The Trades

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The price of re-opening – should we fear inflation?

by Cranley Macfarlane

I always look forward to the arrival of spring. The weather improves and the days get longer. This year there is extra cause for excitement as lockdown restrictions in the UK are due to be relaxed. With our regained freedom come more ways to spend our cash. Out go the unused DIY tools, loungewear and equipment for the home office/ kitchen table. In come restaurants, holidays, haircuts, and pubs!

In lockstep with the increase in spending is an expected rise in inflation. Inflation can be a good thing: it is the product of a growing economy, of rising wages, of increasing wealth and prosperity. But as one should remember when the pubs do re-open, too much of a good thing can be bad. If my supply of money (wages, savings) falls behind rising prices, I am unable to afford those products and services I may want in the future. To prevent a boom and bust, central banks try to cool down an overheating economy by raising interest rates and encouraging people to save rather than spend.

The current messaging from the US Federal Reserve is that any increase in inflation will be temporary, as it will be driven by the flurry of spending as the economy reopens, and that there will be no need to raise interest rates yet. But markets do worry, and all eyes are on the Fed’s Chairman, Jerome Powell, for any hint or slip that might signal higher interest rates in the US sooner than expected. So just as vaccination programmes are offering hope to those desperate for a pint, financial markets are already worrying about a premature end to the economic recovery.

In the Endeavour Fund we aim to make the most out of any inflation that should materialise. Over 50% of Endeavour’s equity weighting is in cyclical stocks that are most sensitive to the post-pandemic recovery. Banks, railroads, housebuilders can all do well as strong growth outweighs inflation; but higher interest rates are a problem for expensive stocks, such as tech, as they reduce the current value of their future earnings. Nonetheless, equities should do well as companies and their employees benefit from a stronger economy.

Rising inflation is detrimental to bonds, as the future value of their fixed income stream becomes less attractive. Nevertheless, we have increased our weighting to protect against a faltering recovery, while shortening the maturity and lowering the credit quality of our bonds to limit the impact of higher interest rates.

Gold can perform if inflation does run away. It has no income stream to be diminished by rising interest rates, and it is seen by many as an ultimate store of value. For some, bitcoin provides similar characteristics, but I have given up chocolate and discussing bitcoin for Lent, so have no further comment.

With the prospect of a slower recovery in mainland Europe, and the risks that come with higher inflation, there is no harm in a little caution. At least I will be able to relax better when in three weeks’ time, I will be sitting in a pub garden enjoying a beer. I hope it won’t be raining, and I won’t be surprised if the price is a little higher than the last time I was there.