



Retirement *Lifestyle* Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
Market-Ticker.org

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Dennis Tubbergen:

Welcome to RLA Radio. I'm Dennis Tubbergen, your host. Whether you are listening to the podcast today or you're watching on YouTube, welcome. Joining me in the second segment of today's program is returning guest Mr. Karl Denninger. I'm going to chat with Karl about is the US in recession and what will Fed policy be moving ahead and how might you be affected?

I'd like to remind you that if you've not yet gone to Retirement Lifestyle Advocates and created a free login to access our free resources there, I'd encourage you to do that. Again, the website RetirementLifestyleAdvocates.com. And when you go there and create a free login, you'll get access to my weekly portfolio watch newsletter, this podcast, as well as the weekly headline Roundup newscast, and you can participate in that every Monday live at one o'clock Eastern time.

So in this segment, I want to chat with you a little bit about the inevitable deflation that we're going to see coming.

Now, that seems a bit strange. It seems a bit counterintuitive, if you will, since we're all concerned about inflation. Why is it that I am going to talk to you about deflation in this segment? Well, first of all, debt in the private sector is going to drive this. I'll explain in a moment, but debt in the United States remains at nosebleed levels as far as the private sector is concerned. And we're seeing some trouble now in the private credit market that tells us that this will likely be a bigger problem moving ahead. Now, according to World Bank Group, private sector debt in the United States is at about 200% of gross domestic product or economic output. Now, let me put that in perspective for you. At the onset of the Great Depression, private sector debt levels were 132% of economic output, which was the highest that we had ever seen in the United States up to that point.

So that means that private sector debt is about 50% higher today when measured as a percentage of GDP than it was at the beginning of the Great Depression. Now, this level of debt is a precondition for economic collapse. Let me say that again. This level of debt is a precondition for economic collapse. Here's why. What is debt or an obligation to one party is an asset to another party. So let's just say for one moment that I have \$100,000 cash in an account. That \$100,000 cash is listed on my personal balance sheet as an asset. Now let's say I have a friend of mine come to me and says, "Hey, Dennis, I need to borrow \$100,000. I'll pay you some interest and I'll pay you back in a year." So I decide to help my friend out. I take \$100,000 out of my cash account.

I give it to my friend. My net worth has not changed. I have a \$100,000 cash asset that is now a \$100,000 note payable to me. Both assets on paper are worth \$100,000. My net worth is the same. It has not changed. Now, if the friend to whom I made the loan should come to me and say, "Hey, I can't pay you back." That \$100,000 asset on my personal balance sheet is now worth zero, and it reduces my net worth by \$100,000. My personal net worth deflated, deflation technically defined as a contraction to the currency supply. So this is counterparty risk. And when it comes to counterparty risk, there are two things that are always true. If an asset in your portfolio has counterparty risk, that asset is only an asset as long as the counterparty is creditworthy and can pay you. If you don't get paid by the counterparty, your asset disappears and your net worth declines.

When debt in the private sector are too high to be paid and mathematically this debt cannot be paid, creditors will eventually take an asset hit. These creditors will see their net worth decline as counterparties default on the debt. Now, this is essentially what happened in the banking sector at the time of the financial crisis. Many banks made subprime mortgages or loans to non-qualified buyers in a lot of cases for 100% or more the purchase price of a house. Now, there is a story behind this. Congress set quotas for banks to make loans to low income and middle income people and households under the idea that we want to make housing affordable for everyone. So not surprisingly, it was government meddling, if you will, in the banking sector that really caused this. So what happened at the time of the financial crisis is the government chose to bail out some banks, the banks they deemed too big to fail, while other banks were allowed to fail.

So the government assumed some of this private sector debt default responsibility, but with debt now at 200% of the economy in the private sector, the government cannot absorb this. There is no way the government can absorb this. That's why we will have to see deflation at some point. Let me inject a little bit of common sense here. If there's too much debt to be paid, it won't all be paid. And we're starting to see signs that this debt is going unpaid. When you look at the current level of delinquent mortgage payments, in every income quartile, they are higher, anywhere from 50% to double. Credit card delinquency rates, people behind on credit card payments up to the highest level since 2011. There's \$1.23 trillion in credit card debt. That's up 33% over the past three years. And now delinquency rates, credit card holders not making payments timely are at an all time high.

The same thing is true about student loan debt. Student loan debt had a delinquency rate of about 17% in 2019. There was then a period of time when student loans were not being collected, and now we are right back to

about a 17% student loan delinquency rate. Auto loans. The delinquency rate on auto loans, particularly subprime loans, are higher. We are seeing trouble in the private credit markets. We are seeing trouble with commercial mortgage backed securities. We are seeing now symptoms that these debt levels cannot be paid. This will at some point have to be deflationary. I believe the Fed's response will be the response that they always have, and that is to create more currency. However, I believe this deflationary wave of private sector debt going unpaid will be very difficult, if not impossible for the Fed to overcome. So what does this mean for you?

It means that likely we're going to see risk assets like stocks and real estate decline over the longer term. By the longer term, I mean the next couple, three years. And I believe that we will at this point be in a recession. I think that some future revision of the data will show that we are in recession presently. So protect yourself. If you're approaching retirement, certainly you want to take a look at what can you do to mitigate risk in your portfolio. I'll talk more about this with my special guest, Mr. Karl Denninger, after these words. Don't go away.

Hey, Dennis Tubbergen, host of RLA Radio. I'd like to invite you to get for the very first time a complimentary copy of my bestselling book released in January. The book is titled Portfolio Playbook: Investing Strategies for the Current Economy. To get your copy of the book, all you need to do is visit the website, requestyourbook.com, [request yourbook.com](http://requestyourbook.com), and I'll be very glad to send you a complimentary copy. Portfolio playbook reveals why traditional investing strategies, especially the 60 / 40 portfolio I believe have the potential to fail in today's debt-driven boom and bust economy. And I give you a clear common sense roadmap for you to consider, to use to protect and grow your wealth in what I believe could be turbulent years lying ahead. So to get your copy of the portfolio playbook, which contains investing strategies for the current economy, all you need to do is visit the website, requestyourbook.com. The website again is requestyobook.com, and I'll be glad to send you a complimentary copy.

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. Joining me once again on today's program is returning guest, Mr. Karl Denninger. Many of you will recognize Karl as the proprietor, the host of the website, market-ticker.org. He is a prolific commentator, very bright guy, and I'm always excited to have him on the program to get his perspective. So Karl, welcome back to the program and thank you for joining us.

Karl Denninger:

Thank you for having me on.

Dennis Tubbergen:

So Karl, let me jump right in. Are we in a recession?

Karl Denninger:

If we're not officially yet, well, of course the NBER is always late.

Dennis Tubbergen:

Yeah. By the third revision, we might be in a recession.

Karl Denninger:

Well, it's not that they try to be late because they backdate their recession call. It's just that you can't make the call until you have all the data and the data is collected late. So I mean, they're not looking forward. They're looking at now. So for example, we're going to get an employment report here in the next few days and that has already happened. The sample week was the third week of the month. So whatever's going to be reported has already occurred. Likewise, the CPI, all the other elements that go into a recessionary call or not, same thing with GDP. All of these things are in retrospect. But the pressure that's been building on this, I put an article up about this a few days ago, is actually from one place and one place only. And if we do not resolve this in the United States, we're not going to get out.

I mean, they can try to play games and maybe get another number bubble going, whatever, but we can't actually have any kind of balance in the economy. And that is, if you take a look at the federal funds rate from when they started collecting it, there was a kind of one prior to 1953, but it wasn't recognized as the Fed funds rate, so it wasn't the same thing. So the series starts then in the 1950s. And you look at that or you put that on a graph, and then you look at the federal deficit or surplus as a percentage of GDP and put that on the same graph and overlay the two on the same thing. You'll see that up until the 2008 housing crash, there was no consistent trend ever where you could borrow on the short end of the curve, which of course is always at the lower rate because time has value.

There was never a place where you could borrow under the rate of deficit spending. Now, there was a short excursion in right after 2000 because, of course, everybody thought that the world was going to come to an end because all the old COBOL programs were not going to be properly updated. And the financial world was going to literally have a seizure or die. It didn't happen, but that was the fear that was run at the time. And then of course

we had nine eleven and short-term excursions like that from exogenous events, you can say, yeah, they were bad, but what you can't say is that it was a systemic plan because it wasn't and the data is what it is. However, post the 2008 bubble, there has been no time since then that the federal funds rate has been at or above the federal deficit as a percentage of GDP.

Now, if you think about what that means, it means that anyone who can borrow at or near that rate is being paid to borrow in real terms. In other words, they don't have to do anything productive with the money because there is a negative cost to borrowing. Well, this of course cranks asset prices to the moon and it has, but there's no production behind that. And if you look at other statistics, you'll see this. For example, primary energy production in the United States, there's been no advance. Now, you can excuse some of this as being due to efficiency, which is true. I mean, we have better air conditioners today. We have better mileage in our cars than we had in the 1970s and 1980s. Okay. All of that is true. However, these correlates are deeply troubling. And then you add to that supply system, shocks, like what we're going through right now with this excursion in Iraq, I'm sorry, Iran, the war du jour and what many people do not realize, and we all see it at the gas pump when we go to the store and we go to fill our tanks up.

And of course, the people with electric cars are, some of them are growing right now because they say, "Well, it hasn't gone up for me. " Well, it's going to because where do you think the energy is produced that goes into the socket that ultimately comes out? And the answer is an awful lot of it comes out of carbon-based fuels, all of which are impacted by this. But there's many knockout effects. As an example, natural gas is the primary feedstock for fertilizer. A lot of people don't know this, but it is. It's also the feedstock for a decent number of other industrial chemicals without which modern technology does not exist. So even potentially worse down the road, but not today, natural gas wells are also the source for helium, the only source. And helium is they use it once and then you'd better capture it because if it gets out, it's gone.

You can't take it back out of the atmosphere. The reason is it's light enough that it actually leaves.

But it is essential in semiconductor manufacturing and also in MRIs, as an example, as a liquid to cool the magnets and the MRI for super cooling without which the machine does not run. So there are multiple things like this that come out of the energy supply chain at present. They're all essentially outside the United States are shut down. The United States is for the first time in a long time, very close to being completely energy

independent in terms of carbon-based fuels. Unfortunately, one of the things that happened in the run up to and time after 2008 is that we incentivized American companies to essentially allow a free market across the world in not just crude oil, but also in refined products. So the reason you've seen diesel spike so high is because for the same reason, a diesel is no longer cheaper in the summertime than gasoline, and it used to be.

And that is obviously in the summer, nobody needs home heating oil

But if you can sell it overseas, if you can sell a gallon of diesel overseas for \$5 a gallon, but here in the United States, it only goes for 250, guess what it sells for in the United States? Sells for \$5. Because if I am a person that has some, I'm going to sell it to the person that bids the highest. And if their supply is cut off, then their demand, assuming it remains reasonably constant, means the price is going to rise. And one of the realities of commodities is that you pay the same price for every gallon of gasoline, every gallon of diesel, every barrel of oil, as the last one costs for you to acquire. Everything is priced on the margin. So this is an imputed cost into everything because of course, every good that you buy, everything in a grocery store, everything in a Home Depot, whatever have you, at least the last mile moves by truck.

So yeah, I mean, that's an input cost, that's going to show up in inflation. And we have seen already in the last two, three months, there's been a pretty ... And this was before the Iran thing started. There was a pretty serious cost push side inflationary spike in the PPI numbers. And I've been writing about this now for a while, and that's a very bad thing because that in three to six months shows up in the CPI and consumer prices, and a producer can only do two things. One is eat it, in which case their margins get whacked. That does not do good things for stock prices. Yeah, I mean, you have a bad earnings report because you ate it. The other possibility is to pass it through and then it shows up in the CPI, which of course is consumer inflation. So it shows up there.

Dennis Tubbergen:

So Karl, just putting two and two together here, we're likely, based on what you're saying, going to see inflation accelerate just based on the fact that the higher oil prices have not been calculated in, and that affects everything. At the same time, we're seeing the real estate market look topy here. The stock market's looking a little bit anemic. Are we headed for this stagflationary outcome where we have higher consumer prices, but the asset prices go down at the same time?

Karl Denninger:

Oh yeah. I think that's essentially a certainty because with the inflationary input, the Fed cannot cut rates and we'll probably have to raise them. At the same time, what presented most of the stagflationary stuff in the 1970s was first the oil shocks. Okay. That's what started

Dennis Tubbergen:

It.

Karl Denninger:

But then what occurred after that was that the government decided that they were going to both try to put wage and price controls in and at the same time increase deficit spending. Well, we've already got a problem there. So the reaction has already been seen to a large degree in the bond market. The spreads have moved the wrong way pretty seriously. They've come back in a little bit in the last few days, but we've ... Good Lord. I mean, I look at that chart and over the last couple of weeks, that move has been extraordinary. And the only good news is it appears to be plateauing here. Now, I don't know whether that will hold. I think that has a lot to do with whether or not the Iranian situation actually gets resolved. On the other hand, if it doesn't, then those spreads are going to continue to blow out.

But there is absolutely no possibility that you're going to see lower borrowing costs into this.

If the Federal Reserve was to do something like that, that would just immediately reflect back into the CPI numbers. And I don't see that kind of thing happening. What I think is a real concern, and one I think people should be very concerned about is the possibility that we get a snapback kind of reaction on the long end of the curve. So that's the 10 year and beyond. That of course is going to have a major impact on borrowing costs for housing because the mortgage rates are pretty much based off the TNX, the 10-year treasury. There's anyone that thinks that we're going to see 2% rates again, anytime in the reasonable future, no, we're not. And not when you're running a 7% fiscal deficit, which we are.

I think Powell needs to have a come to Jesus moment with the Congress and show up and basically tell them, look, we are going to set rates at 50 basis points plus whatever the federal deficit spending is as a percentage of GDP. And that's where we're going to put short end rates. Long rates go wherever they go, but short rates, that's where they're going to get paid. And if you

guys don't like where that number is, then the way you fix it is you solve the deficit spending problem. And we're not going to tell you as the Federal Reserve, because it's not our job, whether you do that through taxation or spending reductions, but you got to do one of the two because that's the only way this is changing.

Dennis Tubbergen:

Karl, assuming that that hypothetical come to Jesus meeting happened, is there a path forward to balance this budget without casting the country into a really intense recession or depression?

Karl Denninger:

No. That option came off the table 15 years ago.

Dennis Tubbergen:

Right. The numbers are the numbers.

Karl Denninger:

I mean, the decisions that were made back in 2008,

Dennis Tubbergen:

And

Karl Denninger:

Especially Obamacare, which has turned into a catastrophic impact on the federal budget, and many people, including myself, warned that that was exactly what was going to happen with it, because it essentially codified into federal law cartel behavior that's been illegal for a hundred years. Gruber, who was a stooge for the medical and insurance industry, wrote the bill, he's admitted to that. I mean, Barack Obama still crows about this being his crowning achievement. Well, the crowning achievement he had was a ruination of the federal budget. In the last year alone, and this actually managed to hit the mainstream media, which was surprising to me, in the last year alone, \$10 trillion of unfunded mandate in Medicare Part B by itself was put under the federal sheet.

Dennis Tubbergen:

I saw that. In one year.

Karl Denninger:

In one year, that's a third of GDP. That's crazy. We have a \$30 trillion economy and we put 10 trillion in just in that one place. That doesn't even account for the rest. Okay. People like to talk about entitlements and social security. Social security is not the problem. Social security does have an operating deficit, but it's fixable. The Medicare system, as it stands, is not. You'd have to multiply the tax rate by about five or six. That's never going to happen. I mean, if you lifted the social security tax rate by 1%, half percent on employers, half percent on employees, you'd balance it. You'd balance the system. I mean, nobody's going to like that, but you can do it. You absolutely cannot multiply the Medicare tax by five.

Dennis Tubbergen:

Right.

Karl Denninger:

Okay? I mean, no. And secondly, the problem is that those costs are escalating by double digits on an annual basis. And this problem goes all the way back to 1993, four, five when I first noticed it when I was running my company and anybody else that's run a business knows this because they've seen the premium increases for their employees each and every year as they've come through.

Dennis Tubbergen:

So Kyle, when we talk about these big deficit numbers, we talk about shortfalls in Medicare, social security, the national debts approaching 40 trillion, seems to me that the Fed has only one play left in its playbook and its QE. That obviously has its own side effects, but I'm reminded of a story I just read that Gideon Gono, who is the Zimbabwean Central Bank chief at the time of 2007, 2008, said, "They told me to print currency because we had to pay the military and pay other bills. We all knew what the outcome was going to be, but I obeyed because there was no other choice." I mean, the US dollar has some reserve currency status. I mean, we're not Zimbabwe, understood, but same path. Aren't we destined to have the same outcome or do you think the Fed will show restraint here?

Karl Denninger:

You can't go there. You take 50% of the population and make it impossible for them to eat. All the politicians die. Cities burn. I mean, it's a different situation when you have a country that is to a large degree agrarian and people really don't have very much. They start from not really having very much. Okay? That's not the United States. You can't go out in your backyard in suburban America and grow enough produce to survive. That's not a choice. There's just no way to do it. What do you do with a city like Chicago that in the greater Chicagoland area has roughly seven million residents? There's not enough arable land to feed 100,000 of them. I mean, no. And secondly, the Federal Reserve has a legal constraint. Now, they violated it in the past when they bought Fannie and Freddie paper, that was illegal

Dennis Tubbergen:

Because

Karl Denninger:

At the time there was no government guarantee on those bonds. However, their mandate requires that they only purchase federally guaranteed paper. Okay. Now they can emit currency against that paper. Yes, that's what QE is. Okay. But the Treasury has to issue the bonds. Now, when Treasury issues those bonds, people have to buy them. Okay? Well, the Fed's can buy some of them, but what happens when the rest of the world says, "We're not buying that crap." And that's the essence of the problem is that if you do this, if you continue to increase the money supply in this kind of a fashion, which is what the federal deficit is, is an increase in the money supply. That reflects right back into inflation. So, okay-

Dennis Tubbergen:

I'm sorry, Karl, what will be the catalyst? At what point will the Fed do an about face and say, "Okay, enough is enough. No more QE. We're just going to have to take our medicine."

Karl Denninger:

Well, I think you're seeing it now to a large extent. I mean, this last meeting, Powell got up there and I mean, according to the dot plot and what the traders have expressed in the Forward Fed funds futures market, rate cuts are off the table at this point. And in fact, they're pricing in the possibility of rate increases. So you went from a couple of months ago, the

traders were saying there were going to be four, four more quarter point cuts this year. Well, not only did you not get the one this last time, you now have zero and maybe increases.

Dennis Tubbergen:

So let me play devil's advocate here in the little time we have left, Kyle. We have a new Fed chair coming in presumably in May, Kevin Warsch. Presumably. Presumably. There's a couple of hurdles. Yeah, we don't have time to talk about those, but didn't he get the nomination because he's going to play ball and reduce interest rates and implement QE? There's a lot of political pressure to do that. Do you see the Fed holding the line even with potentially a new chair?

Karl Denninger:

Well, you ought to look at some of the things he said when Bernanke was aggressively leading rate cuts back in the 2018. He was absolutely not in favor of that policy and he knew exactly what it would lead to. By the way, he was right.

Dennis Tubbergen:

Right, right, right.

Karl Denninger:

Okay. So I don't know what kind of promises he made to people in Congress or to the White House in order to get the nomination. I have no idea. Do I think they can realistically reject him? No, given his tenure. Will there be some strum and fear? Sure. But again, once he's in office, there you are. And the other thing to remember is he's ... Unlike back when Burns was ... Everything was opaque. All you had, you had a decision, but you had no minutes, there was no discussion. Today, it's actually a vote and the chair is one vote. He does not set policy for the committee by executive fiat. That's not how it works. And now, of course, he has the loudest mouth, obviously, but that's really where his influence ends is that he has the loudest mouth. So I think there's going to be a lot of people, especially a particular taco in the White House that's going to be rather disappointed with the outcome from this

Dennis Tubbergen:

Interesting. Well, the clock says, Karl, we're going to have to leave it there. My guest today has been Mr. Karl Denninger. His website is market-ticker.org. If you're not a regular reader, I encourage you to be. Karl is a prolific commentator. Karl, always a pleasure to catch up with you. Appreciate your perspective. Hope we can do it again soon.

Karl Denninger:

Anytime, you bet.

Dennis Tubbergen:

We will return after these words. Hey, Dennis Tubbergen, your host of RLA Radio. I'd like to invite you to get for the very first time a complimentary copy of my bestselling book released in January. The book is titled Portfolio Playbook: Investing Strategies for the Current Economy. To get your copy of the book, all you need to do is visit the website, requestyourbook.com, request yourbook.com, and I'll be very glad to send you a complimentary copy. Portfolio playbook reveals why traditional investing strategies, especially the 60 / 40 portfolio I believe have the potential to fail in today's debt-driven boom and bust economy. And I give you a clear common sense roadmap for you to consider, to use to protect and grow your wealth in what I believe could be turbulent years lying ahead. So to get your copy of the portfolio playbook, which contains investing strategies for the current economy, all you need to do is visit the website, requestyourbook.com.

The website again is requestyourbook.com, and I'll be glad to send you a complimentary copy.

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen, and thanks again to my special guest, Mr. Karl Denninger, for joining us on today's program. So what's going on with private credit? I mentioned it in the first segment of today's program, but I want to dig into it a little bit here in the last segment. There have been a number of private credit funds that have either limited or capped or out and out refused redemption requests from shareholders. So let's jump in and talk about that. BlackRock has an HPS corporate lending fund, and that fund recently denied redemption requests from shareholders. Now, all this information is sourced at my website, retirementlifestyleadvocates.com. I'd encourage you to go check out the March 30 issue of the portfolio watch newsletter, and I dig into that in detail. However, this corporate lending fund, this HPS corporate lending fund from

BlackRock has \$26 billion in assets, and the fund issued a statement that shareholders requested 9.3% of their shares.

BlackRock's management determined that not all these redemption requests could be honored, and they capped redemptions at 5%. So in dollar terms, investors said, "Give me \$1.2 billion of my money back," but they only got 620 million, just a little bit more than half. Now, Blackstone, a completely different company to avoid confusion, their private credit fund, BCRED, recently faced record high redemption requests from fund investors. To meet all the withdrawal requests, Blackstone Company executives ponied up \$400 million of their own capital. Blue Owl Capital, a very large player in the private credit space stopped honoring redemption requests altogether and began issuing IOUs to investors instead. Morgan Stanley also capped redemptions from its North Haven private income fund. The company stated it met 45.8% of redemption requests. That means they denied more than they accepted. They capped redemptions at 5% for the quarter. Now, I am not here to be an alarmist, but this is a development that you need to be paying attention to.

I see many parallels to 2007. In August of 2007, two hedge funds run by Bear Stearns folded after they suffered mammoth size losses on subprime mortgage securities. Soon after, other funds followed suit. As the CEO of JP Morgan recently said, Jamie Dimond, that when you see one cockroach, there's usually more than one, and he was referencing the problems in private credit. Well, going back to 2007 and the parallels that I see, the Bear Stearns funds folded in August of 2007. Stocks largely held up until 2008, but then the global financial crisis hit hard and stocks collapsed. I wouldn't go so far as to say that another global financial crisis is imminent, but I will tell you, as I've talked about in the past, private sector debt in the US is now 200% of GDP and cannot possibly be paid. So there will have to be some type of a reset or crisis.

So I would suggest moving forward in your investment portfolio with caution. Be aware of what's going on, and if you are planning for retirement, you might consider using the revenue sourcing planning strategy that I outline in that book. That's all the time I have for this week. I'll be back again next week with my special guest, Mr. Gerald Celente, with a brand new program. Thanks for tuning in.