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The PLYMOUTH ROCK Fund

MARKET INSIGHTS

INVESTING FOR INFLATION

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By The Plymouth Rock Fund

Q: How should I invest my money to protect myself from inflation? Are there any investments that will actually profit from inflation?

Image: A man with a wheelbarrow of money during a time of hyperinflation.

A: Some people are afraid of the prospect of inflation, and for good reason. The numbers speak for themselves. While the US National debt is just under $28 trillion, this is 129.5% of our GDP. According to Harvard history professor Nial Ferguson, countries such as Russia, The Soviet Union, The Weimar Republic, Yugloslavia, and even the Roman Empire experienced a currency collapsed long before national debt reached 50% of GDP. And it gets worse than that: US unfunded liabilities are closer to $160 trillion, which translates to about $1,113,081 of liabilities for every taxpayer in the US. How are we going to pay off that debt? Simply put, we aren't. The US unfunded liabilities are growing at a rate faster than our taxable base can support.

But there is hope. The US dollar has a few things supporting it, such as the fact that it is the global reserve currency, and oil trades in US dollars. We also have some form of gold in Fort Knox and elsewhere backing some of the US dollar. According to our calculations, the worst that the value of US dollar could collapse is roughly 70%, because as the currency fell the price of gold would rise to support it, and at some point the currency could hit a price floor when the value of the reserve gold is at parity with the US M2 money supply. Because of this, our currency might not experience "hyperinflation," which is defined as more than 50% per month. In many of our lifetimes, the UK experienced its “Winter of Discontent” where currency dropped by 15% abruptly. This caused power outages, labor strikes, and all sorts of trouble. So while we are safe from needing wheelbarrows of money to go buy our groceries, one thing is certain: even a 15% abrupt spike in inflation can be very bad. We are headed for some sort of inflation.

The good news is that we learned a lot from studying the Winter of Discontent. There were certain asset types that performed well during this time. These assets were the same ones that performed well during the runaway inflation of the Roman Empire, Yugoslavia, Brazil, Argentina, the Soviet Union, and more. When currencies drop in value, these stocks shoot up and perform very well. I met a man whose grandfather came over from Germany. He went to the bank as a poor man and took out a huge loan in the Wiemar Republic, so he could buy a farm. Then after one year of inflation, he sold one (yes, one) chicken, paid off his entire farm, sold it, and came to the US with his huge profits to buy more land. Get out your pens and write these down, because every investor should be buying these assets.

Banking stocks always do well during times of inflation, because someone has to create all of those loans, and that means bank profits. This can include banks and other lending companies that issue secured debt, as long as they have very little credit cards assets in their portfolio, but take care to ensure that all banks have prudential portfolios with proper diversification.

Fuel & energy stocks also have a history of great performance during times of inflation. This can include oil, natural gas, solar, wind, nuclear power, and other related businesses. We do not recommend stocks such as developmental high-risk alternative energy positions or other developmental stocks, as these are speculative in nature. A prime example of this is hydrogen. People aren’t currently using hydrogen powered cars, and there is no reliable infrastructure to support such an industry at this time. Another reason we do not like hydrogen is because of the inefficiencies required to convert energy into electricity, then to convert that electricity into separating hydrogen and oxygen, then to store and compress that gas. According to the estimates of one analyst, for hydrogen powered cars to become economically practical we would need to see gas prices reach $20 per gallon. Small town and sunbelt properties do well during times of inflation too. In the past, when we had a lot of inflation during the 1970’s, consumers moved to Florida in record droves. Warmer climates are cheaper in the face of rising energy costs. Energy efficient products tend to do well too, such as manufacturers of insulation and economical cars.

Commodities in general always do well during times of inflation, and this includes some consumer durables, consumer staples, and just about anything traded in the commodities markets. We do not recommend playing in the commodities markets due to the risk that can be involved. We do like stocks that are vertically integrated, because they are not susceptible to price increases on the things they need to survive. For example, a dairy company that owns its own land, produces its own feed, owns its own cattle, breeds and raises its own calves, owns its own shipping trucks, and has long-standing relationships with stable buyers for products that are shelf-stable such as butter or powdered products. Stocks that own a lot of agricultural land are some of our favorites. This is a great example of vertical integration. If prices rise for a company that is not vertically integrated, they are at risk of going belly up as they struggle to pay for the things they need. We also do not like mining operations very well, because they do not vertically integrate. They have to buy a lot of fuel to drive all of those trucks and operate all of that machinery. Rising fuel costs can eat into their profits.

Sin stocks are also somewhat resilient to inflation. When people are poor and depressed they tend to do the same thing that they do when they are excited and ready to celebrate: go gambling, drink alcohol, smoke something and so forth. We do not like casinos that rely on a lot of vacationers, because consumers spend less on travel during times of inflation. So we favor casinos that are online. The most prudential alcohol stocks to buy are not purveyors of rare and exclusive Scotch whisky, such as you or I might enjoy, but rather the cheap stuff that struggling people can afford to buy.

Exporters do well during times of inflation, because from the perspective of foreigners, everything in the US goes on sale because our currency drops. So again, we like US commodies stocks that are prepared to profit from exports. Likewise, we do not favor importers because the price of everything made outside the US will appear to get more expensive as we experience inflation.

In the event of an inflation panic, the following ideas may be helpful. The types of stocks we have discussed, in general, seem to serve as the “life boats” during these inflationary runs. A panic can cause these stocks to skyrocket to unreaonably high, fundamentally unsupportable prices. When these stocks are at unreasonably high prices, a prudent investor should be prepared to sell. It may feel disconcerting to sell when crowds are all fighting to buy in a panic. But the time to buy is now, before any panic. A prudent investor should also have a plan of other assets to buy during such a panic. This may, however, be the subject of another discussion.

Our quantitative analyst likes to say, “There are three things in life that are certain: Death, taxes, and *inflation*.” Overall, we believe that a period of strong inflation is one of the most predictable and profitable opportunities for any investors in the stock market. We encourage all investors, no matter where they are, to take their own steps to prepare to profit from the incredible opportunity of inflation.

*All numbers were taken or calculated from data provided at www.usdebtclock.org, on March 2, 2021.