

Pathfinder Investment Outlook

For the week ending February 19th, 2021

Reasons Why Inflation Readings May Increase

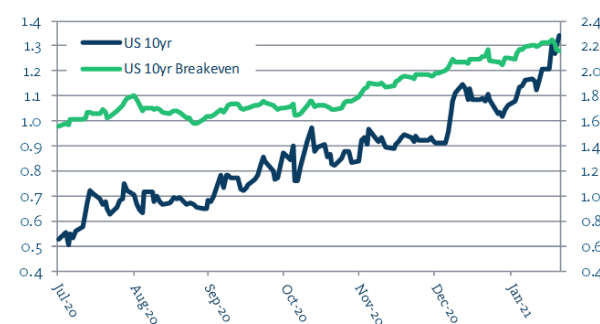
In the second part of our four-part inflation series, we wanted to identify several reasons why inflation appears likely to be increasing. The real question for investors is whether the reasons below are short-term (temporal) or if there is a good reason to expect that there has been a structural change to the investing environment. Below are several items that we will pay attention to in order to try to determine our view.

- Demand & supply imbalance:** There is increasing evidence that the pandemic has impacted small businesses. This means that just as demand increases as vaccinations and herd immunity take hold, there will be constrained capacity to deal with the uptick. The result would be increased prices. There is potential that this could be temporary until new businesses open or permanent if businesses formation is truly impaired.
- Many businesses have adjusted the way they operate** (more video commuting, offices moving away from downtown cores, changing global supply chains and holding more inventory). This is not as efficient as it was before and will impact productivity, thereby adding to inflationary pressures across all industries.
- “Comparables”:** Consumer prices decreased last spring at the start of the recession. When this year’s pricing is compared with last year’s, it will look as if inflation has increased; but in reality, this could reflect last year’s price drop rather than an actual price increase. We call this “a tough comp” and it also happens regularly with financial results for the companies that we follow. The US Federal Open Market Committee (FOMC) has a soft target of 2% for inflation and it will look like we have passed through this target, just based on the math alone.
- Governments are stimulating with both fiscal and monetary measures** but the FOMC has also guided that they will now target an *average of 2% inflation* which means that price increases would need to “run hot” and over 2% in order to bring average inflation up, as it has been so low for so long. This could give the impression that inflation is increasing in a potentially uncontrolled way. Financial markets do not like out-of-control inflation.

“This means that” while inflation expectations have somewhat stabilized over the past week, Figure 1 shows that the trend remains up. There are several reasons noted above for us to consider but the real question for us as investors is whether we should believe that the coming inflation is a long-term change or just temporal. We will discuss more next week.

Michael Rudd, CFA | President, CEO & Portfolio Manager

Figure 1: United States Inflation Expectations February 19, 2021



Source: Bloomberg Markets LP, Pathfinder Asset Management Limited



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Sources: Bloomberg, Pathfinder Asset Management Limited

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