FIRST CAPITAL FINANCIAL

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Sponsoring Mutual Fund Dealer

With governments around the world printing money like mad, the question arises as to when inflation is likely to return? By any name deficit financing, monetary stimulus, or quantitative easing, increasing money supply beyond what the real economy can use productively will inevitably prove to be inflationary. In turn this would mean higher interest rates, and exactly at a time that consumers, businesses and governments are carrying record amount of debt. This all seems very straightforward, yet since the era of loose money began in 2008 with the Financial Crisis, inflation has remained subdued.

"But think of all the things you're not going to die of."

As the article from Mackenzie Financial explains <here>, the case for higher -even runway inflation- remains weak. The graph in Figure 1 shows how dramatically higher Central Bank asset purchases have not translated into higher inflation. So while temporary price pressures are possible once vaccinated countries re-open their economies (especially in those sectors hit markets by the pandemic), the core rate of inflation is expected to remain low.

The one unknown that could change this outlook is what governments do *after* their citizens have been vaccinated. Once government spending starts, it's very difficult to stop it. New programs (like CERB) take on a life of their own, as voters get used to government largess -even if it puts us further in debt as a nation to do it. It reminds me a little of the B2 Bomber program underway during the Carter Presidency. Carter was opposed to the horrendous cost of the new plane, considered it to be a waste of time and taxpayer money and campaigned vowing to end it. Despite his best efforts however, the airforce generals who supported the program kept re-naming the project and funding continued uninterrupted through billion dollar military appropriations bills. So it could be with the alphabet of acronyms that governments have created since Covid-19 arrived. Will future governments be able to wind these down, or will they just be called something else, adding to the mountain of debt we have accumulated. We are watching this situation closely, as deficit spending as a permanent fixture of government fiscal policy will surely end badly, as governments will be left with no choice but to inflate their way out of debt.

As has been written here before, time will tell what happens next. What we can be more sure of though, is that higher inflation is associated with a rotation from growth stocks including high-flying tech companies, to more cyclically-sensitive sectors. Our fund positions with **Dimensional** and **Edgepoint** are well positioned to benefit from this rotation and we expect these to be significant drivers of return over the next 12-24 months.

Be safe, be well!

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