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Conference Call

The Current Drivers of the Bond Market
May 22, 2025, Conference Call
(This transcript has been lightly edited)

Welcome to the conference call. Let's begin with some typical housekeeping. The handout was updated about 15 minutes ago and re-uploaded to the website. I made a couple of minor changes to it, nothing major. If you want to grab it, feel free to do so. I'll drive along and do my best to yell out page numbers if you're just listening to the audio-only broadcast with the handout. There is a question window. Go ahead and shoot your questions in there. I've already seen a couple of good ones. If they catch my eye during the call, I'll try and answer them where appropriate. Otherwise, I'll pick them up at the end of the call.

The title for today's call is 'Current Drivers of the Bond Market'. So, what's going on with yields? Why are yields going up? First of all, I want to talk about where we are in the cycle. I believe that the secular bull market in bonds ended in 2020. We are now in year five of a multi-year rise in interest rates. Year six starts in August.

What does that mean? It means that rates are going to keep going up. It also means that rates should be going up, because I would argue that we're only at fair value with bonds and everyone's getting themselves worked up about this because they're not used to it. It also means that we need to stop talking about zero interest rates and money printing. The only way that's going to happen at this point is if we have a complete wipeout. Call me when the stock market's down 50%, and then maybe we could start that conversation. But that era is over. This whole money printing thing is a bygone era. We're in a different era. It's more like the 80s and 90s, where the neutral rate is four. When we have a recession, we go to two and a half, and when we want to tighten, we go to six. That's the environment that we're in right now, which is why I say it's a secular interest rate.

Now, what's been bothering bonds lately? There are three issues with the bond market. Issue one is the bill that passed, which is going to increase the deficit. It's a negative for bonds because it's going to be more supply. Besson can stand on his head all he wants and try and change the mix of bills, notes, and bonds, but he can't fix this because we're going to have to issue a lot more one way or the other, and I think that's a drag on bonds.

The other thing that I think is a problem with the bond market is inflation. I am, to put it bluntly, an inflationist. I've been arguing that the turn in interest rates has been the turn in the inflation cycle, and I still think that we've got this turn in the inflation cycle. You can forget about 2% interest rates unless you tell me that we're in a recession. Call me when the stock market's down 30% on its way down to fifty, that's killing inflation. That's my signal that something is amiss, is when the stock market is way off of its all-time high.

The last thing I'll point out is that if you tell me that the economy's going to slow, might have a recession, and unemployment's going to go up over here, and over here you tell me that prices are going to go up and there's going to be more inflation, good luck with your recession and unemployment. There will be no Fed rate cut, that inflation and prices take precedent over the weakening economy.

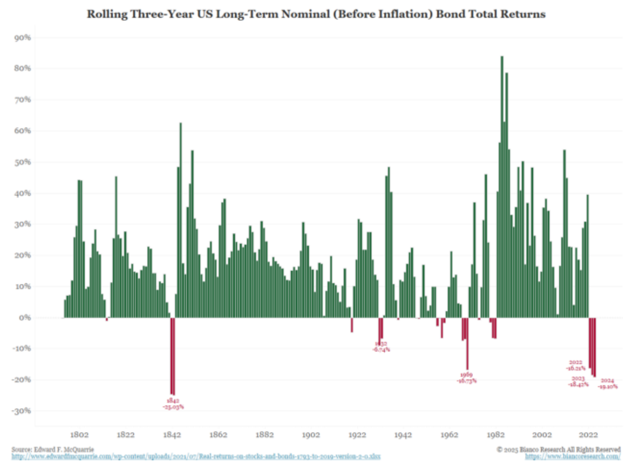
Now, why do I say that? Because I watch financial television like everybody else. Everybody else is like, let's say there is no inflation, now let me give you forty-eight reasons why the economy's going to slow, the Fed's got to cut. That's an old cycle. That's pre-2020 thinking. In this environment, it is good luck with your recession. We aren't doing anything until prices come down. If you want an example of that, think 2022. In 2022, the first quarter was negative GDP, just like the first quarter was this time. But we had inflation going to 9%, what was the Fed doing in response to negative GDP? They were hiking rates seventy-five basis points a meeting. They were taking precedent on prices and Powell gave his famous speech in August of twenty-two at Jackson Hole, which was eight minutes long, dubbed the 'will be pain' speech.

And I used to joke about it on this call. Remember, your patriotic duty was to lose money, because therefore you would stop spending cool demand, bring down prices for the lower half of income. The point there is prices take precedent. If you tell me that inflation is going to go up because of tariffs or anything else, the conversation's over. There will be no Fed cut. Unless you tell me, things are going to fall apart so bad that it will offset that rise of inflation. And that's bad. It's got to fall apart. There will be no rate cuts.

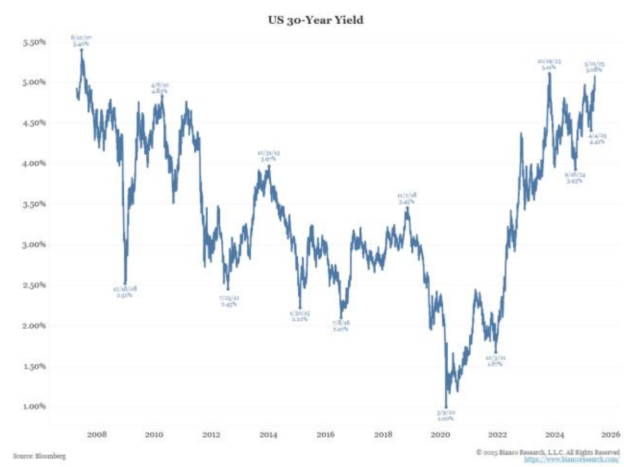
Finally, if I have some time, we do run an ETF, and I wanted to update you a little bit on the ETF. So, with that as where I want to go with this, let's talk about the current drivers in the bond market.

Here's a chart of the 10-year Treasury yield back, it's two hundred or so years or so. This chart starts in 1792, and it's updated through the end of April of this year. Yes, the Treasury does have data on it. And I put some cycles on this chart. And you can see what I've pointed out here is the high was 1584 on the 10-year note in September of eighty-one. The low was in August of 2020 at 52 basis points. That's your 40-year cycle. It's over. And we are now in a multi-year cycle of higher rates.

Let me back up on this chart here. Getting off of zero to somewhere around four and a half to five, depending on if you're using the 10-year or the 30-year, was extraordinarily painful. I've used this chart before. Ed McCrory of Santa Clara University has put together a yearly total return index for long-term bonds. And long-term nominal before inflation, he's also got a real index as well, I took his numbers, and I put them into a rolling three-year average. In the three years ending in 2024, the bond market lost you 19% of your money. That is the worst that we have seen since 1842.

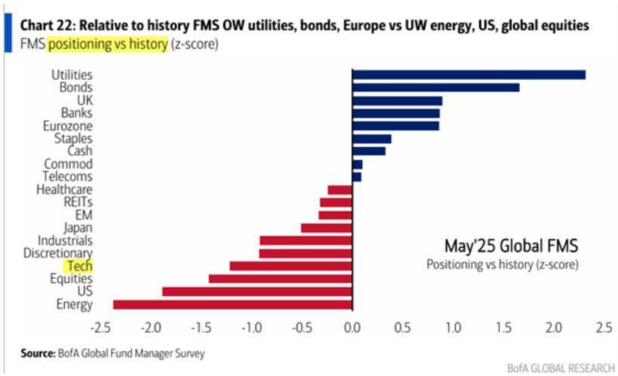


By the way, what happened in 1842? We actually were down to $30,000 of debt. We almost completely extinguished all the debt in the United States. So even though it lost you 25%, it lost you like $4,000, the entire country or something like that. It was not a significant number. But nevertheless, we have never seen a wipeout like this in the bond market. And it has scarred a lot of people, that wipeout in the bond market.

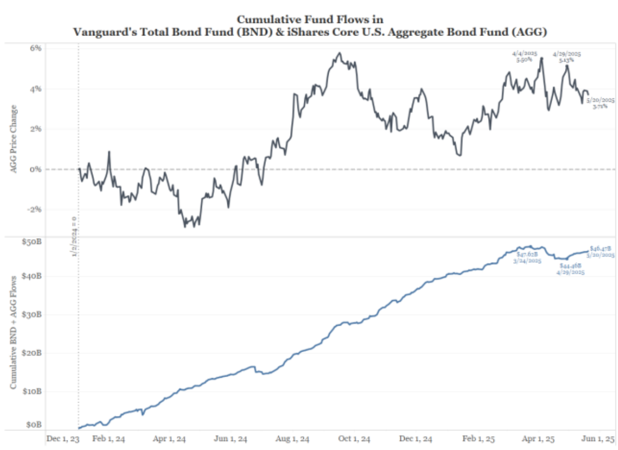


And that's, again, here's the 30-year bond. So that's because to get from that 1% low in March of 2020 up to over 5% right now, this is yesterday's close, 508. And as I look at my screen right now, we are at 510. We have traded as high as 515 today. But to get from here to here required the worst bond market in 180 years.

The good news about that is that that era is now over for us right now. And going forward from here, you'll have lower durations because of higher coupons, the positive to the lower durations. You'll have a coupon to offset it. So, in this environment, and I'll talk about this when I get to some of the return numbers in the ETF, a bad year in "Bonds are not going to be like 1% or zero. They're not going to be minus 19. That era is over for us for right now. Where is the public on the bond market? They're pretty bullish on the bond market.

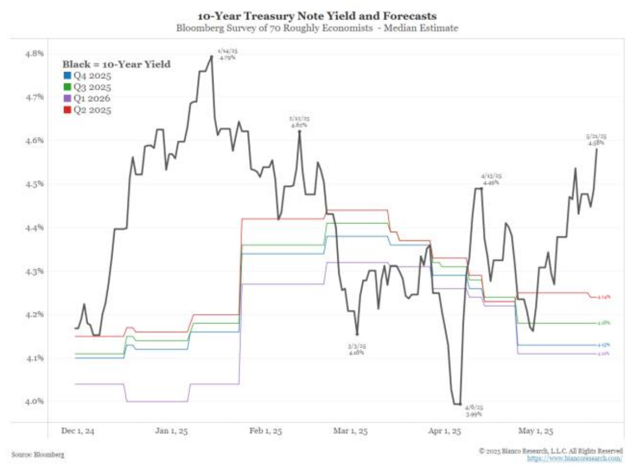


So, here's the Global Fund Manager Survey done by the Bank of America. This is the May FMS's Fund Manager Survey. And this just shows you their positioning versus history on a z-score. A z-score is a number of standard deviations off of an average or so. And what I'll point out to you is bonds are number two right here. Everybody's long bonds right now. What they hate is the U.S. The U.S. has been outperforming since this report came out. But everybody likes the bond market right now, at least global fund managers are.



Additionally, here's the cumulative flows in chart slide six. Here's the cumulative flows into the two largest bond ETFs, BND, which is the Vanguard Total Bond Fund, and AGG, which is the iShares BlackRock U.S. Core Aggregate Bond Fund. Both of these ETFs are benchmarked to the Bloomberg Aggregate and U.S. Aggregate Index. For those of you that are old enough, they used to be Barclays, they used to be Lehman Brothers, same index. And both of these funds are within a couple of billion dollars each other at about 130 billion dollars each. So, this is over a quarter trillion dollars of money in it.

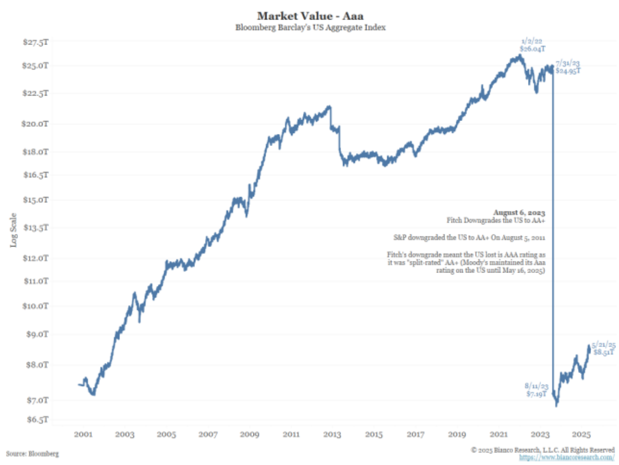
So, here's the return of AGG, BND is exactly the same. I just put one of them up there so you can see what the returns are. And over the last 18 months or so, you could see that something like forty-six billion dollars has come into these funds. Now, this isn't the entire bond universe, but it's a good proxy for it. The two largest fixed income funds in the world, which are almost identical to each other. But you could see that there is that giant upward pull, again, just like the fund manager survey. Everybody seems to like bonds at this point.



And then finally, there's the economist survey. So, Bloomberg surveys a bunch of economists, they ask them lots of questions. What I pulled out of this survey was, what do you think, where do you think the ten-year yield is going to be at the end of the third quarter, fourth quarter, first and second quarter of next year? The black line is the actual level of the ten-year, so 458 as of yesterday. But you could see, here is where they think that rates are going to be, lower and progressively lower as you go from the third quarter to the first quarter, the first quarter to the second quarter of next year. So, there's still this belief that rates are going to come down.

So, while a lot of investors have been scarred by that period of 2020 or 21 to 24, there is a lot of hope out there in the market right now. From a contrarian standpoint, it's a little worrisome. But these are all long-term numbers. These are all long-term measures. Now, you could say, well, what about like the commitment of traders or what about some of these other shorter-term measures or TLT inflows, which is more of a trading vehicle than an investing vehicle. This BND and AGG are what we would call allocator funds. Money goes in, it stays in for a long time. TLT, which is the iShares 20-year treasury, is a trading fund. We just punt on that. But in all the allocation investment decision type of money, a lot of money flowing into bonds right now.

Now, part of that might be because there's a bit of a negativeness about stocks or the overvalued Ness of stocks. And part of that might be because there's a coupon again, and that that coupon kind of fits everybody. But let me jump on, talk a little bit more about bonds on a couple of other things as well, too.

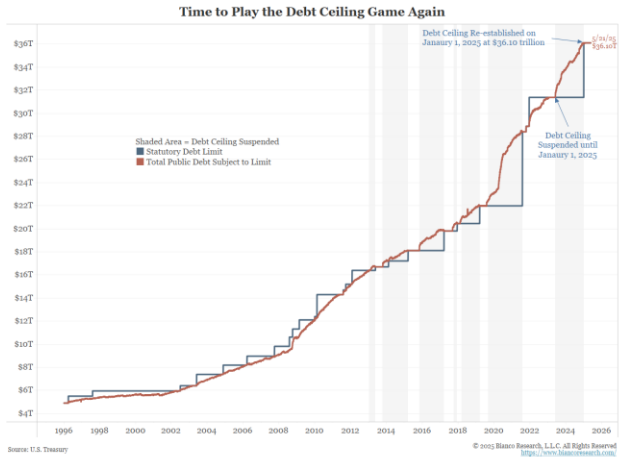


Here is the market value of all AAA securities in the Bloomberg, boy, I got to update this title because Barclays is not, it used to be called the Bloomberg Barclays, which was many years ago. But it's the Bloomberg U.S. Aggregate Index. And as they point out, in August of 2023 is when you saw the big drop in this aggregate index, almost two years ago. Remember that there's three rating agencies, there's S&P, Fitch, and Moody's. What is the rating of a sovereign, whatever the preponderance is? So, in August of 2011, S&P downgraded the U.S. from AAA to AAA+. The U.S. was still a AAA country because Fitch and Moody's had them at AAA, so we were split rated AAA.

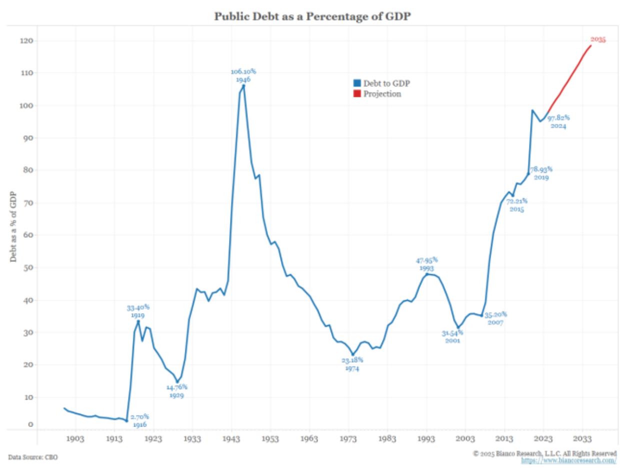
What interestingly, for this crowd, you'll find it interesting, hopefully, is that when S&P downgraded the U.S. to AAA+, in August 2011, all hell broke loose. And the reason all hell broke loose was that a lot of investment directives, a lot of collateral requirements, loan agreements, and the like, all stipulated that any kind of collateral or investment ideas had to be in AAA securities. Well, S&P just downgraded everybody, and they freaked out. Does that mean forced selling? Does that mean that my T-bills up at margin for whatever marginable security I have are no longer valid? Well, it turned out they were because they were still split rated AAA. So, when we all got worked up about it, we said, well, they're still AAA.

So, what did we do over the next several years? A lot of those contracts got rewritten to say government securities are AAA or government securities to that degree. So, government securities, regardless of their rating, would apply in investment directives and in collateral requirements and everything else. So, when you got to August of 23, when Fitch downgraded the U.S. to AA+, then we became a split rated AA plus country in August of 23. And it had almost no impact on the market because no one was forced to do anything because now it's that government securities. And when you got to Moody's last week downgrading the U.S., newsflash, we've been an AA plus country for almost two years. So, they didn't downgrade the U.S. They changed their opinion to bring it in line with what we already were.

Now, is it an important message that Moody's had? Yes, it's a very important message that Moody's had. Their message, which gets me to the next set of charts, was we have too much debt, too big a deficit, the crowding out of debt, and the amount of borrowing that we're going to do, especially based on the big, beautiful bill, is problematic. And I agree with that. And that is one of the issues that we have to face with.



So, starting with this chart, time to play the debt ceiling game again. And we're playing it right now full time. So, the red line is the total amount of public debt subject to the debt ceiling. And that's at $36.1 trillion. The blue line is the debt limit. That's also at $36.1 trillion. We've been at the debt limit since January 1st.



Now, you might ask, wait a minute, why is the blue line under the red line? That means that we have more debt than the debt limit would allow. All these shaded areas, starting in 2013, what the Congress has started to do is all these shaded areas is they would suspend the debt ceiling. And what they would say is, on this date, and this was in July of 2023, they said, on this date, we will suspend the debt ceiling. It doesn't count anymore until January 1st, 2025. Whatever the level is at that date becomes the new debt ceiling. And so, it's not surprising, by the way, I might add, that in July of 2023, we suspended the debt ceiling in the last debt ceiling fight.

So, these are all the times we suspended it. We've never done it before 2013. That's kind of the new mechanism that they use. They just say, we're going to ignore it. Well, in July of 2023, we decided to ignore it. August 2023, Fitch downgraded the U.S. And it's precisely because of this measure that we've been seeing these downgrades in 2011, 2023, and last week, based on the bill.

So, we are now at the debt ceiling. We are using what is known as extraordinary means or extraordinary measures, whichever phrase you want to use, in order to keep funding the government. What are extraordinary measures? They come in two forms. Form one is we can't net borrow anymore, but they can collateralize borrow. What that means is that the government issued $16 billion worth of 20 years yesterday. The auction didn't go particularly well. We saw yields go up. Well, how'd they do that under a debt ceiling? They went to the government pension plans of government employees, and they collateralized $16 trillion against it.

Now, as I've often joked about talking about this, if you're a private corporation and you were to say, "Hey, we need to borrow some money to fund this company, keep it afloat. Well, the bank won't give us a loan, but we'll just collateralize it or secure it against the employee's pension plan." Everybody goes to prison. You're not allowed to do that. Well, the government's allowed to do that, and they do.

Eventually, they'll run out of collateralized money. And then what they have is the Treasury's general account. That's like the Federal Government's checking account held at the Federal Reserve. And that's got about $400 billion in it. That's the operating account that they use to pay the Federal Government's bills. Well, they could start running that down.

When you've run out of extraordinary means, and you've run out of TGA money, and you both hit zero, then you get to what's called the X date. The X date is the technical default date. That is estimated to be somewhere around August. And so, we're OK right now, but somewhere in the month of August, the Treasury has been a little bit vague on what is the exact date.

Now, part of the reason that what is the exact date, and I was planning to talk about the X date probably in July or something like that, if it still applies. And I think it will. I'll give you more detail on it then. But I'll just tease you. The Treasury has a lot of leeway in how they can define this stuff. They can't define the debt ceiling forever, that we could somehow keep collateralizing and playing accounting tricks until the end of time, so that the debt ceiling stays at 36.1, the amount of debt stays at 36.1, but we keep borrowing until the end of time.

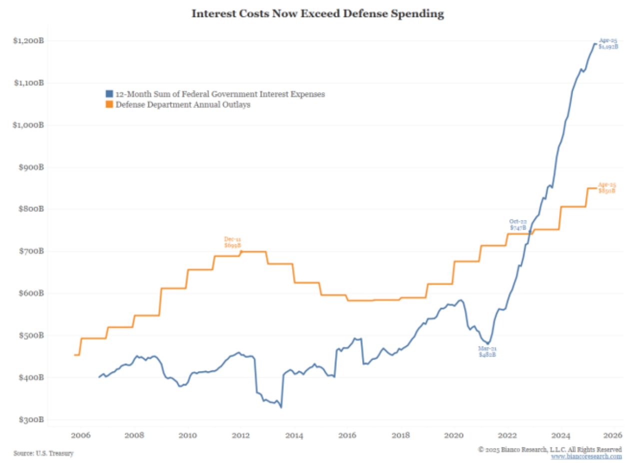
They could play the game. They could say, if it's to their advantage, they could say, "Look, middle of May, we hit the X date," if that's what works for them. That's what always worked for Yellen and for Biden because they wanted to pressure Republicans. So, they wanted an X date as soon as possible. But now they could say August, and if they run into problems with the bill, Bessett could do some hocus pocus and say, "Well, it looks more like around September 30th or something like that," if they need more time.

Like I said, it's all about the assumptions they use. They can't say, "Well, I did some hocus pocus and it's 2035, don't worry about it." He could play in the period of weeks or a month or two, but he can't play much beyond that. And again, that's just because it's a forcing mechanism that we hit the technical default and that that would hopefully get a crisis atmosphere in Congress to pass the bill.

Do they want the crisis atmosphere sooner or do they want it later? They want it later because they just passed the House bill last night. Actually, this morning, around 6 a.m., they passed the House bill. For those of you that are not familiar with the government, remember, the House bill passed. The Senate will then take up this measure and pass a different version of it. And then it will go to conference and get ironed out. And then it has to repass House and Senate is exactly the same bill. And then it goes to the president's desk. And in the bill will be the raising of the debt ceiling.

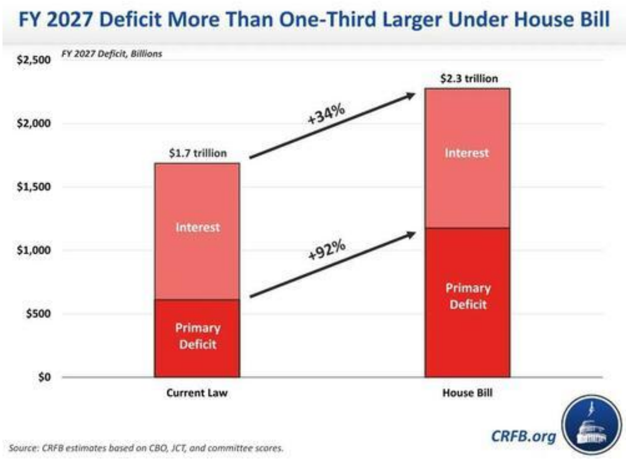
So, if they don't get this done by August, then we're going to have a real problem on our hands. Just finish filling up about the problem that we saw with the Moody's downgrade. And here's public debt as a percentage of GDP. 1946, that is 106 percent. That's the funding of World War II. Clean this up. That's the pay for World War II right there. That is nominally the highest level we've ever seen. We're at 97 percent right now.

And this red line is a Congressional Budget Office's estimate from a month ago before they started working in the bill. Now, they won't change this until the actual bill passes. They'll score the bill, but they won't change their ten-year estimate until the actual bill passes. But yet what we're talking about is a new high in debt to GDP.



Also, we're talking about we're at the Ferguson ratio. Now, I've talked about this before. Niall Ferguson is an economic historian. He wrote an essay in February in The Wall Street Journal talking about the Ferguson ratio. It's not named after him. It's named after the 17th-century economist during the Enlightenment, Adam Ferguson. And Adam Ferguson said that whenever a country pays more in debt service, and that is the U.S. right here, $1.2 trillion a year in debt service than they do in defense, $850 billion. And what I show here is that crossed over in October of twenty-two.

One of two things happens. Either that great power that's paying more in interest costs than debt stops being a great power, or they quickly correct this. And Niall Ferguson, taking Adam Ferguson's rule, went through the last 250 years and said that's pretty much true. Whenever a great power starts paying more in interest costs, they're done, unless in the case of the British Empire in the late 19th century and some other examples, they reversed it really quick. And they reversed these numbers really quick. And that isn't that, oh, we just need to spend more on military because that just raises your debt ceiling, and you never catch up to it. It's that you have to get your finances back in order.



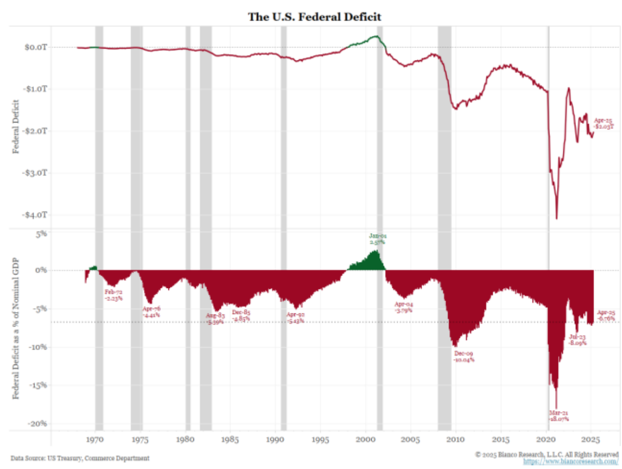
This is the problem. Now, this is the problem. Now, here's the bill. And here's the estimate of the current law and the House bill as far as the primary deficit in interest goes, that it's going to take it from $1.7 to $2.3 billion.

Now, here's the issue. 60 days ago, maybe even 30 days ago, it was a reasonable estimate that what we were going to see in the bill was two things. We were going to see what's called the tax cuts, which aren't really tax cuts. Nobody's taxes are getting cut. It's that they cut taxes in 2017. It's supposed to expire at the end of this year. And if they don't do anything, there's a massive tax increase. So, the tax cuts they're talking about is just making the current level, which has been enforced for eight years, permanent. So, nothing will change from that.

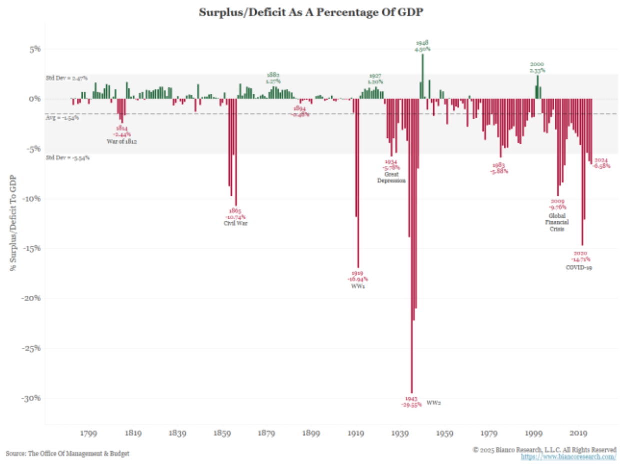
But we were also expecting two other things. The first thing we were expecting was under the Republican Senate, the Republican House, the Republican president, and Trump himself described himself two days ago as a fiscal hawk. We were expecting to see a reduction in the budget outstanding. This is showing that there's no reduction in the budget outstanding.

At the very least, if you go back 30 or 60 days ago, we had Doge and we had Elon. And they were promising $2 trillion of cuts. Did anybody believe we were going to get $2 trillion? No. I don't think anybody believed it. But we thought we'd get something. In other words, they would identify waste, fraud, and abuse, and it would get factored into the bill to basically legislate out that waste, fraud, and abuse. Now, not $2 trillion, but some meaningful number.

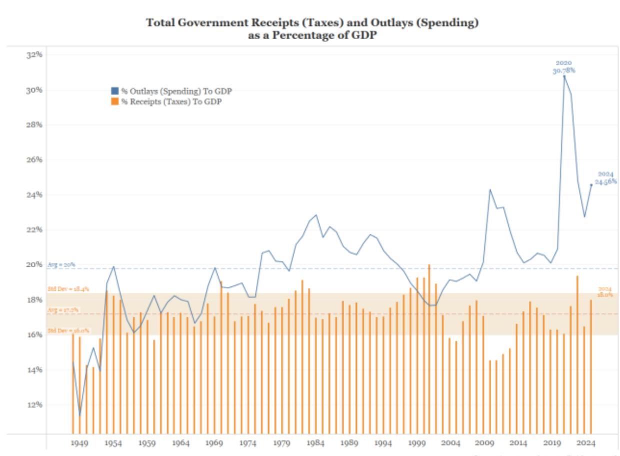
Fast forward to today, there was almost none of that in the bill. Elon's not spending any more money on politics, and he's back to running Tesla. So, all of those, I think that all those, I'll be blunt about it, get my point. All of you that lit Tesla's on fire, you won. You won. And the reward is the country's worse off now, because we are going to have to deal with bigger deficits and higher interest rates. Because we all know the government, It's inefficient. We all know that there are ways that they could save money without impairing the delivery of government services. But we elected not to do that. We elected to continue to send forms down to a mine in Pennsylvania and waste money on all the other things we are doing. And we're all going to pay for it with higher interest rates. So, I don't know exactly what we won, but Elon backed off. He's running Tesla. He's not spending money on politics. We didn't get that in the bill. And Trump came out and said, 'Look, we're not going to touch Social Security. Now we're going to touch Medicare. We're not going to touch disability. We're going to increase the defense budget to $1 trillion a year to modernize the military.' Okay, that's why we've got a bigger deficit.



And what the bond market hears is, 'You have to issue more bonds.' And Bessie can't fix this by saying, 'We'll issue more bills and less notes and bonds.' You just have to issue more bonds. And that's what's being reflected in the price. Now, this bill is not done. We'll see what the Senate produces. And then we'll see what they produce in conference. But the expectations are that the deficit, and here is the deficit chart right here. And it's shown in a couple of different ways. Here is the actual deficit of $2 trillion. This is as a percent of GDP at 6.76%. The CBO and Moody's are saying, 'Look, this number is going to go to 8%, or it's going to go to 9% is what that number is going to go to.' And that's why they downgraded the US.



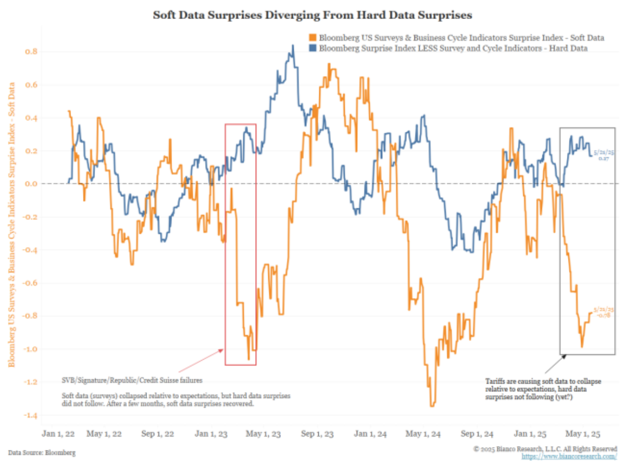
Now, let me show the chart this way. Here's the deficit as a percent of GDP all the way back to 1790. And what I'll point out here is, let's say we go to 8%, because that's what the bill is suggesting that we're going to go to. When have we ever been at 8% or more in American history? Five times. COVID, the financial crisis, World War II, World War I, and the Civil War. Only times we've ever seen a budget deficit this big was in the middle of a major crisis that defined this country. The Civil War, World War I, World War II, the financial crisis, and the immediate trying to stimulate the economy out of the financial crisis and the global shutdown because of COVID. And now what we're saying is, what used to be the level of the budget during a major crisis is now normal. And that's why you're seeing rates tick up. And I think you're going to continue to see rates tick up.



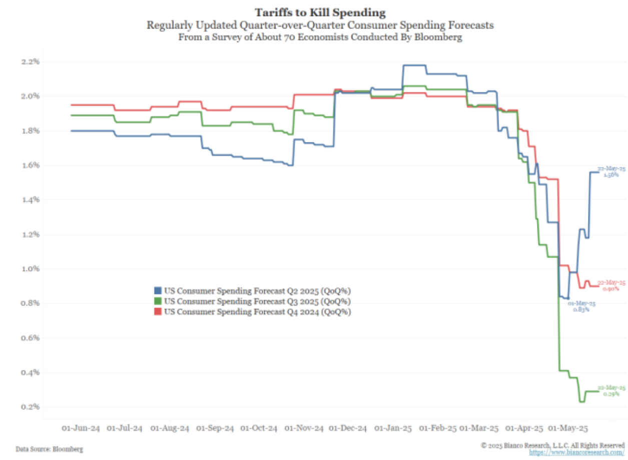
Well, how do we fix this? And this gets me kind of leading into my transitioning into my second section. So how do we fix this? Raise taxes. Okay, here's the problem with, or cut spending. Well, here's the problem with both of these. So, this chart goes back to World War II. This is as a percent of GDP. The blue line is outliers are spending. What is the government spending as a percent of GDP? 24.5%. Or in other words, a quarter of our economy is now the government. And as you can see from this chart, all the way back to World War II, the only other time it's been higher than this had been the COVID response. Not during the financial crisis, not during any of the other recessions, not during the Vietnam War, the Korean War, throughout the nineties, throughout the 2000s, the aughts. Never, never seen it this high other than the COVID response.

Well, one argument you can make is we need to cut spending. Everybody agrees with that. But as I said earlier, Trump came out and said, 'We're not going to touch Social Security, not going to touch Medicare, we're not going to touch defense. We're not going to touch any of this stuff.' So, we're not going to cut spending. Okay, so what's the other thing we could do? Is we could raise taxes. Best metric of taxes is the bars. This is taxes as a percent of GDP. And I put an average and a standard deviation shading on that chart. Now, for those of you that are not, you know, got a C in statistics, 66% of all the readings are within the shaded area. When it goes above or below, it's one of the more extreme readings. What we've found over the last 70 or 80 years is the optimal amount of taxes that the US economy can handle is somewhere around 17%, 18% of GDP. The average has been 17.2%. When you start getting above 18, you know, pushing nineteen or so, the economy starts to drag at that point. It can't handle, you know, you could tax up to 100%, but then you're just going to have a poorly functioning economy.

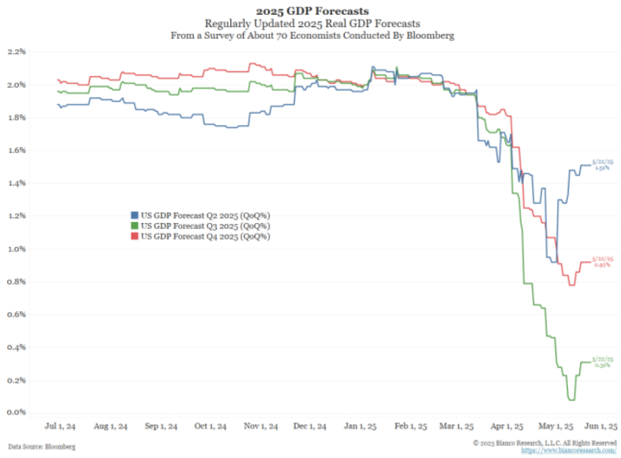
So, this is why you see that number fairly constant. And by the way, the biggest variability in this is capital gains. In 99 and 2000, we had the tech bubble, and everybody had capital gains. It went up. Then we had the bust. Then we had the bust after the financial crisis and capital gains became capital losses. And that's why you saw the percentage that the government took in is less. So, what you've seen, what you see in this number is around 18% is what we could tax. We cannot go much more. Like I said, we could go wherever we want. But if you want to continue to have, you know, robust economic growth and low unemployment, then, you know, you got to stay there. Now, if you want to have what this is, is European style, you know, social spending. And then if you want to push this up to European style taxes, you're going to have a European style economy. You're going to have a poorly performing economy with chronically high unemployment and, you know, and very little innovation and a lot of regulation. And we don't want that. And so that's why we're kind of stuck in this quandary. The difference between this is the budget deficit, but we can't really raise taxes to the extent that we want to. And I'll shelve the tax argument for a second.



And I'm going to move on. I'm going to move on to the next set of charts, and I'll come back to that. So where are we with the regular, with the economy? Soft data versus hard data. So, as we know, economic data can be split up into two broad categories. Hard data, the number of cars you sold, the amount of retail sales, the number of people that got a job, actual physical statistics that you could measure on the economy. Soft data is surveys, your opinion about certain things. That's not only consumer confidence, but it's ISM, the Institute of Supply Management, the regional Fed surveys, just to name a few of them as well. What we have seen is in orange is the soft data has gone down, but the hard data has not gone down. That is a rare situation. Has not happened that much in history, and certainly not to this degree. The last time we saw something similar to this was the middle of twenty-three when the soft data went down, and the hard data went up. That was when Silicon Valley Bank, Signature Bank, Credit Suisse, First Republic all failed. We thought we were going to have a financial crisis. That's why the soft data went down. We didn't. And eventually, when we realized, we weren't going to have a financial crisis, the soft data started to recover.

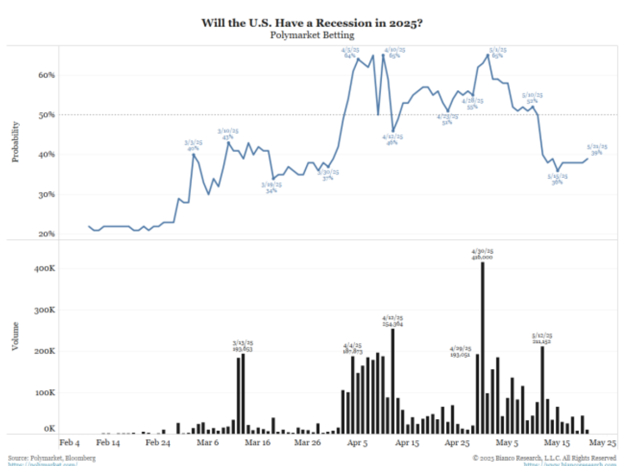


Right now, we're in an unusual circumstance. On May 22nd, we think the economy is okay, but we think that on September 22nd, it's going to be a disaster, that there's this wall up that we're going to hit. And that's why the soft data went down. The hard data is not showing it. So where are we with the economy? So let me go back to this Fed, excuse me, Bloomberg survey of seventy economists. They asked, like I said, lots of questions. I pulled out another question. What is your quarter-over-quarter estimate of consumer spending? Blue is the second quarter. Green is the third quarter. Red is the fourth quarter. Two things to note. First of all, all of these numbers have started to turn down with the tariff war, especially after Liberation Day. Green is the third quarter, and red is the fourth quarter, expected to see really low numbers of increases in consumer spending. The second quarter was expected to See that, but it's been rebounding quite a bit now over the last couple of weeks in the second quarter. Now, that could be potentially because we have the reprieve in the tariffs.



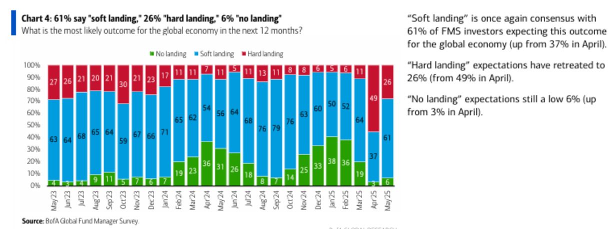
Before I comment on that further, let me show you a very similar-looking chart. This is their forecast for GDP. Again, blue second, green third, red fourth. You could see that in this chart, the same pattern started to turn down with tariff talk. The second quarter is rebounding higher, and so the hard data is showing you that the second quarter, which we're in now, ends June 30th. We just went past the halfway point.

The second quarter is going to be okay, but we still have this fear of the third and fourth quarters that the economy is going to slow, and it's going to slow dramatically. Are we going to have a recession? That's really what the question then becomes. Now, remember, the definition of a recession is not two negative quarters. It's almost always been the case that two negative quarters is a recession. There's only been one case in history where that was not, 1947. A recession is whatever the National Bureau of Economic Research Committee decides is one. But are we going to have a recession?



So, there is a betting market, a poly market, one of the prediction markets that I looked at during the election, and they're very robust as well. Will we have a recession in 2025? There's a whole definition of what it is. They actually will use two negative quarters as well. It was on May 1st, 65%, and currently it is at 39% or so. So, the potential of a recession is coming down, but 39% is still pretty high.

How accurate is this? It's, you know, I've used the analogy, it's as accurate as the point spread. If you tell me that your football team is a seven-point favorite, it doesn't mean they're going to win by a touchdown, exactly seven points. But it does give me some useful information that my team is perceived to be better than the other team by roughly seven points. And then we'll play the game, and we'll see how it plays out. Well, this is what is the perception. But how accurate is that perception versus other metrics?



So here is the fund manager survey, the BFA Global Fund Manager Survey. There is May. We use the airplane metaphor. Soft landing is in blue, which is weak growth. No landing, which is in red, which is full growth, if not more. Hard landing in red is a recession. It was 49% in April. It's 26% in May. Roughly speaking, this PolyMarket betting market is roughly in line with the Global Fund Manager Survey. So, there is a high elevated chance of a recession.

Bear in mind, how should you look at what the probability of a recession should be? If every seven-odd year we have a recession, then in any given year, if you think we're not going to have a recession, then your odds should be 15%. One in seven. If you put it at 30%, you think that there's twice as likely a... It should never be zero. It should only be one hundred when we're in a recession. So 15% would be you saying, if you think that a recession happens on average every seven years, and that's about historically what it's done, and we're five years in, from the last recession, because last recession ended in April of 2020, so we're actually five years and a month in, you could argue that if you think there's no recession, what is the appropriate probability you should assign to a recession five years in and you think there's going to be no recession? Probably a little bit higher than 15% because we're in five years. Maybe around 20%, 25%.

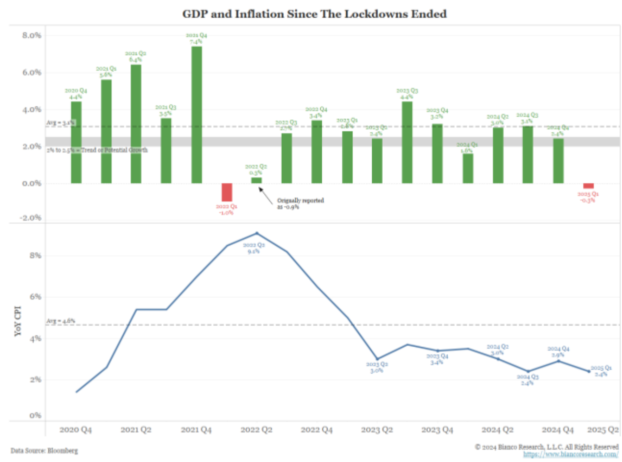
So, 36% or so from PolyMarket is a bit elevated. Obviously, 60% is, 50% is or so. But I just wanted to point that out. I think that's the proper way to look at recession probability. It's not that it's zero or 100%. It's that at this point, 2025 would be somebody saying that there's no, I don't think we're going to have a recession. It should be a little bit more elevated because we're in the fifth year. Twenty-five percent says that we'll probably have a recession in the next four years. Well, that means we're going to go nine years without recession. That's about as long as we've ever seen. The record is like ten and a half. So that sounds about right. Or 20% is five years without a recession. I would put it's 10 years, one in five chances of a recession. That's about right as well.

Economic expansions do not die of old age, they are murdered - Rudi Dornbusch
Post WW2 Recessions and Their Triggers

Start	End	"Murder Weapon"
Feb 1945	Oct 1945	Dramatic Drop in Military Spending (End of WW2)
Nov 1948	Oct 1949	Demobilization of the WW2 Economy
Jul 1953	May 1954	Dramatic Drop in Military Spending (End of Korean War)
Aug 1957	Apr 1958	Suez Crisis/Sputnik
Apr 1960	Feb 1961	Tight Monetary Policy
Dec 1969	Nov 1970	Vietnam War
Nov 1973	Mar 1975	Arab Oil Embargo
Jan 1980	Jul 1980	Highest Inflation of the Century
Jul 1981	Nov 1982	Punishing Interest Rates (15% 10-year)
Jul 1990	Mar 1991	Iraq Invades Kuwait (~200% rise in Crude Oil)
Mar 2001	Nov 2001	Tech Bubble Popping/September 11
Dec 2007	Jun 2009	Housing Crash/$145 Crude (July 2008)
Feb 2020	Apr 2020	COVID-19

But let's talk about, again, what a recession is. Economic expansion. I use this all the time. So, I assume most of you already know it. Economic expansions do not die of old age. They're murdered. The economist, Rudy Dornbusch. Again, the natural state of an economy, of a capitalist economy, and we are one despite everything, is to grow. And what happens is we have all of these events, COVID, wars, oil embargoes, that cause people to change their behavior and cause them to stop and the economy to track. Is the next line going to be tariff war? That's why I was elevated. In the last call, I said I was 50-50. But I also said in the last call that in 90 days, I'll either be 15% or 20% or at 70% or 80% or something along those lines.

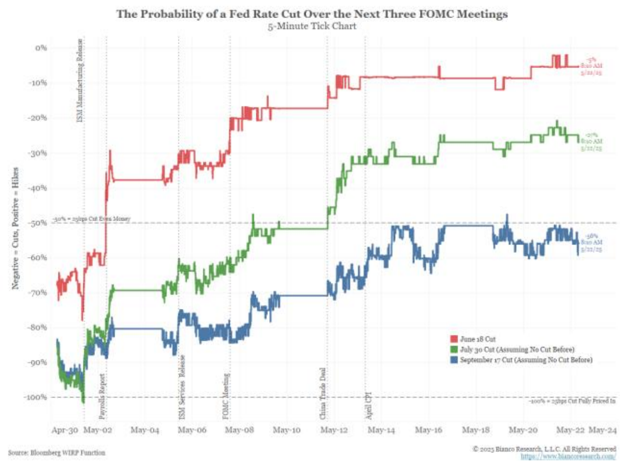
Well, I was at 50-50. And now I think that I'm probably now moving back towards 40% or 35%. And thinking kind of in line with everybody else. But I'm thinking that the possibility or the probability that the tariffs are going to cause everybody to get scared enough to change their behavior is receding right now. And the reason I was so high was this was a legitimate murder weapon, these tariff wars. Just like I said two years ago, it was a legitimate concern that the bank failures were the murder weapon. But it turned out the bank failures weren't. Maybe this is still work in process. Maybe this does or doesn't. But if you asked me to say one or the other, I'd say we're probably not going to have a recession.



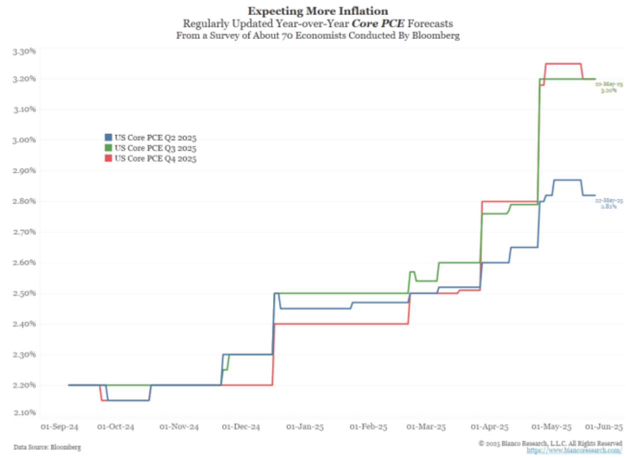
That gets me to the point of what is the point of a recession? So, here's GDP since the recovery began. Averaging 3.1% is what you see over this period is what GDP has averaged. The economists don't know what potential is. Potential is if no one is stimulating or slowing down the economy, what does it grow at? Untouched. But that's around 2% to 2.5% is what that is. That's this shaded area right here. And so, here's all the quarterly numbers. In the first quarter of twenty-two, we had a negative number. In the second quarter of twenty-two, we had what was originally a negative number for over a year, and then eventually got revised to positive 0.3 a couple of years later in one negative number. We got a negative number now.

Here's CPI. CPI was shooting up to 9%. What was the Fed's response to that week period with negative growth in a barely positive number? They were raising rates like crazy throughout twenty-two, including seventy-five basis points a meeting for four consecutive meetings from May to August of 2022 because the inflation rate was going to 9%. In other words, good luck with this slowdown. We are hiking because of prices. And so, I would argue we're going to have something similar to that, too. Good luck with this slowdown.

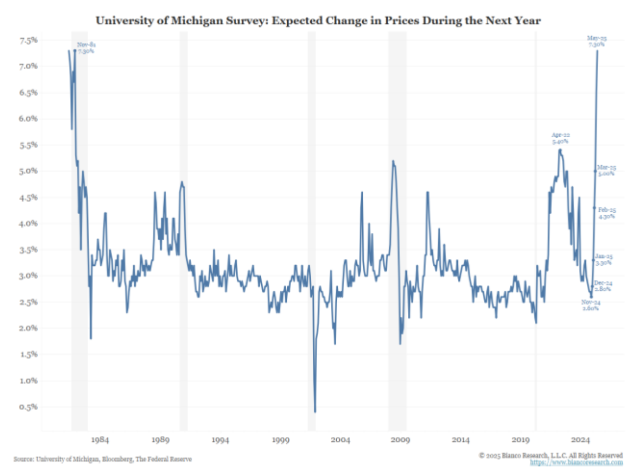
Go ahead and argue all day long that we're going to have a recession and higher unemployment. And I'm not going to disagree with you for argument's sake. But I'm going to say that if inflation is going to stay elevated, then what you're going to see is you're going to see no movement from the Fed, no matter how bad you think the real economy is.



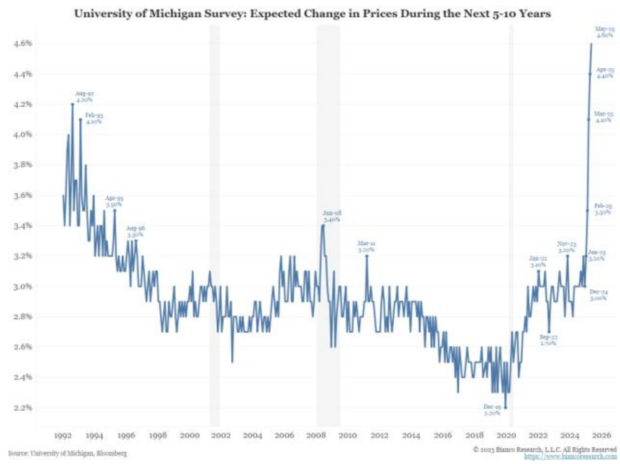
Stagflation means no rate cut if you want to put it in the simple terms. And here's the probability. I updated this about 20 minutes before we started. So, here's the probability that the Fed's going to cut rates. It is 5% at the June meeting. It is 22%, you know, 78% that they hold at the July 30th meeting. Now we're in the football season. September 17th is 56%. That means a 44% chance of no move. That's a coin toss. So, to "The economy's in trouble. We're going to have a recession. Everything's bad. The Fed's going to get right on it. In four months, they're going to cut rates. Now, notice the trend. Give this another month, and we'll be talking about the next rate cut beginning of next year, and so on. Then give it a couple more months, and it'll be the middle of next year. At this point, it is about prices and inflation. You could end the conversation that maybe we have a recession. Maybe we have unemployment. That isn't going to do anything about that if we have higher prices.



Now, why is it that we're going to have higher prices? Let's start with the Fed's favorite measure. Back to my Bloomberg survey of seventy economists, core PCE. Here's second, third, and fourth quarters, year-over-year core PCE forecasts. Here's the beginning of the year. They are going up right now, those forecasts. You'll notice that they dip down a little bit right here. That's probably because they backed off on the Chinese tariffs. OK, I could down tick my already elevated forecast. But let's just go with these forecasts just for an argument's sake. If in the second and third, you know, if we're saying the second quarter is going to be 2.8%, which is where it is now. And then the third and fourth quarter is going to move over 3% on core PCE. I'm sorry, Fed's not going to cut rates. They're just not. They are not going to cut rates in this environment.



And why aren't they going to cut rates in this environment? Well, actually, I jumped the gun on that question. I'll answer, why aren't they going to cut rates in this environment? Because if this forecast is right, I'll say it this way. If this forecast is right, and inflation is going to go up, and maybe this is skewed because it's more Democrats than Republicans. But here is the University of Michigan. And all these surveys are showing something similar, two different degrees.



The Michigan survey is the most extreme of them. They're expecting a 7.3% increase in the inflation rate in the next year. That is something similar to what we had in 2022. Now, maybe that's overdone. Probably is. But the expectations are that inflation is going to go up. And even on a 5-to-10-year basis, the expectation is that inflation is going to go up to some degree. Maybe not this much, but it is going to go up at that point. And that is going to keep the Fed from cutting rates.

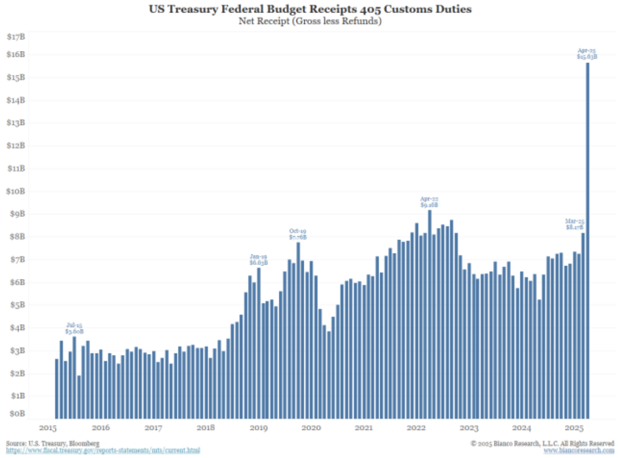
Kayla asks, the real estate market is showing signs of slowing, sort of. I'll talk about that in a second. The economic slowdown hits first. Won't the Fed be prompted to cut rates later this year to contain a systemic risk? No. They didn't in twenty-two. And know if all of this inflation stuff is playing out.

And why did I say sort of? I am of the opinion that everybody's overstating. And let me make my argument here. In mortgage rates, they're not going to save the market. Let me talk about residential real estate. If the argument is that the average price of a home, $440,000, the average house in the United States with a 7% mortgage or so, you do the math. And I think if I'm remembering properly, I know I'm pretty close on this. It's like $3,200 a month is like the average mortgage in the United States. OK, that's too high. We got to get the average mortgage rate down. We can't. We can't unless everything falls apart.

In other words, why did I say it that way? Because if the Fed came out and said, as the question implies, that first of all, what the question implies is that interest rates are these made-up numbers. So, we'll just make up. They're also driven by market forces. And market forces are pushing them higher. Too much debt, fear of inflation, stagflation are pushing rates up. If the Fed were to lower rates, and let's argument leaving off the side that I actually think if the Fed were to cut rates today, you'd probably see a big spike up in long term rates like you did in September. But leaving that aside for a moment, if the Fed were to cut rates and mortgage rates were to come down, homeowners are just going to raise the price of the home. And you're going to be backed with $3,200 a month payment for that house. You're going to have to pay $3,200 a month to get into the average house. And if you cut mortgage rates, then the house is just going to become more expensive. And you're still going to pay $3,200 a month for it.

Now, the only way you're going to pay less than $3,200 is if the economy falls apart, demand falls apart, mortgages go down, and homeowners can't raise their price. Now, you don't want the home, even though the price is going to fall on a monthly payment. And so that's the part that I think if you look at the Zillow numbers, not Zillow, Redfin, I'll try and put this in news clips tomorrow. But we have these Redfin statistics that show the price per square foot of a house. What Redfin does is they look at every home in the multiple listing services. And they look at the price. They look at the square footage that is listed on the house. And they calculate national average of a price per square foot. It's all-time high. It's at an all-time high is what's happened. And so, if you lower mortgage, yes, so what's happening is that real estate market is weakening because mortgage rates are rising. So more of it's being sucked up by mortgage rates than by prices. If you cut mortgage rates, home prices are going up. And we're right back at the same price. So, there isn't going to be any reprieve from home prices or from monthly payments if we cut mortgage rates.

And that's why we overstate this. The only reprieve you're going to get is if the economy weakens and you kill demand and you have lower mortgage rates. And so therefore, I would argue that what you're seeing in the economy or what you're seeing in the markets or in the real estate market, that's what I was looking for, what you're seeing in the real estate market isn't as much weakness as a resifting that more of it is going towards mortgages.



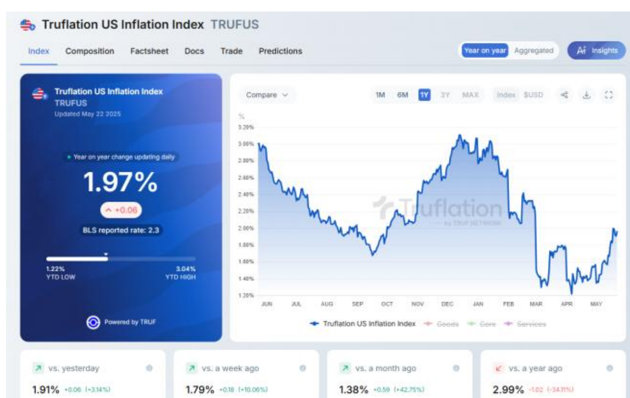
Let me get back to this inflation. So, what is driving the belief that this inflation is going up? This chart. This is the number of customs and duties that the Treasury has collected monthly. In March, they collected $8.17 billion. $8.17 billion in customs and duties, otherwise known as tariffs. March is relatively average, maybe a little bit elevated in March. OK, fine. In April, they collected 15.63 from 8.17. So that means that they collected $7.5 billion more in tariffs in April than they did in March. And I'll throw out one other number on the chart here. $400 billion is the value of goods that we import every month. So, of $407.75 billion extra in tariffs, which is like a 1.75% increase in the price of imported goods.

And the argument I've been making is somebody is paying those extra prices. Who is that somebody? Well, Doug McMillan, the CEO of Walmart, last weekend his earnings call said they're going to start raising prices this month because of tariffs. Trump put out a truth, a social media post, Adam, over the weekend with big, huge letters, eat the tariffs. You make enough money, eat the tariffs. Carolyn Leavitt, his press secretary, said Monday, China will absorb the tariffs. OK, who's paying this 7.5%? Trump and Carolyn Leavitt are telling me it's going to be the Chinese and Walmart. And you, me, and anybody else who shops at Walmart, we don't have to pay it. If that's the case, if that's the case, and let me be clear, I don't think that's the case. As I jokingly said, if that's the case, then get the chisels out and put Trump on Mount Rushmore right now. Because I'm going to get back up to a chart here that I had a second ago. This one. How do we fill in this gap between what we can tax?

Can we continue to have growth in our country and what we seem to be spending it on? We can't tax the country more because we'll slow growth down. We can't slow down spending because nobody wants to slow down spending. So where do we find the money to fill that hole? From somebody else, from foreigners.

So, if the answer is Trump is going to fill that hole by getting the Chinese to pay for it through higher taxes, then get the chisels out and put him on Mount Rushmore right now. Because he found a new person to tax, somebody who doesn't vote in our elections, the Chinese. And they're going to pay for Social Security, Medicaid, Medicare, and a Defense Department build-up. The rich aren't going to do it through taxes. The middle class isn't going to do it through taxes. The Chinese are going to do it for us.

Now, again, I said, I don't think that's going to be the case. They'll absorb something. There won't be zero. But I don't think it's going to be the case that they're going to absorb enough of it. Walmart will absorb something. It won't be zero, but it's not going to be enough.



So where are we with these taxes? So here are two metrics. The first one is Trueflation. If you're not familiar with Trueflation, this is one of these efforts where they look at millions and millions of prices on the internet. And they then calculate a daily CPI statistic. What is the inflation rate doing daily? Now, you can look at this number and say, look, it's 2%. It's very low. That is true. But I think a better way to look at these measures, and you'll notice that this is updated through today, so this is today's number, is to look at the rate of change.

So down here, what it's showing you is a month ago, this measure was 1.38. Now, part of the reason this number might be so low is we spend the majority of our money on services. And the majority of prices on the internet are goods. So, this is a little heavily skewed towards goods more than services. And goods prices tend to be more depressed. You're not going to see doctors offering a free annual exam with their price up on the internet. And then you get to shop and compare plumbers to unclog your toilet. They're not advertising their price. Or roofers, they come, they estimate, and then you haggle with them. So those are not easily discerned prices off the internet. Goods are. So that's why this is lower. But the more important thing is it's up 0.6% since May 1st. That right there. And that's really what Truflation has been arguing about, about what I've been arguing. The prices of tariffs are starting to show up in this measure of high-frequency inflation right now.

Keep in mind one other quick thing. But wait a minute, don't we exclude taxes from inflation? Yes, we do. That is why when you go to the store, there's the price on the shelf. And when you take it to the checkout, they add the taxes in at the checkout, you pay a higher price. That is because the price that they're going to use for CPI is the price on the shelf. They don't consider sales taxes. But in tariffs, we don't separate out sales taxes. So, it's embedded in the price, and it will show up as a higher price on the shelf. So, tariffs will cause CPI to go up.

Amazon, about two weeks ago, said that they were thinking about breaking it out. Here's the price of the item plus tariffs. Here's the final price. And Trump went crazy on them on another truth. And I think called them like un-American or anti-American or something like that. And then Jeff Bezos stepped in, or maybe Bezos didn't step in. But Amazon, oh, we're not going to do that. We're not going to do that. Somebody suggested it. We put it down. And none of that's going to happen. None of that's going to happen, is basically what they said.

So, if it's not going to happen, then tariffs are going to show up as inflation, unless Mr. Mount Rushmore is right, and the Chinese and Walmart are going to pay it. And you and me, or you and me being people that shop at Walmart, aren't going to have to pay for it.

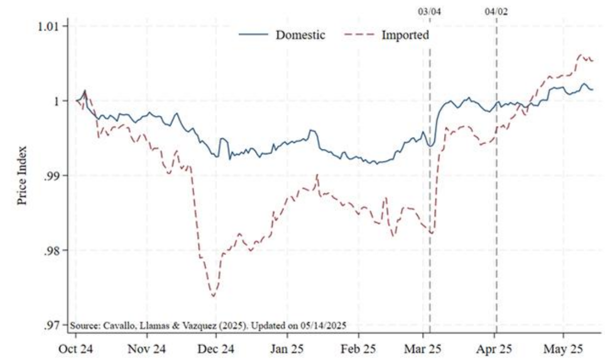


Figure 1: U.S. Retail Price Indices - Domestic vs Imported

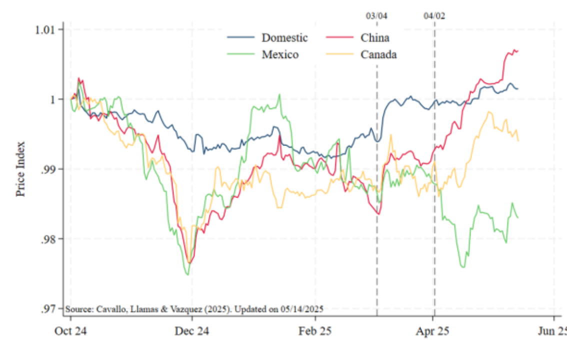


Figure 2: U.S. Retail Price Indices by Country of Origin

Note: Data from four large U.S. retailers. Vertical lines denote major tariff events.

So, Alberto Covello is a Harvard economist. He developed the original version of this look at all the prices on the internet and calculate the CPI. It was called the Billion Prices Project, which is now called Price Stats, which is owned by State Street Bank. Covello has been now, he's been tweeting out that they've been updating their numbers weekly. This is through May 14th right now. And he's showing something similar.

So right here, what they do is they look at a couple of online, he said large online retailers. They look at the prices offered, the hundreds of thousands, if not millions of prices offered by large online retailers. He didn't say Amazon, but it's assumed that they're one of them. Well, anything that is made domestically, that's their price increases that you see. Anything that's made is imported is going up at a faster rate. They also then break it down by, here's domestic again, the blue line, the same one that you see over here. But then whether it's from China, Mexico, or Canada, our three biggest trading partners, China, Mexico, and Canada. And the red line here is China. Those prices are going up the fastest right now. Mexico's prices are going down because things like avocados and stuff like that, we get a lot of avocados from Mexico, are very depressed.

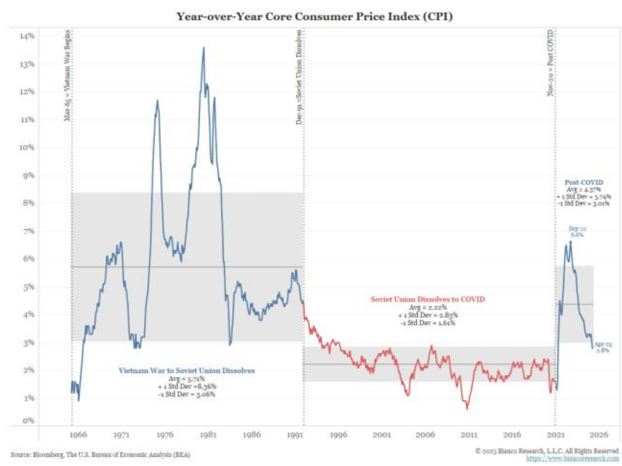
Now, what I'll point out is, they're also pointing out that these domestic prices are going up as well. Now, they're not going up as fast as imported prices, or Chinese prices are going up. And it's consistent with what we're seeing with Trueflation. We are seeing from these metrics, that inflation is on the march higher because of tariffs.

So, two examples. I'll start with the newer one, May 10th. Beth Hammack, who's now the president of the Cleveland Fed. Hammack said she's hearing, this was from her speech, quoting her from her speech in the Wall Street Journal. Hammack said she's hearing from businesses that they're raising prices, even though they are not affected by tariffs, because competitors who do face higher import taxes are raising prices. Firms are also reporting that because they don't know how much tariffs could ultimately rise, they're likely to phase in price increases in a series of steps, rather than in one shot.

Then, I would point out from the March 19th presser that Jay Powell did, I've used this example before. A great example is washing machines were tariffed in the latest round of tariffs and prices went up. But the prices in dryers also went up, which were not tariffed. So, manufacturers just kind of followed the crowd and raised prices. This is what the Fed fears more than anything else. This is what they call unanchored inflation. Give me a reason to raise a price, and I use it to raise every price. And this is really what we're going to have to watch.

In the next couple of months, if tariff-driven prices are going up, going back to this chart here, the blue line, domestic prices, does that mean that every price is going to go up? Because everybody's going to, you know, to use this example here. Well, we don't know what's going on, so raise them all. Unanchored inflation is what that is.

I'll remind you that back in 2022, when the inflation rate hit 9%, Procter & Gamble on their second quarter earnings forecast call in July of 22 said, we're going to have to raise prices on our staples, and we're going to do it in September, and our economist is going to write a white paper to explain why we have to do it. That was the mentality three years ago. You raised the bare minimum, and then you apologized, and you wrote a white paper to explain why you had no choice but to raise prices. Now you don't even, just raise them. Just raise them. One day you walk in the store, and the price is higher. "It just is. That's the environment we're in right now. And the fear is that these tariff-driven prices are going to lead to more prices. That's what the public is fearing here. They're going to raise everything. They're just not going to raise tariffs. We'll see if the public's right. It's like a seven-point spread in the football game. Doesn't mean they're going to win by seven. Doesn't mean we're going to get 7.3. But it's a fair bet that if you're a seven-point favorite, you're going to win the game. We're going to have more inflation, just maybe not seven points more inflation is where we're at. I'm running a little bit long. So let me finish a couple of the quick things about inflation.

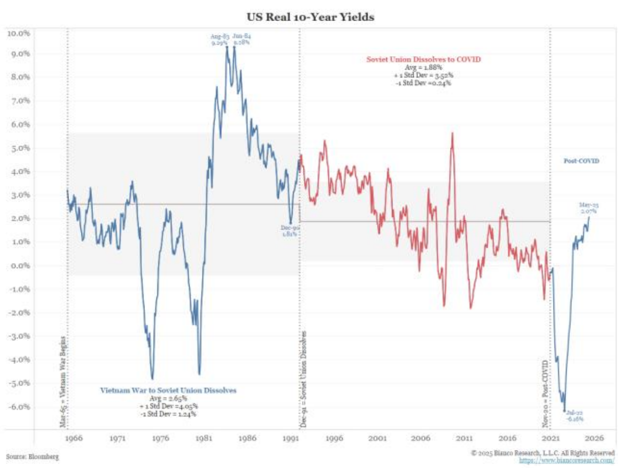


So, here's a long-term look at inflation. And I want to argue to you that the inflation cycles changed. And so, what I did here is I color-coded a chart of year-over-year CPI going back to 1965. March of sixty-five, the Vietnam War begins. December of ninety-one, the Soviet Union dissolves. During this period, the inflation rate averaged 5.7%. March of 65 to December of ninety-one, with a standard deviation of 8.9 to 3%. That's what we had during that period. That was the inflationary period. It ended with the end of the Soviet Union in ninety-one.

Then from the Soviet Union to COVID, we had a period here where the inflation rate averaged 2.2%, with it being 2.8 to 1.6 on the standard deviation. That was the period after the Soviet

Union dissolved until COVID. And then since COVID, this is what we've seen so far. Now, we're at a low right now on it, right now. But I would argue that this is starting to look a lot more like this, that this cycle has changed, that what we're seeing in the inflation rate now looks nothing like that, that we are in a different cycle.

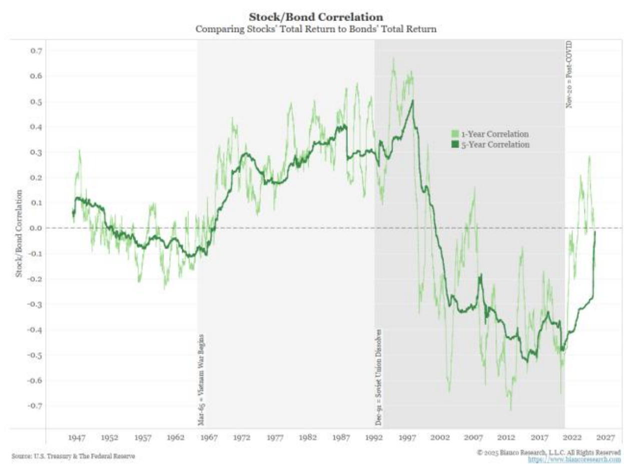
As I've often said, when you have a recession or a financial crisis, we have both in 2020, you change the economy, and we did. Same chart frame, Vietnam War, Soviet Union, COVID, but now it's real rates. During this period here, real rates averaged 265. During that low period after the Soviet Union fell, real rates were in a decline. And now in the post-COVID period, real rates are back up and we're marching. This period is starting to look a lot more like this period.



So not only are we going to have more inflation, but we're also going to have more inflation but we're also going to have higher real rates, which implies, as I've often argued, that if you want to put it in these terms, 10-year real, that if we're going to have 3-ish percent inflation, and I think that's what I've argued for a couple of years now, we're going to have like a 3-handle on inflation, somewhere between 3 and 3.99. Let's take the lower number 3, and we're going to have like low twos in real rates. It means the fair value of the 10-year note is in the 5% range.

For those of you know, I've been arguing for almost 2 years now, we're going to go to 5 to 5.5 on the 10-year note. And the reason I've argued that we're going to go to 5 to 5.5 on the 10-year note is because that's where we are, 3%, 2 real, 5-ish, and that is neutral. That is neutral. Three percent plus r star of one is 4-ish. We're 4.25 to 4.5. We're at neutral right now.

Now, I know a lot of people still think neutral is down around 3 or 2, and there's still this argument that in a recession, we'll go to zero and we'll print money. That era is over. That era is over because we have sticky inflation, and we have higher inflation right now. And why is that era over? Because when you have a financial crisis and you have a recession, the economy changes. It changed. And as I've argued for years here, the biggest example of change is remote work. The labor market is fundamentally different than it has ever been in the last 150 years, because a quarter of us are like me at home and working from home right now or remote working and the like.

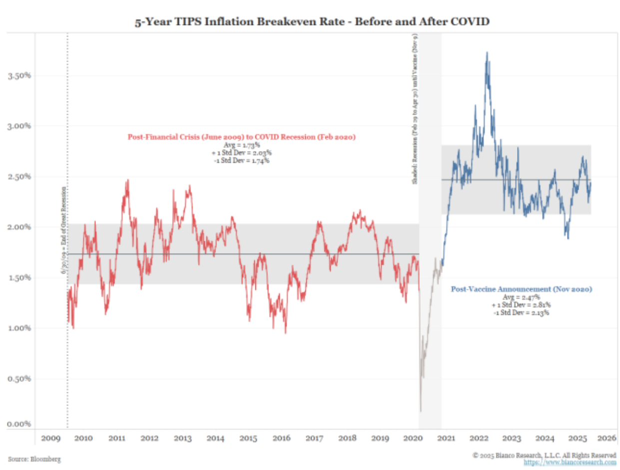


So, the last chart I'll give you is the stock-bond correlation. And this gets to kind of the 60-40 portfolio as well, too. And so, here's the beginning of the Vietnam War. Here's when the Soviet Union ended, and then here's COVID right here. During this period here, from 1965 to 1991, the stock-bond correlation was going positive. What does that mean? Stocks and bonds move up and down together. As I've argued, that is about the mindset of inflation from 65 to 91, you had the mindset of inflation. When you were worried that inflation was a problem, when you were worried that inflation was a problem, that was negative for stocks. And they went down. Stocks don't like inflation. They don't. Bonds don't like inflation. They went down, and bond yields went up.

But then you got post-Soviet Union, especially after the financial crisis of 1998, the Asian financial crisis and the like, and then you had that downtick, and you went negative. That meant that stock prices and bond prices moved opposite each other. So, the example here was that during this period, disinflation or deflation was the fear. If you were worried about deflation, that was negative for stocks, that was positive for bonds. If you were relieved there was going to be no deflation, but we're in a low inflation environment at 91 to 2020 period, no deflation, low inflation environment, good for stocks, bad for bonds, is what happened during those periods.

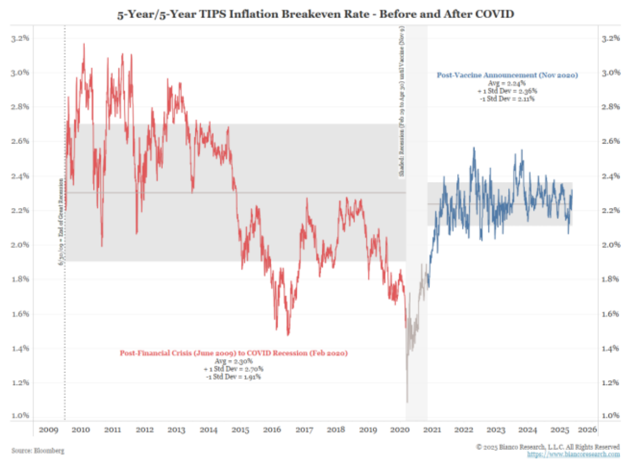
Then that changed, and we're starting to see these move up. Now, a quick little technical note here. You see that big spike in the five-year right there. That's because it's a five-year correlation, and it just rolled off March of 2020. That's why it spiked up. But nevertheless, we're seeing that these correlations are starting to look more like this period right here, meaning that we're returning more to an inflationary period.

So, if you're of a certain age, you can remember that a 7% mortgage was a good deal. You can remember that 5% or 6% was kind of shrug your shoulders as kind of what interest rates were. Today, people are frothing at the mouth at the idea that we're going to have 5% or 6% inflation, 5% or 6% interest rates. We're just not used to it. We're still anchored to that period before 2020. We still think that's normal. We still, I mean, like I said, you can accuse me of being too online. You still see a lot of people that I know are professionals talking about mouth-breathing, talking about printing money and going back to zero and all that other, that era is over. We are in a new cycle. That cycle turned in 2020.



Last two charts, and then a quick word about the ETF, and I'll take questions. What about tips? What about tips? Tips are saying that there's no inflation, that everybody keeps jumping up and down, says, look at tips. OK, let me point this out.

Here's the five-year tips break even, color-coded. Here is COVID, the COVID period. I excluded that. Here's what the marketplace thought that the, remember, the tips five-year break-even rate, for those of you not familiar with it, this is like the, this is you take the five-year tip yield, or you take the five-year nominal yield, the five-year yield, minus the five-year tip yield. And this tells you what the market says the average inflation rate will be over the next five years.



Well, in red, it was 1.73%. That's what it was expecting pre-COVID. From when the Fed started to do, from the end of the Great Recession in 2009 to COVID, 1.73%, and that was the standard deviation right there. Since COVID, the blue part here, it has been 2.47%, and the bottom half of the standard deviation here is above the top of here. It is step-functioned higher, in other words, is what I'm saying. So, the market is saying to you, bigger picture, expect more inflation now than you would have expected pre-COVID. That makes sense to me.

Powell said in 2021, inflation will be transitory. We're four years la "The market is saying over the next five years, expect elevated inflation. That is a nine-year inflation cycle. Okay. Inflation cycles run about ten years. Nine years, ten years, close enough. So, what the market is telling you is over the next five years, we are in an elevated inflation cycle of about seventy-five basis points to 1% higher. That's another way I back into the Fed used to say the target for inflation was two, and now it's probably three, and I'm a little bit more aggressive than that, where I go from three to 3.99.

But what about the five-year, five-year? Because here is the post-COVID period. The average was

2.30 with this wide standard deviation, and now the average is 2.24 with the smallest standard deviation. Jokingly, people say, look, the inflation rate went from here to here with the smallest standard deviation. Send Jay Powell to Oslo to get the Nobel Prize in economics. Boy, he's done a great job.

Hold on. This is the five-year, five-year. What does that mean? You take the ten-year TIPS break-even rate, ten-year yield minus ten-year TIPS. What is the average for the ten-year inflation rate for the next ten years? You take the five-year yield, TIPS break-even rate, and then you calculate what will be the five-year average in five years. What the market is telling us is after 2030, inflation will settle down. But before 2030, we're going to have an inflation problem. So that's where we are with the TIPS, and it's perfectly consistent with everything else.

We have elevated inflation. If you want to be blunt, what's the difference between two and three? Well, two things. One, it's about interest rates. Get used to five and stop hyperventilating about a 5% 30-year because it's kind of normal. But of course, we're not. We are hyperventilating about it because we're not used to it.

Second of all, as I've pointed out, if we have elevated inflation, half the country cannot produce $1,000 in an emergency, according to bankrate.com, if they're putting in a credit card or borrowing from a friend or a relative. Those people, the only way that they can expand their income is if their boss gives them a raise. If we're getting a tariff-driven inflation, and the Fed has put out some models that suggested the tariff-driven inflation could run as high as 4%. If the average person doesn't get a 4% raise at work, they're going to fall behind. They're going to have to buy fewer things because the price is going up faster than their paycheck.

The rest of us that own homes and watch Zillow to see what our home price is worth and track our portfolios, we have a cushion. We don't like it any more than they do, but we can pay it. And we just got up and pay it and have some choice for a lot of words and move on with our life. They have some choice for a lot of words, and then they start taking things out of the basket that they're going to buy so that they can buy something else because they have a finite set of money. So that's why the inflation rate matters and matters a lot to it.

Index
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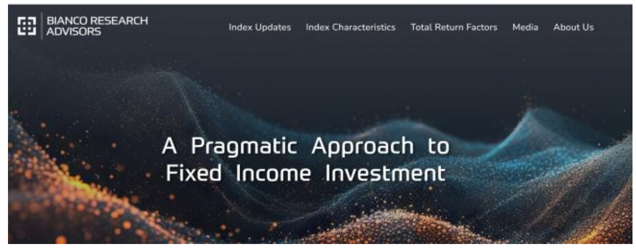
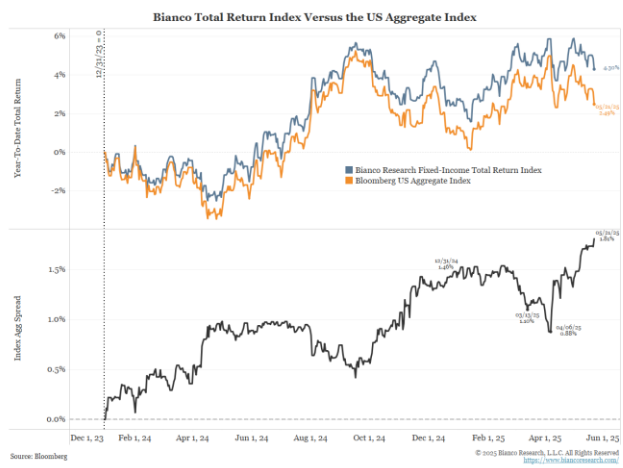
Bloomberg = BTRINDX <index>

Ticker: WTBN



Okay, finally, we do run an ETF. I haven't talked about this in over a year. I just wanted to point it out, WTVN. Well, to be specific, I'll be specific. We manage a total return index. So, we discretionarily pick the weightings and the structure of the index. B-T-R-I-N-D-X on your Bloomberg or Bianco Advisors is the website for the index. WisdomTree, our partner, has an ETF that tracks our index, WTBN. Think of it as I'm the head of the index committee that decides on B-T-R-I-N-D-X, and WTBN tracks us. The S&P Index Committee decides on the makeup of the S&P 500, and SPY tracks that. Structure's very similar to that.



So how is our index done? So, we've been in business since December of twenty-three. So, we're coming up on 18 months. Our index right now, if you want to look at it on a relative basis, because we are a fixed 100% long, investable, invested fixed income index. So, we're trying to balance total return against yield, underweighting, and overweighting various sectors in the market. You can find that on Bianco Advisors. And we've outperformed a benchmark like the Bloomberg aggregate by 181 basis points.

What's that meant? According to Morningstar, this is from Morningstar right here. In 2024, out of 473 funds, we were in the 19th percentile for the upper quartile. We're in the 18th percentile for the year. We're in the 21st percentile for year to date. 15th and 15th for three months and one month as well too. So, we've been one of the better performing funds.

And then the final thing I'll say, I've talked about this before. I thought I'd mention this right now. This is the percentage. This is from the S&P SPIVA report. I could talk about this more later if you want me to in the Q&A. This shows you the percentage of funds that have these benchmarks, S&P 500, 1500, and the like that outperform their benchmark. And in red means less than 50%. And in green means more than 50% outperform. And then the shaded ones are between 40 and 60.

WisdomTree Bianco Fixed Inc Ttl Ret ETF WTBN Morningstar Medalist Rating

Performance | Medalist Rating as of Mar 31, 2025 | See WisdomTree Investment Hub >

Total Return %	2024	1-Year	YTD	3-Month	1-Month
Investment (Price)	3.00	4.43	1.38	-0.11	0.02
Investment (NAV)	2.33	4.42	1.41	-0.01	0.19
Category (NAV)	1.68	3.84	1.17	-0.30	-0.09
Index (Price)	1.36	3.87	1.26	-0.19	-0.22
Percentile Rank	**19%**	**18%**	**21%**	**15%**	**15%**
# of Invest. in Cat.	473	460	471	472	475
Category Name	CI	CI	CI	CI	CI

USD | All data based off of NAV except where noted | Investment (Price) as of May 21, 2025

And what you'll see is that nobody in equities cannot perform their index from one year all the way to 15 years. In fact, you see some single digit and some 10% numbers in there too, meaning 90% underperform in index. But what you'll see in fixed income is a lot of them can outperform their index. And even when they don't, they're very close. It's almost a coin toss in some of these metrics as well.

S&P Dow Jones Indices

Percentage of Funds that Outperformed Their Benchmark

As of: December 31, 2024

Asset Class	Fund Category	Comparison Index	1 Year	3 Year	5 Year	10 Year	15 Year
U.S. Equity	All Large-Cap	S&P 500®	35%	15%	24%	16%	11%
U.S. Equity	All Domestic	S&P Composite 1500®	21%	12%	15%	10%	7%
U.S. Equity	Global Funds	S&P World (USD)	16%	9%	12%	10%	8%
U.S. Equity	International Funds	S&P World Ex-U.S. Index (USD)	31%	22%	19%	15%	12%
U.S. Fixed Income	Investment-Grade Short & Intermediate	iBoxx $ Overall 1-5Y	88%	79%	71%	**48%**	27%
U.S. Fixed Income	General Municipal Debt	S&P National AMT-Free Municipal Bond	87%	16%	29%	33%	**41%**
U.S. Fixed Income	General Investment-Grade	iBoxx $ Liquid Investment Grade	70%	66%	**42%**	18%	10%

The bottom line I'll give you is, can a professional active manager beat an index? The answer is in equities, largely no. Now, maybe that changes. And this is a little outside the scope. But in fixed income, commodities, alternatives, real estate, and the like, the answer is yes. And as I've often argued, that in equities, the game is golf. You're playing against the course. You have to beat par. The game in everything else, fixed income, commodities, alternatives, real estate, is tennis. There is no objective standard. There is no par to beat the opponent. And that's what you have to do.

So really, that's why the percentile rankings matter in fixed income, because a lot of people beat the index. It's you are beating your opponent, is really what it boils down to. So, I wanted to crow a little bit about our fund, because if I'm not going to crow about it, who's going to crow about it? If you've got any questions about that, let me know. Thank you very much.

Q&A

All right. With that said, let me jump into some of these questions here. First name only basis, I know who you are. Charles asks, "Jim, is the data in the house bill in the charts updated next to that just passed? If not, how are the projections likely to change?" They're very close. Those are the previous projections before the last scoring. And the last scoring is not going to materially change what you are asking about, I assume, is this chart right here. Yes, it's not going to materially change those.

But remember, that's the house bill. Then there will be a Senate bill that will get scored differently. Then they will go to conference. They will agree on one bill that will get scored again. If both of them pass that bill, it goes to the president to sign. So, there's going to be other bills, and there's going to be a lot more scoring. But really, the takeaway here is the Republicans, you know, the joke is the Republicans are going to blow out the deficit. And the Democrats are saying, "Man, these Republicans are irresponsible." And the argument is, "Vote for me, because you blow out the deficit, too."

I mean, so, you know, so we'll have to see. Or if the Republicans, if the Democrats' argument is going to be, or vote for us, we'll bring in deficit by jacking up taxes. You're going to kill the economy. So, you know, it's either you bring down spending, or you find somebody else to tax. And Trump has been screaming, 'The Chinese are going to pay the tariffs.' We'll see. We'll see. Like I said, we'll see. I have my doubts on that. Could the U.S. have a Liz Trust moment? Would you probably attach that to happening? I would almost argue, yes, we're going to have a Liz Trust moment. I would put the probability of it fairly high, above 50%. The only thing I can't tell you is, when are we going to have it? Is it going to be later this year? Or is it going to be, you know, in three years, five years, ten years, or something like that?

Where do I think we're going to have the Liz Trust moment? If I were to go back to this chart here, we are spending right now, as if we are in a crisis. And we are not in a crisis. What about when we do get into a crisis? What happens if we actually do get a material slowdown, spiking unemployment rates, and the pull on the social safety net? People taking unemployment insurance, more Medicare, more disability, and the like. And the government wants to pass stimulus to get the government moving. We're going to get these giant bars. And the response is going to be, yes, you can borrow. You can run the deficit to $4 trillion. You can run it to 10% or 12% if you want. You're going to have to pay 7%. And the average mortgage is going to go to 10%. But wait a minute. I want the average mortgage to go to 3%. Nope. You're borrowing too much money. You're going to have to. The only way you're going to borrow that much money, $4 trillion. We're going to have to suck it out of the stock market. We're going to have to bring rates up so much. We're going to have to bludgeon the stock market. So, every stock investor says to hell with the MAC-7. Put your money in a ten-year Treasury. It's a better investment. And as I've said, the old argument is there are no bad bonds. There are only bad prices. If the bond market needs to be funded, it will destroy the world to fund itself. It will just take yields so high; it will suck money out of everything else. That's my fear, is when does the Liz Trust moment hit? When things go sideways and the government thinks now, we need to Keynesian spend like crazy to get the economy out of its slowdown, the result is going to be such a demand on the bond market that rates will go up and kill everything. And the reason is because you're already starting from a point where you should be. You're already starting from a crisis point. And now you're going to go to a crisis point squared in its next downturn. And that's why you're going to wind up with higher interest rates. So yes, we are going to have a Liz Trust moment. I just don't know when. There's an argument to be made that it's already begun with the 30-year back above 5. Not sure about that, but I understand the argument. I understand the argument.

Let me see here. Next question here is, is it safe to say George was a complete and utter failure and we won't be hearing much going forward? Yes, it is. I don't know if I'd say it's been a failure to date. It could be revived, and we won't hear much about it going forward. Yes. And I think that we're all worse off for it. I don't think anybody thinks that there aren't trillions of dollars of wasteful spending in the US government. And that we could deliver exactly, we have a $7 trillion budget. The government spends $7 trillion a year to deliver services. Elon argued that I bet you we could deliver those same services in the same quality for five. I don't think he's wrong about that. I'm not talking about cutting anything. And that's what DOJ was about, and it didn't work. And we're not better off for it because we need smaller deficit. It would have been nice to have attached, found hundreds of billions of dollars of savings, maybe not two, that they could have put in the bill to help relieve the deficit. They didn't. So, is it a failure? Yes. Is it a complete and utter failure? Remains to be seen. Is it good that it's a failure? No, I don't think it's good. We all know the government wastes money. And by wasting money, it's keeping interest rates up. And we need them to stop to spend less. And that would have been better off for us if they would have spent less. Now, maybe Elon went about it the wrong way. Or maybe the people that lit Tesla's on fire are running the country right now. But you could tell where my point of view is on this.

Jim says, don't worry, we're going to inflate the debt away. Well, that seems to be what we're doing is we're going to inflate the debt away. The problem with inflating the debt away is I'll go back to my statistic that half the country cannot afford $1,000 in an emergency. They are going to pay the price. I'm not going to pay the price. You're not going to pay the price. Look, I got enough money that if prices go up, I'll still buy a new car when I need one. I will still go to the store and buy what I need. I will still go on vacation. So will you. But some people that are on a fixed date, some people have no savings in rent. They see prices go up faster than their paycheck is going to have to do with less. So yes, we're going to inflate the price away. And the bottom half of the country is really going to pay the price for it. And that's really why you almost don't want to do that.

Jonathan asks, it looks like all the Dems and Independents believe that inflation will go up when split by party. That is true. GOP voters being complacent because they still are in the honeymoon period. That is true. But even the GOP voters are moving up. But nevertheless, even though you want to say it's partisan, and I agree, it's partisan, there is a molecule of truth that everybody expects, even the economists. You know, from the Bloomberg survey, I used to go to this chart here, which is probably this chart here. What's the expectations for core PCE among economists? I mean, it's not supposed to be partisan. It's going up too. The expectations are that we're going to get more inflation. They think core PCE is going to be 3.2% in the second half of this year. Maybe it's not 3.2%, but it is around 2.8% right now. But if it does start to move up because of tariff-driven prices, and again, here's the evidence that we're getting tariff-driven in prices. You know, Trueflation and Covello's price stats are starting to move up. Fed isn't going to move. The Fed is not going to cut rates because the housing market goes bad, or unemployment goes up, retail sales back off. If at the same time, you have higher inflation, stagflation, they're going to do like twenty-two, and they're going to respond to prices. They're not going to respond to growth.

Rich asks, what is the underlying monetary mechanism that will fuel continued inflation? Inflation is everywhere and always a monetary phenomenon. The argument here is that what you're going to see is twofold. The definition of money has always been a difficult one to measure. M2 is an incomplete measure of money. There's another part of money among the wealthy, the top 10%, unrealized gains. And it has been demonstrated through various studies that if you take somebody who's in the upper 10% of income and they say, wow, look at what my portfolio did, and look at what Zillow says my house price is, they have a propensity to want to spend more because their net worth went up. That is a form of money, monetary phenomenon that causes inflation. Now, let me throw another statistic at you. The latest set of retail sales numbers show that the top 10% of income are 50%, top 10% is 50% of all retail sales. Ten percent of people are spending 50% of the money. If they're seeing gains from the stock market, gains from their home prices, gains from income from bond funds and the like, they're going to be willing to spend more and that's going to push prices up. So, the argument, and this is an old argument, it's not a new argument, is that M2 is woefully incomplete as a measure of money. Money is a construct at this point and unrealized gains. This first came in in the late nineties when we had the tech boom. We started seeing that during the tech boom in the early nineties. Look no further than the home prices in Silicon Valley and San Francisco. The average home price in San Francisco is over a million dollars. But the average income in San Francisco is not materially higher than New York, or it's a little bit higher than say bigger cities like Chicago, Philadelphia, or Houston. It's higher, but not materially higher. Why are home prices so much higher? Not worth, because all these people have this income, and they have their Nvidia stock options that are worth $10 million. And then they say, look, I got a $300,000 income and I buy a $5 million home. Well, no one else would do that unless you got $10 million worth of Nvidia stock. Or $15 million worth of Nvidia stock because you worked there for five years. Net worth, you know, net worth, wealth effect. That's what the argument would be. And we are more concentrated towards the higher end than we've ever been.

Jen asks, if we factor in tariff revenues, what is the budget impact on the deficit? That's a good question right now. If it's an extra $7.5 billion a month, that's $100 billion that it adds to revenues. Nothing, but in a $2 trillion deficit, it's not really a big debt. Now, maybe it goes up. There's another argument to be made. And that other argument to be made is that some people are starting to think now that Trump is getting aggressive again. And in July, when the 90 days expires in the EU, Canada, and Mexico, we're going to see those inflation. We're going to see those tariff rates go back to liberation day levels. And that would ratchet it up even more. But yes, tariff revenue is not anything. But in a world of $7 trillion budgets and $2 trillion deficits, it isn't really enough to make a dent. And we'll have to see where it goes from there.

What is the mechanism for China paying tariffs? They would lower the price. And they would say, when this product gets to the port of Los Angeles, a customer duty is attached to it of 30%. So, the price becomes 30% more expensive. So, we will lower the price by, if you believe Trump, 30%. So that when you put the custom on it, so we will sell it to the importer, the US importer, who puts it on a boat and brings it in for 30% less. Then you stick the 30% tariff on it, and you're back to the same price as if we didn't have the 30% tariff. There's a little bit more to it, but that's kind of the simple way to do it. They would just lower the price, is what they would do. Are they going to lower it 30%? I don't think they are. Are they going to lower it some? Maybe, maybe five, just to throw out a number. We don't know. Maybe five. But it isn’t going to be enough to cover the tariffs. But we'll have to see. But that would be the mechanism for how they would pay it.

Simon says, I agree with you. Inflation and real rates going forward, having entered a structurally higher level, where does that leave gold in your view? And where would the price, where would you weigh the bid on price regardless of central bank purchases? Well, it's been very bullish for gold, and gold has been going very up because it's been going higher. Gold, again, I would argue to you that gold is the investment choice you take when you've got fears about the financial system. Now, fears of financial systems come in a multitude of ways. It could come in failure, deflation. It could come in inflation. And it could come in the form of real rates being punishingly high. All of those are working in gold's favor. That's why gold's up 26% this year. It's kind of blown off near 3,500. And I think it's got a period of consolidation, just being Mr. Chart Reader here. But the trend in gold is going to stay up. It's a very positive for gold.

Craig asks, have you done or seen any research on the upside correlation versus downside correlation between stocks and bonds? I know it's a stats 201 question, but it seems like during this environment, the correlation is that stocks and bonds go down together more often than they go up together. I've not seen it broken down that way. And you might be right because, you know, what's the old saying that the market takes the escalator up and the elevator down? That advances tend to be kind of long and protracted and at a slower slope. And declines tend to be very sharp and a very steep decline. It's kind of the way markets have always traded. And so therefore, it's easier to see the stock correlation on the decline than it is on the advance. Now that I've said that I have not seen a study of it done. But they are going, they are becoming more correlated together is what we've seen. And we've actually seen that in the last month or so. Yields have been, you know, moving up in the stock market's been recovering since we called off the Liberation Day tariffs.

What is your view near term on the 10- and 30-year yield? Meaning what levels do you see those within the next 12 months? Thank you. So, 10-year yield, high for the year is 485. It's 18-year high is 503. We're 460 right now. So, we're twenty-five, the 485 was in January. 503 was in October of twenty-three. That was an 18 year high 503. I think in the next 12 months, we take out 503. We go to 5 to 5 and a half. The 30 years, the high for the year is today, 515 is what we hit intraday. 509 is what we closed yesterday. And we're up, at least we were up a minute ago. We're now down one basis point on the day. But yesterday was the high of the year. The high of the last 18 years in October of twenty-three was 518. We had 515 intraday. We got within three basis points. That goes to five and a half. But almost at this point, where you could count it on one hand, or at least we were when I started this call, you can count it on one hand, how far away we were from an 18 year high on the 30-year yield. Those yields continue to go higher, especially as we start to see the idea that A, the, I'll go back to it, throw out a couple of charts here at you. Not only do we see inflation go up. I'll leave this chart up here, the Trueflation one, just as one example. We see with the Trueflation chart, we see that inflation numbers are going to go up because of tariffs. But then the other chart I was going to throw out at you was this one. The Economist survey, second quarter GDP is rebounding. There ain't no slowdown. There is no recession, stagflation. That will produce higher rates because the Fed won't respond to stagflation as well.

Does rising yields in Japanese bonds pose a risk to global liquidity? Not really, because most of the Japanese market is owned internally by the Japanese themselves. It is not a broad based foreign owned market. So, I don't think it really poses a liquidity problem for the rest of the world. Does it pose a problem for the Japanese economy? It could, but I would argue we're not there yet. Just like I said, you got to get used to 5% being kind of a normal rate, and we're not. The Japanese right now, the Bloomberg survey, I was looking at this this morning. It was outside the scope of what I wanted to put in this handout. The Japanese 2025, 2026 forecast for inflation by economists in Japan is something like 2.8% to 2.6%. Well, if they're going to get 2.8, 2.6 on inflation, and they're going to stay at least above zero on real growth, then their rates at 140 on the 10-year note that's got everybody suffocating themselves, get used to it. They might actually be a little bit too low, and then they might have to keep moving up into the low twos in order to get to the proper rate. Again, we're so anchored on this idea that the world is zero and money printing in negative interest rates, and we're not that anymore. I don't necessarily think that the Japanese, their rates are punishingly high. They're normalizing is what they're doing. Because so little of it is owned by foreigners outside of Japan, I don't think it poses a liquidity risk for the rest of us.

Malik asks, does that mean the US needs to reduce the size of government? Yes, it does. We don't need the size of government to be 25% of GDP in a non-emergency war or financial crisis or a bad recession. We don't have any of that right now. We're not fighting any of the wars. Ukraine, Russia, we're not fighting it. Gaza, Israel, we're not fighting it. Pakistan, India, we're not fighting it. It's not our wars. So, we don't need to be spending this level of money. But we don't want to reduce the size of government. Everybody's afraid to. So, there's only one forcing mechanism. That's a new phrase in Washington. What's the forcing mechanism to get them to vote on these things? The forcing mechanism now in Washington is going to be the bond market. And the bond market will just punish them with ever higher and higher and higher rates, in which case they're going to say, look, you can't afford this interest payment. You're going to have to start spending less. That's the Liz Trust moment.

John asks, let's go back to pre-COVID spending levels, adjust for inflation idealistically. But I thought the House bill would have made meaningful strides for this. Yes, as I said, 30 or 60 days ago, everybody thought the House bill was going to do something like that. What was the spending pre-COVID? What would it be if we adjusted for interest rates? Let's go back to that level because we're way above that level. Throw in a bunch of weight loss and abuse savings that Doge will have uncovered. Not $2 trillion, but some meaningful number. And that's what we thought the big, beautiful bill was going to entail with the continuation of the current tax levels. It continued the current tax levels, and it's spending a whole lot more, and it's not really cutting any waste, fraud, and abuse, not anything at this point.

Dan asks, if the bloom is coming off the idea that Besant is the adult in the room as long as the Treasury heads with the medium of having Trump's ear, we avoid a Liz Trust moment. Keep in mind, Besant is the adult in the room, but Besant doesn't make the policy. Besant's policy is pulled to him by Trump. And therefore, he has to follow through on Trump's policies. He'll do the best he can, but if Trump wants higher tariffs, if Trump wants more spending, it's Besant that has to sell that program.

I'll go back to something I've said on and off here for the last couple of years. Why do I argue that Jamie Dimon will never be a Treasury Secretary? That there's only one job in Washington that Jamie Dimon would ever take, and that's president, and he will never run for president. But why won't he be Treasury Secretary? This is my argument. As Treasury Secretary, Jamie Dimon gets to be in the room, and he's an important voice to shaping policy. And he will be taken very seriously, maybe even the most serious person in the room. But at the end of the day, Jamie Dimon doesn't set the policy. The president sets the policy. And when the president says, thank you, Jamie, you have good points. I understand what you're saying, but we're going to go in a different direction. Here's the policy. Now, you're going to take that stellar reputation of yours, and you're going to prosecute the hell out of it. You're going to sell this shit sandwich that I just gave you. He won't do that. He will not do that. He will say, this is the policy we need to do. It's the right policy. You've produced the wrong policy. I'm not going to sell it, and that's why I'll never be Treasury Secretary.

At the end of the day, Besant gets to have an important voice. And Besant is arguably the most important voice in the room right now. But at the end of the day, Besant doesn't make the policy. Trump does. And when Trump tells him what the policy is going to be, he's got to prosecute his reputation to sell it. I'm not disparaging Besant. I'm saying that this is what every Treasury Secretary this is the job of a Treasury Secretary. And if you don't like those criteria, don't apply for the job. And that's why I don't think Jamie Dimon is going to be a Treasury Secretary. And yes, Besant isn't dealt in the room. Besant's voice carries a lot of weight. But Besant is not the president. Trump is the president. And Trump will tell Besant what is the policy that he is selling.

For now, they're on the same page. I hope they stay that way. But Besant doesn't get to decide that. Trump decides that.

Karen asks, it seems like the economic market bull case is contingent on a lot going right in the quarters ahead. Can you discuss how the bull case might unfold? Yes, you're right. This is a previous conference call that I've done. But in the previous conference call, what I've done is the valuations in the market are very high. Whether you're talking about 4P ratios, the Shiller-Cape ratio, or the like. Does that mean that the market is destined to go down? No, it doesn't mean the market's destined to go down. But in order to buy a market with high valuation, you have to bet on a lot going right. And if we're in the process of doing epic change between tariffs and budgets and everything else, it really lowers the chance that everything's going to go right. And that's why it gets misconstrued in my take on it, is why is everybody investing in Europe? Because Europe's got very low valuations because they've been struggling for a number of years. They're cheap for a reason. You want to put it that way. And when you look at Europe, you say, look, it doesn't need a whole lot to go right, and those stocks could go up. And right now, it is why everybody seems to be rotating into Europe. And we call it the end of American exceptionalism and all that other stuff. And yes, there's a bit of a froth going on in Europe. One of the American online brokers was saying that the number one European stock is Rheinmetall, which is the German defense contractor. That's become the new meme stock right now, is the European defense contractors. Because Europe is going to spend all this money on raising their own army and building their own weapons. And you've got to get into these companies. And I think they've overdone some of these companies as well, too. But that's really what the argument is. When you buy a high-valuated company or high-valuated market, you're betting out lots of things going right. When you buy a cheap market, you're betting on a few things going right. Now, the problem with betting on a few things going right is sometimes you don't even get that. And that's why the market is cheap. And for a lot of time, for a lot of years, you didn't even get that out of Europe. But that mentality is starting to change. So, I see it as too many things got to go right for the US market. Only a couple of things have to go right for the European market. Everybody rotating to Europe. But we overstate it. I think it's political. I think it's partisan. It's the end of American exceptionalism, as I've argued before. Where does that term American exceptionalism come from? It's a derivation of Alexis Tocqueville's book in 1835 talking about the American political experiment, that it was exceptional. Not that it's morally superior. Not that we're better or more superior than anybody else. It's exceptionalism. The word exceptionalism two hundred years ago meant we're different. We're different. “Different. We're unique. That's what it meant. Our system of government was different and unique, the American exceptionalism. But now it's been taken as a condescension to the rest of the world, that we're superior to the rest of the world. And that's why they're trying to knock it down a peg or two. So, it's like, I hope I don't get in trouble. It's a bunch of salty Europeans that are using the term loss of American exceptionalism. It's the rotation to me from high-valued companies and stock markets to low-valued companies and stock markets.

Two more questions here. It's total BS that Chinese exporters would pay the tariffs. To be honest, there's a zero chance the Chinese business can lower their price by 30%, but possibly by 10%. So, by the end of the day, the Chinese exporters will bear some cost. The US consumer will pay higher prices. And all will suffer this tariff war. Yeah, I agree with that. I agree with that. They might lower the price a little bit, but they're not going to cover the tariffs. The consumers and Walmart might lower the price a little bit, but they're not going to cover the tariffs. They're not going to come close to covering the tariffs. The consumer is going to pay the brunt of the tariff.

We'll have to see where it's going to go. Now, I've said that we've never had this example before, right? When we've done this giant jump in tariffs, and we're going to have to pay the tariffs. Giant jump in tariffs, and we're going to have to see how it gets passed along. It is kind of an unknown, but I would be ... Like I said, if the Chinese ... I was trying to be sarcastic, and I'll say it again. If the Chinese are going to bear the brunt of the tariffs, get the chisels out, and put them on Mount Rushmore right now before his term is over, because he found a way to close the deficit without taxing Americans. He's going to tax the Chinese. As silly as that sounds, that's what we're seeing in tariffs. The Chinese are going to pay, so we can increase our military budget to a trillion dollars to defend ourselves against them. They're going to pay for us to build weapons to fight them. That's where I'm trying to argue, is the logical inconsistency with this.

Last question from Larry. Could you comment on what would drive the dollar much lower, 85, 90 DXY, like ninety-nine now, or something like that? Yes, it is ninety-nine now, something like that. What might drive the dollar ... Let me see. Can you comment to what drive the dollar lower, 85, 90, what market levels might, 6%, ten-year notes, 30% drop in equities, and the like? I don't think so, because maybe if equities go down, but the one thing I've learned about currencies, this is my subjective take on currencies. By the way, Matthias asked the same question. What is your view on the dollar, given your call for higher rates and growth, too?

Currencies tend to trend a lot more than people think. They go further than everybody anticipates. Or as I like to say, you think they're overbought now or oversold now? Wait how overbought and oversold you think they're about to get. And that's really where I think that you could see with the currencies where they're going to go. So, the dollar has been weak. The dollar is going to stay weak over the next several weeks or months. We're actually positioned in local emerging market debt, because you want to be in a strong currency, and those currencies have been strengthening, and they've got a big fat yield. That's why we're in local, not dollar-based emerging market debt. So, I think that the dollar will continue to go down. That is the trend of the dollar. The dollar tends to over trend it. In theory, you would think higher rates would be a benefit for the dollar, but it really hasn't been, because there's much more going on with the dollar. I think it's just a rotation out of the highly valued markets into lower valued markets, and that will continue, and that will keep the dollar weak.

Now, I said weak. Do not confuse that with loss of dominance, loss of reserve currency. It will always be the reserve currency until a credible alternative comes up, and there isn't one. It will just be lower, and I think within the halls of the White House, they're fine with that. It's still the reserve currency, and it's now cheaper. I think that they're definitely fine with that.

I missed a question. Jeffrey's question. Historically, during both in high-low inflationary environments, the S&P multiple has been highly correlated to the twenty minus ten-year rule, rule of twenty. If rates are not going back to the period of printing money, and then why are stocks so confident in trading at 22 instead of fifteen times, or twenty minus 4.5, or 30% overvalued? They are. They are overvalued if that is the case.

Now that I said that they are overvalued, what I have noticed with stocks is if we are in a period of higher rates and higher real rates, and that we are no longer in a period of zero interest rates to justify 20 to 22 PEs, but we should be in a 10 to 15 PE environment, we need to get the stock market back to 10 or 15 PE environment. It doesn't crash down there. It underperforms for a series of many years. So, in a previous call, I talked about that I think for the next several years forward, that we're going to, this is like two months ago, four, five, six markets. Cash will return four, bonds will return five, stocks will return six. And I talked about that they're overvalued. One of the things I said about the 6% market is on average, you get about 9% or 10% earnings growth a year on average. So, let's dial that down to 8% or 9% earnings growth. And you get the stock market to grow six. In a decade, you'll be at 10 to 15. You'll average six. Now, you could have a 20% year and a minus 20% year in there, but you'll average six with 8% or 9% earnings growth, you'll bring the PE ratio down over a decade. That's historically, I think how it does. It's not the market wakes up and says, we're 30% overvalued, we need to crash 30% this month in order to bring all the valuations back in the line. Just like the chart of real rates. I wish to go back to my chart of real rates here. Where was that chart? This chart right here. So, here's CPI. And you can see that after the Soviet Union fell, CPI went down and stayed down. But the market didn't just ratchet down and stay down. It went down, real rates fell over a period of many years. The market adjusted slowly to it over time. I think the same thing with valuations in the stock market. If it's a 10% to 15% PE ratio world in a 20% to 22% actual PE, then look for 6% growth. Six percent returns, 8% or 9% on earnings, you'll get there in 10 years. You'll get there in seven years or something along those lines. Not that you'll get there all at once.

Thank you for listening. Everybody has a happy Memorial Day weekend. We will talk to you again in this format in about three weeks. So, thank you and goodbye.

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