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Conference Call

Has A Recession Already Begun?
June 23, 2022, Conference Call
(This transcript has been lightly edited)

Good morning everybody, this is Jim Bianco, welcome to the conference call. Couple of housekeeping items. As I usually do, I just minorly tweaked the handout and we uploaded it to the website about 15 minutes ago. Virtually all of you now are on the webcast. Well, I remember pre pandemic when that was less than a half, and the rest of you are on the phone. I'll just drive along. If you have any technical issues, Alex Amalitas, A-M-A-L-I-T-A-S@biancoresearch.

Otherwise, go ahead, and in the questions box, you could shoot in your questions. I'll do my best to look at them during the call, but I'll take them all after the call. Okay? Today's topic, has the recession already begun? Let me give you some highlights. Yes. I think it already has begun. Or let me rephrase that, because this is a prediction about the future, and we never really know what the future is going to be. I think the evidence is such that you have to prove to me we are not in a recession as opposed to me proving to you, we are in a recession, because we've got enough evidence now that if we actually skirt a recession, don't have one, that would be the unusual thing.

And again, it looks like it's already begun. This is an unusual, but not unprecedented one if it has begun that we still have positive labor growth, and yes, you can do that in a recession, have positive labor growth, but remember, recessions are on real growth. You have positive nominal growth because of high inflation, which includes positive jobs. But the inflation rate is so much higher that your net is negative real, which is why you have a recession, and you still have job growth. That is possible. That is not the preferred situation because it means recession, the federal state people are still creating jobs, there is still high inflation hike.

I don't mean to sound like a quarterback, but that might be what we might have wind up happening here if we're not careful. Along the lines, I don't think that the stock market ... The next question that everybody says is, "Oh, it's all priced in." I don't think it's priced in; I don't think it was close to being priced in. When I get there, I'll talk about the wipe out in the market last week, down 6% in the S&P, down 9% from the day before the May CPI, when we were all saying, "Oh, all the bad CPI was priced in, we got one bad CPI report and markets collapsed."

And we saw 70 basis point rise in the two years note in four days. And that was one of the largest rises that we've seen over such a period of time and over 40 years. You've got to go back 40 years to when you had 12 or 13% to your notes to see it rise 70 basis points of four days. No, we're not close to pricing this in. And the reason that we're not close to pricing this in is there's a lot of people that are not of the belief that this is actually happening as well.

And then at the end, time permitting, I wanted to talk a little bit about the breakdown of inflation, and I wanted to remind, not remind, I wanted to highlight some other things. I wanted to highlight some other things about inflation in that there is a strong access demand component to San Francisco Federal Reserve, did a new study that shows that it is a very incomplete statement to say, "Well, the Fed can't do anything about oil." Yes, but even if you strip all that out, we have an inflation problem.

It is not, as Lawrence Summers said this, and he's been right on this for the last 18 months, it's not possible to have this level of inflation 8.5% when it's only one thing or the other, it's only supply and or demand. It's both. And there was too much stimulus. That is a problem. with that, let me turn, and there's a question in from Charles. "Does crypto have any impair value above one?" And the answer is yes. If I get some time at the end, I'll make some comments about crypto and DeFi.

Let me go to the first question. This is the crux of the real question here, is we have an inflation problem, the Fed is dealing with the inflation problem. There are a number of people that believe, and I don't think they're wrong for believing this, it really comes down to where you think things are, the minute that the economy wobbles, the Fed will cave, they'll stop raising rates, they might even cut rates back to zero at some point, they're not as committed as you think they are to this inflation fight. They only are now because we don't have the evidence that there is a serious slowdown in the economy.

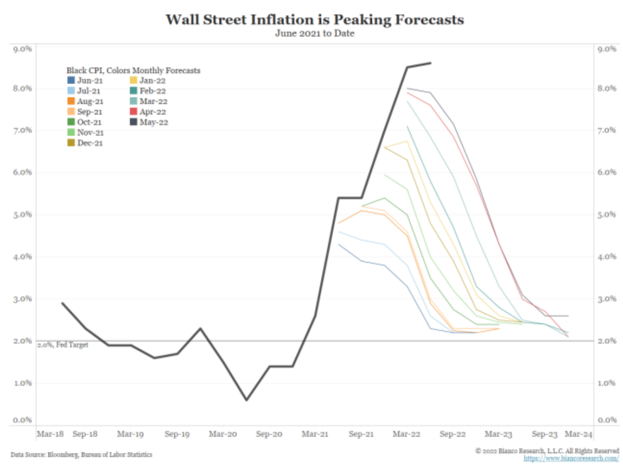
Hal said this last week at its press conference. But I will say the worst mistake we could make would be to fail, which is not an option he's channeling his Jim Lovell, Apollo 13 comment there because we have to restore price stability. We really do because everything it's the bedrock of the economy. If you don't have price stability the economy is not going to work the way it's supposed to. It won't work for people; their wages will be eaten up. I think my personal opinion is, I don't think they could be possibly clearer. They are going to break everything until inflation breaks.

And if inflation doesn't break and things are breaking left and right, they're just going to keep going till inflation breaks. Yeah, there might be a mistake, or as I've said, look, the catastrophic mistake the Fed made was last year with using the word transitory, and not admitting when we went from one and half to seven and half percent inflation in a year that there was a problem bubbling. This year is the consequence of it.

Now, I can be wrong on that, and it's a reasonable argument to say, "Yeah, the Fed thinks that now because we just printed 390,000 jobs in May, there is hope, at least among the Fed that we are going to have a softish landing and skirted recession." they could say this about inflation, that its failure's not an option, but you print negative jobs, or you print some serious draw downs in the financial markets, they will cave, and they will start printing. That's a reasonable argument.

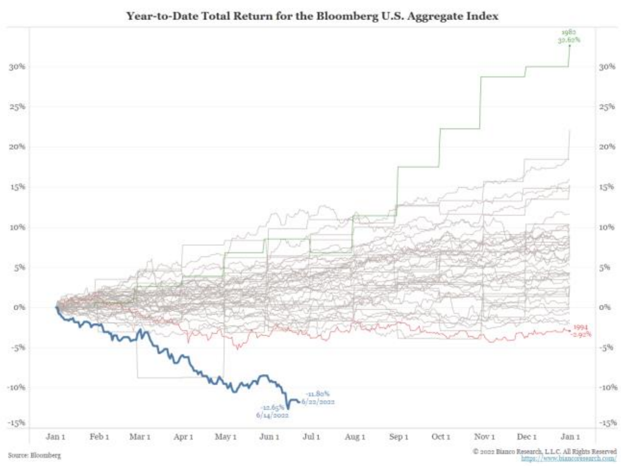
I happen to think they're not going to do that. And the reason I think that they're not going to do that is because the president essentially ordered the Fed, and the Fed believes ... The cynic in me would tell you that the most important thing to being a federal reserve official is to protect the institution itself. And they are under a severe credibility challenge right now, the institution is, because of what they've missed and where they've put the economy right now. I do think that when push comes to shove, they'll break things left and right. If you want to be a real cynic about it, they believe they can fix them after they've broken them. They know, well, we'll just print like crazy once inflation is broken.

Now the other problem we face too, is that they keep breaking things until they break inflation, and then inflation comes down, then they print like crazy to fix all the damage, and then inflation goes back up. That's the mid to late seventies. '74 we had a big high inflation, lots of things broke, the Fed ease to try and bring it back, everything back to normal. And then '78, '79 inflation rained right back up to a higher level that is a possibility we'll have to see.



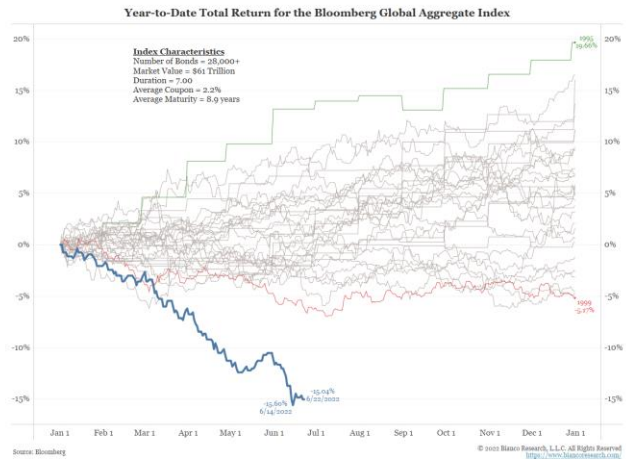
The next chart, you're looking at slide three. I draw on the line here, the black line here is the quarterly inflation numbers. where is the inflation rate on a quarterly basis? Each one of these colored lines is a Wall Street forecast by Bloomberg. Bloomberg asked about 70 economists, "Where do you think the inflation rate's going to be for the next six quarters?" And really what I wanted to point out is, when it comes to the idea that things are priced in, and I'm using the economist, but the Bank of America survey, and a lot of other things are somewhat similar to this. What has been the call throughout this entire rise? Wherever we are on inflation, it peaks, it goes down to 2% and then it's 2% for the rest of eternity.

That's really what everybody's call is, it's wherever it is, B line, straight down to 2% and then it stays at 2%. In other words, there is a belief in some version of transitory inflation. Transitory inflation means we don't have to do anything, all we have to do is wait, it will peak, it will come down and it will settle out around 2% without it being a problem. If this is the opposite of transitory persistent, if this is persistent inflation, then the only way it's coming down is, we have to intervene in the economy and make it go down. We have to tighten financial conditions, which is a fair market, we have to slow the economy, we have to force it lower.



So Really, there's a number of economists that still think at the end of the day, we don't have to force inflation lower. When I get to equity market, guys, they definitely think that. Of course, the result of this, it's been, which are now becoming very popular charts, the year-to-date numbers, this is the Bloomberg US Aggregate Index, which used to be Barclays, which was originally Lehman. When you see the stair steps, that's when they used to do it monthly. This chart goes back to 1976. There's January 1st, there's December 31st. Each one of these is a different year.

The worst year ever was 1994, at minus 2.92. The best year ever was 1982 at 32%. And the blue line shows you the absolute carnage that we've had this year, and that through yesterday, we were still down nearly 12%, 11.8% to be exact. We've never seen anything quite like this in the bond market. And part of this is, this belief in the bond market that the federal reserve is going to have no choice, but to raise rates aggressively. Now I used that chart because it goes back to 1976 to show you that we could go back to the pre inflation peak, and we still see something like that.



When we look at the Global Aggregate Index, this chart only goes back to 1990. that's when it was created, 28,000 bonds, 61 trillion in value is what this index is made up of. 1999 was the worst year down 5%, 1995 up nearly 2019, 0.7%. And we're down nearly 16% on the Global Aggregate Index year to date, nothing close to this. Of course, we don't have the late eighties or the early eighties, late seventies in this chart. Bonds are collateral, collateral money, and they're losing tremendous value. And I've argued these charts, especially this chart shows you that there is tremendous stress in financial markets. Why haven't we seen it? Why haven't we seen a failure? Look to the crypto markets.

This is the way it works, they're stressed, they're stressed, they're stressed. Then everything breaks at once. You get the Terra collapse and then you get Tether, you get Three Arrows Capital, you get Maple Finance, you get Babble, you get FTX and Sam Bankman-Fried, trying to bail out some of the lenders to make sure that they don't go under. All of that happened in four weeks. here's what's happened. The bond markets under stress, the bond markets under stress, where is it? The bond markets under stress. If it gets worse, something snaps, and 17 things go bad all at once. That was the fall of 2008.

All I'm explaining here is, this is the way stress tends to work in financial markets. When it snaps, Lehman goes bad. Yeah, there's no problem, we had the Bear Stearns thing, we've got that resolved in three days, but when Lehman goes bad, everything goes ... Literally, within an hour, we had AIG, and within a day we had the reserve fund breaking the buck. everything falls apart at the same time just because we haven't seen the big blurring breathless headline, some hedge fund has to close because of higher rates. Archegos did, but that wasn't necessarily higher rates earlier this year or some financial services firm or investment bank is going to report horrific losses.

That doesn't mean that we're still under stress and that when one comes, they tend to all come because when you stress the markets hard enough, as we found with crypto, all of the weak points become a problem at the same time, all of the weak points will become a problem at the same time. Now, with that said, let me diverge into why I think that there's a recession right now. Let me start with this chart here. This chart shows the dates that bear market started. That's a minus 20% correction on a closing basis.

Last week on the 16th a week ago today is when we closed at the lowest, a down 20% from the previous high it was about a week ago that we did it. here's the date that the bear market begins. Here's the date that the recession begins. What you'll see here is all of these numbers are days between bear market and recession, these are positive numbers, meaning that all of these are positive numbers, 95 days is the average. Meaning that the recession was already 95 days old, three months old. We were three months into the recession when we got down 20%. There were three instances of no recession after a 20% decline. The last one was the '87 crash, fell 34% from top to bottom. S&P 500 did not have a recession. And then the other two were 62 and 66.

Recessions Tend To Lead Bear Markets

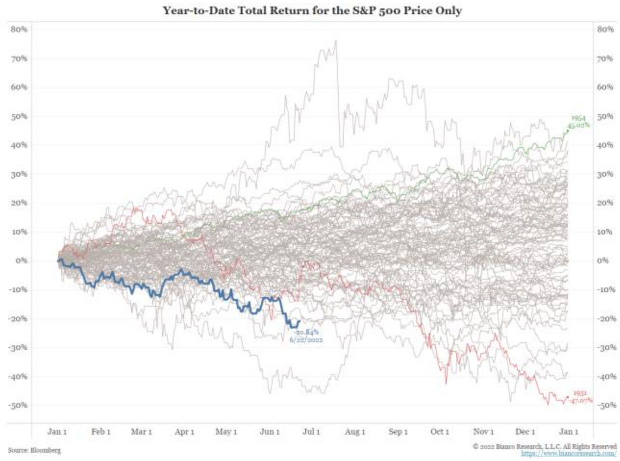
Bear Market Start Date	Recession Start Date	Days Between Bear Market & Recession	Total Drawdown
10/28/1929	8/1/1929	88	-86%
	7/1/1953	No Bear Market	
10/21/1957	8/1/1957	81	-22%
	4/1/1960	No Bear Market	
5/28/1962	No Recession		-28%
8/29/1966			-22%
1/28/1970	12/1/1969	58	-36%
11/27/1973	11/1/1973	26	-48%
	1/1/1980	No Bear Market	
2/22/1982	7/1/1981	236	-27%
10/19/1987	No Recession		-34%
	7/1/1990	No Bear Market	
3/12/2001	3/1/2001	11	-49%
7/9/2008	12/1/2007	221	-57%
3/12/2020	2/1/2020	40	-34%
6/16/2022	?	?	?
Average		95 Days	-40%

When you sum it all up, what this suggests is that there's been 11 corrections since 1929. And notice from 1929 to 1957, there wasn't one, because it took 25 years to make a new all-time high. But there's been 11 corrections of 20% or more. Of those 11 corrections, eight of them ... When the day you got down 20%, you were already in recession. Every single one of those eight, the recession had already begun from as little as 26 days or about one month in 1973 to nine months or so, 236 days in 1981 with an average in 95. And the other three, you just didn't have a recession.

And of course, there's a couple of others, 1990, 1980, and then 1960 and 1953, you had four recessions without a 20% correction. But this one, we do have a 20% correction. what is it that I'm trying to highlight here? What is it I'm trying to highlight? A 20% correction has never predicted a recession. You are already in it when you had the 20% correction. The only exceptions are when you had to use an options term, a negative gamma event, the one exception was the 1987 crash, you had no recession, 1962, the steel tariffs that plunged the stock market, 28%. You had no recession. These were cascading financial crises because of specific events or a negative gamma event if you want to think of them in options terms.

1966 was the only one that wasn't, but then that was barely a 20% correction what does a 20% correction mean? From a historical standpoint, recession's three months old, is what it means. It could be one month old, it could be nine months old, but on average it's about three months old. But the point is, it's already started.

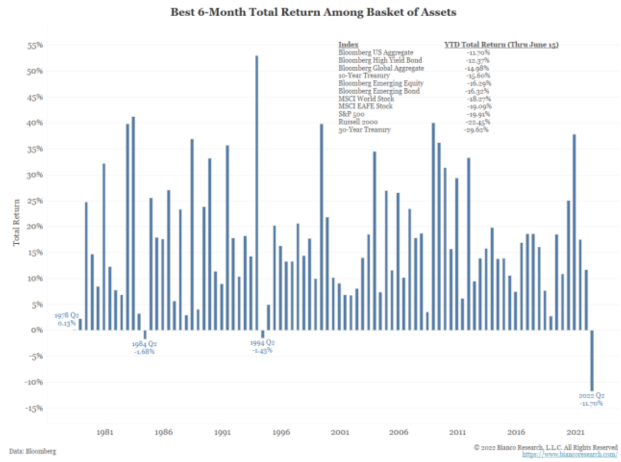
Another way to look at this here's that same chart again, goes back to 1926 for the S&P 500 price only. Why price only? Because the daily total return in this, because you only go back to the eighties. I used price only January 1st to December 31st.



The worst year in record was you lost 47% in 1953, and you made 45% in 1954. Right now, if you look at through yesterday, 1932 was worse than we were through June 22nd of the year. you had 1932, you had 1970 and 1962 we're off to at least the worst start in 50 years in the market or 52 years in the market. If not something like 70 years, that's on a year-to-date basis. Now, I like to use year to date because this is the way the world works. Whatever happened before December 31st has been booked and profit has been booked and bonuses have been paid, and that is in the history books and cannot be changed. The yearly calendar, the calendar year matters quite a bit.

Now the other thing I want to point out is, I showed you that the bond market is having a disastrous year. Deutsche Bank has a study, which we actually had in news clips today as a matter of fact. In our reading section again, this is the worst five months start to a year since 1788. Yeah, I said that right, 1788. Global Financial Data has some data on it, and they put that together. this is the worst bond market ever. This is the worst stock market we've seen in at least 52 years, if not something like 90 years.

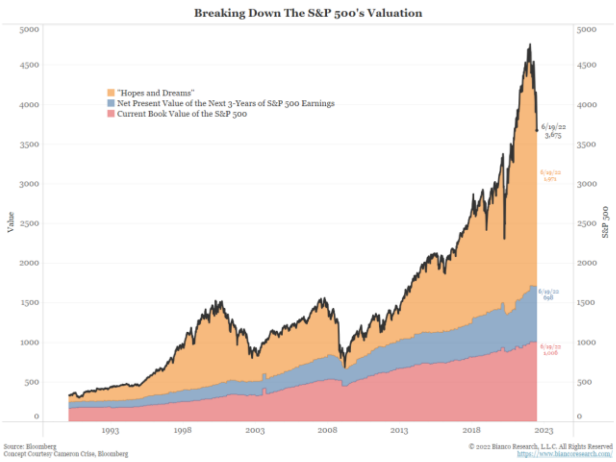
When you look at the best six month returns, this looks at all of these indices here, and is our stock and bond indices. they're domestic international emerging for stock and bonds together, a various set of indices. What is the best performing index, the best performing index? Well, right now the best performing index is the, Affirm mentioned US Aggregate Index down 11.7%. This is through a couple of days ago, it's down a little bit worse. And that negative bar, this goes back to 1978, that negative bar is unlike anything we've seen. As a matter of fact, only the second quarter of '94 and the second quarter of '84 have seen negative bars. Now, what does that mean?



That means every option, every financial asset, financial asset option in stocks and bonds loses you money, and now loses you money, but lost you at least 10%. We've never seen anything close to that. Yeah, commodities, volatility, cash. These are other types of asset classes that can make you money. But I'm talking about financial assets, the bread and butter of what everybody invests in stocks and bonds. And the reason I like to use this chart is I like to say as a macro guy, people always say, "What am I going to do with my money?" Because something's always up. Some asset class is always got a positive return.

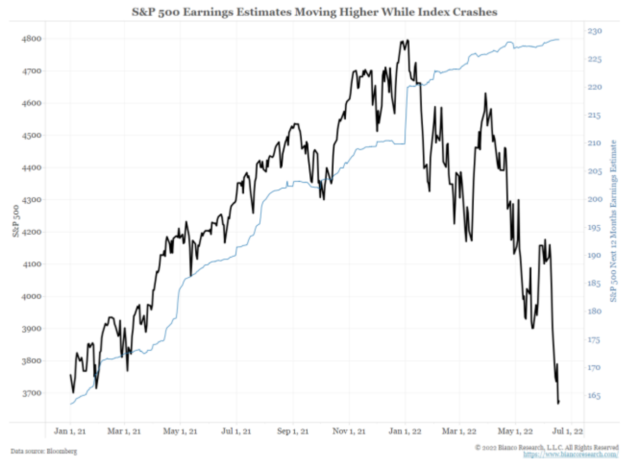
Which one is going to have the big positive return? The answer has never been, for 28 years, "Oh no, you can't do anything with your money." You're going to lose it, or you have to go to some alternative like buying into crude oil as an asset class, as opposed to an idiosyncratic type of investment or so. that has made this period very stressful for a lot of people. There's nowhere to hide unless ...

At any point, anywhere in life, there's always limited partnerships, individual stocks, narrow investment themes that can make you money. But we're talking about asset classes, and asset classes, the perception is there's always an asset class. Do I buy emerging bonds? Do I buy domestic stocks? One of those is going to go up a lot. This year has not been the case.

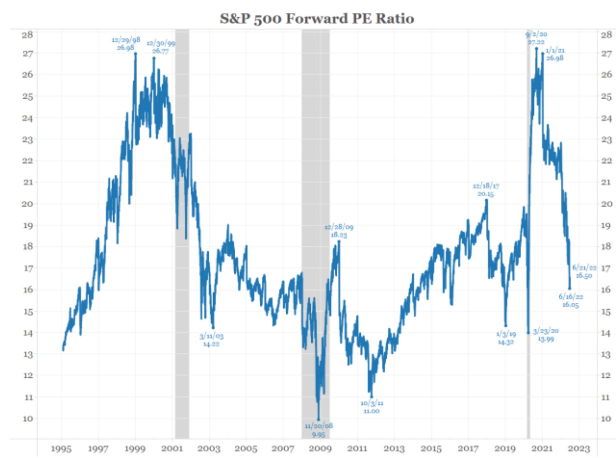


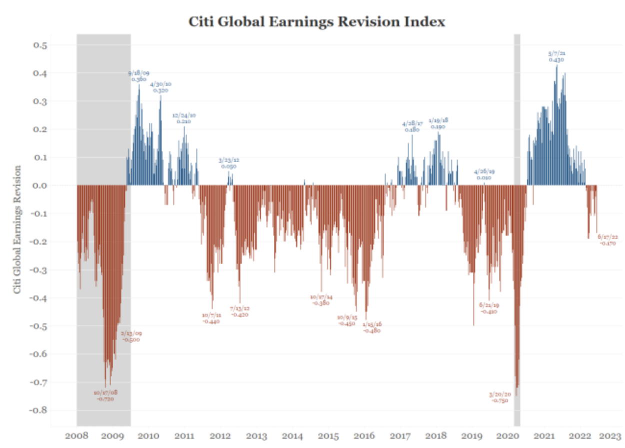
Let's talk about the stock market and the problem with the stock market. here is a breakdown of the valuation of the stock market. Cameron Crise over at Bloomberg popularized this, and basically what you do is you take the S&P, so on the 19th when the last updated, this it's 3675. And the book value of the S&P is 1,000, 1,000 of S&P points. If you take the three years out earnings estimate, and yes, Bloomberg does survey a myriad of strategists ask them what their three years out earnings estimates are. Then net present value it back to with the current interest rate, you get another 700 points of valuation, so that if a stock is the value of its assets, plus it's expected cash flow, which gives you about 1700 points of the 3,600 on the S&P. The rest of is what Cameron Crise calls, hopes and dreams. I used his phrase. I like it, because remember, a company is organic. It can change, it can change its products. It can change its management. It can change its direction. It is not something fixed like a barrel of oil or a fixed income security that cannot change, so they should always trade with some version of hopes and dreams.

In fact, all the way back to 1990, there's never been a negative period. The closest was +2%, right at the low in 2009. The question is, how much should they trade at? At that point at the high in January it was one of the highest we've ever been and it's still pretty heady. There's still a lot of belief in companies, and so let me show it to you this way. Here is, in the black line on this scale here on the black scale, there's the S&P going down, that we're all familiar with.

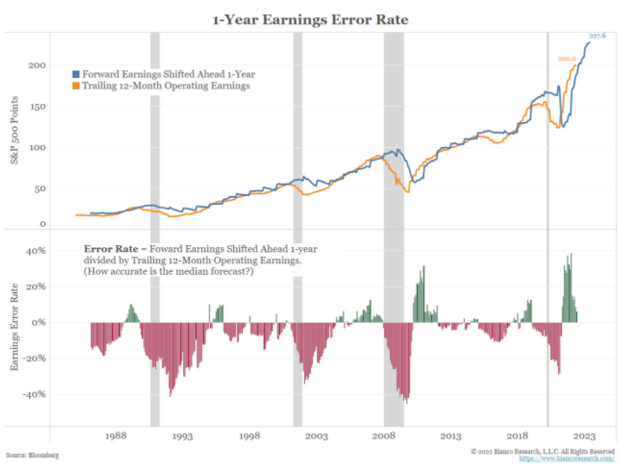


Here are 12-month earnings forecasts going forward, $228 on earnings forecast. But notice this was the beginning of the year and earnings estimates have been increasing all year as the stock market has been falling and we get a number of people then that want to say, see, what that does is it takes Wall Street's favorite valuation metric, the 12-month forward PE ratio and it's been falling quite a bit, and it's down around under 17 from a peak at the beginning of '21, late '20 at around 27.





The stock market is "See," is what you're what you're hearing from a lot of people. The problem is, to go back here is, can we trust these earnings estimates? The answer is largely no, we can't trust those earnings estimates. Citibank does a global earnings revision index. This is just looking at all the analyst estimates for that week. How many went up versus down? they put together an index. The index has been negative. Last week was one of the more negative numbers we've seen. In fact, it was the third most negative week since the financial since the COVID lockdowns in 2020, so the revisions are heading lower, and then the final chart on this is to look at what I call the error rate. here are the forward earnings shifted forward one year. the 228, what we're expecting by June of '23 is plotted in June of '23, even though that's what we're expecting now. Then the orange line is actual 12-month earnings. what I look at here is, what did we think earnings were going to be a year ago?



What were they actually, and what's the difference? A couple things: first of all, you'll notice most of the bars are negative, meaning that without even looking at it, whatever Wall Street's estimate is just scream too high, and you'll be right about 70% of the time. But also notice that during the recessionary periods, that's when earnings really undershoot. That's when you wind up having the 12-month forward, the blue lines wind up being way, way too optimistic. In the case of the 1990 recession, 40%, 35% in the case of the great financial crisis, I'm sorry. In the case of the 2001 recession, over 40%, meaning the earnings estimates were 40% too high, ultimately when we went into recession. During the financial crisis and during the lockdowns, they were 25% too high. if we are having a recession and we are saying that our evidence is, "You prove to me we're not having one, because there's enough evidence for me to prove that we are having one," and I'll get to more of that in a session in a second. Then these earnings estimates might go under 200.

What it implies is, going back to my PE ratio, this number's way too low because the denominator earnings are way too high. It's way too optimistic if we're going to have a serious downturn. Now, more evidence we're going to have a serious downturn. Now The Wall Street Journal has been doing a poll of economists since 2005. 44% of them think that a recession is coming in the next year. They point out that in December of 2007, the month that the great recession began, that number was 38%, and in February of 2020, the month that the last recession began during the COVID lockdowns was 26%. We're at 44 now. When you get the consensus on Wall Street to predict this greater percentage of recession, Citibank's over 50% in a Citibank's over 50%, Nomura's saying the recessions already started, but there are outliers. 44%, that means it's already begun, is really what it means. Bill Dudley, again, he is the former president of the New York Federal Reserve.

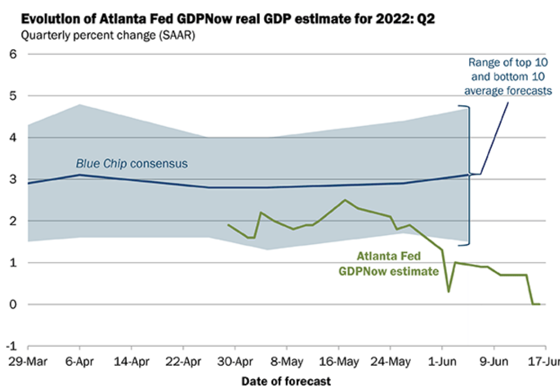
Again, I think that the former fed officials are the most interesting because they don't have the filter. To be the cynic about it, what happens when you are a fed official is you're handed talking points and go read them like you meet them. Dudley doesn't have that. We are headed towards a hard landing. The conference board did a survey, 60% of CEOs globally expect a recession in their primary region; remember this is globally, before the end of 2023. These types of things, when you get a majority of CEOs predicting it and you get former fed officials saying hard landing, these are not forward forecasts. This has already begun. This is what history has shown us, that it's already begun. Then we've got the latest GDPNow statistics. Remember that the first quarter GDP was negative, Atlanta Fed right now is predicting 0% for the second quarter a technical recession might very well be in the offing. Again, a recession is real growth.

You can have nominal growth of 7% or 5% if you want to use PCE, and that can include within that 5% nominal or 7% nominal growth, which can include some positive jobs creation. But if you have inflation higher than that, which we do, you wind up with negative real GDP, and then you wind up with a recession, even though you have positive growth. This, to me, is the worst-case scenario because this tells the fed, "Oh no one's losing their job. Hike, hike, hike." Well, when do we stop? When the inflation breaks, do we have any evidence that inflation's breaking, at least not yet. To that end, let me talk about the inflation statistics. This comes from the Cleveland fed. They do a now forecast for inflation. Atlanta Fed does GDP. A lot of regional feds do these, but the Cleveland Fed is the more popular one when it comes to the inflation. Now casting the Atlanta Fed is the more popular one when it comes to the real GDP Now cast.

Latest estimate: 0.0 percent — June 16, 2022

The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the second quarter of 2022 is **0.0 percent** on June 16, unchanged from June 15 after rounding. After this morning's housing starts report from the US Census Bureau, the nowcast of second-quarter real residential investment growth increased from -8.5 percent to -7.7 percent.

*The next GDPNow update is **Monday, June 27**. Please see the "Release Dates" tab below for a list of upcoming releases.*



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

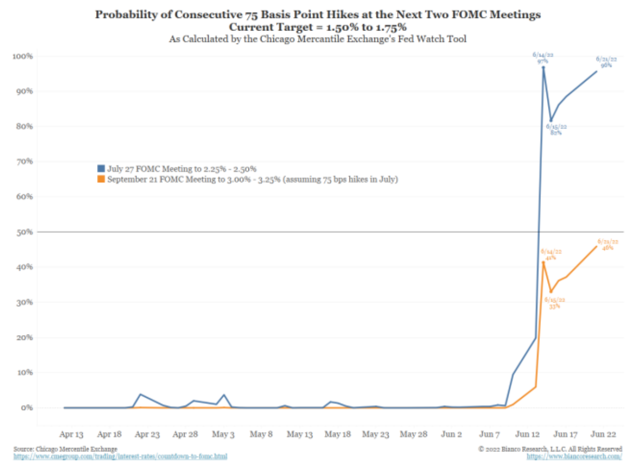
Monthly Inflation Nowcasting

	Inflation, month-over-month percent change				
Month	CPI	Core CPI	PCE	Core PCE	Updated
June 2022	0.98	0.49	0.67	0.39	06/22
May 2022			0.71	0.46	06/22

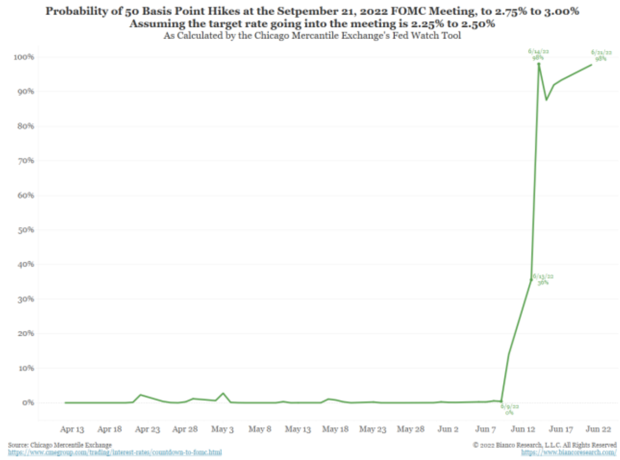
	Inflation, year-over-year percent change				
Month	CPI	Core CPI	PCE	Core PCE	Updated
June 2022	8.67	5.66	6.60	4.70	06/22
May 2022			6.46	4.79	06/22

Note: If the cell is blank, it implies that the actual data corresponding to the month for that inflation measure have already been released.

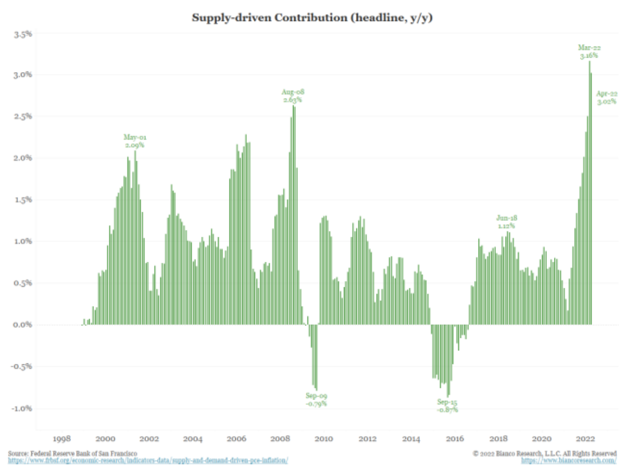
They are projecting as of yesterday that we are going to have essentially another 1% month for June CPI driven largely by gasoline prices, and that that will push the June year-over-year to 8.7%. If anything, the Cleveland Fed has been undershooting the numbers the last few months. This is the only report that we're going to get before the July 27th meeting. If it is at all in this ballpark, even if it undershoots it by 0.8 or something like that, and the 8.6 becomes 8.5 or 8.4, fed has no choice, I think, but to raise rates, and that's what the market is suggesting. 96% chance of the fed raising rates, 75 basis points at their next meeting on July 27th. That's actually 90% as of this morning, but still 90, 96%, it's a virtual lock that we're going to get another 75 basis points at the next fed meeting July 27th to take the funds rate to two-and-a-quarter to 225.



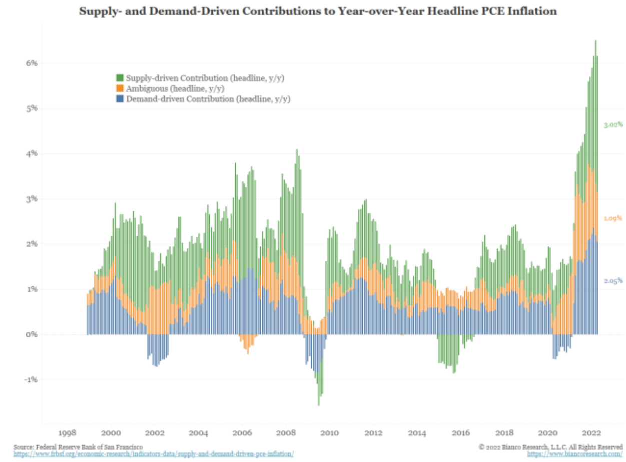
Well, at the September meeting, will they go a third 75 in a row to take it to three-and-a-quarter to 325, the probabilities were 46% two days ago when it was Tuesday's close, and now it's around 38%. Not quite 50, hasn't been above 50, but it's definitely in the conversation. Now, why does the marketplace think that the fed is going to back off of that number? Because there will be two inflation reports after July 27th, before the September 21st meeting, we'll get the July one and mid-August, and we'll get the August one in mid-September. The thinking in the marketplace is those numbers will back off and let the fed, as this chart shows, downshift to 50. if you assume a 75-basis point hike, it's a July 27th meeting, the probability that the fed raises 50 at the next meeting is 98%, that's just looking at that is separately, the probability that the fed raises 75 is 37%. You throw in another above consensus CPI report in July or August, and that number for 75 could go way up.



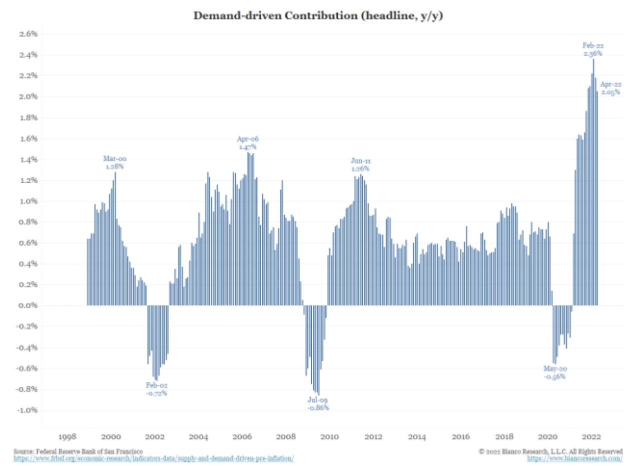
We're talking about 75 again, and another 50, that would take the funds rate by the first day of fall, September 21st is the first day of fall to 275 to 3% as we move forward from here. Now, let me make a quick comment about inflation here really quick. This comes from the San Francisco Fed. This is a paper that they put out this week.



They looked at what percentage of the inflation rate is supply-driven versus demand-driven. Now they've used PCE. PCE is around 6%. CPI is around eight-and-a-half percent, but let's think about this in terms of percentages. They're saying that roughly half of this gain is because of supply constraints. They're saying about 2% of this gain is because of excess demand, and 1% is in that ambiguous area where it's hard to tell whether that inflation is supply-driven or demand-driven. let's break this down. The supply-driven component at 3%, they went back to 1998, is the highest it's ever been. yes, the fed can't do anything about oil.



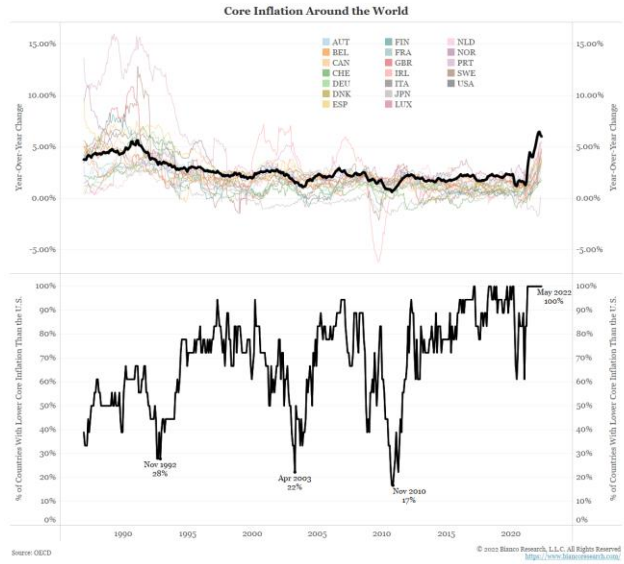
Supply is a problem. You are correct, but here's demand. Demand is also at the highest level it's been in 25 years. We printed too much money. We mailed too many checks. We did QE far too big for far too long. We over stimulated. We stuffed everybody full of money and they spent it like crazy, and we've got inflation. That is correct too. It is incomplete for when you hear people say, "Well, we have a supply problem." It's an incomplete statement. It's true. But then we also have a demand problem too. Fed can do something about demand. This chart says they got to hike like crazy to bring down that excess stimulus to rein in inflation. This chart here suggests that they are correct that they need to be raising inflation as much as they have been. I'm sorry, raising interest rates to deal with inflation as much as they have been. keep in mind again, the mistake the fed made was last year. They should have never been on transitory last year. They should have been dealing with this excess demand problem last year.



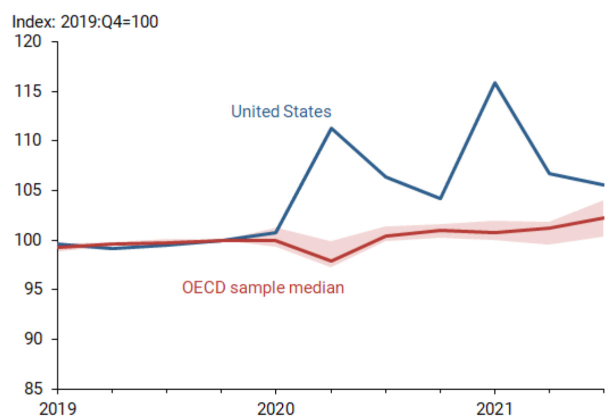
Right, there is the middle of '21. They should have been dealing with it last year at this point.

This year is the consequence of dealing with it last year. Just to reiterate what I said at the top, I still think this is Volker 2.0. I still think that the mandate is very clear. The reputation of the fed is on the line. The president has ordered them, they have to have to have to bring down inflation. If a bunch of portfolio managers are screaming and yelling that their portfolios are getting blown apart tough. If we start printing some seriously negative payroll reports, maybe. The last one was positive. 390,000. Today's initial claims report was 226,000. That is down from two years ago, 700,000 on claims. It's trending higher, but it's nothing odd that should get you worried. Look, all time low and claims was three months ago. we're coming off all time, 55 years low and claims, and we're slightly trending higher on it. There's no evidence at this point that payroll or that the labor market is suffering.

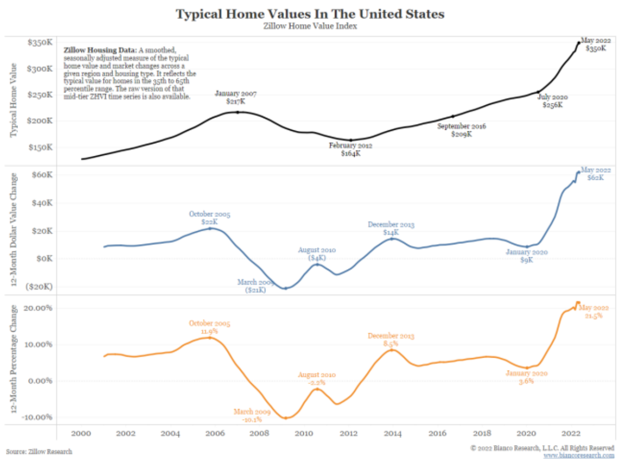
There's a lot of hope, that I say that kind of in a backward way, people want to see signs that the labor market is suffering so that they can scream, "Jay, stop, stop what you're doing right now," but there isn't now, a week from tomorrow, we're going to get the payroll report. We'll see what that suggests. Again, good news is bad news when it comes to payrolls. You print a decent payroll report, go back a month ago, in the first week of June, when we printed that 390,000, stock market started falling apart immediately right off that number. Everybody said on TV, "Oh, this is good news." Yeah, good. We could zoom you with a 75-basis point hike, and that's essentially what we did. We print 300 to 350,000 jobs again; we could zoom you with 100 basis points is what we could do in July. We'd need to see the jobs markets severely slow down to have a conversation, whether or not the fed will cave. We have got no evidence that's happening at this point. We've got some layoff announcements have picked up and some other things.



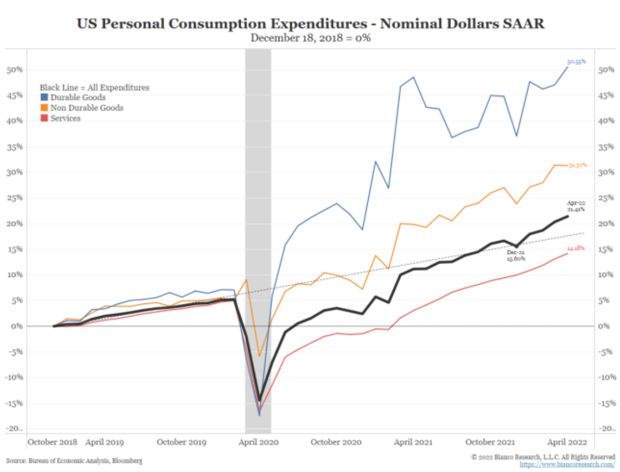
Maybe some companies are quietly rescinding some offers. That's not enough to change policy. That's not even beginning to be enough to change policy. Again, I'll just point out this chart here, core inflation around the world from the OECD, these are all of the developed countries of the world. The black line here is the U.S. This is core inflation harmonized. They harmonize it so they're all being measured the same way, and what the bottom panel shows is the U.S. has the highest core inflation rate in the developed world. We're usually not 100%, but we are right now. Again, why? Real disposable income. This comes from the San Francisco Fed again, the same guy who did the other study. If you look at the amount of stimulus that we put in and the checks we mailed out, disposable income, disposable personal income, went up during the pandemic. Here are the other 28 countries of the OECD. We were clearly an outlier. We are clearly an outlier from all of these other countries, and there's the median.



We stimulated the hell out of our economy way more than anybody else, we've got the highest inflation rate in the world. Demand is a big part of the inflation thing. This is why the fed can do it, and the demand numbers never come in more clearly than when we look at home sale value.



This comes from Zillow and Zillow says that the average home price in May, now that's the end of May, which was three weeks ago, $350,000. The average home in the last year is up $62,000, or 21-and-a-half percent in the last year. There's evidence everywhere left and right that maybe the home market is slowing down. Mortgage rates are spiking, maybe, but in the last year, the average person saw their average home go up $62,000. The average person in the United States makes $51,000. As I pointed out, never has this been close to being the case before that your house made you more money than your job. You want to know why the airlines are packed? My anecdote was, I'm in Chicago. I was on the Kennedy Expressway last night at 4:30.



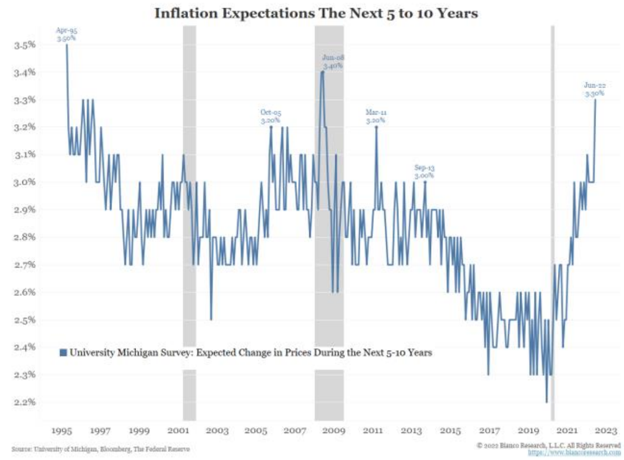
You would have thought it was pre-pandemic when 100% of the people were still working downtown in the loop. It was packed. I was going five miles an hour the whole way. Whatever happened to six-and-a-half dollars gas causing demand destruction? I saw cars packed on the highway where each one of them had one person in it and I did too. I was as guilty as anybody else was as well. this is part of the problem is the stimulus. We should have attacked this last year before we let this get to $62,000, and this is what I think the fed is trying to deal with. Personal consumption expenditures, I just wanted to point out this. The black line is expenditures. You'll see, here's the pre-pandemic trend. There were the lockdowns, the restart. I'm looking at the black line. The dotted line shows you the trend. We got back to trend in December of '21, and now we've trended a little bit above trend, but if you break it down, durable goods, those things that last more than three years, way above trend.

Non-durable goods, those are stuff that lasts less than three years above trend and services, which is the majority of the index is below trend. Again, I still have been arguing. This is the post-pandemic economy that we live in the work from home, remote work economy. We consume more things, less stuff that has been the driver of that inflation. You hear everybody all the time saying there will be a shift away from goods and more towards services. One of the latest data is as of May there's no evidence that there's been any shift away from goods and towards services, so the heat is still on services, as much as it's been all along. Last two charts, and then I'll sum it up and start taking some questions. Oh, I'll make a comment about crypto too. Paul said this also at his presser last week. Let me back you up. Before I read this, let me explain. The fed uses forward guidance, believes heavily in forward guidance.

That is the easy, simple way of saying forward guidance, is they have to tell you over and over and over what they're going to do before they do it. They told us over and over and over that they were going to raise rates 50 basis points in the June meeting. Then we got the bad CPI report on Friday, and we got the bad Michigan confidence number on Friday. I'll attack that in a second, and the joking way, I like to point it is, somebody at the fed called Nick Timiraos, the Chief Economics Correspondent of the Wall

Street Journal. If you're old enough to remember the reference Blue Horseshoe like 75 referenced from the movie Wall Street, and Nick hung up the phone and wrote the story that the Federal Reserve is considering moving 75 basis points at this week's meeting. Monday afternoon, one minute before he wrote the story, the probability that the fed was going to raise rates 75 basis points at that meeting as priced in by the Fed Funds futures, one minute before the story hit the website, it was around 25%. Five minutes after it hit the website, it was in the mid-90s why did the Fed abandon forward guidance of 50 basis points to call Nick and tell him blue horseshoe like 75? As a matter of fact, Esther George was a noted Hawk dissented from the meeting because she wanted to raise 50 precisely because they had pre forward guided 50. Don't mess it up now, but they decided to do that anyway Paul was asked that, and I'm reading here from the highlighted area. If the data came in worse than expected, we would consider moving even more aggressively we got there. We got CPI data and we also got some data on inflation expectations late last week. We thought about it for a while. That means over the weekend. And we thought, well, this is the appropriate thing to do.

Let me sum this up. When you want to know what the Fed's going to do, there's three sets of statistics you need to look at. The first one we've detailed a lot. That is the inflation report. We're going to get according to the Cleveland Fed Nowcast a near 1% number again in June. And that should intel the fed to go 75, which is why it's in the 90 plus percent range that the Fed hikes 75. Only 46 to 38%, depending on when you measure it for 75, a third consecutive in September, because there's hope the July and August CPI numbers will downshift to let the Fed downshift back to 50. We'll see. Let's just get through the July 27th meeting. The second thing he mentioned too is he said, "We got the CPI data, and we also got some data from inflation expectations late last week."



That's the University of Michigan inflation expectations survey, what do you think the outlook for inflation is over the next five to 10 years? They're asking 500 random people this question. It came in at 3.3% over the last 28 years, only one reading was higher than that. And that was $147 crude oil in July 2008, which was the old all-time high and gas prices before we took it out. Second highest reading in 28 years how does the Fed decide policy? They look at three things. They look at first the CPI report. Yes, it's a lagging indicator. That's the way they work. Then they look at the Michigan consumer confidence number. And then they look at the collective of everything else. And so those two numbers matter. Now, Michigan consumer confidence is put out twice a month. They put out a preliminary reading and then they put out a final reading.

Tomorrow we will get the preliminary University of Michigan June report. Preliminary we'll get an update of this one for June. Then at the end of the month, we will get the final June month, June reading. And then in the middle of July we will get the preliminary July reading and then we will get the final July reading this comes out every two weeks we have an event coming tomorrow that is every bit as important as the following Friday payroll report. And it's the Michigan confidence number because that got the Fed to abandon 15 years of forward guidance to call Nick and tell him we're going 75, because that one number and higher than expected CPI number. That to me is more evidence. They're going to break everything until they break inflation. They cannot back ...

Call me if we get minus 200,000 jobs, call me if we get claims that it's now around 225,000 up and around 400,000. Then maybe we could discuss them backing off because maybe at that point, the discussion is they've already busted inflation, that they broke the economy so bad that inflation has already been broken. We just got 390,000 jobs in May. We've got a slight uptick in claims. We'll see what the confidence number says tomorrow. But I think that they have no choice. Now I get the argument that they will cave. They will collapse and they will start easing when they see signs, the economy's going bad. And people are trying to point that out, that there is evidence of it. Look, I'm already in the camp that the recession has already started, but I don't think it's enough to get them to stop. I think that they have to see evidence of a disaster to stop. Otherwise, they're going to keep going until they break inflation.

Bottom line is I think that we're going to continue to see restrictive policy. We're going to continue to see markets under stress. If you look at the valuations in the stock market, I'll be blunt about it. The fan is full. We're not going to get $227 on S&P 500 earnings in one year. If we're in the midst of having a recession, that number can be up to 40% too high from what we've seen in the past. That would put it well under $200. The valuations in the stock market will get worse as we move forward when the recognition comes in that earnings estimates have been way over guessed at this point. We also have not seen the signs of anything other than the Fed is focused on inflation. I get it we're going to continue to be in a tough spot, a hole. Short term, a couple of short-term comments about the market. We were down 6% last week on the S&P. That was the worst week that it had since the bottom of the market in March 2020.

You got to go back to the lockdown panics to find a week that bad far this week, we're up two and a half, 3%. Now that's what you do when you have a 6% correction. Oil. Oil was up seven weeks in a row and nearly 40%. Now it's getting smashed. Well, that's what you do when you have a correction after seven weeks and 40%. I guess people have a hard time understanding volatility. If a market has had a record run on the upside or downside, the correction is going to be a record run on the other side, every counter move is a function of the previous move. If the previous move was near record, the counter move is going to be near record. My point here is it's too early to say, well, oil's down $15. Or interest rates are down nearly 40 basis points. That means that the market is pricing in recession and disaster.

Yeah, it could be. It could very well be that's the case. But it could also be the case that what we're seeing is just the natural correction to a horrific move in the previous 10 days. 70 basis points in the 10-year note, biggest move in 40 years. If you had a 12 or 13% handle, last time we saw that. These are world record types moves. Now I'm in the camp of a recession. I ultimately think that when the bond market is going to price in a true recession, the yield curve is going to invert and invert severely and invert persistently. I'm talking two years tenure curve. It isn't inverted yet. It's flirted with it. It's less than 10 basis points. But it hasn't inverted. What it needs to do, why would I see a severe inversion? Because two-year notes are going to stay high because the Fed's going to keep raising rates.

Tenure note is going to rally in yields are going to collapse because we're in recession, severely invert the curve. Let's go and look at September 21st of this year. The funds rate is either going to be 2.75 to 3% or it's going to be three to three and a quarter. As I speak now, just looking at my screen. The two-year note is the two-year note is 2.91 and the 10-year note is 3.01. If we're going to get 2.75 to three or three to three and a quarter, they're going to be inverted to the funds rate by September 21st. Or this is just part of the counter trend. Get used to 50 basis point moves every three or four days. This is the environment we're in. Ultimately I do think we're going to see a peak in rates and we're going to see on a severely inverted yield curve. At the end of the day, if this decline in rates off of last week's high was the sign of a recession I would've expected the curve to be inverted.

I would've expected the tenure yields to fall through two-year yields into inversion. They didn't. As a matter of fact, as I look at my screen again, if anything, the curve is slightly steepened in the last three or four days. It's 13 basis points. It was like five slightly steepened. That to me screams correction in a larger up trend. And I think rates are going to continue to go higher. The two-year note will invert to the funds rate when the market thinks the fed is done raising rates. It is pricing in at least 2.75 to

3% by September 21st, if not three to three and a quarter. And the two-year notes of 2.91 you'd have to argue that the Fed is literally done raising rates on July 27th in order to say that those rates are correct. And the reason the Fed would be done is because the economy's going to crap out so bad that it'll be obvious after the July 27th rate hike, which is priced to be 75, that they got to stop.

Or this is just a correction and rates are going to continue higher. Somebody asked about Crypto. I'll make a quick comment about Crypto. What is the problem that Crypto's trying to fix? And the problem Crypto's trying to fix is public good money. And what we've learned over the last several years is that as I like to say, everybody listening to me on this call, me included, all of our net worth’s are zero. We have no money. What it is, is our financial institutions have money and we trust that they keep good accounting ledgers that say that part of their money we are allowed to use. And what we've found in recent years is more and more restrictions are coming on the use of our money. You can spend it on this, you can spend it on that. The left doesn't want it to be spent on things like ammo and guns. And the right doesn't want it to be spent on things like abortion. And they're trying to push those down the line.

And then we get the Canadian truckers. Then we get the sanctions, the freezing of central bank assets of the Russians. Yeah, they're bad people and they deserve it. But the takeaway from all of this is we have lost. We are not in control of our own money private property money is what is trying to be created in the form of digital cryptocurrencies. And to some degree, we could discuss how decentralized they are or not decentralized they are. But that is what the experiment is trying to become. And along the way, this is a little different experiment than others in that it is open for all to participate in, and all new technologies are subject to manias and crashes, and huge manias and huge crashes. Two days ago, at the bottom of what we're reading, I had a series of stories highlighting that one of the largest manias at the end of the light 19th century, early 20th was bicycles.

There are 500 companies listed on the London stock exchange that were bicycle manufacturers. Half of them didn't even have any assets or produce anything. They were just invented shell companies or SPACs, what we would call today. And they put the name bicycle in it and investors just bought them up like crazy. And there was a massive crash in bicycle manufacturers on the London stock exchange. And it was a recession in the UK. And guess what happened after that? Then I put another story from last month's economist. The bicycle is the most underrated invention in human history. Literally that was the title of it. That we had this massive mania. Everybody lost money. We created a recession off of a bicycle mania collapse. And then the bicycle changed the very face of humanity as we went forward from there. It happened with the telephone, New England companies were cropping up left and right, they were fraudulent companies claiming that they were telephones after Graham Bell invented the telephone.

We saw it with the internet. We saw it in the 1920s with radio. We saw it in the forties and fifties with television. We saw with mobile phones 15 years ago. We see this with every technology the mania and the crash within cryptocurrencies should have been somewhat expected. Now, if you split out what's happening in cryptocurrencies into two values, the centralized exchanges, which are essentially unregulated banks and the decentralized protocols. The decentralized protocols have been performing marvelously. Look, the cryptocurrency prices are collapsing, but the AVEs, the curves, the balancers, the Uniswaps of the world, all of these major protocols. The sushi swaps of the world, these are the trading protocols, the lending, the decentralized trading protocols, lending protocols, borrowing protocols that are available to see what they're doing online on chain. You could see everything unfold in real time and everything is run by smart contract.

They are just working and working without problem. You bought a bunch of cryptocurrencies. You're getting wrecked. You're being liquidated and moving on. Everything is working. The centralized exchanges, the Celsius, the Three Arrows Capital, the Babel Finance, the Maple Finance. These are unregulated banks that took everybody's money, pulled it together in some kind of dark pool that no one knew what they were doing. Invested it in TARA, invested it in

STF, invested it in some other places, lost the money and they might be insolvent. And now FTX and Sam Bankman-Fried is giving them more debt by giving them, extending them more loans to try and keep them afloat. The centralized exchanges are failing left and right here within this mania. Look, there's been six declines of 80% or more in Bitcoin since 2010. In 2019, Ethereum was 93% off its high, under a hundred dollars.

And within 15 months it was trading 4,800 bucks. This is what it does. We're in a crypto winter. We're wiping out too much leverage. A lot of people are going to be sent to the showers to use a sports metaphor. And even people that were acting prudently will. And this crypto winter might last several years. It might last several more months. It might have another downturn. And we could see more pain and suffering from people like FTX or Coinbase or Binance or some of the other players. But the promise of private sector money is still there. And I still believe that it will become a thing even after we get through this winter yeah, I do think it has some value. Where is the use case? The use case ultimately is going to be web three. Now what is web three really quick?

That is, look, social media, the YouTubes, the Twitters, the Facebooks, the Instagram's of the world. Collectively, these companies are worth trillions of dollars. But I don't own my Twitter feed. You don't own your YouTube feed. YouTube and Twitter own it. Now, when you get to a certain point, they'll throw you some crumbs in terms of advertising revenue back at you, but they own it. They can censor you. They can turn you off or block you for whatever reason and they can decide how much money they've made off of you that they'll give back to you. But if we ultimately turn this around, that I can own my Twitter feed. You can own your YouTube feed. The idea of a private sector form of money, a digital token to represent the value of that feed that can be exchanged and used as a currency is the hope. There is where the use case is. This is early days in terms of crypto.

I still have my laser eyes on Twitter, and you have no idea the amount of criticism that I am getting from having those laser eyes on Twitter. And my pin feed is I still believe long term this is going to be a very disruptive force for finance. Again, I'll use my statistic that I've used many times before, since 2007, there's 11 sectors in the S&P the worst performing is financials. And within financials, one of the worst performing is the banks. The market is screaming that the current financial system is broken. It needs to be fixed. Now I think that cryptocurrencies might be a fix. Some people think FinTech might be a fixed. FinTech by the way, I Tweeted this out yesterday, the FinTech index is down more than cryptocurrencies. It's down more than Bitcoin. The FinTechs are getting wiped out. But that doesn't end. The bank stocks are still getting hammered.

Ultimately, the financial system is somewhat broken. Vladimir Putin gave a speech today. I know it's Putin. I know that he has a vested interest, but he made exactly the same point that the financial system for anybody who's not in the United States is broken and it needs to be changed and it needs to be fixed. The rest of the world understands that if not cryptocurrencies, we're blowing up the financial system as we know it now. How are we going to do it? I think it's going to be some version of what we're doing with decentralized finance and cryptocurrencies. It's going to take many more years to unfold, but it's still coming. And this winter is getting rid of too much speculation finance, too much speculation fraud, too many people that cut corners and running their programs out that wound up getting hacked or exploited. And that era is over, good.

It's over. And it's going to be a painful winter, but it will emerge out of it count me bullish, lost a ton of money. We'll probably stay in a loss of a ton of money for a while. Let's check back in 2, 3, 4 years, and let's see where the cryptocurrency space is at that point that's my comments on that.

Q&A

All right. Let me so open this up for some questions and we'll go from there. Let me get to the top of my questions bar here. First name only basis. I know who you are. I see your last name here. That's all that really matters. I feel first name only lets you just go ahead and say your question.

David asked, "In your opinion, what is the current timeframe for the current monetary policy to take effect? What is the lag? Seems like everybody's talking about yesterday or tomorrow versus reality." I think the current monetary policy is taking effect right now. I think you're starting to see a broad slowdown in real growth. I think we're in recession. I think that there's enough evidence as I pointed out with the surveys, the decline in the market, Atlanta Fed, GDP and the like that we're in recession right now. If the question is what's it going to take to break inflation? Inflation's a lagging indicator. It's the last thing to break it's going to take some pain along the way before we eventually break inflation enough that we could do something about that as well, too. "What breaks? What do you think are the weak points? How does the stress spill over into the economy, private markets, private equity, commercial real estate?" Things are breaking right now. I think we're in recession right now.

Stock market's down 20% right now there's a Wall Street Journal story today that VC companies are worried that they're not going to be able to go public. They can't finance it at, they can't finance their junk offerings to finance their highly leveraged companies. Because junk rates have gone from 4% to eight and a half percent this year. I think things are broken. I think that's clearly, we have broken things already. Look, we're in recession. I already think we're in recession. the answer is we've broken it. If you're asking when the hyperventilation is that some financial firm is creating a contagion effect, if that's what you're asking obviously we're not there yet, and I don't know where we are. But whether you look at Three Arrows Capital or you look at Bear Stearns, 48 hours before each one of those blew up, the head of each one, Alan Schwartz at Bear Stearns, Su Zhu at Three Arrows Capital, 48 hours before made statements that they're fine, they have no liquidity problem.

And they were correct. 48 hours later they closed their doors. And that happened too. Those two things, they were not fraudulent or lying, that's how fast these firms wind up collapsing. The last one we saw that was like that was maybe Robinood back in January '21 during the GameStop saga, and then they had to basically stop trading on GameStop because it was getting ready to create a contagion.

These companies will honestly tell you there is no problem, and they are correct, and then 48 hours later they have to close their doors. That's how these things happen. I don't know when we're going to be at that 48-hour warning any more than anybody else does, but I'm just trying to point out it all is fine until it's not. And there is enough evidence that things have been broken all over the place.

Commercial real estate is back to its lows of March of 2020. The realization of work from home and that a structural change is taking place in the real estate market is very real and very profound, and that is happening. Next question. Chairman Powell's comments yesterday, we may have a recession, is this Powell putting a stop on dropping treasury markets 340 to 305? No, I don't think it's a sign that he's trying to manipulate the markets.

Because remember he doesn't want rates to go down, he wants rates to go up. He doesn't want the stock market to rebound, he wants it to go down. He wants inflation down. He wants rich people, people that own bonds and stocks, that's the definition of rich people, to spend a little less money to bring off the heat on inflation. What he's saying is he's trying to cover for the credibility of the Fed by opening up the possibility that there might be a recession.

See, I told you we might have a recession. I said that we were hoping we won’t, and I didn't think we will, but there was a possibility that we would. That's the way that I read his statements from yesterday. 340 to 305, look at what we did in the 10 days through Friday. Like I said, one of the biggest moves in 40 years up in the two-year note. We went up 60 basis points in the 10-year note.

The stock market I think was down 11% in the previous nine trading days through Friday. yeah, this is the type of rebound you're going to get when you have multi-decade moves like we did through Friday in the market**. Charles asked, could crypto collapse alone and cause a recession? If not, what else is likely to break the cause of recession?** No, I don't think crypto alone will cause a recession. I do think that crypto is a good leading indicator.

One of the things I've been doing if you've been following me on Twitter over the weekends is I usually run this chart where I overlay S&P futures with Bitcoin. And man, lately it's been about 100%. And then you can look at where Bitcoin is trading on Saturday or Sunday to get an indication of where the markets are going to open on Monday morning.

And over the three-day weekend, this past three-day weekend, by Saturday night it was looking pretty bleak when Bitcoin was at $17,600, but then it rebounded all the way back to $21,000 before the stock market opened. no, crypto cannot cause a recession, but it is a signal of other things. If crypto collapses, I don't think that it collapses in isolation, I think it means as I like to say for all of the no pointers that, "Oh, look at crypto, ha, ha, ha, you guys are getting your head handed to you."

And I always like to joke, you looked at what the S&P's doing? It's getting smashed. If you looked at the bond market, it's having its worst year in 200 years. those markets are not immune from it. if crypto goes down, most likely the other markets are getting whacked really hard too. And yeah, that could cause recession.

Again, I think we're already in one, or as I said, again that's a prediction of the future, that's a prediction that it may or may not be right, but I think the evidence is so clear that we are in a recession and you'd have to argue to me why we're not as opposed to me further explaining why we are at this point.

Any idea what might explain the divergence between consumer sentiment and spending? Does it have to do with spending coming in higher net worths more than previous cycles?

I think it has to do with nominal growth versus real growth. I think that what you're seeing in the consumer sentiment numbers is they recognize that they are getting a 5% wage increase according to the land effect. Wages are up about 5% in the last year or so. everybody's getting a raise, hooray, but we have 8% inflation, you can buy less things now than a year ago.

Sentiment is reflecting that my real purchasing power is declining. That's why the University of Michigan Overall Sentiment Report two weeks ago was the lowest ever. They started that report quarterly in 1952 and monthly in 1978. It was lower in June of this year, the June preliminary number. I think I might have said that wrong. We already got the June preliminary number; we're going to get the June final number tomorrow is what we're going to wind up getting.

It was worse than 1980, the '87 crash, the '90 Gulf War, the 2000 bubble, the 2008 Great Recession, the Kennedy assassination in '73, the gas lines in '74, the COVID lockdowns in 2020. Take all of those events over the last 70 years and when did we have the worst consumer confidence in 70 years? This month. Why? Because what is also shown in the charts is the gap between wage growth and CPI is -4% points, 8%, 8 1/2% inflation, 4 1/2% wage growth, 400 basis points behind, that might be the largest number ever.

Because at least in 1980, you had 14% inflation as they measured it then, and you had 12% wage growth or some crazy number like that. That's why you see the consumer sentiment numbers at a 70-year low. Spending is nominal spending. I'm spending more than I did last year because prices are going up, and that's what you're seeing in the spending number. That's my best guess, is to try to explain the two.

Inflation changes a lot of things, inflation changes a lot of metrics, and that's one of the metrics that I think it is changing.

Brian asks any thoughts on the possible consequence of corporate debt being refinanced at increasingly higher rates.
Yeah, it's going to be a problem because you are right, rates are going up, the nominal rate is going up, spreads are widening.

A lot of zombie companies, a lot of marginal companies are going to be in trouble. And as I mentioned before, a lot of those companies are VC companies that have been bought on extreme leverage. And with those companies being bought on extreme leverage, they didn't, I'm going to guess, oh well, we're going to take this company via our leverage buyout. Let's use the old term as opposed to a venture capital acquisition.

What happens when you have a 450-basis point rise in funding costs in the junk bond market to 8 1/2% over six months? My guess is six or eight months ago the answer would've said, why would we model that? It's not going to happen. And it did. And that's why I think a lot of those companies are going to be really struggling. Thoughts on the long bond level at these levels. Ultimately, I think we're going to get a peak in long bond rates or in long rates with the recession.

Again, I would be more convinced that this was a real peak if we inverted the yield curve, but because the two-year notice falling faster than the tenure or the 30-year bond after the big rise in rates in the previous 10 days, I think this looks correction. When you get a real rally in the 30 years of the 10 years into inversion to the two years, that to me says the market now thinks recession is full on and we got to start pricing it in.

It's not quite there. It's 13 basis points. It's not that far away either. When I say I think we're in recession now, market's not that far away from it. It won't take a lot to invert the curve to do it. I would think that this is a correction. Ultimately, we might see higher prices or higher yields, excuse me, as we move forward through the rest of the summer.

Otherwise, if we're going to get to 275 to 3 or maybe 3 to a quarter by September, if you think this was the high, then you're making the case that we're going to invert to the funds rate by September. And what that really means is the Fed's done raising rates in September. And to me, there's only one reason the Fed would stop raising rates in September.

The economy absolutely imploded on itself because they are so committed to trying to rein in inflation and the June number's going to be bad if you believe the inflation now casts from the Cleveland Fed. that means the earliest you could possibly get one decent payroll report, I mean, a CPI report is the middle of August, and that would be one and it would be all the way in the middle of August and then we would make the case that we're five weeks away from the end of the rate hike cycle.

Now that's why I think we're going to keep going up in rates. Unless the two-year note goes back up, the 10 year stays down, the curve inverts, the market says recession is underway. The Fed can't lower rates because they're fighting inflation, but the 10-year yield can fall because it's a risk off instrument in the middle of a recession, inverted curve.

Let's see, I'm just wondering on page 23 and 24 charts it seems like the other core lines are pretty close to that of the US. I'm guessing, I'm wondering how that connects with the fact that we stimulated a lot more than other countries. If anything, it seems like they are catching up. Okay. what we're talking about here is... Oh, let me go back here.

Yeah, this chart right here, that here is the US and all these colored lines are moving up and that the gap between the US and everybody else is closing. We're still at 100%. Yes, that is correct. The gap is closing and the reason that I would argue that the gap is closing is you could see that the gap between our disposable income and the rest of the OECD countries is closing.

We aren't mailing out more checks. We are reducing the stimulus. We are raising rates. We are doing QT. we are closing with everybody else. the amount of excess money that we have created is being reduced. We still have more money that we've produced than anybody else. And we still have the highest rate, but the rate is closing.

And unfortunately, the rate is closing with everybody else rising to us, no sign, because if you look at this, everybody else is rising to us, really no sign that there's some kind of global peak in the inflation rate. Let's see. Couple of more questions. Does a sub 50 ISM number cause the Fed to rethink? Not even close. Maybe several sub 50 ISM numbers, maybe sub-40. But I don't think that that would be enough for the Fed to rethink.

They are on a commitment. Again, I understand people can disagree with this. They are on a commitment to break inflation. And if they have to create pain and suffering to do it, they are going to do it. And again, Paul mentioned this, I'll use my words, but Paul said essentially the same thing yesterday. And that is 40% of the American public has less than $1000 of savings and they rent.

They don't have rising home... They didn't see their home go up $62,000 last year. They didn't see their stock portfolio go up 29% last year. Yeah, it gave it back this year, but it went up 29% last year. They don't own any of that stuff. Those 40% are getting annihilated. And he understands it and he need to do something for those people. And if that means he wrecks our lives, our lives being people that own stocks and bonds and our own home, then that means he wrecks our lives. I believe that that's their thinking.

I understand others think no they won't go that far. And maybe they don't because we've never tried this experiment with Paul, and we've never tried this experiment since Volcker for 40 years. But we've never had inflation like this for 40 years. I am of the opinion that they are going to be uber hawkish till they break inflation. Others can disagree and we'll just find out as we move forward from here.

Okay, last question and I'll call it a meeting. It should be on the three-week schedule that we like to stay on. **Larry asked, what are your thoughts on how responsive oil will be to the US economy falling in recession? $75 a barrel. Any comments on US elections?** Okay, two at a time. Yeah, oil is really a demand indicator right now. Yeah, it's down like 103 or so from 120 a week ago. That's a big fall.

But again, look at the rally that we had in oil in the seven weeks before the peak last week. And you could argue that this is just a retracement of that rally and that the fundamental move is still higher. We'll have to see, but your point is well taken. We get a recession and I'm assuming US recession also means a global recession. I didn't say that earlier, but I'm assuming that.

You'll see falling oil prices because demand should come off and demand should come off quite a bit because remember there's only about half of oil consumption is for transportation purposes, turning it into gasoline or turning it into jet fuel. The other half is for a lot of other needs like powering industry and powering manufacturing. And a lot of that can be reined in because of a recession and that can bring down the price of oil.

Comment on the US election. We've been updating in these numbers, and we were going to start rolling them out. I am a big believer in the betting markets. I think that the betting markets... And the reason I'm a big believer in the betting markets, let me be clear, they are an aggregation of all opinion into one probability. That's all they are. They're just aggregating opinion into one probability.

And right now, they've got about a 91% chance that the Republicans take the House and they've got a high 80s percent chance that the Republicans take the Senate. The polling data with the president's approval rating at the lowest level ever at this point in any presidency, the old record was Trump and he's worse than Trump right now, Biden is worse than Trump right now.

And the generic ballot showing that the public is favoring Republicans over Democrats for the first time in five years all suggests some sort of a wipe out in the election. Now, if you are a Democrat and you don't like that, there's five months left and maybe something happens in those next five months positively or negatively to change that equation. But if you look at the betting markets, again, can they be wrong? Yes. But then so is everybody else.

They just take what's known and aggregate it into one probability. And what the betting markets are telling us is it's a done deal. In January, we'll probably have a majority Republican Senate and a majority Republican House. And if I was to give you one qualitative remark about it, the way the public tends to work is, and I'll use some salty language here for you, is that we think that the Democrats suck, we hate them, we favor Republicans, we favor Republicans.

The first Tuesday in November, we vote Republicans into office and then the next day you suck. And then we start seeing if you could start unsucking, otherwise we're going to vote Democrats in in 2024. enjoy election night because the next day, again, salty language, you're a piece of shit and that you better start fixing things right away.

That's essentially what happened in 2020. We voted out Trump, we voted out the Republicans, we put in the Democrats, congratulations, you're in charge and now you're a piece of shit and you didn't fix anything, so now we're going to try the Republicans and then next day after the election, you're a piece of shit and let's see if you can fix things. That seems to be how the cycle goes right now.

We're still four months ahead of the election. Stranger things have happened. It's not just a series on Netflix. And we'll see if something comes down the pike that can fundamentally alter the outcome of the midterm elections. But the betting markets an aggregation of all known information into one probability, it's a done deal and the Republicans are going to take over.

All right, with that said, and I'll try and start publishing some of that stuff more and more. I was planning on doing it this summer and increasing the frequency into the November election as well. With that said, thank you for listening. We'll be on this three-week schedule. Talk to you again in this format in a couple of weeks. Bye-bye.

Inquiries: (800) 606-1872