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Investment Outlook

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Update

Perspective on a Hot Topic: Inflation

Should we be worried about inflation? That's the question that comes to mind when hearing predictions from some experts who suggest the Fed is courting disaster by delaying a policy response to recent inflation data. It's the subject du jour in the financial media during the current news void leading up to next month's earnings season. Prognostications of Doom always sell advertising. So, should you be worried? Well, "It depends". If you *own* financial assets, real estate, and have checked all the boxes re: the big expenses in life, you're probably not overly concerned. If you're among the those who want to *purchase* any of the above or start or retool a business and hire employees, you're noticing the increase in the price of all things and might have a case of FOMO (Fear of Missing Out). The current housing market stands as a prime example of what happens when buyers succumb to FOMO. Our advice is to be patient since this will pass.

In our business, you can't escape the current debate among economists and analysts as to whether the inflation data we're seeing in this recovery is merely a *temporary* result of the brisk rebound from last year amidst a variety of supply curtailments or something more ominous. The Fed subscribes to the former view and is holding fast to its policy agenda. We support that view. There won't be a return of 70's style inflation. Today's technology-enabled economy is infinitely more adaptable to changing conditions and as supply constraints abate the currently "hot" US economy should respond by settling into a moderate and sustainable rate of GDP growth such as we saw in 2018-19. We don't expect the current surge of inflation to extend beyond this time next year.

Traders see this debate and the current news-rich landscape as a reason to do what they do best, *trade*. For most of this year, we've seen significant amounts of capital reallocated from Growth and the stay-at-home stocks to the Cyclicals that usually prosper in an extended, broad-based recovery. In recent weeks, we've seen a rekindling of interest in mega-cap Growth issues that had retreated in price due to inflation fears. This week's headline at CNBC read "investors return to Growth". We've got news for them. *Investors never left Growth.* Properly diversified portfolios continue to hold both Growth *and* Cyclical stocks, allowing those investors the luxury of making only minor adjustments to portfolios rather than major reallocations.

We're seeing signals that the inflation surge will ebb. The decline of the 10-year treasury yield and the recent, rapid retrenchment of some commodity prices are encouraging signs. So too is this week's advance of the S&P 500 and NASDAQ to new record highs. The stock market hates excessive inflation. However, we reserve the right to be wrong. Here's a few things we'll be watching for with regard to longer-term, higher-than-optimal inflation.

- Fed statements regarding the rate at which they'll taper treasury purchases.
- Persistent US dollar weakness, symptomatic of sustained monetary inflation.
- Supply constraints: Symptomatic of structural inflation, they should abate by year-end. Shipping will lag in its recovery but rail and trucking should continue to rebound barring electrical grid or fuel supply issues. That should improve current component shortages for manufacturers.
- Housing. We're looking for anecdotal and then widespread increase in Time On Market data that usually precedes a peak in prices.

Someone once said "the cure for high prices is high prices." Stay tuned.