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Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer

May 2023

A Few Words (and Pictures) on Inflation

The April inflation reports (Consumer Price Index or CPI and Producer Price Index or PPI) provided some good news for investors in terms of prices and were supportive of the narrative that the Federal Reserve is closer to a point where they might pause after increasing rates at each of the past ten meetings. Overall CPI came in slightly below consensus, falling to 4.9% (Chart 1), the first time it has been below 5% since April 2021. Consumer prices were over 7% as recently as November, and looking through the data, some encouraging signs are emerging.

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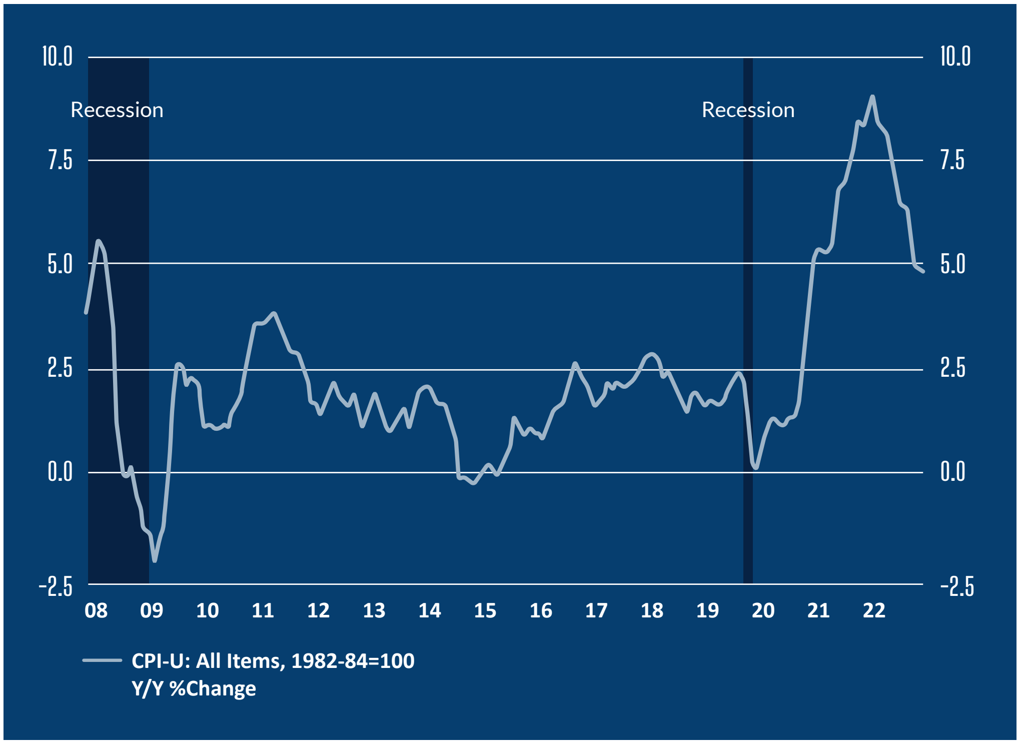
Chart 1



Source: Bureau of Labor Statistics/Haver Analytics

Shelter is the largest weight in CPI at almost 35% and has several components to it, with the largest being either rent (renter occupied) or implicit rent for an owner-occupied unit. The actual survey questions ask what your monthly rental charge is, or in the case of an owner-occupied unit, "if someone were to rent your home today, how much do you think it would rent for monthly, unfurnished and without utilities?" Shelter has been impacted by both higher housing prices and higher financing costs (mortgage rates), and the measure has remained elevated. For example, in the April CPI report, shelter was up 8.1%. However, that was lower than the previous month, the first time that shelter has declined since February of 2021, consistent with housing as a lagging indicator. Stripping out shelter, CPI rose at a 3.4% rate in April versus. last year, and that measure has been declining steadily over the past 12 months (Chart 2). April CPI was also heavily influenced by a 4.4% month-over-month increase in used car prices, a puzzling deviation from recent trends in that series. While used cars are a very small weight in CPI, an increase of that magnitude in a single month has an outsized effect.

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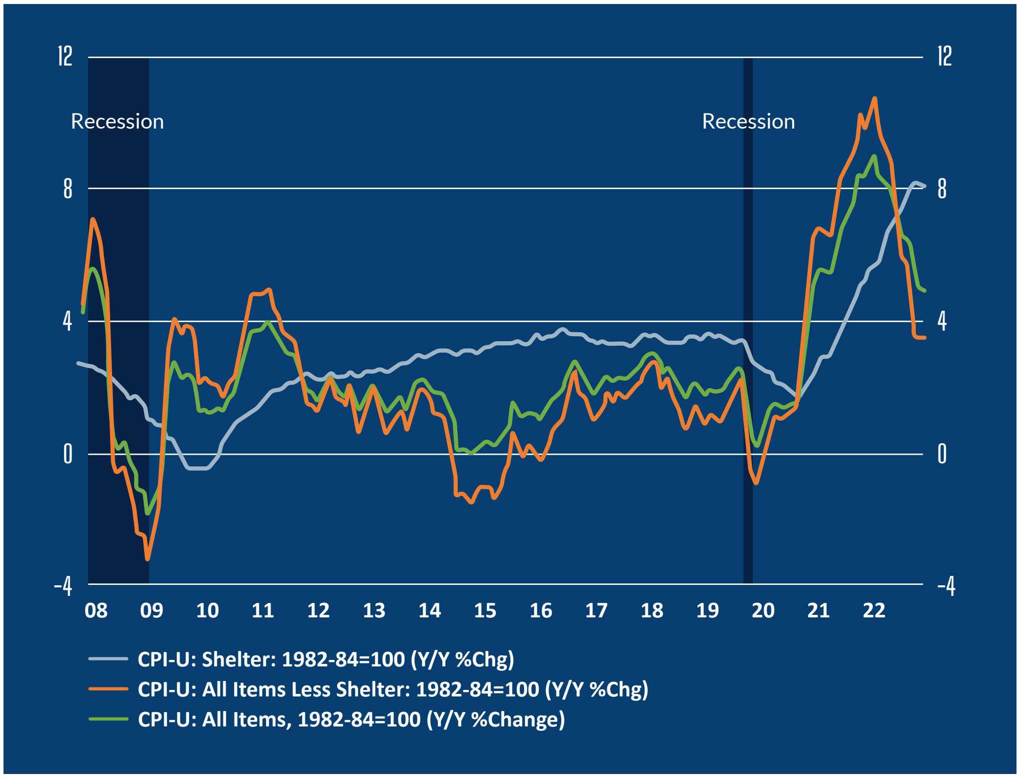
Chart 2



Source: Bureau of Labor Statistics/Haver Analytics

Most measures of inflation show a similar pattern of recent declines, although measures of core inflation (excluding food and energy prices) have not declined as much. The Federal Open Market Committee measures inflation using personal consumption expenditures (PCE) which peaked at 7% last June, and in March (most recent reading available) had declined to 4.2% and is forecast to fall further in the coming months. Core PCE peaked at a lower rate last year but has also declined less (Chart 3).

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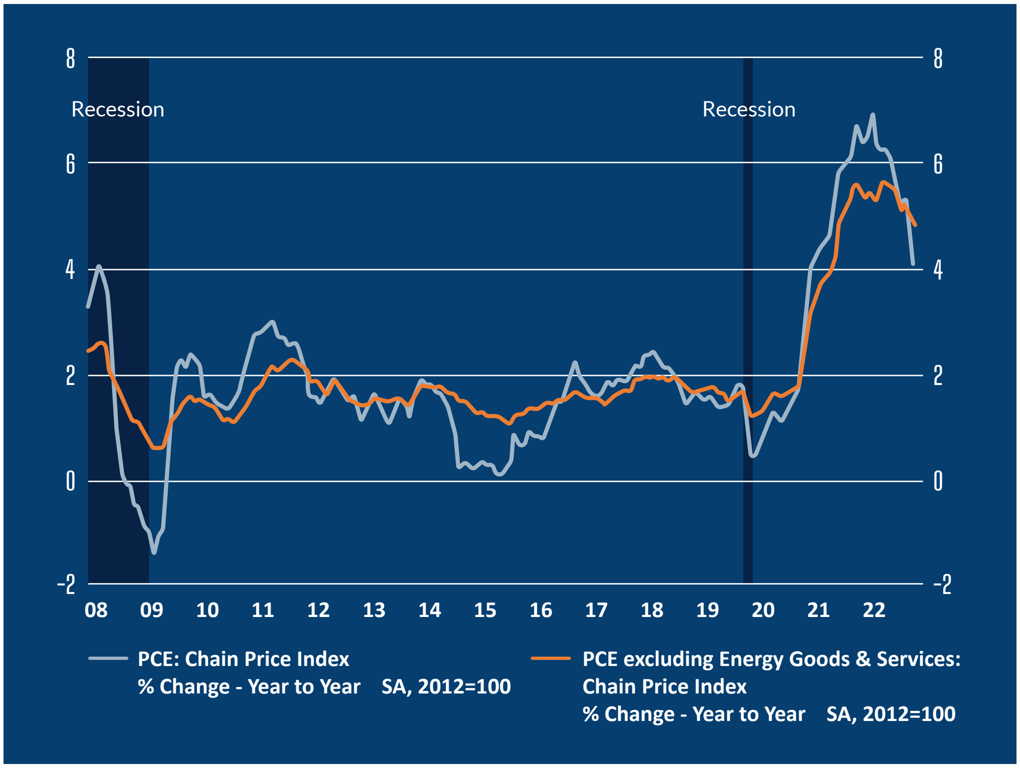
Chart 3



Source: Bureau of Labor Statistics/Haver Analytics

“Softer” inflation data gleaned from surveys show similar patterns. The Institute for Supply Management manufacturing and service surveys contain price indices, and both are consistent with declining rates of inflation (Chart 4). Both market-based and survey-based indicators of expected inflation remain relatively well contained although recent consumer surveys show increases, which has potential ramifications for consumer spending. The inverted yield curve and the collapse in M2 growth are also leading indicators suggesting inflation will continue to decline as the economy slows in the wake of aggressive Fed policy.

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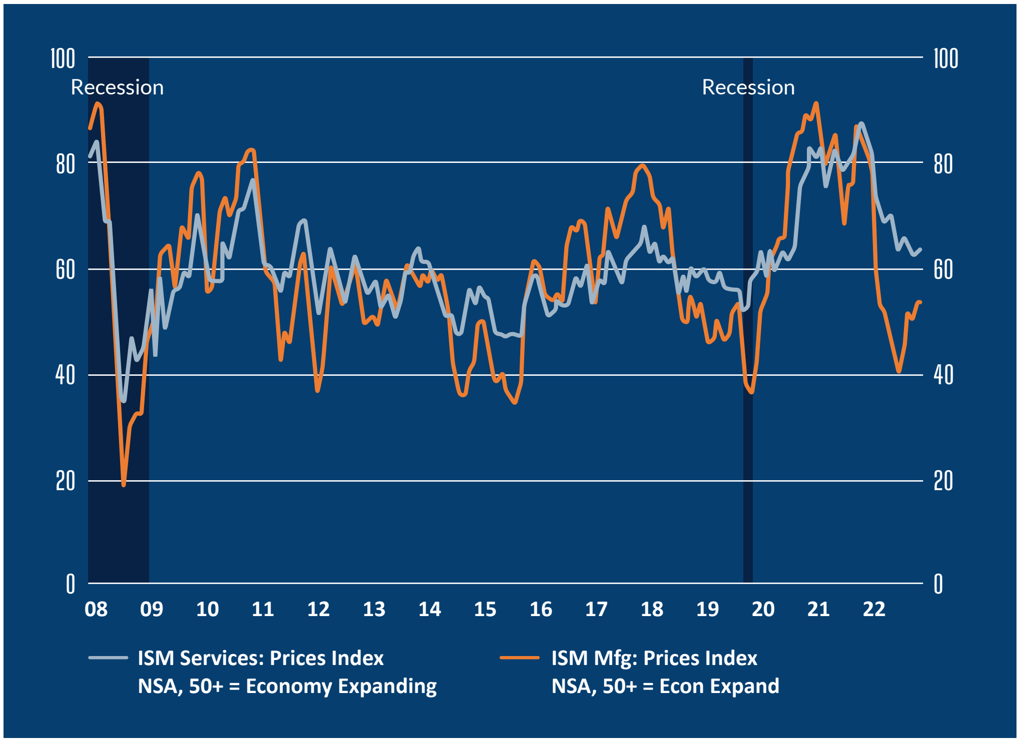
Chart 4



Source: ISM/H, ISM/Haver

Based on the most recent PPI report (April PPI was 2.3%) and the base effect versus last year, we would expect CPI to continue to decline the next several months and would not be surprised to see overall CPI in the 3% range (+/-) by July. That would be consistent with a slowing economy and the lagged impacts of aggressive monetary policy tightening.

In terms of Fed policy, the recent declines in inflation and the increase in the Fed funds rate have resulted in a positive real (inflation adjusted) Fed funds rate, a relatively rare occurrence since the Global Financial Crisis (Chart 5). As mentioned previously, the next several months will be key in the Fed's fight against inflation. The lagged effect of tighter monetary policy, less supply chain disruptions, and the "friendly" comparisons to the same period last year could result in much lower inflation through the summer. The key to Fed policy is whether the aggressive tightening will slow the economy enough to keep inflation declining and sticky at an acceptable level.

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Chart 5

Source: FRB, BEA/Haver

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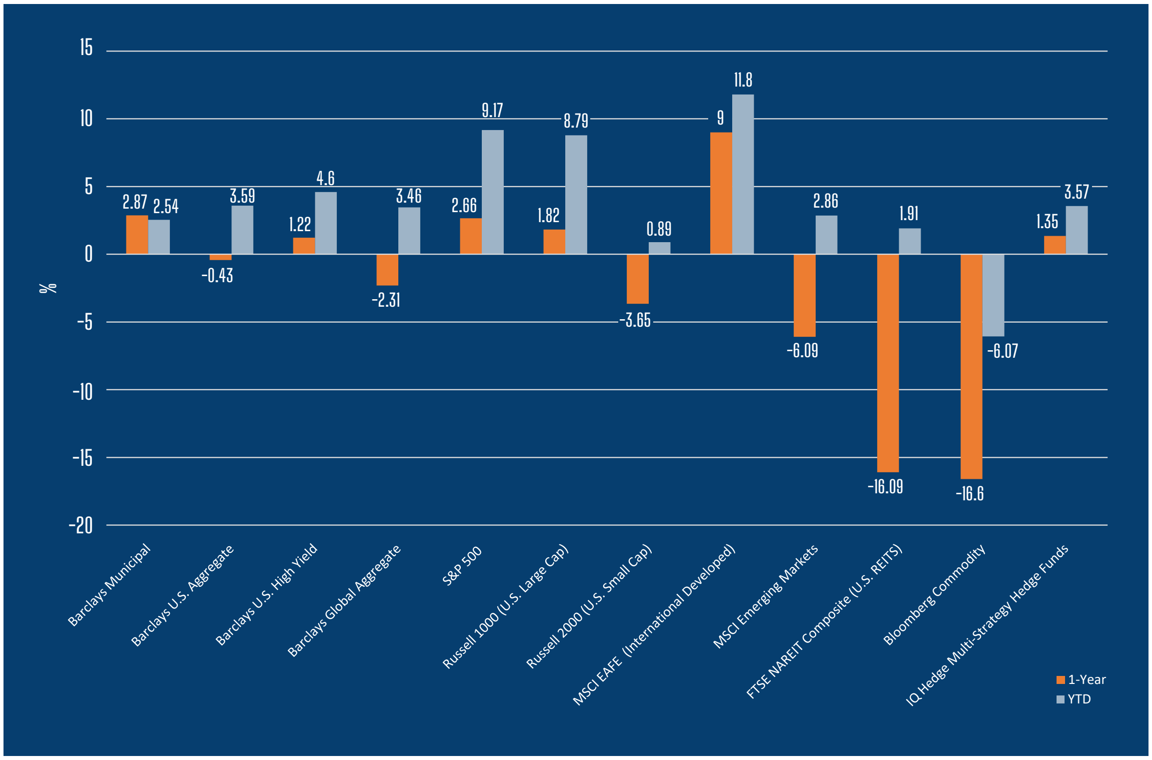
Asset Class Returns as of April 30, 2023

Comparing Recent 1-Year and Year-to-Date Total Returns



Source: Conway Investment Research

Fixed Income

- While fairly range-bound during April, yields generally trended lower.
- Core fixed income performed well, but weak technical factors led to losses in municipals.
- Credit benefited from spread tightening in April, led by floating rate loans and high yield.
- Sovereign debt and emerging market debt benefited once again from slight U.S. dollar weakness. Yields also trended lower throughout the month.

Equities

- U.S. large cap stocks posted another month of solid performance in April.
- Large caps outperformed small caps, but value stocks led growth stocks reversing the strong YTD trend.
- Small caps were particularly weak in April as investors grew concerned about higher borrowing costs and the impact from broad economic weakness.
- International developed stocks (as measured by EAFE) generated relative outperformance versus U.S. equities led by the strong rebound in value stocks.
- Emerging market equities struggled a bit last month led by weakness in China.
- U.S. dollar weakness added 55 basis points to EAFE returns and 43 bps to emerging market returns.

Alternatives

- REITs were able to eke out small gains in April despite concerns over commercial real estate due to higher interest rates.
- Commodity prices remain weak due to concerns over economic weakness. Energy prices in particular have been soft this year and lumber has fallen on weaker housing activity.

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April 28, 2023	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.39%	0.39%	1.48%	2.97%	1.04%	1.43%	0.87%
Barclays Municipal	-0.23%	-0.23%	2.54%	2.87%	0.70%	2.06%	2.25%
BBgBarc U.S. Govt/Credit Intermediate	0.34%	0.34%	1.86%	1.15%	-0.47%	1.35%	1.03%
Barclays U.S. Aggregate	0.61%	0.61%	3.59%	-0.43%	-3.15%	1.18%	1.32%
Barclays U.S. High Yield	1.00%	1.00%	4.60%	1.22%	4.71%	3.28%	4.01%
S&P/LSTA Leveraged Loan	1.05%	1.05%	4.31%	3.39%	7.31%	3.76%	3.81%
Barclays Global Aggregate	0.44%	0.44%	3.46%	-2.31%	-3.91%	-0.93%	-0.03%
JPM GBI EM Global Diversified	0.86%	0.86%	6.06%	6.56%	-0.13%	-1.62%	-1.77%
U.S. Equity Indices							
DJ Industrial Average	2.57%	2.57%	3.53%	5.64%	14.19%	9.49%	11.22%
S&P 500	1.56%	1.56%	9.17%	2.66%	14.52%	11.45%	12.20%
NASDAQ Composite (Price)	0.04%	0.04%	16.82%	-0.88%	11.21%	11.59%	13.89%
Russell 1000	1.24%	1.24%	8.79%	1.82%	14.22%	11.07%	11.95%
Russell 1000 Growth	0.99%	0.99%	15.49%	2.34%	13.62%	13.80%	14.46%
Russell 1000 Value	1.51%	1.51%	2.53%	1.21%	14.38%	7.75%	9.13%
Russell Mid Cap	-0.53%	-0.53%	3.51%	-1.69%	13.78%	7.97%	9.85%
Russell 2500	-1.30%	-1.30%	2.04%	-3.32%	13.63%	6.32%	8.89%
Russell 2000	-1.80%	-1.80%	0.89%	-3.65%	11.90%	4.15%	7.88%
Russell 2000 Growth	-1.16%	-1.16%	4.84%	0.72%	7.82%	4.00%	8.44%
Russell 2000 Value	-2.49%	-2.49%	-3.13%	-7.99%	15.44%	3.66%	6.96%
Non-U.S. Equity Indices							
MSCI World	1.80%	1.80%	9.82%	3.72%	13.64%	8.69%	9.29%
MSCI ACWI	1.48%	1.48%	9.04%	2.59%	12.56%	7.56%	8.47%
MSCI ACWI Ex-U.S.	1.81%	1.81%	8.94%	3.61%	10.25%	2.99%	4.45%
MSCI EAFE	2.93%	2.93%	11.80%	9.00%	12.22%	4.14%	5.25%
MSCI EAFE Growth	2.52%	2.52%	14.00%	8.62%	9.55%	5.45%	6.21%
MSCI EAFE Value	3.34%	3.34%	9.68%	9.15%	14.52%	2.41%	4.05%
MSCI Europe	4.31%	4.31%	15.51%	12.77%	15.03%	5.27%	5.95%
MSCI Japan	0.37%	0.37%	6.77%	4.74%	6.04%	1.59%	4.54%
MSCI AC Asia	-1.19%	-1.19%	3.85%	-1.99%	4.38%	0.46%	4.17%
MSCI EAFE Small Cap	2.09%	2.09%	7.25%	-0.75%	9.61%	1.41%	6.09%
MSCI ACWI Ex-U.S. Small Cap	1.54%	1.54%	6.42%	-2.27%	11.75%	2.16%	5.34%
MSCI Emerging Markets	-1.11%	-1.11%	2.86%	-6.09%	4.71%	-0.67%	2.18%
MSCI EM Asia	-2.34%	-2.34%	2.40%	-6.42%	3.60%	0.00%	4.14%
MSCI China	-5.16%	-5.16%	-0.69%	-5.64%	-6.15%	-4.88%	2.91%
MSCI EM Eastern Europe	12.05%	12.05%	16.73%	14.15%	-32.06%	-21.86%	-11.06%
MSCI EM Latin America	2.71%	2.71%	6.86%	5.57%	17.29%	-0.67%	-1.22%
MSCI EM Small Cap	0.70%	0.70%	4.67%	-5.12%	16.35%	2.40%	3.42%
MSCI Frontier Markets	0.55%	0.55%	3.74%	-14.46%	6.11%	-1.84%	2.77%
Hedge Fund Indices							
IQ Hedge Long/Short	-0.07%	0.51%	0.51%	-7.20%	3.28%	2.30%	--
IQ Hedge Multi-Strategy	0.51%	0.51%	3.57%	1.35%	2.00%	1.49%	2.31%
Real Assets Indices							
FTSE NAREIT Composite	0.35%	0.35%	1.91%	-16.09%	7.31%	5.68%	5.49%
Alerian MLP	1.72%	1.72%	5.88%	16.78%	29.33%	6.12%	0.65%
Bloomberg Commodity	-0.75%	-0.75%	-6.07%	-16.60%	21.14%	4.67%	-1.51%
S&P Global Infrastructure	2.62%	2.62%	6.66%	2.42%	13.14%	5.90%	6.17%
Other							
Oil Price Brent Crude	-1.76%	-1.76%	-8.78%	-25.59%	57.68%	0.98%	-2.71%
CBOE Market Volitility (VIX)	-15.61%	-15.61%	-27.18%	-52.75%	-22.69%	-0.19%	1.56%

Source: Morningstar

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