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Noel Swain: Inflation

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Someone recently asked me about inflation. With the price of gasoline, groceries, clothing and cars soaring in price, everyone has noticed that inflation today resembles the late 70’s. So, why are prices soaring, what can we do to prepare, and most importantly… what should we do with our investments?

First, let’s look at why inflation fears have been front and center on everyone’s minds…

We’re paying more for gas at the pump. Our grocery bill is higher than it was a few months ago. Now to be fair, prices for everyday goods and services have been creeping higher for pretty much all of modern history.

So, why is inflation suddenly on everyone’s minds? It’s simple… the government is finally admitting that inflation is a problem. In June, inflation hit its highest level since 2008. Inflation is now the talk of the investment world. CNBC and other mainstream financial media outlets can’t go a day without a feature on it.

Inflation isn’t just a matter of everyday stuff getting more expensive. The inflation rate is one of the most important pieces of data in all of finance. A small tick in the rate can cause billions of dollars to flood out of some investments and into others.

That’s because the inflation rate affects EVERYTHING. It anchors investors’ expectations about the returns they need to generate. That’s why inflation (along with taxes) is such a huge consideration.

Basic Materials, like lumber, steel, concrete and aluminum, and commodities like silver, oil, natural gas, palladium, corn, and soybeans are the building blocks of our economy.

They’re the “inputs” that form its foundation. While there are a lot of ways to hide or misstate inflation... basic materials and commodities prices always tell the truth. In other words, if there’s real inflation going on... it’ll show up in the prices of these items.

Lumber is probably the most glaring example. Last October 30th the Lumber Commodity Index closed at $496. On May 7th of this year, that index had soared to $1,686, a 240% increase in price. As you know, that was all over the news.

But have you heard about the dramatic decrease in lumber prices lately? That index, as of August 10th, was back down to $505, just a little over the $496 it was at last October.

And that's just one example. Silver is down on the year after a short-lived rally, while gold— what many investors consider to be their "inflation hedge"— is down 13% in the last year.

At the same time, bonds have surged recently. Bond prices typically fall when inflation is rising. That's because most bonds pay a fixed rate of interest. But bonds have been marching higher since early spring. So what does that say about inflation?

Remember: Markets look to the future. However, this doesn't mean that inflation is over. Thanks to the Federal Reserve, prices for everyday goods will likely continue increasing.

But the time to bet on inflation isn't when it's being plastered all over magazine covers. It's when no one else is talking about it.

If you're concerned about inflation, think about this as an idea… own stocks, or stock mutual funds, or stock ETF's.

Owning stocks is a good way to protect your wealth when inflation is eating away at your purchasing power.

The simple definition of inflation is too much money chasing too few goods. The amount of money in circulation, called the M2 Money Supply, is up about 170% since the last global financial crisis… thanks to a surge in money printing by the Federal Reserve.

US stocks have climbed 212% over the same period… making ownership in great American companies, which is what stocks are, an excellent way to preserve and grow wealth.

At the same time, the S&P GSCI Commodity Index—which tracks the performance of hard assets like gold—has climbed just 58% over the same time.

In other words, stocks have massively outperformed traditional inflation hedges over the past decade.

Keep this in mind the next time someone suggests you make a big bet on inflation by buying gold or silver.