



IS RECENT VOLATILITY CAUSED BY INFLATION CONCERNS?

In our quarterly market report, we recommended to shorten duration of fixed income portfolios.

Investors seem to react slowly to register that inflationary pressures , if not yet existing, are around the corner. The issue at the moment surrounds the potential return of a more concerning level of consumer price inflation. The underlying trend of inflation is of significance for investors and consequently for the financial markets.

The rise in both equity and bond prices since the financial crisis of 2008/09 has occurred in a period of subsiding inflation pressure and from recent efforts by central flooding the economy with cheap money.

Since the first lock-down a bit more than a year ago and the abrupt shut-down of the economy , we are observing a speedy recovery. As a consequence higher readings of inflation are surging. A measure of US core inflation has not been seen since 1996, running ahead at 3% annual gain.

Core readings exclude food and energy prices , and considered a more reliable measure of underlying inflation pressures.

This jump in core measure has raised quite some attention, even if accounting for the short deflationary shock the pandemic created.

As activity recovers from this sudden economic „void“ , helped by hefty tailwinds of fiscal stimuli , one cannot but concern himself about inflation. The uneven recovery , however , makes it difficult to judge at this moment. We will have to wait another 6-12 months to gauge the inflationary impact of the recovery and fiscal measures.

The recent raise in prices for inflation hedge and commodities shows that investors start to worry . On the other side however, disinflationary trends like aging population and cheaper tech will continue to have its effect. So the Federal Reserve and a large number of investors believe that the surge of inflationary pressure is only temporary. We believe that the immense scale of monetary and fiscal stimuli will have its consequences and that is the upside of prices.

Not all is negative. Inflation erodes in part Government debt and is also a driver of bank profits.

Keeping it in check will be a task that the Federal Reserve is well equipped for. Companies that have earnings more influenced by the economic cycle will have the ability to pass on higher prices to customers in the near term and offset a squeeze on profit margins and will be preferred by investors in their asset allocation.



The “temporary ” argument could be challenged if economic growth continues to run hot into 2022, accompanied by a trend of higher wages. Before reaching that point, expected inflation priced into the bond market may well push past the peaks of the past and enter uncharted territory in the US and also for other developed markets .

All in all, future inflationary pressures will be an „un-known“ in the equation of forming a resilient fixed income portfolio.

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