INFLATION
MAY 2022

JVL WEALTH STRATEGIES
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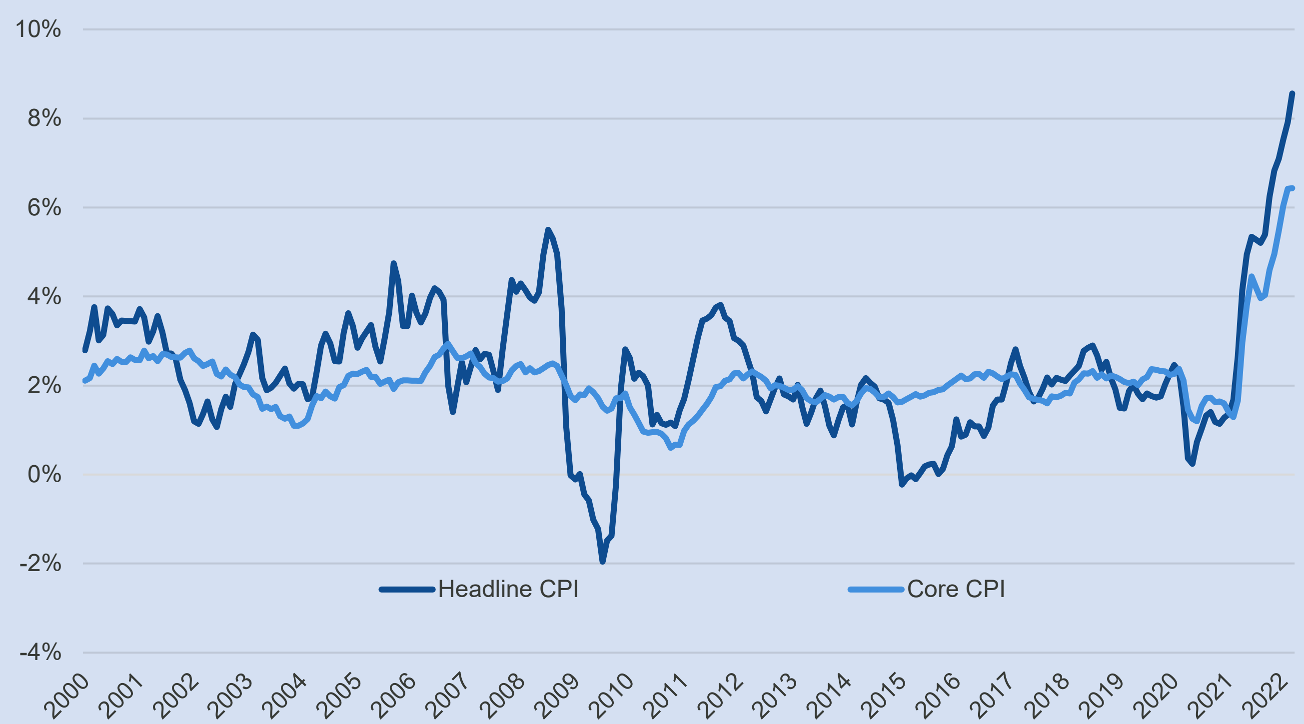
Inflation has become a dominate theme in the financial news over the past year. In general terms, inflation is the result of demand growing faster than supply. In college we learned it was too many dollars chasing too few goods and services. Either way there is a demand component and a limit of supply component in order to have rising prices. Inflation causes the price of goods and services to go up thus reducing the purchasing power of a dollar. While some price inflation has been deemed acceptable, it is generally held that too much inflation is bad for the economy and for the consumer.

During the financial recession of 2008, the Federal Reserve set the acceptable target rate of inflation at 2% in order to justify keeping their interest rates at record lows. This policy on inflation has been in effect ever since.

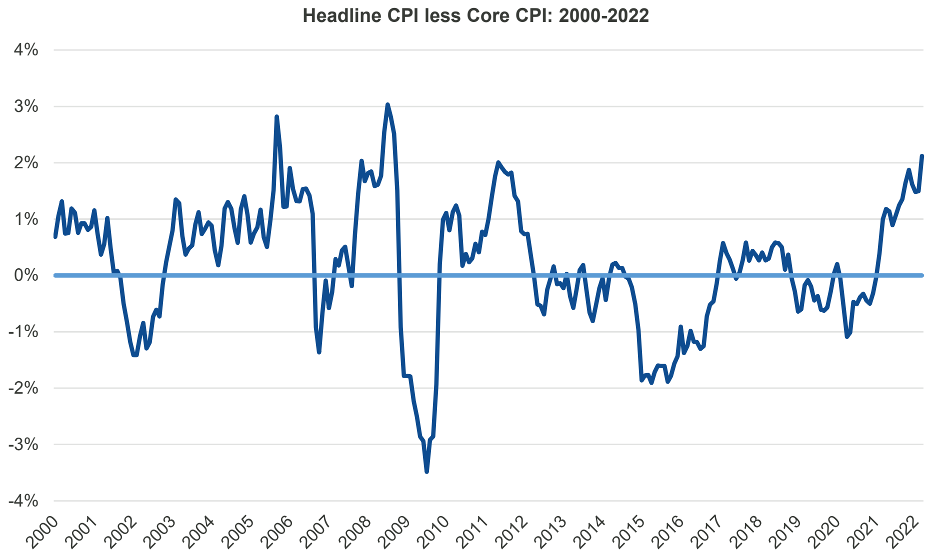
The Federal Bureau of Labor Statistics (BLS) is responsible for the computation of inflation which is called the Consumer Price Index (CPI). In the words of the BLS "the CPI measures the change in prices paid by consumers for goods and services." The CPI is "based on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 housing units and approximately 22,000 retail establishments (department stores, supermarkets, hospitals, filling stations, and other types of stores and service establishments.) Prices of most goods and services are obtained by personal visit, telephone call, or web collection by the Bureau's trained representatives."

Year over Year Change in CPI: 2000-2022

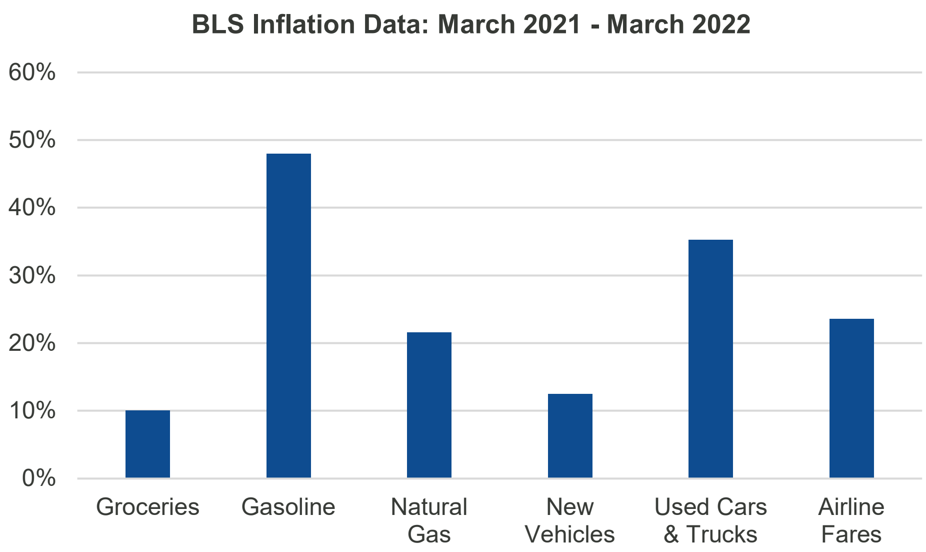


The CPI is then divided into two calculations. Headline CPI is calculated on the entire basket of goods and services described above. Core CPI is computed after excluding food and energy which tend to be the most volatile items on a month-to-month basis. Over the past year, inflation has been rising and there is growing concern that it is going to be difficult to bring it back down to an acceptable level.

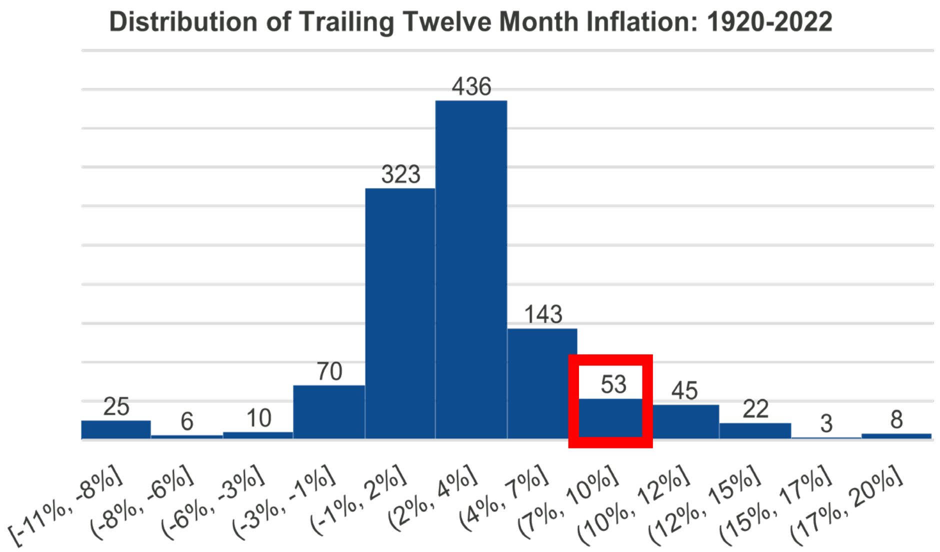
It is also good to analyze the difference between Headline CPI and Core CPI to visualize the inflation on food and energy only. The following chart subtracts Core CPI from Headline CPI and graphs that difference. When the line is above -0- food and energy prices are rising faster than the entire basket and when the line is less than -0- food and energy prices are rising less than the basket.



The headline CPI is the highest it has been since 1981. Looking back over time, we can compare today with other periods of high inflation. The following graph goes back to the 1950's.



Every month the BLS publishes the data used to calculate the CPI and gives the data in detail. We have charted the inflation for the past twelve months (March, 2021 – 2022) on various items used to make up the basket of goods and services.



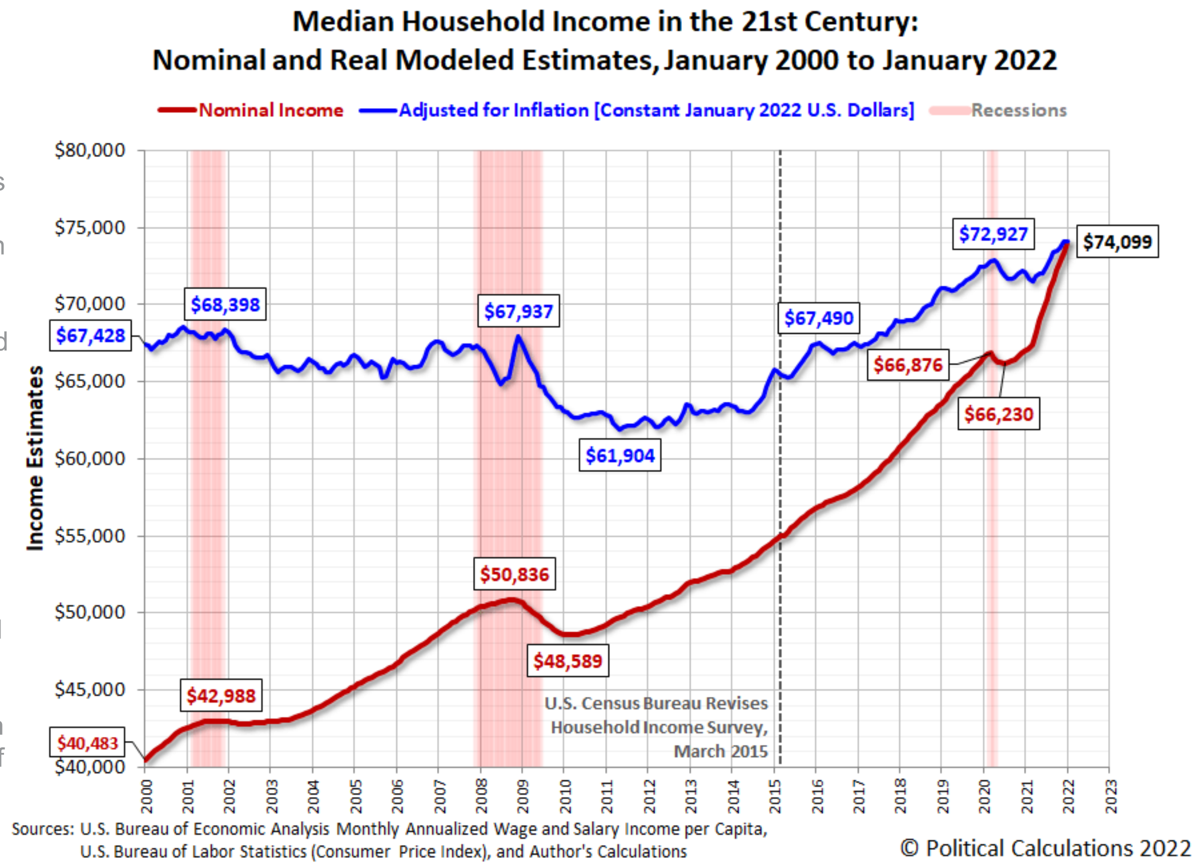
Another way to look at historical rates of inflation is to graph the distribution of trailing twelve-month inflation rates back to the 1920's. This graph shows us how rare it is that inflation is this high!

The events of the world over the past two years have had a major impact on the overall supply of goods and services. During the covid shutdown, businesses had to curtail their output. Manufacturers had a hard time getting raw materials and retaining labor. Many service businesses ceased operations altogether for a period of time, while others have closed for good. Employers find it difficult to staff at capacity as many individuals have chosen not to return to the work force.

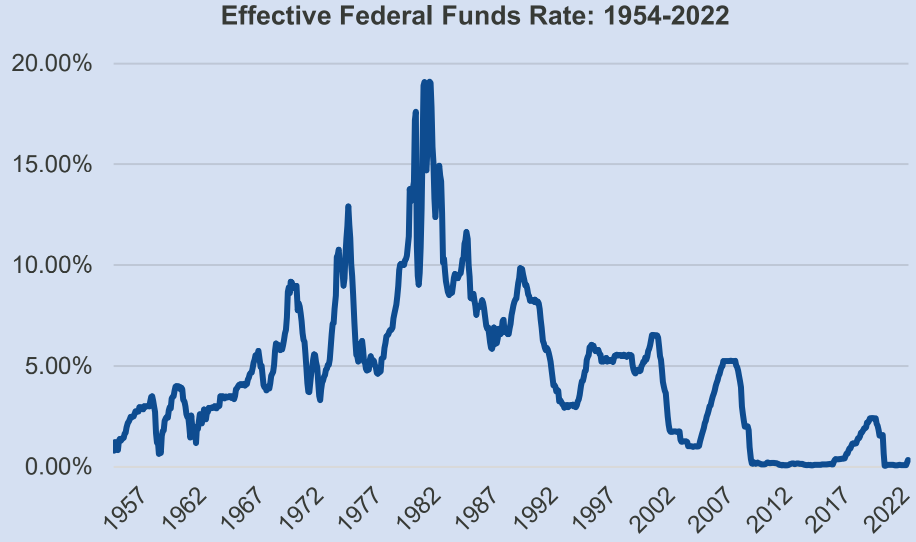
There are currently over 11.4 million job openings and only 5.9 million people wanting to work and looking for a job.

Covid played havoc with both imports and exports as many emerging countries were unable to operate efficiently. As the world becomes more digital, the shortage of computer chips is having an outsized impact on production capacity. Add in the Russian invasion of Ukraine and its impact on energy prices and we begin to see the impact of limited supply on overall prices.

Demand is a function of consumers plus businesses plus government spending. Real (after inflation) median household income has rebounded from the impact of the covid shutdowns, and is at historical highs thus driving consumer demand. Businesses are spending and investing to enhance their ability to increase supply, and governments spent heavily to combat the covid shutdowns with the U.S. passing both covid relief measures and the infrastructure bill. Adding everything together, we can see the combined impact of demand on overall prices.

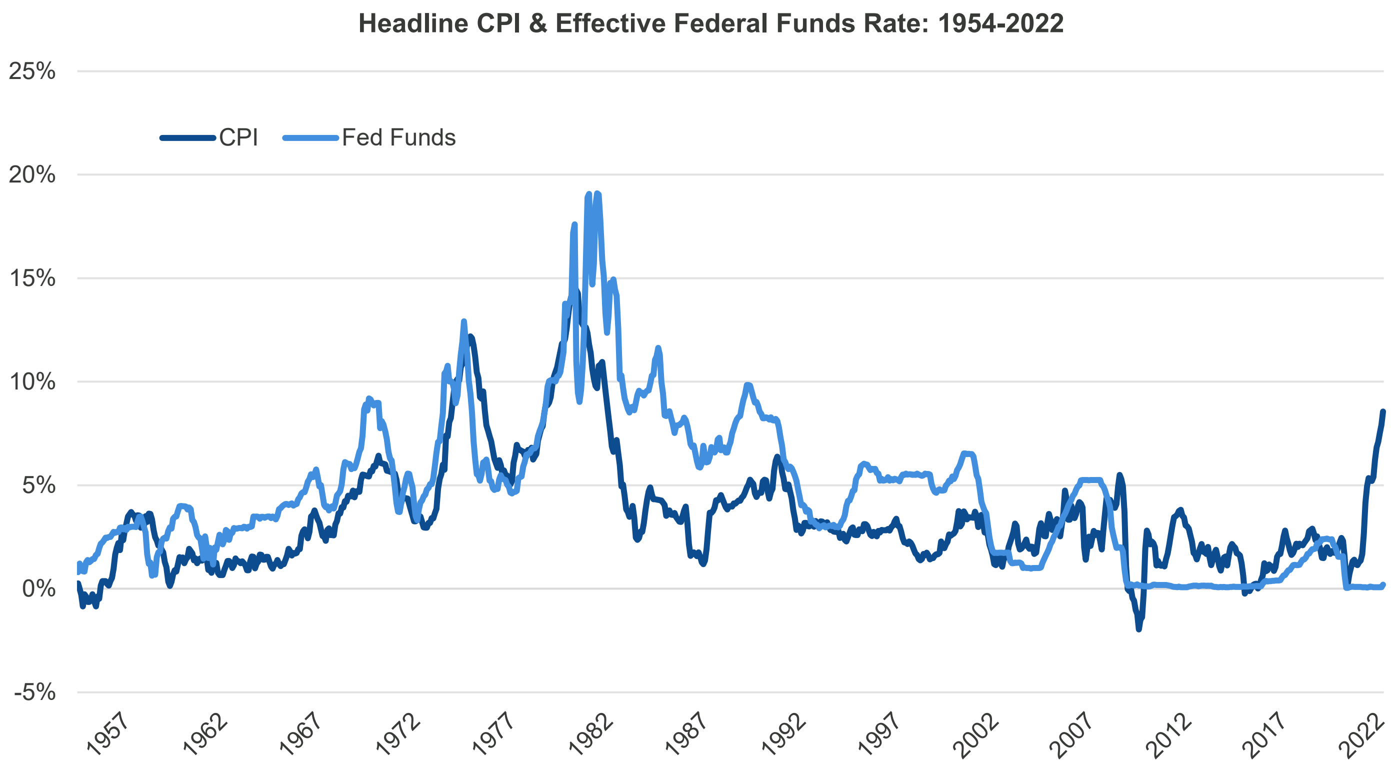


The Federal Reserve is the primary driver of interest rates. They use interest rates in an attempt to achieve both maximum employment and stable prices. When they keep interest rates (Fed Funds Rate) low, businesses have better access to low-cost borrowing and thus more money to spend or invest. Low interest rates allow businesses to borrow so they can grow and expand and create more jobs. More jobs mean more people are taking home pay checks. More take home pay allows families to spend and invest in goods and services, thus increasing demand. Low interest rates also benefit families when they wish to borrow for larger purchases like vehicles or homes. This increasing demand requires businesses to increase output and thus increase supply.

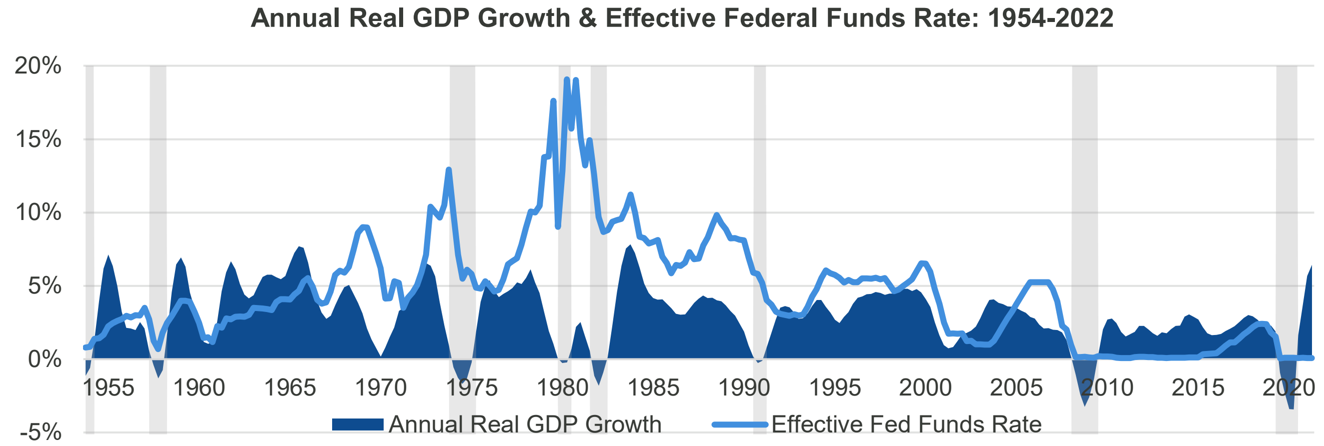


This circle continues and starts all over again. Thus, the influence of the Federal Reserve over interest rates has been a tailwind to economic growth. The above chart shows the Fed Funds Rate back to the 1950's.

As inflation rises, the Fed starts to raise interest rates in an attempt to curtail demand. Higher interest cost brings less borrowing and thus less demand. The drawback to this is that slower demand hurts economic growth, thus the balancing act of inflation, rising rates and economic growth is a delicate one. The chart below graphs the inflation rate with the Fed Funds rate to show the historical relationship between the two.



It is also relevant to compare economic growth (as measured by GDP) with rising rate periods.



We can also compare historical periods of inflation with the impact on investments. The chart below identifies the five periods with inflation of 6% or greater since 1950 and shows the investment impact during those periods.

Start	End	# Months	Annualized GDP Growth*	Fed Funds Rate Period Start	Fed Funds Rate Period Max	Absolute Increase / Decrease 10 Yr Tsy Yield	As %	Annualized S&P 500 Total Return*
December, 1950	December, 1951	13	6.19%	N/A		N/A		26.41%
August, 1969	December, 1970	17	0.96%	9.19%	9.19%	-0.30%	-4%	-0.21%
May, 1973	August, 1982	112	2.22%	7.84%	19.10%	6.21%	91%	4.93%
August, 1990	January, 1991	6	-0.09%	8.13%	8.20%	-0.66%	-8%	-5.71%
October, 2021	***	7 ***	0.88% Through 1/1/2022	0.08% Through 4/1/2022	0.33%	1.17% Through 4/1/2022	74%	-5.62% Through 5/1/2022

*Periods greater than 1 year are annualized.

The start to 2022 has been tough for both stocks and bonds. The first quarter of 2022 was just the 16th time in the past 185 quarters (back to 1976) - that both stocks and bonds were negative in the same quarter. The table below gives us historical context as to what transpired for stocks and bonds following the other 15 times this has occurred.

Stocks and Bonds Falling Together - What Happens Next
January, 1976 - March, 2022

	6 Months Later	***1 Year Later***	***3 Years Later***
Average Return - Stocks (S&P 500)	+ 1.3%	+ 9.6%	+ 12.4%
Percent Positive - Stocks (S&P 500)	67%	73%	93%
Average Return - Bonds (U.S. Aggregate)	+ 5.9%	+ 10.7%	+ 8.8%
Percent Positive - Bonds (U.S. Aggregate)	87%	100%	93%

It has been forty years since the U.S. has faced this high of inflation. The Federal Reserve has begun to raise rates and it remains to be seen how that will affect the economy.   We continue to monitor the economic impact on individual asset classes.

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At JVL Wealth Strategies, we plan for all events and how they may impact your planning. Our strategies are built to survive the ups and downs in the economy and in the markets. We continue to evaluate how current conditions affect your investments and ultimately your overall plan.

If you would like to discuss this further, please don't hesitate to reach out and we are happy to share our thoughts with you.

REFERENCES

[1] Information obtained from Morningstar Direct
[2] Information obtained from Morningstar Direct
[3] Information obtained from Morningstar Direct
[4] Information obtained from BLS
[5] Information obtained from Morningstar Direct
[6] Information obtained from Political Calculations
[7] Information obtained from Morningstar Direct
[8] Information obtained from Morningstar Direct
[9] Information obtained from First Trust Portfolios

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