The Costs of Coping with Inflation

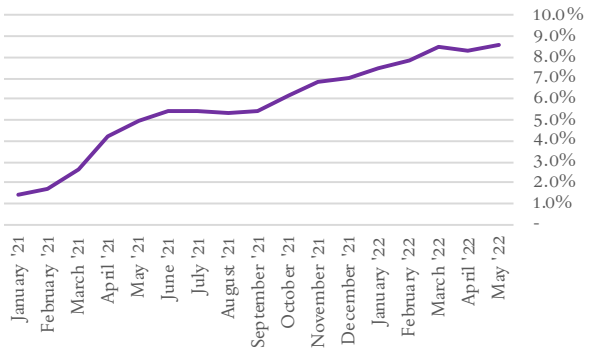
How this began

Since the start of the COVID-19 pandemic in Q2 of FY2020, the United States federal government and corporations around the world were forced to respond to our new economic reality. What we saw as a result of demand hitting all-time lows, businesses being forced to close, and millions relocated to the remote work environment, were unprecedented levels of quantitative easing. I will later cover where we currently stand with our fiscal and monetary policy as it's one of the many levers driving our economies supply and demand. First, we must discuss how businesses have been impacted by the tertiary events that have taken place over the last two years. As of this memorandum being written, supply chain bottle necks have continued to persist with imports of essential commodities yet to return to pre-pandemic levels. Within the technology sector, semiconductors have faced the biggest slowdown in decades which has adversely affected a variety of other industries such as auto manufacturing, consumer electronics, LED manufacturing and clean energy to name a few. Prices in oil have increased by over 40% with crude currently standing at $105.76 per barrel due to the Russia-Ukraine conflict. With NATO countries placing a variety of sanctions on Russia, developed nations are aiding Ukraine with military and financial support. Unfortunately, the EU has suffered greatly with 1/3 of oil imports coming to a halt. Although the United States has only seen an 8% decline in oil imports as a result of the sanctions, the Biden Administration has released 100 million reserve barrels to offset the increasing costs. We could continue listing the endless number of events that have affected our economy during the last two years but I'm afraid a book might be necessary to capture all that has occurred. In short, from the death of George Floyd to the January 6th, 2020 riots, to millions around the world affected by COVID-19, human civilization has without a doubt gone through one of the most unique periods in history. The rest of this letter will be centered around the topic of inflation, but what has been mentioned thus far are some of the key catalysts to what may question the world reserve currencies status and our goal towards globalization.

Important Metrics to Understand

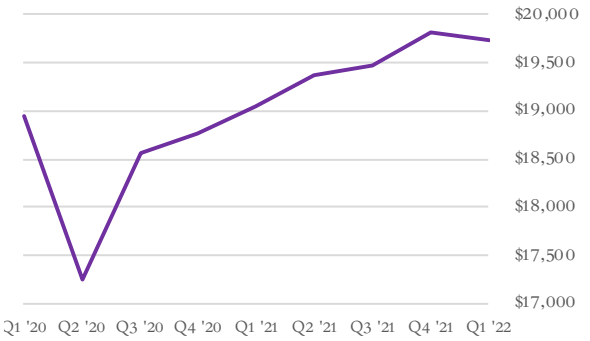
The chart below shows the past two years of the consumer price index (CPI), and although many will argue what prices are included in such an index, it goes without saying 8.6% is unsustainable. Some notable increases are food which rose 10.1%, the first time this index has been in double digits since 1981, gasoline which rose 48.7%, electricity at 12%, auto sales at 12.6% and air fares at 37.8%. Another graph that I find important to look at is real GDP in an attempt to capture the economic growth over the same time frame. We have been seeing a continued deceleration in the rate of growth which has fallen in line with a variety of correlating forecasters such as birthrates,

Figure 1: CPI Growth MoM%



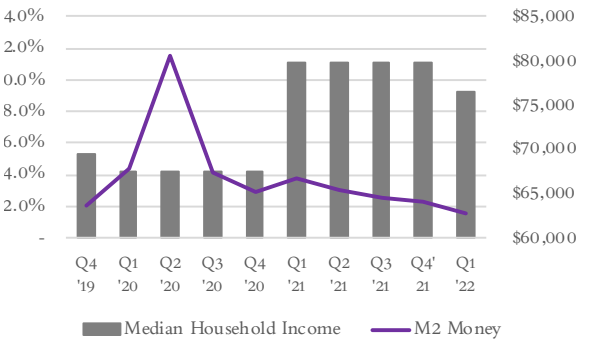
Source: Bureau of Labor Statistics

Figure 2: GDP Growth in Billions



Source: Bureau of Labor Statistics

Figure 3: M2 Money Supply % Growth vs. Median Household Income



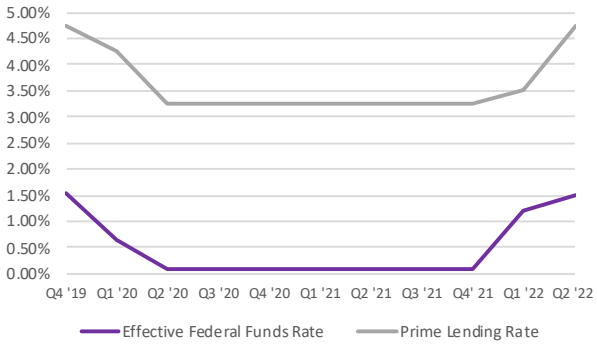
Source: St. Louis Fed

government spending and middle-class market share. The top 5% of wealth in the United States saw significant increases to asset values as the federal funds rate lowered to .25% and consumers had excess deposits due to stimulus checks. What's been grabbing a bigger share of the public's attention has been crypto assets which I will cover later in this memorandum. As consumers have moved into 2021 and 2022 with excess cash, this has allowed business to maintain their elevated prices to offset supply chain bottle necks. There have been significant increases in the costs of raw materials, transportation, and wages. These are just some of the factors limiting the supply side's ability to lower selling prices, but as demand stays consistent such changes to price do not seem like a near term plausibility. It is a shared fear among Americans that our economy is pasts its glory days, with our status as the world reserve currency and top military power, the questioning of our number one positioning as a developed nation is far and from any competing nations. I hear this argument widely countered with the rise of China, but many don't know or choose to ignore the debt crisis currently facing their country. In addition to this, they lack regulation and transparency which allows for government funding and influence over their largest firms, whilst causing public foreign investors to shy away from supplying capital. Before any company in China makes global influence, they first must address the free-market system and its government's regulatory role.

The Impact of Policy

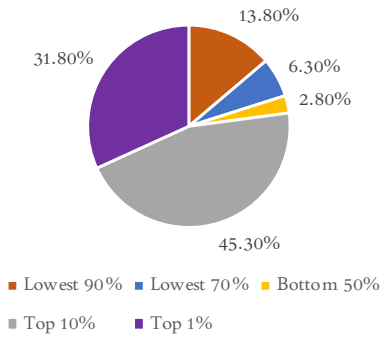
As we can see from the graph to the left, the rate of growth in M2 Money supply has been consistently above 2% until this most recent quarter. Fiscal and

Figure 4: Effective Federal Funds Rate vs. Prime Lending Rate



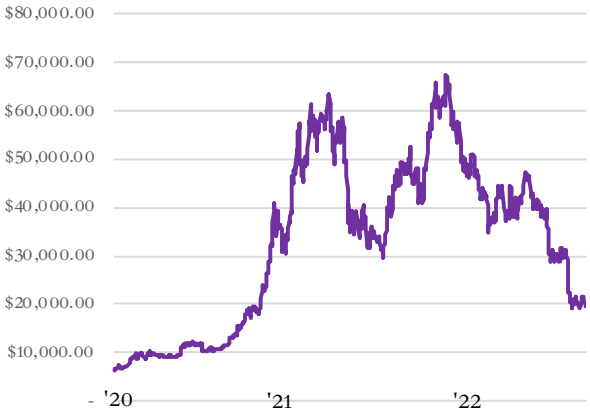
Source: St. Louis Fed

Figure 5: Wealth Distribution by Income



Source: Statista

Figure 6: Bitcoin Value in USD



Source: Yahoo!Finance

monetary stimulus has never been so great in such a short period of time. With the average growth of M2 Money supply well below 2% in the pre-pandemic years, the United States has continued to devalue the USD through its excess printing past 2021. With the federal funds rate at .25% until this most recent quarter, quantitative easing has put more money into the system than intended. Currently, we are seeing the federal reserve play pick-up, having just increased the federal funds rate by .75%. With the lag in quantitative tightening, the federal government has thrown $1.5 trillion at US consumers over 2020-2021 and now retracted $1.1 trillion in 2022 alone! This has aided in the streets consensus of recessionary risk above 50% across all bulge bracket banks in June of this year. Although 'recession' sounds pessimistic, it might be necessary with the excess cash placed in consumers pockets. The federal reserve has arguably the toughest job amongst all federal employees, the scale they must balance going forward is between the supplier's ability to produce through bottle necks and the consumers ability to maintain spending power. In summary, the United States consumer has an extra $2 trillion to spend even with quantitative tightening, and although the former facts hint towards a weakening economy the dollar index has stayed relatively strong compared to other currencies.

Cryptocurrency or Cryptocommodity

The pandemic gave many individuals the time and capability of looking over their at home situations. With millions more tuning into daily news, the recession we ran into in March of 2020 allowed assets classes such as the stock market, bond market, and crypto market to gain much attention.

Many believed the U.S. was going through a paradigm shift between currencies as crypto assets began to take on much speculation from retail investors. In total, this led to a 1000% price jump in Bitcoin which started the yearlong debacle of the dollars place in modern society. Many asset managers even believed in the relic online currency. Since then, we have seen Bitcoin eclipse $1 trillion in asset value in April and again in October 2021. Those worrying about the USD being in question by crypto is quite humorous. Bitcoin at its peak didn't even eclipse 1% of money supply in the United States, making this 'currency threat' ideal a gimmick. Nowadays, the currency has lost over $600 billion in value where it currently trades at $28,380.20 from its peak of $67,553.95 just eight months ago. I do not have a definitive stance on the crypto market, but I do find it hard to call a crypto currency when it is rarely being used for trade and more for store of wealth or as a hedge. Conclusively, I believe it is best to be treated as an alternative asset such as gold. Until developing nations where inflation limits economic growth; Brazil, Argentina, Columbia and Peru to name a few, enhance their daily economies to suit crypto assets, only then will we be able to call it a currency.

The Road Ahead

Going forward one thing will be more certain, there will be more uncertainty in our markets and in the economy. Although we are seeing increased volatility, lower valuations on earnings multiples and aggressive quantitative tightening, our underlying health as a country is strong. Aside from the infusion of capital over the prior two years, which was considered essential for many businesses, the federal reserve and central bank are working hard in grasping the lingering inflation. It is also important to note that in no period of modern history has the free market ever come to a sudden halt. With $2 trillion in excess savings, a stronger consumer base has arisen from the pandemic although businesses still face many challenges. With increased consumer savings businesses are capable of maintaining the elevated prices which will most likely persist into next year. My forecasts predict it won't be until 2024 that these inflationary effects begin to wear off and in 2027, we might begin to see consistency again within the capital markets. Keep in mind 95% of Wall Street is incorrect on their forward-looking estimates, and I most likely am as well. What we must instead choose to focus on is the innovation and stabilization that has kept the United States prosperous over the last century.