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Events raise the risk of higher inflation

For professional advisors only, please read
the important information.

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*“Events, my dear boy, events”,
ex-PM Harold Macmillan*

Image source: Wikipedia

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What's the big picture on inflation?

1. Key events in history have influenced inflation
2. Assessing inflation drivers
3. Investing in an inflationary environment
4. Risks and issues for markets

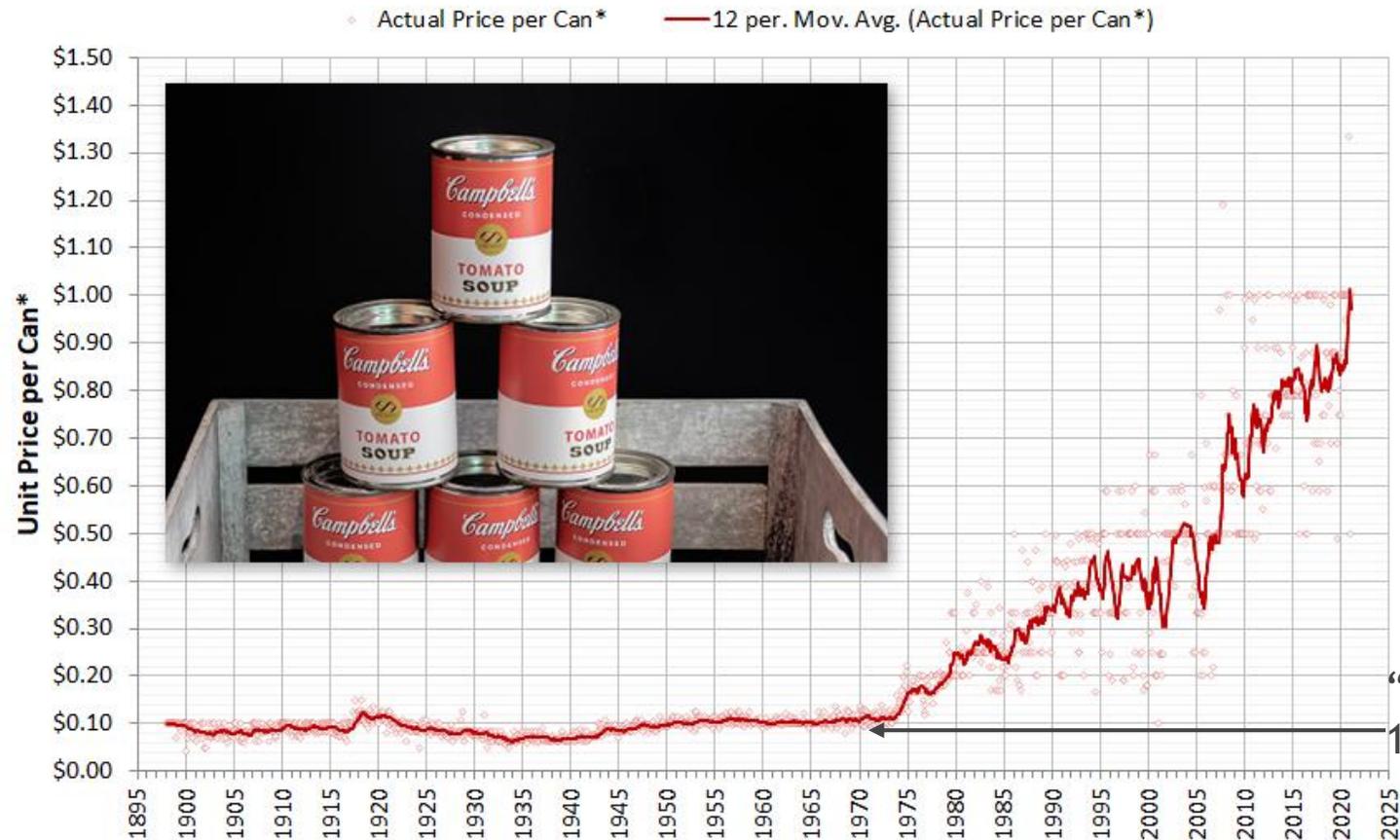
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1. Key events in history have influenced inflation

The “Nixon Shock” event moved the world to a pure fiat currency system and more inflation

Unit Price per Can* of Campbell's Condensed Tomato Soup at Discounted Sale Pricing, January 1898 - January 2021



Data Sources: Selected Advertisements in U.S. Newspapers, 1897-2020

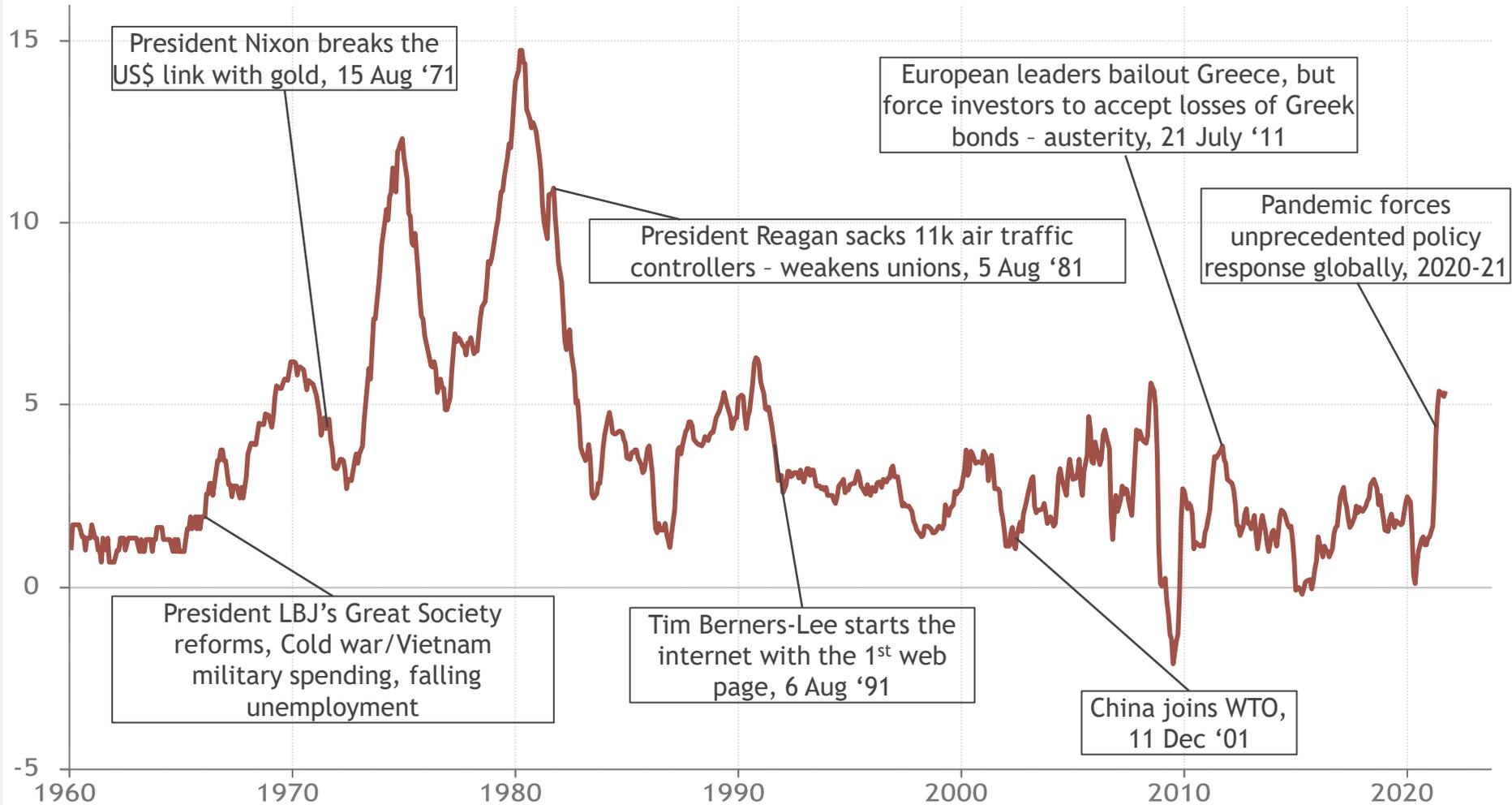
* Can refers to the iconic No. 1 "picnic" can of Campbell's Condensed Tomato Soup

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Inflation has picked up sharply since the pandemic

50-plus year US inflation cycle, with key events every decade

Headline CPI, % yoy



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 19/10/2021

The pandemic could reverse decades of low inflation

- Policy constraints on debt sustainability and inflation are probably not binding anymore

Debt sustainability: 2020-21

Political agenda has changed to favour reducing inequality



Inflation: August 2020

Major change in US monetary policy



“Wow. These prices on Amazon have really gone up”

Image Source: Federal Reserve, Twitter

2. Assessing inflation drivers

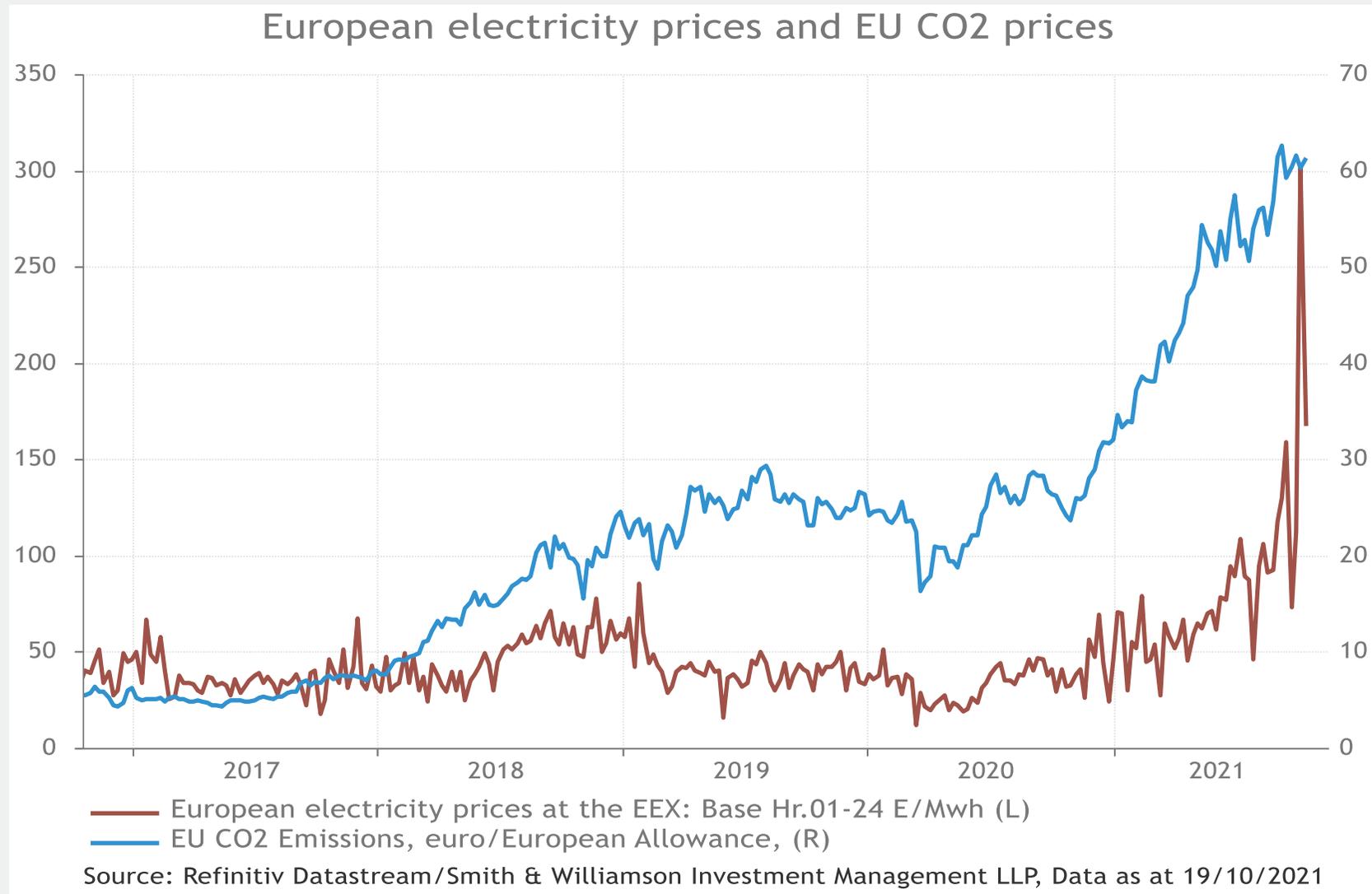
A qualitative assessment of traditional inflation drivers show:

Higher inflation: ESG, inflation anchoring, globalisation, Tech

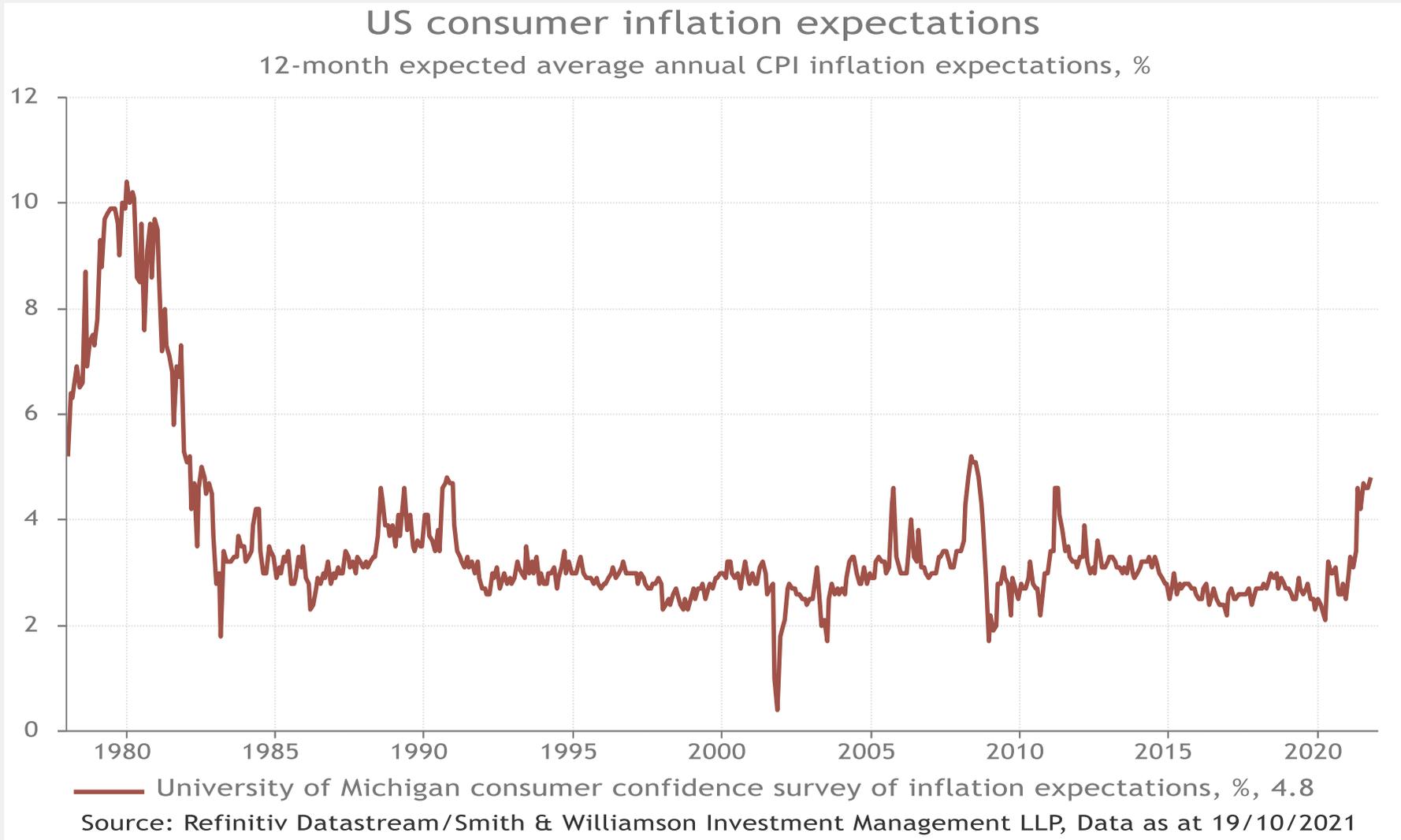
Inconclusive: Demographics

Lower inflation: Demographics, Tech, inflation anchoring, globalisation

The Environmental Social and corporate Governance (ESG) agenda is driving up energy prices and inflation



Anchors away! - most people think that inflation is going up



Globalisation is no longer reducing imported inflation



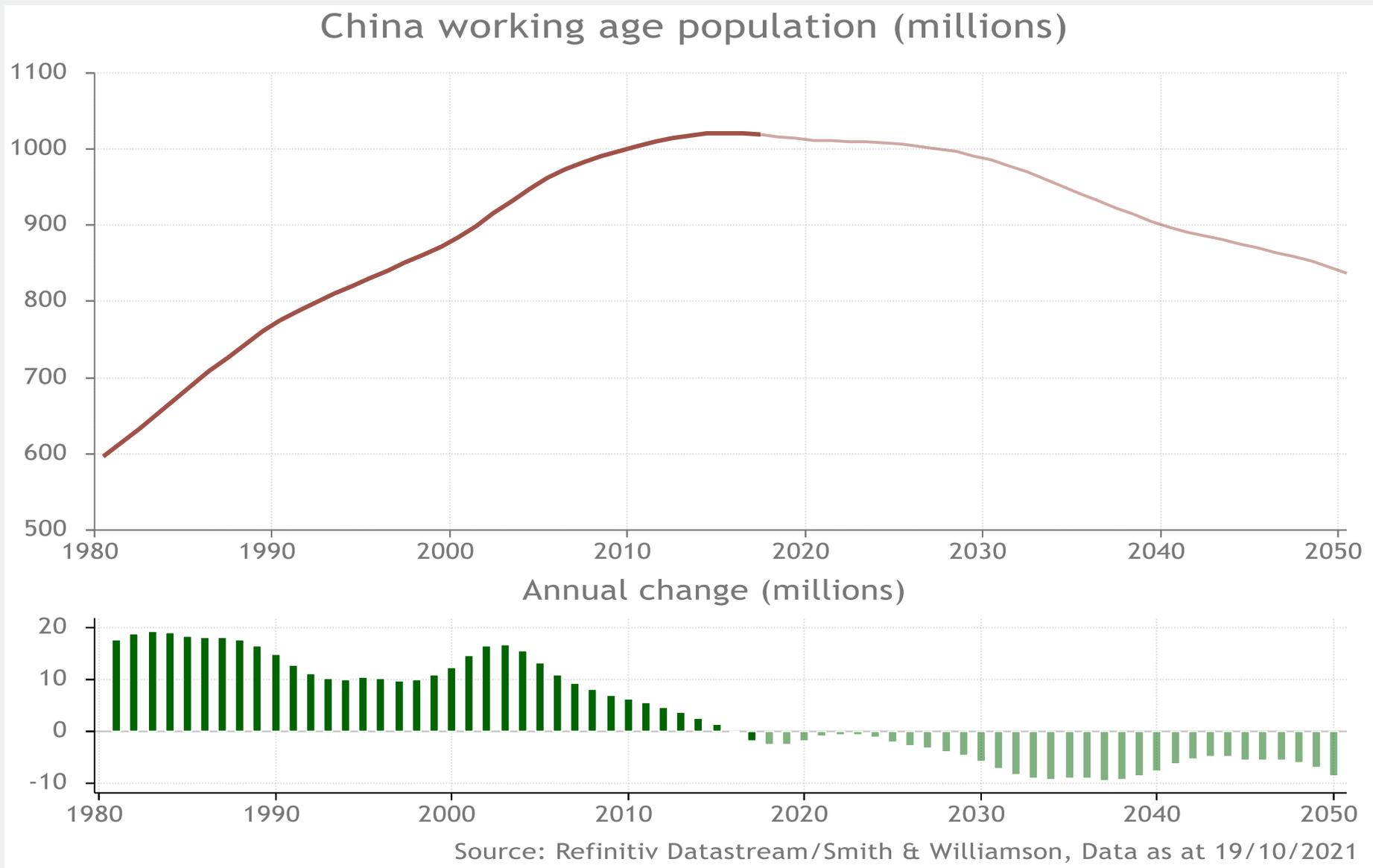
US tech consumer prices are rising for the time in 30 years

US CPI inflation for information technology, hardware and services
% yoy



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 19/10/2021

Demographics - Chinese labour supply has peaked



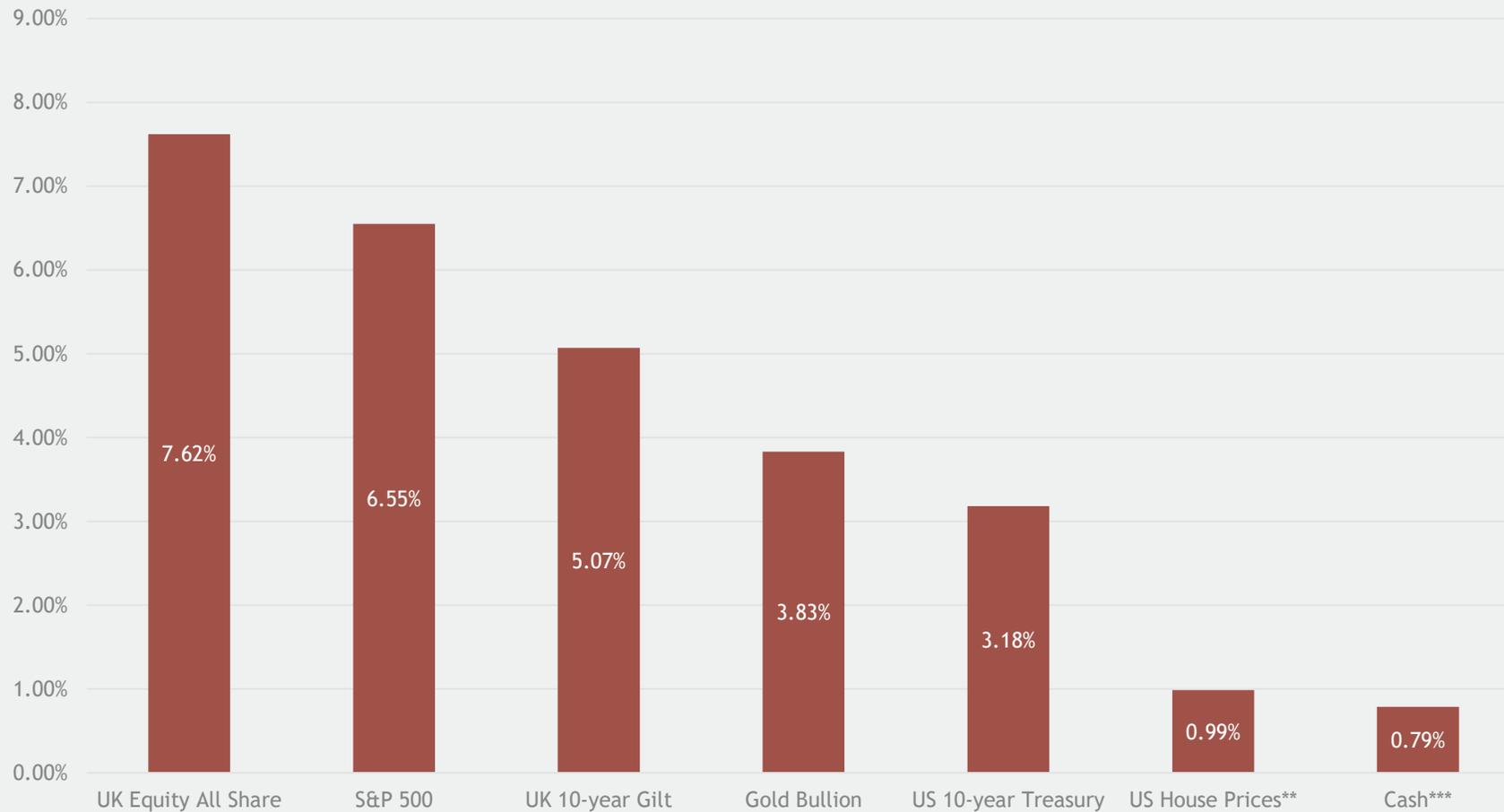
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3. Investing in an inflationary environment

Stocks are a long-term hedge against inflation

Asset class average annualised performance (in real terms) since August 1971*

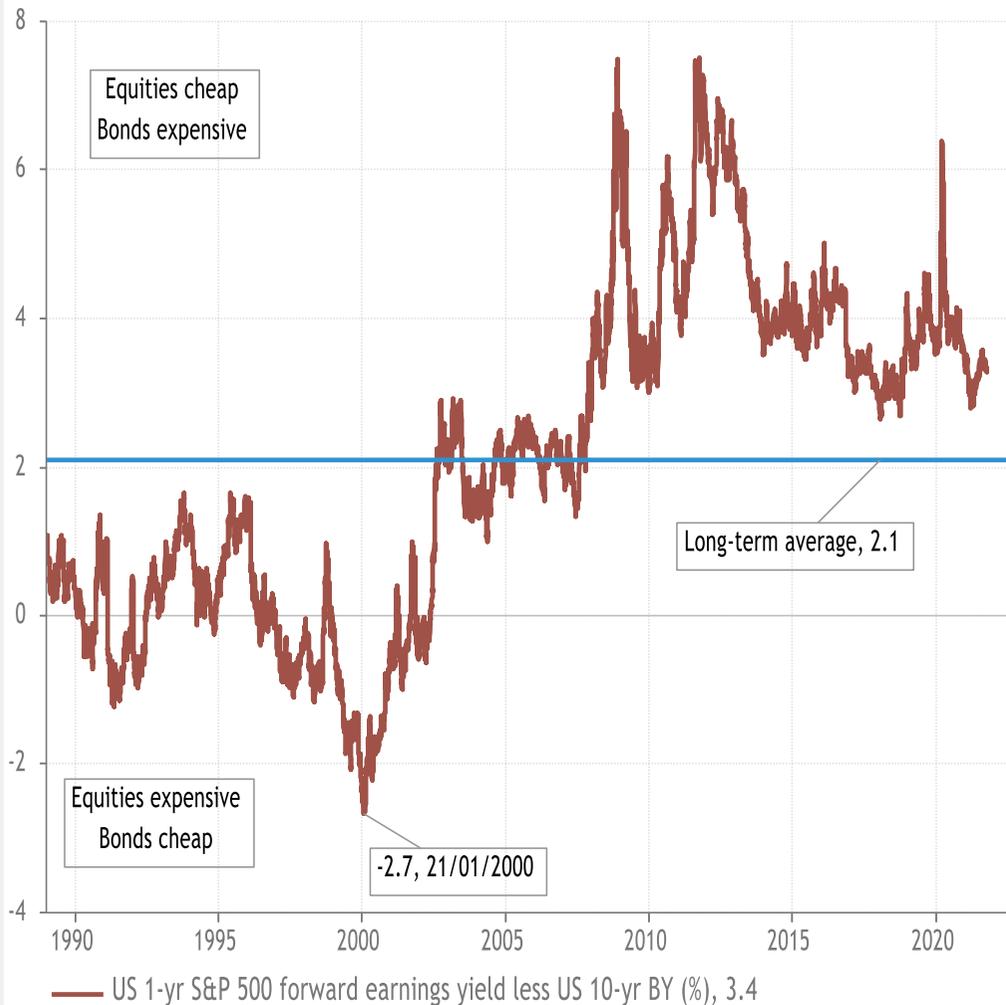


Source: Global Financial Data, **Robert Shiller/Smith & Williamson Investment Management LLP, data as at 31 December 2019

*Performance is calculated in real terms in local currency, deflated using US CPI, annualised since 1 January 1971

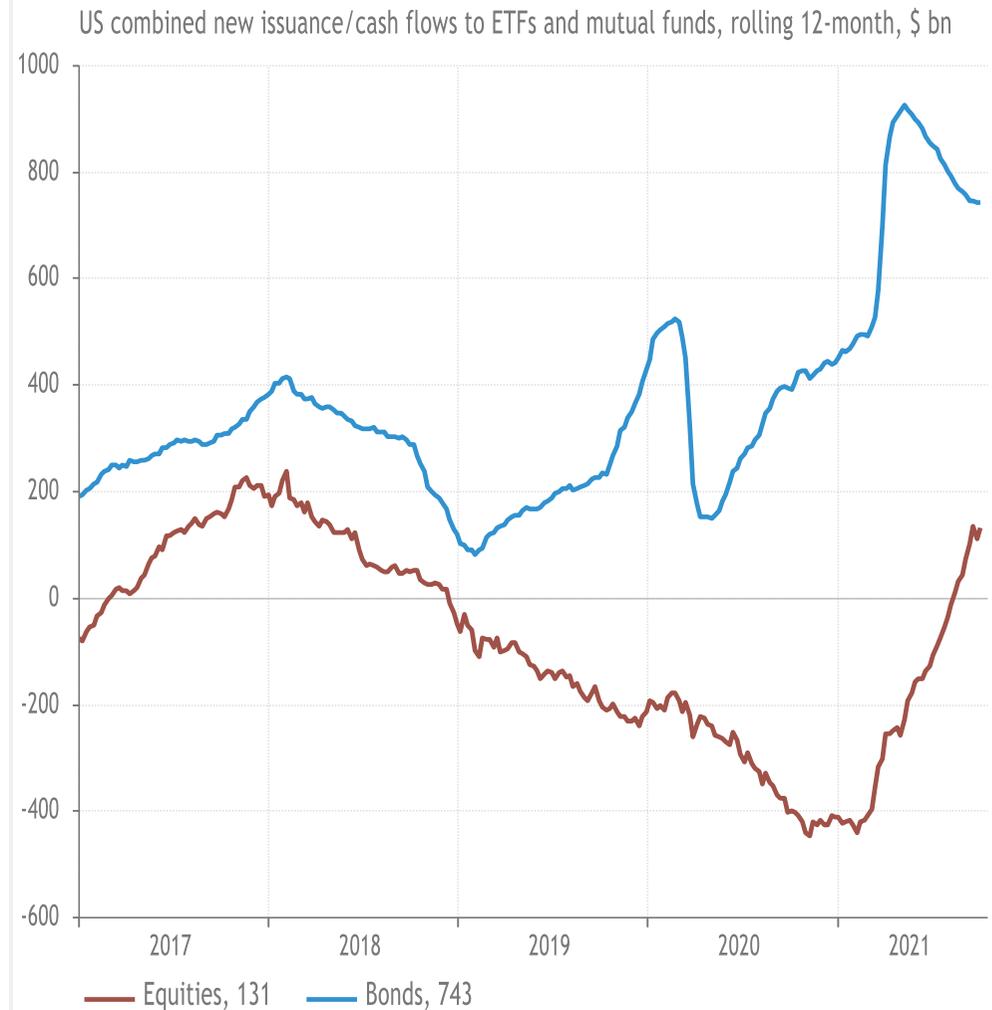
Higher inflation is a greater challenge for bonds than equities

US equity earnings yield differential to bonds



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 19/10/2021

Investors are recently positioned in bonds



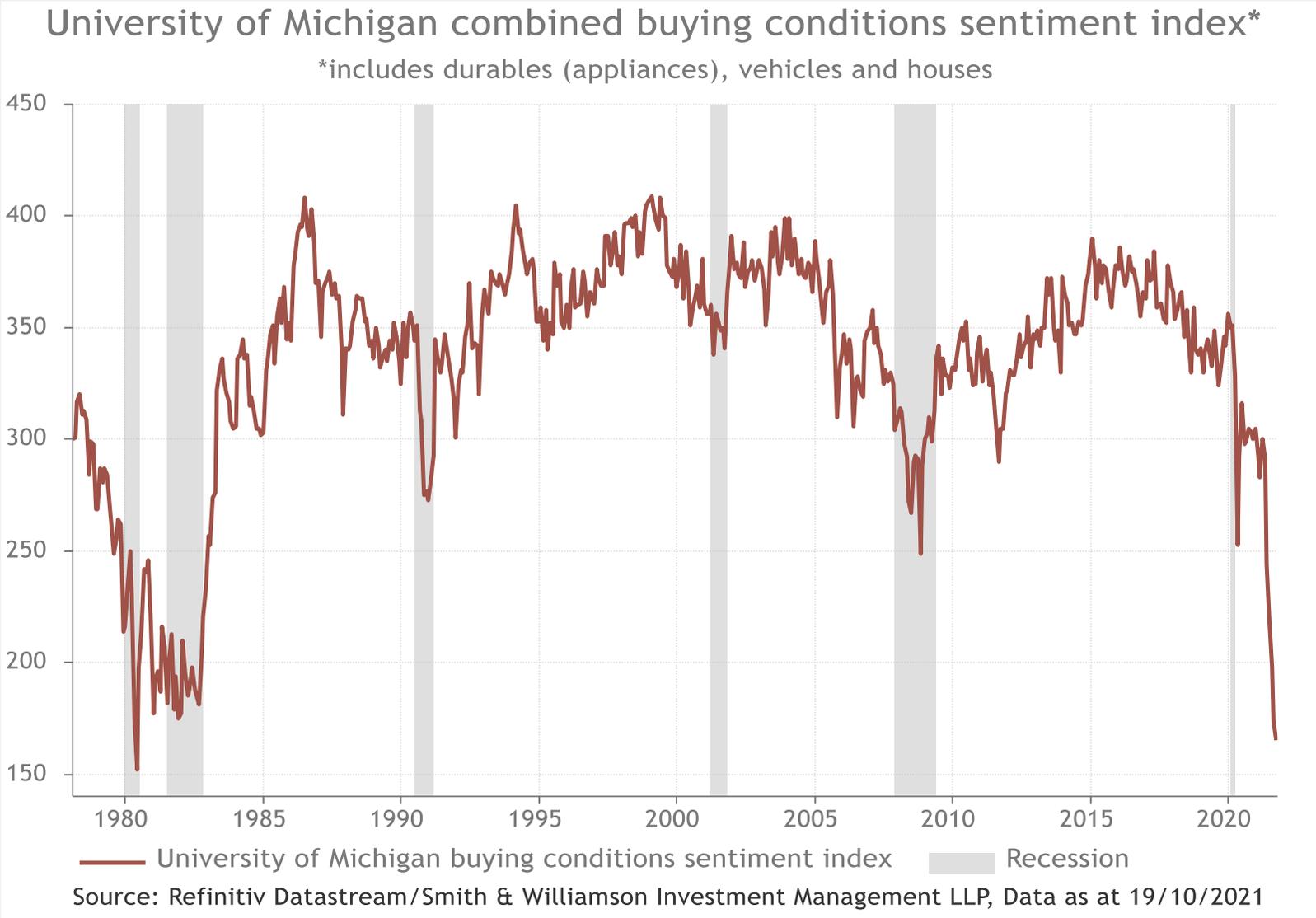
Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, Data as at 19/10/2021

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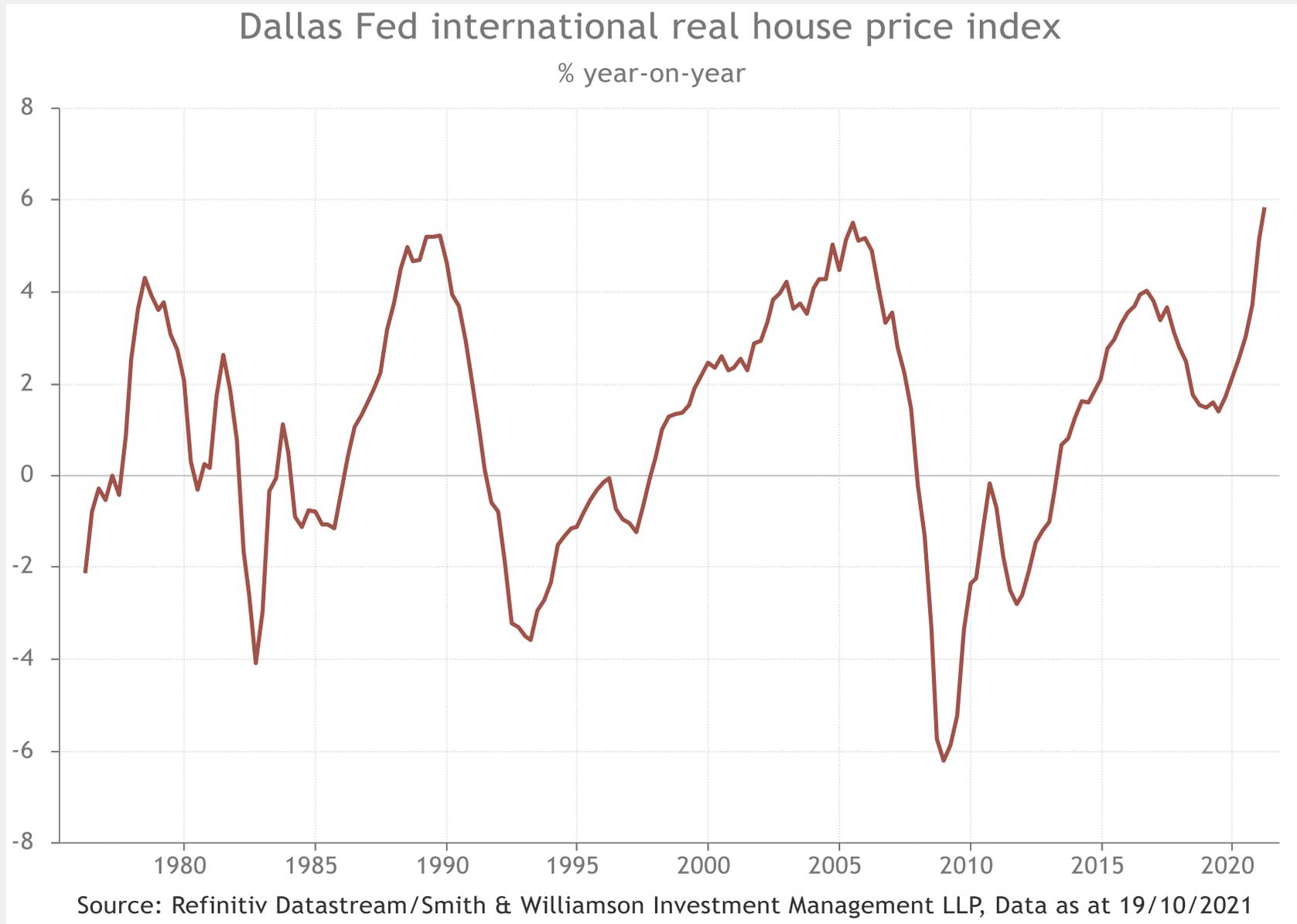
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4. Risks and issues for markets

Consumer “demand destruction” from higher inflation could reduce growth



Speculative froth in house prices could reverse



Conclusions

- The unprecedented policy response from the pandemic and a pro-union US president are events that could lead to a turn up in the inflation cycle
- Stick with equities over bonds for now
- However, higher inflation creates economic imbalances and comes with market risks

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