

Looking for Evidence of Inflation - February 8, 2021

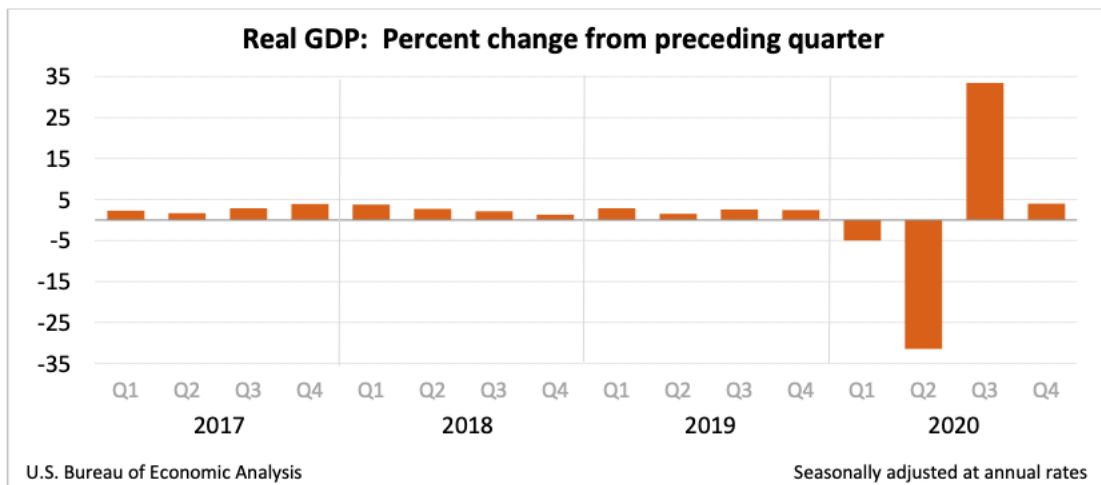
By Steve Valentor

Stock prices are at record highs. Most people consider that to be good news. Also, it feels as if the economy is hinting at recovery - also good news.

With so much confusing information and politically biased rhetoric, I wanted to do my own research and gather some data about the money supply and how much of a gap there might be between it and the underlying Gross Domestic Product (GDP) that backs it up.

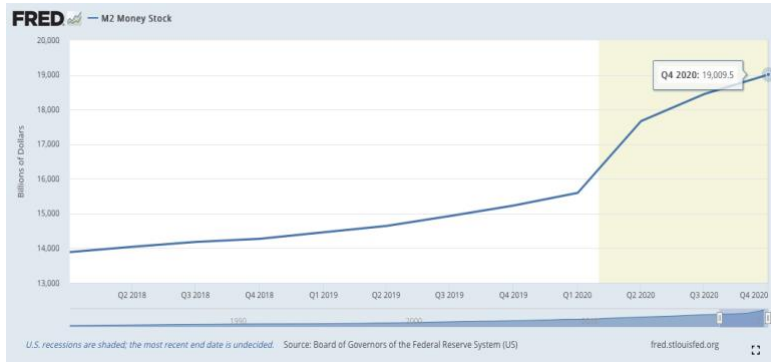
The chart below shows that while the US Gross Domestic Product had been growing every quarter from 2017 through 2019, COVID-19 took its toll in the first half of 2020.

According to the US Bureau of Economic Analysis, the GDP growth rate rebounded in Q3 after a deep dip in Q2 and appears to have returned to pre-COVID-19 levels.



This feels like good news too. But I can't seem to squelch the feeling that the COVID-19 relief might trigger inflation. The money supply has increased. That is likely to continue this year with additional relief.

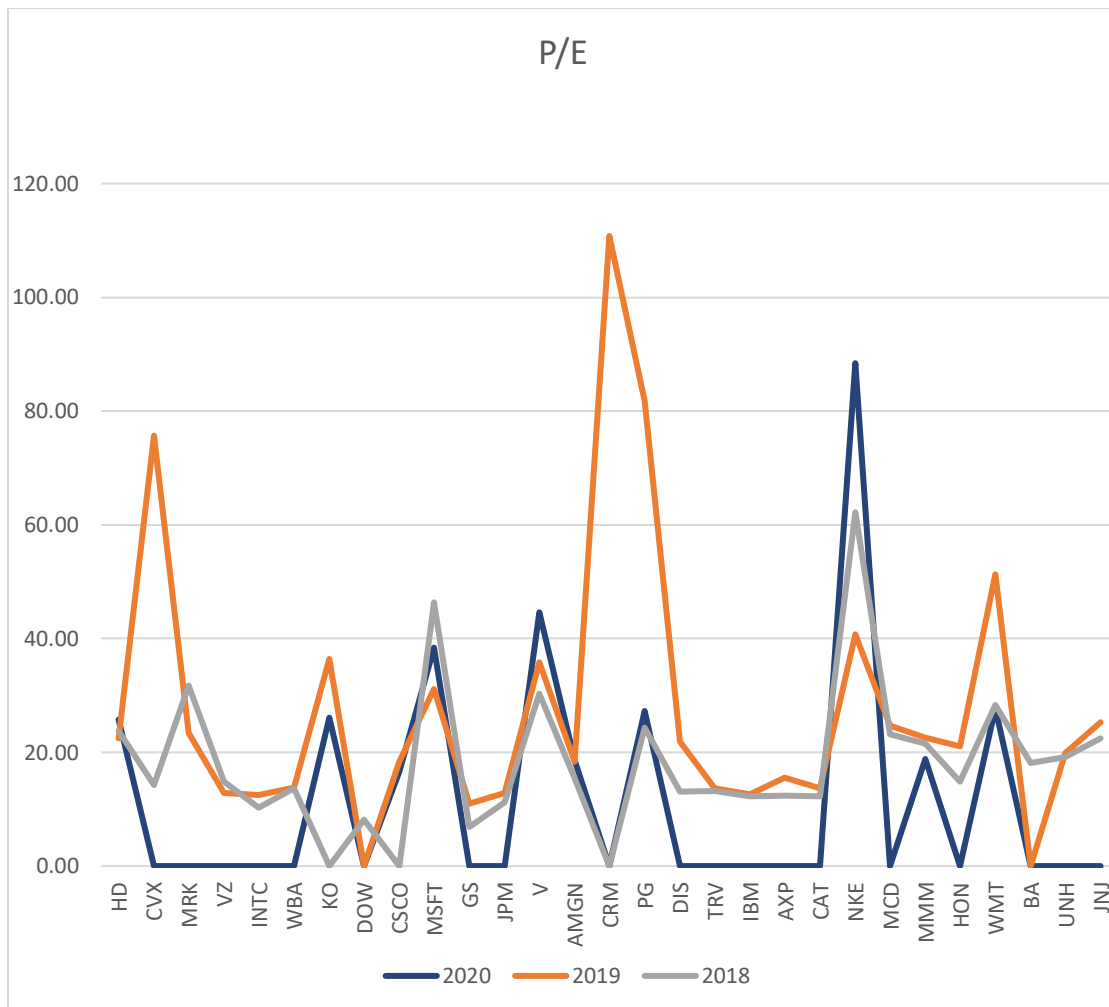
The following chart from the Federal Reserve Bank shows that the money supply (M2) had been increasing at a linear rate of about \$1 trillion per year since 2018. COVID-19 relief has required nearly \$4 trillion of new money in 2020 alone.



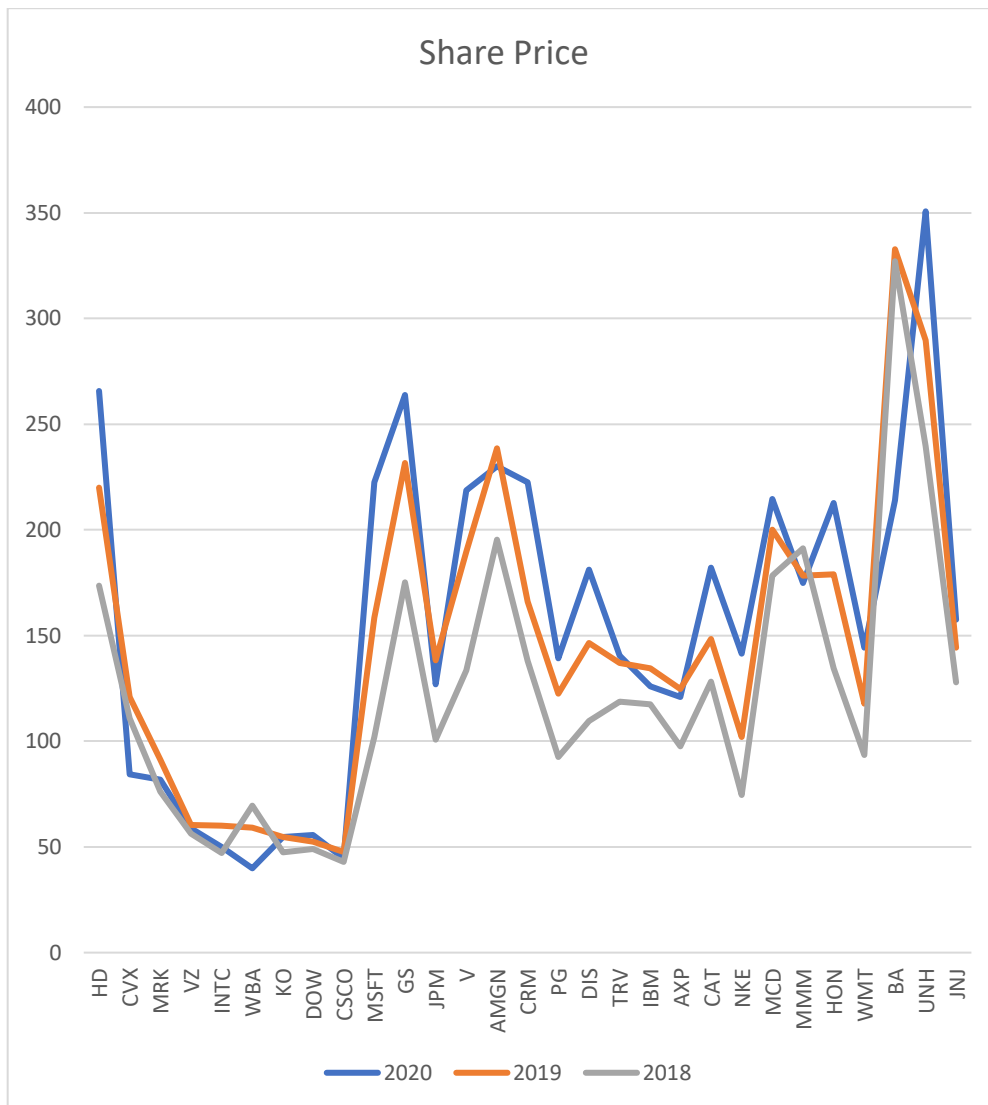
I believe that this money provides much needed relief for our citizens. As they spend it on medical care, food, shelter, clothing, and other essentials, it works its way through the economy. Some of it trickles down and some bubbles up. We know that a lot of citizens are suffering financially. Many

corporations are suffering too. But how are they really doing in general?

Share prices are up. Earnings per share are down. In fact, while the Dow Jones Industrial average increased by 6.9% in 2020, the companies that make up the Dow saw their Price to Earnings ratios drop by 59%. The chart below shows the P/E ratios for the DOW stocks over the last three years. The blue line (2020) shows quite a few companies with generally lower, or no earnings. There are a few exceptions.



These ratios can then be correlated with corresponding prices for the same periods.



It is my hope that sharing this data provides some empirical corroboration for how we are feeling about our economy. I'll leave drawing conclusions as an exercise for the reader.

Steve Valentor is a 30-year technology industry veteran who has worked in computer engineering, semiconductor R&D and software development for companies ranging from startups to the Fortune 200. He has held positions from entry level engineer to senior technical management, CEO and board chair. Currently the managing partner of Polynomial Ventures and an adjunct professor at DePaul University, Valentor holds an M.B.A. in finance and a bachelor's degree in math, both from the University of Illinois at Chicago.

Polynomial Ventures invests in early stage technology companies outside of Silicon Valley and Boston. The Chicago-based firm is an emerging, registered investment adviser (RIA) operating an evergreen fund.