Word of the Day
Stagflation, and maybe Tariff.

"The whole plan is not to have stagflation, so we don't have to deal with it." – Jerome Powell, November 2024[1]

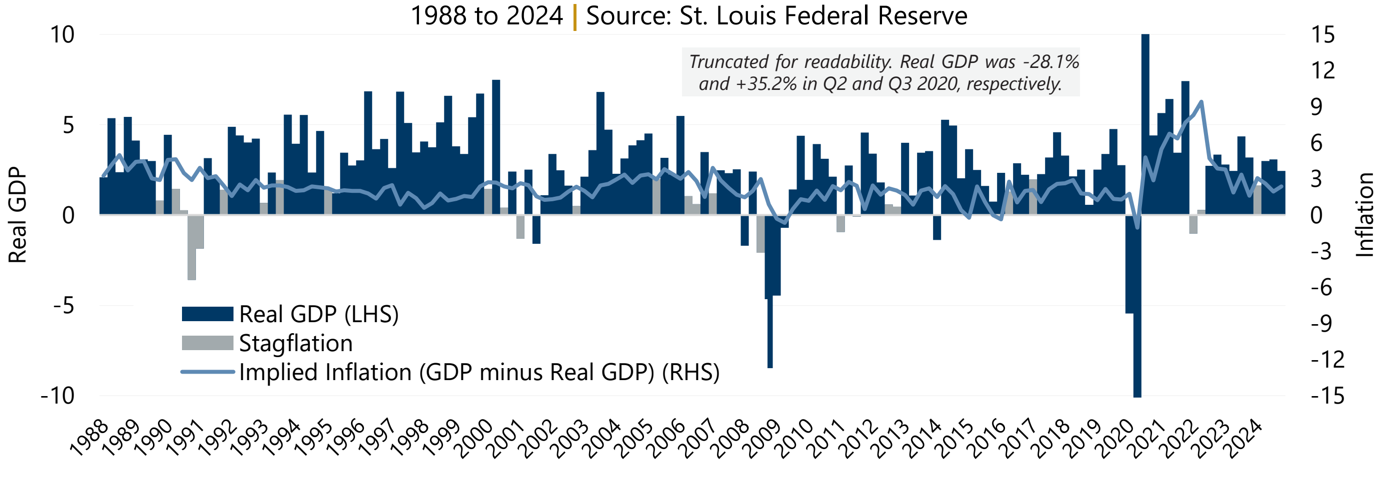
Uncertainty around the economic impacts of the Trump Administration's tariff policy has caused concerns of a potential environment where inflation reaccelerates while growth slows. Proponents of this type of trade approach suggest tariffs can be an effective negotiating tool for balancing trade and/or a strong and underutilized source of revenue. Opponents have voiced concerns that tariffs could be inflationary and/or have a negative impact on domestic economic growth by slowing down global trade or causing the U.S Dollar to become too strong. Given such an outlook and lacking the ability to predict the future, investors may benefit from an examination of the past.

Stagnant + Inflation
Stagflation is generally understood to be an economic environment with high inflation, low or declining economic growth, and elevated or rising unemployment. Possibly the most common measure referenced when considering the economic growth component of stagflation is Gross Domestic Product (GDP), or the market value of the goods and services produced by labor and property located in the country. Real GDP is simply the same information, adjusted for inflation. For our purposes here, and to keep the measurement simplified, a stagflationary environment is one with quarterly inflation greater than *2% plus* quarterly and year-over-year Real GDP less than 2%.

Limiting data to 1988, to celebrate the launch of Gateway's Flagship Strategy, shows inflation levels were low (less than 2%) approximately 39% of the time, moderate (ranging 2-4%) during 52% of the period, and high (greater than 4%) just 9% of the time. The same data shows that Real GDP was more evenly distributed during the period – coming in low 30%, moderate 43%, and high 27% of the time.

Shifting trade policy is not the only thing that can trigger stagflation however. Most recently, in 2022, as supply chains recovered from a global pandemic and war broke between Russia and Ukraine, inflationary pressures were reintroduced and global growth slowed. This backdrop resulted in actual stagflation during the first half of 2022.[2] To find the next period of more than two consecutive quarters of stagflation, investors need to travel back to the early 1990s from Q2 1990 through Q1 1991. For some investors, however, thoughts of stagflation trigger memories of the 1970s where, by the final quarter in 1982, stagflation existed in the U.S. at a peak 50% over the trailing 10-year period.

Quarterly Real GDP and Implied Inflation
1988 to 2024 | Source: St. Louis Federal Reserve



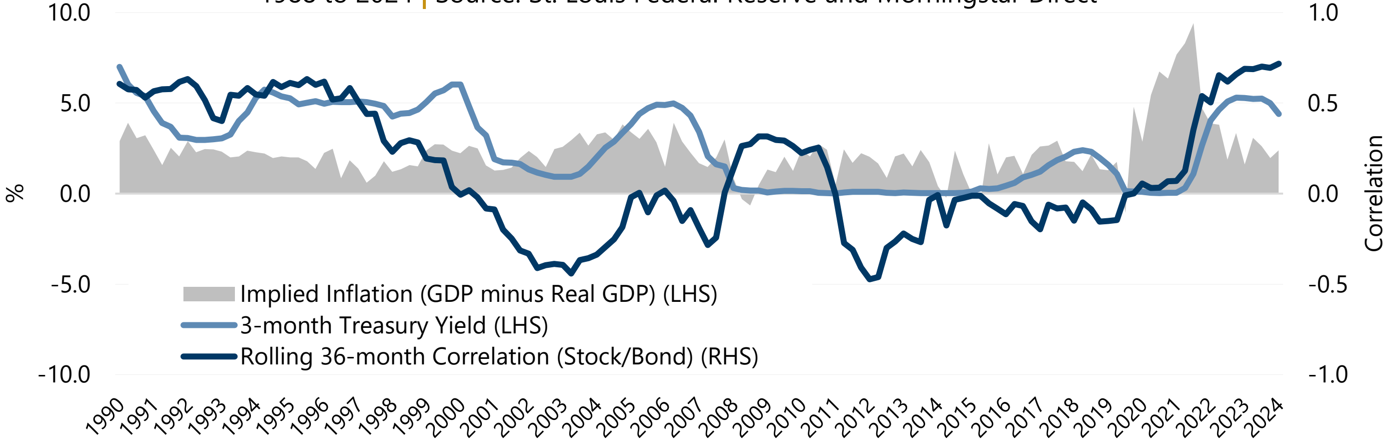
Diversification Can Help
Typically, investors look for diversification in returns between fixed income and equity allocations, but both inflation and the level of interest rates can influence correlation. Consider rolling 36-month correlation between bonds, represented by the Bloomberg® U.S. Aggregate Bond Index (Agg Index), and stocks, represented by the S&P 500® Index. By these measures, the two asset classes have been positively correlated over rolling three-year periods 54% of the time since 1988, and it can get more complicated during periods of stagflation.

[1] Mace News. (n.d.). Transcript: Fed's Powell says 'no,' wouldn't leave if Trump asked. Retrieved April 21, 2025, from https://macenews.com/transcript-feds-powell-says-no-wouldnt-leave-if-trump-asked/

[2] World Bank. (2022, June 6). Global economic prospects: Slowing growth, risk stagflation - Expert answers [Video]. https://www.worldbank.org/en/news/video/2022/06/06/global-economic-prospects-slowing-growth-risk-stagflation-expert-answers

Inflation, Interest Rates & Correlation

1988 to 2024 | Source: St. Louis Federal Reserve and Morningstar Direct℠



As inflation increases, the correlation between stocks and bonds tends to increase and diversification benefits wane. Rising inflation can also trigger tightening monetary policy, which often results in rising interest rates that have the potential to negatively impact bonds (as rates rise, bond prices decline). Inflation averaged 3.21% during periods of positive correlation, whereas inflation averaged just 2.26% during periods of negative correlation.

Impacts of Inflation Level	Low (<2%)	Moderate (2-4%)	High (>4%)
S&P 500® Index Total Return	1.34%	0.92%	0.49%
Agg Index Total Return	0.44%	0.48%	0.36%
T-Bill Yield	1.18%	3.35%	4.70%

Past performance does not guarantee future results. Source: Bloomberg® Index Services Limited. Please see Important Information section for full disclosure.

Consider interest rates over the same period. Since 1988, the rate on U.S. 3-Month Treasury Bills (T-Bills) averaged 2.94%. Interest rates averaged 4.01% during periods of positive correlation between stocks and bonds whereas the average rate was 1.54% during periods of negative correlation. The current market environment is facing robust inflation and above-average interest rates, while correlation climbed to its highest level since 1988 at the end of 2024.

So Now What?

Volatility remains on the horizon with ongoing global conflict, shifting geopolitics, and potential large-scale transformation to global trade – not to mention unclear monetary policy. Given the uncertainty and recent market turmoil, investors may be hesitant to increase equity exposure and unable to find the typical diversification benefits they seek in bonds. Higher interest rates and volatility are tailwinds for options-based strategies. Gateway's strategies can fill the void to help reduce portfolio risk, offer equity market loss mitigation, or increase income through cash flow generation and tax-aware investing while avoiding interest rate sensitive or illiquid investments.

Important Information

Past performance does not guarantee future results. Periods greater than one year are annualized. Sources: Federal Reserve Bank of St. Louis, Bloomberg® Index Services Limited and Morningstar Direct℠.

For more information and access to additional insights from Gateway Investment Advisers, LLC, please visit www.gia.com/insights.

BLOOMBERG® and the indices referenced herein (the "Indices", and each such index, an "Index") are service marks of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg") and/or one or more third-party providers (each such provider, a "Third-Party Provider,") and have been licensed for use for certain purposes to GATEWAY INVESTMENT ADVISERS, LLC (the "Licensee"). To the extent a Third-Party Provider contributes intellectual property in connection with the Index, such third-party products, company names and logos are trademarks or service marks, and remain the property, of such Third-Pary Provider. Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Neither Bloomberg nor Bloomberg's licensors, including a Third-Party Provider, approves or endorses this material, or guarantees the accuracy or completeness of any information herein or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither Bloomberg nor Bloomberg's licensors, including Third-Party Provider, shall have any liability or responsibility for injury or damages arising in connection therewith.

REQ-ALLM