Weekly Wire

MAY 9, 2022

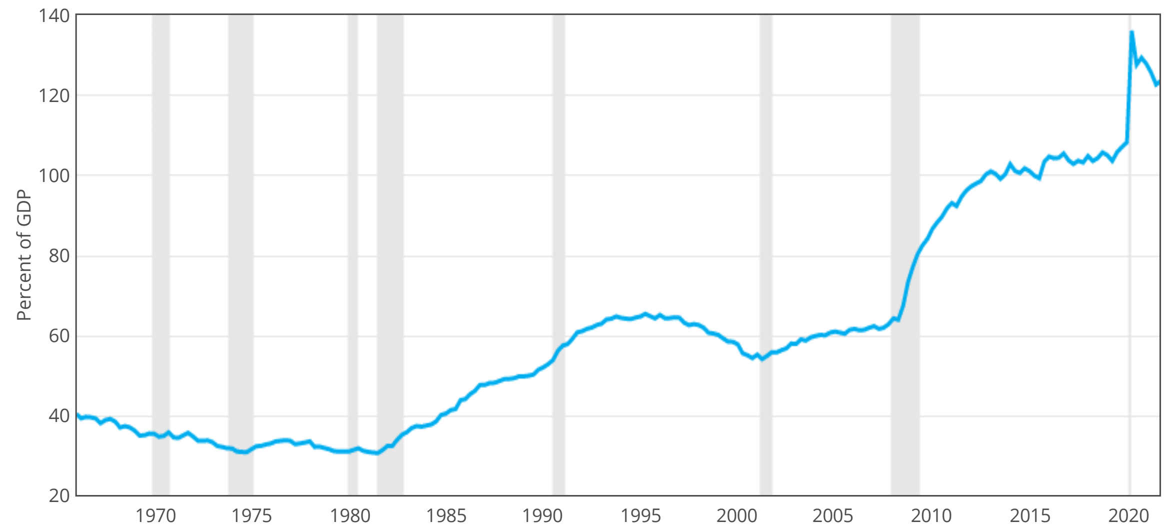
The Upside of High Inflation

There aren't many folks singing the praises of inflation these days - and for good reason. Gasoline and grocery prices are up meaningfully year on year, a tremendous financial burden for most Americans, particularly those making a lower wage; operating costs have jumped for most publicly traded companies, a real headwind for earnings growth, and the stock market has been biased lower as investors worry the Federal Reserve's efforts to bring inflation under control will also lead to a recession.

We acknowledge that persistent, historically high inflation is responsible for all these difficulties, and we prefer a much lower rate of inflation for goods and services and are hopeful we will see price gains for both moderate as we move through the back half of 2022. That written, there is at least one substantial benefit that high inflation provides, and that is its impact on a country's debt burden. As we know, we live in a nominal world when it comes to the economy (a company's sales and a nation's GDP reflect both volume and pricing, e.g., if a company makes and sells one widget for $5 one year and one widget for $10 the next year, sales have doubled even though volume is flat because prices are up 100% - the same dynamic holds true for an economy overall).

But while inflation pushes GDP higher, the amount of debt taken on by a country remains static. If the US economy has a debt to GDP ratio of 100% and our economy grows by 100% -- even if it is only a result of inflation – our debt to GDP ratio drops to 50%, and a nation's debt to GDP ratio is among the datapoints most used by investors to discern a country's ability to manage its debt burden. Not surprisingly, we have seen a dramatic drop in our debt to GDP ratio as the economy has reopened and inflation has taken off, from 136% in mid-2020 to 123% as of year-end 2021 (see chart). And that ratio will move lower still, considering nominal US GDP grew mid-single digits in the first quarter of 2022.

Federal Debt: Total Public Debt as Percent of Gross Domestic Product



Stocks, bonds, and commodities (5/6/2022)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	4123.34	-8.99%	-13.49%	-2.58%
MSCI AC World ex USA	292.83	-9.51%	-14.96%	-16.65%
MSCI EAFE	1972.82	-9.57%	-15.55%	-15.13%
MSCI EM	1031.50	-9.66%	-16.27%	-23.51%
Bloomberg Barclays US Agg	92.72	-5.22%	-11.47%	-12.54%
Crude Oil WTI	110.61	10.30%	47.07%	70.43%
Natural Gas	8.04	42.57%	126.15%	171.94%

Treasury rates (5/6/2022)

	Price		Yield
2Y	99.19 /	99.1	2.708
3Y	99.03 /	99.0	2.941
5Y	98.14 /	98.1	3.084
7Y	98.09 /	98.0	3.149
10Y	89.13 /	89.1	3.138
30Y	81.11 /	81.1	3.228

Weekly reports

This week (5/9/2022)

- CPI NSA Y/Y Apr
- PPI NSA Y/Y Apr

Week of 5/2/2022

- ISM Manufacturing SA Apr 55.4
- Nonfarm Payrolls SA Apr 428.0K

Brinker Capital Market Barometer

MAY 2022

A strong labor market, wage growth, and healthy consumer balance sheets are boosting the US economy, although geopolitics, inflation, and Federal Reserve policy are taking center stage. Global markets have fallen back to year-to-date lows as interest rates continue their upward ascent. Expectations are high for the Federal Reserve to raise interest rates more than 0.25% during the May FOMC meeting. The conflict in Ukraine rages on, with related headlines contributing to price volatility across asset classes. The second quarter earnings season is in full swing, and early results are favorable. Company commentary around controlling costs and maintaining margins will be important to monitor throughout the season. A strong consumer bodes well for economic cycle durability, but we are watching to see if the persistence of inflation and geopolitical worries may curtail spending.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum	←	●			Market has returned to year-to-date lows, giving back the recent recovery
Trend	←	●			Index levels have dropped back below moving averages
Investor sentiment				●	Surveys show significantly more bears than bulls, a contrarian indicator
Seasonality	← ←	●			Markets are entering a period of seasonal weakness, particularly in a midterm election year

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy			●		Fiscal drag a headwind in 2022; unlikely to see any major new fiscal spending
Monetary policy				●	Markets have tightened ahead of the Fed, but financial conditions are still accomodative
Inflation		●			Persistently high inflation may cause Fed to adjust timeline; weighing on sentiment
Interest rate environment			●		Rates remain historically low, but the effects of future rate hikes remain to be seen
Macroeconomic				●	Consumer balance sheets remain strong and the labor market remains healthy
Business sentiment				●	Business confidence measures declined from recent highs, but remain elevated
Consumer sentiment		●			Consumer sentiment is deteriorating as inflation persists
Corporate earnings				●	Broad-based strength in earnings, closely watching margin pressures and basing effects
Credit environment				●	Corporate credit spreads are widening but still at tight levels relative to history

LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation			●		Equity valuations have moved closer to long-term averages
Business cycle				●	In an economic expansion period with positive GDP growth since 3Q20
Demographics			●		Emerging markets with more favorable trends overall than developed markets

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