Casey Mullooly: Welcome back to the Mullooly Asset Podcast. This is episode 381, and I'm your host Casey Mullooly. And this is another one about inflation. We recorded it on the day of the CPI print and it was such a hot print, and it's been such a hot topic lately that we figured it would be good to talk about once again, with all of the guys. Back live with me here in the conference room, I've got Tom and Brendan joining me on this one. We're just going to jump right in to episode 381.

Tom Mullooly: It seems like every episode of deflation, inflation, expansion, recession is a little different.

Casey Mullooly: This time, it's different.

Tom Mullooly: I hate that line. I really do. This time it's different. But they're all unique in their own ways. How did we get here this time?

Casey Mullooly: It's frustrating too, because I think that you look back and you try and apply history as best you can to certain situations, but while some of the numbers might be the same, the context of how we got those numbers is, it's different every time, and there's not a one size fits all approach of how to get certain outcomes, whether it's how to slow down inflation or how to grow the economy. There are certain levers that can be pulled, but it's not going to be the same thing every time.

Casey Mullooly: So we're recording this on November 10th, we got the highest inflation print in 31 years today. That came in at 6.2%. That was the Consumer Price Index report. So that is the year over year inflation rate, which hit 6.2% in October. And it's just piling on in this inflation story that's been taking place over the last couple of months.

Tom Mullooly: I think if you take out the blip that we had in 1990 or '91, when we had that 5 or 6% inflation, if you were to just skip over that one year, this is probably the highest print that we've had in almost 40 years, and maybe more.

Brendan Mullooly: We had some high readings in the 2000s and 2008 also. And again, those were spikes on the chart if you look at CPI. So we haven't actually had a sustained period of time outside of the '70s that I would say was an actual sustained period of inflation. Pretty much, if you look at the CPI chart over time, all of it is just spikes, peaks and valleys in the data. So it's not like we have a stock market chart where it's up and to the right, climbing perpetually. And I know that some of that is the nature of how we're measuring this in most cases, which is year over year percentage change. So the data obviously smooths at some point, but it's not as if we haven't had spikes in inflation before. We've had some of these same conversations, same stories that we're seeing now. We've seen them in the last 20 years too, despite this being technically the highest reading in 31 years. It is by 0.1, I think.

Tom Mullooly: So I know that I had alluded to briefly about how this time is different and the path that we take is different. I just want to spend two minutes and just talk about a few things that may help give some perspective. So we talk about, and this was before we turned the mic on, we talked about how the '70s, most people label the '70s as the period of inflation, but when we really started to get inflation was in the second half of the '60s. We didn't really feel it as an economy until the '70s. There is a lag effect when this happens. And think about what happened in the '60s. We had the Great Society. Lyndon Johnson basically created a new division of the federal government with Medicare and Medicaid and a war in Vietnam that really became a quagmire. They were just pouring money into it and not getting anywhere.

Tom Mullooly: It just makes you think about what happened, go back 30 years before that in the 1930s, we had this terrible economic depression where we had year upon year of negative GDP growth. Franklin Roosevelt was able to go out and basically create Social Security along with the New Deal. That was the one thing that remained from the New Deal was Social Security, which was extremely expansive and very inflationary, but he was able to do it during a deflationary period. So there was no demand in the economy at the time. And then as we got through 1937, then Hitler started coming on the rise and then we had World War II. And that created the demand that we needed.

Tom Mullooly: As we came out of 2008 and then into the early part of the last decade, people were saying, "We're getting economic growth, very little economic growth, but there really doesn't seem too much demand that's out there." And now here we are in 2021, we're seeing outrageous demand and people talk about how we don't have truck drivers, all these barges are stuck out in the water with 94 containers on them. So we're getting the inflation that we've seen.

Casey Mullooly: I think it does take a while for this to work its way through the system, and that these higher inflation prints will probably continue into 2022, into next year. So I'm not going to make predictions on where it's going to be, but going into this, it wasn't a war that created the need for all of this stimulus that we saw that was caused by the COVID-19 pandemic.

Brendan Mullooly: The alternative was a recession. So I mean, in terms of what we were supposed to do, I think we're seeing the ramifications, and it's not as if this was unexpected when we were doing it, but we saw not only monetary policy, quantitative easing, and additional measures that the Fed took in 2020 as a result of what was happening, but we saw the fiscal part of it come through too, which we hadn't seen in a very, very long time. So the conjunction of those two things is resulting in some inflation readings now, some of which have to do with where we're measuring from because the inflation reading is telling us that it's up 6% over a year ago, and last October, we were still pumping stimulus into the system. We were getting ready for the second round of economic impact payments, which continued from 2020 into 2021.

Brendan Mullooly: A different set of people in charge. They all agreed that it was still a good idea to do because it beat the alternative, but now we're here on the other end. And while it beat the alternative, we have a separate set of issues to deal with now. I'm not really sure what the solution is. People are talking about the Fed should hike rates. All that does, I think, is coke off the demand that we're seeing in the economy. Is that really a good thing that we want? Or should we wait and see if this is something that persists and really needs to be addressed with fiscal or with monetary policy, rather?

Tom Mullooly: I think Casey you'll agree. That seems to be the great debate in the sense that, like Brendan said, we had an economy that was moving along, not at a great speed, but it was basically shut down to zero. I think there was a GDP print at one point, third quarter of 2020, where the economy was negative 20 or something like that, just a number you've never seen before. So it seems natural that as we reopen the economy, and we're still trying to reopen the economy, that we're going to have these very high numbers, these high prints like we're having now. Is this something that's going to smooth out over time, or is it the beginning of something else?

Brendan Mullooly: I'm not really sure one way or the other, but a healthy economy is probably the most important thing to the majority of Americans out there. So I think that they're going to, like we talked about in the beginning, there are levers that they can pull. When they're going to do it, I know the Fed started, they're going to start tapering next month. And they're talking about talking about interest rate hikes next year. Nothing is going to happen the rest of this year, but they're starting to talk about these things. They're feeling the pressure as well and they're paying attention to this data even more so than we are. And I think unfortunately, it's just one of those things that we're just going to have to see how it plays out.

Tom Mullooly: Naive for me to say, but I think if eventually, say a year and a half or two years from now, if we were to get interest rates back to where they were in January of 2020, we've basically just gone back to where we were. It'll seem like a dramatic shift in interest rate policy to get there from here, but I don't think that that's really going to strangle the economy. The economy seemed to be moving along okay at that point. Not great, but seemed to be doing okay.

Casey Mullooly: Yeah. And you look at some of the other economic data, like jobs, job growth and the unemployment rate, and we're seeing those numbers come back to pretty much where they were before the pandemic, which I think inflation is just one measure of how the economy is behaving.

Brendan Mullooly: It's only one part of the Fed's mandate. They want stable prices and they want as full employment as we can get. So I think that one of the arguments they're making now is that they would still like to see the unemployment rate lower, and I think we all would. So, to preemptively hike because we're all worried that this is going to be forever, remember that kid who went to the dentist and he got all the medicine and then he wakes up in the car and he's like, "Is this going to be forever?"

Casey Mullooly: [crosstalk 00:10:52].

Brendan Mullooly: That's what I'm thinking of now. And it always feels that way. It's like we're headed in one direction. It feels this way too, especially when the market goes down. It's like, is this going to be forever? And it's not going to be forever. TBD how long we're going to be dealing with this, or if the Fed will have to make adjustments. But I think them taking the approach of hanging tight for now while just facing the criticism and outcry from the public that they have been now for several months.

Brendan Mullooly: I guess what I don't think we'll see is if they turn out to be right for waiting a year from now, two years from now, and we're back to more normal readings on things like CPI and other economic data points, then the noise has shaken out so to speak, and it turns out it was somewhat transitory, whatever that period of time means. You won't see any of the people crying today about the inflation print, saying, "I was wrong and the Fed was right." They'll be onto some other thing that they're shaking their fist about. And maybe that makes me a Fed defender, but just looking at the landscape of their options right now, I do think that hanging in there makes sense. Obviously we're going to continue getting these sort of readings. And at some point in the future, if they continue to be as hot as they have been the last several months, then something's going to have to happen.

Casey Mullooly: I also wanted to shift a little bit and talk about what inflation actually means besides making people upset or angry, so they shake their fists at the people in charge. What's the practical side of an inflationary environment in terms of things that we can be doing or shouldn't be doing in terms of investing strategies or more financial planning related topics? I know we talked before we turned the mic on about how looking at your cashflow situation on a month to month basis and seeing where those numbers are at and how financial planning is more of an ongoing process, and this is why it's a process, because these readings and situations change over time. So, any tips or tricks on that front?

Tom Mullooly: Well not a trick, but a tip. I think it's important to examine your cashflow, in particular the expense side. It's a little easier to manage if you're still working and you have income coming in. If you're retired, living on a somewhat fixed income, you really need to have a good grasp of what things cost and what your needs are going to be from your income sources, Social Security, dividends income, the amount that you're taking from your investments to sustain. I think it's important that you know the numbers.

Brendan Mullooly: Right. So when we're mapping out a financial plan for somebody, we're assuming things within the plan, one of which is inflation. So we have to make an educated guess to assume some rate to estimate, if somebody's expenses are X today, what will they possibly look like in the future? And we hope to be as accurate as possible, but we do this with investment returns too. So while we update each year to see what the actual rate of return on the investments are, because I think as we've mentioned time and again in the podcast, we very rarely get the number that we will bake into a financial plan as the average. That's just something we need to assume to make some educated guesses about the future. We're doing the same thing with inflation.

Brendan Mullooly: That's tied directly to cost. So each year along the way, you should be taking a look at doing an audit, so to speak, which we can help with, looking at what things cost. So if we assumed that you spent a $100,000 last year, and that inflation might run at 2% over the lifetime of your financial plan, I don't know that I'm willing to say right now because of one CPI reading that I would change that assumption in the plan. However, what we can do is instead of taking a look at what we projected your costs to be this year, we can take a look at that number and compare it to what the actual costs are, and then on a go forward basis, continue with our assumption of 2% or whatever. Updating with those real time numbers for things like expenses alongside the investment returns, that is why planning is an ongoing process, because we've made guesses, but we get to fill in along the way with the real data.

Hard numbers. Hard numbers.

Brendan Mullooly: Right, exactly.

Tom Mullooly: I think we should also touch on some of the conversations that we've been having lately, like oh my goodness, inflation is out of control, we should be doing something. I always like to default back to don't just do something, sit there. It's the opposite of what people expect. So I think sometimes people are caught a little off guard when we tell them, as Brendan just mentioned, we've already pre-baked this into the cake. I mean, when we are putting together plans for folks, we're usually throwing around some higher than usual inflation numbers. But what should be the reaction for folks when they open their statement next month or six months from now, and they see that their accounts are down? Should we be making changes because of inflation?

Casey Mullooly: I think it's tricky because I know we, me and Bren talked about this, well, it was actually in the one that I clipped you guys in on last week, but it was when you hear stuff like we should be doing something in terms of our investments. Usually the something is we should be getting out of the market or we should be playing it more conservative, and put our money into quote unquote, "safer investments". In an inflationary environment, we talked about how that is literally the opposite of what you want to be doing in that situation. So if their accounts are down and you're taking the appropriate amount of risk, I don't necessarily know that there's anything to do about that. Because you want to be exposed to more growth oriented things, meaning stocks and not safer investments like cash or bonds. You invest in growth oriented assets in order to keep up with inflation. That's literally why you do it.

Brendan Mullooly: It also would be a little, I think, simplistic to assume a monthly statement is a negative number because of anything in particular. We're talking about one month in the stock market. That could be because of anything. So to pinpoint it and say it's because of inflation, it doesn't actually work that way. But just along the lines of what are-

Tom Mullooly: But there are a lot of people who think it does.

Brendan Mullooly: Yeah, it doesn't work that way. I'm glad to tell them that too. Just talking these returns that we get, whether it's inflation over time in a plan or investment returns, we're going to be above and below trend in terms of, hey, if we projected a number for investment returns, we're going to spend time above that, we're going to spend time below that trend. But the educated guess we're making is that we might add average that over the lifetime of a plan. And how does that all look? Does it all work?

Brendan Mullooly: Same thing for inflation. If we assume something like 2% inflation rate, we may be well on our way to that over the lifetime of a 30 year retirement beginning today, even though the print from this morning was 6%. We're not updating our financial plans to assume 6% annual inflation on a go forward basis because there's no historical precedent for that. Even the '70s, it came to an end at some point. So to assume that for ... A 30 year retirement beginning in 1970, let's call it, didn't have a 10% inflation rate over the 30 years from 1970 to 2000. It was probably something more like 3 or 4% tops.

Tom Mullooly: I think in 1980-

Brendan Mullooly: Historically it's been 3%, if you go back to the '20s through present day.

Tom Mullooly: We're talking about 100 years.

Brendan Mullooly: Right, and that includes time periods that are no longer relevant to-

Tom Mullooly: Boom and bust periods.

Brendan Mullooly: Right.

Tom Mullooly: Yeah. I think in 1980, we had 13% inflation. And it's also, for some of the older folks, they say, "Boy, that's when I was getting 16 or 15% on a CD." It's like, well, yeah, your real return after inflation was 2%. So, that's about right.

Brendan Mullooly: So back to a prior point, is the entire reason that we're investing in growth assets specifically like stocks is to get a real return. So if it's any comfort for anybody, if we end up with a year over year print come January for 2021 of inflation and it's 5 or 6%, if you made 12% and it was 6%, the 6% real return is the increase in your purchasing power that you're going to require to have enough money to get through the course of a 30 year retirement or whatever your specific case may be. You're not going to get a positive real return every single year, but that's no different than making 6% when inflation was zero a couple years ago. I know that those numbers don't actually, that's not what you see on your statement, but that's the point of all of this is to get a real return, meaning after inflation, what's left over.

Brendan Mullooly: So the exposure to stocks is your best way to do that because if we're in an inflationary environment, that means input costs are rising for businesses to produce the things that they do. And when input costs rise for them, they consider what they're selling those things for to consumers, which is how the prices go up. And then if the business is making more money to remain a profitable business, then owning a portion of that via the stock market is the best way to keep up at least with what's going on in the economy. And you're going to be feeling that in your pocketbook, because costs are increasing on you, because you're both a consumer and an owner of the company in this instance, but it at least hitches your wagon to what's going on and everything else. And you don't get that at if you're in cash or other safer stuff like bonds. You have no guarantee of that rising income over time that the businesses are generating.

Casey Mullooly: Yeah, the only guarantee you have by holding cash is that you're not going to keep up.

Brendan Mullooly: Right. You're losing purchasing power. You need the cash to cover short term liabilities because you don't want ... I don't think I would have the conversation with somebody where they say, "Hey, inflation's high. I get this point about needing stocks to keep ahead of inflation. Should we take more risk because of inflation?" I don't think that I would do that either. You need to have stocks in your portfolio, but it should be right size based on not only your comfort levels, but the actual short term liabilities you have. Like you can't afford to be 100% stocks if you have short term cash needs, which all of us do to some degree. So if you have, as you said before, if you have an income, you're still working, then perhaps yes, maybe then you should be more in stocks if you're worried about staying ahead of rising call cost of living.

Brendan Mullooly: But if you're somebody who's drawing on your portfolio to a degree, I don't think you go further out the risk spectrum just because inflation's high because you have fixed needs in the short term that are not going any place. You need to have a cash stockpile to get through a couple years because while-

Casey Mullooly: If anything, your cash need's going to be more.

Brendan Mullooly: Right. So you-

Casey Mullooly: And your expenses are going up.

Brendan Mullooly: And also because-

Tom Mullooly: You've got to let the market do its thing.

Brendan Mullooly: Right. Your inflation hedge, which is stocks, has no guarantee of a positive real return every year. I feel very good about that over 5, 10, 15 plus years. However, you've got to get there first.

Casey Mullooly: We do these podcasts and these videos and these blog posts to try and address people's concerns about what's going on in the financial world and the financial media.

Tom Mullooly: I think a lot of this is driven by conversations that we're having right now.

Casey Mullooly: Well, that's one of the things that I think is interesting about inflation, and it's kind of hard for me to get my arms around, is how inflation expectations actually cause inflation to get worse. So the more people expect inflation to be worse in the future, it's kind of like a self-fulfilling prophecy, because-

Tom Mullooly: This is why everybody bought toilet paper last year.

Brendan Mullooly: Right.

Casey Mullooly: Yeah.

Brendan Mullooly: Yeah.

Tom Mullooly: There isn't going to be any. Holy crap, let's get some.

Brendan Mullooly: Right. Remember how stupid that was?

Tom Mullooly: It was ridiculous.

Brendan Mullooly: And we're all okay.

Tom Mullooly: Yeah, we lived.

Brendan Mullooly: Yeah.

Casey Mullooly: So of course it sucks going and paying more for gas and it costs more filling up your tank, and seeing those numbers rise at the gas station, I think is the biggest.

Brendan Mullooly: Or the grocery store.

Casey Mullooly: Or the grocery store or if you're buying a car. You hear that inflation affects different people differently, and if you're driving a lot and feeding a family of seven or eight, if you're doing those things, you're probably feeling it more than other people.

Brendan Mullooly: CPI, we get inflation data and it's like an aggregated basket of goods that we've decided upon to measure something like that, but everyone has their own personal rates of inflation that they feel to varying degrees. So yeah, you might be feeling it more than other people. These economic data points that we get, these stats, I know that CPI's a percentage, but we can also not get a percentage on that. But we get these data points that are numerators without denominators, just meaning context. There's no context. So somebody who might be feeling the impact of these rising costs this year, who has also invested in stocks, is probably still net positive on real returns, meaning so long as they're right sized and putting them ... If they're an asset owner, meaning they own a home, they own stocks, they own a business. These are all things that are on the other side of inflation, meaning building your assets, while some things are costing you more.

Brendan Mullooly: And on a net basis, I think as long as people are taking some amount of risk with the assets that they own, they're probably still okay, even though it may not feel like it when they're getting the bills for these things that cost more. Because we're seeing growth in those assets, just as we're seeing inflation in the cost of other goods. So I think it's important to remember that and have context around these things when we talk about that.

Tom Mullooly: I know it's easy to say that, gee, in the last year and a half, the price of gas has gone from X to Y, but in the same period of time, what has your 401(k) done? What has your retirement plan done in the period of time from X to Y?

Brendan Mullooly: Or your home.

Tom Mullooly: Yeah, or the value of your home. So, yeah, we're seeing returns in different places that we may not have even considered. People talk a lot about the price of gasoline or the cost of groceries at the store, because it's in your face and you have to do this every week. But what people forget is that the phone in your pocket, to think about all the things that your phone does, if you were to buy them all separately 10 years ago, it would've cost you $10,000.

Casey Mullooly: Or 30 years ago, they didn't exist.

Tom Mullooly: Didn't exist.

Casey Mullooly: I think we have more power in our pockets on our cell phone than they did at the Pentagon 30 years ago. So yeah, there's deflation-

Tom Mullooly: It's definitely more than on the Apollo, what they sent to the moon, because they had something like eight megabytes. I mean, eight megabytes, it's like, oh my God, I've got to wait 30 seconds for this thing to download to my phone. This sucks.

Casey Mullooly: I use that before breakfast.

Tom Mullooly: Right. So, we lose sight, like what you're saying. We get these numerators without denominators. So, it's a great discussion point to say, gas costs twice as much as it did a year ago or a year and a half ago.

Brendan Mullooly: But also my net worth rose X percent over the last year as well.

Tom Mullooly: We got that part, yeah.

Brendan Mullooly: So net, I'm better off, and maybe the world doesn't suck so bad.

Casey Mullooly: And there you have it for episode 381 of the Mullooly Asset Podcast. Like we said in the beginning, inflation has been the hot topic of the last couple of weeks definitely, and even so far this year it's been the biggest economic and financial concern we've seen across the board. So like we said, we wanted to talk about it and let you, our listeners, know our thoughts. Thanks as always for listening. And if you have questions about anything we discussed here in episode 381, feel free to get in touch. We'll see you on the next one.