Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: A. Gary Shilling
Insight Newsletter

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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 Dr. A. Gary Schilling. Gary is the editor publisher of the very popular Insight newsletter. I would encourage you to learn more about that and if you would like to learn more about the newsletter, you can visit agaryschilling.com. You can also call the number 888-346-7444. I'll give that number again in this segment. But Gary, as we noted before we started recording, certainly not dull times in which we live. Welcome back to the program.

Gary Shilling:

Oh, yeah. Well, that's what keeps guys like me and you in business, Dennis. Obviously, if everything were going smoothly, who would need astute commentators like you and forecasters like me. But there's plenty going on right now and obviously we're looking at a huge problem in the banking area. The real question, of course, is first of all, how far it's going to spread. Secondly, what regulators are going to do to try to continue to arrest it. But more importantly, what are the ultimate effects on investor behavior, investing, consumer spending and the economy?

Dennis Tubbergen:

So, Gary, let's dig into that because we had Silicon Valley Bank followed by Signature Bank, followed by First Republic, followed by Credit Suisse. Where is this going to end in your view? I mean, is this a problem that runs extremely deep in the banking sector?

Gary Shilling:

Yes, I think it does. It had its origin after 2008, the financial crisis. The Fed engineered low interest rates and that reflected low inflation for a number of years really up till the pandemic hit in 2020. During that time, the Fed was flooding the economy with money, other central banks the same. We also had the bailout money coming in relation to the pandemic and all this money really floated around. It went into two areas in this country principally. One was single family housing, particularly as people fled big city apartments during the pandemic and went to suburbia and rural areas. But also, of course, it went into huge speculations and the money was so readily available, venture capital was surging and of course, this led to tremendous growth in bank deposits. It dulled any sense of worry about bank deposits over the $250,000 FDIC limit on insurance.

And it led to a very, very relaxed attitude where in effect, depositors who had deposited more than that FDIC limit, really didn't seem to care. So we had a situation which was very, very conducive to speculation and of course there was plenty of that. Silicon Valley was sort of the center of this with all the venture capital operations and so on. But the whole thing was just wonderful until about a year ago when the Federal Reserve started raising rates and boy, that was a dramatic 180-degree shift.

Dennis Tubbergen:

So, Gary, I was kind of following what happened, probably not to the same extent you were, but it seems to me that this is a problem that at least indirectly partially was created by the Fed with these artificially low interest rates and all this quantitative easing. And now the Fed is by trying to make all these depositors whole to this point, as I understand it, they're kind of trying to solve a problem that maybe they had a hand in creating. Would you say that there's some validity to that statement?

Gary Shilling:

Oh, I think there is. I think there is. And of course, these guys are mere mortals, and they aren't inherently any better forecasters than you and I are, at least not in my view. So, you do have reactions to current situations which don't always reflect what is unfolding and of course, none of us can foresee the future with any great perfection. But I think it's fair to say that the Fed was, in retrospect at least, overly accommodative. And even more important, the Federal Reserve, you got the credit operations there, which we principally think about, but also the regulatory operations. And it's in the Fed, it's in the states, it's in the FDIC and so on. And the regulators, and I'm just writing our Insight for next month, but regulators were really asleep at the switch on this one. They had all the red flags for Silicon Valley Bank back in 2019.

They raised concerns, but they never forced any actions. The rating agencies, they were asleep at the switch as well. They were right up to the end with these bad banks, Silicon Valley Bank, Signature Bank. They were rating them as investment grade, their securities. So, you really had a pretty much universal euphoria here and very little analytical concern. And of course, ultimately you say who's going to be looking over this? I guess a lot of it really depends on individual investors and institutions and they can't really rely on regulators or monetary authorities or anybody else in a government or quasi-government position to do the job for them. Now, of course, that's pretty hard because everybody gets swept in it. You wouldn't have bubbles if you didn't have a lot of true believers. If everybody were as skeptical as I am and I think you are at times, you wouldn't have the bubbles to begin with. It's tough to fight the crowd, but that's when it's important to do so.

Dennis Tubbergen:

Well, if you're just tuning in, I am chatting today with Dr. A. Gary Shilling. He is the publisher of the Insight newsletter, which is a very extensive publication every month. You can learn more about Gary's work by visiting agaryschilling.com or calling his office at 888-346-7444. Gary, I found it I'll just say interesting, that the co-author of the Dodd-Frank Act, Barney Frank, actually helped the board of directors of Signature Bank. And I don't know if there's anything to that, but I'd just like your comment if you have one.

Gary Shilling:

Well, yeah. It's pretty common that Washington is a revolving door. That these people who have picked positions in Washington and they're not particularly well paid there, but then they go out into the private sector and really clean up. Barney Frank, since 2014 when he went on that board, has been paid 2.4 million dollars and he was a very strong advocate, not surprisingly, of easing the limitations on smaller banks. As a result of his pushing and others, they increased the limit of banks that require special supervision from 50 million in assets to 250 million in assets. Now that opened for Signature Bank and Silicon Valley Bank, that really put them in the pass zone, no real serious supervision. And so yeah, Barney Frank got his share of the loot.

Dennis Tubbergen:

Well, let me just refer listeners, as we've got about four minutes left in this segment. Many of our listeners are concerned about their bank. They're concerned about, is this going to spread? Am I going to be affected? What would you say to people that have those thoughts in their mind listening to this program today?

Gary Shilling:

Well, I think they're legitimate concerns. Now, you've already had Signature Bank and Silicon Valley Bank deposits regardless of size, basically guaranteed. Treasury Secretary Janet Yellen has basically said that they may have to step in with others. I don't think that that's a serious risk, but you do have uncertainty. You do have rigidities of the system, the problem of moving money around, particularly if things get tight. And I can tell you what we're doing in my own personal funds, our company and we manage money, the excess cash there. We're putting it into treasury bills and other safe short-term areas. I just say, why take unnecessary risks? I don't think you're getting paid for that and leaving money in banks over 250,000 or whatever an institution needs for working balances, I just don't see any reason to do it. And I think for individuals, unless you really love the bank and the bankers love you, why take unnecessary risks?

Dennis Tubbergen:

Well, Gary, we do have a couple more minutes in this segment, so let me go back and if we need to carry over on the other side here, we can. But you had mentioned that a lot of these funds really went into the single-family housing market. Can you talk a little bit about what your forecast is moving ahead for housing?

Gary Shilling:

Well, housing is very sensitive to interest rates and that's because it's so highly leveraged. You think about it, if somebody gets a FHA-guaranteed loan, puts down 3%, that's a 33 times leverage. And it means that any fluctuations in rates can make a huge difference, can wipe out their capital and certainly can discourage people who don't have a lot of excess money from going out and buying houses, incurring new mortgages. You also have a lot of people who had low mortgages from earlier, 4% or less. Well, they were at 7%. They're back to 6%, a 30-year fixed mortgage, but they're locked in. So, you have a situation in housing which may be stabilizing now, but at very low levels. And it's hard to see the circumstances, particularly given the Feds pretty much guarantee that they're going to continue to raise interest rates. They are absolutely determined to kill inflation, to knock it down to their 2% target and that process is far from completed. So, I think housing is going to continue to be under a cloud.

Dennis Tubbergen:

Well, I'm chatting today with Dr. A. Gary Schilling. He is the publisher of the newsletter Insight. You can learn more about his work by visiting the website, agaryshilling.com. You can also call his office to learn more about Insight. That number is 888-346-7444. I'll return after these words with my special guest, Dr. A. Gary Shilling.

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen, and I'm chatting today once again with returning guest, Dr. A. Gary Shilling. If you're just tuning in, Dr. Shilling is the publisher of the Insight newsletter. You can learn more at agaryshilling.com. You can also call his office 888-346-7444. And I'll give that number again in this segment.

So, Gary, prior to the break, you had mentioned that you believe the Fed is going to be resolute in continuing to raise interest rates until inflation is tamed or brought under control. How much further do you think the Fed needs to go? How high do you see interest rates getting?

Gary Shilling:

Oh gosh, they're in a 4.5, 4.75% range on the federal funds rate, which is their policy rate. They're now more talking about 25 basis points; quarter of a percentage point increases rather than a 50 or 75 basis point jumps they had earlier. But I think you could see another 100 to 200 basis point increases though. In other words, one or two percentage points because the Fed is absolutely determined they're going to kill inflation and kill it dead. And they've made it clear they don't care what happens to the economy. Well, they do care, but they are willing to see a recession if that's what it takes to get inflation down. That's their primary concern and it's damn the torpedoes, full speed ahead.

Dennis Tubbergen:

So, Gary, it seems then that, would it be correct to say that your view is that a recession is imminent, that we're going to see recession in 2023?

Gary Shilling:

Yeah, we may already be in one, Dennis. Now you never know that until way after it starts. No administration would ever want to be in the business of declaring the peak in business and onset of recessions. So, it's left to a private organization called the National Bureau of Economic Research. This is the outfit that first studied business cycles extensively going back in the 1930s. And they're the ones that date it. Now, they do not call the top until they get all kinds of information and are convinced. They never change their calls. So, they want to make sure. They're waiting for delayed data, revisions and everything else. And it's usually well into recession, sometimes even after the end of it, if it's a short recession, before they tell you where the top was. Well, that's about as handy as a pocket in your underwear from an investment standpoint.

So, you got to look at other things. You look at things like stock market, you look at consumer sentiment, new orders for durable goods, in this case, the banking crisis and so you look for things like that. I'm convinced that if we're not in a recession, we're certainly close to its onset and it'll probably run the balance of this year and into next year. I think it's going to be drawn out for two reasons. One is the Fed wants to make sure that they've done their job. In the last four cycles, they actually shifted from credit restraint to ease before the peak in business. They saw they'd done the recessionary deed; they backed off. This time, I don't think they're going to back off prematurely because they are so concerned about killing inflation.

The other delaying factor is layoffs. Layoffs occur obviously when business sales and profits decline, and they already are in that mode. But a lot of businesses are going to be very reluctant to lay people off when they've spent so much time in the last year or so hiring them. To get that mindset shifted 180 degrees takes time and real conviction. So, I think you're going to have a delay in layoffs. So, between the Fed delay and layoff delay, I think the recession will be stretching out and probably extend into next year.

Dennis Tubbergen:

Gary, I was reading, I believe it was yesterday, that credit card debt in the United States has now topped a trillion dollars for the first time. At the same time, it seems that retail numbers are down three out of the last four months. It seems like those two statistics are a bit at odds with each other. How would you reconcile those if you agree with that assessment?

Gary Shilling:

Well, consumers, if you look at retail sales and subtract inflation and say what's happening to real retail sales? What's happened to physical goods that they're buying? They actually have been declining. You had a burst in January, a back off in February. But I think consumers have been generally cautious. And of course, the fact that they are increasing their credit card debt, delinquencies rising, increasing auto loans, it suggests that people are pinched, and they don't have as much money as they had earlier. They had a lot of money earlier from the bailout money after the pandemic.

But I think the consumers are really scared and their sentiment is declining. And if you put on top of that this banking situation, and I think a lot of people are going to be a lot more cautious, a lot more concerned about the safety of their money, and they say, "Well, I've got a bank deposit I can fall back on." But if they have any concern that it may not be there, now that's regardless of whether it's going to be guaranteed by the Fed and FDIC and so on, but if they have concerns, it certainly can reflect their financial decisions and spending plans.

Dennis Tubbergen:

Well, I'm chatting today with Dr. A. Gary Schilling. He is the publisher of Insight newsletter. You can learn more about his work at agaryshilling.com. You could also call his office at 888-346-7444 to learn more.

So, Gary, with debt level's rising, I don't remember the year, but you wrote a book about the age of deleveraging and I apologize if I don't have the title exactly right, but ...

Gary Shilling:

It's a long title.

Dennis Tubbergen:

It seems like this whole deleveraging process, this getting debt purged from the system because of the Fed policy, it seems like this problem maybe has been exacerbated and this whole process is going to be more painful than maybe it otherwise would've been. Is that a problem?

Gary Shilling:

Yeah, I think that's true. I mean, these things come in cycles. I think we are in a longer term deleveraging process, but you've had recently a lot of spending really financed by the Federal Reserve largess and the bailout money. But I don't think that changes the overall trend. I think people are being more cautious. You also have other factors, demographics, aging population. People age. They tend to save more, spend less. They don't need to buy as many cars and baby equipment and so on and so forth. So, I think you got a lot of factors that suggest longer term and consumers are going to be more cautious and they're going to be saving more of their money. As I say, this banking crisis I think is a strong encouragement for people to save because they're much less convinced that the future is going to be predictable and favorable.

Dennis Tubbergen:

Well, Gary, in the time we have left, do you expect the Fed's going to stay the course and continue to increase interest rates? For someone that has money in a 401(k) or an IRA and they're in traditional investment classes like stock funds and bond funds. Let's start with bond funds. That certainly can't be good news for those investors.

Gary Shilling:

Well, yes and no, Dennis, because bonds were certainly beaten-up last year. But starting last October, bond prices, and I'm talking about treasuries, my concern is about treasuries because there you don't have the credit risk and they have actually rallied on balance since then. Prices have gone up. And why is that? Well, yeah, okay, the Fed is tightening, but on the other side is the idea of a recession which knocks down credit demand, makes treasuries more attractive and also the safe haven aspect. That's very important in terms of treasuries on a global basis. So, I think, as I say our investment themes and anybody looks at our Insight can see that, and by the way, let me say our investment themes, we did a compilation of our investment strategies which we first published there 10 months ago in May of last year, and up through February they had an increase of 8.6%.

That portfolio equally weighted all of those themes. And in relation, of course, you've had substantial declines in stocks and other more speculative areas. But anyway, I think treasuries, but we're still very negative on stocks in general. I think they've further to go down. We had predicted a 40% decline peak to trough or down about 20% so we've got another half of that to go. I think weak earnings are going to be the primary driver as well as further Fed restraint. I think the dollar is a safe haven. Things like housing, still under a cloud. Growth stocks, they're dependent on earnings way out and the discounted present value and the higher the interest rates the less that current price and value is. There are a number of things that we spell out there every month, but I think they're still very much in a cautious investment strategy mode. At least that's our view.

Dennis Tubbergen:

So, Gary, just to finish up on the topic of stocks, it seems that when you do have a bottom in the market, that you have a lot of investors throwing in the towels saying, "I'm never going to buy stocks again. I can't believe I was ever that crazy." And we don't seem to be there yet. It seems that we still have this buy the dip mentality, which a lot of times from just the people I've interviewed and the research I've done, means that there's more downside. Is there some validity to that in your view?

Gary Shilling:

Yeah. The way I put that graphically is we haven't reached the puke point. The puke point is when people want to regurgitate their last equity and swear, they'll never buy another one. And that's what you need for a good bottom, which you just articulated. You need to run out of sellers. You need to get the last seller who can be shaken out. And then you're faced with nothing but potential buyers. And that's what makes good bottoms. I'm very much in that camp that we're not there yet. I think we will get there. But you've had all the way up in terms of interest rates in the last year.

The Fed has been raising rates. They've been saying, we're going to really kill inflation. And investors periodically say, "Oh no, the Fed is almost through. They're not going to raise rates for their stocks rally." And then Chairman Powell, other Fed officials come in and really say, "Uh-huh, that's not our intention." And it's been a sawtooth pattern along a declining trend in stocks. But investors, yeah, I share that view. Investors are not yet convinced that the whole thing is over, and we do need evidence of a nice, well-defined puke point.

Dennis Tubbergen:

Well, on that note, Dr. Shilling, the clock tells me we are out of time, but my guest today has been Dr. A. Gary Shilling. He's the publisher of Insight. His website is agaryshilling.com. The phone number to learn more about Insight is 888-346-7444. Gary, always a pleasure to catch up with you. I get terrific feedback when you're on the program and I do sincerely enjoy our conversations and your perspective. So, thank you for joining us.

Gary Shilling:

I do too, Dennis, look forward to the next one. Thank you.

Dennis Tubbergen:

We will be back after these words.