

Inflationary Pressures Surprise to the Upside as Economy Reopens

Producer and Consumer Prices Both Rose More Than 5% Y/Y in June

Headline CPI rose 5.4% y/y in June 2021, the fastest pace since August 2008. Core CPI was close behind at 4.5% y/y, its fastest pace since September 1991. Headline and core CPI both rose 0.9% on a monthly basis. All four of the CPI readings, (headline y/y & m/m and core y/y & m/m) came in above consensus estimates. Data shows inflationary pressures are strong as the economy reopens. Three factors are driving the high inflation readings: supply chain bottlenecks; exceptionally strong demand as economies reopen; and the base effect exaggerating y/y comparisons.

A quick scan across consumer categories shows where pricing pressures are most acute. Energy prices rose 24.2% y/y and 1.5% m/m, with gasoline prices up 44.8% y/y. Food away from home rose 4.2% y/y and 0.7% m/m. Used vehicle prices rose 45.2% y/y and 10.5% m/m amid a global semiconductor shortage. Car and truck rental prices rose 87.7% y/y and 5.2% m/m due to tight rental vehicle inventories after companies aggressively sold their fleets. Lodging away from home rose 16.9% y/y and 7% m/m, and airline fares rose 24.6% y/y and 2.7% m/m.

The takeaway is clear — the biggest price jumps are occurring in areas of the economy where demand is roaring back. In our view, it will be difficult for companies to sustain these price increases as demand normalizes, which will occur quicker than investors think. What happens to travel demand this fall as workers return to the office and schools reopen? What happens when auto manufacturers are able to snap in computer chips and flood the market with new vehicles? We view production issues and surging demand as both temporary and fixable.

June 2021 producer prices rose higher and faster than consumer prices. Headline PPI rose 7.3% y/y, the fastest pace since the Labor Department started tracking it in 2010. Core PPI rose 5.6% y/y, which was also the fastest since 2010. Headline and core PPI both rose 1% on a monthly basis. Similar to CPI, all four of the PPI readings beat consensus estimates. Digging in, the Labor Department reported 20% of June's m/m increase in final demand services traces back to automobiles and auto parts retailing, which rose 10.5% m/m. On the goods side, final demand energy prices rose 35.2% y/y and 2.6% m/m. One item to note -- the tight gap between PPI and CPI indicates companies are successfully passing through increased costs. If this relationship holds, inflation will likely run hotter for longer.

We remain in the 'inflationary pressures are transitory' camp. The bond market appears to agree, with the 10Y Treasury yield moving below 1.35% after brushing up against 1.75% in March. Multiple factors frame our transitory view. The primary factor is technology, which is a big deflationary force. There is no doubt the pandemic sped up secular trends favoring technology. Increased tech adoption should continue to lower costs by making companies more efficient. Another factor is the reality of shifting supply chains. While it is exciting to talk about big macro themes like reconfiguring global supply chains, the reality is much more complicated. It took decades to optimize supply chains, and it will take decades to undo and reshore production. We continue to expect inflation to run hot near-term but expect it to revert back to a lower level over the next 12 months.

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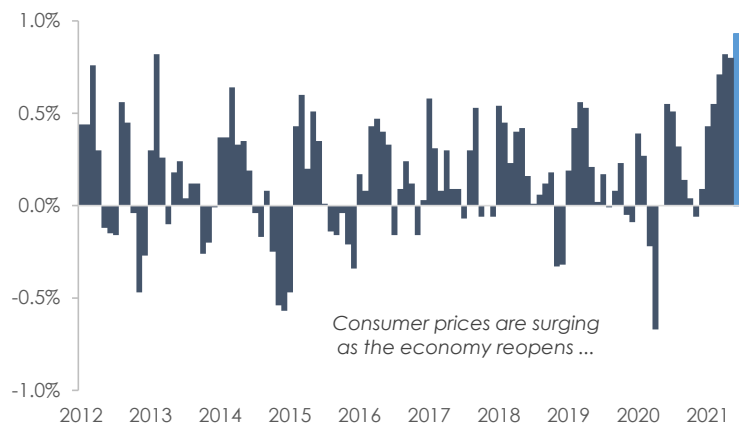
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- Producer Inflation
- Growth vs Value
- Jobless Claims
- Industrial Production
- Chinese Equities Oversold

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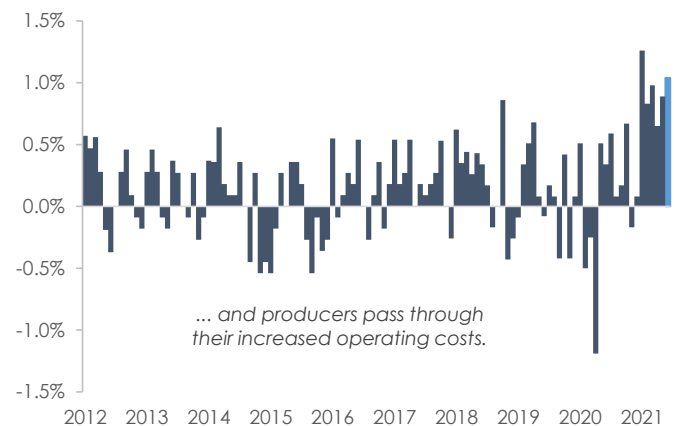
- Overweight China
- 3Q21 Allocator's Guide
- Equity Model Update

Figure 1: Headline CPI M/M Growth (Past 10 Years)



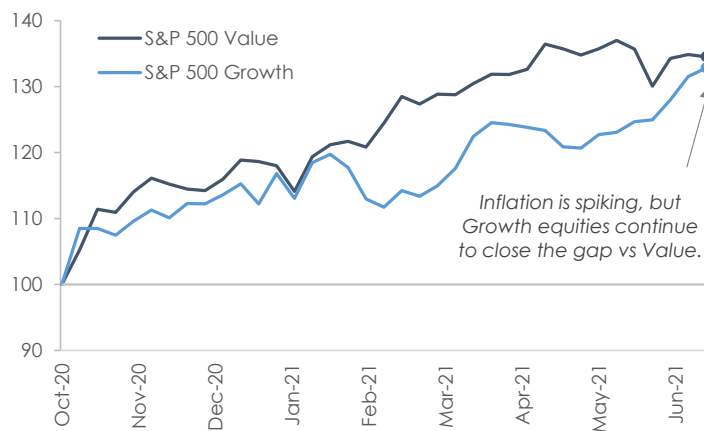
Source: MarketDesk. **Note** : Data not seasonally adjusted.

Figure 2: Headline PPI M/M Growth (Past 10 Years)



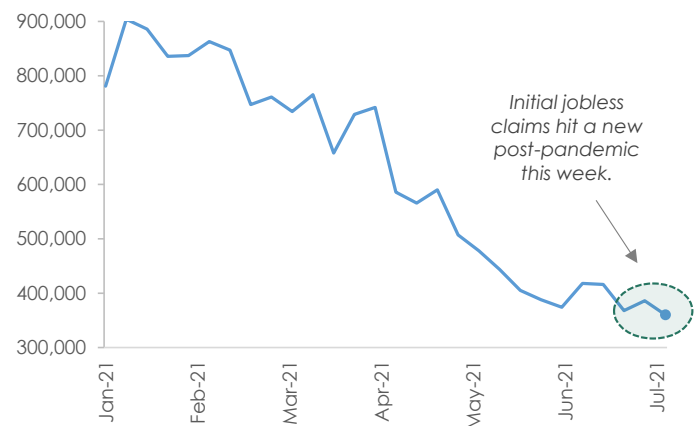
Source: MarketDesk. **Note** : Data not seasonally adjusted.

Figure 3: Growth vs Value Trade Since November 2020



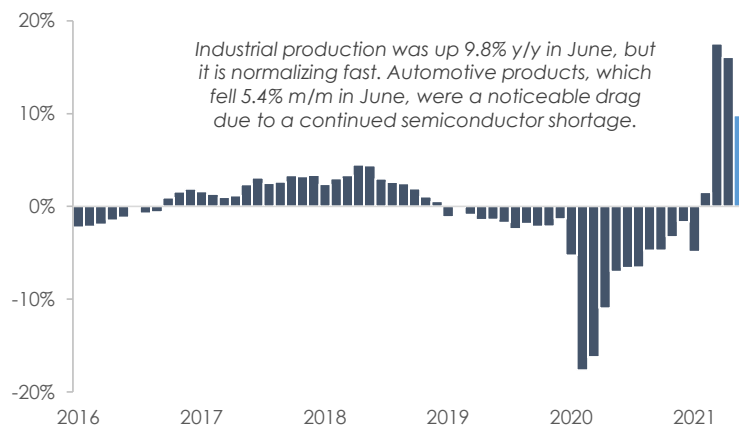
Source: MarketDesk. **Note** : Returns indexed to 100 on 11/1/2020.

Figure 4: Initial Jobless Claims Hit a Post-Pandemic Low



Source: MarketDesk. **Note** : Seasonally adjusted data.

Figure 5: Industrial Production Y/Y Growth (Past 5 Years)



Source: MarketDesk

Figure 6: 51% of Chinese Equities Are Now Oversold



Source: MarketDesk

Asset Class Performance

	1W	1M	3M	14d RSI	m/m%	Std
Market Caps						
U.S. Large	-0.5%	3%	4%	63		+0.1
U.S. Mid	-2.7%	-3%	-3%	37		-0.6
U.S. Small	-4.7%	-6%	-4%	24		-0.9
U.S. Sectors						
Utilities	1.2%	1%	-2%	61		-0.4
Cons Stpls	0.8%	2%	2%	64		-0.2
Tech	0.1%	7%	6%	70		+0.6
REITs	0.1%	2%	10%	66		-0.0
Health	-0.3%	4%	6%	71		+0.3
Financials	-0.8%	-2%	3%	47		-0.4
Industrials	-1.0%	0%	2%	54		-0.3
Materials	-1.1%	-2%	0%	50		-0.6
Comm Svcs	-1.6%	2%	4%	36		-0.1
Cons Disc	-1.7%	4%	0%	56		+0.4
Energy	-5.5%	-10%	4%	30		-0.9
U.S. Factors						
Low Volatility	0.1%	3%	4%	72		+0.3
Quality	-0.4%	4%	6%	63		+0.3
Dividends	-0.6%	-1%	2%	50		-0.5
Growth	-0.8%	6%	6%	64		+0.5
Value	-1.0%	-1%	1%	48		-0.4
Momentum	-1.4%	1%	-3%	42		-0.1
Fixed Income						
UST (+20Y)	1.2%	5%	7%	70		+1.1
UST (7-10Y)	0.5%	2%	3%	71		+0.7
EM USD Sov	0.4%	1%	2%	54		-0.0
EUR IG	0.2%	1%	1%	70		-1.0
US MBS	0.2%	1%	0%	59		+0.1
US IG	0.2%	2%	4%	63		+0.3
US Muni	0.1%	1%	1%	75		-0.0
EUR HY	0.0%	0%	1%	55		-0.6
UST (1-3Y)	0.0%	0%	0%	57		-0.5
US HY	-0.3%	1%	2%	43		+0.0
Commodities						
Corn	7.8%	-3%	-5%	54		-0.5
Soybeans	5.3%	-1%	2%	66		-0.5
Steel	2.8%	10%	35%	79		-0.7
Gold	1.1%	-2%	3%	74		-0.7
Silver	0.6%	-5%	1%	51		-0.7
Natural Gas	-1.1%	12%	36%	57		+1.0
WTI	-3.2%	0%	14%	51		+0.0

	1W	1M	3M	14d RSI	m/m%	Std
Americas						
Brazil	2.6%	-2%	15%	40		-0.4
Mexico	0.9%	1%	4%	50		-0.1
Argentina	-0.6%	-4%	0%	34		-0.4
Colombia	-1.5%	-2%	-6%	36		-0.3
Canada	-1.6%	-3%	4%	36		-0.6
Chile	-3.8%	-9%	-24%	29		-1.0
Europe						
Turkey	-0.8%	-5%	-7%	52		-0.5
Russia	-1.1%	-2%	8%	35		-0.4
Germany	-1.2%	-2%	-1%	45		-0.6
France	-1.5%	-4%	2%	37		-0.8
Italy	-1.7%	-6%	-1%	35		-0.9
U.K.	-2.0%	-3%	1%	44		-0.6
Greece	-2.9%	-8%	-5%	28		-1.0
Spain	-3.8%	-9%	-2%	25		-1.4
Middle East & Africa						
Saudi Arabia	0.0%	1%	8%	44		+0.0
UAE	-0.4%	-2%	8%	42		-0.5
S. Africa	-1.6%	-5%	-7%	48		-0.7
Asia-Pacific						
S. Korea	1.5%	0%	-2%	37		-0.3
China	1.2%	0%	-3%	30		-0.4
Hong Kong	0.8%	1%	0%	46		+0.0
India	0.5%	0%	8%	49		-0.3
Taiwan	0.0%	2%	4%	56		-0.0
Thailand	-0.5%	-8%	-5%	30		-1.0
Japan	-0.9%	-2%	-2%	47		-0.5
Singapore	-1.1%	-2%	-3%	46		-0.6
Philippines	-1.6%	-7%	0%	26		-1.0
Australia	-1.7%	-4%	-1%	41		-0.8
Vietnam	-2.8%	-2%	0%	22		-0.7
Currencies						
\$/AUD	0.6%	4%	4%	67		+1.1
USD	0.6%	2%	1%	62		+1.5
\$/MXN	0.3%	-1%	0%	58		-0.2
GBP/\$	0.2%	-2%	0%	48		-0.8
\$/JPY	-0.1%	0%	1%	43		+0.0
\$/CNY	-0.4%	1%	-1%	52		+0.7
EUR/\$	-0.4%	-2%	-1%	32		-1.6
\$/BRL	-2.9%	2%	-9%	64		-0.1

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