Harry's Take

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Reader Mailbag: Questions and Harry's Answers on Managing the Market Crash

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. Reader questions may be edited for clarity.

Q: You have said that 30-year Treasury notes were the safest play. I am not in the market in a big way; that being said, the money I have saved over the years needs to bring in something. I would like to buy Treasury bonds and I have researched them, but I don't understand enough about them. Would you please break down how Treasuries work, using layman's terms?

A: Treasuries are the safest U.S. bonds and are among the safest and most liquid assets globally in which to invest. They are backed by the U.S. government and thus are the least likely to default, as credit is everything for Treasuries, especially considering that the U.S. borrows so heavily from other countries around the world to fund its deficits. Therefore, Treasury yields are lower than those of high-quality corporate bonds—and Treasury yields are lower now than they have been historically, as a result of quantitative easing, a plan wherein these bonds are purchased to push their yields down and to insert money into the financial markets.

Why should you buy Treasuries? The 30-year Treasury locks in yields the longest and will appreciate in value (or market price) when the economy fails. Risk-free rates like this fall with disinflation or deflation, making Treasury bonds a good choice as a safe haven.

Other bonds with more risk see their yields go up due to rising defaults. So, don't focus on the low yield. Look back at the stock flash crash that happened in February to March of 2020 and you will see that long-term Treasuries actually went up, outperforming gold, other highly rated corporate bonds, and every other so-called safe haven—especially Bitcoin, which got crushed the worst.

Q: Do you have a target for the Nasdaq? I can see the megaphone pattern on the SPX easily, but I was curious about your downside targets for the Nasdaq and about whether there was any pattern alerting you to a bottom (much like the megaphone bottom for SPX, down 50%).

A: The target for the Nasdaq is near 6,700, the late March 2020 low. So, yes, there's a 53% downside, a little more than the S&P 500 downside at 50%.

Q: I am in Australia. As you may well know, home prices have gone up here by 20% during COVID. I sold my home just before COVID on the basis of your recommendations and was excited that prices might drop and I would be able to get a better home for the same money. I am now renting and paying top dollar, as prices continue to rise. Do you still expect the real estate market to fall in Australia, and should I continue to sit on the fence and rent?

A: Yes, I do still anticipate that the Australian real estate market will fall. Despite stronger demographics ahead in Australia compared with the U.S. and Europe, Australian real estate is substantially more overvalued, comparatively—in fact, it is second in overvaluation only to China's leading cities, including Beijing and Shanghai, and Hong Kong. For the best-case scenario, look at what your real estate was worth at the bottom in 2009 or bit later. For the worst-case scenario, look at what your property was worth in 2000 when the bubble started. It will be some time in 2023 at the earliest before real estate becomes a buy opportunity again, and it will be a better opportunity in Australia then than it will be in the U.S.

Q: In much of your writing and many of your interviews that I've seen, you talk about how low or no inflation (2% or less, I think) is coming. However, while that matches with what the government is saying, it flies in the face of food, energy, and housing prices, which seem to be inflating rapidly. Can

you please direct me to something you've written or said that could explain what I'm misunderstanding? Have your thoughts on deflation changed?

A: Food and energy prices are reflected fully in the inflationary data, but housing prices are not, as they use implied rents, not housing prices, which have gone nuts. Right now, inflation is likely a bit higher than reflected, but that is across the board and everywhere in the world. The key is that inflation rates will turn from modestly positive to negative (which will cause deflation) once we have massive debt defaults, as happened in the early 1930s.

In that scenario, the default risk mushrooms for most bonds but falls with disinflation or deflation for the highest-quality assets, like Treasury bonds and AAA corporate bonds. Those are the bonds to buy—not for the yields, which are low, but for the appreciation that is likely to happen when risk-free rates fall, once we are in a deflationary crisis, which I think will happen again much as it did in the early 1930s and briefly in the COVID flash crash of February to March 2020, as well as in the second half of 2008 in that crisis. Such drops in bond yields (and price appreciations) tend to bottom out either near or just before the stock bottoms.

Q: I would love more insight as to what you see the market doing after the initial megaphone top blows up this summer (if they let it). I don't mind trading the crash, but once we bottom out, I would be super interested as to what you think would be a good asset class to own.

A: The megaphone pattern projects about a 50% crash, to 2,100 on the S&P 500. But first, note that this will be only the first (and most violent) crash. After that will come a sharp rebound, as central banks and governments ramp up stimulus again... 50% to 62% of that 2,100-point drop will be given back in a rebound to something like 3,150–3,400. Then, by late 2022 at the earliest, we'll get a longer, grueling crash down to around 1,500 at minimum on the S&P 500 that possibly could go to as low as 600. That's when you'll need to start to buy again. I'll have to weigh in on that again once this pattern plays out further.

Be on the lookout for the June *HS Dent Forecast* coming out next week. I will be discussing how China continues to look like the biggest trigger for this sharp crash, although the market is so bubbly that it doesn't even need much of a trigger at this point.

Harry

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