PART I

THE COMING AFTERSHOCK
We open this fourth edition of *Aftershock* (2015) with the same chapter title we used in the third edition of *Aftershock* (2014) and in the second edition of *The Aftershock Investor* (2013). Notice a pattern? The so-called recovery was 100 percent fake back then and it’s still fake today. Even if you’ve already read an earlier version of this chapter, you may want to take a look at it again. The updated evidence here that reveals the bogus “recovery” is just as compelling today as it was a few years ago. In fact, it’s even more damning.

But don’t expect many people to point it out. The economic cheerleaders and bubble-blind experts from whom most people get their financial news are simply not going to warn you about what is really going on or tell you how to protect yourself. They either don’t see what’s coming or they don’t want you to. With stocks hitting new highs and home prices rising, it’s pretty easy for the “experts” to convince the public (and themselves) to think that all is well or soon will be. The economy, they tell us, is in recovery, and the coming Aftershock, our critics say, has been canceled.
How wonderful that would be—if only it were true. But nothing has happened to change our minds about our earlier forecasts. In fact, current events fall in line pretty well with our previous analysis and predictions, dating back to our earliest books, *America’s Bubble Economy* in 2006 and the first edition of *Aftershock* in 2009.

From the beginning, we said that massive federal government support would keep the bubble economy going as long as possible. Through massive money printing and massive money borrowing, the stock market bubble, along with the real estate, private debt, and consumer spending bubbles have been reinflated. That is the only way to keep this temporary bubble party going, and the government is doing all it can to keep pumping helium into the balloons. This government stimulus to support the bubble economy has pumped up two additional bubbles: the dollar and the government debt bubbles. With the total national debt now more than $18 trillion and the Federal Reserve having radically increased the U.S. money supply to more than $4 trillion (a quintupling increase since 2008), our predictions are looking pretty spot-on.

We never said the stock market wouldn’t rise as a result of the stimulus—in fact, it may go even higher. We never said the economy couldn’t temporarily stabilize or that home prices couldn’t rise in some areas in the short term. We said this is a bubble economy and that the government will do anything it can to keep the bubbles going—and that is exactly what they are doing with so much money printing and borrowing. But please don’t confuse a temporary, artificially created stock market recovery or a modest economic recovery with the real thing. Any recovery that is created by massive government stimulus and can be maintained only with continued massive government stimulus is a *fake* recovery.

Why? Because the fundamental economic realities have not changed, and even massive government stimulus cannot permanently override the fundamentals. The fact is that since the early 1980s we have been living in a bubble economy (see Chapter 2 for why we say so), and bubbles don’t last forever. We saw the beginning of the pop with the partial decline of the real estate bubble in 2007, which helped kick off the stock market decline and global financial crisis of late 2008. Since then, we’ve seen a mammoth effort to partially reinflate and maintain the sagging bubbles with ongoing government stimulus.

So contrary to popular belief, this “recovery” in the stock market and the overall economy is 100 percent fake and the Aftershock has not been canceled.
Isn’t a Fake Recovery Better than No Recovery at All?

That seems true, but it really isn’t. The massive money printing and borrowing that is creating this fake recovery and delaying the Aftershock will only make the coming crash all the worse later. That’s why we say it’s nothing to cheer about. A fake recovery may feel good now—like postponing a trip to the dentist with a strong painkiller—but it will only bring us much more pain later.

“Now we just have to sit back and wait for the Fed to bail us out.”
Not only will the temporary painkiller eventually wear off, but the medicine itself will later become a poison.

And, of course, just like postponing a trip to the dentist, putting off dealing with our underlying problems only increases our future pain because it postpones the fundamental changes we desperately need to make in order to create a real economic recovery. What we need is not more government borrowing and more dollars created out of thin air to keep the party going. What we need is a true economic recovery based on fundamental changes that will boost real productivity (the subject of future books). Real productivity growth would generate real economic growth and real, nonbubble wealth that would not be vulnerable to bubble pops.

The problem is that those changes are difficult. No one wants to hear that we have to make tough choices and endure a lot of pain now to create real economic growth later. It’s much easier to let the government borrow and print for now, and kick all the rest of it down the road. Politicians might talk about fiscal and monetary responsibility, but the short-term consequences of stopping the current bubble-supporting machine would put their jobs in jeopardy. This is why we have been predicting since 2006 that our bubble economy will continue to be maintained until that maintenance is no longer possible. We will throw everything at it until it no longer works and eventually explodes. While marginally effective in the short term, eventually this strategy will fail. Until then, no one wants to pop the temporary bubble party.

**Inflation or Deflation?**

Nobel Prize–winning economist Milton Friedman in the 1970s famously said: “Inflation is always and everywhere a monetary phenomenon.”

In fact, inflation and deflation are both “monetary phenomena,” meaning they both result from changes in the money supply. Inflation results from *increasing* the money supply faster than the economy grows, devaluing the dollar and causing goods and services to cost more. Deflation results from *decreasing* the money supply relative to the economy, pushing up the value of the dollar and causing goods and services to cost less.

The Great Depression gave us deflation, not inflation. Too few dollars relative to the economic needs of the time caused the value of the dollar to rise, and the cost of goods and services to fall.
In sharp contrast, we are printing enormous amounts of new money, increasing the monetary base much faster than the economy is growing, which will bring us future inflation, not deflation.

Those who point to falling prices or the threat of future falling prices, and call it deflation, are making a fundamental mistake. Separate from inflation or deflation, prices also rise and fall because of changes in supply and demand. For example, when an asset bubble pops (such as real estate), falling home prices are not due to deflation; home prices fall because there are more sellers than buyers.

Just before and during the Aftershock, multiple popping bubbles will cause many asset prices (in inflation-adjusted dollars) to fall. That is not deflation—it’s a good investment gone bad!

If the Aftershock Has Not Been Canceled, Why Hasn’t It Happened Yet?

While we stand by our past and current predictions for the coming Aftershock, we admit that predicting exactly when the bubbles will fully burst is difficult. What we can do is look at the fundamentals of this economy, and they don’t look all that impressive. Given the huge amount of government stimulus (massive money printing and borrowing) for seven years, the fact that the economy has only grown slowly is very telling. What it tells us is that this is a falling multibubble economy whose inevitable fall is being temporarily delayed by enormous bubble-supporting efforts that cannot continue forever. If seven years of massive, unprecedented money printing and borrowing has only given us the economy we have today, what kind of economy and stock market would we have without that massive stimulus? And, of course, none of the underlying problems that got us into this mess in the first place (see Chapter 2) have gone away.

So while we cannot easily predict the timing of the coming Aftershock, we have no doubt that it will happen. The big multibubble pop and Aftershock cannot be permanently avoided, only delayed.

To understand why the Aftershock hasn’t happened yet, let’s take a closer look at what is keeping this fake recovery going and how long we think it might last.
The Key to Creating and Maintaining the Fake Recovery: Massive Money Printing

Massive money printing is quickly becoming the key support of our multibubble economy and the stock market in particular. We are not talking about creating only a modest amount of extra money to keep up with a growing economy, like we used to do. We are talking about a truly staggering amount of new money printing—more than we’ve ever done in U.S. history. If you think we are exaggerating, consider this: following the creation of the U.S. Federal Reserve more than a century ago, we printed roughly $800 billion from 1913 to 2007. But from 2008 to 2014, the Fed printed an additional $3 trillion. That’s more money printing in just seven years than the total money they created in almost 100 years!

Since the financial crisis of 2008, the Fed has increased the monetary base from about $800 billion to more than $4 trillion. This is a truly enormous increase. By making money so abundant and therefore cheap to borrow, money printing allows the government to run high deficits. And money printing also helps boost the stock market and real estate markets as well.

Figure 1.1 Massive New Money Printing
We have printed more than four times as much money since 2008 than in the history of the Federal Reserve up to that point.
Source: Federal Reserve
A government can boost the economy by running a large deficit. But, eventually, it will have to pay higher interest on its bonds as investors become more and more skeptical of the government’s ability to pay its increasingly large debt obligations. The solution to having to pay higher interest costs: money printing. The central bank uses printed money to buy government bonds in large quantities, thus creating an artificial demand for those bonds and keeping interest rates low.

The artificial demand for government bonds and mortgage bonds carries over to the rest of the bond market as well, where interest rates are often defined by the markup over the rate on Treasury bonds. The low interest rates in the bond market carry over into the mortgage market as well, keeping up demand for easy home loans and propping up the real estate market.

Low yields on bonds leave many investors chasing bigger gains. And what better place to increase their return on investment than the stock market? There’s plenty of capital to put into stocks, too. After all, when the Fed prints money to buy bonds, it has to buy those bonds from somebody. The Fed gives the newly printed money to the investors from whom they buy the bonds. Much of that new money goes right from the investors’ bank accounts into the stock market, raising demand for stocks and boosting the overall stock market. In turn, the rising stock market further encourages the real estate market and general consumer spending, creating the fake recovery we have today.

So if money printing enables the government to run large deficits with little consequence and it boosts the stock, bond, and real estate markets as well, what’s the downside?

The answer is future inflation. Printing many more dollars while economic growth is very slow means those dollars will eventually become less valuable (please see Chapter 5 for more on how this happens). Rising inflation ultimately pushes up interest rates. Higher interest rates in a bubble economy will mean collapsing markets and exploding government debt. Rising inflation is something a bubble economy cannot afford.

When the Fed’s first two rounds of quantitative easing (QE1 and QE2) failed to create the sustainable stock market recovery they wanted, they moved to yet a third round of quantitative easing (QE3). But this time, perhaps losing confidence in the power of short-term QE to keep the stock market going after it ended,
the Fed put no time limits on its money-printing operations, saying it would commit to $40 billion a month in bond purchases until unemployment figures had reached a satisfactory level. It didn’t take long before that $40 billion commitment became a staggering $85 billion per month in November 2012 and continued until the Fed began to taper in February 2014 and then temporarily paused money printing in October 2014.

It’s only a matter of time before the Fed will have to begin money printing again to keep the bubble economy going. But even if there is no more money printing—and there definitely will be more—increasing the U.S. monetary base from $800 billion to more than $4 trillion is an awful lot of artificial government stimulus. So far, it’s working. Stocks are up, real estate has rebounded, and the rest of the bubble economy is holding on (although hardly booming) due to massive money printing. QE has mostly boosted the asset bubbles, not the economy.

But does anyone really think that simply printing new dollars is a path to future prosperity? It’s almost silly to believe in such a fantasy, and yet the psychological drive to accept this as a safe and effective cure for our economic problems generally overrides logic. Investors love the easy-money fantasy that money printing supports, and they want it to go on forever.

We are not saying that if we stopped the stimulus today, all would be fine. Just the opposite, ending the stimulus entirely would quickly throw the economy into a severe recession. But our economic problems are not due to a lack of stimulus; therefore, the stimulus, no matter how massive, will not save us; it will only delay the inevitable economic pain and will make it all the worse when the Aftershock happens later. This is a falling bubble economy (see Chapter 2 for details) and the money-printing and money-borrowing stimulus is simply delaying its further fall. But the more stimulus we throw at it now, the harder the crash will be later because inflation and interest rates will be that much higher.

In a Supporting Role: Cheerleading

Cheerleaders root for the home team. They won’t tell you the quarterback has a weak arm, or that the offensive line is outmatched, or that the head coach is inexperienced. Their job is to be positive and cheer for the home team!
In recent decades we’ve seen the financial world take on a “home crowd” type of atmosphere, with financial pundits and economists assuming roles as cheerleaders rather than analysts. They won’t tell you about the fundamental problems in the economy. They’ll only assure you that everything is bound to get better, the recovery is right around the corner, or that it’s already here. The cheerleading mind-set is a big reason we ended up with a bubble economy in the first place. Brokerage firms needed to sell stocks in order to make money. Fundamentals didn’t matter, as long as everyone played along. They cultivated a deep belief that stock prices were always going to go up, up, up. And even if they do happen to go down, they guarantee they will go back up. Remember how optimistic all the experts were before the 2008 financial crisis?

The cheerleading mind-set persists, as the analysts hype every little positive and ignore or downplay every important negative. They say we can’t possibly have future inflation; it doesn’t matter how much money the Fed prints. The unemployment rate is falling; it doesn’t matter how many people leave the workforce. New home sales are on the rise; it doesn’t matter how small the number is compared to the past few decades.

Oh, but if gold prices drop, that’s a “rational correction” on a fundamentally bad investment, even though gold has risen 300 percent since 2000 (unlike the stock market).

The cheerleaders always root for the home team based on selective data, no matter what other data are available for consideration. Anything that supports their cause is automatically true and highly significant, while the rest of the facts are considered insignificant or entirely ignored.

**Ammo for the Cheerleaders: Inflation Appears Low**

Our critics like to point to the current absence of rising inflation to show that we are wrong about money printing causing rising future inflation and interest rates, which are key to our predictions for the coming Aftershock. They say if we need inflation to push interest rates up and kick off the Aftershock and we have no inflation, then clearly the Aftershock has been canceled.

We disagree. To a large extent, the reason we haven’t seen significant inflation yet in spite of massive money printing is that, as we’ll explain in more detail in Chapter 5, there are “lag factors” that create a delay between when money is printed and when inflation sets in.
But also keep in mind that we have seen some inflation. While inflation may not be 10 or 20 percent yet, the government’s sub-3 percent figures are difficult to believe. Anyone who buys food or pays tuition of any kind knows that prices of many things have gone up in the past few years. So why doesn’t the government’s measure of inflation seem to more fully reflect this?

One important reason has to do with the way the government measures inflation, which they have purposely changed in the past couple of decades in order to downplay the inflation rate. While manipulation of economic statistics is expected and accepted as an everyday occurrence in some other countries, the United States is not known for regularly manipulating our statistics. However, that doesn’t mean it doesn’t happen, albeit in subtle ways.

One of the easiest and most convenient statistics to manipulate is the inflation rate, and the United States is almost certainly massaging its chief measure of inflation, the Consumer Price Index (CPI). This figure can easily be manipulated by making changes to the basket of goods and services measured over time and making subjective judgments about product substitution.

We are not at all surprised that the government is taking steps to hide the real inflation rate. The stakes are very high, and the people generating inflation statistics are likely under a certain amount of subtle pressure to produce statistics that are more supportive of current economic policy. Aside from the danger that inflation leads to higher interest rates that can hurt the markets, inflation also puts a big strain on the government budget. The government has to make higher and higher payments for any inflation-indexed programs, including pensions and Social Security, and higher interest rates mean the government has to offer higher rates to finance its debt.

Inflation also eats away at gross domestic product (GDP) growth figures. If inflation reaches 4 or 5—let alone 10 or 20—percent, any growth in GDP has to be adjusted accordingly. With our economy right now officially growing by only about 2.5 percent annually (and likely the real number is less than that), it’s very much in the government’s interest to report low CPI figures. That has no doubt played a role in the shifting standards for measuring inflation over the past couple of decades.

The unreliability of government statistics makes it difficult for us to say exactly what the inflation rate really is right now. But we don’t
see any reason to believe that the government’s “new and improved” measure of inflation is more accurate than the way they measured it 30 years ago. In fact, the new measure of inflation is probably less accurate. Based on the old method, today’s inflation rate would be around 7 percent (see www.shadowstats.com for some more realistic estimates). It seems that the changes in the way they calculate the CPI were made out of self-interest, not a concern for accuracy.

**More Ammo for the Cheerleaders: Relatively Low Unemployment Rate**

When you combine the inflation rate with the unemployment rate, you get the *misery index*. Generally speaking, the higher this number is, the more economic and social woes we face. So unemployment is another figure the government has a keen interest in understating. And while employment statistics are not as easy to manipulate as the CPI, that doesn’t mean we should take them all at face value.

More jobs were lost from 2007 to 2009 (almost 9 million) than were gained in the housing boom, and no net jobs were created from 2000 to 2010. So misleading employment statistics are important numbers for the media and the cheerleaders.

To be counted in the official “unemployment rate” a person has to be out of work entirely and actively seeking a job. This means those who have given up searching and whose unemployment benefits have lapsed—referred to as the *discouraged unemployed*—are not counted in the popular unemployment rate that gets reported so much in the news.

Also not counted in the typically reported unemployment rate are those working part time when they would rather work full time, or who are working well below their education and skill levels. In July 2013, Gallup reported that more than 17 percent of the workforce characterizes itself as “underemployed.” Many previous full-time workers have been forced to take part-time work while they continue to look for better employment. When the media and cheerleaders tell us to feel good about the creation of new jobs, they don’t often mention that most of those new jobs are only part time.

While the typical unemployment rate reported in the media is under 6 percent, it doesn’t tell the whole story. For that, we need to look at what is called the U6 unemployment rate, which conveniently the government and the media avoid discussing too much. The U6 rate, which includes discouraged unemployed and those working part time when they’d rather work full time, is officially
11.3 percent, as of January 2015. When you also add in those who left the workforce, the number is even higher (see Figure 1.2).

Nonetheless, it has become an increasingly common phenomenon to see the official unemployment rate figure remain flat or even go down slightly while the number of people dropping out of the workforce goes up. In fact, according to the Bureau of Labor Statistics, the number of working-age Americans who have now dropped out of the workforce is about 3 to 4 million. The majority of these folks are under 50 years old, so they aren’t retiring. They are just giving up. There are typically some working-age Americans out of the workforce—such as full-time parents—but this is an exceptionally high number. Recently, the employment-to-population ratio (in which “population” counts anyone 16 years of age and older) was down to about 59 percent, when it had hovered around 63 percent for much of the previous decade.

And if you think job growth is bad, wage growth is in even worse shape. In fact, according to Commerce Department data, real wage

![Figure 1.2 Pulling Back the Curtain on Unemployment](image)

**Figure 1.2 Pulling Back the Curtain on Unemployment**

The official unemployment figure (U3) is about 5.7 percent. However, adding in the underemployed and discouraged unemployed (U6) puts the unemployment rate significantly higher, and adding those who have left the workforce puts it near Depression-era levels, which ranged from 15 to 25 percent.

*Source: Bureau of Labor Statistics*
growth (adjusted for inflation) is worse now than it was during the Great Depression. In fact, household incomes have not grown since 1989 (see Figure 1.3).

Between the underreported unemployment figures and the lack of income growth, much of the pain in the economy is quiet pain—meaning that it doesn’t get much media coverage and few people are discussing it. But its impact is widespread. Perhaps some of our readers know people who have lost their jobs and are looking for work, or who have dropped out of the workforce entirely, with little or no hope of finding a job. Or you might know some who have seen their wages or income fall or their business suffer. In spite of these realities we all see right in front of us, the government will still claim we are in a “recovery,” trying to distract us with numbers that don’t tell the true story.

More Ammo for the Cheerleaders: Annual Deficit Going Down and GDP Going Up

Cheerleaders like to point to the lower annual deficit as a good indication that the fake recovery is real. While it’s true that the
federal government is going into debt at a slower rate now than our record $1.4 trillion deficit in 2009, the current rate of nearly $500 billion of new annual debt is still much higher than before the financial crisis. How soon we adapt and let ourselves forget that spending $500 billion more than we have is still an enormous amount of new debt to add to the already $18 trillion we currently owe—and $500 billion per year is nothing to celebrate.

Also keep in mind that one reason we were able to trim back the deficit to “just” $500 billion was massive money printing boosting the stock market, which indirectly creates more tax revenue to the federal government. But don’t count on tax revenue to rise enough to lower the annual deficit much further; $500 billion is a very large deficit, and it is only making the very large government debt bubble bigger and bigger.

The other cheerleader argument—that GDP is now rising rapidly—is just as silly as being happy about a $500 billion deficit. They are so happy to report that the U.S. GDP is now “racing ahead” at an astounding pace: a whopping 2.5 percent. That’s right, our economy is now growing a whole 0.5 percent faster than it was in 2010, after more than seven years of intense money printing and borrowing. In other words, for a mere $3 trillion in printed money, we have managed to buy ourselves a sluggish, unimpressive 2.5 percent GDP. Not exactly “breakout” economic growth.

Pardon us if we don’t uncork the champagne.

Money Printing = No Inflation = No Taxes! We Are Fooling Ourselves—and We Know It

One of the craziest ideas that the cheerleaders promote can be summarized as “Don’t worry, massive money printing is always perfectly safe!”

Really? If it’s really so safe, why are we doing it only on an “as-needed” basis? Why not do it all the time, not just in a crisis? If it’s really so safe, why ever stop?

And if it is really so safe, why not do a whole lot more of it? After all, if massive money printing doesn’t cause future inflation, why are they so afraid of doing more? Surely, if $3 trillion in new money is good, wouldn’t $4 trillion be even better? What the heck, if it’s perfectly safe, why not go to $5 trillion, $7 trillion, or even $10 trillion for that matter? Think of how much all that new money would boost the markets and
the economy. It would be great! In fact, if money printing is so risk free, why should we have to pay any taxes? Let’s just print all the money the government will ever need, whenever it’s needed!

But you’ll notice we don’t actually do that, do we? How come? Because everyone, even the most diehard cheerleaders, knows that it can’t work. If we didn’t know full well that it can’t work, we’d be doing it all the time without limit, so obviously we know that massive money printing comes with a nasty future price tag (inflation). Like smoking crack, we know darn well that this massive money printing is a dangerous drug; we just can’t kick our addiction to its bubble-supporting short-term high.

How much crack can we smoke before we scare ourselves by the sheer quantity? Well, if we start out slowly and get ourselves used to it, our love of the short-term high can convince us that we are always printing the just the “right” amount of new money. When we first started with limited quantitative easing (QE1) in early 2009, the idea of printing $85 billion/month without an end date would have seemed irresponsible. But by raising the amount of money printing gradually over time to create and maintain the fake recovery, each new round of QE was welcomed as perfectly safe and perfectly sized. By the time we got up to $85 billion/month in late 2011, that enormous amount seemed “just right.”

Since then, the Fed has lowered and then temporarily paused money printing for a while, in an attempt to appear more responsible. But it’s only a matter of time until the Fed will have to print again. At this point, we simply cannot maintain the bubbles for very long without new money printing. The Fed’s temporary gestures to reduce or pause money printing are really just for show, designed to make the insane appear saner.

Still Not Convinced This Recovery Is 100 Percent Fake?

So far, we’ve explained why this recovery is entirely fake and the coming Aftershock has not been canceled, but maybe you’re still not convinced. Maybe you think the economy really is turning around, that employment will pick up, or that China will carry the rest of the world out of this malaise. If we haven’t yet convinced you that the fundamentals of the economy are not significantly improving, and you still believe this fantasy “recovery” is real, here are a few questions to ask yourself.
If This Recovery Is Real, Why Is Government Borrowing Outpacing GDP Growth?

While many people seem to cheer every little positive sign of growth in the economy (and ignore or downplay any negative news), what’s really astonishing is just how little economic growth we’ve seen in spite of all the massive government intervention. Between 2008 and 2014, the government borrowed $7.1 trillion, yet over that same period the cumulative increase in GDP in the United States was only $3.2 trillion (see Figure 1.4). That’s a whole lot of borrowing for not much growth.

Such huge government borrowing relative to GDP shows just how fragile the U.S. economy really is. It also shows how ineffective government intervention has been at turning a falling bubble economy into a healthy, growing economy. Pro-intervention pundits and academics like to think of government intervention as a parent holding up a young child’s bicycle, ready to pull the

![Figure 1.4 Increase in GDP Growth versus Increase in Government Borrowing](image)

We are borrowing far more than the economy is growing.

*Source: Bureau of Economic Analysis*
hand away as soon as the child can stay upright. In truth, the
government is more like pushover parents who keep giving their
children barrels of money well into their adult years, seeing less
and less return on their investment as the kids become increas-
ingly dependent. If the parents cut them off, they would be out
on the streets immediately.

It’s the same for this economy. If you took away the huge
borrowing, we’d be thrown into an instant recession. At this
point, the massive money printing and massive money borrow-
ing are keeping the economy on temporary life support. In
order to get real and sustainable economic growth, we need
something more than massive temporary stimulus; we need
significant increases in real productivity growth, which we
have not had for decades. Understanding the real cause of our
economic problems is the first step in solving those problems
(see Chapter 12).

Figure 1.5 GDP Growth versus Current Government Borrowing
We are borrowing at a rate that exceeds our current growth rate. We are not getting much of a
bang for our borrowed buck. Take that borrowing away and there would be almost no growth.
Source: Congressional Budget Office (projected budget), Bureau of Economic Analysis (GDP,
calculated assuming 2.5 percent annual growth)
What’s So Bad about Deflation?

We often hear cheerleaders say that the real threat to the economy is not future inflation (prices going up) but the even bigger threat of future deflation (prices going down), and therefore the Fed has to “guard against deflation” with massive money printing.

To this we say, really? What’s so bad about deflation? It’s hard to imagine that many people would be terribly upset if their groceries started to cost less, or their kids’ education became more affordable, or health care began getting cheaper and cheaper, instead of the other way around. No one complains when the cost of living goes down.

Of course, money printing is very good for the stock market and the other overpriced bubbles—and that’s the real reason the Fed is so concerned with avoiding deflation. The absence of money printing would lead to the opposite conditions (falling stock prices, falling real estate prices), which is what the government stimulus is aimed to avoid. The Fed’s goal is to support and maintain the bubbles for as long as possible, which means keeping investors from noticing that they are bubbles in the first place.

Drumming up fear of deflation helps support their effort to boost stocks and bonds.

If This Recovery Is Real, Why Are Stock Prices Growing Much Faster than Company Earnings?

Lately, we have relied on the stock market for optimism. And while anyone can appreciate some healthy optimism, the kind of blind optimism we’re seeing in the stock market right now helps no one.

A big reason for the stock market’s record highs in 2013 and 2014 was investors’ outlandish expectations for future earnings. According to FactSet, industry analysts in spring 2013 expected record earnings for the Standard & Poor’s (S&P) 500 in the third and fourth quarters of 2013. In fact, projections for the fourth quarter of 2013 were more than 15 percent above the fourth quarter of 2012. That would be an impressive rise for any period and a great reason for people to want to own stock in these companies. However, earnings barely rose 2 percent in the third quarter of 2013. Did the market care that earnings were so far below expectations? Of course not! This is a fantasy market, not a real market driven by real earnings.

This optimist trend continued with new stock highs in 2014, despite ongoing lackluster earnings. Earnings grew only 4.17 percent
for S&P 500 companies in 2014, compared to 11.39 percent growth in the stock market.

Revenue growth has also been unimpressive, with S&P revenues up only 3 percent for most of 2013. Nonetheless, the stock market kept rising in 2013. In 2014, S&P revenues grew by only 4 percent. Yet the S&P rose over 11 percent in 2014.

This kind of freakish optimism isn’t just calling the glass half full. This is like behaving as if the glass is overflowing when there’s actually not much real water there at all.

Think about it. If stock prices are rising much faster than the growth of company earnings and revenues, aren’t you paying a lot more for the same earnings and revenues than you could have bought for less in the past?

That’s nothing to cheer about.

*If This Recovery Is Real, Why Are Stock Prices Growing Much Faster than GDP?*

It won’t take more than a quick look at Figure 1.6 to see that stock prices are far outpacing lackluster economic growth. What does
that tell you about the short-term power of positive investor psychology fueled by massive money printing?

Can this kind of divergence between stock prices and GDP growth continue for a while longer? Yes, it probably can. Can it continue indefinitely? No! Even our biggest critics would have a hard time justifying such a fantasy. Without greater GDP growth, job growth, and company earnings growth, this kind of continued stock growth is unsustainable. Eventually, some investors will look around and notice the glaring lack of overall economic growth, despite the happy talk, and the massive stimulus that is temporarily supporting stocks today.

If This Recovery Is Real, Why Is the Stock Market So Dependent on the Fed’s Money Printing?

Since the Federal Reserve began its program of quantitative easing (QE) in early 2009 in response to the stock crash and global financial crisis, the stock market has been nothing short of addicted to money printing. The cheerleaders can insist that the huge stock market rise since 2009 has resulted from real and significant economic recovery, but once again the facts just don’t back that up.

If the stock rally was the result of real economic growth or real investor faith in future economic growth, why do rising stock prices always cool down (and even fall) soon after the artificial warmth of the Fed’s money printing is temporarily removed?

As Figure 1.7 shows, like an addict’s highs and lows, the S&P 500 has predictably risen and fallen in direct response to QE. Print money and stocks go up; stop printing money and stocks go down.

After seven years of this, you might think most people would have noticed by now that the stock market has been and continues to be directly dependent on money printing. But like any good addiction, denial is oh-so-sweet when everyone plays along. Facing reality is a real buzz-kill.

If This Recovery Is Real, Why Is New Household Formation So Slow?

Part of any good denial system is avoiding facts. One important yet overlooked indicator of real economic growth (or its absence) is the rate of new household formation. Paying attention to how many new households are being set up (for example, because a recent college graduate is financially able to get his first apartment rather than living with mom and dad) gives us a good general view of the health
of the economy. If the number of new households being formed is growing or at least not dropping over time, we can assume that the economy is in better shape than if that number is lower or declining.

So what are the numbers? Before the financial crisis, more than 1.6 million new households were formed in the United States in 2007. But after the financial crisis hit, new household formation fell to just 398,000 in 2008. That’s down to less than one-quarter of what it was just two years earlier—a big drop.

Since then, the numbers have risen, but we have yet to fully return to the 2007 level. Surely, if we had a real recovery, we would expect to see new household formation get back to the 1.6 million range, as before the crisis. For a while we did see new household formation climb up from the 2008 lows, but it has never been able to return to pre–financial crisis numbers, and more recently the numbers are dropping again. In 2014, only about 770,000 new households were formed—not even half the rate we had prior to the financial crisis.

As with tepid GDP growth, slow stock market company earnings growth, and so many other economic indicators, these low numbers on new household formation reveal what the cheerleaders don’t
want to face: If this were a real and significant economic recovery, many of these key numbers would be significantly higher.

If This Recovery Is Real, Why Is the Global Economy Slowing?

One reason for slow earnings growth in the United States is the slowing global economy. For multinational corporations, like those that make up the S&P 500 and the Dow, a significant portion of their revenues come from overseas operations. And the news from overseas has been pretty bleak.

In Europe, the north is in recession, while the south is in depression. Unemployment numbers in Spain, Italy, and Greece are still staggering, with Spain’s jobless rate at more than 20 percent even seven years after the financial crisis. The entire eurozone grew only 0.3 percent in the fourth quarter of 2014.

China, the engine many thought would pull the rest of the world out of this mess, is experiencing a slowdown in growth even by its own admission. The truth is likely even worse than the Chinese government lets on, as the enormous construction bubble that was built up in response to the 2008 financial crisis is becoming increasingly unsustainable. A 60 Minutes report in March 2013 showed entire cities being built—high-rise luxury condominiums, expansive malls—with no one living in them. So much for the world’s growth engine.

China’s slowdown, which has hammered the price of oil, iron ore, and copper, is having negative impacts around the world. Brazil’s impressive growth has slowed to a crawl, even sliding into contraction at times. Turkey, another country that seemed to be flying above the global earthquake, saw less than 1 percent growth in 2014—down from about 9 percent in 2010 and 2011. Japan’s economic growth has been so poor that the government began a money-printing campaign in 2013 that would make even Ben Bernanke blush—printing $75 billion a month in an economy that is less than a third of the size of the United States. And it still went into a recession in 2014.

This is important because the global slowdown has a direct impact on the U.S. economy and U.S. stocks, particularly those that collectively make up the S&P 500. In today’s global economy, no country is an island. Some countries may fare better than others, but trends around the world operate as a large feedback loop. When the United States falters, Europe slows down. When demand in Europe drops, exports from China drop. When China slows down, Europe sinks further, and other economies cannot keep up their previous
pace. In the global economy, every economy really does depend on other economies. The United States is not exempted from that.

**How Do You Define a Bubble? Assets Up, Economy Flat**

The only thing we are getting from all this massive government stimulus is more support for the bubbles, not real economic growth. As we saw earlier in Figure 1.6, only asset prices have been significantly rising, not GDP.

**How Do You Define Insanity?**

The classic definition of insanity is doing the same thing and expecting different results. That’s exactly what we’ve been doing: applying the same stimulus (massive printing and massive borrowing) and expecting different results. More money printing, more money borrowing, more cheerleading, and more statistical smoke and mirrors are not going to give us the needed productivity improvements that can lead to significant GDP growth, more quality jobs, rising wages, or anything else that comes with real economic growth and recovery.

The only thing we are buying with this all this ongoing stimulus is temporary asset bubble maintenance—that’s all.

**Don’t Believe the Stimulus Has toEventually End?**

While the federal government does have much more power to affect markets and the overall economy than any private investor or company, even the federal government has its limits.

The limit to continuing the stimulus of massive money borrowing is the government’s ability to find investors willing to continue to buy our debt. In a way, we’ve already hit that limit. The fact that the Fed started printing massive amounts of money in 2009 to buy our debt was a clear indicator that the government’s ability to borrow at low interest rates had essentially come to an end. We had to print the money to enable the government to keep borrowing at low interest rates and to keep us from falling into a much deeper recession.

Although recently there has been a temporary pause in money printing, which ended QE3, this current temporary pause is no different than when QE1 ended. Eventually, because there was no significant recovery, the Fed had to start QE2. And when QE2 ended
and there still was no significant recovery, the Fed had to crank up QE3. Now QE3 has ended and this latest pause is just a stopover en route to QE4, even if they might decide to dress it up with a different name. Without a real and significant economic recovery, massive money printing cannot be stopped, only temporarily paused. Otherwise, the bubbles will start to fall again.

So what is the limit to the Fed’s massive money printing? Theoretically, there isn’t any—if investors never change their thinking or their behavior. But in practice, investor psychology and behavior do change over time. History and the laws of economics tell us that the stimulating effect of money printing becomes increasingly ineffective as people begin to notice that the massive stimulus is not buying all that much economic growth.

In the early stages, investors may be slow to notice this because the powerful group psychology of denial is so strong (and because of possible manipulative interventions in the markets to keep the party going for as long as possible). But, in time, a small but growing group of increasingly skeptical investors will want to be a bit more cautious, exiting some of their stocks and bonds.

For a while, foreign money can fill the gap, but, in time, that too will slow down. As more investors become more cautious, others will begin to notice and become somewhat anxious, too. As positive investor psychology gradually becomes negative, the Federal Reserve will fight hard to keep stock prices up, but eventually the Fed will fail. Once investor psychology turns negative enough, a critical threshold of anxiety will be reached and a series of mass exits out of bonds and stocks will occur—pushing us over what we call the Market Cliff (see Chapter 4). Time is the death of all bubbles.

With stocks and bonds falling and investor and consumer psychology now rapidly falling too, the ugly price tag of all that earlier money printing will begin to show up in rising inflation (see Chapter 5). Eventually, rising inflation will naturally lead to rising interest rates, crippling the economy and ultimately canceling out the earlier positive effects that the stimulus originally provided.

The fact that there are lag factors between money printing and inflation is the only reason money printing can be so effective in the short term. After that, the long-term negative consequences of money printing (rising inflation and high interest
rates) will kick in. That would be bad news for any economy, even a strong economy in a real recovery and with real growth. However, for a sagging multibubble economy in a fake recovery with almost no growth, the consequences will be very bad, indeed.

It’s only a matter of time.

Wondering Why the Aftershock Hasn’t Happened Already? “Animal Spirits” Are Keeping Us Going
For some of our biggest fans, the question isn’t “Has the Aftershock been canceled?” but “Why the heck is it taking so long?!” You might think, given the staggering amounts of money printing and borrowing, lack of growth of good-paying jobs, overvalued assets, and low GDP growth, that the bubbles would have popped by now. Why hasn’t the Aftershock happened yet?

The reason that the Aftershock has not happened yet is that our economy is not simply a bunch of statistics, facts, and mathematical equations. Our economy’s behavior is also the direct result of collective group behavior, and group behavior is highly driven by collective group psychology.
Without continuous positive investor psychology, no amount of money printing, cheerleading, or massaged statistics would be very effective at maintaining the fake recovery. Just as for a rising bubble, for a fake recovery to continue, you need people to continue to believe in it.

Sometimes the term animal spirits is used to refer to the emotional component of the economy, represented by consumer and investor confidence. Without positive animal spirits, the government stimulus simply would not work. But as long as the animal spirits stay positive, the stimulus to maintain the fake recovery will work for a while longer. People have to believe this recovery is real—once they stop believing in the strength of the Federal Reserve and the soundness of the markets and the financial system—the game is over and the bubbles will pop.

At that point, any additional money printing would translate immediately into inflation, with no beneficial effect. Cheerleading will fall on deaf ears. Currency and market manipulations will fail to make people invest. And no amount of dumping gold on the market to lower its price will turn investors away from its perceived safety.

If you are asking, “When will the Aftershock hit?” you are really asking: “When will positive psychology turn negative enough to pop the bubbles?” In the end, the timing of the turning point comes down to how people feel, not to economic statistics or sophisticated financial analysis.

While the final trigger won’t be about numbers directly, in the buildup to the change in investor psychology, some numbers will matter because they will begin to weigh heavily on investor optimism. Two of these important, psychology-changing numbers will be continued slow GDP growth and continued slow growth of good jobs after more than seven years of tremendous stimulus.

Instead of a real recovery, investor confidence will wane and all the bubbles will pop.

The most likely sequence leading up to the Aftershock:

1. Continued slow economic growth and continued lack of growth in high-paying full-time jobs.
2. Gradual decline of positive investor psychology.
3. Increasing negative investor psychology.
4. The bond and stock markets fall in the Market Cliff (see Chapter 4 for details).
5. Rising inflation.
6. Rising interest rates.
7. The multibubble economy fully pops.
8. The Aftershock begins.

At that point, the bubble economy will be no more. Remember: bubbles go up because of irrational exuberance based on irrational thinking, but they come down because of rational fear based on rational thinking.

It is hard to time these triggering events with precision, but they will happen. In the end, the final trigger will be time itself. Time kills all bubbles.

**The Fierce Fight to Save the Bubbles**

In the meantime, as long as investor psychology is still good, it is in the government’s and the financial system’s best interests to keep animal spirits up *at all costs*. There is even some evidence that there may already be government intervention in the stock and gold markets (see Appendix). The motivations for this are strong because the stakes are so high. As long as the powers that be can convince people that the economy is recovering and real job growth is just around the corner, they can keep the stock market and other asset bubbles going.

Of course, all of this works only because most people are all too willing to believe the good news. Just like the government, they also have plenty to lose by facing reality. Jobs, careers, businesses, and lifestyles are in jeopardy. No one wants to face that our beloved Age of Easy Bubble Money cannot go on and on.

Could additional money printing and borrowing maintain the asset bubbles and positive investor psychology for a while longer? Most definitely, yes. Will more money printing and borrowing be able to keep the party going for another decade or more? Absolutely not.

**When Will It Happen?**

Our best guess about when the bubbles will pop and the global Aftershock will begin:

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Likelihood</th>
</tr>
</thead>
<tbody>
<tr>
<td>2–5 years</td>
<td>Probably</td>
</tr>
<tr>
<td>5–10 years</td>
<td>Possibly, but much less likely</td>
</tr>
</tbody>
</table>
Even if the bubbles don’t pop in the next 2 to 5 years, they certainly won’t last another 10. The longer it takes, the worse the pop will be. Successfully delaying it won’t make the future pop any better—only worse.

**Please Prepare Now**

Let’s review. Right now, massive money printing (and the low interest rates it creates) are boosting the stock market, protecting the bond market, supporting the overall economy, and allowing the government to borrow massively. We like to tell ourselves this is all risk free, but even the cheerleaders know that’s a lie (otherwise, why be concerned?). Massive money printing will eventually cause rising future inflation, which will push up interest rates, which will pop our multibubble economy (hurting stocks, bonds, and real estate).

No one enjoys thinking the current recovery is entirely fake—not even us. We are not “perma-bears” always predicting the economy will get worse. In the future, we look forward to writing about what can be done to bring about real productivity improvements and how to cash in on the real economic growth that will create. We just aren’t there yet.

We’re not writing this book to cheer the collapse of the economy. We know it is uncomfortable to face these facts and it is uncomfortable to have to go against conventional wisdom in order to prepare correctly. Group denial will certainly delay the Aftershock for a while, but please don’t count on group denial to last forever. History (from 1720 France to the 2008 financial crisis) tells us that people do eventually smell fire in a burning building, even when they initially didn’t want to. Remember the Internet and housing bubbles.

As group denial turns into growing group awareness, conditions can change very quickly. At that point, the bubbles will pop and no amount of additional money printing or other stimulus will be able to stop it. In fact, additional money printing at that point will only fan the flames, not put out the fire.

*Please prepare now, while you still can.* Don’t pretend this isn’t coming, and if you do see it coming, don’t count on perfect timing of the markets or your exits. Too early is better than too late. It is not necessary to run and sell off all your investments today or tomorrow. But it is necessary that you pay attention to the fundamentals of the economy so that you can protect yourself and your
investments before it’s too late. In this updated fourth edition of *Aftershock*, that continues to be our goal.

Remember, we saw these problems coming prior to publishing our first book in 2006, back when many experts expected that home prices would rise forever. The fundamentals of our macroeconomic point of view were correct then and are still correct today. All we ask is that you listen to what we have to say and decide for yourself. The popping of America’s bubble economy and the coming Aftershock will be like nothing we’ve seen before. The good news is that there’s still time to prepare.

Along the way, if you’re ever tempted to think that all is well, just remember these four damning facts:

1. **Massive money printing.** We’ve quintupled the monetary base, keeping the stock, bond, and real estate bubbles afloat.
2. **Massive money borrowing.** We owe a staggering $18 trillion in total debt, and are borrowing another $500 billion this year—three times more than what we borrowed in 2007.
3. **Low GDP growth.** We’re growing at only about 2.0–2.5 percent per year, which means the government is borrowing almost as much as the economy is growing.
4. **Pitiful income growth.** Real wages (adjusted for inflation) have been essentially flat for decades.
5. **Full-time employment still not at pre-crisis levels.**

We leave you now to enjoy the rest of the book, offering our insights into how to protect yourself and even profit from some of the unique opportunities we are about to experience before, during, and after the Aftershock.

Two thoughts sum up the situation nicely. The first is from Benjamin Graham, considered the father of value investing in the twentieth century. (The added parenthetical comments are the author’s.)

In the short run, the market is a voting machine (bubbles form), but in the long run, it is a weighing machine (bubbles inevitably pop).

George Soros, one of the most successful investors in the United States, tells us:
Economic history is a never-ending series of falsehoods. It represents the path to big money. The object is to recognize the trend whose premise is false, ride that trend and step off before it is discredited.

This recovery is 100 percent false, and the Aftershock has not been canceled! Please don’t stay asleep with the sheep. If you want to protect yourself, you have to wake up before everyone else does. Chapters 2 through 8 will show you how we got ourselves into this mess, and Chapters 9 through 13 will help you prepare for and profit from it.