Harry's Take

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Reader Mailbag: Questions and Harry's Answers on the Crash, Commodities, and Currencies

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've been following you for a long, long time... and have been losing lots of money following the Big Crash. I have to say that someone keeps calling for a fire and no one shows up anymore, LOL. That said, I am not sure that I am believing it any longer. I've been chasing this CRASH for five years...

A: What goes up must come down, especially when things bubble up. In addition, for the first time, spending momentum led by demographic generational peaking has been going sideways-to-down in most developed countries. It has been up since the stock markets started in the late 1700s. When investors finally get that the markets don't have to go to new highs ahead as they always have in the past, then the overall tone will be much more sober. Given that this has not only been the strongest, but also the longest major bull market in history, investors are taking some time to accept this. But it shouldn't be long now!

For the first time in history, since 2008 the Fed and central banks have declared war on recessions and are fighting this crash, which is unlike any other in history. They seem doomed to fail, as taking the easy way out by printing money is not a credible solution... But how else will they learn?

This whole scenario now has been stretched out further by about two years. If things had proceeded naturally, stocks would have crashed between late 2019 (or early 2020) and late 2022, and the downturn/recession would have bottomed well into 2023. For the present situation, in which markets were propped up artificially by stimulus, it looks like stocks peaked in late 2021. They should bottom between mid- and late 2024, and the economy should bottom in mid- to late 2025. If stocks don't start to crash again by year-end, then I'll have to reconsider this scenario. I think the next major crashing wave will start very soon. It's better to be safe than sorry; hence, investors should be out of stocks and should be long T-bonds (TLT, TMF, etc.).

Q: What is your view on SPXS AND SQQQ, the ETFs to short stocks? If someone invested in them three months ago, should they wait it out? What is your outlook on the market?

A: Yes, this takes some patience, but it should be well worth it. The bounce off of the first crashing wave has been longer than usual. The one in 1929 lasted only five months; the current one has gone on for eight months. But the next move downward looks imminent now. It's best to hold at least through mid-July to see that begin. I will give updates to subscribers if it no longer looks like a good short. These two ETFs are triple short, so you need to understand how fast they will move, either way. You can be single short through PSQ or SH.

Q: Do you think it will be a six-year crash like last time?

A: I tend to think this crash will not take as long to bottom, as speculators will shake out faster this time, given that the last crash was so devastating. This crash looks to be worse. I expect early 2025 forward to be a good time to start buying homes, but people likely still will be able to get real estate bargains well into 2026-2027. Stocks should bottom by late 2024 or so.

Q: I am not a savvy investor, but I have been following you for the last two years and what you say makes sense. My query is this: given that there is the potential for the Fed to go to a digital coin as the currency, what would be the smart play to safeguard the cash on hand without having to fall into the digital trap?

A: I don't see any difference, whether coins or currency are digital or in cash. In reality, your bank account is digital. The banks don't have the cash to make good on everyone's account at any given time. The biggest risk is currency devaluation, and in the crisis that I am forecasting (which will be like 2008 times 1.5), the U.S. dollar will tend to appreciate, as it did in the 2008 crisis. After this crisis peaks, around late 2024 or so, then the U.S. dollar should fall for a long time to come.

Q: What about gold and silver? Should people buy or sell?

A: Gold could go to $2,200 or so at best near term, but I think that it will go back to $950-$1,000 in the crash ahead. Gold already should have advanced more, so there is a chance it has already gone about as high as it is going to. Hence, it may not be worth waiting for gold to reach $2,200. I think for now that it's just better to be out of gold but then buy if it crashes toward $1,000 in the next year or so. After that, gold likely will rise in tandem with India's China-like ascent over the coming decades, as Indians have an affinity for gold and there are more people in India even than in China.

Q: When rates were so low for so long, why did the Treasury continue to issue short-term debt, mostly 10-year bonds? That would've been the ideal time to issue more 30-year bonds. The interest rates were not appreciably cheaper. It's confusing that both the Democrats and the Republicans would be so reckless.

A: It's true that the government was just doing business as usual, allocating between different maturities of Treasury bonds to fund their debt. It would make sense to issue longer maturities when inflation and rates are low and shorter ones when they are high. In this case, inflation and risk-free bond rates should continue to be low for a long time, as workforce growth will be 1% or less and will come only from immigration.

My biggest fear is that we in the U.S. will keep thinking immigration is not that necessary, when it now is our only means of workforce growth in the future, because we are aging as a nation, like most of the developed countries in the world, and are having fewer kids as we become more

affluent. But, because of low workforce growth—the biggest driver of inflation long term—the penalties from this will not be substantial, as 10-year and 30-year T-bond rates should stay low for decades ahead. As is true now, the differences between the 10-years and the 30-years will be minor.

My view is that inflation will not be a challenge again (as in the 1970s and recently, with the blast of stimulus set off by COVID) in the developed world for as long as any of us live. Our challenge will be growing as a result of productivity alone instead of through population and workforce growth... Ask the Japanese about that. They peaked demographically back in 1996. They've been in what I call a "coma economy" ever since, with near-zero inflation-adjusted growth for decades, and it will get worse ahead for Japan, South Korea, and China, as well as for Southern Europe than it is for us. Given lower, more-stable inflation in the years and decades ahead, it won't end up mattering as much whether they financed short term or longer term.

Q: Is inflation different from currency devaluation?

A: Inflation and currency devaluation are two different things that tend to be inversely related. High inflation is one of many reasons that a currency can deflate. High inflation is bad for the economy and eventually can lead an economy to slow, which can make that economy's currency appear less attractive.

Currencies can deflate for a lot of reasons. Some governments intentionally drive their own currency down by means of direct purchases, to increase their exports and to stimulate their economy. Others run constant and/or rising trade deficits, and that drives their currency down. When a government does that, it is likely that their currency will fall, as that makes their economy look worse overall. Such a country is consuming more than it is producing, and that is like borrowing to grow. So, inflation and falling currencies can be related inversely, but the two don't have to correlate and at times, they don't. Rising debt levels can cause an economy to grow faster, and sometimes that can cause its currency to go a bit higher. Excessive debt tends to slow an economy or to make an economy seem like it is more likely to default, which can make the currency drop. But the main point is that

currency values and inflation are not directly correlated, although they do tend to correlate inversely: High inflation=lower currency value.

The most extreme example is Germany, which after World War I increasingly defaulted on foreign debts. German currency collapsed after the war, and the nation had hyperinflation into 1923. Extreme inflation caused extreme currency collapse. The currency collapse exponentially increased foreign debts in German dollars, which made the debts even harder to pay off. This created a hyperinflationary spiral, a rare occurrence and an extreme example of inflation causing currency collapse. The most important difference is that currencies tend to fluctuate relative to each other. If one country has rising inflation but another has even higher inflation, then the higher-inflation currency tends to fall relative to the lower one and the lower-inflation currency could rise. In that case, a country could have both rising inflation and a rising currency.

It's a good question without a clear-cut answer.

Q: What's your take now that Nasdaq has blown past 13,100, which I believe was top of range?

A: Yes, it's frustrating. The markets are still acting like they want to make new highs, although the Fed has declared war on them and has confirmed recently that it is still likely add a few more minor rate hikes. We are still dealing with the 14 years of unprecedented stimulus we got before March 2022. The markets got so high on and addicted to the extra money that they still don't make a lot of sense. They'll just go until they blow.

The 2022 crash took out the long-term momentum, and I really don't expect new highs, although the S&P 500 has a shot at one. It will take another strong wave downward to take the effects of the monetary "crack" out of the markets. That's still what I expect to happen… But if we don't see a crash to major new lows by year-end, then we may be in for mediocrity and a more-sideways market for a long time.

The paradox is that only a bigger crash and debt detox will allow for a healthier, Millennial-driven boom, and even then, the stock and real estate markets likely will not reach new highs, even into the next natural

demographic peak around 2037. We are witnessing the peaking of the U.S. and broader developed world, which should happen between 2007 and 2037, and the late 2021 top should hold for longer than most of the aging Boomers will live or even beyond.

Q: Household savings and checking account balances remain well above their pre-pandemic level (north of $4 trillion today vs. a little over $1 trillion before the pandemic), as you can see from the attached charts ***[Ed. Note: not attached here]***. Americans are still flush with cash; there is still plenty of money out there. In addition, retail sales are on the rise again. Retail sales still are materially outpacing their 10-year trend, as resilient wage inflation and buoyant deposit balances keep consumer spending elevated. Do you believe that interest rates are too low to provoke the demand destruction necessary to tame inflation?

Overall, the stock market remains in "la-la land," as investors assume that a fairy tale ending is on the horizon. However, since 1948, six of the last seven times that the headline CPI (Consumer Price Index) rose above 5% year-over-year, recessions followed. And with the imbalances much greater this time around, in my opinion a soft landing is extremely unrealistic. Nevertheless, won't the Fed's pause in hiking interest rates actually lead equities to a blow-off top and new all-time highs for the S&P 500 before finally crashing?

A: I think the strong Fed hint at another two 25-bp hikes to come dampened the party over the pause. The good news is in, and this rally could end anytime now. It is already way overstretched. If we don't see stocks turn downward pretty soon, then I'll have to reconsider. I am hoping stocks will turn downward too quickly for the Fed to react and extend the pause or to raise rates again at the next meeting. The next move is a hard one to call, now that the Fed has reversed from massive loosening to the strongest tightening in decades (and have hinted at a bit more to come). I just think that given this rebound from the October 2022 lows, investors have already discounted the good news. The economy may disappoint in the coming months from the tightening already in the system, which will keep hitting on a 12-month+ lag. The next month or two will be key.

Q: The AI optimism seems to be keeping the market up to levels of crack cocaine addiction, as you mention in your Rants. Is it possible that AI could make up for the demographic trends by offsetting lower productivity? I have a bet on the SQQQ at $31 that has gone down to $21. This bet seems like a losing proposition. Nvidia seems to be the magic genie of the AI world, offsetting demographic trends. Thoughts?

A: This rebound has been stronger than I would have expected after 14 months of tightening... and is another sign of the markets "on crack." What needs to happen for stocks to turn back down rapidly—before the Fed can change back to lowering rates and stimulus—is for the economy to start showing unexpected weakness on the 12-month+ lag soon. As I said, the next month or two will be critical. If the stock crash is to continue, the market should head back downward soon; otherwise, it likely will go more sideways and will be hard to predict. We could even see a slight new high on the S&P 500, but if so, we'd likely see major divergences with the Nasdaq and, to a greater degree, the Russell 2000 small caps. I'll be watching with bated breath and hope to come to a clearer conclusion soon.

Q: I am confused by your triangle theory. It can't be a contracting triangle from Nov 2019 or a barrier triangle from June 2022, as both would point to a break on the downside, which would be bullish for stocks. If you start the triangle in June 2022, it doesn't work as a contracting triangle, as wave C would be deeper than wave A, if you think it is currently in wave E.

A: This triangle could be drawn in two different ways, depending on whether the A wave starts at the top in June 2022 or at the bottom in August 2022. I chose the one that fits more with a downward ultimate break in stocks, as that is more what I expect and also is what would be natural at the point where this is hitting. This triangle pattern should merely be an extension of a natural A-B-C bounce that adds another sideways wave, or the D-E. Which interpretation ends up being correct will be seen only after it plays out. That's what makes technical analysis probabilistic rather than deterministic. A downward break below where I drew the E wave would suggest that the A wave should have been placed at the top in June 2022 instead.

Q: For years you have said that there are too many houses and not enough Millennials to fill them and that with Boomers dying off, homes will be plentiful. What has changed, and why do I read about nothing but housing shortages for years to come? What am I missing? Why are there not enough homes?

A: Since the 2008 financial crisis, home builders have been very conservative in building. They got hit hard. The Millennials started their home-buying wave around 2016, and that should continue into 2032. So, demand is rising but supply is very low. Also, the recent 500-bp hikes have locked past buyers into their much lower mortgages. They cannot afford to sell in order to downsize or move, as the much higher rates would kill them. That limits supply even more. But ultimately, the unprecedented high prices will price most out of the market and will kill demand. That should be the next shoe to drop.

Harry

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