Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

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

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Dennis Tubbergen:

Welcome back to RLA Radio. I am your host, Dennis Tubbergen. Joining me once again on today's program is returning guest Dr. A Gary Shilling. If you're a longtime listener, you'll recognize Dr. Shilling as the publisher of the widely read newsletter Insight. It's a monthly publication that is more like a magazine. I would encourage you to check it out. You can get more information by visiting agaryshilling.com or by calling his office at (888) 346-7444. I'll give that number again before this segment is over (888) 346-7444. Gary, welcome back to the program.

Dr. A. Gary Shilling:

Always glad to be with you, Dennis.

Dennis Tubbergen:

So, Gary, give the listeners your assessment of the health presently of the US economy. Are we in recession? Are we headed there? What's your take?

Dr. A. Gary Shilling:

A lot of people are hoping that it's a soft landing, but we Americans tend to be perennial optimists, so you expect that. And also, you got to recognize that most people on Wall Street are paid to be bullish, particularly on stocks. So, you got to take that with a grain of salt. The economy is really growing slowly, whether it's going to tip into recession or not remains to be seen. But there are a lot of very reliable recessionary indicators out there. Things like the index of leading indicators, things like stock prices and housing starts, things that normally precede the economy, they've turned down. The Fed, the Federal Reserve, raising interest rates as it did, that's almost always a prelude to a recession. And by the way, the normal, the average, if you look at the last seven recessions, the Feds started to raise interest rates 26 months before the onset of the recession.

Well, it's been 24 months since they started raising rates. That was back in March of 2022. So, we're right up to the point where at least historically on an average basis, and it varies of course, you would say the economy is due for a downturn. And you look at other things, you look at consumer intentions to buy houses and cars, that's declined. Consumer confidence is 20% below where it was before the pandemic. Small business. Small business is a very good indicator of the economy because small businesses tend to be thinly capitalized and it makes it very sensitive to economic conditions. And their intentions to hire have declined. And then you look at labor markets, they're starting to ease. People are staying put, they're not

quitting the way they were earlier because. They’re not sure that jobs are available.

There are a lot of these indicators now. It doesn't guarantee that we're going to see a recession in the sense that total economy will turn down, but it certainly points that way. And there's a lot of historical evidence, the idea of a soft landing, well, by my reckoning, the only one that we've had in the entire post World War II period was in the mid-nineties. And I defined a soft landing as a time when the Federal Reserve raised rates and then lowered them without the economy turning down. If they raise them, you don't know what's going to happen until they raise them. They maybe just have jacked them up and then paused and then going to push them up higher. It's only when they then actually turn from tightness to ease that you can say they've affected a soft landing. And the only one in the post-World War II period was in the mid-nineties. So, the odds are very much in favor of recession.

Dennis Tubbergen:

Well, if you're just joining me, I'm chatting with Dr. A Gary Shilling. He is the publisher of Insight. You can learn more about that terrific monthly publication at agaryshilling.com or call his office at (888) 346-7444.

And Gary, back in December, chairman Powell said that rate cuts are on the table. Maybe it was a head fake, but he kind of didn't really reverse course, but said maybe we'll put it off for a little bit. What's your take on what Fed policy will be for the rest of 2024?

Dr. A. Gary Shilling:

Well, I think the Fed intends to cut rates at some point here. They seem to signal that they're through raising them, but how soon they're going to cut them, what they say and what markets have perceived, are very different. If you look at their numbers and the last published version was in December, they looked at three cuts this year of a quarter of a percentage point in their policy rate, the overnight federal funds rate. Now the markets have been ensuing six or seven cuts, and it's interesting that there was a widespread belief that the first one was going to start in March. And then a couple of weeks ago, Fed Chairman Powell came out and said, "No, that's not on the table." And boy, it caused a momentary setback in the optimist views.

But the Fed is in no rush. And I think there are a couple of reasons that they are no rush to cut rates. One is that you had so much tightness in labor markets earlier, that all the hiring has created a mindset where businesses don't want to turn around and fire people even though their sales and profits

are soft. It takes time to shift gears 180 degrees, particularly after they had so much pain and expense and trouble hiring people. So that stretches it out. And the Fed, I think, is not going to do anything until they see considerable softness in labor markets. It's starting to be there around the fringes, but not substantially.

The other reason is that the Fed was very slow to recognize the burst of inflation in early 2022. As a matter of fact, they didn't start raising rates until March of 2022, and it was only three months later that inflation actually peaked. They were way behind the curve. And everybody thought that Chairman Powell was going to repeat the practice of his predecessors, Greenspan, and then Bernanke and then Yellen. And they call those the puts. The put in a sense of futures markets that you could put, you could hand off any economic problems to the Fed, that Wall Street could put their problems to the Fed. Well, that left Powell getting a late start and having that expectation there was going to be a Powell put, it left him really behind the eight-ball. So, he's had to be extra vigilant. And I think that's another reason that the Fed is going to take their good, sweet time in cutting rates. They want to make sure that inflation is back to their 2% target and sustainably.

So, I think this whole process is going to take a lot longer than even now, markets believe. And they've had some setbacks from Powell's comments that threw some cold water on their expectations.

Dennis Tubbergen:

Gary, another thing that I've been reading, in fact, I just read that in the fourth quarter of 2023, consumer debt pretty much all across the board was higher. We're seeing delinquency rates on auto loans, on mortgage loans, certainly go up. Credit card debt now, I think $1.1 trillion. Consumers continue to be adding debt and at some point, it seems that that trend will have to reverse. And isn't that also recessionary just by its very nature?

Dr. A. Gary Shilling:

Oh yeah, very much so. And Dennis, matter of fact, I'm just this morning, I've been writing about that for our March monthly newsletter Insight. Because consumers have been, they have been in effect living beyond their means. They have been borrowing, they've been running down the savings that, all the checks they got back during the pandemic. They've run up credit card debts, and of course they now have run out of that ability and there's $1.3 trillion in consumer debts as of last October. They now are being forced to be repaid. So, I think we're going from a period where

consumer spending was rising faster than incomes, to the reverse of that where people are going to be retrenching. So yeah, I think this has gotten to the turning point and consumers account for 70% of total economic activity. So, if consumers switch from exuberance to caution, it makes a huge increase for the total economy.

Dennis Tubbergen:

Gary, I think the other proverbial elephant in the room is US government debt. I was reading that the US government has to refinance between 8 and $9 trillion of debt this year. And of course, as we all know, the deficit still looks pretty big. What impact do you think that this US government, that's really a ticking bomb? I mean, at some point this can't continue. How do you see this end game playing out and how does that impact the economy?

Dr. A. Gary Shilling:

Well, matter of fact, we've written in our previous Insight newsletters numerous times about what we call a debt bomb. And that's the condition in which the interest on the debt gets so big that the interest adds to the debt, and it grows exponentially and the whole thing blows up. Now, we've never been there in this country, thank goodness. And to get there, I think it would take a very high interest rates on a sustained basis to push the interest on the debt to astronomical levels. And how will you get there? Well, it would take, I think, double-digit inflation over a number of years. So, you'd roll over the government debt to higher interest rate costs, or a complete collapse of confidence in the Federal government and the treasury. Now we've got an advantage in this country that we abuse, and the treasuries are pretty much the premier security in the world. Everybody wants them.

So, we can, and we're issuing debt in our own currency. So, US has the opportunity to be really exercise very little discipline relative to other countries. But I think that debt bomb is out in the future. It could happen, but it isn't there. And the idea of people say, well, you're going to have to pay it off eventually. Well, that's true if you think the country is coming to a grinding halt. I think people confuse a family with the total economy. The family, you start out when you're young, you're borrowing a lot of money to finance cars and kiddie equipment and houses and so on. And then later on you accumulate assets. The kids leave for college, take their tuition payments with them and so on, and you accumulate assets, and you end up paying off debt and end up with a positive net worth. That's true of a family, but it's not true of a country. Unless you think the country is going to come to a grounding hall out there somewhere in the foreseeable future, you don't have that generational kind of progression.

So, I'm no fan of government debt and deficits because I think a lot of it goes to finance unproductive activities, but in terms of it really turning into a collapse, the idea, well, our grandchildren are going to have to pay it back. I don't see that as an absolute necessity. I wish it were true, but it's not.

Dennis Tubbergen:

Well, my guest today is Dr. A Gary Shilling. If you have not checked out his Insight newsletter, I would encourage you to do that by visiting agaryshilling.com or calling his office at (888) 346-7444.

We will return after these words.

Dennis Tubbergen:

I'm Dennis Tubbergen and you're listening to RLA Radio. My guest on today's program is the publisher of Insight newsletter, Dr. A Gary Shilling. You can visit his website agaryshilling.com and learn more about Insight or call his office at (888) 346-7444. And Gary, let me talk just a little bit, there's a lot of noise being written out there about the BRICS coalition starting with Brazil, Russia, India, China, South Africa. Now we've got the oil producing countries of Saudi Arabia, Iran, United Arab Emirates that are part of BRICS. To what extent do you think that will impact the desire for US treasuries internationally, if at all?

Dr. A. Gary Shilling:

Well, treasuries are one of the few safe havens and the only one of any size. I mean, you could say, well, Swiss francs are very safe, but it's a small economy, small market for Swiss francs. So really there isn't much choice except the dollar and treasuries. I mean, China would like their yuan, their currency, to be an international currency, but they want to control it. And international investors are just not interested in controlled currencies. The British, they ran the world in the 19th century financially, but that's history.

I mean, the Japanese, they do not want the yuan to be an international currency. So, there's really no option in the dollar. You may say it's the best of the bad lot. It's the cleanest sock in the laundry. It's the tallest midget. It's the slowest falling rock. But whatever it is, it's the best of a lot. So, you really do have this tremendous advantage. And as I say, I think we abuse that. We take advantage of this international zeal for the dollar and for treasuries, but that's the way the world is.

Dennis Tubbergen:

So, Gary, you mentioned in the first segment that stocks, the market was pricing in six or seven cuts. Powell came out and really put that to rest, that maybe that's not what they're looking at. Yeah, we've got stocks at new all-time highs, and it just doesn't seem that stocks should be at those levels given some of the economic news that is out there. In past interviews you've not been overly bullish on US stocks. So where do you stand right now on where US stocks go for the rest of 2024? What are you telling your subscribers to Insight?

Dr. A. Gary Shilling:

Well, I'm suggesting that they're way overpriced if you look at stocks in relation to earnings. One of the ways I like to look at it in terms of is what's called cyclically adjusted price earnings ratio, developed by a friend at Yale. And it really looks at stock's earnings on the S&P 500 over the last 10 years, adjusted for inflation. And this is Bob Shiller at Yale who developed this. But anyway, if you look at that, stocks are about 45% higher than their long-term average. And that average goes back to 1880. Now you can say history's no longer relevant, but as Sir John Templeton said, the most dangerous words in the English language are "This time is different." So, I think you have to be very careful. I mean, stocks are very, very expensive now, and they're expensive not only in measured in earnings, they're expensive relative to treasuries, to other investments, competing investments.

So how stocks get corrected, you never know. But if we wake up one of these days and find that a major company has gotten into trouble and that triggers a huge sell-off in stocks, I wouldn't be at all surprised.

Dennis Tubbergen:

So, Gary, given that you said stocks are 45% higher than the long-term average going back 130 years or so, if the math in my head was right, does that mean that we could see a correction here of maybe 40, 50% in your view?

Dr. A. Gary Shilling:

Possible. Possible. I mean, I've been looking for something around the 20 to 30% range, but it could even be bigger than that. Yeah, I think so. I think so. And you look also at all the speculation we've had. I mean, you look at things like Bitcoin, here's a black box, and I don't believe in black boxes, and you don't even know who created a thing. You look at all the FTX, you look at all the out-and-out speculations and fraud that have taken place. This has

been a wildly speculative kind of market, and it's reminiscent. And then there's the Magnificent Seven, these seven stocks named after the Magnificent Seven, the old movie, these seven-gun slingers that basically freed a Mexican village. Well, remember that only three of those guys survived. But in any event, the concentration of interest into relatively few stocks, I think, is always dangerous because it means that investors are telling you that they really don't like the rest of the stock market and therefore the bulk of the economy.

It's very much like the Nifty 50 back in the early 1970s. And when you got down to the fact that the only thing people wanted to buy were amusement parks, Disney, motor homes, Winnebago, Polaroid, gimmick cameras, when it got down to ... These are the outward flourishes of the economy, they're not the guts of it. And as a result, I think that period was telling you that there was big trouble for the economy. And there was. We had, following after the 1973, '75 recession, the sharpest up until that time since the 1930s. And interesting in the case of Polaroid, what happened there, they simply knocked a zero off. It went from 140 to 14.

Dennis Tubbergen:

So, Gary, let me, if I could, just play devil's advocate here for a second, US treasuries being a safe haven, I don't think there's anybody out there that would argue with that. But when you take a look at the performance of long-term US treasuries over the past couple of years since the Fed has been increasing interest rates, an investor holding US treasuries or US Treasury ETF, could be down a lot of money. What's your comment on that and do you see that changing moving ahead?

Dr. A. Gary Shilling:

Well, there's no question there's been a setback. I mean, as you know, I've been a fan of treasurys since the early eighties when the yield on the 30-year bond was 14.3%. Now it has gone below ... 14.3, it got below 3%. It's now in a 5% range. But I think that with the Fed likely to ease, with the economy softening, with inflation receding, I think we're in for another substantial rally in treasuries, meaning higher prices, lower yields.

Dennis Tubbergen:

Gary, do you have a take on commodities? Agricultural commodities, industrial commodities? What's your take on where those go?

Dr. A. Gary Shilling:

Well, commodities matter of fact, we've done some work on that. We have a chart that we show periodically, as matter of fact, I'm going to show it in this March Insight again. It looks at inflation adjusted commodity prices going back to 1700. And what's interesting is that since the mid-1800s, they've been in a declining trend. Now, there have been spikes during wars, oil embargoes and so on, but the trend has been distinctly down. And that's interesting because there's always the argument there's only so much copper in the world's surface and cobalt and iron and what have you. But the point is that commodities in the long run are a negative. A negative investment is the winner in commodities.

I mean, I can remember back when people thought the telecommunications sector was going to come to a grinding halt because there wasn't enough copper on the Earth's surface to make all the transmission lines. Well, what happened? They discovered fiber optics made out of silicone, and silicone is the second most common element on the earth's surface. And so that was the end of that scare. Human ingenuity always beats shortages, and that's particularly true in commodity substitution, new developments. Commodities are just, on a short-term basis there certainly are plays there, but on a long-term basis, commodities, they're more to be played on the short side than the long side.

Dennis Tubbergen:

Gary, we have time for one more question here. I can't believe how fast time goes when I start picking your brain, but I'm enjoying it thoroughly. Tell me a little bit about your forecast for housing. We're starting to see some slowdown around the fringes, but if we're expecting maybe lower interest rates and inflation subsiding, does that give this housing market another leg up? Or where do you see that going?

Dr. A. Gary Shilling:

Well, housing has been certainly depressed largely because of the leap in interest rates and previous overbuilding. But the rise in interest rates, it made houses more unaffordable. And it also meant as I think everybody knows, that people who had gotten mortgages before the pandemic, back when they were getting around 3%, they don't want to sell their houses and move to another house because they'd have to take out a mortgage at more than twice the yield on their current mortgage. So, they're going to stay tight. So, you have this really odd situation of high mortgage rate, yet shortage of housing inventories. It's an anomaly. Well, interest rates, 30-year fixed mortgage rates, are very much tied to 10-year treasury yields, a very close correlation. And as the treasury eases rates, inflation eases,

possible recession, those yields are going to come down on 10-year treasuries and affect 30-year fixed rate mortgages, which is sort of the standard for the industry.

So, I think we will see a revival in housing later on, but it is going to take time. It isn't something that's going to happen overnight, but I think over the next three or four years, we'll probably see a considerable revival in housing activity.

Dennis Tubbergen:

Well, my guest today has been Dr. A Gary Shilling. I would encourage you to check out his Insight newsletter. You can visit his website agaryshilling.com or call his office at (888) 346-7444.

Dr. Shilling, always great to catch up with you. Thank you for joining us today. Love to have you back down the road.

Dr. A. Gary Shilling:

Look forward to it, Dennis. Thanks for having me. Bye

Dennis Tubbergen:

My pleasure. We will return after these words.