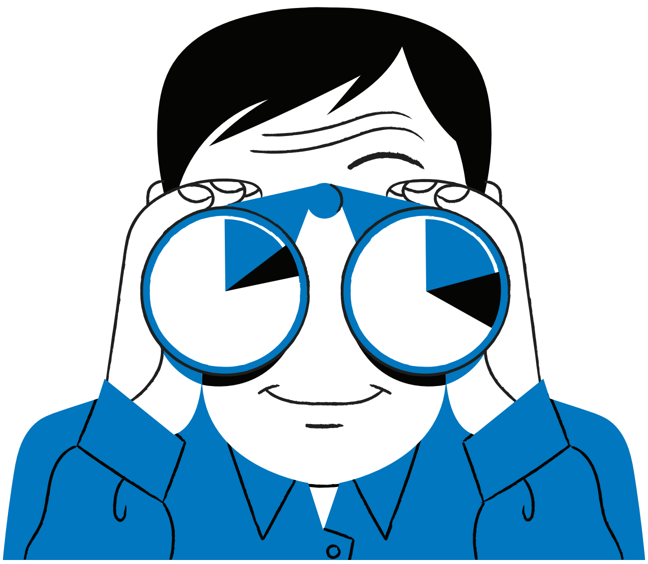

“If inflation increases, investors may be less willing to pay high valuations for earnings far out into the future.”

Market outlook

Potential for inflation continues to rise

By David Royal

Six months ago, I wrote about the possibility that we could see significant inflation in the economy. Back then, I felt a little sheepish raising the topic, since the consensus view was that inflation would remain tame for the foreseeable future. These days, however, we’re hearing more and more commentators discuss the potential for inflation.

Between asset purchases by the Federal Reserve and stimulus spending by the federal government, trillions of dollars have been injected into the economy. We’ve also seen the savings rate spike over the past year, perhaps driven by more cautious consumers or maybe there are just fewer things to spend money on during a pandemic. As the economy reopens, people who have delayed consumption and increased savings over the past year may increase their spending. More money chasing fewer goods could be a recipe for inflation in an economy still producing goods at a rate below its long-term potential due to COVID.

So which investments could make sense if we see a pickup in inflation? Within fixed income, one would look to bonds with shorter maturities, which would be harmed less by an increase in rates than longer maturity bonds. With respect to stocks, an increase in inflation could adversely affect the large technology stocks that have performed so well in recent years. If inflation increases, investors may be less willing to pay high valuations for earnings far out into the future. More economically sensitive cyclical stocks, such as banks and industrials, could outperform.

With interest rates still low but the risks of inflation potentially rising, it can be a particularly challenging time to generate income without taking excessive risk. Your Thrivent financial professional can help you navigate through this economic environment.

David Royal is chief investment officer at Thrivent.

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Illustration by David Saracino