CETERA® INVESTMENT MANAGEMENT

COMMENTARY

September 13, 2022

Inflation Report Surprises Higher

- Inflation disappoints investors, rising more than expected in August.
- There are signs inflation will moderate soon and data may be lagging.
- Volatility will remain as we continue forward in this rate hike cycle.

The Labor Department released its long-awaited August Consumer Price Index (CPI) report, and it surprised investors that had been anticipating a weaker inflation reading. Headline CPI, which includes the more volatile food and energy categories, rose 8.3% from a year ago and 0.1% from the prior month. The consensus expectation was for a 0.1% monthly decline. However, the Federal Reserve historically does not put as much weight into headline CPI as it does core CPI. Core CPI, which excludes volatile food and energy categories, rose 6.3% from a year ago and 0.6% month over month, exceeding expectations for a more modest 0.3% monthly increase. This new report likely cements at least a 0.75% interest rate hike next week when the Federal Reserve meets for the September FOMC meeting. Many investors had been anticipating inflation to fall month over month, bidding up stocks over the past week, hoping that easing inflation would allow the Fed to ease back on the pace of rate hikes. Stock markets are falling sharply today because higher than expected inflation could lead to a more aggressive Fed.

Why are investors so surprised though, and why did they anticipate lower inflation figures? Perhaps they were just early. We have seen gasoline, used car prices, and airfares all retreat. Inventories, which were abnormally low for retailers a year ago, have risen this year. This could indicate future sales and price cuts as companies look to reduce inventories and get ready for new shipments. While the labor market is very strong with the unemployment rate at 3.7% and over 5 million more job openings than people looking for work, some companies are starting to reduce headcounts. A large retailer, the largest private employer in the United States, announced corporate layoffs last month and several employers ranging from automobile manufactures, cell phone companies and technology companies have also announced job cuts. This could tame inflation in the labor market, but we anticipate the labor market to remain healthy. Inflation data may just be lagging what is currently happening.

One of the key metrics driving inflation higher is owners' equivalent rent, which was up 0.7% on a month over month basis. This tends to lag home prices by a year, so we may not see this fall until well into next year. Home prices were on the rise until recently when mortgage rates jumped. Though higher mortgage rates increase the monthly payments for recently purchased homes. Shelter, which also includes rents, makes up around 25% of CPI and 40% of core CPI. There may also be a lagged effect from outsized rent increases that lasted until earlier this year.

As we continue through this rate hike cycle, we expect more stock and bond market volatility. The dance will continue as investors anticipate what the inflation data will be and what the Fed will do. It may be confusing too as investors may interpret good economic data to be bad news. Good economic data could mean more inflation and more rate hikes. Also, inflation will eventually fall, but perhaps not as much as expectations. While all this is going on, Fed officials will be speaking at events and investors will be hanging on virtually every word. Markets could rise after one official speaks and fall after another one speaks and vice versa.

We will continue to focus on the data, especially labor data, as labor inflation tends to be more persistent. We will also be looking closely at shelter inflation, which may not slow until next year. Ultimately, the data will drive the Fed's decisions going forward. As we go through this rate hike cycle, please continue to work with your financial professional to make sure you are properly diversified to help mitigate market volatility and your portfolio is aligned with your long-term investment objectives.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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