Higher Inflation: A Re-Run of the 1970s?

The economic recovery has triggered a rise in prices—and maybe a touch of déjà vu.

So you've just returned from the used car lot where you were shocked to discover that a two-year-old Toyota pickup truck cost more than it did two years ago. Now you're wondering: Is it finally time to pull those old red-and-white "Whip Inflation Now" buttons out of the junk drawer?

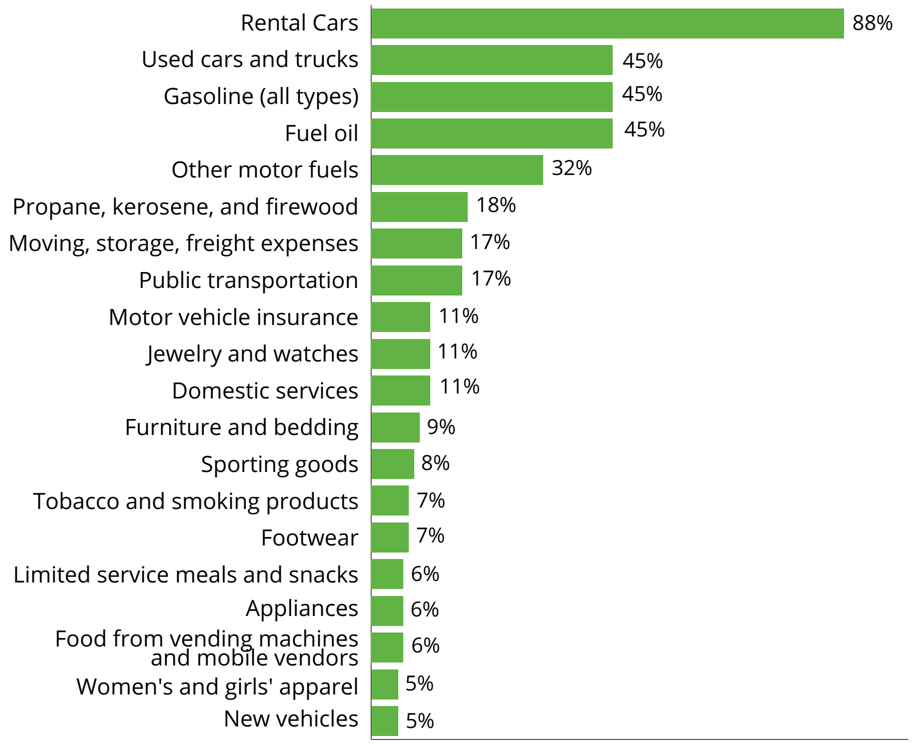
Wait! You don't remember those corny "WIN" buttons from 1974? When inflation surged more than 13%? When the Ford administration solemnly declared inflation "Public Enemy Number One"?

Inflation, mercifully dormant for nearly four decades, has sprung back to life this year—hitting an annual rate of 5.4% in July. As the US economy emerges from a pandemic, the mostly good news of the budding recovery has been tarnished by a surprisingly fierce run-up in prices.

FIGURE 1

Change in Prices From One Year Ago

Top 20 Items



Source: Bureau of Labor Statistics. Unadjusted data as of 6/30/21.

Key Points

- Inflation recently sprang to life as prices for travel, gasoline, used cars, and consumer staples unexpectedly surged.
- A repeat of '70s-style inflation, which peaked at 13%, is highly unlikely.
- The recent price hikes are attribued mostly to the ongoing economic recovery and to temporary supply-chain bottlenecks.

Inflation: The Silent Killer

The resurgence of inflation has drawn lots of nervous attention from policymakers, particularly at the Federal Reserve (Fed)—and for good reason.

Inflation is called the silent killer because it secretly eats away at your purchasing power for a wide range of goods and services. It makes the dollars you hold today worth even less in the future.

When severe, inflation saps the value of real wages and compels many consumers to buy goods sooner and save less. What's more, inflation tends to become a self-fulfilling prophecy as higher prices lead to demand for higher wages. This can prompt companies to raise prices, which in turn can lead to even stronger demand for higher wages, and so on.

If you were born after 1985, your experience of inflation so far may have extended no further than watching the price of gasoline shoot past $3 per gallon. For those with longer memories, the double-digit inflation of the 1970s was no joke (WIN buttons aside). Meat prices soared, sparking a consumer revolt. Worse yet, the Organization of Petroleum Exporting Countries shocked the nation's oil supply by quadrupling crude prices in 1973 and doubling them again in 1979. When the Fed finally decided that higher interest rates were the only appropriate cure for persistent inflation, mortgage rates hit an all-time peak of 18% in October 1981.[1]

It literally took a painful recession (1981–1983) to finally wring inflation from the public psyche. When citizens no longer expected their dollars to lose value every day, the vicious cycle of too much money spent on chasing too few goods finally came to an end.

This Time It Could Be Different (Really)

Today, the Fed—which acknowledged in July that inflation was running hotter than it expected—believes the current spasm will be short-lived. If the Fed is right, the recent spike should subside in the months ahead, particularly once supply-chain bottlenecks adjust to the sudden re-opening of the US economy and to the demand surge fueled by excess savings and stimulus checks.

There's already some evidence the Fed may be right. Lumber prices, which soared in April 2021 and made new homes less affordable, have come down almost as fast as they rose. Other commodity prices are also subsiding.[2]

But if the Fed is wrong (as some economists argue), inflation could stick around for years to come.

Your Inflation Playbook

If inflation suddenly gets out of hand, the Fed may be forced to raise interest rates or cut back on the bond-purchase program it's been using to help stimulate the ongoing recovery. Higher rates could be especially painful for growth stocks, raising costs and eating into profit margins.

In an economic environment that involves higher inflation and continued growth, investors may flock to traditional inflation-protection hedges, including: industrial metals commodities, emerging-market currencies, inflation-linked bonds, or natural-resource equities.

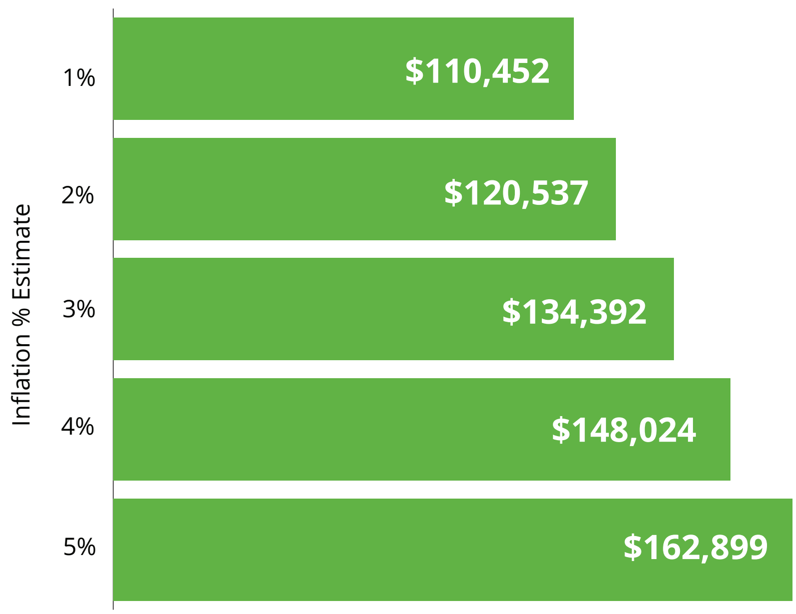
Value stocks tend to perform better in inflationary environments since companies paying high dividends are those that stand to gain the most from a strengthening economy. Savers and bond investors could also see better yields on fixed income and savings deposits.

It's understandable if you might feel unaccustomed to thinking about rampant inflation (unless you've been binge-watching re-runs of "That '70s Show"). But like it or not, inflation is back. Now would be the good time to speak with a financial professional who can help you devise a strategy to keep pace with whatever inflation we face in the future (see **FIGURE 2**).

FIGURE 2

Will You Keep Pace With Inflation?

How Much $100,000 in Today's Dollars Will Need to Grow After a Decade of Inflation



Source: Hartford Funds

Talk to your financial professional about preparing for the possibility of higher inflation.

[1] "Historical Mortgage Rates: Averages and Trends from the 1970s to 2020", valuepenguin.com, 3/6/21.

[2] "Supply and Demand Are Coming Back Into Balance. These 9 Charts Show How", barrons.com, 6/15/21.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets. • Investments in the commodities market and the natural-resource industry may increase liquidity risk, volatility and risk of loss if adverse developments occur. • The value of inflation-protected securities (IPS) generally fluctuates with changes in real interest rates, and the market for IPS may be less developed or liquid, and more volatile, than other securities markets. • Different investment styles may go in and out of favor, which may underperform the broader stock market.

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