Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Dr. A. Gary Shilling
A. Gary Shilling & Company, Inc.

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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 Shilling. Dr. Shilling has been a long-time Forbes columnist. He is a prolific newsletter publisher. His newsletter, Insight, is actually more like a magazine that is distributed each month. He is going to give the listeners, any listeners, that would like today, a complimentary copy of Insight. You can call 888-346-7444 to request a copy, and I'd encourage you to do that. His website is agaryshilling.com. And Gary, welcome back to the program. Always a pleasure to have you on.

Gary Shilling:

Oh, same here, Dennis.

Dennis Tubbergen:

So, Gary, you talk about the Fed's dilemma in your most recent Insight, that the Fed, if they raise rates, they almost ensure a recession or they back off and risk feeding an inflationary spiral. What option do you think they choose?

Gary Shilling:

I think they've got the bit in their mouth. I think they really, if they were approaching this without any history, they might want to hold off, particularly after the Russian invasion of Ukraine. But I think they've been prepping the market so much on the idea of raising rates. And, of course, they were behind the curve when inflation took off last year. So, they really, their reputation is somewhat at stake, too. And, of course, they hope they can pull off a soft landing.

Gary Shilling:

And by that, I mean, when a series of rate increases, from their policy rate, the overnight federal funds rate. And a soft landing's when they raise rates and then reduce them without a recession. Well, that is not the odds-on favorite. If you look back to the early '50s, when they started using this as a policy rate, more times than not, they got a recession.

Gary Shilling:

And I think now with all the turmoil of supply chain disruptions, reopening the economies after the virus and, of course, disruptions because of Russia's invasion in Ukraine, the Fed's job is much, much more difficult. So, I think to say that even though Chairman Powell says they hope they can pull off a soft landing, I'd say, "Lots of luck, buddy."

Dennis Tubbergen:

Well, yeah, Gary, when you take a look at inflation, and the methodology that's been used to calculate the inflation rate has changed over the years, it just seemed to me that a quarter-point rate hike was the equivalent of using a garden hose on a forest fire. Do you agree?

Gary Shilling:

I agree with that. I like that analogy. Yeah, I think it is. And I don't know why they get themselves locked into this. I mean, gradualism usually doesn't do the job in many, many, many, many fields. I mean, whether it's in military, whether it's in finance or whatever. Because what happens is everybody adjusts to it and it doesn't have the impact that you want. I mean, there are times, like in the late '70s, early '80s, when inflation was raging.

Gary Shilling:

And it's very interesting. Paul Volcker was Fed chairman then, and he went to Europe and wanted the European central bankers to support the dollar, and they said, "Oh no, Paul, it's your problem." And so, he came back and convinced the rest of the Fed policy committee to tighten credit. They didn't want to raise rates, but, of course, it's the equivalent, and they got interest rates up to almost 20% and that did the job. But that's very much the exception.

Dennis Tubbergen:

So, Gary, when, when you, when you take a look at the... There's a couple ways I want to go here, but let's start with inflation. Because I'm sure you know what the actual inflation rate is, as reported by Chapwood Index or ShadowStats. They're saying that calculated the way inflation was at the time Volcker actually made those decisions. We've got 15% inflation. Let's start with the fact that, do you agree with that assessment?

Gary Shilling:

Economists call that growthmanship. Growthmanship. You can prove almost anything by picking the endpoints, by redefending, redefining the spectrum. You throw out what you don't want in order to prove your point. I don't find that a very fruitful approach. I mean, when you get inflation up into double digits, hey, it's pretty difficult, because in the past has encouraged inflation or expectations, and that's much more important to me than the inflation rate.

Gary Shilling:

Now, what I mean by that is people say, "Wait a minute, prices are going up. I better buy goods ahead of need to beat price increases. So, everybody does, inventories are depleted, capacity is strained, prices go up. Everybody says, "Hey, suspicions confirmed. I'll buy even more." And the thing is self-feeding. Now that's what happened in the late '60s and '70s. We don't have that now. It's interesting when you look at the data the surveys made by the Michigan, University of Michigan and the Conference Board, the New York Fed, all these, sorry, the Wall Street Journal, they all show that yeah, people worry about inflation one year out, but that's pretty normal.

Gary Shilling:

They project their current situation. But when they get out three to five years, they're looking at inflation rates more like, two or three percent, much different than it was in the past. In other words, there hasn't been those inflationary expectations. And it's interesting, it's ironic, right up until the pandemic, the Fed was worried about quite the reverse, self-feeding, deflationary expectations, where people hold off waiting for lower prices and it feeds on the way down. So, we've had 180-degree change. I wouldn't really want to be a Fed policymaker now. I think these guys got a big problem.

Dennis Tubbergen:

So, the Atlanta Fed came out and adjusted their first quarter GDP growth rate to zero. So that tells you that they may be looking at that we're in a recession. You, just a minute ago said if they're looking for a soft landing, good luck with that. Are you predicting a recession and…

Gary Shilling:

Yeah. Yeah, yeah, I am Dennis, and I've been mentioning it in the last couple of months of our newsletter. And just as very clear statistical evidence, in the third quarter of last year, the real GDP, in other words, month-over-month, annual rates taken out inflation increased 2.2%, 2.1 out of the 2.2 was because of inventory building. And in the fourth quarter, the number was 6.4, and 4.9 of that was inventories.

Gary Shilling:

Now those inventories, I feel, a lot of them were not really desired. Everybody thought they were going to be short of Christmas gifts. They brought in a lot more, and we're bringing a lot more inventories from Asia as those ships get unloaded in California and moved inland. And I think that we... If you had a reversal of what happened in the third and fourth quarter, you'd be down by, you wouldn't be flat, you'd be down in terms of the economy, economic growth by a couple percentage points. And I don't think you should be surprised if that turns out to be the case.

Dennis Tubbergen:

So how severe do you think this recession becomes in your view?

Gary Shilling:

Well, that's a tough question. Because recessions have a lot of features. They historically have had these inventory buildups, and then liquidation. When you're liquidating inventories, you're not producing because you're meeting orders out of past inventory holdings, not new production. So that's always a feature. But, of course, we had in the, after the financial crisis, you had this huge collapse in housing. Housing's a small sector. It's only about 6% of the economy, but in that recession, accounted for about two-thirds of the decline in economic activity.

Gary Shilling:

Now, I don't think we have that extreme this point, at this time, but we've got a lot of other things out there. There's been tremendous speculation going on. Fed's been fueling the economy since 2008, and even more so in reaction to the pandemic. So, you've had a lot of money floating around there. This has created tremendous speculation. You look at cryptocurrencies, you look at these SPHCs, you look at coins, Bitcoin, et cetera, a lot of speculation out there. What I'm getting at, we could have a considerable recession here, probably more on the financial side than on the goods and services side, but that's still pretty tough for investors.

Dennis Tubbergen:

Well, if you're just joining us, we're chatting today with Dr. A. Gary Shilling. He is the publisher of the newsletter, Insight. Our listeners can get a complimentary copy of his newsletter by calling 888-346-7444. And Dr. Shilling's website is agaryshilling.com. Gary, just to go off on a little bit of a tangent here, and you mentioned it in your March Insight, gasoline prices, obviously, are the big headline in most households today. That's the topic of conversation? Where do you see gas prices going?

Gary Shilling:

Well, they probably aren't going to go down with any appreciable amount until the economy gets soft. Now, the modern catch phrase for this, Dennis, as you know well is, demand destruction. In other words, prices get high enough, people can't afford it. They drive less, they make more trips with other passengers, et cetera. So, you do have a reaction. And, of course, that's detrimental to the economy. But gasoline, it's tough to say because we don't really know what's going to happen with Russia.

Gary Shilling:

And, of course, all the plans to reinvigorate US production, frackers, and gas from Qatar and other places, these take time. So, it's possible you could have a considerable further spike in gasoline prices before this whole thing unwinds. But I think the ultimate result is going to be a recession. And, of course, gasoline is very important, as I point out in that March Insight. Because people buy it frequently enough.

Gary Shilling:

They remember what they paid the last time. I mean, you look at something like a water heater, you remember what you paid the last time you had water in the floor, in the basement, and you had to get a water heater? Probably not. It may be 10 or 15 years, and you don't remember that. But gasoline, when you're tanking up at least once a week, you do remember. So that makes it a lot more psychologically important.

Dennis Tubbergen:

Well, my guest today is Dr. A. Gary Shilling. His website is agaryshilling.com. You can get a complimentary copy of his excellent Insight newsletter by calling 888-346-7444. I'll return with Dr. Gary Shilling and continue my conversation with him after these words.

Dennis Tubbergen:

You are listening to RLA Radio. I'm your host, Dennis Tubbergen. I have the pleasure of chatting with Dr. A. Gary Shilling today. Dr. Shilling is the publisher of the newsletter, Insight. If you're just joining us, you can get a complimentary copy of his newsletter by calling 888-346-7444. And his website is agaryshilling.com.

Dennis Tubbergen:

So, Gary, you mentioned in the last segment, just to pick up about where we left off, that you're forecasting a recession. You also talk about, in your March Insight, that in your view, the housing market looks vulnerable and certainly we're seeing mortgage rates tick back up. So how do you see that playing out in a recession?

Gary Shilling:

Well, weakness. I mean, housing has been supported by several things. One is low mortgage rates, which you pointed out. One was people with the pandemic leaving cramped city apartments, moving to the suburbs or rural areas, with more room for home offices or homeschooling of the kids. And the third one was the stimulus money that was pumped into the economy in reaction to the pandemic in 2020 and last year. Now, those factors are largely gone, and you point out mortgage rates are rising and housing is very expensive.

Gary Shilling:

I think we are going to see a lot more weakness in housing. It's already started. If you look at existing home sales in February, they were down 7.2% from January. And I think we're going to see a lot more of the same. Because people cannot afford the mortgage rates, they're priced out of the market, there's been a mad scramble. It has had some of the self-feeding aspects of people coming in with their checkbook and outbidding each other.

Gary Shilling:

This is not the bubble we had with subprime mortgage-driven housing. That was absolutely insane and collapsed into the financial crisis in 2008. But it certainly is a problem. And as I say, a lot of people, when you look at where have they accumulated assets in the last few years? Well, it's been stocks and owner-occupied housing. Those have been the big factors. And if they're in trouble, a lot of people are going to have to pull on their horns.

Dennis Tubbergen:

So, Gary, you're not thinking we're going to see a decline like we saw, then, in 2007, 2008. You're thinking it's going to be more mild.

Gary Shilling:

Yeah. I mean, back then, house prices declined by about a third. I would look more like 10, 15%, but still, that's a lot for somebody that's highly leveraged. Because think about it, people don't normally look on housing as highly leveraged, but if you put down 3%, which you can with a FHA loan, and borrow the rest, you've got a 33 to one leverage. Now, normally people say, "Well, that's fine, because house prices rise and you're going to live in a house." But that didn't happen in 2008 when they collapsed. A lot of people learned what leverage is on the downside.

Dennis Tubbergen:

So, Gary, let's shift a little bit, because often when we see real estate decline, we see stocks decline at the same time. In your view, did we see the highs in the market at the end of 2021?

Gary Shilling:

Yes, I think we did. I think we did. I think we're in the opening stages of a bear market. And if you look back historically, bear markets associated with recessions, I think the average decline of the S&P 500 was 37%. Now we're not down, close to 10% so far. So, I would say this is in the opening stage. Because I think we are in for recession this year. And we're seeing... When the Fed raises rates, you almost always get a recession. When the yield curve inverts, when short rates jump up more than long rates, you get a recession. You got a lot of things here that suggest this is almost inevitable.

Dennis Tubbergen:

So, Gary, how much stock do you put in the stock metric, if you will, that's referred to as the Buffet indicator, market capitalization over GDP which, obviously, reached levels that were significantly higher than in 1999, which, obviously, preceded the tech stock decline. Do you put a lot of stock in that, and do you think we could see a decline of that magnitude?

Gary Shilling:

Well, it's one indicator and it makes a lot of sense, because it basically says, how much are you willing to pay for the total output of the economy? Now, the output of the economy's got a lot of pieces. It's got government spending, and their consumer and business spending, the foreign sector and so on. So, it's a pretty broad brush approach. But I think it's one of the many indicators that say that the stock market is just out of hand.

Gary Shilling:

Another one that I like is one put together by a friend of mine, Robert Shiller, Nobel Prize-winning economists from Yale. And he looks at stocks in relation to earnings, not in the future, but over the last 10 years. And to run out the cyclicality. And right now, to get stocks back to their long-term average in relation to earnings, you'd need a 55% decline in prices on the S&P 500. And markets usually don't just stop at the trend line, they go below. So, you can look at a lot of things, but I think that Buffet's measure or Shiller's cyclic-adjusted PE. They're a lot of them, and they all tell you that stocks are very overpriced.

Dennis Tubbergen:

So, Gary, if we could look at one element that's often used to talk about economic health, the unemployment rate is pretty decent. How accurate do you think that figure is? And how many people have left the workforce? Give us your take on just the employment picture.

Gary Shilling:

Well, the unemployment rate is, and there're a whole bunch of measures, but the headline number is fairly misleading because here's how it's defined. They look at the people who are looking for a job, actively looking for a job. And this is a survey. In other words, they got to say, "I'm looking for a job," and then, that's the numerator. And the denominator is those people plus the people who are actively employed. That's how they define the unemployment rate. So, it can change dramatically, depending on what's happened.

Gary Shilling:

If you have fewer people employed, the unemployment rate goes up. If you have more people looking for a job, it will go up. And I think right now, it's very confusing, because you've had a lot of people who dropped out of the labor force. You look at the people who are retired and there are about a half a million people more since the pandemic who have retired than the normal trends would suggest.

Gary Shilling:

So, you have a lot of things going on. And, of course, you had all the subsidy payments in reaction to the COVID. So, I'm not sure the unemployment rate tells us a lot. Because I think what we've seen is a lot of people who really were on the sidelines, but now they've run out of money, they haven't got the resources. I'd rather suspect a lot more of them are going to be forced back into the labor market and we'll see the unemployment rate rise because of that.

Dennis Tubbergen:

Gary, in your March Insight, and I'm just going to read this. You say, "There's no limit on federal government borrowing. That's the message of modern monetary theory, which maintains there's plenty of money to fund virtually any level of federal deficits and debts, and that the federal government never defaults." What's your take on MMT?

Gary Shilling:

I'm no fan of federal deficits or debt. And for one reason, I think that the government is inherently inefficient. There's no bottom line, there's no pressure for efficiency. So, government spending, I think is inherently inefficient. Now, there are sometimes when you get into a deep recession and so on, where you really do need that help. But yeah, I just think that right now, there is no practical limit. Now, that article that you cite, we went through a whole bunch of calculations and analytical exercises to say, what would it take? What would it take to get to the point that you did have a problem?

Gary Shilling:

And I define that as a debt bomb, a point that the debt is so big, that interest on the debt, which is, of course, a big component of the deficit, simply grows geometrically. And the way it turns out, just looking at numbers, we would have to have basically a quadrupling of the interest rate average that the Fed, that the Treasury pays on its debt. It now pays 2.1% of GDP as the interest on the debt. It would have to go to about 8% before you got into what I call a debt bomb.

Gary Shilling:

Hey, how would you get there? You'd have to have a collapse of confidence in the federal government or inflation in double digits. Could happen, but I don't think so. So, the only thing I think may happen is that, as the interest rates go up and it does get more expensive, we won't have a debt bomb, but we could have a lot of concern in Washington, in administration, whoever's in the White House and Congress, realizing that this is really just getting out of hand.

Dennis Tubbergen:

Well, Gary, in your newsletter, you talk about, as part of this whole analysis, you talk about the growth in entitlements. We've got a debt of over 30 trillion. What could happen between now and the time that this theoretical, hypothetical debt bomb were to occur to allow us to reverse course? Isn't that going to require some type of fiscal responsibility on the part of the politicians?

Gary Shilling:

Yeah, I think it will, Dennis. Because if you look back historically, the debt, and you always have to look at debt in relation to something else. And I look at it in relation to the size of the economy, GDP. Well, what happened after World War II, with a war, that debt, in relation to GDP, shot up to 104%. Now, it's subsequently declined to about 35%. They didn't repay the debt; it was just the economy grew. In other words, this is a ratio of the debt to GDP. Historically, and that's the only instance we have where that happened.

Gary Shilling:

But I just don't see that kind of growth in GDP. I mean, that was really the aftermath of World War II. All the veterans came home. We had a housing boom, a catch-up spending, because all the production had gone to the military in World War II. Very little spending on housing, et cetera, during the '30s, the Depression. So that was a pretty unique era. I just don't see this going away anytime soon. It might be arrested if there's enough nervousness in Washington, but boy, that hasn't happened yet.

Dennis Tubbergen:

Yeah, not even close yet, has it? Well, my guest today has been Dr. A. Gary Shilling. If you're just joining us, I would encourage you to get a complimentary copy of his newsletter, Insight. He's been gracious enough to offer a free copy to any listener that would like one. You can call 888-346-7444 to get one. His website is agaryshilling.com. I'd encourage you to check that out as well. Gary, always a pleasure to catch up with you, and always appreciate your insights, if you'll excuse the pun.

Gary Shilling:

Well, I always enjoy talking to you, Dennis. You're one of the greater, greatest interviewers that I have the privilege of working with, and I always look forward to it.

Dennis Tubbergen:

Well, you're very gracious and I thank you for that. We will return right after these words.