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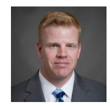
Revisiting Inflation Concerns

December 2021

Asset Allocation Insights

KEY INSIGHTS

- Inflation has increased worldwide and could prove to be higher and more persistent than expected.
- An increased allocation to assets that help provide an effective hedge against inflation risk could be beneficial.



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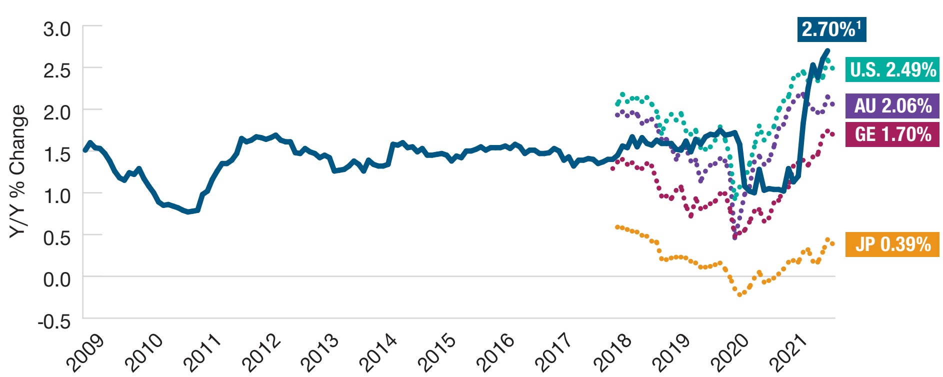
Overall, inflation has proven to be higher and more persistent than both the Federal Reserve and the market had expected. From March through October, inflation measures across the globe increased meaningfully (Figure 1), and future expectations have shifted dramatically.

The spike in prices has primarily been driven by supply bottlenecks and labor shortages and could be exacerbated by higher housing costs or a resurgence in the pandemic due to a new coronavirus variant. In this environment, we believe an increased allocation to assets that effectively hedge against the eroding effects of inflation may be beneficial.

Inflationary Pressures May Be More Than Transitory

(Fig. 1) Core prices continued to climb



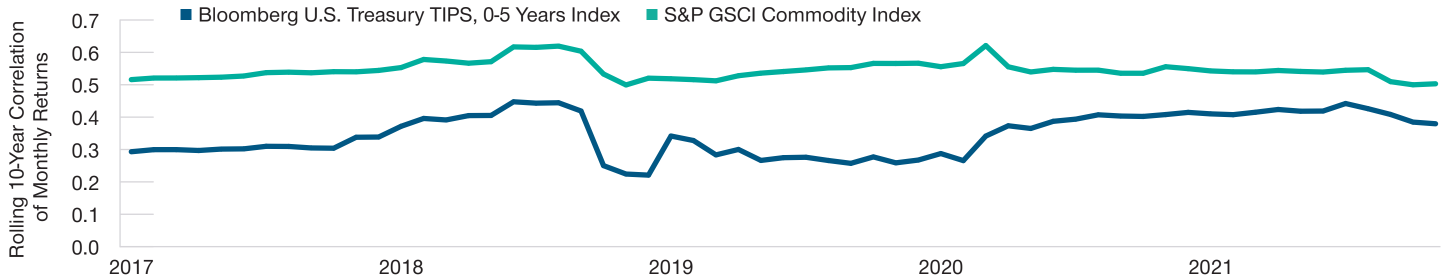
As of September 2021

[1] Line represents the market-implied inflation expectations for G-10 countries over the next 10 years.

Sources: Bloomberg Finance L.P./Haver Analytics. Russell. See Additional Disclosures.

TIPS Could Offer More Ballast Given Lower Correlation[1] to Equities

(Fig. 2) TIPS have had a lower correlation to the S&P 500 Index than commodities



15 years ended November 2021, monthly data.

Source: Standard & Poor's, Goldman Sachs, Bloomberg Finance L.P. See Additional Disclosures.

[1] Correlation measures how one asset class, style or individual group may be related to another. A perfect positive correlation means that the correlation coefficient is exactly 1. This implies that as one security moves, either up or down, the other security moves in lockstep, in the same direction. A perfect negative correlation means that two assets move in opposite directions, while a zero correlation implies no relationship at all.

Historically, commodities and stocks in commodity-related sectors—including energy and industrials—have generated strong gains during periods of high inflation. However, although commodity prices have surged this year, their upward trend has reversed sharply over the past month. Further upside may be limited given notable headwinds, including fading demand for industrial metals due to slowing industrial production in China. Also, even as U.S. oil rig counts rapidly increase, the U.S., and potentially China, plan to release strategic oil reserves, which could help to alleviate the oil demand and supply imbalance.

For investors seeking to hedge inflation risk, inflation-linked bonds such as U.S. Treasury inflation protected securities (TIPS) could offer an alternate option.

TIPS are indexed to an inflation gauge to mitigate an investor's risk from the decline in purchasing power typically caused by inflation. A review of monthly returns over a rolling 10-year period shows that, historically, short-maturity TIPS consistently have had a lower correlation to the S&P 500 Index than commodities (Figure 2), and may, therefore, provide better diversification benefits. Both commodities and commodities-related equities have also historically been much more volatile than TIPS.

As a result, our Asset Allocation Committee recently increased the allocation to TIPS, as they could, in our view, offer an attractive hedge against inflation and also help to mitigate overall portfolio risk.

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