Harry's Take

August 31, 2021

Reader Mailbag: Questions and Harry's Answers About the Crash, Bonds, and Deflation

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: Okay, we are waiting for the top or a breakout of the bottom line, but where should our money be right this moment, in cash or in bonds? Obviously not in stocks.

A: If you are in stocks, I would wait to sell until we get a clear signal with either a test of the top channel at 4,650+ on the S&P 500 or a break through the bottom. We're looking to get into 30-year Treasury bonds, TLT ETF, AAA corporate bonds, and cash, in that order of preference. The best place to be in a deflationary crash like I'm seeing in the next year or so is in the 30-year Treasuries. If you are not in those, there could be a better entry position near term as well, as they have rallied strongly in the past few days. So, I would buy on a pullback ahead, especially if TLT gets back to around 147 optimally or at least to 149.

Q: You always recommend long-term Treasuries as great investments that have good appreciation during the down cycle, and you reference the 1930s. But the level of national debt then was so much lower than the present $30 trillion plus. Isn't the dollar vulnerable to devaluation risk, and won't the results of this devaluation hurt the value of Treasury holdings?

A: I have to keep stressing that this debt bubble is global. The U.S. has trailed in its government debt–to-GDP ratio; in comparison, the ratios for Europe are substantially higher and the ratio for Japan is off the charts. Hence, although the borrowing binge for the U.S. is the most extreme in its history, our dollar has not gone down and even has appreciated relative to our main trading partners, as they are getting into even more debt and leverage. In the downturn that is now imminent, the U.S. dollar actually is likely to spike into the worst of the crisis, as it did in mid-to-late 2008—because we are seen as the best safe-haven country due to our size and world dominance and our relatively lower debt levels. Currencies don't have absolute values like stocks and bonds, they trade relative to each other. U.S. T-bonds were clearly the best safe haven asset—way better than gold—in 2008, and they will be again, but even more so this time, given that this time, the downturn will be deeper and include much more debt deleveraging.

HOWEVER, once this next spike occurs, likely into around late 2022, it will be time to get out, as bond yields will come down into the next global boom as default risks fall, even though inflation will creep up modestly again. So, I won't always be touting Treasuries or even corporate bonds in the next boom, which should have modestly rising inflation, in contrast with the great boom that started in 1983, in which inflation and interest rates largely fell despite the long-term growth.

Q: Your recommendation that we buy U.S. Treasuries as a safe harbor asset makes sense, but these are not normal times. The biggest risk I see is the unknown of what will happen with Treasuries if (or when) the Great Reset happens and as the current basis for the value of Treasuries changes. Am I not looking at that possibility correctly? Do you see Treasuries as a safe preservation tool even if that occurs?

A: I see the 2008–2009 crisis as the appetizer for what we are about to see into 2022–2023 or so. This crisis will be similar, except it will have a deeper downturn and more debt deleveraging, because in the last crisis, government stimulus cut short the necessary deleveraging process; thus, this downturn will be worse. I don't think central banks will be able to "blow" their way out with stimulus as liberally as they did last time. I expect that will finally fail soon. In such a deflationary

downturn, Treasury bonds are the best safe haven, as they appreciate. Cash only holds the value of your money, as everything else deflates. T-bonds expand the value by as much as 40%+ in such crises. The U.S. government will do anything not to default on their Treasury bonds, so I don't see them being devalued for that reason. We will still look more viable than other major countries even with the high government debt; hence, our bonds should hold up the best.

Q: I am wondering whether it's prudent to reenter TLT positions at current levels. Should I wait?

A: That is a good question. TLT has already rallied strongly since May. At this point, I would wait for a better buy opportunity, back around 147 on TLT. Bond yields would normally go up and bond values down with rising inflation in the late stages of a boom like this one, but there is another issue: Two things are going on, and it's hard to judge which one is more important. First, bond buyers are seeing a recession and slowdown just ahead while stocks keep rising into the sunset. Second, bonds are extremely overvalued compared with fundamentals, just like stocks; they are acting like inflation is zero when it has risen to 5%. Even longer-term expectations are 1.5%–2.0%. Because bonds are overvalued vs. the trends (unless the bond buyers are dead right about a sudden downturn), yields may go up near term, contributing to inflation fears and stock valuations, which could help trigger that recession and stock crash. I would be cautious here and wait to see whether bond yields start to head up again soon.

If the economy does show signs of weakness, then you will have to be quick to buy TLT and T-bonds again. If stocks keep rising and look even more toppy, then it makes sense to start moving into the T-bonds, especially if yields go up again first. Rising yields will not last if the economy starts to turn down, and I think that is highly likely by early 2022 at the latest. To summarize here, I would be inclined to buy 30-year or T-bonds in general if TLT gets back to around 147, but if there is a more serious inflation scare, then I might have to reevaluate in the coming weeks.

Q: Why did the stock market recover to new record highs from the 2020 stock market crash from Feb 20, 2020, to Apr 7, 2020? If ever there was a trigger for the next depression, then it would have been the COVID crisis. Since the virus failed to set deflation into motion, what event in the next few weeks possibly could?

A: The Fed and the government saw how deep the economic contraction would be—a short depression—and they quickly came out with a combined $9 trillion combo of monetary and fiscal stimulus, totaling 42% of GDP! That's why the stock market instantly jumped to a new high, even though the economy is still well below pre-COVID levels of GDP and unemployment.

The stock market has had less to do with the economy since massive QE started in late 2008, and now it is totally divorced from it. The problem now is that when stocks start to crash again and the economy starts to weaken again, what are they going to do next, print and borrow 100% of GDP? There is a point of both diminishing returns on exponentially expanding stimulus and a loss of credibility from doing the same thing and expecting a different response... like anticipating a sustainable recovery without ever more stimulus. At that point, stocks will go down no matter how much money they print. This is a simple go-until-the-bubble-blows strategy, and I think we are in the final days, weeks, or months of it at most, as Jeremy Grantham said recently. It's better to get out a bit early than too late at this point.

Q: What will these metals do when we have the crash? In your opinion, will they go up or slide down with the crash?

A: How about they go deader than a doornail? Gold may still rally a bit in the earlier stages of the likely stock crash ahead, but now seems less likely to make that slight new high to 2,200–2,250, although that is still possible into perhaps early 2022. I still see a crash to around $1,000 into late 2022 or well into 2023 before gold goes into a bull market again into 2037–2040 on the next 30-year commodity cycle and with the next global boom. My target for that is $3,000+.

In the next issue of *The HS Dent Forecast*, coming out on Wednesday, September 1, I will examine how stocks look like they are very near a top (if they have not topped already) and why later in September looks like the most likely time for a top at this point. Stocks, T-bonds, and Bitcoin are all at key break up or down points in their charts.

Harry

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