View as Webpage

Market Comment:

Gold, equities, Bitcoin, and inflation

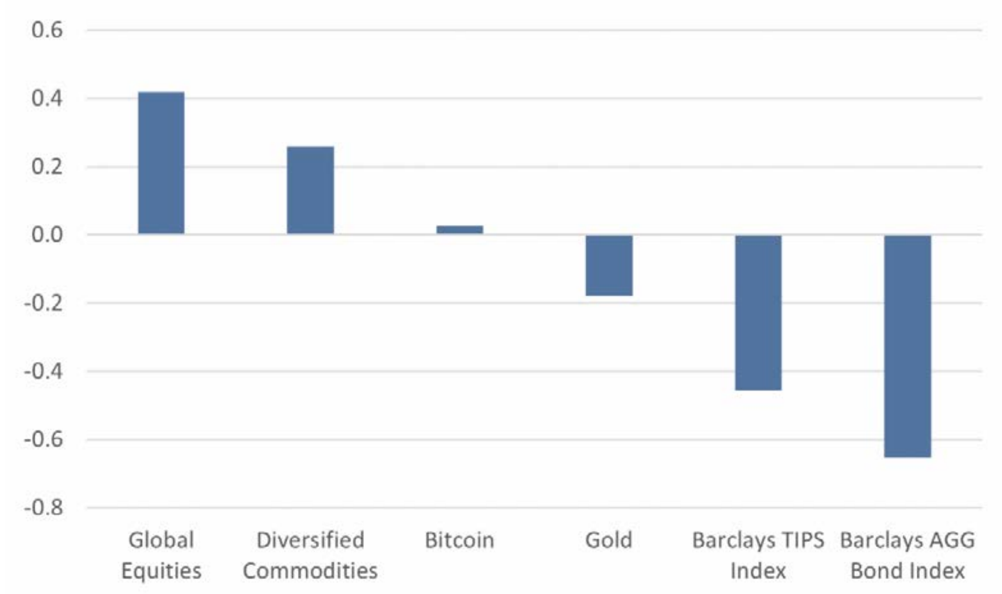
Market participants now expect inflation to average slightly over 2% for the next decade. Although realized inflation continues to run below 2%, many investors tell us they are concerned about upside risks to inflation — that they are concerned a combination of fiscal stimulus, monetary stimulus, and post-pandemic economic growth will result in inflation overshooting current expectations — and they want to protect against inflation risk in their portfolio.

It is difficult to discuss inflation without assets like gold and (more recently) Bitcoin entering the conversation, but a good starting point is to simply look at what has done a good job of protecting portfolios against unexpected inflation in the past (Fig. 1).

While it can be tempting to “do something” about perceived inflation risk, investors holding a reasonable portion of their assets in a well-diversified global equity portfolio already have one of the best inflation hedges available. Gold, perhaps surprisingly, has shown a negative correlation with inflation expectations over the last two decades (a topic we’ll address more next week). Bitcoin has exhibited no systematic relationship with inflation expectations since it was created in 2010.

However, investors that hold most of their assets in fixed income (or cash) should be concerned about inflation risk and seek ways to maintain a palatable risk profile while reducing their reliance on fixed income. Higher-than-expected inflation can quickly lead to negative real returns and the erosion of purchasing power in their portfolios.

Fig. 1: Selected asset class correlations with inflation expectations



Source: Bloomberg, Mill Creek. Correlation measures the relationship between two things. A positive correlation suggests the asset does well when inflation expectations go up. A negative correlation suggests the asset does poorly when inflation expectations go up. A zero correlation implies no relationship.

Updated Benchmark Performance:

Benchmark Performance by Asset Class			
	Week-to-Date	Month-to-Date	Year-to-Date
U.S. Large Cap Equities	-1.28%	0.75%	0.75%
U.S. Small Cap Equities	1.51%	7.53%	7.53%
International Developed Equities	-1.36%	1.76%	1.76%
Emerging Markets Equities	0.33%	5.18%	5.18%
Global Equities	-1.16%	1.52%	1.52%
U.S. Bonds	0.19%	-0.76%	-0.76%
Intermediate Municipal Bonds	0.04%	0.01%	0.01%
High Yield Bonds	0.12%	0.35%	0.35%
Oil	-1.15%	6.85%	6.85%
Gold	-0.31%	-3.45%	-3.45%
Key Rates	1/15/2021	12/31/2020	1/15/2020
U.S. 2 Year Treasury Note	0.13	0.13	1.56
U.S. 10 Year Treasury Note	1.11	0.93	1.79

Week in Review:

President-elect Joe Biden laid out his $1.9 trillion Covid-19 relief plan in a speech last week. Details include:

- Direct payments of $1,400 per person to most households
- Additional $400/week of unemployment benefits through September
- Expanded paid leave and increased child tax credits from $2,000 to $3,000
- $350 billion for state and local governments
- $160 billion towards nationwide vaccination program

Economic data released last week showed:

- Retail sales fell 0.7% in December from the prior month. Meanwhile, November sales were revised lower to a 1.4% decline. December was the third consecutive month of retail sales declines
- First-time unemployment filings reached 965,000 vs. the 795,000 expected by economists
- On a more positive note, industrial production in the US rose 1.6% in December. The metric measures factory, mining, and utility output in the economy

Three large banks kicked off earnings season on Wall Street last week, giving analysts and economists an early indicator of strength or weakness in the economy. Despite the companies releasing a total of $5 billion of loan loss reserves that were set aside during the pandemic, their stocks traded lower after a warning from Wells Fargo about a “long road ahead.”

- JP Morgan beat analyst estimates on revenue and earnings on record trading revenue and $2.9 billion in loan loss reserves being released
- Wells Fargo beat earnings estimates by 4 cents, but revenues fell short. Consumer banking and investment banking revenues both declined significantly
- Citigroup beat on earnings while revenues came in below expectations – mostly due to the release of loan loss reserves.

Economic Calendar:

- Housing Market Index – Wednesday, January 20th
- Housing Starts – Thursday, January 21st
- Existing Home Sales - Friday, January 22nd

This week’s contributors: Michael Crook, CAIA and Dusko Jankovic, CFA, CAIA

Indices Used: U.S. Large Cap equities: Russell 1000 Index, U.S. Small Cap Equities: Russell 2000 Index, International Developed Equities: MSCI EAFE Index, Emerging Market Equities: MSCI Emerging Markets Index, U.S. Bonds: Barclays Aggregate Bond Index, U.S. 10 Year Treasury Note: Bloomberg 10 Yr. Treasury Note, Municipal Bonds: Barclays Intermediate Municipal Bond Total Return Index, High Yield Bonds:

Barclays U.S. High Yield Total Return Index, Oil: Bloomberg WTI Crude Sub-Index Total Return Index, Gold: Bloomberg Gold Sub-Index Total Return Index