HOW TO PROFIT THROUGH THE COMING SAFE-ASSET SLAUGHTER

DENT
RESEARCH

We have seen the greatest debt bubble in modern history. Every such debt bubble also sees asset prices from stocks to real estate bubble, and then those bubbles deleverage in the years to follow. That destroys money and wealth, and creates fewer dollars chasing the ame goods. That is the classic definition of deflation. It means that the price of almost everything comes down.

In short, deflation is inevitable…

It followed every debt bubble in history, including the 1870s, 1930s, and ahead. That is precisely what the government and financial institutions have colluded to prevent.

If this massive debt and asset bubble deflates, they are the ones that will be hit the hardest. They borrowed much of the money, made most of the loans, or invested at high leverage in the asset bubble. In fact, deflation is part of the reason the government's irresponsible monetary and fiscal behavior hasn't resulted in run-away inflation... and why it never will.

Between 1942 and 1968, the U.S. economy enjoyed a boom driven by the rise in spending from the Bob Hope generation. This turned into an inflationary bust from 1968 to 1982, when they stopped spending and the Baby Boomers were entering the workforce at great expense. The growth boom that followed saw the creation of the biggest bubbles in history as powerful computer and internet technologies moved mainstream, while inflation and interest rates fell from rising productivity. And in 2008 we turned the corner again to head into a deflationary bust that will last until 2023.

Ultimately, it's all about people. We are what drives the rise and fall of our economy.

When revolutionary changes in medicine and agriculture in the 1940s transformed our standards of living, our health, diets, and our fortunes, we added 108 million more consumers to the economic pot through the massive Baby-Boom birth wave and the largest immigration wave in U.S. history.

Over the last three decades, these Baby Boomers bought houses… then McMansions… then holiday homes in exotic places. They bought cars, SUVs, minivans, and sports cars.

Home prices skyrocketed. Industry ramped up production.

Everyone was living the American dream.

Then in 2008 they ran out of money. They had maxed out their credit cards and suddenly couldn't balance the budget every month.

They'd hit a wall. A slight increase in interest rates and millions of Americans could no longer meet their monthly mortgage repayments. Then they could no longer make their credit card payments. Then they could barely get food in the house.

At the same time the wheels were coming off, the leading edge of 108 million Baby Boomers began to prepare for retirement with greater urgency. All of this set into motion a shrinking of the money supply.

Consumers borrow more to buy homes, cars, and furniture. This increases the economy and the money supply. Then the Fed lowers interest rates every time we have a crisis, and that encourages people to borrow even more. That's how you get a debt bubble. As the economy continues to grow and interest rates continue to fall from rising productivity, speculation increases and asset bubbles inflate in stocks, real estate, and commodities.

When times turn deflationary — when people stop spending money at their disposal and start paying back their debt — suddenly there's no more air for the bubbles. The more people save and pay down debt, the more the economy falls, the more debt deleverages, and the more asset prices fall. This creates a deflation spiral like the 1930s, unless governments step in and inflate massively to offset such natural deflation.

That's what's happened since governments began QE more than a decade ago. Yet, no matter what central banks do, it's not going to make consumers spend more. As demand dwindles, prices come down. That's why we face a safe asset slaughter ahead.

So what can you do to protect yourself? Start by looking to the dollar, which gains value during a deflationary period.

Cash is King!

Currencies aren't like stocks or bonds in that they have no "intrinsic" value, so to speak. You can "correctly" value most stocks by estimating earnings or dividend stream years into the future and then applying a "discount rate" to tell you what that earnings or dividend stream is worth in today's dollars.

It's messy and subjective, of course. But at least, at the end of the day, a share of stock represents a piece of a real business, and that business has value.

Likewise, you value a bond by discounting its future interest and principal payments to present-day dollars. Again, it's messy and depends on your assumptions for inflation, default risk, and any number of other variables. But you're buying a future income stream, and that income stream has value.

Currencies are not like that. There was a time, not that long ago, when major currencies were backed by gold. But since Richard Nixon officially closed the gold window, all world currencies have been backed by the "full faith and credit" of the government that issued them… whatever that means.

I'm not here to romanticize the gold standard. It was far from perfect as a financial system. My point here is simply that currencies have no intrinsic value. They can only be valued relative to each other. So, when someone tells you the dollar is going up or down, your next question should always be, "Relative to what?"

Dollar bears seem to miss this point. They often highlight that our government spends too much money… or that the Fed creates money out of nothing.

Well… every other country does the exact same thing, but often on a bigger scale.

Let's use Japan as an example. If you think the Fed is irresponsible… well, our guys are a model of propriety and respectability when compared to the Bank of Japan. When the Fed owned about 13% of all outstanding U.S. federal debt, the Bank of Japan owned 40% of all outstanding Japanese government bonds… And the Bank also snapped up about 70% of new bond issues. For all intents and purposes, Japan's central bank was directly funding the Japanese government budget.

Given all this, the yen should have been on the express train to zero. But there was a problem: Ironically, it tended to rally during global financial crises.

Here's why…

Since the Japanese equivalent of the Fed funds rate had been stuck at zero for years, the yen was the favored currency for the "carry trade." One of the most popular macro trades in history was to sell low-yielding currencies and invest the proceeds in higher-yielding currencies and bonds, earning a profit on that spread.

Well, when the markets got rocky, traders closed out their carry trades, and so had to buy yen. This pushed up the price of the yen relative to other world currencies.

So, even though Japan remains a ticking time bomb, shorting it is extremely dangerous.

The euro doesn't have these issues, so it is a significantly safer short.

That's why I want to introduce the ProShares UltraShort Euro ETF (NYSEArca: EUO).

This ProShares fund allows us to go aggressively long the U.S. dollar by shorting the euro using forward contracts. The ETF is designed to move by about double the daily change in the exchange rate. So, if the euro dropped 0.1% relative to the dollar, EUO should rise by about 0.2% that day.

What Makes Currencies Move?

Currency moves tend to be pretty random in the short-term. But over longer periods of time, money tends to flow where it is treated best. And in the case of currencies, that means that money tends to flow to the countries with the highest overnight interest rates (the equivalent of the Fed Funds rate).

Well, today the American Fed Funds rate is 2.5% as of March 2019. The European Central Bank's rate is sitting at a big, fat 0% with no immediate plans to change. So, all else equal, we should see money flows making their way to U.S. shores over the next year.

Inflation – or expected future inflation – also plays a role in currency movements, and it was one of the reasons the dollar was beaten up in 2017. Investors assumed that a Trump presidency, together with a Republican congress, would be inflationary.

Needless to say, that hasn't been the case. Trump and his fellow Republicans can't seem to agree on much. They did pass the corporate tax cut, of course, causing our national debt to rise by another $1 trillion to $2 trillion over the next decade (by Congressional Budget Office estimates). But sadly, with debt already over $20 trillion, it's hard to see an extra $2 trillion really moving the inflationary needle much.

U.S. inflation rates are hovering around 2% today, a little higher than the 0.78% in Europe. The difference in overnight interest rates more than compensates for the slight difference in inflation.

For what it is worth, the U.S. Federal Reserve is mostly out of the quantitative easing business. And in fact, has been working to reduce it's balance sheet. All else equal, that is anti-inflationary and should help to support the dollar.

Europe was slowing its quantitative easing… but may not be done yet.

I'm not blind. I'm well aware of how reckless the U.S. government and Federal Reserve can be. But again, it should be pretty obvious that the dollar is still the best house in a bad neighborhood. And I expect that we'll see profits in EUO as the dollar continues to rule the roost.

Action to Take: Add to your watch list ProShares UltraShort Euro ETF (NYSEArca: EUO). Do not buy yet though. We will send a buy signal when adding this play to our official *Boom & Bust* portfolio, so be sure to read your weekly *5 Day Forecasts* and monthly issues when they arrive.

Income Producing Assets Win in a Deflationary Environment

If you believe that the U.S. dollar is poised to remain strong in the years ahead, like we do, then high-quality, income-producing assets make all the sense in the world.

Let me introduce the BlackRock Municipal 2030 Target Term Trust (NYSE: BTT), which owns a diversified portfolio of high-quality, tax-free municipal bonds.

Closed-end funds (CEFs) like BTT are very different from the mutual funds you've bought in your 401k plan and elsewhere. They trade on the NYSE, like stocks and like another type of fund you've probably heard of: ETFs.

But while they superficially look the same, CEFs and ETFs are very different animals.

ETFs are generally designed to track an index, and when their prices deviate from the index, large institutional traders can force the price back into line by creating or destroying ETF units.

Well, that mechanism doesn't exist for CEFs. So, the price of the fund can wildly deviate from the value of its underlying portfolio net value (the value of the holding minus any debt).

This means you can often buy a dollar's worth of high-quality stocks or bonds for 90 cents… or even less. You just have to be patient and wait for your moment.

Well, we have one of those moments now in BTT. At time of writing, the fund is trading at 9.1% discount to NAV, meaning we're paying less than a dollar for a dollar's worth of assets. And we're getting paid an attractive 4%... tax free. If you're in the 35% tax bracket, that 4% is the equivalent of a 6.2% taxable yield, which is pretty darn good these days.

In the next bear market, investors will dump their stocks and high-yield bonds and will run to the safety of high-quality Treasurys, AAA-rated corporate bonds, and safe municipal bonds. And when they do, you should see the prices of muni CEFs like BTT enjoy very nice runs.

Action to Take: Add to your watch list BlackRock Municipal 2030 Target Term Trust (NYSE: BTT).

Short the Stock Market

You probably remember the 2008 meltdown. If you're like most investors, you watched helplessly as your 401(k) plan and other accounts saw their values sliced in half.

But while 2008 was unique in terms of day-to-day volatility, it wasn't especially different or unique as a bear market. From peak to trough, the S&P 500 lost 57% of its value in that bear market. In the 2000-2002 bear market that followed the "dot com" crash, the S&P 500 gave up a full 49%, and the Nasdaq lost nearly 80% of its value.

But let's go back even further in time. In 1987, the year of the largest single-day market crash in history, the S&P 500 was down 34% peak to trough.

In the 1973-1974 bear market, which corresponded to the oil embargo, the S&P was down 48%. And going even further back, to the great 1929 crash and the Great Depression that followed, the market was down nearly 90%.

Most investors that lived through these bear markets took heavy losses. Many ended up swearing off the stock market forever, and missed out on the bull markets that followed.

But some investors actually made money by actively betting against the market as short sellers.

A lot of investors are intimidated by short selling and consider it risky. But the truth is that shorting stocks is not any more dangerous that buying them, so long as you're disciplined, you're willing to patiently wait for your opportunities, and you stick to your risk management.

I'm not going to recommend a short position right now because, frankly, the right conditions are not in place.

The logistics of shorting can also be somewhat intimidating as well, as you have to borrow the shares from another investor in order to sell them. But with inverse ETFs such as the Proshares Short S&P 500 ETF (NYSEArca: SH), shorting has never been easier. The ETF moves inverse to the S&P 500, meaning that for ever 1% move down the S&P 500 makes, SH rises by approximately 1%.

But the time to short is coming soon, so you'll want to be ready for it. So, please do the following:

Action to Take: Put the Proshares Short S&P 500 ETF (NYSEArca: SH) on your watch list but don't buy it today.

We'll wait for Harry's safe asset slaughter scenario to play out, and then we'll buy SH and profit while the market tanks.

Boom & Bust

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