Quick Take: Inflation—Scary Headlines, Rational Markets

June 2021

View from the Bond Market: Rising Inflation but Minimal Risk of a Breakout

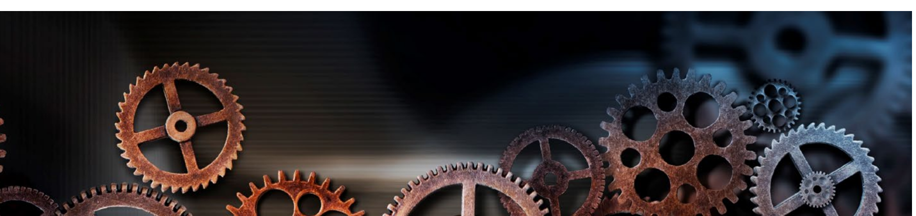
- While U.S. Treasuries are pricing in the highest inflation expectations since the GFC, markets have priced in confidence that central banks will maintain control.
- Ten-year inflation breakevens are below 2 and 5-year (top chart), consistent with the Fed's stated willingness to let inflation pulse higher to broaden employment.

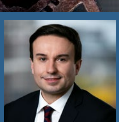
View from Commodities: A Nuanced Outlook

- The gold market is keenly watching the Fed's reaction function. Although U.S. real yields resumed a downward trend last year, with the 5-year nearing -2%, gold only rallied at the end of March as nominal yields stabilized and the Fed indicated that it will keep rates low despite the improving economy—no hikes likely before 2023.
- Industrial metals are reflecting the specific nature of this reflationary cycle—Developed Markets leading as opposed to China. Copper prices in Shanghai, for example, have underperformed prices on the LME (bottom chart). The relative weakness in Shanghai reflects the Chinese government's hawkish moves—tightening credit, removal of stimulus, and tamping down speculation—and highlights the importance of regional factors driving commodities prices.
- In oil, the physical market is currently tight but also aware of significant spare capacity from multiple sources that can be brought online quickly to help offset rising demand. OPEC has been in the process of gradually bringing production back online, thus preventing the existing deficit from widening excessively.

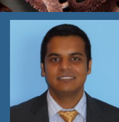
On Balance: A Rational Market Response

- While inflation expectations have climbed, fixed income and commodities markets are pricing in largely rising but controlled inflation with some headwinds against sweeping increases in input prices.
- Given current information, the market's response seems reasonable from the perspective of a dispassionate, systematic investor. We would caution investors to avoid reflexive and reductive inflation trades that dismiss information that we see markets efficiently pricing.



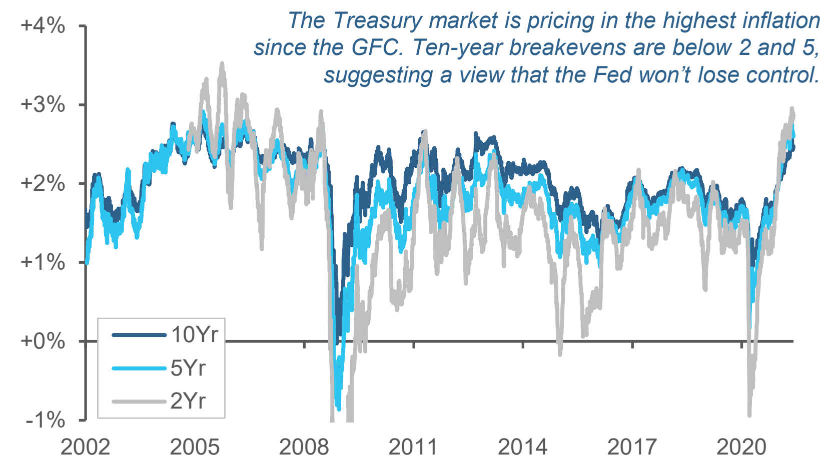


Michael Ponikiewicz
VP, Portfolio Manager
Multi Asset Class Strategies
mponikiewicz@acadian-asset.com



Aditya Panda, FRM
VP, Assoc. Portfolio Manager
Multi Asset Class Strategies
apanda@acadian-asset.com

Inflation Breakevens: U.S. Treasuries



Source: Bloomberg. For illustrative purposes only.

Copper "Arbitrage" Pricing: Shanghai vs. LME (USD/metric tonne, 30d MA)

The "arbitrage" calculation reflects the approximate cost of buying copper in London and shipping it to China, reflecting VAT, currency, and tariff effects. Please see https://www.lme.com/Education-and-events/Online-resources/LME-insight/LME-SHFE-Cross-Market-Arbitrage for additional information. Source: Acadian. For illustrative purposes only. Past results are not indicative of future results. Investors have the opportunity for losses as well as profits.

LEGAL DISCLAIMER

ACADIAN

GLOBAL AFFILIATES

Boston London Singapore Sydney

ACADIAN-ASSET.COM