John Mauldin: No sign of imminent recession

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Erik: Joining me next on the program is John Mauldin, founder and Chairman of Mauldin Economics. John, thanks so much for joining me on the program.

The question that seems to be on everybody's mind right now is: Are we looking at the end of a relatively small market dislocation with this VIX complex blowup and so forth? Or is this actually just the beginning of something much bigger?

John: I don't think you could characterize anything as the end. There's always things that move forward. But let's remember that there's always another recession. I don't think Trump has repealed the business cycle. He's trying to repeal the wisdom of tariffs, but he hasn't repealed the business cycle yet.

And when we have a recession we will have a 40%–50% or more drawdown. So whatever bumps that we get between now and then will just be that – bumps.

Now let's remember something: The last drawdowns that we had – the corrections if you will – were not the unusual part. They weren't the odd part. The odd part was 15 months in a row without a 2% correction. Never happened, ever, ever. So that was the odd part. That should have been what we were all looking at and going "this is scary."

It wasn't a 5% or 6% correction. The type of correction we just went through was something that we normally get at least once every 12 to 18 months. You get a 5% correction every 90 days, every quarter. So that was the normal, if you will. The not normal was no corrections and just almost straight up.

And we're going to see probably more corrections. We're going to see more volatility. But I would argue that any correction we see now, absent indications for a potential recession, are buying opportunities. If you're a trader you, you know, see things – when they get to the top you raise a little cash, and when they go down some it gets into your buying session. You buy some, you go back in.

But market drops, absent a recession, are V-shaped. When you get a recession, that's going to be ugly. And you want to be sitting somewhere on the sidelines and not involved. Because the buying opportunity will come.

Erik: And what is your outlook for both the recession risk as well as the equity market generally? Are you basically seeing that this correction that we're going through will resolve itself to new all-time highs and will move higher? Or is there something else on the horizon?

John: I don't know if we go back to all-time highs. More than likely. I forget what forecaster it was that said the race is not always to the swift or the battle to the strong, but that's the way to bet. I think the way to bet would be that the market still wants to go up. And we're still going to be looking at all-time highs.

But I don't know how much higher it gets. I mean, a lot of it is going to depend on whether we really get the boost from the Trump tax cuts in the US. Because, remember, this is by and large a US market.

And I would point out we're also in a global market. And this global market that we're in is taking us to new highs. I should point out that, as many of our listeners are aware of, the emerging markets have done much better than the US market.

The US market may in fact be getting a little long in the tooth. I think that's fair to say. I think sometime this next month, or very shortly, we become the second-longest growth period in history. And it has to go for another year after that to be the longest. And it very well could.

If you're looking for recession indicators, there just aren't any. Several of my friends who really track this stuff – I mean they're obsessed – and one of them has 18 recession indicators. And 17 of them are saying No. Another one has 11 recession indicators. By the way, they're different. I found it fascinating. And the large preponderance of those are saying No.

These are nine months out – one of the interesting things is there's only one really good longer-term recession indicator. And that's the inverted yield curve. And we are nowhere close to an inverted yield curve in the US markets. That means when short-term rates go above long-term rates. And short-term rates have got to go up again, and again, and again. And the Fed is telling us they're going to do that.

But that would still mean that long-term rates would have to drop an awful lot. There's no reason to think that we're going to have a recession, absent something happening in Europe – Europe blowing up because of what's happening in Italy or other places. Or China having some nasty, unexpected event. Which I don't expect to happen. I think Xi's got the world pretty much going the way he wants it.

Trade war, protectionism, if it gets out of hand, that could create a recession. And I am not unconcerned about that. I've said for 16–17 years in my writing, the thing that keeps me up the most at night, the thing that really worries me about the future of our economy and our kids and everything, that's a signal for a depression, not a recession, a depression, is trade wars. Protectionism. Smoot–Hawley.

I mean, you get Herbert Hoover, who didn't know anything, really, about a lot of the things that he was coming into, not unlike maybe some people would suggest our current president is like – he's learning on the job. But Herbert Hoover let Smoot–Hawley get through and he signed it.

And it was all over for the world. We had a depression.

That worries me. In and of itself are these steel tariffs a problem? No. I mean, are some people going to lose their jobs over it because it makes their products too high? Yes. The steel companies are already at record profits, for gosh sakes. I mean, it's like, they don't need any help.

But it's a little bitty market. In the grand scheme of things it's not that big. And, by the way, under George W., he put steel tariffs in. Steel workers, now, there's 160,000 of them. That's all we've got left. And people say, oh, my goodness, all those jobs have left. They've gone overseas. And I say, no they haven't. We are producing more steel today than we have ever produced.

It wasn't the jobs that went to China or Mexico or whatever. It was technology. It's just silly to think that you can make those jobs come back with tariffs. 80% of the manufacturing jobs that have been lost in the United States have been lost to technology.

And we've become more productive. We're producing more stuff than we've ever produced before. You go back 60–70 years, maybe you have to go back 80, we're now producing six times more food with 10% of the people than we produced back in the '20s and '30s. Think about that. That is a marvelous production machine, and that's happening all over the world as the rest of the world is catching up with our technology.

And then we wonder why food gets cheaper. We are spending half the amount of money on food. You just take a pie, and go back to 1950s and the '60s and say: How much were families spending on food? And then how much are they spending on food today? Even with Whole Foods and all of these high-priced organics things in there, we're still spending about half of what we spent just 50 years ago.

The world is actually in a much better place. People are living longer, we're more educated. I'm pretty much an optimistic fellow. I'm just not all that optimistic about governments, Erik.

Erik: Well, speaking of governments, since you mentioned inversions of yield curves and so forth, let's move on to bond yields. We're back down on the Tuesday that we're speaking to only 2.85 on the ten-year after coming pretty darn close to 3%. A lot of people think that that trend is going to continue.

What do you think the driver is? Is this inflation fears? Is it something else? Why are we seeing this backup in interest rates?

John: Well, number one, the Fed is raising rates. And the short-term tail will wag the long-term dog a little bit.

First of all, taking interest rates down to zero, taking them down to zero for as long as we did,

was a mistake. Greenspan leaving rates as low as he did for as long as he did, creating a housing bubble, was a mistake.

And we don't know what Jay Powell is going to do. But I think it's fair to say that they're going to try to move rates up at least three times this year. The inflation numbers have come out recently. There's nothing to be alarmed about. Core is still below 2%. Core PCE, which is what the Fed looks at, core PCE is way below 2%.

They're reloading their ammunition for the next recession. I really do think – if you look at their dot plot, they'd like to be somewhere between 2.5% and 3% before the next recession starts so they have some room to cut. At the rate they're going, at 25 basis points every four months, it's going to take a long time to get to 3%.

Erik: I had Jim Grant on the program last week and he pointed out that, although it's certainly not going to happen overnight, he thinks eventually we do get back to the point where we approximately double long-term yields from here. And that would mean a doubling of the US government's cost of debt service. Now, we've been at those yields before, but we had half the national debt last time we were at those yields.

How far do you think the ten-year can go before something breaks? And what breaks first? Would it be the government's ability to finance itself? Or the stock market? What do you think the risk is in terms of this trend with rates?

John: You've asked a couple of leading questions here. First of all, let's understand the budget deficit for the United States – all the newspapers write in their headlines – is $1.2 trillion. That's a lie. That's the number that the congressional budget office, congressmen and everybody, puts out.

We'll probably have to sell $1.7 trillion dollars of new Treasury Bonds for this year – it could be a little higher or lower. There's something called the off-balance sheet debt. And there are years recently where $.5 trillion is – that's a real number, by the way – some years it's as little as $250–$300 billion dollars. Some years it's $.5 trillion.

It's things like student loans and social security. Basically both the Democrats and the Republicans got together and said let's not count this. Let's move that into the off-budget sheet of debt. Just to make their budgets look better.

And then Trump passes a tax cut – the Republicans pass a tax cut – that's worth an extra 150 maybe. I think it's going to be worth more. Not so much the first year. The first year, we're going to get a lot of income from businesses pulling money in from offshore. I think somebody told me the other day, Apple pulled $300 billion in. They've got to pay taxes on that. That's a one-time thing. They're not pulling that in every year.

This next year, our taxes may not be as bad as everybody was expecting. But the year after that,

we could easily see 1.2, 1.3, 1.4. And if we go into a recession, we'll be at $2 trillion a year deficits. Faster than you can turn, we'll be at 30 trillion dollars. That's 150% of debt to GDP.

Now, riddle me this, Batman. If Trump is facing a recession, or any Republican is facing a recession, or any president is facing a recession going into his election, what are his odds of being elected? Not very good.

Then when we get a Democrat administration in, they're going to run on, well, we want to balance the budget. They're going to run on higher taxes. And they will give us higher taxes. What will that do? It will put us back into a recession. All of a sudden, now, by the middle of the 2020s you're looking at $40 trillion.

And, my friend Jim Grant's words about, well, what's that going to cost us in terms of interest rate on the government? Just take that and double down on it. Now you're starting to talk real money. Even at 2%, $40 trillion dollars is $800 billion. That's just staggering.

To all of the listeners out there who are going, well, they can't pay that. I would like to tell you that you're absolutely right. That can't be paid. If something can't happen, then it won't happen.

What will happen, and what I'm arguing, is that we're going to all turn Japanese. The Japanese have monetized their debt. They literally have put on the balance sheet of the central bank 140% of their GDP. And they're buying every bond that they can get. The market's just not selling it to them.

And you would think, well, why would the market not sell it to them? Well, they have insurance companies, they have pension companies, they have all of these institutions that are required to own Japanese debt. And they bought that Japanese debt when it was paying a little bit higher rate than it is today. And if they sold, they wouldn't have anything to buy.

The central bank of Japan is buying indexes, they're buying ETFs, they're buying – they're up over 20% of the Japanese stock market now. If it's not nailed down, they're pushing money into the system.

And you know how much inflation they have? Zero. It's almost nothing. What are their rates? Almost nothing.

Erik, macroeconomics, it's turned upside down. I was talking with a former chief economist from the Federal Reserve here in Dallas who is now teaching a class at SMU, Macro 101. It's a freshman class. I said, well, what are you going to teach them? He said, macroeconomics. I said, but what are you going to teach them? What macroeconomics textbook? And he rattled off one of the popular ones. And I said, but that textbook doesn't explain Japan. It doesn't explain what's happening in Europe. How do you – none of those things that we learned last century happen anymore. And he looked at me and he says, John, we're dinosaurs.

The world is upside down, Erik. And, for us to be able to look at the past and say, well, we've seen this before, we know what's going to happen in the future, my answer is to you: No, you don't.

We are getting ready to go into the next decade with more change. Not just in macroeconomics. We're going to see more change in the next 20 years than we have seen in the last 100 combined. It's frightening; it's exhilarating. The opportunities we're going to have are going to be enormous. If you're in front of the freight train, rather than on it, not so much.

Erik: Speaking of upside down macroeconomics situations that center in Asia, we had Jim Grant tell us last week that China's banking assets have now reached the point of 40 (four zero) trillion (with a "t") dollars. That's about double the US. This seems to me like it could end badly.

I guess my question to you is how might it shake out? Is it just a problem that's going to be contained to China? Or is there a contagion risk that this bleeds over into a deflationary wave when this all blows up that affects the rest of the world?

John: Well, China has been the exporter of deflation now for a long time. That's going to change a little bit. We're going to see other countries in the world begin to export deflation as their populations start working for less money.

If I went into an economic crowd, into a school, into some place where there are supposed to be educated people, and I said: How big is Indonesia? What's the population of Indonesia? Not one in ten would come within even 100,000 of it. It's 300 million people. We don't realize how much and how many businessmen and entrepreneurs are trying to figure out how to sell stuff into the United States cheaper and better.

I'm not so much worried about China having a banking asset blowup. They will just print it. Now, they're going to let some of those companies die. And they're zombies. They're zombie companies, they should be dead. 1.8 million steel workers have lost their jobs in the last ten years. (We're worried about 10 or 15 thousand.)

They've built too much capacity. They're slowly reducing their steel capacity. Reducing their cement capacity. They're beginning to try to bring it down. They're trying to turn themselves into a consumer economy. I'm not terribly worried about China. I'm not a China bull, but I don't think that they're going to blow the world up.

Xi Jinping has basically said: I'm going to be the dictator for the next 10 to 15 years. He's still relatively young as Chinese leaders go. He has moved himself into the pantheon that only Mao and Deng Xiaoping held, Sun Yat-sen. And he's moving himself beyond Deng Xiaoping now, which I honestly never thought would happen. Xi Jinping is – if you pay attention, if you're a China watcher – he's impressive.

Erik: For several years now, I think people have gotten very used to the idea that deflation is the backdrop that's the only thing you have to worry about. And I would even go so far as to say there's a whole generation of professional finance people now who have never experienced inflation in any serious way.

Finally we're seeing more and more economists come around and tell us that inflation is probably coming back. Some say sooner, some say later. Do you think that we have an inflation problem on the horizon? And, if so, what are the potential consequences and knock-on effects?

John: Define "problem." I'm serious. This is a serious question. Tell me what an inflation problem is.

Erik: I guess the way I should have phrased the question is: Do you see inflation on the horizon as some economists are suggesting? And, if so, what will the consequences be? Is it a big problem?

John: Well, we have inflation right now. The number that came out today was core CPI was 1.8% year-over-year. That's inflation. You keep that up for about 52 years, and your currency is worth half of what it was, your buying power is half of what it was today. No, if you keep that up for 36 years, excuse me. My math is terrible.

Do I see inflation? I think we would all agree that inflation in the '70s was a problem. I lived through the '70s. I remember literally walking in and they would be changing prices in the grocery store while you were walking through. They'd just be putting a label over a label.

I remember going to the bank and borrowing money at 19% and 20%. And thinking I was lucky to get it. And, by the way, I would go out and buy – because I was in the printing business at the time – I'd buy carloads, literally train carloads of paper that was going up at 30% a year. So my 20% money was making me money on the paper that I was buying.

Now that's inflation. That's a problem.

2% inflation, 2.5% inflation, 3% inflation, not a problem. Really, it's just not. Do I think it could get as high as 3%? Not really, as I look at the numbers. What you have to do – this gets wonkish – inflation they measure in a kind of a year-over-year basis, for whatever reason, as opposed to two or three years.

So you go back 12 months and you have to look at what the base number was back then. And what you see is that there's a lot of numbers making it look like there's inflation today. Those numbers are rolling off over the next two to three months. And the new numbers that are going to be the base month for 12 years going forward will not give us the same level of inflation that we're seeing today.

So I'm not really expecting an inflationary moment that takes us to 5%, 6%, where the Fed

would just have to slam its foot on the brake pedal. I think they can continue tapping, raising it slowly, and trying not to do anything that's going to upset the market. They're telegraphing it so far in advance, everybody knows what's doing. It's all built in to the prices.

I will say this, since we're talking about the Fed: I think the one thing they are doing that is really dangerous is they are reducing their balance sheet at the same time they are raising rates. They're doing this monetary experiment with two variables, and they won't know which one was the problem.

I think reducing the balance sheet is a fine thing to do. But don't do it while you're raising interest rates. On-budget balance, a deficit of $1.2 trillion. Off-budget $400–$500 billion. And the Fed's going to push another $460 billion into the marketplace, saying: Here, buy this stuff.

We are very possibly going to have to figure out where to buy $2.2 trillion worth of bonds somewhere from somebody. And foreign governments will buy $200 maybe $250 billion. The dollar's getting weaker, which means that foreigners are going to buy more of our stuff. We're going to end up buying less because it costs us more.

You want to go back to 1987? 1994? Let me give you some parallels. The dollar was getting weaker. Fed was raising rates. And they were doing it at the same time and we had a market crashes. Really weak markets.

So if you ask me is there the potential for volatility? Yes there is. I think the push by the Trump administration for a weaker dollar, this whole extraordinarily misguided attempt to reduce the trade deficit – we need to be pushing more dollars out into world. That's what makes us the global reserve currency. They have to have those dollars to trade.

We start pushing less dollars out into the world, we lose our reserve currency status. If we lose our reserve currency status, we lose the ability to fund our deficit without having serious consequences in the valuation marketplace.

Japan works as a reserve currency, mostly for Asia. And so they can get away with it. Europe works as a reserve currency for much of the world, they can get away with it. But if we get rid of our trade deficit, we're not a reserve currency.

This is silly. We give them electrons and they give us stuff. We should be trying to figure out how to get more of that trade. Call me old-fashioned; trade deficits are not a problem. The money comes back to us – they buy our bonds, the money comes back to us in that they invest.

Our current account deficit is not a problem. And what we should be worried about is if that money wasn't coming back some way, if for some reason that wasn't in control, then we should worry. But we don't need to be worried about that.

Erik: John, your firm, Mauldin Economics, is very well known, among other things, as the

producer of the [Strategic Investment Conference] in San Diego, which just occurred last week. It's the event of the season for a lot of people.

Tell us a little bit about the past event that just happened last week. What did you learn there? What were the surprises from the various speakers and attendees that you learned from the conference?

John: I think the biggest surprise was two of the biggest macro traders that I know, guys that have made their living (and a really good living) being macro traders, shifting their business and saying we're moving into completely different styles. We're becoming country-focused. We're becoming very rifle-shot focused. And, oh, by the way, we're going to get heavily involved in blockchain and cryptocurrencies.

It was kind of like if you woke up and General Motors says: We're going to stop producing cars and we're going to go compete with Amazon. It was a surprise to me.

But I got into some side rooms and I started talking. I said: Guys, what are you doing? These are friends of mine. I go to their homes. I go into their offices. And these were shifts in the last two or three months. And they are shifting their entire staffs and business. And one of them, John Burbank, said: John, there is a regime change coming in the world. What I was doing is no longer working.

And I think this is where the value propositions are. I mean, he has one country that he's launching a fund – you're looking at it and you're going that's the last country that you should be looking at. And he lays it out and you go, oh, I want in that fund. And I really am, I'm going to give him money.

Because, number one, the guy is just a brilliant thinker. He says: John, if you see something that's glaring and bright, you stop doing what you were doing. Even if it was successful, even if you're making money, you walk away from it. And you now think. And you devote all of your management and effort time to where the world is going. Not on where it's been.

So many businesses – think Blockbuster, think Kodak, think whatever – focused on protecting what they had and not saying: Where do we go? What's happening? How do we change and move with the times? They've become legendary for failing. And we all know that.

But to actually do it. And to see more than one. I mean, there were several people at the conference who were saying: Yeah, we're changing. We're moving on.

That was a surprise.

I was surprised at the preponderance of some of the best macro thinkers in the world thinking that we're going to have a recession by 2020 – 2019 many of them were saying. I knew some of them would be. I just didn't think there would be that many of them.

The panel that we did on Thursday night – with the Democratic pollster Pat Cadell; Neil Howe who is the expert on generations and the millennials and wrote *The Fourth Turning*, one of the most brilliant intellectuals in America; Steve Moore; and myself – where we were talking about what's going to happen in 2020? Where is politics going?

This was a pure political panel. It ran long. It ran 90 minutes. I looked at the audience and said, we've been at it 90 minutes (it was 9 o'clock), I'm going to start wrapping it up. And actually, Erik, I was booed for the first time in 15 years. That was clear discontent. And I said, okay, how many of you want to keep going? 95% of the hands in the room went up. And they stayed.

And when I finally closed it down, because it was 9:35, there were people that crowded the front. They wanted to go on. Because what we were talking about was how things will change. For decades, politics have been kind of irrelevant to economics. The market grows, businesses grow, we move forward.

Geopolitics is going to become central over the next 10 12 years. We talked a lot about technology. We talked about markets.

David Rosenberg was there. With all humility, there's not a better economic conference in the country – anywhere. Because most economic conferences – I had so many veterans of economic conferences come up to me – I had one guy sit down and he says: I've been to 40 of these. You go there and you exhibit or you do whatever. And they have two keynote speakers and the rest are people who paid to get on the stage. He says: You have nothing but keynotes.

Nobody pays to get on my stage. Which is why you would think, looking at the prices we charge, we actually make a lot of money from this conference. We actually don't, because my speaker budget would choke a horse. I bring people on that I want to hear, that people want to hear, that have something to say. So it's nothing but the firehose giving you information.

And, believe it or not, most of the attendees – we give them a reduced rate. We have something called a Virtual Pass where you can get all of the videos, audio if you want it, and a transcript, the slides, and all their decks, and it's all there.

Just google John Mauldin, and you'll get to Mauldin Economics. On our front page will be some place to buy the Virtual Pass for the Strategic Investment Conference. And you can scan through it, you can look through it at your leisure. You can get the transcripts.

Honest to goodness, this – as everybody told me going out – and we have people that have been coming to this conference for seven, eight, ten years. I mean, that's the highest compliment you can get for a conference, when people come back again, and again, and again.

So I would recommend you get the Virtual Pass. And, by the way, if you're listening to this and you don't read my letters, my letter is free every week. Just go to Mauldin Economics, google John Mauldin, stick your email address in, and you're one of my one million closest friends.

Erik: Well, John, I can't thank you enough for a fantastic interview. Definitely, for our listeners, I recommend you look first at *Thoughts From The Frontline,* the free newsletter. You can sign up for Mauldin Economics. And while you're there check out those Virtual Passes for the Strategic Investment Conference.

Kevin Muir and I will be back as MacroVoices continues right here at macrovoices.com.