COOPER WEALTH MANAGEMENT
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THOUGHTS FROM HOME

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The Inflation Situation

"Rising prices or wages do not cause inflation; they only report it."
- Walter Wriston, Past CEO, Citigroup

At this time between earnings periods, a lot of media and market attention has been focused on inflation, and the possibility of raising interest rates to combat it. However, very little time is being spent on the different types of inflation and how they impact the economy and the market as a whole. This month we will focus on breaking down inflation and how interest rates might be impacted.

The first type is Cost-Push Inflation, where the cost of raw materials rises due to a surge in demand for manufactured goods.

This has definitely been the case recently as the world begins to emerge from the Covid crisis, with the prices of commodities such as lumber, oil, copper and iron ore hitting multi year highs as consumers globally return to spending. This type of inflation is generally short lived as raw materials producers will raise production to take advantage of the higher prices and demand eventually returns to normal, bringing the economy back into balance.

Next is the inflation that is the least troublesome; Asset Inflation, which is the rise in prices of material things such as stocks and real estate.

This type of inflation has been good news for market investors and homeowners alike in recent years. The concerns raised by asset inflation are housing affordability and the sustainability of stock market valuations. Fortunately, the demand for housing remains strong and despite tougher lending rules in Canada, the demand for housing remains robust. On the market side, while stock prices have moved higher, corporate earnings have mostly managed to keep pace. In any marketplace, there are bargains, overpriced items and speculations. Currently, the market is providing all three, which makes for a robust and active stock market.

Lastly, we look at Monetary Inflation, which is the sustained increase in the money supply of a country.

In Zimbabwe for example, the country was issuing $10 trillion banknotes before the currency collapsed completely. Canada, the U.S., the European Union and Japan have all been issuing money at a record pace since the the Covid crisis began. The good news is that all these countries have used this cash to purchase bonds, which actually helps lower the net debt level. If they had used the cash merely to pay bills, monetary inflation would definitely have been a problem. However, with most major nations able to print money, this is an unprecedented moment in international finance as global liquidity reaches new record levels.

The U.S. Federal Reserve has hinted at possible rate increases over the next two years but this seems more like the political posturing of 2018 where they simply tried to talk global rates higher. This proved to be a failure as market forces dragged rates lower and we see these lower rate conditions to be in place for the foreseeable future, with continued global government debt repurchases as well as $18 trillion of negative interest rate debt to keep a hard cap on North American rates.

In our view, any cost-push inflation will only last to a maximum of 3 years before the forces of supply and demand come back into balance. This inflation has already been absorbed by the market without much impact.

With all this in mind, our view for equities for the second half of 2021 remains positive. So far in 2021, S&P 500 companies have announced $542 billion in stock buybacks, a new record, with more on the way from U.S. banks. This is a strong signal from corporate America. Combined with the continued low interest rate environment, the stage is set for higher equity returns, as long as corporate earnings continue to co-operate and Covid cases continue to decline.

As a result, we continue to focus our investments on growth, balanced with enough higher dividend value investments to help cushion any short term downturns. Investments in Apple, Microsoft, Salesforce and MasterCard drive our technology led growth strategy, while Royal Bank, Enbridge, TD Bank and Pembina lead our value names.

In conclusion, while inflation is a current hot topic of conversation, we believe it will be of a short term nature. Since 1873, long interest rates have only had one sustained period of increase 1973 to 1999 which was the height of the Baby Boomers demand for borrowing. We are now in the 22nd year of low interest rates and there does not appear to be anything on the horizon to change that any time soon. Overall, the investment landscape for stocks continues to look positive.

As always, comments, opinions, questions and concerns are always welcome.

Yours truly,

Trevor, Walter and the Cooper Wealth Management Team