

Investing Through Inflation

Why a New Investment
Management Firm is Needed for
Inflation

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Why a New Investment Firm is Needed For Inflation

Summary: The investment industry has evolved over the years to provide conservative, reliable advice to investors. There have been market shocks but by and large the advice and products offered have not changed. To manage through inflation this will have to change.

As a soon-to-be-teenager my parents took me downtown to meet a stockbroker they knew. I was being taught to save and invest and I bought a \$100 Canada Savings Bond. Forget the life lesson. Once I saw the quote machine I was enthralled. That flashing grey cursor against the low resolution black screen with a bevy of blinking stock quotes spoke to me. It was the spark that drove me to want to work in the investment industry. Ten years later someone opened the door for me and I stepped into the business - sub-basement level but hey.

Forty plus years later the industry is still recognizable. As recognizable as your kids trying to guess which picture is yours in the high school year book. They'll find it but they will laugh. When I started the industry was made up of small independent firms where partners' capital was at risk. Excluding the corporate finance business revenue came from client commissions and bond trading. Firms are now large, publicly owned with a broad shareholder base. The revenue base has shifted to emphasize advisory fees and product management fees. These two new revenue sources have transformed the industry and the clients' relationship with the industry.

The business model for a fee driven business is scale and consistency. First job; attract assets, manage assets, retain assets. Second job; manufacture new fee earning products to attract, manage and keep – rinse and repeat. What has noticeably been missing in the past twelve years is innovation. In terms of innovation there is no comparison between the twenty years preceding the Great Financial Crisis and the twelve years since. Admittedly some of those innovations may have been seen at or near the scene of the 1987, 1998 and 2008 crashes but transformation and change sometimes involves cracking eggs.

The stasis in the industry has occurred during a time when the central banks have collaborated to reduce market volatility and manage the business cycle. The investing clients haven't called for change and the industry hasn't offered it.

Change is needed because the investment climate is changing. Just as you change your outdoor clothing when the weather forecast changes, you'll need to change your investment approach. What's changing?

Only long-term global trends rooted in the 1980's such as globalization of trade, long term declining trends in interest rates, long term periods of disinflation and the long term decline in asset volatility. As Crash Davis (Kevin Costner) tells the Assistant Manager (Robert Wuhl) when he visits the mound in Bull Durham to find out "what the hell's going on", Crash tells him "we're dealing with a lot of shit".

What exactly is needed? The investment industry has three primary assets; 1) its people, 2) its services and 3) its products. The products pose no problem. Referring to the recommended asset mix in a prior paper all the necessary products currently exist. The service isn't an issue because ultimately the clients' objective of income, growth and capital preservation is the same. And lest you think I'm about to throw the people under the bus they're not the problem either. What then? I'd suggest it starts at the top where the culture and the direction is determined. A gap analysis of a conventional portfolio and the recommended inflation protected portfolio identifies strategies, products and tools that generally don't exist in conventional management firms. Management has to empower and train their advisors and portfolio managers to expand their repertoire and provide their people with additional degrees of freedom.

Consider the recommended fifteen percent allocation to alternative strategies. This could include allocating to external fund managers which requires a skill set to identify and evaluate the firms, strategies and traders. Alternatively, some strategies could be managed internally such as yield curve trades, breakeven strategies or outright real yields. This requires being licensed and comfortable with derivatives and leverage. Direct exposure to commodities is devilishly difficult and may require additional licensing. Real assets provide a final example. Exposure through publicly traded equities may be less than optimal depending on the premium paid for public market liquidity. Often, private and direct investment is optimal to isolate targeted real assets which requires the skill to structure private transactions.

Isn't the first step to identify the problem? This, and the related papers, is a voice deep in the woods yelling there's a problem. Summerwood is set to tackle the problem and seek solutions for investors to protect and grow assets through an inflationary period. What caught my eye when I was making my first investment still keeps me engaged. The ensuing 40+ years have Summerwood well positioned to manage inflationary challenges.

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