LAWSON KROEKER

As we see it

May 2021

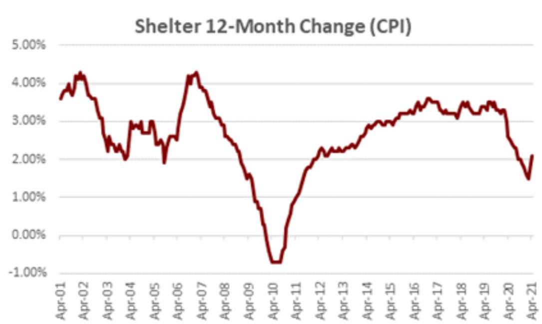
"Inflation is the parent of unemployment and the unseen robber of those who have saved."

--Margaret Thatcher

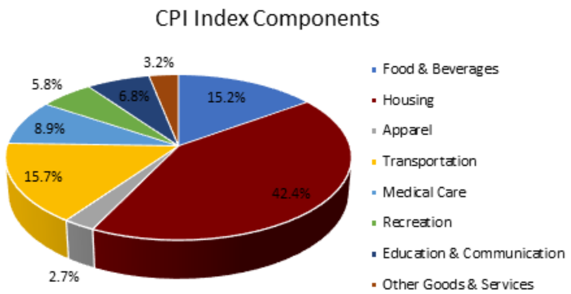
As our economy continues to pull through the Covid pandemic, we find ourselves at a stage where everything feels more expensive, yet everyone is wondering - What can we do about it? A far cry from where we were a year ago, increased consumer demand combined with a largely constrained supply chain have made the prices of most goods and services notably higher. Government stimulus, low interest rates and pent-up demand combined to drive consumer purchases sharply higher while many goods and services are increasingly scarce. Add in the Federal Reserve's comfort with higher reported inflation and the stage has been set for increasing prices.

If it is safe to say that everyone feels inflation, how are we not seeing it in the reported numbers? The Federal Reserve's first mandate is to control inflation and have a long-established way of monitoring living expenses through the Consumer Price Index (CPI). If they are tracking the cost of living closely, how could they fail to prevent it? Let us start at home where everyone has been hunkered down and spending an increasing percentage of their time and living expenses. There is no doubt that home prices have risen sharply nationally during the pandemic. Interest rates continued to decline and people wanted to upgrade or expand where they now worked and lived. Housing-related expenses are usually the average family's largest expense, and it became increasingly so when they were spending more of their time at home. The Fed's CPI index has a large weighting for shelter-related expenses, though it focuses solely on rents rather than costs of home ownership (which is considered an *investment* instead). Because of this, the climb in housing prices and many costs incurred from home ownership have escaped the CPI's radar.

At the same time, rent increases have remained in-line or below the Fed's stated inflation target. The labor market was soft and demand for rental housing was low. Assuming the labor market strengthens as we emerge from the pandemic, it would seem safe to think that rent increases would be another stimulant to inflation. While that effect would be to elevate the reported CPI, it would be on a trailing basis rather than in a more foretelling fashion.



Outside of the home, consumer demand is coming back. Low interest rates, stimulus checks and increasing numbers of those who are vaccinated have combined to embolden spending while supplies are still down. Building supplies, from copper to lumber, are seeing sharp price increases. Whether for groceries or dining out, food prices are up noticeably.



Historically, technology has rescued us from increasing cost curves. Among technology's most endearing qualities was that it reduced costs over time. However, even the technology most embedded in our lives is failing to hold the guard. Since their initial release, the increases in the average purchase price of an iPhone have left wage increases well behind

If prices are increasing faster than the Fed may be tracking, how do we position ourselves accordingly? Inflation is a risk that is both real and ever present, but not one investors should face on their heels. As investors, our objective is to not only maintain purchasing power by keeping up with inflation, but hopefully to increase it by investing and delaying spending.

Among the asset classes we can invest in, fixed income investments currently do not offer much protection in purchasing power as yields are often below the Fed's targeted CPI objectives. As bondholders, we receive a lower, largely fixed rate return as lenders to businesses. However, as we shift from lenders to owners of businesses, we may find an answer when interest rates are low and inflation is present. A long-term portfolio invested in equities offers better prospects of tackling inflation and increasing purchasing power over time.

As shareholders, we are able to allocate capital wisely to the businesses and operations that are naturally more hedged against inflation, specifically, owners and producers of hard assets and commodities. A time-tested guard against inflation is investing portions of our portfolios in the businesses that are able to push through price increases to consumers and protect their business models and profit margins in times of inflation. Through equity ownership, investing in such businesses allow us to place our capital "with the house" in times when it feels like the house may always win.

Across our portfolios, a large component of our holdings are businesses that own or produce assets that protect against inflation – land, real estate, timber, and other commodities. It has been a component of our investment philosophy all along, but one that may offer additional support in times like these. Rather than asking what we can do about possible inflation, we believe it is a prudent first step to have invested as though it already existed.

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