Fear Not Inflation

Stockholm (HedgeNordic) – With investors and societies optimistic for a Covid-19 vaccine and a government spending-fueled economic recovery, inflation expectations and concerns are rising. Inflation has been dormant through the decade-long economic expansion that kicked off in 2009, but no economic question is being more frequently debated at the moment than whether countries around the world will see inflation getting out of hand.

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Will Li, who founded Arete Macro Fund – one of the nine constituent hedge fund strategies within Brummer Multi-Strategy, believes consumer price inflation sometimes is taking up too much bandwidth in discussions about inflation. “I tend to think from a contrarian and unorthodox angle when I can,” says Li in a discussion with Brummer Multi-Strategy’s Head of Research, Kerim Celebi. “Policymakers tend to be singularly focused on consumer price inflation, which may not in fact be the only key driver of economic harmony and success in the world,” continues Li, who manages the Arete Macro Fund, a global macro strategy fund focusing on China and the rest of Asia, out of Hong Kong.

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“It’s equally important to pay close attention to asset price inflation and its wealth effects,” argues Li. “The costs of housing, your equity portfolio, and other assets also affect spending,” he continues. Consumers tend to be more willing to spend when they observe their homes rise in value, and on the contrary, consumers tend to be much more frugal in the face of a more pessimistic outlook on the value of their assets.

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Li views the significance of equity valuations for entrepreneurial start-ups as further evidence of the importance of considering asset price inflation. The hiring plans, capital expenditures and options-based employee compensation schemes of up-and-coming businesses are all tied to start-up valuations. “Today, asset inflation has just as important an impact on the fundamentals and smooth functioning of the real economy as consumer inflation,” argues Li.

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However, Li warns of uncontrolled asset price growth, which can ultimately lead to a lot of “dislocation” in the global economy. As evidence, he cites the 2008 financial crisis precipitated by inflated US home prices, which were fueled by various schemes to make financing easier. Easy borrowing brought more participants into the market, resulting in artificially high prices, which eventually came crashing down, causing a deep recession. “We ended up seeing dramatic dislocation and a very deep impact on the global economy and on the lives of economic participants,” says Li.

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Despite recent hints of emerging consumer price inflation, Li believes the inflation in consumer prices remains largely in check, with prices for many components in the consumer price basket actually declining due to technological innovations. In the agriculture sector, for instance, advances in genetics continue to increase harvest and productivity, while artificial intelligence is helping streamline customer services in the retail and other consumer sectors. Costs for education and healthcare are not included in the consumer price basket, points out Li. “But even more importantly, asset prices are not included in the basket,” he adds. “And if you are a young person trying to buy a home, you are acutely aware of how asset price inflation impacts your livelihood. And this can, in turn, impact the social harmony that governments strive to foster in societies.”