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Opinion: This contrarian trade lets you scoop up stocks on the cheap

By **Mark Hulbert**
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Take advantage of stock investors' fear of inflation

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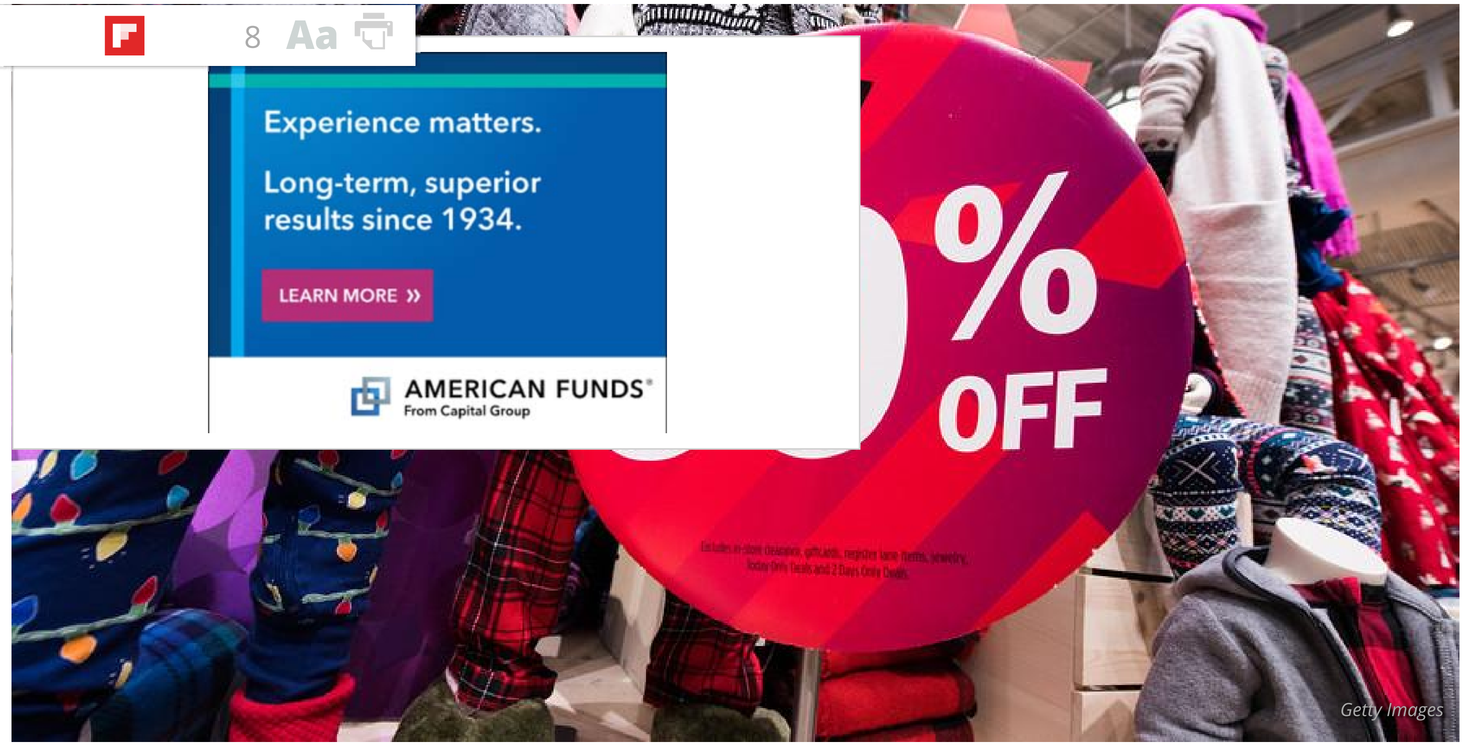


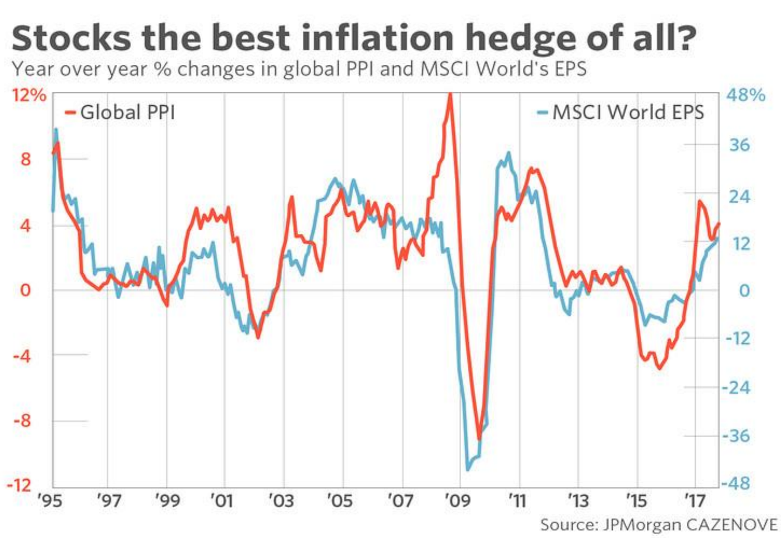
Stocks are the best place for your money if you're worried about inflation.

That's the opposite of what most investors think. Their knee-jerk reaction is to sell whenever inflation appears to be rearing its ugly head. Just take this past week, for example. Following the stronger-than-expected early-February Labor Department report on employment and wage growth, investors panicked, the stock market plunged, and volatility has returned to the markets.

But stock market history does not support their panic. On the contrary, earnings growth rates historically have been significantly correlated with inflation — growing more quickly when inflation is high than when its low. So if inflation heats up considerably in coming years, it's a good bet that corporate earnings will be higher than they would have been otherwise.

Another way of putting this: Earnings growth rates are significantly steadier when measured in real, or inflation-adjusted terms, than they are in nominal terms.

Take a look at the chart, below, which plots year-over-year changes in the global producer price index and earnings per share of the MSCI World Index. The remarkably close correlation is just the opposite of what most investors think has been the case.



ichard Warr and University of Florida finance professor Jay Ritter.

s to acquire stocks at

' ability to hedge inflation because they confuse
r to as "inflation illusion." As a result, they

re stocks at bargain prices. "When inflation spikes, a
arian should tilt his or her allocation towards equity funds," according to Warr, thereby "reaping the gains from the
those suffering from inflation illusion."

Skeptics may begrudgingly concede Warr's point, but nevertheless insist that investors searching for an inflation hedge should look to gold **GCG8, -0.18%** rather than stocks. But gold is not nearly as good an inflation hedge as conventional wisdom believes.

To appreciate how poor a job gold does hedging inflation, it's helpful to realize that if it did a good job then the real price of gold would be relatively steady — in contrast to the volatile nominal price of gold. This real-is-steadier-than-nominal pattern is what we saw above in the case of corporate earnings, for example.

But it isn't steadier for gold, according to a study conducted by Claude Erb, a former fixed-income and commodities manager at mutual-fund firm TCW Group, and Campbell Harvey, a finance professor at Duke University's Fuqua School of Business. They found that "the volatility of the real price of gold has been basically the same as the volatility of the nominal price of gold."

The bottom line? Investors may very well continue to react irrationally to fears of worsening inflation. But if they do, a contrarian should be happy to take the other side of their trade.

For more information, including descriptions of the Hulbert Sentiment Indices, go to The Hulbert Financial Digest or email mark@hulbertratings.com.

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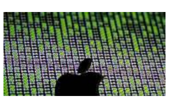
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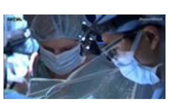
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2 yr CD	0.99%

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0.37%
0.29%
0.42%

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MARK HULBERT

Mark Hulbert has been tracking the advice of more than 160 financial newsletters since 1980.

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Dominic DAmelio 1 day ago

But wouldn't high inflation lead to high interest rates and this might explain why stocks went nowhere during the stagflation of the 1970's.

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Darren Gordon 2 days ago

This is such a silly article, you have to consider valuations. This idea of buying at any price is going to burn a lot of people. Also periods of high inflation have been TERRIBLE for stocks historically, look at the 70s for example. How could it possibly be 'contrarian' to do what everyone else is doing?

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Daniel Brockman 2 days ago

@Darren Gordon

S&P 500 was about 85 on Jan 5 1970 (sorry, my info doesn't go further back) and about 115 on Jan 2 1980, an increase of 3.07% per year (Fidelity.com).

CPI increased about 7.33% per year (**https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=10000&year1=197001&year2=197912**).

How did other decades do during the 20th & 21st centuries?

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Darren Gordon 1 day ago

@Daniel Brockman @Darren Gordon Take a look at this chart my friend:

http://www.macrotrends.net/2324/sp-500-historical-chart-data

If you still don't see it, I can't help you.

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Bruce Cobb 2 days ago

Once the FOMOs and fwady-cats scamper off, the grownups will clean up.

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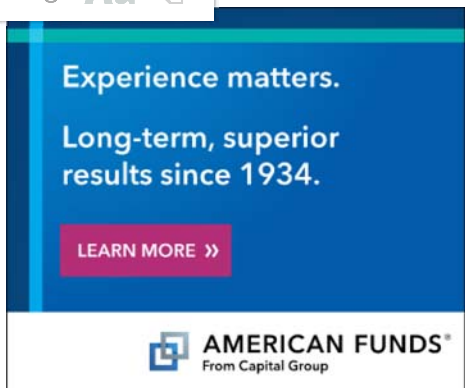

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