Inflation Update

Good morning. Yesterday, July 13, 2022, we received another upside surprise in inflation with headline inflation up 9.1% over June 2021. To the surprise of many, the equity markets, which initially were hit hard in the pre-market after the 8:30 AM announcement of the inflation numbers, held up remarkably well. We had a similar reaction today when two of the largest banks reported disappointing earnings, and after an opening plunge, the market clawed its way back to near even as of the time of this writing in the mid-afternoon hours of July 14, 2022.[1] So, what does this all mean?

CNBC had a great interview with Prof. Jeremy Siegel of the Wharton School of Business. To many, Prof. Siegel needs no introduction as one of the most well-respected economist in the world. I have been following his thoughts on the markets closely since the outbreak of Covid since he was one of the first to point out that the explosion in money supply would lead to serious inflationary consequences. His latest thoughts on inflation are that all of the data that we are looking at, including the June CPI, is too dated and backward looking to rely on. In short, the June CPI report could be the peak inflation reading that we have all been waiting for. How you may ask? Well, since June gas is down well below $5/gallon, oil is trading around $95/barrel - close to where it was when Russia invaded The Ukraine, wheat is well off of its highs and the growth in money supply has halted. Furthermore, and most importantly, the economy has slowed to a point where it appears to be stalled out which will mean that the demand side of the equation takes care of itself and take a very heavy load off The Fed. For the Feds July meeting later this month, a .75% increase is priced into the bond market with a chance of them going to a full 1.00% but that appears to be less likely. It’s important to note that this is the last Fed meeting until September and when they do meet the next time in September, they will have 2 months of economic data to consider when deciding on rates. If the current, real-time trends continue, they could seriously slow down the hikes or pause them all together. If you look at the yields on longer dated bonds such as the 10-year Treasury, it has actually DECLINED in the last 2 days to a current yield of 2.96%, well off its June highs of almost 3.50%. If forward-looking inflation is a problem, it should show up in the price/yield of Treasury Bonds and that simply is not the case.

The biggest thing going for the U.S. economy right now is that the employment market is still about as strong as it can get. Not only are we at full employment at 3.6%, but we still have an astounding 11 million job openings!! With everyone employed that wants a job, and wages remaining healthy, it will be tough to have a deep economic downturn and/or recession. It is our base-case that any economic downturn or recession will be shallow, and with the Fed raising rates this year by the most in decades in the rear view mirror, things should slow down enough to cool inflation, bring down prices and alleviate the supply chain issues. There are of course wild cards like China, Covid, political surprises and a Fed mistake but at the margin market stabilization may be getting closer and a surprise rally could come at any time. We are cautiously optimistic.

See my Video: [Thoughts on the markets April 29 2022]

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