Harry’s Take

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Reader Mailbag: Questions and Harry’s Answers on Special Drawing Rights, Safe Havens, and Modern Monetary Theory

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: Do you think that the recent allocation of special drawing rights (SDRs) by the International Monetary Fund (IMF) as a direct liquidity boost to all member countries is a game changer for postponing a crash, accelerating it, or partly preventing it (because a new layer of fiat money can be distributed without adding to the debt burden)? The size of SDRs has tripled now, as far as I know.

A: Such actions tend to boost the bubble more at first, and then make it larger, which ends up leading to a greater crash. The point is this: The longer you push a financial asset up artificially above its natural value, the further it must fall to return to that value—which is a good example of how you don't get something for nothing.

Q: Would you recommend holding TLT over cash for the next crash? I feel like the U.S. Dollar Index (DXY) will spike the most and appreciate during a deflationary crash, as opposed to any other asset class.

A: Yes, TLT is definitely better than cash, as it appreciates in a deflationary environment. DXY also will appreciate as the dollar rises, but with global demand, the Treasuries benefit, because they are

denominated in U.S. dollars and they lock in higher rates when they fall, even from these low levels.

Q: What are your thoughts on modern monetary theory (MMT) coming soon?

A: MMT is the problem, not the solution. Central banks have killed the natural rebalancing mechanisms the free market uses to promote efficiency and innovation. When businesses and investments are not allowed to fail, you get a zombie economy, like Japan's at the extreme today. Playing God and trying to create an economy that always grows shows an appalling lack of understanding of economic innovation and growth…. Oh, most economists are academics that never had success in or ran a business!

Q: I know you like Treasuries as a safe asset in the coming crash. However, I looked at the history of SQQQ during March 2020, and it went all the way to $127 per share. I was also thinking of SDOW. Do you think these could be better investments than Treasuries?

A: Yes, you'll get more appreciation shorting stocks than going long on Treasury bonds, but you'll also have extreme volatility. Most people will sleep better if they have 30-year T-bonds or TLT ETF. More-aggressive investors can do both and earn more toward the short stocks. I would choose to be short through SQQQ, as the tech stocks will tend to crash a bit more than the S&P 500, etc.

Q: I have not heard anything about credit default swaps for a long time, but it seems that the exposure of counterparties during the rash of impending bond defaults is a very real threat to international and domestic monetary systems in that the costs of making good on the liabilities will swamp many institutions, big and small. Counterparty defaults will spread across the globe like lightning, and if the notional value really is $70T, the international financial system is toast.

A: Yes, this risk is major, understated, and not discussed much, as no one thinks things could get that bad. But they did in 2008, and they will only get worse this time. So yes, the international financial system is toast, and the consequences have reverberated beyond direct loan defaults into arenas like this that almost no one looks at.

And you are right, people also have forgotten about these counterparty risks only 12 years later. This time, I think they won't be bailed out, as the last bailout didn't work and the risks are bigger now.

Q: How convinced are you that deflation, not inflation, is what we'll see next? Also, haven't you written recently that you think gold likely already has topped?

A: We may see inflation go only a little higher in the late stage of this bubble before it bursts. When it does burst, 40%–50% of the $525T in global financial assets (6X GDP) will disappear, meaning that deflation will be the only possible scenario, unless governments print 10X the recent stimulus, and that will only happen after stocks fall 50% in 3 months or so, which likely will be too little, too late. There's no way you get hyperinflation in this scenario, as it is not like 1923 or the more typical situations that occur in emerging countries that borrow from foreign countries and then suffer a currency collapse on top of loan and debt defaults—and during inflationary times like the late 1960s to the early 1980s that I call the summer season... we are in the winter season now!

And yes, odds are growing that gold already has topped, but there is an outside chance of it making a slight new high around $2,200 or so. Gold tends to go up in the early stages of the crash, as in late 2007 and early 2008, and it might not even do that this time, as investors learned that gold does crash when the st hits the fan, as in mid- to late 2008. I see the downside for gold as $900–$1,050. When gold gets to that level, I would consider buying it—but not now, unless you hold out for $2,200 and sell if gold doesn't rise to that level within a few months… and you really should sell if it does get there. By then, they will be saying it's going to $5,000!**

Q: Which is safest, short-term bonds or long-term bonds? I am in short-term bonds now. When should I get into long-term bonds?

A: Short-term bonds are always safest, as they go up or down very little due to their short time exposure to interest rates going up and down. In the downturn, I'm thinking that risk-free rates on Treasury bonds will go down, as they don't have default risk and will benefit from the falling economy and deflationary trends with interest rates

falling. The longer the term of the Treasury bond, like the 30-year, the more you benefit from rates falling. This is not true for most bonds, including corporate bonds, as they have default risk. In a strong downturn, the rise in rates to compensate for default risk overwhelms the fall in inflation and risk-free rates. So, ultimately, you want to be in the 30-year Treasury bond or the ETF TLT, which holds average 20-year Treasury bonds. The 30-year will appreciate more in a deflationary crash, but TLT is easier to buy and sell.

Q: So, you are saying now is the time to get out of all stocks?

A: It's always tricky trying to pick an exact top, as the markets want to hide it as much as possible. The period from now into September is the most likely time for a top. While it's is not looking like a top, it still could be one. My best guess would be a modest correction into early July and then a rally into late July or into as late as September before we see a top. Investors can average into this. Sell, say, 20% of your stocks now, sell 40% more if we rally into late July, and sell the rest if we keep rallying off and on into September. I also have trend line breaks on the downside that add to the need for caution and selling. The first one would be a break of 4,220 or so on the S&P 500 after a run higher toward 4,500. I will advise you again once we approach and hit more critical breaks and sell points as the markets fall further.

Q: Obviously, inflation is raising its head presently in the U.S. When do you think this stops and the deflationary scenario begins?

A: It stops when the economy breaks down and we go into another recession. Governments won't stop stimulus programs, as they are the only thing keeping a dying demographic and debt-burdened economy going. They have to keep doubling down and escalating until they lose confidence and the economy goes down anyway. As long as the economy keeps chugging along, inflation will trend upward. If inflation gets too high, as it has already started to do, then that will cause bond and borrowing rates to go up, and that hurts the economy—and the stock market. If the stock market goes down substantially, the economy will feel it, and the megaphone pattern over the last 4 years strongly suggests that we'll get a 50%+ crash in a few months once stocks finally fall, and likely sooner rather than later.

In the *HS Dent Forecast* coming out later this week, I'll go into detail about cryptos and when the markets will peak.

Harry

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