Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
Market-Ticker.org

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Dennis Tubbergen:

I'm Dennis Tubbergen. You are listening to Retirement Lifestyle Advocates Radio. I'm pleased to welcome back to the program Mr. Karl Denninger. Karl is a prolific writer. He's written some books. His thoughts on a daily basis can be read at Market-Ticker.org. I follow his work. I would encourage you to do that as well. Again, the website, Market-Ticker.org. Karl, welcome back to the program and thank you for being here.

Karl Denninger:

Oh, well thank you for having me on Dennis.

Dennis Tubbergen:

So, Karl, we're in an election year. Stocks are going to go up. We're going to have a bull market. Right?

Karl Denninger:

Uh-uh. And let's see, the last two crashes, when did they happen? I think they were both election years. That'd be 2008 and 2000.

Dennis Tubbergen:

I think you're right. But what do you think of all this bullishness that exists? The Fed's going to cut rates this year, and that's going to mean stocks go up. What's your take?

Karl Denninger:

Well, where did anybody actually hear the Fed say they were going to cut rates? The funny thing is is.that that's what the market has taken from these meetings, but I haven't actually seen that from... you could say, well, the dot plot. The dot plot is a projection. It's not a statement. It's not a promise. By the way, it tends to move a lot over time. That's why it's called a dot plot. But the real question is from a inflation and similar point of view, where is the belief that other than from demand destruction, that the inflationary impulse is actually gone?

Certainly, if I look at the PPI, which leads the consumer price index, because that's from people making things the production side, and it takes time to show up on the shelf, where I'm seeing the decline is in trade and transportation and warehousing. Well, that tells me that we've got profound economic softness. That's why you have basic supply and demand. You have falling prices because you have less demand. That's how this stuff works. And then I look at things like the New York and Philly Fed Index, and they're not so robust either. So, I don't see... What I see is the leading edge of a recession. If the Fed cuts rates because there's a recession that's not usually good for stock prices, is it?

Dennis Tubbergen:

Correct. I think the last several declines in the market have occurred when the Fed has started cutting rates, which they typically do in response to exactly the conditions you just outlined.

Karl Denninger:

Yeah. Certainly, there isn't a strong indication of this yet in the labor market. We had the labor report that came out. Now, there was a rather ominous piece of information in there in that December is usually not the firing month. It's usually January. And January is also a difficult month to read because it's the rebase month. It's when the department of the Bureau of Labor statistics goes through and adjusts all their metrics. So, there are frequently dislocations in the data in January that make it somewhat tough to get an apples-to-apples comparison.

And in some cases they're severe enough adjustments that it's basically impossible. But we saw, in the household survey, we saw a very large negative print on the unadjusted numbers, and that's actual number of people working. Now, if you have two jobs in the establishment survey, you get counted as two people working because one employer does not know that you have a job with the other one.

And they ask how many people do you employ? But in the household survey they call people and they say, do you have a job? Well, if you say you have two jobs, you still count as I've got a job. So, you count as one. And if you don't have a job, you count zero. And in the household survey we saw well over a million people fewer working in December than January, and that's a problem. Because the third week is the sample week, and that is before Christmas. So, these were people that got laid off or fired in front of the holiday.

Dennis Tubbergen:

Interesting. So, Karl, what does all this mean for stocks? We've got listeners that aspire to a comfortable stress-free retirement. They have money invested in IRAs and 401Ks. Many of them follow index investing in stocks. What do you think their portfolios look like at the end of the year?

Karl Denninger:

Well, I think they look really good at the end of the year, but I think you need to be a little bit cautious at this particular point because valuations are usually a decent predictor of forward returns over time. And a few years ago, being in short-term treasuries, it didn't make it... Yeah, your money was safe and you can get any return on it. That's not true today. Today you can do, five, five and a quarter easily in a managed, in an ETF type of product from essentially any of the mainline brokerages.

And those are a hundred percent daily liquidity, all in the short end in treasury. So, they carry no rate risk. And that's the alternative that you can be in. You can park your money there and make your 5.1 or 5.2, and you can, if you're willing to do the work yourself in Treasury Direct can get into the five three area. But for a lot of people, they're like, Hey, I'll give the guys 15 or 20 basis points in order to take care of handling that rollover every four weeks or 13 weeks.

And frankly, I think for most people, if you've got to actually go out and work or whatever, yeah, okay, would I rather have the 15 basis points? Sure. But is that a reasonable price for the service? Yeah, it is. And so, I don't have any quarrel with that. I've got an awful lot of money stuck in those right now simply because I find valuations unattractive at these prices. And it's not that I necessarily think everything is going to go down the toilet on me, it's that looking on a forward basis, I am never going to wake up in the morning and find that 20%, or 10%, or even 5% of my treasury-only money market fund is gone. Okay.

At the worst case is I wake up and rates have come down and well, it's not making 5%, now it's making three, and I sell it and put it in something else. Whereas, on the other hand, if you're in a stock fund or if you're in individual stocks, you could wake up one morning and very easily find that that is in fact the case. And there's absolutely nothing you can do about it. 5% or 10% of the value is just vaporized.

Dennis Tubbergen:

So, Karl, assuming we get a stock market correction this year with valuation levels this high, and I happen to agree with you, I think the Buffett Indicator is now at its second-highest level of all time. Do you think that U.S. Treasuries become a safe haven again and we see yields come back down? How do you think this plays out?

Karl Denninger:

It's tough to tell because part of the problem you have is that there's... So, there is a basic concept that you have within the treasury market and that the primary dealers, which are all large banks, they have the obligation to bid on treasury auctions. And people seem to think this means that the automatic thing that happens is that that is going to drive rates down rapidly and violently. What people forget is that the obligation to bid does not mean at what price.

Dennis Tubbergen:

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

Karl Denninger:

Yeah. They're obligated to bid, but nobody said at what number. And so, what those guys are going to be looking at is first off, what can we sell off to our clients in the secondary market? Because that's what they do with most of these things. They buy them. They don't sit on them. They sell them to their clients. But the other question is, what is a client expecting in terms of forward inflation? Because we have just gone through a twenty-year period where the real rate of interest to borrow money and do things, for an awful lot of people, certainly not if you're running up credit card debt.

But for an awful lot of people, especially in the industrial area, that real number has been negative. And that is now, if you believe the CPI, it's not negative now. I don't happen to believe the CPI. But at the point that currency, money actually has a cost to borrow, a real cost, pretty much all of these little games that go on where people, oh, well, we'll just double into this because we're getting paid to do it. That all comes to an immediate end, and that's what's driven an awful lot of this expansion that we've seen over the last really over 20 years.

And we're now at the point where you have two exponential curves, the one on the bottom, the debt side. When you start doing this, you start this kind of a policy. It feels really good because the gap between the two grows for a period of time. During that time, everyone feels great. And it's kind of like starting to use hard drugs. It feels great when you start, but what comes later is not so good. And we're now in the phase where those two lines have converged and crossed. And so, at a certain point, this becomes uneconomic. And I think we've gone a number of years past the point where that should have corrected. The pandemic certainly didn't help things because they threw money at the problem. And now the question becomes, well, can we keep the plates in the air or are they all going to come crashing down? And I just don't like being on the side of the table that says, oh yeah, this is an indefinite forward thing. There's never going to be anything that goes wrong here.

Dennis Tubbergen:

So, Karl, we've got a couple of minutes left in this segment. We are in an election year, as we said at the outset of this segment. Do you think we're going to see more stimulus, more goody bags, if you will, for the electorate? And what does that do to the deficit and how does that affect the bond market?

Karl Denninger:

So, there's a lot of political strum and fear right now. There is a growing group of people in the Congress who are saying, this insanity must stop. A few years ago, there was none. Now there is a... It's not growing fast, but it's growing. And you just had another CR that was put up after the new speaker said there weren't going to be any more CRs. That was obviously a lie because now it has happened.

So, at some point, fiscal responsibility is going to have to come back into the game. And I don't know when it happens. I think an awful lot depends on what happens in November, of course. But if you go around and you talk to people and you look at the polling data, which is... And polling data is notoriously inaccurate. But if you actually talk to people around you and you're not one of those people that has their own private Learjet, I think you'd be hard-pressed to find somebody who doesn't think that the higher prices they're paying for car insurance and groceries and things like this are good.

I think you'd have trouble finding, someone that says, oh, that's not a big deal. That doesn't really matter. The fact that my grocery bill's doubled in the last three years is no big thing. I think everybody is saying, yeah, it is a big thing. And historically speaking, in elections, no matter what the pundits try to tell you, everyone votes their wallet. And I think most people, when they look at their wallet, it's thinner than it was.

Dennis Tubbergen:

Well, we're going to have to leave it there for this segment. My guest today is Mr. Karl Denninger. His website is Market-Ticker.org. That's Market-Ticker.org. I'd encourage you to check it out. I'll continue my conversation with Karl when RLA radio returns. Stay with us.

I'm Dennis Tubbergen and you're listening to RLA Radio. My guest on today's program is returning guest Mr. Karl Denninger. You can read his work at Market-Ticker.org. That's Market-Ticker.org. I follow his work regularly. I would encourage you to do the same. And Karl, we were chatting a bit before we started recording today about electric vehicles, and I think you used the term EV scam. Let's jump in. Can you explain?

Karl Denninger:

Yeah. I did use the term scam. So, there's this thing called the Cafe Standard. Most people have probably heard of it. It's a fleet standard for fuel economy that the energy department, the EPA have, and has been adjusted many times over the years, always higher. And the premise behind this is that if your General Motors or Ford or Chrysler, or whoever, you make vehicles and your entire fleet is supposed to have equal or better than a particular number of miles per gallon, a certain amount of fuel efficiency. If you fall short, you have to pay a fine. And the fine is determined by how short you are. Well, if people like buying big trucks which don't meet the standards. The more trucks they buy as opposed to nice little small cars, the bigger the fine is. That's not so good. So, what's happened is that electric vehicles, of course, don't use gasoline or diesel fuel.

So the energy department comes up with an efficiency standard end to end for an electric vehicle by looking at, okay, I got to generate the electricity, I got to deliver it down the wire to where the person charges, whether the house or one of those superchargers, whatever, they put the power in the battery, and then they drive the vehicle, and we can calculate the thermodynamic efficiency of this entire process from one end of the other, turn that into BTUs, and then compare that against the fuel efficiency of a gasoline-powered car. Because energy is energy. We're just using different forms to turn the wheels.

Well, so when you look at this, a Tesla Model Y ends up, in reality, at about sixty-five miles per gallon equivalent to gasoline. Well buried in these regulations, thirty-seven thousand pages into the Federal Register, by the way, where they hope nobody would find it, is a multiplier of 6.67. So, the compliance value of the EV is not sixty-five miles per gallons, it's 430 miles a gallon. And why is that important? Well, because Ford sells F-150's, they can either pay the fine or they can buy the credit from somebody who has much better than the mandated mileage. They get a credit that they can sell to someone else. It's a tradable commodity. So, Tesla has sold an awful lot of these credits and pocketed an awful lot of revenue, and they sell it at a price that's a little bit cheaper than the fine, which Ford, General Motors, and

Chrysler all gladly buy because Well, that way they don't have to pay the fine. They have the credit, they can offset it.

Dennis Tubbergen:

It's a business decision. It's cheaper to buy the credit.

Karl Denninger:

Oh, absolutely. It's a pure business decision. If I can buy a credit for a dollar and the fine's $2, well, okay, that's not very difficult to figure out what I'm going to do. Right?

Dennis Tubbergen:

Right.

Karl Denninger:

All right, well, the problem is now this is out in the public, and as it turns out, the way the law's written, you're not allowed to do this. So, this is now going to get challenged. There will be lawsuits over this. This is going to upset the apple cart in all probability because Congress would have to go back and specifically authorize this chicanery, which I sort of doubt they're going to do. And if they don't do it, then you'd expect this would get clawed back because it was never legal. Yeah. Good luck. In the world we live in today, that kind of justice never happens, right? Amazon did the same thing with sales tax and captive LLCs with their warehouses. And you would've thought that the states would've clawed back all their retroactive sales taxes. Well, they didn't, but Amazon ultimately did have to start collecting them, which is why when you buy something on there now, it's charged.

But even if it just ends up with this ceasing, when EV makers build these cars, it's not just that nice credit you get, the $7,000 for buying it or whatever it is. The price of the vehicle also reflects the credit that gets generated by making it. So, if that car, without the credit, was $50,000, with that credit out of the picture, it might be 55 or 60. And that's absolutely. Now what's the take rate? What choices do people make when, oh, now wait a minute. Excuse me. How much? So yeah, this has the potential to completely upset the apple cart. And then you have all the issues that people are running into that they're now discovering, oh, by the way, you can't charge lithium battery packs in under freezing temperatures.

And so, when it's very cold, the pack has to be preconditioned first so that it's above that temperature. Well, if it's negative 10 and the wind is howling and you're outdoors, you don't have a garage, you may not be able to draw enough energy from the system to be able to heat the battery pack to the point that you can charge it and you end up with a brick. And that happened to a bunch of people in Chicago here just this last week. So how practical are these vehicles in the real world when you get away from the, I'm saving the planet virtue signaling stuff and into actual economics. And the answer is, well, we made them look a whole lot better than they really were with this scheme, with these credits. And now that appears that it's going to go away. And so I think this changes the entire economic picture for EVs.

Dennis Tubbergen:

Well, and Karl, the pendulum already started to swing the other way. Ford has cut back their production. People are not buying EVs. And I've talked to a number of people here in the last few months that have gone from a pure electric vehicle to a hybrid vehicle because they found for the way they used the vehicle, the EV just was not as practical.

Karl Denninger:

Well, yeah, part of the problem you have with the EVs is that there's always this range issue in the rate of charge, which there isn't anything you can do about. It's a matter of physics. A battery-powered vehicle has to carry the oxygen for its reaction inside the battery. And a fuel-powered vehicle gets the oxygen from the atmosphere. So, it is always going to be at a significant penalty in terms of energy density simply because you have to carry the other part of the reactant around with you in the box. And for a fuel-powered vehicle, that's not true. And that's a huge difference. If you think about what do you end up with at the end of this CO_2. Well, that's one carbon, two oxygens. Well guess where the oxygen came from? Out of the air.

In a battery-powered vehicle, you're still creating a what's called a redox reaction. It's basically the same sort of chemical reaction, except the oxygen has to be inside the case. So, you got to cart it around with you, and there isn't any way to get around that. And then of course, the other thing is it takes you forty-five minutes or an hour to charge it at one of the supercharger stations, whereas, I can put 500 miles worth of range in my gas car in five minutes at a pump. So is there a market for them? Yes, there is. There's a market for a high-performance sports cars, too. But do you want a high-performance sports car when it's snowing to beat the band and it's 10 below zero outside? Don't think so.

Dennis Tubbergen:

Right. So, Karl, with these developments, how do you think that impacts the broader economy? How do you see that impacting where the U.S. economy goes? It is obviously going to be another drag.

Karl Denninger:

Yeah, I think it's pretty significant because so much of this, so-called transition to green energy doesn't work on mathematics. You wouldn't have put a 667% multiplier into the regulations if the math worked without it. You just wouldn't.

Dennis Tubbergen:

That's a great point. That's absolutely good.

Karl Denninger:

Yeah. And do you like buying power out in California where it's 35 cents a kilowatt-hour and here in Tennessee it's 10? Well, I don't think so. Up in Michigan where you are, I mean, the average up there I think is 13 or 14 cents. Why would you pay double for the same thing just because you want to claim, well, I'm saving the planet. Well, okay, maybe you are and maybe you're not. And we could have that debate, but I'm going to stay out of the political side of it and just look at the economic side of it.

If you take the economics, the cost-shifting out of this, that $80,000 Ford F-150 becomes 65 or 70, and the Tesla isn't 35 or 40, it's 55. Now, does that shift demand? I think so. And then you have to look at the rest of the industry spread that has gone on with regards to a lot of these energy projects. They're very expensive. They employ people. But do they actually make economic sense? I think the answer is no. And driving costs up, that's an inflation driver. Wouldn't you like to see those inflation drivers go away? Wouldn't that help the economy in general? I think it would.

Dennis Tubbergen:

Absolutely. So, Karl, what's that because we've got a couple minutes left in this segment. Do you see this really coming to a head this year in 2024, or what's your take on timing here?

Karl Denninger:

Well, I don't know that the whole green energy EV thing blows up in everybody's face this year necessarily. But now that this is out in the public, I'm sure there's going to be... It's become a campaign issue. I don't think there's any way that that's avoided and exactly how that all plays out and when is a little unclear. But I do believe that we're going to see some economic earthquakes this year simply because the squeeze is still on. People are saying that, well, the headline CPI inflation number is coming down, and in a few places it is.

But where I'm seeing it come down on the input side, on the inlet side is in demand destruction. And that's being signified by the fact that those deflationary impulses are showing up in trade and transportation. And that tells me that you've got a demand problem. So basically, people, even with all the credit that's available, they're running out of money, and that means slack demand. That's going to mean unemployment is going to go up. You're going to see firings and layoffs. And into the maw of an election, that's not going to be a very popular thing for anybody to be running on.

Dennis Tubbergen:

Well, my guest today has been Mr. Karl Denninger. His website is Market-Ticker.org. The website again, Market-Ticker.org. Karl, thank you for joining us today. Always enjoy the conversations we have here. I know the listeners do too. Love to have you back down the road.

Karl Denninger:

You bet. Anytime.

Dennis Tubbergen:

We will return after these words.