NO DEMOGRAPHIC HEADWIND UNTIL LATER IN 2019

Ask the PORTFOLIO MANAGER

Why do you think the inflection in equity volatility will not be a problem for investors?

Transcript of a video recorded on May 30, 2018.

MICHAEL GRANT

Co-CIO, Sr. Co-Portfolio Manager, Head of Global Long/Short Strategies

Equity volatility is closely related to corporate credit spreads, and the commonality is the perception of disruptive influences that raise insolvency risk. The reason it's not a problem is because what investors are understanding is that growth can be stronger for longer, but what we're not experiencing yet is reflation.

This might sound like semantics, but it's important. Growth is stronger, but price expectations are not rising. Inflation expectations are not rising. Reflation is growth that's associated with rising inflation expectations.

If you look carefully at the behavior of the bond market, the adjustment that we've seen in interest rates is almost entirely because of the higher growth component, not because of a higher inflation component. Broadly speaking, pricing expectations are still deeply anchored in the psyche of investors, consumers, policymakers, and so forth.

That's what's going to allow this cycle to continue for an indeterminate length in time. Eventually, that will change. There are many different reasons that are discussed as to why inflation has stayed so low, technology, global competition, and so forth.

The one that we're looking at most closely is demographics because we think the demographic headwind for inflation will turn sometime in later 2019. There are two components in particular that we're looking at. The first is that Baby Boomers, people like myself in their 50s, today make up the majority of the workforce.

Baby Boomers don't change jobs. They tend to stay in the same job for a long period of time. Most of the wage gains in the workforce occur when people change jobs, and that component of the workforce, which today is millennials, is still not quite large enough.

There's a demographic component that we think will begin to come out of the wage numbers. The other factor is what I call the [former Federal Reserve Board Chair] Janet Yellen factor, where the Fed's policy has been to purposely run the economy hot in order to pull back the permanently dislocated workers after the financial crisis, and all the evidence suggests that that is now finally happening.

By the second half of 2019, the participation rates in the workforce will be back to where they were pre-the financial crisis. We think sometime in the second half of 2019 is when you're finally going to get a move upward in inflation pressures, and that's the much less benign problem that markets will have to confront.

WATCH VIDEO

Video recorded 5/30/18.

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Calamos Financial Services LLC, Distributor
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | www.calamos.com | caminfo@calamos.com

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