Harry’s Take

May 31, 2022

Reader Mailbag: Questions and Harry’s Answers About Bonds, Stocks, and Recession

We receive many questions on various topics, including 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 subscribers as part of our Reader Mailbag series. Reader questions may be edited for clarity.

Q: If you say that TLT, etc., are ready for a 40% rise at 118, how come you are still predicting the market crash? Are stocks and bonds not inversely proportional?

A: When the crash actually sets in, stocks and Treasury bonds (not broad corporates) will go more in the opposite direction: T-bonds up and stocks down. The crash likely has begun, but it’s not a slam dunk yet. Another wave down into July will make a top fully confirmable, but it already looks very likely now. TLT and T-bonds did rally into 2020 but had fallen from 173 back to 109 as of this writing. We might retest the lows of $112.62 or a bit lower, but a large and likely final major rally toward $180–$200 should start soon. I expect a bigger spike upward in TLT once we actually see a recession set in and a larger drop in stocks. Before the 2008 crash, T-bonds initially rallied before the stock peak in October 2007, had a setback, and then had a larger spike in 2008 during the worst of the crisis, when stocks crashed the most. That is what we are looking for just ahead: stocks and bonds finally to “see” a recession and, hence, for stocks go down much more. T-bonds would be the only assets to go up and would be at their the strongest when the crisis is at its worst, much as into late 2008.

Q: As the Fed moves to raise interest rates and transition to quantitative tightening (QT), is there the possibility that Powell will then buy ETFs and stocks in large quantities to keep the market propped up? If so, what are the outcomes or impacts to your studies?

A: Japan has been buying stocks in addition to bonds for a long time now. It is as simple as this: These central banks will keep stimulating until the bubble gets so big that it starts to burst, and then they won't be able to stop it. You can't keep a dead economy going on something-for-nothing policies forever, given the other simple, universal principle of diminishing returns. This does make it hard to predict when this cowardly policy will fail, but it will. It looks like the economy may be starting to roll over, despite the most massive QE policies yet, $5.1T in the last 2 years, along with new fiscal commitments of $5T. The Fed's own GDP model is pointing toward 1% growth ahead, despite such massive stimulus... diminishing returns!

Q: At what point in time would you change your crash theory? If the crash does not occur by May–June or by the end of the year, would you change your opinion?

A: Yes, the culmination of my worst cycles is at the end of this year. If we can get through this year without a recession and a stock crash kicking in, I will have to assume we are on the "coma economy" track, like Japan. We won't necessarily have a big crash and depression, but we won't grow much again for a long time. That's the worst scenario to me. I'd rather flush out the debt and bubbles so we can move forward as the Millennial boom kicks in from 2024 into 2037. That boom will be compromised if we continue to be weighed down by bad and unproductive debt as money velocity continues to fall. For more on this topic, read the June *HS Dent Forecast* newsletter. First-quarter GDP just came in at -1.5% inflation-adjusted. We likely have just entered the recession. One more negative quarter will confirm it.

Q: As an Australian resident I wonder, do you see the market playing out in the same terms as a crash when compared to the U.S. markets? Do your same comments apply to purchasing Australian government bonds as an Australian, and, if so, what prices would you think to purchase at? Also, in a video you released quite a while ago, you discussed crypto briefly and mentioned that you were a "fan" of Ripple. Is this still the case?

A: The downturn will play out in Australia similarly, but real estate will get hit a bit harder and stocks likely will be hit a bit less. Australia's demographics are stronger, but its real estate bubble is more extreme; U.S. real estate got some reality testing in the 2008 crisis. I prefer the U.S. dollar and Treasury bonds as safe havens during the crash ahead, as the U.S. dollar and bonds did the best in the 2008 crash. But Australian stocks and Asia should do better than the U.S. in the next boom. So, go to U.S. Treasuries in the downturn and to Australian and Asian stocks in the next boom, from around 2024 to 2037. Bonds will not fare well anywhere when inflation is rising mildly in the next boom, as was the case in the 1950s and 1960s. Real estate will come back stronger in Australia than in the U.S. but likely will crash more this time. Ripple and other leading crypto stocks will crash further and then be a good buy as the leading sector of the next boom. It's not time to buy yet.

Q: Several pundits like you say we are going to have an epic crash to the order of 80% but that it won't occur until there is an implosion in the debt market and that the key indicator is the 10-year yield rapidly bumping up. As long as it dinks around 3%, your risks are not high. Why are they potentially wrong?

A: It's the rise in rates that's important. The 10-year has gone from 0.4% to 3.20% in this rate rise. That is a rise of almost 3% points. That is the same as going up from 5% to 8% in the past, etc. And at such low rates, you wouldn't expect as big of a relative rise. This should be enough to stop the stock rise, and thus far, it has. But it could take more. Stocks broke to new lows recently, and that is a sign that they may be finally reacting to rising rates. But we'll need to see follow-through on the downside here with stocks. I

think that is likely into around mid-July. We won't know for sure this was a top until stocks are down more like 40% on at least the Nasdaq.

Q: Do you believe it to be relatively safe to stay invested in energy and agricultural stocks for now?

A: **Oil stocks go down when the economy goes down, even though they often go up in the early stages, as they are doing now. I would get out while the getting is good. Agriculture tends to hold up the best in a downturn, but still will go down in a deep recession like the one I'm looking at. It's better to be out of everything but 10- and 30-year Treasury bonds and see how the downturn plays out in all of the risk assets... and then judge what to buy when.**

Q: What to do/buy after the downturn: could you write more about that? You hint at it sometimes (crypto, Southeast Asia). But those are rather broad strokes. For me, it would be interesting if you could elaborate on that in more detail.

A: I am not focusing on that now, as it is 2+ years away, and we have to see how countries fare in the downturn. Basically, the focus will be on Asia, except China, because it will be the first emerging country in Asia to peak demographically and because China's real estate is overbuilt for a decade plus ahead. There are eight countries in Southeast Asia to keep an eye on. To that you should add India, a huge country that will be the one to lead the next boom, much as China did the present one. Crypto in its present stage is comparable to the dot-coms in their early stage bubble into 2000. The dot-coms crashed 95% and then rallied big time into 2021. I likewise see crypto crashing into late 2023 or so, before having a big longer-term rally into around 2037.

Q: With respect to the housing bubble, I have been reading about how housing prices are only expensive if priced in dollars. If you price them in other assets, like, say, gold or oil, they appear to be at historical medians. So,

cash is going down, housing is not going up. I know you expect all assets to drop in price and therefore cash to be king.

A: Gold and oil are in major bubbles, so this is not a good way to measure. This is an "everything bubble," more so than the tech bubble into 2000, which didn't include a real estate or commodity bubble, and more so than the first real estate bubble, in which we saw more moderate stock gains into 2007: stocks were not as bubbly as real estate. In this last "bubble-to-end-all-bubbles," everything will deflate together, only some assets, particularly stocks and oil, will deflate more, and some, like real estate and gold, will deflate a bit less.

Q: Do you think we really will see a substantial drop in energy prices over the next 5 years? Without that, I would expect inflation to continue to rise. If the cost of building goods is going up, can housing prices still drop?

A: Everything goes down together. High home prices cause home sales to slow, as is already occurring, and then demand for lumber falls. The falling home prices cause people to get scared and not buy as many homes, and that leads to even lower prices in houses and lumber, and so on. It's the same with oil: when the economy falls, stocks fall, but so will demand and prices for oil. At some point after the peak, everything will fall together until prices become so low that people start buying again and the recession bottoms. Then people will buy more of everything again, including stocks.

Q: When the Fed begins to reduce their balance sheet, will that tend to have a negative impact on TLT and ZROZ? I think the reduction in mortgage-backed securities should have no impact, but at some point, they will just let what Treasuries they hold roll off, which I would not think would impact these ETFs. But if they start selling Treasuries, wouldn't that cause interest rates to rise and TLT and ZROZ to fall?

A: Yes, at first. And to a smaller degree, the rise in rates will cause the T-bonds to go down. But the bigger impact is the expectation of and then the actual, substantial slowing of the economy, along with a fall in inflation

and bond rates. There might be a small bump in rates at first, or the economy may be overwhelmed by the expected slowing from the beginning. But there's no question that raising rates will slow the economy, and that will bring bond rates down, unless some weird inflationary surge happens beyond what's occurring now. The slowing of the economy is more impactful than the slight fall in T-bond values due to the government selling off part of its stash.

Q: Should investors sell oil and gold investments, given your recent update? If not, when?

A: You definitely don't want to own oil or gold in this large crash that will be in all financial assets and commodities. Gold usually peaks in the early stages of the crash, later than stocks. My high target for gold has been $2,300, but given that stocks already peaked months ago, the odds of gold not reaching that level are growing fast. I would sell into any gold rallies ahead, but be out by mid-July at the latest.

Oil is trickier. I would prefer to go ahead and sell now. Oil is not thought of as a safe haven like gold, and it is an illusion to see gold that way, as the 2008 crash proved: gold crashed sharply by nearly 50% into late 2008.

Q: Please let your subscribers know if you predict a short-term bounce in Bitcoin like you do on the stock market. If yes, then to what price do you think Bitcoin will go for a short-term trade?

A: I don't expect a big bounce in Bitcoin near term before it heads down further, likely to around $31,000 max. The next stop would be around $20,000 and the ultimate bottom target would be $4,000, or in a range of $3,000–$7,000.

Q: I think a lot of readers would like to see how you see QT playing out and how it will impact the TLT and ZROZ ETFs, as it sounds like QT will have a significant unfavorable impact on long-duration Treasuries and, therefore, also these ETFs. So, haven demand looks like a positive for 20- to 30-year

Treasuries, assuming slower growth and perhaps a recession. However, I can't tell what QT will do, but it seems like it would be a negative for long-duration Treasuries. So, are these ETFs still a viable position, or is it more likely that holding individual Treasuries across the maturity curve now makes more sense and these ETFs actually contain a significant level of risk? It's just not clear to me how the dynamics will work with QT and a $9T balance sheet. It seems like it would have a significant detrimental impact on long-term Treasuries and these ETFs.

A: QT raises short-term rates, largely. It's the longer-term bonds that look at the bigger reality that growth will slow dramatically from tightening. In the 2007-2009 crash, T-bonds and TLT started to rise more in the second half of 2007 when stocks peaked, and then spiked into the worst of the crisis into late 2008, just before stocks bottomed in March 2009. Unless we get a big surprise again in inflation, it's not too early to buy TLT or ZROZ. If the recession starts to set in more clearly, I would buy more only into a likely peak crisis into mid- to late 2023 or so. Both are correcting again and look ready for buying or adding, especially if they make slight new lows in prices or highs in yields just ahead.

Q: What are your thoughts on how Treasury yields will respond when the Fed starts selling off their balance sheet?

A: Two things will happen when the Fed sells off its bond stash. The Fed sales will push prices down a bit, as any selling pressure would. But the act of tightening money policy projects a slowing economy, and that will lower inflation and long-term Treasury yields and push the prices up. Remember, bonds like falling yields, not rising yields. The slowing impact is definitely the more powerful here. I expect yields to go down as the economy moves into a recession increasingly in 2022 (we're already on the verge, by the best indicators), and the recession likely will last through 2023 or even mid-2024. That's why we buy the highest-quality bonds here, those for which default risk won't lower the prices in a recession. Treasuries have nearly zero default risk. Even if the government gets in financial trouble, it can print money to pay bond interest and principal.

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