Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Michael Pento
Pento Portfolio Strategies

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Dennis Tubbergen:

Welcome back to RLA Radio. My guest on today's program is Mr. Michael Pento. Michael is the host of the very popular podcast, The Mid-Week Reality Check. You can learn more about his work at pentoport.com. And Michael, welcome back to the program.

Michael Pento:

Thank you so much for having me back on, Dennis.

Dennis Tubbergen:

So, Michael, I'm not sure what the new definition of a recession is. I always thought it was two consecutive quarters of negative economic growth. I may be wrong. Where do you think we are? Are we in recession?

Michael Pento:

Well, the first half of the year, GDP was lower than the start of the year. I mean, yes, the economy is in contraction territory. So, you can change the definition of a bear market. You can change the definition of a recession. And they're now trying to change the definition of a dovish pivot from Powell. So, the central banker used to be dovish or pivoting dovishly, if they lowered rates from wherever they were back to zero or were lowering rates back to zero and doing QE. Now, the definition of a dovish central banker is one that's no longer hiking at 75 basis point increments, but is now hiking at 50 basis point increments, hopefully. So, I mean, that is not a dovish central bank. We have over 80 global central bankers now hiking interest rates into a global recession. Now, you could define that any way you like, but those are the facts, and they're not pretty.

Dennis Tubbergen:

So, Michael, when you look at the economy, we have an economy that is in recession, we have inflation that is still raging, this just looks like it's going to be a hard landing and going to be ugly, and then there's no way out of it. Well, what's your take?

Michael Pento:

Well, there's no easy way out of it. There's a very smart way out of it. It's painful. But I call it the grand reconciliation of asset prices, Dennis. I mean, you just can't have home prices go up 20% per annum, for ever and ever, amen. You just can't do it. I mean, you priced out the first-time home buyer. The real estate market is now a systemic risk to the global economy, once again. What you need to do is have asset prices come back to some form of reconciliation. The total market cap of equities was 210% of GDP in January of this year. You had some $14 trillion of, negative sign, foreign debt around the world. So negative interest rates. 14 trillion at its peak. Now those rates have come down, but you have an unbelievable and epic triumvirate of asset bubbles, stocks, bonds, and real estate, all existing concurrently.

And what you need to do is have the central bank of the United States, regardless of what happens, bring The Fed funds rate above the rate of inflation. Now, don't get me wrong. I believe inflation has peaked. I think it's coming down. But it's coming down from 9.1%, down to what I think probably will be mid-single digits by the end of the year. So, The Fed has to have the bravery, I wouldn't call it temerity, because it's not foolish bravery, it's just bravery, to do the right thing. Bring interest rates to three and a half percent at the minimum. Leave them there for the next few years, regardless of what happens to asset prices. And then, let's reconcile this economy and have a real economy, not one, Dennis, that is clinging to every word from Jerome Powell. I mean, we don't do any discount of cash flow analysis anymore. We don't look at the economy anymore.

We're looking at what Jerome Powell, one unelected official, is going to do, because if he's dovish and he's cutting rates, then we just have stagflation forever. If he's raising rates to a real, in a real sense, above the rate of inflation, we're going to have a deflationary depression. But that's because of what they did, not anything that we did. It's because we've given central bankers plenary, plenary power to run our economy. And it's a disgrace.

Dennis Tubbergen:

Michael, you mentioned deflationary depression though. That's obviously a very ominous combination of words when you describe where we might be headed. But is that in your view, the inevitable outcome here?

Michael Pento:

Well, that would be... It's not inevitable, in the short term. It all depends on the central bank. Like I said, right now, look what the data was today. We had a flash US Services PMI at 44.1. Now, that was a 27-month low. And I want to remind you, Dennis, that The Feds started hiking rates from zero in March of this year. They're going to go from 0% to 3.3% on the effective Fed funds rate by the end of this year. And monetary policy works with a lag. So, the rate hikes that have occurred in March, really aren't going to start taking effect until September. We're not even there yet. So, we have a global recession, and the effect of central back tightening hasn't really even started yet. And you add to that, the fact that we have $95 billion a month of burning of base money supply starting in the next few weeks.

So yeah, deflationary depression is painful, but absolutely necessary in the short term, because if they don't, if they don't do the right thing, if The

Federal Reserve and the rest of the central bankers and the important economies, and I'm talking about Europe, Japan, the United States and China, if they don't do the right thing, and clearly they're not doing the right thing in Japan, and clearly they're not doing the right thing in China, but I have my doubts if that China can actually save the world like they did in 2008. So, they're not as important as they used to be. Their population growth, their labor force growth is shrinking. They have very little productivity.

Their housing market is a disaster. So don't look for China to save the world this time. The central bankers around the world have to engender as best they can a reconciliation of asset prices, no matter what the consequences are in the short term, because if they don't, we're going to be left with intractable stagflation, which by the way, as you probably were alluding to, eventually will lead to that deflationary depression, because you cannot have interest rates, long duration bonds, rise inexorably, and have a nice outcome for the stock market or the economy.

Dennis Tubbergen:

So, Michael, I certainly, I hear what you're saying and agree with you. And when it comes to The Fed doing the right thing and hanging in there, is it realistic to expect that Jerome Powell's going to say, "Yeah, the economy's contracting. We are in this severe recession, but it's necessary. We just need to suck it up and get through it, and things will be better on the other side." I mean, is that something Powell's really going to say?

Michael Pento:

He will say it. He's saying it now. I mean, that's out of his own mouth. He just says it might be a soft landing, it might not be a soft landing, but we have to fight inflation. We have to bring inflation down to 2%. Eight and a half percent is much higher than two. It's four times, over four times higher than The Fed's asinine target of 2%. I mean, as to why a central banker put in charge of making sure your purchasing power is maintained. In other words, they should be charged with 0% inflation, but somehow, it's two. It's over four times that level. So, will he continue to fight inflation? Yeah, I think he will until the credit markets freeze. In other words, until commercial paper can't be floated, until you cannot float a junk bond. Until the repo market comes under stress, despite their overnight facility that they have.

So yes, Powell will continue to fight inflation until we have a steep recession that leads to a credit crisis. And then, I think he has to relent to the markets, because there's one thing... You can lie about inflation. You can lie about it. They lie about it now. I mean, they claim inflation's 8.5%. If you measure it the way it used to be measured pre-Boskin, it's really 17%. So, you can lie about inflation and tell people, "Hey, you have a job, you have an income, but inflation isn't that bad, even though you're spending all of your income on food, fuel, and housing." You can lie to them about that. But what you can't lie about is a deflationary depression, because you lose your job. You can't tell people that they have a job when they're not working. So, the worst outcome for a central banker is a deflationary depression. It's necessary, it's needed, it would be healthy, but they too will relent once the credit markets break, and we have that deep recession.

I want to hasten to add, Dennis, that if we have that scenario where The Fed continues to hike rates, they raise to 3.3, to three and a half percent, the recession intensifies globally, before they relent and start to cut rates, before central bankers start to fix everything again, and I put that word fix in quotes, that's not going to be good news for the stock market. You have a credit market freeze, again, and asset prices will plunge 30% plus, in my opinion, in a very short amount of time, before The Fed can do anything. Now remember, The Fed needs to, and this is a real pivot, they need to cut rates from where they will be by the end of this year, 3.3%, so three and a quarter to three and a half effective Fed funds, 3.3, back to zero. They need to go back into QE. They will be very reluctant to do that, given the fact that the sting of record high inflation is going to be just months in the rearview mirror.

Dennis Tubbergen:

Well, my guest today is Mr. Michael Pento. He is the host of the popular podcast, The Mid-Week Reality Check. You can learn more about his work at pentoport.com. And Mike, we've got a little over a minute left in this segment. Why don't you explain to the listeners what it is that you do?

Michael Pento:

Well, I'm an SEC registered investment advisory firm, a fiduciary. I have a website called pentoport.com. In that website, you have access to a free five-week trial of my podcast, which I record every Wednesday evening. It's a five-week free trial. If you like it, it's $50 a year. And I give you the actual economic data that you need to know, that's not well-promulgated by the mainstream financial media. And on top of that, I give you some pretty good insights as to how you should interpret that data. And if you have a $100,000, a minimum of $100,000 to invest, and you are a US citizen, you can contact me and my firm through that website, and I will manage your money, myself, for you.

Dennis Tubbergen:

Well, my guest today, again, Mr. Michael Pento. The website is pentoport.com. I'll continue my conversation with Mr. Michael Pento when RLA Radio returns. Stay with us.

I am Dennis Tubbergen, and you are listening to RLA radio. My guest today is Mr. Michael Pento. If you're just joining me, Michael hosts the very popular podcast, The Mid-Week Reality Check, and you can learn more about his work and the podcast at pentoport.com. And Michael, I just want to kind of pick up on a couple topics that you discussed in the last segment.

You mentioned that, at some point, the credit markets will break, and The Fed will be forced to step in and fix them. And I think we're seeing maybe the beginning of that now. I was reading this week that first guarantee declared bankruptcy. A lot of the non-bank lenders in the mortgage arena are having significant financial issues. Are we seeing the beginning of these credit markets now breaking down?

Michael Pento:

Well, if you look at the... I like to look at the high yield option adjusted spread, and it rose from, in January of 2022, so the beginning of this year, it was about 300 basis points spread between 10-year sovereign debt and the high yield junk bond market. That index rose to almost 6% in early July. Now we're back to about four and a half, 4.6, 460 basis points spread. But that spread is starting to unravel. And just what that means, is that what you're seeing in the credit markets is people are rushing to US sovereign debt, bringing yields lower, and I'm saying in relative terms, relative to the riskiest corporate debt, high yield and junk bonds. And that's just showing that people are starting to be very fearful of defaults in the credit markets.

And so, if you follow, this is one of the things I follow, also part of my 20-point model, is the spread between the 10-year note sovereign US debt, and the two-year note. That's been inverted for quite some time now. And it actually went to an inversion of 50 basis points not too long ago. That's the steepest inversion we've had since the early eighties. And we still are inverted today by about 25, 30 basis points. So a recession is here. A recession in a more intense variety is coming. And I think the first part of 2023 is going to bring an exacerbation of that freezing or that stress in the credit markets, which will eventually lead to a genuine Powell pivot. As I talked about in segment one, a Powell pivot is when The Fed cuts rates significantly, like they did in the year 2000. They had to cut rates by 525 basis points. They did it again in 2008, all the way back to zero this time, in 2008.

They did it in 2019. They went from two and a half down to one and three quarters before COVID hit. Then they returned to zero and went to unlimited QE. Those examples, those examples are examples of real and genuine pivots, Dennis. A pivot is not raising rates by 50 basis points instead of 75. A pivot isn't going from $47.5 billion a month in quantitative tightening to $95 billion a month in quantitative tightening, which Powell said will last to two, to two and a half years in duration. That came out of his mouth in the press conference. Nobody's talking about that. Two and a half years, so that you're over a trillion dollars of base money supply is supposed to be burned in 2023. You will definitely... I can't guarantee anything. I look at putting the odds of investing in my favor and in my client's favor.

You are most likely going to freeze the credit markets again, and that is not good news for stocks. Like today, we have the stock market loves the fact that new home sales, month over month, plunge 12 and a half percent. They love the fact that the flash S&P Global combination index, so the combination of services and manufacturing indexes compiled, called the composite index, plunge to minus. It's below 50, 44. They love that fact. Why, Dennis? You say, "Why would the stock market go up?" Because they believe that's going to lead to a Powell pivot. You will probably hear Friday, at the Jackson Hole speech, from Jerome Powell, there is no such pivot coming until the credit markets freeze. And that is not good news for the stock market.

So very soon, bad news in the economy, which you are going to get in spades, you are going to get a plethora of bad economic data, both in the United States, in Europe, the UK, China, Japan, you pick the country, Turkey, you pick the country. You're going to get a plethora of a parade of bad economic data. That is just going to be bad news for stocks, because the cavalry isn't coming. They cannot pivot, not with inflation four times higher than their ridiculous 2% target.

Dennis Tubbergen:

So, Michael, in the first segment, you suggested that stocks, I believe you said maybe 30% plus downside from here, after the correction we've already experienced. Is that a fair statement to say that that would be your forecast?

Michael Pento:

Okay. So, this is a news flash for you, Dennis. I'm not God. But I will tell you that stocks, in my opinion, and that's how I'm investing, are headed lower. I think they're headed much lower. A 30% figure that I stated, was just a mathematical determination based upon putting the total value of equities, as a percentage of the economy, back to 100%, which historically, is still high. And that assumes that GDP, the denominator, doesn't fall, and that's not going to happen. So, GDP is going to fall in nominal terms, in my opinion.

So, 30% is an indication of how far we have to fall just to be reasonably valued, as far as that ratio of total assets, total market cap of GDP as a percentage of the underlying economy. Now, I think you could go much lower than that. That depends on when Powell actually pivots. And that's determined by when the credit market freezes. So, it might be 20, it might be 30, it might be 50. I can't tell you, but I will tell you this again, that the stock market today at 170% of GDP, is not in any regards reflective of the underlying conditions of global central banks tightening into a worldwide recession.

Dennis Tubbergen:

And Michael, when you quote that 170% figure for market cap to GDP, I think, and this is off the top of my head, but aren't those valuations still higher than they were at the peak of the tech stock bubble a couple decades ago?

Michael Pento:

So, the peak of the tech stock bubble was 140%. You are exactly correct. 140%. In March of 2000, the total mark gap of equities was 140% of GDP. In 2007, before the stock market dropped by 50%, until March of 2009, that figure was 104% of GDP. So, when people say, "Mike, Mr. Pento, you should 30% decline. You're a permabear," listen, ask my clients if I'm a permabear. It's just not true. I've been long, many times in the past. And correctly so. Long, in a net sense in the portfolio. I'm just telling you, Dennis, and your clients, and anyone else who's listening, that if you think at 170% of underlying GDP, that this market is pricing in anything but a perfectly soft and innocuous landing from The Federal Reserve, it's already priced in, that almost impossible feat of unwinding three of the greatest asset bubbles in history.

And I'm just naming three, stocks, bonds, and real estate. I'm not including SPACs or Bitcoin or any of the other ridiculous bubbles out there. I'm just saying that the big three, if you think that The Federal Reserve has any history of unwinding an asset bubble innocuously, you'd be wrong, except for maybe 19... They like to point to the early eighties, as an example of peak inflation being great for stocks. Well, in the early eighties, the P/E ratio was 7.7 times. The price to earnings ratio was 7.7. So, we're not there yet. Now we're 21 and a half times, trailing 12-month earnings in the S&P 500. So, we're not even close to that. Oh, by the way, the total market cap of equities back then was 35%, as a percentage of GDP. So, the valuations are insane, and they have to come down. And it's my job as an investment advisor to first protect our investors, principle, and then to safely ride asset bubbles higher when the liquidity and macroeconomic conditions are correct. And right now, they are a 400 mile an hour headwind.

Dennis Tubbergen:

So, Michael, in the time we have left, we've talked a bit about stocks and you're talking about this grand reconciliation of asset prices. What do you think that means for real estate moving ahead? Is this going to look like 2006/7 all over again?

Michael Pento:

Well, I don't think it's going to look... Let me just tell you. It's not going to be as bad, probably, as 2006 to 2008, in the real estate sector before home prices dropped, I think it was 33% annually, nationally, because the underwriting standards are better this time around. However, I hasten to add that the home price to income ratio has never been higher. So, the rate of increase in home prices, in nominal terms, is off the charts. And even as a percentage of income, it's higher much higher, today than it was in 2005, 2006. So, could you get a correction of 20% in the real estate sector? Absolutely. And that is going to be a function of how deep and how long the recession lasts. So, I would not be at all surprised if it's 20%, not 30%. But really, 20% haircut in the principle of a person's home is going to put a lot of homeowners, a lot of mortgages, underwater, once again.

Dennis Tubbergen:

Well, my guest today has been Mr. Michael Pento. He is the host of the popular podcast, The Mid-Week Reality Check. You can learn more about the podcast and Michael's work at pentoport.com. Michael, always a pleasure to have you on the program. Love to have you back for an update down the road. And thank you for joining us today.

Michael Pento:

Always a pleasure, Dennis.

Dennis Tubbergen:

We will return after these words.