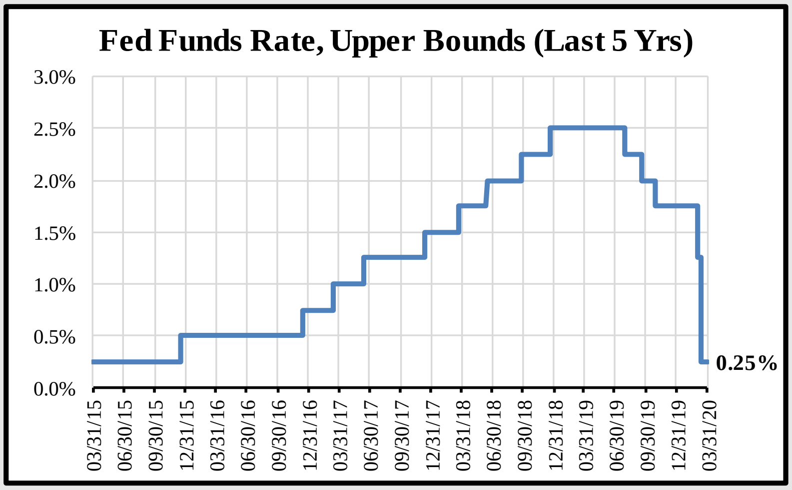
Do Investors Need to Worry about Inflation?

In short, 'yes' but the economy has to rebound, manufacturing has to return, and more people need to be spending money like they did pre-coronavirus. Consider inflation-sensitive assets like TIPS and commodities as hedges.

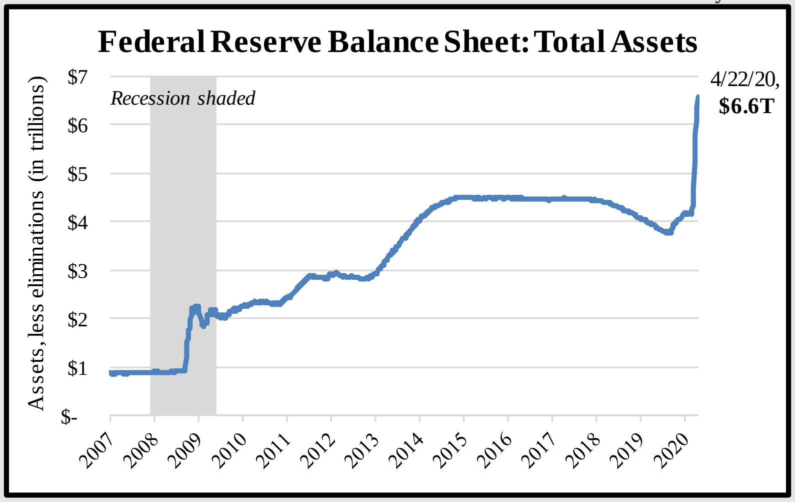
Monetary and Fiscal Stimulus is Historically a Big Driver of Inflation

- Recognizing the immense economic stress brought about by strict "social distancing," government officials pulled out all the stops in their policy response. The Fed moved swiftly, tethering short-term interest rates near zero and injecting unprecedented levels of liquidity into bond markets.



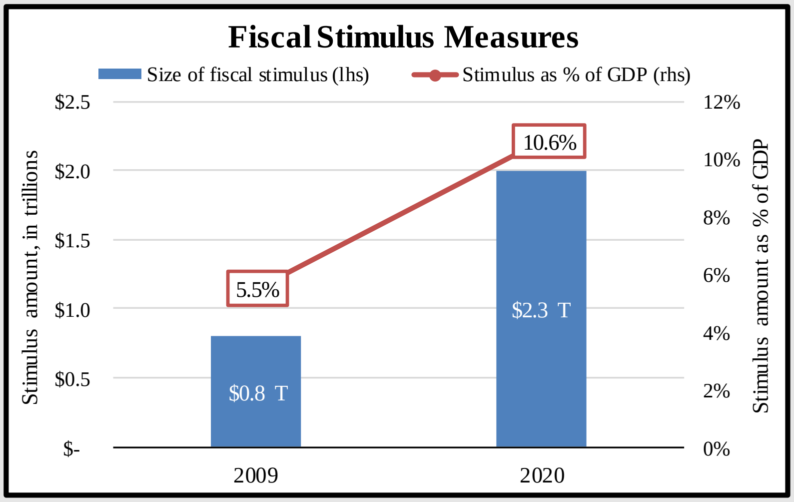
Source: Board of Governors of the US Federal Reserve System

- For its part, the Federal Reserve has launched an extraordinary effort to inject liquidity into the economy by taking its balance sheet to all-time highs. Though last reported at assets of $6.6T, the Fed's balance sheet has been estimated by some to go as high as $10T. Historically, such attempts to reflate the economy have been expansionary to GDP and we'd expect the same this time around with a rebound in the back half of 2020 and on into 2021.



Source: Federal Reserve

- In late-March, Congress passed the $2.3T CARES Act aimed at providing grants to embattled industries, forgivable loans to corporations, and direct payments to U.S. taxpayers. Pairing the impact of the CARES Act with an aggressive Federal Reserve empowered to make direct asset purchases gives us confidence equity markets will rebound sharply when the spread of COVID-19 abates.



Source: U.S. BEA

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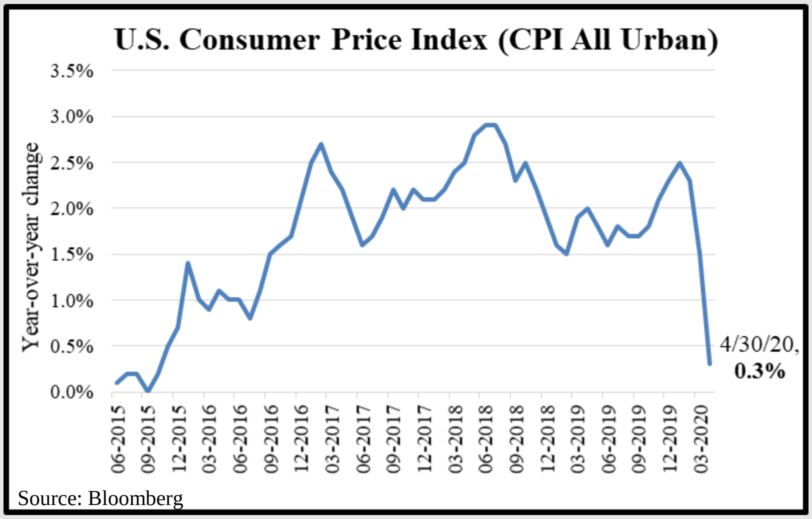
Market Update

June 2020



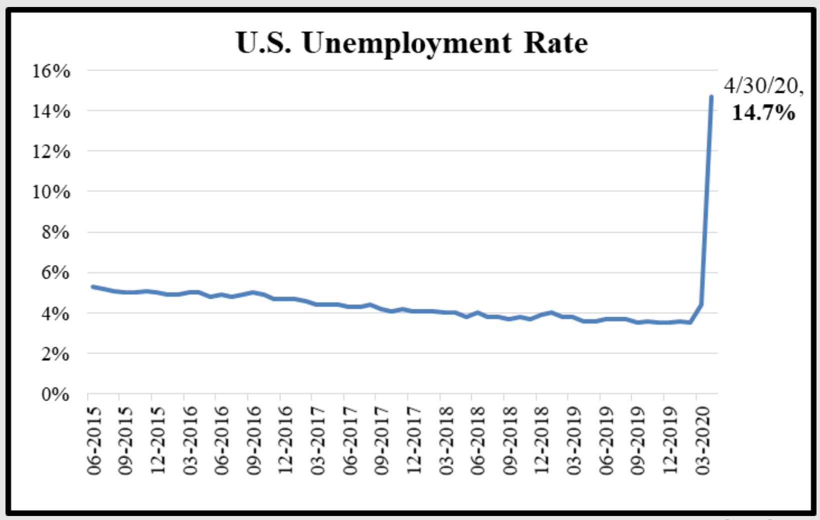
But inflation levels remain low…

- Ordinarily, such enormous amounts of monetary and fiscal stimulus would be highly inflationary. However, inflation levels remain very low as measured by CPI. The unprecedented global shutdown has corresponded to subdued inflation. In fact, demand is so low that the opposite of inflation is more concerning to policy makers, deflation. Expect more stimulus measures should inflation fail to eclipse the 2.0% level as measured by CPI.

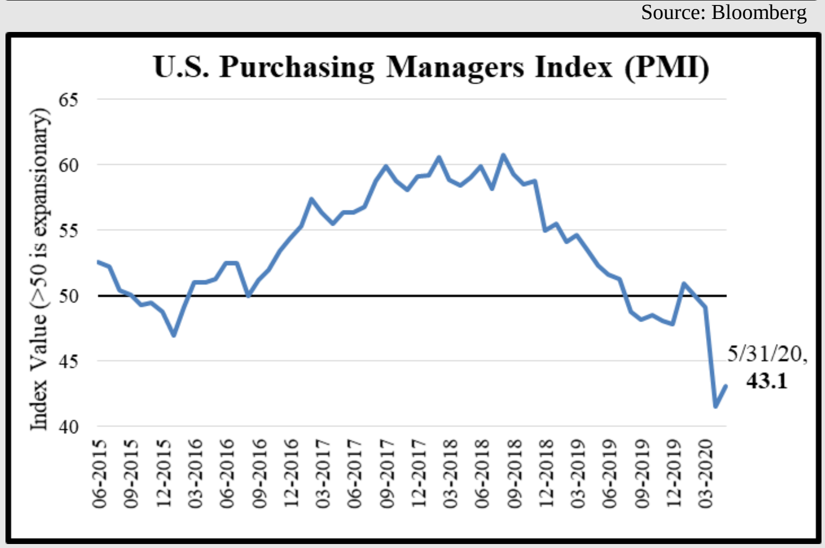
Sign Posts for Investors to Watch: Falling Unemployment Levels and a Recovery in Manufacturing

- In an astonishingly short period of time, unemployment has jumped to its highest level since World War II to 14.7% along with a surge in unemployment claims. As the economy starts to put more people back to work, this will spur demand for everything from commodities to services.

- Second, with so much “slack” in the economy or the degree to which resources and machines are not being utilized, this too is deflationary. So another metric to pay attention to focuses in on manufacturing activity as measured by the ISM Manufacturing PMI Index. When the index value notches over 50, that means manufacturing activity is expected to expand while levels below 50 indicate contraction. As manufacturing picks-up, that should also coincide with rising levels of inflation as demand returns.



Source: Bloomberg



Source: Bloomberg