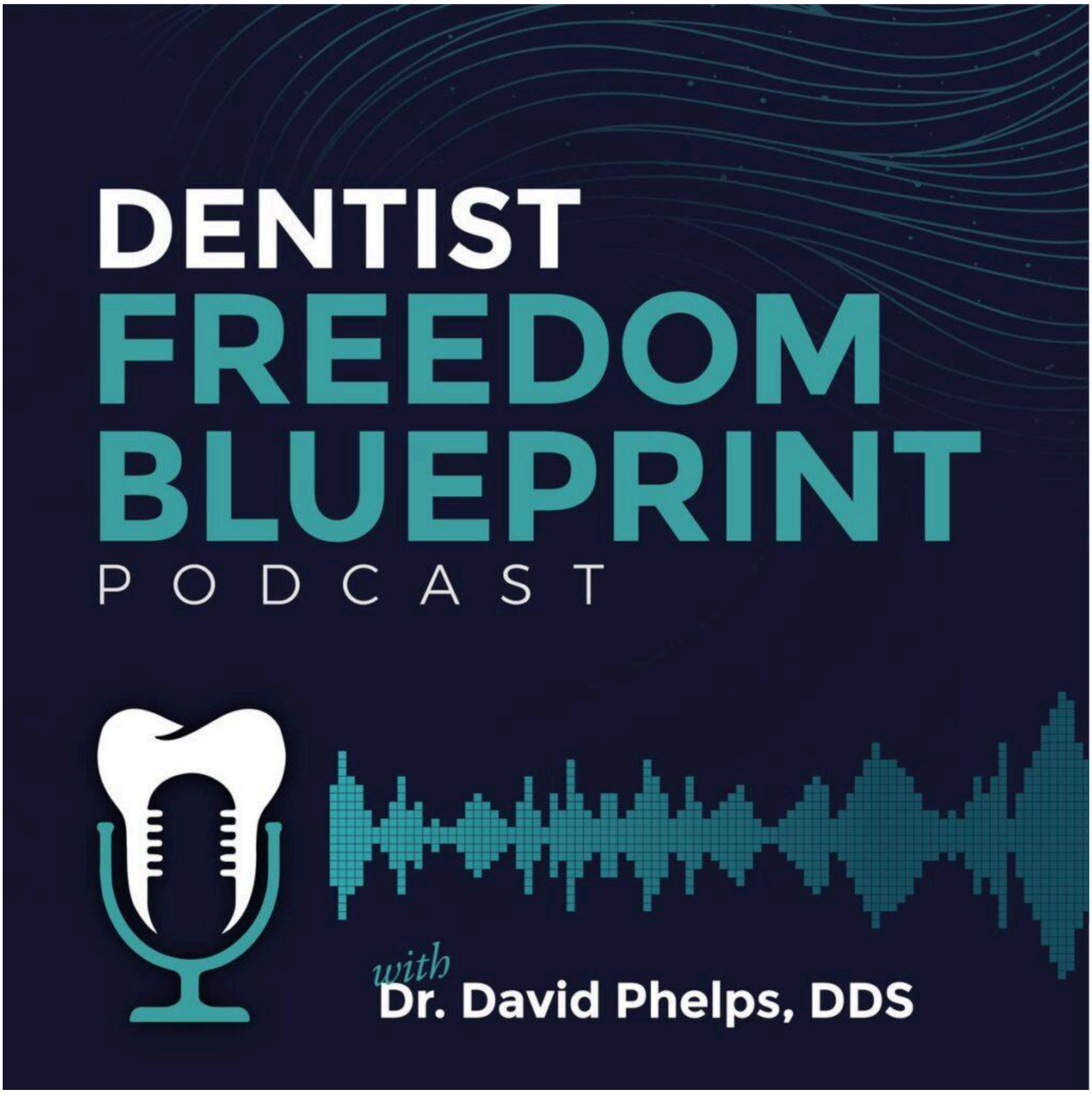
Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don't Know May be Harmful to Your Financial Future! - David Phelps: Ep #490



Full Episode Transcript

With Your Host

Dr. David Phelps

Dentist Freedom Blueprint with Dr. David Phelps

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don’t Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

Frances Newton Stacy: *The precursors to the fall of Rome and the precursors to the French Revolution are you get the bulk of the assets. Let's say 90% of the wealth and a very small percentage of people—maybe it's 3% of the population, and that happens from the wealth gap widening, and the wealth gap widens through every iteration of the business cycle and the reason is because the upper percent own assets in the lower percent generally don't own assets. And that seems to be the point of bifurcation.*

Dr. David Phelps: Hello everyone. I'm Dr. David Phelps. And you're listening to the Freedom Founders podcast—a podcast about becoming your own financial advocate and using alternative investments to create freedom, choices, and options in your life without playing the Wall Street casino.

Today, I have a conversation with market analyst, Frances Stacy about some of the major market cycles that are converging, what history can teach us about what comes next, and what indicators we can be looking for in the days ahead. I also follow up with some of my commentary on the turning of a 40-year cycle, and what this means for us as investors.

We are entering a new era of investing. It's a decade of living dangerously. There has never been a better time to take personal sovereignty of our future. So sit back and enjoy this episode of the Freedom Founders podcast.

Intro:

“David was of course a dentist, but he was a very sophisticated real estate investor. He had run with a circle of probably the most sophisticated housebuyer types in the country.”

“David is a student of the game.”

“I would never say this about most people. I would get in a foxhole with David.”

“His knowledge is unreal. I mean, it's off the charts.”

“This is not some person in front of you going, ‘Yeah, just give me your money and I'm going to invest it in real estate.’ It's way more elevated than that.”

Dentist Freedom Blueprint with Dr. David Phelps

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don't Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

"He speaks truth. He really cares. He's committed to this group like it's a family."

"You can't get higher integrity than David. If I named Top 10 smartest, most informed real estate investors I know, he's in that list."

"The most common message I get, I want to thank you so much for introducing me to Dr. Phelps because my wife and I—we went to Freedom Founders. We're on a path. We're going to be financially free. We are going to retire sooner. We are going to be happier. This changed our life."

Dr. David Phelps: Today I'm honored to have a person who I've had some recent connection with and some conversations. And that is Frances Newton Stacy. Frances is a market analyst and trading expert. She appears in the financial media, advises policymakers, and she manages portfolios at Optimal Capital. Frances, we've certainly seen with monetary and fiscal policy that we have today what I think you would term in others *a bifurcated economy*.

We have people that have assets, they have investments they can make. And with the policies we've had, those assets have increased in value. We have the moderates of the country, hardworking wage earners who really, in my opinion, are taking the brunt of the inflation that we've had and are struggling.

Policymakers might be saying, "The rate of inflation is down. So let's clap our hands. It's wonderful." And look at the stock market at all-time highs. So aren't we doing well? But where's the problem in that for people that just are not equipped to have investments that can take advantage of these policies?

Frances Newton Stacy: Dalio has them split between the upper 40% and the lower 60%. I believe he did that research before COVID. The first time I saw that was 2017, and the reason is because the upper 40% own assets and the lower 60% generally don't own assets. And that seems to be the point of bifurcation in how these various seasons treat these various people, so yes.

And then in the upper 40%, you could have people who own houses and 401ks, and houses and 401ks don't necessarily do well in all of those seasons. When you get into the really the top 1 or 2 percent because of the access to the level of sophistication of risk management and investments, you do get some people that are lucky enough to have their assets, their money invested in a way where—and the risk of the assets in the various seasons mitigated in a way where they tend to have positive performance and all seasons.

So you just have sort of a curve of people all along the curve. Now the people that are the lower 60%, just like in the fall of Rome and the French Revolution, there are consequences to the fact that when the bulk of society is really struggling because they are being left increasingly behind, as we roll through these iterations of seasons, then it breeds a populist movement, and it breeds a populist movement both on the left and the right, and you start to see really extreme politics.

Dalio defines a populist by *somebody who wants to win at all costs*. And winning at all costs goes against the notion of democracy, which is sort of forward the will of the people and serve the will of the people. And so we are seeing the very early signs of that with political fracas.

And we're not just seeing it in the United States. It's happening in the United States. It's happening with the Middle Eastern conflicts. And it is just when people are desperate, they do desperate things, and we will increasingly see that as we move forward because the cycle is going to get worse before it gets better.

Now, I will say that while COVID could have elongated certain aspects of the cycle, because they have put so much money in the system and that liquidity is something that really matters when determining catalysts for the changing of seasons, the mechanics haven't changed, and really the mechanics haven't changed since the dawn of central banking, but certainly since the Federal Reserve Act in the first part of the 20th century. I mean this passed in 1914, so those mechanics are still in place, and it's just about watching the catalyst to roll over into the next season and being able to anticipate that.

Dr. David Phelps: So with this populism and the fact that we are in an election year, which I think also creates some imperatives in some respect for J Powell and the federal reserve, the treasury, and their policies.

How do you read the tea leaves in terms of what their options are? Because again, you manage portfolios and I'm not looking for specific investment advice, of course, but I'm just saying in general, how are you trying to look at these seasons? Where might this go pre-election, post-election?

It's anybody's guess, right? But seems to me that Powell is in a hard place, between a rock and a hard place, and any moves he makes are just going to exacerbate one of the other. I mean, he's taken obviously very unprecedented rise in interest rates, 500 basis points in a very short time. So that was a big move.

And yet, again, they're kind of applauding themselves, and on one side say, "Well, hey, soft landing coming and the markets are high and labor seems to be solid." I mean, there's a lot of data. I don't know how much you want to speak about data, and how accurate it may be, but I'll let you kind of take it from there.

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don’t Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

Frances Newton Stacy: Certainly. So the challenges is that, basically, you look at the 10-year yield, and the 10-year yield becomes a benchmark for a lot of investments and a lot of asset classes, whether you're looking at credit, you're looking at the spread between various credit investments in the 10-year.

Or you're looking at just various ways that interest rates affect different sectors of the economy, different sectors—when you're talking about the stock market and things like that, and that's all the back-tested data. The challenge becomes the fact that the Fed really can only adjust the discount rate.

They give a range for the Fed funds rate. And then the Fed funds rate is actually determined by the bond market and traders, which is supply and demand. That's why sometimes the 10-year doesn't match the range on the Fed funds rate. As we see now, it's actually lower. And the point of that is that bond markets are anticipating the future.

And when they anticipate the future, we did see an uptick in rates, but it has not taken out the all-time high because as the economic data comes out, we are starting to see cracks in private credit. We are starting to see cracks in credit, and we are starting to see an increase in defaults and things like that.

And Powell's data dependent. And as we are higher for longer, you will start to see more and more distress in capital structures, as you've seen in the real estate space, right?

Dr. David Phelps: Right.

Frances Newton Stacy: Because the longer those rates remain higher, it sort of precludes various projects. And then you have to bring in second-tier debt, and pay a premium for that, and keep investors interested in that.

So the thing is, is that he is a bit between a rock and a hard place. If he preemptively lowers rates, we have seen a bit of an uptick or reacceleration and inflation. Many of the commodities prices that are in the basket, which is of CPI are going up, and then they don't actually land in CPI until you have a lag.

So if you have those commodities prices rising, you know that depending on what it is, food can be four to eight months time, or gasoline's one to two months time, or owner's equivalent rent has a huge lag. And that's a third of CPI. And so those things, as they tick up, you know that the future Prince of CPI haven't yet seen the price appreciation in some of those commodities.

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don't Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

So you know that you have sticky or potentially reaccelerating inflation. So he doesn't want to lower rates in the face of that. The other reason he has not to be incentivized to lower rates is with all of the fiscal spending that's going on and all of the deficit spending, you have to keep demand in the bond markets, and the way to keep demand in the bond markets is to pay a premium, which is the interest rates, and so you've got to keep those rates high.

And on an international stage, and Dalia goes into this as well, there's some de-dollarization going on internationally because we have such high debt levels, etc. So, which shoe drops when is very hard to predict, but you can see that markets, the bond market in particular, really tries to anticipate these mechanics, and the bond market right now is disagreeing with what Powell is doing, and yet Powell is stuck in this rock and hard place. So really, he just has to wait until there's something that he has to be proactive about.

Dr. David Phelps: Some people talk about the fact that higher interest rates as set forth by Powell and the Federal Reserve meant to decrease demand, borrowing expansion. Actually, adds gasoline, if you will, to inflation, because with higher rates, those who have assets and have money, more returns coming to them higher than before.

I mean, the risk operate today in treasuries is what? Five and a quarter, five and a half-ish. And yet, four years ago, three years ago. it was down next to zero. Do you see that as part of the inflationary aspect that higher rates is not assisting in reducing inflation, or where does that balance out for you?

Frances Newton Stacy: Well, okay. So there are a couple of things here to note and they look contradictory, but what they really are is they're at different places of how the cause-and-effect relationship plays out. Number one, inflation is the ratio of money in circulation to goods and services. So the more money you have juxtaposed to the goods and services, the higher price, there's more money to allocate to those goods and services.

But as you continue on in a higher rate environment, as you note, they can participate in keeping inflation sticky because those borrowing costs as they get higher sometimes corporations will—first of all, you do have people with returns that will keep spending, but corporations will also push those costs through to consumers by raising prices.

And so it can participate in those ways, but you have the first effect and then you have sort of the secondary and tertiary effects of inflation. But that is one of the reasons that inflation can remain quite sticky because those costs will very stubbornly go down.

Now, if you have a situation where the money supply suddenly drops, which is what you had in the financial crisis, because people couldn't service the debts, and so those loans had to be written off and writing those loans off removes them from the system. And so you had this massive drop in the money supply. You actually did have a massive deflationary impact despite the fact that they were raising into the start of the financial crisis.

So it's hard to kind of pick these pieces apart, but when you look at the primary cause and effect, the secondary cause and effect, the tertiary cause and effect, you can see a progression of the cycle. It still is not perfect to predict when the shoe is going to drop and which shoe is going to drop.

And the reason is that every time a piece of debt is created, that's adding to the money supply. So in this particular cycle with COVID, they put so much liquidity into the system, which is debt, right? But even though the Fed has raised rates, which ultimately disincentivize borrowing, and borrowing equals new liquidity, even though they've done that, you had banks with commercial industrial loans go down, but you had massive fiscal stimulus coming in.

You had private credit coming in to take the place of those banks and those commercial and industrial loans. So instead of having those loans default, they were restructured into a private credit, which means you're not having that defaulting mechanism of dropping the money supply. And then thirdly, you had people—that lower 60%—putting groceries on credit cards.

And when you put groceries on credit cards, you're entering new debt and new liquidity into the system rather than spending out of your salary, which has already been in the system—or your savings, which has already been entered into the system. So you had these three forces really stretch out the business cycle, which was surprising.

I mean, almost everybody, the consensus certainly was we expect a recession with rates going up so high, so fast. And in hindsight, these three things were able to sort of elongate the season of the business cycle.

Dr. David Phelps: That's really interesting. You explained it very well and really kind of giving me a lesson and just understanding a little bit more of the dynamics and how all these factors can work either in tandem or against each other.

We're talking about this. The elephant in the room that doesn't get talked about a lot, although we're talking about debt right here, you and I, but as far as the government and our representatives, it's just spend, spend, spend. So, as deficit spending increases the national debt, just again, at unprecedented rates of increase, what you're saying, I think is this increase in debt, although we would, as practical people say, this doesn't work.

In my own life, I can't just expand debt and have the liquidity to go on and on and on. But you're saying this actually does increase liquidity on a domestic basis. And this is what seems to keep things running without having a massive downturn, or reset, or recession. This is what's prolonging it essentially.

Frances Newton Stacy: Yeah, so what it does is it creates new liquidity in the shorter term, right? But number one, debt matures at some point, right? When debt matures, it comes off the balance sheet. So we have a wall of maturities. And in commercial real estate, we have a wall of maturities coming in.

Corporate debt, we have a wall of maturities over the next five years in the private credit that was issued, and so you have this wall of maturities coming and if those things are not—it's like when the bonds roll off of the Fed balance sheet, if they're not repurchased or reissued or, they don't get new bonds, then that liquidity comes out of the system.

But if they choose to get new bonds, then that liquidity comes out of the system and it's replaced with this liquidity. So on the shorter-term trajectory, yes, there's more liquidity in the system. And when there's more liquidity in the system, that adds to that ratio, which pushes growth and inflation ultimately higher. However, when you start taking liquidity out of the system, you can't take the debt out of the system.

So unless you have defaults massively like the financial crisis, and if somebody were really sinister, they would say, “Yeah, we want to create credit events to take liquidity out of the system,” which is a game of musical chairs. People are left without chairs. And that's always a sad thing, whether they're being laid off from their jobs or they're not able to service their debt and have to suffer those consequences.

So debt is a short-term solution. The modern monetary theory people would argue that that's a sustainable thing from my perspective and I think Dalio as well; you just reach a threshold where it's not sustainable and that happens in our personal lives And that also does eventually happen with governments.

It takes a lot longer. He wrote a piece where he delineated the 48 debt crises across time and countries, and you can see that the debt to GDP ratios, they all broke in different places because they had other factors that played a role. But yeah, when you're getting well over 100 percent debt to GDP, which we are now, and you have these higher rates and you have the interest on the federal debt is this huge chunk of the economy, yes, that eventually does have consequences.

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don't Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

Dr. David Phelps: Frances, this is very, very interesting. And I know my listeners love to hear someone with your experience and insights bring this to the forefront. So we gained some understanding because I'm a believer that even if we are not trained as you are in economics or financial policy, there's things we can learn and become more astute in how we might "manage" our own investments.

So for credit investors who may be in the financial markets today and riding the highs there, maybe looking at alternatives and real estate, we've talked about where real estate is. And certainly, that's an area that we won't dive into today, but in terms of—you talked about private credit, so we've got equities, we've got credit.

Today, personally, I'm just a little bit—I'm more skewed towards the private credit side, whether that's in treasuries, which I keep some money there for liquidity And just because I want some safety, I look at this higher ground in real estate. Because it's an area that I know a lot about and have access points.

I do put some money in as a lender and private credit there. I'm not pushing really hard with equities right now unless it's something I can really see, well, that to me is a value add. It's a one-off. Maybe I'll put some money there. Can you just give any of your sentiment to equities versus debt or however you want to couch it for investors, the way they may be looking at the volatility in the markets and how they may read the tea leaves, so to speak, in terms of what they may be looking for going forward?

Frances Newton Stacy: Yeah, so we've had a sort of a re-acceleration in growth and inflation generally, which could turn into a damper on growth and a continuing acceleration in inflation because of those lagging effects going into the CPI, but also, retail sales was weak. We do have some cracks in the employment picture.

We do have some cracks in the credit picture—these really early warning signs—to whatever degree that consumer starts falling off that will dampen growth remains to be seen. So you could have a stagflationary setup, and you certainly have asset classes that outperform in the stagflationary setup.

But the thing that's interesting is private credits is a very crowded space right now because so many people loaded into it. You're not getting paid that much of a premium over the risk-free rate because the risk-free rate is so high. So you're taking a lot of risk. There's a lot of covenant light or very loose underwriting in private credit.

And so if you're only getting a few points above that risk-free rate, the reason that those yields are so high is rates. And so you're just not getting paid a ton of premium for taking the risk that might be in the underwriting standards of private credit. So those deals have to be analyzed very carefully.

And then furthermore, a lot of this private credit will hit some wall of maturity over the next, let's call it, five-ish years. And it might be better to keep some dry powder for the re-issuance of some of that debt, depending on if other lenders are not participating. Right now, banks are kind of coming back in. Leverage loans are kind of coming back into the space, and it's going to get bubbly and it's going to get crowded. And then the shoe doesn't drop until the shoe drops. Early warning signs is I did see some statistics where it says that almost 9% of credit card debt's going into default. And I think it's 8% of auto loans.

So we're talking in excess of 100 billion in both cases, where these loans are starting to get into default because the lower 60%, even if they're making $100,000, are living paycheck to paycheck. And with credit cards over 20%, and some of these used car loans with very high rates, it's hard to keep up with.

And to the extent that these creditors stop issuing credit, then their only choice, unless they have somebody to come and rescue them, is to start defaulting on these various things. I've always said when the consumer falls off, when the bottom 60 falls off because of the tightening—the long and variable lags from monetary policy tightening—it just depends on what percentage of that consumer falls off and how systemic that is.

And then it's determined by what the Fed's responses. Do they have a huge response like they did in COVID? Do they have a little bit of a less of a response? And that depends on where inflation is versus where the credit markets stand. Now, Powell knows if a lot of stuff is set to default, that money comes out of the system.

So then you'll be able to inject more liquidity. This will have consequences coming down the road. I cannot say that we are living in simple times for individual investors, because I don't know how astute they are with analyzing and doing due diligence on some of these deals.

Equities, I agree with you. We're a little over our skis, but it will still probably astound us that it can go higher and higher and higher until. Some of this risk gets repriced. Right now, spreads are really tight and that's really not an accurate depiction of the actual credit risk, especially if these percentages and these numbers are true. So that will have a violent repricing, and that violent repricing and spreads will put credit risks. And then that will have a repricing and equity markets. It's not for the faint of heart to play with something you can lose.

Dr. David Phelps: It's difficult for a lot of people because we all get used to what's happened in the recent past, the historical run rate. We try to extrapolate, what's happened in the last decade and think, well, it's just going to keep doing more. I think your words would be—I'm not putting words in your mouth—but it's a time for some patience, right. And some dry powder and not have that FOMO that everybody has is like, "I got to jump on. It's the last train out. And if I don't catch the shooting star, I'm missing out."

Frances Newton Stacy: Yeah, absolutely. Unless you have an edge on being able to anticipate something in the future, which it's hard for people even that are in the industry, let alone people that aren't professionals in the industry. That's not to say that things can't continue higher for a little while longer, but like you said, it's sort of the FOMO—if you're buying into equities, I mean, most things are overbought.

Definitely, if you want to get into equities, wait for dip, study things that do well in a sort of stagflationary environment, but that's not guaranteed. What's happening right now, which is so interesting is that those four seasons, markets are trying to reprice those all the time. So they're jumping back and forth as if the season changes every day because they're trying to anticipate which season is next.

And so that creates a lot of internal volatility. There's certainly that in the options market. And when you look at the equity markets, most of it's electronic trading of one kind or another, so you have to just invest in things that you believe in, but just right now, deploy money that you can afford to lose.

And personally, I would deleverage certainly while you have a job and everything else, just in case there are problems ahead with elections and credit markets and things like that.

Dr. David Phelps: My conversation with Frances was a high-level overview of where we are in the economic cycle and a sneak peek into some of the trouble I see ahead.

But where does that leave us as individual investors? What's the game plan? How do we adapt to these realities? I recorded some of my thoughts shortly after my interview with Frances, digging into the question, *What does this mean for us?* Specifically, I drew on my own experience in our last economic downturn, The Great Financial Crisis of 2008.

News Reporters:

"It was the worst day on Wall Street since the crash of 1987."

"The stock market is now down 21%."

"…because we're now down 43%."

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don’t Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

“The NASDAQ, everything, and more has been completely wiped out.”

“…could be the most serious recession in decades. And that means life, as most Americans know it, is about to change. In some cases, dramatically.”

Dr. David Phelps: I remember back coming out of the 2008 great financial crisis, how much despair there was in the overall economy. And people, consumers were spent. They were over-leveraged. People were losing their houses. We had the subprime mortgage collapse. And it was really a time when the country was really at a bottom point in the overall economy.

People call it the Great Recession of 2008, 2009, and 2010. The greatest recession that we've had since the Great Depression back in the ‘30s. That being said, there are always people who make it through these times of economic contraction and they happen on a regular basis, maybe not as deep as we had in 2008, but they regularly happen.

And you can read the writing on the wall. The tea leaves are there to know what's going to happen. We've been talking about this in Freedom Founders for, I guess, a good number of years, really expecting us to have a downturn or correction way before. Now, how do you position yourself under the things you can control?

Well, I've always talked about having your own house in order. That means making sure your debt, the debt that you still carry is fixed long-term or pay it off. Get rid of it. Reduce your spending, get your overhead in your business down to as low marginal level as you can, get efficient as you can, be wary, just wary of expansion.

I'm not saying don't expand. If you have an opportunity to expand, but do it carefully, do it with resolve and be careful again of variable rate debt. On the investment side, this is where most people miss it because they're not ready for it because they're taking care of their family and their home budget and their business. And they're trying to sort things out.

They're not ready for the opportunity that comes every time there is a major correction in the economy. I had the first time to really take advantage of this back in 2008. Up until then, I'd been working hard in my business, my practice. Yes, I'd built up a real estate portfolio that was carrying the weight.

I exited my practice back in 2006 because of my daughter's situation with her health. And I had the first opportunity because I was literally there on the front door of when the correction happened and assets went on sale. I'll say it again, assets went on sale. I'm talking about the financial markets took its hit by 50%.

Frances Stacy - Investor Alert! Navigating Market Turbulence - What You Don't Know May be Harmful to Your Financial Future! - David Phelps: Ep #490

If you're a player in the stock market, you certainly could buy down deep and write it back up, which a lot of people did. I'm not a financial market player. So I didn't do that game. I'm a tangible asset investor. I like real estate or businesses, but real estate's the one I really enjoy because I just became good at it and I have a network of people that I can rely on to make it happen.

So when everything collapsed back in 2008, 2009, and 2010, and there's no liquidity, no credit, no ability to finance things, people were selling their assets to try to get liquidity back, that's the time to buy. And it's here again on our front doorstep. But you've got to be ready to do it.

You've got to be positioned. Where's your capital base? Do you have to have money set aside? Do you have money that you've moved out of the market into higher ground? Like money markets or treasuries? Do you have money in retirement accounts? If you move it to self-direction where you can actually invest in alternatives, are you set up there? It's too late.

Once this happens and things start to roll, you've got to be ready. You've got to have access points. You've got to have a network. You've got to have enough education and understand where the opportunities are. I'm preparing you all for what's coming. And it's not a time to be dismal or feel depressed.

It's time to be ready, to get ready. We can't control what the markets do. We can't control what the government does. But what we can control is how prepared we can be to take advantage of the opportunities, get through the gap, the gap period, and be ready to buy those assets. I did in 2008, more than double my net worth, more than double my net worth.

Come out 2008, you can do the same thing, but you've got to be prepared. You've got to know what to do. You've got to have access to the right investments at the right time. It's all about your freedom. I hope you're ready to take the action that you need.

I hope you've enjoyed this episode of the Freedom Founders Podcast. If you enjoyed this new and updated format for the show, be sure to subscribe so that you can continue to get more weekly episodes with great guests like Frances Stacy. The Freedom Founder's mission is to help practitioners like you, my colleagues, to become your own financial advocates, ditch the Wall Street model, and use real, tangible assets to create more freedom, choices, and options in your life.

If you want to do a deeper dive into the macroeconomic trends we discussed in this episode, I invite you to request a free copy of my recent book, *Inflation: The Silent*

Retirement Killer. I go into much more detail about the turning of the larger 40-year secular cycle and what history can teach us about the road ahead.

Also, if you are a practitioner who is ready to fire your financial advisor, get off the Wall Street roller coaster, and use real tangible assets, such as real estate, to take back control of your investments, I invite you to schedule a call with my team. They can answer your questions about Freedom Founders and help you see what is possible in your future.

Just go to freedomfounders.com/discover. That's freedomfounders.com/discover right now to book your call. Finally, I want to say that change always brings opportunity. Dentistry is changing. The financial markets are changing. The old models are no longer the sure pathway to the life you desire.

The future belongs to those who are willing to adapt, ask the hard questions, and take personal responsibility through education and decision-making. If that message resonates with you, I invite you to join me on this journey. Be sure to hit subscribe and I'll see you back next week for another episode of the Freedom Founders Podcast.