

The Fed's Next Move

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Ed D'Agostino: Dr. Ed, it's always good to see you. Really appreciate your time. The labor market, kind of what I want to talk with you about, seems to be what's mostly driving interest rates and Fed policy these days. But then it dawned on me, I'm going to speak with an economist about the labor market, and you don't have much data to work with. So how has that been, being an economist and not having any official data?

Dr. Ed Yardeni: Well, there's some official data. There's, for example, the yearly percent change in the Red Book Retail Sales Index. So that's available every week, and that still shows that consumers are doing what they do best, which is consume, or at least on the retail side. I don't really have anything on services other than I travel a lot and the airports are absolutely mobbed.

People are definitely traveling, and when you travel you eat at the airport. Wherever you're going, you're either on business or on vacation, I guess. And that entails eating at restaurants, going out, staying at hotels. So that's just totally anecdotal. Yeah, it's kind of like winging it here trying to figure out what's going on. But it's difficult. I really like the weekly initial unemployment claims data. We don't have that.

The consumer credit data did come out from the Fed. The Federal Reserve is still open for business. And the revolving credit looked disconcerting because on a year-over-year basis, revolving credit has stopped growing. And usually when the consumers are spending, they're using their credit cards. But I'm of the opinion that the consumer sector is being held up by retiring baby boomers.

There's about 70 million baby boomers, I would guess, maybe something like 30, 35 million households of baby boomers. And these folks are retiring and they are the richest retiring generation ever. They're retiring with \$80 trillion of net worth and they're going to spend it. They are spending it. I think that accounts for the ongoing strength of the consumer in the face of what looks like not much job growth. And it suggests to me that we will continue to see the

consumer surprisingly strong, which would obviously be quite a contrary perspective on what's going on in the economy.

Ed D'Agostino: You wrote recently that you think the labor market is in a bit of a funk, but you had an interesting explanation. Can you explain what you mean by a funk?

Dr. Ed Yardeni: Well, I think Fed Chair Jerome Powell has expressed some opinions on this and didn't use the word funk, but did say it's unusual to see what's going on in the labor market. He pointed out that the supply of labor is declining and so is the demand for labor. And so the unemployment rate is at 4.3%, which is basically full employment. But we're at full employment with this funky development, that unusual development where instead of growing, we've got the payroll employment basically flat. At least that was the last data we saw. And some indications that it might actually be turning a bit negative.

Hirings have slowed down. There are people saying it's the no hire, no fire economy. Actually, the last data we have was August, which showed 5.1 million people were hired. So it's not like nothing's going on and nobody's getting hired—quite the opposite. But the separations, which includes both quits and layoffs, guess what? That was 5.1 million. So basically, I guess you could argue that whoever quit or whoever was fired was basically replaced on a one-to-one basis. But we usually see hirings exceed separations, and that's what's kind of funky about this labor market.

But I think on the supply side, clearly the freezing of illegal immigration from the southern border has had an impact on increasing labor. And at the same time, deportations have led to a reduction of labor. And anyone who had a tendency to hire undocumented workers probably decided that's not such a good idea anymore, because any day ICE could come in and your labor force could be gone.

So that's what's going on on the supply side. On the demand side, it may very well be that AI may actually be having an immediate impact on employing young people, young and new entrants. I think a lot of companies are spending some money on AI trying to figure out how to use it. And I think they are going to find uses for it and conclude that a lot of the entry level jobs that they had, maybe they don't really need to hire in that end.

To work with AI, you actually have to have some experience because AI is artificial, but it's not intelligent. You really have to know what you're doing when you're using it and you have to proofread it. You have to read what comes out just to make sure that it didn't hallucinate and get something wrong. But it is very useful in getting a lot of information together very rapidly,

giving you a summary, and that's starting to affect the availability of work for teenagers as well as for people coming out of colleges.

Again, the data that we have through August showed that the unemployment rate for teenagers and for 20 to 25 year olds has increased rather sharply. And anecdotally we know it's hard for young people to find jobs. So we've got this very funky labor market, which has led to a lot of concerns about consumer spending. And I've pointed out that we have to look at the demographics of the baby boomers to explain why the consumers are still spending.

Now, right now, as we were speaking, the market got a little funky about consumer debt. There's been an issue with debt in the subprime auto market. A couple of the regional banks have raised some concerns about loans they've been making. I don't think this is going to lead to a real big problem in the credit markets or in the economy, but it is something that everybody's focusing on.

But again, I think that it's undoubtedly lower income workers are struggling. But on the other hand, higher income workers, which tend to be retiring baby boomers—now, I think the savings rate is actually going to go negative because baby boomers, when they retire, they don't get a paycheck anymore. And meanwhile, they keep spending. And a lot of them are getting a real tailwind with the stock market because they do own stock, and so they're spending money and then they look at their net worth and it's actually gone up during the month.

Ed D'Agostino: You mentioned consumer credit, something I wanted to circle back on with you. Have you looked at the whole buy now, pay later aspect of consumer credit? My understanding is that it's not really followed by credit rating agencies. So is it hidden?

Dr. Ed Yardeni: Yeah, I don't think it is. Yeah, it's a fairly new development, right? About a year, two years that it's really kind of caught on. And yeah, it's got all the earmarks of a trouble-making scenario. And that may be contributing to some of the stress that we're seeing in lower income consumers that decided that they wanted to buy and hope they could pay later.

Ed D'Agostino: So I also wanted to circle back on your comment about entry-level jobs. The last data that I saw indicated that youth unemployment, so 16 to 24-year-olds, was between 2 and 2.5 times higher than the rest of the economy's unemployment rate. Is that normal?

Dr. Ed Yardeni: Yeah. It is. I mean, it's normal for teenagers to have a higher unemployment rate than any other age group. It's normal for kids coming out of college to have a somewhat higher. And then it's quite normal for older age groups to have a very low unemployment rate. They

tend to be the last ones to be laid off. So there's really nothing that abnormal going on in the labor market when we look at things.

It's just some people look at those charts and say, "Uh-oh, you know, the next thing that's going to happen is we're going to go straight up in the unemployment rate." But that only happened in the past when the credit crisis hit, shut off credit to everybody, and then caused a recession. So I think what the market may start to worry about is that any signs of trouble in the credit markets today could lead to an economy-wide credit crunch, which then would cause a recession.

My counter to that is that things have changed dramatically in the capital markets. It used to be that when we had a financial crisis in a bank or a few banks or savings and loans, it did very quickly become a credit crunch and a recession because when financial institutions lose money, they have to take charge-offs and that depletes their capital. And then that might actually force them to significantly cut down lending. That then becomes a general credit crunch and then a recession.

What's changed in the credit markets, or the capital markets, which is both the banks and the equity market and the bond markets, is that we have private equity now. And if something blows up in the private equity realm, it's really just a haircut on somebody's rate of return. It's not a situation where they've got to stop lending. I mean, if somebody has a private equity or private debt fund, that's what they do. And if their investors continue to give them money, they will continue to invest in private equity and private debt, which tend to be—we use the word funky, but I think it applies as well to that kind of debt. But it doesn't shut down, it doesn't cause a credit crunch. And so I think there are a lot of shock absorbers now in the credit markets.

Look at what happened with commercial real estate, all the hand-wringing about how that was all going to lead to a calamity for the economy because we've kind of seen that before back in the early '90s. But what's different this time around is we have lots of distressed asset funds. Those people, some of them are my clients. And when I see them and I walk in and I've got a big smile on my face—"Hey, the stock market's making a new high!"—he said, "You forgot we do distressed assets. We want things to go badly." They want to buy stuff at 25 cents on the dollar. And, you know, a lot of this stuff gets cleared off the market very quickly because of the distressed asset funds.

We've got vulture capital funds. We've got venture funds. So there's a lot of money in the private equity and private debt credit markets. And guess what? You lose some, you win some, you lose some. More often than not, you win a lot, but occasionally you do lose quite a bit.

Ed D'Agostino: So Dr. Ed, does that mean there's too much money in the system? You've got the Fed saying that they're probably going to wind quantitative tightening down. So their balance sheet is going to end up being incredibly high compared to historic averages. And you're saying that there's just so much money out there.

Dr. Ed Yardeni: Well, the Fed is so yesterday. I mean, everything's been changing in the economy and the Fed's still operating as though it's a fairly predictable business cycle. In other words, they think that when they raise interest rates, that slows the economy down and brings inflation down. Well, they did that. They raised interest rates. The economy didn't really slow down. Inflation did come down, but it probably would have come down on its own because a lot of that was pandemic-related supply-side disruptions and all that.

And now they actually think that the federal funds rate, the interest rate they control, is still too high relative to some fictitious mythical magic neutral interest rate. They think it's 3% is the Fed funds rate and we're at 4%. So they think they still need to lower rates by 100 basis points, but they don't want to do it too quickly because inflation is still 3%, not 2%, because of the tariffs. So now the administration is saying, "Hey, tariffs had no impact whatsoever on inflation." That's nonsense.

Durable goods inflation is up from zero—from down 4.2% year over year a year ago to up 1.5% year over year now. So durable goods inflation has gone up. And so what Trump's tariffs have done is they've kept inflation from coming down. We'd probably be down at 2% now. But the Fed thinks that this is just a transitory thing. We'll get down to 2% within the next couple of years. And meanwhile, they're concerned about what they see in the labor market.

And my counter is, well, wait a second, you really think that lower interest rates is going to do anything? Last data we had showed that second and third quarter real GDPs were increasing by over three and a half percent. So what are they trying to do? Stimulate even more demand? Are they really going to get more people coming into the labor force by creating more demand than we have right now? I kind of doubt it. I mean, again, these are structural changes in the labor market that lower interest rates aren't going to do much about.

And meanwhile, consumers are spending, especially the baby boomers. Capital spending is strong. A lot of that technology stuff is being financed with cash flow. So all lowering interest rates is going to do is give us more of a melt-up in the financial markets. We have a melt-up in gold for sure. And I think we're sort of on the edge of a melt-up in the stock market, which then creates financial instability.

You know, I'm not on the list of people who are being considered to be Fed chair. I'm kind of annoyed about that because for many years I've offered to do what the Fed does for half the price. I'll give them a 50% discount. I'll do it from home. I don't need a big staff. I don't need a renovation. You know, I mean, well, you know—

Ed D'Agostino: You don't need a billion dollar renovation to your office.

Dr. Ed Yardeni: We're still going to need people to do regulation of banking and all these boring things that I really don't want to get involved in. But let's have a spin-off of the FOMC and just make me the chair and I won't need anybody else. It can be done by one person if they know what they're doing, but let's not go there any further into my fantasy of how things should be.

But again, I think that the Fed, if I was doing it, I'd leave the Fed funds rate right here. We've got the inflation rate still at 3%, not 2%. And the Fed says, "Well, it's transitory." We know about their track record in calling transitory versus persistent inflation. And then the other thing they say is, "Yeah, but the labor market is weak." And yet the last unemployment rate we had was 4.3%.

And their own survey, their own forecast of their collective judgments of what the full employment rate is, is 4%. So, you know, we're 100 basis points above their targeted inflation rate and maybe 0.3 percentage points above their long-term ideal unemployment rate. And they're getting all concerned about lowering interest rates.

You know, we'll see. I mean, when they did it last year and lowered the Fed funds rate by 100 basis points, I said that'd be a mistake, that the bond market wouldn't like it. I coined the phrase "bond vigilantes." I warned them that my friends, the bond vigilantes, might act up. And sure enough, they lowered rates by 100 basis points in the Fed funds rate market and the bond yield went up 100 basis points. So completely offsetting their easing move. And I think they're running the risk of seeing the same thing happen now.

You know, we are going to get a CPI number. I guess it's October 24th. I guess some government workers are giving us a freebie. They're not getting paid, but they're still coming in to calculate the CPI. I don't know what happened to the PPI. I think the PPI was also going to be released by them, but CPI is for sure on October 24th. The FOMC meets at the end of October and it'll be interesting to see how the CPI plays out.

Ed D'Agostino: I want to move on to your comment about a melt-up because you've made some pretty bold calls coming up for both gold and the stock market and you've been incredibly

right for four years now. But before we get there, I just can't resist asking you about tariffs as an economist. What do you see as the pros and cons of the tariff policy right now?

Dr. Ed Yardeni: Great way to raise additional revenue. I mean, 10, 15% seems to be the base tariff that the administration has implemented. And then around that, there's higher tariff rates. And then of course, for steel, aluminum, I think copper, some other specific items, there's higher tariffs. And that's bringing in at an annual rate—it's bringing in about \$350 to \$400 billion in duties and revenues. And so if we're talking about a deficit of \$1.5 trillion, that's a significant decrease in the deficit. And I think it's one of the reasons that the bond market, the bond yield has actually been coming down because even the bond market recognizes this is an important development in terms of bringing in revenues.

The problem is the Supreme Court may very well rule that all this tariff nonsense might turn out to be illegal, unconstitutional. They might give the administration six months to figure out what to do instead, maybe try to get legislation from Congress, but it could throw a lot of things up in the air with this issue.

It's basically a tax. I'm not a big fan of taxes as a market-oriented economist who likes to see smaller rather than bigger government. But then again, I deal with the facts and the facts are that politically we just don't have the stomach to meaningfully cut back on outlays. And so if we can't do that, we should try to do the best we can to find revenues.

And so far, the evidence is that tariffs do have an impact on inflation. Instead of down to 2%, which is I think where we would have been, we're kind of stuck at 3%. And that's because the durable goods inflation rate has gone up, as I mentioned before. And in addition, the services inflation rate, which is not affected by tariffs, has kind of stalled out around 4%. And that's even with rent inflation coming down. So the Fed's being pretty irresponsible, I think, in basically declaring victory on getting to 2%. 3% is transitory, we'll get there in a year or two, and kind of focusing on the labor market issues, which are very complex and may not be something that cannot be solved with easier monetary policy. All that'll do is create financial instability.

Ed D'Agostino: Okay, well let's move on to the stock market. I think that's what probably a lot of viewers are interested in hearing your take on. If I did my math correctly, you are predicting a 19% gain for this year. Because I think you said that, yeah, 7,000 for S&P 500.

Dr. Ed Yardeni: 7,000, yeah. Yeah, it'll be the third double-digit year in a row.

Ed D'Agostino: How sustainable is that?

Dr. Ed Yardeni: I think it's sustainable because I've been thinking that the economy is more resilient than just about anybody else. For the past three years, I've been saying that we have the most—we're experiencing the most widely anticipated recession of all time that isn't happening. And, you know, a lot of people are still worrying about a recession. I said, haven't you learned anything from the past three years? Maybe you have to understand why the economy has been so resilient.

Look, we had the pandemic. The pandemic immediately led to a two month lockdown, which caused a two month recession, just two months, official recession. Then the lockdowns were ended and the economy started to lift, even though there were still social distancing requirements that should have kept the economy pretty weak, but people went out and bought goods like mad. And so we had a really pretty remarkable recovery coming out of the lockdowns.

And then what? Well, then we had supply chain disruptions, which caused a surge in inflation, which caused the Fed to raise interest rates. And yet the economy continued to grow with the Fed funds rate going from zero to five and a half percent. We continued to grow. And then since then, we've had tariffs. Now we're stress testing the economy with a labor market that's kind of got everybody scratching their head about what's going on. And yet the economy continues to be resilient.

So I've said that, and the other thing is earnings have kind of confirmed that. So we had really strong earnings, much better than expected in the first quarter, much better than expected in the second quarter. Third quarter analysts expect 6% year over year. I'm expecting 10%. So it's an earnings-led bull market. It's been a melt-up, but it's been a melt-up that's been earnings-led.

Now, how do we get to 22 on the forward P/E? I mean, isn't that a melt-up? I would just point out that when the pandemic hit, we had our lockdown recession and a bear market that lasted, you know, a few months, a couple of months, from February to basically March 31st, right, when the Fed came in with all that liquidity. So it was a great buying opportunity, an amazing buying opportunity. We thought so at the time.

And about six months into that V-shaped recovery, we bounced back to a forward P/E of 22. And that was led by the, guess what, Magnificent 7. And ever since then, the market's been going higher. From that point to now, the forward P/E is basically around 22. So the market, the S&P is up 100% since we fully recovered from the sell-off in the lockdown recession. And so it's been a completely earnings-led market with a high P/E.

And the high P/E obviously has something to do with the fact that the Magnificent 7 are selling at something like 30 times forward P/E. And there's a reason for that. They truly are magnificent. Only a few years ago, people were saying you got to buy the Magnificent 7 because they don't have any debt. They have a tremendous amount of cash flow. They can use their cash flow to buy back their shares, to buy leading edge small companies that they can leverage up their technologies.

And now that they're using all that cashflow to invest in AI, everybody's freaking out. "This is 1999 all over again." And the point I've been making is in 1999, a great part of that bubble was debt financed, particularly by telecom companies who sold or financed their customers and they got their money in the junk bond market. This time around, the money is coming from cashflow.

These companies are just generating a huge amount of cash and they're spending it. And so what's the worst case scenario? It's that they'll conclude that we're overbuilding, we've got more than we need. So they just slow it down and guess what? They'll be even more profitable because their capital spending is slowing down. But they know better than any of us what's going on with the capacity of their data centers. And they see that it's growing like mad. And all these people that are kind of freaking out that it's all going to be a bubble should kind of look at their own lives and ask themselves, "Am I using AI?" And the answer in my case is I'm using it all the time. It's not perfect. And I'm still trying to figure out how to—you know, you got to learn its lingo and nuances, but I use it every single day.

Ed D'Agostino: Yeah, me too. So if the Mag-7 is truly magnificent and at the same time gold is just on fire—is it the Mag-8?

Dr. Ed Yardeni: It's Magnificent 8. It should be the Magnificent Elite. All you need is gold in the Magnificent 7 and come back in a few years when you want to retire.

Ed D'Agostino: So do you consider it the same trade? I heard someone yesterday arguing that this is really about concerns about debasement of the dollar and flight to safety. And so where can you go? You can go to gold and you can go to the strongest companies in the world.

Dr. Ed Yardeni: I know. I haven't even used the word debasement. I think that's because I've been arguing that the dollar is just in a correction. It was down 10%. I hate the DXY index because it's basically a fixed—it is a fixed weight index where the euro is 57% of it. And I keep asking everybody, what is so great about the euro? Beats me. They've got more problems over there than we've got over here. So I don't really feel as though everything that's happening is because of the debasement of the US dollar.

I've been talking about the roaring 2020s. I've had a happier outlook on things. I guess it's my nature. And back in 2020, I started this. And 2020 was not a year to be optimistic. But I said, "You know what, this is going to turn out like the 1920s. The 1920s started out very depressing, and then it turned out to be the roaring 1920s." I think this has already—we're not finished with the decade yet, and things could still foul up. But economy's at a record high, real GDP, consumption record highs, stock market at a record high, gold at record high. Tell me this isn't the roaring 2020s so far, which certainly feels like that.

And I think the stock market's going up on earnings. I think productivity is making a comeback. I think that AI is real. I don't think it's comparable to the dot-com bubble. There's similarities in some cases, but I don't think it's going to add up in a macroeconomic sense in the same way. We had a bursting of the AI bubble just at the beginning of the year. Remember DeepSeek came out of nowhere? And the stocks got hit and then they came back because the companies said, "Yo, despite what you think, we're still going to spend this kind of money because we need to." And so the stocks came right back.

So the market outlook is reflecting the optimism on the economy, the resilience of the economy. The valuation multiple is holding up this high because people have come around to my view that the economy is resilient. And if it's going to not have a recession anytime soon, which by the way, does not come with a money-back guarantee—but you know, that's been my forecast. The resilience of the economy has been my forecast for the past three years. It's worked out. And I think it just makes me feel even better about the resilience concept because it's proven itself so far.

So you put it all together and the question is, so why is gold up? And the answer is because there's a lot of people who are pessimistic. Pessimism sells. People like Ray Dalio, very smart billionaires, are going around saying you should own more gold because everything's going to blow up. There's going to be a debt crisis any day now.

I think a lot of it's geopolitical. I think I turned bullish on gold when it rose above to a new high above 2,000 back in—I think it was actually 2024. And I said, I think it may simply be because Russia invaded Ukraine, the US and Europe froze the assets of the Russian central bank. And ever since that, people who are not our friends, central banks that run in China, Russia, Venezuela, North Korea, and Iran, they're all buying gold. And so it kind of feeds on itself.

And then we've had Trump come in, kind of throw the global world order up in the air. And so nobody quite knows where it's all going to land. And maybe all you really have to know is the Chinese people lost a tremendous amount of money in their investments in real estate. And they've got a huge negative wealth effect. And they've gotten the whips out of their stock

market. And they're watching gold going up every single day. Maybe we're kind of appealing more and more to them to do exactly the same thing. So that could be a big factor driving gold up.

I've never had an opinion on gold because as an old-fashioned strategist, I can't value it. And now I have an opinion. I think it should be in a portfolio. And I think that it's going to go higher. And I've got the S&P 500 at 10,000 by the end of the decade, the end of 2029. And I've also have the price of gold going up to \$10,000 per ounce by the end of 2029.

Now, let me just make a point about gold and Bitcoin. If Bitcoin could go from basically zero to \$125,000 in a few years, why can't gold do the same? The wonderful thing about assets that everybody thinks are real assets that one should own, but have no income, no earnings, is you can say whatever you want about how high they can go. Some people have been saying like a million dollars for Bitcoin. I said, I don't have a valuation model to argue against it.

So gold and Bitcoin are similar that way. Where they're different is I think Bitcoin is a risk-on asset, as proven recently. And I think that gold is a risk-off asset, as is the dollar, which is, again, why I think the dollar could actually hold up pretty well, even though gold seems to be indicating debasement. What we may be seeing is the debasement of the yuan, the Chinese currency. The economy that's really the disaster case in the world today is China's, with the amount of debt they've accumulated and their horrible geriatric demographics.

Ed D'Agostino: And, you know, a portfolio manager friend of mine said to me a few years ago that the bearish case is always the most compelling. It sounds the most intellectual and it's almost always wrong. And then over time stocks tend to go up. And, you know, hearing that and then following you for the last several years and seeing the success that you've had and that your customer client base has had has really sort of turned me around and given me a new framework for looking at investment opportunities and markets. So I appreciate that. How can viewers learn more about you and what you do?

Dr. Ed Yardeni: Thank you. Well, you can always Google me or AI me, I suppose. But Yardeni.com is our flagship website. And then we have a flagship service for our institutional accounts. And then we had a request from quite a few accounts, from quite a few individuals that they wanted to have some access to our thinking. So we came up with Quick Takes, which is a daily where we do our best to try to help people understand the relationship between the macro and the micro of investing. So Yardeni Quick Takes is probably the product that most individual investors might want to have a look at.

Ed D'Agostino: Yep, I get it. I read it every day. Can't recommend it enough. Dr. Ed Yardeni, always a pleasure speaking with you. Thank you so much for your time.

Dr. Ed Yardeni: My pleasure as well. Thank you.