

Stagflation Risks: Reassess Your Retirement Portfolio NOW

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Here's what stagflation means for your investments. Plus, specific strategies to protect your nest egg in this uncertain economy.

Robert Powell: What do retirement investors need to know about stagflation? Well, here to talk with me about that is David Marra. He's the Chief Investment Officer at Morgan Asset Management. David, welcome.

David Marra: Thanks, Bob. It's a pleasure to be with you again.

Powell: It's a pleasure to have you here. It'll be a pleasure to have you sort of walk us through, I guess, one, what stagflation is, maybe a little bit about its history, and then we can talk about what investors need to know about it.

Definition and Historical Context

Marra: Stagflation, as you're alluding to there, hasn't been with us. It's not quite with us yet, but it's concerning a lot of economists that it may be with us. The last time we experienced it in the US was in the 1970s and very early 80s. Obviously, stagflation is, from a terminology point of view, a combination of the words stagnation and inflation.

Normally these two things don't happen together. Stagnation is low economic growth. And we know what inflation is. We've just been through a bout of it and are still working our way through that. Normally, inflation doesn't happen when you have low growth, because with low growth, the economy is typically not fully engaged and you don't have inflation.

Current Economic Conditions

Marra: Tariffs right now, not only the actual tariffs but the threat of more tariffs, represent a very fast-moving situation. We have a high level of tariffs right now. The current estimates are about 15 percentage points in effective real tariffs for the United States right

now. And we used to have around, just if you went back a few months ago or a year ago, around 2% or maybe 3%. So they've ratcheted up a lot and that causes a supply shock.

From an economic perspective, what we're going through right now is a supply shock. In the 1970s, we also had a supply shock, and that was an oil shock, which caused the price of energy to go up and caused a lot of items across the board to become much more expensive. Growth came down as a result of that. Supply shocks like this are very sudden, where you're not going to be able to get all the items on the shelves you used to have. And the items you can get are going through a tariff wall, so they're going to be higher in price. That's what causes stagnation, higher prices, less efficient production. Production is being moved out of the most efficient places in the world today to less efficient places, at least initially less efficient places.

That's the stagnation side of it, and the inflation side of it is the tariff itself—it causes inflation.

Investment Strategies During Stagflation

Powell: Yes. So I know you've had a few busy weeks, as have many people throughout this period of uncertainty of back and forth and flip-flopping and whatnot and pausing. I'm curious what you think is the best course of action for investors. Is it to understand the historical risks of stagflation? And if so, how best to safeguard their investments should stagflation materialize?

Marra: So just first, before I go into that, just a couple of quick effects of inflation. One effect, particularly for a retiree, is it's going to erode consumer purchasing power. It's going to erode every consumer's purchasing power because of the inflation side of it. But it's going to erode, of course, any fixed income investors' purchasing power even more because inflation always erodes fixed bond payments' value. You get a fixed bond payment, you get your dividend payment, you're getting the same dividend payment, but all of a sudden now inflation is taking more and more of it away every month.

Impact on Retirees

Marra: That's what the consumer experiences. And just to point out why that's so serious for a retiree—if you compare the 1970s to today, the average retiree is living five years longer. That's about a third longer than it used to be in the 70s. So that's a lot in economic terms. You need to fund something that's five years longer, a third longer than you would have had in the 1970s. So we're talking about potentially very big impacts should stagflation materialize.

Corporate Impact

Marra: The second is from a corporate perspective. From the individual consumer or retiree's perspective to the corporate perspective, the stagnation means lower profits. It means either lower growth, lower margins, or both in combination, which will produce lower profitability. Lower profitability means for the retiree or any investor, they're going to get less return on their investments. Where we've had fantastic returns on investments averaged over the last 10 years in the United States, we're looking at dramatically lower returns on equity investments, for example, risk investments.

Historical Perspective

Marra: To put historical perspective on it, if you took the stagnation period from 1972 to 1982, roughly that 10-year period, the real inflation-adjusted return of the S&P 500 was negative 57%—negative 57% over that 10 years. So people lost half their buying power, their return over a 10-year period. Again, not to scare your viewers here or anything, we're not in a stagflationary environment now, but certainly the tariffs are creating an environment which would tend to lend itself to that.

Powell: Yes, so this is bad news, right? The cost of living goes up and my portfolio value goes down, or at least the equity portion of my portfolio goes down.

Marra: And my dividend payments are worth less to me. Yes.

Powell: Yes. Alright, more bad news?

Recession Risks

Marra: No, I mean, I think that the last piece of the bad news is, and again, this is not the base case of most economists, but stagnation itself, if it goes on too long, tends to, again, based on that 70s, early 80s experience, would tend to go toward recession. So it raises the risk of having the economy go into recession.

Fixed Income Investments

Powell: And what about for folks, retirees who might be depending on fixed income investments for their income in retirement? Does stagflation impact them at all?

Investment Recommendations

Marra: So that's a good turning point for, like, what should people do? Because it's clearly going to impact them depending on how they're invested. The kinds of things that are

inflation-resistant tend to be commodities. So think oil, think metals, think gold, think agriculture. Right now oil has come down in price. So oil may not be, in this particular bout of stagflation, should we go through it, maybe the best. It has worked in other periods. But certainly things like metals, gold is the most accessible metal for most people. Agricultural things, because people have to eat, right? So even if the price of agricultural goods goes up, people have to eat anyway, and they tend to shift what monies they do have away from discretionary investing into things that they just have to spend, so-called staples.

So those could be good hedges. Consumer staples themselves, thinking in terms of like stock categories, consumer staples, pharmaceuticals, utilities—utilities because they pay interest payments, to give you a little bit better equity return combined with a dividend payment return.

Those are things that also tend to perform well in a stagflationary environment. And the last one I think I'd mention is high-quality international investments. There's that favorite phrase that when the U.S. economy sneezes, everybody else catches a cold. I think that probably holds true now today. But I think probably most U.S. investors today, because just the last 10 or 15 years have been so great for U.S. equities, a lot of people were probably under-diversified relative to other developed markets like Europe, Japan, et cetera. It may be a good time to talk with an advisor and think about am I internationally diversified enough to the extent I could diversify myself away from U.S. equity risk.

TIPS as Protection

Powell: Yes. What about treasury inflation-protected securities, TIPS? Does that play a role?

Marra: Yes, yes, TIPS also at a time like this is a good diversifier within the bond part of the portfolio. That's correct. Yes.

Areas to Avoid

Powell: Yes. Where should people be reducing their exposure?

Marra: So-called cyclical is a good place to reduce it. The really bad cyclical is like consumer discretionary, which has performed very badly year to date, that sector. So stay away from consumer discretionary. As the name implies, discretionary is the things we tend to spend when we have lots of money, the extra money we have. And when people worry about not having extra money, when they're worried about inflation, when they're worried about their jobs potentially in the case of a recession, stay away from consumer discretionary.

And then the other thing is technology. There are some bright spots in technology—artificial intelligence, for example, is a bright spot within technology. But outside of the growth areas of technology like AI, hardware, semiconductors, traditional semiconductors now—those are areas that tend to get hard hit, and they have been hard hit so far this year.

Alternative Investments

Powell: So everywhere I go, David, there seems to be growing interest in alternative investments, private credit, private equity, et cetera. Where does that belong in this scenario?

Marra: Well, as you know, Bob, and some of your investors, some of your audience who follow you and me closely together, I'm an alternative investments portfolio manager. And I'm a strong believer in that because what we can do with alternative investments is we can bring hedging into the picture, which is active hedging, the ability to profit when the market goes down in a more direct way through sometimes options-based hedges or sometimes through shorting. These are the two primary ways. There might be some sort of futures-based as well.

But I'm a big believer in being able to hedge a portfolio, particularly in a time like now when you've got big tail risks. Tail risks means the potential for large drawdowns like we've sort of had so far. I mean, technology was down, go back just a week, week and a half ago, as of this taping, technology was down about 15 or 20%, depending on how you measure technology sector, and the overall market was down about 10%. So these are big drops for certain people who are drawing on these funds or need it. It's a big drop for anybody to look at their 401(k). And alternatives where hedging is involved can certainly, and certainly what I do is, it hedges those tail risks away.

Professional Financial Advice

Powell: Yes, so one of the things I'm fond of saying, David, with the articles that we publish by authors like yourself or the videos that we do, like the one we're doing right now, is that I'm not here to create a nation of do-it-yourself investors. My goal is to help people get from street level to curbside to maybe advisors' doorstep. And I think as I think about how someone might prepare for the possibility of stagflation and how they might prepare their portfolio for the possibility of stagflation, seeking the guidance and counsel of a competent financial advisor is probably one of the best things that they could do now, especially if they're biting their fingernails and not knowing what to do.

Marra: I always recommend that and I particularly recommend it now. And I'm glad you mentioned it because this is a complicated time that's actually changing very fast. As a portfolio manager, I mean, since the early days of those initial days of COVID, myself included, nobody's been busier in our lives than right now because the situation is constantly changing. COVID was a shock and we all had to deal with it as portfolio managers. But this is an ongoing shock. It's a sort of a shock every day and from slightly different directions.

So there's a lot to keep up with. I mean, what we're saying in the industry, and the industry meaning portfolio managers like myself, nobody's able to take vacation. I mean, that's just, I mean, that's impossible because the environment is so fluid. And so I think a good financial advisor who keeps up with who are the portfolio managers like myself who are appropriate for the kind of portfolios and clients that they deal with is the kind of advisor you want to seek out because this is, for the most part, this is not an environment where, unless you want to just sit in front of a screen eight hours a day, it's not an environment for people to really be doing it yourself, I don't think.

Conclusion

Robert Powell: Well, David, we covered a lot of ground. Anything we missed or just bears reemphasizing before we wrap up?

Marra: The only thing I would like to end on a positive note, which is, you know, the things that we've talked about are definite things that have worked in the past. They've worked year to date to soften the blow. And I do believe that, you know, it's good advice that could work moving forward. But, you've got to find, as we talked about, the right advisor and managers that fit your particular situation.
