Harry's Take

December 29, 2020

Reader Mailbag: Questions and Harry's Answers for Bonds—Part 2

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.

Today, I am answering the second half of our reader questions on Treasury bonds as safe-haven investments in the crash ahead. To read the first half of the questions and answers, see the December 22 *Harry's Take*.

Q: You say go into 30-year Treasuries… do you mean buying direct from the U.S. government? Can I buy Fidelity funds, bond funds with long-term bonds, or maybe an ETF? —Ken

A: There are several ways to buy Treasury bonds for a deflationary or safe-haven play, and the new Fidelity fund is one of them. Here are some choices:

> 1) Buy 30-year T-bonds or zero-coupon versions (stripped of the interest at a discount) direct from the government or on the market.
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> 2) Buy 30-year strips in the market, like zero coupons.
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> 3) Buy TLT ETF, with an average 20-year maturity.
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> 4) Buy TMF ETF, which is 3x TLT and on average appreciates more like 2.5x TLT.
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> 5) Buy ZROZ ETF, an average 25-year zero coupon, which appreciates about 1.5x TLT.

Q: Why invest in strips for a 30-year low guaranteed return? Won't the market rebound eventually after the low is hit? —Bill

A: Yes, this is a play only in the deflationary crash from around now into late 2022, for about 2 years. It will be one of the few profitable plays in a crash that deleverages all financial asset bubbles. Only shorting stocks will make you more money, but with more risk and volatility. I expect 30-year T-bond yields to decline toward zero, or at least to 0.4%. Then, yields will bounce back modestly in a low-inflation boom from 2023 into the next 30-year commodity/inflation cycle into 2039–2040. Bonds, including Treasuries, will not do well in that environment. Inflation rises modestly in the spring economic season and the most in the summer season. When inflation drops in the fall season, bonds boom, which continues into the deflationary winter season. In the latest round, we had a bond bear market with rising rates from around 1940 into 1981, followed by a bull market that started in 1981 and that I project will continue into mid- to late 2022. That chart is in my recently published December newsletter.

Q: I know that bond price and yield is inverse and that long-term Treasuries have a negative correlation to stocks, but I also know I lost quite a bit with a holding in TLT in March. That loss was due to shifting into TLT from QQQ as the market was melting down. I made that move based on a risk off signal from Adam's 10x service. Regardless, TLT dropped in March just like other financial assets. Why didn't TLT go up then? Was that an anomaly? Or do bonds behave differently inside a fund? Ultimately, I'm wondering if it would be better to wait in cash until after the crash, to load up on bonds, or do you think it will be different with the impending crash? —Mark

A: TLT did the best among stocks, gold, and corporate bonds if you follow the crash from beginning to end. But they all went up and down at different times. Bitcoin actually did the worst. TLT was up the most at the best part and is still the only sector up over the starting point. Sorry, but you must have bought TLT at the worst time, when it spiked up at the worst of the crisis and came back down a bit into the end. In general, if we get a prolonged crash, as is possible into early next year, the stocks will go down and TLT will largely go up. Actual 30-year T-bonds will do best due to the longer duration and bigger deflationary play than 10-years. TLTs are the average of 20-years and still skew closer to the 10-year appreciation rate rather to the rate of the 30-years. The second best is ZROZ, which has a 25-year average and zero coupon for a bit more leverage. Be careful not to buy T-bonds or TLTs if they are temporarily rising dramatically (crashing in yield) in the worst of the crisis. Wait for yields to come back down, as in late 2008, and then get in if that's the case. It's best to be in the safe-haven bonds at the beginning of the crash and get out after a major spike in the middle or at the end of the stock crash.

Q: In your November 17 email alert, it was an eye-opening note regarding 30-year Treasury. The take-home lesson is that even with a low-interest coupon rate, it is possible to get significant returns of 38%+ in a deflationary scenario. Where I have a problem is that I don't know how the 38%+ was determined. I am not versed on bonds, especially Treasury Bonds. In short, I can't make the connection to the 38%+ return. May I assume that a big part of the increased return is due to increased demand driving up the value/price of the 30-year Treasury bond? If so, why would one pay a premium on the Treasury bond if the coupon rate on it is so low right now?

Secondly, is it better to buy an ETF on Treasury Bonds (like the TLT) or buy individual Treasury Bond, which I can order/purchase through, say, Vanguard Brokerage? —Donald

A: From Harry: First, realize that just in the flash crash of February and March 2020, 10-years dropped to 0.32%, 30-years dropped to 0.71%, and TLT went up 24% at best, and that is with a 20-year average. Hence, these appreciation estimates will only be a bit higher in a deeper downturn. They are more likely to be understated than overstated by the figures I quoted.

A: From Rodney: The calculation was done by using an estimate of how far interest rates might fall in the coming downturn, and then using that rate differential to calculate the change in the price of a 30-year Treasury bond. You can find bond calculators online and plug in the maturity (30 years), enter the current interest rate as the set interest rate, and then enter the estimated future rate (lower) as the Yield to Maturity. This will give you the potential rise in price from $100 to $138.

As for the best way to own, if people are not versed in bonds, then funds are better, and Harry notes that he likes zero coupon bonds better, because the prices move a bit faster. In the December newsletter, he mentioned the Pimco Zero Coupon Treasury fund, ZROZ.

Harry

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