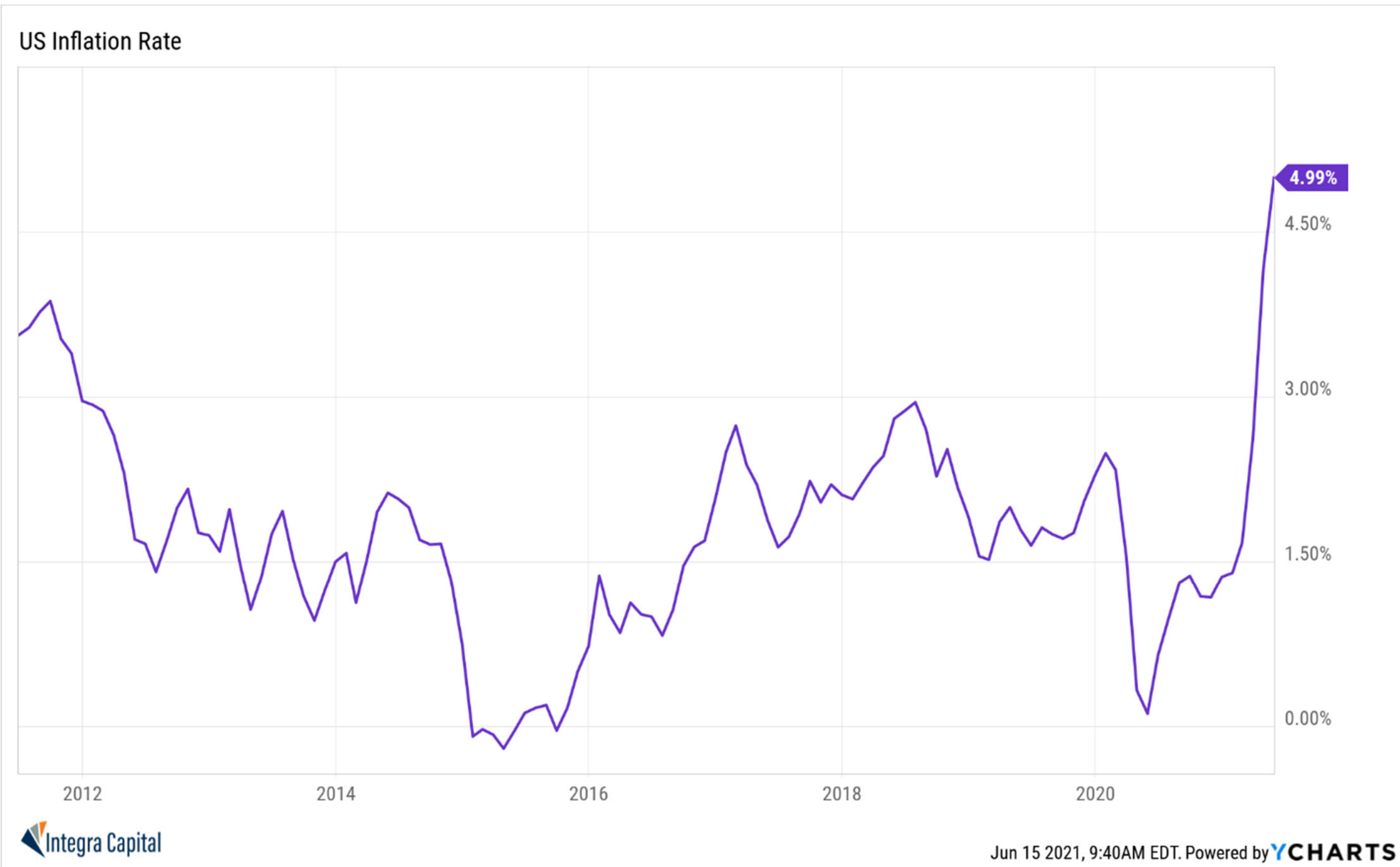
Inflation; Part 2

In our February *Market Note* captioned, "Is Inflation Already Here?", I made the case that inflationary forces had already begun to push prices of goods and services upward. Fast forward a few months later and the inflationary trend has continued as evidenced by the chart below of the US inflation rate pattern from 2011 through today's current rate of 4.99%. This reading compares to the long-term average US inflation rate of 3.22%.

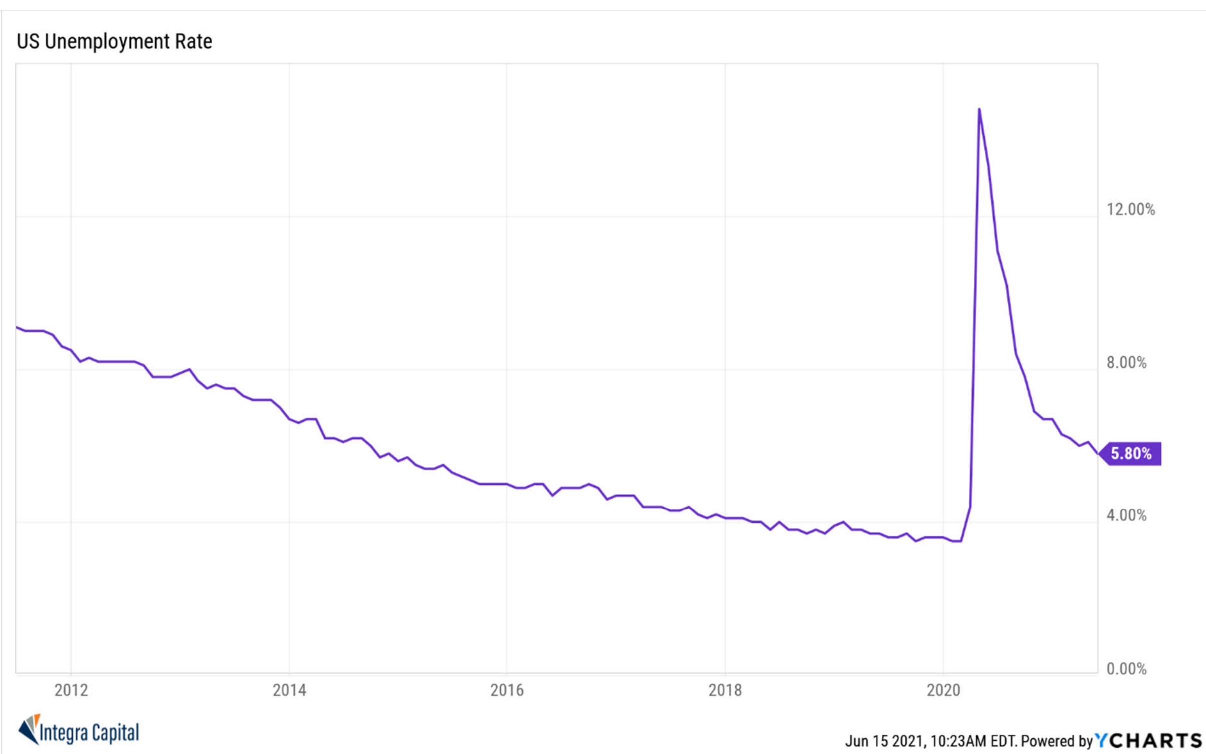


Other than shelling out more for gasoline, groceries, lumber, and other goods, the question we field most often lately is how will inflation impact your portfolio of investments? Inherent in this question, of course, is the assumption that the US Federal Reserve Bank will act at some point to keep inflation in check if it becomes more than short-term.

First, the majority of respondents (slightly north of 50%) to a recent Fed survey indicated they were in the camp that inflation is transitory, or temporary. The problem is, it is very difficult, if not impossible, to predict if inflation will be transitory before it plays out in real time.

Second, the Fed has many tools to scale back easy monetary policy. To keep things simple for purposes of this note let's assume the two tools they are likely to use: 1) targeting a higher short term federal funds rate, 2) reducing, or tapering bond purchases. Most Fed watchers believe, as Fed policy has played out in the past, the central bankers are likely to taper the magnitude of bond purchases (treasury bonds and mortgage bonds) before targeting a higher Federal Funds Rate. I think market participants, and investors alike, automatically harken back to when then Fed Chairman, Ben Bernanke, announced the central bank would begin to reduce (taper) bond purchases in 2013, the financial markets sold off in what has been referred to as a "taper tantrum". However, as First Trust Portfolios Chief Economist, Brian Wesbury, points out in his Monday Morning Outlook for this week, this isn't 2013. In 2013 experts were worried about a "double dip recession" because growth was slogging along at a tepid 1.7% pace coming out of a deep recession. The impetus for tapering bond purchases this time is an economy that is recovering at a much stronger rate than expected and nobody is talking about the next recession, yet.

Let's also remember that the Fed has a DUAL mandate; price stability (inflation) and **full employment**. Without getting lost in the weeds on the various measures of the employment environment, suffice to say the US economy is not at full employment yet. I hesitate to include the below chart of the overall US Unemployment Rate because it doesn't tell the whole story. However, a glance at the chart does provide an easy visual that we have not yet returned to a level of employment prior to the pandemic induced recession. As such, the Fed has not achieved its goal of full employment, hence their reluctance to alter the current course of easy monetary policy was the economy continues to heal.



After considering the data it stands to reason that the Fed is likely to do exactly what they have been saying publicly; no rate increases until 2023 and no tapering of bond purchases quite yet, but tapering will occur before rate increases. Because the US is awash in liquidity, in stark contrast to conditions in 2013, a taper tantrum by the order of magnitude experienced in 2013 is on the lower end of probabilities (possible, but not highly likely). However, the current scenario certainly warrants constant monitoring because we really are in uncharted territory in terms of the cause of the recent economic recession and the measures taken to reduce its impact.

As always, if you have questions or concerns, please reach out to your Integra Capital Advisors representative and he or she will be very happy to assist you. I wish you all a safe and enjoyable summer season!

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