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INVESTMENT MANAGEMENT

Will the $1.9 Trillion Stimulus Cause Inflation?

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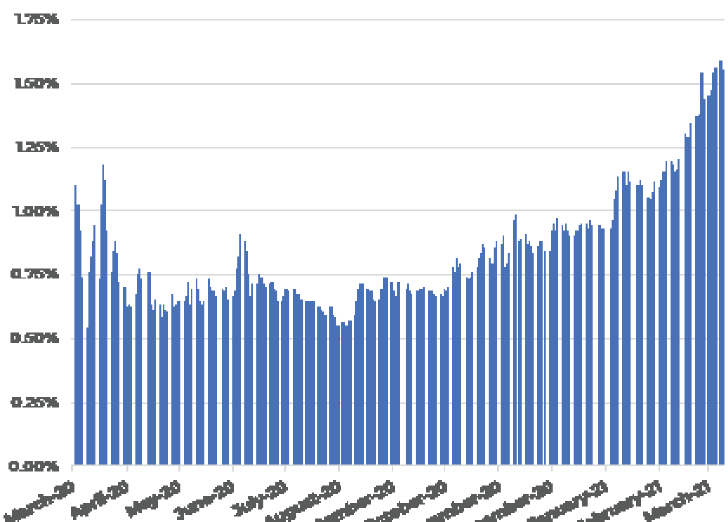
WATCH THE 10-YEAR TREASURY AND OIL FOR EARLY SIGNALS

Two data sets that are worth examining when thinking about inflation and the impact on your retirement portfolio are: the rise in the 10-year Treasury yield and the price of West Texas Intermediate (WTI) crude oil. The first might foreshadow inflation whereas the second might contribute to it.

10-YEAR TREASURY YIELDS CONTINUE TO CLIMB

The yield on the 10-year U.S. Treasury has more than doubled in the past year. The steep increase in bond yields will absolutely impact the stock market, but to what extent is anyone's guess. In simple terms, when bonds are paying higher yields, they tend to become more attractive to many investors. The inverse relationship between stocks and bonds will sometimes cause investors to consider moving out of lower-yielding stocks and into the steady income of bonds. This is the push-pull-dance that has been going on between the bond and stock markets forever.

10-YEAR U.S. TREASURY YIELD CMT



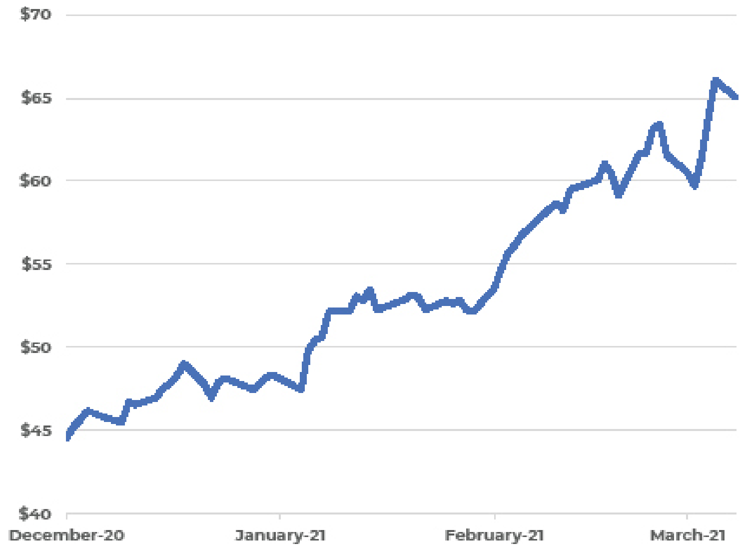
Source: FRED

Consider one of the most direct ways in which Treasury yields will impact the average consumer: mortgage rates. As yields rise, banks charge a higher rate of interest for mortgages of similar duration. Due to many banks borrowing money short-term in the form of checking and savings accounts, and lending long-term, rising rates are generally good for the Financials sector. While the correlation is not perfect, the 10-year Treasury yield impacts 15-year mortgages, just as the 30-year yield influences 30-year mortgages.

As interest rates rise, the cost to borrow money becomes increasingly expensive and makes it more challenging for people to purchase homes. This negatively impacts GDP growth, which may impact the stock market.

OIL PRICES ARE CLIMBING

WEST TEXAS INTERMEDIATE (WTI) PRICE PER BARREL



Source: FRED

WTI is trading near $65/barrel, a price not seen in about 2.5 years. The increase in the past 3 months has been dramatic. Oil and inflation are linked because oil is such a huge component of our economy. As a barrel of oil rises in price, that means fueling our cars and heating our homes gets more expensive. But even this simple example shows a broader implication. Oil is used in the production of a large number of products. As an example, let's review plastics. The input price (oil) rises, so does the end-product (the plastic). That means that virtually any item that contains plastic could be more expensive to produce, which often leads to the inflation of prices for those products.

FUELING THE ECONOMIC REBOUND

One of the quickest ways to incentivize spending is government stimulus. Now, consider the fact that Congress recently passed the $1.9 trillion American Rescue Plan Act. This legislation will send approximately $450 billion of the $1.9 trillion directly to the wallets of 158.5 million Americans. As consumers have more money in their pockets, the demand for goods and services could increase.

Also, consider that the FDA just approved a third COVID-19 vaccine. According to the CDC, the U.S. is now administering more than 2.1 million injections per day with 18.8% of the country already receiving at least 1 dose, while 9.8% of the population is already fully vaccinated. President Biden is encouraging each state to permit Americans of any age to be eligible to receive a COVID-19 vaccine beginning on May 1, 2021. This means the economy could begin operating at full capacity sooner than many expected. A return to travel for business and leisure could occur for many as early as this summer. As the demand for services in the travel industry increases, so will the demand for goods and services.

INFLATION IS NOT ALL BAD, RIGHT?

An optimist would suggest that higher inflation is the product of a healthier economy and rising demand, so a move toward higher longer-term rates is a sign that confidence in the economic rebound is also rising. But at some point, as the economic rebound from the COVID-19 pandemic strengthens, inflation pressures could cause the Fed to intervene by hiking rates prematurely.

Remember when the Fed initiated its first interest rate hike at the beginning of 2016? There was a 10% correction in the market. The stock market corrected again in 2018, when Wall Street thought the Fed had hiked rates too fast. The Fed has been clear that they have no intention of raising short-term interest rates until at least 2023. Therefore, we are a long way from the Fed raising interest rates....or are we?

INFLATION & RETIREMENT

On a personal level, inflation has a direct impact on how much retirement dollars are worth. Over time, it can take a serious bite out of one's nest egg. Understanding how inflation might hurt one's retirement strategy is a requirement for ensuring investors have enough money to last through their retirement years. Making sure to account for inflation as investors develop various retirement scenarios and goals is key. Failing to account for inflation is a mistake investors can easily avoid.

To learn more about how this potential rise in inflation could impact your personal situation, reach out to the professionals at Meeder by calling 866.633.3371, or visit us online at meederinvestment.com.

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