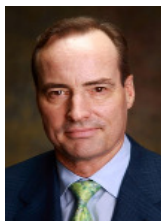


Q&A with Harry Dent on the current economy and his upcoming book, *The Great Depression Ahead*

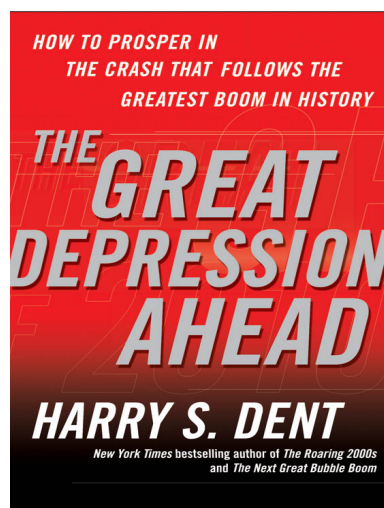


Harry S. Dent, Jr.,
is also the author of:

- The Next Great Bubble Boom
- The Roaring 2000s Investor
- The Roaring 2000s
- The Great Boom Ahead

THE GREAT DEPRESSION AHEAD: How to Prosper in the Crash that Follows the Greatest Boom in History

The new book is due to be released in
early January 2009.



Q: Why do you classify the current economic downturn as a depression rather than a recession?

A: Depressions occur after long bubble booms like 1816 – 1834 and 1914 – 1929, and now 1983 to 2007/2009. Such bubbles leverage capital for exploiting and experimentation in radical new technologies and business models when they first move mainstream and create new economic models for prosperity that last for many decades to follow. Such bubble booms bring stock, real estate and commodity prices to unsustainable levels. When the fundamental demographic and technology trends underlying such booms finally wane, the bubbles have to deflate and this results in a “survival of the fittest” shake-out that makes the best businesses and new business models even stronger. These businesses gain market share and scale which makes them more cost effective, and the deflation of asset values brings costs and prices down as well. Are high real estate values really good for our cost of living and business costs long term, or for the next generation that are our kids and grandkids? This very difficult crisis paradoxically brings new technologies and products to greater affordability and lays the groundwork for a middle class boom in prosperity to follow – as opposed to the “rich getting richer” bubble booms like 1914 – 1929 and 1983 – 2007. There will be a broader-based boom that favors the everyday household and worker in the 2020s and beyond, like the boom from 1942 – 1968.

Q: How long do you predict the current conditions will last?

A: This present crash and severe downturn will likely last into mid- to late 2012, with a minor reprieve into early to mid-2009 for stocks and a temporary economic recovery from mid- to late 2009 into as late as early to mid-2010 – from the strong stimulus and rescue plans in the U.S. and around the world. But that rebound, if it occurs, will be quickly thwarted by rising inflation,

interest and mortgage rates and commodity/oil prices into late 2009 to mid-2010. Then, inflation becomes the problem and governments can't keep stimulating the economy and will have to raise interest rates instead. That and higher oil prices bring down the economy by mid-2010 and we finally see the necessary deflation and depression to bring real estate, stock and commodity prices to much lower, more sustainable levels to foster the next boom when demographic trends turn up again from 2020/2023 into the mid 2030s and beyond.

Q: In *THE GREAT DEPRESSION AHEAD*, you write a lot about the “three bubbles” or the “three bears.” Can you explain these and the role they have played in the current market?

A: There has been one bubble after the next in this “greatest boom in history” driven by the largest generation (baby boomers) and the most powerful technologies (Internet/personal computing). After the tech bubble peaked in 2000, the massive investment flows rushed into real estate – with the aid of very low interest rates from the Fed and the minor recession of 2001. When housing went to extremes and crested due to peak baby-boom home buying in 2005, investment flows went into commodities and emerging markets. Now, they all have started to deflate due to the credit implosion from bad loans and the extreme levels of securitized debt and derivatives that made risky loans look less risky, and were often rated AAA when they shouldn't have been. The investment industry was desperate for new fixed income returns of 6% plus when interest rates dropped so dramatically (with the aid of the Fed) in the last downturn in the early 2000s. Hedge funds emerged to use leverage to create equity returns more in line with the strong returns of the 1990s equity and tech bubble, even after such returns declined to more normal levels in this decade. When housing started to fail due to predictable demographic trends (that we forecast in 2003 and 2004), these often highly leveraged investment strategies started to melt down and created the subprime and banking crisis of 2008, which will continue into at least mid-2009 before the massive stimulus plans likely start to kick in – if at best they actually work to stem the tide of imploding credit. But by mid-2010, the long term baby-boom trend of spending will slow down either way and create a greater crisis in economic growth, home values, derivatives and the banking system.

If the massive stimulus plans cannot stem the credit contraction, then we could see the deflation or depression stage set in during 2009, although our demographic indicators suggest that there could more likely be a minor rebound starting in the second half of 2009. But here is the key point: Even if that rebound occurs, we will finally enter the “Next Great Depression” by mid- to late 2010, despite the government efforts to stimulate our economy out of this crisis. Any substantial recovery will be met by rising inflation pressures, interest and mortgage rates and commodity prices that will create the next bubble and crisis. Why can't the Fed and U.S. Treasury calculate that long term interest rates — that are way below inflation rates now — will accelerate dramatically towards 5% to 7% 30-year Treasury rates and 7% to 9% 30-year fixed mortgage rates if there is a recovery? And oil prices could go back to \$110 to \$170 in a short period of time. That would kill any chance of a housing recovery and put the banks and economy back into a major crisis again. Governments will then be out of ammunition from their present stimulus efforts/borrowing and we will fall into a deflationary environment just as baby boomers are finally set to slow their long term

spending spree by 2010 that sees all three bubbles or bears deflate: real estate, stocks and commodities!

Q: You say that investors should keep their investments in cash to the greatest extent possible right now? What about the stock market? Will any stocks do well in a downturn?

A: The truth is that we are likely close to a low in stock and commodity prices from the panic-selling of highly leveraged hedge funds recently. We possibly bottomed near term at 7,450 on the Dow in November or will do so soon on much stronger support between 7,000 and 7,200 (the 1998, 2002 and 2003 lows) in early 2009. The Dow is likely to rebound with the impacts of the stimulus plan into early to mid-2009 and commodity prices are likely to rebound and even possibly make new highs into late 2009 to early 2010. It is better for investors to hold stocks and invest more in commodities near term on any further weakness. The worst place to invest now is long term bonds (where many investors are running to for safety) that will be crucified by a likely sharp rise in short term and long term interest rates if the economy recovers in the latter half of 2009 and beyond. Once stocks rebound to somewhere likely between 9,800 and 11,800 (10,800 more likely), investors should sell stocks and reinvest in commodities or safe short term cash/cash equivalents like T-bills or Swiss francs, etc. Then, when the commodity and interest rate/inflation trends peak between late 2009 and early 2010 (if there is a recovery in the latter part of 2009), they should switch to long term bonds and play the greatest bond bull market since 1931 – 1942 and 1980 – 1986 and take advantage of both high yields and falling interest rates for appreciation to boot. That opportunity is likely to come in a temporary inflation scenario into late 2009 to as late as early 2010.

Q: Your theory suggests that baby boomers and their spending have created much of the downturn we see today. Can you explain?

A: That is only partially true. The baby boomers will predictably create a greater slowdown from around 2010 forwards, even if we didn't have this subprime/banking crisis or \$147 to \$170 oil prices. We predicted in 2003 and 2004 that the housing boom would peak by 2004 to 2005 due to demographic spending trends that peak by age 42, earlier than the overall peak in spending and the broader boom between the ages of 46 and 50 – around late 2009 or so. The peak baby boomers still have their kids in school or college and still need to spend to support their kids until they leave the nest – again, more around 2010. That is when we see the real long term downward trend in spending that hit Japan (as we predicted in 1988 – 1989) in the 1990s and early 2000s. Baby boomers have peaked in housing spending for a long time to come, and the credit contraction has hurt their ability to borrow and even finance cars and other durable goods wherein they are still in a mild spending trend upwards. The economy will be impossible to revive through government stimulus once the demographic trends significantly turn down around 2010. They will be “pushing on a string”, much like Japan from 1990 onwards, with a long decline despite near “zero” interest rates and banking supports. The real and greater crisis comes between 2010 and 2012, unless this credit and banking crisis just continues to implode dramatically into 2009 despite the massive stimulus programs to counter that at first.

Q. When did you begin to see this “perfect storm” of economic and demographic cycles that you said have together created the current economic conditions?

A: We first saw this perfect storm when we first created our long term demographic spending, inflation and technology cycle indicators between 1988 and 1989. In *The Great Boom Ahead*, published in late 1992, we forecast the next great depression to occur from 2008 into 2022/2023 on page 16 and in other references in that book. We did not forecast the CMO or CDS or subprime crisis, as that is more specific and was hidden from most analysts' views due to high ratings on such securities that were not ultimately warranted. Every major bubble boom in history has ended with great speculation and a misperception in risk that ultimately creates the deflation of such bubbles in asset values caused by such demographic and technology booms – and a banking crisis and shake-out that creates the greater efficiency from such massive innovation to generate the next more mainstream and broader boom to follow, like 1942 - 1968. Such speculation and misperception of risk always occurs in the late stages of such bubble booms, although it always takes on new strategies and forms. The Japanese are traditionally more conservative than we are, but their banks still lent against bubbling real estate values without regard to repayment quality increasingly in the 1980s. And their real estate values plummeted by 60% to 70% between 1991 and 2005. How could our rating agencies have so undervalued real estate risks after that more recent modern example, as well as the minor recession in real estate in the U.S. in the early 1990s and the more major downturn between 1925 and 1933?

Q: How do you think Obama’s presidential win will affect the economy?

A: We don't find that politicians greatly affect the economy. They simply react, as they are currently. When there is a downturn they will stimulate and try to counter, to look like they are doing something. Barack Obama is very fortunate to have this banking crisis start to set in before he became president. Otherwise, he could have been blamed for it, even though he didn't create it – much like George Bush, Sr., getting blamed for the early 1990s recession and S&L crisis – or Bill Clinton getting credit for the incredible 1990s boom. But our long term economic cycles strongly suggest that we are leaving a pro-business/innovation era from 1968 – 2008 (wherein republicans controlled the White House 28 out of 40 years) to a pro-everyday-person-era like 1932 to 1968 wherein the democrats control the White House most of the time. Obama is an inspirational, FDR-like president that could be re-elected in 2012, despite the worst crisis in the economy since the early 1930s. Even if he does get blamed to a greater degree, it is more likely a democrat will be elected in 2012 and will continue such more liberal policies. The economic crisis and huge deficits will likely delay some of his liberal proposals for tax hikes and health care reform at first as we will be seeing a one trillion dollar plus deficit in the next few years for continued bail-outs and slowing government revenues. Such deficits will give greater incentives to pull out of Iraq, which may have good or bad consequences – likely more de-stabilizing for the Middle East just as oil prices peak and decline creating greater potential problems. But in the end we will see the

next “New Deal” to restructure our economy out of a “Chapter 11” bankruptcy situation internally and externally (to foreign countries like China) to restructure debts and asset values that are not sustainable — towards greater regulation and protection of everyday workers and dramatically rising taxes on the affluent and businesses, as occurred from 1932 into 1946. I personally think Obama will end up being one of the most popular presidents in U.S. history and be re-elected in 2012, despite this major crisis ahead. We need strong leaders and communicators in times of major transition in the economic cycle like this one, and like the 1960s with JFK, the early 1980s with Reagan, and the early 1930s with FDR.

Q: What about the government stimulus package?

A: This is a long term crisis, not a short term one like the early 1990s and the early 2000s given that we are at the peak of two important long term cycles: 1) the 40-year demographic or generational spending cycle of the baby boom generation, and 2) the 30-year commodity/energy price cycle. The government’s “panic” plan for stimulus, at worst will not be able to stem the tide of banking and loan failures (from extreme leverage and bad loans in the last decade) that contract credit faster than the government can create liquidity and new banking reserves. Or, at best, it will create a short-term rebound and recovery that will cause rising inflationary pressures, interest rates and a final commodity bubble that will kill off that recovery and the economies of emerging countries around the world – and end any credibility for further inflationary/stimulus policies just as baby boomers really run out of spending power in 2010 and start to retire in much greater numbers as well. Either way, the government stimulus plan will ultimately fail and we will see major deflationary trends and a depression to at least rival the 1930s. It’s just a question of whether that deflationary crisis begins in 2009 or 2010. We still lean towards a minor rebound from the stimulus into 2009 and the bigger crisis or “perfect storm” from late 2009 into late 2010 with the aftermath lasting into 2012 or mid-2013. But we clearly see a “perfect trap” for the economy and government either way!

See this storm like the typical hurricane. The first edge of the storm hits and then you get the eye of the storm with a relative calm. Then the strongest part of the storm hits and builds on the damage of the first part of the storm to create the greatest impact. Then there is flooding and damage that continues afterwards. We see the first part of the storm hitting in 2008 into mid-2009, then the eye into late 2009 to early 2010 or so, then the worst of the storm from mid-2010 into 2011 – with flooding and the aftermath continuing into 2012 to as late as mid-2013 or longer.

Q: Is it too late for investors to protect themselves or has the damage already been done?

A: We have seen an early credit collapse from highly rated securities that were sold around the world to replace the higher fixed income returns prior, even though such securities were ultimately not worthy of such ratings and were very highly leveraged by hedge funds and

investment firms from Merrill Lynch and Morgan Stanley to insurance companies like AIG. This stock and commodity crash is likely overdone here in late 2008 and we should see a substantial bounce from late 2008 to early to mid-2009 before we see the next great crash and the real depression and deflation trends in 2010 to around 2012. The biggest question is how long and how high this bounce before the next more serious crash and downturn sets in? Investors should not buy long term, even high-quality bonds, as interest rates will likely rise dramatically if we do see a rebound due to any success in the stimulus and bail-out program. Conservative investors should move more to high-quality short-term fixed income like T-bills and Swiss francs on any rebound near term, and more aggressive investors should look for a substantial rebound in the coming months to between 9,800 and 11,800 on the Dow to sell longer term – don't sell in the panic. If you do or have sold, reinvest if the Dow hits stronger support around 6,900 – 7,200 – or if it holds above the October lows and breaks above 10,100. The best higher return investment over the next year to year-and-a-half will likely come in gold and energy commodities and stocks if we see a substantial rebound in the second half of 2009 forward from the stimulus plan.

Q: You're known for being bullish. Is there anything left to be bullish about?

A: We have been very bullish since the late 1980s after we developed our key fundamental indicators: The Spending Wave, The Inflation Indicator and the S-Curve for new technologies. We said even back then that this boom would end between 2008 and 2009. But even such depression or deflationary downturns create much lower costs of living and greater efficiency that drives the next boom to follow. Even back then we said that next boom would occur by around 2022/2023. And our expanding research into global demographic trends and longer term cycles strongly suggests that there will be a quicker recovery in Asian countries and in the health care sectors of developed countries like the U.S. The bottom line is that the new generation of echo boomers here will greatly benefit from lower real estate and living costs, after this unemployment and deflation shock, as they don't own most of the assets that will deflate, their baby boom parents do! It is the aging baby boomers that will see their first major economic crisis as they move into their retirement (after being spoiled by a good economy most of their lives, unlike the Bob Hope generation that preceded them with The Great Depression and World War II early in their life cycle) they will most suffer if they don't see this major change of deflation coming. There will be a more concerted global boom again from the early 2020s into the mid 2030s – and beyond in many countries from India to even the U.S – as we outline in Chapter 6 in *The Great Depression Ahead*. But we are very unlikely to see as a great a worldwide boom as we saw from 1983 to 2007 in our lifetimes – unless we live, work and invest in major emerging countries like India.

Q: If readers were to leave THE GREAT DEPRESSION AHEAD with a single thought about the future, what would you hope that would be?

A: Even though this book's title is focused around the more ominous trends in the next few years — and both the greatest crisis and opportunities we will likely see in our lifetimes — the real message is: demographic, technology, commodity and geopolitical cycles can allow you to see the key economic trends that will affect your life, your business, your family and your investments over the rest of your lifetime! You can't change the winds – but you can

reset your sails! In this book we give you a blueprint for opportunities in business and investments, locally and globally, over the rest of your lifetime. We have been off on the magnitude of such trends at times, but no one has been more right about the direction of such long term trends than we have been. Who predicted the great boom of the 1990s before it occurred and countered the greater “depression” forecasts for the 1990s? Who forecast Japan would enter a long term decline in the late 1980s when they looked invincible? Who forecast the unprecedented federal deficit in 1992 would turn into a surplus between 1998 and 2000, regardless of which political party was in control? Who gave very strong buy signals for stocks in October of 2002 and again in March of 2003? Who warned in 1992 that the next great depression would be from 2008 to 2023, fifteen years in advance?

Smart people understand that change is the norm, not stability. “We help people understand change!” That is the motto of the HS Dent Foundation. And when we get important divergences from our long term forecasts (that most economists don’t even dare to make) we reconsider our indicators and quickly refine or update them for new ones that matter, like our 29 – 30-Year Commodity Cycle and our 32 – 36-Year Geopolitical Cycle added in 2006.

The bottom line is that there are clear economic cycles that go through seasons just like the weather. There are always “curve balls” and changes from the norm that occur. But understanding how our economic cycles change have been the key to our rising standard of living even as our world and economy have gotten more complex and have changed more rapidly over time. New information allows us to increase predictability and to reduce risk even in such greater times of complexity and change. Economists have it backward. They think that long term trends are less predictable and short term ones are more so. The crash of 2008 proves that it is such short term trends that are the least predictable at times. In the long term, you can understand the key economic trends that will allow you to plan for and adapt to the future, despite such short term variations. But we are presently at a critical long term change in trends that will impact you more than perhaps any time in your lifetime. You will have to question the established economic and financial planning logic that you have learned in the past decades to survive this “once-in-a-lifetime” deflationary crisis or depression . . . and to profit from “the greatest sale on financial assets” in your lifetime, likely between late 2010 and 2012!

In his new book, Dent will offer FREE periodic updates to readers who sign up on using freeupdates@hsdent.com. This is a very volatile environment that will continue to see “curve balls” for many years to come despite our best fundamental, cyclical and technical indicators.

For more research from HS Dent, please visit our website at www.hsdent.com and review our HS Dent Economic Forecast, a monthly newsletter.