you will, openings that they were previously looking to fill.

This has accelerated the belief that the Fed is going to pivot and stop raising rates. In fact, there was an expedited hearing yesterday, it was closed door, at the Federal Reserve on exactly that topic. Now those expedited procedures meetings are not all that uncommon, but what Pavlov's dog thought was that we were going to get a 4 o'clock in the afternoon announcement that the Fed was going to actually stop raising rates or maybe even cut them. So, this has produced a furious rally in the market, but the truth is, is that if you do any of those things into an inflationary environment you're just going to make the inflation worse.

Dennis Tubbergen:

A couple of things I want to go back and revisit here. If you're just joining us, I'm chatting today with Mr. Karl Denninger. You can read his work at market-ticker.org.

I want to go back and talk about pensions too, Karl, but let's just talk about the Fed. Aren't they kind of in a damned if they do and damned if they don't situation? In my view, we're in a recession, and continuing to raise rates to get inflation under control exacerbates that, and reversing feeds this inflation monster, so can the Fed win here?

Karl Denninger:

No. The problem is that it's not the Fed fault, okay? The responsibility is in fact in Congress and it's in us. The people that are screaming now that the Fed must stop, the Fed must stop this, the Fed must stop this, are the same people who are saying but if you don't my house price is going to collapse by 50%. Well, yes, it is. What made you think that the 50% rise actually had anything to do with real value? It did not.

Why have people been trained to use a home as something other than shelter, as a speculative instrument against which they can draw off funds and spend on other things? That's crazy. That's just crazyland stuff. The idea that time has no value is what has underlain all of this for the last 10 plus years, but we all know that's nonsense.

We get up every morning, we go take a shower, we go do our thing, and whatever you spend your time on today you can never get back. You can never have that day over again. If you decide to go to the bar tonight and suck down six beers and the next day you have a head banging hangover as a result, you cannot have that day back. You could have spent that afternoon building something or doing something productive. Instead, you chose to spend it on a leisure activity. That's fine, but you can never recover it.

Yet the idea of a zero-interest rate is to say that time has no value. That's the declaration that you're making with zero interest rates, time has no value, and every single one of us from a child forward knows that's a lie.

Dennis Tubbergen:

So, Karl, let's go back and take what you just said and apply it to pensions, because pensions have been put in a very difficult situation. The traditional defined benefit pension plans really use actuarial assumptions to make some reasonable assumption as what they can earn on their assets safely. This low interest environment has obviously not allowed them to meet the assumptions that were used, and that has led to some of the speculation in leverage. So, what do you see as for pensions? I see some storm clouds on the horizon for pensions.

Karl Denninger:

Think about the basic premise here behind a pension, okay? The premise is that the entity that set it up, whether it's a government or a private company, pays into a fund in advance of your retirement, and that then allows the forward obligation that is to you to be met, right? I mean that's the idea behind it. That's the basis of a pension.

Okay, this is not a bad thing. This is a good thing. But what has happened is that if rates go down because somebody has determined that we have to do this for other reason, then the pension fund is supposed to go back to the entity that's funding it and say, "Hey, guys, where you were giving us $100 every pay period out of everyone's paycheck in order to fund this pension, it now needs to be $130 because we can't get a safe return anymore because interest rates are zero."

Well, rather than do that these people lied. They went out and they took on leverage as a need to do it. That's crazy. That's just crazy, and people who did it should all go to prison and those entities should be liquidated to pay for this. I understand this would mean private companies would be bankrupted by it. Fine. It also however means that those government institutions that put this kind of thing together, government schemes, those entities need to be destroyed and their assets sold off in order to pay these things.

In the case of state pensions, the so-called constitutional protection against them being aggregated, I'm sorry, you can't get blood from a stone. That which can't happen won't, and if you think you can just indefinitely raise property and other taxes in order to pay for this, no, you can't. But the people who live in these states and in these municipalities, you voted for this. You allowed it to go on. Stop it.

Dennis Tubbergen:

So, Karl, we've got just a couple minutes left in this segment. We'll probably have to pick this conversation up on the other side. But when you look at what happened last week in the UK with the Bank of England literally creating, I think it was £65 billion out of thin air to make sure that pensions having to meet margin calls had a market to sell bonds, this whole thing just about imploded the UK last week.

Karl Denninger:

Yeah, it very nearly did, and it's coming, and it's coming here. The idea that this could go on, on a permanent basis... If the Fed actually does react to this and does actually pivot, then the result is that you're going to see the destruction of everyone's standard of living, including those people who didn't do anything wrong, because the inflation problem is not going to go away, and as I have always said, it does not matter how many dollars you have. What matters is what they buy.

Dennis Tubbergen:

That's exactly right. My guest today is Mr. Karl Denninger. I would encourage you to check out his work at market-ticker.org. Karl is a prolific author. I think, Karl, we've got just a second here in this segment, but correct me if I'm wrong. I believe your book, Leverage: How Cheap Money Will Destroy the World, was written about 10 years ago and it turned out to be pretty prophetic.

Karl Denninger:

Yeah. And surprisingly enough it hasn't been remaindered yet. It's still out there.

Dennis Tubbergen:

Well, we're going to continue our conversation with Mr. Karl Denninger when RLA Radio returns. Stay with us.

You are listening to RLA Radio. I'm your host, Dennis Tubbergen, and I have the pleasure today of chatting once again with returning guest Karl Denninger. If you're just joining me today, Karl's website is market-ticker.org. He is a prolific author and commentator, one of the hardest working researchers I think that I get an opportunity to interview.

Karl, we talked in the last segment about pensions and all the looming issues out there, and inflation. So, given what the Fed's choices are; one, get inflation under control and we go into what will likely be a deep recession, or two, they capitulate, they say we can't win the inflation battle so let's at least try to keep things afloat, what are they going to do?

Karl Denninger:

I'm not entirely sure. Jerome Powell has talked up a good game. There's a lot of people that think that Volcker went overboard in the 1970s and the early 1980s and that he should have stopped long before he did. The truth is, at least in my opinion, he did exactly what he had to do. What he needed to do was impress upon people in the markets, whether it be the housing market, whether it be the banking system, whatever, or Congress for that matter, that we are not going to react to you throwing a temper tantrum by allowing you restart the leveraged gain. We're just not going to do it.

You can scream all you want, but we're going to break the Pavlovian response so the next time the bell rings you are not standing there waiting for the steak. That's the reason he went as far and as fast and as hard as he did, and it has to be done again, because the root of this problem lies in Congress. It does not lie in the Federal Reserve. It does not lie in the private banking industry. It lies in Congress.

Congress shoves trillions of dollars into the economy that was entirely unjustified, every penny of it. We had a virus that came into play in the United States. It created havoc, but that had nothing to do with the economic reality of it. We have 40 years' worth of academic knowledge that says that the right thing to do in the event of a pandemic virus of some kind is to do nothing essentially from an economic perspective, to do as little as you possibly can.

Yes, it's going to hurt. However, it does less or no long -erm damage, and whatever toll is going to be taken by the virus in the people is going to be taken. There isn't anything you can do about it, and all of your economic nostrums that you try to put out there are going to make it worse.

Of course, we followed exactly zero of that advice, even though we've had decades of academic study on this, and it's continued. Of course, the latest thing out of the Biden administration was using the pandemic as justification for taking several hundred billion dollars’ worth of student loans off the books. But you can't take them off the books, you can just force somebody else to pay for them. So, what did that do? That showed up immediately in inflation, and it's going to continue to. This must stop.

It's unfortunate, if you are one of those people that bought into this and leveraged yourself up and you became one of Pavlov's dogs you're going to get hurt, maybe very badly, but that needs to happen. Because if you think about this, if I'm a business person and you are running a company and you go bankrupt and I can buy your building and your machinery for ten cents on the dollar that you paid for it five or ten years ago, that is to everyone's benefit in the economy except yours, because now I open up the new factory, or the new bank, or whatever it is, my costs are lower, and that means that what I sell to the public costs less and is of equal or higher quality. That is what you, as a consumer, want. You want that to happen.

Now the person that ends up busted in the street, or the people who get laid off, they of course don't want it to happen, but in terms of the common benefit for the population and for humanity, that's what you want. You want people that do stupid things to have to pay for it because somebody else seizes on that and makes a profit.

Dennis Tubbergen:

Karl, it seems to me that we are definitely in a recession here, and it sounds like from your last comment you would agree. Although I don't mean to put words in your mouth, how deep does this get?

Karl Denninger:

I think it gets pretty nasty. Frankly, I would not be at all surprised if this is formally a depression. As I pointed out in Leverage over 10 years ago, we should have stopped this crazy after 2000 with the tech wreck. Rather than stop it we bailed it out, and an excuse we used, of course, was 9/11, which came about a year after the tech wreck started.

Then in 2007 and 2008 we had stoked a huge housing and real estate bubble. In general, rather than take the medicine then we bailed that out. Then, of course, the pandemic came, and we did even more crazy things, and it's not just the United States, it's global.

The more you compound back into this the worse the damage is that has to be absorbed. So, what we're talking about at this point is a very deep and nasty recession, probably a loss in... I would not be surprised if the markets trade, S&P 1576 again, and frankly it would shock me if we traded down in the 2009 lows. In terms of housing and other real estate and similar investments, I think you're going to see most, if not all, of the gains of the last five to ten years come right back off.

Dennis Tubbergen:

I tend to agree. I read some data that we have private sector debt levels today... You talk about leverage; private sector debt levels today are on par when measured as a percentage of the economy with where we were in 1929. You used the word depression. It's kind of a scary word, but the data seems to indicate that that's kind of where we are.

Karl Denninger:

Well, yeah. Nobody wishes to acknowledge this. Nobody wishes to talk about this because if you look at the polls it's been consistent over my entire adult life, everyone says Congress sucks, but they all keep voting to send their guy back, so Congress sucks except my Congressperson. Why? Because your Congressperson takes somebody else's money and brings it home and sprinkles it all around your district. That's why.

It's not that hard to figure out what the mechanism is, but this has to stop, and the idea that we can manage the business cycle and we can make it go away, it's never been true. It's never going to be true. The reality of it is, by is that people get over-exuberant, it always happens. People are always more confident than they should be, but they're also more depressed than they should be on the other side.

How many people get all cranked off about this and that and the other thing that really isn't all that big of a deal? It's a normal human reaction. It's just the way humans are. Trying to prevent that is very, very bad in the general sense, because, again, it is the ability to do more with less that defines human productivity, and one of the ways you do more with less is by capitalizing on other people's mistakes.

Dennis Tubbergen:

So, Karl, you mentioned real estate. It seems to me that prior to, as of last week anyway... Last week, Friday I think, the markets were down just about... Using the S&P 500 about 25% year to date, and yet valuations using the Buffett indicator were still higher than they were at the time of the tech stock bubble, and now it seems that, at least from what I've seen, I'd like your take, it seems the real estate numbers are starting to break down a bit.

Karl Denninger:

Yeah, they are. One of the problems that you're seeing within the markets, and this applies in real estate as well, is that the concept of taking debt and never actually paying it off... And how many people have done this even in their own residence? You get a loan, a few years later the interest rates are lower, so you refinance, get a lower payment, but you restart the amortization schedule.

Essentially you are mimicking what corporations have done for the last 40 years. They never pay anything off. They roll it over, and it always costs them less to do. When you do this, it goes directly to your earnings. It shows up as a larger earnings number on the bottom of your balance sheet. You look at any public company, you'll see this. This pattern has been there forever, and this is what drives valuations, and ultimately drives stock prices.

The presumption is, is that can go on forever, and of course it can't, because you can't go below zero. When it stops and reverses, that same benefit that you get turns into cost. So, what we're looking at today is that this is exactly what you're seeing. Prices have come down, but earnings have just started to drop.

When you take that debt level and then you look at what the interest expense is going to be across a corporation's debt at say 6% or 7% instead of 2, well, gee, that comes right off the top line, which means the E number goes down. That means the PE number goes up, right? So now all of a sudden what used to look like a decent price earnings number is actually crazy, and as a result stock prices collapse. We're nowhere near the end of that. That's going to be going on now for years.

Dennis Tubbergen:

So, is there a way in your view for the Fed to engineer a soft landing, or are we just going to have to take our medicine here?

Karl Denninger:

I think we have to take the medicine. They're going to try to find a way to prevent it from happening, because that's what they've done over the last 30 or 40 years. But I don't think they can succeed, and furthermore, if they do try to pull something like this off with the trade sequestration essentially stopped as a result of the Russian/Ukraine war, which is a large part of why they've gotten away with this for the last 20 years or so, is all trade sequestration dollars. That's gone.

Any attempt to do this is simply going to reflect back into inflation, and that destroys the entire point of doing it, because your eggs go from $2 a dozen to $4 a dozen, well everybody has got to buy food. We're seeing the same sort of thing... Look at what's happening in oil. You have OPEC turning around and saying they're going to actually cut output. Why? Because demand is collapsing.

All you have to do to see that is the spread between diesel fuel which runs heavy trucks and gasoline. Gasoline has come down substantially except in places like California, where they're deliberately trying to screw people. In fact, we're at $3 a gallon here. Diesel is still... I was just on a trip up into Michigan. There was a $2 spread between regular gas and diesel. I've never seen anything like that before.

Dennis Tubbergen:

It just shows you that the big trucks are still running, and the everyday common citizen is not driving like they used to.

Karl Denninger:

That's right, but that's demand destruction. That's exactly what happens in a recession.

Dennis Tubbergen:

My guest today has been Mr. Karl Denninger. His website is market-ticker.org. Karl, I always get amazing feedback when you're on the program, so I'd love to have you back down the road. Thank you for taking time out to chat with us today.

Karl Denninger:

Any time. Thank you much.

Dennis Tubbergen:

We'll return after these words.