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Investment Outlook

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Update

Some Perspective on Inflation

Since our last Update, we've seen investors turn a blind eye to an impressive Earnings Season, a ransomware attack shut down a major pipeline, a semiconductor shortage slow auto production, and a stumble in the employment numbers. The market has swung between record highs and a mild pullback with some segments descending into correction and even bear market territory. There's also the elephant in the room, the revival of inflation fears that has triggered a tug 'o war between investors favoring either Growth or the Cyclical stocks. The thinking is that the return of inflation would require the Fed to abandon its current policy stance and throw water on the valuations enjoyed by large-cap Growth companies.

Presently, investors favoring the Cyclicals are winning that battle with the DOW and S&P 500 off their record highs by only 3% while the Growth-heavy NASDAQ has declined more than twice that amount. This is hardly the stuff of a market correction (a decline of more than 10%) but beneath the surface there are a number of last year's big winners residing in correction territory or worse. While Amazon and Apple are among those that have corrected a bit more than 10% from their highs, there's been real carnage in Tesla (-36%), Zoom (-48%), Peleton (-44%), and others that enjoyed nosebleed valuations in 2020. Meanwhile, Financials, Energy, Pharma, and Industrials have held their own in this mixed bag of year-to-date results. The lesson here is that portfolio diversification matters most when headlines move the market.

The inflation narrative has drowned out much of the positive investor reaction to what can only be described as a notably positive earnings season. This week's jump in the headline CPI inflation indicator of 4.2% was the highest in thirteen years. Core inflation (less food and energy) rose to 3%. That shouldn't come as a surprise when compared year-over-year to the depths of last year's pandemic, especially in light of the current supply curtailments we mentioned earlier. However, it seems to have surprised some folks at CNBC who provide the grist for traders to amp up the market volatility that sells advertising. This won't last. The Reopening has unleashed a massive amount of pent-up demand. It's a natural part of this recovery process. Companies will respond in the time it takes to revive operations, retool, and rehire. That response should temper any *longer-term* inflation pressures. We're not seeing a repeat of 70's style inflation where the oil embargo affected all corners of the economy.

Yes, there will be inflationary pressures in the near-term but they should be transitory and certainly no reason for the Fed to alter its current policy at this juncture. Not forgetting the 8 million still unemployed from 2019, the focus of their mandate has moved from inflation to *employment*. Fed Chairman Powell announced *several times* in the past six months the Board's willingness to accept inflation above their stated threshold for a period of time. That said, should investors be on the lookout for a correction? Always. However, the results from this earnings season and the continued expansion of The Reopening point to this pullback in the indexes as being nothing more than a temporary, and healthy, consolidation of stock prices. Stay tuned.