Harry's Take

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Reader Mailbag: Questions and Harry's Answers on Weathering the 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: Please say whether the following developments impact in any way your current analysis: the short-term increase in the dollar, the coming major recession/depression, and the expected downturn in house prices. I sold my house in 2019 and am waiting for a downturn in the real estate market to purchase a new home. So, I am concerned with the possibility of uncontrolled inflation and loss of the purchasing power of the dollar.

A: A deep recession is unfolding. This will knock out inflation, which is only temporary and resulted from a massive stimulus overreaction to COVID. Longer term, inflation will be more like 0% to 1%. You won't have to worry about inflation a year or so from now! Home prices should come down 50% or so, and will fall more in higher-end areas. That process took six years last time, although most of the damage was done in two years. So, wait for that. It takes home prices longer to bottom than stocks. I think the time to look for house bargains will be from 2025 forward. The dollar will tend to go up only in a global financial crisis. It should top in the next year or two, and then fall longer term. It will lose its world reserve currency status in the next few to several years, but not during the financial crisis ahead.

Q: So, my wife and I have been out of stocks and bought a lot of TLT around 112 or 114. How long do you think it will be until we know if the markets are going to break downward? If the market is going to go sideways forever, we would at least capture some dividends if we were in stocks. We are 30% in CDs, so that's something. We are waiting for stocks to bottom, and unless the U.S. defaults, earnings seem better than expected. Apple is killing it, and P&G and others are nearing highs. We are so sick of waiting. It's like we are hoping for a catastrophe to happen, and, well, that makes for a sh**ty life. We've been waiting for stocks to drop since Oct 2014, for sure. We did get back in for a few years and did well.

I know you stated that the U.S. has printed lots of money. The world is saying that it is gone. Is it true? If it is, then with prices as they are, people should have stopped spending, but they haven't. Can people put everything onto their charge cards for two more years? Then we will be into 2025. I'm sure it's frustrating for you, but you're not the only one. We've bought into the demographics, but people seem to be spending after they are supposed to be done spending, if that is even a thing. Perhaps people change? A hundred years ago, hardly anyone lived to 65 years old. We don't know what to do here. Do we give it three more months or six more months?

A: If we don't see stocks turn back down in the next few months, then the deeper downturn looks less likely, for now. With so much stimulus since 2009, demographics hardly matter much. It's all about how far the governments and central banks can blow up this bubble before it bursts. The best sign has been that 38% first crash in the Nasdaq.

Markets should make new lows before the end of this year, but it looks more like a sideways market for a while, and that does not bode well for stocks either up or down. If you are thinking about getting back into stocks, that is very risky at this point. TLT and ZROZ in T-bonds should be going in the right direction, given the tightening since March 2022, i.e., that should result in slowing. But as the safe haven, most of the gains are made when things get really bad, as they did in the second half of 2008. If you don't have patience, which is the key to investing, then I would advise just standing neutral until things become clear. Major crashes come in sudden surges, like happened from January to June 2022. If you are not there and patient, you miss them. The biggest risk I see would be if you were betting

on the upside after a 38% first crash off a major bubble like we had from 2009 to 2021. Now, that would be very risky. If the crash continues, gains will be made more quickly in short stocks like PSQ or SH, but this strategy would be volatile and more painful if this crash does not continue. The T-bonds have a lot of upside (50% to 80% within one or two years), and they don't have nearly as much downside as stocks if you go back long and the crash continues... And these T-bonds will soar the most when the safe-haven play kicks in, as happened in the second half of 2008.

If you can't get clear here, I would advise being in cash. For the continued crash, the best play with the least downside volatility is TLT or ZROZ. The best play until the bond safe-haven surge kicks in would be simply to go short on something like PSQ (short Nasdaq 100) or SH (short S&P 500). If the crash gets more serious later this year, then you'll want to move more toward TLT and the T-bonds. If you are not clear, just be in cash and wait for either a much lower bottom to get back into stocks or an upward surge that either fails to make or barely makes a new high. That is the least likely scenario, in my estimation...

Q: Of late, I don't see you recommending ZROZ as you did earlier. I followed your recommendations and have been buying ZROZ. Please advise if it has fallen out of favor with you.

A: ZROZ is fine for smaller investors. It goes up about 1.6X TLT. The only problem is that ZROZ is not as liquid, as it doesn't trade in as high of volume. I don't have a problem buying it myself, in modest amounts like $100,000 to $150,000. My fund in Australia is more in TLT because TLT has higher liquidity. The problem could come if you were trying to sell a lot quickly in a volatile market.

Q: I'd be interested in how you'd play your cards if you were a British investor or speculator right now. Our inflation is more stubborn than in the U.S., where it is still above 10%; our economy is in worse, shape for sure.

A: It's fine to short the FTSE or your markets, or in the U.S., to short the Nasdaq (PSQ, SQQQ, etc.). The FTSE has held up the best thus far, as Brexit took some wind out of its sails so that it didn't get as overvalued. That index should catch up to other markets on the downside in the near future.

However, for the safe-haven and bond play, I would focus on buying U.S. Treasuries, as they and the U.S. dollar will be a better safe haven than the British government bonds. U.S. Treasuries are the most liquid market in the world, and the U.S. dollar should have a safe-haven rally as well into the worst of the crisis. After the crisis recedes, from roughly 2025 forward, the U.S. Treasuries will offer no advantage and will be overvalued as a safe haven.

Q: I have a question about crypto. Should I sell Bitcoin and Ether and then buy again after the crash?

A: Yes, crypto is the most volatile asset now, much more so than stocks. I think Bitcoin will go to at least $10,000 and likely will go to $3,250-$4,000. That's a big fall from here. Such a fall would be THE buy opportunity of a lifetime, especially in the leaders, like Bitcoin and Ethereum. There should be a massive shakeout in most coins, and many could become nearly worthless. Stick with the "big boys" that are more likely to survive the big shakeout.

Q: I'm concerned that when the Fed pivots and starts printing money again we will get stagflation or hyperinflation along with negative GDP. Do you think this may happen, and if so, how will it affect long-term Treasuries like TLT?

A: The whole point of the largest Fed hikes in decades was to slow the economy. I think that ultimately the economy will slow more than the Fed thinks, because it's been living off stimulus and demographic trends will stay sluggish until late 2023 or 2024. Slowing means a recession, and that means stocks will go down much lower and Treasury bonds and TLT will rally. It's that simple. Note that the Fed is very likely to pause; the question is, does the economy slow on the typical 12-month lag to the recent tightening from March to May 2022 into early next year? If so, stocks will go down and TLT will goes up. TLT will go up more gradually at first and then surge sharply into the peak of the crisis (as in late 2008) when stocks start approaching their lows.

If we don't see new lows in stocks by year-end, we likely will move more sideways in stocks for years. If there are substantial new stock lows, as I

expect, investors and consumers will lose confidence in the Fed's rescue plan and pull back on spending, especially on housing and big-ticket items. That will compound the downturn and lead to a major crash that should last well into 2024. The next few months are critical.

It is a deepening recession/short depression that will create deflation and end the artificial inflation cycle caused by the massive Fed overreaction to COVID. Only a reversal to strong stimulus soon would rekindle rising inflation again, but it will be hard for them to shift back to strong stimulus too fast without pausing for a few months first. That would make them look wrong and reckless for tightening.

Q: There is a hell of a lot of talk about a U.S. default. Wouldn't that mean the dollar drops off a cliff and defaulting on bonds (like TLT)?

A: This happens almost every time the debt ceiling is reached. There's a lot of posturing, but Congress comes through at the last minute. The U.S. government has been running deficits for decades now. They have to borrow money to do that, and that actually creates or prints new money. They can't afford to have their borrowing interest rate go up even as a result of short-term defaults. This always causes some short-term concerns, but the government and central banks can and will print money to cover it. I am not worried about this, and it can create a short-term buying opportunity… but we are likely close to another sharp move downward, so I'm not into buying stocks here, either. The clear truth from the 2008 financial crisis is that the U.S. dollar and even more so the safe-haven long-term Treasury bonds will be the best play in a deep financial crisis. Compared with the 2008-2009 crisis, I expect this next crash to be 1.5 times deeper in terms of stocks crashing, to have 1.5 times longer of a downturn, and to have unemployment 1.5 times as high.

Q: The latest narrative on housing is that the supply for sale is limited because home owners have low-interest-rate mortgages, so moving unless absolutely necessary is out of the question, because their payments would substantially increase. Substantially!

While the higher rates have decreased housing prices somewhat, they are still artificially high in many places. What are your thoughts about real estate values going forward, and do you see any things that would spark a dramatic decline in prices?

A: This is the second and last housing bubble. We never saw this in history before artificial, ultra-low interest rates and wide mortgage availability. The fact that housing prices are responding only modestly to dramatically higher mortgage rates is another sign of the bubble... And it will not last! I'm advising people to sell any real estate you can, ASAP. When the real estate market fall, it will be worse than the 34% crash in the 2008 crisis. I am predicting a drop of 50% this time. People have learned to buy real estate casually, and some are buying extra houses to speculate. It's these people who will be forced to sell, stimulating the downturn in home prices. The more the prices go down, they more they'll keep on going down, as speculators are forced to sell. A lot of experts say low supply is the reason prices can't go down. It's going to be the sharp decline in casual buying that will start this crash, and then a lot of people who have speculated will panic to sell before prices fall further, and that will continue in a vicious cycle.

Q: TLT and TMF have been taking a hit with markets up and down the last couple weeks. Should we hold a pat hand, or would you add to those two positions?

A: TLT and TMF are very likely getting ready to make the biggest move in history in a year or two. Hence, they are going to fake a lot before that happens. This is a clear hold here and a buy for new investors. I would add more if TLT breaks above 110; that will show it is finally starting to make a run. TLT has been trading in a range between 99 and 109.50. I also would buy more in the 99-100 area, but with a stop around 97.90, in case it breaks down out of that range. Such a break down seems unlikely to me, unless we see a rising trend in inflation, despite the tightening.

Q: The bulls on CNBC never mention zombie companies or the fact that a recession may be just around the corner. When the odds of a recession come up, they either say it will be mild or not happen at all. I'm with you, but I do watch CNBC, so it's been difficult. It seems oil has the whole market in a buyer's mood. Do you think 4,200 will be the barrier that will stop this market?

A: I think 4,320 is the biggest resistance on the upside for the S&P 500. That was the big bounce on the way down into mid-August: 13,186 on the Nasdaq. Those targets are getting close, and the markets will have a harder time breaking through those levels. This is a good time to add to shorts or to start to short, and it is the very last chance to sell stocks. If they can break convincingly above 4,320 on the S&P 500 and 13,186 on the Nasdaq, then I might have to reconsider.

Q: According to your latest updates, you are forecasting the third wave down starting in June, which should then last until around the end of 2023, right? Did you include the fact that three of the last four Fed rate hiking pauses have resulted in significant bounces?

> 1995: SPX 15% up/Nasdaq 40% up.
> 2000: SPX 10% down/Nasdaq 35% down.
> 2006: SPX 20% up/Nasdaq 30% up.
> 2018: SPX 20% up/Nasdaq 30% up.

Therefore, can it perhaps be that your predicted third wave down first takes place, and then the Fed takes a pause, so that the above-mentioned gains can take place? This would then probably be the fourth wave up from about the beginning of 2024 to about mid-2024, after which the last fifth wave down would start in the summer of 2024 and last until about the end of 2024 or even early 2025.

Also, would you still hold running short positions like SPXS & SQQQ? Unfortunately, I went in too early, at about 21 USD (SPXS) and at about 47 USD (SQQQ) and am now already at about a 30% loss.

A: There are variations on my scenario like the one you mentioned, especially since it is totally unprecedented to have created a totally artificial bubble and then have it burst. The key is that the Fed will always tend to react late. They have tightened for 14 months and now will likely pause. I think the slowdown will be more than they expect, so they will likely have to lower rates by September or October. Between now and then, debts could start to unravel and a downward slide could be hard to reverse… and so on.

That's why I focus on the chart patterns. They are clearer. It looks like we are seeing a strong bounce in its last stage that is about to reverse and go down strongly again. But if we don't see signs of that by mid-June, then maybe we just move sideways for many months with no new highs but no deeper crash, for now. In that case, it won't make sense to be in stocks at all. It wouldn't make sense to be in the Treasury bonds either, because if the economy doesn't slow and stocks don't fall again, then the Treasury safe-haven play will not be attractive. The least-clear scenario here would be if stocks break convincingly above the August 2022 highs. If that happens, a new high in stocks would be possible, but it still could be just a big fake and suddenly reverse at any time.

I always have a preferred scenario, but I am willing to change that as the patterns change. The wild card is how hard the economy will react to the tightening already in place. I think it will react strongly… but we'll see soon!

Q: We are already in the hole with TLT, ZROZ, SQQQ, QID, SRS, etc. How much worse will these get with passage of the debt ceiling increase? Also, how much will they be affected by no vote to pay the debt? I am holding for now. I have followed your advice . Timing is everything.

A: TLT looks like it bottomed at 92. You have to be patient with these safe-haven bonds. They will explode when the crisis hits, as occurred in late 2008. If you don't have the patience, just be in cash and buy stocks again after they crash. The reality is that the move I am predicting in TLT and long-term Treasury bonds will be the largest in history in a short period (1 to 1.5 years). The markets will hide such a move as long as they can, as they aren't in the business of giving you layups! You are going to have to be patient if you want to catch this T-bond play of a lifetime. If not, I would stay clear and just sit out until a major crash makes the scenario clearer or stocks break convincingly above those August 2022 highs, after which we could see new highs... I still think that is unlikely after 14 months of tightening, especially given the likelihood that the economy will weaken on a 12-month or so lag.

Q: The real estate predictions are pretty interesting to me, since I am in the industry. The one thing I keep asking is where all of the excess inventory will come from to cause a crash. Builders are not keeping up with new household formations. You mentioned rates went up because of the Fed starting to tighten in March 2022. These are two totally separate events, because mortgage rates were going up way ahead of the Fed finally pulling their heads out of the sand with the “transitory” inflation, when in fact, inflation was real. For seven or eight of the last 10 years, builders have not kept up with demand. So, where will the new inventory come from? In your last real estate–focused letter, you talked about the steep rise in foreclosures. The fact of the matter is that foreclosures are at a lower level than before the pandemic. Yes, foreclosure rates will come up when the moratoriums expire. What will cause the drop in housing?

A: The biggest impact simply would be a dramatic fall in demand. There has been a lot of speculation in housing, including many large funds and also everyday people buying an extra house for speculation. This would dry up quickly and some of such funds would be forced to sell for liquidity. Recall that housing took six years to bottom between 2006 and 2012. So, there is a lot of time to keep squeezing out major and minor speculators. My biggest take is simply to look at the charts. If I looked at the U.S. home-price chart and did not know what it was, the target would be back down to the 2012 lows… That’s a 50% crash.

Q: You haven’t mentioned TLT in a while. What's your position? Is it down because of the debt ceiling? Fill us in.

A: TLT is in a trading range between 99 and 109.50. It should break out to the upside above 110 and then make a strong move up to as high as 186 if there is a recession, and that looks likely. The biggest surprise would be a convincing break below 99. I would stand back and watch if that happened and reconsider later. That would be saying that 14 months of tightening did not slow the economy hardly at all. That is unlikely, to me.

Q: You are firm on the stock rally as being a second wave. What is the bond action telling us?

A: Rising rates on long-term Treasury bonds and the inverted yield curve are saying that we have a recession just ahead, which will be bad for stocks

and corporate bonds but good for long-term Treasuries. A break in TLT below 99 would cause me to reconsider. I don't think that is likely.

Q: Thanks for your valuable opinions about what is going on with the housing market, but given the low supply and after more than 85% of homeowners have refinanced at a less-than-4% interest rate, in your opinion, how will the inventory rise enough for home prices to fall?

A: Falling demand at such high prices will cause the next crash. And the number of sellers will dwindle, because a large number of people have been selling for a long time to cash in on those high prices. The logic is this: What bubbles the most, bursts the most. In U.S. history, no bubble in housing has been greater than this one. This one is even greater than the first bubble into early 2006. People have been buying more out of speculation. That will change very rapidly when weakness appears, as this surge has not been primarily from demographics. Once demand and prices fall enough, then large corporate funds and small speculators will be forced to sell. That will cause inventory finally to rise and demand to evaporate. The thing about housing is that when it finally falls, demand evaporates much faster than for stocks. There just won't be buyers, as it is such a big commitment.

Harry

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