

Inflation and Oil Prices! How long and how high?

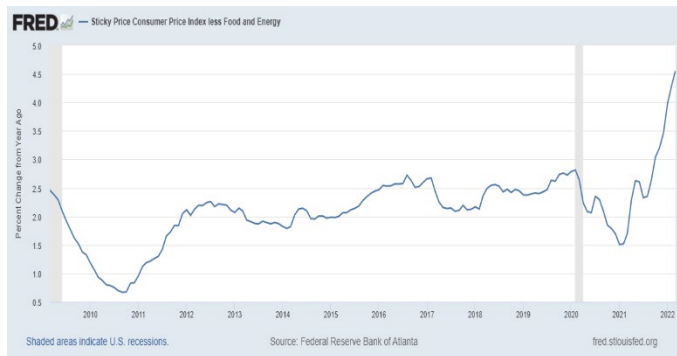
That is a question on a lot of peoples' minds these days. Inflation and oil prices are making headlines. How might this impact your life? Are inflation and high oil prices sustainable? What might it mean for your investments?

Keep in mind there is always the short-term headline news and the more lasting impact (if any) on your life. It is difficult sometimes to separate the wheat from the chaff!

Why Does the Fed Hike Interest Rates to Reduce Inflation?

To put it simply, the Fed raises short term interest rates to slow the demand for money.

A famous economist once said, "inflation is and always will be money times velocity." By raising the



price of money, the consumer and businesses are less inclined to borrow money at these higher rates. Fed rate hikes can also bleed over to longer rates, such as the recent rise in the 10-year treasury. The Fed usually raises rates in small increments maybe over a year or two. They want to see how little they can raise interest rates before inflation slows. Too much too fast and it is like drinking water from a fire hose!

If this is done too quickly, unemployment rises too fast and the country falls into recession. Done too slowly and inflation can accelerate causing a simultaneous slowing of the economy. This is called "stagflation," a modestly growing economy and high inflation. Stagflation occurred in the 1970s.

The Truth About Oil and Gas.

First, crude oil is the largest commodity trading globally. It is hard to manipulate oil prices when it trades at such vast numbers. No one has enough trading capital to have any major impact. However, that does not mean the value doesn't get pushed beyond supply and demand equilibrium through production.

Second, the current war is potentially a problem as Russia produces about 11 million barrels a day. Globally, we produce about 98 million and world needs 100 million (approximately). You can see Russian oil cannot be offline for an extended period of time or the fundamentals turn pretty bleak.

Third, oil and gas prices have accelerated over the last 12 months. Oil prices have risen from about \$38/bbl. to over \$100/bbl. It approached \$125/bbl. at the outset of the Russian/Ukrainian war and currently is around \$110/bbl.

The ultimate truth is that high prices are not sustainable. The economy will go into recession with rising interest rates and high oil prices. OPEC and Russia will have more to do with pricing than the US. The US is close to peak production and without incentives to drill it may in fact decline. This could turn around but only time will tell. Alternative energy is not in the cards anytime soon for fossil fuel replacement. This is a long discussion and has many moving parts.

Putting it Together for Your Best Outcome.

Inflation may be here to stay, the bull market of low interest rates is over, and expect oil to remain above \$90 for 2022. I expect inflation to settle in around 5% with short term rates around 4%. This may take up to two years. This is an election year, and my expectation is the Fed will not be too aggressive and inflation will be stubborn. Expect four rate hikes. The fundamentals for higher oil prices in the medium term are intact. Volatility is here with every up and down of the war as well as with every mention of strategic releases or inventory reporting.

When putting it all together be mindful of your debt load and ability to service it. Inflation is the silent killer to portfolios. Rates will rise over the next decade, if you hold bonds it is going to be a problem. Pay more attention to your portfolio. Do not assume that the next 10 years will look like the last 10 in terms of returns both in bonds and stocks. Expected returns for stocks are low single digits over the next decade. Make some adjustments to your outlook and understand what a much more modest investment environment will mean to you. We always say, you will be wrong sometimes. Be wrong small, not big!

Feel free to give us a call or visit our website www.ChasefieldCapital.com for more information. To schedule an appointment (see "contact us" on our website).

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