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Market Musings

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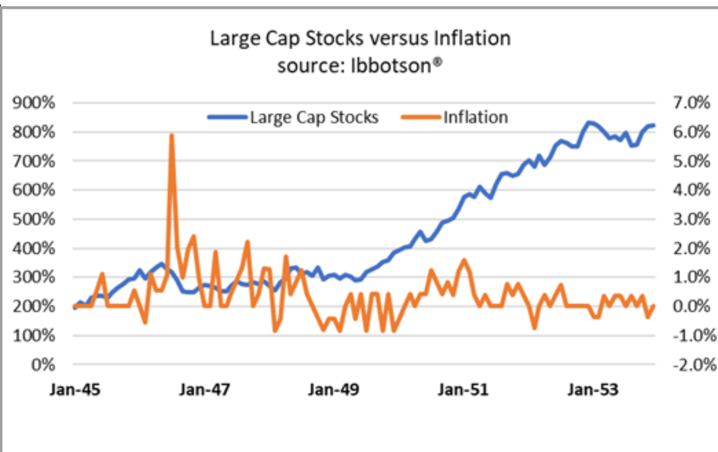
The chart shows inflation since the period following World War II compared to stock market returns. The period after WW II could be a mirror image of today's pent-up demand following COVID, demonstrating that rising inflation in a growing economy does not negatively affect stock market performance.



Digging Deeper into Inflation

Here is one definition of inflation that dominates the economic world: "Too much money chasing too few goods." The problem with this definition is that it is composed of two variables, either of which could affect the impact of "inflation." There are two good examples of one type of inflation, the type that occurs when the goods side of the equation becomes "too few." The first occurred in Post-World War I Germany and the second appeared in the African country of Zimbabwe in the 2000s. Both involved the collapse of goods leading to hyperinflation and shrinking economies. The other side of the equation, the "too much money" side, is not the boogeyman that it has been made out to be. When consumers have increased pent-up demand for goods and services and have the wherewithal to pay for them, unanticipated demand can push prices higher. But that is not inflation as the seller of goods receives more income while the consumer must spend more to purchase the same goods. The key to evaluating this type of inflation is whether the economy is growing or shrinking.

America experienced the "bad" type of inflation when OPEC imposed an oil embargo on the U.S. The shrinkage in the supply of oil and all its byproducts produced double digit inflation in the mid-1970s. Long lines at gas stations and the related quadrupling of gasoline prices attested to the impact of a supply shortage.

We also experienced the "good" type of inflation in the period following World War II. Good inflation can be recognized by the experience of rising economic activity as prices rise. In the late 1940s, consumers had accumulated wealth during the war years as there was a shortage of consumer goods due to the need for defense spending. After the war, there was a surge in demand as reflected in the exhibit above. The post WWII experience could be compared to the current post-Covid experience and the surge in demand as consumers spend accumulated savings and government granted subsidies. If we are correct in assessing the similarities of these two periods of demand driven inflation, then the rise in inflation should be temporary and financial markets should flourish not unlike they did in the Roaring Fifties when the stock market rose at an annualized rate of 16%!

"Today is the fodder of tomorrow's dreams, so we'd be wise to invest in today so that we don't show up with empty hands tomorrow."

Craig Lounsbrough

Market Commentary

For high-flying stocks in the market, May could have been too late to get away. Many of the high multiple stocks continued to take a beating last month even though the market has advanced by double-digits so far this year. The biggest loser in the high-flyer category was not a stock but a so-called cryptocurrency— bitcoin —and related innovations in the digital asset category. During May Bitcoin declined 36% in price and is in correction mode. Compare that to the 2.08% increase in small-cap stocks and 0.70% increase in their large-cap brethren. Foreign equities advanced by 3.12% and emerging markets rose 2.12% putting global stock markets well-ahead of historic growth rates in only five months.

Long-term Treasuries maturing in at least 10 years fell by 13.5% (total return) in the 1st quarter 2021, the worst quarterly performance for this asset group in 41 years.
(source: Bloomberg-Barclays)

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