U.S. demographics and labor trends

A long-term recipe for stagflation?

BY TOM COUGHLIN, CFA, CMT

Tariffs have dominated discussions about inflation in 2025, and for good reason: they function as an incremental tax that consumers feel shortly after implementation. However, the market's recent focus on tariffs overlooks the long-term structural drivers of inflation that have strengthened in recent years. We believe market participants will be disappointed when they discover that inflationary forces – previously attributed solely to tariffs – persist in the coming years.

The U.S. Federal Reserve is correct in assessing tariffs as having a one-time effect on inflation as retailers pass through the higher costs of goods. Once tariffs are in place and enough time passes, the upward pressure they put on prices wanes.

Now, however, we are in a new secular regime regarding inflation. Higher fiscal deficits, reduced global trade, and stringent environmental regulations that impede investment in natural resources are certainly three components boosting inflation levels. But a particular concern is the changing labor force dynamics within the United States.

Key takeaways

- Looming U.S. challenges: An aging population, low fertility rates, and a reduction in the number of foreign-born workers (which was estimated to account for more than 100% of private-sector job gains in 2024).
- Possible risks: Upward pressure on wages, downward pressure on potential growth, and a U.S. economy more susceptible to stagflation in the long term.
- Implications for investors: Diversifying portfolios could get harder as the performance of stocks and bonds becomes more closely correlated in a higher inflation environment.
- Our response: In the future, we believe income-focused investing should look fundamentally different from the past. Think U.S. Treasury Inflation Protected Securities (TIPS), as well as exposure to cyclical equities and precious metals.

The demographic challenge

Economists often look at the life cycle of individuals and populations in a rather dispassionate way. When we are young, we are consumers. While we do not consume high levels of healthcare or require significant additional housing space, we also don't produce anything of tangible economic value. This all changes when we enter the workforce, gain experience, and, for the most part, become more productive with age. However, after a certain age, we again become solely consumers, only now we consume a lot more in terms of healthcare and housing. Higher levels of consumption and lower levels of production have historically led to higher prices, and we see this time as no different.

According to the Social Security Administration, 56.1 million Americans aged 65 or older received Social Security benefits in December 2024,[1] up from 37.2 million in 2010. More importantly, the ratio of older dependents relative to the working-age population has moved from 19% in 2010 to 28% in 2024. The World Bank projects this number to rise to 32% by 2030.[2] With fertility rates below 2% for the last 20 years, there is no means for the United States to grow the working population outside of immigration, which has recently come to a standstill.

Long-term labor supply and stagflation

Over the past four years the number of foreign-born workers in the United States has risen from 27.6 million to 32.7 million. Given the recent increase in native-born retirements, it is estimated that immigrants made up for more than 100% of net private-sector job gains in 2024. Put simply, without immigration, the U.S. labor force would be shrinking today and for the foreseeable future. If the country wants to grow and reduce the inflation pressures that an aging population brings, a sound immigration policy would seem like a logical solution.

While this is not intended to be any sort of political statement (both parties have failed on multiple occasions to address immigration policy), it is clear the president's hawkish stance on immigration is starting to have harmful effects on the economy. In fact, net migration has not just slowed to a halt: it will likely turn negative for the first time in 50 years as the administration signals that it will revoke the visas for more than 2 million asylum seekers in coming quarters. Obviously, the president is even less tolerant of the illegal immigrants in the United States. Regardless of anyone's feeling about undocumented workers, it is estimated they make up roughly half of the nation's crop workers, and large portions of the construction and hotel service industries. With deportations running at roughly 2,000 per day, these industries are starting to feel the effects. We expect these policies, if they are to continue, will put upward pressure on wages, and downward pressure on potential growth for the foreseeable future. This will increase the probability of a stagflationary environment unfolding in the United States. Though this is not our base case for the coming quarters, as fiscal stimulus will likely boost growth through most of 2026, we now see a path for such an outcome in the latter half of the decade.

Implications for investors

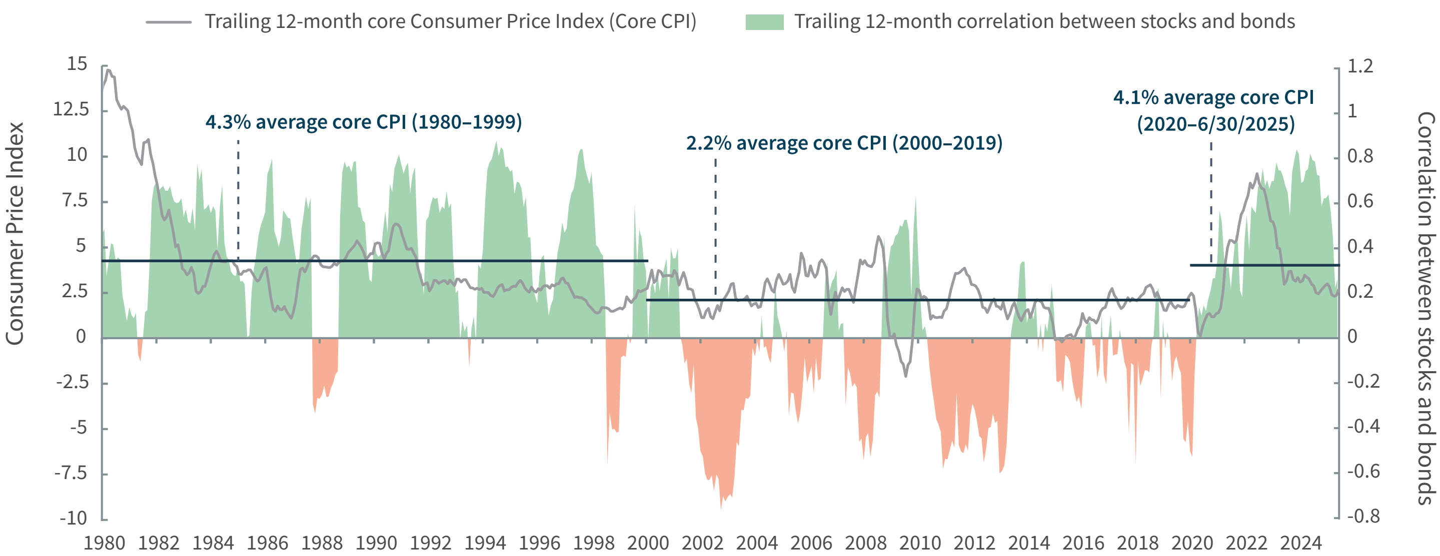
Investors should note that correlations between asset classes differ significantly between high and low inflationary regimes. During periods of low inflation, the Fed's primary concern is preventing deflationary spirals when the economy weakens. This explains why the Fed maintained extremely low interest rates while launching large asset purchase programs in the early 2000s. This was a key reason the 60/40 portfolio (60% stocks/40% bonds) performed so well during this period. The two asset classes were negatively correlated and served as effective hedges against each other: when stocks declined, bonds rallied due to low rates and asset purchases, and vice versa.

In higher inflation environments, however, the central bank's mindset shifts dramatically. The Fed quickly tightens monetary policy at any sign of economic acceleration to contain inflation, putting upward pressure on interest rates and downward pressure on both the economy and risk assets. Conversely, when the economy weakens, the Fed is less likely to intervene with aggressive monetary accommodation. As a result, stocks and bonds become more highly correlated, reducing the diversification benefits of the traditional 60/40 approach.

In this environment, adopting a diversified portfolio approach to income investing becomes essential. To help meet this goal, we focus on Treasury Inflation Protected Securities (TIPS) – fixed income instruments that adjust their principal value based on CPI changes – as a core holding. However, investors must recognize that longer-dated TIPS carry substantial interest rate risk, so we believe allocations should focus on the short- to intermediate-term portion of the TIPS curve.

While other fixed income products such as credit and mortgage-backed securities may offer yields above inflation rates, these instruments can also face pressure in a rising rate environment. To hedge against this risk and smooth overall returns, investors should consider adding a modest allocation to cyclical equities. The energy and materials sectors have historically shown the strongest positive correlation to rising rates. Notably, they represent the smallest sectors in the S&P 500 Index today, so investors should be proactive about adding exposure.

Higher inflation makes portfolio diversification harder

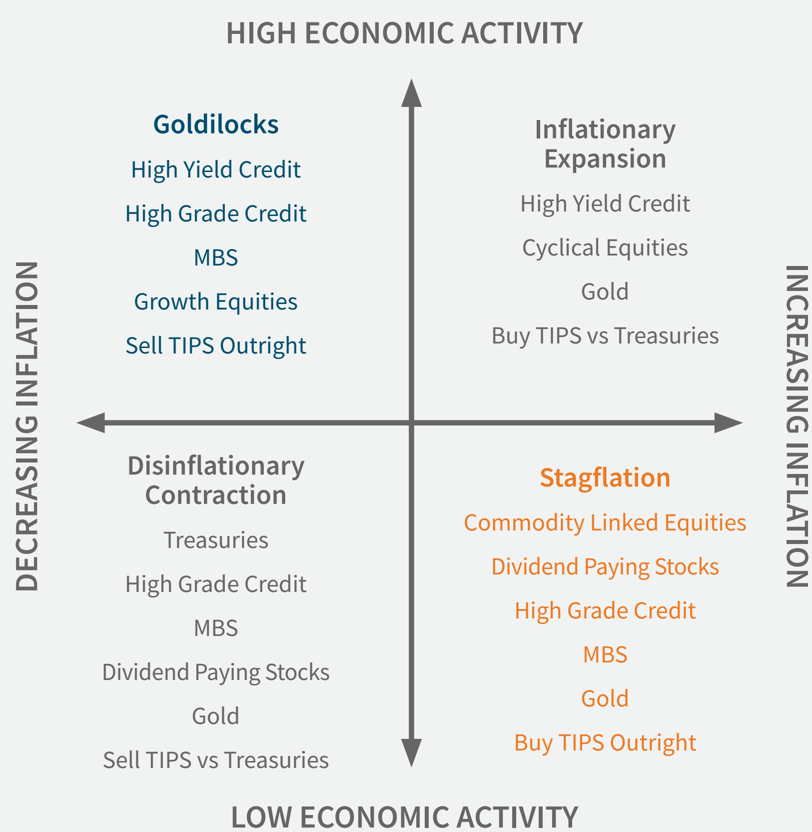


Source: Bloomberg, as of 8/12/25

Finally, commodities, in particular precious metals, typically perform well during periods of higher inflation, making them a potentially valuable portfolio component.

To navigate this changing environment, we at Chartwell Investment Partners believe income-focused investment products should look fundamentally different over the next 15 years from those investors have relied on in past decades. As inflation persists, we expect investors will become increasingly concerned with preserving the purchasing power of their life savings rather than pursuing nominal return objectives alone. A 5% return goal may sound reasonable for a fixed income portfolio, but it provides little value to retirees when inflation runs at 4% or higher. That's why we believe focusing on the real rates of return offered by U.S. Inflation Protected Securities (TIPS) in combination with a small allocation to cyclical equities and precious metals could help fixed income portfolios pursue returns above the core Consumer Price Index rate of inflation over a complete economic cycle of 3 to 5 years.

Different macro environments call for different investment approaches



[1] Social Security Administration. Monthly Statistical Snapshot, December 2024. U.S. Social Security Administration, Jan. 2025, https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/2024-12.html. Accessed Aug. 28, 2025.

[2] World Bank. Age Dependency Ratio, Old (% of Working-Age Population). World Bank Group, https://databank.worldbank.org/source/population-estimates-and-projections/. Accessed Aug. 28, 2025.

About the author

Tom Coughlin is a Portfolio Manager and Senior Analyst on Chartwell's Fixed Income investment team. He follows the information technology, telecommunications, and healthcare sectors. In addition, he also helps craft the team's economic and interest rate outlook. Prior to joining Chartwell, he was employed at Janney Montgomery Scott, LLC, where he held multiple analyst positions.

Tom earned a B.A. in Economics and History from Swarthmore College. He is a CFA® charterholder and member of both the CFA Institute and the CFA Society of Philadelphia. Tom also has the Chartered Market Technician (CMT®) designation.

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Definitions

Commodity-linked equities include companies with businesses and values tied to the price of a particular commodity, such as oil or precious metals.

The U.S. Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The U.S. Bureau of Labor Statistics bases the index on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 households and 22,000 retailers.

Core CPI, officially known as the "Consumer Price Index for All Urban Consumers: All Items Less Food & Energy," is an aggregate of prices paid by urban consumers for a typical basket of goods, excluding food and energy. This measurement is widely used by economists because food and energy have very volatile prices.

Correlation is a statistic that measures the degree to which two securities or variables move in relation to each other. Negative correlation, also known as inverse correlation, tracks the movement of two variables that tend to move in opposite directions, so that when one rises, the other falls.

Cyclical stocks have prices influenced by macroeconomic changes in the economy and are known for following the economy as it cycles through expansion, peak, recession, and recovery.

Deflation refers to a widespread decline in prices for goods and services in an economy. Deflation usually is associated with a contraction in an economy's available credit and money supply.

Dividend payers are the companies that distribute a portion of their profits to shareholders in the form of a dividend.

Fiscal policy refers to the tax collection and spending a government uses to influence its country's economy.

Growth investing is a stock-buying strategy that focuses on companies expected to grow at an above-average rate compared to their industry or the market.

Hawkish immigration policy generally favors more restrictions on immigration and more stringent enforcement of laws regarding legal immigration.

A hedge is an investment or investment strategy that is designed to lessen the potential for losses in other investments. The price of an investment considered to be a hedge often moves in the opposite direction of the prices of the investments being hedged.

High-yield bonds have credit ratings below BBB- from Standard & Poor's or below Baa3 from Moody's.

Investment-grade refers to fixed-income securities rated BBB or better by Standard & Poor's or Baa or better by Moody's.

Monetary policy refers to the decisions made by central banks to raise or lower benchmark interest rates or otherwise tighten or loosen credit to influence an economy's growth, inflation, or employment levels.

Mortgage-backed securities (MBS) are a securitized product created by pooling mortgage loans from a variety of sources and issuing bonds that are backed by these loans. Creditworthiness stems from the credit quality of the underlying loans, as opposed to corporate bonds in which creditworthiness is derived from the earning power of the issuing company. The primary risk of these securities is interest-rate risk. Rising interest rates might cause loan principal prepayments to slow, resulting in less available principal to invest at prevailing higher rates. Conversely, rate decreases might accelerate prepayments, leaving more dollars to invest at lower rates.

Net migration reflects total number of immigrants to a place minus the total number of emigrants who left that place over a specified period of time.

Nominal returns represent the annual percentage of profit returned on an investment without making adjustments for taxes or inflation.

Risk assets refer to investments such as equities, commodities, high-yield bonds, real estate, and currencies, where the value may rise or fall due to fluctuating interest rates, changes in credit quality, default risks, supply and demand disruption, and other factors.

Secular trends are large-scale and ongoing changes in economies and societies that have the potential to drive broad and lasting economic, technological, social or other kinds of changes.

A 60/40 portfolio is based on a widespread investment strategy calling for a portfolio allocation of 60% equities and 40% bonds or other fixed-income securities.

Stagflation, first described after the oil shocks of the 1970s, is an economic condition that includes slow economic growth (or even declines in gross domestic product), relatively high unemployment, and inflation.

U.S. Treasury Inflation-Protected Securities (TIPS) provide protection against inflation. The principal of a TIPS instrument increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, investors are paid the adjusted principal or original principal, whichever is greater.

Index

The S&P 500 Index measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

About Chartwell Investment Partners

Chartwell Investment Partners believes that actively managed strategies with high conviction and lower turnover will generate a consistent pattern of portfolio returns over the long term. Our portfolio managers take a long-term perspective with their investments, maintain focused portfolios, and strive for increased active share of their holdings to deliver attractive investment performance.

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