Harry's Take

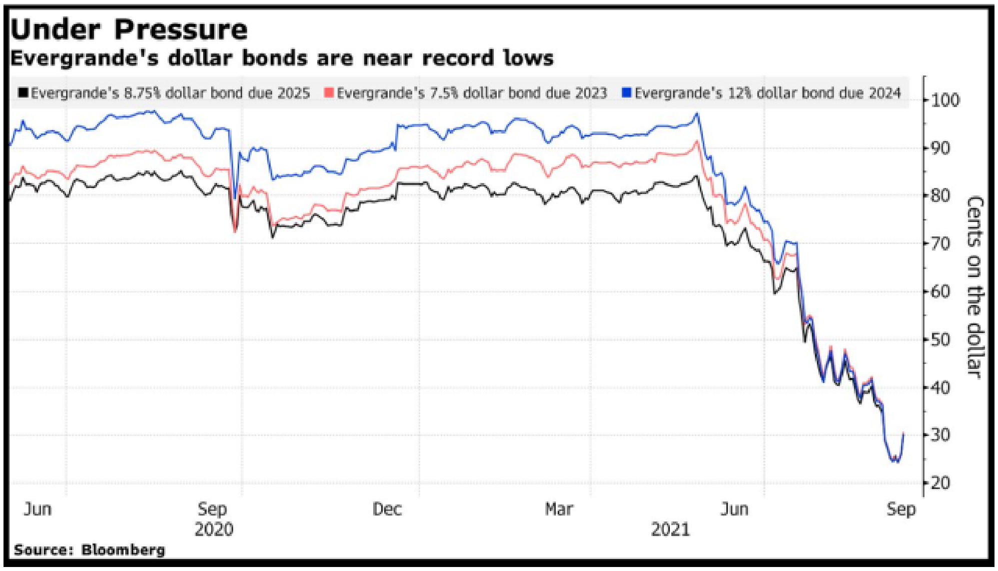
September 14, 2021

China's Evergrande Bond Default Signals the End of This Debt Bubble

Every great debt bubble comes to an end when some notable debt defaults hit. Where else would you expect this but China during the greatest debt bubble in the world? And in what sector? In its unprecedented housing bubble, China's home prices have gone up 20 times in 20 years. How's that for a bubble?

Evergrande is a large home developer in China. Its bonds crashed 75% into early September and since then have bounced only tepidly to 30 cents on the dollar, which indicates that a big and notable default is priced in. Evergrande continues to warn that its sales are falling and a default is likely.

Chinese Home Developer's Bonds Crashed 75%: The Global Trigger?



Source: https://www.bloomberg.com/news/articles/2021-09-12/evergrande-haircut-of-75-is-now-a-base-case-for-bond-analysts

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Obviously, these were junk bonds from the beginning. The three issues are shown in this chart: 8.75% yield due 2025, 7.5% due 2023, and a whopping 12% due in 2024. This default has been priced rapidly into the market since early June. Evergrande stock has fallen 80% as well.

More importantly, this event is coming at a time when a crash in the high-yield bond index in the U.S. (HYG) seems imminent, as I have noted many times before. In late 2007 when everything looked great, this index was priced above par at a peak of 106.5. HYG crashed 42% in the 2008 financial crisis and recovered to 97 in 2013. Since the crash into early 2016, it has not been able to get back over 89.5, despite three failed attempts. The last one peaked at 88.5, and the most recent surge went to 88.10.

Major Crash Imminent for High-Yield Bonds (HYG)? Stocks Follow Harder

Unless this index can break out above 90, then the likely scenario is a deeper crash than the 24% fall in early 2020. This is an ominous wedge pattern, with slightly lower highs and dramatically lower lows. The projection is that by late 2022, when the economy and stocks will be at their worst according to my predictions, HYG will crash 51%. If it continues trending downward until as late as late 2023, the crash could be 63%.

That drop would be commensurate with a stock crash of 70% to 85%—and 85% is my ultimate target for the S&P 500. Stocks are in a rising wedge that looks to peak ahead, and I will be updating that soon for subscribers, as it is threatening to break the bottom trend line. This HYG chart is clearer to me and adds to my conviction that we'll get a major crash ahead in stocks and corporate bonds.

Fasten your seat belts. Subscribers, stay alert for updates ahead, maybe even later today.

Harry

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