



Our Weekly Paid Newsletter

Richard Cluver Predicts

In our 34th year of service to the investing public of South Africa



Volume: 34

Issue: 10

12 March 2021

Many readers of this column read my 2019 book 'The Crash or 2020' and so you will be broadly familiar with my then thesis that a black swan event originating in China would trigger a global share market crash in response to which major governments would vastly increase their already gross indebtedness to try to ward off the next Great Depression.

If you care to turn back to the book you might read, "The likely trigger event for the next global share market correction could originate in China where, in its rush to grow it has built far too many buildings, produced far too much steel and other commodities and made far too many bad loans." As China has begun re-building its economy since the lock-down, that fear is arguably now being exaggerated and poses a new threat!

But to continue my 2019 thesis, I was concerned then that the interest burden of the resulting debt of nations would bring leading governments ever closer to the day when the sum of their tax income would be insufficient to meet the cost of servicing that debt. Only two options would then remain, to either use their central banks to flood the system with so much money that interest rates would be driven downwards making debt-servicing more manageable or, alternatively, to create an explosion of monetary inflation which would erode the debt. But either way, so much new money would normally make inflation a high probability.

There is nothing new about this problem. Global debt has been growing steadily ever since the post-war Bretton Woods agreement freed national governments from the discipline of maintaining central bank reserves of bullion and hard currencies. Furthermore, since debt required less accountability than tax increases, it enabled governments to indulge in vote-grabbing social welfare programmes and as a result, as each global financial crisis and subsequent rescue attempt has ended with ever-greater global monetary supplies, sovereign bond interest rates have steadily fallen.

In my graph below, the purple trend line shows how the yield of US five-year bonds has fallen at compound 13.4 percent annually since the Asian crisis of 1997 which saw America intervening to support Thailand. That crisis began with the collapse of the Thai baht because the Thai government lacked sufficient foreign currency to support its currency peg to the US dollar. Capital flight ensued almost immediately beginning an international chain reaction which soon engulfed most of Southeast Asia and Japan. Slumping currencies devalued their stock markets and caused a precipitous rise in private debt. The effect of that Fed issuance was a massive 40 percent decline in the yield of US 5-year bonds from 6.76 percent to 4.05 percent as my first red trend line on the left highlights.



Over the next two years the US Federal Reserve was able to gradually recover the effects of that issuance bringing bond yields up to the same level as before as highlighted by the first green trend line on the left. But it was not to last. The 'Dot Com' bubble on Wall Street, caused in large measure by the excess of money printed by the US Federal Reserve to cope with the Asian Crisis subsequently finding its way into the hands of share market speculators, saw the Nasdaq Composite stock market index rise 400 percent.

Then the bubble burst and the Nasdaq fell 78 percent taking with it a slew of major online shopping companies, such as Pets.com, Webvan, and Boo.com, and communication companies, Worldcom, NorthPoint Communications, and Global Crossing. A few like Cisco, whose stock declined by 86 percent Amazon.com, and Qualcomm, lost a large portion of their market capitalization but survived.

Fearing another recession the Fed again intervened and the consequence was my second descending red line and this time the yield fell from 6.68 percent to 2.11 and this time it took four years to partially recover to a yield of 5.18 percent before the United States subprime mortgage crisis struck in 2007. It quickly became a global crisis which, but for Fed intervention, would have brought down a range of merchant banks which were judged "too big to fail." It was triggered by a large decline in home prices after the collapse of a housing bubble and led to mortgage delinquencies, foreclosures, and the devaluation of housing-related securities.

This time, note my third declining red trend line, the 5-year US bond fell from 5.18 percent to 0.58 over a five-year period and it took over six years for the rate to gradually claw back to only 2.94 percent leaving the Fed with little ammunition to intervene when a recessionary phase began in late 2018 and worsened when Covid-19 followed in 2020. This time the yield fell to 0.22 percent last August and it has had a catastrophic impact upon the pensions industry making it impossible for many Baby Boomers to retire which has in turn severely impacted youth unemployment.

Now the world economic crisis which I warned was pending in my latest book has moved immeasurably closer as a result of Covid. Governments, companies and households raised \$24 trillion last year to offset the pandemic's economic toll, bringing the global debt total to an all-time high of \$281 trillion by the end of 2020, or more than 355% of global GDP, according to the Institute of International Finance. Worse, however, is the fact that central banks no longer have any ammunition to counter another crisis because of the obvious fact that it is impossible to lower bond rates below zero.

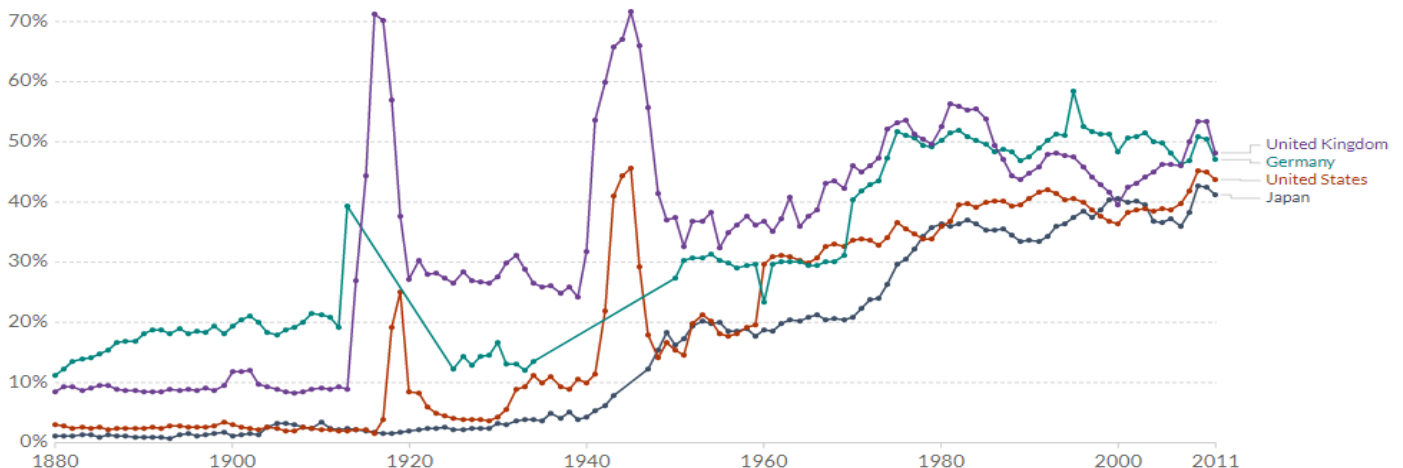
Once upon a time the universal government solution to debt was to raise taxes. But apart from the obvious fact that the world is in a severe recession as a consequence of the pandemic and increasing taxes in such circumstances might well push it into a full-blown depression, global tax levels are already at historic highs. Prior to the introduction of the Welfare State in the 1920s, few governments gathered in more than ten percent of the earnings of their citizens. That is why, economists tell us, the Industrial Revolution was able to happen. But after the Welfare State came about and the idea spread around the world, taxes rose steadily until they peaked around 30 percent in the United States, 40 percent in Britain and at 50 percent in most of Europe.

Government spending, 1880 to 2011

Total government spending, including interest government expenditures, as share of national GDP

Our World
in Data

+ Add country



Indeed, as a percentage of GDP, government spending is already at an historic high and is the major reason for the global recession we are experiencing. So additional direct taxation is impossible. But without it how might debt be reduced?

Inspired by the fact that their abuse of the monetary system to engineer low interest rates has simultaneously allowed people like hedge fund managers to become overnight billionaires, many governments have recently toyed with the idea of a wealth tax to enable governments to settle their debts. However, the sobering fact is that in 1990, twelve countries in Europe had a wealth tax. Today, there are only three: Norway, Spain, and Switzerland. Most governments eliminated the tax because it was problematic in design and enforcement but mostly because they often hit people with plenty of assets but little cash on hand to pay the taxman. Worst of all, it has almost always cost more to collect than it effectively brought in.

Others, like the ANC recently, have been eyeing the accumulated savings of the Baby Boomers as a potential lifeline. Recent experience has shown politicians that idea also cannot fly. Having floated an alternative idea of a two percent wealth tax which initially seemed to strike a popular accord with a US public grown weary of billionaires as a result of the Donald Trump presidency, two recent contenders for the US presidential nomination, Senators Elizabeth Warren and Bernie Sanders arguably lost their chances once the voting public - who were as retirees often asset rich but income poor - realised that the bulk of Americans would be caught up in that sweep.

Here in South Africa, an idea to make it compulsory for ALL pension money to be invested in government bonds met with such outrage that it had to be abandoned. Public experience of how apartheid era public service pensioners were impoverished by this measure also made it a non starter.

Governments have accordingly been left with the belief that there is only one way left to deal with their debt and that is to use monetary inflation to drive down the face value of their currency denominated sovereign bonds. That is why investors globally have been keeping a very sharp eye on US bond rates for fear that any increase might be a harbinger of the inevitable inflationary backlash. And just that has begun – note my enlargement of the recent period of my original graph which, in large measure explains why many fear a fresh share market collapse. That red trend line, moreover, is climbing at an annualised rate of 960 percent which provides good reason for investor alarm.



Now economic theory is that interest rates lie at the heart of all securities values and that bond yields and dividend yields are thus immutably linked. From that it is deduced that if bond yields increase, share prices will need to fall in order that, in the absence of increased corporate profits, dividend yields might also rise. But that view obviously stems from an earlier period in history before central banks started printing money and logically broke the link.

In the following graph I have compared the same US 5-year bond yield with Wall Street's widest measure of share price movements which makes it clear that the although theory still seemed to hold true in the late 1990s – before they began printing excess amounts of money - and that it was partially true between 2009 and 2012, but recently both markets moved more or less simultaneously.... presumably as a result of central bank stimulation. But remember that option no longer exists! So there is reason to be concerned about the rise in US bond rates.

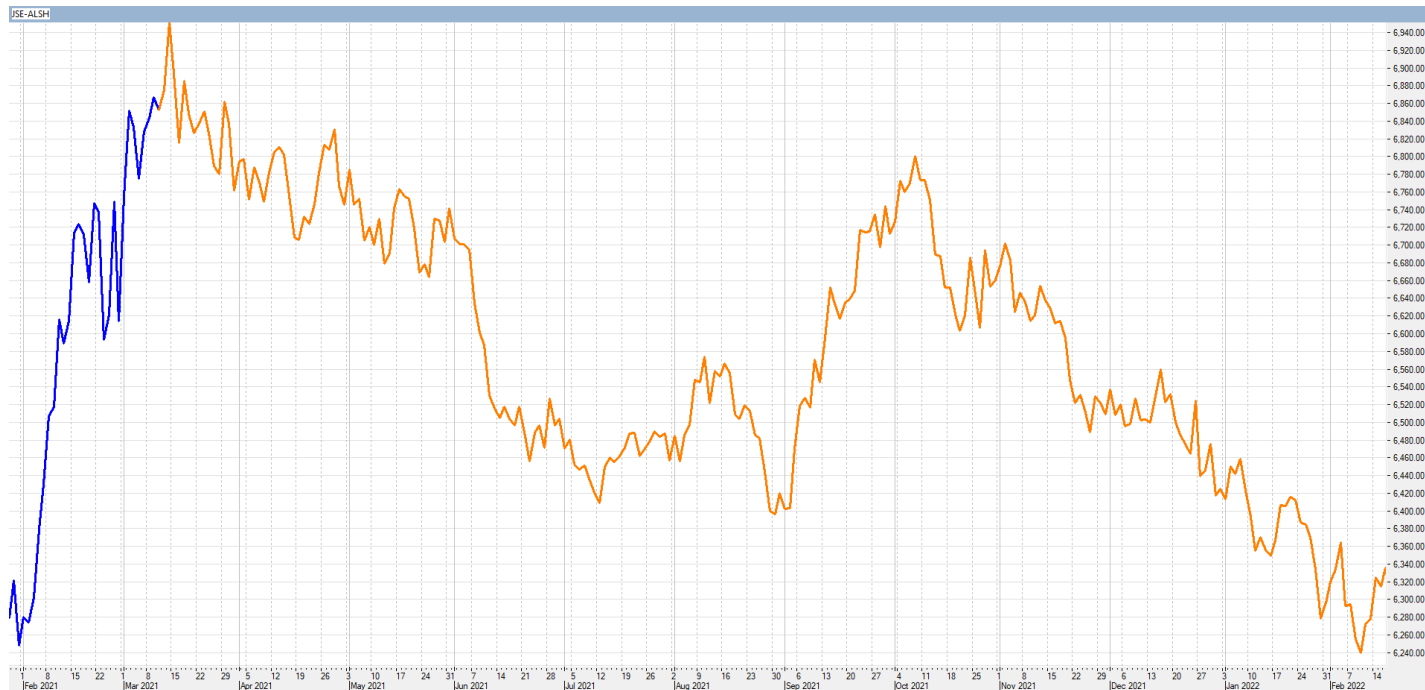


Excess diversion of the wealth generated by the private sector to governments whose employment of that money on social rather than infrastructure expenditure has throttled economic growth and engendered global recession. Thus, when governments try to initiate GDP growth by, for example, channelling increased amounts of money to low income consumers whose resultantly increased retail spending triggers apparent GDP growth, investors who fear the onset of inflation accordingly rush to buy blue chip shares. Bond buyers, for the same reasons will only buy bonds when yields rise to match their inflationary expectations.

Meanwhile US inflation numbers came out this week at 0.4% which was in line with expectations though Core CPI, which excludes volatile food and energy prices, rose 0.1 percent below expectations. And that seems to have tamed the market for now. After sharp declines from mid-February until last Friday, the New York stock exchange is again on the way up and ShareFinder sees this continuing until late May when the next set of jitters seems on the cards:



The result has been to give the JSE a temporary new lease on life but ShareFinder expects it will be over after the close of trade today. Then it will be down-hill for a year with a temporary reprieve for six weeks at the end of August:



In closing I should add that in The Crash of 2020 I proposed an alternative means of paying off the national debt which was pioneered by the City of Durban in the 1980s which got buy-in from ratepayers for a debt-buster levy in return for a promise that rates would be steadily reduced. It worked. Durban became debt free and then began investing its surpluses which resulted in a series of subsequent rate reductions. However, since the city ceased honouring that promise once the ANC gained control and has been running up debt once more, Durban has since become South Africa's most highly rated city. Arguably then, it is probable that the South African public would not trust the government with a similar national project. But it was a good idea at a time when there was no politics in local councils and when citizens trusted their local councillors!

Do enjoy your weekend

The month ahead:

New York's SP500: I correctly forecast a recovery which I now see lasting until late May and then a decline to early August followed by another recovery until next January.

Nasdaq: I wrongly predicted the decline would continue. Now I see gains until early April followed by a month-long correction and then gains through May and June before the next phase of weakness.

London's Footsie: I correctly predicted volatile gains which I still see until mid April and then a steep decline until mid-July.

Germany's Dax: I correctly predicted gains which I still see lasting until early April ahead of a big decline until mid-June.

France's Cac 40: I correctly predicted the recovery would continue towards a peak in mid-April ahead of a long decline until late December.

Hong Kong's Hangsen: I correctly predicted the end of the down-spike but the recovery is likely to be very brief. I see declines from the 16th until April when a six-week recovery is likely ahead of a long slide down to mid-July.

Japan's Nikkei: I correctly predicted a new up-phase should last until mid-April before turning down until mid-June.

Australia's All Ordinaries: I correctly predicted a decline until late March followed by a strong up-tick beginning now to mid-May and thereafter a fresh bear phase until mid-September... and my views remain unchanged.

JSE Top 40 Index: I predicted the start –probably today - of a long declining phase until July when I expect the market to bump along the bottom until late-August when quite a sharp recovery is possible.

ShareFinder JSE Blue Chip Index: I prematurely predicted the beginning of a volatile decline which has now begun. However, it is likely to be brief followed by a recovery from the 24th until mid-April when the next long decline should last until September.

Rand/Dollar: I wrongly forecast weakness. Now I see gains until the end of June.

Rand/Euro: I correctly forecast the beginning of a brief recovery until mid-March followed by weakness beginning early in the new week until the end of the month and then gains until early September.

The Predicts accuracy rate on a running average basis since January 2001 has been 86.08 percent. For the past 12 months it has been 92.88 percent.

Flood of New Debt Tests Weakening Bond Market

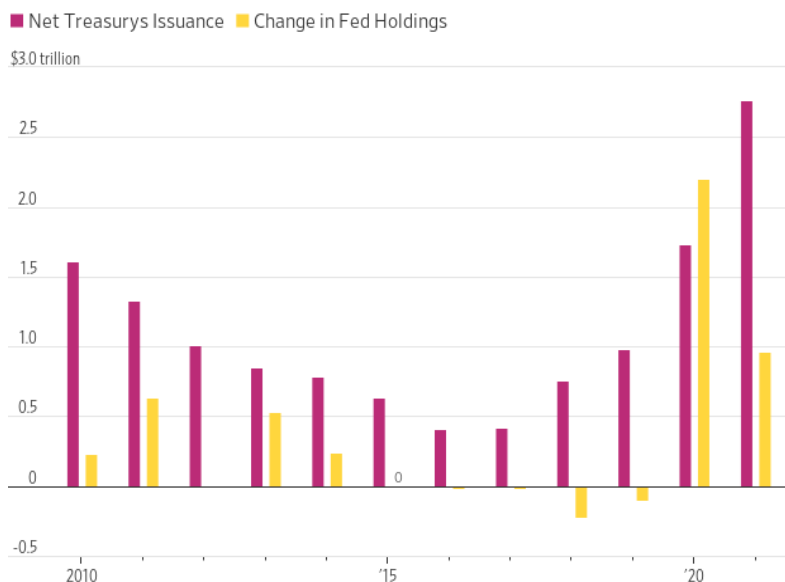
By Sam Goldfarb of the Wall Street Journal

Some on Wall Street see signs the U.S. government's extraordinary borrowing spree is starting to test investors' appetite for new Treasury debt.

Over the past few months, [falling bond prices](#) have pushed the yield on the benchmark 10-year U.S. Treasury note from about 1% to more than 1.5%, around its highest level in more than a year. Most investors think the climb largely reflects expectations for a vaccine- and stimulus-fueled economic resurgence that could eventually lead the Federal Reserve to raise short-term interest rates.

Another factor pushing yields higher, many analysts and traders say: the sheer volume of Treasuries now flooding the market—a byproduct of the trillions of dollars the government is spending to support the economy during the coronavirus pandemic.

Treasurys Supply Vs. Fed Buying



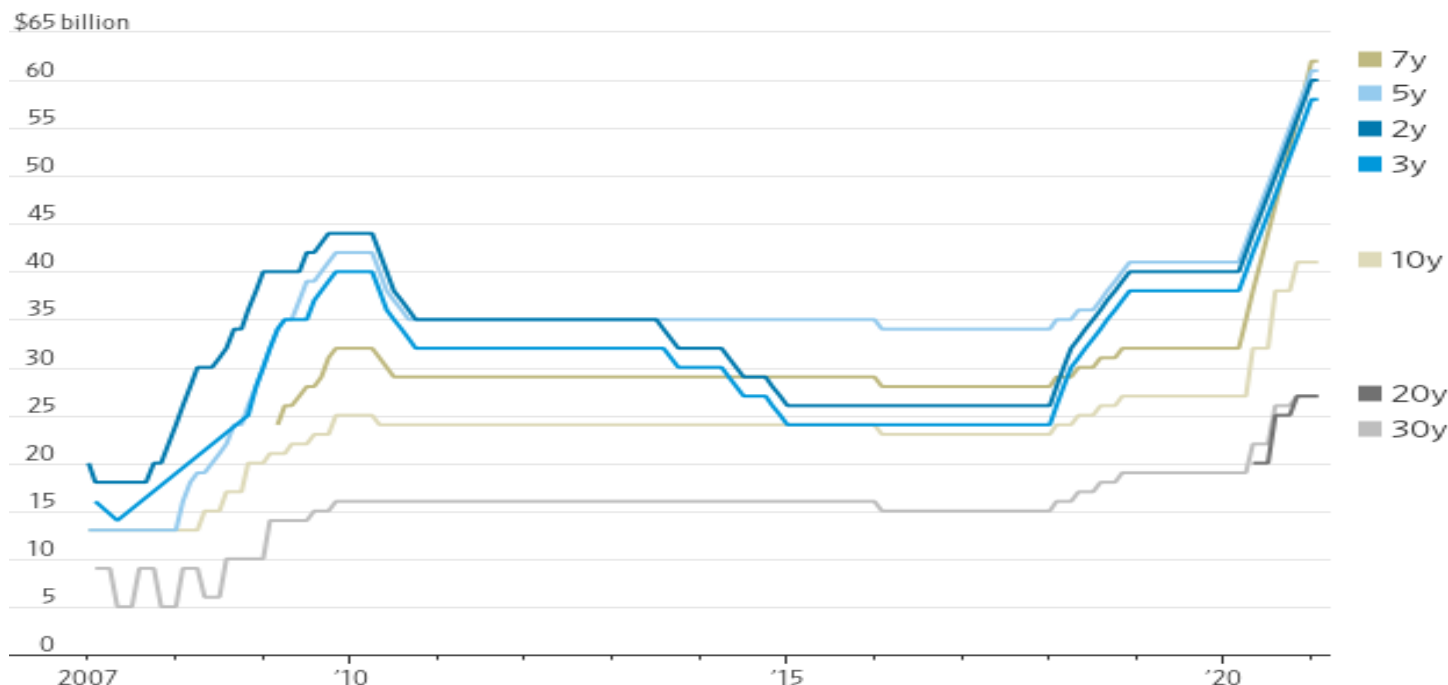
Source: BofA Global Research

"Richard Cluver Predicts"

March 12, 2021

Page 6 ©2021 Sharefinder International

Treasury Debt Auction Sizes



Source: BofA Global Research

Net new supply of two- to 30-year Treasuries is expected to reach \$2.8 trillion this year, according to BofA Global Research, up from \$1.7 trillion last year and around \$990 billion in 2019. The Fed, meanwhile, is expected to purchase \$960 billion of Treasuries, down from more than \$2 trillion last year.

Supply may not be the primary factor driving yields higher. But it has been an accelerant, weighing on the market precisely because [the economic outlook](#) has already made investors hesitant to buy bonds, traders say.

“It just makes everything so much worse,” said Daniel Mulholland, a senior bond trader at Crédit Agricole. The size of Treasury debt auctions is “completely out of control,” he added.

Perpetual Boom

By Jared Dillian

Let's talk about the business cycle for a second. Like the fact that we don't have one anymore.

In the old days, we used to get expansions and recessions. The authorities generally didn't mess around too much with the business cycle.

If they did, they did it in a countercyclical way—hiking interest rates when the economy got hot, and taking the punchbowl away.

Nowadays, the authorities act in a *procyclical* way, easing monetary policy even more in the middle of a roaring expansion. This has left us without a business cycle.



- **We are now constantly in a state of a perpetual boom, punctuated by the occasional sharp crisis where we all have a near-death experience.**

That is a function of monetary policy, yes. But it is also a function of going off the gold standard in 1971. Most of the economic distortions that we experience today can be traced to that cataclysmic event.

One could make the argument that if we hadn't experienced a global pandemic, then the economy would have never gone into recession. Twelve consecutive years of economic expansion, and possibly more.

That falls under the definition of perpetual boom, punctuated by the occasional crisis, which we had about a year ago.

- **The perpetual boom model is perhaps the most important thing to understand about today's markets.**

That's because it has implications for the underlying distribution of asset prices. It also has implications for [volatility](#) and [options trading](#). It even has implications for how you conduct your daily life.

Let's talk about this.

Stocks

Stocks basically go up all the time, and when they don't, they crash. What kind of distribution is this?

It's not a normal distribution, that's for sure. It's a bit skewed to the right, with a massive left tail.

Now, if I had the mathematical tools, I could graph this distribution, and then look at option prices, and graph an implied distribution based on that, and compare them.

I think what you'd find is that the tails are massively underpriced. And we know this to be true because performance of tail-risk funds has been pretty good.

From a risk-management standpoint, it puts you in a little bit of a pickle, because you're supposed to stay fully invested—and then experience a breathtaking drawdown every so often.

- **This puts people in a position where they have to hedge—and very few individual investors are sophisticated enough to hedge.**

Plus, hedges are expensive, and few investors have the fortitude to buy money-losing puts every month.

It also makes the [Awesome Portfolio](#) even more awesome—because diversification across asset classes becomes even more important. Under the perpetual boom/crisis model, a portfolio of 100% equities becomes almost impossible to hold as a long-term investor.

Your Life

In a perpetual boom world, where we have frequent crises, there is a good chance that you are going to lose your job.

In a normal economic cycle, there are always layoffs. But the downturns are a bit more gentle, and businesses can often cut costs in other ways so as to minimize layoffs.

But when it looks like the world is ending, like what happened last year, businesses simply disappear, and millions of jobs are lost.

You might say that the pandemic is a bad example—it was a big, exogenous event, after all.

- **In a normal economy without as much leverage in the system, that wouldn't turn into an end-of-the-world event, where people are actually contemplating shutting down the stock market.**

That's how bad things got last year, because we went into the crisis with an insane amount of leverage. There's even more leverage today.

The tail-risk guys tend to be libertarian macro doom guys. They often go around predicting financial collapse and a return to the gold standard. They've been singing this tune for 20 years or more, but we're getting closer to that day (though it still might be years away).

I am not too much into financial philosophy, but keep in mind that a flexible monetary standard is a pretty short experiment—only about 50 years. And except for a few hiccups, we've managed to keep the global economy in perpetual boom mode.

- **But what if we've merely lengthened the business cycle, not eliminated it?**

What if, following a 50-year boom, we have a 50-year bust? What would *that* look like?

If that happens, there will obviously be bigger things to worry about, but an 80% stocks/20% bonds portfolio is not going to work in that scenario.

We have a lot of debt and money printing. More than 25% of all money in existence was printed in the last year.



Source: [St. Louis Fed](https://fred.stlouisfed.org)

When I tell people that sorry statistic, they typically look at me and ask, is that sustainable? And I just shrug. Party on.

But we're setting ourselves up for a much, much bigger crisis down the road. The real problem with big crises is that they change politics in fundamentally malignant ways.