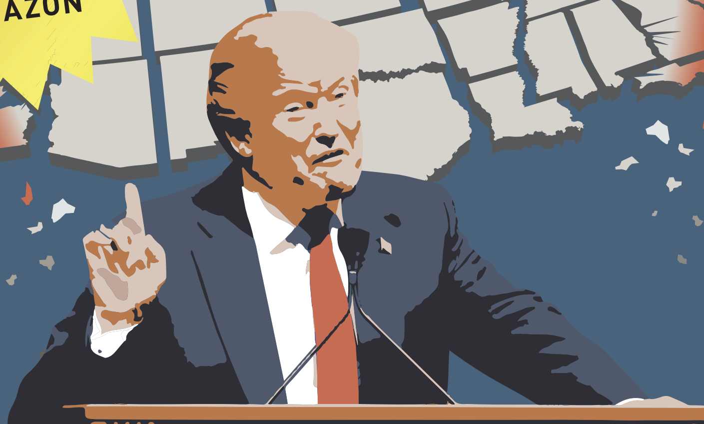
#1 *NEW YORK TIMES* BESTSELLING AUTHOR

TRUMPED!



A NATION ON THE BRINK OF RUIN... AND HOW TO BRING IT BACK

DAVID A. STOCKMAN

BONUS CHAPTER

What's Coming Next and What to Do About It

We are on the brink of ruin.

That's subtitle of my book, *Trumped! A Nation at the Brink of Ruin and How to Bring It Back*, which we provided to you when you became a subscriber to *Contra Corner*. This is a supplementary chapter that's not publicly available to those who purchased the book on Amazon.

I believe that all hell is going to break loose in the financial markets very soon. Donald Trump was right when he said that "we're in a big, fat, ugly bubble" during the first presidential debate. As soon as the Federal Reserve lifts their foot off of the neck of interest rates in this country, we're going to have another big crash.

We're at the end of this tepid and barely measurable economic recovery. It's the weakest one in economic history. We're headed for another recession, and when we enter it, investors are going to find out that the central bank has no tools or dry powder left. They've already printed $3.5 trillion, and if that fails, I think that it's likely they'll try to print more—except if they do that, it will scare financial markets, instead of reassuring them.

We're on the brink of a fiscal situation that is ready to explode, too. President Obama talks about the deficit coming down. Of course, even when you have a weak recovery like today's, there is some pickup in revenue. But the deficit is back up again—we're going to exceed $600 billion this year. And we're on our way back up to $1 trillion, even before the next recession hits.

We're in a different ballgame. And for that reason, I think it's very possible that you and I see a Donald Trump win on Nov. 8.

The Clinton campaign had a phrase back in 1992 that was "It's the economy, stupid." Today, the Trump people are saying, "It's the Federal Reserve, stupid" (more on that below . . .).

The reason that Trump has been doing so unexpectedly well all along is that Flyover America—that's the whole white area on the map of the United States that's on the cover of this book, *Trumped!*—is hurting badly. That's due to the negative impact of Fed policies.

Two percent inflation targeting is a job and wage destroyer. Zero percent interest rates for 94 months is a hit to retirements of enormous proportions. Massive monetary stimulus and bond buying has basically turned the stock market into a casino . . . and the executives of American corporations into stock-pumping operators.

What's the alternative that Trump offers?

Again, this book is no defense of Donald Trump—but he has pointed out the elephant in the room. He's said that this is a phony market and false economy and Janet Yellen should be ashamed of herself. Finally, someone called attention to the core of our problems!

The Federal Reserve has created massive wealth for the bicoastal elites . . . and enormous bubbles. I'll show you why the market is crazy today at its current valuation, below. The solution is to call the Federal Reserve out for their policies, which are only helping Wall Street and punishing Flyover America.

Now, I should make something clear: If Donald Trump is elected, we're going to have chaos in the market. And the market needs to wake up to that now. The frogs are in the boiling water right now and don't have enough sense to get out of the market. The chances are high the world economy is not recovering as the elites have been saying, but instead slipping into a deep, lasting, deflationary recession.

Unless you're a day trader, why would you stay in a market where the upside is maybe 2% but the downside is 40%?

One answer is Wall Street thinks they're going to be bailed out by the Fed. But as I detail in my book, the Federal Reserve is out of dry powder.

Even Larry Summers has said we can't get through the next presidential administration without a recession, because economic expansions don't last that long. There's no way the next president can stop a recession— it's baked into the cake.

I do hope, based on our choice between Trump and Hillary, that we don't get another Clinton and that "The Donald" does actually prove to be a disrupter. Someone who breaks the status quo and finds better policies than the ones that Washington and Wall Street kept drifting along with for the past decades.

I don't think Donald will be good for the market at all, however, because he's unpredictable and unschooled in all of the illusions of the status quo. So I think he'll scare the hell out of Wall Street. But that's OK, for two reasons:

1. The point of economic and fiscal policy is not to make the stock averages go higher—that's a modern illusion. We never used to believe that back in '70s, '80s or even the '90s.
2. I think the stock market is going to tank anyway, whether Trump is elected or not.

But especially under a Trump administration, there will be a Washington that's totally divided and in conflict. For the first time, the fundamental policies of the last 30 years are being challenged—and I don't think there's going to be any smooth transition.

Finally, this vaunted "independence of the Fed" is going to be challenged frontally. If Donald Trump wins the presidency, he needs to take control. There is no such thing as the independence of the Federal Reserve. It is entirely a political institution. After all, why else in the world are they afraid to raise interest rates after 94 months of effectively being at zero when the vice chairman of the Fed says that we're at full employment.

That is a political decision in a profound way. All of the problems facing our economy are structural—meaning there's nothing the Federal Reserve can do to fix them. They need to be addressed by supply-side policies and renewed incentives for investment. We're not getting any

investment right now: Real net business investment in this country today (after depreciation) is 20% lower than it was in the year 2000. We have no breadwinner jobs that have been created in the last decade—only part-time jobs.

If we're going to avoid ruin and change direction, we need to tell Janet Yellen:

> *You're fired!* You and your people have wrecked this economy. You ought to resign, and we're going to put in a new slate of people that are going to run the central bank in a way that's compatible with productive capitalism.

IT'S THE FED, STUPID

The Fed's core policies of 2% inflation and 0% interest rates are kicking the economic stuffings out of Flyover America.

They are based on the specious academic theory that financial gambling fuels economic growth and that all economic classes prosper from inflation and march in lock step together as prices and wages ascend on the Fed's appointed path.

Au contraire! Those propositions are the most economically destructive and wantonly unjust notions ever embraced by an agency of the state. They clobber the middle and lower ends of the income ladder while showering the top tier of financial asset owners with stupendous windfalls of unearned gains.

So the nation's rogue central bank is essentially a reverse Robin Hood on steroids. If Donald Trump wants to hit the ball out of the park, therefore, he needs to quickly skip over his dog-eared income tax cut plan and put the wood good and hard to the Fed, Janet Yellen and our unelected financial rulers.

They are killing wages, offshoring jobs, trashing savers, subsidizing the banks, gifting Wall Street speculators with endless financial bubbles and rigging the markets to ensure that the Democrats win.

In response to that line of attack, Hillary will harrumph and sputter about the sacred "independence" of the Fed, claim that by slashing interest

rates the Fed "saved" the American economy and scold that such reckless talk will unsettle markets.

But none of that will even register with the hurting voters of Flyover America. They know the Fed serves Wall Street and the moneyed classes and that rigged financial markets have done nothing to arrest their shrinking living standards and diminishing job prospects.

Unfortunately, what will register loudly with so-called Reagan Democrats and other working people is the chart below. If Trump keeps listening to his semigeriatric economic advisers, who are stuck in a 1980s time warp, he will spend the rest of the campaign answering Hillary's irrefutable accusation that the Trump tax plan amounts to a 1.3% cut for the middle class and 16% cut for the top 1%.

No, we are not channeling Paul Krugman or Professor Piketty. In principle, lower income taxes are better than higher taxes, and deliberate redistributionism by the state is always doubly bad. But the villain of the piece in 2016 is not the IRS tables; it's the central bank's printing press. So there is no point in taking a political hit to solve the wrong problem.

It was a totally different world in the early 1980s. "The Gipper's" promise to slash incomes taxes by 30% across the board resonated with Reagan Democrats because double-digit inflation was causing a rip-roaring bracket creep. Wage and salary workers were getting nailed with unlegislated tax increases, and they weren't going to take it anymore.

Indeed, without the tax rate cuts, the Federal revenue take would have risen from 19.5% of GDP under Carter's last budget to 24% of GDP

by 1986. By contrast, the federal income tax is now *indexed*, and has been for 30 years. Tax brackets, the standard deduction and personal exemptions are all shielded from inflation by law.

So when Steven Moore and his Club for Growth high rollers start jawing about income tax cuts, no one in Flyover America hears them. Instead, what they hear is “Hillbama” demagoguing about the wealth inequality that their minions at the Fed have actually caused, and the prospective 12-1 distributional benefits from the proposed Trump tax cut that go to the 1%—who could readily do without it in the name of the more urgent tax cuts described below:

Comparison of static distributional analysis of 2015 and 2016 Trump tax plans
Change in after-tax incomes

Income group	2015 plan	2016 plan
0% to 20%	0.7%	1.2%
20% to 40%	2.2%	0.8%
40% to 60%	6.0%	1.3%
60% to 80%	7.3%	1.9%
80% to 100%	12.0%	4.4% / 6.5%
90% to 100%	13.6%	5.4% / 8.3%
99% to 100%	20.7%	10.2% / 16.0%
Total	**9.2%**	**3.1% / 4.3%**

Source: Tax Foundation, Taxes and Growth Model

Indeed, after three decades of indexing and GOP tax cutting, the ranks of wage and salary workers in Flyover America hardly know from income taxes. In the most recent year, the bottom 75% of tax filers—and that’s about *104 million* citizens—paid only *14%* of the income taxes.

Moreover, a goodly portion of that huge number paid no federal income tax at all. Overall, these 104 million tax filers posted $2.8 trillion of adjusted gross income (AGI) but paid only *$169 billion* in federal income taxes. That’s just *5.9%*.

And as the man on late-night TV says, wait, there’s more! The bottom 50% of tax filers—the 69.2 million filers who are really getting

monkey-hammered by the crooked regime of the Wall Street/Washington ruling elites—paid only *$34 billion* in federal income taxes. That's an average of *$9 per week, or 3.2%* of the group's $1.03 trillion of AGI.

So Donald Trump needs to stop visiting the Supply-Siders Nursing Home and get with the current facts of life. To wit, the top 10% of tax filers—just under 14 million—pay *70%* of the income taxes and will get upward of 85% of the benefits from the Trump tax cut announced last Thursday.

Here's the thing. Well more than half of this tiny slice of the electorate will vote for him anyway, because they live in Houston, Indianapolis, etc. And the rest live in the precincts of the bicoastal elites, where they get their news from *The New York Times* and will thank him for the extra cash by voting for Hillary anyway.

By contrast, there are 160 million payroll taxpayers in America. And they are getting hit with the ol' double-whammy. That is, due to the Fed's disastrous 2% inflation targeting policy, the bottom 130 million are losing jobs to China and the offshore markets and purchasing power to domestic inflation.

At the same time, they are paying through the nose on account of a nearly 16% payroll tax levy. To wit, the average wage earner at $22 per hour gets *$3,000* extracted from his/her pay envelope, even as their employer is whacked for another *$3,000*. On the margin, that $6,000 wedge kills jobs and shrinks real household incomes.

Yet there is a Trumpian solution that makes far more sense under today's conditions than the tired old supply siders' income tax cut for the 10%, and most especially the top 1%—who pay *14X* more in income taxes than the bottom 50%, and who would capture upward of 45% of the Trump income tax cut.

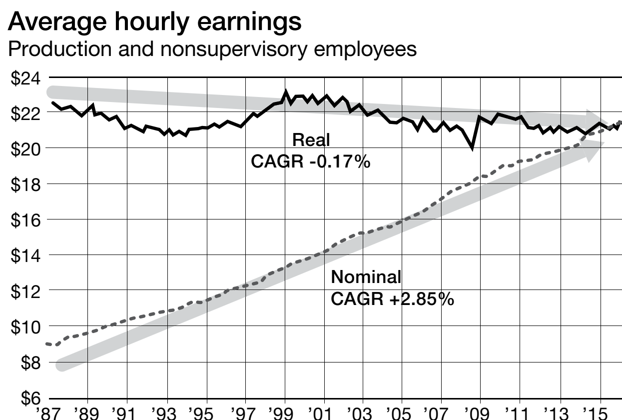
To wit, eliminate the payroll tax entirely and replace it with a tax on imports and business sales (otherwise known as consumption). That was proposed by "Lyin' Ted" Cruz in the primaries, and at least that part of it he got right.

Yes, and for political protection from the Social Security calamity-howlers, he could revive Al Gore's "lock box" and dedicate every penny to funding Social Security—especially for the 90% of recipients who actually need it.

That gets us back to the Fed and its malefic 2% inflation targeting.

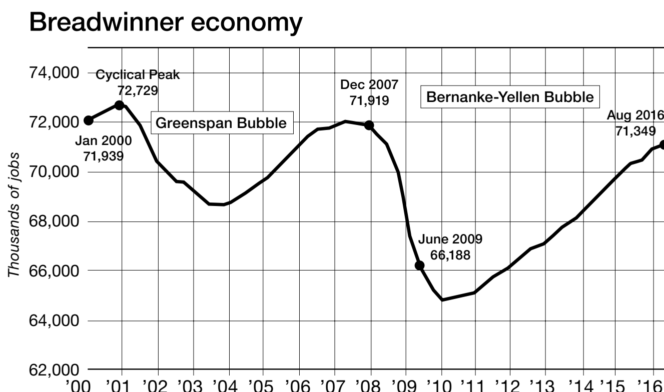
In an open global labor market, high-paying jobs in finance, government, entertainment, the professions and business management get offshored last, but are also the first to inflate at or higher than the general CPI rate.

By contrast, it is lower-tier jobs that get offshored in response to the China price for goods and the India price for services. That is, the average nominal hourly wage in the U.S. has nearly tripled since 1987, but all that "inflation" was for naught. Real wages went nowhere even as soaring nominal labor expense caused good jobs to be offshored in droves:



It should not be surprising, therefore, that there are no more full-time, full-pay breadwinner jobs at $50k per year in the U.S. today than there were when Bill Clinton was packing his bags to shuffle out of the Oval Office in January 2001.

On the margin, any goods and service jobs that can be offshored have been sent abroad. Indeed, in the context of the highest nominal wage rates on the planet, a central bank not in thrall to Keynesian voodoo would actually welcome deflation and not print money until the cows came home trying to stimulate inflation, thereby deliberately making war on wage earners who must compete in the world labor market:



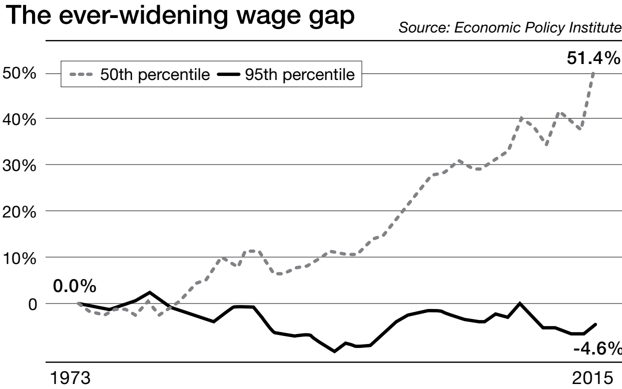
And it's also not surprising that what has been created in the labor market since 2000 are jobs that so far can't be offshored. That is to say bartenders, waitresses, hot dog vendors, retail floor sales clerks and temp agency gigs, which fill the cracks and come and go with the business cycle.

Unfortunately, that category of employment averages just 27 hours per week, $14 per hour and $20k on a full-year basis for holders lucky enough to be paid 52 weeks per year by computerized, demand load-driven scheduling systems.

Yet they all count as one-job-one-vote on vote on bubble vision during the monthly ritual of jobs Friday. Needless to say, they know better in Flyover America.

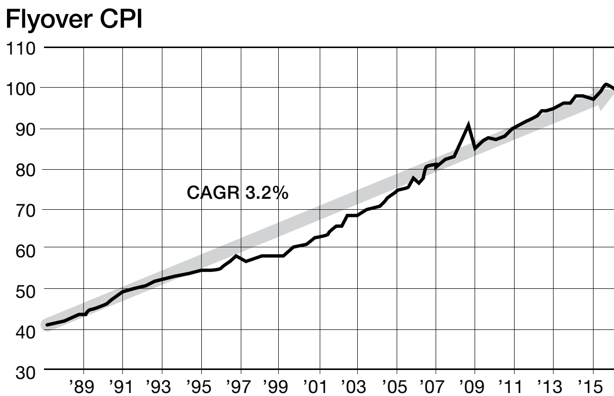
Yet that's not the half of it. The fact is 2–3% annual inflation is not a lock step affair. Nominal wage rates for import competing production and services jobs tend to rise slower than the CPI, meaning that the longer and more fully the Fed's specious goal of 2% inflation is realized, the further behind real wages become.

In an excellent post today on the fraudulent median household income gain reported by the Census Bureau, Charles Hugh-Smith powerfully illustrates the point that only academics with their heads in the sand could believe that inflation is a benign vehicle of lock step prosperity. Accordingly, among male wage earners since the 1970s, the top 5% have experienced a 51% gain in real wages—even using the BLS' sawed-off inflation measuring stick—compared against a nearly *5% loss* for the median earner:



And that's especially true for the overwhelming bulk of Main Street households, where upward of two-thirds of paychecks go to the four inflationary horseman of medical, housing, food and energy.

When you weight these true cost-of-living factors at 66% versus the BLS' 55% weighting and you use an accurate measure of medical and housing inflation, you end up not with "lowflation," as our monetary central planners so risibly claim. Actually, you end up with more than 3% per year inflation year in and year out since 1987:



Furthermore, when you then deflate the nominal median household income as reported by the Census Bureau by the Flyover CPI, you end up not with the spurious 5.2% gain so loudly ballyhooed by Washington and Wall Street last week. No, what you get is a 16.7% decline in the real median household incomes since 2000.

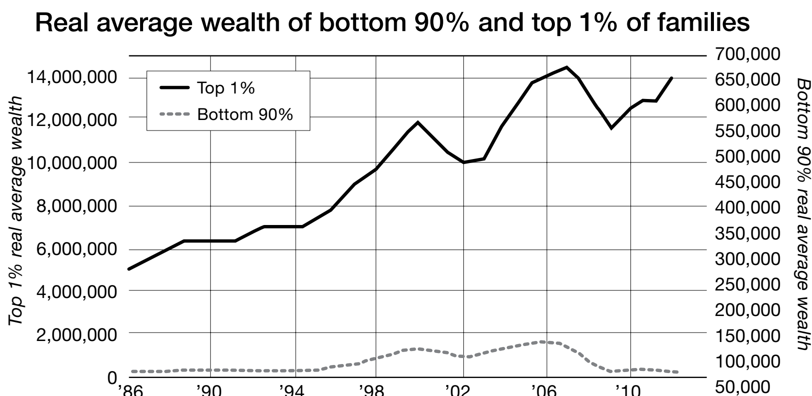
That figure dramatically contrasts with the 2.2% decline reported by the Census Bureau last week based on an inflation index (the CPI-U-RS) that seriously undercounts the true cost of living. Either way, however, the very idea that a posse of academic pettifoggers is attempting to spur more inflation should be reason enough for The Donald to go after the Fed with both barrels blasting during next week's debate.

It is bad enough, of course, that inflation targeting clobbers households in Flyover America, as depicted above. What's worse is that the resulting flood of central bank liquidity never leaves the canyons of Wall Street in today's world of Peak Debt. Accordingly, the values of financial assets have been massively, systematically and relentlessly inflated.

So doing, the central bankers bring about the ultimate affront to the struggling households of Flyover America. In a word, Main Street households have precious little discretionary income to salt away in "savings" and none that they can afford to put in harm's way in the Wall Street casino.

Indeed, the very idea that the policy of the state's central banking branch is to force savers out of bank accounts and into so-called "risk assets" is beyond the pale. Yet a retiree who has been thrifty enough over a working lifetime to salt away $250,000 in a bank account is earning the equivalent of one Starbucks cappuccino per day in interest under the Fed's 93 months and counting of ZIRP.

In short, since the onset of Bubble Finance, when Greenspan panicked in October 1987 and flooded Wall Street with cash in order to keep the insolvent banking houses of the day afloat, the wealth-creation process in America has been rigged in exactly the manner that The Donald has implied:



Putting the wood to the Fed is the right answer for what ails the American economy. The Donald needs to line up with the 90% who have been left behind.

The GOP establishment that he defeated has already done more than enough for the top tier, even as it has helped populate the Fed with the Keynesians and Beltway apparatchiks who have brought American capitalism to the brink of ruin.

THE DONALD NAILED IT: "WE ARE IN A BIG, FAT, UGLY BUBBLE"

Most of the 90 minutes that was the first presidential debate on Sept. 26 were a waste—with both candidates lobbing well-worn cliches, slogans and sound bites at the audience and each other.

But there was one brief moment that made it all worthwhile. That was when Donald Trump peeled the bark off the Fed's phony recovery narrative and warned that the stupendous stock market bubble it has created will come crashing down the minute it stops pegging rates to the zero bound (emphases mine):

> Typical politician. All talk, no action. Sounds good, doesn't work. Never going to happen. Our country is suffering because people like Secretary Clinton have made such bad decisions in terms of our jobs and in terms of what's going on.
>
> Now, look, we have the worst revival of an economy since the Great Depression. And believe me: We're in a bubble right now. And the only thing that looks good is the stock market, but if you raise interest rates even a little bit, that's going to come crashing down.
>
> *We are in a big, fat, ugly bubble*. And we better be awfully careful. And we have a Fed that's doing political things. This Janet Yellen of the Fed. The Fed is doing political—by keeping the interest rates at this level. And believe me: The day Obama goes off, and he leaves, and goes out to the golf course for the rest of his life to play golf, when they raise interest rates, you're going to see some

> very bad things happen, because the Fed is not doing their job. The Fed is being more political than Secretary Clinton.

Trump thereby landed a direct hit on the false Wall Street/Washington postulate that the Fed has been the nation's economic savior. And he also elicited an almost-instant defense of its destructive, anti-capitalist regime of Bubble Finance—albeit in the guise of a "fact check" by *New York Times* Fed reporter Binyamin Appelbaum.

To be sure, there were actually no "facts" to check in Trump's statement. It was simply an entirely correct judgment that the utterly unnatural interest rates engineered by the Fed have fueled an egregious inflation of financial asset prices and that "some very bad things" are going to happen when the Fed's market rigging operation is finally halted.

Still, opinion or not, Appelbaum emitted a barrage of harrumphing and scolding, implying that Trump is some kind of yokel who does not understand the sacred independence of the Fed (emphases ours):

> In attacking the Fed, Mr. Trump is plowing across a line that presidential candidates and presidents have observed for the past several decades. There has been a bipartisan consensus that central banks operate most effectively when they are shielded from short-term political pressures. Indeed, President Richard M. Nixon's insistence that the Fed should not raise rates in the early 1970s played a role in unleashing a long era of inflation—and in convincing his successors that it was better to leave the Fed to its technocratic devices.

Technocratic devices? Now, that is downright balderdash because what the Fed is doing is profoundly and resoundingly political.

To wit, after 94 months on the zero bound, the Fed has executed the most massive income and wealth transfer in American history. Upward of $2.5 trillion has been extracted from the hides of Main Street savers and retirees over that eight-year period (at $300 billion per year). All of that and then some was gifted to the banks and Wall Street speculators.

Needless to say, a wealth redistribution that monumental in scope and capricious in impact would never see the light of day among the un-

washed "politicians" that Appelbaum apparently thinks are too benighted to be involved in monetary policy. That's because whether or not they embrace the Keynesian nostrum that saving is bad and debt is good, the nation's politicians are smart enough to know that the sweeping fiscal transfer at the core of Fed policy would be shouted down by the voters in a thunderous chorus of denunciation and derision.

Stated differently, the politicians at least know that if the Congress were to enact anything remotely similar to the Fed's savage and relentless attack on savers and wage earners, they would be on the receiving end of the torches and pitchforks that would descend on the Imperial City.

In fact, this wanton redistribution from savers to debtors and speculators is occurring only because a happenstance of history has put lethal financial power in the hands of an insulated, unelected monetary politburo—one that has been taken over by a tiny posse of delusional and power-hungry Keynesian academics, to boot.

Journalistic hacks like Appelbaum, along with Steve Liesman of CNBC and Jon Hilsenrath of *The Wall Street Journal*, not only exhibit the worst kind of access-driven mendacity; they also faithfully perpetuate all the myths, shibboleths and outright lies that insulate the Fed from any policy accountability whatsoever.

In the case at hand, Appelbaum claims that it was Nixon's manhandling of the spineless Fed chairman Arthur Burns in the run-up to the 1972 election that proved the case for the strict "independence" of the Fed. The resultant decade-long inflationary wave instigated by the nefarious "Tricky Dick," therefore, was the inadvertent founding event; it allegedly fostered a newly minted separation of powers doctrine that has invested the 12 members of the FOMC with virtually dictatorial powers over the nation's financial system.

Well, yes, Nixon was the evildoer that paved the way to our present form of mutant casino capitalism. But it was not because Arthur Burns had a propensity to bend over in the presence of great power.

To the contrary, the real evil happened in August 1971, when Nixon was persuaded by a passel of so-called free market economists, led and

inspired by Milton Friedman, to trash the Bretton Woods system and sever the dollar's last link to anything other than the whims and economic theories of the FOMC.

It did take several decades, of course, for the denizens of the Eccles Building to realize that with the shackles of gold and convertibility removed, they were free to generate dollar liabilities at will. Indeed, the great Paul Volcker fully understood what had happened at Camp David and strove mightily during the next decade, first at the New York Fed and then in the Eccles Building, to keep the fiat genie bottled up via sheer intellectual discipline and willpower.

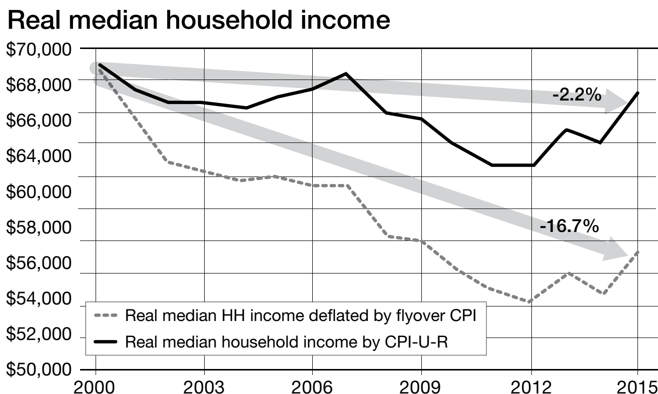
But it couldn't last, and not just because Alan Greenspan checked in his hard-money doctrines in the cloakroom of the Eccles Building the first day he arrived and never reclaimed the check. What happened was that the financial press discovered that it could swap journalistic integrity for access to the Fed's inner sanctum, and the rest is now history.

What has materialized, in fact, is a cult of central bank flattery and subservience that is every bit in the emperor-has-no-clothes modality. Not since the days of Bill Greider has a mainstream journalist even dared to suggest that Fed policies have untoward effects on the people or that its real function is to serve the interests of its Wall Street masters.

But now it's gotten downright hideous. There is not an honest price left in any precinct of the financial system. Dangerous, unstable speculative bubbles infest every corner of the money and capital markets.

Likewise, the Fed's fatuous policy of inflation targeting has caused the massive offshoring of breadwinner jobs to the China price for goods and the India price for services. And that wasn't the half of it.

At the same time, this sweeping and perverse job destruction policy has generated massive slack in the domestic labor markets — upward of 180 billion hours in quantitative terms. That overhang, in turn, has suppressed nominal wage rates in the middle and bottom ends of the labor market, causing wage earners to fall increasingly behind a relentlessly rising cost of living:



Furthermore, our monetary rulers then added insult to injury by fueling the fantastic bubble in the stock market that Trump so accurately called out in the last debate. And the problem is not just that it will soon crash and wipe out tens of trillions in paper wealth.

Actually, the real evil of ZIRP and QE has already been done.

To wit, can anyone not drinking the Wall Street Kool-Aid believe that Wells Fargo CEO John Stumpf and his patron saint, Warren Buffett, were actually running a bank?

In fact, the C-suites of Corporate America have become stock market gambling dens. Corporate balance sheets have been strip mined to fund the greatest financial engineering Ponzi schemes—trillions in stock buybacks, M&A deals and other leveraged distributions—ever conceived.

The truth is Janet Yellen is a paint-by-the-numbers academic fool who has no clue about the havoc she and her posse have unleashed on the American economy. Yet she gets away with it exactly owing to the "Fed independence" cover story so mendaciously peddled by the likes of Appelbaum, Liesman and Hilsenrath.

So thank heavens for The Donald. He knows a rigged operation when he sees it and, at least in the last debates, was undomesticated enough to let 100 million voters hear the truth.

THE FED'S MONETARY POLITBURO IS FINALLY CATCHING SOME FLACK

Echoing Donald Trump's first debate-night bull's-eye regarding the Fed's thoroughly political essence, Rep. Scott Garrett put more wood to Janet Yellen during a House Financial Services Committee hearing (emphasis mine):

> Rep. Scott Garrett, R-N.J., seized Trump's mantle during Wednesday's hearing, saying "the Fed has an unacceptable cozy relationship" with the Obama administration and Democrats.
>
> "As the saying goes, perception is reality," Garrett told Yellen. "Whether you like it or not, the public increasingly believes that *the Fed's independence is nothing more than a myth*."

Of course it's a myth, and a dangerous one, at that. The truth is Keynesian monetary central planning is inherently, massively and irremediably "political."

That's because it interjects the state deeply into the money and capital markets—the very heart of capitalism—and thereby in plenary fashion manipulates, rigs and falsifies the prices of all financial assets.

So doing, it supersedes governance by the many via continuous auction and free-market processes of financial valuation and allocation with governance by the few, who rule arbitrarily and often secretly via ideological whims and shibboleths that they are pleased to call "policy."

Worse still, the *Eccles Building politicians* who rule the financial markets directly—and through them much of the balance of capitalism indirectly—are unelected and are accountable to no democratic oversight and control whatsoever. They have essentially seized great power in the manner of a coup d' etat, and have then added insult to injury by proclaiming the utterly spurious doctrine of Fed "independence."

The cover story, of course, is that central banking is such a complex, arcane and intellectually demanding business that only a tiny elite of the best and brightest are capable of manning the monetary dials.

Indeed, it is claimed that the job of keeping capitalism on the straight and narrow path toward the Keynesian nirvana of full employment—and

off the shoals of underperformance, recessionary lapse and depressionary crisis where it is otherwise inclined—can only be accomplished by an elite politburo, and one that is accountable only to itself and its esoteric econometric models.

Folks, that is self-serving bunkum and poppycock. If you want to have financial rule by politicians rather than markets, the FOMC has absolutely no more competence than the House Financial Services Committee. In fact, if you want to set the money market rate by essentially throwing a dart at the wall, you could pick the FOMC by lot from the phone book!

After all, the so-called science of Keynesian central banking amounts to nothing more than deciding by how much you want to falsify the market price of money and financial assets—along with how frequently you want to change the "fix" and which components of the yield curve and tradable assets you want to rig.

Since the purported geniuses who occupy the 12 chairs at the FOMC have essentially not changed the peg for 94 months running, the job can't be all that hard. Does it really take an economics Ph.D. or ex-banker to figure this out, or, for that matter, to ascertain that Wall Street gamblers prefer free money, as opposed to expensive money, to fund their speculations?

In fact, it all boils down to the very kind of binary decisions that both elected politicians and average voters excel at making. To wit, if you are rigging the financial markets, whom do you want to help and whom do you want to hurt?

That is, borrowers or savers, speculators or entrepreneurs, money shufflers or wage earners, bankers or depositors, the risk-prone or the risk-averse, day traders or business-builders, etc.? It's really not all that hard to rig markets if you have a printing press and plenary authority to redistribute economic gain and pain and societal income and wealth by political fiat, and without the inconvenience of periodic elections.

Needless to say, there is one hell of an argument in favor of market-based price discovery by capital providers and capital users in their tens of millions, as opposed to a tiny posse of politicians in the Eccles or Rayburn buildings or from the phone book. But until very recently, the

choice between financial rule by politicians versus markets wasn't even on the radar screen of public discussion.

No more. Donald Trump deserves the nation's eternal gratitude for finally raising the topic—even if his point was narrowly partisan and electoral. But politics is politics, and now that Flyover America has been reminded that the Fed is knee-deep in it, hopefully, the drumbeat will grow louder.

Fortunately, the obtuse arrogance of the monetary politburo itself is helping to screw up the courage of politicians like Rep. Garrett. He has, apparently, come out of the monetary closet and, hopefully, provided an example for his Capitol Hill colleagues.

In this instance, Hillary Clinton's Treasury secretary designate, and lifelong financial apparatchik, Lael Brainard, made it easy. She's been an in-your-face contributor to the Clinton campaign, and has been visibly lobbying for the high office that Jack Lew, Tim Geithner and Hank Paulson have recently so thoroughly defiled with their bailouts and booty. From Bloomberg:

> Federal Reserve Chair Janet Yellen's defense of the central bank as nonpartisan came under attack on Wednesday, as a Republican congressman cornered her on whether a key policymaker would have a conflict of interest in discussing a post in the next U.S. president's administration.
>
> Fed Gov. Lael Brainard has donated to Clinton's campaign and is widely viewed as a potential Clinton pick for Treasury secretary. Yellen hesitated and then demurred when Rep. Scott Garrett of New Jersey asked whether Brainard would have a conflict of interest if she were indeed in talks with Democratic nominee Hillary Clinton's campaign about a position. The election takes place Nov. 8.

As it happened, this isn't the first time. Our Wall Street/Washington financial rulers have become so brazen in their political machinations that Tim Geithner actually confessed to lobbying Obama for the Treasury job in the white heat of the October 2008 meltdown.

That is, when as the president of the New York Fed he was supposedly helping to administer the secret ministrations by which the best and brightest go about saving capitalism from itself, he actually had his head far up the Democratic candidate's keister in pursuit of politics (emphasis mine):

> In his memoir, Timothy Geithner recalls meeting with then-Sen. Obama in his room at the W Hotel in Midtown Manhattan before the 2008 election, *where the future president suggested that he might ask Geithner—then head of the New York Fed—to come to Washington as Treasury secretary*. That meeting was in mid-October; Geithner voted at the next Fed meeting, at the end of the month, to cut interest rates by a half percentage point amid the deepening financial crisis.

The process of defrocking the high priests of the monetary temple might even become contagious. Recently, one Ruchir Sharma, who is chief global strategist at Morgan Stanley Investment Management, let loose a real stunner. Excerpts from his Wall Street Journal piece are highlighted below.

But first let's cut to the chase. Approximately 3,200 days have elapsed since January 2008, and on 70 of those days, or *2% of the time,* the monetary politburo was in session at the Eccles Building. Yet *mirabile dictu* (wonderful to relate), *60%* of the entire stock market gain during that nearly nine-year period occurred on exactly those *2%* of days.

Can you say rigged!

Donald Trump did. Scott Garrett did. Now even the Morgan Stanley guy has let the cat out of the bag (emphases mine):

> Since the Fed began aggressive monetary easing in 2008, my calculations show that nearly 60% of stock market gains have come on those days, once every six weeks, that the Federal Open Market Committee announces its policy decisions.
>
> Put another way, the S&P 500 index has gained 699 points since January 2008, and 422 of those points came on the 70 Fed announcement days. The average gain on announcement days was 0.49%, or roughly 50 times higher than the average gain of 0.01% on other days.

> *This is a sign of dysfunction. The stock market should be a barometer of the economy, but in practice it has become a barometer of Fed policy.*

Yes, you could call it "dysfunction." But the right phrase is sheer madness. In effect, the politicians at the Fed have entered a symbiotic embrace with the gamblers on Wall Street. Yet finally, even an honest voice from the latter has dared to describe the untoward results.

Here is more unpeeling of the Fed "independence" lie from Sharma's blockbuster Op-Ed:

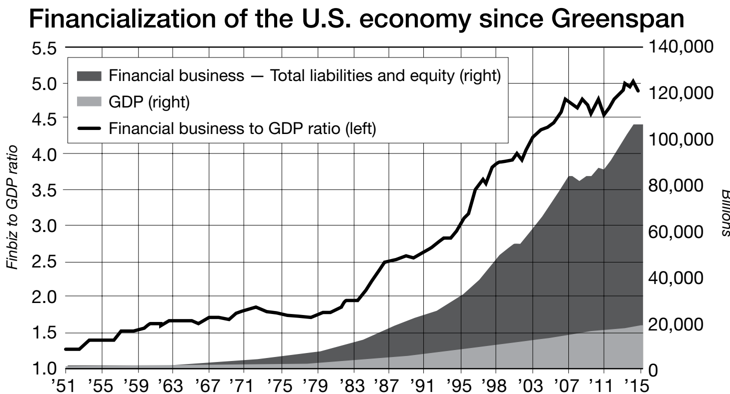
> Fed policy proclamations had little influence on the stock market before 1980. Between 1980 and 2007, returns on Fed announcement days averaged 0.24%, about half as much as during the current easing cycle. The effect of Fed announcements rose sharply after 2008 when the Fed launched the early rounds of quantitative easing (usually called QE), its bond purchases intended to inject money into the economy . . .
>
> Whether this is a "big, fat, ugly bubble" depends on how one defines a bubble. But a composite index for stocks, bonds and homes shows that their combined valuations have never been higher in 50 years. Housing prices have been rising faster than incomes, putting a first home out of reach for many Americans . . .
>
> Mr. Trump was also right that despite the Fed's efforts, the U.S. has experienced "the worst revival of an economy since the Great Depression." The economy's growth rate is well below its pre-crisis norm, and the benefits have been slow to reach the middle class and Main Street. Much of the Fed's easy money has gone into financial engineering, as companies borrow billions of dollars to buy back their own stock. Corporate debt as a share of GDP has risen to match the highs hit before the 2008 crisis . . .
>
> In this way, the Fed's policies have fueled a sharp rise in wealth inequality worldwide—and a boom in the global population of billionaires. Ironically, rising resentment against such inequality

> is lifting the electoral prospects of angry populists like Mr. Trump, a billionaire promising to fight for the little guy. His rants may often be inaccurate, but regarding the ripple effects of the Fed's easy money, Mr. Trump is directly on point.

So now perhaps another question can be raised. Why do we even need politicians to peg and falsify the price of money and financial assets?

Has there been a shortage of debt that requires artificially low interest rates to encourage households, businesses and government officials to borrow?

Has the financial sector languished and dragged down the real economy—especially since Alan Greenspan discovered the printing press in the basement of the Eccles Building during the stock market crash of October 1987?



Do we need chronic, egregiously "easy money" when the financial sector's size has risen from 1.5X national income during the halcyon days of the 1950s and 1960s to 5X the flat-lining economy of the present era?:

Do we need a posse of politicians at the Fed empowered to ride roughshod over every financial asset price for the absurd purpose of generating more inflation? Is that not the equivalent of carrying coals to Newcastle when the American economy already has nearly the highest costs and wages in the world?

Have these central bank politicians ever offered a smidgen of proof that consumers don't buy flat-screen TVs, computers or iPhones because

their prices are falling? Or that they delay purchasing food, fuel and necessities because the CPI is too weak? Or that they need to be smacked in the forehead by "sticker shock" in order to buy a car?

To the contrary, in a world in which massive numbers of jobs and incomes have been offshored owing to the China price for goods and the India price for services, what would be so bad about a little deflation, exactly?

In fact, workers in the middle and lower reaches of the job market have not even kept up with the average nominal wage, which has nearly tripled since 1987, even as their after-inflation paychecks—measured by an honest cost-of-living deflator—have been shrinking for decades.

At the end of the day, the current regime of political rule of financial markets is based on the monetary politburo's self-serving myth that flexible, mobilized, market-set interest rates will impair economic prosperity and that left to its own devices, capitalism has a death wish.

To the contrary, mobilized, free-market interest rates are the only route to financial stability, efficient capital allocation and the extinguishment of the rampant speculation and malinvestment bringing American capitalism to ruin. Accomplish that much and the business cycle will self-correct and capitalist prosperity will be off to the races.

To be sure, there is a long way from here to there. But calling out the politics-ridden nature of the Federal Reserve and the myth of its vaunted "independence" is a least a start in the right direction.

RIDE THE S&P 500 BACK TO EARTH AS THE CASINO COMES UNHINGED

The casino has become so unhinged that analysis is almost beside the point. To wit, after seven years of unrelenting financial asset inflation, which has lifted the S&P 500 by an incredible 225%, the stock market is finally heading for an encounter with the Grim Reaper.

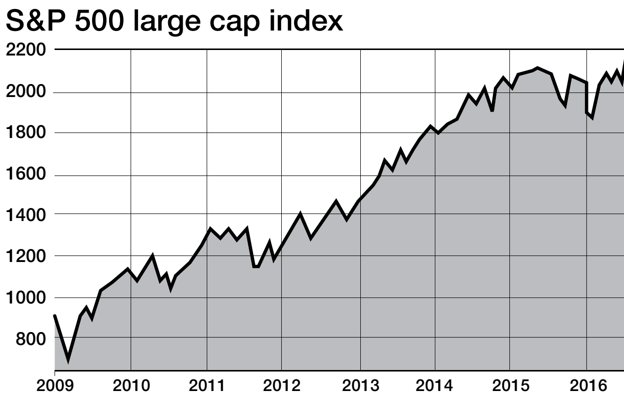
If you value current earnings of $87 per share at a generous 15X P/E multiple, the implied value of the S&P 500 index is about *1,300. That's a vertiginous 870-point, or 40%, plunge from here*.

So our strategy at this point is simply to short the S&P 500 and wait for the visage pictured below to make his appointed rounds. You can find our preferred instrument to and allocation for this trade in Stockman's *Contrarian Portfolio*, right here.

Meanwhile, there is little doubt that the stock market has now entered the zone of pure mania. From a technical viewpoint, it is egregiously overvalued at a P/E ratio of 25X, which is in the nosebleed section of history. At the same time, the global and domestic economies are heading into a prolonged patch of deflation, recession and slumping profits.

These conditions alone would be enough to leave the market vulnerable to a black swan-type shock. But what is truly different this time is that the bubble-makers at the central banks are finally out of dry powder. They are facing a drastic and sudden loss of credibility.

Two decades of central bank financial repression have destroyed honest price discovery on Wall Street. So the most recent 15% market surge from last February's low is just the last gasp of the greatest speculative bubble in history:



Indeed, the boys and girls on Wall Street are now riding their bikes with no hands and eyes wide shut. That's the only way to explain the most recent lunatic buying-spree post-Brexit shock.

Let's start with valuation as measured by the P/E ratio for the broad market represented by the S&P 500.

VALUATION FOR THE BROAD MARKET

When the S&P 500 first peaked at 2,130 back in May 2015, reported LTM (last 12 months) earnings were $99.25 per share. That was already down 6.4% from the cyclical high of $106 per share in September 2014. Thus, stocks were being valued at a nosebleed *21.5X in the face of falling earnings*.

During the five quarters since then, reported LTM earnings have slumped by a further *12%*, to the $87 per share indicated above for the LTM ending in March. Beyond that, even the talking heads on bubble vision agree that this quarter will be down another 5% versus from the prior year.

So let's give it the benefit of the doubt and assume LTM reported earnings for June come in no lower than $85 per share. Yet with the S&P 500 now at 2,175 that brings the P/E ratio to *25.5X earnings—yet that profit figure will have shrunk by nearly 20% over the last seven quarters*.

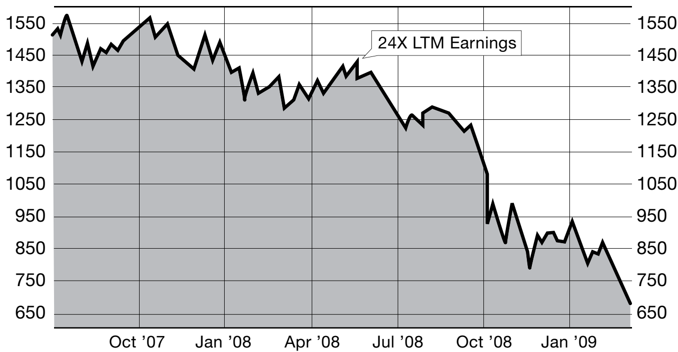
Needless to say, in a world economy that is visibly grinding to a halt, and with strong head winds assailing Japan, China, the eurozone, Brazil, Canada, Australia and most of the rest of the EM (emerging-market) economies, current stock market valuations are just plain nuts. But as is typical of a mania, the revelers do not see their precarious position until after the bubble bursts.

For that reason, May 16, 2008, is instructive. That was the last time P/E ratios on an honest GAAP (generally accepted accounting principles) basis were near current nosebleed levels. It was also a time when the U.S. economy was already in its sixth month of recession. But no one had bothered to tell the Eccles Building or the Wall Street punters.

In fact, at the time, the White House Council of Economic Advisers said there was absolutely no recession in sight. Likewise, Bernanke had proclaimed that the subprime problem was "contained" and was preaching mainly blue skies ahead.

At that crucial turning point in the financial and macroeconomic cycle, however, LTM earnings for the most recent period (March 2008) had posted at $60.39 per share. So when the market hit an intraday high of 1,430, the implied multiple was nearly *24X*.

Needless to say, it was a long way down from there. In fact, 10 months later, the market was *53% lower*. S&P reported earnings actually bottomed that quarter at $6.86 per share, or *90% lower*:



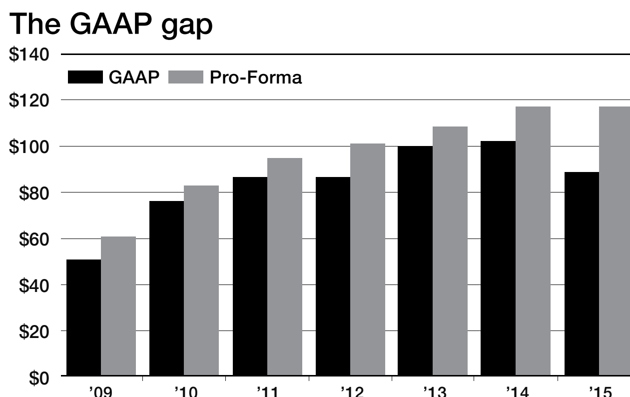
In truth, the current unhinged mania is worse than déjà vu. That's because the casino's financial narrative has been so corrupted by recency bias and accounting promiscuity that it has no idea what the profits picture really is or where it is going.

As *The Wall Street Journal* recently documented, Wall Street's heavily medicated and manipulated version of corporate earnings, usually referred to as "ex-items" or "operating earnings," came in at $1.040 trillion in CY 2015.

Now, that compared with only $757 billion of GAAP earnings. It would appear that CEOs and CFOs who filed their SEC statements on penalty of prison time averred that their actual profits were exactly $256 billion smaller than what they told their investors.

As it happens, that quarter trillion-dollar fib is exactly the size of the ex-items charade back in 2007. It seems as if companies actually need a periodic recession so that they can toss into the kitchen sink the write-offs for all the dumb deals and investment mistakes they made while the bubble was still inflating.

In any event, not only are Wall Street's hockey sticks extremely crooked from an accounting point of view, but they are also egregiously predictable in the magnitude by which they deflate. Eventually, reality overtakes Wall Street's one-year forward earnings.



WHAT'S REALLY HAPPENING WITH "OPERATING EARNINGS"?

So let's briefly consider what has been happening with "operating earnings" as Wall Street construes them. The crucial initial point is that they are always presented on a one-year forward basis. This is based on the pretext that the stock market is still a "discounting" machine with respect to the unfolding future.

But the real reason is that on a current basis, the P/E multiple on "operating earnings" is still scary high. Based on the most recent estimates, operating earnings for June LTM are expected to be about $100 per share. So even that is pushing a P/E multiple of *21.8X*.

Here is where the perennial "sell-side" scam comes in, and especially late in the business and profits cycle. At 87 months, this one is surely long in the tooth already. But nevertheless, the Wall Street brokers keep projecting "consensus" earnings gains of 30% for the year ahead—even as it never remotely materializes.

For example, back in March 2014, the one-year forward estimate for CY 2015 came in at *$135* per share of "operating earnings" for the S&P 500. At length, CY 2015 unfolded—bringing with it a collapse of oil and materials prices and a sharp slowdown of global growth that came as a big surprise to Wall Street.

Accordingly, the official statistician for Standard & Poor's, Howard Silverblatt, now certifies that actual operating earnings for CY (calendar

year) 2015 came in at *$100.45* per share. Apparently, in a world where "onetimers" don't count, that gigantic *26%* miss doesn't count, either.

That's because in March 2015, Wall Street's "bottoms up" consensus for the next year ahead—2016—was pegged at, yes, $135 per share, again.

The problem is that the 2016 hockey stick has already been rolled down to just $114 per share. Yet even after Q2 came in at $25.89 per share, and if there is no further earnings decline in Q3 and Q4, earnings will total just $98.33 per share for 2016. *That will be another 27% miss*.

Never fear. The Street consensus estimate for 2017, as of this March, was *$135* per share for the third year in a row!

You might conclude that Wall Street mendacity has no bounds — and that would be correct. But the more important takeaway is that Wall Street never, ever sees a recession coming, either.

FACTORING IN THE MONTHLY BLS JOBS REPORT

As we have argued many times, the BLS (Bureau of Labor Statistics) monthly jobs report is not worth the paper it is printed on. This is because of seasonal maladjustments, the phony birth/death imputation of hundreds of thousands of phantom jobs each month and something we call trend cycle adjustment.

The latter means essentially that the initial estimates published by the BLS are *modeled, not counted or surveyed,* as Wall Street would have you believe.

That's why the BLS job count is a lagging indicator and is always substantially overstated when the economy slides into recession. During the last cycle, for example, the BLS overcounted jobs by an average of *560,000 per month* between September 2009 and February 2009. That's based on its own "revisions" years after the fact.

So we give zero credibility to the headline numbers published that get the day traders and robo-machines so excited.

In fact, you don't even have to puzzle through the wild swings emanating from the BLS random numbers generator to know that the actual U.S. economy and labor market are weakening rapidly.

There is absolutely no need for the essentially useless BLS employment report in the first place. That's because the daily payroll tax withholding receipts of the U.S. Treasury tell you all you need to know, and with one huge advantage, to boot.

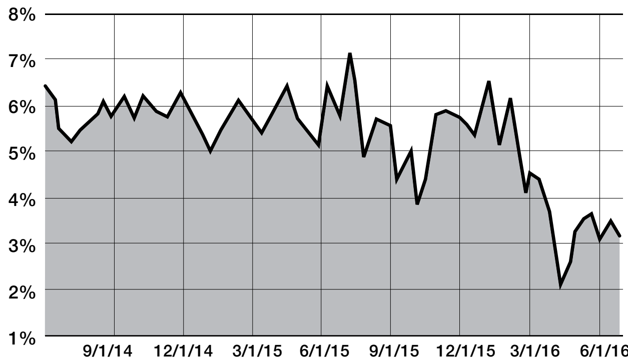
To my knowledge, there is no sentient employer in the U.S. who sends payroll tax money to Washington based on phantom jobs owing to seasonal adjustments, birth-death imputations or trend-cycle adjusted models, which recalibrate shop floor head counts to fit a prior trend.

Accordingly, if you strip from the payroll tax data an allowance for any tax policy changes, and allow for the going rate of nominal wage increase, *you essentially get a proxy for real units of labor input to the American economy*.

That is to say, you get real-time estimates of labor hours worked. You don't get medicated and manipulated statistical model projections of what a handful of GS-16s think the Census count in the nation's workplaces should have been.

Now, according to the U.S. Treasury's cash box, June employment did not come "roaring" back at all. To the contrary, it has continued to skid, and has been for several months now.

To wit, compared with a 5–6% average annual gain late last year, the collections trend has now fallen to just 3%. Strip out of that the 2.6% annualized rate of hourly wage and salary inflation reported for June and you get hardly a 0.5% growth in real labor inputs:

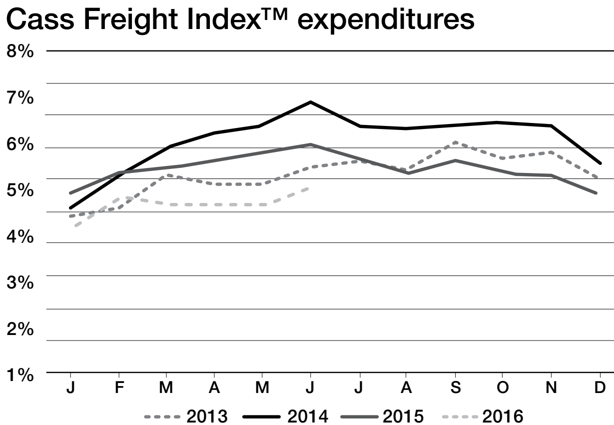


And that's not the half of it. The above data probably understate the slowdown because they represent a three-month moving average designed to strain out seasonal and calendar effects. More recent tax collections data suggest the U.S. economy may be barely treading water.

DAILY CONFIRMATION OF RECESSION

That recession is knocking on the door is confirmed almost daily. The recent batch of data for June freight shipments was especially dispositive. That's because the movement of goods and commodities directly tracks the pace of business activity in the $18 trillion U.S. economy.

As shown in the graph below, the Cass Freight index is now at a four-year low and *13% below* its level of June 2014. Indeed, it is no coincidence at all that the S&P 500's peak earnings occurred in mid-2014 just as freight throughput in the U.S. economy was also peaking:



Finally, the most recent data for business sales and inventories leave little to the imagination. Total business sales as reported by the Commerce Department is the big enchilada because it captures the sum of retail, wholesale and manufacturing activity in the U.S. economy.

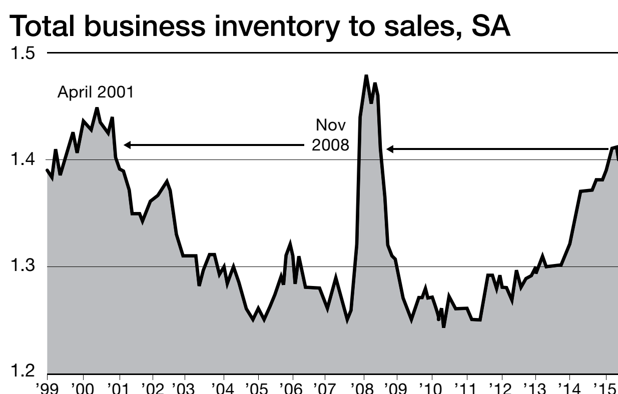
During the most recent month (May), total business sales clocked in at $1.351 trillion, meaning about $16 trillion at an annualized pace. That's down nearly 4.5% since the peak in July 2014.

Here's the thing. On an annualized basis, total business sales have dropped by nearly $700 billion during the last 24 months. During that

same period, however, total business inventories continued to rise. They currently clock in at $1.81 trillion, representing a $50 billion gain even as business sales have been steadily shrinking.

The result is what always happens on the eve of a business cycle downturn. The inventory-sales ratio spikes, triggering a period of liquidation and reduced output and employment.

That's a recession. And it doesn't take too much chart gazing to see that we are close to the 2001 and 2008 triggering points:



BRING ON THE HELICOPTER MONEY SCAM

That gets us to the final prop under the market's bottled air: "helicopter money."

The key point is that there is nothing new or magical about it at all. It's just more of the same aggressive monetization of the public debt that has been going on for nearly two decades.

That is, whether the central banks buy public debt from the inventories of the 23 prime dealers and other market speculators or directly from the U.S. Treasury makes no technical difference whatsoever.

The end state of "something for nothing" finance is the same in both cases. In fact, helicopter money is just a desperate scam emanating from the world's tiny fraternity of central bankers. The same central bankers who have walked the financial system to the brink and are now trying to con the casino into believing they have one more magic rabbit to pull out of the hat.

They don't. That's because it takes two branches of the state to tango in the game of helicopter money. The unelected monetary central planners can run the digital printing presses at whim and continually "surprise" and gratify the casino gamblers with another unexpected batch of the monetary drugs.

By contrast, helicopter money requires the people's elected representatives to play. That is, the Congress and White House must generate large incremental expansions of the fiscal deficit. They have to do this so that the central bankers can buy it directly from the U.S. Treasury's shelf and then credit the government's Fed accounts with credits conjured from thin air.

To be sure, the cynics would say, "No problem!" When have politicians ever turned down an opportunity to borrow and spend themselves silly, and to then be applauded, not chastised, for the effort?

But that assumes we still have a functioning government and that today's politicians have been 100% cured of their atavistic fears of the public debt. Alas, what is going to cause helicopter money to be a giant dud—at least in the U.S.—is that neither of these conditions is extant.

Regardless of whether the November winner is Hillary or The Donald, there is one thing certain. There will be no functioning government come 2017. Washington will be the site of a political brawl of deafening and paralyzing aspect—like none in modern U.S. history, or ever.

At the same time, the existing budget deficit is already reversing. It will end the current year at more than $600 billion. That's baked into the cake already, based on the recent sharp slowdown in revenue collections. It means that the fiscal 2016 deficit will be one-third higher than last year's $450 billion.

Moreover, when the new Congress convenes next February, the forward budget projections will make a scary truth suddenly undeniable. *That is, the nation is swiftly heading back toward trillion-dollar annual deficits under existing policy, and even before the impact of a serious recessionary decline*.

The reality of rapidly swelling deficits even before enactment of a massive helicopter money fiscal stimulus program will scare the wits out

of conservative politicians, and much of the electorate, too. What fools like Bernanke haven't reckoned with is that the very idea of helicopter money strikes most sensible people as preposterous, offensive and scary.

Even if Wall Street talks it up, there will be massive, heated, extended and paralyzing debate in Congress and the White House about it for months on end. There is virtually no chance that anything that even remotely resembles the Bernanke version of helicopter money could be enacted into law and become effective before CY 2018.

Will the boys and girls still in the casino after the upcoming election gong show patiently wait for their next fix from a Beltway governance process that is in sheer pandemonium and indefinitely paralyzed?

We think not. And with the inverse S&P 500 described in our Contrarian Portfolio, you'll be well suited to profit as the market crashes back down to earth.