



ASSET ALLOCATION INSIGHTS

Preparing for Higher Inflation

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KEY INSIGHTS

- Inflation has remained at low levels for several years but is expected to rise in 2021 because of an anticipated increase in consumer spending.
- We believe investors should consider including investments in their portfolios that could potentially benefit from higher inflation.

After remaining at low levels for several years, inflation expectations for the rest of 2021 have risen because of an anticipated release of pent-up consumer demand in the U.S. and abroad. In our view, investors should consider adjusting their portfolios to prepare for this potential shift.

The coronavirus pandemic created dramatic changes in consumer behavior, and it meaningfully curtailed spending. At the same time, the U.S. federal government provided massive stimulus to replace lost wages. Consequently, U.S. consumers

are expected to exit the pandemic with a remarkable savings glut, likely leaving them plenty of resources to draw from once they are safely able to spend (see left chart). A sudden increase in spending may lead to rising prices.

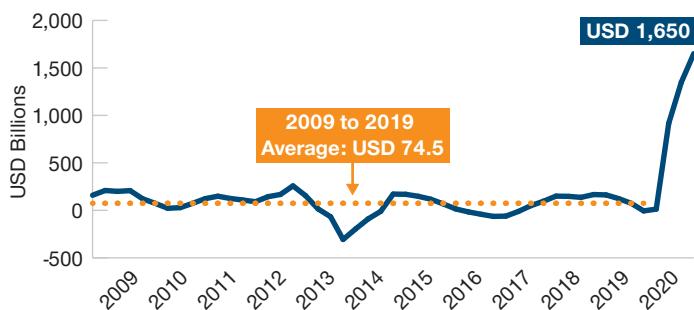
To gauge inflation expectations, investors can compare U.S. Treasury bond yields with yields on Treasury inflation protected securities (TIPS), shown in the right chart. While the anticipated inflation rate is relatively modest, it is notable because expected inflation levels have not been this high since June 2014. In our view, U.S. investors should not continue to expect the abnormally low levels of inflation seen over the past decade.

Given this expected shift, we believe investments that could potentially benefit from higher inflation may add value to an investor's portfolio. These assets typically include value, small-cap, and emerging markets equities; while within fixed income, TIPS and floating rate loans may be attractive options. "Real assets"—which include natural resources and real estate equities—also appear to be good alternatives as these assets have the potential to maintain or gain value during periods of high inflation.

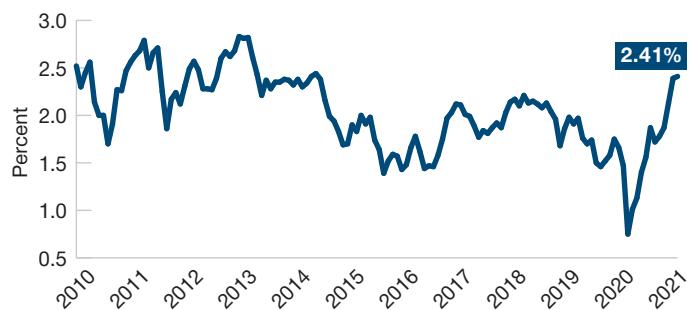
Inflation Expectations Are Rising

Anticipated increase in spending points to higher inflation

Change in U.S. Personal Savings, Rolling Four-Quarter Average 1Q 2009 to 4Q 2020



Inflation Expectations, 10-Year Gov't. Bond Yield Minus Gov't. Inflation-Linked (7-10 Year) Yield—10 Years Ended February 23, 2021



Past performance is not a reliable indicator of future performance.

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