

Get your leading and lagging the right way round

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From Mr David Ranson.

Sir, Richard Bernstein correctly reminds us that "financial markets lead or forecast the economy" ("Investors must be wary of the US inflation bandwagon", Insight, July 10). But he finds it "curious that investors are paying so much attention to US inflation because it is a notorious lagging indicator".

I heartily support the idea of distinguishing carefully between lagging, coincident and leading indicators, and getting them right would clear up much of the confusion surrounding the whole inflation issue. Unfortunately, Mr Bernstein himself has his indicators hopelessly confused.

First, inflation is a process and not a statistic, so it cannot of itself be an indicator of any category. Leading indicators of inflation include commodity prices; lagging indicators include the consumer price index. Credit expansion may or may not be an inflation indicator at all, because it depends on the willingness of financial institutions to lend as well as that of borrowers to borrow. Indicators are readily subjected to empirical testing, so there's no excuse for getting them wrong. In the US, the time interval between the earliest group of leading indicators (prices of precious metals) and what is perhaps the longest lagging group (indexes of average wages) is many years long.

Pointing out that Treasuries have outperformed the S&P 500, Mr Bernstein omits to mention that this has been true only part of the time, and usually by a narrow margin. Much more telling is the fact that hard assets such as commercial real estate and commodities have outperformed both Treasuries and the S&P by double-digit percentages over the past several years.

It is Mr Bernstein of whom investors "must be wary". Those who made inflation bets in the past few years have already profited mightily at the expense of others.

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