

Hello Everyone,

***“Life can only be understood backwards; but it must be lived forwards.”***

Soren Kierkegaard, Danish Philosopher and Theologian.

Given what is going on out there, I couldn't agree more. :>)

So, let's live “forwards” and try to “look through the fog” to see what is coming. And since economics and finance are our beat here, let's start defending the “inflation is the ultimate endgame” premise.

Oh, and two things as we begin this short inflation series:

- There are some very sharp men and women who make compelling deflationary arguments.
- You can have inflation and deflation at the same time.

So, there you go.

I hope today's missive helps you understand the “backwards” part of inflation.

Signed Your In-The-Last-Six-Weeks-We've-Had-30-Million-Jobless-Claims-And-A-30%-Rise-In-Stock-Prices Financial Advisor, Greg

## **KKOB 05.04.2020 Inflation Cycles Part 1**

**Bob:** So, Greg, on Friday we left it at----- “inflation is coming”.

So, in that investment environment, low-tech makes sense. But, once that trend exhausts itself, you would flip back to high-tech. Right?

**Greg:** Right. So, how do you know when to flip? When does the cycle end? To answer that, you must understand that inflation, historically, has its own pattern of behavior.

So, over the next few shows, let's see where we've been... where we are...and how I believe this will ultimately end. Sound good?

**Bob:** Sure. And my guess is---- if we connect this cycle to the ***Eight Stages of Crisis*** series we just completed, then our listeners could have a better framework from which to make decisions.

**Greg:** Exactly. That's the goal. So, let's get to it.

Inflation is a crafty fellow. In the early stages of any inflationary cycle, inflation hides. And it hides with the aid of the very government that causes it. Here is how the game works.

- **Step 1:** Government promises more than it should.
- **Step 2:** Government then prints excessive currency to cover those promises.
- **Step 3:** Private businesses realize there is more currency in circulation. The currency is being debased.
- **Step 4:** Businesses then raise prices to compensate.
- **Step 5:** Government then does two very predictable things:
  - They blame greedy businesses for raising prices and causing inflation. And...
  - The government rigs the statistics to deflect any blame that might come their way.

**Bob:** I know where you are going with this. And I would add one more thing. I don't think businesses want to raise prices. They don't like the customer blowback.

**Greg:** Exactly. So, businesses find other ways to adapt...which, unfortunately, helps hide inflation. For example, rather than raise prices, they can lower quality. Plastic parts might replace metal. Lower quality ingredients are substituted for better ones.

Or, businesses can adjust via shrinkage. Instead of 13-ounce soup cans, you get 10 ounce-ers. Instead of eight ice cream sandwiches in a box, you get six. We call this shrink-flation.

And, it's not that businesses are being dishonest. They are just compensating for a declining currency.

**Bob:** And, of course, people don't see the government printing money. All they see are bags of air ---with a few potato chips at the bottom. So, I can see why voters could blame businesses instead of the real cause...the government.

**Greg:** Right. And, to further hide inflation, government agencies alter the methodology to calculate the inflation statistics. For example, we all know official statistics often exclude so-called "volatile" food and gas prices.

But, here's another government trick. It's called substitution.

Bob, let's say the price of steak goes way up. Rather than including steak in the inflation calculation, they'll substitute chicken. When chicken gets too expensive, they'll use ground beef. I suppose if ground beef prices get too high, they'll substitute dog food.

Another trick is to employ something called hedonics. The root word of hedonics is the same as for hedonism---- or pleasure.

Here's how it works.

We all know a new computer today has exponentially more memory, speed, and features than a computer of five years ago. Therefore, the number-crunchers say, you can't compare today's computer prices with those from 2015. Consumers are getting more for their money...more pleasure. Thus, they will adjust today's computer price from say \$1500 to \$900.

They do the same thing with cars. Because of rearview cameras, or better safety equipment, the price of a new car might drop in the statistic from \$40,000 to \$33,000.

So, Bob, can you see how *substitution and hedonics together* could understate the Consumer Price Index?

**Bob:** Sure. But I still pay \$1500 for the computer or \$40,000 for the car. And, once in a while, I still buy a steak. So, the statistic doesn't reflect what's real to me.

**Greg:** Exactly. Independent/non-government sources say inflation is really running around 10% vs. the 2% government statistic. And I'd guess most of your listeners would say 10% is closer to truth.

Anyway, this is how inflation "hides" in the early stages of an inflationary cycle. I believe we are just now leaving that stage. So, let's pick it up there on Friday.

**Bob:** Sounds good. How do people reach you?

**Greg:** My number is 250-3754. Or, go to my website at [zanetifinancial.com](http://zanetifinancial.com).

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