THE KWAMMENTARY

March 2021 Edition

ODLUM BROWN
Investing for Generations®

Kwame Boateng, CFA – **Associate Portfolio Manager, Investment Advisor**
T 250 861 8173 | Toll Free 1 800 788 5677 | kboateng@odlumbrown.com
Odlum Brown Limited | Suite 1500 – 1631 Dickson Avenue | Kelowna, BC V1Y 0B5
Member-Canadian Investor Protection Fund

In my household, I do the grocery shopping. Since I usually do it solo, it functions as my little weekend getaway. Just me and my cart, a podcast/audiobook to listen to and a list that my fiancée has lovingly compiled – which allows for no deviations for my vices (i.e., chips, chicken nuggets, etc.). On this week's list, we had apples. Not just any apples, though; she wanted Ambrosias. The last time I purchased these apples (approximately five months ago), they were $1.49/lb. This time around, they were $2.50/lb! The Fuji apples right next to them were $1.49/lb and looked just as delicious, so I decided to pick those up instead…

Later, as I sat in the dog house reflecting on these apples, the whole situation got me thinking about the topic of inflation. Increasingly, we're seeing concerns around stimulus globally and what the subsequent inflationary impact will be, ultimately resulting in an interest rate adjustment. I want to take some time to unpack a couple of my thoughts on the subject.

If you search for the definition of "inflation" you'll see permutations of "increasing prices" and "falling purchasing power." Conceptually, it's pretty simple: if a good or service goes up in price, inflation has happened. What's more important is the "why?" Going back to the apple example, we can make a few assumptions about what's going on. Ambrosia apples are very tasty (according to my fiancée), so if everyone else thinks so as well, and they are also purchasing these apples, chances are the price is going to go up. We call this "demand-pull inflation," because the increased demand has pulled the price of apples up. This is the more common type of inflation action, but there is another type that comes into play every so often as well. Imagine that, instead of these apples being so delicious that everyone was buying them, the cost to grow the apples had actually increased (e.g., fertilizer prices increase, labour costs increase, etc.). This is what we call "cost-push inflation," because the cost to produce a good or service has pushed the price up. Although less common, I suspect that more recently, this type of inflation is coming into play more than the former.

Breaking Down the "Why"

We can make a few general assumptions about the economy coming out of 2020:

1. People spent less money, on average, than they usually do.
2. People saved more money, on average, than they usually do.
3. Businesses' supply chains were/remain severely impaired.

Points 1 and 2, although similar, are not two sides of the same coin. If you take economic activity (Gross Domestic Product, specifically) as an indicator of people's spend, it's fair to say that wallets were less active in 2020 than they historically have been. Looking at the savings side, however, is quite different. According to the U.S. Bureau of Economic Analysis, Americans saved approximately 7.4% of their disposable income from January 2015 to January 2020. That average, through 2020, was closer to 16.4%. A portion of this can be explained by the lack of opportunities to actually spend money, as rolling lockdowns and restrictions prohibited many regular economic functions. However, the amount of stimulus provided (CARES Act, CERB, etc.) also plays a big part in why this spike occurred. I think this is likely indicative of how future stimulus will impact personal spending/

savings and, consequently, economic activity. The fact of the matter is, if you're getting "free" money and you have nothing to spend it on except for the things you need (e.g., food, clothes, rent, debt repayment), you're likely to spend it on essentials or add it to savings. Some of that activity is inflationary, but most is not.

Business supply chain impairment is a different issue altogether. If you're an international business and your usual suppliers are in an area that has completely shuttered their economy, chances are you're having a difficult time fulfilling orders or getting product. That scarcity will put upward pressure on the price of your supplies, and subsequently, your price on goods or services. I think this is one of the more important notes on the inflation discussion, at least in the immediate term. As the economy starts to gradually reopen around the world, a lot of kinks will need to get worked out as that global supply chain starts moving again. We've already seen instances of this in various industries, like semiconductors and energy, where constraints in supply for raw materials have led to shortages, delays and price inflation (I encourage you to read this Reuters article for more information on NXP semiconductors). A lot of this inflation will be transitory, sure, but it will happen.

What Does it all Mean?

Unless something is very wrong, inflation is likely to occur. This is largely healthy, if, like most things, it happens in moderation. As mentioned above, people have had fewer opportunities to spend their money and have therefore spent their disposable income on necessities or debt reduction. Businesses have also had to reposition their supply chains to make the best of a very bad situation – which has led to viable (albeit, subpar) supply chain setups. As things start to open up, and as there are more opportunities for people to spend money (i.e., travel, restaurants, vacations) you will see prices for these things start to increase. As the businesses that supply these goods and services sort out supply chain issues at the same time that demand is increasing, you will also see increases in pricing. The extent to which all of this inflation will occur is unknown, but we believe that the strong businesses we invest in will benefit in any environment.

As always, I'm happy to chat anytime and can be reached by email or phone if you have any questions or concerns.

Sincerely,

KWAME BOATENG, CFA
Associate Portfolio Manager, Investment Advisor

Tel 250-861-8173
Toll Free 1-800-788-5677
kboateng@odlumbrown.com