Midstream and Natural Resources: 2 months ago, we published "The Great Inflation Misdiagnosis," arguing that commodity capex – not Fed policy or GDP growth – is the key driver of inflation. Of the feedback we received, one question stood out: are commodities a less impactful driver of inflation for a modern "services economy?"

Surprisingly, data show that commodities drive inflation in today's "services economy," just as they did in the 1970s. How is this possible?

- First, the shift to "services" is often misunderstood as being driven by the Internet. It's not: *Housing* is the largest driver of the increase in services as a share of GDP (+20% since 1970). Homebuilding, financing, and utility inflation are all correlated with commodity prices.
- Second, transport and energy "goods" (motor fuel, heating oil) have stagnated as a % of GDP, but transport and energy "services" (airline tickets, electricity) have increased, and these "services" exhibit equally high correlations to commodity prices.
- Third, much of the shrinkage in "goods" – appliances, televisions, clothes, books – are categories with little/no relationship to commodity inflation, so the shrinkage in "goods" has actually increased the correlation of inflation with commodities.

Click here for our latest white paper, "The Great Inflation Misdiagnosis"

## MLP & Infrastructure

### Performance review

During the month of August 2022, the Recurrent MLP & Infrastructure Strategy generated net returns of +2.06%, lagging the Alerian MLP Index's (AMZ) +3.98% return by -1.92%. Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +4.99% (annualized, net of fees). Please see the performance section at bottom for more detail.

## Natural Resources

### Performance Review

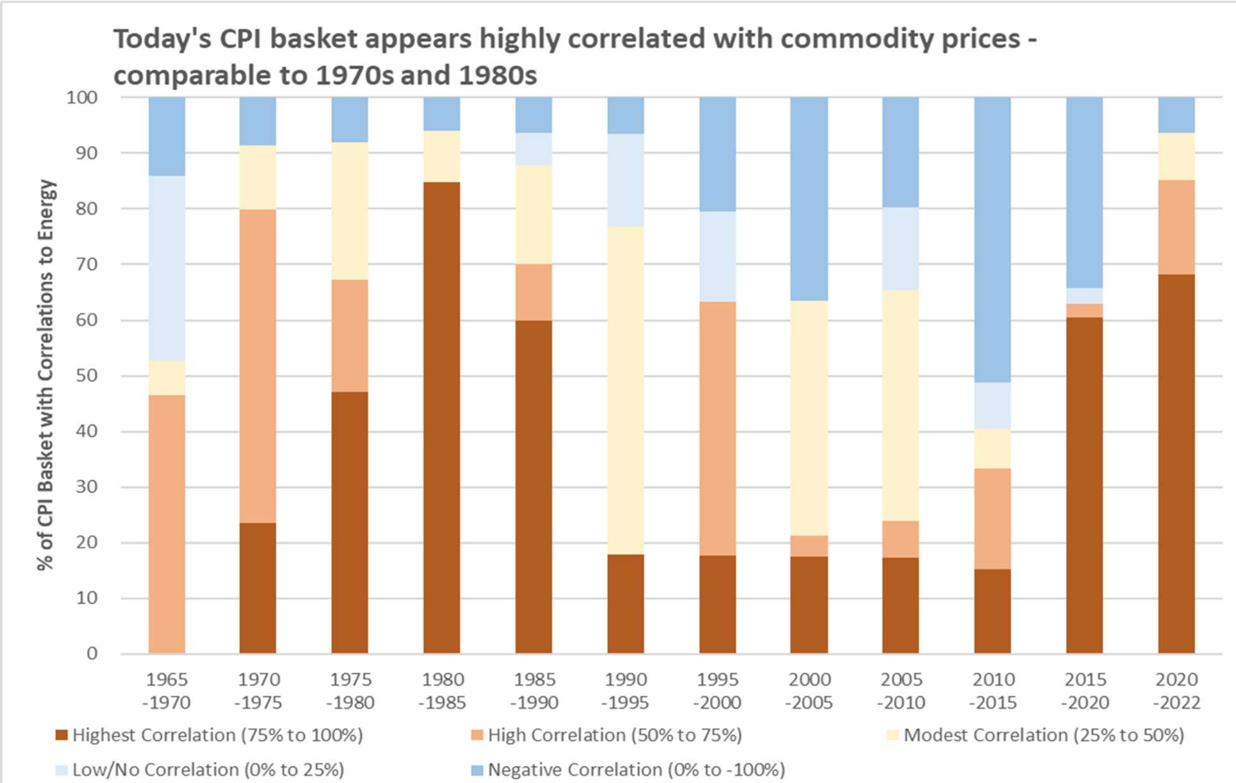
During the month of August 2022, the Recurrent Global Natural Resources Strategy rose by +0.96% net of fees, outperforming the S&P Global Natural Resources Index's +0.60% return by +0.36%. Since the strategy's June 2018 inception, Recurrent's Global Natural Resources Strategy has outperformed the index by +3.47% (annualized, net of fees).

## Following up on our recent inflation white paper

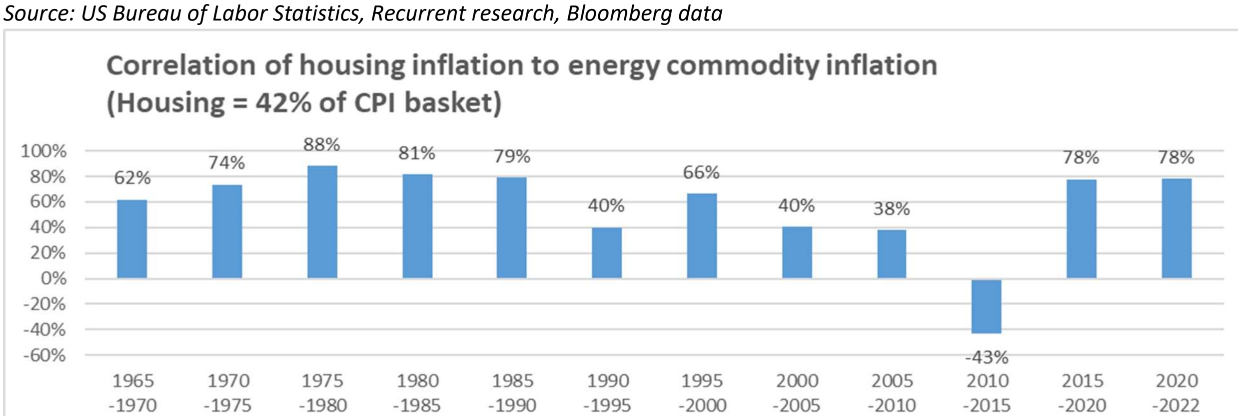
**The refrain of "we're a services economy now" oversimplifies, obscures impact of commodity inflation**

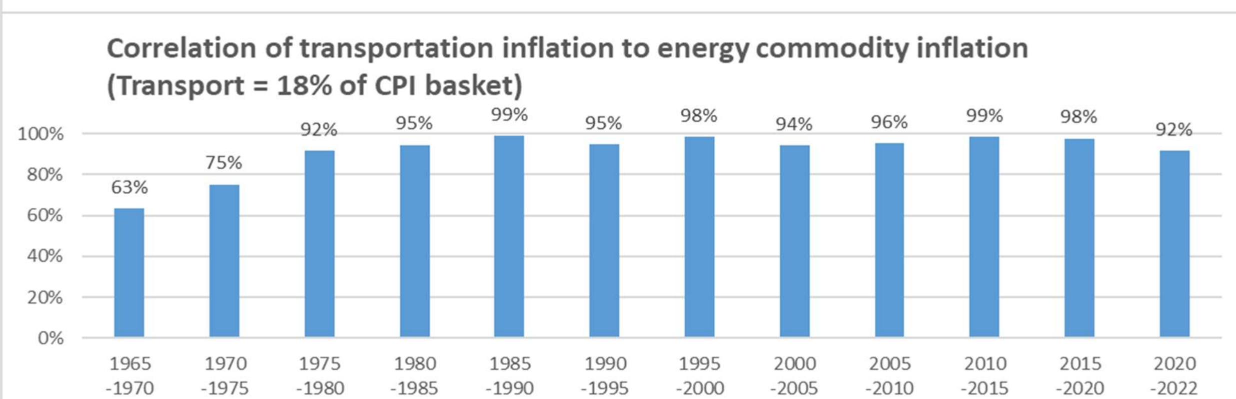
Many believe that the growth in "services" is composed of school tuition, cable TV, internet, cellphone plans… but those education and IT have contributed only +6% to the shift since the 1960s. Healthcare has contributed another +2%. The reality is that the increase in "Services" is disproportionately **Housing,** dwarfing all other service sectors' growth with +20% since the 1960s. Housing is a category which has historically been correlated to commodity inflation (building materials, interest rates/financing costs, rents, utilities – all correlated to commodity prices, with stronger correlations when prices are rising).

## The rise of the "service economy" has not reduced correlations between commodity prices and CPI




*Source: US Bureau of Labor Statistics, Recurrent research, Bloomberg data*




*Source: US Bureau of Labor Statistics, Recurrent research, Bloomberg data*

### A more accurate description is that "we're a housing and transportation economy now"

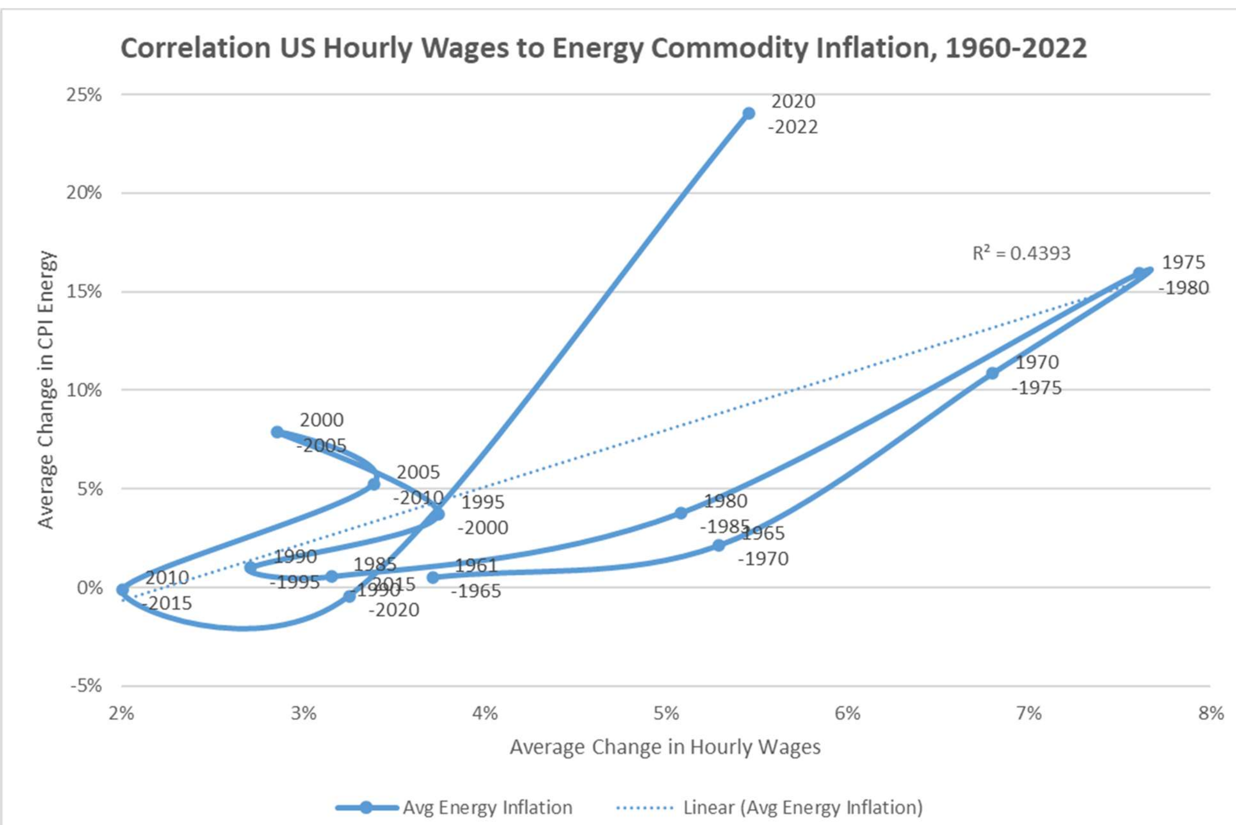
So while many believe "services" to be largely "non-physical" expenditures like a doctor's visit or paying the phone bill, the reality is that **70% of services**, or **60% of the total CPI spending basket** – actually consists of **housing** (42% - rents, maintenance, utilities) and **transportation** (18% - motor fuel, auto purchases, air travel) – which are highly correlated to energy prices, but are included under "services."

### Energy commodities drive CPI inflation via housing and transport (in goods and services) - how else?

As shown above, commodity inflation currently appears correlated to 80% of the CPI basket – a relationship between commodity inflation and broad CPI not seen since 1970-1985. The thesis that "increasing services should reduce the influence of commodity prices" does not appear to be supported by the evidence. Commodity price spikes seem to be correlated with inflation across housing and transport, and to a lesser extent categories such as food (food is 14% of CPI, vs. 42% for housing and 18% for transportation, for an aggregate of 74% of the CPI basket).

### Increased correlations between energy prices and various services suggests that commodities are being passed through to consumers via higher wages

Today, there is more correlation between energy prices and food **services** inflation (restaurant dining) vs food **goods** inflation (groceries). This suggests that **wages** are a possible way that commodity prices are driving inflation, and that potential food **goods** inflation (resulting from the war in Ukraine and fertilizer shortages) have not yet appeared in the data. Below, we can see that while wage growth has not returned to the high levels of the mid-1970s, we do see that wage growth is accelerating and has reached levels not seen since the early 1980s.




*Source: US Bureau of Labor Statistics, Recurrent research, Bloomberg data*

### It appears that even a services-oriented economy requires commodity investment to maintain low inflation

Many investors and economists have expressed optimism that today's services-oriented economy would exhibit less of the "commodity-dependence" of the US economy of the 1970s and 1980s. This belief was driven by two assumptions, only one of which seems at least partially supported by evidence.

1) Inflation in a "service economy" should be less impacted by commodity inflation.
2) De-unionization should prevent a significant pass through of commodity inflation via wages

#1 seems at odds with the evidence, as inflation in many service categories are now exhibiting high correlations to commodity prices, since many services are simply transfers of commodity consumption. #2 seems more supported by evidence, as commodity prices have triggered wage growth, but not at the record levels of the mid-1970s, despite comparable energy price inflation.

As a result, we would expect that long-term inflation to remain elevated as long as commodity investment (in real dollar terms) remains in the bottom quartile of the long-term historical range, despite our GDP's shift to a higher composition of services.

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