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When a Pair of Sneakers Sells for Almost $2 Million, Can Inflation Be Far Behind?

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Bitcoin is regularly trading at over $50,000. A pair of Kanye West's Nike Air Yeezy 1 sneakers was snapped up for $1.8 million. Christie's sold an NFT (non-fungible token) in the form of a video by the digital artist Beeple for $69 million at auction. These are just a few of the eyebrow-raising headlines that indicate extreme levels of optimism about the economy.

While many investors who are anxiously buying into Bitcoin probably can't explain what they are actually investing in, it looks likes cryptocurrencies have to be taken seriously. S&P Dow Jones has just launched three new indexes—S&P Bitcoin Index, S&P Ethereum Index, and S&P Crypto Mega Cap Index—with the promise to add other coins later this year. And there's a good chance that the SEC will approve the first Bitcoin ETF in June.

The $1.8 million sneakers are another story altogether. Kanye West's shoes weren't bought by a hero-worshipping fan but rather by the investment firm Rares, which plans to offer shares in the sneakers as an investment. And speaking of sneakers, there's also a blossoming cottage industry of individuals trading in affinity sneakers, limited edition shoes that are often resold at a considerable markup. This limited-edition sneaker resale market is estimated at well over $2 billion a year and has been predicted to be as large as $6 billion by 2025.

What does all this unusual economic activity mean? For one thing, it seems like a sign of a cavalier "it's only money, there's plenty more where that came from" attitude. It's definitely an indicator that people are not being conservative with their investments. It's also a sign that there's just been so much money printed out there. That has helped reduce the amount of distressed debt outstanding and major banks are all releasing reserves that they had taken onto their balance sheets during Covid because the expectation now is that we're in recovery mode and the economy is going to keep growing.

According to the Bureau of Economic Analysis, we had a GDP increase of 6.4% in the first quarter of 2021, and some projections estimate it could be as high as 8% growth or more for the year. The unemployment rate should continue ticking down, maybe below 4% by the end of the year, but how that will all play out for the markets is the question still to be answered.

While the widespread optimism is understandable, I caution that many signs are pointing to a coming correction. There seem to be a number of asset bubbles in place right now, in addition to the head-scratching investments mentioned at the top. No one can predict when or if they'll deflate, some of them might go on for an extended period and some of them might suddenly burst causing a massive shock, but I have to wonder, who's going to be left holding the $1.8 million sneakers.

One of the biggest risks to the post-Covid recovery is the risk of inflation, which is especially relevant for fixed income investors since it decreases the value of their holdings at maturity. Treasury Secretary Yellen obviously had inflation on her mind when she recently indicated that interest rates might need to be raised to help pay for some of President Biden's ambitious spending proposals. She walked back that statement later in the day by saying, "I don't think there's going to be an inflationary problem, but if there is, the Fed can be counted on to address it," but I think her original statement might be closer to the truth.

There has to be an end to all this fiscal and monetary expansion at some point, although Fed Chair Powell recently committed to continue supporting our economic recovery by keeping rates at nearly zero for up to three years if necessary. In 2020, lawmakers passed massive new government spending measures and even more fiscal spending measures are expected this year. This will all help to ensure that the U.S. economy continues to grow in 2021. However, there is an increasing risk that all this stimulus is excessive and has thereby created ever-expanding asset bubbles which may cause systemic risk once they collapse.

And while increases to the consumer price index ("CPI") appear somewhat moderate at 2.6% according to Bloomberg, CPI overlooks asset inflation. Consider a few of the multiple indicators of substantial asset inflation of late:

- Stock markets at all-time highs
- Bitcoin near all-time highs
- Semiconductor prices +60%
- Copper prices hit highest level in decade
- Lumber, gasoline, soybean, and wheat prices all soar
- $12 TN in negative-yielding debt (lower yields = higher prices)

Recent stock market appreciation, along with numerous other signs noted above, increases the likelihood of a potential downward retracement in stocks. Additionally, several non-business-friendly political proposals, such as doubling capital gains tax rates and doubling minimum wages, seem to be gaining traction. Even so, most economists forecast the U.S. economy to continue growing rapidly during 2021 and that, fueled by the potential for additional stimulus, implies that equity markets should do fine this year.

With all that's going on it might make sense for investors to temper their optimism with a certain amount of caution. This is a time when it makes sense to look for hedging any risk a portfolio takes, particularly hedging for inflation and market risks. Those buying long should exercise due diligence and make sure that any company they invest in has a good business plan with a strong management team and a clean balance sheet without excessive debt and an ability to generate cash flow without so much speculation.