Harry’s Take

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Reader Mailbag: Questions and Harry’s Answers on Inflation, Global Safe Havens, and Oil

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: [Consider] this idea that aging Boomers may cause inflation.... not deflation as most think, because Boomers still have pretty high consumer demand in retirement (especially for health care, restaurants, leisure) but are leaving the workforce, causing a chronic labor shortage and thus chronic high wage growth, thus causing the Fed to maybe have to stay more hawkish than in the last 25 years. Thoughts?

A: The Boomers, on a 63-year lag for average actual retirement, have been leaving the workforce in increasing numbers for over two decades. That trend will peak in 2024. So, this workforce shock is almost over, and we likely have a short-term deflationary shock on the way from the final bubble burst that I think is underway now. Hence, if this inflationary shock from shrinking workforce was going to happen, it should have by now.

The more important point is that inflation is actually driven the most by the entry of new workers into the workforce, i.e., by workforce growth, as we have to invest in new infrastructures and training to accommodate them. Hence, slowing workforce is by nature disinflationary or deflationary. My Inflation Indicator correlates the best long term of any indicator I have

seen, and we can project it forward, with workforce entry at age 20 on average and exit at age 63 on average. That indicator projects 0%–1% inflation well out into the future and has the rising retirement of Baby Boomers in it as a component…

So, there's no inflationary surprise from Boomers retiring; they've already done that with very low inflation—and this recent surge to 9.1% is totally due to the massive (over) stimulus we got in reaction to COVID. That inflation will disappear fast when the economy crashes again from 2022 into 2023–2024.

Q: What is your long-term view on oil?

A: Oil will be down big time in the downturn, as usual (unless there is a major Middle Eastern conflict). It should rally again longer term in the next boom, from 2024–2025 into 2037+. My best bottom target in the next year or two would be around $12... That's not a typo! Oil has been at that level twice since 1986 and hit $20 just over 2 years ago right after COVID hit. I don't see it getting back to the $140 all-time peak for a long time, and if so, it would happen more around 2037-2039... when I'm near dead!

Q: TLT and ZROZ are U.S. ETFs. Retail European and United Kingdom clients cannot trade U.S. ETFs due to PRIIP (EU Packaged Retail and Insurance-based Investment Product) restrictions. What would be an alternative for European citizens with a subscription to your newsletter?

A: There are three things you can do: (1) find a fund in your country that invests in long-term U.S. Treasuries in part or largely (best), (2) buy your own government's longest-dated bonds, 20-year+ if possible (this will not be as good as U.S. Treasuries, though), or (3) buy the most highly rated, conservative corporate bonds your country offers, i.e., your country's equivalent of AAA U.S. corporate bonds.

Q: What is wrong with using a short-term T-bill ladder rather than parking in cash?

A: It's better than cash because of the (very small) interest you will be paid on a short-term T-bill. The advantage of the 30-year Treasury bonds (or TLT

ETF at 20-year average or ZROZ at 25-year average) is that by locking in yields long term, they appreciate very substantially if there is an economic slowdown and fall in long-term rates. TLT went up 40% during the last stock crash from late 2007 into early 2009. I think it could go as high as 60% to 80% this time.

Q: Last time around (aka GFC [Global Financial Crisis]) when the indexes were going to crash, you recommended inverted ETF tracker symbol: SH for shorting the SPY. How come you're not recommending the same this time around for this bubble burst? Not to mention that SPXU is 3x ultra short.

A: All the shorts are good; it's up to the investor. I see S&P 500 going down 86% from top and Nasdaq or QQQQ down more like 92%, so there's not that much difference in the end. SQQQ is the most potent, at 3x QQQ. SPXU is 3x SH. The key is to be short stocks at the risk you can tolerate. In the end, I think SH and SPXU are better, as they will be less volatile on the way down than SQQQ and PSQ—and people have to consider whether they can handle being 3x short.

Q: Can you circle back with Chinese real estate and how that piece fits in with all this other mess? And [I'm] hearing more noise of credit tightening in the U.S. and abroad.

A: China was the first major country to see its economy and real estate start to slow. They are trying to stimulate against that, but that's not likely to work for long, with the world economy continuing to slow down and likely to be in a deep recession in 2023.

Q: Your July update suggested it might be good to have some position in gold along with Treasuries in case the Fed was to start printing again. Do you have a suggestion on the best way to do this? I was thinking the GLD ETF? Thoughts?

A: GLD is the simplest and best. Gold tends to do better in the early stages of a stock crash, when inflation is still rising, and then near the end when the central banks are printing money massively again to stimulate harder. Gold already had its early stage rally into March. I think it will be a while

before gold again stages a significant rally. I would wait or just have a 10% allocation for diversification at this time.

Q: I know that you are predicting yields will come down once the recession is in full swing and the Fed lowers rates. I've read that some believe that while that is generally an accepted Fed move, others believe that, since inflation will dominate decision making by the Fed, the Fed will raise rates because inflation containment is the most important issue. What are your thoughts on this matter?

A: The Fed will have to raise rates until economic growth and inflation show signs of slowing. They created this monster inflation out of an otherwise 1%–2% inflation environment. The problem is that the Fed thinks that the underlying economy is strong, when it is at its weakest point in the demographic cycle in 2020–2023. That means the economy likely will break down harder than they think. And, in such a stretched bubble, stocks will collapse fast. Then it likely will be too late to reverse course and stimulate again fast enough. The Fed has cooked its own goose by overreacting to the short-term COVID crisis and by overstimulating for 14 years now.

Q: If you own Bitcoin now, what should you do, hold on or sell?

A: I would sell into bounces, which could go as high as $30,000 or so. But don't wait too long, as I think it's going as low as $3,250, maybe by year-end.

Q: You haven't mentioned the ZROZ Pimco 25+ Treasury in a while. I invested significant capital on ZROZ. Are you expecting the same trend as the TLT?

A: ZROZ and TLT are the same trend and trade very similarly. ZROZ is 25-year-average T-bond duration vs. a 20-year average for TLT; hence, ZROZ is more leveraged and goes up and down about 50% more. Here is an example of a past 12-month high-to-low range: ZROZ 163.61 high vs. 99.57 low (range, 64.3) vs. TLT 155.12 high vs. 108.12 low (range, 43.5). In this example, ZROZ has 48% more volatility, up and down, over 12 months, and that's about what you should expect.

Q: With so much stimulus, will it not serve as a cushion during this crash? In other words, stocks will go down but the trillions of dollars that are still in the economy will prevent the S&P from an 86% crash; the cushion may limit the crash to only, say, 40% or even smaller.

A: That is certainly possible, but history does not support it as much. Bubbles go back to where they begin. That means the higher you pump the bubble up through artificial stimulus, the further it falls when the bubble bursts, as the long-term fundamentals of the economy do not change from such superficial stimulus.

Harry

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