Harry's Take

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Reader Mailbag: Questions and Harry's Answers on the Fed, Govt Spending and the Markets

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 and answers on a few topics and send them to subscribers as part of our reader Mailbag series.

Q: What's your best pick at the moment for the possible crash? SQQQ or TLT/TMF

A: SQQQ will move more in early stages and first sharp crash. TLT will tend to explode at the worst of the crisis. So, SQQQ now. I'll look for when TLT looks more ready to explode.

Q: If the market continues to enter a correction phase, would that not cause the 10 year yield to drop because of a flight to safety? Yet, in just the last two days the 10 yield rate has risen beyond what most people were expecting. Will the 10 year drop in the first quarter of 2025 or are we looking at yields rising to 5 percent or maybe as high as 5.5 percent?

A: The 10-year is reacting more to stubborn inflation around 3%. It will take clear signs a recession is starting to form instead to bring inflation expectations down and a strong 10-year rally.

Q: With deflation in the chinese economy. Do you see deflation coming to western economies anytime soon?

A: Yes. This is a global financial asset bubble with China leading it, especially in real estate. China will tend to be the first to blow and then it will spread across the world to Australia, North America, Europe and so on. This is the greatest and longest real estate bubble in history. It's obvious, but most investors won't see it until they see other bubbles bursting.

Q: Where do you see BTC's performance, or pullback happening? And what do you see as a probable timeliness?

A: There is resistance in the $105k to $107k area. Normally on the 4-year cycle, the peak would be in late 2025 around $150k. But it started to accelerate a year earlier. Could mean it peaks a year early and takes 2 years to bottom around late 2026. Or we could see a higher peak in late 2025. A continued break above $107,500 would more favor a late 2025 peak at $150,000+.

Q: How will the Trump presidency, significant government spending cuts (DOGE's estimate of $500B to $2.0T), and AI advancements influence the economic cleansing through a recession in 2025? All three will have a stimulus effect on the economy.

A: The most obvious impact will be the spending reduction from cutting up to $2 trillion a year from the federal budget. That would tip us towards a recession, the opposite of stimulus. $2T is about 7% of GDP which has been growing more like 2% adjusted for inflation. $2T not spent could create as much as a 5% decline in GDP… that's more like a depression.

Q: Can you tell me your thoughts on TLT. Do you think it is worth holding on to with the recent downturn?

A: Yes, TLT is the only major financial ETF that will appreciate when the "everything bubble" bursts, and that looks more imminent. Bubbles are always pernicious and alluring, but they do always burst and with the Fed tightening still in force, 2025 is the most likely time to see that first crash of around 50% that leads to a 80%-90% deflationary crash.

Q: In regards to deflation, even TLT?

A: When a financial asset bubble bursts, everything including real estate goes down, except the highest quality US Treasury bonds and A+ corporate

bonds. They become the safe haven that won't default, and hence will appreciate and not crash.

Q: What are your thoughts on ending the Fed as Ron Paul had been pushing for years? I just listened to his book, and he makes a good case for ending an institution with no constitutional basis. How do you think it would affect the economy? What are your thoughts on some of the DOGE proposals and how that would affect the economy?

A: I would love to end the Fed, at least in its economic steering. You can't espouse the merits of free market capitalism - which are astounding - and then second guess the free markets. Just not likely to happen. Everyone still likes free lunches and feeling like someone is in charge.

It is possible to come into question if this bubble bursts as big as I think. Past bubbles have come more from a strong confluence of economic trends, i.e., Roaring 20s and 90s. But this is the biggest and 100% from Fed money printing and fiscal stimulus mostly during good times. We also need restrictions on deficits, especially in good times when we should run surpluses. Budgets should have to be balanced in 3-year periods outside of recessions, or something like that. Hopefully, there are restrictions passed on the Fed interfering with the economy.

Q: The contraction in M2 since the early spring months 2022 may not be as bad as it looks. I use this chart all the time. It shows M2 has averaged 6.75 percent annual growth over the last 60+ years. Since March 2020 covid stimulus, that average has been a little over 7 percent and for most of 2024 has been tracking its historical average.

The big stunner for me is in the context of long-term price pressures. How can we not have inflation when M2 about doubles every 11 years?

A: First surprise is that 525bps and $1.8T Balance Sheet contraction did not cause greater slowing… but 70% of stimulus has been the deficits and those are still running full force.

But I do think that inflation pressures are stubborn at 3% for the reasons you state, and 425bps despite 100 reduction assumed, is still net tight by 125bps or so. Fed's dilemma is that they are committed to stable 2# target, and can't get there.

Hence, I am assuming that this stubborn inflation is what keeps Fed tight enough to create a slowing which then triggers debt failures and the biggest, longest financial bubble EVER finally bursts and gains momentum faster than Fed loosening enough. Most economists celebrate the longest period ever without a serious recession - COVID doesn't count for me. But I look at: longer the boom/bubble, greater the debt detox to follow!

We'll see. That's why 2025 is a critical year and most likely time for the bubble to burst, while the Fed remains net tight. If not, I may just quit my profession! I know how to predict a real economy, but a fake one ends up in "go until you blow." And that's harder. Bubbles last as long as it takes to suck everyone in!

Harry

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