

Investing Through Inflation

There's More Than One Type of
Inflation – Broadening the
Discussion

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There's More Than One Type of Inflation – Broadening the Discussion

Summary: *Inflation affects one's ability to maintain a lifestyle. To understand inflation and its affect on us individually and as a society the discussion needs to broaden beyond just the effect of rising prices. All types of inflation have an insidious effect.*

There's a problem with talking about inflation. It's the same problem that happens when talking about politics, religion, economics or sports, i.e., all the subjects we like to talk about. The problem is we all presume we have a common starting point. We don't. We rarely do.

Given we're all talking about it the definition should be easy. Look up the definition and the simple definition you'll find is, it's an increase in prices. Or, a fall in the purchasing value of money. Huh? Everybody gets prices rising. Who gets 'a fall in the purchasing value of money'? Ninety percent of inflation discussion is about rising prices. Ten percent about the fall in purchasing value. Already the discussion is too narrowly defined.

I'll give you a definition for inflation. All types of inflation affect the ability to maintain your lifestyle. Which is a problem because it causes household stress which becomes societal stress. Important note - I didn't mention prices. Because *price inflation* is only one of many types of inflation none of which is less impactful than the others. Let's broaden the discussion.

There's a book written in the 1930's often cited by economists as providing the basis for their inflation based research. *Seven Kinds of Inflation* was written by Richard Dana Skinner who had experienced the destruction of the 1919 – 1920 inflation and the crippling effect of the 1932 deflation crisis. As a frustrated bond analyst, he felt compelled to write "what the layman wants to know – what he *must* know if he is to conduct his business or his investments or his daily family affairs with any reasonable intelligence and soundness. First: Are we having *any* type of inflation? Second: If so, what type? Third: How can we detect and measure the course of this inflation?". Remember – this was written in the 1930's. Query how far have we advanced our knowledge of inflation?

The value of Skinner's writing is to raise awareness that "inflation" is not singularly defined. He notes seven kinds of inflation. I won't detail the full catalogue but will highlight components of his writings. Most interestingly he identifies absolute types of inflation and relative types.

The former, i.e. absolute, is what we generally talk about. Milk costs more today than it did yesterday. The relative version is what if the price of milk is constant but my income declines. The effect is the same. I, literally, can buy less milk. It's a relative form of inflation.

Focusing on the 'absolute' types of inflation Skinner identifies and notes bond price inflation and stock price inflation as important as price inflation. As we are currently experiencing, pensioners dependent on interest income have had their incomes drastically reduced by the reduction in interest rates (i.e., bond price increase). Asset price increases are overlooked because who doesn't like a 'wealth effect' but the real effect is currently being manifest in housing prices beyond the reach of home buyers. As per my definition of inflation each of these examples affects one's ability to maintain a lifestyle.

Skinner's window of experience ranged from 1917 through to 1936. He was able to identify periods where each of the seven types of inflation were experienced. He cautions that at times two or more types can occur concurrently. Prescient to today he wrote "Every so often we shall be engulfed by several forms at once and go through a true *general* inflation". I chose the word 'prescient' as I defy anyone to claim we are not currently in the grips of bond price inflation, equity price inflation, asset price inflation and general price inflation concurrently.

Skinner wasn't trying to forecast inflation. Nor am I. His objective was to help the layperson understand inflation to answer the question "Where are we now?". I'm not forecasting inflation because it need not be forecasted any more than standing in the rain requires a 'chance of rain' forecast. Skinner specifically states he wasn't answering the question "Where do we go from here?". Whereas I am.

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