ROCKMAN CAPITAL UPDATE

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2nd July 2021

Inflation

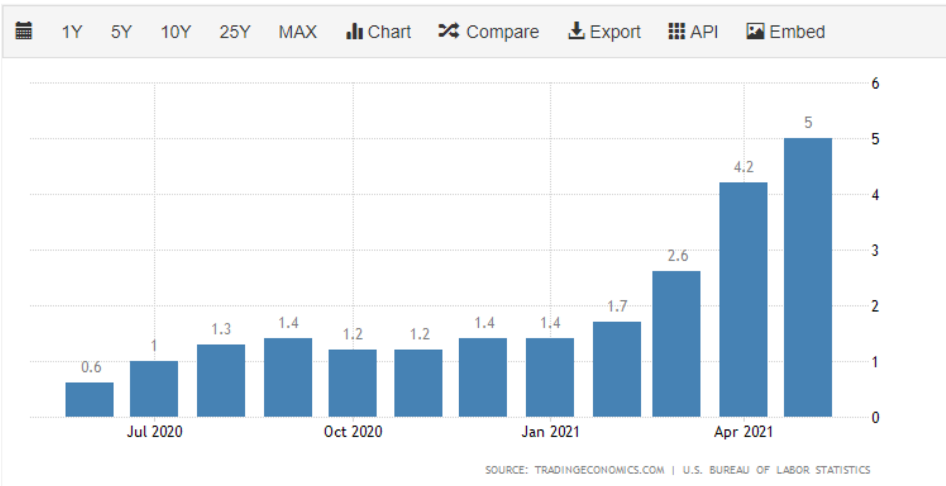
The Rise of Inflation

Inflation is seen to be guided by 3 factors:

- The effect of supply shocks,
- The effect by which an economy/country is operating above or below its productive capacity, and
- People's inflation expectations.

The present spike in US Inflation, to 5%, has its roots in the supply disruption of COVID-19 lockdowns and the subsequent uneven opening of the US economy. The rise of inflation over the last 12 months is the highest since the global financial crisis of 2007-2009. Despite this, the US Federal Reserve (the *Fed*), has reassured markets that it does not expect inflation to 'get out of hand' in the coming months. This comes in response to growing concern, that higher global inflation may damage the global economy. It was stated that the recent rise in inflation, is the result of temporary a whiplash effect post the COVID-19 pandemic. Supply chains in, from commodities to semiconductors have been disrupted by demand first collapsing and then surging back. This has made prices very volatile, including US house prices. On this notion, it is believed that inflation will normalize over the coming months.

**US Inflation Rate: June 2021:*



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We as a house, believe that there will be continued inflation pressures in the short-medium term. However the long-term inflation trajectory remains unclear. This will rely on the extent of monetary and fiscal policies that are put in place which may lead to increased production and not only consumption.

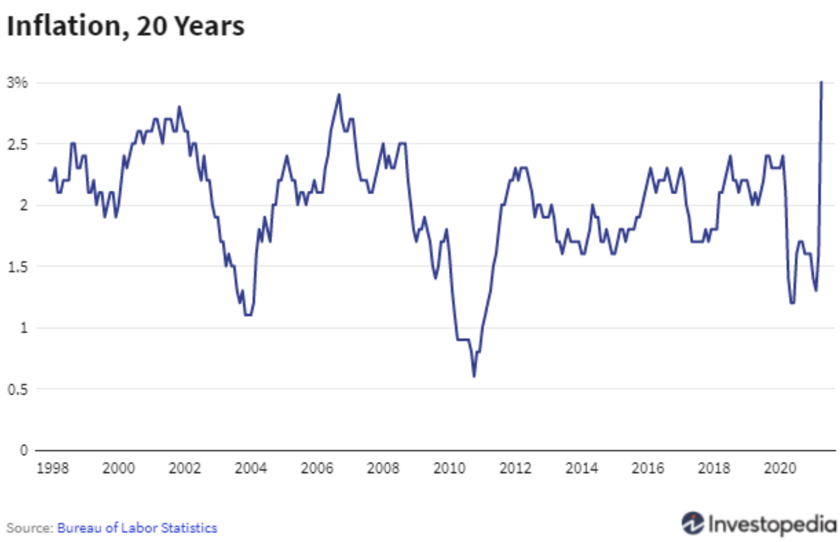
The Correlation between inflation, monetary policy, and commodity prices

Over the years, commodities such as precious metals, agriculture goods and oil & gas, have often been seen as a portfolio diversifier, that serves as a hedge against inflation. Historically, there has been a positive correlation between inflation and commodity prices. Alongside this relationship, there has been an inverse relationship between commodity prices and the US Dollar. This means that a stronger US dollar will impact inflation, through commodity prices. Therefore, a key factor to consider in anticipating how the currency will affect inflation, is through the behavior of commodity prices. With the recent rise in inflation we have witnessed a rise in commodity prices (such as gold and alternative assets such as…), with a decrease in the strength of the US dollar.

That the Fed has referred to the present spike as transitory, suggests that present supply pressures should ease when disruptions are resolved. Managing productive capacity, is more politically and socially pressured: The Fed needs to be seen managing unemployment, in the face of these pressures. Whilst US unemployment remains short of pre-pandemic levels (indicative of spare productive capacity), this may change quickly, adding to additional inflationary pressures.

Through its major spending programs, the Biden administration have signaled their intent, to drive labor participation and stimulate higher wages, thereby eliminating the same potential deflation that was witnessed in 2010.

Economists, market participants and commentators worry that the Fed and US Government stimulus (Interest rates of 0.25%, the increase in money supply to USD 8 trillion, pay-check programs, primary and secondary purchases of market instruments etc.) will lead to more persistently high inflation. This is seen as a perceived challenge to the Fed's commitment to price stability.



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With the Fed indicating a possible easing of their loose monetary policies, capital markets have entered a rotation stage, with a slight strengthening in the US Dollar, a move out of ICT stocks into consumer cyclicals, but persistently high commodity prices.

As we discussed in our last newsletter, entitled *Market Rotation,* Rockman Capital's portfolios remain weighted appropriately, taking into the changes in the inflationary environment.

The US Housing Market

Another factor influencing the recent rise in US inflation, is the US housing market. Fast-rising housing costs have accounted for over a quarter of the overall increase in inflation in May 2021. This is due to the low interest rates increasing the demand for housing, owing to consumers' easy access to credit. Demand has been further stoked US Government injecting of trillions of stimulus dollars, into the US economy. Consequently, consumers have been encouraged to take out bigger mortgages and spend more on housing.

Owing to the COVID 19 pandemic, US citizens who lost their jobs were forced to find cheaper housing alternatives. This pushed rents higher for the least expensive apartments and homes in the suburbs. The pandemic also caused a shift to remote working and low interest rates which has intensified things.

The Case-Shiller national house-price index measures the change in value of the US residential housing market. It does this by tracking the purchase price and resale value of single-family homes that have undergone a minimum of two arms-length transactions. This index is currently rising at an annual rate of 13% - its fastest for more than 15 years (see chart below). Recently, home prices in April saw an annual gain of 14,6%, which is the highest reading in more than 30 years of Cape-Shiller data. If these numbers continue to rise, we believe there will be further pressure on the Fed to push out the timelines for normalized inflation and it may force the US Central Bank, to start increasing interest rates to counter in order to rein in inflation.