Staying ahead of inflation

More than a year into the pandemic, shortages and pent-up demand from lockdowns have put upward pressure on the prices of many goods and services. Enter inflation.

This quarter, we break down the forces behind inflation and how the diversified nature of your portfolio keeps you well protected.

What is inflation?

Put simply, inflation is the increase in prices over time. The inflation rate measures how prices have changed over a period of time.

Cost of a dozen eggs over the years

- $1.47 in 1991
- $3.80 in 2021
- $4.63 in 2031

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1Source: Statscan, Bank of Canada as of May 2021. 2Source: Statscan, Bank of Canada. 3Calculated using projected annual inflation of 2%.
**What’s driving inflation?**
Here are some of the reasons inflation has trended higher since the start of this year.

**Low starting point**
Inflation is relative. Today’s prices have risen more significantly because of last year’s pandemic-induced lows. The lockdowns of last spring resulted in store closures and lower demand for goods and/or services. This drove last year’s comparable prices down.

**Government fiscal stimulus**
Record government stimulus has increased the amount of money available to consumers and many Canadians are starting to spend. If consumer demand outpaces supply, it can push prices higher.

**Central banks**
Around the world, many central banks have stated they intend to let inflation run slightly higher than average before adjusting interest rates higher in response.

**Technology**
The rate of technological progress should continue to increase productivity and output – providing ample supply for many in-demand goods and services.

**Demographics**
Slower population growth and an aging population should also work to reduce demand and, in turn, prices.

**Why are lumber prices through the roof?**

383% How much the price of lumber has increased over the past year

A pandemic-induced home renovation boom, combined with production delays contributed to a surge in price.

**EXAMPLE: The cost of a 500 sq ft deck**

$2,100 Cost of wood May 2020 vs $9,600 Cost of wood May 2021

Lumber prices have fallen from their record highs in May, spurred by the economic reopening and an increase in production.

**Inflation affects asset classes differently**
Inflation can affect some asset classes more than others. A well diversified portfolio can help you stay ahead of inflation and reduce its impact on your overall wealth.

**Inflation can impact bonds, so diversification is key**
Inflation and interest rates tend to move in the opposite direction from bond prices. When they rise, it can reduce the value of your bond holdings.

**Equities tend to protect investors against inflation**
Company revenues, and therefore earnings, can outpace inflation over time.

Over the last 20 years, equities have delivered returns approximately 6% higher than inflation.

**What’s the outlook for inflation?**
RBC Global Asset Management believes today’s higher inflation will likely be temporary as markets work through the effects of the pandemic. Some inflation signals have peaked and begun to edge back down in both the United States and Canada.

While inflation may be higher over the next few months, it’s likely to run only moderately above 2% over the next few years. Over the long term, several forces will likely keep inflation in check:

- Technology: The rate of technological progress should continue to increase productivity and output – providing ample supply for many in-demand goods and services.
- Demographics: Slower population growth and an aging population should also work to reduce demand and, in turn, prices.

Inflation is just one of the many economic forces that can affect your investments. If you’d like to review your portfolio, or if your goals or personal situation have changed recently, contact your financial advisor.
The latest wave of COVID-19 infections is now retreating, allowing governments to incrementally reopen their economies. We anticipate rapid growth in 2021, followed by slower but still good growth in 2022. Risks include further waves of virus infection, fiscal hangover in 2022, withdrawal of central bank stimulus, and high inflation. Bond yields paused after a massive rise earlier in the year. We see yields peaking at levels not far above current levels in the shorter term and, as a result, expect low returns in sovereign bonds. Strong growth, surging corporate profits and elevated investor confidence have helped to extend the bull market and boost global equities to record highs.

All opinions contained in this document constitute our judgment as of June 30, 2021, and are subject to change without notice.