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US & Western Stimulus will give rise to crazy inflation in commodities?

Implications of massive money orienting by the western world

In order to “aid” the citizens and businesses due to the disruption due to covid, the western governments doled out trillions of dollars to satiate their citizens. Many ageing/ fiscally irresponsible countries who have not seen growth in productivity and its GDP following the US to do the same. This reckless printing led to massive inflation in many countries.

This macro thesis has recently been reinforced by gold's resurgence as a crucial asset for central banks, particularly following the Russian-Ukraine conflict, when the US froze approximately \$300 billion of Russian holdings in Treasuries. While the European Central Bank, the Bank of Japan, and other close US allies maintain substantial holdings of Treasury securities, China, once the primary financier for the US, has unmistakably shifted its focus towards gold as its core holding. In our perspective, this transition is just the beginning

This has spurred the resurgence of Gold as a safe asset to back the currencies (as it was prior to the Nixon shock of 1971). To say it succinctly, massive money printing leads to resurgence of Real Assets. Real Assets are physical, tangible investments the supply of which does not increase in proportion to the printing machine of the central banks. These include- Real Estate, precious metals, timber, hard infrastructure & energy related assets (coal, uranium, oil etc.). These types of assets are generally far upstream in a value chain and close to the primary or raw material stage. When inflation is present, the producer of raw material has been better able to manage inflation than companies that are closer to the consumer in the value chain. Many investors who succeeded in 1970s did it by abandoning U.S. stocks and bonds for other types of investments. Gold for instance, rose by an astounding 19.4% a year from 1968 to 1979; diamonds climbed 11.8% annually while real estate became the favourite inflation hedge among small investors with the price of single-family homes rising 9.6% per year. Shrewd investors who were in the right place at the right time made money in oil stocks- over the course of that decade, oil stocks gave a CAGR of 34.7%. Let us go through some real assets that can act as store value in the coming scenario.

- **Commodities- precious metals:** There are four precious metals that are commonly considered for investment purposes i.e. gold, silver, platinum and palladium. Despite being used in jewelry, gold is an established metal as a safe haven from inflation, currency devaluation, political & economic disruptions. India has many gold & silver ETFs to invest in. However, in case of other assets like platinum and palladium, one does not have many domestic options to invest in. Due to regulatory paralysis, it would not be prudent to invest in international ETF unless, the amount invested is > \$10000
- **Commodities- energy related:** Coal, uranium, oil & gas. Only way to play this in India is individual stocks i.e. Coal India, PowerGrid, GAIL, Petronet LNG, ONGC
- **Real Estate- Securitized assets like REITs** would be best to hold rather than physical real estate. The thing with real estate is that it is very location specific (not only city specific but also micro market specific) but many view commercial real estate as an inflation hedge due to a number of factors:
 - As the price of goods and services rises, so may the rental rates that the property owners can charge tenants.
 - Replacement cost is a significant component to determine whether a new development will occur or not. If it costs more to make the construction than it did 1-2 years ago, the prices have to rise with time. However, once the construction is complete, the inflationary component of construction i.e. high labour costs for construction & material inflation have limited impact on the bottom line of the income statement.
- **Infrastructure assets-** Toll roads, ports, airports, utilities like power distribution companies & gas distribution companies.

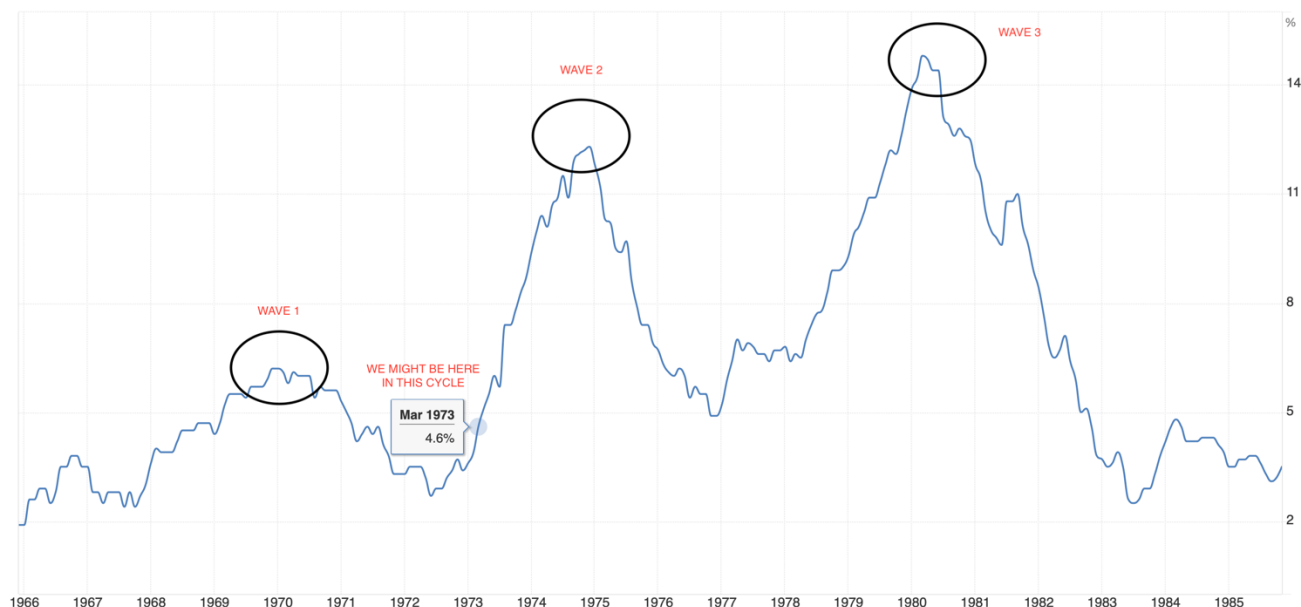
How long will this cycle last?

While the macro environment today differs from that of the 1970s or 1940s, a lesson from history remains: Inflation tends to develop through waves. Despite all the debate regarding the 1940s and 1970s, inflation turned out to be structural in nature and manifested itself through waves during both periods. Take note of that in perspective of what is unfolding today. Inflation is likely in a bottoming process, and the recent developments in commodity prices and breakeven rates are adding to that case. This is unlikely to be a cyclical issue; instead, the main drivers of today's inflationary regime are:

- Deglobalization
- Irresponsible levels of government spending,
- Ongoing commodity supply constraints further worsened by the ESG phenomenon



- Wage-price spiral, especially among lower-income workers.



U.S. Bureau of Labor Statistics

Value Chg Chg%

(graphed in tradingeconomics.com)

Inflation is here to stay and hard assets will MOST PROBABLY outperform.

What is likely to work apart from sectors and assets mentioned above?

The best bet is to hedge yourself by buying commodity and old economy stocks, as they have been starved of capital for nearly a decade. In their case the valuations are cheap, and the earnings could go through the roof!

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