StraightTalk
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Things Are So Good…We're Going To Have Inflation?

We did it! We have successfully made it to the other side of the Covid economy, and should all allow ourselves a victory lap. Yes, I am aware that there are still more than a few among us who are not yet vaccinated, and restaurant servers and health care workers are still wearing masks – but it should be apparent to even the most casual observer of life in America that we have reclaimed our "normal." Stores, restaurants, museums and schools are all once again open. Airplanes, hotels, cruise lines and travel tours are all filling up as demand for all that was paused last year has come roaring back. Companies are moving employees back into offices, and traffic on the roads has resumed – all of which has resulted in a monster recovery in corporate earnings, which was accurately forecasted by the stock market many months ago.

And, of course, the media reaction to this unalloyed good news is…*to startle you with fears of inflation.* Honestly, you can't make this stuff up. But before we discuss inflation, and its historic effect on both bond and stock markets, we must once again revisit the most important ingredient in your successful investing recipe – human nature. As the financial forbearer to Warren Buffet and founder of value investing, Benjamin Graham, famously said, "The investor's chief problem – and even his worst enemy – is likely to be himself."

I hear some version of the following on at least a daily basis.

"The market's too high."

"It's come too far too fast."

"The market is going to correct any day now."

"Inflation is going to hurt the market."

These, and many others like them, are trotted out by talking heads, and repeated in social settings all across the land as an excuse to try and time what cannot be timed.

Stocks have historically paid a fortune in the long run, but seek punitive damages when you try to be paid sooner. Going to cash until things settle down or waiting to invest accumulated money until the market pulls back is just as bad of a behavior as selling what is down recently to buy more of what has been running red hot.

As a reminder, we don't do any of the above. Preventing capitulation at market bottoms and stopping mindless speculation at market tops is just part of my role as your advisor. Aside from the obvious functions of building and maintaining a financial goal plan, and then constructing a portfolio that hews to that plan, behavior modification and battling the media's constant drumbeat of impending doom are a big part of my value proposition…one that has been tested several times in the last year or so. A quick review:

COVID-19. This was going to be the modern day black plague, wiping out one third of humanity. Of course, any deaths related to this novel coronavirus were tragic, but in the end, this proved to be far less horrific than the Black Death, or the 1928 flu pandemic.

Economic Collapse. Essentially, governments all over the world put their economies in a medically induced coma to blunt the spread of the virus, resulting in the fastest decline in economic activity in history, and a cratering of corporate earnings.

2020 Election. This was the most bitterly divided and partisan election in living memory, which saw rioting and looting beforehand, in the wake of the killing of George Floyd, and afterwards, with an unprecedented storming of the Capitol.

Robinhood. With too many people out of work, with too much money on hand, investing became a video version of a parlor game, as gamblers shared information via an online platform called Reddit, and used the online brokerage firm to target stocks in a mania I had not seen before.

Market Overvalutaion. The stock market (accurately, in hindsight) looked past the economic carnage and surged to all-time highs, led by a handful of tech stocks benefitting from the lockdowns. This resulted in very high price-to-earnings ratios, and was said to be symptomatic of a bubble being ready to burst.

And, now…**Inflation.** We are being told by the financial "news" to worry about Weimar Republic type devaluation of our currency, or at the very least, a repeat of the double digit inflation many of you lived through in the late 1970s. We have gone from reporting on fantastic recovery news to dreading the effects of that recovery faster than a Tesla goes from zero to sixty.

Never mind the fact that the bond market has been largely ignoring this inflation fear, with the 10-year Treasury yield staying between 1.1% and 1.5% so far this year. (The average yield for the 10-year has been between 5 and 6% over the last half a century.) In order to buy into the inflation Armageddon scenario, we should also ignore the stock market's behavior, with the S&P 500 moving up from 3,700 to 4,200 this year. In other words, millions of people, representing trillions of dollars are not seeing the world coming to an end from inflation, or any other negative media narrative.

Bloomberg and the Department of Labor report that continuing jobless claims are falling each month, while weekly retail sales are rising. Open Table reports an increase in restaurant reservations each week, and Box Office Mojo details movie box office receipts growing. First Trust Advisors shows hotel occupancy increasing and the number of daily commercial flights increasing, while the TSA shows a concurrent bump in traveler checkpoint data. Steel production is up, rail car traffic has increased, and the barrels per day supply of gasoline is growing each week, according to CNBC.

In short, the economy is reopening, and so we should expect kinks in supply chains, and surges in product demand – some inflationary numbers are to be expected. But as one portfolio manager recently put it when asked about inflation, "We only get one reopening." In other words, his answer was that inflation may not be very short term, what is referred to as transitory, nor will it be long-term as it was in the Carter administration, but rather we could see a mini-cycle of inflation, lasting a year to eighteen months, which I personally think makes the most sense.

However, I do not pretend to offer a prediction – I can't see around corners any more than you can – and more importantly, we don't make investment policy out of predictions. However, a refresher on inflation may help ease any short-term heartburn you may experience in the event it does occur in the near future.

The simplest definition of inflation is too much money chasing too few goods. But the more important definition (and damaging effect) of inflation is the erosion of purchasing power over time. Namely, that which costs a dollar today, costs much more than a dollar tomorrow. Thus, the goal of the well-constructed financial plan and portfolio is to offset this loss of buying power. ***This is precisely why we own equities.***

The research firm Ibbotson details that the average annual compound return of the stock market from 1926-2020 is a fraction over 10%, while inflation over that exact same period of time averaged 3%. In other words, money invested in stocks not only kept up with inflation over that time, preserving it's purchasing power, it actually accreted in value, which allowed purchasing power and quality of life to improve well over the rate of inflation. Who doesn't want more ability to spend, help improve the lives of children and grandchildren, and give to causes they cherish? And, what did you have to do in order to obtain this powerful growth? Nothing – the great companies of America and the world were doing it for you! (Actually, you did have to do something – you had to ignore virtually every news headline, every day, throughout your lifetime…)

Great companies not only can raise their prices in order to pass through inflationary costs and maintain profits, but they also tend to constantly innovate and improve, resulting in earnings that grow even faster than inflation. At least, that has been the pattern for the last 100 years, which should give all of us hope that whether we get sustained higher inflation in the future – or we don't – owning the companies in your portfolio is exactly the right strategy, no matter what the negative news headline is today, or tomorrow…..or ever.

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