David Rosenberg: Inflation Will Be Transitory

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Erik: Joining me now is David Rosenberg, founder of Rosenberg Research. David, I've really been looking forward to this interview with you specifically because all of our best macro experts that used to be devout deflationists have turned inflationists. To the point that we literally have to go looking to find a deflationist left. Tell us your view, is the world changed? Is at all inflation from here?

David: Well, I mean, that certainly has become the narrative in the markets and in the media. I personally find it difficult to believe that the first global pandemic in over a century managed to unleash the inflationary forces that we couldn't generate over the course of the past four decades. That somehow it's the pandemic and the policy response to that pandemic, which has been to basically try and fill a leaky boat and preserve social stability. That we somehow now have in our hands a sustained inflationary experience to deal with. I think that we've just swung the pendulum the other direction. This time last year, we had three months in a row of negative CPI readings. We had three months in a row of declines in producer prices. Commodity prices across the board were plunging more than 20%. And if you remember, there was a day where the front month contract on WTI actually went negative.

So did we get an outright pernicious, sustainable deflationary experience? The answer is no. What we had was we had a global shock, the pandemic, and the shock created, the conditions where initially the plunge in demand more than offset the reduction in supply and that created the conditions for several months of negative pricing. We fast forward to the current environment and we have the situation now where you know, courtesy of the economy reopening, the vaccinations, all the fiscal juice that's in the system, demand has come back vigorously. And at the same time, the supply side has lagged behind. So we have this disconnect right now in the opposite direction between supply chains and demand. And it is creating I mean, nobody in their right mind can tell you that we don't have inflation right now. Inflation in the sense that we do have a temporary period where pricing is accelerating in several of the COVID related sectors. And in parts of durable consumer goods, where there are shortages.

To me, it is borderline disingenuous to say, well, the vaccinations and the re-openings are going to create the conditions for a surge in demand. But somehow the supply side will come back. The supply side will come back, all you have to do is take a look at the dramatic increase we're

seeing in shipments and exports out of Korea and Taiwan. And all they really do is make semiconductors. So with a lag that's going to help ease the pressures everybody's talking about in the chip industry. And you just have to take a look at the container ships that are filled to the brim outside the ports of LA and Long Beach, which are the two busiest ports in the United States. They haven't been unloaded yet, and partly because of the lingering impacts of the COVID.

But to suggests that the supply will not come back to me is ridiculous. To start talking about labor shortages. Indeed, because you do have some people that that do fear going back to work because the pandemic is not over not even in the United States. And I say that, you know, with over 40% of the population having been fully vaccinated, you know, we will get there in probably four months if you're talking about herd immunity. But the lingering impacts of the pandemic, the variants are keeping people at the margin, reticent to going back to work. And of course, we have these extended extremely generous jobless benefits that are paying people more to stay at home than to go back to the real job.

This will all fall out of the data come September, October where I expect the supply side is going to play catch up to the demand side. And we have to keep in mind what is the story on the demand side outside of the vaccines is fiscal stimulus. But all the fiscal stimulus is just all very temporary. As we saw, with the April retail sales data, everybody blew their brains out on the spending in March. So we have a stop and go economy on our hands. The fiscal policy and the short term nature of the stimulus has just accentuated the volatility in the data. So I actually believe that come the fall, we will start to see the reopenings having a positive impact on aggregate supply at a time when we're gonna see fiscal withdrawal having a downward impact on demand. And so a lot of the inflation we're seeing today is going to reverse course I expect either by late summer or early fall.

Erik: Now one of the arguments that a lot of people are positing here is that we've got a situation where there's been a political shift where the last 10 years of QE has resulted in inflation in a sense in asset price inflation. The reason that these people have suggested that it didn't go into consumer price inflation is because the money didn't go into the real economy. Now we've got a shift where the government aid money is being much more directed toward Main Street than Wall Street. Doesn't that change the calculus?

David: You know, I keep hearing about that. We're into a new era, and that I keep hearing these words of regime change. But I heard the same things when Barack Obama got elected in 2008. Regime change, a socialist out of Illinois, going to shift everything to the left and of course, we got Obamacare. And then we had the bailout of the banking sector that really put the lows in for the stock market back in March of 09'. And then we had Ben Bernanke, who was and as a Republican with repeated QEs, zero interest rates. I mean, keep in mind that by the time the last expansion was six years old, the Fed was keeping the funds rate at zero, and relentlessly expanding its balance sheet.

So you could have argued back then that we had big regime change on our hands. But you know, where was the inflation when all was said and done? And then we have Donald Trump being elected in November 2016. And tell me that we didn't have regime change on our hands said. Do you remember how many times we were told to read that book, hillbilly elegy? and Steven Bannon, and we had a new era unless I'm mistaken. Did we not have a new era with Donald Trump? protectionism, isolationism, nationalism, and Donald Trump's inaugural speech in January of 2017. He used the word protection nine times. And he surely went ahead with trade barriers and tariffs and restricted immigration and so where was the inflation? Where was the inflation? You know, I remember everybody talking about inflation after Donald Trump got elected, and we're going to have fiscal reflation, because of course, he cut taxes, and ultimately took the deficit up to a trillion dollars by the end of the last cycle and a trillion dollars, I guess, at that point, we view it as a pretty big number.

So, you know, I hear regime change all the time, whenever we get a political shift, we get regime change. If I'm not mistaken, we're supposed to have regime change all the way back with Bill Clinton back in 1992. What happened to that regime change? So, you know, look, I've made my living and a career out of fading. You know, just the phraseology that comes out. Where, where is this regime change? You know, we're talking about that we didn't have trickle down all the gains in the stock market, the real estate market, but someone's got to explain to me how it is that, you know, Donald Trump didn't get reelected more because of character and personality issues than it had to do with how he handled the economy because his approval rating on the economy, wait till the bitter end, was the strongest point. So where does this come out that both the, you know, the haves and the have nots, and there is no trickle down? You know, when month in month out towards the end of his presidency, all Donald Trump talked about was how the unemployment rate for African Americans and for Hispanics, and for Asian like for all minority groups, youth, women, they all went to historic lows all time lows.

And the reality is that the data are where the data are. Those were areas where he was actually correct. We went into this pandemic, if you don't mind me saying so. And I will throw the question back with unemployment rates among minority groups and the youth and women, the lowest levels on record. So explain to me again, what was broken, we had a 10 year economic cycle. And we had the lowest unemployment rate of three and a half percent in 50 years. And at the peak inflation was barely more than 2%. So what am I missing exactly in terms of this so called regime change that we're seeing right now? How is that going to cause inflation? So you get these people out there and these are smart people. They are economists, these are people I know. Many I'm friends with who will tell you well look at the money supply numbers.

But I come back and say but for the past 20 years, the money supply numbers have had no correlation with anything except maybe asset prices. And you're quite right. We've had dramatic asset inflation. Well, look, there's different ways even regulatory, that we can deal with that. That's a big problem. But you cannot predict inflation with just the money supply because you have to take a look at money velocity and money velocity has been contracting for decades because we're choking on too much debt. And it has impaired the credit multiplier. So I don't see that that's changed. Money supply against money velocity is not leading right now to an

inflationary conclusion, oh, people are now saying, well look at wages. Look at all these companies announcing wage increases. And then of course, to lure these people that work in the consumer cycle industries, whether it's restaurants, or in the hotel business, or theme parks.

You know, once again, a little history goes a long way. I remember back after Trump cut taxes on the corporate side and allowed companies to repatriate tax free their earnings from abroad back home and all these companies. I listed 20 them in my morning note the other day. 4% of the corporate sector announced wage and bonus increases back in early 2018, some bellwether companies too. So where was the big inflation coming out of that? And now all of a sudden, you can't read a headline without some company weight raising wages. But where is that really inflationary? How do you just basically say wages go up, inflation goes up when you know, as an economist, that it's unit labor cost, his productivity adjusted wages that will drive inflation, that was the 1970s. The 1970s wasn't that wages went up 10% a year. Instead, wages went up 10% a year in a decade where productivity was stagnant.

So here we have a situation which nobody talks about what's really important, which is that we just got last week, a first quarter productivity number that's showing that productivity is running over a 4% annual rate. Now, whether that's a secular or structural change, I'm not sure. But you know, everybody talks about regime change in an inflationary way. But nobody talks about the fact that in the weakest year for the US economy since 1946, it was the best year for productivity in a decade. Companies actually realized for all the lamenting of shortages and job shortages and job shortages and job shortages. The reality is that the corporate sector actually had its best productivity performance in a decade in the same year that we had the worst year for employment since the 1930s.

But we had the numbers for the first quarter, and pass the eye of the storm for the pandemic. And productivity even with employment coming back, we had a situation with over 60% of the jobs that were lost have come back. And yet even with that productivity is running over 4%. Now it's hard to really judge whether that's noise or whether that's a fundamental shift. But let me just tell you that if you have productivity running over 4%, and let's say that that's what the data are showing right now. You could have wages running at 5% and they're not even running at 5% yet and you still wouldn't get the inflation. Because what drives inflation is productivity adjusted wages, not nominal wages on their own. And I can't believe how many people can't wrap that simple economic theory around their head. And so they come out and say, well, you know, and look at the fiscal stimulus. All the fiscal stimulus, yes, indeed, we have rampant deficits.

But you can't take a look at the overall inflation and interest rates without looking at National Savings. This is the problem people had in Japan, who basically paved more riverbeds and built more bridges to nowhere in the name of fiscal stimulus than Japan where they've had blow of fiscal deficits for 20 years. And yet, look what interest rates and inflation have done there. Because nobody pays attention to what's happened with private sector savings, which has been an offset to the de-savings in the public sector. So everybody's taking this very myopic and narrow view and what drives inflation and what drives interest rates. So you can't look at fiscal policy, without looking at the context of what's happening in the household sector and in the

business sector. You look at the business sector, there's been a negative financing gap of over $100 billion in the past year. Companies and there was an article on the front page of The Wall Street Journal the other day, and now companies are retaining cash on their balance sheet.

Okay, so I'm taking a look at retained earnings, and taking a look at corporate cash flows, and take a look at capital spending intentions. There's no signs here that the corporate sector is doing anything but raising its defacto savings rate. And what about the household sector everybody's talking about? Well, look at this 30% personal savings rate that's out there, that's dry powder for future spending. Well, I don't know, that didn't work so well with April retail sales did it? It didn't. And so we don't know where the personal savings rate is going to end up. What we do know and the New York Fed has done the work for us is the New York Fed has shown that only one quarter of these stimulus checks and there's been three rounds so far dating back to last year have gotten into the real economy. The other three quarters are split pretty evenly between savings and a lot of that savings is indeed going into the market, which is why you've had this explosion of Reddit accounts and Robin Hood accounts. But a third of the money is going to pay down debt.

I'm looking at the bank lending numbers and look at the bank lending reports. The banks beat their earnings. Yes, capital markets activity, wealth management trading. Look at the loan books of the major banks in the United States, they're shrinking. There's credit contraction in the private sector. You've seen it in the bank lending data. So what I'm saying is that you have to take a real holistic view. Inflation as is the case with most broad economic variables it's very complex. But I'm just finding people are either doing partial equilibrium analysis or they're just taking a very narrow view to what ultimately is going to drive inflation down the road.

We have tremendous distortions and disturbances in the data. I mean, take a look at what happened in the April CPI numbers. I mean, come on. The CPI sports ticket price up index went up a historic 10% in one month, in one month. But meanwhile, if you took a look from July to December of last year at the BLS wasn't even reporting what prices were doing at sports events from last July to December. The next thing, you know, stadiums, arenas, baseball parks are filled with five or ten thousand fans or they're selling out in Texas because you're talking about people that will pay anything now to watch any game. Oh, and there's big inflation. This is not anything that's sustainable. You had, what you had a 10% surge in airfares. Yes, they've cut capacity, people are dying to fly. Are you going to tell me like in six months, the airlines are going to be raising prices 10% again? This is the one area I do agree with Jay Powell. There was tremendous noise and disturbance and dislocation and all the data right now because guess what? We are still living with a global pandemic and there's all sorts of offsets between the re-openings and the vaccines. And with fiscal policy, which is very short term in nature. And I'll just hazard to say that this time last year, we're talking about deflation. Now, this time this year we're talking about inflation. And I will tell you with a virtual guarantee, we'll be talking about something else in four, or five, or six months time. And I'm saying it will not be about today's inflation experience.

But with respect to today's inflation experience, it sounds like what you're saying is the Fed actually has it exactly right in describing this as a transitory phenomenon. We've got some inflation right now, because the economy is having trouble getting started up and responding quickly to demand, it'll all come back out and we'll be back to what we've been used to for the last several years. That's the way you see this playing out. If that's right, it means a whole bunch of people are really, really wrong. And that means market opportunity, because a whole bunch of things have moved quite a long ways in a inflation is coming and not just inflation, but secular inflation is coming. If people are wrong about thinking that, and we don't really have secular inflation coming. What's the best trade to kind of play the crowds got it wrong?

Well let me just say that I'm not gonna actually say that the markets have anything particularly wrong. What I'm saying is that the narrative that you're reading and hearing about day in day out, that narrative is wrong. You know, look, The Wall Street Journal runs with an editorial that uses as its inflationary thesis, the one year, the one year inflation expectation component out of the University of Michigan index, which just came out on Friday for May. What they don't tell you is that if you back out the two to five year inflation expectation, because the one year is just if you plot the one year inflation expectation against gasoline prices, that's your story.

But the two to five year, the two to five year hasn't moved, it's still in the range. For that particular metric, it's 2.7%. It's still in the range. The two to five years, if you go into taking a look at the TIPS market, or the breakeven inflation levels out of the bond market, you'll see that most of the inflation expectation is still a very near term. Like really out to the next two years. If you take a look at the breakeven spreads between twos and fives and fives and 10s and twos and 30s. You'll see that there's been no big outbreak of longer term inflation expectations. That's actually very encouraging. They're just telling you that right now we have a tremendous dislocation. And yes, it's going to probably gonna last a few more months. It's not just your base effects. There is some real price increases coming into the fore. But what would you expect? I mean look, we just had a 10% increase in airfares and the CPI index, they're still down 20% from where they were pre-COVID. You know, the sports tickets and the like that were up 10% in April. You know they're down significantly for where they were pre-COVID. And so there's still tremendous amount of distortions.

And yes, you're gonna find that some companies will continue to raise prices while they can to preserve their margins. But remember, inflation is a long term process. There's nothing in there, there's nothing actually in the markets telling you that it's going to be long term in nature. We have a short term dislocation on our hands. And I do believe that it's going to be resolved for the reasons that I've discussed, which is that demand will slow in the second half of the year I think materially once the fiscal stimulus runs out. And I think that April's retail sales, which nobody talks about, because every so consumed about inflation, nobody's talking about the fact that core control, retail sales were down one and a half percent in the month of April, that's a pretty big deal. And it's telling you that people already spent what they want to spend out of that fiscal stimulus. There's no pent up demand in merchandise goods that much is for sure. And we're not getting another round of stimulus checks.

And then we're gonna have the jobless benefits that are going to term out. That has to be your expectation. And so we're going to have different contractors that will not continue to hear stories of there being labor shortages beyond the end of the third quarter. That's my expectation. You know, if I'm right on this, I guess that you'd say that whatever inflation expectation that is in the market will come out. I think that that would mean that the Treasury market undergoes a bull flattener. And I'll just say this much, you know, it's interesting that you know, that when I take a look at the Cleveland Feds five year inflation expectation measure. So the Cleveland Fed actually has a model. What's the model for TIPS breakevens? It's not a model, it's just a residual, and it's correlated to the CRB index. And that's all people in the markets look at for their inflation view as they look at the CRB index. And so you got these measures, say, in the TIPS area that are at least call it roughly two and a half percent for inflation expectations in the bond market.

The Cleveland Feds five year inflation expectation measure is actually 1.48. It was 1.37 in March, so it's not as if it stayed static. But you see that the Cleveland Fed actually has a model. And I've actually found that their numbers actually do have at least some correlation with the labor market. There is no correlation with the labor market in the TIPS breakevens. It's all the CRB index. So when you're asking me how to be positioned, look, if the breakeven inflation expectation metrics in the Treasury market converge on the Cleveland Feds inflation expectation measure, you know, you'd be talking about at least a 25% total return to the long bond in the next 12 months. If the convergence happens that the market ends up gravitating towards what the Cleveland Fed. Keeping in mind that the Cleveland Feds model is a real model. Okay. I'd say that if I'm right on this call, you know, because a lot of it is premised on the economy slowing down.

You know, nobody talks about the fact that the Citi group economic surprise index today just hit the lowest level in 11 months. Okay, did you know that?

Erik: I didn't know that

David: I don't think anybody knows that. Nobody knows that well, because why? Because everybody has inflation on the brain. But inflation is really all about a supply and demand curve, aggregate demand, aggregate supply, and we have supply constraints right now. Inflation is going to rise near term, it already has and I think the operative anybody rolls their eyes when you use the word transitory today, people just laugh at you. But you know, what else could it be? Demand is going, we borrowed so much growth from the future with these rolling temporary fiscal stimulus packages. We just bought all this growth from the future. Look, we just hit a million units on new home sales in the month of March. Well, I got news for you we built we you know, they're up 60% year on year.

Now you'll say what is coming off a really depressed numbers in 2020. That much is true, but even if you correct it for that. So you know, people talk about well, you know, housing, the shortage is here. And shortages, the total shortages of labor in housing. Meanwhile, residential construction employment in March and April together we're up over 30,000. It's just finding,

people are just making things up. The reality is that we have no pent up demand. Autos, 18 and a half million units when you hit 18 and a half million units in any cycle in the past that is peak autos. They are down substantially in the next 6 to 12 months. Home sales like I said over a million units. Last time we were there was in the summer of 2006. Home sales were down 30% in the next 12 months. Housing starts were down 20%. So it's very interesting to me that we don't have pent up demand for the things that normally carry the expansion through the, through the recovery phase. This is how unusual we're relying on demand in the comeback with the reopening in airlines and restaurants and theme parks and movie houses.

And basically we're talking about 4% of GDP is where this V shape recovery is going to come. But at the same time, because we have no pent up demand and durable goods, which is a $2 trillion business. That I think is what people are going to be surprised at how weak demand is going to be. Once we see the Emperor disrobed. When I say the Emperor disrobed, I mean that the economy has been medicated so many times on fiscal stimulus. What happens when you take the candy away? and Joe Manchin has already said, and there's no more important person in Washington then Joe Manchin has already said he's not signing on, he is not signing on to more stimulus checks. Especially to people that don't need them, which is how this fiscal policy has been constructed. You're talking to me about haves and have nots and about inequalities. And here you have the Biden. This is the irony, is Joe Biden has only exacerbated those inequalities, by giving fiscal stimulus by stimulus checks to people that don't need it.

Like the New York Fed has already come out and said only a quarter of this money is actually going into the real economy. Three quarters is not and about half of that three quarters is going into the market. And here we're talking about that we have a new regime of leveling the playing field really? By giving money to people to open up Robin Hood accounts that's and to drive equity prices even higher. You know, that's, my head is spinning over that concept. But the point I'm making is that is that what people can't see around the bend is that demand is going to be weakening I think significantly after the second, maybe third quarter, and supply is going to come back and people will be surprised how low inflation is.

So I said bull flattener, and treasuries. And I would say that growth will reclaim its leadership over value since value was so deeply cyclical value really needs higher interest rates, higher inflation, which has been getting for the past call it six months. But they call it a value trade for a reason, because it's a trade. And there's a reason why growth stocks outperform value 80% of the time in the last expansion. And that's because the structural factors at work that have kept inflation at bay haven't gone away because of the pandemic or the policy response to the pandemic. And we're talking about Asian demographics, which is disinflationary not inflationary. When you take a look at the whole demand supply effects of aging demographics. And you look country by, we did the cross sectional analysis on this, you know, somebody wrote a book, and a client of mine sent it to me about how demographics are inflationary. It's like everybody's got inflation on the brain.

No aging demographics are not inflationary, and aging demographics, disruptive technology and that's ongoing. And that we did not have in the 1970s. And we're choking on too much debt.

That's why money velocity is going down. That's why people are choosing to save most of the stimulus. And so when you have an all economy when you look at households, businesses, and governments together. Because we all own this debt, we all own this debt. This debt is all ours, we can talk about the government sector all we want, but the government represents the people. Debt at all levels of society in the United States has never been as high as it is today. 366% of GDP that does not include, by the way, the unfunded liabilities in the system. 366% of GDP, I cannot believe how people are not alarmed at that number. It's up 40 percentage points in the past year. Well, of course, we had to fight a pandemic. But you see, we've never had a year where that ratio went up 40 percentage points.

But if you notice in the past 40 years, we peak in a new debt ratio. And yet inflation is peaking at lower and lower levels, bond yields peaking at lower lower levels because this is a tourniquet. This is the most pervasive constraint and aggregate demand in the future is the grotesque level of debt we have on our hands right now. Now people will say, oh, but we can afford the debt because interest rates are low. Yes, of course. That's exactly the story. Interest rates can't rise with that level of debt without sending the economy back into a destabilizing recession.

Erik: David, I'm still having a hard time understanding what seems to me like a dichotomy here. because on one hand, you're saying something which I agree with very much, which is the Biden administration should not be paying people to stay home and not work, when that is what they're doing. But wait a minute. That's the reason I think we do have a inflationary impulse here is specifically because the government is paying people to not work and you're losing supply of labor, to people who are collecting a stimulus check. How is it that I get a conclusion that's inflationary and you don't? I feel like I'm missing something.

David: Well, because it's more to do with our timeframe. So if you're going to tell me that the Biden team has taken out blank number of people permanently out of the labor market. I'd say, Uncle, I submit, but that's not the case, right? Like these extended benefits end in early September. So the answer to your question is, yes, that's part of the temporary supply constraint. Well, the Biden team turned this into a UBI, a universal basic income. Well, let's wait and see for that to happen. And now we have at least 10 states run by Republicans that are terming out these extended and overly generous benefits earlier than scheduled. Maybe they'll serve as some useful templates in terms of what's happening to their participation rates and unemployment rates and what's happening with labor competition and wages in those states. So we'll have a few months of a template.

But what I'm saying, I never said to you that we're not going through a short term dislocation, and part of that is the policy response. But I said in the very beginning of the show that we have three months of outright pernicious deflation a year ago. Did it last? Why didn't it last? Was everything permanent? It wasn't permanent. You know, we found out that actually, the COVID-19 was not the bubonic plague. It was not the robotic plague. That is, is not going to be a repeat of the Spanish flu, that killed so many other people and young people in 1918-1919. And then we had the vaccinations, which was a huge game changer, obviously. So if the deflation a year ago wasn't permanent, why do you think that the inflation we're seeing right now is going to be

permanent? That's what I'm saying. I'm not saying I mean, I do have two eyes. I do see what's happening in front of me. But I guess it comes down to your question before, I'm not the least bit embarrassed and believe me, I have I have disagreed with Jay Powell in his tenure, more than I've agreed with them.

I probably agreed with him a lot more, you know, when he was governor, then when he took, but then when you take the reins of the Fed, you become somewhat of a politician. Be that as a mate, I think that the Fed has got the narrative right. I think that they've done a stellar job actually in your communication skills. I'd actually, if I was Jay Powell at the next press conference, after the meeting, I would wheel out a blackboard and explain to people what inflation truly is and inflation is not four months of accelerating prices or wages. That's not what it is. Would you say that Paul Volcker was a big inflationist? Would you say that he was?

Erik: I would not say that.

David: I don't think anybody would, right? But what if I told you that the price level in his seven years at the helm of the Fed. The price level, the CPI under the "inflation dragon slayer" ,the CPI went up 60%. Has your mind changed about Paul Volcker? The price level went up 60% under his tenure. No, because the rate of inflation, the second derivative, because inflation is a process and went from 12% down to 4%. The inflation rate went from 12 to 4 and he's viewed as the world's most significant "inflation dragon slayer" of all time, but the price level went up 60%. But how can you not call that inflation? But he's the "inflation dragon slayer." Well, you asked before about anomaly, is that not an anomaly? It's not because the inflation rate went down.

And Ben Bernanke, who tried to create more inflation than Ben Bernanke? He is helicopter, his nickname was helicopter Ben. He was at the Fed, at the helm of the Fed for eight years. And did you know that in his tenure, the price level went up like 15%? It went up a fraction of what it did, under Volcker. Volcker tried to create disinflation, and he got it even though the price level rose, who tried harder? I mean, you talk about regime change. I mean, I'm asking you once again, rhetorically. There was no regime change with Ben Bernanke who even knew what QE was before 2008. I was at Merrill Lynch back then, I had to do teaching lessons on QE. And they didn't just stop at one QE, and ZIRP, zero rates. And so that wasn't, quantitative easing wasn't regime change. And where was the inflation? Well, all the structural factors I was talking about which have gone even more disinflationary acted as a massive offset to anything we ever saw cyclical, I will come back again.

You know, the optimist and the pessimist meet for a cup of coffee and the optimist says to the pessimists, you know, things can't possibly get any better. And the pessimist says, You know what? I think you're right. So I guess somebody's got to explain to me that if we, how it is that we got to a three and a half percent unemployment rate by early 2020 and late 2019. Lowest unemployment in 50 years, coming off a 10 year expansion, a five fold increase in the equity market, a booming residential real estate market. And inflation was barely above 2%. With a three and a half percent unemployment rate, the tightest labor market in 50 years and the last

time we had an unemployment rate that low the inflation rate was more than double where it was this time around. But yet somehow, because of the pandemic we just miraculously created, we waved a magic wand that we got a new inflationary experience on our hands.

So I'm just saying, how, how is that possible? You're talking to me about temporary dislocations, I'm saying that in reality, we have a use six, the broadest unemployment rate measure is 10.4%. But like, I only know my history, and you know what, maybe, maybe it's different this time, maybe it's different this time. But I know from the past that full employment, a really fully employed economy is when the U-6 is at 8% or 10.4%. Oh boy, we got some big big wage inflation coming. Big inflation with a 10.4%. U-6. How does that make any sense to anybody? And then, of course, we have a cap U rate in industry, in manufacturing, that's 74%, 74! But I know historically, that metrics got to get to 78 to get real inflation, not four months inflation, four years of inflation. Let's just talk about inflation is not a four month phenomenon.

You cannot judge if you're in a bull market or a bear market just on four months. Okay? So time is every bit as important. Duration is important to making these calls, as magnitude. So I'm trying to say here that well, boy when I am taking a look at the unemployment rate in the labor market, and where there usually is when, we have meaningful inflation. And I'm taking a look at the unemployment rate in the manufacturing sector, the cap U rate, and where it normally is, when we actually get more than just a few months of inflation, but a few years. I get it, I get that we still have an output gap in this country of over 2% of GDP. And we're already halfway through the biggest fiscal stimulus we've ever seen before with the stimulus checks that looks to have already been spent in the month of April. So what am I missing? What am I missing?

How is it I'm looking at the supply of labor, I'm not talking about what is temporarily held back for reasons due to COVID. or the policy response to COVID. I'm looking at I'm seeing the total supply of available labor in the United States is 17 million. Before the pandemic It was 10 million. We have a labor pool that is 7 million, the delta is 7 million over where it was before the pandemic. But all of a sudden, we have this radical hitting the wall on labor supply. And now we're thinking, well, that might be the story right now, for a variety of reasons that have temporarily held back this labor supply. But I don't spend my time talking about what's happening right now. I talk about what we'll be talking about 6 and 12 months down the road. That's how I spend my time because that's what's most important, because if the markets are forward looking. Why would they care about what's happening at this very moment in time? It got priced in already. So I'm saying yeah, what I see is that we're going to see a supply response and we're going to see a demand slowing, that is going to rectify a lot of these imbalances that we're seeing right now in the data, especially the inflation data.

Erik: You mentioned a bull curve flattener as a potential trade here, I assume that means you don't think that 10 year Treasury yields are going to continue backing up the way some people, know some people are afraid we're headed to 5% from here. Where do you see Treasury yields headed?

David: You know, look, I remember turning on CNBC after Trump got elected and Larry Lindsey, who was governor of the Fed was talking about 5% Treasury yields. I mean, we barely at one point in late 2018 got above 3. Who wasn't talking about all of this, who wasn't talking about when Trump got elected. That's all you heard was about inflation. You heard so you heard restricting immigration, wage inflation, tariffs, trade barriers, nationalism, protectionism, all the stuff Steve Bannon was all about. I mean, what am I missing? Weren't the same people talking about inflation after Trump got elected? Am I mistaken about that? So I think that's very interesting is that Treasury yields seem to have peaked.

You couldn't have thrown much more in the way of data million jobs a couple of months ago, point nine on core CPI and other big number on PPI. And the bond market right now is just in a range. And I would say that there's certainly a high level of that elevated level of inflation uncertainty. And I think that there will be a premium in the Treasury market until they get resolved. But you see, I'm saying the inflation uncertainty will get resolved in a certain direction that I do think that the consensus is gone the other way, but that doesn't. What the consensus is saying is, look, I'm waiting. I'll tell you the truth. I read vociferously, voraciously. I read all the newspapers, I read all the periodicals, I read as much as I can my competitors research, I'm dying, for somebody to put out something insightful. That will get me to change my view. I haven't seen it yet. I just see a lot of partial analysis. I don't see any general equilibrium analysis. I don't see how nobody's even talking about how is it that we can get an inflation, whether U-6 of 10.4. Who's explained that?

You know, and so everything is just all very short-termism. I admit it, we have inflation now and for the next several months, admittedly, admittedly. Just like we had deflation a year ago for a few months and I asked the question if the deflation wasn't persistent, why would you think the inflation is going to be the persistent? What is it, that's going to take inflation higher that wouldn't have done it last cycle? We finished the last cycle with negative real interest rates. If I'm not mistaken, Powell, cut rates three times in 2019. We expanded the balance sheet as the repo market blew up in his face. And we had ongoing trade frictions, and tariff barriers, and tariff increases, and a three and a half percent unemployment rate. Like what do you do for an encore and now people are talking about we're going into a new inflation cycle. But you see, they said that after Clinton got elected in 92', the big socialists of Arkansas gonna rewrite the social contract. Really?

You know, what happened to Bill Clinton? Whenever Bill Clinton was called the 1994. midterms. Oh, and then we had regime change inflation regime change with the other socialists from Illinois, Barack Obama. Didn't you know? Big inflation coming. And Bernanke is on a side which he was. Explain to me where was the inflation from that regime change? What got in the way of a Barack Obama was once again was the midterms in 2010. Oh, let's see Donald Trump. Donald Trump was supposed to be massively inflationary. And that was actually the mantra at the very beginning and bond yields went up, cut taxes at a time of full employment. Where was the inflation ?Tariff increases, we're going to have tremendous cost pressures from tariffs. Okay, did it last a month or two? Was it a pernicious month over month inflationary environment? We

finish off the cycle with a three and a half percent unemployment rate and inflation is barely above 2%.

So it is all very interesting. And what gets in Donald Trump's way, of course on regime change is the 2018 midterms. So people are just, uh, you know, I don't know. Do they look at history? Do they understand history? Do they not know that there is no regime change in a country that has a two year political cycle. Do people not understand and they don't, because everybody lives in the here and now and they can't see past the tip of their nose. There is no regime change in a two year political cycle. So everybody's talking about we're gonna have modern monetary theory, we're gonna have ongoing fiscal expansion never ending, we're gonna go to universal basic income. Really? Well I think people don't quite understand how lucky Biden was to have emerged with those victories razor thin in the house and in the Senate. And my assumption is that they're going to go, they're going to flip that both houses are going to flip. But all you need is one and the 2022 midterms, which all of a sudden is just next year. So explain to me where the regime change is in a two year political cycle.

Erik: Well, David, I can't thank you enough for another terrific interview. Before I let you go though, I do want to change the subject to Rosenberg research because you have become an iconic figure in the industry in the last several decades for writing "Breakfast with Dave" your daily newsletter, but you've expanded your offerings now with Rosenberg research for people who don't know what's new at Rosenberg research, please bring us up to date.

David: Sure. Well, you know, I would invite everybody to go on the website, just google Rosenberg research, and it'll take you right there. And we have the capacity actually, we have group deals and we have discounted packages. But if you wanted to create your own à la carte, you just have to talk to one of my client representatives. They'll help you construct something that is going to be relevant for you. And it's true we have, you know, I used to be when I was at my previous jobs, it was always just "Breakfast with Dave". But now we have a monthly strategizer, it's called the *Strategizer*. And it's a very active equity market, fixed income, and currency market idea generation on how to invest.

You know, in my missiles, I'm usually 20,000 feet up in the air to strategize for the active investor, who's more like, you know, maybe 20 or 100 feet up in the air. So we do that monthly. I do a variety of webcasts as well. I've had Howard Marks on the call, I've had Jeffrey Gundlach on the call. I've had Leon Cooperman on the call, and Neil Ferguson and the like. So I do those pretty well once a month. And there's a variety of other written material, special reports that we try and cover everything quite often. It's our clients that give us ideas on what to write on. So also doing special reports that we'll do a couple of months. on big picture issues. We're just finishing, just finished one on the outlook for emerging markets as an example. So we cover a lot of ground. I invite everybody to go on the website. Just go to Rosenberg Research, you can always email me directly at *drosenberg@rosenbergresearch.com*. And we offer free one month trials. So we always want to have people come in and kick our tires. They can either buy our basic or premium packages, or quite often just say, No, I like this, and the other can you mock up? What makes sense that could work. So we also have that custom. But we'd like everybody

to come on, have a full month experience, and then make up their minds. You know what it is that they would, that they would like to purchase. You know, the business has gone great. We were up to 3000 relationships in 40 different countries. So it truly is global in nature. And it's been a lot of fun.

Erik: Well, folks, Rosenberg Research may or may not be for you long term, but you can't go wrong with the free trial. So I strongly recommend that and certainly Breakfast with Dave is one of the best known and best respected letters in the entire industry. David would look forward to getting you back on the show in a few months for an update. Patrick Ceresna and I will be back right after this message from our sponsor.