The Abernathy Group II
Family Office

# Why Inflation will Continue to be a Problem for Investors

Inflation has been dominating headlines recently, but how did it get to be this way?

In basic terms, inflation is caused by a surplus of demand driving prices up. For the past 30 years the US has enjoyed stable and controlled inflation despite several large economic shocks. As a result, we have all but forgotten the painful lessons of "stagflation." In those years, a combination of high unemployment, oil price shocks, and the Fed not having a clear path forward resulted in a tough economic situation that was only cured by the Fed raising interest rates to high double digits and causing two recessions in the process.

Today, the combination of many years of easy monetary[i] policy and ever increasing demand have resulted in record-high inflation. Fuel prices have spiked, housing has become even more unaffordable, and supply disruptions threaten to increase the price of food as well. The supply shocks that emerged during the COVID pandemic are lingering on, driving prices even higher. For a while, the Fed called this inflation "transitory" and seemed to hope that it would go away on its own. Along with that hope, the Fed continued with even more easy monetary policy, driving the pricing imbalances even further into extremes.

Now the sleeping giant is awake. The Fed has already increased interest rates from 0.25 to 4.75 in the course of a year. The mortgage industry has almost stopped as a result, and given the market's volatility savings accounts are outperforming historically risky and profitable investments. Several banks have failed, partly due to the rapid increase of rates, and yet the Fed has continued raising interest rates even further. The extreme of easy monetary policy has, almost overnight, shifted into extreme tightening with no end in sight. All of this while the yield curve has already been inverted for 6 months, which has been a reliable signal of upcoming recessions since 1968.

The question on everyone's mind is: what comes next? Will the Fed keep hiking rates into the double digits? Will a prolonged period of high rates plunge the US into a recession? Will inflation somehow ease just as quickly as it appeared, allowing everyone to sleep more easily again? All signs point to a possible recession and increased uncertainty. The situation could very easily become worse before it gets better.

Without a crystal ball, it's best to plan for more uncertainty going forward. Follow your long-term plan, manage unnecessary risk, and soldier on.

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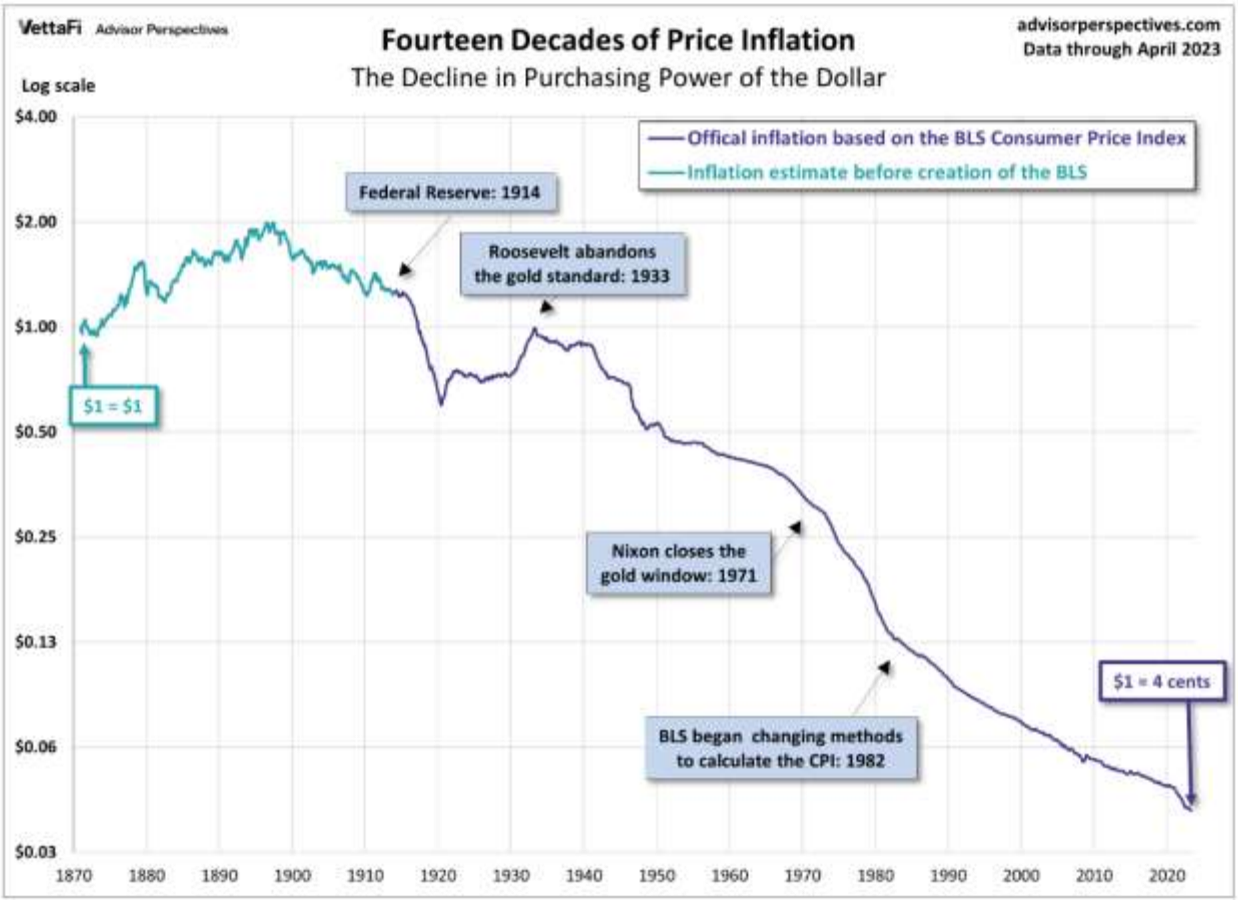
[i] The chart below demonstrates the cumulative effects of inflation over a longer term. Often inflation is called the “Silent Thief” because it erodes the ability to purchase goods and services, yet keeps the nominal value constant. What most people don’t

understand is that money – or currency – is just a means of exchange. You have $1.00 and you exchange it for a good or service. The currency maintains the named value of $1.00, *yet the goods and services cost changes*. Today it is $1.00 in our hypothetical example, and next year the good/service cost $1.04, and the year after that the same good/service costs $1.08… this continues while the consumer is lulled to sleep because they still have $1.00 in the bank. At some point the consumer revolts as they are unable to afford the basic necessities due to inflation.
Below, you will see a chart which chronicles the value of $1.00 starting its decay in 1920 and continuing through 2023.




This chart clearly demonstrates the reasons the U.S. Federal Reserve has a mandate of controlling inflation.