Harry's Take

December 22, 2020

Reader Mailbag: Questions and Harry's Answers for T-Bonds—Part 1

We receive many questions on various topics, including the direction of the markets, demographics, and interest rates. From time to time, we gather a series of questions on a topic or two and send them to all subscribers as part of our Reader Mailbag series.

We have had many questions in the past few weeks about buying Treasury bonds as a safe-haven investment. This is an important topic, as we are fast approaching the point where you have to make a decision about preparing for the next, larger phase of the crash—and we have chosen the most representative questions to post here. We had so many questions that this article will address only half of them. I'll address the rest of the questions next Tuesday, December 29, in *Harry's Take*.

Q: Based on the comments in your recent newsletter, may I assume that ZROZ and TMF are your suggested tickers in the 30-year Treasury bond space? Thank you. —Tom

A: Yes, but it's a matter of risk tolerance. The highest returns, in order, should be from TMF, ZROZ, and TLT, but these bonds are both more volatile and riskier in that same order. TMF appreciates by about 2.5x; TLT and ZROZ by about 1.5x.

Q: Harry, what would you anticipate the gross return to be in 2021, on your only advice to buy the safety of the 30-year Treasury bond? —John

A: I estimate that the 30-year bond will appreciate by about 40% in the next two years or by about half that or 20% or so in 2021. The best part is that you'll make that amount, while other financial assets will fall by 50% to 80% over the next few years.

Q: I understand the rationale supporting the thesis that we are getting close to a top and it's time to exit equities and perhaps short-term cash sitting in banks. I don't understand why you think the 30-year Treasury bond is where we should go, with the dollar clearly getting weaker and weaker and as there is no end in sight to this trend as we are going to print more paper. Further, the euro and yuan are showing up more and more in currency transactions and the dollar appears to be slowly losing its position as the reserve currency. So, I understand risk in equities and the commercial paper market and potential risk of having liquid assets in banks in the form of savings. But why go to the 30-year Treasury bonds? They just seem like another losing investment and perhaps no longer a safe haven. —Bob

A: If you are going to be in bonds, it's best to be in those that are safest and of the longest duration, i.e., 30-year T-bonds. All bonds outside of Treasury and AAA (or Aaa) bonds will experience more default risk than the fall in risk-free rates that happens in a deflationary scenario. The 30-year bond could fall from near 1.7% today to near zero. That is still significant for appreciation from deflation with near-zero risk. The dollar has proven to rise even in the worst of downturns, as has happened from mid-2008 forward. It is the best house in a bad neighborhood of money printing and debt.

I see the dollar and Treasuries as being the safe haven, especially, several months into the next crisis. And in the U.S., you are not exposed directly to

dollar risk. Indirectly, it could impact T-bonds a little due to global demand. The dollar has only gone down in the last several months because the U.S. has printed more money than other major nations since the COVID-19 pandemic began, which has not been the case otherwise since late 2009. Mark my words, the dollar will likely be more up than down in the next two years…. I get mildly bearish on the dollar longer term, as Asia continues to rise and dominate. We are not likely to see the dollar as the reserve currency any more than a decade or two longer.

To get more strategic, the best sequence would be to lean toward shorting stocks first, as the next crash is likely to be the deepest before we get in a longer, more-dredging bear market. Then, around April or May 2021, lean more toward the 30-year T-bonds. There could be a little late-stage inflation (less likely) and some mild dollar weakness (more likely) at first, as in first half of 2008.

Safest deflation play: long T-bonds.
Strongest play: short tech stocks, like QQQ, through SQQQ.
Potential strategy: 80% short stocks/ 20% long 30-years into around early April 2021, and then switch increasingly to 50/50 after that into late 2022.

Q: Regarding the 30-year Treasuries, the yield curve still seems rather flat for these longer-maturity bonds. See the dynamic yield curve: https://stockcharts.com/freecharts/yieldcurve.php. Do you think that the 20-year Treasuries might be a better buy, since they are on the steeper portion of the yield curve? —Michael

A: It's flat partly because yields are so low. The 30-years are currently about 75 basis points higher than the 10-years. It was more like 40 basis points not so long ago. And yields are way higher than the shorter-term bonds, which are closer to zero. I don't think it gets better than this with yields this low. Our recent analysis showed that a likely fall in yields on 30-year from around 1.60% to 0.4% with a fall on the 10-year from 0.96% to zero would see roughly a 38% appreciation in the 30-year bond vs. 9.5% in the 10-year. That's a huge difference and would look very good for being in safe-haven bonds if we have that major stock crash and deflation scenario I expect. During just the recent flash crash in February and March 2020, the 10-year went down to 0.32% and the 30-year went down to

0.73%. So, that scenario is even likelier in a deeper, longer crash. The only way to make more money predictably is to short stocks on the QQQ (SQQQ) or S&P 500 (SH). There, you could see 70% to 80%+ gains, but with much more risk if you were wrong.

I recommend doing both but just mixing the two strategies according to your risk tolerance, as I said in the previous question.

Harry

Got a question or comment? You can reach us at info@hsdent.com.