THE "YOU MAY NOT KNOW REPORT"™

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Debt Consequences Looming?

"Some debts are fun when you are acquiring them, but none are fun when you set about retiring them."

— Ogden Nash

"It is the debtor that is ruined by hard times."

— Rutherford B. Hayes

While many debt headlines appear in the news presently, in my view, the day is coming when debt headlines and the consequences of excessive debt will dominate the news reports.

We are already beginning to see such headlines. I'll share a few of the more important ones that have caught my attention momentarily, but first a couple of 'debt eternal truths' for context.

The first 'debt eternal truth' is that today's currency is debt. U.S. Dollars ceased being an asset, directly redeemable for gold at a fixed rate,

in 1971. Beginning in 1971, US Dollars have been created by loaning them into existence. That makes today's US Dollars debt.

With a 10% reserve requirement (the current mandate), banks can loan out 90% of the deposits received. That means if I make a deposit into a bank CD in the amount of $100,000, the banker can reserve 10%, or $10,000, and loan out the other $90,000.

For discussion's sake, let's assume the banker makes a $90,000 loan to a customer who wants to buy a motorhome. The borrower takes the $90,000 in loan proceeds and uses the funds to purchase the motorhome.

The motorhome dealer takes the $90,000 she received from selling the motorhome and deposits the funds in her bank. Her banker reserves 10% or $9,000 and loans out the other $81,000.

This process continues for as long as there are borrowers who want to borrow.

Because new currency is created as borrowers borrow, currency became debt in 1971.

As debt increases the currency supply expands. However, debt accumulation DOES have a limit. One cannot accumulate debt to infinity, debt accumulation is finite, limited to the ability of the collective borrowers to make payments to service the debt.

That is the second 'debt eternal truth'. If debt accumulation is finite or limited, then currency creation through debt creation is also finite or limited.

Over the past two decades, we've seen first-hand, indisputable evidence that this second 'debt eternal truth' is indeed a truth.

From 1971 until 2009, whenever the Federal Reserve wanted to increase the currency supply, the central bank would simply reduce interest rates. Lower interest rates make it more attractive for people to borrow and the more borrowing that took place, the more currency that was created.

Conversely, if inflation got out of hand and the Federal Reserve wanted to contract the currency supply, the central bank would increase interest rates, which would suppress borrowing, which would contract the currency supply. There is another important point to make here – to get inflation under control interest rates must be increased to the point that they are positive on a real basis. In other words, interest rates must be higher than or greater than the inflation rate. But I digress.

After the financial crisis, the Federal Reserve, under the leadership of Ben Bernanke, reduced interest rates to zero with little effect, proving that currency creation via debt creation has a limit.

Responding to this reality, Bernanke began a 'temporary' program of quantitative easing, which despite its academic and innocuous sounding name, is currency creation from thin air. History teaches us that this policy of currency creation or money printing, whatever one prefers to call it, creates price inflation as the currency supply expands.

Since 2020, we've seen a lot of evidence of this, especially when looking at consumer prices.

The average American household spent $227 more in March of 2024 than in March of 2023 to pay for the same necessities such as food and rent[1].

Going back two years from March of 2024 to March of 2022, the same household spent $784 each month to pay for the same expenses.

And, going back three years from March of 2024 to March of 2021, that household spent $1,069 more each month to pay for the same items!

History teaches us another lesson too. While currency creation or quantitative easing can make the economy feel prosperous for a period, eventually inflation gets out of control. While it's reasonable to argue that we have not yet seen out-of-control inflation (at least yet), it's undeniable that higher consumer prices that have come about because of this currency creation, are squeezing many lower income and middle income Americans.

It remains to be seen what the Fed's policy will be moving ahead, but I expect more easy money policies beginning with an interest rate cut prior to the November election. This will likely lead to more inflation in the near-term. but eventually the excessive debt levels that exist in the private sector and on the balance sheet of most world governments will have to be dealt with and the outcome will be deflation, perhaps like the deflationary period experienced in the 1930's.

That's the third 'debt eternal truth' – debt will have to be dealt with. And there are only two ways to deal with debt. You either pay the debt or you default on the debt.

Looking at the debt numbers that exist in the private sector and in the public sector, there is simply NO WAY that the debt will be paid. That leaves default as the ONLY option to deal with the debt.

That said, there are only two ways to default on debt. One, state outright you are not paying the debt. Or, two, in the case of government debt, create currency to pay the debt which results in more inflation or even hyperinflation.

Total debt worldwide is presently more than $300 trillion, $315 trillion to be more precise[2].

That $315 trillion in debt includes household debt (including mortgages), credit card debt, student loan debt, auto debt and other debt. Total household debt stands at $59.1 trillion.

Business debt stands at $164.5 trillion and public debt totals $91.4 trillion.

The United States debt in the private and public sector makes up a large portion of private sector debt and government debt. The official US Government debt as of this writing is about $34.9 trillion. According to "Trading Economics"[3], US private sector debt is about 216% of economic output or Gross Domestic Product.

By comparison, private sector debt to economic output in 1929, at the onset of the Great Depression, was just over 140%[4].

While Government debt may be somewhat monetized via currency creation, that will not be the case for private sector debt. That means that at some future point, we will have to endure a deflationary period that could be like the 1930's.

In prior time frames when private sector debt got to unsustainable levels, deflation occurred. It happened in 1837, 1873, and 1929.

One of the first signs that we may be entering deflation is banks begin to fail. This is logical when you consider that banks have debt as assets. When enough debt goes unpaid, banks become insolvent.

In 1933, President Franklin Roosevelt, declared a bank holiday which was the equivalent of a 'bail in' (as opposed to a bailout). When a 'bail in' occurs, bank depositors lose their money on deposit.

Similar outcomes happened at the beginning of the long depression of 1873 and the panic of 1837.

Since last year, as you are probably aware, there have been four bank failures. And, just last month, the Federal Deposit Insurance Corporation released a list of 'problem banks'. This[5] from "Norada":

> *The Federal Deposit Insurance Corporation (FDIC) has placed 63 lenders on its 'Problem Bank List,› signaling financial, operational, or managerial weaknesses that could lead to insolvency. These banks hold a combined total of $82.1 billion in assets, marking a concerning trend in the financial sector. The rise in unrealized losses—primarily from residential mortgage-backed securities—reflects the impact of higher mortgage rates and persistent inflation.*
>
> *The number of banks on the Problem Bank List, those with a CAMELS composite rating of "4" or "5," increased from 52 in fourth quarter 2023 to 63 in first quarter 2024. The number of problem banks represented 1.4 percent of total banks, which was within the normal range for non-crisis periods of one to two percent of all banks.*
>
> *Despite these alarming figures, it's important to note that the FDIC does not consider the U.S. banking system to be at imminent risk. However, it acknowledges that ongoing issues such as inflation, volatile market rates, and geopolitical concerns continue to exert pressure on the industry. These factors could lead to credit quality, earnings, and liquidity challenges, necessitating close monitoring and ongoing supervisory attention.*
>
> *The current state of affairs has also sparked discussions about the role of cryptocurrencies, with some analysts suggesting that Bitcoin's value could surge as it regains its status as a safe-haven asset amid banking crises. This perspective highlights the evolving landscape of financial security and the search for alternative investment options in uncertain times.*
>
> *As we look ahead, it's clear that the U.S. banking system is navigating a complex environment. The FDIC›s warnings serve as a reminder of the need for vigilance and preparedness in the face of potential financial instability. For individuals and businesses alike, understanding these developments is crucial for making informed decisions and safeguarding financial well-being in an ever-changing economic climate.*
>
> *The potential consequences of bank insolvency are far-reaching and can have significant impacts on the economy, the banking sector,*

and individuals. When a bank becomes insolvent, it means that its liabilities exceed its assets, rendering it unable to meet its financial obligations. This situation can lead to a series of events that affect various stakeholders.

For the banking sector, failure can result in a loss of confidence among consumers and investors. This can trigger a bank run, where depositors rush to withdraw their funds, fearing the loss of their savings. Such a scenario exacerbates the liquidity crisis and can lead to the failure of the bank.

The economy can also suffer due to bank collapse. Banks play a crucial role in the financial system by providing credit to businesses and consumers. When a bank fails, the supply of credit is disrupted, which can lead to a slowdown in economic activity. Additionally, if multiple banks are affected, it can lead to a systemic crisis, potentially resulting in a recession.

Individuals who have deposits in an insolvent bank face the risk of losing their savings. Although deposit insurance schemes exist to protect depositors, these typically cover only a portion of the deposits, and retrieving insured funds can be a lengthy process. Moreover, individuals employed by the insolvent bank may lose their jobs, and shareholders may lose their investments.

The legal consequences of the bank collapse can involve restructuring the bank›s debt, selling off assets to pay creditors, or even liquidating the bank. In some cases, the government may intervene to bail out a failing bank to prevent systemic risk, using taxpayer money, which can be a contentious issue.

Overall, the banks being on FDIC's problem list is a serious matter that requires prompt and effective management to mitigate its adverse effects on the financial system and the economy at large. It highlights the importance of robust regulatory frameworks and prudent risk management practices within financial institutions.

While you can't access the specific Problem Bank List, you can find information on recent bank failures on the FDIC's website: https://www.fdic.gov/resources/resolutions/bank-failures/index.html

Are Consumers Collectively Tapped Out?

The retail sales numbers were recently released and while they may seem like decent numbers on the surface, when one digs into the numbers, it's apparent that consumers are becoming tapped out.

April retail sales numbers were revised downward from flat to a decline of .2%[5]. Looking at the most recently released retail sales numbers on an annual basis, retail sales have increased just 2.3%.

But that's an increase, right?

Isn't that good? Especially considering the US economy is more than 70% dependent on consumer spending?

The reality is the reported retail sales numbers don't tell the entire story mainly because the reported numbers are not adjusted for inflation.

That means the reported numbers not only reflect the volume of items that consumers buy but also the price of the items that they buy.

The actuality is that Americans are forking over more money to buy the same stuff that they were buying one year ago. Mike Maharrey explains this phenomenon[5]:

In other words, just because dollar widget sales increase doesn't mean people bought more widgets. It could be that they bought fewer widgets but paid a lot more for them. Conversely, falling sales could reflect price drops and don't necessarily mean people purchased fewer widgets.

When you factor in an annual CPI of 3.3 percent, it's clear that Americans aren't even keeping up with rising prices.

Looking at the internals, it appears Americans are cutting back on discretionary spending. Sales at bars and restaurants fell by 0.4 percent. Home furnishing retailers saw sales fall by 1.1 percent.

With an annual retail sales increase of 2.3% and a reported inflation rate of 3.3% (which is understated), it's clear that Americans are buying less but paying more for what they buy.

Maharrey makes another interesting point in his piece:

Not only are retail sales falling, but we've seen a sudden drop-off in the increase of consumer debt over the last few months. Revolving debt, primarily reflecting credit card balances, contracted by $500 million in April, saw a 0.4 percent decline.

That may well indicate Americans are starting to max out their credit cards.

American consumers are currently buried under 1.34 trillion in revolving debt alone. When you factor in non-revolving credit including student and vehicle loans, and borrowing for other big-ticket items, Americans owe $5.05 trillion. That doesn't even factor in mortgages.

Americans used stimulus money handed out during the pandemic to pay down credit cards and beef up their savings. Then prices started surging.

As prices skyrocketed, Americans blew through their savings to make ends meet. Aggregate savings peaked at $2.1 trillion in August 2021. As of June 2023, the San Francisco Fed estimated that aggregate savings had dropped to $190 billion.

In other words, Americans ran through $1.9 trillion in savings in just two years.

Then they turned to credit cards.

Now it appears they have maxed out the plastic. We see this in both the consumer debt data and sagging retail sales.

As noted above, with private sector debt levels this high, once debt accumulation reaches its limit, deflation is the only possible outcome.

Could this be another sign that the inevitable deflation is approaching?

Perhaps.

There is no other possible, eventual outcome. The only question is how much inflation we see before deflation begins in earnest.

Pending Home Sales Fall

"The market is at an interesting point with rising inventory and lower demand."

— National Association of Realtors

Wolf Richter does an excellent job monitoring and reporting on the housing market. In a recent article[6], Wolf noted this:

We here in our little corner don't normally more than glance at the "pending home sales" data by the National Association of Realtors. It's a forward-looking indicator of "closed home sales" based on contract signings – on deals that haven't closed yet and could still fall apart. But today's release of pending sales was interesting for several reasons, including the NARs' expectation that the collapsed demand along with rising inventories is going to cause home prices to "stabilize" in the second half of the year. So here we go.

The index value of pending home sales in May dropped by 2.1% from April, and by 6.8% from a year ago, to 70.8 (seasonally adjusted annual rate), what headlines dubbed an "all-time low" or "record low" in the data going back to 2001, and that's close enough. In the NAR data we have access to via YCharts, today's reading was still a hair above the prior all-time low of April 2020 (index value of 70). But the idea is the same: demand has collapsed, even as inventories have risen.

The index value was set at 100 for contract signings in 2001. So, today's value of 70.8 is down 29% from the index average in 2001. Compared to the Mays in more recent years:

- *May 2022: -28%*
- *May 2021: -39%*
- *May 2020: -30%*
- *May 2019: -33%.*

Those statistics jump off the page, don't they?

May 20224 home sales were down 28% from 2022, 39% from 2021, 30% from 2020, and 33% from 2019. Those are hefty declines sure to make an impact on home prices in the future.

Candidly, I hear different opinions on where residential housing goes moving ahead.

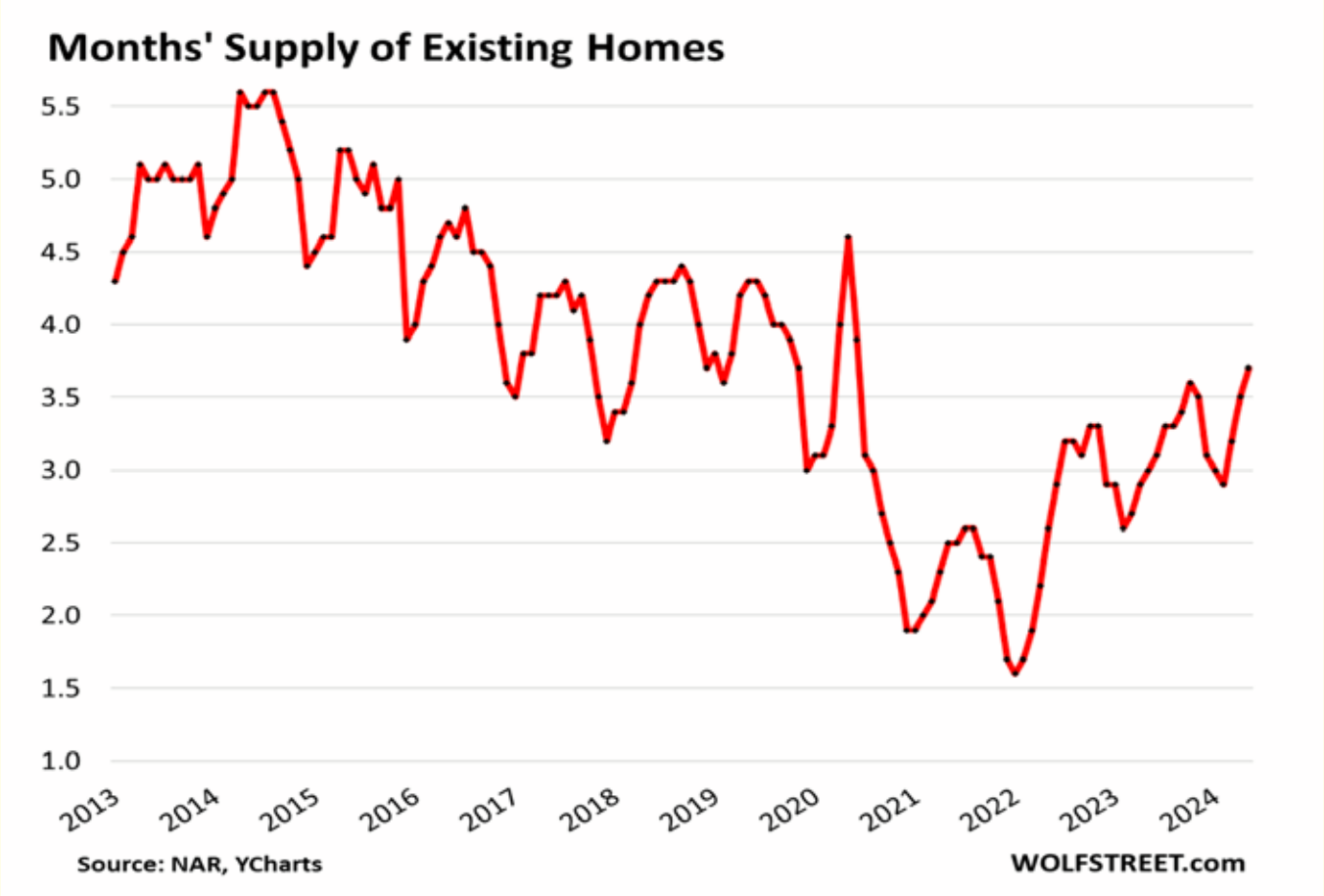
My take has always been that once deflation seriously emerges, we will have to see a decline in asset values, stocks and real estate. Let me be clear. I don't have a crystal ball, nor do I consider myself to be smarter than the guests I interview. I am not.

I have however studied history and I've found that every time private sector debt levels get to unsustainable levels, real estate prices and stock prices are negatively impacted, often dramatically impacted.

I can't imagine that this time will be different. These numbers, at least on a very preliminary basis, seem to confirm my forecast. We will see.

In his piece[6], Richter published a chart illustrating the number of months' supply of existing homes on the market. I've republished the chart below.

Notice that inventories are climbing and have increased from about a 1.5 month's supply in 2022 to a 3.7 month's supply presently.



Feeling the Inflation Pinch? 42% of Americans Say 'No' to Summer Travel

As I noted above, costs of everyday essentials have been rising rapidly over the past three years. Rising costs may be the primary reason that four in ten Americans are electing to skip any summer travel this year.

This[7] from "Statista":

According to Deloitte's 2024 summer travel survey, money and high price are by far the biggest hurdles for American would-be travelers this summer. According to the survey, 42 percent of Americans do not plan to travel this summer season, i.e. between Memorial Day and the end of September, up from 37 percent last year. Among those without travel plans 39 percent said that they simply cannot afford it, while 32 percent said that travel is too expensive right now and 19 percent said they'd rather spend the money on something else. While money is a big concern this year, health no longer is. Only 7 percent of those planning to stay put said that health risks are among the reasons behind their decision, down from 43 percent in 2021 and 33 percent in 2022.

With money a big factor in people's travel plans this year, it's not surprising that fewer people from lower income households will go on holidays this summer. According to Deloitte, people from households with an income of $50,000 or less make up 19 percent of the traveling public this summer, down from 31 percent last year. Meanwhile the share of travelers with a household income of $100,000 or more has climbed from 35 to 44 percent, resulting in higher holiday budgets for the average traveler.

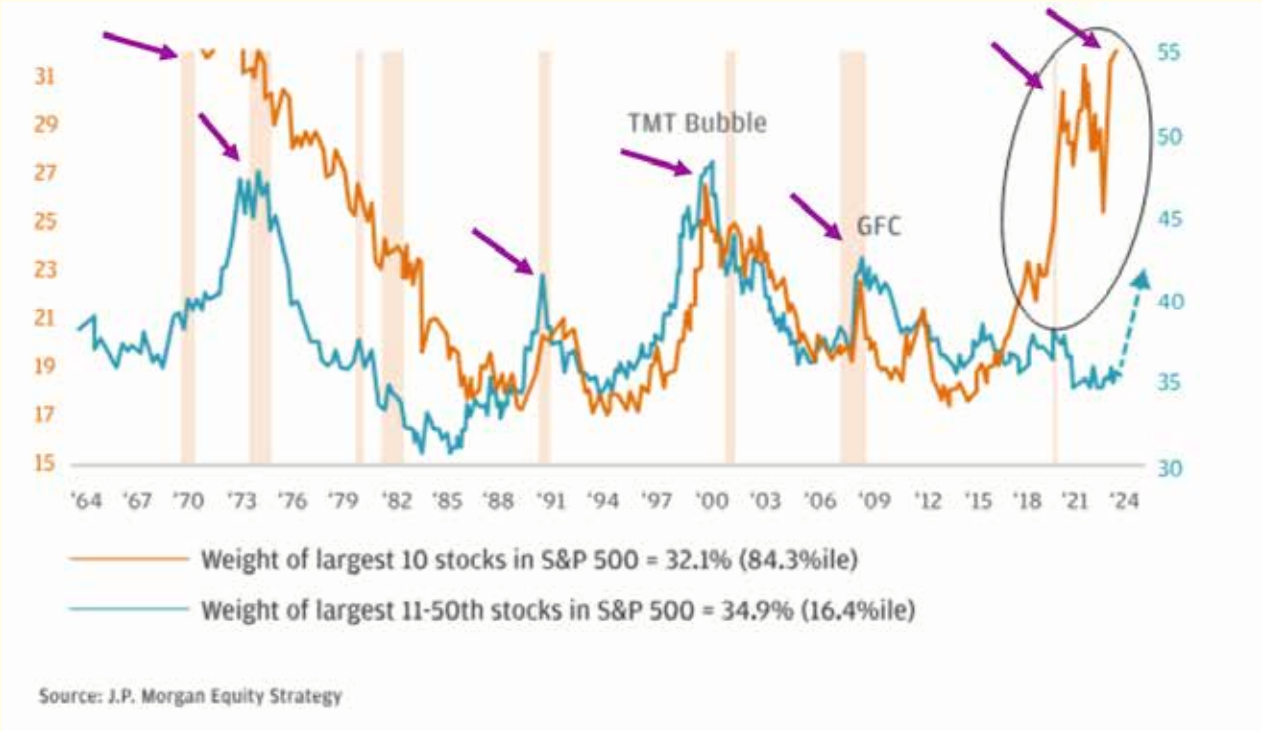
I've been writing about how the easy money policies pursued by the Federal Reserve since the time of the financial crisis have widened the wealth gap. This survey is yet more evidence that is the case.

Stocks: Proceed with Caution

During a recent interview Dr. Robert McHugh, one of the hardest working technical analysts in the industry, made the point that the current stock market is being dominated by just a few, large companies. He then pointed out that there is a pretty solid correlation between periods of time when the stock market is being dominated by a few, large companies and recessions with steep stock declines. The chart below is published on Dr. McHugh's site[8].

Bob notes that the top 10 market cap stocks are dominating the market at the 85% highest level seen in the history of the stock market. Looking at the chart, the last time this occurred at this level was just prior to the extreme bear market in stocks of 1973 and 1974. Historically speaking, looking at the chart, one sees that this condition in stocks has often led to steep declines in the stock market.

If you are holding stocks, caution may be warranted here.



August 2024 Special Report

Tax-Free Retirement Strategies

During the month of August, we are offering a free special report titled, "Tax-Free Retirement Strategies".

The August special report will offer some strategies and techniques that some aspiring retirees and existing retirees can use to potentially enjoy a retirement that is completely income tax free.

To request a copy of this report for you or for someone who might appreciate it, use one or all of the postage-paid reply cards included with this month's newsletter, or visit:

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Time Deposit Rates

At the time of publication,
these rates were valid in most states:

1-Year	5.00%
2-Year	5.25%
5-Year	5.60%

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Why You Need to Consider Adding Precious Metals to your Portfolio

Gold and silver have always been real money.

As inflation rages and fiat currencies like the US Dollar lose purchasing power, gold and silver can be a great way to preserve purchasing power.

Look at this example.

When Richard Nixon eliminated the convertibility of the US Dollar to gold in 1971, an ounce of gold sold for $35 per ounce and the average cost of a new home was $25,000. At that time, you could buy a new home for $25,000 in cash or 700 ounces of gold.

Fast forward to the present. The average cost of a new home is $380,000. The $25,000 that once bought a home fifty years ago is now not even a down payment on an average new home.

However, the 700 ounces of gold that used to buy a new home now buys 4 average new homes.

Given the current rampant inflation, doesn't make sense to consider metals in your portfolio? IRA, Roth and even 401(k) funds may be used. Visit **Densmore.PreciousMetalsBuyersGuide.com** to get a free precious metals investing guide.

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