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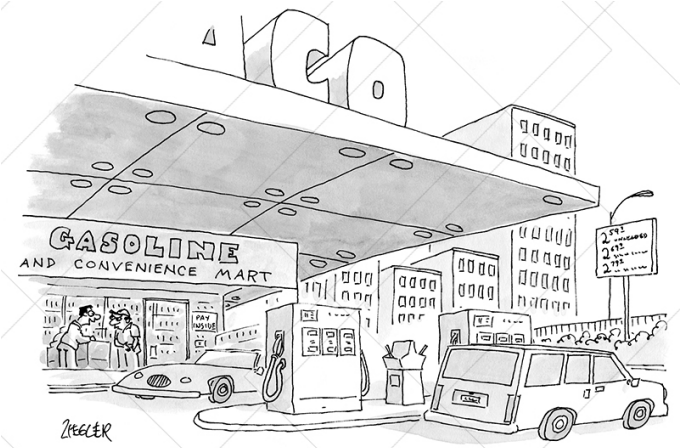
Sponsoring Mutual Fund Dealer



"The good news is that a delicious stick of jerky is still a very affordable seventy-five cents."

It may be one of the most familiar words in economics: **inflation**. Inflation has plunged countries into long periods of economic instability. Indeed many countries have grappled with high inflation -even *hyperinflation*, as was the case in Zimbabwe which saw price increases as high as 500 billion percent in 2007. As such central bankers often aspire to be known as "inflation hawks", ready to swoop down and carry it away before it presents a threat. Politicians have won elections with promises to combat inflation, only to lose power after failing to do so. President Gerald Ford even declared Public Enemy No. 1 in the United States in 1976. What then is inflation and why is it so important?

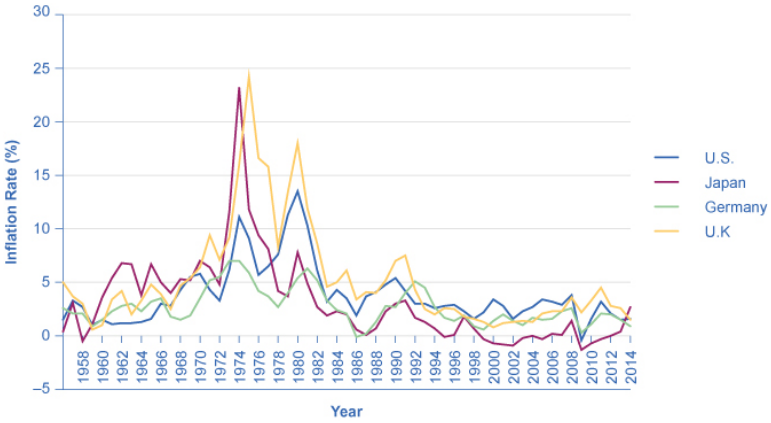
Inflation is the rate of increase in prices over a given period of time. Inflation is typically a broad measure, such as the overall increase in prices or the increase in the cost of living in a country. But can also be more narrowly calculated -for certain foods, such as food, or for services such as a haircut. Whatever the context, inflation represents how much more expensive the relevant set of goods and services has become over a certain period -usually a year.

Consumer's cost of living depends on the prices of many goods and services and the share of each in the household budget. To measure the average consumer's cost of living, government agencies conduct household surveys to identify a basket of commonly purchased items and track over time the cost of purchasing this basket. Food, housing, transportation -which includes the cost of filling and re-filling your vehicle, are all part of the standard basket of goods. And unless you've been living on hoarded goods purchased before Covid-19, you know the price of all of these things has gone up dramatically. This is the result of interest rates being so low for so long and the shift in consumer spending from travel/entertainment/leisure to bricks and mortar. Gas prices have climbed because of all the items consumers are purchasing on-line, which get shipped to tens of millions of households around the world.

Inflation has been virtually non-existent since the Financial Crisis of 2008, that most of us have forgotten about it altogether. Large economies including Japan's have actually experienced deflation, where prices slowly but surely get cheaper every year. But inflation is back and economists are trying to determine whether inflationary pressures will ease once economies open up, or whether the opposite will happen, and we will see the kind of rampant rates of the late 1970s and early 1980s. As far as the effect that inflation has on stock markets, this much we do know:

*Value stocks perform better than Growth stocks in higher inflationary periods
*Higher inflation depresses income-orientated dividend paying stocks
*Stocks are more volatile during higher inflationary periods

Source: Investopedia



May has seen markets more sharply in both directions, but mostly lower. This in itself is less of a concern than a longer more protracted period of higher inflation would represent. Governments have borrowed trillions to support the economy throughout the pandemic and inflating their way out of all this debt may be the end result. We have adjusted our portfolios to overweight in Value stocks and funds which historically have exhibited lower volatility than the capital markets themselves. This coupled with higher-yielding, higher investment-grade quality corporate bonds should mitigate market swings as we move forward in the year.

Historically, stocks have delivered the highest returns of all assets classes, and our view is that they offer the best hedge against higher inflation. As always, call me anytime on this or any other topics. Glad to provide additional commentary!

Be safe, be well!
Martin
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