

INFLATION

What is inflation? As defined by many experts, “too much money chasing too few goods and services.” Or inflation is the situation where the price you pay for products and services increases because of the scarcity of those products and services that you want and need.

Government decided in 2020 to shut down the economy. Therefore, the government decided to compensate people for closing their businesses and dealing with layoffs. This caused government spending of trillions of dollars. Thus, a new experiment, the government can spend anything it wants, and the Federal Reserve can print money, as long as we end up with no problems.

“No problems” is the least likely outcome. You are already seeing inflation in gas prices, lumber prices, home prices, corn prices, and computer chips. While this probably is not hyper-inflation, inflation growth is likely to be 3%–5% per year in 2021 - 2023.

While this is a good environment for stocks, it is likely a difficult time for fixed income (bonds). Notice below the four different combinations of inflation and economic conditions from 1976 – 2021.

Asset Class Returns During Different Market Environments

Annualized Total Return (1/30/1976 – 2/28/2021)

	Rising Inflation & Growth 208 Months	Declining Inflation & Growth 194 Months	Rising Inflation & Recession 25 Months	Declining Inflation & Recession 37 Months
S&P 500 Index	↑ 14.6%	↑ 13.7%	↓ -8.7%	→ -1.3%
Bloomberg Barclays US Aggregate Bond Index	↓ 6.2%	→ 7.4%	→ -1.6%	↑ 23.2%
Bloomberg Commodity Index	↑ 15.2%	↓ -0.5%	↑ 22.2%	↓ -19.2%

Rising, declining, or steady inflation is calculated as the month-over-month change in the YoY inflation rate based on the CPI Index. Monthly change > 0: Rising inflation, Monthly change = 0: Steady inflation, Monthly change < 0: Declining inflation. The arrows are based on percentiles (top third, middle third, and bottom third) of returns in each column.

Sources: Bloomberg and National Bureau of Economic Research. Table is for illustrative purposes only and not indicative of any actual investment. **Past performance is no guarantee of future results.**

The Federal Reserve calls this “transitory” and once these products and services are not scarce, the prices will balance, and inflation will moderate. While this is somewhat likely, it is more likely that inflation is here to stay through 2023.

While the economy is still in a growth mode (likely through 2022) stocks are likely a good investment. Until interest rates begin to significantly rise (10-year treasury yield over 2%) stock prices should continue to increase.

If you have any questions or concerns, please reach out to me and we will discuss what is important to you.

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