My thoughts – Inflation
By Andrew Schultz

If there is a tax (tariff) on an item, the price of that item would be higher than without the tax. A rise in price is known as inflation. If the United States has a fully employed workforce and a company needs to hire someone, it probably would need to hire that person away from another job. Odds are in order to do that the company would have to pay them a higher wage than the job they are leaving. Increasing wages is also known as inflation.

I think this is very real, yet it seems many intelligent people will find every which way to explain why these two examples will not cause inflation. The claim is more and more people are coming back into the workforce so wages won’t go higher. The claim is that tariffs are all threats and will not be implemented. What if these two statements are not correct? Is your portfolio prepared?

On many occasions in anticipation of, and in reaction to inflation, interest rates have gone up. Let’s see what has happened to interest rates over the past two years. On July 1, 2016 the yield on the 10 year US Treasury bond was 1.45% and on July 3, 2018 it was 2.83%1. On July 1, 2016, the Fed Funds target rate was .25-.50% and on July 2, 2018 the Fed Funds target rate was 1.75-2%2. Clearly rates have moved higher. What happens if the inflation rate moves higher from here? The defensive and wise move, in my opinion, would be to anticipate that interest rates would continue to move higher as well. I do not predict the future, but clearly a trend is in place for rising interest rates, unemployment is at historical lows, and the United States has begun imposing tariffs on certain goods. You do the math.

If rates do continue to go higher, then the cost of borrowing money for individuals and corporations will be higher. That can hurt commerce and hurt earnings. Thus it could affect stock prices and could cause the prices of fixed rate bonds to drop. I am keenly aware of this and greatly concerned about valuations of both stocks and bonds as a result. I have attempted to position portfolios accordingly. One can make an argument that I may have been too early to the call. I’d rather be early than late on this one. I fear too many investors will be late and potentially overreact, which could easily cause market volatility and sell offs.

The best way to be prepared for this is to be properly and defensively diversified. It does not hurt to have some cash on hand as well. There is no way of timing this but there are absolutely ways to be prepared.

Are you?

I believe if you are following my allocation and investment strategies you are prepared, but let’s be clear that does not mean you would not feel some pain in a major sell off. The key is not to feel too much pain, that your emotions kick in and you do the wrong things at the wrong time.

Please feel free to forward this article to anyone who might benefit from reading it. Your referrals are always greatly appreciated.
About the author: Andrew Schultz has been a Financial Advisor at Morgan Stanley and its predecessor firms for over 25 years. He is a Private Wealth Advisor, a group within Morgan Stanley Wealth Management who focus on Ultra High Net Worth individuals, families and foundations. Andrew has recently been recognized by Barron’s as one of the Top 1200, by Forbes as one of the Top 200, and by the Financial Times as one of the top 400 Financial Advisors in the country.

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