Interviewee: **Michael Aronstein**
Title: **CEO**
Company: **Marketfield Asset Management**

Interviewee: **David Stockman**
Title: **Former Director**
Company: **Office of Management & Budget under President Reagan**

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Interviewer 1: **Carol Massar**
Interviewer 2: **Matt Miller**
Interviewer 3: **Adam Johnson**

Carol Massar
Let's get to our next guest. He says the debt crisis in Europe is what has been sending US stocks lower. With me now is Michael Aronstein. He's the CEO of Marketfield Asset Management where he oversees more than $1 billion.

Michael Aronstein
Thanks for having me.

Carol Massar
So you're listening to Europe. I mean, they're not even close to what they need to be doing, is it?

Michael Aronstein
No, no. They're sort of flopping around like beached dolphins at this point, and I guess that's what they like to be is on the beach.

Carol Massar
What are they waiting for at this point, Mike?

Michael Aronstein
Crisis. I think the history shows that they don't act until forced to by panic and so much pressure from markets that there's really no course of action other than to do what the markets demand. Right now, they're battling the imperatives of a free market system. They don't like what the bond market's saying about sovereign debt. They don't like what's going on in credit default swaps. They don't like what's going on with stock trading. They don't like short selling. So they're trying to manipulate all of these things more to a political aim, and that's not possible.

Matt Miller
What do you think, Michael, they need to do. I mean you heard over the weekend Giulio Tremonti calling for Euro bonds, but out of Italy, of course, you'd expect him to be calling for that.

Michael Aronstein
Matt, I think the ECB needs to reflate. They really need to go in there and purchase a lot of this paper and not sterilize the transactions and allow their balance sheet to increase to the same degree that the Fed did. You know, in the 15 or so months since the crisis in Greece broke out last year, the ECB has actually contracted its balance sheet, which I believe accounts for the timing of this particular crisis in sovereign finance. Whether or not they intend to, they've been quite tight on the liquidity provision basis.

Matt Miller

So you think the Eurobond issue is not one that should be raised right now because, surely, Angela Merkel is going to have problems selling that to voters next month.

Michael Aronstein
Yeah, I think, you know, weøve talked about this for more than a year. I think the German populationøs going to be pretty skeptical of that using its credit and its standing in the world to support the habits of politicians around the periphery.

Carol Massar
Mike, you anticipate that weøre going to continue to see market volatility until Europe gets their house in order.

Michael Aronstein
Yeah, I think this reminds me of pretty much every crisis Iøve seen for the lasté

Carol Massar
Weøve kind of been here before havenøt we? Just a few yearsé

Michael Aronstein
é 33 years. I remember when Argentina dissolved their currency board, I think right up until two days beforehand, they kept getting on television and professing that, ñwe will never de-link the peso and the dollar. We will never do that. Thereøs no chance.ò And then two days later they did it and they didnøt even apologize. They just said, ñwell, the exigencies of arithmetic have forced us to do this.ò

Matt Miller
All righté Sorry, Carol.

Carol Massar
No, go ahead. Iøm just going to say that it sounds like weøre going to have to be patient and kind of wait here, but, Matt, you go ahead. Take it away.

Matt Miller
Well, and we can wait with Michael Aronstein. Heøs going to stay with us, fortunately. I want to get, though, right now the 13F reports that weøve been combing through. Adamøs been looking through what Wall Streetøs biggest investors are buying or selling. So, Adam, what are you finding?

Adam Johnson
Banks and gold. Thatøs what itøs all about and on the banks, itøs a lot of selling. Let me start there. Sellers of banks. Here you go. John Paulson selling Bank of America Citi SunTrust; George Soros selling Citi and Wells Fargo; Paul Tudor Jones selling KeyCorp and SunTrust. We keep talking about the banks, whether itøs Bernstein talking about headline risk and not being able to quantify what the put-back risk is, or whether itøs this news now that Bank of America may unwind some of its Merrill Lynch assets. The problem is you canøt quantify it. These guys, the big guys who have been bulls, they are selling their positions. And, again, just to put it in plain terms, Manal Mehta of Branch Hill Capital: *as you spend more and more time on the banks, in other words, picking them apart, trying to understand them, you come to the conclusion that we're dealing with an unquantifiable set of mortgage liabilities. That's the problem. It is impossible to handicap how these lawsuits are going to play out.* Again, thatøs the problem with the banks, uncertainty. Very cheap, and they may get cheaper; thatøs the problem. Now, we also talk about gold. On gold, itøs a lot less clear-cut. There have been sellers of banks, but on gold, there are still bulls, there are still bears, as there always is in any market. But look at this, John Paulson, Steve Cohen, clear bulls on the gold debate. John Paulson keeping his position. Heøs made a lot of money there. Meanwhile, George Soros and Eric Mindich becoming bears, unloading. But thereøs one point we should make about Eric Mindich. What he has effectively done is sell his

GLD position and he's replacing it with options. In other words, with gold up at $1800, that's expensive. You sell that. You buy options. That's a lot cheaper. It's a way to manage your risk. So he sells a little bit of both. And just so we're all on the same page, gold is poised to close at a new all-time high, $1785. It's up 45% on the year. That's the chart. I know we talk about it every day, but that is quite a move, Carol.

Carol Massar
Yeah, it seems like the only sure thing in the last decade has been gold, that's for sure. Let's go back to Michael Aronstein. Mike, I want to go to what Adam started talking about and that was financials, a lot of big names selling. You guys have been short financials.

Michael Aronstein
Yeah, we have been for a long time. I just don't see, forgetting the ultimate mortgage liabilities and the clawbacks, I think going forward, the industry is going to have a very, very difficult time making any money and I think they have a cost structure that really has been calibrated for boom times, not for retrenchment or restructuring and I think the returns on equity are going to be very, very disappointing for a long period of time whether or not they have any further balance sheet impairment.

Carol Massar
So even when folks say, hey, check out the valuations of some of these financials. They're so low. Who cares at this point because of what the outlook is for these guys going forward.

Michael Aronstein
Yeah, I think the valuations are based on a history that is receding farther and farther into the distance.

Carol Massar
Speaking of history, we've been looking at US history over the last couple of weeks because of that downgrade. We actually talked to Warren Buffet, got some comments. He actually spoke to Charlie Rose last night about the US debt rating downgrade, which he had said in the past is worth a quadruple A rating. Listen up, everyone.

Warren Buffet
We can print money. We don’t have to worry so much about our government becoming dysfunctional as we have to worry about that damn printing press becoming dysfunctional.

Charlie Rose
So, in fact, you are saying that the United States can always pay its bills and, therefore, it should not have had its AAA rating downgraded.

Warren Buffet
Yeah, that’s correct.

Carol Massar
So, Mike, should we be comforted by the idea that the US can always print money so we don't have to worry that we can always pay our debts or does that, even when you hear it from everyone?

Michael Aronstein
Well, clearly, when you borrow in your own currency and you have a central bank that has basically unlimited ability to create money, you don't have any credit risk. You have all kinds of other risks, but if...

Carol Massar
So is the downgrade ridiculous, in your view?

Michael Aronstein
Yeah, and I think S&P is a business in search of a mission and theyôre trying to get their names in the newspaper, I suppose, to remain even slightly relevant, but they have a pretty outstanding record as a contrary indicator.

Carol Massar
Thatôs a good point. Hey, weôre going to come back and talk more with Mike in just a moment.

[Ad break]

Carol Massar
Letôs get some reaction to Perryôs criticism of Bernanke and the Fed. David Stockman is the former director of the Office of Management and Budget under President Reagan and a former executive for Wall Street and private equity firms. Also still with us, of course, is Mike Aronstein of Marketfield Asset Management. David, I want to kick it off with you. So, Rick Perry being very harsh about the Fed. Your thoughts in terms of what he had to say.

David Stockman
Well, wrong choice of words. He should have said stupid, destructive, another windfall to Wall Street thatôs left the middle class high and dry, thatôs going to slam savers for another 2-1/2 years.

Carol Massar
Youôre very critical of the Fedôs zero interest rate.

David Stockman
I think it is terrible.

Carol Massar
And telegraphing that itôs going to be that way for several years here.

David Stockman
Yeah, this will make 4 ½ yearsð 2 ½ already done, 2 more to goð of zero interest overnight money. Itôs a screaming invitation to speculation and to every kind of carry trade known to man. It tells Wall Street, load up the truck, short, borrowing money overnight. Buy the 10-year. We got your back. In fact, weôre going to actually do Operation Twist and appreciate the 10-year so just lay back, have a nice sleep and print money for the next 2 ½ years. This is outrageous. This is a scam and I donôt agree with the word Perry used, but Wall Street needs to be stopped and Bernanke needs to be stopped because this has gone over the top.

Matt Miller
David, what do you think the Fed and Bernanke should be doing because when you look over at the ECB and see them tightening into a recession? It also must make you ponder whatôs going on over there.

Matt Miller
Not really. This has nothing to do with interest rates. This economy is drowning in debt that we created over 30 years. We donôt need low interest rates to encourage households or businesses to borrow more and when we have a 19-basis point, 2-year Treasury, weôre telling Congress donôt worry about the deficit. Just keep spending. Just keep the red ink going because debt doesnôt cost anything. The interest rates are the price of money. Theyôre giving a terrible signal to all parts of the economy to speculate and borrow, and it is not going to solve any of our problems. So I

think what the Fed ought to do is basically retire from the scene and get out of the way and let this economy slowly heal itself. Get interest rates back to some normal level.

Carol Massar
Mike, I want to bring you into this. Do you agree with any of this?

Michael Aronstein
Yeah, generally, I think the Fed is engineering an enormous wealth transfer away from people with savings, and it's a global phenomenon. It's not just the Fed. People with money that they have designated for safety are not being paid a thing for it, and people who are borrowers—whether it's corporate, private households, or government—are being basically aided at the expense of those people who've accumulated savings. Philosophically, I am not a believer in having Central Bank intervention in money markets or setting interest rates, period. I think we'd be much better off if the interbank rate was more volatile, and on a day-to-day basis banks had to adjust their funding given what the market conditions were. That would be a much, much better way than guaranteeing that they always had access now at no cost to as much liquidity as they needed.

Carol Massar
All right. I'm being told I have to take a commercial break. Is that right, guys? We do, but we're going to continue talking with David Stockman and Mike Aronstein. We are going to take a quick break here on Street Smart. Stick around.

[Ad break]

Matt Miller
All right. Let me ask you, starting with you, Michael. As an investor, purely looking at the underlying economic fundamentals, neither one of those things seems too far off as far as the realm of possibilities. Do we have another recession?

Michael Aronstein
Well, I don't think so. Other than government, you don't really have an extended sector here that needs to be liquidated. Recessions are a process of liquidating excess and the liquidation of the excess in government, both actual and conceptual, is going to take many, many years. So I don't think it's going to be in an acute phase the way it is, say, in Greece or in Italy. That said, you have enough monetary tightness outside the United States, so we're going to feel the effects, I think, of some pretty sharp slowdowns in some of the emerging market countries—some of the big ones—and in Europe. So that's going to have a derivative effect on not only our economy, but on business prospects in some sectors.

Carol Massar
David, if you were still within the administration, would you be advising your President or your economic team that, hey, get ready for another recession here?

David Stockman
I would say that we're at stall speed. We have been for four years. The GDP of the second quarter in real terms was lower than it was in the third quarter of 2007. And the reason we're at stall speed is that government is shrinking. Business has no reason to invest aggressively and the household sector is going to start shrinking in my judgment because all the gain in disposable income was indirectly compliments of Uncle Sam's backdoor borrowing. Let me give a number: $1 trillion gained in disposable income over the last four years; $600 billion from transfer payments that were borrowed; $200 billion of that from tax reductions that were borrowed. And now that the government has reached the edge, the credit card is done. It can't borrow anymore. There will be no more stimulus to disposable personal income. The consumer's going to get weaker and the economy is going to continue to stall, and the budget deficit will be much worse

as a result of that because the baselines assume that weõre having a normal recoveryð twenty million jobs and so forthð and itõs not going to happen.

Matt Miller
David, let me ask you about taxes, something we love to talk to you about. Warren Buffet also chiming in on that yesterday in his *New York Times* op-ed saying, ñI would raise rates immediately on taxable income in excess of $1 million, including, of course, dividends and capital gains. And for those who make $10 million or moreð and there were 8,274 in 2009ð I would suggest an additional increase in rate.òIõm assuming you agree with him.

David Stockman
Well, I hate to agree with Warren Buffet, but I think the idea that he was on that we shouldnõt be taxing capital gains at only 15% when you have the huge payroll tax and the income tax that the laborer or the wage earner has to pay was exactly right on. The capital gains rate was put in in the õ70õs. I was there when we had double-digit inflation; there was a reason for it then. Today, itõs obsolete. Itõs a windfall to the rich. Itõs a windfall to speculators and people with money to invest and it is not right that we should be allowing, say, hedge fund managers to be taxed at 15% when the middle class is struggling and paying 30% of their income in payroll and income taxes.

Carol Massar
You know, Iõm curious where you are on this, Mike. I mean, there seems to be a gap between those who are either hedge fund managers and so on and so forth and those investing versus those who are not in terms of what theyõre paying for taxes. Where are you on this?

Michael Aronstein
Well, I think itõs a technical question. The carried interests of people who get a proportion of the increase whether itõs a hedge fund, or a real estate partnership, or a private equity fund, I think thatõs something that can be discussed. But I say, in general, raising marginal tax rates is not the way to increase the revenue to government. I donõt have any objection to having more revenue come into the government, but raising the marginal rates whether itõs on income or capital gains is not an effective way of doing it.

Matt Miller
Carol, weõre not getting the fireworks here that I want. Michael and David should be with boxing gloves in a ring. I mean, guys, donõt hold back.

David Stockman
Okay, I wonõt. Look, I believe generally marginal rates shouldnõt be raised, but we are so deep in the hole. We are generating so little revenue, 15% of GDP, and thereõs been such a massive gain to the rich, the top 5, 1% over the last 30 years that we have to look at the equity and the shared sacrifice and not just the narrow economics. And on that basis, I would say donõt raise rates across the board on working people, but get rid of the capital gains and whatever rate youõre going to have, make it the same for every kind of income that comes in.

Carol Massar
Can I give you 10 seconds just quickly, Mike? Any thoughts?

Michael Aronstein
Well, if you want more jobs, you need to encourage capital formation. I mean, that is the necessary precedent to job creation, and to the extent that you want that within the economy, raising capital gains tax rates is destructive.

Carol Massar
We could certainly continue on. We got to run, though, guys. Michael Aronstein and David Stockman, thank you so much.