



## ***January 2022: Is it Inflation's turn to shake things up?***



*Federal Reserve Chairman Powell recently announced that he anticipated the return of inflation but that it would be “transitory”.*

*That sounds to us like a ten-dollar way to say “temporary”, a one-dollar word. According to Mr. Webster, “transitory” does sprinkle an additional flavoring to mean “fleeting”. As in, “won’t be around for long at all.”*

*If we use a ten-dollar word we just learned playing Scrabble friends might think we are just trying to look intelligent.*

**But when a prominent and influential person uses a fancy word to mean something that can more plainly be said, it might be time to pay closer attention to what’s going on around you.**

Like at the supermarket, where the register tape at checkout jolts you to check if you tossed fillet mignon in the cart by mistake. According to the folks that keep a close eye on these things, the average price of meat, poultry, fish, and eggs has indeed gone up—by about 11% since 2019. And still going. Transitory doesn’t seem so temporary.

***So, who are you going to believe, your own lying eyes—or the pronouncements of one of the most powerful people on the planet?***

Inflation has been with us throughout modern times. In varying degrees, it is everywhere (*cars, houses, college tuition, pretty much everything*). Prices usually creep up so slowly we hardly notice. If Social Security benefits, wages and portfolio values increase along with the cost of living, it feels like we are at least keeping pace, and maybe falling under the illusion that we are richer. We all can celebrate occasionally lower prices in some arenas (*big screen TVs whose prices dropped from oversupply and technology changes*) while we quietly buy more chicken and less beef or look twice at the high price of private over public universities.

If some of us own assets like real estate and commodities, often favored by a degree of inflation, we may indeed be richer. But that wealth can be offset once the reported rate of return of your investment in stocks and bonds is adjusted for the impact of inflation and taxes.

**When our purchasing power falters in the face of higher and higher prices, we call inflation hyperinflation, and we abandon chicken to buy tuna fish. We feel poorer. We are poorer.**

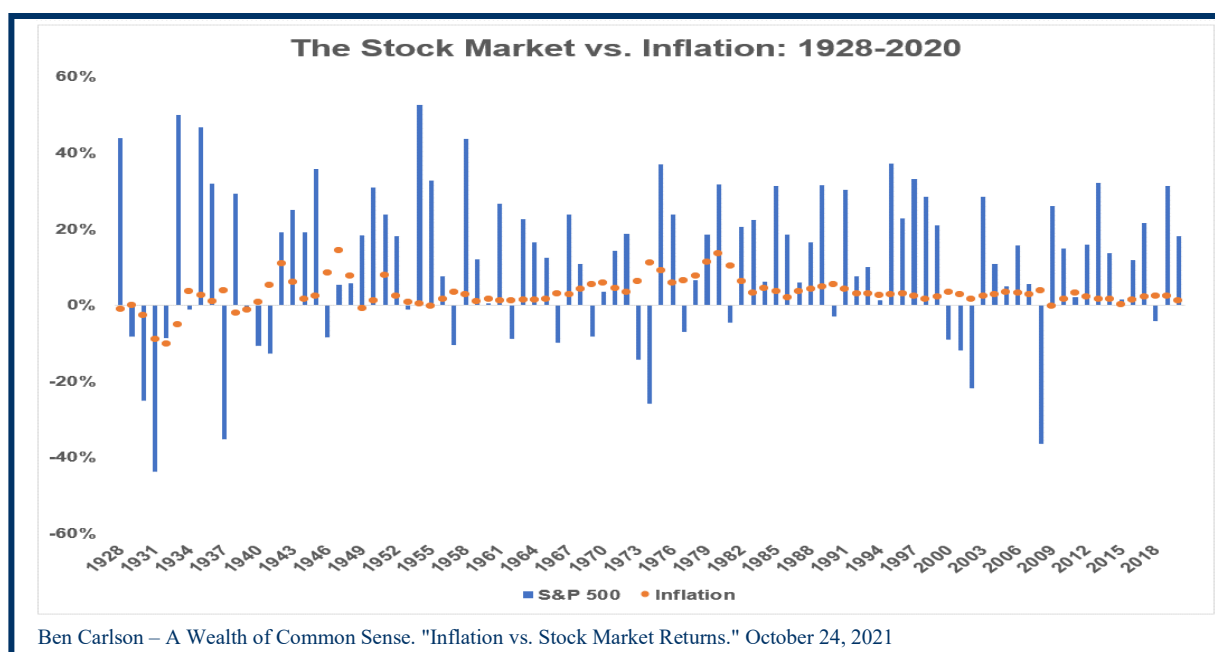
At times inflation’s evil cousin, deflation, takes center stage. Higher and higher prices soon crush demand for goods and services. Prices begin to spiral lower and lower. Regular folks stop buying wherever they can, waiting to buy at hoped-for lower prices to come.

**Some seventy percent of the US economy is driven by consumer spending. When consumer spending stalls, the economy slows and can even grind to a halt. Company profits evaporate. Stock prices evaporate with it.**

Inflation comes in several flavors; **Demand-Pull** (*supply can’t keep up with demand*), **Cost-Push** (*costs of production and supply delivery increases prices*) and **Built-In** (*when wages rise to meet higher living costs*). Details of each are beyond the scope of this letter. The various ways the government reports inflation add to the confusion: CPI Core, Headline, Adjusted CPI, etc. It’s no surprise that the relation

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between inflation and the value of your portfolio is unclear (*see below*).



## INFLATION and STOCK MARKET RETURNS

*Examining historical returns data during periods of high and low inflation can provide some clarity for investors. Numerous studies have looked at the impact of inflation on stock returns. Unfortunately, these studies have produced conflicting results when several factors are taken into account, namely geography and time period. Most studies conclude that expected inflation can either positively or negatively impact stocks, depending on the investor's ability to hedge and the government's monetary policy.*

Massachusetts Institute of Technology. "Inflation Risk and the Cross Section of Stock Returns." April 2020

## What might inflation mean for your portfolio and retirement plans?

We have written many times about the regularity of stock market drops—even big ones, and the various ways one might go about riding the storm. Fearing the reemergence of undesirable levels of inflation from the side effect of historic interventions, the Fed is now talking about reducing the government supports it put in place in the 2008 financial crisis and again with the Covid pandemic.

Does that imply higher interest rates to the benefit of your fixed income investments—but to the detriment of your stock market investments? If inflation forces can be complicated, their impact on stock prices, interest rates and even taxes can be equally so.

2021 was a good year for stock market performance. Money printing and easy credit have been a lifeline for the economy and a boon for investors, at least so far. With luck and a heck of a balancing act, better times will continue. **Time-honored strategies and some new approaches are what we will use on your behalf in 2022, as we navigate uncertain waters.**



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