Interest rates and inflation - Keep rising?

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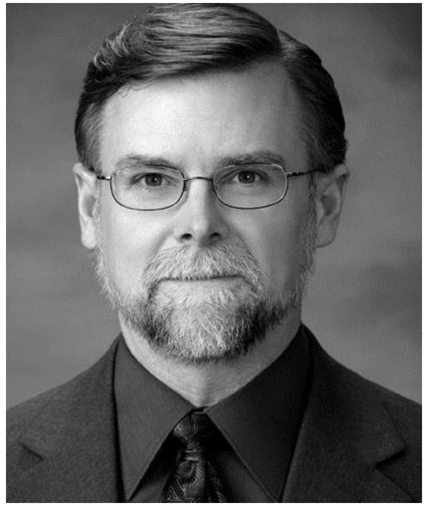

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Today . . . Right now

Interest rates today - straight Treasuries

Treasury Yields

NAME	COUPON	PRICE	YIELD
GB3:GOV **3 Month**	0.00	2.51	2.56%
GB6:GOV **6 Month**	0.00	3.01	3.10%
GB12:GOV **12 Month**	0.00	3.13	3.25%
GT2:GOV **2 Year**	3.00	99.49	3.27%
GT5:GOV **5 Year**	2.75	99.03	2.96%
GT10:GOV **10 Year**	2.88	100.83	2.78%
GT30:GOV **30 Year**	2.88	97.75	2.99%

Interest rates today - TIPS (inflation protected)

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Treasury Inflation Protected Securities (TIPS)

NAME	COUPON	PRICE	YIELD
GTII5:GOV **5 Year**	0.13	99.25	0.29%
GTII10:GOV **10 Year**	0.63	103.06	0.31%
GTII20:GOV **20 Year**	0.75	97.50	0.89%
GTII30:GOV **30 Year**	0.13	82.65	0.78%

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Inflation today

- Year-over-year
- Consumer Price Index

- 8.5%

Context is necessary

Long-run history

Interest rates - details

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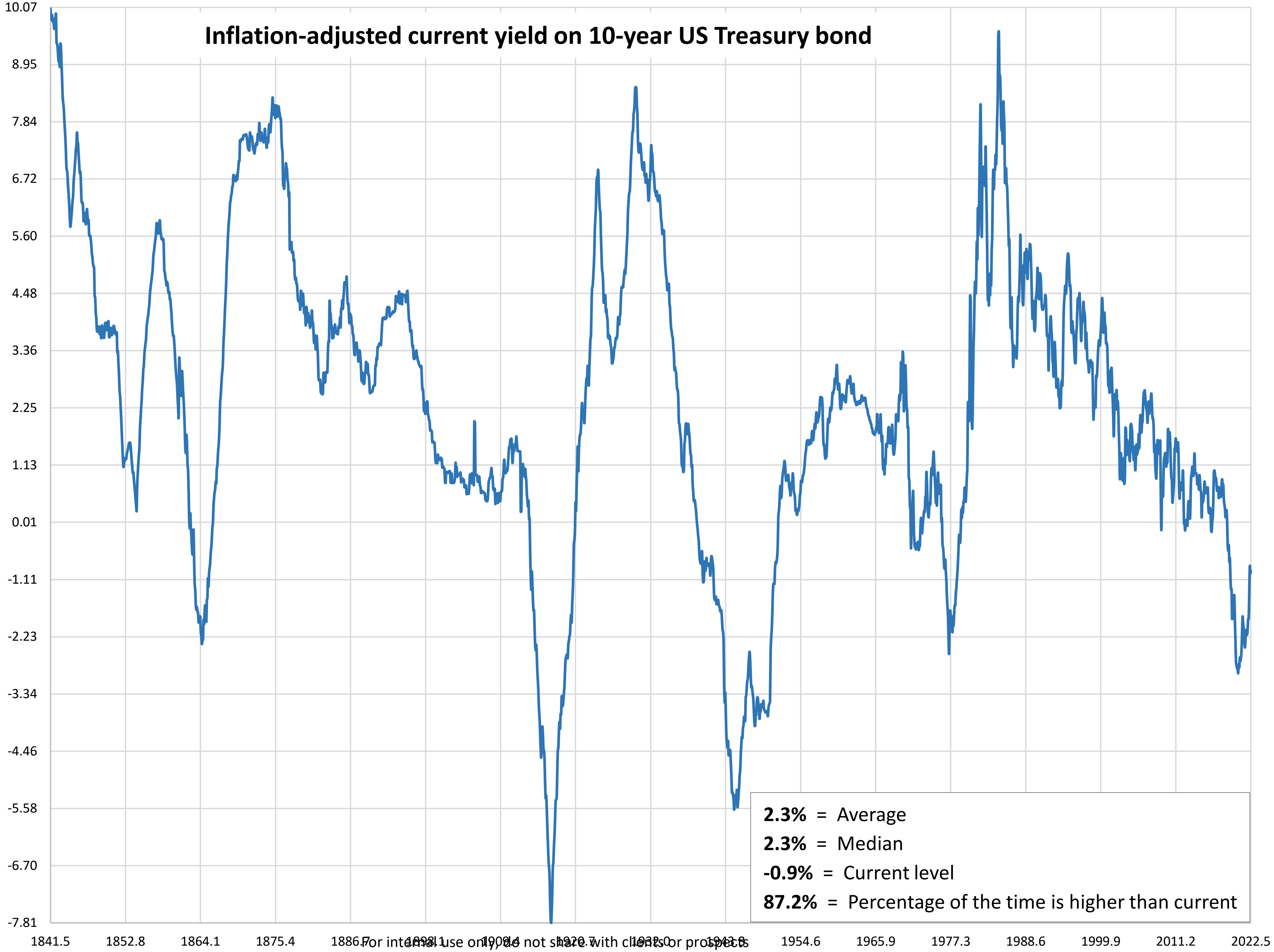

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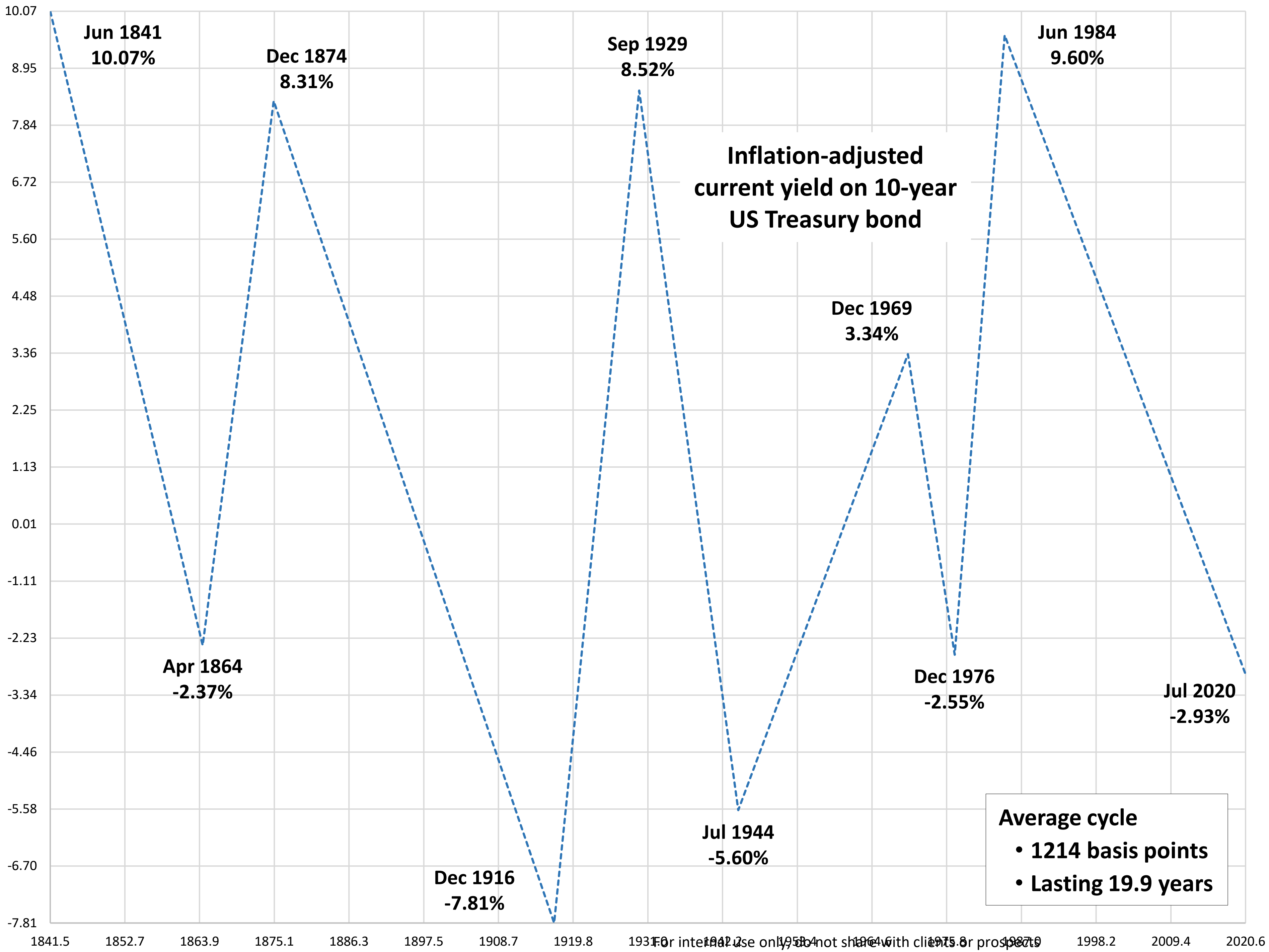
Interest rates - the cycles



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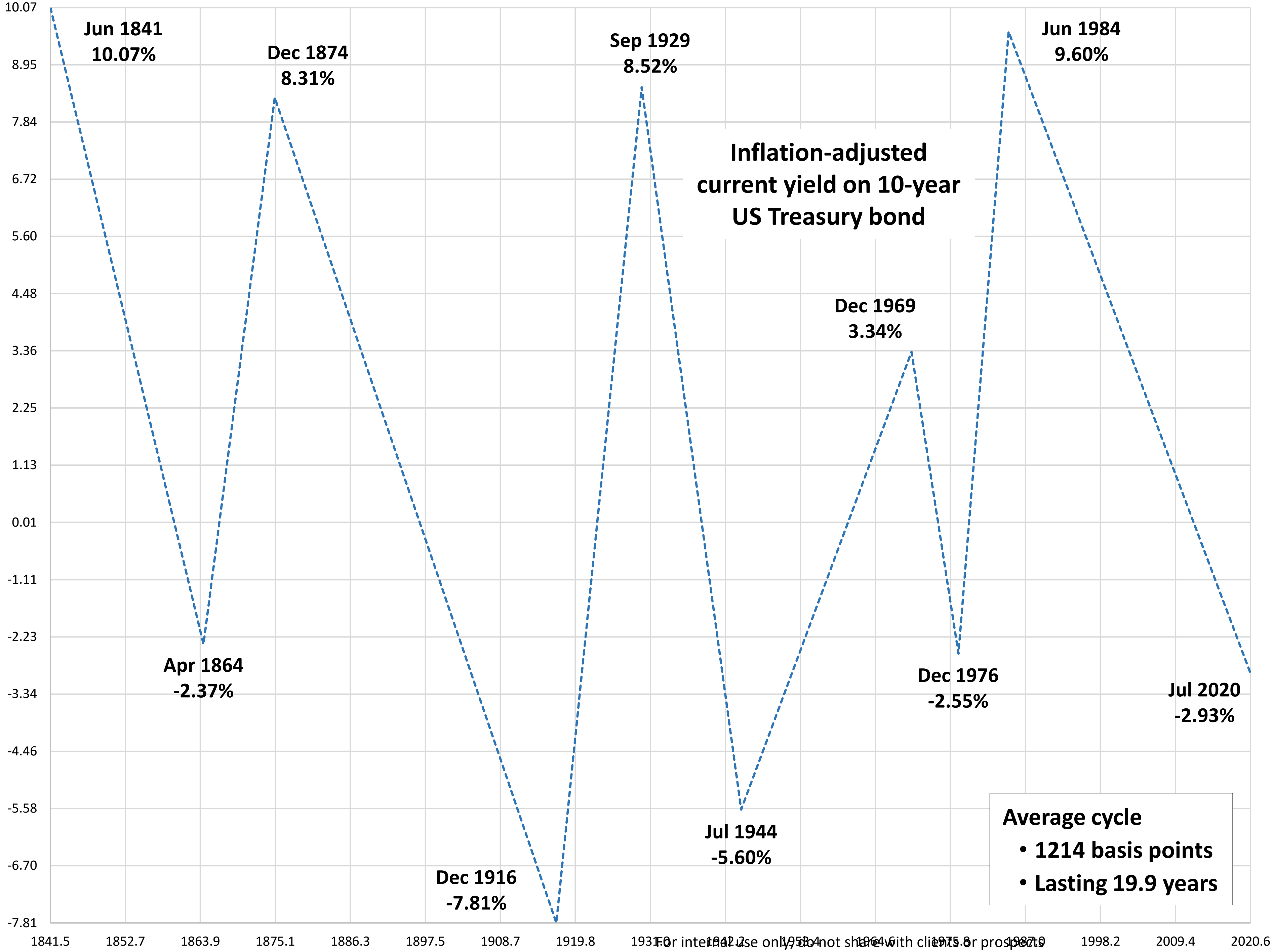
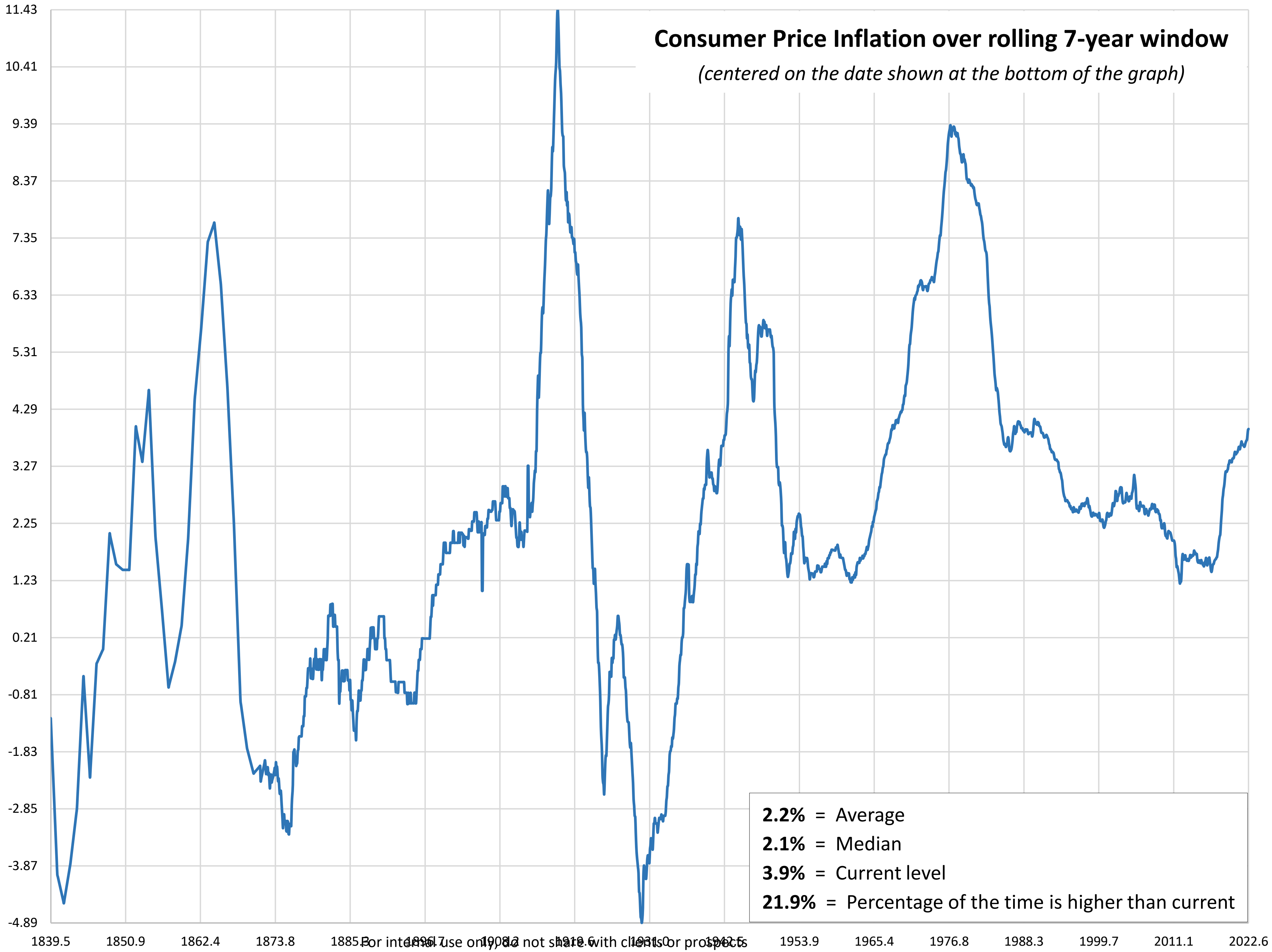


Interest rates . . . Now rise for *"19.9 years"*

Like they've always done

Inflation - the details



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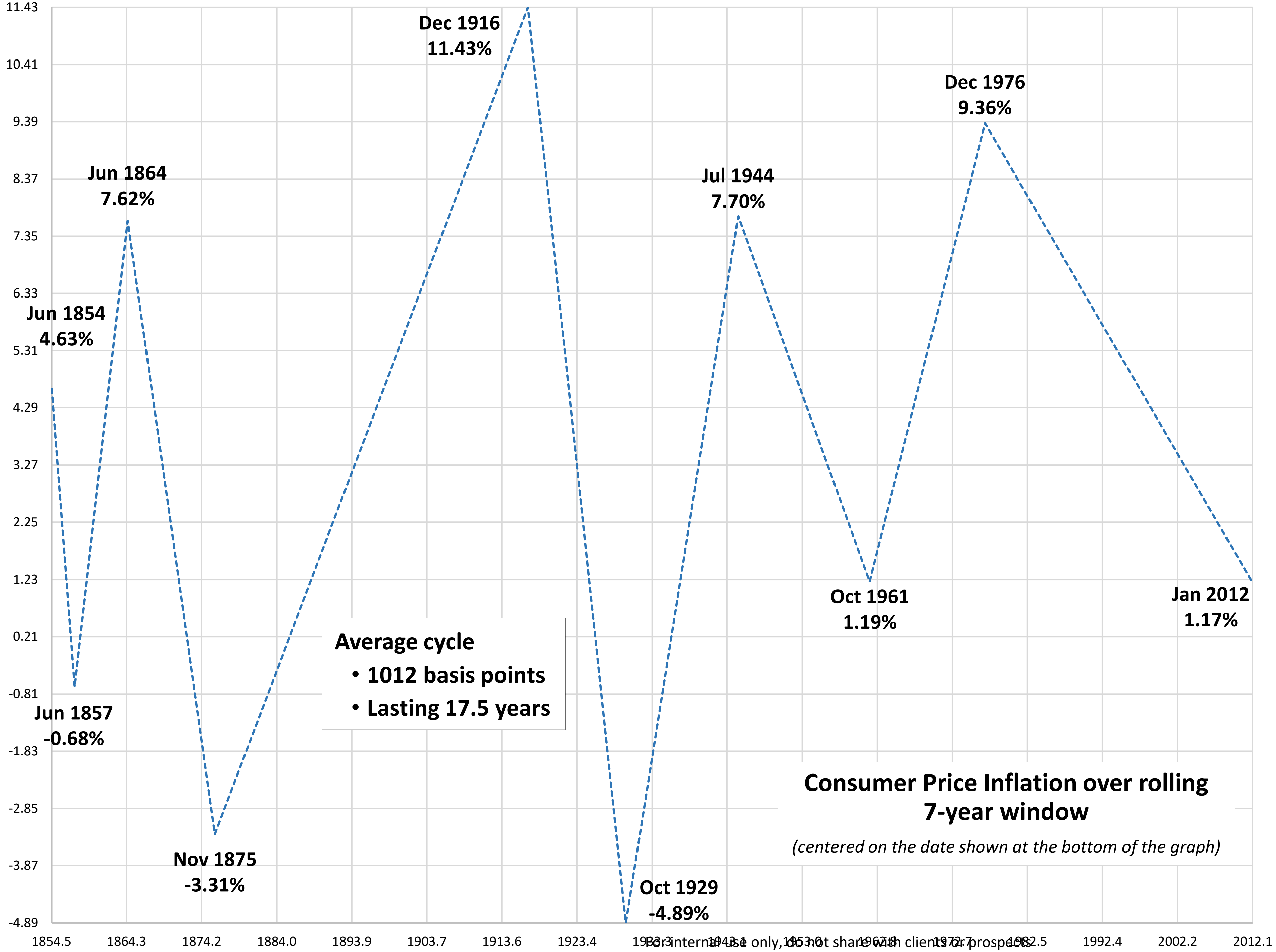
Inflation - the cycles



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Inflation - the cycles

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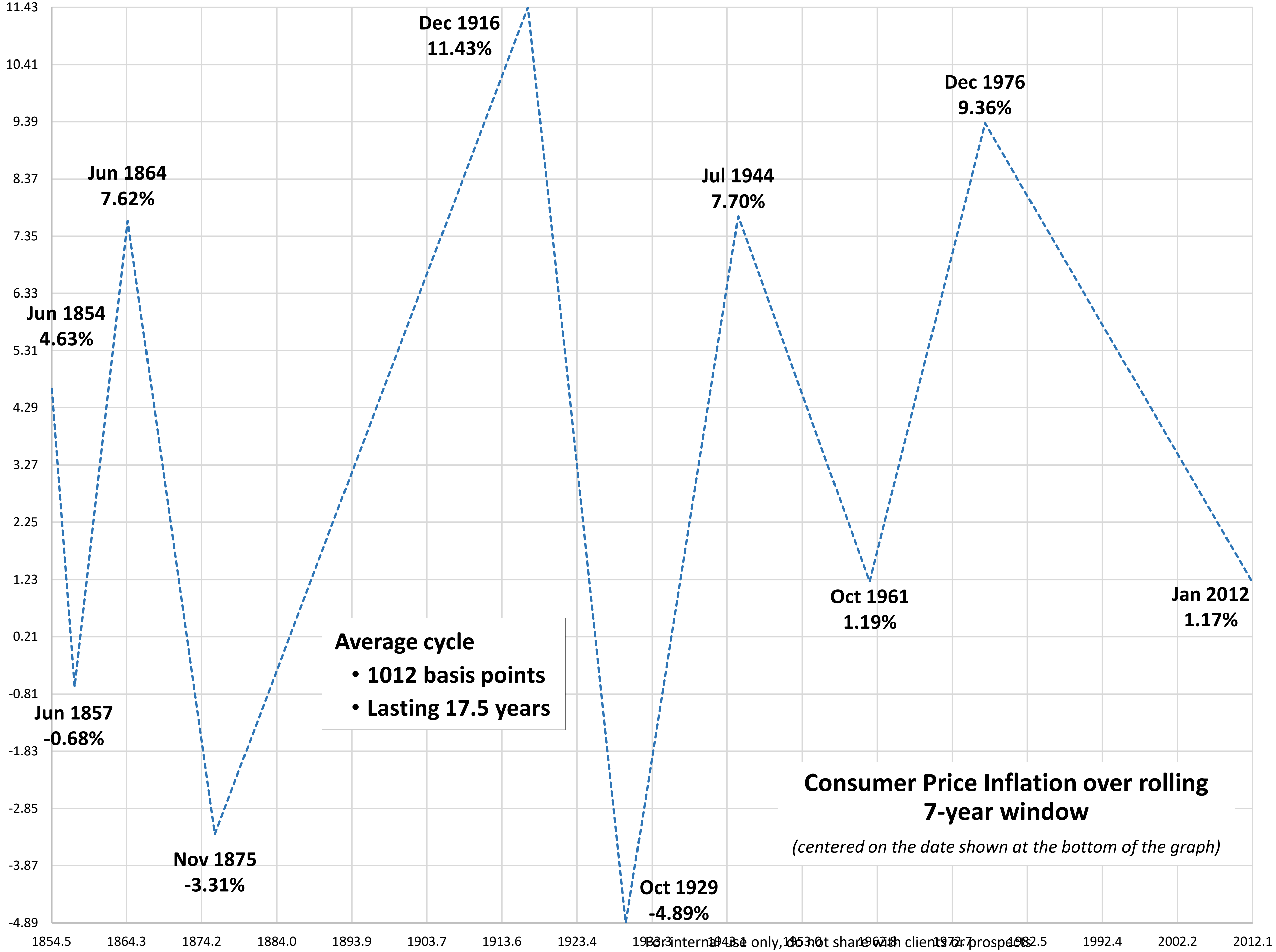

Inflation . . . Now rises for *"17.5 years"*

Like its always done

If we just “accept” history

Take history as the forward-looking forecast . . . . A good/best starting point

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Future interest rates

- **Bottomed out**
  - July 2020
  - At -2.93% . . . Inflation-adjusted . . . Note, that is a negative interest rate
- **Typical cycle**
  - Runs for 19.9 years
  - Moves interest rates by 1214bps
- **If history repeats (the best possible starting point) . . . interest rates will peak**
  - On June 2040
  - At 9.21% . . . Inflation-adjusted
  - Is this “heroic”? . . . . Nope . . . This would be normal, vanilla, boring . . . and typical

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Is this a bond bear market? YEP !!!

Bear markets for inflation-adjusted U.S. bonds since 1845

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
	-22	2.67	Mar 1863	Nov 1865	6.1	31	-9.1
	-50	11.42	Dec 1908	May 1920	4.8	41	-5.9
	-31	16.58	Jan 1941	Aug 1957	3.3	45	-2.2
	-40	16.33	May 1965	Sep 1981	6.4	45	-3.0
	?	?	Jul 2020	?	?	?	?
Median BEAR market	-35	13.87			5.4	43	-4.5
Mean BEAR market	-36	11.75			5.1	40	-5.0

Author: Rob Brown, PhD, CFA at www.robbrownonline.com. Statistics based on data provided by Global Financial Data, Inc., at https://finaeon.globalfinancialdata.com and are current as of July 15, 2022

Bonds were defined as 50% intermediate-term U.S. Treasury bonds and 50% liquid high-quality U.S. corporate bonds. And were constructed using three total return bond indices provided by Global Financial Data. Intermediate-term U.S. Treasury bonds are defined by the GFD Indices USA 10-year Government Bond Total Return Index. Prior to 4/30/1915 liquid high-quality U.S. corporate bonds are defined by the GFD Indices USA Total Return AAA Corporate Bond Index. After 4/30/1915 liquid high-quality U.S. corporate bonds are defined by a 50/50 mix of the Dow Jones Corporate Bond Return Index and the GFD Indices USA Total Return AAA Corporate Bond Index

Results rely on month-end total returns adjusted for the All Urban Consumers Not Seasonally Adjusted Consumer Price Index as provided by the U.S. Department of Labor. Indices are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results

Bear and bull markets are defined as moves of at least 20.95730035% using month-end bond index total returns. This information in this presentation is for the purpose of information exchange. No representation or warranty is made to the reasonableness of the assumptions made. Investment advice offered through Integrated Wealth Concepts LLC (a Registered Investment Adviser), d/b/a Integrated Financial Partners, Inc.

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Median BEAR market	-35	13.87			5.4	43	-4.5

And inflation ?

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Future inflation

- Bottomed out
  - Jan 2012
  - At 1.17%

- Typical cycle
  - Runs for 17.5 years
  - Moves inflation YOY by 1012bps

- If history repeats (the best possible starting point) . . . inflation will peak
  - On July 2029
  - At 11.29% . . . YOY (year-over-year)
  - Is this "heroic"? . . . . Nope . . . This would be normal, vanilla, boring, and seriously typical
  - RECALL . . . inflation hit a high of 14.8% on Mar 1980 YOY

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Important qualifications

Drawn from today's . . . quite serious realities

Rob's attempt at . . . current-day qualifications

- It's all about COVID
- And the US government's response to COVID
- And many other country's . . . respective responses to COVID

- We seriously need to modify our history-based conclusions for the once-in-a-hundred-year event of COVID

- I struggle to see . . . how this has anything to do with "long-run" interest rates

- BUT . . . It has serious implications for inflation

How did inflation get to today's extreme high level

- Why is inflation happening . . .
  - COVID
    - Millions left the labor force . . . stopped working
    - The global supply chain broke . . . and it takes years (not months) to reconnect it
    - Consumers got bored . . . and just started buying stuff . . . a lot of stuff
  - Federal government stimulus
    - Monetary - by Federal Reserve
    - Fiscal - spending by the US Congress
  - Ukraine
  - Deglobalization

What happens to inflation next

- It goes down . . . Big time

- Security markets are forecasting inflation to AVERAGE just
    - 2.7 % over the next five years
    - 2.5% over the next ten years

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Why is it necessary that inflation falls from today's level

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- Why must inflation fall from current levels?
  - COVID
    - Millions left the labor force . . . stopped working
    - The global supply chain broke . . . and it takes years (not months) to reconnect it
    - Consumers got bored . . . and just started buying stuff . . . a lot of stuff
  - **Federal government stimulus**
    - Monetary - by Federal Reserve
    - Fiscal - spending by the US Congress
  - **Ukraine**
  - **Deglobalization**

These five factors are all working in reverse, serving to push inflation back down

These two factors are working hard to drive inflation higher

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But why ?

It's always necessary to ask and adequately answer the question of "why?"

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The BIG issue at play . . . What is really determining everything

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- It’s all about funding (paying for) . . . projects . . . that’re at play

- Society and governments have several projects that they’re attempting to finance
  - Cold war with Russia
  - Cold war with China
  - Conversion from fossil fuels to renewables
  - Income inequality gap
  - Wealth inequality gap
  - Expanding social welfare programs
  - Transitioning from one political structure . . . To a different structure

- Inflation is a method for both obscuring the cost . . . and dispersing its burden

- My 2 cents . . . The French revolution (reign of terror) of the <u>late</u> 18^{th} century . . . Is helpful

Rob’s interpretation

Let’s try to start with a healthy dose of humility

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Start with humility

- We need to adjust for COVID
- And governmental responses (US and Int'l) to COVID

- Without this adjustment . . . Any view is delusionary

- Interest rates
  - Temporarily suppressed

- Inflation
  - Seriously . . . But temporarily distorted . . . To the upside
  - BUT . . . It's complex . . . And nuanced

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Inflation

- Comes down quickly
- Returns to “normal”

- But is temporarily distorted by all-things COVID

- Once it returns to normal . . . (pre COVID) . . . It climbs and reaches a high about 2029

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Rob's fearless forecast . . . Well grounded in history

- Grounded in history
- And not in crystal ball gazing

Interest rates peak in 2040 at 9% (inflation adjusted)

Inflation YOY peaks in 2029 at 11% YOY

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Politics

- Just stop

- Just stop

- This has absolutely zero to do with which political party gains dominance

- The forces at play are far far larger than any political differences . . . Which honestly are trivial

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What’s to be done

OK . . . So maybe just a couple of ideas . . . 2 cents

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What's to be done

- The old irrelevant approach is dead . . . For goodness sake, just admit it's dead
  - MPT - Modern Portfolio Theory
  - Mean variance optimization
  - 60/40 portfolio
  - See the very nice piece on this by GMO . . . out of Boston

- What works . . . What's needed
  - Tactical asset allocation (TAA)
  - Serious, institutional, well-structured . . . alternative investments . . . If it's offered at a B/D it won't work

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Alternative Investments - The good, the bad, and the ugly

Friday

Aug 19th

11:00 a.m. EASTERN

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