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# Drawing Capital

## Economic Perspectives on Inflation and Portfolio Returns

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## **Economic Perspectives on Inflation & Portfolio Returns**

Presented by:

Sagar Joshi and Jugal Lodaya



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Drawing Capital is an innovation-focused private investment firm headquartered in Silicon Valley, CA.

Drawing Capital aims to capture the expansion of a technology-forward world by investing in leaders that we believe carry undervalued growth. Our expertise in finance and data science enables us to participate in investment opportunities in public markets not captured by passive investing.

# Table of Contents



Background on Inflation



Inflationary Expectations



Investing With Inflation

# Background on Inflation

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- What are the definitions and causes of inflation, disinflation, and deflation?
- How does inflation reduce the purchasing power of cash over time?
- What are the 6 methods of managing debt?

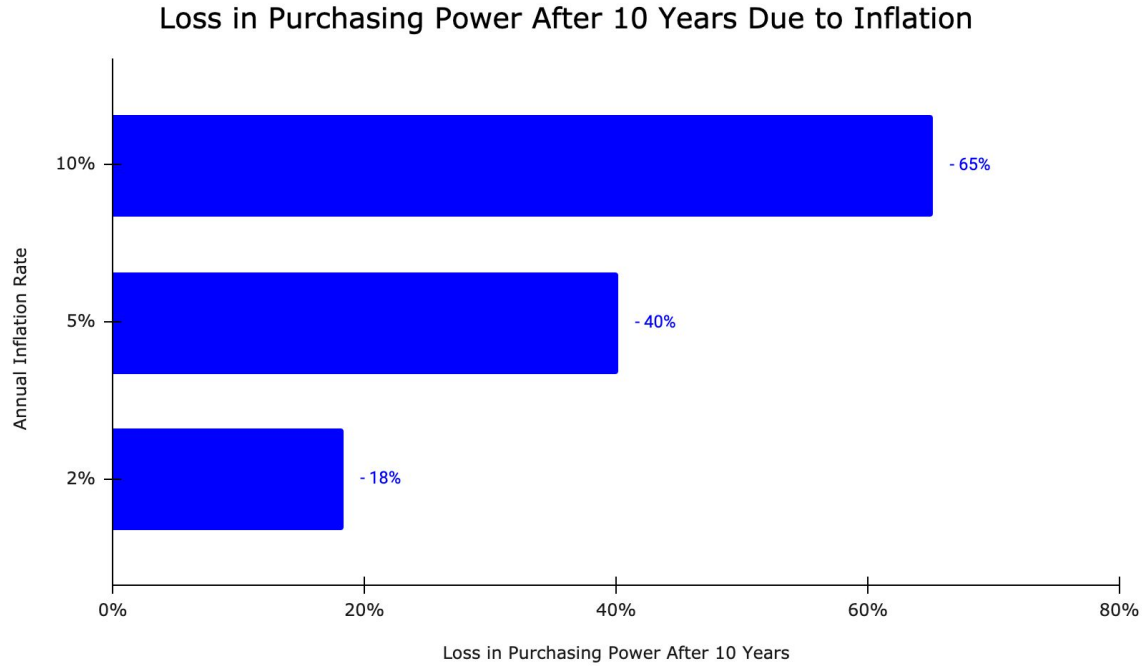
# What is Inflation, Disinflation, and Deflation?

- 1 Inflation decreases purchasing power. Deflation increases purchasing power. Disinflation represents a decline in the inflation rate.
- 2 There is a reduction in the purchasing power of cash when interest rates are lower than inflation rates.
- 3 Monetary debasement is leading to financial asset inflation.
- 4 Different demographics experience different inflation rates.
- 5 There are both direct first order effects, second order effects, and indirect implications of inflation.

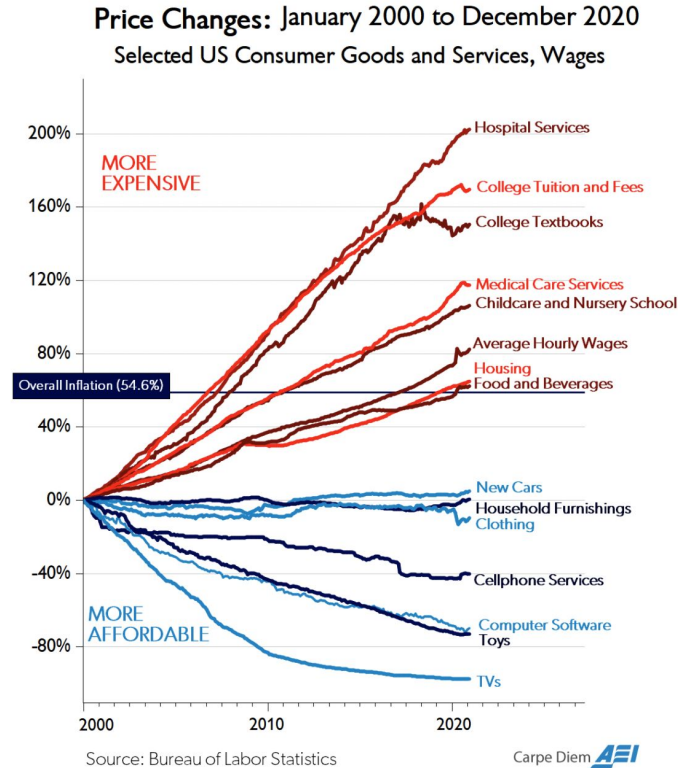




# Inflation Reduces Purchasing Power of Cash



# Economist Mark Perry's Chart on Consumer Price Changes





# Causes of Inflation

Population  
Growth

Economic  
Growth

Technological  
Stagnation

Inflationary  
Expectations

Increasing  
Money Velocity

Low  
Unemployment

Expansionary  
Fiscal Policy

Regulatory  
Capture

Resource  
Scarcity

Nationalism &  
De-Globalization

Rising Input &  
Commodity  
Prices

Accommodative  
Monetary Policy

# Causes of Disinflation & Deflation

Aging  
Demographics

Economic  
Overcapacity

Technological  
Progress

Fierce  
Competition

Declining Money  
Velocity

High  
Unemployment

Low Labor Force  
Participation

Credit  
Contraction

Declining  
Commodity  
Prices

Sovereign Debt  
Crises

Bursting of Asset  
Class Bubbles

Slowing  
Consumption

# A Quick Note on Managing Debt

1

Repay the Debt

2

Restructure the Debt

3

Receive a Bailout

4

Deliberately Re-Negotiate  
the Debt Terms

5

Devalue the Currency to  
Finance the Debt

6

Default on the Debt

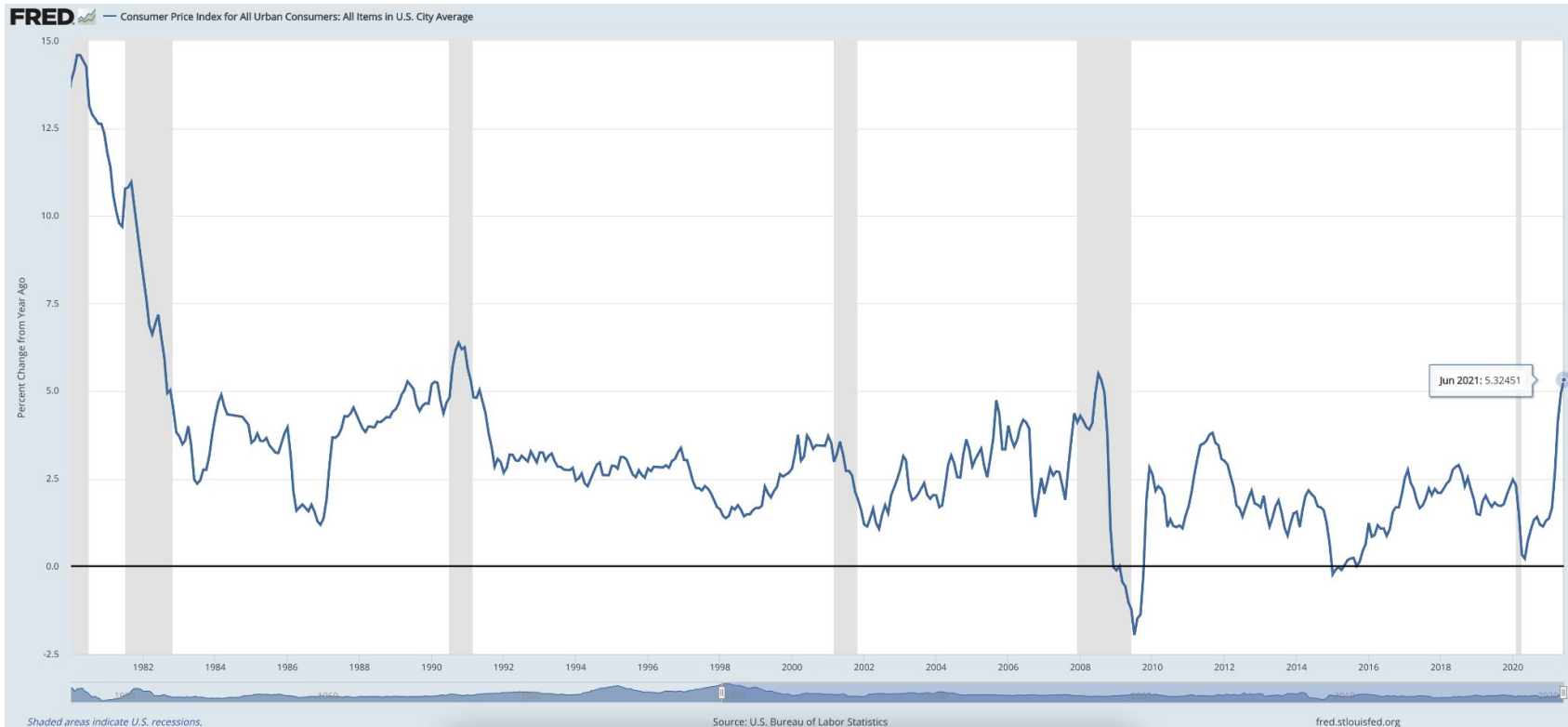
# Inflationary Expectations

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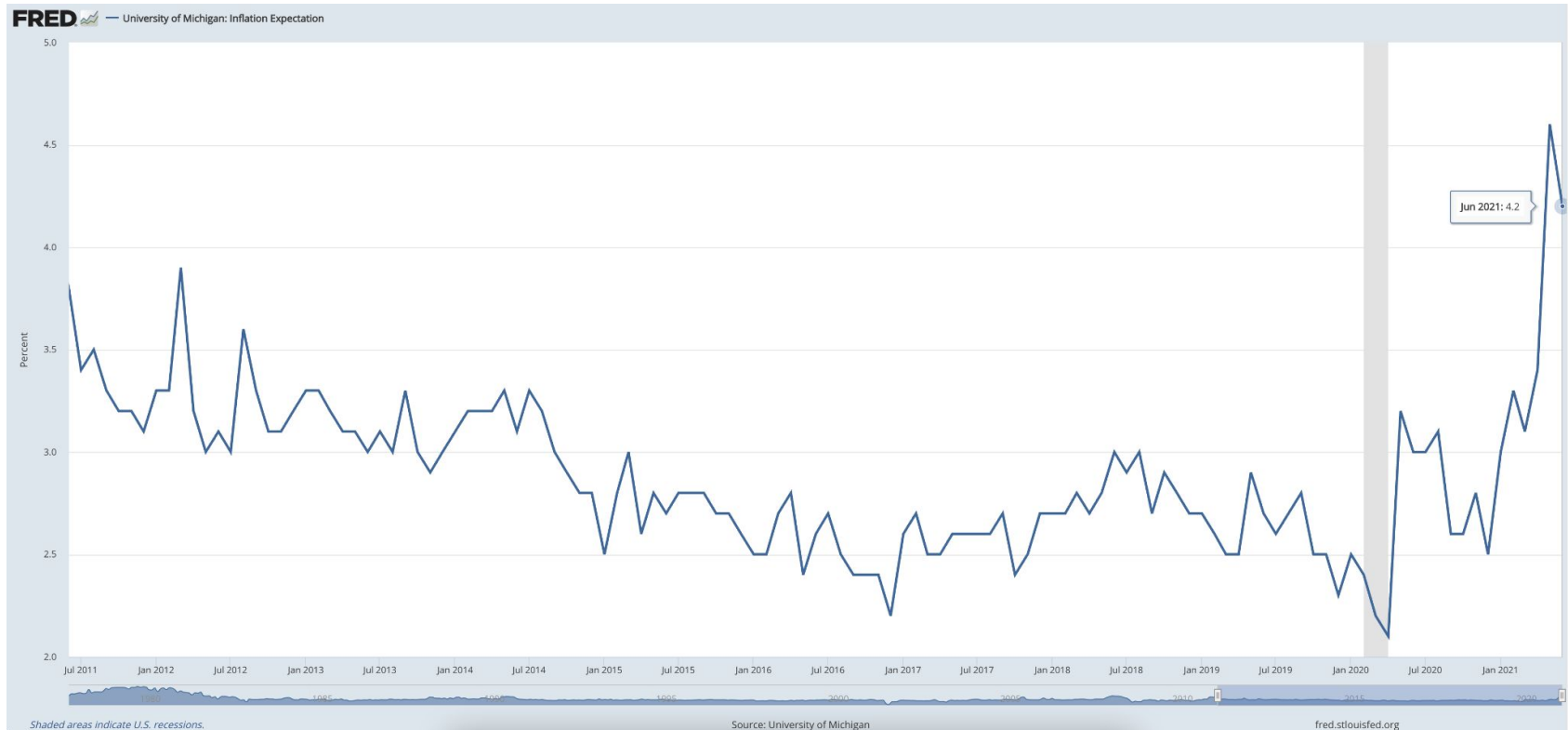
- Inflation in specific industries has amplified wealth inequality.
- There are many types of inflation beyond just the headline CPI data.
- Surveys on inflationary expectations provide a lens to view consensus inflationary estimates.
- Historically, the M2 velocity of money has been a leading indicator for CPI inflation.



# Consumer Price Inflation Rate has Recently Risen Significantly



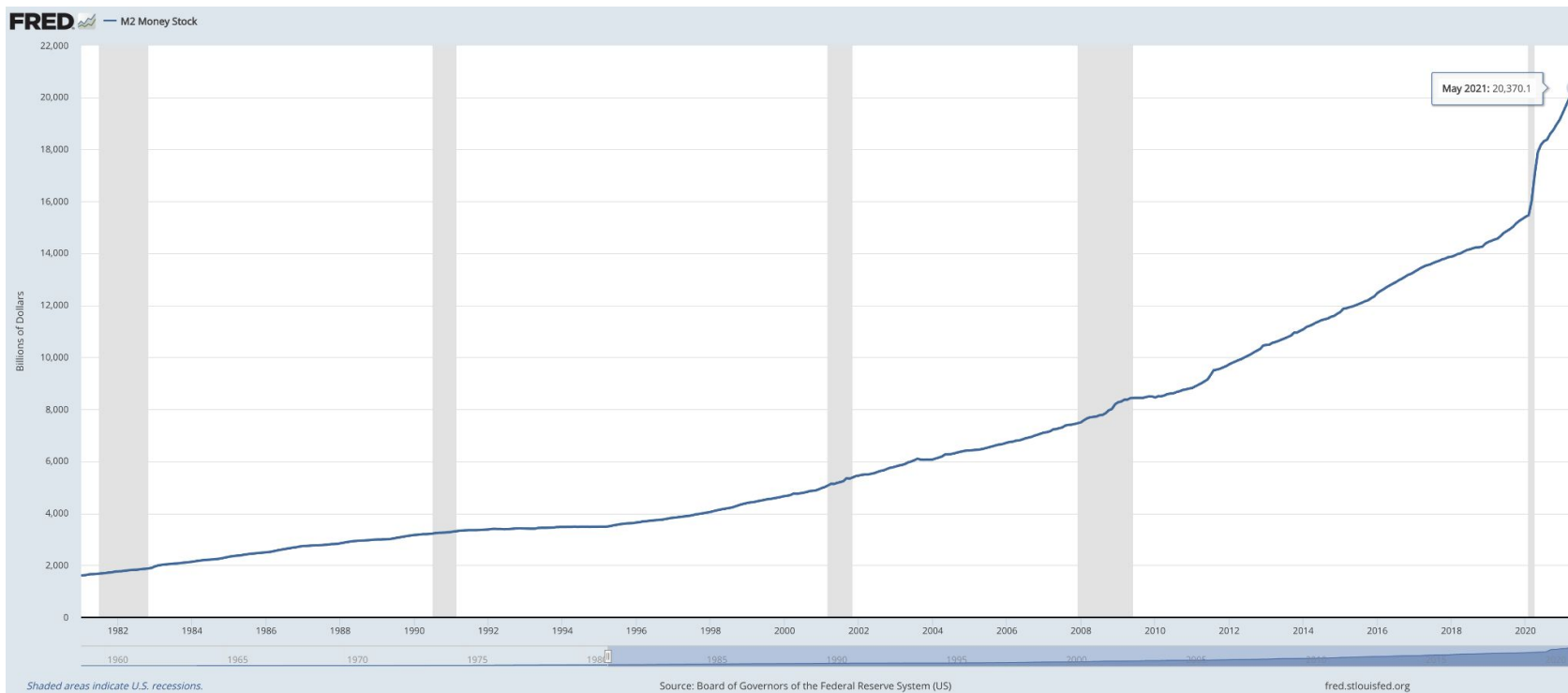
# Inflationary Expectations Reached a Local Peak in May 2021 in 10 Years







# Money Supply has grown at a ~8.4% CAGR from May 2011 - May 2021

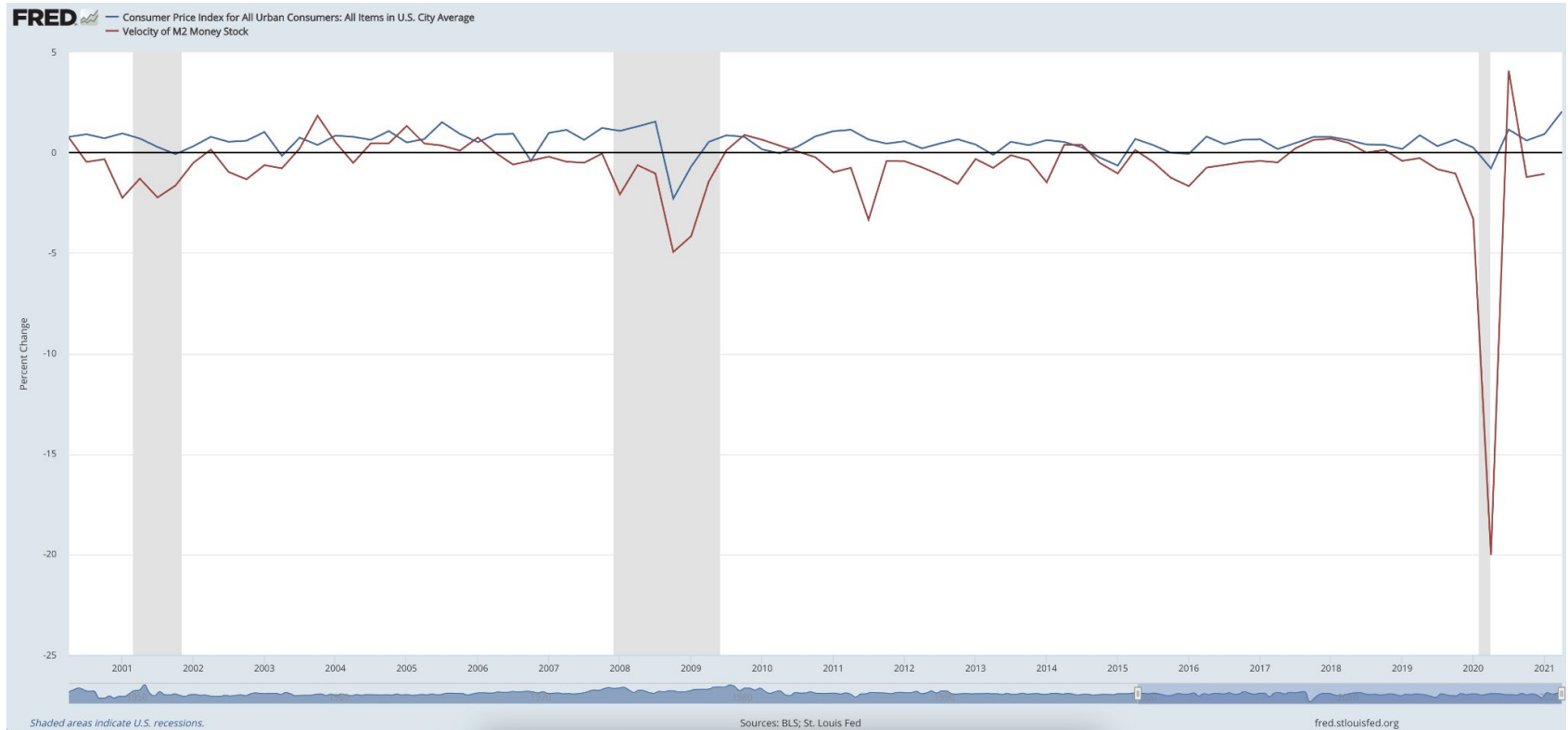




# Federal Reserve's Balance Sheet Size has Surged



# M2 Money Velocity is a Leading Indicator for Consumer Price Inflation



# 6 Types of Inflation

1

Consumer Price Inflation &  
Shrinkflation

2

Financial Asset Inflation

3

Input Price Inflation

4

Wage & Labor Increases

5

Middle Class Inflation &  
Inflationary Expectations

6

Time Inflation



# Inflation Impacts Industries & Socioeconomic Classes Differently

Measuring American Inflation: Cumulative Percentage Increase Between 1990-2020

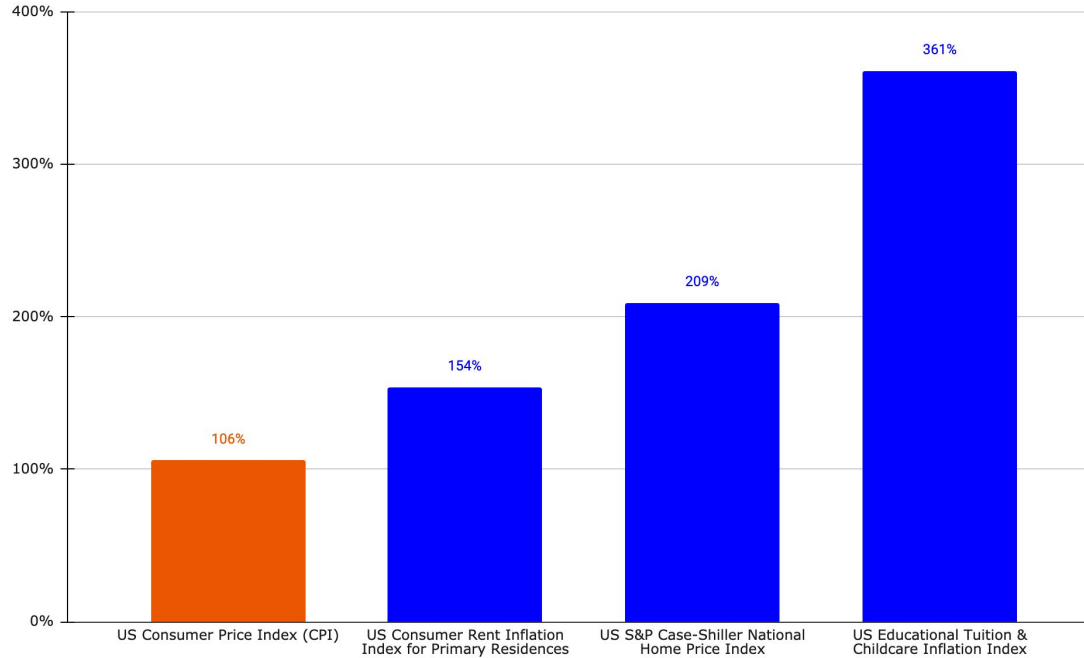


Chart by Drawing Capital and Data from Federal Reserve Economic Database (<https://fred.stlouisfed.org/>)



# Healthcare Spending Per Capita has More Than Doubled in 20 Years

Healthcare Expenditure Per Capita in America

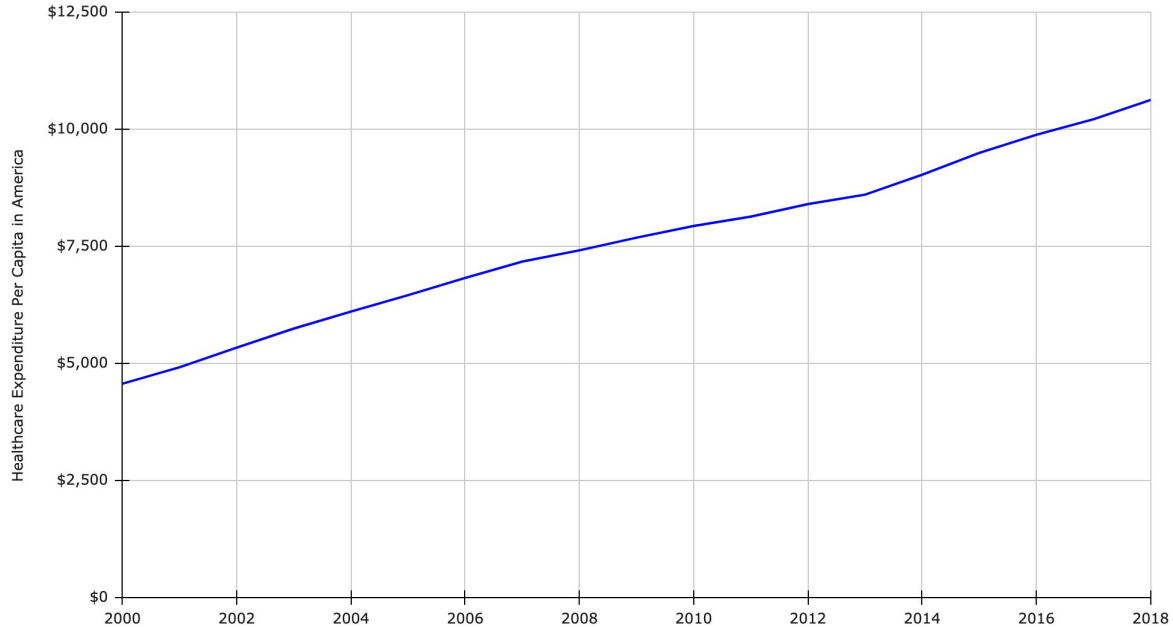


Chart by Drawing Capital and Data from The World Bank (<https://data.worldbank.org/indicator/SH.XPD.CHEX.PC.CD>)



# Tuition at Harvard College has More Than Doubled Since 2000

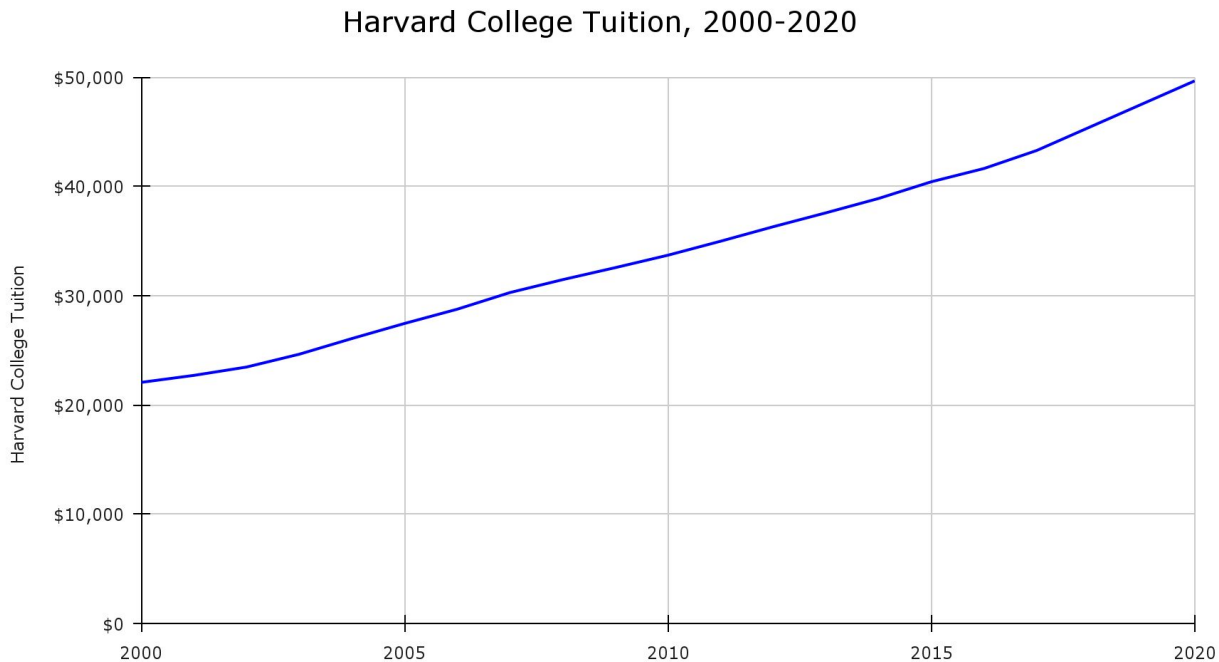


Chart by Drawing Capital and Data From Harvard University ([https://oir.harvard.edu/fact-book/undergraduate\\_package](https://oir.harvard.edu/fact-book/undergraduate_package))

# Investing With Inflation

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- Steps in the expansionary monetary policy journey
- Impact of monetary policy on portfolio returns
- Methods of increasing potential portfolio returns in a high inflation, low yield environment



# Steps in the Expansionary Monetary Policy Journey

1

Lower Interest Rates

2

Increase Money Supply

3

Asset Purchasing Programs

4

Financial Market  
Stabilization

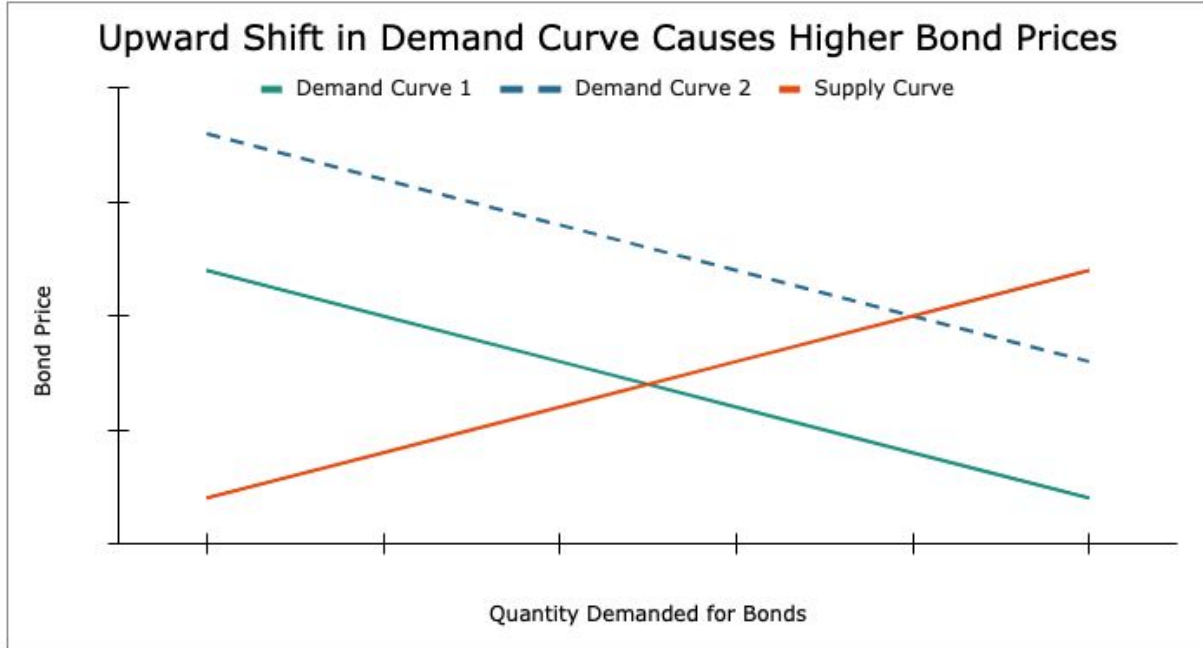
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Yield Curve Targeting &  
Expectations Management

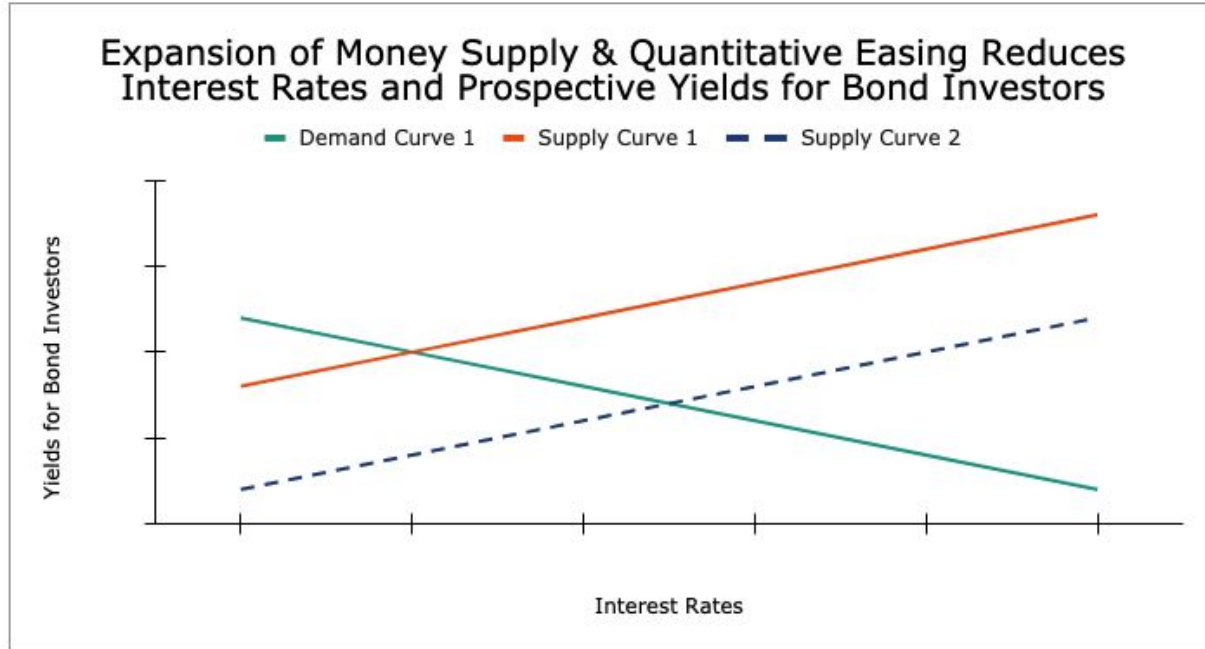
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Debt Monetization

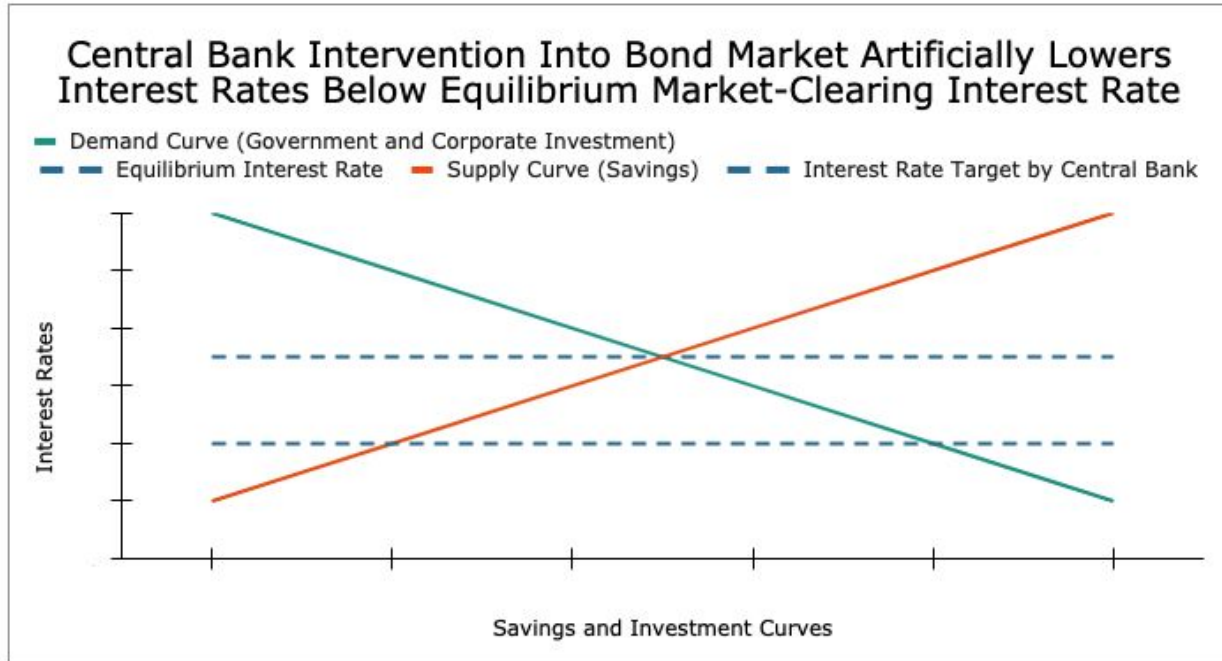
# Bond Prices & Interest Rates



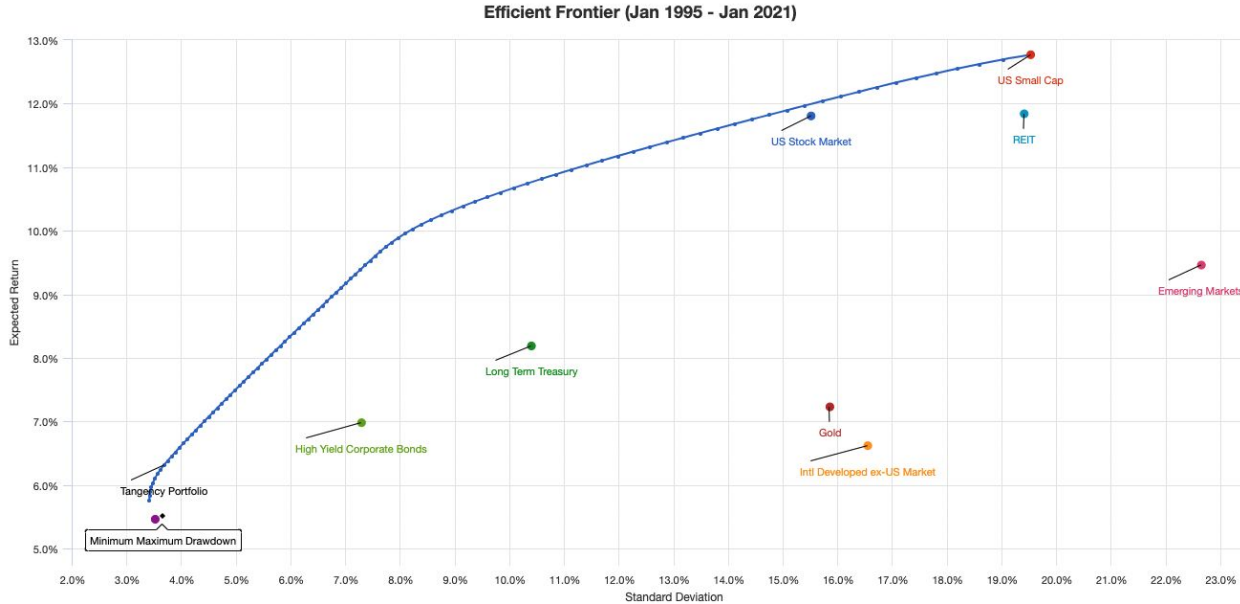
# Quantitative Easing and its Impact on Bond Prices



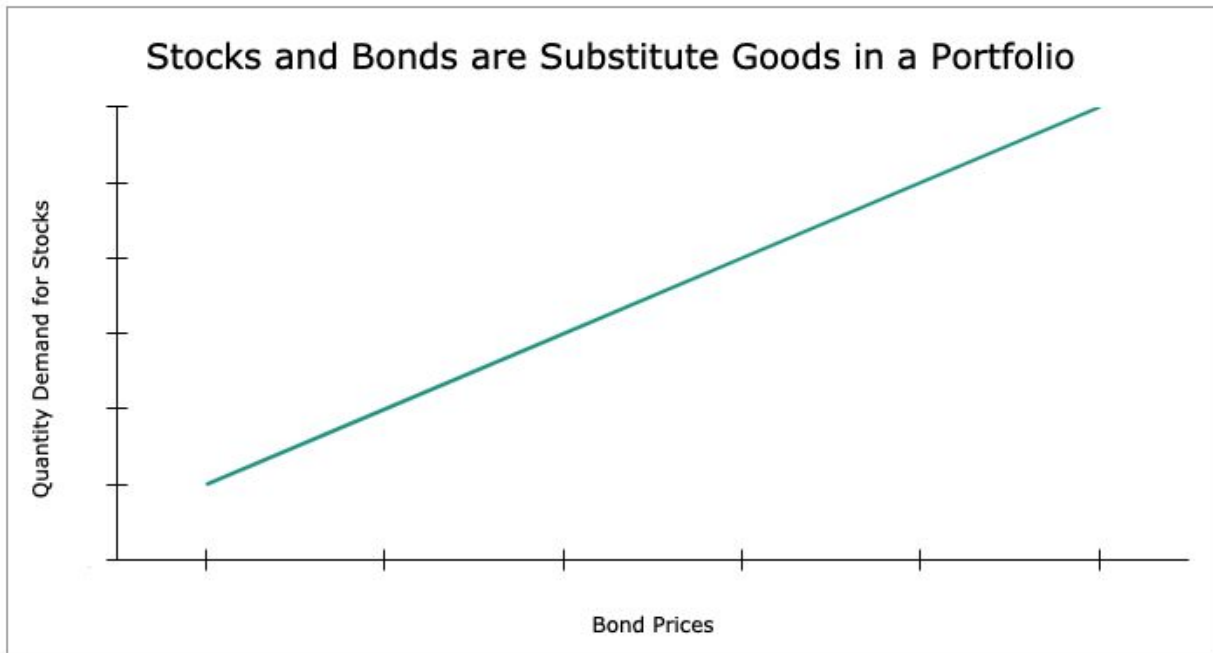
# Savings & Investment Curves



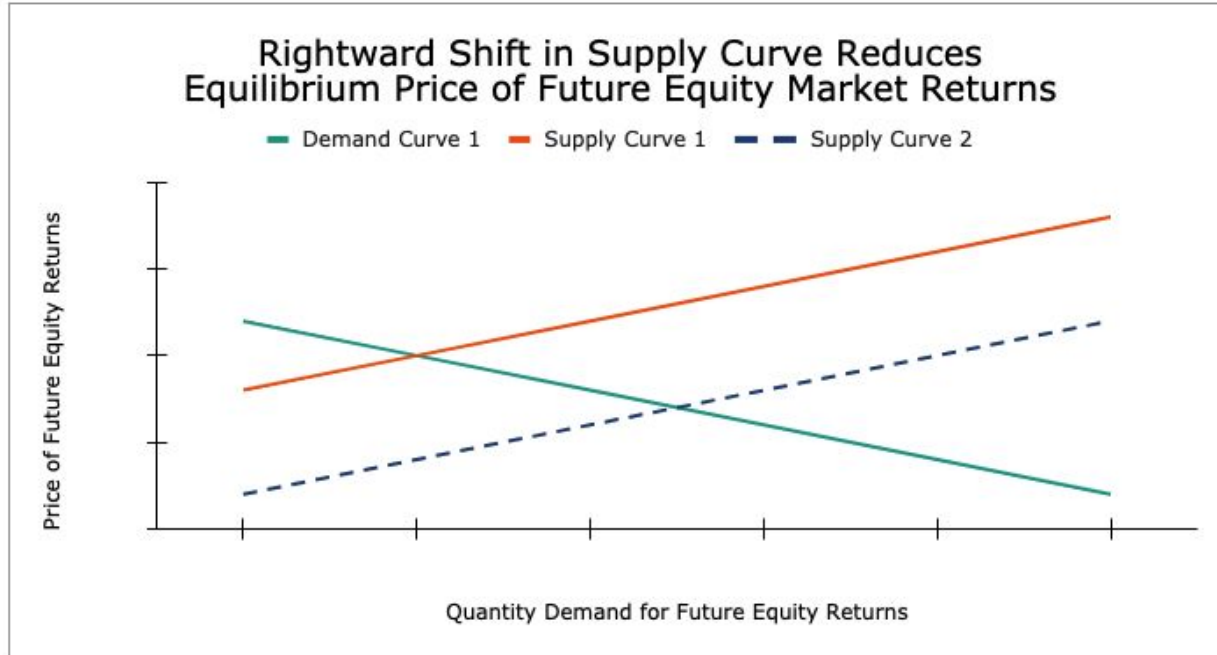
# Savings & Investment Curves



# Substitution of Stocks and Bonds in a Portfolio



# Equity Market Returns & Inflow of Capital





# Summary: 5 Ideas of Increasing Potential Portfolio Returns in a High Inflation, Low Yield Environment

- 1 Find a way to add material value to existing portfolio companies.
- 2 Increase beta via increasing market risk exposure and/or increasing portfolio leverage in hopes of achieving leveraged positive returns on equity, especially when the cost of debt financing is below an asset's rate of return.
- 3 Add risk premiums to a portfolio that have the possibility of earning higher returns. Examples of risk premiums include illiquidity risk premiums, international & currency risk premiums, and duration risk premiums.
- 4 Look at assets that are scarce, digital, or experiencing supply-demand shocks, such as physical land, real estate, Bitcoin, NFTs, collectibles, art, and specific commodities, metals, and minerals.
- 5 Find a differentiated thesis that focuses on exponential growth as opposed to tepid and slow linear growth. Often, this differentiated thesis comes from investing in technology-enabled companies with transformative and innovative technologies.



## Resources



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