CURRENT MARKET NEWS

April CPI – higher prices are here

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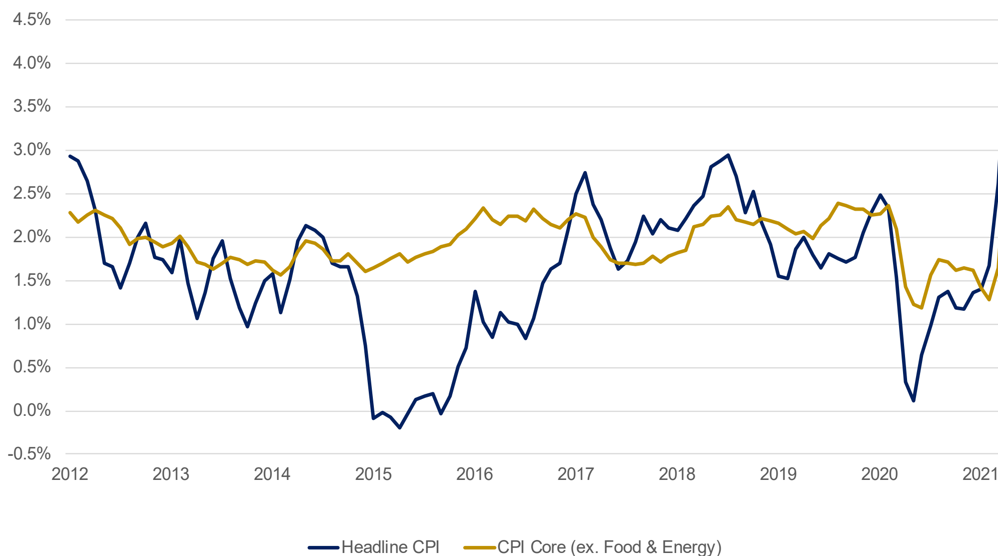
The Consumer Price Index (CPI) for April exceeded expectations showing a monthly increase of 0.8% and a year-over-year (y.o.y.) increase of 4.2%. Core CPI, which excludes food and energy, showed a monthly increase 0.9% -- the largest monthly increase since 1982 – and a y.o.y. increase of 3.0%. Amazingly, a record jump in used car prices accounted for about a third of the total monthly increase in CPI. Other notable price increases include airline fares, car insurance, and the price of certain meats. The rent measures used to determine housing price inflation in CPI increased a modest 0.2% on the month and only about 2% on the year – numbers we expect to trend upward later in the year. Energy prices were up 25% on a yearly basis, but actually declined slightly on the month.

Fed Chairman Powell has been vocal in recent months that he believes much of the coming inflation will be transitory and is partially due to "base effects." This latter consideration has to do with the slow rate of inflation in early 2020 – for example, the April 2020 y.o.y. CPI reading was just 0.3% – which means that the present jump is coming off a depressed base level. On a 2-year basis, for example, the CPI reading is up an *annualized* 2.2%, but almost all of that 2-year combined increase has come in the past 12 months.



Market Reaction

Following the CPI release, the yield on the 10-year Treasury Note has increased from 1.62% to 1.70%. The S&P 500, while subject to many forces and still showing healthy gains on the year, was down around 2% on the day of the CPI release. In terms of Treasury yields, we continue to expect the rate on the 10-year Note to climb in the coming quarters and end the year above 2%. Even if that yield reaches the mid-2% range, that level of interest rates is manageable for an economy that is exhibiting strong economic growth and an equity market with similarly robust earnings growth.

Looking Ahead

We agree with the Fed that much of the inflation pressures will prove to be transitory. That said, the market is accustomed to thinking of "temporary" in terms of a couple of months, not a handful of quarters where it becomes trickier to sift through and have conviction on the durability of different price pressures. The coming months are likely to have similarly high inflation readings. Some of the categories that showed modest price increases in April could begin to rise in the coming months as costs due to supply bottlenecks, commodity price increases, and general reopening work their way through to the consumer. Looking into 2022, however, fading stimulus, increased labor participation, and the clearing of the supply chain should blunt continued price increases.

There are likely to be periods where the market takes time to digest new information relating to inflation and interest rates. Nonetheless, we believe the equity market backdrop will have a positive bias and support risk-taking. On a medium-term basis, equities actually provide a natural inflation hedge as rising prices also imply rising revenue as long as profit margins are not squeezed, which we do not expect.

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