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Inflation Playbook: What You Need to Know

A breakdown of which asset classes have outperformed during periods of rising and falling inflation.

Whether you're at the gas pump or the grocery store, everything seems more expensive these days. How long could this inflation last and, more importantly, what can investors do to protect their portfolios from the damaging impacts of inflation?

What's Fueling Inflation

Combined with supply-chain disruptions, there are many factors pointing to healthy economic demand—which could mean inflation—for years to come. First, household real-estate equity values are at all-time highs compared to the 2008 recession. Second, consumer debt, as measured by household debt service, is at a 40-year low—while average hourly earnings are growing at multi-decade highs. Finally, government deficit levels are the highest they've been since the post-World War II era, which may be another tailwind for economic demand.

Fortunately, not all asset classes react the same way when inflation is on the rise, as the chart below shows.

Key Points

- Inflation is on the rise and could last for quite some time.
- To prepare portfolios, investors should consider allocating to asset classes such as commodities, stocks, and Treasury inflation-protected securities (TIPS) that have historically fared well during periods of rising inflation.

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Asset Class Returns During Periods of Rising Inflation Since 1970

1973–1975	1977–1980	1983–1984	1987–1991	1999–2001	2003–2006	2010–2012	2020–2021	Average
Commodities 58.34%	Commodities 41.96%	International 9.08%	Commodities 14.46%	TIPS 10.50%	International 17.91%	US Small Cap 15.53%	US Small Cap 38.63%	Commodities 19.25%
Treasuries 6.77%	US Large Value 22.18%	Treasuries 3.85%	US Large Value 11.63%	Treasuries 10.08%	US Large Value 14.96%	US Large Value 15.51%	US Large Growth 33.29%	US Large Value 11.49%
IG Corporate 2.05%	International 22.06%	High Yield 1.53%	US Large Growth 10.93%	IG Corporate 9.69%	US Small Cap 13.39%	US Large Growth 11.84%	Commodities 32.65%	US Small Cap 10.14%
International -5.30%	US Small Cap 21.71%	IG Corporate 1.31%	International 8.43%	US Small Cap 7.11%	US Large Growth 10.61%	TIPS 8.55%	US Large Value 31.70%	TIPS 7.73%
US Large Value -8.83%	US Large Growth 21.40%	US Large Value -1.84%	IG Corporate 8.19%	US Large Value 6.62%	Commodities 9.48%	High Yield 8.13%	International 23.29%	International 7.13%
US Small Cap -13.44%	Treasuries 6.57%	Commodities -3.22%	Treasuries 7.86%	Commodities 3.02%	High Yield 7.68%	IG Corporate 6.57%	High Yield 11.17%	High Yield 5.36%
US Large Growth -17.22%	IG Corporate 2.09%	US Small Cap -8.84%	US Small Cap 7.01%	High Yield -0.45%	TIPS 4.70%	Treasuries 4.77%	TIPS 7.17%	Treasuries 5.13%
		US Large Growth -10.90%	High Yield 4.11%	International -17.48%	IG Corporate 3.62%	International -0.96%	IG Corporate 2.35%	US Large Growth 4.71%
				US Large Growth -22.24%	Treasuries 3.16%	Commodities -2.66%	Treasuries -1.99%	IG Corporate 4.48%

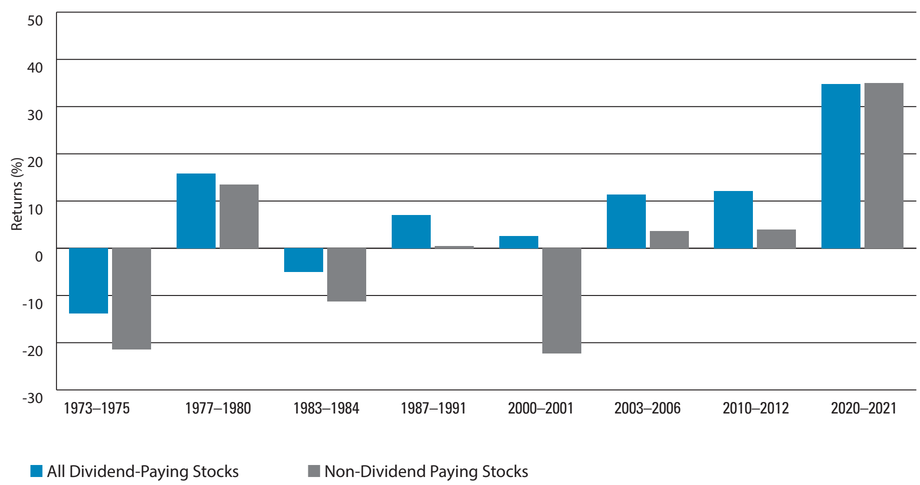
Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. See last page for representative index definitions. For illustrative purposes only. Note: Historical data unavailable for some asset classes. Inflation is measured by Core CPI, or the consumer price index, defined by the Bureau of Labor Statistics as a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services excluding food and energy prices. Rising core CPI periods defined as increases of about 1% or more. TIPS, Treasury-inflation protected securities, are Treasury bonds that are adjusted to eliminate the effects of inflation on interest and principal payments, as measured by CPI. Source: Hartford Funds as of 12/31/21.

With this in mind, investors may want to consider including the following asset classes in their portfolios to help mitigate the impacts of rising inflation:

- **Commodities** — Commodities have performed well during inflationary periods because they're generally positively correlated: Commodity prices tend to rise when inflation rises. When demand for goods increases faster than they can be produced, commodity producers can pass price increases along to consumers.
- **Equities** — Both large-value and small-cap equities have benefited during periods of rising inflation. This can be partially linked to the strong economic growth often associated with rising inflation: Value- and small-cap stocks tend to be more economically sensitive, enabling them to benefit from the early and mid stages of economic recoveries.

  Within equities, **dividend-paying stocks** have the potential to provide yields that outpace inflation. With the exception of the current inflation cycle, which is still playing out, dividend-paying stocks have outperformed non-dividend paying stocks during all other periods of rising inflation since the 1970s, as shown in the chart below.

Dividend-Paying Stocks Have Generally Outperformed Non-Dividend Payers During Periods of Rising Inflation



Past performance does not guarantee future results. For dividend-paying stocks, dividends are not guaranteed and may decrease without notice. Ned Davis Research conducted a study in which they divided companies into two groups based on whether they paid a dividend during the previous 12 months (dividend-paying stocks) or not (non-dividend paying stocks). Source: Ned Davis Research, as of 12/31/21.

- **International equities** — Inflation historically weakens the US dollar, which can serve as a tailwind for international equities. From a sector standpoint, international equities also tend to be more cyclically oriented than the US, which can position them well during periods of strong demand.
- **TIPs** — Treasury inflation-protected securities can adjust their principal to account for rising or falling inflation (which also adjusts their interest payments accordingly), while providing a high-quality fixed-income investment that's backed by the US government. (Individual TIPS securities are backed by the US government but funds that invest in TIPS are not.)

What if Inflation Doesn't Last?

The other side of the debate is that inflation is transitory. If inflation reports continue to run high, the US Federal Reserve is likely to accelerate their announced tapering plans and could increase interest rates more quickly than expected. This would likely reduce liquidity in financial markets, slow economic growth—and quickly halt inflation.

Insight

In terms of portfolio positioning, investors who believe inflation is transitory, meaning it could level off or fall in the near future, may want to consider small-cap, large-growth, large-value, or international equities, which have tended to outperform when inflation has fallen in the past.

Asset Class Returns During Periods of Falling Inflation Since 1970

1970–1973	1975–1977	1980–1983	1984–1987	1991–1999	2001–2003	2006–2010	2020	Average
International 37.16%	US Small Cap 22.08%	US Small Cap 27.55%	International 49.85%	US Large Growth 23.19%	Commodities 24.91%	High Yield 8.94%	US Large Growth 12.19%	US Small Cap 15.36%
Commodities 25.90%	US Large Value 20.74%	US Large Value 19.38%	US Large Value 31.33%	US Large Value 18.56%	High Yield 12.76%	IG Corporate 7.16%	Treasuries 3.38%	US Large Growth 14.92%
US Large Growth 24.21%	Commodities 11.14%	US Large Growth 12.05%	US Large Growth 29.55%	US Small Cap 18.45%	TIPS 12.41%	TIPS 6.97%	TIPS 2.41%	US Large Value 14.61%
US Large Value 18.89%	IG Corporate 10.91%	IG Corporate 10.96%	IG Corporate 24.92%	High Yield 11.83%	US Small Cap 10.80%	Treasuries 6.79%	US Large Value 1.65%	International 14.25%
US Small Cap 18.86%	US Large Growth 10.42%	Treasuries 10.87%	US Small Cap 24.14%	International 9.70%	IG Corporate 9.18%	US Small Cap 4.39%	IG Corporate 1.26%	High Yield 10.88%
	Treasuries 7.11%	International 4.90%	High Yield 23.33%	IG Corporate 8.14%	International 8.35%	US Large Value 1.54%	International -0.95%	IG Corporate 10.36%
	International 5.37%	Commodities 1.24%	Treasuries 20.80%	Treasuries 7.26%	US Large Growth 7.48%	US Large Growth 0.31%	High Yield -2.45%	Treasuries 9.02%
			Commodities -0.25%	Commodities 4.28%	Treasuries 6.91%	Commodities -0.17%	US Small Cap -3.40%	Commodities 7.33%
					US Large Value 4.80%	International -0.41%	Commodities -8.38%	TIPS 7.26%

Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. See last page for representative index definitions. For illustrative purposes only. Note: Historical data unavailable for some asset classes. Falling CPI periods defined as an average decline of 1% or more. Source: Hartford Funds as of 12/31/21.

What You Can Do

Regardless of how long inflation lasts, the most prudent course of action is to review strategies that can help hedge portfolios against its damaging effects.

Hartford Funds That May Help Hedge Inflation

DOMESTIC EQUITIES	Ticker
Hartford Dividend and Growth Fund	HDGFX
Hartford Equity Income Fund	HQIFX

MULTISTRATEGY	Ticker
Hartford Global Real Asset Fund	HRLFX

INTERNATIONAL EQUITIES	
Hartford Schroders International Stock Fund	HSWFX

TIPS	
Hartford Inflation Plus Fund	HIPFX

Talk to your financial professional to make sure your portfolio is prepared for rising inflation.

Commodities are represented by the Bloomberg Commodity Total Return Index, an index composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. This combines the returns of the BCOM with the returns on cash collateral invested in 13 week (3 Month) US Treasury Bills. **High Yield** is represented by the Bloomberg US Corporate High Yield Total Return Index, an unmanaged broad-based market-value-weighted index that tracks the total-return performance of non-investment grade, fixed-rate, publicly placed, dollar-denominated and nonconvertible debt registered with the Securities and Exchange Commission. **International** is represented by the MSCI World ex USA Index, a free float-adjusted market-capitalization index that captures large- and mid-cap representation across developed-markets countries excluding the United States. MSCI performance is shown net of dividend withholding tax. **Investment-Grade (IG) Corporates** are represented by the Bloomberg US Corporate Index, a market-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more. **Treasuries** are represented by the Bloomberg US Treasury Index, an unmanaged index of prices of US Treasury bonds with maturities of one to 30 years. **US Large Value** is represented by the top 30% of the top 1000 US stocks based on a value score that equally weights multiple valuation metrics to arrive at an aggregated valuation metric. Valuation metrics include: Earnings Yield, Operating Cash Flow/Enterprise Value (EV), EBITDA (earnings before interest, taxes, depreciation, and amortization)/EV, Sales/EV, Dividend Yield, and Equity Yield. **US Large Growth** is represented by the top 30% of the top 1000 US Stocks based on 50% year-over-year total earnings growth and 50% year-over-year revenue growth. **US Small Cap** is represented by the US universe of small-cap stocks as identified by US stocks between the 85th and 98th percentiles of market cap. **TIPS** are represented by the Bloomberg US Treasury Inflation-Linked Bond Index (Series L), which measures the performance of the US Treasury Inflation-Protected Securities (TIPS) market. Federal Reserve holdings of US TIPS are not index eligible and are excluded from the face amount outstanding of each bond in the index.

Investors should carefully consider a fund's investment objectives, risks, charges and expenses. This and other important information is contained in a fund's full prospectus and summary prospectus, which can be obtained by visiting hartfordfunds.com. Please read it carefully before investing.

Important Risks: Investing involves risk, including the possible loss of principal. • Investments in the commodities market may increase liquidity risk, volatility, and risk of loss if adverse developments occur. • For dividend-paying stocks, dividends are not guaranteed and may decrease without notice. • Small-cap securities can have greater risks, including liquidity risk, and volatility than large-cap securities. • Different investment styles may go in and out of favor, which may cause a fund to underperform the broader stock market. • Foreign investments may be more volatile and less liquid than U.S. 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. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall.• 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. • Obligations of US Government agencies are supported by varying degrees of credit but are generally not backed by the full faith and credit of the US Government. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities.

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