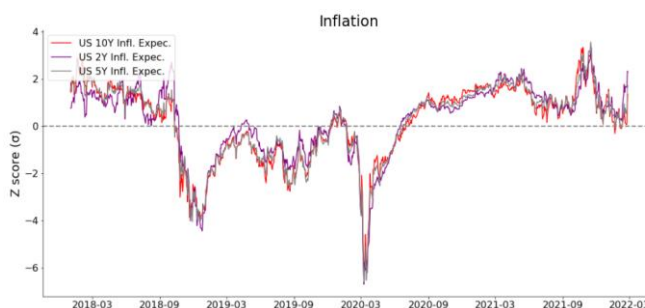




28.02.2022

## Navigating the inflation trade

- The impact on energy & grain prices will be a key transmission channel from the Russian/Ukraine conflict to financial markets.
- The striking feature of the Q4 2021 inflation scare was how sanguine the bond market reaction was. Inflation expectations – measured by inflation swaps – spiked aggressively but then equally quickly unwound.
- In the chart below, Qi's z-score measure for US inflation expectations experienced a 3 standard deviation shock but then reverted to trend.



- The Ukraine conflict has now prompted another surge in inflation, but **it is critical to understand the nuances.**
- The initial market reaction saw short term (2y) inflation expectations spike – they are now 2 standard deviations above trend. But longer term (10y) expectations remained relatively contained. It was **a classic commodity supply shock**. Near term price pressures but limited impact for the longer term inflation picture.
- That spike is starting to filter out the curve. Inflation fears are showing signs of potentially becoming entrenched. Arguably that **diminishes the room for manoeuvre for Central Banks juggling the growth shock from the conflict.**
- Macro investors will watch the shape of the TIPs break-even curve as a critical gauge of how the markets view the inflation outlook. For equity funds less in tune with macro factor shifts, the Qi portal can provide a way to track both the underlying move in inflation & which securities are most sensitive.

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