Weekly Markets Commentary

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Equities Shake Off Inflation Concerns – Can it Last?

The chorus of those warning about the rise in inflation seems to be getting louder. Two weeks ago, as they have been for some time, St. Louis Fed President Bullard and former Treasury Secretary Summers were among the more prominent voices warning that the Fed risks falling behind the curve. Last week, Fed Vice Chair Clarida said a faster taper schedule could be a topic for discussion at upcoming meetings. Atlanta Fed President Bostick said it may be appropriate to begin normalizing interest rates by the middle of next year. West Virginia Senator Manchin has cited inflation fears as contributing to his concern about the Build Back Better bill. And a number of prominent business leaders have warned about the rising danger of inflation as well.

These concerns are by no means unanimous, however. Last week, the Federal Reserve Bank of Philadelphia released its fourth quarter Survey of Professional Forecasters. Survey participants expect headline CPI, currently running at 6.2 percent in October, to average 4.6 percent in the fourth quarter, and to moderate thereafter. They forecast a first quarter rate of 3.0 percent, falling thereafter to average 2.7 percent for the full year, down from 5.8 percent this year. They see a similar path for the Fed's preferred rate, the core PCE deflator. After an expected 3.0 percent rise in the current quarter, the survey participants expect a moderation to 2.5 percent in the first quarter, with a full-year increase of 2.3 percent, down from 4.1 percent this year. The PCE results for October will be released on Wednesday of this week. The Bloomberg consensus anticipates a twelve-month rate of 5.1 percent, up from 4.4 in September. The core rate is expected to climb by 4.1 percent, up from 3.6 percent in September.

Will Inflation Prove to be Transitory?

Bond yields have risen but are hardly sounding an alarm. The two-year Treasury note yield has climbed to 0.52 percent from 0.21 prior the Fed's September meeting. And the ten-year yield has climbed to 1.55 from 1.32 percent. And certainly, part of that increase is in response to stronger economic data so far in the fourth quarter. Nevertheless, traders are pricing in an earlier liftoff for Fed funds than the bond market seems to anticipate. According to the CME FedWatch tool, there is a better than even probability of a first rate hike coming by next June, and two to three quarter point rate hikes coming by year-end.

Whether rising inflation proves to be transitory or is in danger of turning into a spiral of higher prices remains to be seen. And that is the Fed's dilemma. It hopes to see evidence of moderating inflation in the months ahead, while attempting through accommodation to bring about full employment. But if inflation proves to be stickier, it could force the Fed to play catch up, and tighten policy faster and further than it currently anticipates.

The current spike in prices is, of course, primarily attributable to surging demand in the wake of Covid-related restrictions, turbo charged by massive fiscal and monetary stimulus, and the resulting global supply-chain bottlenecks. Recently, there have been some tentative signs of improvement in the supply-chain. Shipping costs have declined, although they remain elevated. The number of ships at anchor waiting to unload at West Coast ports has begun to decline, although many remain.

At the same time, however, the pandemic continues to exert it influence. A number of European countries are imposing new Covid restrictions in the face of spiking infection rates, resulting in various episodes of social unrest. And third quarter earnings reports were replete with evidence of strong pricing power among corporations intent on maintaining profit margins. And, as anecdotal evidence of newly discovered bargaining power by labor, John Deere last week settled a contract dispute by conceding to generous pay increases and cost of living adjustments.

Investors Currently Favoring Growth Stocks; The Economic Calendar Is Full on a Shortened Holiday Week

So far, equity investors have taken all of this in stride, although the leadership last week was heavily tilted in favor of the growthier parts of the market. The S&P 500® index ended last week at a new record weekly close at 4697.96, after establishing a new daily closing high of 4704.54 on Thursday. Consumer Discretionary and Technology stocks led the way higher, while Energy, Financials, and Materials lost ground. The Russell 1000 growth index rose 1.8 percent last week, while the value index fell 1.9 percent. WTI crude oil fell $4.69 a barrel, or 5.8 percent, to $76.10 last week. From its peak at $84.65 on October 26, oil is now lower by 10 percent.

In addition to the October PCE data, the economic calendar in the holiday shortened week ahead contains several other important scheduled releases, including new and existing home sales, flash PMIs, durable goods orders, personal income and spending, jobless claims, and the minutes of the Fed's early November meeting.

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A **10-year Treasury note** is a debt obligation issued by the United States government that matures in 10 years.

The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics

The **Philadelphia Fed Survey** is a survey that tracks regional manufacturing conditions in the Northeastern United States. The intention of the survey is to provide a snapshot of current manufacturing activity in this region, as well as provide a short-term forecast of manufacturing conditions in the area, which may provide an indication of conditions throughout the United States.

The **Consumer Price Index** (CPI) is an inflation indicator that measures the change in the total cost of a fixed basket of products and services, including housing, electricity, food, and transportation. The CPI is published monthly by the Commerce Department and is also commonly referred to as the cost-of-living index. Unless otherwise noted, CPI data in this report is one month trailing.

The **personal consumption expenditure** (**PCE**) measures of the prices that people living in the United States pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior

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An index is a statistical composite that is not managed. It is not possible to invest directly in an index.

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