

Is Inflation A Concern As We Begin 3rd Quarter 2021?

By Bob Deitrick, CEO of Polaris Financial Partners, LLC

A little inflation is not a bad thing. For more than two decades, inflation hawks have warned us, incorrectly, that an inflationary outbreak was “just around the corner.” Haunted by memories of the double-digit inflation of the late ‘70s and early 80’s, these pundits have suggested the US economy is poised for runaway inflation and that dramatic action needs to be taken before we see our trust in the future eroded and the very pillars of capitalism destroyed. This is simple nonsense... The U.S. economy is on fire today which is what one would suspect after an 18-month pandemic.

The latest round of fiscal stimulus this Spring, on top of loose monetary policy, have brought inflation hawks back in droves. Former Treasury Secretary Summers cautioned recently that the additional stimulus package passed by Congress will overheat the US economy and ignite extreme inflationary pressure. We believe he is incorrect. With the 10-year Treasury note falling from 1.73 in April to below 1.30% last week, the runaway inflation that these pundits are portending is an illusion.

The recent pickup in inflation is likely to be temporary, and it is a welcome change for those who feared a slowdown and recession in the U.S. last year. Like market corrections, inflation is a byproduct of a healthy growing economy, so its dormancy for the past two decades (due to NAFTA et al) has raised eyebrows.

Although stock market returns this year will not likely be a repeat of 2019 or the result we achieved in 2020; we envision presently a robust finish to 2021 with several sectors shining. The S&P 500 stands at 4,369 as of market close July 13th. Steven and I suspect we will close between 4600 and 4800 by year end. We believe oil and gas and energy will shine in the last two quarters. Oil has idiosyncratic virtues as supply wanes and demand increases. Anecdotally, the largest oil refinery in North America, located on the isle of St Croix, closed in April. As a result of this and other factors affecting supply, we believe energy stocks will likely have a strong finish to 2021 with a potential 20% to 30% gain.

Strong markets remain strong – they also climb walls of worry. This market has done both on numerous occasions since 2009. The FAANG stocks and the Tech sector have underperformed and have recalibrated this year. We envision a huge catch-up trade occurring in the Tech sector as the 2nd half of the year continues. If this happens, we will have a nice finish to 2021.

I do not often agree with investment pundit Kevin O’Leary. But I do agree with him on one thing he said recently and that is the United States economy **“is on fire now”**. So the government on both sides of the aisle needs to leave things alone... Anecdotally, in my travels to the US Virgin Islands over the past year, I have never seen it as busy there as it is today. People are traveling!

5-year, 5-year forward expected inflation, 2016–2021



Source: Federal Reserve Bank of St. Louis FRED Economic Data

What will kill the stock market is “real” inflation, which we have not seen, YET, and the slowing down of earnings, which there is no sign of at all. Equities in the U.S. will continue to rule for the balance of this year and there is nowhere to go with fixed income. We may be in store for a nice finish to 2021.

Is inflation picking up? Yes, it is, but wages are picking up too. If wages continue to increase in a manner corresponding with higher prices, we will be fine. Again, a little inflation is not a bad thing - especially for those of you who hold homes, real estate, and other inflation sensitive assets.

<u>Nation</u>	<u>City</u>	Price in US Dollars per Gallon
Netherlands	Amsterdam	\$6.48
Norway	Oslo	\$6.27
Italy	Milan	\$5.96
Denmark	Copenhagen	\$5.93
United Kingdom	London	\$5.79
Germany	Frankfurt	\$5.57
France	Paris	\$5.54
Portugal	Lisbon	\$5.35
Croatia	Zagreb	\$4.81
Ireland	Dublin	\$4.78
Switzerland	Geneva	\$4.74
Spain	Madrid	\$4.55
Japan	Tokyo	\$4.24
Czech Republic	Prague	\$4.19
Brazil	Brasilia	\$3.12
Cuba	Havana	\$3.03
United States	Columbus, Ohio Costco	\$2.91
Lebanon	Beirut	\$2.63
South Africa	Johannesburg	\$2.62
Russia	Moscow	\$2.10

Puerto Rico	San Juan	\$1.74
Saudi Arabia	Riyadh	\$0.91
Kuwait	Kuwait City	\$0.78
Venezuela	Caracas	\$0.12

We can use one of the Fed's forward looking indicators to see how the market interprets the gap and subsequent risk of long-term inflation. The Fed strives to keep inflation expectations anchored near 2%. To the extent that expectation is widely held, then short-term blips above or below 2%, like this one, will represent nothing but commotion around the normal long-term trend.

Some above-trend or temporary inflation is to be expected as the economy is re-opening everywhere. A modest jump in inflation should be viewed as a positive sign because it is indicating the economy's return to a sense of healthy normalcy. Long-term price pressures leading to double-digit inflation are possible but unlikely. Keep in mind, even with the price of gas at \$2.91 today at (Costco in Columbus) if one factors in normal inflation from 1980 to 2021 when gas was \$1.28 in 1980. Based on normal inflation data we should be paying \$4.18 at the pump today - instead, we are paying only \$2.91!

Our upcoming events for the balance of 2021 follow:

- *September 3rd, at Huntington Park, will be our annual Clippers Nights at the Ballpark on Friday of Labor Day weekend. We have leased the Pepsi Party Deck and two suites on the right field side of the plate for the evening and can hold ~ 100 for that event.*
- *November 9th and 12th we will hold our year end academic seminars at Eddie Merlot's on Tuesday and Friday of the second week of November in the Merlot Room.*
- *November 27th we will hold our bi-annual Crush Michigan/Harbaugh Event at Eddie Merlot's beginning at 12:00 noon that day. We will have great food and a pig roast to honor the roasting of Jimmy Harbaugh once again.*
- *December 12th, 2021- we will bring back our traditional Christmas Holiday Celebration at Eddie Merlot's starting at 5:00 p.m. This will be an event for the entire family.*

On another positive note, Polaris Financial Partners, LLC reached another milestone in total assets under management (AUM) in the first week of July. We continue to grow due to our investment results and to new client development and that is a great thing for all our clients. We thank you for your business and please feel free to reach out to us with any questions at any time.

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