

QUANTITATIVE ESTIMATION OF INFLATION PERCEPTIONS

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Is It Cold In Here?

Objective (Homo Economicus)

Measurement



Perception

*"How cold is it in here?"
"It is $68 \pm 1^\circ$ in this room."*

Subjective (More Normal)

Measurement

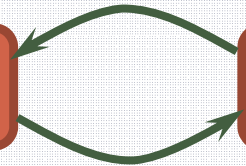


Perception

*"Is it cold in here?"
"I'm freezing!"*

Behavioral Feedback

Measurement



Perception

*"Is it cold in here?"
"Not any more, I just put on
a jacket."*

Bernanke: "Undoubtedly, the state of inflation expectations greatly influences actual inflation and thus the central bank's ability to achieve price stability."

Inflation Expectations and Inflation Forecasting. *At the Monetary Economics Workshop of the National Bureau of Economic Research Summer Institute, July 10, 2007*



Inflation Measurement Is Analogous To Temperature Measurement

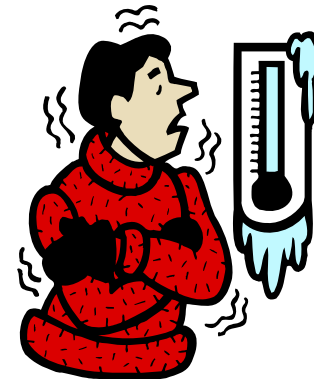
Consumer Price Index (CPI)::Average temperature in the U.S.



Local CPI::Average temperature in NY

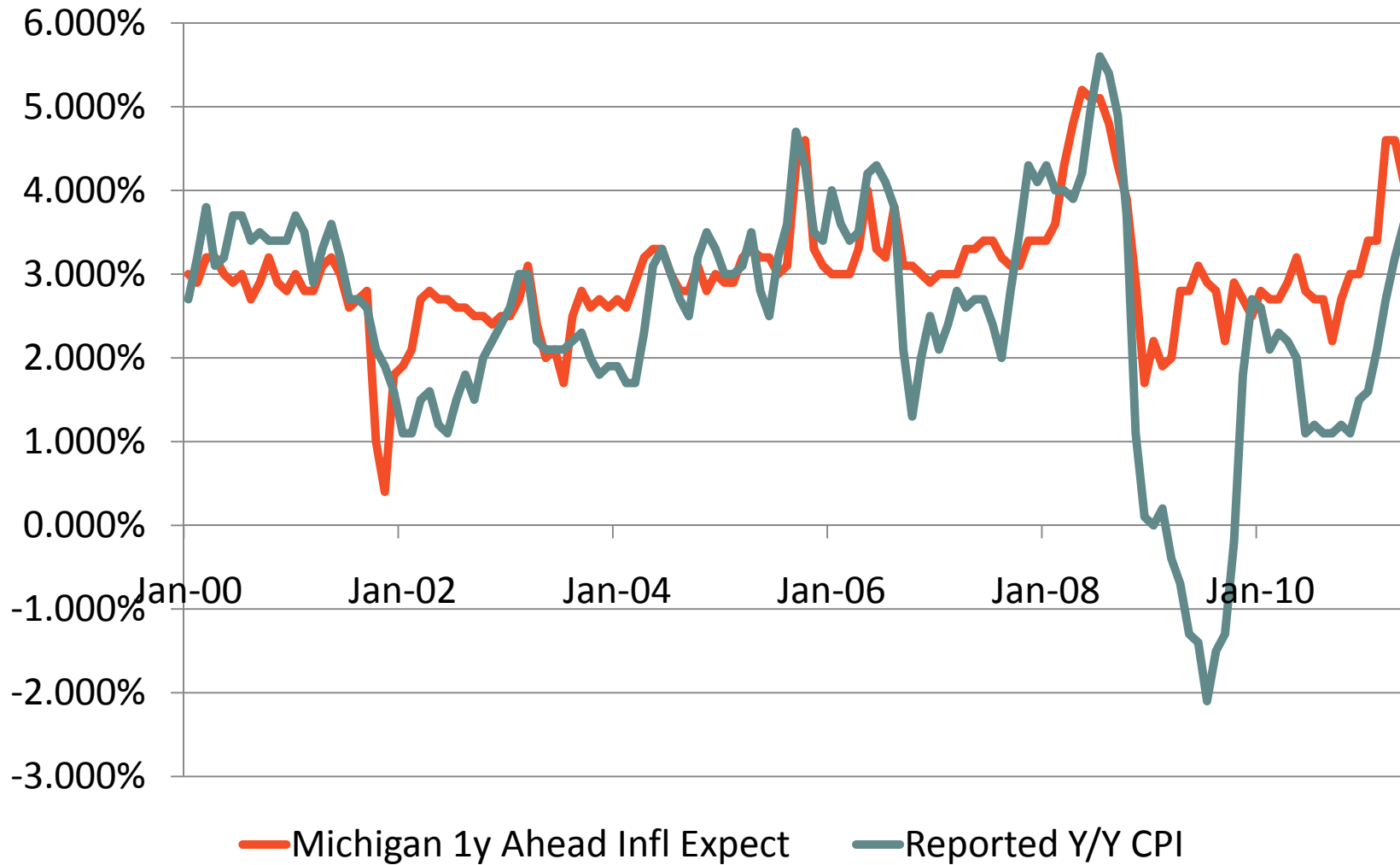
Perceived CPI::Wind Chill

$$T_{wc} = 35.74 + 0.0215T_a - 35.75V^{0.16} + 0.4275T_aV^{0.16}$$



What's Wrong With Surveys?

Michigan Survey vs Reported CPI



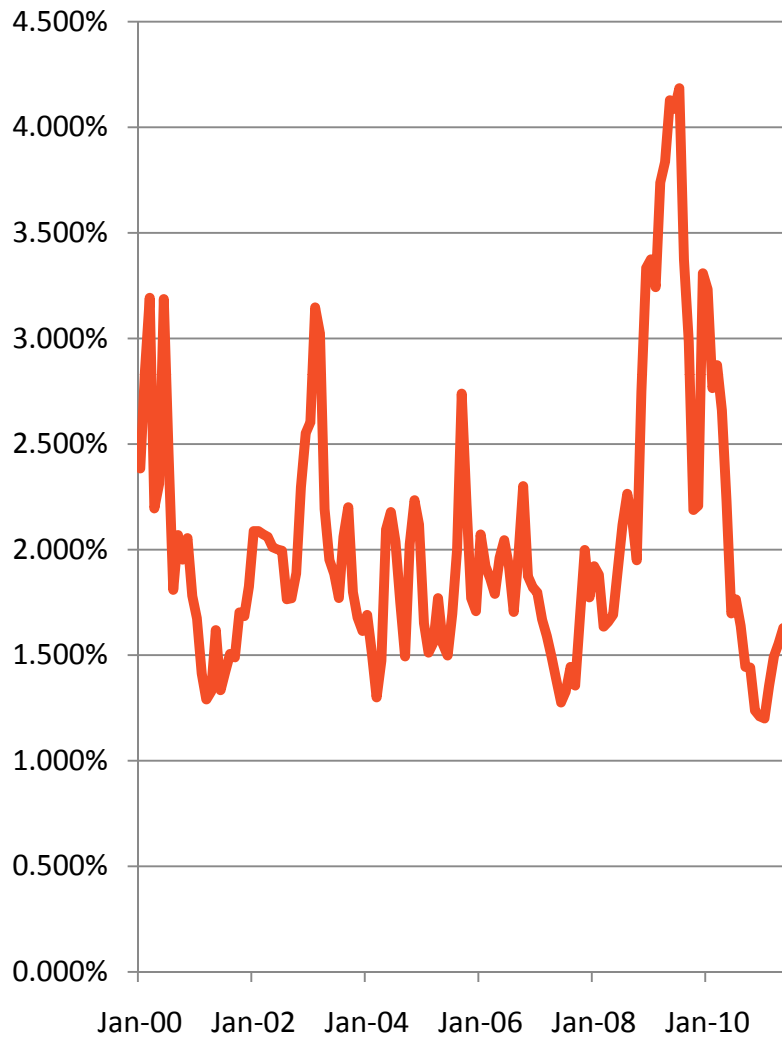
Some Cognitive Errors That Operate On Inflation Perceptions

- Loss Aversion
- Attribution Bias
- Mental Accounting
- Recency Bias
- Volatility as Velocity
- “Imputed Costs” Hard To observe
- Taxes Suck



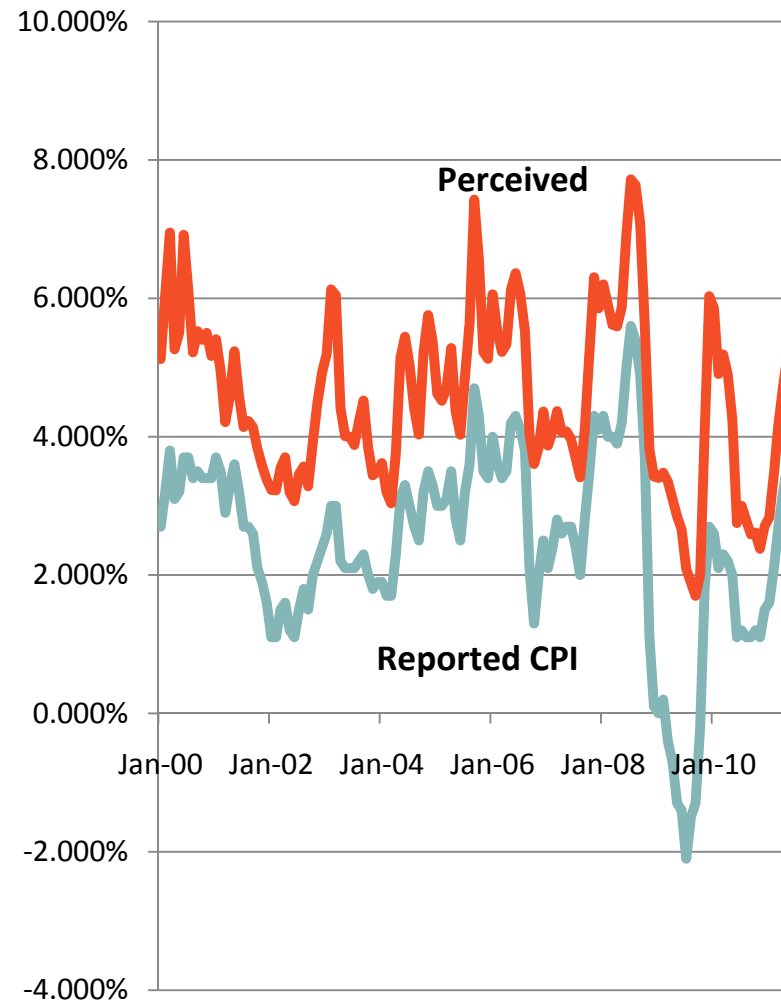
Crisis Volatility...

Aggregate Adjustment for $\lambda=0.7$



...Blunted Sense Of Deflation

Perceived Inflation vs Reported CPI for $\lambda=0.7$



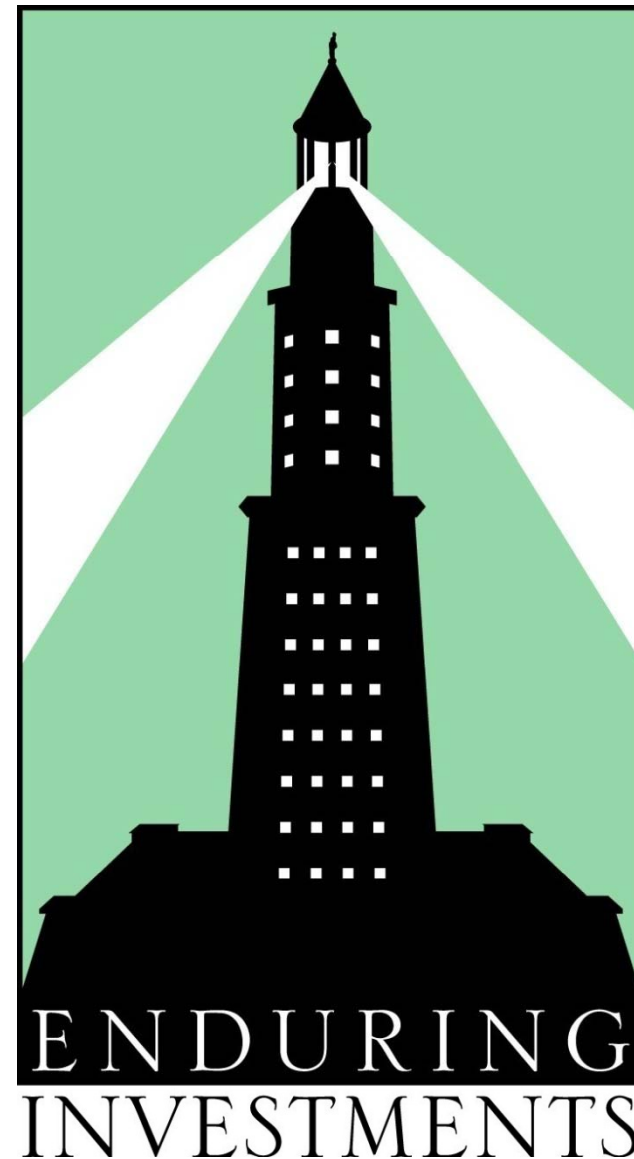
Link to Paper: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1661941



Enduring Investments is a boutique consulting and investment management company offering focused inflation-market expertise to solve general as well as specific, “niche” problems in inflation.

We use our advanced understanding of inflation-linked bond markets to construct customized solutions for our clients and to exploit relative value anomalies for our clients’ benefit in both long-only and leveraged absolute return strategies.

Enduring Investments can solve those problems that other investment managers may believe are unsolvable.



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