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Hello, and welcome to another episode of Dividend Cafe. I'm your host, David Bahnsen. I am sitting in my hotel in Orlando, Florida, but I'm literally Running to the airport. I've been at a conference last couple of days where I've had the privilege of speaking a few times meeting with a lot of other financial advisors, been a very, very busy couple of days.

And now I'm heading back to New York city for just a day and then heading to Nashville where I'm going to be at our Nashville office all of next week and very much looking forward to being in the great city of Nashville and seeing lots of clients. and all kinds of good things. But before I get there, it's important that we go into the Dividend Cafe.

And we're going to talk a little bit about this word inflation. And it's something I've spent a significant amount of time studying throughout my adult life. My guess is that my early study of inflation at a just sort of rudimentary level in economics started before, well before my adult life. I think that there was a fair amount of introduction to Milton Friedman in my life when I was younger.

And I've always taken very seriously the notion of inflation as a monetary phenomena. And over the years, done as much work as I can to understand Why certain countries where people expected or predicted to have higher inflation did not and I've Applied that to the lessons learned from Japan and their massive policy errors and then the United States behavior post financial crisis and the work I've done over the years in the theme of Japanification the impact of economic growth impact to economic growth from the fiscal and monetary policy that countries adopt to deal with hiccups in growth.

And inflation is always a political story. It can be a presidency killer. You can ask Jimmy Carter and Joe Biden but it is a much more than a political story. It is an economic story. in my chair, meaning being responsible for decisions both on a macro level, asset allocation and risk reward trade offs in a portfolio.

And then on a micro level opportunities from a bottom up standpoint, in terms of investment selection, I have both top down and bottom up macro and micro reasons for caring very much about this subject in terms of the money that we manage on behalf of clients. And I believe that the political side of inflation can be separated from the economic side very easily in this sense.

Most people have no interest, they don't need to have an interest, they, I'm not asking them to have an interest in economic explanatory phenomena behind inflation as a monetary phenomena, the way Friedman would describe it. When I say things like it is too much money chasing too few goods. When we talk about a quantity understanding of money, and I've used the formula over the years, the Irving Fisher made famous money supply times its velocity, equaling the price level times the total supply in an economy, goods and services.

These are algebraic things and economic things that just don't matter. politically because people don't care. If I say gas prices are higher, I've probably said something that's problematic for a politician. And I have said something that sounds like inflation to the person paying it. They went to the gas station, hoping to pay three bucks a gallon, and they paid four bucks a gallon.

That is irrelevant that it isn't actually necessarily monetary inflation. High prices are problematic and that, and yet one of the reasons that eggs do not become a systemic issue or certain items in the economy that are much less expensive now. are not helping and certain things are more expensive, don't become a mass issue is because they're not mass.

They're not at scale. They're not widely distributed across the economy, but gas prices and shelter are the two things that are always in forever politically relevant because everybody has to pay them and they represent a very significant portion of wallet, especially for middle class and lower income consumers.

Now, it also happens to be two things that are highly susceptible to price movements that are not inflationary, meaning Caused by the overall price level going higher. What I mean by that is too much money chasing too few goods and services. So, when you see a spike in one item and let's just say you could freeze money supply, which you can't, and you could freeze the total supply of goods and services in an economy, which you can't.

And if you did, and one item went more expensive. That would not, that would be inflation for the person paying it, but it wouldn't be what we'd call inflation, meaning an aggregate price level. It would mean that one thing went cheaper, while another thing became more expensive. That inflation at an aggregate price level going is always related to there being too much money chasing too few goods and money supply can go higher as long as the production of goods and services goes higher and vice versa without it having an impact into the aggregate price level.

Now there's lags in this and it and then when you're talking about 330 million people and trillions of transactions and products, it's very complicated. However, housing goes up, rent prices are higher, house prices are higher, right now, because of the fact that we have an inadequate supply level to demand, and it doesn't do you any good to someone who's paying 50 percent of their disposable income in rent, to explain that well goods are down over the last year, that there's been deflation or significant disinflation, Goods, it just feels like inflation when the thing you're paying the most for has gone up.

And I think that when you're talking about some like oil prices, that's very volatile, which is why they created a dis a difference between core and headline inflation. But it goes up and down on supply movements that are not year by year. You know, it takes a long time to build a house, but you can have a refinery shut down for two hours and it impacts supply dynamics.

You can have a straight in the middle East shutdown or a disruption of some sort of, you know, military or geopolitical activity that cuts things off for two hours, two days, two weeks. So there's just a lot of volatility in theory that can happen around oil. But it's very rarely monetary inflation.

So, you're in this odd predicament where politicians are going to get credit for cheaper gas and credit for cheaper housing and more affordability. And they're going to get more often blame for expensive oil and expensive housing shelter. And they're very unlikely to have a whole lot to do with it.

That's the discrepancy between political inflation, which is basically oil and housing. and Economic Inflation, which is a monetary phenomenon that works its way over years across the whole economy. And I believe it's important for us to understand when we're thinking about where interest rates are going, where is inflation going, what is the Fed going to do what is the, if the President wants to have an impact on oil prices, he wants more supply.

And he probably wants OPEC producing more oil is not a ton. He's going to be able to do to get us producers to produce more that they at 72 oil, they're making good money. They may be okay at 68, 66. They don't want a whole lot cheaper in that there. If it were to get up to 85 to 90, that becomes very problematic politically, but then producers have a lot of incentive to turn on more spigots.

The cure for high prices is always high prices, those are basic economic facts that are immutable. The shelter thing is largely state and local there's not a ton that they can do out of the federal government to impact housing, other than try to beat up state and local municipalities around their zoning requirements, their entitlement process.

There's things that might impact the regulatory environment at cost of insurance, which is a major input right now in pricing, especially on multifamily rentals. But for the most part, the most politically vulnerable things do not have a lot to do with money supply and where there are these other elements, these things are going lower.

Now, what can the president do to push prices higher? I would argue tariffs is a good way to do it, and the market has started to price in an expectation that that may happen to some degree. Now, let's not get carried away. Inflation expectations, and you can measure this with trillions of dollars of real life money by looking at tip spreads.

That is the yield being paid by bonds and the yield being paid by tips that adjust for price of inflation and that difference gives you a market pricing that's highly efficient on what we are expecting for inflation over 5 year and 10 year periods of time. And it had been about 2. 4 years. percent, 2.

3 percent has jumped up to 2.6, 2.65 in just a very short period, just in the last couple months. So, 25 to 30 basis points is not huge, but as a percentage move, it's substantial. I had this discussion backstage with Brian Wesbury yesterday, he's an economist at First Trust, I've known a long time, I think very highly of.

And his argument is that tariffs push prices higher, but they're not inflationary, and what he means by that is the things being tariffed, of course it does push prices higher, but it isn't adding new money supply, it isn't distorting that relationship between money and total goods and services, therefore, it doesn't have to be macro inflationary, and I said I think you're right about the first half.

that higher tariffs do not increase money supply, but where they become inflationary is beyond just the micro price increase to the thing being tariffed. It is in its downward pressure on production to the in, in, to the extent it impacts total trade, that higher impediments and cost and barriers for trade, and then let alone the reciprocal tariffs that come, and retaliatory tariffs that come.

They not only put downward pressure on total trade, but then that, of course, leads to downward pressure on total supply. So now tariffs have not done anything to bring money supply down, but even, and they also haven't done anything to bring money supply up. But if they've left money supply down and total goods and services, if they've left money supply static and total goods and services lower, So I would make a supply side case for tariffs being inflationary, and I think that's what tip spreads have been pricing in the last couple weeks.

That then in turn could impact, as I wrote about in our annual white paper PE ratios, valuations, in a market that is entirely about valuations. That is vulnerable to not delivering profit growth that's been promised that is has a fair amount of economic uncertainty But that if you bat a thousand to get all the economic things to go you avoid a trade war you avoid You get tax reform done you get economic growth you Get profit growth and then you're still stuck with this risk of high valuations, especially at the top end of the market and big cap growth big cap tech.

I think that valuations are the big vulnerability and that they can be impacted if tip spreads are wider, if inflation expectations are higher, if bond yields are higher. And while I do not believe There is an inflationary story to fear. There is a politically inflationary issue around housing and oil.

And those two things have to be looked at outside the monetary phenomena, and within both the political realms, but then the other factors that impact it. Hence the need for deregulation, which is generally very disinflationary. And I would argue, hence the need for tax reform, which some say is inflationary because of the incredible misnomer that people having more money to spend causes inflation.

It simply isn't true. People having more money to spend, especially in the corporate sector, produces more goods and services and is anti inflationary. So, this is a great conundrum in the market right now. If I were running for office, which I will never, ever, ever do in my life, I would be unable to answer the question of what can you do to bring house prices lower and oil prices lower because to start giving a wonky economic answer, as I'm trying to do here for you all, it's totally unhelpful politically, yet for those of us trying to legitimately understand this in the monetary phenomena realm and in the macroeconomic wisdom required to make portfolio decisions.

Very important. Unpack these pieces cogently. That's what we tried to do here in The Dividend Cafe. There's a couple other nuggets and charts I encourage you to go to at DividendCafe. com. We certainly appreciate your questions, feedback, comments. Send them our way anytime. Questions at TheBahnsengroup. com and we would love for you to subscribe if you're either on the video or the podcast and have not done so.

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Put it into your feed. Helps our algorithms and other than that, have yourself a wonderful weekend. We'll see you next week in The Dividend Cafe from Nashville, Tennessee.