Harry's Take

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Reader Mailbag: Questions and Harry's Answers on Rates, Bond Yields, and the Crash

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: I am confused about why mortgage rates are so high, when the 10-year bond is at 4% and the 30-year bond is around 4%. Mortgage rates are usually closely related to the 10-year rate, I presume because Ginny Maes (Government National Mortgage Association bonds) pay off on average around 12 years, historically.

A: First, note that none of these bonds or rates correlate much with the higher inflation rates, which recently were as high as 9.1% and which are around 6% even now, as investors don't think these inflation levels are sustainable—and inflation has increased only as a result of short-term money printing, which already has been reversed to tightening. So, the markets are a bit confused but not that far off. My inflation indicator, based on slowing workforce growth, projects 0% to 1% inflation down the road for as far as the eye can see. In the near term, due to recession, looming default risk will make corporate bond rates rise, especially the rates of high-yield or junk bonds... But for the safe-haven assets, risk-free Treasuries, yields will go down only during the recession/short depression now in progress, because inflation will disappear like a magic trick and Treasuries have no default risk. I see near-zero or mildly negative yields for

10-year Treasury bonds during such a phase, given that T-bond yields reached 0.4% in the last crisis, the COVID scare of 2020. That's why a nearly 4%-yield product like the 10- or 30-year Treasury will appreciate dramatically into the downturn and crisis. A 4% yield will look glorious compared to yields near zero!

The only thing that will bring clarity to this issue will be if an economic breakdown happens and bad debt and bubbles are purged from the economy. Then we will see the truth. Stocks and Treasury bond yields will have to go much lower before we can get back to reality. Yields for corporate and higher-risk bonds will only rise as a result of default risk; they will come down in the next boom, when inflation remains low despite continued growth and as default risk evaporates again. The simple strategy for the downturn continuing ahead is this: short stocks and go long on T-bonds. In the next boom (2025-2037), go long on stocks, especially those from India and Southeast Asia and on the Nasdaq here, and long on corporate bonds, especially high-yield bonds, when risk recedes again, and those yields fall along with inflation.

The only clear safe havens in this crash, which will be larger than the 2007-2009 crash, are 10-year and 30-year Treasury bonds or the T-bond ETFs, (TMF, ZROZ, and TLT, in order of leverage), to play the T-bond rally. The usefulness of such T-bonds as a safe haven was demonstrated in the 2008 downturn, when gold finally crashed near 50% and T-bonds rallied into the worst of it (late 2008); it will happen again similarly this time. Gold has held up into the early stages of this crash as in early 2008, but this time, gold likely will crash back to around $950-$1,000 before rallying with the next economic boom, which will feature India and Southeast Asia, an area with a total population around 2 billion where many people love having gold jewelry! Gold likely will not beat stocks in that boom, but it will once again be a good diversifier.

Q: In case the Fed stops the rate hike, are there more chances of the fourth-wave rally and not a third wave down? I am getting confused. Is the third-wave-down scenario only applicable if the Fed keeps on hiking up the rates?

A: A major up or down wave tends to progress in a 5-wave sequence. If it's heading down, it goes like this: the first wave goes down, the second wave bounces partially against that, and then the third wave falls much lower; this third wave typically is the strongest. Next, there is a fourth-wave bounce, followed by a final, fifth wave down to the bottom, which completes the sequence. In this crash, we appear to be just seeing the second-wave bounce. If we don't see new lows below the first wave down of 10,089 on the Nasdaq in the next few months, then this downward move will look more like a correction, with new highs eventually to come. In other words, it won't look like the first wave down in a larger five-wave sequence, it will look like a correction, with higher highs likely ahead. That is not what I expect to happen!

So, it is a big deal to see the Nasdaq and stocks break to new lows; it demonstrates that the markets are likely going a lot lower. The next stop most likely would be a drop to the COVID lows of early 2020. On the Nasdaq, that would be a fall of 58% or so from the top, which would be most likely to happen into the end of 2023 or so. That would be the third wave down, and it likely would be followed by a weaker, fourth-wave bounce and then a fifth wave down sometime into mid-2024+ to complete the pattern. That is what I expect, given that the first wave down, in 2022, ultimately led to a 38% drop on the Nasdaq, which from a historical viewpoint strongly suggests that the bubble is over and that we aren't going to see new highs for a very long time. But we need more confirmation; a convincing break of 10,088 on the Nasdaq just ahead would be a clearer sign of this.

Q: I continue to believe, based on the numbers provided, that you are going to be right about the coming crash. Having said that, we do appear to be entering a cyclical bull market within the broader, secular bear market. These cyclical bull markets can last a couple of years. That would be a long time to do nothing. Have you considered that possibility?

A: We are in the most screwed-up financial scenario in history, as the central banks have totally perverted the markets. We are also in the

strongest convergence of down financial cycles ever, and if things had proceeded naturally, the situation would have come to a head by the end of 2022. If we do not see a greater crash and lower lows by the end of 2023, then I don't think we will, and the penalty will be a "coma market" that will go sideways for a long time—as Japan has seen since 1989. If the markets don't get the downturn that they need to rebalance and clear bad debts and bubbles, investors will just pout and the markets will work it out by going sideways for a long time to compensate. This is why I prefer to just get the crash over with now and let the economy rebalance and get efficient again. Taking the easy way out almost never pays off!

If January 4, 2022, was a major top in the S&P 500, then we should see a third-wave crash soon toward the COVID lows (down 58% or so). If stocks do move sideways to up instead from here, then the situation will be very hard to read. I don't expect that. The Fed has tightened enough already for the economy to feel it more on the typical 12-month lag that most aren't talking about—from now into early 2024. Further weakening in the months ahead should lead to that third wave down, and then there will be no hope for a new high for a long time.

Q: Do you believe U.S. bond yields will bottom prior to the summer stock market crash of 2024? I'm assuming that once the crash starts, bond yields will go up, as investors will sell stocks and switch to the safety of U.S. bonds.

A: Bond yields on U.S. 10-year Treasuries peaked last at around 4.5%, fell toward 3.3%, and are now bouncing back to near 4%. When the economy shows clearer signs of slowing, likely soon, yields will fall toward zero, and risk-free 10-year and 30-year bonds will go up in value as the best safe havens, whereas gold will fall, not rise. I think the 10-year Treasuries will go to zero yields or maybe even will go slightly negative; they fell to 0.4% in the 2020 COVID crisis. TLT could rise to $186+ from the recent level of $101; ZROZ will go up around 1.5x-1.6x that. TLT topped near the end of 2008, a few months before stocks bottomed in early March 2009. So, I could see TLT topping around early to mid-2024 and stocks bottoming from

mid- to late 2024 on a few months' lag, like last time. But bond yields likely will bottom (TLT tops) just before stocks bottom… again, like last time.

Q: What is your take on first-time home buying? Given that the recession and looks-to-be crash are taking longer than first expected, is summer 2023 a bad time to purchase a home as a first-time home buyer? Would waiting until summer 2024 be of benefit?

A: I see mid-2024 as the earliest time to consider buying, unless you just get a great deal, like I did in Puerto Rico. Real estate takes longer to bottom than stocks, so there typically is longer to wait, which means that you have longer to consider buying and finding the ideal house and price. Stocks bottomed in March 2009 and real estate bottomed more in early to mid-2012, although most of the damage was done by mid-2009 near where stocks bottomed.

Q: Why not wait until the Fed stops raising interest rates to buy TLT or ZROZ?

A: The markets anticipate the future and already expect an increase in total of 500 basis points or so, and it looks like the Fed is already backing off, as the economy is showing signs of slowing, as shown by the recent bank failures. TLT has been rallying since early October 2022. If you wait until the Fed stops raising rates, you can miss a lot of the rally. TLT already has gone up 20% since its October low of 91.85. My target for when we go into a deep recession or worse is 186+. That will turn inflation into deflation, and then you'll see 10-year rates go to zero or even go negative. If the Fed decides to go higher than expected with short-term Fed funds rates, it will just slow the economy further. The longer-term Treasury bond rates go down when the economy slows from raising short term rates. At some point—and we likely are there already—they will end up going in opposite directions. Short-term rates will stay high for a while and long-term rates will fall with the slowing economy.

Q: Can I please have some information on gold and silver? If I'm not mistaken, I remember you saying that gold will go down to as low as $1,000. When do you see these commodities reaching their lowest point?

A: I still expect gold to go down to around $950-$1,060, likely into early-to-mid 2024, just before stocks are most likely to bottom. The big question is, "Will gold make new highs of $2,200-$2,250 first?" Time is running out on that, and gold already has trended up to near $2,000. If gold does not continue to rise toward $2,200, I would sell by late May, anyway.

Q: How does the S&P outperforming the Nasdaq in the latest bounce show that the market is weak? Is that because the Nasdaq has 2,500 stocks, vs 500 on the S&P?

A: No, it has nothing to do with the number of stocks. Normally, the Nasdaq is more volatile up and down than the S&P 500, as the Nasdaq has more growth and tech stocks. When the Nasdaq is weaker than the S&P 500, as in a bounce like this, it shows that the bounce is weak and that investors are preferring the less-volatile S&P 500. That's bearish. If investors thought this correction was over, they'd be buying the more-aggressive indices, like the Nasdaq, QQQ, and Russell 2000. They are not!

Q: What are your thoughts about the FDIC stating that the Frank-Dodd Act has a provision allowing banks to seize depositors' funds (a "bail-in") instead of a government bailout? If they take our money, then we can't take part in the greatest opportunity of a lifetime.

A: It is hard to tell whether that will happen, and it's not likely. You can't just stick it straight to everyday households in a downturn with high unemployment. What I have always *clearly advised* is that you as an investor should put all of the money that you don't immediately need for paying your monthly bills into a separate brokerage account, preferably at a firm like TD Ameritrade or E-trade. Such online trading firms don't have high exposure to the broader financial services crash that could greatly compromised their entire financial position. These firms are just

transactional, and they make money whether people buy or sell! So yes, do not keep much cash in traditional deposits or savings accounts! If you can pay some of your bills out of your investment account, do that to reduce your normal bank accounts even more.

Q: Have you considered the possibility that Treasuries might not be a safe haven?

A: Money has to go somewhere. It will go into money market funds and the safest bonds, which are the U.S. Treasuries. I've often said that we're "the best house in a bad neighborhood." If the central banks can print money to stimulate the economy, they can print it to pay bonds and interest. In 2008, we got the worst downturn since 1929-1933, and long-term Treasuries went up nearly 50% into the end of 2008. We were the best house in a bad neighborhood then. Now, in a 50% worse crash, we should be even more so, which means that the U.S. dollar also will rally again. After this crisis, I likely will be more bearish on the U.S. dollar longer term and more bullish on Asian currencies like the Australian dollar, the yuan, and maybe the yen.

Q: How would you reconcile your position that the S&P should drop by some 80% with your position on the TLT, currently at approximately 101 and going to approximately 187? If you are correct on the TLT, then wouldn't the stock market go back up?

A: Stocks don't like recessions (what we are in now should be more like a short depression), so they crash… and historically they fall by more like 70%-90% rather than by the 50%+ you'd get in a deep recession like from 1973 to 1975. The deep downturn causes inflation to turn to deflation, and that brings yields down only on risk-free bonds like U.S. Treasuries, which makes their values go up, as risk-free bonds benefit from falling inflation and longer-term interest rates. Bonds go up in value when yields fall, and the longer the duration (think of the 30-year Treasuries), the more the appreciation. The values of higher-risk bonds drop because the *risk of default* goes up, and this can be especially dramatic in a depression. TLT went to 173 in the COVID shock; it should go substantially higher in this

downturn, which I expect to be the deepest since 1929-1933. That's why 186+ is my projection. TLT bottomed recently at 92. A level of 186 would be a gain of 102%. If that happens, you will never see such gains in a short period of time ever in your lifetime!

So, in this scenario, stocks would go down 86%+ from their top, and Treasury bonds through TLT would go up as much as 80% from here. Stocks and bonds go in opposite directions, but only into the worst of the crash and financial crisis, as into the end of 2008 last time. Higher-yield corporate bonds would go down like stocks, just not as much… again, due to default risk, which the Treasury bonds don't have. Gold would go down, as it no longer is a reserve currency, and its value would drop (as would other commodities). Silver would go down even more, as it "acts even more like a commodity," i.e., it has more industrial uses.

Q: Can you give us an update on Bitcoin? Do you still see it going to $3k to $4k, or is it time to buy now, before it goes any higher?

A: This is called a "bear trap." I still have the same targets, but $10k-$11k is also a possibility. That's the forecast of my friend, market insider Michael Terpin. And even he doesn't think it's over yet. I am no crypto expert, but I do uniquely compare this first bubble in Bitcoin (what I call its "baby bubble") to the dot-com and Amazon bubble that peaked in early 2000 and crashed into late 2002. I don't expect experts within the industry to be that objective, but people like Terpin do know how big a new thing and trend this is...

So here, I trust my own forecasts more in the near term, as I am just as bullish as they are long term on this one. I keep calling it the "next big thing," after all. Amazon and the dot-coms were just as big in their baby bubble, but nobody in the industry expected that first bubble to crash by 95%. That's where I get my target of $3k-$4k, which represents a crash of about 95% from $69,000. I am using the most credible analogy, one that played out both top and bottom 22 years ago, which just happens to be about half of the 45-year technology cycle, wherein there are two major

mega-innovation surges. This is simply the second surge in the cycle, the newest “next big thing” in its early stages—and the best analogy to the current situation is the first “next big thing” from this 45-year cycle, the first bubble in the Internet! If you have a better theory, be my guest: introduce me to the idea or model that makes more sense than mine. I will gladly consider another opinion here!

Harry

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