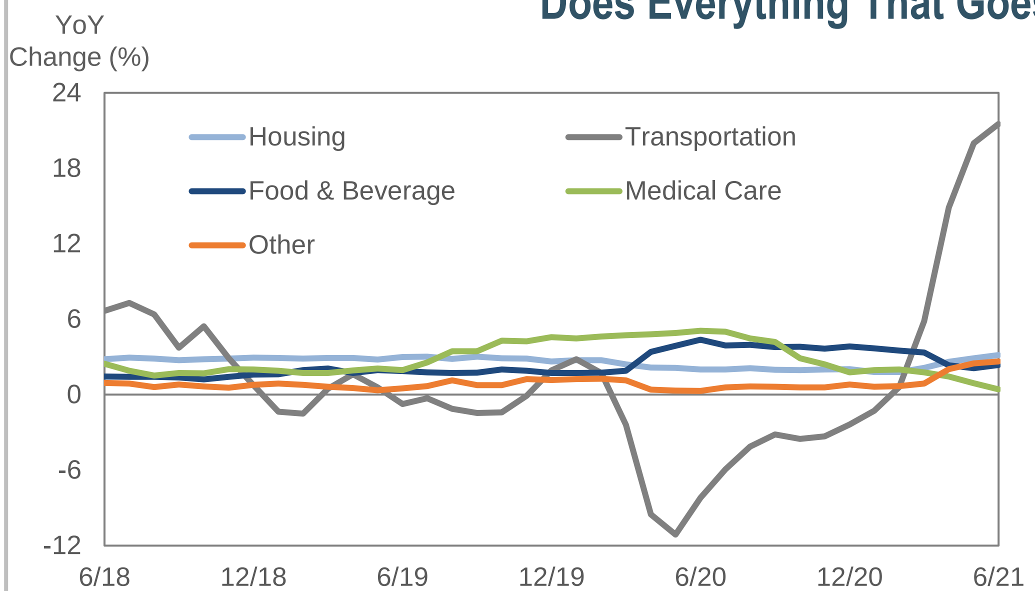
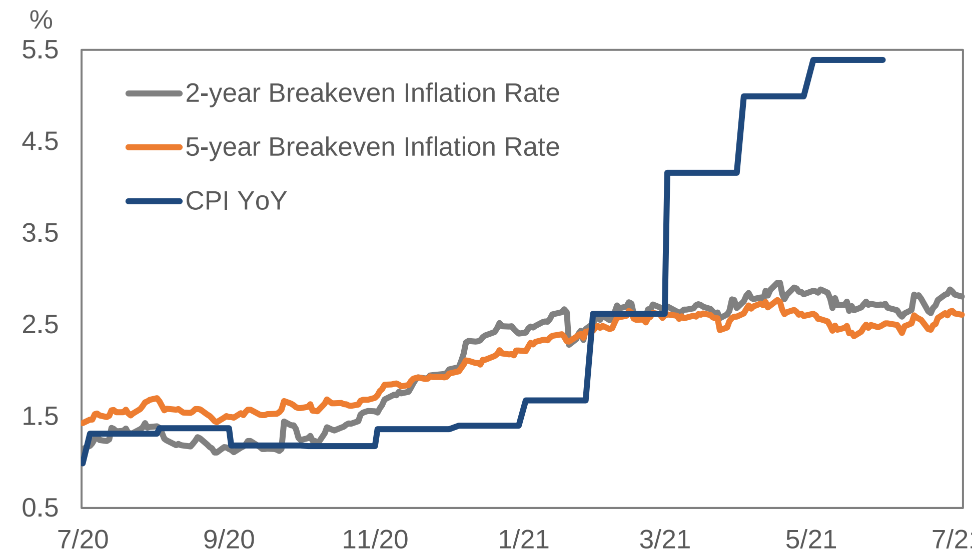
INCOME RESEARCH + MANAGEMENT

August 4, 2021

Does Everything That Goes Up Have To Come Down?





- The US economy continues to rebound from the COVID-19 pandemic. The re-opening of the economy has caused upward, uneven pressure on prices impacting different parts of the economy. The question is whether these price increases will prove to be temporary (transitory) or sustained (inflation).
- **What is the inflation data saying?** June CPI increased by 5.4% year-over-year, the highest increase since 2008. However, some components had outsized impacts. Used cars and trucks rose over 45% over that time period, while gasoline and fuel oil rose by a similar amount. The subset directly impacted by the re-opening were the main drivers of the increase, reflecting shortages and increased consumer mobility, which implies the higher inflation may be transitory.
- **What is the market saying?** The breakeven inflation rate is a market-based measure of expected inflation. Breakevens trended upward in the second half of 2020 and the beginning of 2021, signaling the market expected longer-term inflation to increase as a result of the economic recovery. However, since then, breakeven inflation rates have traded sideways on expectations of lower growth, suggesting the more recent uptick in CPI may be shorter-term.
- Although inflation data and the market hint that the jump in inflation is likely transitory, there are still many uncertainties, such as wage inflation, the delta variant, and the expiration of the eviction moratorium. While TIPS may seem like the natural choice to protect against inflation, at IR+M, we seek to buy bonds that will perform well in a variety of inflationary scenarios. We will opportunistically add TIPS within our broad market portfolios when breakevens are attractive, as mentioned in Bill O'Neill's blog post, Tactical TIPS.