Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
Market-Ticker.org

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Dennis Tubbergen:

Welcome back RLA Radio. I'm your host, Dennis Tubbergen, joining me once again on today's program is returning guest, Karl Denninger. Karl is a prolific commentator on the healthcare industry, on politics, on the economy. Karl has a very unique background that I will share with you here. You can read his work at market-ticker.org, market-ticker.org. And on the landing page, there's also a link that says, "Click For What The Media Does Not Want Published." He's got some alternative content there as well, that I'll let him explain. But, Karl, welcome back to the program.

Karl Denninger:

Oh, thank you for having me on Dennis.

Dennis Tubbergen:

So, Karl let's jump in, because as we were chatting before we started to record our conversation, I think you used the term that, "Inflation is the 800-pound gorilla in the room." It seems to me that the Fed is taking action, that is really more form, than it is substance. What's your take?

Karl Denninger:

No, not for long. I mean, they certainly have been hoping since last Summer that inflation would be as Jerome Powell said at the time, transitory and mild. Of course, what they've gotten over the last six months has been anything, but transitory and mild. And this is showing up in places that cannot be ignored and has very little evidence that it's actually going to snap back the other direction. So, I have long said that we have lived in an extraordinary time since the 1980s. A period of time when interest rates inexorably went from the upper right, or the upper left of the page to the lower right, okay? And it's been the case for 40 years now. What this has made possible, is all manner of distortion. And the reasons for this are very complex and multi-faceted.

Karl Denninger:

One of the things that has occurred, is that it has made possible setting up companies that actually don't produce anything, they're a cash furnace. And yet, they show great earnings and fantastic internals. And yet, I can literally in that environment, set up a company that does nothing, but borrow money, burn some percentage of it, pay myself, pay a group of people to sit in a room and issue financial statements every quarter. And this will continue to work and show fabulous numbers, right up until that trend runs out, because I never pay the debt off. I just roll it over and finance it. And every time I do, it's cheaper and therefore, the covering costs for however much money I had out originally, is less. Therefore, I can take out more to continue to pay the salaries and I pay less in interest. And I haven't actually manufactured a single thing, right? During this entire time.

Karl Denninger:

And this has been the world that every single investment professional alive today, is operating in. So, all the advice you're hearing from these people, and there's a handful of folks, that have been in the markets for more than 40 years, but you can count them on the fingers of your hands. Everybody else has lived... That's all they know. And if you believe that this can continue, when it obviously can't, you can't go below zero. And now, you have the other problem, which is that we have avoided the inflationary impact of our economic policies, because of the trade balance. Because we shifted things offshore. We shifted textiles offshore originally, that was one of the first big ones that went. The entire textile industry in the United States was destroyed and shipped over to Vietnam and wherever else, okay? Laos and all these other places.

Karl Denninger:

You look at your clothing labels, manufactured in Vietnam, manufacturing here, and manufacturing. None of it says, United States. Then, of course, electronics and all other manner of mechanical things went to China, along with other places. We moved all of our auto-manufacturing, the vast majority of it to Mexico, and a lot of the parts sourcing coming from China on that as well. And all of this was done with these macroeconomics, so-called experts, who all claimed that the cheaper labor in places like Mexico, as soon as we did this, the labor costs would normalize with the United States. You would create a huge consumer economy in Mexico that would be buying the cars and trucks that were assembled in Mexico, because wages would go up to equalize with the United States. And as a result, this was going to be good for everybody, because it would grossly expand the market and at the same time, here we are.

Karl Denninger:

Well, that didn't happen. It didn't happen with cars. It didn't happen with electronics. It didn't happen with anything. What happened, is that the governmental forms that have always been used to essentially, treat human capital as slaves, was maintained. The wages, they continued to be suppressed. Environmental destruction became part and parcel of how you got cheaper products, okay? Whether, it be in Mexico, and you just look at the sewage outflows, just South of our border from Mexico, compared to the same thing in San Diego, where it has to be treated. And then, of course you have all the stuff over in China, to make one EV battery for one electric car, you have to dig up half a million pounds of earth, half a million. Now, that's just for one battery, okay?

Karl Denninger:

And then, of course, you have to process everything, which takes all noxious chemicals and nasty processes that we won't allow to be done in the United States, because the cost of treating that material, so it doesn't destroy the environment's too great. China doesn't care. So, this is what we've done. And people think this is about a Petro dollar, or some conspiracy theory. It's not, it's simply this. If I sell you something as a Chinese manufacturer, or as any other manufacturer, it takes three months for that thing to be made, put on a boat and shipped to the United States. During that period of time, I haven't been paid yet, because a product isn't here. As a supplier, you want to be paid in a stable currency. And if the most stable environment for value is US dollars, that's what you're going to demand.

Karl Denninger:

And what that does, is take the credit that is created from deficit spending in the United States Federal Government and sequesters it overseas. And as a result, you don't see the inflation. Well, when we turned around and sanctioned Russia and said, "All your dollar assets belong to us. And oh, by the way, we're going to name individual people." We'd done this with Saddam's people in Syria and little companies and little nations that have no international trade impact. All of a sudden, we take one of the largest industrial producers of things like potash and other things that go into the products that we have to have, fertilizers, rare earths, the copper, all the stuff that goes into things that we build. And we turned around and we upset that Apple cart. And so, now, if you're a producer, what do you want to be paid in? You want to be paid your local currency. You don't want to be paid dollars anymore. Otherwise, it might be stolen.

Dennis Tubbergen:

Yeah. So, Karl let's jump in there, because we talked about this on the program a couple weeks ago. It seems to me that this is going to do nothing, but accelerate inflation, because all of these countries around the world that now are bypassing dollars in international trade, they're not going to roll over their US treasury holdings.

Karl Denninger:

Well, they may, or may not, but it doesn't matter whether they do. I mean, obviously, if they don't, then yeah, then it accelerates it further. But the important point that everybody has to take from this, is that we essentially, defrauded the American public by doing this and claiming we could issue this credit, that we could have the government, the Congress. And folks, this is not the Federal Reserve, this is Congress. Your congresspersons are the ones who did this, that they can spend money, they didn't tax, just because they want to. And every time they do that, every time there is a deficit at the federal level, it is directly inflationary somewhere.

Karl Denninger:

And what we have done, is isolate the impact of that overseas through trade policy, that is now over, and it's not going to come back, because we have now decided that we can deem that those funds, that somebody is going to trade in, to not be theirs. We essentially, took property rights and turn them on their ear and said, "No, if your government does something, we don't like, not you personally, but your government does something we don't like, we're going to confiscate your property."

Dennis Tubbergen:

Yeah. And then, I think, when you look at what's happened historically, this is a line that hasn't even been crossed in total war time. And yet, it's really changed the dynamics of world economics, just in the last couple months.

Karl Denninger:

Well, it's a pure act of insanity, when you think about what's really going on here over in Ukraine and Russia. Russia produces gas, which Europe became dependent on. This was warned against, 20 years ago, "Don't do this, okay?" But, in the name of green energy and whatever have you, they did this, okay? They shut down their own power plants. France has natural gas resources. All of Europe has coal resources. Germany has a crazy amount of coal and resource. That's how they ran World War II, for crying out loud. Hitler used, what's called the Fischer–Tropsch process to produce synthetic fuel from coal, which is, I mean, we've known how to do this now for 70 years, but it's not green enough. So, we're going to buy Russian gas. Okay. So, you now have Ukraine and Russia, they're at war. They're trying to kill one another. Ukraine is where the pipes go through. So, if Russia is Ukraine's mortal enemy, tell me why Ukraine hasn't shut the valves on those pipes?

Dennis Tubbergen:

That's a great point. That's a great question.

Karl Denninger:

Right? I mean, come on, the pipes go right through their land, okay? And how is Putin getting the money to conduct the war? He's selling gas. Well, why would you give money to the guy who's trying to kill your people? Is that nuts?

Dennis Tubbergen:

So, Karl, let's go back to the economic part of this. And we've got just a couple minutes left in this segment. Do you see then, this whole Russia Ukraine situation will obviously, accelerate inflation with a lot of the things that have happened with the Russia now requiring rubles, or gold from unfriendly countries with whom they trade. But my question is, do you have a sense as to how much worse inflation gets, not only as a result of FED policy and deficit spending, but also as a result of the geopolitical situation?

Karl Denninger:

Well, I don't think the geopolitical situation is driving the majority of it. I think, it's essentially, that has pointed out the craziness of using dollars as an international exchange mechanism, which is, it's over, that's not coming back. That egg's broken. The additional problem is that the Federal Reserve has to step on this and step on it hard, because it is not just inflation today, it is the expectations of the public. And when you look at the most recent GDP report, when that first came out, I said, "We have a serious problem here, because the average consumer has lost 3% in real terms, purchasing power, even though they saw raises." Well, that doesn't go on for very long before the people at the bottom end can't eat and that generates civil unrest and ultimately, very bad things. So, they will stomp on this. People think that they won't, because the market must be protected along.

Dennis Tubbergen:

Well, we're going to have to leave it there. My guest today is Mr. Karl Denninger, his blog can be found at market-ticker.org, that's market-ticker.org. And I'll return after these words with Mr. Karl Denninger.

Dennis Tubbergen:

I'm Dennis Tubbergen, you are listening to Retirement Lifestyle Advocates Radio. I'm talking today with Mr. Karl Denninger. His website is market-ticker.org, that's market-ticker.org. And then, Karl, let's just pick it up where we left off at the end of the last segment. As inflation accelerates... I mean, John Williams of Shadowstats.com says, "Our current inflation rates about 17%." If we use the inflation calculation methodology that was used the last time, we had inflation this high. And that's really, as you pointed out, that when interest rates started to fall, how high do you think it gets? And where would you say we are realistically, today, as far as inflation goes?

Karl Denninger:

Well, I disagree with Williams, in that, he's been putting up numbers like that for the last 15 years, or so. And if that was the case, then the average price level would've been up by a factor of about 300% by now. And that obviously, hasn't happened. So, I mean, you can take something that looks awfully good in the present tense, because it serves as confirmation bias. And when you run it backwards and you take a look at the claims over the space of some period of time, you go, "Wait a minute. There's something wrong here." On the other hand, the CPI index that's produced, is deliberately gamed and transparently, so. I mean, one of the biggest ones and one that I've been screaming about for a couple of decades is Owner's Equivalent Rent, which is a cute way of hiding the impact of housing cost increases in homes that you own.

Karl Denninger:

So, in other words, a house you buy, whether it's mortgaged, or not. And essentially, what it does, is it depresses the price intentionally, as long as interest rates continue to go down. So, for the last 30 to 40 years, hasn't this been convenient? Because Owner's Equivalent Rent is of course, tied to what it would cost to borrow the money, if you were renting the house to somebody else. And what happens when interest rates go up? So, OER is due to have a rather nasty thing happen to it, somewhere in the future. The problem with inflation, is that once it gets ingrained into people's minds, it drives decisions. And when it is on the cost side of the equation, it's especially nasty, because it takes just as long for it to go away, as it does for it to start.

Karl Denninger:

So, I track the PPI much more than the CPI, because the PPI gives me about six months' worth of lead time, in terms of where it's going to go on the CPI. And the PPI has been screaming that we're in trouble since last Fall. And gee, here it is, right? So, there you go. But, today, one of the biggest issues that we have, and it's going to be very difficult to solve, with the political environment we have today that says, "You may not drill. You may not have oil. You may not have gas. You may not have pipelines." Is that the price of diesel fuel has gone through the roof. And absolutely everything in our economy, gets moved in the last mile by truck. So, every single thing you buy, is going to get hit by this. And the only way to stop it, is for that price to come down.

Karl Denninger:

And that means that the things that have been done by the current administration, including shutting down the leasing on federal lands, Keystone. Everybody says, "Oh, that's just a drop in the bucket." Yes, it is a drop in the bucket. However, the basics of commodities are this. If I want to burn one million barrels of oil today, whatever I have to pay for the last one, is what they all cost. And that's how commodities always work. It's always been that way and it will never be different. So, we have to make a decision as a society.

Dennis Tubbergen:

So, you mentioned Karl, I want to go back, because I made a note, you said something in the first segment that, we've had 40 years of really declining interest rates, which is created an artificial environment. I think, you used the term all manner of distortion. Let's expand on that a little bit and talk about how that might relate presently to where stocks and real estate are.

Karl Denninger:

Well, it's rather interesting with what you've seen over the last 30, or 40 years. When my parents bought their house, it was right around 1960-ish. And it was built. The lot and the house cost about $20,000. Now, interestingly enough, of course, 25 years, 30 years later, that was worth a whole lot more, right? But was it really worth more, in terms of hours of work? In other words, my father went to work every day and earned a paycheck. Well, if you price things in hours of work, did it take him more hours of work, or less hours of work to earn the house, in say, 1980, as it did in 1960? Well, that's a good question. And that's how we really ought to take a look at things, because it's not how many dollars you have, it's what they buy.

Karl Denninger:

And when you can borrow at an ever-cheaper price, what ends up happening, is that I have a house, I'm incentivized to borrow against it, against the so-called increased price. I feel wealthy and I spend that money, but I'm really not. Because the cost of what I buy with the money goes up. And then, on the back end, what happens is that the assessor comes along and says, "Oh, by the way, that $20,000 house, worth 100 grand." So, your property taxes go up. And what I had warned him, when I was running my company, was that, although this looked really great from his point of view at the time, what he had to be very careful of, is that between the tax increases, that all of this alleged gain that he was getting, was going to get swallowed over the next 10, or 15 years. And as a result, he really made nothing.

Karl Denninger:

And that ended up being exactly the case. So, there is a real problem here, in that you have this unnatural acceleration of so-called value, its really price, it's not value. And we're already seeing it crack in some places. Around where I live, there's a true craziness going on, right? This is an area that does not support 3000 square foot houses, that cost $750,000, it just doesn't. You don't have people that can make 200 grand a year, okay? Just, the number of jobs that support that in this county, it's non-existent, unless you happen to own a business. And that's not an extravagant mansion. You're talking about a very nice-sized place, or a 2000 square foot house, that's three bedrooms, two baths for 400 grand. Again, where are you going to get a 125, 150 grand worth of income to support that? Around here, there are very few jobs that provide that.

Karl Denninger:

So, the problem, is that eventually, this rolls over. People, coming from New York, they buy these places, they pay cash, everything looks fine, except the next buyer has to show up. And now, we have just in this immediate area, a builder who has new construction that has gone up on the market 309 for 2100 square feet. And there's a guy with a, for sale sign up on his yard, about a quarter of a mile down the road from me, that thinks he's going to get 420 for the same space, not going to happen.

Dennis Tubbergen:

So, Karl, it seems like, we're starting to see the cracks in the foundation of the real estate market, to use that analogy. I mean, foreclosures are now accelerating. We've seen interest rates spike from under 3% on a 30-year mortgage, to over five. And of course, there's a bit of a time lag from the time interest rates go up until the time we see it really affect the real estate market. I mean, is it your view that we're going to see real estate and maybe stock roll over this year?

Karl Denninger:

Yeah, I think they're both done. And the biggest problem for people in the equity market, is that everybody says, "Well, it comes back and therefore, just sit on it." Well, it's true, it eventually always does. The problem is the word, eventually, okay? If you take a look at what happened to equities in the 1960s and the 1970s, you sat on that for 20, 25 years, that for most people, is beyond the horizon in which they're going to need the funds, okay? And the same thing happened in the 1930s. So, anybody who thinks this can't happen again, is wrong. It can happen again. And the fact that we've had these periods of time, where the recovery has been two, or three years, like we had with the tech crash. And then, we had, after the housing bubble blew up, has... And again, we have no institutional memory, nor anybody in the advisory business that was around the last time, it took 20 years for you to get back to where you were.

Karl Denninger:

I have a strong suspicion; we're going to trade S&P 1576 within the next 12 to 24 months. And I will be absolutely stunned if all of the pandemic acceleration in housing prices does not come back out.

Dennis Tubbergen:

So, you're talking, a year over year, in some of the major markets, we've got housing prices up 20 to 30%. So, you're talking, maybe 40% on real estate and 60% on stocks, if I'm doing the math in my head here correctly?

Karl Denninger:

Or, worse. That's an optimistic view.

Dennis Tubbergen:

So, Karl, we've got, again, just a few minutes left in this segment. So, let's talk about, if this starts to unravel. The Fed in the past in 2018, when the market started to get jittery, they went right back to more QE, creating more currency. Aren't they going to try to do the same thing again? And in your view, will it work?

Karl Denninger:

They can't do it again, because it will immediately reflect back into inflation. The ability to sequester that offshore is gone, that's the problem. That's what people are not taking into account. Yes, the fed would love to do that, if they could. The problem is you don't have 10% inflation, if they do that, you have 30% inflation if they do that. And then, how do you feed people when they can't heat their house? You take a look at what's going on with heating oil. I mean, heating oil is number two diesel, okay? So, if you look at the diesel price at the pump and you take the taxes out, the road tax, which is typically about 50 cents a gallon, you take that out, that's heating oil, it's the same physical stuff. It's just dyed red, because you didn't pay the road tax on it. You take a look at the people that are still using heating oil in Northeast. And tell me what they're going to do next Winter.

Dennis Tubbergen:

Yeah. And of course, it's affecting agricultural commodities. I'm seeing $12 wheat and $8 corn. And that's likely going to accelerate.

Karl Denninger:

Well, yeah. I mean, does anybody pay attention to the fact that the things that go into fertilizer are number one, natural gas from the nitrogen, okay? Because, you have to fix the nitrogen, in order for it to be absorbed into the soil. And then, the second thing that's necessary is potash. And where is it? And the two major places where that comes from is Ukraine and Russia. Both of which, are shut down right now.

Dennis Tubbergen:

Yeah. Well, my guest today's been Mr. Karl Denninger, his website is market-ticker.org. On the landing page of the website, there's a link, "Click For What The Media Does Not Want Published." There's some alternative content that Karl publishes there. I would encourage you to check it out. Karl, always appreciate your perspective and always enjoy having you on the program. I always get terrific feedback. So, thanks for joining us today.

Karl Denninger:

Anytime, thank you very much.

Dennis Tubbergen:

We will return after these words.