ReSolve
ASSET MANAGEMENT

[00:00:00] Richard Laterman: All right. Welcome everyone. Happy Friday. And before we get started, let's just remind everyone that nothing we discuss here today should be seen as investment advice. I'm just going to have a wide ranging conversation. Welcome Eric. Welcome Jeff. Welcome Jeff again. Jeff's been on the podcast a couple of times. Mr. Philbrick, over to you.

Backgrounder

[00:00:19] Mike Philbrick: Mr. Laterman. Yeah. And actually, this Riffs came about because Eric, you were on a Twitter Spaces with Jeff and I tried to connect with you guys when you were there and I had some technical difficulties, but loved what you guys were riffing on in that episode. And so really wanted to get an introduction to you, get you familiar with the ReSolve Rifts folks who like to watch this content.

And then having Jeff on to chat with us as well, bring his knowledge, his real estate demographics tilt on things. Gents, just great to have you on a Friday. So Jeff Weniger of WisdomTree. Jeff, where can people find you?

[00:00:54] Jeff Weniger: You can go to the WisdomTree.com website. We write blogs and white papers. What we have done in the last few years, as Eric has as well, is really try to put the name out there via social media, via the charts on Twitter. A little bit of LinkedIn too, lately, yeah. Trying to correlate. It's crazy, man. Just so boring. It's the eighties. Like congratulations on your one year job anniversary.

LinkedIn is such a waste. So we've been doing that on Twitter for some time. Look, we're trying to, we're trying to play with BlackRock and Vanguard and State Street in the ETF world, and Jeremy Schwartz and I have made a little bit of a splash on Twitter doing just that. And that's how the relationship with Eric Basmajian really kicked in.

Eric was a total stranger. Guy is running a, an independent research shop. His Eric Basmajian stuff on Twitter, he started popping up for me, maybe 12, 18 months ago. Who is this guy? This guy's getting read. And then boom, it just totally took off. I don't know what you have a hundred… my guess is he's got a hundred thousand followers, and we bring him into the Spaces. The guy is a cycle wizard. He's an economist, and we just go in. So I appreciate being invited on. I'll see what I can add into the conversation. Love it.

[00:02:10] Mike Philbrick: Love it. And Eric, you could be found @EPBResearch on Twitter and EPB Research. So I'd like people to get to know that before we start, who's talking.

And, our one and only Richard Laterman here, the king, and I know that Richard, you're a big fan of Lacy Hunt, and I know Eric, you're also a Mike Philbrick sort of a Lacey Hunt disciple and that sort of thing. So I think it's going to be a neat, a neat conversation with you great macro minds.

I think that listening to some of your content before Eric, it seems like maybe the equity markets are not quite factoring in the recession to the extent maybe bond markets are in, some other indicators are, and that could leave us in a position of, somewhere maybe a 30 plus percent decline in equity markets, which would be a typical recessionary outcome.

So I don't want to bury the lead. That's what's at stake here. But now I'd like to step back and say, okay, walk us through your framework. Walk us through what you're seeing out there. And we're going to try and poke holes in a little bit. Test some of some of your thoughts with some thoughts that we have, some thoughts that we've been hearing from other analysts. And let's dig in and dig around. Have some fun.

[00:03:19] Richard Laterman: And give us a little bit of your background too, Eric, if you wouldn't mind? Sure. Just for the benefit of listeners that are coming at this for the first time and meeting you today for the first time.

[00:03:25] Eric Basmajian: Sure. And thanks for having me on.

It's, I know I overlap a fair bit with Jeff in terms of some of the charts and things that we look at, and it's good to hear that there's some Lacy Hunt fans on the call as well. I've actually had the great privilege over the last couple years of getting to know Lacy and speak to him on a somewhat regular basis.

And it's been quite an educational journey every time you speak to him. He's really got a lot to offer. So I'm sure we'll hopefully get into some of the stuff that, that he speaks about the longer term debt and demographics, which Jeff has also talked about. But what we do at EPB Research is we are predominantly focused on economic cycles or business cycles.And we help asset managers, businesses, and individuals understand business cycles and prepare for business cycle turning points, like recessions. What makes economic cycles rhyme? We always hear that every cycle's

different, but there's a rhyme to each cycle across history is that business cycles follow a pretty consistent sequence or an order of operations, meaning that, there's like a step one, a step two, a step three, and a step four.

That sequence is always the same from cycle to cycle. Whether you go back to the 1950s through the inflationary periods in the seventies and through the disinflationary recessions in the nineties and two thousands, that sequence was the same every single time. However what is different from cycle to cycle and what can be very frustrating when trying to overlay business cycles with asset markets is that the leads and lag time from step one to two or two to three or three to four are definitely different every single cycle. And they can be both long and they can be variable. They are inherently unpredictable in my view which is what leads us to a situation like we have today in which we have very pronounced recessionary signals coming from some of the earlier parts of that business cycle sequence.

But since the lag times are starting to get longer than normal, people are starting to find disbelief in the fact that the cycle and the sequence will play out as it historically does. And that's compounded by the fact that the market has gone up pretty significantly over the past several weeks, which generally tends to set most people's sentiments.

So that's overall what I do and how I help businesses and asset managers hopefully prepare for what's to come from some of the earlier signals that we receive in the sequence.

[00:06:05] Richard Laterman: Do you have a sense as to why these lags have increased between some of these main leading indicators that tend to portend the inflection points in the business cycle?

[00:06:13] Eric Basmajian: So there's a couple of things that, we can point to that are likely explaining why we're seeing a longer than normal lag. Now, I wouldn't say the lags that we're seeing today are outside the historical range of outcomes. In fact, the 2008 recession had lead times that were even longer than what we've experienced today.

It's not like we're in an anomalous period. We're definitely longer than average but we're not longer than the longest case, for example. One of the main reasons we see longer than normal lags is when we come off of an inflationary period. So when we look at the 1970 recessions, the variable that tends to lag the most is employment. And it tends to lag even more than it normally does during inflationary recessions or coming off of inflationary periods, because what ends up happening is

nominal revenue stays quite high while real growth or underlying unit volumes start to contract. So even though a business may be producing less and shipping less, and the number of units they're moving is declining, they're still able to maintain 4%, 5%, 6% revenue growth.

So they continue to pay their employees saying, maybe the volumes will pick back up. And this labor was difficult to find, so we don't really want to get rid of it, because if we get rid of it and then the cycle does pick back up, we won't be able to hire it back fast enough to fulfill that demand.

So you see a decline in volumes, but revenue stays high. People are hoping for that rebound in volumes, but inflationary recessions can be quite nasty because if the economy does go into recession, not only does that unit volume stay negative, but the revenue collapses as well, because the inflation starts to decline and then you see a lag to decline in employment.

But traditionally, a more abrupt decline in employment. The second variable that is causing the lags to be a little bit longer than normal, which is in my view another reason why the 2008 recession was the longest lags, is because when there is a banking crisis associated with the recession or potential recession, there are a lot of interventionist forces used to extend and pretend.

Various scenarios. They don't do it maliciously, they don't do it to cover things up. They're trying, I think, in my view to do the best they can to try and chop off some of the sharp, nasty sides of recessions. But we saw this in 2008, where leading indicators started to contract. In 2006, the yield curve was inverted. And then as we got into the first quarter of 2007, we started to see all of the hiccups. And then in the middle of ‘07 is when the real recessionary forces got rolling with the failure of the BNP hedge fund and the … of the BNP hedge fund and the failure of several mortgage brokers.

But just like we saw with the Silicon Valley scenario. We all know collectively that there is some level of toxic assets in the system in terms of commercial real estate. We all know that the value of the assets that are being marked is not even close to what they're carrying it at. But yet there's a push for leniency from regulators to be nice and be generous with some good standing CRE borrowers.

And we see that in conjunction with increases in the discount window, the new bank term funding program. So there's been a lot of elements that have come into the fold here that certainly have extended what would have been a much sharper contraction, had that situation gone without its intervention.

Pretty long-winded answer, but I would say that when there's a banking crisis, that tends to see longer lags because of the interventionism and when you're coming off of an inflationary period that we see longer lags on the employment cycle as well.

[00:10:17] Jeff Weniger: Don't mind me, I'm trying to get an old, I'm trying to get an old data point from 22 years ago that I can't, I'm trying to remember whether it was $300 or $600, on an intervention. What's that, Mike, years ago. Oh, I, yeah, I was…

[00:10:30] Mike Philbrick: As you're finding that'd, I know, you're OK.

[00:10:32] Jeff Weniger: I could be muted. Am I muted? No, I'm trying to, I'm trying to I'm trying to find something. Do you remember Mike, years ago when we were in the turn of the century recession and George Bush was going to get a $300 per head stimulus package? Do you guys remember that? And I'm trying to remember whether it was 300 or 600 or whether it was 600 for married, filing jointly. And one of the reasons I remember this, you guys are going to like this, is I had a summer job back in school and I earned $7 an hour. This was when I was in, this is when I was in undergrad.

And it was a really sophisticated sounding thing. I was at the Bureau of Economic and Business Research. How about that, $7 an hour and my job was on behalf of the state of Florida to phone everyone and collect the data, kind of like Michigan Consumer Confidence. And so all day long I had the thing in my ear and I called people and I collected, how confident are you with the state of the economy here in Florida?

That type of thing. And nobody ever answered the phone. And so I had the Wall Street Journal delivered to me and I made a pact with myself during those days that I was going to read every single article in the Journal that summer. And that was the summer that it was all about the $300 stimulus package that George Bush was going to give.

And I remember thinking that was really extraordinary, that they're going to give everybody 300 bucks like this. And Eric mentions these interventionist packages in, with reference to the banking system, was the real tenor of his comments. But one of the other things is there's some sort of optionality here where your marginal propensity to take more risk, whether that's buying equities at the top of the S&P 500, speculating in some way, shape or form in that you think that maybe if it hits the fan, there may be a stimulus package, much like the Covid ones, which were not $300 for a family, but $3,000.

In many families, or even upwards of 4,000 plus various other packages that came, and then you also got one in the form of your employer keeping you around perhaps because they got a PPP Loan and so forth. And I wonder, Eric, if I can make the $7 an hour old reference from 22 years ago, is that part of what's extending out these lag times, is that they won't let us have a recession?

[00:12:54] Eric Basmajian: I think that ultimately the cycle is bigger than them. So eventually a, I think that the analogy is plugging holes in a dam. At first there's one hole and they can plug it. Then there's two, then there's three. Then there's five, and eventually they run out of fingers and they can't plug all the holes and the dam breaks.

We're clearly in the phase where they've been able to sufficiently plug all the holes that have developed so far, but I think you're exactly correct. And I would also say that there's growing evidence that the bigger problem that looms, or the bigger the problem, the more the more likely they are to try and come in and prevent that outcome from occurring just because the situation is a little bit more serious.

I would say that, we've also, whether we like it or not, I think we have to admit that over the last 15 or 20 years, there's certainly been a conditioning element to what the Federal Reserve and federal government has done as well in terms of their interventionism providing the signal to markets that they are protected, or financial assets are protected.

And I think that the bailout of SVB, a couple of really misbehaving venture capital funds and the banking sector more broadly just a couple of months ago, was really strong evidence of that. It's an uncomfortable reality that Powell and the Fed have been talking extremely hawkish, and every time he gets off the stage, everyone says, wow, that was such a hawkish press conference.

But every time his feet get held to the fire, he seems to cave. And while I wouldn't like that to be the case, and I every time am personally fooled by what he says, every time he's proven to come in and backstop events that were in a sense caused by his own doing, when the Fed raises interest rates, the mechanism to slow the economy is through a contraction in bank credit.

Interest rates go up, bank credit slows, and then the economy cools. After that, they raised interest rates faster than they have ever done. Essentially, it was clear that was going to cause some problem. And then they got the contraction in credit that they wanted while inflation was above their target, and unemployment was at historical lows.

But yet they still conducted what, in hindsight, can only be described as an extraordinarily generous bailout, both for the banking sector and for some extremely risky venture capital tech funds that were misbehaving, should have received a haircut on their deposits, which may have caused significant trouble to the funds more broadly, but instead got a hundred cents on the dollar.

And then the stocks that have had the most significant rally since that event have been all of the technology stocks. We can ascribe that to be coincidence or not. But I think that it's uncomfortable. It's an uncomfortable reality to know that the Fed raises interest rates to slow inflation.

The mechanism for that is a contraction in bank credit. We got the contraction in bank credit, but they said it was actually too sharp of a contraction. We don't want it to be that sharp. We want it to be a little bit more gradual. But if that was the case, why did you raise rates the fastest ever? You knew that you were going to get a really fast and sharp credit contraction, but they said that's a little bit too much for us.

We don't want it to be overnight. We want it to be more gradual. So they're trying to put in place these mechanisms to absorb the losses from these toxic assets, but amortize them over a longer period of time, rather than have everyone recognize them on their balance sheets upfront, which would be incredibly difficult for a lot of institutions.

[00:16:52] Jeff Weniger: Go ahead, Richard.

Lead and Lag Times

[00:16:53] Richard Laterman: Yeah, no, it was just**,** the Fed is trying to play God. This was something, I think Hyman Minsky was a big critic of this idea, that if you don't allow for some controlled fires, smaller controlled fires, you end up building these, the scenario, where you're going to have a much bigger fire. That, this idea of controlled forest fires is a useful analogy here. And I think what the Fed has done is that it's strike, or it was under the illusion, at least in the late nineties and early two thousands, that it had finally changed the cycles and that it had this all power and then it was the perfect setup for what came as the great financial crisis.

But I wanted to ask you, Eric, to what extent do you think the stimulus that came during Covid, the fiscal stimulus that came, to what extent did that also play a role in adding the lead time, or lagging these indicators a little bit further because consumers continue to be quite flush with cash and they've been able to de-leverage to some extent.

[00:17:50] Mike Philbrick: On on top of that, I wonder if you might just walk us through, because it would set a table for the rest of the discussion on leading coincident and lagging indicators. Okay. Very good. As you see them pass through your framework, because I, but we're firing these bullets at you, but I also want to be able to waterfall them through your framework, so I think this sets a good time.

Yeah. Yeah. Roll through how you see those, the leading, the incident and the lagging indicators, where they are now, and then how some of those things that Richard has asked you, all the money that was put into the system, how's that impact? And how is it impacting when they're in the backdoor trying to put out fires? But I think it, it's important to get that framework first so that we can all be on a similar page.

[00:18:32] Eric Basmajian: Yeah. Very good. The way that I look at the economy is when a data point comes in, most of the time all we hear in the news is, did it beat consensus or did it miss consensus? And there's never really an effort to contextualize whether it's a leading indicator, a lagging indicator, a coincident indicator.

And a lot of times we receive five data points in a day. We'll get building permits, we'll get industrial production, and we'll get retail sales, let's say, all in the same day. And those three things could be an entirely opposite ends of the sequence. But yet they're all viewed as the same or the takeaway of, oh, the data today collectively beat, therefore X, Y, Z. But it doesn't move like that. We really have to see how the data moves through a progression. So what I do is we can look at every individual data point and try and parse it one by one. But I think it's more valuable to bucket the data into several different stages. And I think it's important for a couple of reasons because number one is that no single economic indicator has a perfect track record.

Every single indicator has at least one time where they've failed, or given a false signal. But if you combine, let's say five or six or seven variables that all fall within the same range in terms of the sequence, and then you track the collective movement of that whole basket, it's much more, it's much less likely that the basket will give a false signal as any single indicator within that basket might.

Which is why a lot of times I'll get questions from clients and say the housing starts number was up. Does that mean the economy's improving? And the answer is always, we have to see what the whole basket of indicators did, not any individual data point. So I tend to think it's most appropriate or easiest to separate the data into four major buckets.

You can do three, you can do five. But for this conversation, let's just say four, what we first have is what we call leading indicators. And these leading indicators are traditionally made up of changes in monetary policy or changes in interest rates and how those changes in interest rates affect what we would call commitments or soft purchases or new orders, both in the housing sector and manufacturing sector.

Those are the two sectors of the economy that are most sensitive to changes in interest rates. So pretty simultaneously you'll see, for example, a tightening of monetary policy. You may see a contraction in money supply, an increase in interest rates, and then you may see as a result of that, a decline in housing building permits and a decline in manufacturing new orders.

All of those things would represent leading economic indicators because they don't represent actual activity, but they represent commitments or future predictors of activity. Like a permit. That would mechanically have to lead a construction, or a new order would mechanically have to lead production, which is why it's always somewhat interesting.

When people question the validity of leading indicators, when a lot of times it's not just theory or, it's mechanically leading. I'd love to know a cycle where construction occurs without a building permit first. It's a, it's a mechanical, it's a mechanical reason as to why it will always lead.

However, what we're experiencing now is the delay between a new order and the production could be a long time or a short time. So leading economic indicators are changes in monetary policy, changes in the availability of money and credit, and how those two things impact commitments and soft purchases for construction and manufacturing.

Then we move into our second bucket, which I deem the cyclical economy. And what we're trying to track there is actual activity. We're trying to track the level of production and the level of employment in the construction sector and the manufacturing sector. So you can think about industrial production, you can think about manufacturing employees, construction employees, or the number of housing units that are under construction at any given time. This is actual production data. Actual employment data, and it's the two cyclical parts of the economy that will respond first to changes in interest rates.

So once we move through the leading, we move to the cyclical, then we get to what I call the aggregate economy, which is the whole pie. That's the broadest measures of employment, the broadest measures of consumption.

It's all of the things that the Federal Reserve talks about, the unemployment rate, wages, that's what is the economy as we know it, that's measuring activity today. GDP, GDI, these are the things that fall in that aggregate economy basket.

And then we have our lagging indicators, which would be our fourth bucket, which is mainly comprised of the extremely non-cyclical parts of the economy. Things that aren't sensitive to changes in interest rates. You could think of healthcare, education, government spending, and you could think of some non-residential construction sectors like building a defense base, building an airport. These are things that can take five years from start to finish.

So when the economy is booming, let's say in 2006, you may get a order and start construction on an airport that may not be completed until 2010. So the company that's building the airport would have booming revenue in 2008 and 2009, but they wouldn't have any new orders for that business in 2008 and ‘09, therefore, they would slow, after the fact.

So just rounding it all together, we have our leading economy, which is monetary variables, soft commitments for housing and manufacturing, our cyclical economy, which is the actual activity in the housing and construct manufacturing sector. Then we have our aggregate economy and our lagging economy.

Where we stand today is our leading economy is deeply recessionary. Jeff has published charts on this. The Conference Board Leading Index is a good representation of this leading economy. It's contracting at levels that are only seen during recessions, contracting for 15 consecutive months, as Jeff has pointed out.

Then we go over to our cyclical economy, and while it's not yet contracting yet, what we've seen is the growth rate in that economy has slowed from about 10% at the beginning of 2022 to 1% today. So we've seen the cooling. And then we also have the aggregate economy trending at about 1% as well, which is why this is such a vulnerable position, because the leading economy is contracting signaling recession, and then the cyclical and aggregate economy are trending at about 1%, which is a very weak level of growth. There's not a lot of buffer room before those two parts of the economy move into contraction. And the signal from the leading parts of the economy is that the direction of travel is going to remain to the downside, which is why it's vulnerable, that the stock market is rallying quite aggressively.

[00:26:06] Mike Philbrick: With that backdrop, David Glaser is in the comments and he's saying, Eric, use your charts. You got great charts. So I don't know if we covered this at the beginning, but you can present, so if you do have a chart or two you want to share Eric, for those who are watching on the YouTube, on YouTube versus those who might be listening, you can do that.

[00:26:22] Eric Basmajian: Yeah, maybe I could. And we can. I got a couple of charts that'll be out in my weekly update for clients tomorrow, but I'll go ahead and share some of you now. If you could tell me, share…

[00:26:30] Jeff Weniger: Here we go. You're up.

[00:26:33] Eric Basmajian: Okay. So, what I'm showing…

[00:26:34] Mike Philbrick: Heard it here first on ReSolve Riffs.

[00:26:37] Eric Basmajian: … is before the newsletter even. So what I'm showing here is the aggregate economy. This is what I would call the *aggregate coincident index*. And I didn't pick these indicators. These are listed on the NBER website as the six monthly indicators that they use to define the business cycle. So we're looking at real income, industrial production, employment, real retail sales.

And what we see is that despite the optimism in the marketplace, the growth rate of these objective six variables has actually been decelerating. Now there's been somewhat of a stabilization from the end of Q four till today, and the market is enjoying some optimism on the fact that we've avoided the worst, but we're not accelerating.

And as we know, the leading indicators are not indicating that we're going to see much improvement. If we break those, in those six indicators out, what we see is real retail sales are contracting, each of them are contracting at a 1.1% annualized rate, but aggregate consumption, aggregate employment, and real income are clustering in the 2.2% area.

So if we basket our industrial production on our retail sales and we basket the other four variables, what we see is broad measures of employment, broad measures of consumption are growing at 2%, which is giving everyone their confidence that the economy is very strong. This growth rate is fairly robust and it's not consistent with the start of recession.

But as we can see looking at the 2001 recession or the 2008 recession, the recession begins well before the blue line or employment and consumption moves into contraction. Recessions are generally preceded by the more cyclical elements like our manufacturing, industrial production, and our real retail sales, which is picking up, that durable goods element moves into contraction.

So what we see now is the two elements that generally lead us into recession are leading us into, are contracting, but everyone's finding some hope in the fact that it's just industrial production. It's just retail sales. We're just having a normalization. And there have been periods in the past, like 2016 when this happened, but we didn't go into recession.

The problem with that analysis is that while that is true, we have a situation now where if we take that aggregate growth rate, the combination of those six variables growing at about 1.1%, and we take our most recent inflation data, which was about 3%, we can have an implied nominal growth rate of about 4.2%. And the Fed has currently has monetary policy after yesterday at 5.5%. The red line is above the blue line. Historically, that's a situation that doesn't last very long because the prevailing interest rate in the economy is above the prevailing level of nominal growth. And the situation in 2016 when we had the industrial production and retail sales contracting, but we didn't go into recession, the Fed had not raised interest rates.

The yield curve was not inverted and leading economic indicators weren't broadly contractionary, which is a different setup than we have today. And this chart here really articulates that sequence where, if I pulled this chart back all the way back to the 1960s, you would see that every recession follows a green, red, blue sequence, meaning that leading economic indicators contract, then the more industrial and durable goods element move into contraction, and then the really non-cyclical elements move into contraction. And this set up today to me, perhaps I'm going out on a limb here, looks like much more consistent with recessionary starts or pre-recession periods, or even early recessionary periods than it does a soft landing. So hopefully some of these charts articulate or clearly illustrate how I'm trying to go about making these decisions by picking up on what's happening in the leading economy, then trying to pick up what's happening in the cyclical economy and then move forward from there. So this is the process that I take and why I believe that some of the optimism that we're seeing is misguided.

[00:31:25] Jeff Weniger: All right, Eric, can you go back to the one that had the Fed funds as the red line, or if you have elsewhere in the file, just Fed funds isolated? Before I ask you the question, the answer was on the coincident indicators with the 15 prints in a row. Not on coincident on leading indicators, 15 in a row. We've only been exceeded, in two cycles back to Eisenhower in the number

of prints in a row that have deteriorated like that. The first one was back in ‘73, ‘74. Everybody knows what happened back then. And of course, the global financial crisis where it was eight in a row and then there was respite.

There was one or two prints in a row just to give us a good head fake. And then 24 in a row in which leading indicators declined. I put that one up on the, on social media the other day. And boy, the comment section, people get so angry when you're just pointing out punk economic data.

Let me ask you this, because I, this is a source of the anger that I oftentimes see. What is the, and this is why I asked you to pull up the Fed funds, which, what do we have here? I can't really say I, oh, you only have about 15, 20 years here on Fed funds. If you have a longer term one, pull it out as well.

[00:32:30] Eric Basmajian: But this is all I got in this deck here.

[00:32:33] Jeff Weniger: What is the lagged effect in time from your experience relative to in terms of the transmission mechanism from rate hikes or easing until it shows up in the system relative to the perception that the typical person who is hounding you in the comments section on Twitter tends to think, I think that, oh, the Fed went from zero to five and a quarter to 5.5 in a matter of five quarters.

That is bolder than if you look at this exhibit when … in ‘04, I'm pointing right here. I'm assuming that's pointing right at the image on the camera. Greenspan started that in ‘04 at 1%. Then Greenspan got sent off to pasture and then they put Bernanke in there and he finished that at five and a quarter.

And so that was 425 basis points worth of hikes. But Philbrick, the cool thing was they did that over the course of eight or nine quarters. And then what, when Bernanke stopped that, I want to say, because I was just looking at this, it's August of ‘06 when Bernanke stopped that. Now, when Basmajian was referencing some of the things that blew up, those were ‘07 blowups.

And in, in many respects, Bear Stearns doesn't occur until what, March of ’08?. Lehman is September of ‘08. We don't bottom the whole system until March of ‘09. So you finish off of Greenspan and Bernanke cycle in August of ‘06 and things don't really start coming apart until the back half of ‘07, the credit crunch.

Many people pin the beginning of the credit crunch as being August of '07. I felt at the time, it was in July of '07. So it was a basically a good full year. And you look at this cycle one year from the beginning, the first tightening is that's, and Eric was referencing it, I think rightly, and I think we should almost come back to it as the SVB and Signature debacle, with a 12 month lag from the original hike.

And now here we are in the summer. There's no surprises here. The S&P's melting here up at 4,600 or something thereabouts, on the S&P. And I think that the typical person thinks that monetary policy's transmission into the system as a matter of days or weeks or months. And it really, it could be, Eric, this is the crux of the question, it could be a couple years, right? And so maybe, I think this is what you're insinuating here, there's no real recession right now in '23, but it looks odds on, for '24.

[00:34:56] Eric Basmajian: What I would say to that is people in my view misunderstand recessions as events. They view the recession as the collapse of Lehman Brothers or the collapse of the stock market in September of 2008.

That event was the recession, but a recession is a process. And as you articulated, that process certainly started at the very least in the summer of 2007, dragging on all the way through the end of 2009. So the recession started at a different point, depending on who you talk to and what job you had and where your job falls. Whether your job is connected to the leading economy, cyclical economy or lagging economy. And the reason I say that is because we have the NBER to define broad business cycle recessions, and we know our gray bars, but it really is much more of a process. If you were a real estate investor or a real estate agent, I would submit that the recession for you was way underway in 2007 because we had absolute collapse in volume of transactions, building permits, construction… or

[00:36:15] Mike Philbrick: Or, as you say the mortgage broker.

[00:36:18] Eric Basmajian: The mortgage broker. Wow, though, right? So the recession certainly wasn't '08 for them. And then there's a whole host of other people who are paid on transaction volumes, right?

You think about movers, you think about people who service various home constructions. So recessions for them certainly started in '07. But then I referenced some of the non-residential commercial companies that I consult with who build airports, defense bases, some of these more

non-cyclical elements. They had their best years of business in 2008, ’09, ‘10. The recession didn't hit them until 2010, 2011. Most people tend to say the recession is the gray bars, and that's generally when the stock market declines. But I really want to emphasize that it's totally different depending on where you fall in the sequence.

Just to reiterate, if you are in the leading economy, you're likely being paid off of transaction volumes and real estate. Those things dry up really quickly as you move into the cyclical economy. Maybe you are a residential construction worker, or maybe you're a manufacturing production worker, or maybe you are a truck driver or a trucking company, a trucking executive.

All of these people will experience the recession before the broad population, which is more tethered to the service sector of the economy, more on the lagging side. I would say that if you are being paid off of transaction volumes in real estate, you're probably already in recession. If you're a truck driver or you're a trucking company, as we've seen the continuous string of trucking companies that have gone bankrupt, trucking layoffs that have been occurring those parts of the economy, clearly already in recession.

But if we're waiting for the S&P 500 to collapse as the event that signals the recession that's not really the right way to look about it. Look at it in my view. We all are trying, of course, as asset market participants to try and time that event as best as possible. But it's important to remember these are a process that impacts everybody at a different period of time. We can't say that on March 8th, 2008 is the day everybody went into recession. It's a little bit more complicated than that.

[00:38:39] Richard Laterman: So, let’s bring it to today. We are, have seen on the manufacturing side, PMI and ISM’s in deep contraction territory now for several months, maybe a couple of quarters.

Now, I'm wondering if, because the manufacturing sector as a percentage of the economy has been dwindling over the past several years, maybe a few decades, does the lead time on the manufacturing signal increase or does that lag increase because as a percentage of the overall economy, it's become less relevant?

So the signal's still there. Maybe not quite broken, but the time between the contraction in manufacturing beginning and the overall economy, feeling the actual pinch and having that inflection into recessionary territory, would that make sense? Would that lag, being more right?

[00:39:24] Eric Basmajian: Yeah, I understand the point that you're getting at. Unfortunately, the data doesn't support that because despite the fact that manufacturing has become a smaller and smaller part of the economy, to the point where the cyclical economy is only about 12 or 13% of total jobs, I would tell you that there has never been a recession in US history outside of Covid, which we have to exclude for obvious reasons, there has never been a recession in US history, even the modern ones where job losses in the service sector outweighed job losses in the cyclical economy. So even though the cyclical economy is only 13% of total jobs, the job losses that will come in the coming recession will still be dominated by the cyclical economy as opposed to the service sector economy.

To give you some numbers, Construction and manufacturing equate to about 22 million jobs at the moment. And in a typical recession you'll lose somewhere between 10 to 20% of your total cyclical employment. So that's two to 4 million job losses that will occur just in the cyclical economy. So if you get into a recessionary period, what you tend to see is heavy job losses in the cyclical economy and just a flat lining, mild contraction, maybe still a mild addition in the services sector or non-cyclical economy, but it drags the whole total down.

It's actually entirely plausible. And we've had in my estimation four recessions where services, employment never contracted at all. So the job losses in recessions are still going to be driven by the cyclical economy. Now your point about PMI contracting, but we still haven't seen the manufacturing job losses, at least not yet in size. So what's going on there? In my view, with the benefit of being able to look at the cycle in hindsight, what happened was the monetary stimulus that occurred during Covid caused such a radical increase in the consumption of durable goods and therefore the new orders and purchases of durable goods, which have to all be manufactured.

We accumulated these huge backlogs of orders that needed to be produced that we either couldn't find supplies for or just couldn't produce fast enough because we had too many orders. Then what happened was the Fed started to tighten monetary policy. And those soft commitments went immediately to zero because rates went way up.

And that is what drove the leading indicators to move into contraction. And guys who follow leading indicators, like Jeff and myself, who look at this sequence said, leading indicators are starting to contract. We have to get ready for a slowdown. But what happened was we were still working off so many back orders that manufacturing companies in this example, were still able to sustain production and therefore employment for many months while they were receiving no new orders at all.

Many companies haven't received a new order all year, let's say. It's a, it's something that I'm hearing quite regularly from clients is we haven't received any significant purchase order all year, but yet they're still working off some of the backlogs from orders that were all the way in 2022. This cycle, as a result of the really intense stimulus, caused an accumulation of backlogs that has allowed production and employment to continue while we've had a contraction in new orders.

Now what's happening, as we see in the ISM data, is the backlogs, it's an index that they track in the ISM series, have fallen to 38. And Tim Fiori, the CEO of ISM, does a podcast after each report where he digs into the color. He's the one that's talking to all of these companies. He says as a result of the 38 reading on the backlogs index and his commentary, that the backlogs are broadly gone for most. There may be a couple of pockets here or there, but broadly speaking, the backlogs are gone. And the scary thing in Tim's opinion is that the new orders obviously have not shown up.

So we've been able to extend this just working off some back orders, but now it appears that the back orders have dried up. They've already been produced. But now we have no incoming new orders, which is why I still maintain the position that we're going to see manufacturing job losses accumulate in the second half. And that'll reignite some of the recessionary fears that people had in the beginning of the year, which haven't materialized yet.

[00:44:04] Jeff Weniger: On that reference to the truck, I don't know about you guys, but when Yellow laid off, was it 30,000, I was trying to Google the exact number of truckers that were laid off. This is in the last week or two. That's one of those hit, that hits you really like a ton of bricks because we just spent two years talking about a trucker shortage, or actually more than two years. It was really acute. And I don't know if any of the four of you, I don't cover the name or anything like that.

Is that truly a firm specific risk or is that something that should be getting more media attention. We have a trucking company. All we talked about the whole thesis was trucker shortage. And now these 30,000 guys got dumped a week or two ago. I don't know if any of the three of you dug into that?

[00:44:45] Eric Basmajian: It's definitely not an isolated, it's definitely not isolated. We've seen news flow of bankruptcies and the decline of trucking companies, trucking servicers broadly. This is probably the fourth or fifth major one that we've seen go under already. It's almost like the early mortgage brokers that were going under, all throughout early ‘07, and they ran, they were just mortgage brokers.

It wasn't a big deal. We're not just seeing one trucking company go under. It's definitely industry-wide stress. And it's very consistent with the fact that the, it's on the leading edge. It's much more towards the front end of this economic cycle sequence.

And we're seeing commentary from trucking executives. The folks over at freightwaves.com do a really good job of covering all the things that are happening in freight and transportation, and they're regularly publishing commentary from executives and industry contacts that say, we haven't seen the trucking sector this bad since 2008. And the data really supports that because leading indicators and all of the factors that would feed into that trucking sector, which is more in that cyclical economy support that, based on the chart that I was showing, leading indicators haven't been here since 2008.

So all of that really squares. We're just seeing total disbelief that this is actually going to translate all the way through the sequence, hit the more cyclical companies and continue to proliferate through the rest of the economy.

[00:46:14] Jeff Weniger: Yeah, and I was pulling it that tied in with that, I had, it looks like I, it was a good six weeks ago when I tweeted about intermodal rail traffic. I had it down 19% from the peak, that's going to be North American rail traffic, Canada and the United States together. The top to bottom during that, during the global financial crisis was 26%. As of mid-June it had declined 19. This is a chart back to 1990. The, you should probably just do a screen share, but the chart is just a 45 degree angle with one tanking in the global financial crisis and one other tanking here. It's exceeded the shock decline in the early days of Covid.

[00:46:48] Richard Laterman: Eric, where do banks come in? Maybe you can give us a little bit, how leading is the credit cycle in this big picture? And perhaps this will be a good opportunity for us, to give us an update on the slow moving banking crisis. We had a big shock in March, and then it seems to be simmering underneath the surface, but not another major event that has caught the headlines and that has led to major action. But we do see broad monetary contracting as well. We know that QT is taking place in middle, though. There was a little bit of a reversal in QT in the scare of SVB, the monetary bazooka that came along to support asset prices and keep the contagion at bay. So maybe you can give us an update on that?

[00:47:29] Eric Basmajian: Sure. So I'll share my screen here. Hopefully I can pull this up. What I'm showing here, let me know if you guys can see that, is we're going to do what we did with the whole economy, but we're going to do it for just the banking sector or just the bank balance sheet.

What I'm showing in this chart in red is other deposits, or you could just think about it as deposits. That's the liability side of the balance sheet. Other deposits or total deposits make up 70 to 80% of aggregate money supply. So the red line is bank liabilities or money supply growth. Effectively, the blue line is bank credit.

Bank credit is composed of loans and securities. Securities meaning banks, purchasing Treasuries and mortgages. So the asset side of the bank balance sheet is securities and loans. And then in red in black, excuse me, we have loans.

So the sequence that plays out in the banking sector is that first the liability side of the bank balance sheet declines or contracts. Then as banks experience a decline in the liability side of their balance sheet. The first thing that they generally do before they pull back on loans is they start to get rid of securities. And they do that because securities are more liquid. They do that because securities are lower yielding. And loans is really what they want to keep on their books.

It's very difficult to sell them in an environment where the economy is starting to experience stress. For example, you can't, or you really wouldn't want to sell a commercial real estate loan at the moment. You'd rather sell your Treasury securities, which is what banks were doing, prior to the Silicon Valley Bank failure.

Now they have the great luxury of just pledging them at the Bank Term Funding Program. But the sequence that we're trying to follow here is the Fed raises interest rates, that as the Fed raises interest rates, options appear for depositors. You can move your money to money market funds. You can do things to shift your money out of bank deposits.

So banks start to experience a decline in the liability side of their balance sheet. As they experience a decline in the liability side of their balance sheet, they start to unwind securities because they don't want to grow the asset side of their balance sheet if the liability side is declining. So that's exactly what we saw.

If loans are growing and bank credit is contracting, that means that they are the shedding securities. So first what happened was the Fed raised interest rates. That is all picked up in the leading part of the economy. Then we saw banks pull back on securities. Now bank credit has moved into contraction, and now we're starting to see loans turn down and we're going to see in a very short order a contraction in bank lending.

So that's the sequence that we have to be watching. And it speaks to the fact that bank lending is a lagging indicator. The liability side of the bank balance sheet, deposits, money growth, that's a leading indicator. And bank credit would be in the middle of that because of the securities portfolio.

So this is all following very much the traditional sequence. The Fed raised interest rates faster than ever. You saw a very sharp, quick and precipitous decline in the liability side of the bank balance sheet. It caused funding pressure, it caused them to sell securities, and they were selling securities at a loss because the interest rates have moved.

And all of this is now leading to the fact that the banks are going to start to pull back and have started to pull back on loans. And you won't see bank lending contract until the recession generally is already underway. So that's how the whole banking sector plays into this sequence.

[00:51:39] Richard Laterman: And to what extent is the commercial real estate, I guess you could call it a crisis? We haven't seen it manifest in any acute way yet, but it seems to be, there seems to be some gathering momentum in that direction. To what extent is that going to impact banks' ability to extend further credit given that there's this expectation that there's going to be a high percentage of non-performing loans from that sector?

[00:52:00] Eric Basmajian: Yeah, it's a huge reason why we're seeing banks not grow their balance sheets anymore. Bank credit, which is the cumulative bank balance sheet, is at the same dollar level today as it was in Q4 of last year. So we have no bank credit. Banks are absolutely pulling back and they're pulling back first on securities.

Now they've basically suspended loans for some of their quicker, what are called commercial and industrial or CNI loans. Those get cut very quickly because those are usually lines of credit and things that can be pulled back very quickly. They roll off the real estate loans quite slowly, but we're now starting to see the real estate lending come down.

So, banks are in a situation where the liability side of their balance sheet's declining. And they don't want to grow the asset side of their balance sheet, and they may even have to start shrinking the asset side of their balance sheet because some of these assets, like you mentioned, are probably not worth what they thought they were worth.

So they're going to have to start to stockpile cash, stockpile loan loss reserves, and that'll all continue to amplify the decline in credit that we're seeing. Jeff, I'd love your take on this, but as someone

who generally subscribes to a monetarist theory of economics, not entirely but it's certainly a big variable at the moment. We have contracting money supply, an inverted yield curve and contracting bank credit. I'd love to know where the growth is going to come from.

[00:53:26] Jeff Weniger: Yeah. And some of the net interest margin reports that we're seeing from earnings season are not looking, it's not horrendous, but it's not looking good.

What I've increasingly come to view, and I, it's because I think I've been. I don't want to use the *W word* wrong. I've been wrong on something. Philbrick, I thought that the pace of the bank walk, which is the process by which you look at your statement and say, wait, you're paying me 0.01%. I can get 5% in the money market. I'm going to walk out of here, which is what Eric was essentially verbalizing there. I thought it was going to be faster.

I can't, I struggle to conceptualize and I'm talking, I'm not talking back in March, one day split. I'm talking yesterday when I pulled the data, go do a Google search. Bank of America is paying you one basis point on savings accounts right now, and so is JP Morgan and so is everybody else who's a mega bank. Too big to fail. I think I'm underestimating the general public's marginal propensity to actually do something about their household finances. And they're small business finances. I think there's people running a restaurant with a huge cash balance sitting over there at B of A, and rather than moving some chunk of that over to a money market fund.

And so Eric, one of the situations, I've made this sugary beverage, Coca-Cola reference or a tobacco reference with this, in that liability part of the down there, that liability part of the of the balance sheet, which is those one basis point deposits, if they trickle out at a slow pace and it's measured and it's not a bank run.

And it's like the tobacco business where you have a hundred smokers and next year you have 98 smokers, but you pay, but they pay 50 cents more per pack than 98 who, because only 2% of them quit on you in any given year. And it's in runoff. So long as my deposit base is in gentle runoff, but those who remain, which appears to be almost everybody, except I hope that the four of us all moved our money out.

Those who remain are only receiving 0.01. But I can pocket 500 by just taking those deposits. I don't even have to do any lending. I don't have to go and find commercial ventures to lend. I can just plunk it into a money market fund and pocket 500 basis points and be done with it. If I do want to lend and keep it on my balance sheet, which I wouldn't because I would be securitizing it, I can make

700 basis points because 30 year conforming mortgages, the other day it was 7.04, so maybe the bank walk is a hairy situation, but not the end of the world at least. So I don't have to venture into regionals and try to give an answer for this, at least for the mega banks.

[00:56:10] Richard Laterman: What do you attribute that to, Jeff? Do you think this is one of those situations where it, this is just inertia and people just don't want to venture outside of their, the comfort of what they know and they don't want to buy a money market fund.

They've heard stories from what happened maybe in '08, or is this one of those things where maybe there's a tipping point and then, change happens slowly and then suddenly, we could be arriving at a tipping point where more of these deposits start to seep out?

[00:56:34] Jeff Weniger: There's round number. I'm such a dork, I've thought about this a lot. There's round number psychological levels, and I've talked in the past about Dow 10,000. That's what gets some people to pay attention to the stock market, that type of thing. At 1% yields they didn't move their deposits. At 2% yields they didn't move their deposits. At three they didn't do it, and some proportion of the public did it at four. Some greater proportion did it at five. The risk is, Jay Powell decides in his hubris to take us all the way to six, and then at, and then somebody says, I, now I really need to do this. I think that this is a case study in behavioral finance people acting against their own self-interests, keeping, and I think part of it is because we've been exposed for 30 or 40 years to these self-help gurus who mean, that tell, you need to keep six months of your cash as a reserve and so on.

And they're sitting there. I, this is what I think, I don't know this, but I think there's six months of cash sitting in a bank account at JP Morgan among people who think that they are being prudent and they are just leaving 5% on the table. I don't know how they're doing it. I don't know why they're doing it, but there's a …

[00:57:45] Eric Basmajian: A more cynical, a cynical take Jeff, let's say you would expect, let's say you were the CEO of Jeff LLC, and you had a million dollars on deposit, and the bank said, Jeff, if you keep this money as an uninsured deposit with us, we'll give you a 1% mortgage for your home residence. You might do it, right?

[00:58:08] Jeff Weniger: Yes. Yeah. There's, there are those types of relationships.

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[00:58:11] Eric Basmajian: Would, and would you feel like you were incurring risk for that behavior? You should, because it's an uninsured deposit. But that is the type of behavior that goes on all the time. It's not necessarily nefarious. That's part of banking relationships.

However, yeah. In exchange for that sweetheart deal, you are taking a risk. You're leaving your money as an uninsured deposit in exchange for a different form of compensation. You could get 5% compensation in a secure money market, Treasury bill *sweep* account, or you can get your compensation in the form of a generous kickback on business lending or home personal lending.

The problem is, that's the environment that we live in. People took that risk and they weren't penalized when that risk went wrong. So why would you move it now if you're still receiving maybe some of those beneficial deals? Do you think Janet Yellen really dropped the ball on the communications after SVP? It was like, oh, you are money good over 250,000. Oh no. Now you're not money good.

And it was just, it was, a bit of it was in my personal opinion, it was really bad. It was a huge mistake and they panicked. I don't think they realized what they did by that precedent of putting a pseudo-guarantee on all uninsured deposits, because once you did it once, when First Republic failed, how were you not going to back their deposits?

But you backed the first people's deposits, so now you put yourself in a position where you have to back everybody's deposits when the FDIC is in no position to actually do that. And you create a huge moral hazard of people who should have been punished for taking risky behavior, who now aren't. And now whether we like it or not, there's this pseudo guarantee on all deposits.

So why wouldn't you continue that risky behavior, receive the extra compensation in the form of a sweetheart deal, because you're not really actually taking any risk at this point. So I don't think they really understand the full ramifications of what they did. I think it was a huge mistake and it was a panic in the moment.

But that's also why I think we're seeing the reaction in the market. Because since that event, and I got a chart that I'll show while I'm talking here, since that event, that day is what really kickstarted the rally. And in my view, a lot of it is because whether they like it or not, they put out this implicit guarantee that we are still backstopping credit. Even in an environment where inflation is high, unemployment is low it revealed that they panicked. And I think that the market is really capitalizing on their fear.

[01:00:58] Richard Laterman: We're coming up on an hour and seven minutes. I know we have limited time. I do want to get your take on the bigger picture here, Eric. Given this highly anticipated recession that has yet to arrive, everybody keeps, saying now it's what Q1 next year or maybe even Q2? What is your expectation given the myriad signals that you're looking at from the leading all the way through to the lagging stuff? Maybe there's been some inflection in the lagging as well with the recent labor market being revised downwards for the last couple of months. Where are you seeing the possibility of a soft lending versus hard lending? The extent to which you can actually measure this at this point, and what does this do for inflation in your mind?

[01:01:38] Eric Basmajian: Yeah, the good news is that there's no one left that's actually calling for a recession. So we're back to an out of consensus position, which is a comfortable place to be.

The Federal Reserve, even yesterday got rid of their recession forecast. So it's good to be back as a lone wolf. I would say that as far as where we are, we cannot rule out, based on the way that all of these indicators are moving and I know I'll probably sound crazy for saying this, but we cannot rule out that a recession is actually underway as we're speaking.

It's entirely possible for recessions to begin before job losses. However, for that statement to be true, we will need to see job losses rather quickly. But with that being said, I still very much expect a recession to be dated sometime in '23, whether it's the first half or the back half, whereas too many indicators at this point, in my view, that have crossed the line into never here before without recession in the proper sequence, which is most important.

Leading indicators moving into contraction. Then we move in towards our industrial production contracting, our real retail sales contracting, the average of real GDP and real GDI contracting. All of these are big variables that go into the recession dating process. So the, it's not impossible that the recession is already underway, if it's not already underway.

I still believe that it's quite approximately in front of us, given the progression of all those indicators. One thing we know about recessions, which is historically true across time, is that recessions kill inflation. So we've seen a huge decline in inflation so far, but inflation is a lagging indicator, meaning that the majority of the decline in inflation will occur after the economy goes into recession.

The bulk of the decline in inflation occurred in 2009 and 2010. Inflation didn't bottom until 2012. Inflation didn't bottom until 1993, 1994. We're talking a year or two years after the recession ends.

So all of the decline that we've seen in inflation so far has nothing to do with the business cycle or the monetary tightening.

Most of the decline in inflation will occur after the recession is already over. So just to put a straw man timeline on this, hypothetically, let's say the recession started July, 2023 and lasted until July, 2024. You'll see the largest declines in inflation from January, 2024 to January, 2025. So the fact that inflation has declined this much already before we've experienced the recessionary conditions, is actually alarming to someone who follows the business cycle sequence. Because what that actually does is it tells us that we're likely to experience deflation. The *big D* actually moves through.

[01:04:31] Richard Laterman: Interesting. And it would be good to get your take on this too, Jeff, but I'll pose this to, to both of you guys. To what extent do you think that increasing deficit spending that the US government is expected to make the CBO, the numbers from the CBO that had recently come out, we haven't seen anything like this outside of war times or the pandemic, but this increase in deficit spending is only expected to continue to grow and grow quite a bit. To what extent could this, in addition to some of the other structural changes that we see more globally throw a curve ball to your prediction on the inflation side of things. Could we have an economic slowdown where the inflation remains a little stickier than your predictions might suggest?

[01:05:15] Jeff Weniger: Me or Eric? I, let me start by kind of piggybacking on some of those concepts that he had been talking about. Remember that ‘90, ‘91 recession was over in ‘91. If you give a little hat tip to Ross Perot beating the first bush back there, Clinton was essentially elected because the public believed that in ‘92 we were still in a recession. That's one of the things about these recessions is you don't, what Eric, you were saying earlier about where you are in the timing, it's sometimes you're out of the recession too.

On the other side of this, you still think you're in a recession, because it, and I say that because sentiment when we talk about bottoming out inflation in ‘11, ‘12, ‘13, that's because, did the global financial crisis end in March of ‘09 when the stock market bottomed and we started making money again? Stocks, where did the global financial crisis keep going?

Because if you ask a Greek or an Italian, that thing did not end in the first quarter of ‘09. And so that was really a saga that went on for four or five years and it dragged these things out. Now the interesting thing about this is that cyclically, we are at the point where the *D* on in front of inflation makes a lot of sense, mostly because the rent dynamics and the home ownership dynamics are now either in the red or on the precipice of being in the red. We've got a total freeze in US housing and

I know we've got two minutes left, so we won't have time to really get into that, but that's going to start filtering in.

On the inflation numbers, more and more pushing those numbers down. The problem, Richard, is that it's coming right at the moment where a lot of the things that have been warn, that we've been warning about for all these decades, namely Medicare and Social Security, are perpetually engulfing more and more of the budget.

And now suddenly, I think the number now is on an annualized basis, a trillion dollars in interest servicing for Uncle Sam. That is now an issue once again, because remember, call it something like, what, 36 months ago we were at 0.6 on a 10 year key note. Now you're, at any given session floating with around 4 on that security. As that stuff rolls off, it needs to get refinanced in the mid threes and into the fours.

[01:07:19] Richard Laterman: Guys, Eric, do you want to add anything to that? I would say that if we look at total credit in the economy there's about $90 trillion worth of total debt, both public and private sector. 30 trillion of that is government sector. So of all the credit that's produced in the economy, one third comes from the government, two thirds comes from the private sector.

What really determines some of this aggregate inflationary pressure is not just the government sector, but does the government sector expand credit sufficiently to offset the private economy? So in 2009, for example, the government ran huge deficits because we were in recession. They were providing stimulus, they did bank bailouts.

But in 2009, ‘10 and ‘11, we had flirting with deflation and very low inflation, because even though the government was running huge deficits, the private sector was de-leveraging more significantly. Then the government was leveraging. So today we have a situation where the government's running a deficit.

They're always going to run a deficit, but we also know that we have a contraction in bank credit, and the private economy is starting to contract. So I don't think that we can just look at, hey, the deficit's 8%, we're never going to go into a recession. We have to remember that the government sector's one third of private, of total credit, the private sector is two thirds of total credit.

So if the private sector is contracting, which we know that it is right now, that can certainly offset any expansion that we had in the fiscal side. Covid was an extreme example where government

credit grew 25% in one year, which dwarfed the contraction that we saw on the private side. So aggregate credit grew quite substantially.

Even though the government sector's running a big deficit right now we are getting the signs of a private contraction in my view, since it's double the size. It's going to outweigh what's done on the government sector unless we see something akin to the Covid stimulus again, which I don't think is in anyone's forecast, at least at the moment.

[01:09:26] Mike Philbrick: Love it. Any other final thoughts, guys? It's been about an hour and 15 minutes, and I know we could all talk for many more hours. There's lots of stuff to talk about, but I think we covered most of the key points. Awesome. So a little bit of over exuberance maybe in the equity markets, understanding where, what slot of the economy you are in.

You may feel like you're in deep recession already, or not at all. Exactly. Things to be, these are things to be aware of. If you're out there with portfolios, managing risk is going to be something that gets more and more important. This is not unique. The idea that an indicator like labor has not rolled over is normal.

And it happened in, in ‘06 to ’08. The other time where we had a significant run in asset prices and a very long lag time was 1928. If we think about the depth of the inversion of the yield curve, the pervasiveness across the curve of the inversion, there's lots to be aware of as asset managers out there. I think there's going to be lots of fun to participate in markets over the next six months to 18 months. We'll see what happens.

[01:10:36] Richard Laterman: Yeah, I’d say so. And with that, I think I think we're going to put a pin on this conversation. Yeah. Eric, Jeff, thank you very much for joining us today, guys. If you like, just one more, one more time where people can find you guys just to make sure.

[01:10:46] Eric Basmajian: Yeah, sure. Yeah. No guys, thanks so much for having me on. I enjoyed this conversation. Again, you can find me EPBresearch.com or EPB Research on Twitter or on YouTube. I do a lot of YouTube videos as well. I tried to break into LinkedIn, Jeff, but LinkedIn doesn't work all that well for me either. But I would say that you could reach out to me via a message on EPBResearch.com, that's the website. Again we're mainly working with business owners asset managers, helping them navigate their business cycle and recession risk. And we also help clients understand where they fall in that sequence. If you're in the leading side you may want to pay attention to different indicators than if you were in the lagging side.

So we help clients understand where they are and then help them manage their business cycle risk going forward with that in mind.

[01:11:35] Jeff Weniger: And I'm over at WisdomTree. So it's a mid-size asset mentor. We're knocking on the door of a hundred billion USD that makes you mid-size at the state of affairs. I'm the head of Equities at the firm. I've been there for six years. Find me on the WisdomTree website with the blogs and the research. And of course, as mentioned, we're doing a lot of the chart work over on Twitter.

[01:11:54] Richard Laterman: That's awesome, guys. Love it. And if you've got, if you'd like the episode, hit that Like button, Share, Subscribe to the channel and thanks for watching. Thanks for listening. Yeah, have a great weekend, everyone.

[01:12:04] Mike Philbrick: Yeah, thanks guys. Look forward to having you guys back.