The Inflation Outlook for Non-Profit Portfolios

Executive Summary: The Inflation Outlook for Non-Profit Portfolios
Fall 2021

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For the first time in decades, year-over-year US inflation is meaningfully exceeding the Federal Reserve's 2% target, a notable departure from the low and stable inflation regime that the US has enjoyed since the early 1980s. We would argue that this regime, and the associated lower interest rate environment, has been instrumental in a variety of strong economic and financial market outcomes.

Over the last few months, a variety of market participants, journalists, policy makers, and others have engaged in a spirited debate as to where inflation will head in the coming quarters and years. The key question is whether this recent spike in prices is transitory as the Fed and Biden administration have suggested, or emblematic of a move away from this highly desirable, low, and stable regime.

Our view is that while inflation may be a bit higher than what we have become accustomed to and persist at higher levels for longer than what was originally suspected, we do not believe that the economy will depart the low and stable regime. We have identified and then examined five key dynamics that we feel strongly will be instrumental in dictating price levels in the coming years. Below is a summary of our views on these dynamics:

Inflation Dynamic	Our View
Long-term, secular disinflationary forces (Technology and Globalization)	Diminished in magnitude relative to the past, but still weighing negatively on inflation.
Fiscal stimulus	Inflationary impact has already begun to fade, will continue to wane even if bills pass. A future risk is subsequent large stimulus stoking aggregate demand when it is not needed.
Monetary policy	Low policy rates and QE have not had much of an impact and will likely begin to reverse soon. The Fed, via FAIT, could be more tolerant of higher inflation in the future.
Supply bottlenecks	Highly impactful in short-term, should be resolved over time. Energy shortages and price levels represent a risk to our view, at least in the short-term.
Inflation expectations	Modest move up in long-term measures suggests that expectations still well anchored.

It's worth pointing out that even if inflation does drift into a higher range (e.g. 2%-4%), but remains stable, we do not think that will be overly problematic for the economy or financial

markets. Indeed, over the long term, equities have earned strong returns as long as inflation remains below 6%.

In terms of our positioning, we are still overweight equities and underweight fixed income markets. At current interest rate levels, bonds are quite unattractive, and the risk of higher inflation only amplifies this. While equities are certainly not inexpensive from a valuation standpoint, we do think that the combination of strong earnings growth and low interest rates give equities a good chance of delivering solid returns.

The last 18 months have represented uncharted territory in markets, economies, and policy making, creating a series of fascinating dynamics that we continue to watch play out. While we certainly have a view on inflation and where it is headed, we are acutely aware of how quickly and meaningfully things can change. As the world evolves, we will be clear-eyed in updating our views on inflation and markets more broadly.

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TIFF 35TH
INVESTMENT MANAGEMENT
35TH ANNIVERSARY

October 25, 2021

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