

Video Transcript: Much Ado about Inflation October 18, 2022

Katie Klingensmith [00:00:03] Hi. Welcome, everybody. This is Katie Klingensmith with Brandywine Global recording a podcast with Jack MacIntyre as part of our series Around the Curve. Jack, there's so much conversation around inflation and what it means right now. Welcome and just give us a quick introduction. What do you think the inflation situation is right now in the U.S. and globally?

Jack McIntyre [00:00:22] First of all, it's great to be here and have this conversation. And you know, inflation is a critical variable on a whole bunch of different markets right now. So, you know, inflation, hey, the seeds were planted around the pandemic. You know, we're dealing with it. You know, we've gone from extreme monetary and fiscal policies that were very stimulative to ones that are tightening in response to inflation. It's driven by supply shortages. Demand has been robust right now throughout the cycle. So, you know, we've got to see the idea of inflation kind of peaking and where is it going to decline from here. And how do we position our portfolios to take advantage of that? You know, inflation is certainly peaking with monetary policy turning ultra restrictive. It's going to continue to decline, particularly in this idea of inventories building and demand waning. And I think that's kind of the critical scenario of getting inflation lower.

Katie Klingensmith [00:01:23] So inflation already peaking. What might make the Fed more concerned, or are you more concerned that inflation is stickier?

Jack McIntyre [00:01:31] Yeah. It's this concept of pain, meaning the central banks, politicians that they start to, when we start to see weakness in the labor market, which is a necessary ingredient to get inflation lower, when they start to back off. You know, when central banks say, hey, we've probably done enough, we start to get turned a little bit more stimulative. But it's too early in the cycle. There's been episodes throughout history where central banks have done that, and they've kind of planted the seed of more sustainable inflation and inflation expectations moving higher right now. And you know, again, it's easy to say and introduce this concept of pain, but when you really start to see it negatively impact the economy, it's hard to stick with it right now. And that's my biggest concern, is that we start to see central banks back off of it. And then without really, you know, having inflation reach their targets.

Katie Klingensmith [00:02:30] And what might really make inflation sticky, and do you see expectations being too high right now?

Jack McIntyre [00:02:35] Well, inflation expectations are going to be too high if inflation stays too high for too long. You know, again, inflation expectations are all, not surprisingly, driven by about actual inflation. You know, and again, if it leaks into that, and we haven't seen it yet based on the inflation expectation surveys, but if it does, then that really kind of seeps into that labor demanding more. And then that kind of opens the door for that wage-price spiral to take effect.

Katie Klingensmith [00:03:07] Obviously something that the Fed's watching. Most of this, I think, is especially pertinent to the U.S. But are you seeing similar inflation trends outside of the U.S.?

Jack McIntyre [00:03:16] Yeah, we are. Because again, I mean, you know, the pandemic was a root cause of supply chain issues. They haven't fully worked their way through right now. So that's a global phenomenon. Higher food and energy prices in general are impacting everybody on the same level. The Russia-Ukraine war is exacerbating commodity-based inflation as well. So it is a global phenomenon. And you have to think about the impact of currencies. You know, the U.S. has been in a position we're benefiting from a strong dollar. That's actually keeping a lid on inflation. Europe has the exact opposite issue, other countries as well. So there, you know, again, think about, hey, people are frustrated about how much they're paying for gasoline or certainly that's been a theme this year. But, you know, if you're sitting in Europe, you're paying even more because you've got to, you know, do that currency translation. And that's making energy prices

even more meaningful in terms of the price appreciation. And let alone you got the energy shock of Russia shutting off the pipelines into Europe.

Katie Klingensmith [00:04:25] So bring that all together. In terms of your outlook for inflation, both for the U.S. and globally.

Jack McIntyre [00:04:30] Our mindset is that, you know, this is not a repeat of the 1970s. You know, and again, because the reason, one of the reasons I say that is because the Fed has learned a lot. They know the mistakes that were made in the 1970s. And, you know, the primary mistake is, hey, tightening, but not really tightening enough to break inflation. Volcker ultimately came in and kind of cleaned up the mess and set the stage for decades of low inflation. I'm going to bet that Powell is a little bit more like Volcker. And the reason I say that is because, you know, Treasuries look interesting in here. Again, you know, everything points towards a clear slowing of the economy, global economy, because you've only got a couple of central banks that are actually fighting the trend and doing more monetary stimulus away from that. Everything points towards fiscal and monetary contraction in here, and that ultimately should lead to a much better environment for financial assets, including bonds. And I think one of the things that looks very attractive is that when we look away from Europe and the U.S. to emerging markets, and I've been very impressed that their central banks have had as big a backbone as what central banks -- even more so -- than central banks in the developed world. They started earlier. They've been committed to that. We've seen and this is, I think, the critical variable in a sense that we've seen some countries take their real, so inflation-adjusted, policy rates into positive territory. U.S. is nowhere close to doing that right now, and that ultimately should make those bonds look very attractive. We're seeing that in some of those Latin America sovereign bonds. So, you know, I think that could be the biggest beneficiary as inflation sort of peaks and heads lower over the coming years.

Katie Klingensmith [00:06:15] That's very helpful. Thank you so much, Jack MacIntyre, for joining us at today's conversation Around the Curve.