



Higher Inflation Is Here...What's the Game Plan?

Inflation is one of today's biggest investment controversies—and poses a clear risk to purchasing power. Investors are dusting off their inflation-fighting playbooks, but protecting against inflation isn't free. That requires assessing a critical trade-off: inflation-protecting ability versus opportunity cost.

The Heat Has Been Turned Up on Inflation

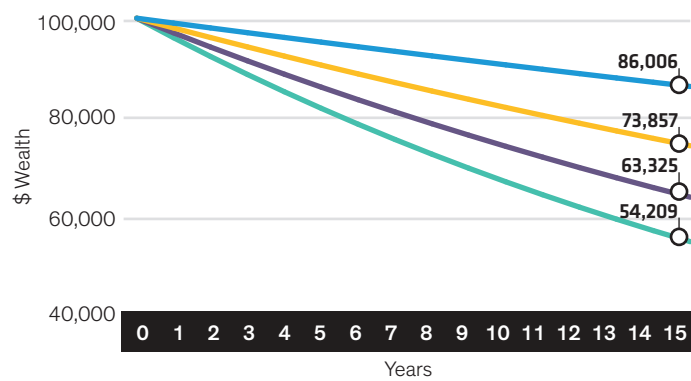
- Over time, even mildly higher inflation can take a big bite out of purchasing power.
- Inflation has been dormant for most of a decade, but has resurfaced with a vengeance.
- Surging prices were initially viewed as transitory, a product of pandemic-related disruptions.
- But inflation has turned out to be stickier than originally thought, and year-over-year headline CPI has grown by as much as 8%.
- The Fed has accelerated its tightening of monetary policy in response.

Higher Inflation: Will It Stay or Will It Go?

- The inflation comeback is fueling a great debate among investors: Is high inflation really here to stay or will it eventually go?
- The “stay” camp believes firmly that inflation isn't going anywhere soon—as COVID-19 recedes, rising prices will persist.
- The “go” camp argues that the inflation spike, while stickier than first thought, will ultimately recede over time as COVID-19 fades.
- Regardless of which camp investors are in, inflation is definitely back on the radar—and investors should dust off their inflation playbooks.

IMPACT OF DIFFERENT INFLATION RATES ON WEALTH

Terminal Value of \$100,000 Under Different Inflation Scenarios



Inflation Rates: 1% 2% 3% 4%

Past performance does not guarantee future results.

This is a hypothetical example and is not representative of any AB product. An investor cannot invest directly in an index or average and they do not include sales charges or operating expenses associated with an investment in a mutual fund, which would reduce total returns. The portfolio comprises 60% stocks and 40% bonds; stocks are represented by the S&P 500 (with Global Financial Data extension) and bonds by 10-year Treasuries through 2009 and Barclays US Treasury 7–10 year Total Return index thereafter. Inflation is measured by US CPI, US City Average, all items, not seasonally adjusted, through December 2015.

Source: Barclays, Global Financial Data, US Bureau of Labor Statistics and AB

The “Stay” Camp

- Lingering COVID-19-related knots in supply chains prove difficult to untangle
- Ongoing labor shortage puts sizable upward pressure on wages
- Central banks are behind the policy curve

The “Go” Camp

- Transition from pandemic to endemic
 - Healing supply chains will take pressure off goods prices
 - Sidelined workers will return to the labor force
 - Restored balance between goods and services demand

Three Reasons Why Investors Are Talking About Inflation Protection Today

Erosion

The use of portfolio inflation protection has eroded after a decade of tame price increases.

Lifecycle Needs

A later life phase makes income—and inflation protection—more urgent.

Uncertainty

Inflation protection might be a fit, but it's unclear how to approach it.

Inflation Protection: Assessing the Trade-offs

Inflation protection isn't free, so every investor needs to assess a key trade-off: How effective is inflation protection versus its opportunity cost—the yield or return potential that's sacrificed? Gold's real return, for example, has been well below that of stocks and bonds since 1980. Treasury Inflation Protected Securities (TIPS) and Municipal Inflation Protected Securities (MIPS) play good defense but exact yield penalties. Stocks and credit investments don't offer explicit inflation protection, but they have implicit protection as well as healthy yields and return potential.

Below is a game plan for investors to consider when building—or rebuilding—inflation defenses.

An Inflation-Fighting Game Plan

	Considerations	The Game Plan
Stocks: Look for Quality Businesses with Pricing Power	<ul style="list-style-type: none"> Some equity segments have fared better in inflation—such as real-asset producers or value. Sizable passive exposures, however, can create concentration risk. 	<ul style="list-style-type: none"> Don't retool equity exposure to lean heavily into historically inflation-resistant segments. Identify quality firms and innovators with pricing power to offset cost pressures.
Bonds: Wrap Diversified Bond Allocation with Explicit Inflation Protection	<ul style="list-style-type: none"> TIPS and MIPS offer explicit inflation protection, but with a yield penalty. Inflation swaps exact a modest cost for contractual inflation protection. Credit can help investors out-yield inflation—a form of implicit protection. 	<ul style="list-style-type: none"> Don't go it alone with TIPS or MIPS to protect against inflation. Bolster yield base with diversified core credit investments. Wrap core allocations, where appropriate, with a CPI swap that offers explicit inflation protection.
Real Assets: Diversify Exposure, Because There's No "Real" Silver Bullet	<ul style="list-style-type: none"> Real assets have historically been effective inflation fighters. However, every inflation regime and real asset is different, so there's no silver bullet. 	<ul style="list-style-type: none"> Evaluate inflation-fighting credentials based on inflation sensitivity, reliability and cost-effectiveness. Build thoughtful, diversified exposure across real-estate equities, commodity futures and other real assets.

A WORD ABOUT RISK—Market Risk: The market values of the portfolio's holdings rise and fall from day to day, so investments may lose value. **Interest-Rate Risk:** As interest rates rise, bond prices fall and vice versa—long-term securities tend to rise and fall more than short-term securities. **Credit Risk:** A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered and the bond's value may decline. **Inflation Risk:** Prices for goods and services tend to rise over time, which may erode the purchasing power of investments. **Foreign (Non-US) Risk:** Non-US securities may be more volatile because of political, regulatory, market and economic uncertainties associated with such securities. Fluctuations in currency exchange rates may negatively affect the value of the investment or reduce returns. These risks are magnified in emerging or developing markets. **Diversification Risk:** Portfolios that hold a smaller number of securities may be more volatile than more diversified portfolios, since gains or losses from each security will have a greater impact on the portfolio's overall value. **Derivatives Risk:** Investments in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments, and may be more volatile, especially in a down market. **Leverage Risk:** Trying to enhance investment returns by borrowing money or using other leverage tools may magnify both gains and losses, resulting in greater volatility. **Below-Investment-Grade Securities Risk:** Investments in fixed-income securities with lower ratings (commonly known as "junk bonds") tend to have a higher probability that an issuer will default or fail to meet its payment obligations. Past performance does not guarantee future results. AllianceBernstein Investments, Inc. (ABI) is the distributor of the AllianceBernstein family of mutual funds. ABI is a member of FINRA and is an affiliate of AllianceBernstein L.P., the manager of the funds. The [A/B] logo is a registered service mark of AllianceBernstein and AllianceBernstein® is a registered service mark used by permission of the owner, AllianceBernstein L.P.

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