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Inflation Back in Fashion

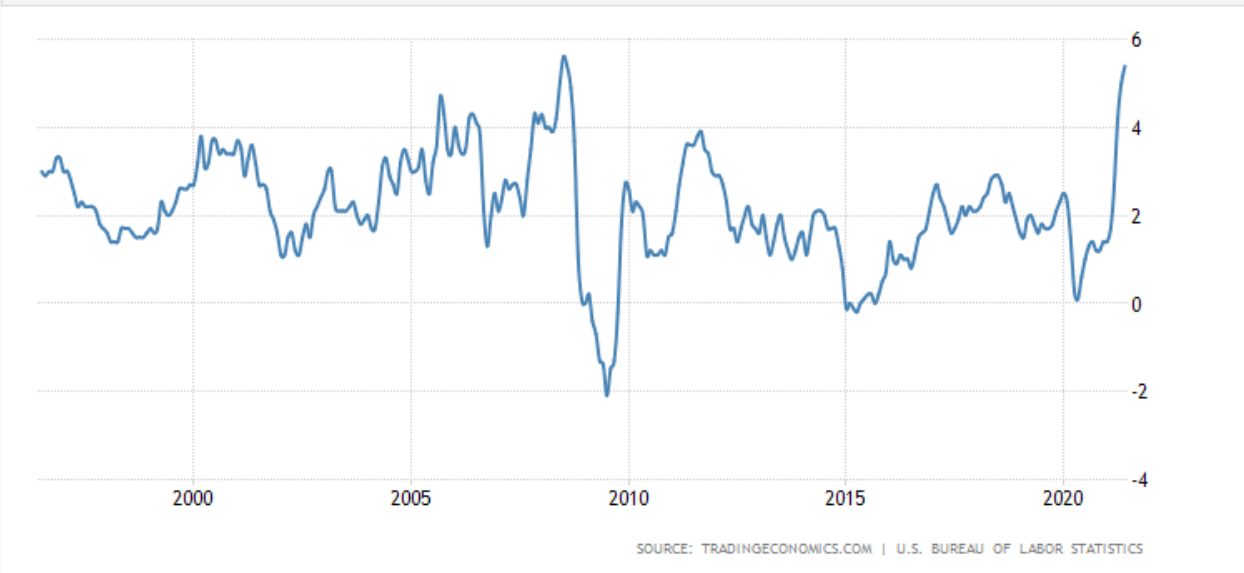
No matter where you live in the world, rising inflation deflates peoples hard earned money. This makes it extremely unattractive for the partisan Central Bank's across the world to report that inflation is high. They usually under report the actual value of inflation.

Over time the US Federal government has adjusted the definition of the CPI (Consumer Price Index) which measures inflation. The Bureau of Labour Statistics has evolved the calculation from a cost of goods index to a cost-of-living index. According to the US government, adjustments have been made so inflation is not overstated when reported. The new number takes the quality of goods and substitution for goods into account. David Ranson, an American economist mentions that the current CPI number is a lagging indicator. He looks to commodity prices as a better indicator for current inflation.

Commodity	Monthly % Change	YTD % Change	1Y % Change
Crude Oil (NYM $/bbl)	10.58	50.89	78.84
Gold (NYM $/ozt)	-7.44	-7.36	-3.00
Silver (NYM $/ozt)	-7.65	-2.33	41.34
Copper (NYM $/lbs)	-8.84	20.92	55.99
Lumber (CME $/bft)	-42.12	36.71	309.67

As of June 30th, 2021, Source: FactSet

By David Ranson's indicators inflation has surged over the past year. Inflation is present in today's economy and in today's markets. The numbers reported by the Bureau of Labour Statistics for the month ended May 2021 placed the CPI at 5.0% (annualized). This was the highest monthly CPI value since July of 2008. That number was beat by June's CPI release of 5.4%.



The June 2021 CPI data will be released July 13th and will be a key number to watch. Investors in both debt and equity markets will be very attentive when it comes to this data release and so will the US FED. Analyst projections are 0.6% for June which on an annualized basis is higher than the May number that set a 12 year high. The June CPI was officially released and it ticked up to 0.9%, 5.4% year over year.

The data does not lie. The inflation numbers are only reported at this level due to the changes made in the calculations by the government. If CPI were calculated before the 1996 changes made at the Boskin Commission, CPI would currently be reported at 9%. If it were calculated like it had been in the 1970s, CPI would be about 12% currently. Today's inflation has slowly sparked conversations comparing it to the 1970s and early 80s, a period where inflation soared throughout the American economy. Inflation peaked in 1980 at 13.5%

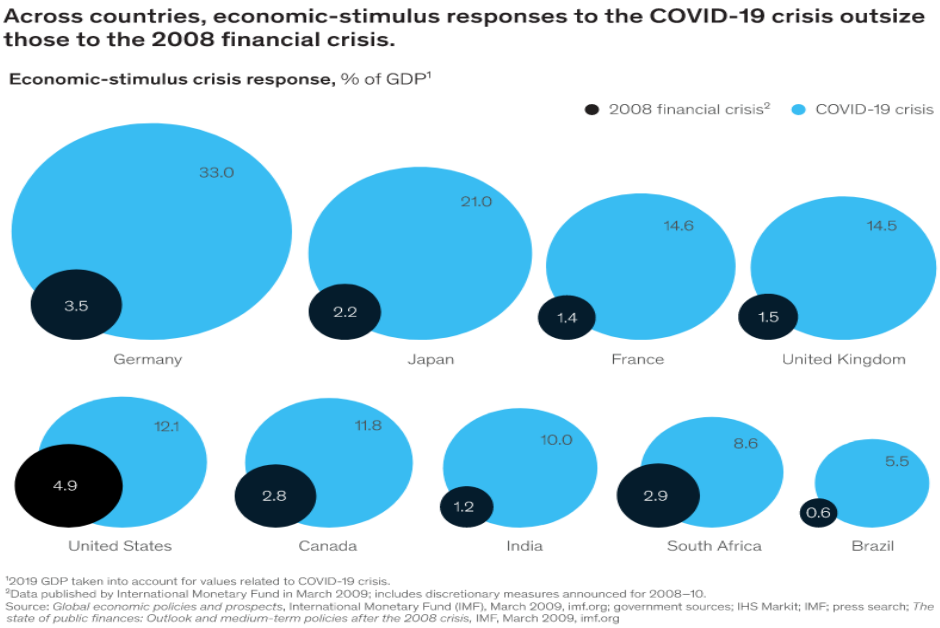
Think inflation is not real? Think again.

Used car and truck prices have increased 29.7% for the year ended May 31. Inflation is showing up across the board for consumers. Input prices are going up not only for auto producers, home builders and manufacturing companies but also for restaurants. Canadian restaurants have already begun to increase prices as certain inputs have risen. Canola Oil has increased from $18 to $30, just over the time of the Covid-19 pandemic. It is safe to say your favorite restaurant will more than likely have higher prices going forward.

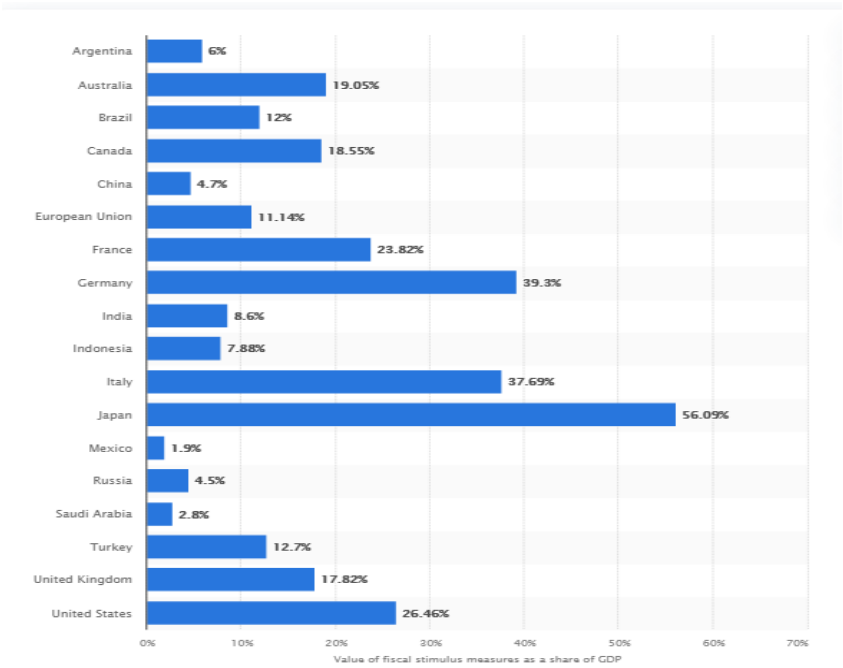
What has caused the present-day issue?

There have been numerous factors that have led to these inflated prices and the issue at hand. The limited supply of certain goods stemming from a halt in production from Covid-19 in numerous industries and the recent re-opening causing a surge in demand have been cited as reasons for short term inflation from federal governments across the world. The supply demand story is a contributing factor but it's not the entire story explaining current inflation.

Federal governments and Central Banks have also been inflating asset prices over the past 10 years by printing more and more money. The FED is using this money to purchase assets from public banks fueling the fire. However, the money creation grew exponentially in response to the Covid-19 pandemic due to mass unemployment, bankruptcies and a financial market drop of about 30% in the matter of days. The government response was to print money and lots of it. This was not just in the US and Canada, this occurred across the world as governments tried to avoid an economic depression.



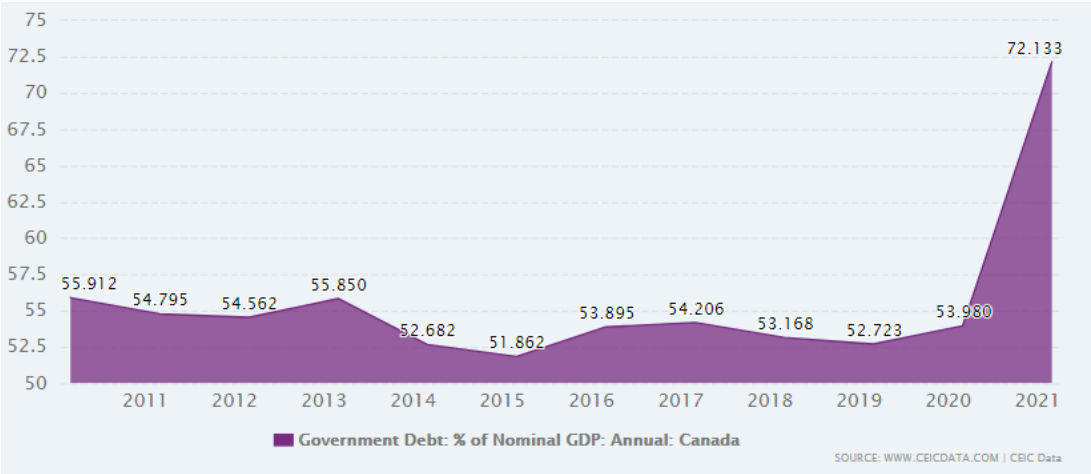
The graphic above depicts how large the financial stimulus packages countries used to battle Covid-19 recessions relative to government responses to the 2008 financial crisis. The graphic above is outdated as it was the response as of June 11th, 2020, so it only displays the first 3 months of fiscal stimulus. The graphic does a great job at showing the magnitude of the recent packages printed by governments. This trend is flat out unsustainable. If it were recreated today the 2008 financial crisis packages would basically be a dot on each one.



It is safe to say, government relief spending reached a new level. 2008 and 2009 have nothing on the amount of stimulus that has been used across the world in 2020 and 2021 to battle Covid-19. The bar graph above shows money spent by governments on Covid-19 relief ended May 2021 as a percentage of

total country GDP. Japan spent 56% of its national GDP on rescue packages. Western Europe as well as Canada and the US also pumped billions of dollars into their separate economies via Central Bank. Debt to GDP levels are at all-time highs for every western nation. The solution to economic uncertainty remains to keep printing and we'll kick the can down the road and figure it out then. Debt levels are truly not managed by any of these governments.

Canada is not exempt from inflation. The Canadian Debt as % of GDP jumped over 20% from March 2020 to March 2021.



The magnitude of these financial packages has caused surges in asset prices across the world. Other than the drop in March 2020, asset prices have soared over the last 10 years and have gone almost straight up. Bitcoin, real estate, and equity markets have all enjoyed some of their highest returns in recent memory. Bitcoin's current price is triple the March 2020 value; in March 2021 it was six times its value from the previous year. The Nasdaq Composite has doubled over the same period. Real estate prices have also soared across the US and more specifically Canada. The GTA and Vancouver now are the two most affordable areas in North America for real estate.

Since the 2009 market low, the S&P 500 has gained more than six times its value. The S&P 500 closed on July 1st setting record highs seven days in a row. As of July 1st, 2021, the S&P 500 closed at all-time highs, 35 separate times. Approximately 28% of trading days in 2021 have the S&P 500 setting fresh all-time highs. Truly euphoric as the market has not missed a beat. Investors cannot miss right now, value investing is an extreme laggard in comparison to commodity prices, growth stocks, "meme stocks" and cryptocurrencies.

There is a possibility this continues as massive economic packages continue to be minted and the money supply continues to increase, inflating asset prices even more. This will add to the already record levels of debt, most Western nations are currently sitting on. Many analysts, political commentators and the government keep telling us this is short term, it will not get out of control, this will not be the 1970s all over again. Whether they believe that or not, they do not want you to realize inflation is here to stay for a while.

Just a few of the hundred headlines telling you not to worry:

Economy | Unemployment | **Bloomberg**

With millions unemployed, gov'ts not worried about inflation

Governments can just keep interest rates low and spending high to support virus-hit economies.

Business

Global inflation pick up is transitory - Citi's King

Reuters

Letter: Inflation is not what we should be worried about

From Cathal Rabbitte, Villars-sur-Ollon, Switzerland

JUNE 27 2021

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MARKET INSIDER

Inflation is hotter than expected, but it looks temporary and likely won't affect Fed policy yet

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Mass spending can only keep up for so long for the western world. US government Debt has risen from under $1 trillion in the 1970s to $28 trillion. Total debt which takes government, business and personal debt into account is $85 trillion, it was under $2 trillion in the inflationary period of the 1970s. Interest rates will almost definitely be raised to account for expiring payments.

This trend is likely to continue. It is vital to all investors to learn how to invest in this environment. Market volatility remains above historical averages, a trend that will not end soon. It seems more than ever, every investor is monitoring every jobs report, CPI report and FED announcement like a hawk. Markets are swinging on every cryptic Federal Bank announcement. The key to watch is when Central Banks decide to raise interest rates, not if they do, when they will. Every announcement since countries have begun to open by Jerome Powell and Janet Yellen have been looked at by investors with extreme detail as they try to predict their moves. They have yet to really raise any rates, but the yield curve has begun to steepen. The US 10 Year interest rate is currently sitting just below 1.45%, down from its high earlier this year.

Rising interest rates still present some opportunities to go on the offense if this melt up reverses. At MacNicol we continue to analyze every scenario Central Banks and markets will throw at us. This will allow us to go on the offense for you and your hard-earned savings.