Harry's Take

September 28, 2021

Reader Mailbag: Questions and Harry's Answers About Bonds and Real Estate

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: The high-quality bonds (TLT) that you recommend make sense to me for capital appreciation, but I'm wary of them—not that I have any other solution. I'm just wondering if cash could be as good as or better than bonds. It seems to me if the Fed tapers, interest rates will rise and bond values will decline, taking away the capital appreciation. Also, tapering may be the catalyst for the crash. On the other hand, if the economy crashes, capital borrowing will need to be cheap to entice borrowing by firms during that motivationally sluggish business investment time period. But lenders may be reluctant to lend, leading to higher interest rates and lower principle.

Will bond values be bouncing up and down wildly in a crash? If so, could bond values bounce/trend more down than up, thereby reducing the net capital value of TLT?

A: Thanks for being a long-time subscriber. The best way to address your question about T-bonds and how they are likely to perform is to look back at the last recession and stock crash. Stocks peaked in October 2007 and bottomed in March 2009, but most of the damage came between January and September 2008. T-bonds through TLT

(20-year average) rallied a bit ahead of stocks from June 12, 2007, to January 23, 2008, going up 19.5%, but then pulled back. The best of the rally was between June 17 and December 18: stocks went up 39.1% in just 6 months. The whole move was 49.9%. The return on 30-year T-bonds would be even higher.

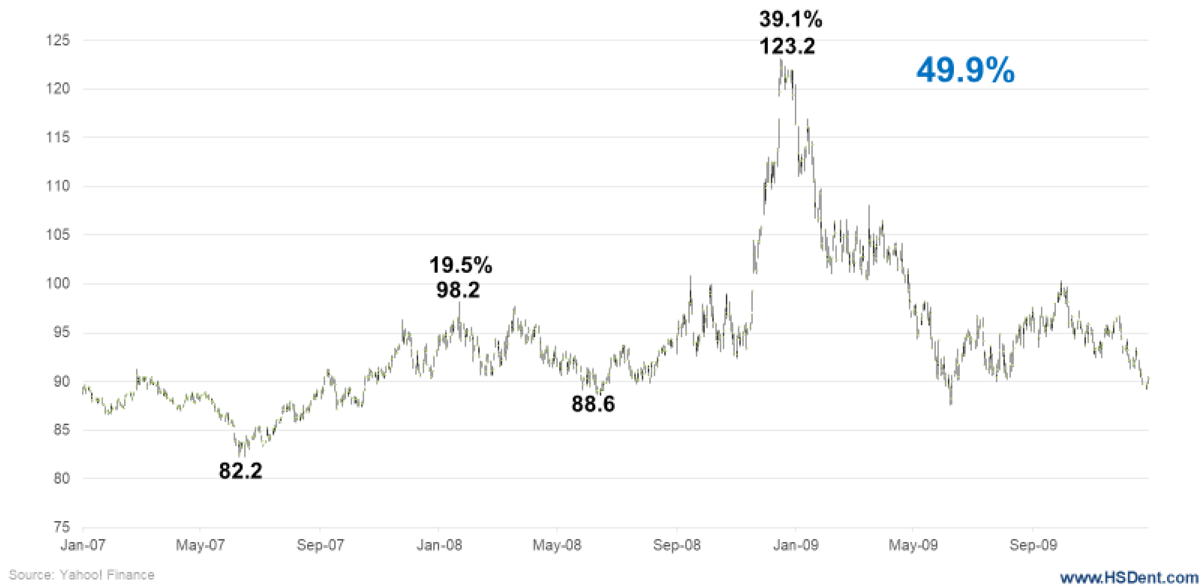
The best move last time around was to be early in ahead of stocks and early out ahead of the final bottom. There is more risk of inflation roaring up this time. You'll have to decide whether to wait for a more ideal setup or just be in TLT on any corrections ahead.

It is likely we're already in that first rally. TLT bottomed recently at 133 and is currently around 146. If TLT gets back to that 133–136 range on a late-stage inflation scare or whatever, that would be the ideal time to buy, and then you'd need to hold into around the end of 2022 unless the pattern suggested otherwise by then. But that large of a pullback is not likely. The best likely entry point that we are very close to now looks to be 145.

If we follow the 2008 scenario roughly, then TLT could rally to around 160 and then pull back to around 145–147. If once we get into early next year (say, February or March) stocks are headed down more clearly and TLT is still near 147 or lower, that also would be an ideal time to buy. My cycles point to the end of 2022 as the most dangerous time for stocks; hence, that could be a good time for T-bonds as a safe haven. I would expect a target somewhere around $200+ on TLT, and the end of 2022 would be the time to start looking for such a top.

Note in this chart that the gains were given back fast after the peak in late 2008. You could combine two strategies and be half-committed near term, especially on pullbacks on TLT, and then go all the way long on 30-year T-bonds or TLT early next year on something like a 50% retracement of the gains from the bottom at 133. I'll comment more on this ahead for subscribers in my October *HS Dent Forecast* newsletter.

TLT Saw Two Surges in 2008 Crash, Second Surge Was Largest



Q: As the market drives toward its unquestionable crash, the event of a Black Swan may suit the trapped Fed, for it would justify the market's slump as a consequence from this "unfortunate" event, which could be the beginning of a war, an invasion of Taiwan for instance, or a mega cyberattack with the disruption of the global supply chain, similar to the one Mr. Schwab has been warning us about. In the event of any of these hypothetical scenarios becoming a reality, what would be the best way to take advantage of it?

A: The best defense against a sudden crisis when stocks are already overvalued is still to be short stocks, especially the small caps like RUT or IWM, and/or long 30-year T-bonds or TLT.

Q: We have a crazy number of Southerners selling up their $2 million to $3 million homes and moving up here to Brisbane and Gold Coast, which is pushing prices even higher, as demand is outstripping supply and anything under $1 million is selling in days, usually at higher than asking price. So, I seem to be having a revolving argument with people I know, whereby when I tell them there is going to be a crash, they say, "Yeah, but Queensland prices won't fall because there are so many people coming up here from the South and also, as soon as travel restrictions are over, they will open the gates to immigration. We won't see a price fall at all, in fact it will go up stronger."

So, the question is: Is there any possibility that immigration from overseas and southern states could be enough to prevent a property correction here in Brisbane Gold Coast areas if there is a stock market crash? Or is there nothing that could stop prices from falling regardless of immigration once the crash begins?

A: Australia does have strong demographics underpinning its bubble, not just speculation. But the best cure for high prices is high prices. This is going to be a worldwide reset. Australia may be one of the last to cave, but prices can't hold at your most extreme valuations while the rest of the world goes down 40%+. There has not been such a global bubble ever, and it's also rare to see two bubbles in a row. But bubbles cannot and have never sustained themselves longer term. House prices cannot outstrip incomes and replacement costs for long.

Q: In today's world, where savings are compulsory via different schemes (here in New Zealand we have "KiwiSaver"), is this underpinning the market? If the market were to crash, these hedge funds would still be getting in millions each pay week that they would need to invest (we can't easily stop KiwiSaver). So, will the need to keep buying/investing thus reduce any market downturn?

A: All markets have institutional investors and sectors of retail investors that regularly invest and bring some stability. The swings are caused by a minority that trade more often or come and go more. Also, the smart money and traders move the markets most on the margin.

People and institutions that move the markets will always be there. When they move enough, the regulars get scared or see the opportunities and then react. The problem is that when the number of such regular investors grows, the markets are pushed more toward overvaluation, which makes the falls, when they occur, larger.

So, I don’t think we have to worry about the market having too much built-in stability if something starts to go wrong. The dynamic is always that the smart money sells first, creating a chain reaction that hits even the regular buyers, who tend to choose safer investments when they get scared.

Overvaluation is the biggest enemy of the markets. Changes in trends (like slower spending demographics or debt defaults) are what cause markets finally to fall.

Q: How do you think the Toronto housing market will evolve in the next twelve months?

A: Canada is likely to follow the U.S. and be headed down by early 2022, and I think Canada will get hit a little harder this time, as it didn't fall as much in the 2008–2009 recession.

Q: *When* will these housing prices drop to a more-normal or somewhat-normal, affordable price range?

A: Home prices are likely to start dropping by early 2022, and there will be more of a buying opportunity from around late 2023 forward.

Q: I know Harry is keen on eventually loading up on Treasuries, but he is vague on AAA tax-free municipals backed by a solid state like Texas. It would seem these might at least be a store of some value. I wouldn't have an Illinois bond, but Texas has a solid foundation. Would it be prudent to hang on to bonds like these or replace them with T-bonds?

A: Yes, high-quality bonds in a good state like Texas should hold up and not have much default risk, but they won’t likely have the same safe-haven halo as the U.S. Treasuries. It’s fine to keep those, but if I had to buy today, I would still choose the 30-year Treasury. Note that in a recent bad day for stocks and most risk assets, TLT (20-year T-bonds) did best, going up about half as much as stocks went down. I do advise having a broad range of safe, long-term bonds, including AAA corporates and top-rated munis.

Q: What do you think about the Evergrande bankruptcy? Apparently, they account for about 2% of the overall Chinese economy. Everything I have read from the "experts" is that this is nothing like the scale of Lehman Bros, and the Chinese government has everything under control. I don't think Lehman was anywhere near 2% of the US economy, and how can the Chinese government just paper over something this large? This seems way worse to me. What am I missing?

A: I agree with your skepticism here. Remember how the subprime crisis affected only a small percentage of mortgages and was dubbed containable by Ben Bernanke? It's not the first company in default that causes the bigger issue, it's the train wreck coming in behind them. Overbuilding and lending in real estate in China are widespread and represent the greatest such bubble in modern history. Many more Chinese companies are in a similar situation. It's like an avalanche: as more companies default, more will follow. I said it this week: Evergrande is the end of this global real estate bubble…. And naturally, the big bubble burst would start in the country leading the global bubble, as it did in the U.S. in 2007 and 1929.

Don't miss the upcoming October issue of *The HS Dent Forecast*.

Harry

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