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TIPS and inflation expectations

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Abstract

Previous research suggests that the market for index-linked bonds is not entirely efficient and that these inefficiencies can be exploited by including inflation forecasts in trades on break-even inflation. Inspired by those results, we test the informational content of inflation expectations using survey data generated by the Survey of Professional Forecasters. We develop trading strategies speculating on the movement of break-even inflation. The results indicate that the market for US inflation-indexed government bonds offers the possibility to obtain excess returns. These results are fairly consistent regardless of market frictions introduced in the return calculation.

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