

# Profitable INVESTING Tips

## Stock Market Investing Tips, Techniques, and Resources



### Price of Taming Inflation

By: [www.ProfitableInvestingTips.com](http://www.ProfitableInvestingTips.com)

Pent up demand, broken supply chains, disruptions in the labor market, and high energy prices have all conspired to send the cost of living up. As inflation raises its ugly head, the Fed has declared its intent to speed up quantitative easing and raise interest rates in the coming year. Investors are hearing the 1970 to 1980s term, stagflation and the general consensus seems to be that higher rates to tame inflation is probably a good idea. What we would like to consider is the price of taming inflation and how that will affect peoples, work, investments, and lives in the coming years.

### Why Is There Inflation?

The European Central Bank offers a concise explanation for why we are seeing [inflation](#). As they note the economy is opening up again with a lot of pent up demand. The pandemic has changed what we buy including more electronics and the supply chain is not keeping up with things like [computer chips](#). Shipping container shortages have made thing even worse. Because car companies cannot make enough cars due to chip shortages people are buying more used cars and used car prices have skyrocketed. Part of today's inflation is likely temporary and based on these factors. Part is probably long-term and based on a re-shuffling of the labor market as workers seek to make up for decades or relatively stagnant wages.

### Raising Interest Rates to Curb Inflation

As noted by the Cleveland Federal Reserve, the Fed raises interest rates to [curb inflation](#) because doing so slows the economy which typically brings inflation down. The dual mandate of the Federal Reserve is to maintain maximum employment and stable prices. The business of raising and lowering interest rates to "adjust" the economy has often been likened to walking a tightrope. If the Fed raises interest rates too fast and high it can cause a recession and if it waits too long inflation gets out of hand. And, the longer inflation rages, the more difficult it is to reduce it without damaging the economy. In other words, the price of taming inflation may be worse than inflation itself.

### The Price of Taming Inflation

In an opinion piece in *The New York Times*, the Nobel Prize-winning economist, Paul Krugman, wrote about a potential [hard landing](#) for the economy as the Fed raises interest rates to fight inflation. He notes that when Fed Chairman Paul Volker drove rates up in 1981 to kill inflation it worked but then unemployment peaked to 11% and did not return to the 1981 level for seven years! The price of taming inflation was seven years of increased unemployment.

Those who have been wondering why the Fed seems to have been so hesitant to raise rates may be getting a better understanding of their thinking by considering the unemployment fallout from the inflation-busting “miracle” of the Fed’s raising rates in 1981.

### **The Price of Taming Inflation for Your Investments**

Nobody likes the idea of a negative [real earnings yield](#) on their investments as inflation negates gains in the stock market or interest-bearing investments. But, what happens to your investments if the Fed overshoots on raising rates and drives the economy into a recession. Or even worse, what happens if you lose your job during that recession and need to rely on your now-diminished investment portfolio to get by? A real concern is that many of the factors that are causing inflation today do not have to do with the economy coming back and pent up demand. High used car prices are an example. Prices are up because they are not making enough new cars and they are not making enough new cars because there are not enough chips. And, part of the reason there are not enough chips is because the [Covid-19 variants keep coming](#) so that we may have a semi-permanent situation in which some prices are skewed indefinitely and will not be fixable by raising interest rates and driving the economy into a recession. Likewise, the stock market may remain skewed for some time to come with stay-at-home, work at home.

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