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The Road to Inflation

Unsettling times. Welcome to the new normal. International monetary policy “has lost all semblance of discipline and coherence,” according to Stephen Roach, now a lecturer at Yale’s School of Management, formerly Chairman of Morgan Stanley Asia and the firm’s chief economist. With this loss of coherence comes the return of extreme volatility in global stock markets.

Here-to-fore, the best investment policy was to be “long and dumb’ U.S. Stocks as the financial markets celebrated quantitative easing (QE). When you print money, it’s gotta go somewhere, right? Why not stocks?

Unfortunately, in our environment of too much debt and too little savings, it just didn’t create the intended traction. Therefore, it is reasonable to assume QE will under shoot the mark in Japan and Europe, just like it did here. What you do get though, is inflated asset prices perched precariously atop moribund economies.

This brings us to the big topic of inflation. For thirty years interest rates and inflation have gone down. This was in no small part due to Paul Volker (Fed Chairman) throttling the economy with 16% interest rates. I’m convinced we’re nearing the end of that era of benign inflation.

How can this be you ask, with oil prices on the wane and interest rates headed lower instead of higher near term? The answer is three fold; first, all the surplus oil, coal, iron ore, etc., will result in significantly lower commodity prices near term. In turn, unlike quantitative easing, this will put more money in consumers’ pockets. Once consumers start spending their windfall from lower commodity prices, their economics will begin to revive (what central bankers couldn’t do the market place will). When that happens, higher prices are sure to follow as these material excesses are worked off. These higher prices will be exacerbated by central bankers current policies of currency devaluation.

Borrowing from Al Jolson’s famous jazz singer line, when it comes to inflation, “You ain’t heard nothing yet!”

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