Casey Mullooly: Welcome back to the Mullooly Asset podcast. This is episode 396. I'm your host, Casey Mullooly, joined by Tom this week.

Tom: Hey, there.

Casey Mullooly: I think this is three or four in a row for you.

Tom: Yeah.

Casey Mullooly: Getting back into the swing of things.

Tom: I like it.

Casey Mullooly: We like having you.

Tom: So the whole idea with the podcast is we want to talk about what's happening right now or topics that are in the news right now. So we do have an educational focus, an educational bias towards a lot of our material, but we do want to use the podcast as opportunity to talk about things that we're talking about with clients. People are calling in. They're asking like," What are we doing with our investments? What's happening with the market, with the economy, what interest rates?" We want to talk about these things and so we record this as a way for you to be a fly on the wall when we're talking to other clients.

Casey Mullooly: I think that sums it up well. So let's get right into it.

Tom: I'm talking about educated people who in many cases trade bonds for a living, don't even understand what's happening at the cash flow and balance sheet level for the Fed, which amazes me that some people just get glued to a screen and they see prices of their inventory tick up, tick down, tick up, tick down, tick up, tick down and they're not paying attention to the bigger picture.

Tom: The bigger picture is, again, not trying to get into politics, but the Biden administration took a victory lap saying that their budget deficit was down at the beginning of the year. Yes, it was down because we didn't do a $2 trillion bailout like we did a year ago that caused a lot of inflation. So now we're running into a situation where the tax receipts at the Treasury are so high. They totally whiffed on how much they would collect in terms of tax receipts.

Tom: And the first thing that people say is, "Oh, that's because everyone paid capital gains last year because the stock market did so well." No, this is actually from wages. These are more people going back to work and more people making more money and paying more income taxes, not capital gains. These are wages, these are income taxes. They missed by a factor of two. It was double. Double. How do you miss like that?

Tom: But anyway, so the money that's on hand at the Treasury is way more than they planned. And so as the Fed has T-Bills, treasury notes, treasury bonds that are coming due, they're getting the cash for these things that are maturing and they are turning the money over to Treasury. And the Treasury is actually destroying the cash.

Casey Mullooly: The opposite of printing cash.

Tom: Oh yeah. So this whole quantitative tightening thing, CNBC just loves to freak people out about how this is going to be the end of the world. And I don't know, seems to me like the Feds got this and the Treasury pretty much have this under control.

Casey Mullooly: Yeah. Maybe it's too technical for Powell and Yellen to get into seemingly positive aspects like the tax revenue being way higher than they thought it would. Maybe that's too technical. Their job is to also communicate with us and the public at large. So maybe not trying to dig into the weeds too much in those types of areas, I think a lot of people are searching for good news right now, especially economic good news. So you would-

Tom: I'm going to say hell yes. This is great news. It really is because these, sorry, bimbos on CNBC, they get on there and they basically tell the same story that we're all going to turn into a pumpkin at midnight because the Fed has to unwind trillions of dollars. They're just going to flood the bond market with all of these bonds that they've got to sell. They can achieve most of their objectives by just letting things run off.

Casey Mullooly: I just want to clarify that, the higher than expected amount in income tax revenue and the Fed stopping, or slowing down their bond purchasing program. The increase in tax revenue is what's allowing them to do that. Or how are those two things connected?

Tom: The original plan was we were doing quantitative easing to help in this emergency pandemic operations and then we get to a point where the economy can stand on its own. And so we have to undo what we did two years ago. So now they're saying, "All right, now instead of quantitative easing, now we're going to do quantitative tightening." Most people simply interpret that as, "Oh, they bought all these bills, notes and bonds over the last two years. Now they're going to sell bills, notes and bonds. Holy crap, I don't want to be a bond holder because-"

Casey Mullooly: Market's getting flooded.

Tom: ... Yeah. The market is going to get flooded by the biggest bond holder out there.

Casey Mullooly: Talk about forced selling.

Tom: Exactly. And so that's part of the reason why we have seen this historic sell off in the bond market in the first six months of this year. I'm here to tell people that this may be a great opportunity. And again, I don't want to get into investment recommendations because it's not always going to be suitable for whoever's listening to this. This is not investment advice, but I think that the majority of news readers out there on these financial networks are going to be wrong. That shouldn't come as a surprise to people.

Tom: So we've all seen the news about how unemployment is at historic low records. And these tax receipts are now coming in way, way higher than expected. If this were money that came in from capital gains, it would be a one time burst that we got when people paid their taxes in the first quarter of the year. It's all due by April 15th, unless you get an extension, but this is money that's coming from wages. So people get paid every two weeks or twice a month. This isn't going anywhere.

Casey Mullooly: Yeah. Do you think that's just because the jobs recovery was much faster than anticipated?

Tom: I don't even know if it was much faster than anticipated. They're not actually all brand new jobs that are being created. These are old jobs that are getting filled again. And so politicians-

Casey Mullooly: Yes and no.

Tom: ... Yeah. They like to spin their stories.

Casey Mullooly: Of course. Do you think that the tax receipts have anything to do with inflation? So the cycle goes, there's inflation in the economy and consumers or workers respond by demanding higher wages, companies raise the wages. People have more money to spend, and then that's how things cycle out of control. So I know wage growth is a key component of inflation and it's something that the Fed has been trying to cool off. So am I-

Tom: You're on the right track.

Casey Mullooly: ... Yeah.

Tom: I'll put it in terms that everybody can understand. Higher wages, higher payroll taxes.

Casey Mullooly: More money for the federal government.

Tom: More money comes in and more opportunities for people to start spending money. So two other points that I'm just going to tack on to what you just said. When it comes to midterm elections, I'm a subscriber to Stock Trader's Almanac, and they came up with the presidential cycle, the four year cycle. The worst year of the four is the year that we go into the midterms. And the worst month in that year is June, historically. And we're recording this June 9th, 2022. I don't know if we already saw the worst month in March or maybe it was May, or maybe it'll be August. But historically the year of the midterm elections is the hardest one. I don't know if that is going to come true. We'll see.

Casey Mullooly: I know it's one of those markets cliches, but markets hate uncertainty.

Tom: They do. The other thing that I wanted to point out about this, is that not only is the federal government seeing their tax receipts go up, but state governments are also seeing their tax receipts go up. And there's a lot of people out there. We see them every morning getting interviewed on Bloomberg

TV. And they just love to say that the economy is going into a recession. In fact, we might be in a recession right now according to some of these experts, I'm using air quotes.

Casey Mullooly: Like Cardi B?

Tom: Yes. Cardi B with her tweet last week saying, "When is someone going to finally admit that we're in a recession?" But the point is in all 50 states, all 50 states, the economy is expanding not contracting. When we start to tip over into a recession, we'll see it because all of a sudden we'll see a report that says 45 states are still expanding. 41 states are still expanding. 32 states are still expanding and fewer and fewer states expand and more are starting to contract. That's a very clear signal that things are slowing down. Right now 50 states, all 50 states, economy is expanding.

Casey Mullooly: Yeah. It just goes to further the narrative that there's two stories happening economically right now. There's good data and then there's bad data. The good data like we talked about was unemployment at 3.6%, one of the fastest if not the fastest jobs, recovery in history, whether or not that was an actual recovery or just jobs that we lost during the pandemic coming back. In that same vein, we're seeing spending shift from more goods to services based.

Casey Mullooly: The idea there is that it might alleviate some of the supply chain issues that we're seeing as these stores like Target and Walmart are reporting record inventories. People aren't buying goods. They're not buying dishwashers, TVs, all of these kind of big ticket items as much. They're going to take trips, stay in hotels, go eat out more, which is a positive for the economy.

Tom: Yeah. It's easy to point at things like Target having record inventories and Walmart having inventory issues and say, "See, this is why we're going to tip over into a recession." No, people aren't sitting at home for two years buying stuff on Amazon.com, or just ordering stuff. They couldn't go on trips. Try and get an airline ticket right now.

Casey Mullooly: Yeah. It's wild.

Tom: It's impossible.

Casey Mullooly: Yeah.

Tom: Prices of airline tickets are going sky high. You can't a rent a car, but we're seeing on the flip side, prices of used cars coming way down.

Casey Mullooly: Yeah. Prices of used cars are down 15% over the last two months.

Tom: Yeah.

Casey Mullooly: And along those same lines, I know we've talked about the housing market over the last couple of weeks here as that is a barometer for the economy at large. Prices are still high, but mortgage applications are down 21% from this same time last year.

Tom: Yeah. And down 40% from just 60 days ago. Housing market is slowing down.

Casey Mullooly: I know we got the Case-Shiller, which was up like 20%, but I saw something that clicked. The number was for the first quarter of 2022, which means that the data that was collected for those numbers, those houses probably went under contract in November, December in '21.

Tom: That's right.

Casey Mullooly: That is like a backwards looking thing.

Tom: Yes. And remember also that we're looking at first quarter Case-Shiller numbers, and these are reporting sales from the end of '21. And now, today's June 9th. The second quarter ends in three weeks.

Casey Mullooly: Right.

Tom: There's a lot happening under the surface.

Casey Mullooly: That's also what I wanted to talk about whether or not we're actually in a recession or heading into a recession. It's this idea that, I don't want to say it doesn't matter whether we're "in a recession or not," but it's like, I know there have been some recent examples where when we enter a recession officially, and then just a couple of months later, it's over. By the time we're technically in a recession, the worst of it is usually past.

Tom: That's right. Historically, how long is the average recession?

Casey Mullooly: I know this because you told me before we turned the mic on. It's 11 months.

Tom: Right. You need two quarters of economic data to know definitively that you're in a recession. You have to have two quarters of negative GDP growth.

Casey Mullooly: Which is six months.

Tom: Right. And so by the time that is released, it's probably seven months since the recession began. And the average recession is 11 months, so that party's over, man.

Casey Mullooly: Yeah. I know we've been talking about a lot. It speaks to our approach when it comes to dealing with everyday investors and making financial plans and building investment plans for folks. And if you're trying to sidestep recessions, you're probably going to end up ripping your hair out. Because like you said, by the time we're already in one, we're out the other side already.

Tom: And we've had some recessions that have been literally six months and it's over. The average length of a recession is 11 months. We've had some that have been very long, but we've had some that have been super short.

Casey Mullooly: Yeah. I think 2008, 2009, I knew what was going on, but I didn't know the ins and outs of it like you did. But I feel like a lot of people are... It still happens, just over a decade ago. The 2020 recession was weird because it was like a month or three months I think. It was officially declared a recession in June and we were already out of it by then.

Tom: We were.

Casey Mullooly: That one-

Tom: That shouldn't even count.

Casey Mullooly: ... It doesn't really count. Plus it was, with COVID and everything, there was a lot of other stuff going on, but the 2008, 2009, man... We see it with the Great Depression, I think with a lot of the older folks where that stuff just gets ingrained in you.

Tom: It sure does.

Casey Mullooly: And then that's your reference point for the rest of your life, basically. But not every recession is the Great Recession. There are just normal recessions as well.

Tom: People like to fight the last war. Every recession is going to be a little different. What happened in 2007 and 8 was, it was bad and it really could have been a lot worse. Because that was not just a real estate recession where home prices collapsed and the bond market collapsed. These were banks that were on the edge. We're talking about Goldman Sachs and Morgan Stanley applied to the, I forget if it was the Treasury or the Fed, but they asked for permission to re-register as banks instead of broker dealers. Are you kidding me?

Tom: They wanted to change their charter so they could not comply with the capital requirements because they knew that most of the or many of the bonds that they held at the present time were not worth the values that were stated on the statements. It was really, really messy for a period of time.

Casey Mullooly: Before we turned the mic on, we were talking about what happened in Europe.

Tom: Same kind of thing.

Casey Mullooly: It was kind of, I don't want to say repercussion of the great financial crisis, but it was along the same lines where I think what was going on was these countries in Europe were basically holding a lot of private debt which was throwing off the value of their currencies and the value of the Euro and the central bank chairman at the time. Is that the correct?

Tom: Mario Draghi.

Casey Mullooly: Draghi came in and said, "We're going to do whatever it takes." And the market really responded to that. And I thought it was interesting, the timing of Draghi saying this, which was July of 2012 when they started their bond purchasing program. And then I actually went and read a Wall Street Journal article from back from this time. So we'll link that up. But the article said the ECBs commitment to intervention didn't spark an immediate recovery for the eurozone, which remained in recession until the middle of 2013.

Casey Mullooly: The ECB was back in the news this week because they came out and said that they're finally going to raise interest rates for the first time in a decade. Plus, and they're going to be raising interest rates to zero. So they're seeing a lot of the same problems that we are over here with inflation hitting multi decade highs. I just wanted to highlight the timing of that and how it took almost a year for these things for the central bank's policies to make an impact.

Casey Mullooly: Because we're seeing the Fed raising rates and starting the quantitative tightening program and all of these little data points that are saying, "Oh, inflation's going to start to cool off, inflation is going to cool off." But we're getting the CPI print tomorrow and it's expected to be elevated, Janet Yellen's words, not mine.

Tom: I don't even know what that means.

Casey Mullooly: It's only been almost three months since the Fed raised rates for the first time. It looks like they're going to continue to do that in this month in June and in July as well. But it's going to take some time for these levers that they're pulling to trickle through the economy and actually start to cool off the headline numbers.

Tom: You're right in the sense that, and Powell has been saying this since he was a fed governor, not even chairman, how it will take usually somewhere between six and 12 months with nine being the average, nine months for any effect of interest rate hikes to be felt through the economy. But yet we saw mortgage rates spike up immediately. We saw home equity rates spike up immediately. We didn't see yields on CDs spike up but...

Casey Mullooly: There's a lag there and I know everyone... No one likes inflation. I don't think the economy is in bad shape but everyone thinks the economy is in bad shape according to all the surveys and sentiment polls that we're seeing out there. So no one likes it when there's these economic issues going on. And I think it's important to be patient and know that there's a lag time and these things will work themselves out.

Tom: In closing, I think we want to talk about when we do have a recession, we're talking about the economy contracting. So we've had many recessions over the course of my career where we've seen a negative print on GDP, that's gross domestic product. But it may be a negative print of 0.7 or 1%. We're not talking about an economy like the, I think it was the second quarter of 2020 when everybody had to stay home because of COVID, where we had a negative GDP print of negative 35%.

Casey Mullooly: Yeah. It was just crazy.

Tom: I mean just that we will never see that again in our lifetime, but that was one quarter of a print.

Casey Mullooly: Yes. That's me knocking on wood.

Tom: I really doubt that. We'll see something like that. But when we have normal situations and the economy is contracting 1%, we're not talking about people are going to be selling apples on the street corner. It's yeah, some people are going to lose jobs. That's part of a recession, but it's also rightsizing different industries so that we can move forward as a whole.

Casey Mullooly: Which I think is a normal part of the business cycle.

Tom: Yes, same thing with our business. We see things ebb and flow. That's the way it is.

Casey Mullooly: That's how it goes. So I think that's going to wrap it up for episode 396 with the Mullooly Asset podcast. We just wanted to walk through some of the broader headlines and economic data points that we've been seeing because we want you guys to hear it from us. So thank you as always for listening and we'll be back with you next week.