Demetri Kofinas: What's up everybody? Welcome to another episode of Hidden Forces with me, Demetri Kofinas. Today I speak with Gary Shilling an economist, financial analyst, and commentator famous for the prescience of his forecasting. Most notably, having called the bottom in what would become a 36 year, and counting, bull market in US [00:00:30] Treasuries. He is the author of numerous books including his most recent, *The Age of Deleveraging*, a strategic manifesto for managing wealth during an epoch of deflation.

In this episode we look at the tax cuts being proposed and the regulatory changes being enacted by the Trump administration. We consider their impact on the economy, on growth, and on equities as we head into the ninth year of an unusually long economic expansion. What does the employment picture [00:01:00] look like for the US economy? How do job prospects and wages fare in the face of rising asset values, and growing debt burdens? If our guest is right, and Treasuries remain in a bull market, then what does this mean for the fate of stocks, commodities, and the US Dollar in 2018, and beyond?

As always, you can gain access to reading lists put together by me ahead of every episode by visiting the show's website at HiddenForces.io. [00:01:30] Lastly, if you're listening to the show on your iPhone or Android, make sure to subscribe. If you like the show, write us a review. If you want a sneak peek into how the show is made over special storylines told through pictures and questions, then like us on Facebook and follow us on Twitter and Instagram @hiddenforcespod.

And now let's get right to this week's conversation.

Dr. Gary Shilling, welcome to Hidden Forces.

Gary Shilling: Delighted to be with you.

Demetri Kofinas: It's great having you here. [00:02:00] I was telling you that the last time I saw you for sure was in 2012 when we did the post 2012 election panel that Lauren, the former host of my show, moderated with Mauldin Economics, and Rich Yamarone was there, I think, also, Mohamed El-Erian was there too.

Gary Shilling: Yeah, you know, Rich, I saw him at Bloomberg literally a week before he died.

Demetri Kofinas: When did he pass away?

Gary Shilling: Oh, yeah, he died about a week ago.

Demetri Kofinas: I didn't know that.

Gary Shilling: He was [00:02:30] hale and hearty. Matter of fact, I gave him a jar of our honey. You know, I'm a beekeeper. We had a nice chat and I was on Bloomberg radio and TV that day and then a week later I got an email from a mutual friend, Dave Rosenberg, from Toronto and he said that Richard had a heart attack. Apparently, no brain oxygen for 30 minutes. He was in a coma.

Demetri Kofinas: Oh, my goodness.

Gary Shilling: Dave came [00:03:00] down to New York, but then I go word that he had died, I think, the next day.

Demetri Kofinas: I had no idea.

Gary Shilling: Yeah, yeah.

Demetri Kofinas: I hadn't seen Rich in years.

Gary Shilling: Yeah, nice guy.

Demetri Kofinas: Funny guy.

Gary Shilling: Super nice.

Demetri Kofinas: Very funny person. He was always making us laugh. That's a shame. Wow, sobering words.

Gary Shilling: Reminds us all of our own mortality.

Demetri Kofinas: Yeah, we're all on our way out. We're all in the same boat.

Gary Shilling: Right.

Demetri Kofinas: It's very true. Well, it's a pleasure having you on and I mentioned to my audience before this on Twitter, that I was going to have the master [00:03:30] beekeeper on, and I didn't tell you that I was looking forward to getting your honey. I wasn't going to ask because it was rude, but thank you for bringing it, and you brought one for my engineer too, which I'm so happy about.

Gary Shilling: Hope you guys like honey.

Demetri Kofinas: Yeah, well, who doesn't like honey?

Gary Shilling: Oh, you're such sweet guys.

Demetri Kofinas: All right, so let's get to the meat and potatoes. We got the honey, but let's get to the meat and potatoes. I also want to mention to our audience, and I'll mention it again, you have a really incredible newsletter. Now, is Gary Shilling's *Insight*the only newsletter [00:04:00] that you produce?

Gary Shilling: Yeah, it is. It's a monthly newsletter.

Demetri Kofinas: Okay, it is heavy. It is heavy and you know what? It differentiates from all the other newsletters that I have read or have encountered because it's very heavy on indicators and on statistics and econometrics and stuff like that. So I found it very useful.

Gary Shilling: Good, good.

Demetri Kofinas: And it's very current. A few of the things that I want to cover today with you are things that were in the December newsletter. Specifically, taxes and regulations. Then we'll get into a lot of other things because we cover macro a lot on the program. [00:04:30] Although I am interested in getting into sort of the deflationary expectations with you, I want to start with the tax cuts that are being proposed by Congress, as well as the deregulation that the Trump administration is currently enacting. Much of it is with executive orders I believe, right? Or, what's the term?

Gary Shilling: It's executive orders, but it's also the people in the various agencies. You know, the federal government, if you go back to right after [00:05:00] World War II, federal spending as a ratio to GDP, was 16%. Now it's 22%. In other words it's almost a quarter of the economy is in the federal hands. It gives the President tremendous power and that, plus executive orders, really can make a difference. Obama, when he was on the way out, he put in a lot of executive orders in the environmental area and holding back the pipelines, the Dakota access pipeline and Keystone XL and so on.

[00:05:30] Trump has reversed a number of those, but executive orders are really interesting. They started with FDR and he just put them in and Congress never bucked him on it, and they've stood there ever since. They're really Presidential legislation. So the President has not only the power over the agencies and carrying out the directions of Congress, but the President can actually make laws, in effect.

Demetri Kofinas: Schlesinger wrote the book *The Imperial \ Presidency*. That was a reflection of the change in the role of the Executive after World War II, really. Much of what he did after World War II and the Great Depression was cemented. FDR, really

Gary Shilling: Yeah, it really started because up until the Depression, the federal government had limited involvement in the economy, but the Depression was such a traumatic experience and so many people had gone from riches to rags overnight from the roaring '20s to the gay '30s [00:06:30], that FDR stepped in and you had all the New Deal programs and so on. It greatly enhanced the scope and power of the federal government. You had all these agencies come in that nobody ever heard of. The SEC starting off, financial regulation, then CAB that regulated airfares, and all the more recent ones, Homeland Security, Department of Energy. Every time we have a crisis like the oil embargo in the '70s, they come up with a [00:07:00] new regulatory body.

Energy Department after 9/11. In 2011-2012 the Department of Homeland Security came in reaction to the 9/11 crisis. It's really done nothing but grow so the idea of deregulation is really a marked change, but say, the President, by putting people in these agencies, and part of it is just what they enforce and what they don't enforce. They have quite a lot of power in those [00:07:30] agencies. Deregulation is not a rose garden signing kind of deal. It's little bit here, a little bit there, but you see it. The FDA, for example, they're speeding up the approval of new drugs. It costs $2.6 billion to bring a new drug to market, and consequently, speeding that up makes a huge difference. Of course, particularly, allowing generics. When generics come in, if there [00:08:00] are 10 or 12 of them, the prices go down about 80% on average versus the patented prescription drugs. If there are only one or two, they go down about 40%. So opening this up ...

These are all very deflationary forces, by the way, which is my theme song for many years, as you know.

Demetri Kofinas: Right, it is. Well, you were the ... I mean, you're known as sort of the king of the long bond trade. Did you actually catch the very bottom of the bond market in '81?

Gary Shilling: I really did.

Demetri Kofinas: Wow.

Gary Shilling: Yeah, it was [00:08:30] October of 1981.

Demetri Kofinas: Remarkable.

Gary Shilling: As a matter of fact, I was about a month premature and I'll tell you, I got in it by repos. Repo trades, which are, you know ... If you think futures are leveraged, repos are way out there. I did this to a good friend of mine who had a small bond house, and I remember that I got into it and the first thing that happened in the first few weeks is I was losing money. I said "Oh my god, here you are supposedly know what you're doing. [00:09:00] This is ridiculous. How much how water am I going to get into?" Of course, I didn't even tell my wife what was going on, but it worked out. You know, that was 1981, and by the mid '80's this one vehicle, long Treasuries, 30 year Treasuries, we'd achieved financial independence for the Shilling family.

Demetri Kofinas: Wow, by the mid '80s?

Gary Shilling: Yeah, by the mid '80s.

Demetri Kofinas: Wow. That's great.

Gary Shilling: They have outperformed the S&P's since the early '80s by five [00:09:30] times, long Treasuries.

Demetri Kofinas: Wow.

Gary Shilling: It's really amazing. You know, a lot of people just don't understand bonds. I don't know what it is.

Demetri Kofinas: They're boring. They're not sexy.

Gary Shilling: Well, yeah, they're boring and, of course, a lot of stock investors, they viscerally realize that when bonds are rallying in price, interest rates are going down, is usually a time when stock prices are going down, so you know, bonds are personified-

Demetri Kofinas: As being [crosstalk 00:09:58].

Gary Shilling: Anybody who likes bonds is really the devil personified. [00:10:00] A lot of people just don't quite understand that bond yields ... When yields go down prices go up. Of, course people say ... I remember way back then I was running my parents' portfolio. I don't think it's because they really trusted me, but their broker of some 30 years had retired so I was running the portfolio. My mom called me up and she said "Gary, I see you put some bonds in our portfolio that are not going to mature for 30 years." I said "yeah, that's right mom. I think it's a good deal, and of course, the longer the maturity the more [00:10:30] price appreciation you get for a given decline interest rates." She said "But Gary, Dad and I aren't going to be alive in 30 years." I said "That doesn't make any difference." You look at it-

Demetri Kofinas: Like "I will."

Gary Shilling: I had a really interesting experience with that with Jeremy Siegel of Wharton, University of Pennsylvania. He had me down for a conference addressing it, and he got up and ... You know, he's a perennial stock bull-

Demetri Kofinas: Perennial bull.

Gary Shilling: Just like I'm a perennial Treasury bull, but he got up and he said " [00:11:00] I don't know" ... and the yield on the 30 year bond now it's 2.8%, well it was 6% at the time.

Demetri Kofinas: This was when, when you went?

Gary Shilling: This was about 10 years ago, I guess. It was at Wharton. They have a course for sort of intermediate Wall Street types. It's a three year course where they go for a couple of weeks at a time and he invited me down to debate with him. He got up and he said, "I don't know why anybody would lock up their money for 30 years for 6%." So, it was my turn [00:11:30] and I said to the audience "Well, what's the yield on the S&P?" Well, somebody knew it was 2%. I said, "What's the maturity on stocks?" Nobody knew. I said, "It's infinity, isn't it?" I said, "There's no maturity unless the company goes bust or the stock is called." It's infinity. I said, "Why would anybody lock up their money for infinity for 2%?" That's apples to apples. That's the same question that people say with bonds. It really amazing how-

Demetri Kofinas: [00:12:00] I was also laughing when you were discussing your long call in '81 because Jim Grant is a friend and he was on the show not long ago and he talked about his horrible call buying gold at the peak. What was it? 1980? Was that the peak in gold?

Gary Shilling: Yeah, '79, '80 something. It got to $800 an ounce.

Demetri Kofinas: $800 an ounce. He said he stood in line and he said the lesson he learned then is never stand in line to buy anything.

Gary Shilling: I think that's where we are with bitcoins today.

Demetri Kofinas: Oh, man. You want to talk about that? We should.

Gary Shilling: Why not?

Demetri Kofinas: Let's talk. What do you think? I'm curious, but it's [00:12:30] something that we cover on this show and the technology is something that I've covered. I started covering quite a bit. I have sort of a background in that as well in technology. Not Blockchain or distributed ledgers, but technology in general. I've been fascinated watching the market around this. The frenzy and just thinking about how problematic it's going to be for many people now that there are going to be futures trading around this.

Gary Shilling: By the way, I started off as a physicist, so I've got a little bit of one foot in that area.

Demetri Kofinas: Right.

Gary Shilling: [00:13:00] The interesting thing about speculations is that they always start with some semblance of reality. The dot com stocks in the late '70s were that way. Housing with relative availability of money with the subprime mortgages in the mid-2000s. There's always some semblance, but then what happens with speculations is it leaves reality behind and it feeds on itself and it's like Jim Grant standing in line to buy gold. Why are you buying [00:13:30] it? Because it's going up.

Demetri Kofinas: Exactly.

Gary Shilling: There was a book you're probably familiar with called *Popular Delusions and the Madness of Crowds.*

Demetri Kofinas: Yes, yes, yes.

Gary Shilling: By a guy named MacKay.

Demetri Kofinas: Covered the tulip bulb mania.

Gary Shilling: Yeah. And tulip bulbs, it was a classic-

Demetri Kofinas: It was remarkable.

Gary Shilling: There was a [crosstalk 00:13:45] for that because tulips were brought for Turkey to Europe in the 1600s, and if you've ever seen any of these magnificent Dutch still lives in the 1600s. They're just gorgeous pictures. They always have all these fancy para tulips and other tulips. In other words, there [00:14:00] was a semblance of that, but then the whole thing ... The bidding got up and up and up and then the thing just ran out of ... That's what makes a top in any market. You run out of sellers, you have nothing but potential buyers. The thing about tulip bulbs, in World War II during the German occupation, the Dutch were so desperate they ate tulip bulbs. Now, I don't know if there's anything you can eat on the bitcoin.

Demetri Kofinas: No, well, you know, it's really interesting. Something else, anecdotally, I don't have the numbers in front of me and [00:14:30] I don't remember what book it was that I had read it in. It might have been that one, but some of the most expensive tulips were the equivalent in value of giant mansions, in other words.

Gary Shilling: Yeah, there was one, it was so many oxen and so many houses and cows and ships. I mean, you got rid of everything you owned to buy one tulip bulb.

Demetri Kofinas: There's an interesting parallel there with bitcoin, not that they're identical scenarios. But there is a similarity in terms of the [00:15:00] gross redistribution of wealth in our economy today and I think it's telling that a cryptographic technology that allows you to essentially transfer and store large amounts of money has gained so much value in price, in other words. I think that is part of it as well.

Gary Shilling: But, you know, when you think about it the only use that I can figure out for bitcoins in today with the easy transfer of money through an electronic system, I think it's very cheap and very easy. The [00:15:30] only logic of bitcoins is money that you want hidden for some reason.

Demetri Kofinas: Right.

Gary Shilling: It's a drug traffic. It's the replacement for what the Swiss used to do. The Swiss had all their hidden accounts and so on, then starting with the Germans and the Belgians and Dutch and finally the US, we ran the Swiss banks out of that business.

Demetri Kofinas: I definitely think there are use cases beyond that for it, but the problem is that the use cases are limited because the technology is limited. Particularly bitcoin with its proof of work and the issues around scalability of the system. It's very [00:16:00] difficult to value. There's a lot of speculation around it. There's also a very ... I think something like 40% of the network is ... Or 40% of the tokens are owned by a thousand people. So you've got a market that is ... you know, it's valuation is very fragile. I'm not talking-

Gary Shilling: Yeah, but what would you use a bitcoin for that's legal that you couldn't do with a credit card or a check or wire transfer?

Demetri Kofinas: One of the things I think bitcoins offers is the same thing that gold offers, which is a way to store value if you don't trust the [00:16:30] bond market and you don't trust assets. Let's say traditional assets-

Gary Shilling: You going to trust something that goes up or down 20% a day?

Demetri Kofinas: Well, I'm just saying. I think there are people who buy bitcoin for the same reason that people buy gold, which is that it's a hedge against credit risk. I think it's a complicated conversation. I mean, ultimately right now I think what's driving the price is speculation, but it's such a difficult asset to value. You don't really know how you want to value it. It's not exactly a currency. It's closer to a commodity. It's essentially an accounting [00:17:00] identity.

Gary Shilling: Yeah, and you don't know whether this isn't a giant Ponzi scheme. I mean sure, there's the algorithms you sign to mine it and so on and so forth, but nobody really knows who created these things and you can't be sure that this guy, tomorrow, isn't going to double the supply.

Demetri Kofinas: Well, I think ... my sort of, you know, not to belabor the point, but I think the big story is really that bitcoin and blockchain technology has created the market for distributed ledger technologies and distributed consensus. They're [00:17:30] attempting to do for the data layer, computation, processing, and storage of what the internet suite of protocols did for communication. The thing is that blockchain can't scale. At least that's my view on it. It can't scale in order to do the types of transactions and it doesn't have the throughput or the security in my view, but there is this sort of promise and hope for other technologies that are not blockchain. I've been following one in particular and covering it on this show. I think that is the big opportunity and use case for distributed ledger technologies. [00:18:00] It isn't this narrow case of currency.

I do want to get into some of these things that are in your newsletter, with you, like taxes, for example, and regulations. We were talking about regulations. Let's stick on that a little bit.

Gary Shilling: Sure.

Demetri Kofinas: The way in which the regulatory debate in the country is usually, it's usually either or, it's very binary. Either you're for deregulation and I like or I don't like that, you know, you're the devil, you're a saint. Or you want to regulate and that means that you're a good person, you care about people or it means, you know, you're dumb, you don't understand anything. [00:18:30] I come from the standpoint that there's some middle ground, but I think, to begin with, it's important to make the point, and you have a great chart in your newsletter that points this out, if you look at the accumulated number of federal regulations since 1970, which is where your chart starts, it's basically a 45 degree angle. There couldn't be that many more things to regulate.

Gary Shilling: Yeah. Well, they always find new ones, and as a matter of fact, any time you get a big problem in the country you get new regulation. [00:19:00] The Department of Energy was set up in 1976. Well, that was after the oil embargo in 1973. Homeland Security in 2002 after the 9/11 in 2001. So, you get these reactions. The thing is that the regulation, it never goes away. The only regulation I know that has gone away in the whole post war period, and that's the only time you had big regulation at the federal level, was the Civics Aeronautic [00:19:30] Board. That regulated airline fares. In other words, if you wanted to fly from here to Chicago, every airline had to have exactly the same fare.

A good friend of mine, now deceased, Alfred Kahn, he was a professor at Cornell and he was head of the CAB and he actually disbanded the agency. It was interesting, they still found out ways to compete. On a particular run to Chicago, and this is truth, they could serve sandwiches only. That was the CAB regulations on this lunch time run. So, the airlines competed [00:20:00] to see what you could put between two pieces of bread and call it a sandwich, and one even put a full chicken between them.

Demetri Kofinas: You're basically touching on the problem of trying to introduce incentives into a market and you're going to get it wrong often.

Gary Shilling: Regulation ... there is a sense, for example, one of the things that Trump has delayed is the fiduciary responsibility. As you know, this means that investment advisors, brokers, have to do what's in the best interest of their clients. Now to me, that's just ethics, that's common [00:20:30] sense, but the rule now is suitable. Suitable can be something that's suitable for the client, but it does a lot bigger commission for the broker. Now, the big banks, and that's an interesting case because this was proposed earlier by the labor department. It was instituted under Obama. Now it's been delayed until next year to take a look at it with Trump, but the big banks-

Demetri Kofinas: They don't want to get rid of it.

Gary Shilling: Pardon me?

Demetri Kofinas: They don't want to get rid of it at this point.

Gary Shilling: They don't want to get rid of it because it's costing so much to adapt to this [00:21:00] that unwinding it and redoing it would be a lot more expensive.

Demetri Kofinas: Sure.

Gary Shilling: And I think they'd be embarrassed to tell their customers "Well, we're going to go back something that may screw you." There are two principles. One is that some regulation does make sense. And secondly, once you get it you build a constituency. Not only all the people administering it, but some of the people who are administered. The point that you're making and this chart that we have in our December *Insight*publication, [00:21:30] it shows that regulation has just gone ... Well, as you said, a 45 degree angle. It's just gone straight up without any lapse. That's the thing, and it does distort things for free markets. Now, you can say it distorts things in good ways. Again, if you look back with brokers before 1929, boy that was open season. Anybody that wants stocks ... It was a land to be shared.

Demetri Kofinas: Epic period.

Gary Shilling: That [00:22:00] was buccaneer capitalism at its best.

Demetri Kofinas: Absolutely. You have another great chart, which is actually republished from data that was collected by Price Waterhouse Coopers and the Wall Street Journal. It shows CEO concerns. Tax cuts are being put at the very top and the line from the Republican congress is essentially, "This is not a tax cut. It's actually a jobs bill. Our corporations are overtaxed." They are overtaxed, but then there's also the [00:22:30] actual amount of taxes the corporations are paying, which is much lower than the 35%. But, you know, if we cut taxes corporations are going to start spending. In one of our recent episodes with Lacy Hunt, we talked about this, and you have a chart of this as well, which is the capacity utilization of the country, and that it isn't a situation where firms need to invest. They don't have the bandwidth to increase supply, and also there's the other argument that is put forward, which is that these corporations don't bring back the money to the United States because the taxes are so high.

But, while this is a [00:23:00] great chart, I think it speaks to something that we both agree on which is that, in fact, at the very top are regulations. Not taxes, it's regulations and below that is, in fact, cybersecurity, which is something else we cover on the program.

Gary Shilling: Yeah. Well, just reading off that chart. 56% of CEOs put overregulation as their major concern. That was the top. You get down to increased tax burden, it was 41%, you know, it's much lower. You get down to protection is at 27%. It was clearly [00:23:30] the biggest concern. This regulation has just gotten out of hand.

Demetri Kofinas: Also, I think there's a case to be made that if corporations would do with money right would be pay down debt and issue stock buybacks.

Gary Shilling: Collectively ... Of course, there was a very clear reason for ... Well, three quarters of the tax cuts go to corporations. One reason for that is that the tax system was just out of whack. In a globalized world, we've got the highest [00:24:00] tax rate, 35%. You go down to Ireland, 14 1/2% they're at the bottom. Also, our taxes are collected wherever the money is earned, globally. Other countries, it's done just within the country involved. In other words, if earnings are made in the UK, they're taxed in the UK and nowhere else regardless of where the company is located. That's why there's $2.6 trillion in money from Apple and Microsoft and so on that's technically stored [00:24:30] overseas, but 90% of that's invested in US securities.

So repatriation is going to be a big boost to the dollar. They can invest in Treasuries or stocks or bonds or anything else. They can't use it to pay wages, they can't use it for capital investments or to pay dividends, but they can buy any financial assets. Most of it is really ... It's just a bookkeeping entry that runs through a foreign subsidiary. Stays in a foreign subsidiary and is repatriated. Repatriation isn't going to make much difference. You pointed out this capacity [00:25:00] utilization. We're now well below ... We're I think 77%, you got to get to the low 80s before, historically, you've touched off a capital spending boom. In other words, if you've got surplus machines on the factory floor now that aren't working, why build more?

Demetri Kofinas: We're pretty much kind of where we were shortly after the 2008 crisis. We're kind of where we were in 2010 in terms of capacity utilization, I think.

Gary Shilling: Yeah, that's right. Actually, it's been on a downward trend for many years. [00:25:30] I just caution listeners; capacity utilization is a very tough thing to measure because it really depends on the price level of supply and demand. I've been in industrial clients where you go in and they go state-of-the-art machines there then they got something over in the corner that was built a hundred years ago almost. You say "Why do you keep that?" "Well, if demand gets strong enough, we're going to use it." Well, that is potential capacity if the price is high enough, but it's not capacity at current prices. [00:26:00] It's a spongy kind of measure, but as long as it is consistently measured through time, that's all you care about. Absolute is of very little importance in economic analysis. It's the changes. If over the years they are consistent through time, then you still have some viable data.

Demetri Kofinas: Where do you fall on productivity? There are a number of economists who are very bearish on productivity in the US economy. You differ in that regard a bit.

Gary Shilling: A couple of points. One is that productivity as measured [00:26:30] in this decade is running at about half a percent a year. That is output per hour of work. Now, one reason that that isn't the whole of productivity. Productivity is the output per unit of input, and the inputs are labor, they're capital, they're management skills, they're technology. The other things other than labor man hours expended are very hard to measure. So you use output per hour of work. That's one [00:27:00] problem.

A second problem is that productivity is very easy. If you're talking about a punch press stamping out widgets per hour, you can get there with a stopwatch and time how many come out, but when you're talking about the productivity of the cell phone you've got in your pocket or I got in my pocket, what is that? That's hard to measure. How much of that is used productively for getting you to appointments on time and useful information and how much is just entertainment? It's very hard to measure that.

Demetri Kofinas: It's a very, very hard thing to measure.

Gary Shilling: Then the third issue here is ... [00:27:30] And we got a chart in here that shows this. That the growth in productivity is just not linked to capital spending. The biggest correlation between capital spending is with productivity changes four quarters hence and the correlation is only 15%. There's very little correlation. Why is that? A lot of technology only shows up moving the productivity [00:28:00] needle years even decades later.

Demetri Kofinas: It takes time to mature.

Gary Shilling: In other words, if you look at a new technology, and like now, self-driving cars, they don't make a blip in the auto sales. But in time, if they grow big enough, they will have a big enough weight and they'll start to move the productivity needle. I think the same is true of biotechnology, robotics, a lot of other new technologies. Even computers, I don't think, have reached their full potential.

Demetri Kofinas: [00:28:30] Well, that I think, speaks to what we were discussing before with blockchain technology and particularly alternative forms of distributed ledger technologies, because what, in my view, the most recent powerful innovation in technology was the mobile device.

Gary Shilling: Oh, yeah, yeah.

Demetri Kofinas: But before that it was the internet. And the internet still has superseded mobile, in my view. Mobile is just a platform for delivering the internet and delivering services, but the internet itself was a protocol for communication. What DLT can do, if it can scale, if a solution [00:29:00] can scale securely, is do for data processing and computation and storage what TCP/IP and the internet suite of protocols did for communication, which would be a revolution unlike anything we've seen. It would solve major problems or begin to solve problems of security and a whole host of other things. That would be pretty remarkable and that's a great example of your point. That's very difficult to quantify and to measure and to sort of predict.

Gary Shilling: Yeah, it really is. Of course, you've got all kinds if unintended consequences. I mean, you look at retailing now on smartphones and [00:29:30] really the whole online sales, I mean, it's just knocking the socks off the brick and mortar stores. As people are ordering online and Amazon delivers it and UPS and other delivery services, FedEx deliver the stuff, but the bricks and mortar guys are stuck.

Demetri Kofinas: To go back to the point of the internet and productivity. I think it's also important to draw a distinction between what types of innovations you're going to see because there are certain innovations that are [00:30:00] great for consumption, but not so great for productions. I mean, the railroads were a revolution in terms of what we were able to do, in terms of what we were able to build. Concrete, steel, all these things. So I think, again, there is a distinction for me between the internet and certain other technologies and something like a distributed ledger technology, which would revolutionize and change so much of what we can do and drop costs and everything else, as opposed to, let's say, VR.

VR can be a really great technology, but it depends on what the use cases are and still it's difficult [00:30:30] to sort of quantify the value proposition there. You know, you could advance medicine for sure with virtual procedures and there's empathic learning and I think that could be very helpful, but I think it also depends very much.

Gary Shilling: Yeah, you look at all the social media. I mean, that does not contribute much to productivity. I mean, it's entertainment, it's consumption.

Demetri Kofinas: Oh, 100% agreed.

Gary Shilling: But, it doesn't do much ... As a matter of fact, you'll walk down the street and you got to be careful somebody doesn't bump into you because they got their head buried [00:31:00] in their cellphone.

Demetri Kofinas: It's an interesting point you make. I'd have a hard time ... I know that there are good things that have come out of social media. I'd have to really sit and think about it to tell you what those were, and that's not a good sign. Besides the fact that plenty of people waste time on social media at work, putting those obvious ones aside, there are a lot of other detrimental effects to it. I think earlier on, before the monetization engine really started to ramp up, it was more useful. There [00:31:30] was more value being created through the platforms, but now there's a dumbing down of the population, actually. There's a huge dumbing down effect that occurs through social media that is net negative. I think that's a very interesting point.

Gary Shilling: Also, the idea of rapid dissemination of news and also fake news. The label on our honey jar this year is "Real news: our honey is the best."

Demetri Kofinas: [00:32:00] Wasn't the last one Trumped or something like that?

Gary Shilling: Yeah, last one was "Nothing Trumps our honey."

Demetri Kofinas: That was before ... You didn't know that Trump was going to be President.

Gary Shilling: No. We had really had to take a chance on that. That was a gamble and we weren't outing on Trump, we were just trying to pick something topical.

Demetri Kofinas: [crosstalk 00:32:14] honey's the best.

Gary Shilling: You look at what this does, for example, just today some guy from Bangladesh had a pipe bomb that went off prematurely in the bus terminal.

Demetri Kofinas: Right by us.

Gary Shilling: Yeah, right. In New York City. I guess it went [00:32:30] off prematurely and this guy really botched the job, he injured himself and three other people. Now, I'm coming in, I'm based in New Jersey and I'm coming in. I immediately know that, I'm worried "Gee, do I have to leave early to get in, et cetera, et cetera, et cetera." It turned out the whole thing really was ... Obviously when people are injured that's not good, but it really was no big deal, but the instant dissemination of that, and that was a true fact.

Demetri Kofinas: Absolutely.

Gary Shilling: Then you talk about some of the stuff that's disseminated that is really fake news and [00:33:00] you sort of say there are some drawbacks to what's happening in social media and rapid dissemination of news.

Demetri Kofinas: Oh absolutely. We talk about that much on the show. Let me ask you in terms of specifics. What regulatory changes that the Trump administration is enacting do you think are net positive, and on top of that, positive for growth? And that you think will have a positive effect on equities in the next 12 months. An ongoing effect, I assume you think that they've had an effect already.

Gary Shilling: [00:33:30] I think some of the easing up on bank regulation is probably helpful. They've increased the size of the too big to fail banks, significantly. What's it called? Significant financial institutions. That not the exact name,-

Demetri Kofinas: Right, it's SIG.

Gary Shilling: But it was any bank with over 50 billion in assets-

Demetri Kofinas: SIGFI, I think.

Gary Shilling: ... was on this list and now they've increased that to 250 [00:34:00] billion from 50. Well, it meant that some banks that were just over that edge or close to it that wanted to merge, they didn't want to get into that too big to fail category, but now they can. That's a plus. In other words, you've really opened up the free markets on that.

Drugs. I think that's a very important thing. It costs $2.6 billion to bring a drug to market, $2.6 billion. [00:34:30] The FDA is now speeding up the process and forgoing some of the repetitive clinical trials. There's always a risk there.

Demetri Kofinas: Right, of course. But there are many people who I know personally, and I'm sure you do, many people who are sick who are frustrated, very specifically by the regulatory burden of the FDA.

Gary Shilling: These are all very deflationary things. That's a big benefit, but generic drugs ... This is just a matter of statistics. If a pharmaceutical comes [00:35:00] off patent and the generic drugs are possible, if there are eight to ten of those that are developed, the prices on average go down 80%. If there are one or two, the prices go down

40%. In other words, there's more competition. The faster the FDA speeds up the approval of these generics, the more competition you have, the lower the drug prices. So it's very beneficial. Again, it avoids [00:35:30] excessive regulation.

The people who are involved in regulation always will tell you that it is absolutely necessary. The Consumer Financial Protection Bureau is certainly a case in point where the diehard liberals, they believe that this is absolutely necessary, that people have to be protected from themselves, that they cannot make rational decisions. Maybe that's true of a lot of people, but by the same token-

Demetri Kofinas: It's definitely true of a lot of people.

Gary Shilling: You know, payday lending, [00:36:00] for example, with some of these annual rates that are hundreds of percent.

Demetri Kofinas: Right.

Gary Shilling: People who are desperate for money.

Demetri Kofinas: These ICOs are a perfect example. Lots of people are making crazy decisions. Investing and not understanding what they're investing in.

Gary Shilling: I think the difference between the Trump administration attitude, and I'm not a wild enthusiast about Trump, mind you, but you look at two situations. One is the net neutrality situation where they're now saying that the internet providers don't have to [00:36:30] treat everybody the same. That they can make deals up and downstream. They're opening that up, but at the same time they opposed the AT&T merger with Time Warner. We say, "What's going on here?" I think what they're really saying is "We're going to avoid antitrust, collusion, and so on." That's a vertical merger, well, that should [crosstalk 00:36:53].

Demetri Kofinas: Well, the Democrats claim that that's-

Gary Shilling: I think they are really saying that "We're going to enforce the antitrust rules, but we're not going to regulate [00:37:00] things day to day." I think the problem with people who believe in regulation, and Obama was certainly in that camp, and Hillary as well, is their attitude is if a regulation doesn't work, you got to have more regulation. They don't seem to ever sit back and say "Well, if it isn't working, maybe we ought to just go to something else."

Demetri Kofinas: Do you think there are certain places or certain ways in which regulation is helpful? For example, just to point out a few, I am concerned about the net neutrality, the roll back of [00:37:30] net neutrality by the FCC. In fact, I'm sort of among the mindset that we have a real issue, not just on the ISP level, but on the software side as well. In this increasingly technological world we're falling into, the control and power that exists in certain very small concentrated areas of the economy, and the information economy, is concerning. There's the other thing, I'm not an expert on the federal and private sector cooperative relationships that exist around the national parks and monuments, but that's also generally a concern [00:38:00] for me. The fact that we're opening up those areas.

Gary Shilling: A lot of that's in the eyes of the beholder.

Demetri Kofinas: Exactly, you're right.

Gary Shilling: Some people believe that those areas should only be available to backpackers.

Demetri Kofinas: Yeah, it depends on what-

Gary Shilling: And wild animals. Others say, "Wait a minute, there are minerals in there, you could raise cattle in there, hunting and fishing." You look at Utah where, you know, Trump went out there personally when they shrunk the size of these monuments and the whole congressional delegation of Utah and the governor, were in favor of [00:38:30] it. Well, okay, it's an economic thing to them.

Demetri Kofinas: Sure, sure, sure.

Gary Shilling: Saying "Hey, we want more development there, we want more hunters, we want more fisherman, more cattlemen, sheepherders." Of course, you can always say "What's the proper balance between, in this case, the economic and the desire to have and environment and open spaces?"

Demetri Kofinas: I think that the unfortunate reality is that a regulation, in theory, or an objective, when it's met with an actual practical regulation often leaves so much to be desired. Of [00:39:00] course, there's the law of unintended consequences. The Federal Reserve is a classic example of that, right?

I want to bring you back to something. You mentioned deflation over and over again, and, of course, that's implied in your long bond call. We've talked about deflation a great deal on this program and it's been something that we've been facing, really, this giant headwind since the financial crisis. In some ways it's almost become ... Preparing for this interview, again, I cover a lot of things on this program, not just economics and finance. We cover [00:39:30] everything. Every time I have an economics guest I want to find an interesting angle or an interesting perspective. What I think I've come to see is ... I think you've mentioned this as well. The story has become exhausting ... it's just the same story over and over again, right? Everyone's talking about the same thing, The Fed. The Fed's meeting this week, for example. Are they going to raise rates? What effect is that going to have on the economy? Are we going to see inflation? Is there going to be a pick-up in inflation? What's happening to gold prices?

It's the same sort of talking points over and over again. [00:40:00] I think that bringing it back to this point about bitcoin, I think part of the excitement around bitcoin is this is like one market where there's volatility. I think that's why Wall Street's-

Gary Shilling: It's been kind of dull out there.

Demetri Kofinas: Exactly. There's a party going on over here, let's issue some options.

Gary Shilling: I want some action.

Demetri Kofinas: I want some action, right, because there's this incredible lull. I think that also creates that general unease. We're all sort of walking around. We all know that this is not going to last forever. We've all been around long enough to know it's not, except for the guys that are going short-vol every day. You need people like that, though.

Gary Shilling: I'm convinced that an awful lot of the interest of individual investors in stocks is the gambling instinct. They want to go to a cocktail party and tell somebody how they got this ten-bagger.

Demetri Kofinas: They're rich.

Gary Shilling: Something went up 10 times. They never discuss the rest of their portfolio. That's why financial media really concentrates on individual stocks. Even though all the research shows that if you want to [00:41:00] see what governs the stock action about 50% is the general market, another 30% is the industry, and that's only 20% left for what the President had for breakfast, and what contracts they sign, and who went to jail, and all the stuff that they spend 90% of their time on. But I think it's because there is this tremendous gambling instinct and it's an outlet for that. It's the same thing you're suggesting with bitcoin.

Demetri Kofinas: You're saying that the primary drivers of equity prices is not the news cycle? That's what you're saying.

Gary Shilling: [00:41:30] No.

Demetri Kofinas: It's other factors. Well, the animal spirits is the number one thing you're-

Gary Shilling: You say "What governs the overall market?" But it's really saying "If you want to decide on a stock buy or a sell, you ought to spend most of your time on what's going on in the overall market." That relates to the economy, the Fed, et cetera.

Demetri Kofinas: That's why [crosstalk 00:41:51] ETF's have been so popular.

Gary Shilling: Another 30% on the industry and spend a minor, minor part of your time on the individual characteristics of the company. But, Wall Street analysts are paid

[00:42:00] to go ... First of all they're basically paid to be bullish. I know that, I was fired twice for my being very-

Demetri Kofinas: By Don Regan.

Gary Shilling: Don Regan at Merrill Lynch, you bet. So I understand that. The whole emphasis is on ... It's really completely reversed.

Demetri Kofinas: That reminds me of a ... You've probably read them, because you're like so many others. *The Reminiscences of a Stock Operator*.

Gary Shilling: Yeah, oh yeah.

Demetri Kofinas: There's that famous scene-

Gary Shilling: Jessie Livermore

Demetri Kofinas: Yeah, Livermore. Was Livingston his pen name?

Gary Shilling: No [00:42:30] I think Jessie ... I think that was his name Jessie.

Demetri Kofinas: One was a pen name one was the actually name. Livermore was his actually name and I think Livingston-

Gary Shilling: I think it was Livermore. Yeah it was Jessie Livermore was his actual name.

Demetri Kofinas: Right. But there was this one where he was on the floor and there was this old timer on the floor and he was walking around and he was like "It's a bull market, remember, it's a bull market." And he had shorted the stock or something, whatever it was and he ended up getting stopped out of his position, lost a lot of money. The lesson of that I don't ... Like I said I'm paraphrasing it, but the lesson was essentially that [00:43:00] it's much more important if you're in a bull market or a bear market to determine what position you should take on equities, than the individual equity itself.

Gary Shilling: The trend is your friend.

Demetri Kofinas: The trend is your friend, exactly. Those macro forces, essentially.

Gary Shilling: Yeah, but of course, that's what makes this business interesting because it's the turning points that are really important. We did some interesting work on that because years ago people said "Well, you got to be invested all the time, because if you're out the top 50 days [00:43:30] your return is going to back to Treasury bills." We did this research-

Demetri Kofinas: Which is not that bad.

Gary Shilling: We looked at this research and the entire post war period and we said "Okay, let's suppose that you're out those 50 days, the best 50 days but let's say you're also out the worst 50 days you're way ahead." Because stocks decline a lot faster than they advance. Also, what's interesting, is that you can be ... If you sense that there's a top in market. The stocks are overvalued, and that looks like the [00:44:00] case today, you can get out early and if you are short, and that's where I made my big money in '08 particularly, being short, if you are short on the way down, you'll make much more money even though you gave away the last 10, 20% at the last blow off at the top.

Demetri Kofinas: Because you went out in cash and you waited. How long did you wait before you went in taking short positions?

Gary Shilling: That's always tricky and the problem is that nobody rings a bell when you get to the top.

Demetri Kofinas: Right.

Gary Shilling: If you sense [00:44:30] what's going on, and you really in effect say "This is completely over blown." My strategy, and obviously there are a lot of different views, but my strategy is to take a small position. Enough that you're not going to get hurt if it goes against you.

Demetri Kofinas: Wet your beak.

Gary Shilling: But one that you don't then feel the urge to rush in if it starts going for you because there can be a lot of false starts. Either up or down and you don't want to be chasing things. You want to have a position so you can then build it at a leisurely and more rational pace [00:45:00] than being panicked in or out.

Demetri Kofinas: When did you start going short to market? Do you remember when it was, like when you started to sort of test the waters?

Gary Shilling: In '08?

Demetri Kofinas: Yeah.

Gary Shilling: That was very interesting because as you may know, I was very negative on housing. It's an interesting story because we were doing a lot of monthly *Insight*reports.

Demetri Kofinas: Does anyone ever confuse you with Robert Shiller?

Gary Shilling: Pardon me?

Demetri Kofinas: Has anyone ever confused you-

Gary Shilling: Oh, yeah, yeah. CNBC, they've done that a numerous time and I just say, "Bob Shiller's a good friend of mine, but I answer better to Dr. [00:45:30] Shilling." Anyway, this was-

Demetri Kofinas: They call you Dr. Shiller. I interrupted you, please go ahead.

Gary Shilling: This was back in, and I remember precisely, in July of '06, a guy I never heard of before, John Paulson, was sent one of our reports by one of our clients at Goldman Sachs. He called me in because he was setting up this credit opportunity fund, which was buying credit default swaps.

Demetri Kofinas: Yeah, he made billions on that trade.

Gary Shilling: He wanted to set up an advisory council and he wanted me to be the first member. I was very happy to do that. Then [00:46:00] by about August-

Demetri Kofinas: August of '08.

Gary Shilling: ... I realized what he was doing and I'd been looking for a way to take a big negative swing on subprime mortgages and he had a very disciplined approach. With these credit default swaps nobody believed housing could go down so they were selling very, very cheap. So, he figured you could lose 25% collectively. Of course, a credit default swap is basically a put-

Demetri Kofinas: It's an insurance contract on the mortgages.

Gary Shilling: Yeah, right.

Demetri Kofinas: On the CDOs.

Gary Shilling: So [00:46:30] at that time the bill rate was about 5%, so you're getting that on your money, you know [crosstalk 00:46:35] that. So if 25% and you figure that over three years, and the fact you're getting the 5% on that, it worked out that you could invest up to about 12 times leverage on these things. Well, we made 15 times on our money on that.

Demetri Kofinas: So you were invested in that deal [crosstalk 00:46:53] partially invested, wow.

Gary Shilling: As they say, I figured it out by August and I put what, for the Shillings, was a major piece of change in in September [00:47:00] and the first couple of months it didn't do anything. Then in early '07 New Century had a very bad ... Which was a very big mortgage company, had a bad quarter and the ABX triple-B minus, which is in effect an indicator for these credit false swaps, just went off the cliff.

Demetri Kofinas: Were you buying insurance only on the AAA tranche, or were you going ... I mean on the ... yeah, on the AAA tranche ... I mean not the AAA, I'm sorry on the mezzanine?

Gary Shilling: The triple-B or the junk, which is, of course, below the triple-B. What was interesting [00:47:30] about that is there were a number of other guys who were in this and got scared out and chased out by their limited partners when they were hedge funds because they were too early.

Demetri Kofinas: Right, right.

Gary Shilling: I mean, Paulson was not only right, but his timing was very good. As I say, it was an amazing situation because it was a matter of figuring out what was going on, but also being right on the timing.

Demetri Kofinas: Well, for anyone in our audience who's seen *The Big Short*, Michael Burry is [00:48:00] an example of what you're describing. That he was managing a certain amount of money and he was very early on that trade. I think he went in in 2006 and he was being bled dry.

Gary Shilling: Another guy who shows up in that, I've forgotten the name he used, is Greg Lippmann, he was the guy with the slicked back hair.

Demetri Kofinas: Right, right, right.

Gary Shilling: He's a friend of mine. Because Greg, interestingly enough in-

Demetri Kofinas: How was he portrayed in the movie?

Gary Shilling: I've forgotten who he was.

Demetri Kofinas: What's his name played him.

Gary Shilling: He had a real slicked back, you know, New York type.

Demetri Kofinas: What's his name played him?

Gary Shilling: Interesting, because in [00:48:30] January of '06 Greg Lippmann had called me up and he said, "I know you're negative on housing and I'll tell you how you can make a lot of money." So, he described this and I never heard of credit default swaps and I thought this guy was selling snake oil. I just took these notes and I threw them in a pile. Well, then after I was involved-

Demetri Kofinas: Was he at-

Gary Shilling: He was at Deutsche Bank.

Demetri Kofinas: Deutsche Bank, yeah, so he was played by what's his name in the movie *Blade Runner*. What's that guy's name? The guy that was in *The Notebook*. Let me ask my engineer here.

Gary Shilling: Anyway so, after [00:49:00] I got involved in Paulson this started to work. I was cleaning out this pile of papers and I saw these notes from Lippmann and I said "Good grief, this is exactly ..." so I called him up and we set up a nice consulting relationship. He was at Deutsche Bank then he got branched out and set up his own hedge fund. But what happened with him was that he was buying these credit default swaps at the same time other guys at Deutsche Bank were selling it.

Demetri Kofinas: Right, yeah.

Gary Shilling: They didn't know that they were on opposite sides of the same trade. Well, he ended up making about two [00:49:30] billion and saved Deutsche Bank's bacon, but what's interesting is that the authorities ... this is what he told me ... That Deutsche Bank came to him, and he was losing about $50 million a month and they said "Hey, Greg, this isn't what we had in mind." And they almost shut him down, but he talked them out of it, luckily.

Demetri Kofinas: That brings up another point, right? Which is that you stand to make a tremendous amount of money in a highly leveraged system, but at the same time, if the system breaks, everybody loses, right? I mean, the concern, the risk that you ran with that trade was that you wouldn't get [00:50:00] paid out, right? AIG collapsed. If it wasn't for the government that stepped in.

Gary Shilling: It depends what you're in. We had, in '08, and we managed money and our lowest performing account, which was literally a retired widow, IRA, made 26%, and that was basically in long Treasuries. If Treasuries go to hell, you might as well get your dried food and rifle and bottled water.

Demetri Kofinas: It is possible though. Do you think ... Obviously, [00:50:30] I know you're bullish on Treasuries, but do you imagine scenarios in which that would occur and what that would require?

Gary Shilling: It would require complete collapse in confidence in the US government and the Treasury and I don't know what would be left in the world, literally, except dry food-

Demetri Kofinas: What about some kind of Constitutional crisis or, I mean ... You can envision situations where the political apparatus of the country goes into crisis. [00:51:00] I mean, those are ... I'm just saying theoretically.

Gary Shilling: We had that with Nixon.

Demetri Kofinas: With Nixon, right. What happened to the bond market during Watergate?

Gary Shilling: Not much as I recall. I know I don't remember precisely, but I don't think it was a ... If it had been big I think I would have remembered it.

Demetri Kofinas: Although it was a bipolar world. I would imagine that it would-

Gary Shilling: Nixon disbanded the link to gold, and he had to because the gold was ...

Demetri Kofinas: [crosstalk 00:51:23]

Gary Shilling: You know, we were linked to gold and everybody else was linked to the dollar and they could, in effect, through the dollar could buy gold and they were just cleaning out the gold [00:51:30] because inflation was raging. At that point Treasury yields were jumping up with inflation. Now we've got a chart in this newsletter that simply shows a very high correlation between inflation and Treasury yields. So, if you're right on inflation, you're going to be right in Treasuries. History tells you. That was really an inflation, that was Watergate. That was the involvement in Vietnam and the Great Society, which just put way too much demand on the economy with federal spending.

Demetri Kofinas: Do you question [00:52:00] our measure of inflation? What do I mean here? I'm not talking about the everyday measure of inflation, that somehow the CPI doesn't accurately capture that. What I mean is that so much of the inflation that we would normally see in everyday goods, because we used to have a strong middle-class economy, and a large percentage of the population is participating in the economy now with the lopsided wealth and income distribution, so much of the inflation shows up as asset price inflation. Do you think about that at [00:52:30] all?

Gary Shilling: Let's put it this way. You can probably remember what you paid for gasoline the last time you filled up your tank, right?

Demetri Kofinas: Probably not because I don't drive much anymore.

Gary Shilling: Within a couple of pennies.

Demetri Kofinas: Yeah, sure.

Gary Shilling: Do you remember what you paid for the last refrigerator you bought?

Demetri Kofinas: No.

Gary Shilling: No. They're actually cheaper than they were 10 years ago and that's without the quality improvements. A lot of the things that you buy-

Demetri Kofinas: But not real estate. Not real estate, not-

Gary Shilling: Housing declined, if you use the Case-Shiller tent city index, it [00:53:00] declined 34%. It's now back, but it's still down about 10% from its peak. That's national house prices.

Demetri Kofinas: So why does life feel so much more expensive?

Gary Shilling: The housing prices, per se, are not in the-

Demetri Kofinas: We also live in New York. There is a point to be made that my anecdotal experience is built in here, but I do experience a rise in cost of living, at least for the types of things we're describing here. The stock market has tripled, not that that's a cost of living, but this is inflation. The question is, is [00:53:30] that justified by the fundamentals? Is the asset price inflation we've seen-

Gary Shilling: Hey, if there's more money around, why shouldn't the guy selling goods and services to you and other New Yorkers get higher prices, you know? It's a-

Demetri Kofinas: No, I don't mean it in terms of, is it right or wrong? I mean it ... We covered this in a way. I'm touching on something, this is important for our audience to remember as well. We had Sebastian Mallaby on the program, we covered the entire Greenspan ... Not just the Greenspan administration, but really Greenspan's whole life [00:54:00] because he wrote a biography on Greenspan. There was a speech that he gave to the American Statistical Association in 1959 where he talked about asset bubbles and the wealth effect and financial stability. What the Fed used to refer to as financial stability is asset price inflation. It's just something that ... We talk about inflation a lot, but I wonder how accurately we're capturing it considering the high level of asset price inflation we've seen.

Gary Shilling: Yeah, assets have inflated, no question about it. Real estate earlier and stocks more [00:54:30] recently. Bear in mind though, that most people think whenever they get a lower price it's because they're great bargainers, they're wonderful shoppers. When a price is higher, it's the devil personified at work. That is just human nature. Very few people will admit, or acknowledge, that they get lower prices, and particularly when you adjust for quality improvement. I mean, you look at a cellphone today. This whole studio we're in right now, you couldn't have put enough electronic gear to do what the cellphone in your pocket does [00:55:00] 20 years ago.

Demetri Kofinas: Especially this studio. I'm going to tell you something. You're not going to find many soundboards like this in this city.

Gary Shilling: There's a lot of features in that board.

Demetri Kofinas: There's a lot of ... It's very analog. It looks like the flight deck on the-

Gary Shilling: It did have kind of a museum quality look to it. As I say, inflation is just routinely over estimated. It is a measurement problem, but I think it also is a perception problem.

Demetri Kofinas: So let me ask you this on a practical level. We didn't get to all the tax stuff that I wanted to get into [00:55:30] and all the regulatory stuff, but it's fine. I'm more interested now, before I let you go, to ask you, what are you projecting for the next 12 months? Let's say if someone want to go long Treasuries, for example. How would advise someone to do that? What's the easiest or best way? Obviously, ETF's are a very easy way to do it.

Gary Shilling: Well, you can buy Treasuries outright. There are weekly auctions for Treasury bills. There's periodic auctions for notes, which are anything issued under 10 [00:56:00] years, and bonds, where they're initially over 10 year maturity in terms of issue. You can buy them through mutual funds, exchange traded funds. We use exchange traded funds in portfolios that we manage, where we're not using cash bonds. We use both. If you want more bang for buck, you get zero coupon, which give you a lot more movement. Unfortunately, of course, it works both ways, if rates go up you lose more money, but they're readily available. It's the most liquid market in the world. It's trades hundreds of billions of dollars a day. I doubt there's any of our listeners here who could [00:56:30] have the slightest effect on the market by the amount they buy or sell. It's just that huge.

Demetri Kofinas: Considering some of the regulatory cuts we discussed and the tax cuts, do you expect this rise in equities and the trends that we're seeing in the market to continue for the next one or two years?

Gary Shilling: Stocks are overvalued by a lot of measures. I mean, you mentioned Bob Shiller and his 10 year of cyclically adjusting price/PE ratio. Stocks would have to decline about 40% to bring you back to the long-term trend [00:57:00] of, I think, 16.5, something like that. Having said that, you look at how do bull markets end? One of two ways. One is the Fed jacks up rates to the point that they kill the economy and by my reckoning in 11 of 12 times the Fed has tried to cool off the economy with higher rates, they have resulted in a recession.

Demetri Kofinas: And we're in a recession.

Gary Shilling: From the time they started jacking up the Fed funds rate, and there's a chart in this *Insight*, it can be years before that happened, but that's eventually. The other thing [00:57:30] that happens is a shock like the dot com blow off at the end of the nineties, or the subprime mortgage collapse in the mid 2000's. So you say "Well, what's going to occur first? Something's going to happen. Is the Fed going to jack up things and kill the goose? Or is it going to be some shock?" Bitcoins, you know, that's not big enough, probably, to do the job, but if that takes off for a year or two, maybe that would do it. Or you can conjure up anything.

Demetri Kofinas: Geopolitical.

Gary Shilling: North Korea or a blow up in the Middle East. There's nothing-

Demetri Kofinas: Saudi Arabia, what do [00:58:00] you think of that? That's an interesting one, right? That feeds into energy. I think that's an under-talked-about story.

Gary Shilling: Yeah, it is. It really is. Mohammed Bin Salman, the now designated next king, is really trying to reshape the country and whether he's going to pull that off or not-

Demetri Kofinas: You can see [crosstalk 00:58:15] now [crosstalk 00:58:15].

Gary Shilling: ... without a revolt, I don't know. He's buying Rembrandt, he's buying da Vinci paintings. You know, a shock is possible, but I've made a career of ... The last book I published is called *The Age of [00:58:30] Deleveraging: Investment Strategies for a Decade of Slow Growth and Deflation*, and I listed in there, I think eight, what I called great calls, and they all were shocks that I had predicted, luckily, and seen these bubbles developed. I don't see anything right on the immediate horizon that really equals the dot com nonsense of the late 90s or the subprime exuberance in the mid 2000s.

Demetri Kofinas: That is true. There is nothing like that right now.

Gary Shilling: No, there's nothing like that. Now, this bitcoin, if it ran a couple of more years and really sucked [00:59:00] in enough people.

Demetri Kofinas: Too small of a market, yeah.

Gary Shilling: It's possible, but it's still pretty young. It's still a fad it hasn't become a national sport quite yet.

Demetri Kofinas: Right, well, you're talking about a market event, but there could be a recession, which could drive it.

Gary Shilling: Yeah. Oh sure, but as I say, historically those recessions are Fed caused and or a shock. It was probably the collapse of the subprimes starting in '07 really [00:59:30] the end of '07, it caused that '08, '09 recession. The Fed was tightening a little bit, but it was only a minor part. It was the collapse of the housing.

Demetri Kofinas: I'm going to, so you know Dr. Shilling, we put up book lists and everything on the website, but also for our audience, I'm going to remind you and you can find it on the website. If you go to agaryshilling.com you can find Dr. Shilling's newsletters, I assume these are a subscription service.

Gary Shilling: Yeah, it is.

Demetri Kofinas: And well worth it. Like I said, these stand out, I've read many newsletters, these [01:00:00] stand out for the amount of data that you have in them. I want to ask you one more thing. One thing I was thinking of before we did this interview, before I came in here. I was thinking about energy and I was thinking about oil. I was thinking about all the books that came out in the mid-2000s, *Twilight in the Desert, Out of Gas, The End of Oil*, all this stuff, right? I think one of the most unlikely scenarios that anyone could have conjured at that time, in 2006, 2007, 2008, with 140 Brent, would be that we would be where [01:00:30] we are today with energy. I think, carrying on to that point, one of the most under reported stories out there is Saudi Arabia. You want to talk about not being able to price risk, how about the price of the political instability in the kingdom. The potential for an Arab Spring or something worse, really, to manifest in a country that has that level of control over its population and is that dependent on patronage through its oil revenues?

Gary Shilling: Yeah, it is. Obviously, it's a major oil producer. [01:01:00] It's the second largest exporter behind the Soviets or Russia now. Yeah, it could be a-

Demetri Kofinas: You were short oil for a while. You're no longer short, right?

Gary Shilling: No, I'm not because right now the current thinking is that most of the fracking ... good fracking sites are close to a peak, that's the Hubbard's Peak of yesteryear.

Demetri Kofinas: It's the second Hubbard's Peak. It's the camel.

Gary Shilling: And that OPEC in there and their allies are going to be able to cut back enough to reduce excess inventories. I'm not [01:01:30] convinced of that long run, but at the moment I just don't want to stand in the way of that freight train. We made very good money in oil short earlier,-

Demetri Kofinas: Sounds like you made quite a bit.

Gary Shilling: ... but right now I'm not long, I'm just on the sidelines.

Demetri Kofinas: Do you think Russia would join forces with OPEC in any way to try to help ... For geopolitical reasons, do you see that happening?

Gary Shilling: Putin really wants to reestablish the Russian empire so he is operating in Russia's behalf. Right now, he thinks it's an advantage to join with OPEC, but, you know, you talk about this. Back in [01:02:00] 1978, which was sort of between the first and second oil crisis, I wrote up a report and it really said that human ingenuity beats shortages any day. I used a couple of interesting examples. One was whale oil, you know, that was used for lighting and they thought they were going-

Demetri Kofinas: It was really popular with the whales.

Gary Shilling: Whales. What happened? Colonel Drake drilled a well in Pennsylvania, it was kerosene that they wanted and the remaining whales were saved. And

New Bedford, [01:02:30] Massachusetts is now just a whaling museum. There's no whale ships anymore. Another one was the industrial revolution. I took my family down to Jamestown, Williamsburg, Jamestown, Virginia. The original colonists were trying to figure out how they could make money because they were importing most of their goods from England. Well, glass blowing was one of the things they did and they were exporting glass to England. Now you think about making glass things and putting them in ships and what was the odds of them arriving unbroken? But the reality [01:03:00] was, at that time, the industrial revolution was underway. They were denuding the English countryside of hardwood timber to make charcoal to smelt iron.

Demetri Kofinas: Yeah, absolutely.

Gary Shilling: They ran out of hardwood and so it was economical, plenty of wood in Virginia to make the glass there. Then what happened? Some iron monger in Shropshire, wherever Shropshire is in England, figured out you could make coke out of coal. That saved the remaining hardwoods.

Demetri Kofinas: That's a remarkable story. You're a big fan of history, I know that already, but when it comes-

Gary Shilling: Human ingenuity beats shortages [01:03:30] any day. It always has anyway.

Demetri Kofinas: Well, it works both ways. We're pretty ingenious for all sorts of things. Not all good.

Gary Shilling: Sure, good and bad.

Demetri Kofinas: Dr. Shilling, thank you so much for coming onto *Hidden Forces*. I really enjoyed having you on the program.

Gary Shilling: It's been a great interview and I appreciate it.

Demetri Kofinas: I was sorry to hear about Rich. I did not know about that.

Gary Shilling: Yeah, it was a real shock. He was a friend of a lot of people, but just very sudden. And as I say, I had just talked to the guy a few days before he [01:04:00] had this ... I think it was a heart attack, but went into a coma and died.

Demetri Kofinas: Well, we're all passing through, and on that note, Dr. Shilling, I wish you safe travels wherever you're going next and I hope to do this again with you sometime in the future.

Gary Shilling: Same to you.

Demetri Kofinas: All right. Thank you.

And that was my episode with Gary Shilling. I want to thank Dr. Shilling for being on my program. Today's episode was produced by me and edited by Stylianos Nicolaou. [01:04:30] For more episodes you can check out our website at hiddenforces.io. Join the conversation through Facebook, Twitter, and Instagram @hiddenforcespod or send me an email. Thanks for listening. We'll see you next week.