Is More Volatility Inevitable, Given Fed Stance on Inflation?

If the Fed’s resolve to fight inflation has been responsible for keeping markets relatively stable for decades, what does the current change in course mean?

The Wall Street Journal last week suggested that, "Some investors are preparing for wild swings in financial markets, worried that inflation, and the Federal Reserve's pledge to let it rise, will lead to a more volatile world."

But a Wealth of Common Sense post has found that not to be the case historically (see table at bottom right). "Not surprisingly, returns have been much lower in a highly inflationary environment...But surprisingly," the post said, "those lower returns didn’t come with higher volatility. Of course, returns were roughly half as much with three-quarters of the volatility in the above average inflation scenario, but I figured the volatility would have been higher too."

Allowing that “sky-high valuations may act as a countervailing force,” the post raised the possibility that persistent higher inflation might actually dampen volatility.

**Economic Releases vs. Consensus (week of 5/31)**

- Markit PMI Index: 62.1 vs. 61.5
- Nonfarm Productivity Growth: 5.4% vs. 5.5%
- Unit Labor Costs: 1.7% vs. -0.4%

**Economic Releases (week of 6/7)**

- Balance of Trade (6/7)
- CPI (6/10)

**MARKET PULSE**

**MONTH-TO-DATE**

<table>
<thead>
<tr>
<th>VALUE</th>
<th>CORE</th>
<th>GROWTH</th>
<th>As of 6/4/2021</th>
<th>YEAR-TO-DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.77</td>
<td>0.55</td>
<td>0.34</td>
<td>LARGE 19.31</td>
<td>6.68</td>
</tr>
<tr>
<td>0.81</td>
<td>0.47</td>
<td>-0.24</td>
<td>MID 21.84</td>
<td>3.17</td>
</tr>
<tr>
<td>1.82</td>
<td>0.78</td>
<td>-0.38</td>
<td>SMALL 29.79</td>
<td>3.70</td>
</tr>
</tbody>
</table>

**HIGH INFLATION HAS DEPRESSED STOCK RETURNS—BUT HASN’T DRIVEN VOLATILITY**

<table>
<thead>
<tr>
<th>S&amp;P 500</th>
<th>% of the Time</th>
<th>Annualized Returns</th>
<th>Volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td>1926-2020</td>
<td>41%</td>
<td>6.6%</td>
<td>15.9%</td>
</tr>
</tbody>
</table>

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The S&P 500 Index is considered generally representative of the U.S. equity market. The MSCI World Index is considered generally representative of the market for developed market equities. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index cited as a measure of the performance of emerging market equities. The MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The Russell 3000 Index measures the performance of 3,000 publicly held US companies based on total market capitalization, which represents approximately 98% of the investable US equity market. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe and includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe and includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The ICE BofA U.S. High Yield Master II Index tracks the performance of U.S. dollar denominated below investment grade rated corporate debt publicly issued in the U.S. domestic market. The Bloomberg Barclays Capital U.S. Aggregate Bond Index covers the U.S.-denominated, investment-grade, fixed-rate, taxable bond market of SEC registered securities. The Bloomberg Barclays U.S. Government/Credit Index is comprised of long-term government and investment-grade corporate debt securities and is generally considered representative of the performance of the broad U.S. bond market. The Bloomberg Barclays U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. The ICE BofA Global 300 Cv Index (VG00) is a $US/Local-denominated unmanaged index generally indicative of the overall global convertible market. The ICE BofA All U.S. Convertibles Index (VXAA) is comprised of approximately 700 issues of only convertible bonds and prefers of all qualities. Source ICE Data Indices, LLC, used with permission. ICE permits use of the ICE BofA Indices and related data on an ‘as is’ basis, makes no warranties regarding same, does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the ICE BofA Indices or data included in, related to, or derived therefrom, assumes no liability in connection with the use of the foregoing and does not sponsor, endorse or recommend Calamos Advisors LLC or any of its products or services.

Oil - West Texas Intermediate (WTI - Cushing): A crude stream produced in Texas and southern Oklahoma which serves as a reference or “marker” for pricing a number of other crude streams and which is traded in the domestic spot market at Cushing, Oklahoma. Gasoline: Weighted average based on sampling of approximately 900 retail outlets, 8:00AM Monday. The price represents self-service unless only full-service is available and includes all taxes. Gold - Gold Fixings Price: The Fixings are an open process at which market participants can transact business on the basis of a single quoted price. Orders can be changed throughout the proceedings as the price is moved higher and lower until such time as buyers’ and sellers’ orders are satisfied and the price is said to be ‘fixed’. Orders executed at the fixings are conducted as principal-to-principal transactions between the client and the dealer through whom the order is placed.

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