An Inflationary Mulligan Stew

Published 24 May 2021

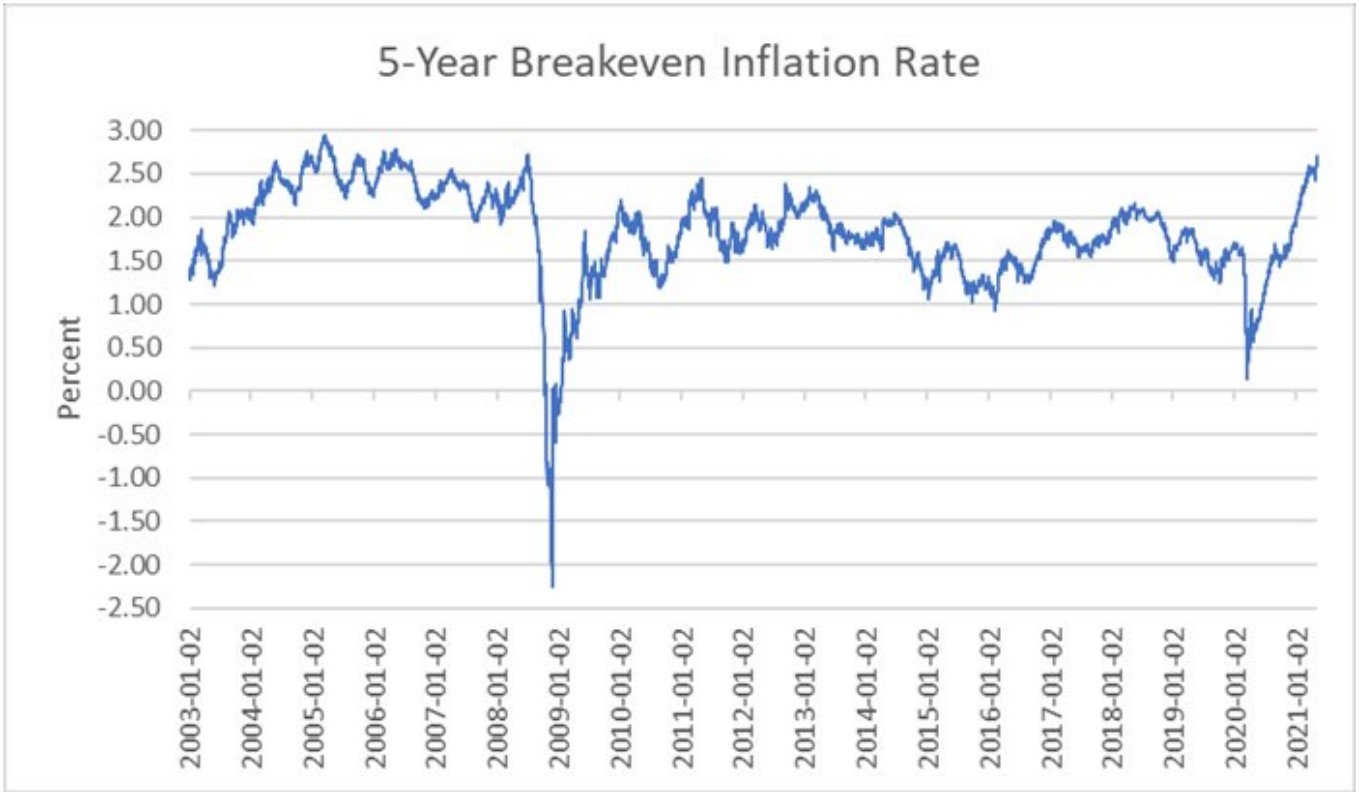
Kevin Flanagan
Head of Investment and Fixed Income Strategy

Treasury Secretary Janet Yellen seemed to forget for a moment that she was in a new role, one that does not set monetary policy. Against that backdrop, let's just say Secretary Yellen got her first mulligan1.

As a reminder, Yellen said that "it may be that interest rates will have to rise somewhat to make sure our economy doesn't overheat"2, but quickly pivoted away from that statement later on. The premise of Secretary Yellen's initial comment came from being asked if the current, and proposed, spending from the Biden Administration could create a setting where inflation may need to be reined in.

There is no question the inflation debate is currently gaining momentum in the markets, specifically the fixed income arena. Is inflation looming on the horizon, and will any potential increase prove to be 'transitory' as the Federal Reserve (the Fed) believes, or will it be more sustainable? At this stage, there appears to be four undeniable factors that should push inflation higher in the months ahead:

- Base effects, i.e. year-over-year readings will be compared to very low readings from 2020
- Higher commodity prices
- Disruptions in supply chains and low inventories
- Pent-up demand from Covid-related reopening's



Source: St. Louis Fed, as of 5/7/2021

Historical performance is not an indication of future performance and any investments may go down in value.

So, who is right in this inflation debate? I like to take my cues from the bond market, and as you can see, inflation expectations have been on a rather visible ascending trajectory. Looking at Treasury 5-year breakeven spreads, the latest reading of roughly 2.70% has now gone back into a territory that is rarely visited…in other words between 2.50% to 3.00% In fact, as of writing this, the last time the breakeven rate was this high you have to go back to the pre-financial crisis days of 2006.

1 Mulligan is a golf term for: getting an extra stroke after a poor shot but it's not counted. The broader meaning is one getting a 'do-over'.

2 Source: CNBC as of 4 May 2021

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an oer for sale nor a solicitation of an oer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can oen lead to a number of dierent interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.