

Bond King Talks Inflation, Fed, Crypto, Taxes, and More

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Introduction

Jeffrey Gundlach, who was dubbed the “King of Bonds” in a February 2011 Barron’s cover story, is an American investor and founder of \$85 billion asset manager DoubleLine. This week, we are presenting an interview between Yahoo Finance’s Julia LaRoche and Jeffrey Gundlach where the two discuss many of today’s hot topics, including:

- Inflation
- The economy
- The Federal Reserve
- Cryptocurrencies
- Stimulus checks
- Taxing the wealthy
- Why more businesses and people are leaving California.

The conversation can be viewed in its entirety below and has also been transcribed for those who would prefer to read the interview.

[Watch on YouTube](#)

Transcript

What is your overall view of where we are in the markets? What do you make of what’s transpired over the last year plus?

Well, we’ve had a relationship between the Fed growing its balance sheet and the value of the S&P 500 that’s been in place for years now ever since they started quantitative easing and it’s almost like a law of physics. It’s like if you take the capitalization of the S&P 500 and you divide it by the Fed’s balance sheet, it looks a lot like a constant and so once the Fed started quantitative easing, that reversed the stock market’s collapse from the pandemic, and they slowed it down a little bit because they were

doing it at such a breakneck speed. They continue to do it and so the stock market continues to be supported by that. Also, the valuation of the stock market – even though it’s really high by historical comparisons – also has very low bond yields relative to inflation. Particularly, this week, the CPI came out at 4.2% year-over-year and then the PPI is up to 6.2% or something like that and bond yields on the 10-year Treasury is at 1.65%.

When you look at the classic relationships, like P/E ratios, they look elevated. Dr. Schiller’s cyclically adjusted CAPE ratio was kind of matching those all-time highs. Yet, weirdly, if you look at “Earnings” divided by “Price”, it is below average in terms of its valuation versus bonds. The Fed has been manipulating markets for a long time and on top of that, obviously, we’ve had incredible amounts of free money and fiscal stimulus. Last month, there was another round of checks, and I don’t think a lot of people are aware that about 1/3 of last month’s personal disposable income was given by the government. Also, the government is running a deficit that is about 30% of GDP in terms of their spending and they are only paying for a little less than half of it. So, there’s a lot of distortions that are going on but with the money that’s flowing it’s helped to distort many economic series and also the value of most asset classes.

If we move beyond markets, you’re talking about distortions. Where are you seeing those distortions taking place in the economy?

Well, the housing market is a good place to start. Home prices are up very strongly over the past 12 months. I think the median home price in America is up 17% year-over-year. There are some markets that have been particularly attractive for people that may be rethinking their life in view of the pandemic that are up 30% to 40%. So, there’s a massive distortion there. We also have this strange thing of 8 million job openings and everywhere you go, businesspeople are saying “I can’t fill them, no one will take them.” It was obvious when they started these money giveaways that there was going to be an issue because right away everyone noticed that a certain fraction of people are making more money sitting at home watching Netflix than they are at work and they don’t want to go back. I think one of the dangers that we’ve opened the door to is that these stimulus checks are starting to feel like they might not go away. It seems like there’s always going to be another round of them.

In fact, this week, Gavin Newsom, the Governor of California, announced \$600 to people that are

making less than something like \$75,000 because California has gone into a large surplus of their budget thanks to Federal government money. Now, in New York and California, a lot of people are getting \$57,000 per year tax-free by not working. So, there's a lot of distortions there. We've seen big distortions partly due to government programs but partly to the pandemic. We've seen a lot of distortions with automobiles not being available. I actually bought a truck a couple of weeks ago and the lot at the large car dealership had no new trucks. There weren't any. Now that's partly due to the chip shortage, but all he had on his entire lot were two used trucks. The truck I bought was used and had 8,000 miles on it, but the price was only \$2,000 less than the sticker price of a new truck. The fellow who sold it to me claimed, and I think I believe him, that he was doing me a favor because he probably could have sold that truck for more thanks to shortages.

When we look at economic statistics, we have to understand that there's been a huge mixed shift. The types of people that are in the mix of average hourly earnings are higher baseline job earners so average hourly earnings looked like they spiked. But, you have to take the mix shift into consideration and it's kind of hard to do. I was talking to Felix Zulauf today and we were talking about how murky the crystal balls have become because we have such different data sets than what we have had historically. This is thanks to the sudden shock of the recession, but also the way it was very unevenly felt in the economy. My profession - investments and finance - actually hasn't had any growth in unemployment at all. But, when you look at casino operators and carnival cruise line employees, there is a very large shock that's taken place. So, we're trying to figure it all out and it seems to me that interest rates are starting to get loosened up a bit on the upside. We had that incredible decline where the long bond in the United States went to exactly 1.00% intraday and now it is up at 2.4%. I don't think a lot of investors are aware how much money has been lost if you panicked into Treasury bonds last March or April. We're talking about losses that are pretty substantial, about 30%. Those are equity market-types of losses and your potential reward was 1% per year for 30 years. So, lots of imbalance was brought on by the pandemic.

You kind of have to wonder, who wants to own government treasuries right now?

The Fed. The Fed is the one that wants to own them.

Can we talk about inflation for a bit? This is such a hot topic right now and you hear two sides of the

debate: one side says it's transitory and the other side says it's going to be more rampant. When are you going to start to get worried about inflation and the consequences?

It feels to me like the market started worrying about it a little bit this week because the CPI print was the biggest miss on CPI in many years and maybe even in my whole career. The guess was for 0.3 and it comes out at 0.8-0.9. That really shocked everybody. We have a model of inflation at DoubleLine that's quite helpful for a few months forward. It's been quite accurate, and we knew that inflation was going to go above 3 1/2 but we thought it was going to be in a month or two. I believe in our model that it's probably going to go higher in the next couple of months - with a possible peak in July. If we keep going higher from there, then I think people are going to be seriously worried because the concept of transitory has everything to do with what they call base effects.

Inflation got so low, that it was a natural rebound. But one thing to think about is that CPI is kind of a false construct. They use things like owner's equivalent rent to calculate shelter inflation and orders equivalent rent for the last 12 months is up 2% but the whole median home price is up 17. So, if you would replace owner equivalent rent with home prices, the inflation rate would have been 8% year-over-year. There's reasons to really worry about inflation. The Fed, I think, likes to talk about transitory. The Fed is most content when the inflation rate is higher than bond yields all the way across the yield curve, which they've managed to accomplish. So they're trying to make people not scared about inflation by calling it transitory, but how do they know? How does anybody know whether it's transitory or not given the unusual circumstances that we're in? Don't forget that, way back in the day, Ben Bernanke had a completely wrong interpretation of the dire nature of the mortgage crisis. He said it was confined to subprime and it was many, many times worse than that. So, I'm not sure how they know it's transitory. When they all say the same talking point, it starts to sound like some of the mainstream media. You wonder if it's just a brainwashing mechanism where the Fed's trying to get investors to buy into this transitory stuff, but I'll get worried if inflation remains elevated through the summer. I think the bond yields would start to test the Fed's resolve. They say there's no limit to their quantitative easing, but we'll see. Foreigners have been selling treasuries for years and domestics have been gently declining their ownership, so all you have is the Fed. With all of the debt that we have, absorbing those bonds if inflation stays high is going to be a really big problem. If you can't absorb those bonds and yields are allowed to rise, well that's going to be really problematic for the valuation of

the stock market which is depending on zero short-term interest rates and suppressed long-term interest rates via quantitative easing.

I want to go back and talk about stimulus and enhanced unemployment. Do you think we're opening the doors up for Universal Basic Income (UBI)?

I do. I mean, I think we're already there. We had basic income way back in the 1960s. It's still with us with welfare programs. Now we've been expanding it and expanding it. I mean there's a lot of conspiracy theories that typically should not look attractive but with the deficit going up so much and the Federal debt now pushing \$29 trillion, it's almost like they're moving into UBI and even sort of a wealth tax situation by having the deficit so big. But yes, UBI has been expanded. It hasn't shrunk at all. We started out with checks from the government and people thought it was going to be a few months of unemployment assistance, but it has been extended and extended. Now it is being increased as I just said in California. My guess is the Federal government is ready to roll out another one because that has just been their pattern.

I was most struck when President Biden signed the \$1.9 trillion relief bill, and it had some benefits for certain parts of the economic structure in America. It took all of three days for Nancy Pelosi and Chuck Schumer to clamor for those stimulus checks to be permanent. So, they've already talked about the permanence of this type of stimulus and people's behavior is already partly modified to factor in ongoing government assistance. The government doesn't seem to be discouraging them from thinking that it's going to be here for a long time.

I want to shift topics and bring up cryptocurrencies - bitcoin specifically. I know you have commented on past webcasts about bitcoin. We saw bitcoin drop 10% because of an Elon Musk tweet that came out about no longer accepting bitcoin for payments of Tesla. What do you make of what has been going on in the bitcoin space?

Bitcoin and the other cryptos have clearly been objects of speculation. Again, it had a lot to do with government stimulus. I mean, remember the GameStop thing that happened? A lot of people are just playing with funny money. When you give people money that don't need it, they feel like they're playing with the house's money, so it actually does resemble a casino to them psychologically. I

thought bitcoin was really low at the beginning of 2020. I was really bullish on it. I went so far as to say I thought it was going to go to 15,000 when it was at 4,000. I looked like an idiot by the summer because it was still languishing at around 5,000 or so. Then all of a sudden, it blew right through 15,000 and it was at 23,000. That's when I turned to neutral on it. I was too early, obviously, because it's now doubled. It was nearly triple that. But it's moving around like crazy. This is all based upon speculative fervor. It's almost like every era of really highly valued markets – after they've run a lot – has some sort of a poster child, if you will. For example, some of the crazy .com-era stocks that had no revenue that were coming to market very successfully in the year 1999. Here I think it is really these cryptos.

What I think is presently most interesting about bitcoin is what you just alluded to: that it has peaked. Now, maybe it's only temporary, but when you're looking at a speculative fervor, I look for the poster child to roll over last. You know, the Nasdaq is underperforming the S&P 500 and it has been for a while now. So that's another sign that some of the speculative fervor might be in the process of dissipating because, for the longest time, the super six that power the Nasdaq were tremendously outperforming everything else. They just aren't anymore. So, I always look for sustained trends that get out of hand and then quietly rollover. It's a sign that risk is increasing, and I feel that the market is more at risk now than it was thanks to higher interest rates. I think that if we take out the highs on the 30-year Treasury, we're one really bad day away from going to a new high yield on the 30-year. I think that's something to watch out for as a risk factor.

I think our viewers would be interested to know where you are finding opportunities and what you are buying right now?

I've been very bullish on commodities and they've gone up almost every single day for the last year. They look overextended, so I think we're going to be taking a pause in the short term on commodities. I think the dollar might have a little bit of strength for the rest of this year. One of my recommendations from January that I still hold to for fixed income investing, is that I think that floating rate corporate debt is good...

Ever since we started DoubleLine – until about six weeks ago or so – we never owned any European stocks. We hated them. We didn't like their negative interest rates, we thought there were all kinds of structural problems in the Eurozone. Thanks to the valuation and thanks to our longer-term dollar view,

I think you're going to be better off in European equities. So, we actually bought some and they've performed this year exactly the same or slightly better than US stocks. That's not one of these trends that seems to be changing. Just like the Nasdaq is no longer outperforming the S&P 500, suddenly non-US stocks are not lagging anymore. They are in Japan and China, but not in Europe. Europe is actually slightly outperforming. Another thing I think it's too early for but that I like longer term is emerging market equity. Emerging markets are having significant problems with slower vaccinations and are really struggling. Emerging markets will do well, but I don't think it will be this year.

What's your view on raising taxes to help pay down the ballooning Federal debt?

Well, it incrementally helps but I don't really think the tax proposals that have been floated come close to paying for the spending. I mean, to repeat, government spending is more than half paid for by deficit.

It's an incredible fact that most people don't know. In fact, for the last fiscal year, 56% of all government spending was borrowed.

Now, one thing about these stimulus checks is that on the surface, people might think "well if we give money to the poor and we take it from the rich we're going to help get rid of wealth inequality." But there isn't any historical reason to believe that would be the outcome. Once we go into an unmoored type of monetary and fiscal policy - which is territory that we've entered - we can go back in history and look at what happened in prior examples and it's pretty depressing to do that. The outcomes are often civil wars and revolutions, like the French Revolution. They went off the gold standard in the 1770s and by the late 1780s there were basically riots about food. There was the women's march where they couldn't get any bread because it was too expensive, and they were so upset by it that they started marching towards Versailles where King Louis XVI and Marie Antoinette were. So why did it come to that? The money printing ended up making the middle-class poor and the prior poor class was starving to death. At the other end, the people who were controlling the levers of the money printing became wealthier. It isn't really the case that these tax increases will pay for this spending and if we go to another level of free money, I think the wealth inequality will get worse.

The stimulus that's happening has been very beneficial to US consumption, but it's not really

developing our productive base at all. So, we have more consumption but the consumption is stuff coming in from China so Chinese GDP is booming because we're buying all their stuff. That's exacerbating that problem as well. I'm oversimplifying here, but most of it comes through Amazon. Amazon does a very large share of this business, so one of the richest people in the world - Jeff Bezos - is getting made fabulously wealthier because the government's giving money away. So that's kind of how the mechanism works. The stimulus hasn't helped our productive base, it's helped China and it's helped certain very rich people in Silicon Valley. I think the wealth tax is primarily vengeance really. I don't think it raises very much money. I am in the camp that wealth taxes ladled on top of our current tax system basically punishes success. Now, having said that, I would love to have a wealth tax. But only a wealth tax. I think wealth tax makes more sense than income tax. The income tax system is so convoluted though that it's almost nonsensical and it's completely unfair.

In 2012, Mitt Romney ran for President and he put his tax return out and he paid something like 14% in income tax relative to his income. I made about as much money as he did in that year and I was paying 50%. So, I don't like the idea that the income tax system is completely unfair even at equal income levels because of tax shelters and carried interest and things that are essentially just crony capitalism through the tax code. I would get rid of all of that and just have a wealth tax. But to put a wealth tax on top of income tax is really problematic.

You mentioned the capital gains tax for those making \$1 million dollars or more per year. The proposal is to take it to basically 40% which would really affect things very dramatically. That would be a shock to the financial system sort of like the pandemic was to the healthcare system. If you put capital gains tax together with a wealth tax, then you've really got a problem.

How about what's happening with the tax rates in California?

I think it's one of these situations where you look around and it seems like a lot of smart people who are wealthy that made their start in California have already left. Elon Musk, Joe Rogan, Ben Shapiro, Oracle, Hewlett Packard, big companies. I can tolerate it for now, I guess, but I'm at 13.3%. If they take it to 16.8%, which is proposed in Sacramento, and the Federal tax rate goes up, it's going to be hard to really to endure the California taxation. Plus, California services are among the poorest in the country. So, you're paying a very high tax and what you're receiving is an explosion in the past 18 months of

homelessness, crumbling infrastructure, and soaring crime. Yet, you're paying ever more increments of taxation. At some point, I think they're basically going to realize that everybody's going to leave.

What would be the first thing you would fix?

I would run a balanced budget.

One of the things we talked about last summer was this impending wave of white-collar layoffs. Where do you stand on that as it relates to the future of work and has that view been adjusted?

I think it's still coming. When you are working virtually, you almost don't need middle management. I find that with Teams and Zoom meetings, they give us an extra perspective into who's really working and who's just kind of watching other people work. That's the basis for my thesis that middle management will probably be thinning the ranks. I think there's a lot of question marks relative to California where we've been locked down more than other places and there's a lot of confusion and varying ideas as to how to go back to work. We polled our employees - and we're not very different from the broader surveys nationwide - and a lot of people want to work from home two to three days a week. That's a big shift and I think part of figuring out the plan of going back to work at offices will involve right-sizing the middle-management workforce.

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