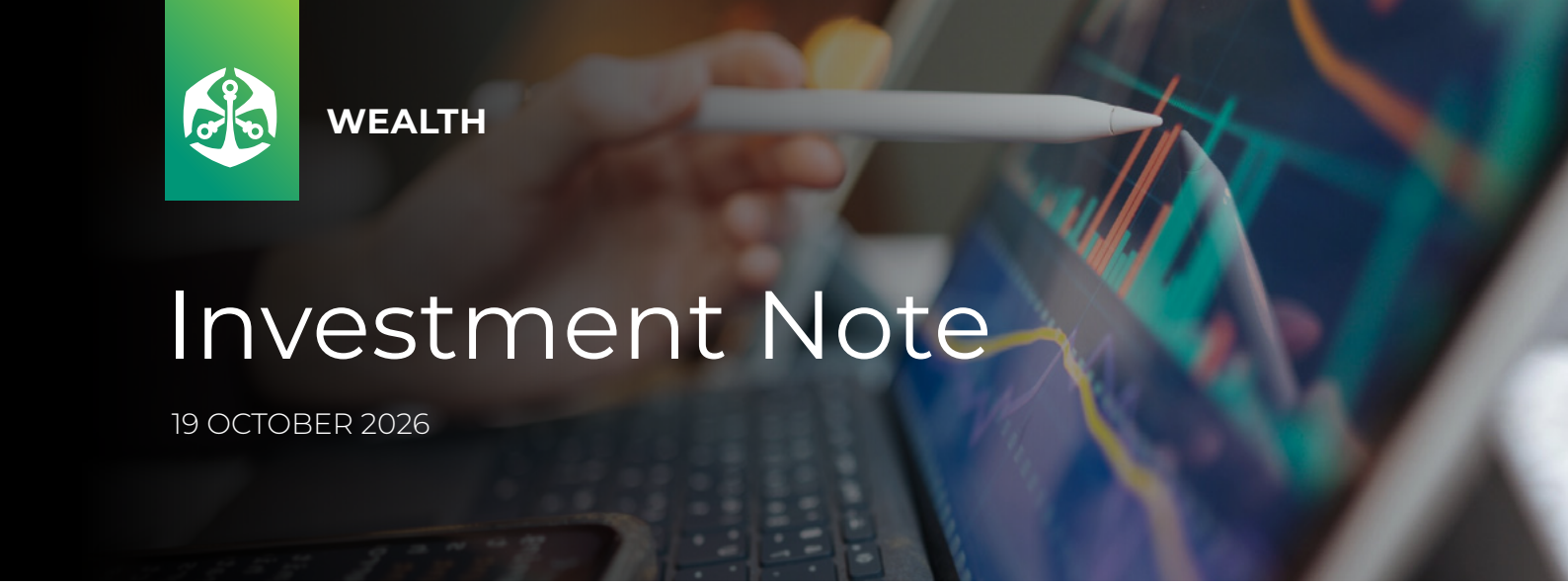


WEALTH

Investment Note

19 OCTOBER 2026

INFLATION AND OTHER FRUSTRATIONS



Izak Odendaal
Chief Invesmtent Strategist at Symmetry

Synopsis:

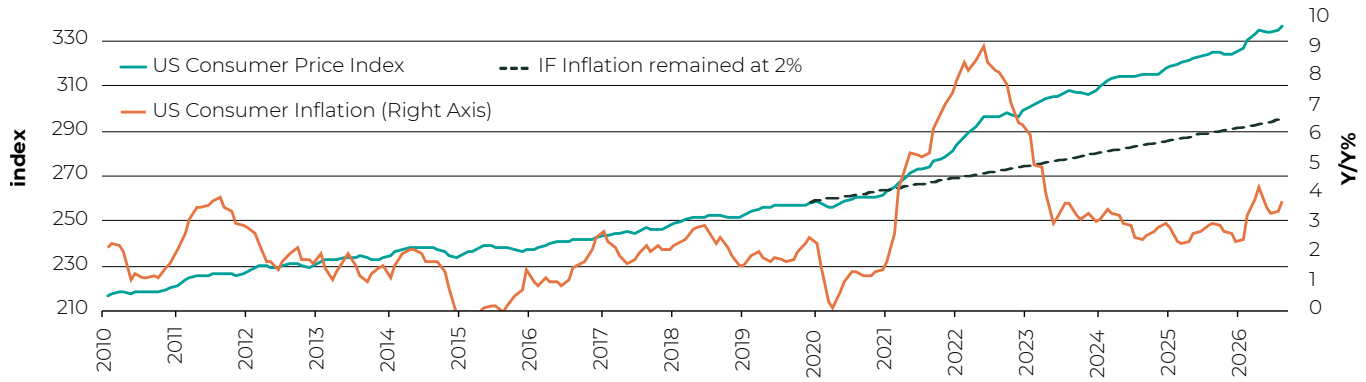
- Inflation influences markets, but the bigger impact is on the financial position of ordinary people. In democracies, this frustration is often expressed at the voting booth.
- US inflation has remained above the Federal Reserve's 2% target for more than five years. It recently started rising again due to higher fuel prices.
- The higher fuel prices, caused by the war with Iran, have added to existing frustration around affordability for households.
- All of this suggests that the Republican Party will lose substantial ground in the upcoming mid-term elections, despite the US economy performing well when measured from a top-down point of view.
- However, rather than resulting in dramatic change, it is likely to cause political stalemate. From an investor's point of view, this is not a bad outcome over the short term.
- Over the longer term, gridlock and political division means the US, along with other Western countries, will struggle to tackle the major challenges of our time.

When US inflation rises, it is a problem for all of us. Higher inflation puts upward pressure on US interest rates and the dollar. A stronger dollar weakens other currencies, raising the cost of imports in those countries. At worst, interest rates in far off places like South Africa can rise due to inflation in America. However, it is an even bigger problem for Americans themselves and is likely to play a role in the upcoming mid-term elections.

Inflation refers to the pace at which the cost of a broad basket of goods and services increases. This is usually measured as the annual rate of change of a consumer price index or similar measure. It doesn't refer to whether things are cheap or expensive. Goods or services can experience high inflation (rapid price increases) and still be cheap. The opposite is also true. Switzerland is considered one of the world's most expensive places, even though inflation is very low at only 1% as per its September data.

Broadly speaking then, the "cost of living" refers to the level of the price index. "Inflation" refers to the annual change of the price index, as shown for the US in chart 1.

CHART 1: US CONSUMER PRICE INDEX LEVEL AND RATE OF CHANGE



Source: LSEG Datastream

After averaging around the Federal Reserve's 2% inflation target over the prior decade, inflation surged to 9% in the wake of the post-pandemic reopening. Things eventually calmed down, but inflation has averaged around 3% since 2023. It has been five years since the Fed's target has been achieved. The dotted line shows where the cost of living would have been if the annual inflation rate remained at 2% over this period. The cost of living in the US is 30% higher than it would have been otherwise, a substantial increase that has resulted in enormous frustration in a country used to relatively stable prices.

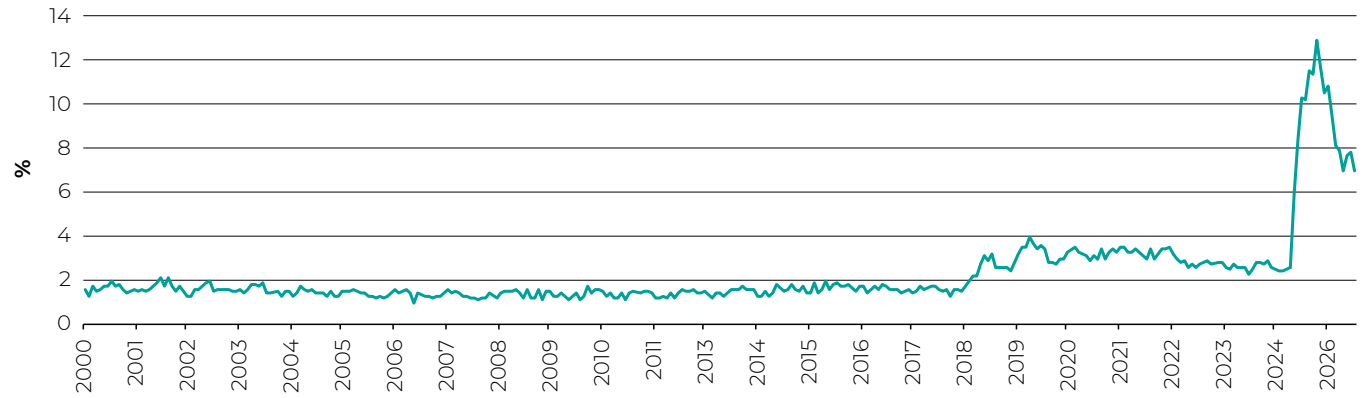
In other words, though the great inflation shock of 2021 and 2022 has faded, it has left a permanent mark on the price level and the cost of living. This played a big role in the Democratic Party losing the White House and Congress in 2024. Many incumbent political parties in other countries were voted out that year. This year, inflation is similarly likely to hurt Republicans, especially since

Donald Trump explicitly ran on a platform of improving affordability for ordinary folk, vowing to bring inflation down "on day one." Instead, the inflation rate has risen.

TRUMPFLATION

Inflation is a complex economic phenomenon, and not the fault of any one person. However, two of President Trump's most notable decisions caused higher inflation over the past year. The first was imposing sweeping tariffs on imported goods, which makes them more expensive. While some of the tariff impact was absorbed by exporters, most of the burden fell on American businesses and consumers. Even though some tariffs were struck down by the Supreme Court, others remain and the average effective tariff rate is still well above where it was before Trump took office last year.

CHART 2: US EFFECTIVE AVERAGE IMPORT TARIFF RATE



Source: LSEG Datastream

Trump's other consequential act was attacking Iran, despite promising not to start any foreign wars, and seemingly without considering that it might lead to a massive disruption in global oil supplies. As a result, crude oil is 75% more expensive than it was at the start of the year. Retail gasoline (petrol) and diesel prices have risen even more, because of pressure on global refinery capacity, including war damage to Russian refineries.

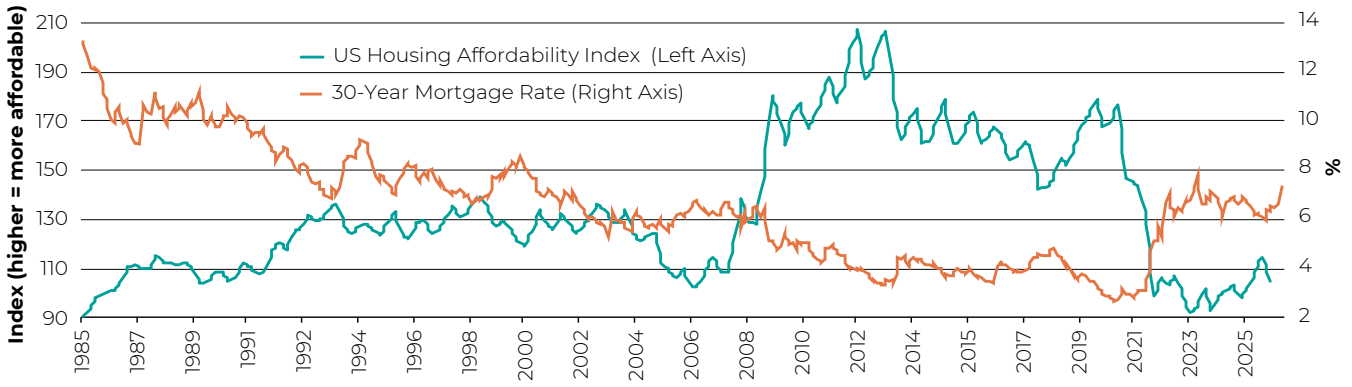
The average gasoline price is now $4.30 per gallon, while the average diesel price is $6.17 per gallon. At the start of the year gasoline cost $2.80 and diesel $3.40. Higher fuel prices pushed CPI inflation to 3.7% according to the latest data. After initially adopting a wait-and-see approach, the Fed hiked its policy interest rate in September. It is likely to do so again, but probably not until after the elections to avoid any suspicion of political motive. Given the uncertainty of the situation – oil prices can drop rapidly if a ceasefire agreement of sorts is reached – and the fact that the negative impact on consumer finances limits the ability for companies to pass on cost increases, there is no need for the US central bank to charge ahead with rate hikes. The same is true for the South African Reserve Bank.

UNAFFORDABLE

The "affordability crisis" Americans often talk about is not just about the cost of fuel and imported goods. The cost of healthcare and housing are also major concerns. US mortgage rates are not directly linked to the central bank's policy rate, as in South Africa. Rather, they follow government bond yields. Therefore, even though the Fed has hiked rates only once, mortgage rates have risen substantially this year, a direct consequence of the Iran war and the oil price shock.

Mortgage rates fell to record lows in 2020, and many homeowners who locked in those low rates don't want to sell now and lose their attractive financing terms. This has constrained the supply of homes on the market, keeping house prices elevated to the benefit of existing homeowners (often older people) and to the detriment of prospective buyers (usually younger families). The other factor in the housing affordability equation is income. Depending on the measure, wage growth has slowed to below 4% in recent months, which means it is flat to negative in real terms.

CHART 3: US HOUSING AFFORDABILITY INDEX AND AVERAGE MORTGAGE RATE



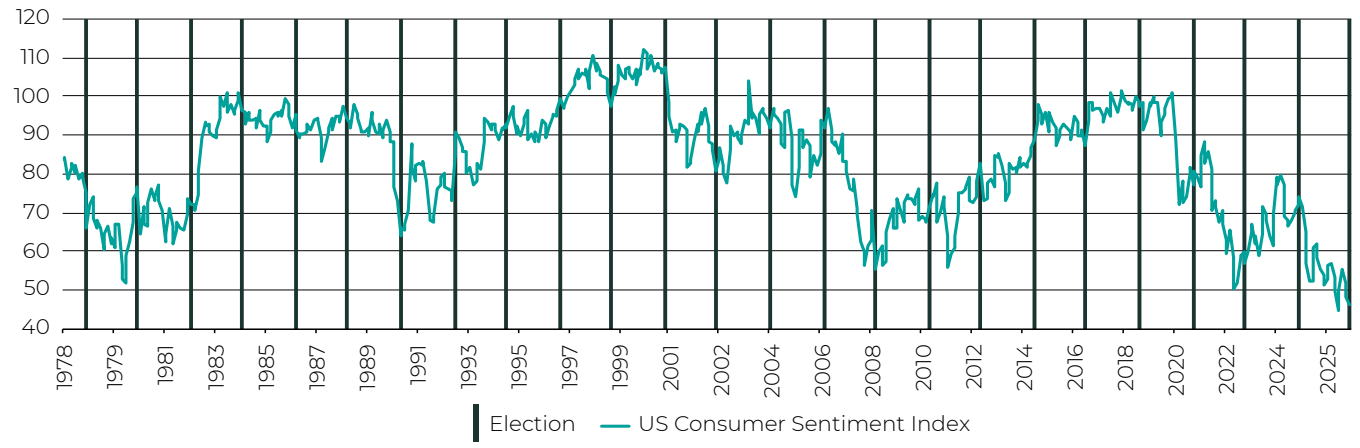
Source: LSEG Datastream

The Federal Reserve Bank of Atlanta produces an index of the affordability of purchasing a house which incorporates those three elements – prices, mortgage rates and incomes – averaged nationwide. As chart 3 shows, housing affordability is hovering near multi-year lows.

All of this results in a paradox. On the one hand, the US economy is posting the best GDP growth among larger developed economies, boosted by the AI boom.

Unemployment is near multi-decade lows at 4.2%, while the equity market is near record highs. On the other hand, the long-running Consumer Sentiment Index produced by the University of Michigan is below levels seen during the great recessions of 2008 and 1981. It has never been this low on the eve of an election (indicated by the vertical lines on the chart) in the last 50 years.

CHART 4: US CONSUMER CONFIDENCE AND ELECTIONS



Source: University of Michigan

In simple terms, people are unhappy. Some of this might reflect skewed perceptions because so many of us live in social media echo chambers these days. But it also highlights real financial strain, especially for lower income households who lack savings buffers and do not have exposure to the high-flying stock market. Consumer spending has held up well in part due to higher income earners spending freely, but affluent and lower income voters each only have one vote.

ELECTION OUTLOOK

This is likely to impact the outcome of the 3 November mid-term elections. While Trump still has a loyal base of supporters, their support is not enough. What matters on election day is how many of your own supporters bother to show up, and whether you can convince independents to vote for you. With the president not on the ballot in the mid-term elections, voter turnout is usually lower, tending to favour the opposition (the Democrats in this case). As for independent voters, they are very unlikely to support the incumbent party in large numbers given the unhappiness described above.

Therefore, it is widely expected that Democrats will regain control of the House of Representatives, the lower house of Congress, where Republicans have a slim majority of 218 seats against 214. All members of the House are up for re-election every two years.

The Senate race is a closer call, since it depends on which individual senators are up for re-election and which states they represent. Since the 100 Senators serve 6-year terms, only a third are on the ballot every two years. Of these only 10 to 12 are considered competitive races, with the remainder “safe seats” for their respective parties. If there is a 50-50 tie in the Senate, Republicans will retain control since the vice-president will have the decisive vote. Table 1 summaries potential outcomes in terms of which party controls the various branches of government.

TABLE 1: POTENTIAL OUTCOMES IN THE 2026 US MID-TERM ELECTIONS

	Presidency	House	Senate
1.	Republican	Republican	Republican
2.	Republican	Republican	Democratic
3.	Republican	Democratic	Republican
4.	Republican	Democratic	Democratic

Source: Symmetry



Scenario 1 is the status quo but is unlikely since the polls strongly favour the Democrats in retaking the House. Scenario 2 is also highly unlikely. If the Democrats win the Senate, they will almost certainly win the House.

Scenario 3 was seen as the most likely outcome for most of the year and is probably the outcome markets would likely favour in the near term. It will result in a form of gridlock, as the House cannot pass legislation without the Senate approving, so almost nothing will happen from a policy point of view. The House could still use its powers of subpoena to investigate into allegations of corruption in Trump's inner circle, which could result in a political spectacle.

The fourth scenario is the "blue sweep," and poses the biggest questions for investors. It was considered unlikely until recently, but polls increasingly point in this direction. In this outcome, Democrats could pass legislation that undermines Trump's agenda, for instance on taxation or foreign policy. However, the president can veto any legislation and return it to Congress. It can override this veto, however the two-thirds majority required to do so will be a stretch.

So even in scenario 4, the ability for Democrats to drastically alter policy is limited. They will be able to clip Trump's wings somewhat but not rein him in completely. Therefore, even a blue sweep should not have much of a market impact as there will be little fundamental change.

However, there is a risk that investors extrapolate to the 2028 election. If Democrats take control of both houses of Congress and the White House in 2028, there could be major policy changes. This could include AI regulation, healthcare reform, and higher company tax rates, factors that will have a material impact on expectations of future profitability. There could also be more social spending, impacting the deficit and the bond market. 2028 is still far away, however, and it would be premature to draw such conclusions now. After all, a week is a lifetime in politics, as the old saying goes. Two years is practically a millennium.

While markets would probably prefer gridlock after November, it comes with long-term downsides. The framers of the US constitution deliberately built checks and balances into the system so that nobody would have unfettered power. It worked well in earlier times when Republicans and Democrats would cooperate "across the aisle" to work on important legislation, but in today's hostile climate, it is a recipe for inaction. The US political system is increasingly unable to respond to the big challenges of our age: rising public debt, ageing populations, climate change and the uncertain impact of AI.

Two final points, also with South Africa's municipal elections in mind. Most of the focus tends to be on politicians, parties and personalities. But what matters for portfolios is policy. It is changes in government policy that influence the economy and markets. Therefore, it is policy that we should keep an eye on. Secondly, remember that elections is a particularly lucrative time for media houses and social media platforms. They have every incentive to keep audiences engaged and clicking. However, this doesn't mean that investors should react to every headline.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	4 908.0	-1.09%	0.10%	10.79%	14.35%
United States	S&P 500	US$	7 659.0	-1.96%	0.09%	11.88%	14.81%
Europe	MSCI Europe	US$	2 763.0	2.52%	0.69%	4.54%	8.69%
Britain	FTSE 100	US$	14 506.0	3.87%	3.11%	8.40%	14.45%
Germany	DAX	US$	2 433.0	2.23%	-0.16%	3.54%	1.84%
Japan	Nikkei 225	US$	413.4	-7.42%	-1.23%	28.65%	28.82%
Emerging Markets	MSCI Emerging Markets	US$	1 621.0	-5.15%	-4.93%	15.46%	17.55%
Brazil	MSCI Brazil	US$	2 148.0	-3.72%	12.87%	30.50%	43.49%
China	MSCI China	US$	69.8	-1.63%	-2.34%	-15.46%	-19.00%
India	MSCI India	US$	910.0	4.21%	2.24%	-13.75%	-13.91%
South Africa	MSCI South Africa	US$	703.0	3.08%	1.74%	-5.38%	1.74%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	110 934.0	2.22%	2.24%	-4.23%	-1.85%
All Share	All Share (Total Return)	Rand	21 740.0	2.31%	2.61%	-0.69%	2.14%
TOP 40/Large Caps	Top 40	Rand	19 919.0	2.51%	2.77%	-0.96%	1.41%
Mid Caps	Mid Cap	Rand	31 853.0	1.98%	3.50%	-3.26%	1.59%
Small Companies	Small Cap	Rand	55 891.0	1.23%	0.98%	3.92%	11.10%
Resources	Resource 20	Rand	11 251.7	1.73%	1.81%	2.17%	3.12%
Industrials	Industrial 25	Rand	27 652.0	2.15%	4.53%	-10.91%	-13.23%
Financials	Financial 15	Rand	21 230.0	3.71%	2.34%	6.33%	18.16%
Listed Property	SA Listed Property	Rand	3 239.4	0.12%	-0.17%	3.23%	15.04%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government Overall (USD Unhedged)	S&P	US$	73.4	0.90%	0.64%	-4.28%	-5.58%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 429.0	0.87%	0.75%	4.31%	12.13%
Government Bonds	BESA GOVI	Rand	1 401.7	0.88%	0.77%	4.26%	11.98%
Inflation Linked Bonds	BESA CILI	Rand	459.0	-0.63%	-1.15%	5.59%	13.50%
Cash	STEFI Composite	Rand	674.3	0.13%	0.30%	5.45%	6.97%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	109.9	4.91%	12.10%	80.10%	80.10%
Gold	Gold Spot	US$	4 185.0	-0.21%	-0.21%	-2.86%	-1.16%
Platinum	Platinum Spot	US$	1 643.0	-3.35%	-4.20%	-18.22%	-1.50%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	16.48	0.18%	-0.35%	0.48%	5.21%
ZAR/Pound	ZAR/GBP	Rand	21.96	-0.46%	-0.82%	1.55%	6.06%
ZAR/Euro	ZAR/EUR	Rand	18.52	-0.17%	0.48%	5.01%	9.44%
Dollar/Euro	USD/EUR	US$	1.12	0.00%	1.16%	4.82%	4.46%
Dollar/Pound	USD/GBP	US$	1.33	-0.72%	-0.23%	1.28%	0.53%
Dollar/Yen	USD/JPY	US$	0.01	-0.17%	0.40%	0.87%	5.04%

Source: I-Net, figures as at 16 October 2026

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