Jim Bianco: Jay Powell's "word salad", FOMC Mood Swings, Interest Rate Outlook, Crypto & More

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Erik: Joining me now is Bianco Research founder, Jim Bianco. Jim, it's great to get you back on the show, it's been way too long. I have been just thinking about you ever since Wednesday evening when you tweeted what I thought was one of the most insightful tweets I've seen in a long time about word salad. But just for anyone who hasn't seen that, let me set the stage for our listeners. About three weeks ago now, there was first some dovish indications from the Fed that, in that crazy Sunday night session sent gold to upwards of $2150, just in the thin liquidity of Sunday night trading. But then it all reversed the next day when Jay Powell basically told the market: look, it would be premature to start speculating at this point, about any kind of rate cuts, it's not time for that yet guys don't do that. Then after that, just about every macro data point that came out, was tilting, at least slightly on the hawkish side. We ought to expect the Fed to get more hawkish at last week's FOMC that caused gold to sell off, it caused a lot of trepidation and equity markets. Everybody was kind of on the edge of their seat. And then the Fed surprises everyone by not only tilting back to the dovish side, but the dot plots and the messaging out of the FOMC statement all indicate that they're basically announcing that they're getting ready to go to rate cuts, exactly the opposite of what Jay Powell had said just a couple of weeks earlier. Then Nick Timoraos asks Jay Powell a question in the press saying, how come you kind of said one thing and then said the opposite thing? And as you put it in your tweet, the man who has earned international accolades, Jay Powell for his ability to speak clearly in plain language that everybody can understand to explain monetary policy decisions, suddenly can't form a coherent sentence to save his life. You called it word salad. What's going on here? How come suddenly Jay Powell, Mr. Clear-concise-and- easy-to-understand, can't explain himself?

Jim: Well, I think the simple answer is, is that he's been asked a question that he doesn't have an answer to. And that's why he's kind of just, you know, word salad eating all over the place trying to come up with one. And specifically, the question that Nick Timoraos asked him was, you're right, December 1, it was premature to talk about cutting rates. Back in early November, they heralded the sell-off in the stock market, and higher interest rates is doing the work for the Fed. And so therefore, we don't have to raise rates anymore. Because the stock market's tightening financial conditions, higher interest rates are tightening financial conditions. And then almost immediately after they said it, we had a monster rally in stocks and in bonds. Bonds, in November had their best month in 40 years. And that continued into December. So what Timoraos was asking was, what happened to tight financial conditions J? Now they're very, very easy. The market is not doing the work for you anymore. And he didn't have an answer to that.

And it's almost like, you know, the cynic in me likes to say that the Fed has kind of made up their mind already in what they want to do. And then they say, hey, look at these indicators over here, and they justify what we want to do. And then you say, wait a minute, all those indicators just reversed. Okay, nevermind those indicators, go look at these over there. And those are the ones that tell us what we want to do. And it seems like he's made up his mind that he wants to cut interest rates, or at least end interest rate hikes. It seems like he's bought into the narrative, that inflation was indeed transitory. It was a one-time thing. You know, it took three years as opposed to three or six months, but that’s transitory. And now they don't have to worry about it. And when I say he bought into it, you remember as well as I do all through ‘22 and ’23, he was channelling his inner Volcker and saying, yes, when inflation comes down, we don't want to ease too fast. And we don't want to stimulate the economy and then have another echo of inflation, go back up. All that's out the door right now. The Fed is in a very dovish policy. And I might add, that if you’re kind of updated through the day, we're talking, it seems like what's been happening is the market has taken his dovish words. And it's gone way beyond where he thought it would go. You know that they're pricing in six rate cuts. The market is for 2024, where the Fed dot chart last week said that they do maybe three. So you've got a bunch of Fed officials, starting with the New York Fed President John Williams, and today even Chicago Fed President Austan Goolsbee, coming out and saying, hold on here, guys, we said that we might be done and we might be cutting rates. But nobody said anything about six rate cuts. Yet, you know that you're getting a little bit ahead of yourself. So they're trying to push back on that right now. But yeah, the word salad is largely because, Jay, the market is easing rapidly, is that stimulative for the economy? And if that is stimulative for the economy, and is going to create a wealth effect, and you know, to use the crypto term, everybody's going to go out and buy Lambos? Does that mean we're going to wind up with inflation in ‘24? He doesn't want to say yes to that question. He doesn't want to say no to that question. So he kind of word salads his way through the answer.

Erik: Okay, so you're saying that they're basically looking for data that will justify what they already want to do. And I agree with that. But hang on, it seems like what they already want to do, has changed because, as you said, for quite a while, they were pretty staunchly like, look, we're not done with rate hikes, we're still in fighting inflation mode, what brought them or you know, what caused them to do an about-face so that what they wanted to do was look for an excuse to cut rather than to hike?

Jim: Yeah, you're right, because they do seem to have changed. And I would agree with you, or agree with the premise that the data is not really supporting a giant U-turn in the economy right now. There's all this talk about a soft landing. And there's all this talk about a slowdown, but you'd be hard pressed to really find it in the data for now. Maybe it comes in the data, but you know, they're data dependent. They're not data forecasters. Right now, I think it comes in the structure of the Fed. The Federal Reserve is unique in that they do release vote tallies. So we know who, you know how many people voted for a policy and if there are any dissents, who they are. Now, the Bank of England does that, the Bank of Japan does that.
The European Central Bank does not do that. They do not tell you what the vote was. Christine Lagarde, when she gives her press conferences, says the members were in favor of but she

doesn't tell you whether their vote, what the vote was and who was the objectors. But within the ones that do give vote tallies, they do have two sets, there are six, three votes in, or five, four votes within the Bank of England, or within the Bank of Japan. The consensus in society, Japan will have a five, four vote among their monetary policy. But the Federal Reserve wants 12-0 votes, but then want 11-1 votes, they pride themselves on that, they think that that puts a forceful input tour on monetary policy if everybody agrees. So my take, and this is just my take, I have no way to back this up, is I think that a lot of the newer members that have been appointed by the Biden administration, we do know that from their history, that they're very dovish. I wonder if they've banded together and said, Jay, we want to cut rates and if you don't join us, you're going to have an eight-four vote, you'll still get to do what you want to do. But it's going to look really bad for you at a four. And I'm wondering if he's acquiescing to that internal pressure of that he's got to follow his members, because there's been a lot of members headed by Austin Goolsbee of the Chicago Fed, Lisa Cook, these are newer members that have been appointed by President Biden, that have really been very dovish on the Fed, and it made no bones about what they want. And then you could throw in, you know, a Mary Daly from the San Francisco Fed wasn't appointed by Biden. But she's definitely in that camp as well, too. And you could see that there's a core of three or four of them or so, that are definitely against this policy of raising rates. And I wonder if he'd read, if he's made the decision that I'd rather look like it was my idea, then to have an eight-four vote or seven-five vote for monetary policy.

Erik: Now, I noticed in that explanation that you're mentioning, who appointed each of these members, that it's kind of telling to me, because I noticed some of the cynics in the market, Zero Hedge and others have said, okay, look, what's really going on here is this is all about election year politics. This is about the Biden White House, pressuring the Fed to say, you better make sure that we don't have any hard landing between now and the election. Is that why you alluded to those being Biden appointees or why did you say they're a Biden appointees specifically, that seems to be the resistance to the more hawkish tilt that we had previously from the Fed?

Jim: No, I think that that's the case. I think that there is a bit of, there's a lot of politics that goes on at the Fed right now. And I think that there is politics at the Fed. I was uncomfortable with… it doesn't matter what I think. But I was uncomfortable with the idea that Austan Goolsbee became the Chicago Fed President and I wasn't the only one. Because typically when a Fed President is appointed, there is a vote by the board. And they always say it's a ceremonial vote. There were some abstentions to his voting. Now, why was that? Because Austan Goolsbee, while he is an economist at the University of Chicago, so he's a perfectly qualified economist. He was an administration spokesman for the Obama administration. He was a regular on especially right-leaning conservative TV, he was the guy that they would send on Fox News. He was a regular with Bill O'Reilly during the Obama administration to basically support the administration's policy. So he was a talking head for them. And that's where he rose his stature to becoming the Chicago Fed President. And you wonder if, if he is continuing that type of policy, or that type of approach is no doubt in all of his speeches, he is one of the most dovish members on the Federal Reserve.

And finally, let me point out, be careful what you wish for. Yes, it's an election year. Yes, I have suggested and like I said, I can't prove it, it’s just my opinion, you know that these members are pushing the Fed to be more dovish, going into an election year. And I get it. But if that winds up over stimulating the economy, and winds up making inflation stickier than people think, this isn't going to work. You're going to wind up with the wrong reaction out of financial markets and the wrong reaction of the economy in the American public, if we're still dealing with an inflation problem in 2024. So bear in mind that the Fed got the inflation story with transitory completely wrong and ‘21. They've got the forecasts for the economy completely wrong in ‘22. So here we are at the end of ‘23. And they're going to basically bet their reputation, that they're going to get their ‘24 forecasts correct, that the inflation problem is behind us, that the economy is going to moderate to a soft landing. And all of that will work for them to cut interest rates. No less than the day we were recording, Bill Dudley, the former New York Fed President said exactly that in an op-ed in Bloomberg. He said, look, they're bent, they're sticking their reputation on a soft landing, and that there's going to be no real inflation. And he said, there's real reasons to think that they that might not happen next year. And then he said, and I hope they're right, because he wants the Fed to be right. But acknowledge is an unknown. So they're staking a policy on that, is not obvious that that's the policy that they should be staking.

Erik: I should mention for our listeners benefit that this interview was recorded on Monday afternoon, just after the market closed, so anything's possible between Monday and Thursday when our listeners first hear this interview. Let's go back then, let's kind of take a step back from, if we're talking about these decisions, the Fed may be influenced politically to make well, what is the underlying core decision itself? And it seems to me that the real core issue is the question of whether or not market rates have topped at peak, you know, have we hit peak interest rates or not? I believe the high print on the 10-year was 5.03. And the 30-year was 5.17. Seems like the Fed is basically going all-in maybe with some political pressure pushing them there to say, okay, that was it, guys, that was peak rates. We're not going above 5.03 in the 10-year, can't happen. It was transitory, it's behind us. Nothing to worry about. Let's get out of speculating about the Fed and into your personal view, Jim, as a market analyst, macro fixed income guy, is 5.03 on the 10-year, is that the never-going-to-see-it-again, or is that actually still up for debate?

Jim: I think it's still up for debate. And I'm still sticking with my forecast for ‘24 or 5.5. Now I know it hasn't been working for the last seven several weeks, hear that there's been a giant rally in the bond market as I've been trying to make the case that you know, ultimately yields are, they've been in a very strong uptrend yields have been since 2020. And I don't think that that uptrend is over. Now, the reason I don't think that's the case, is because as I look at the economy, I see signs of resiliency and I see signs of strength, and that resiliency really shows up in a couple of different places. Let's start with GDP. GDP has been running at or above trend now for five or six quarters, the third quarter was 5.3% GDP growth, that's booming growth that is flat up, boom. And now we expected, we being everybody, expected it to slow down. And so that's not a surprise. If we kept going to 5, that would be a big shock. But so far, if you look at the Atlanta Fed GDPNow tracker, for those of you not familiar with it, the Atlanta Fed does what's called the GDP tracker, I like to use the metaphor of, think of, you know, I take your mile split at the 10 mile mark, and I see what your average mile pace was. And I project what your finish is going to be based on that, that's what a GDP tracker is. GDP is an aggregate statistic of all the other statistics. And all the statistics that have been released to date that go into GDP, have been showing a 2.6% growth rate. Now, the data that's coming in, there's still half the data that is not out yet, could slow down, it could speed up in that could make it change quite a bit. But slowing from 5.3 to 2.6 is slowing from very strong growth, to slightly above growth. That's a boo, that's not a soft landing. That's not a hard landing at all. Initial claims. 202,000, that's among the lowest numbers we've seen in the last 50 years. 199,000 on jobs, even though the three-month rate has been coming down. That's way more than what economists think we need. It's 75,000 to 100,000 jobs to make up for population growth and net emigration. So this economy is looking like it's going to speed just fine.

My fear is that we are in a new cycle, and that this new cycle will spur spending and will spur in stickier inflation. And the reason I say we're in a new cycle is people say, well, we had strong growth from 2010 to 2020. And it never showed up in inflation. But we did have strong growth in ‘21. And it showed up in inflation in ‘22. Now some of that was transitory because of the constraints around the shutdown, restarted the economy, which got us to 9%. But I don't think we're going all the way back to 2% here, that we're going to have some residual, that sticky inflation and if you add on strong growth onto that, that this inflation problem will continue to percolate. So if we wind up with 2.5% inflation, we excuse me, real GDP growth, plus or minus 50 basis points. If we wind up with 3% inflation, 3% to 4% Inflation there abouts, remember, core inflation is, we're recording is 4%. And headline inflation is 3% right now, if we stay in this range, and add in 2.5% inflation, that's nominal GDP growth, nominal is inflation plus real growth of 5% to 6%. That's where I get my 5.5% number from that. Ultimately, the economy should approximate what we expect nominal GDP growth to be. And if we're going to expect it to be 5% to 6%, I ultimately think interest rates are going to go back into that range.

Erik: So we're looking at 3.93 on the 10-year yield as of Monday afternoon, as you said, core inflation is at 4%, 4% is a bigger number than 3.93 is, how can the Fed, in this environment, say, Yeah, we need to cut rates to significantly below the inflation rate and also below the unemployment rate at the same time. Doesn’t seem like…

Jim: You got me, you got me. I mean, that's the word salad, right? You know, you summarized the question very well. Jay, why do you think you need to be cutting rates, or at least talking about cutting rates, when you've got those kind of numbers again? Oh, because the inflation rate is going to go down. Because you've got such a good track record of predicting it for the last few years. You've got to figure it out now, you've got it right? You know, Dan Tarullo was a Fed governor from 2009 to 2017. And I like to joke that when Fed governors leave, they are the ones that you want to pay the most attention to. And wright after he left, he gave a speech at the Brookings Institute in October of 2017. And he said that the Fed has no working theory on inflation, that they've looked at all the theories, they've looked at all the data and they cannot really come up with an explanation for why inflation behaves the way it does. And by the way, I agree with them. It sounds like most people, inflation is easy. Just look at the money supply numbers. So you just look at this. You just look at that, and that, go test it, go test those theories, they don't work. Inflation is kind of its own independent animal unto itself. And so yeah, if they're right about the inflation rate coming down to 2%, then everything they said makes sense. But if their forecasts remain like the forecasts that they've been giving us, wrong, then there could be pro very problematic as we go from here. And again, you hear a lot of people say, but every time we did this in 1990, or 2003, or 2014, there was no inflation. I will emphasize, I think this is a different cycle. And I'll give you one thing I know, I've been on this podcast with you many times before. And I've talked about work from home. I won't rehash that. But I will say that what you've been seeing with 22 months of under 4% unemployment, and that is the longest we've seen it go consecutively under 4% in 53 years, you got to go back to 1970. As I mentioned before, 200,000 on initial claims, one of the lowest numbers in 50 years, 199,000 on jobs, people feel pretty optimistic about their job, they treat their jobs very transactionally. Look, I'm gonna do this job. But if I don't like it, I'll quit, I'll find another one. And I'm comfortable, I could find another one. No less than, the federal government, in the summer, the federal government made a big push to get all of the DC federal workers back into the office four days a week. So many of them quit or threatened to quit, they backed off of it. And they're still on three days a week right now. And what I'm saying is, if workers are comfortable with their job situation, look, I can get another job. If I don't like this job, then honey, go ahead and book those tickets for the week in the Bahamas, I don't have to worry about, what if I lose my job? Do we need to, you know, maintain a higher cushion of savings? They're not in that mode right now. They're spending, and they're spending. And that's why the economy continues to stay resilient. And if it does, and they keep spending, they're going to start bidding things up. They're going to pay for those higher ticket prices, they're going to pay for those more expensive meals. And we're going to see it in the CPI numbers, which is what I think we have been seeing, as we get rid of the transitory inflation of 2021, ‘22. From the lockdown restart, what we're seeing is when that dust settles, is we’re at a higher level of stickier inflation between 3% and 4%.

Erik: Okay, I can't figure out how to even begin projecting what might happen next into 2024. Because what you're telling me is, look, we've already got inflation at 4%. And despite the fact that unemployment is below 4%, and the 10-year yield is below 4%. The Fed is embarking on with what you think is a lot of hidden division inside of the FOMC. You think there's a strong disagreement that's kind of being covered up. But what they're doing is they're telling us that there's going to be this rate cutting cycle of several cuts in 2024. Now, if that pushes inflation up, like you and I think agree, very strongly at almost has to, then what happens is, you get more and more division inside the Fed. If there's some politically motivated members who feel like the thing to do is just keep cutting into the election no matter what, and there's level headed minds in the room that have been saying all along, look, inflation is starting to go out of control, we can't do this any longer if they're going to cover up by not showing us the real division in the voting. So they're trying to make it look like there's always a unanimous vote. It seems to me like that's a setup for the market to have no idea what happens until the Fed’s next mood swing occurs.

Last Wednesday, Jim, a lot of people blew up on that announcement, there were a lot of leverage trades that hedge funds had on that blew up and caused a huge amount of damage. Because it was a completely unexpected message that didn't seem to suit the circumstances of the economic data and the forward guidance that the Fed had given previously. It seems to me like you're telling me, basically from now to the end of 2024, almost anything is possible, it's not really going to be clear what's driving it. And we won't find out until the actual meeting happens or the press statement happens and looking at the economic data, and trying to make macroeconomic sense of it and predict what the Fed is going to do next probably won't work. Am I missing anything there?

Jim: No, in fact, I would argue to you that that's exactly what's been happening since last Wednesday. As I mentioned earlier, you've got this litany of Fed officials coming out and saying, hold on guys, nobody said anything about six rate cuts. We said three, they're going with six and Bill Dudley is writing, you guys are taking a big risk and what is the basis for all of this? No one knows what they're doing. No one understands that maybe the market is pricing in what it wants, what it would like to see. Or maybe the market thinks that if we kind of force the Fed's hand that they'll cave in and follow us, as well, because I don't think that they're being very clear. And that goes all the way back to the beginning of this interview with the word salad or the phrase, word fest salad, is that they're not clear. You're right. And this is what's going to happen. And this is why, not only do you see the market react, you see it react violently when they surprise, and you could see it. Look, we forgot that the market was reacting violently in the other direction in September and October, when it saw very strong data. And now it's reacting violently to the Fed talking about ending rate cuts, and I suspect it will continue to react violently as we move forward from here.

So yeah, it is unclear. And a quick word about the Fed, let me talk about the stock market real quick. On October 27, the stock market, the S&P, had closed 10% off of its July 19 high for its first 10% correction since the bottom in October of '22. That was three weeks into the fourth quarter, that was three weeks into third quarter earnings reports. Over half of the S&P companies had reported they were largely good numbers, that the earnings numbers were pretty good. And while they were reporting one good number after another, like 250 to 280 companies were reporting good numbers, the S&P was going straight down. And it was in a corrected 10% in the middle of all of those good numbers. Why? Because the 10-year yield went over 5%. Then on November 1, Janet Yellen backed off on the quarterly refunding announcement by saying, we won't issue as many notes and bonds, we'll issue more bills and a little bit less of that, and sparked an enormous rally in bonds, lowering interest rates or lowering bond yields to be more specific, and the stock market took off.

So let's understand the environment we're in. I could give you 280 decent earnings reports, or I could give you a bond rally. And right now, the market is saying you could keep your earnings reports I want a bond rally. So really, the stock market seems to be reacting to the bond rally right now. So when the Fed starts hitting hard about, we might have to cut rates, we're done raising rates, and the bond market takes off. You get this everything rally, which is exactly what everybody's been calling it. But the genesis of all of this is lower yields. And if sticky inflation and a strong economy upset that part of the equation, the lower yield thing, it's going to show up everywhere, I think in 2024. Now look, I could be wrong. And maybe the economy does slow down and I could be wrong. And maybe the cycle isn't different this time. And that we are back on a glide path back to 2%. But that's the risk you're taking. The risk you're taking is we're at 4% core, we're at 3% headline close enough for government work, we're on our way to let's-start-the-rally-right now. Don't worry if everybody feels a little richer and might start spending money. They won't create demand for stuff that will push up inflation. That's the bet we're making. I don't think that's a good bet. But look, it could work out.

Erik: Yeah, because inflation never runs away in a self-reinforcing vicious cycle that's never happened before. Let's come back to your 5.50 projection on the 10-year yield, because based on all the things you're saying, Jim, I don't even understand what timeframe, if there is a timeframe? Are you predicting that the things the Fed is trying to do, which are clearly oriented? If they're going to continue cutting, they're clearly oriented toward bringing yields down? Are you predicting that something breaks and they lose control? Or are you predicting that the 5.50 doesn't happen until the Fed pivots back? Because inflation forced them to, how do we get from here to 5.50 yield on the 10-year?

Jim: I think it's because the Fed has to pivot back and then yields go up. And the example I'm using in my mind is what happened in March. If you remember, March 7th, Jay Powell went to Congress and was very hawkish, and at that moment, the market was pricing in better than a 50% chance that the funds rate would be at 6% by September. That was March 7, because he was just full on full Hawk at that point. And we're not close to being done raising rates. The reason that I bring up March 7th twice is, the next day was Silicon Valley, and Signature Bank and Silver Gate bank, bang, bang, bang! All failed, one right after the other. And then a month later was followed up by first republic. You had an enormous rally in the bond market at that point, yields on the 10-year, yields in the 2-year note fell almost 100 basis points in a week, back in March. Because the feeling was the Fed raised rates too much and something broke. And it was the banking system, because these banks are failing every day. And that's it, we're done with the rate hikes, it's all over with. But then the rally in the bond market continued for about two months, took yields down about 100 basis points. And then we realized things didn't break. And the Fed kept raising rates again, in May and in July, and the economy started to heat up. And not only did we recover all of the decline in yields that we saw from the March 7th speech, but we went off into higher highs. So the market, I think right now, is of the back to the same kind of opinion, that the old adage that usually something breaks to cause a recession. If you ask people, what is it that is breaking, causing things to break? It is higher interest rates, is what they think is causing things to break, like they did in March, oh, higher interest rates broke the banks, which is going to break the economy. I'm going to push back on that and say, I don't think higher interest rates, I don't think interest rates are high enough yet, in order to break things. And the reason I don't think they are, is I think we've got an anchoring problem. We are so used to 15 years of QE and zero interest rates, that we look at the current level of rates, and we can't believe how high they are. And we think that everything is going to fall apart.

Jonathan Gray is the CEO of Blackstone, a private equity firm, that benefits from cheap money. And he didn't report good numbers in the third quarter. And he blamed it on high interest rates. And he said that these interest rates were unsustainably high and they were going to break things. Well, if you're a levered private equity firm that needs cheap money, I can understand your point of view. But I don't think we're really seeing the evidence that these high rates are hurting things. And I might add, if you go back to pre 2009, pre QE, and look at real rates, mortgage rates, 10 year yields, corporate rates, these rates are still a little bit below those levels. And during that whole 2000s period, before QE and in the 90s, economy did find we had a bull market in stocks, and we had much, much higher interest rates. The problem is, people can't remember that period, they just think that we've gone from zero to 500 basis points or 5% on the funds rate, that that's too much too fast. And I don't think that they realize that the distortion is not 5% yields now, it was zero for the last 15 years, was to distortion, several 100 of those basis points, was removing the previous distortion. And maybe we're not as nearly as injurious with the level of interest rates, that everybody thinks they are monetary policy, we all like to say works in long and variable lags. And everybody says yes, they are. And the long and variable lags of raising rates is, and I'd like to say maybe the long and variable lags are still from 15 years to zero. We're still not past those long and variable lags. Before we talk about how much interest rates have gone up yet, I still think that they're not nearly as punishing as everybody thinks they are. Now, I know if there's somebody who works in the mortgage brokering business, they've got a different opinion, because they're not getting any refi business. But that's not enough to hurt the entire economy. And I understand that it is not good if you're in the mortgage brokering business looking for reef eyes. But you know, the broad swath of the economy is not nearly as injured by these rates as people think they are.

Erik: Jim, I want to pick up on this theme of interest rates going higher, not breaking things to various people's surprise, because if we go back to when we had zero interest rates, what the doomsday bloggers were saying is, okay, look, someday we're going back to 5%. And because we have so much more national debt than we did last time, we were at 5%. What's going to happen? You just wait, when we get to 5%, all of a sudden, the US government's cost of debt service is going to exceed tax receipts. And you're going to see the US national debt accumulate so quickly, it'll be a trillion dollars in a single calendar quarter. I mean, that's how fast we're talking about accumulating debt. That's what's going to happen. And it's going to be the end of the world. The sky is falling, everything ends at that point, you know, it's martial law. Well, the crazy thing, Jim, is every single part of that story actually happened, including the trillion dollars in a single calendar quarter. But it wasn't even considered newsworthy, nothing happened. Nobody's even talking about it. So, the idea that that was going to cause the end of the world clearly wasn't right. How far can you go? I mean, how many trillion dollars, trillion here trillion there, in a calendar quarter? When does that start to become a problem?

Jim: So, they were correct in their prescription of, or their description of what was going to happen when rates went up, but in their prescription of what it meant. What was not incorporated into that, is the federal government is paying out, you know, a trillion dollars a year in interest costs, now up from about $400 billion a couple of years ago. And that number is going to go up again and ‘24. Because as bonds mature, the Fed still has coupons that they issued with 2% and 3% coupon payments, that will mature and they're going to be reissued out with 4, you know, if their bill’s 5% coupon payments, and so that number is going to keep going up. Who's that pay to? That's paid to bondholders and debt? And who are the majority of bondholders? No, it's not the Chinese, they're not the majority of bondholders, they only own about 15% of the debt. It's important, but it's only 15%. It's domestic people, it's income. And I think if you were to look at the data from companies, first of all, the debt payment, let me finish with it that the debt payment of the federal government usually goes to bondholders, which tend to be the wealthy, so they're receiving more interest income, companies is the same thing. What's this higher interest rate doing for companies? Well, one, companies have used the derivatives markets like swaps and stuff to term out their debt to lock in their lower interest rate cost. So they're not really being impacted by it that much. Now, yes, that terming out is not forever. At some point, all that debt matures, and they'll have to put it out at higher rates. But two, they have a lot of interest income that they're getting. They have a lot of cash. They have a lot of short-term securities, that they're getting interest on that we weren't getting two years ago, Warren Buffett's Berkshire Hathaway has about $130 billion of cash, that $130 billion of cash two years ago was netting him zero interest payments, essentially. And now he's getting about $8 billion a year from that interest payment. So if you actually looked at the financial position of corporations, since rates have gone up, it's gotten better. And it's gotten better because their interest income has gone up faster than their interest expense is going up, largely because they've hedged it. And so, they're improving their financial position, because rates are going up. What about the individual? Well, that's kind of a sticky story. As I mentioned before, with federal government debt is owned by the wealthy, the wealthy, the top 10% of the country in terms of income, measuring it by income, owns about 90% of financial assets and owns about 98% of retirement assets. A lot of those assets are interest based. They're getting more interest income, they're seeing home prices hold together, they're seeing stocks go back to all-time highs, they're doing fine. They're doing fine. And they're going up. What about liabilities? What about mortgage interest rates and stuff? The unfortunate thing is, if you look at a breakdown from this Fed survey of consumer finances, 56% of mortgage debt is held by the bottom 50% of the country. So it's unfair. Maybe it's not unfair, but the reality is that the rich own the assets, and they're benefiting from higher interest rates and the poor on the liabilities and they're being hurt by higher interest rates.

But the other stark reality is, it's the rich that spend the money because they're the ones that have the money. So when we look at the economy continuing to move forward, and those trips to the Bahamas and stuff like that, that's who's spending the money. And that's who's producing the GDP, and the beat in retail sales that we saw last week, and is seeing the financial positions of the corporations that they either work at or invest in improving, and are hiring those 200,000 people a month. And so that's why the economy continues to be able to absorb these higher rates. Now, one thing that could really change that in a big way, would be if we were to return to a steep yield curve, where borrowing costs tend to be on the longer end of the yield curve, and they go way up. And interest income, which tends to be shorter around cash is far, far lower than borrowing costs. That could upset that applecart. But what if we had, for the last year and a half, an inverted yield curve, where short term interest rates are higher than long term interest rates? So interest incomes are rising faster than interest expenses. So that's one of the reasons why I say that these rates haven’t really injured anybody, because Warren Buffett's making $8 billion more, just because, you know, 5% is what the T-Bill is at right now, when it was 2 or zero, excuse me two years ago. And so when they look at the federal debt financing costs, they're missing what it's doing to corporations and people. One last thing about this, to hear a lot of people say, well, the federal debt, the federal government can't handle it, it's going to put the federal government's fiscal situation in a terrible spot. Rates can't go up, they have to come down, the Fed has to cut rates because of the federal government's spot. This is what every over levered person, whether they're an individual or hedge fund says, I got too much debt, please cut my rate to zero so that I can handle my interest payment. Why so then I could take out more debt and continue to do the same things that I was doing before? It's because the federal government has high levels of debt that is pushing those rates up. If the Fed was to say, no, we have to cut rates, because interest costs to the federal government is becoming burdensome, they're going to borrow more, they're going to stimulate more, and we're going to have more inflation, that argument is backwards. You don't cut rates because you have too much debt. So you can suffer, you could support it and then add more stimulus on top of that. And you hear that argument quite a bit.

Erik: Jim, you mentioned the inversion of the bond yield curve. I'm not certain of this, but I think we might be at a record, in terms of how long a yield curve inversion has lasted. Why is that? Why is this such a long inversion? And what's going to change it? When are we going to get back to a regular on inverted yield curve?

Jim: So it is a record, if you measure it as the freely traded yield curve, that this is one of the longest. We did have it inverted longer in the 60s than we do now. And that's only because that was the era in the 50s and 60s, that was the era of Operation Twist, when the Fed set those interest rates and forced it to be inverted during that point. But more to the point about the inverted yield curve. One of the reasons that the yield curve, I think has been inverted is, it's been a market outlook, right? The Fed controls short term interest rates, they're raising them because they were afraid about inflation to 5%. And T-bill yields and short term interest rates, follow them higher, 2-year notes follow them higher too, because they're closely aligned with them. The market has been skeptical of the inflation story, and has been worried that the Fed is going to break something. So long term yields have been very slow to move in parallel up with those yields. And that's why you've had the inverted yield curve.

Now, a lot of people like to talk about the inverted yield curve as being a signal of a recession. And it has been, it's been an imperfect indicator eight for eight in the last eight recessions, going all the way back to 1970, the 1970 recession. Before that, its record was spotty. But then again, before that, the Fed was setting interest rates, there wasn't a freely traded market, like we have now. Now that I said that, I think what we're learning is the yield curve inversions in the past didn't last very long. And that it's actually the un-inversion of the yield curve, that is the signal of a recession or a slowdown. And usually, the way that the yield curve un-inverts, you got higher short term rates and long rates, it un-inverts through a bull steepness, bond market talk for short term interest rates, plummet below long term interest rates, and then the yield curve goes positive, what causes short term interest rates to plummet, the Fed is panicking, the economy's in trouble, and cutting rates like mad. You're not seeing that right now. Actually, since the Fed has been talking about cutting rates in the last couple of weeks, the yield curve has been getting more inverted, it's not been getting less inverted, at least by the 10-year, 2-year metric that I've been watching. It's back to minus 50 basis points, which it was at minus 25 or 30, a couple of weeks ago. So we're not seeing that yet. So when will the yield curve un-invert is when I think we are really truly in a period of a slowdown, that is going to truly put to abreast the inflation story, then you'll see short term interest rates plummet, below long term interest rates, and then an inversion steep in the yield curve. That's not happening now. What's happening is, they're both parallel shifting down with short term rates actually falling, a little bit of short term rates being a little bit sticky as long term rates go down, excuse me, and creating more of an inversion in the curve. And I interpret that as that maybe there's a little bit of a lingering doubt in the market about this idea that we're going to get inflation back to 2%. We're going to have a soft landing. I mean, it's not a total doubt about it. But there is some that the yield curve is not behaving the way you should have if you really thought we were going to have this proverbial soft landing 2% inflation.

Erik: I've focused this interview so far on the bond market because that's your specialty. But let's quickly just touch on how that extends to the equity market. Because a lot of people had the view that, okay, look, there's a good setup here for a Santa Claus Rally into year end, fade that, because you know, all the smart money's already figured out that this thing is coming to an end. Well, okay, hang on, that was before the word salad and the Fed kind of changing its mind. What do we make, or what do you make at this point of the outlook for equity markets, given this change from the Fed?

Jim: So, I think, as I mentioned earlier, the thing that's really driving everything is yields. Like I said before, it could give you 280 decent earnings reports, I could give you a bond rally, and the bond rallies, what makes stocks take off. So if my scenario of the economy stays stronger, inflation stays stickier, yields eventually turn around sometime in the same middle-ish of ‘24. Start looking like maybe 5.5 looks more like a reality than it does today. I think that the stock market will have somewhat of a problem with that, not a devastating bear market problem like it would with a hard landing, but like we saw for most of 2023, except for the Magnificent Seven stocks, they've really all just really meandered sideways and didn't do a whole lot of anything, until the bond rally started in October. And then all of a sudden, everything started to take off.

Now, why is that? Dr. Jeremy Siegel wrote the book, ***Stocks for the Long Run***, fantastic book, one of the greatest investment books ever written. And he put out a new edition of the book this year. In that edition, and I'll just summarize it, looking at the Shiller PE and looking at where the valuation is in the market and everything else, the historical trends suggest that you should expect about an 8% return from the stock market, long term. Look, the last two years, your return has been zero, maybe be a little bit better in the future, but longer term, it'll go up, it'll go down, you'll get an 8% return. Right now, you can get five in a money market fund, money market yields are still above five. So you could get 5/8, 62% of that expected long-term return by taking no market risk, and money market fund does not have market risk. And so the question then becomes, what's going to get you to take that other third? And it's not 2019. 2019, Maybe the return to the stock market long term was 8% too, but your alternative was zero in a money market fund. And that's why we coined the term TINA: There Is No Alternative. There is an alternative, now I can get most of the stock market's gain without much risk in cash. And I might add, what's going to get me to take that risk on the final third. I've got this heterodox opinion that this is the era of the stock picker, the stock picker is coming back. It's no longer: do I buy IWM, the Russell 2000 Index, or do I buy RSP? The S&P equal weight index? Or do I buy SPY or VOO? The S&P market cap indexes? This is, what stocks do I buy? What themes do I play? I should have been playing the AI theme in ‘23 is what I should have been doing. And that we're going to transition away from just buying indexes to buying individual stocks. Now, the indexes worked, because there was the mega cap companies that pulled the whole index up. But there could be a time in the future where 492 stocks are up 15% for the year, but the mega caps are down. So the S&P is unchanged on the year. And you could have randomly done the Dave Portnoy thing and picked letters out of a scrabble bag and beaten the S&P. This year has been the opposite of that. But you could see that coming soon in the market.

So if rates start back up, that is a powerful headwind. I think for the stock market, as we go forward from here, is it a headwind that produces a bear market? No. Is it a headwind that produces kind of what we saw in the beginning of this year? A frustration a bunch of sidewaysness, except for seven stocks? Yes. But then, you know, the retort I hear for people is, well, who cares about all that analysis, just buy the indexes? Because they went up. They went up, because the seven stocks, you know, you better hope that those seven stocks, which are 30% of the index now, continue to go higher, otherwise the index might suffer. And if you're not picking stocks, you're going to miss out on the opportunities going forward from here. So what's it mean for the stock market if my scenario plays out, is a headwind for it. Because of the competition of rates, where I could see people saying, you got to invest in the S&P. Why spy? Because it's got this 8% long term chance. Oh I’m getting five, it's good enough for me. I don't want to take the extra risk. I can sleep at night. It's not 2019 when the alternative was zero.

Erik: Jim, I want to move on, believe it or not to Bitcoin because yours is one of the few voices in finance that I really respect on crypto. Something a lot of people are talking about is, it looks like they're going to approve the Bitcoin ETFS, we already had some ETFs for the futures market, but now the spot Bitcoin market, it looks like the ETFs will be approved for that. What should we make of that? A lot of people are saying that's going to bring institutional capital in and it's to the moon for Bitcoin. Seems to me like everybody is front running it already. I wonder if it's a sell-the-news event?

Jim: I agree with that. I'm worried. I should say I'm worried that it is too sell-the-news event. First of all, a couple of things that I'm assuming, I am assuming that the Bitcoin ETF will be approved, and not just a Bitcoin ETF, but we saw this with the Etherium futures ETF a couple of months ago. The SEC knows that there's a gigantic first mover advantage, he who goes first, wins. And when you bring in a new category of ETFs, so what they did with the Etherium ETFs was, there was nine of them, they've approved all nine of them on the same day. I suspect that somewhere, some people are pointing at January 8th as being one day that they're going to approve all of the spot Bitcoin ETFs on the same day, so therefore no one is accused of, I approved the Blackrock one, but not the other ones. So I gave Blackrock an unfair advantage going first, they're going to just to prove them all, I suspect that they are going to prove them off. You've seen a lot of people talk about, well, this is going to be the thing that's going to drag a lot of institutions into the market and X billions of dollars is going to come into the market and it's going to drive prices higher. Yeah, it already has. And the prices have doubled in the last several months from under 20,000, actually more than doubled, to a little over 40,000. So I think that that expectation of what that adoption is going to mean, is in the price and I fear that it could be a sell-the-news event when it does happen. But I also have another bigger fear. And I might add, I'm bullish generally on the idea of crypto and I'm bullish on decentralized finance and I have been for many years. But I think it's best off telling you about what my concerns are. And if I can alleviate my concerns, I can really, get really even more behind it even though I am behind it to begin with.

So my first one is that this is a sell-the-news event. My second one is oh yeah, we need the Bitcoin spot ETF where it buys physical Bitcoin in our futures, in a regulated brokerage account, like your Schwab account just to pick a name, to buy an ETF that's listed on the New York Stock Exchange or the NASDAQ that owns Bitcoin, somewhat similar to the Grayscale trust. But without all of the discount premium that a closed end Trust has. Well, I thought that the whole idea why I was so positive and optimistic about cryptocurrency was decentralization, permissionless, and censorship, that no one can permission your money or censor your money. No one can manipulate either the growth rate of the number of Bitcoins, or who can do what with it, and that that was the promise of digital cryptocurrencies via the blockchain, was that no one could control it. But if the answer is no, we're going to get everybody to buy these unregulated brokerage firms through regulated investment products, unregulated exchanges, then they are going to be permissioned and they are going to be censored, and they are going to be controlled. And then I'll turn to my crypto friends and go, what have we accomplished, we just created a digital version of what already exists. I thought the whole idea was to create something new and something that was outside of the reach of the regulator and the central bank and end the government from manipulating to their ends. And so I worry that if we think that this is the home run that we've all been waiting for in the Bitcoin ETF, I'm worried that we're missing narrative here and that this might not be the best thing in the world, long term, for what we're trying to accomplish with, oh yeah, it's been great short term and maybe I'm wrong on the sell-the-news thing, although, man, all the projections that everybody hoped for, because of the Bitcoin ETF has already come to pass. But in the long run, is this going to get people to say, I need to consider new ways of getting faster transaction speeds, more decentralization, getting a wider net of these things, getting the technology getting to be better, so it's not hacked, or anything else? Or is this, I just throw my hands feet up in the air and say, everybody buy the Bitcoin ETF and shove and take my bags, my coins and push them up in price. And that's all I really want. I just want the number to go up. So that's kind of where I'm on thinking about with it. And that's what my two concerns are, the sell-the-news event, and I want it to be decentralized and permissionless and not censorship, and I see it going into products that can be permissioned and can be censored. And I don't think that that's good for the whole ecosystem in the long run.

Erik: Jim, it seems to me like there's another really big conflicting signal here. Which is, you've got the US government, first of all, Liz Warren's on this campaign to outlaw Bitcoin. She's worried about criminals in money laundering and so forth. Frankly, I think that they're missing the real story. The reason the US government ought to be trying much harder to outlaw bitcoin is because it legitimately provides competition for government issued money and its competition, which is superior in many ways to fiat currency. If the government wants to protect its monopoly over issuing money, then they ought to be trying to outlaw cryptocurrencies. But now you've got the SEC, in your prediction, maybe on a single day, authorizing not just one but half a dozen or more ETFs. And most of the financial institutions, the major brokerages in the United States, have really started to market crypto pretty heavily. They're encouraging people to hold crypto assets in their retirement funds. There's various vehicles now for having your IRA or your 401 K can have crypto in it. It seems to me like you can't possibly announce a government ban on Bitcoin, after you've, you know, had the whole financial system upgraded to support it with the full blessings of the SEC. Are we getting to a point where the US government will be unable to protect its monopoly because they've already kind of put their foot in their mouth by authorizing all these ETFs?

Jim: Yeah, I think we're already past that point right now. And I agree with you, you said it better than maybe I said it, is that, you know, cryptocurrency has the potential in the promise to be a better form of money than what governments issue. And I want to see them continue to move that way and not just settle on being part of the existing system. And that's really what I think is behind some of the concern in Washington, about cryptocurrency that it has the potential to be a better form of money. They could try and ban it under that auspice, but they don't want to. The other problem they also have is too, while Liz Warren is against it and some others are against it, you know, there's big swaths of the Republican Party that are not against it right now. And they've been very pro crypto. So it is a bipartisan thing. And it's really kind of a funky bipartisan thing. Republicans tend to be more pro crypto than some of the Democrats are. But the biggest consumer of crypto tends to be the young that tend to vote more Democrat than Republican. So it's kind of really a funky kind of product, in terms of how Washington is coming down on it, and who's defending who in this scenario. But yeah, I do think we are past that point where governments can ban it. And also think we've also passed that point too, because I think what we ought to talk, most people listening to us are going to be either in the United States, Canada, Europe, and we are at the apex of the financial system. We have a financial system that has rule of law, that has some transparency, that we trust, and we don't go to bed at night worrying about the health of our bank, or that the government might seize our money in the bank. But most of the people tonight that will go to bed around the world don't have that same privilege, their financial systems, either non-existent or very corrupt, or they're sick, or they're susceptible to fraud and abuse. And they worry a lot about that. They could benefit greatly from something that cryptocurrency is promising, and is building towards right now. So, we could ban it in the United States. We could ban it in Europe if we so elected to, although in the UK, Rishi Sunak, the UK Prime Minister, seems to be very pro crypto, at least for the moment. But in large swaths of Africa, Asia and Latin America, this can provide a real source of stable money and mediums of exchange for people. Now, I'm using these forward looking words, because I don't think we're quite there yet. But we're on our way. But if we just throw our feet again up on the desk and say, hey, we got the ETF and it's pushing all the prices of the tokens and the coins up and that's all we really need. Thank you very much. We're never going to get there and like I said, then what have we accomplished?

Erik: Jim on the topic of ETFs, I want to move on to even more exciting news. You've introduced your own index, the Bianco Research Total Return Index. And it is expected, right now we're recording this interview on Monday afternoon, but by the time our listeners hear this on Thursday, it's expected on Wednesday that Wisdom Tree is going to launch an ETF to track your index. Tell us a little bit more about that, how it came about, what does the index track and who would benefit from investing in Wisdom Tree's ETF, which tracks your index?

Jim: Yeah, thanks for bringing it up. And so the ticker is going to be WT for Wisdom Tree, BN for Bianco, WTBN, it should be trading by the middle part of this week. It will track the Bianco Research Total Return, Fixed Income Total Return Index, just so people understand. I'm in the index business with this index, like S&P is in the index business with the S&P500. Wisdom Tree has an ETF that will track my index, like Vanguard and Blackrock have and others. Lots of others have ETFs to track the S&P500. S&P is not in the ETF business any more than I am. Now, my index, most people, when they look at, you know trying to beat an index, they say no one can do it. 95% of funds outperform indexes. And that's true in the equity market, the S&P500 beats 95% of managers. But in fixed income market, it's not the case, the index is where you would have thought it would be, it's around the middle, it's around the 50th percentile. So there is a lot of ways that you can outperform the index. So my index is going to be long only. So I'm always invested in the fixed income market. And we are going to tilt it. We've identified five factors that helped to lead to fixed income outperformance. Your duration, whether you're long or short the market, you're betting on rates are going up or down. Your yield curve bet, do you think that the yield curve is going to be inverted? Or it's going to steep in your credit, how much credit do you own in your in your fund, structure or volatility that would be like mortgages, how much volatility you have in your fund. And then a fifth factor that we've put into it, which is out of index bet, like whether you own munities are preferred, or in the case, where our index currently is right now, is we have a 20% weighting in our index in TIPS securities, treasury inflation protected securities, because of the big real yield and in short term TIPS yields as well. We have a website Bianco Advisors, Bianco Research is my investment research site, [biancoadvisors.com] is where you could see all of the way that the index is broken down. And the way that it's structured currently, as we're talking right now, the index is slightly…it's positioned for the eventual launch of this ETF. It's positioned slightly underweight, its benchmark thinking that rates might continue to go low. And I tried to take a one year look forward with positioning. So when I talk about these positions, talking about over the next year, slightly underweight duration, meaning that we're biased towards higher interest rates. We're somewhat neutral on the shape of the yield curve, because I'm not sure which way the yield curve is going to go. We're slightly underweight, slightly like 91% of our benchmark, we have a benchmark, we're slightly underweight in corporates, we're slightly underweight in mortgages because of the high volatility in the bond market. And we're overweight in treasury inflation protected securities, [biancoadvisors.com] lays this all out, the day this podcast comes out. I will have hosted a conference call on YouTube page or live stream webcast on our YouTube page explaining all of this in detail but there will be a replay available on the [Bianco Research YouTube] page and probably on [my Twitter] feed and on my LinkedIn feed as well too. So thanks for bringing it up.

Erik: Okay, so the ticker symbol for the ETF is WTBNm Whiskey Tango Bravo November. And in order to get the full briefing from Jim on what it's all about and where it's headed, you want to go to YouTube and type in Bianco Research in order to find the replay of a Thursday morning webinar that's going to explain all of this. Jim, I can't thank you enough for a terrific interview, before I let you go, just also give us your Twitter handle and anything else people need to follow your work.

Jim: So all the handles are not Bianco Advisors, but through Bianco Research. @biancoresearch is Twitter. You can follow me on LinkedIn at Jim Bianco. As we mentioned before, Bianco Research, we are active on YouTube as well with a lot of videos there. Those are probably the big three ones you can also look up Bianco Advisors and you can look up biancoresearch.com as well, that's our research site. Thank you.

Erik: Patrick Ceresna, Nick Galarynk and I will be back as MacroVoices continues right here, at macrovoices.com