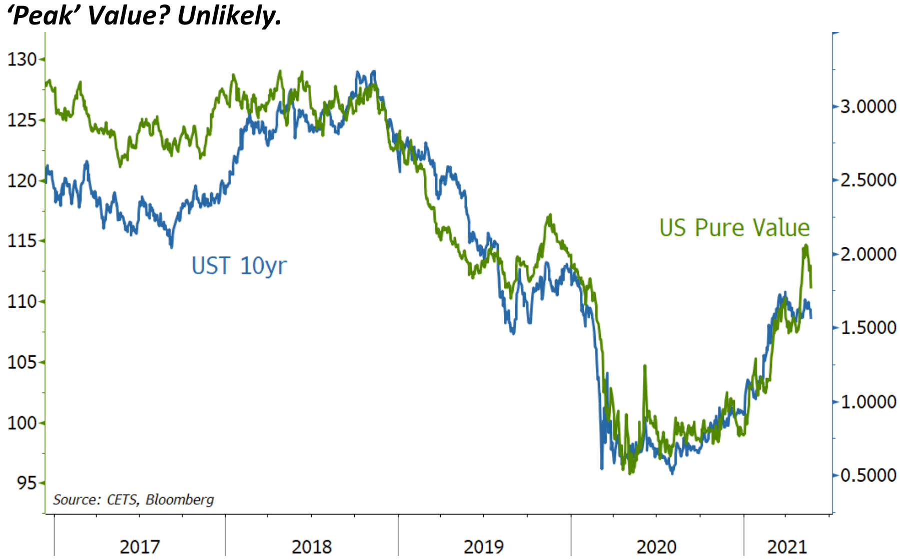
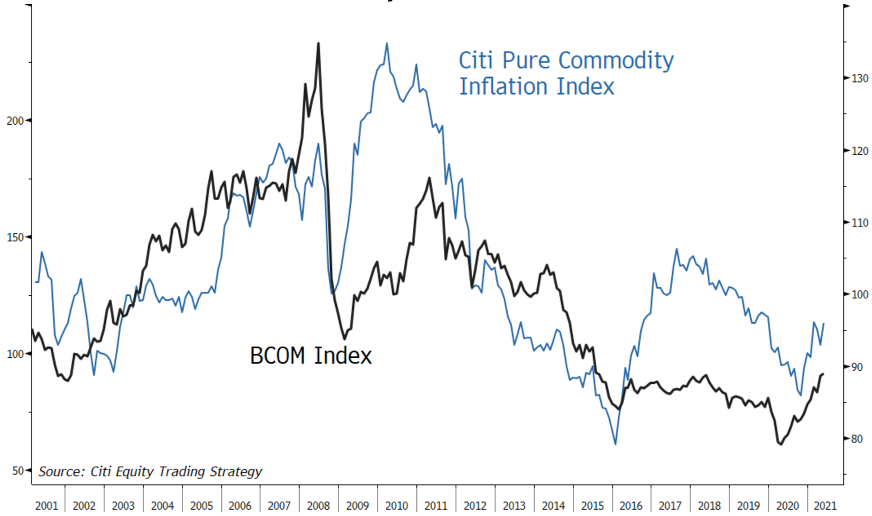
Markets managed to buck the trend of throwing a wobbly during a few days of Alty vacation, and although volumes have been remarkably thin (yesterday was the 5th lowest non-holiday turnover since the pandemic began), there has been one notable topic of focus that repeated itself as I cleaned through the inbox; 'we are now past peak inflation'… or something to that effect. This has manifested itself through a number of channels, be it the sharp reversal in commodities driven by China's announcement to drive out excessive speculation, through to the Tech sector's 2% relative bounce vs SPX over the past two weeks, albeit again on limited volumes and still well off the relative highs observed back in February. Even in the factor space, there's been a notably sharp reversal in Value (**CIISVAUT Index**) that dropped 95bps today alone and is now down over 3% from the mid-May highs. Although we had some whiffy new home sales and consumer confidence numbers this morning, as well as the AMZN vs government news (yet the stock outperformed today), I do think it's worth digging a little into this 'peak inflation' narrative because we once again find the equity market largely at odds with the macro narrative circulating.

'Peak' Value? Unlikely.



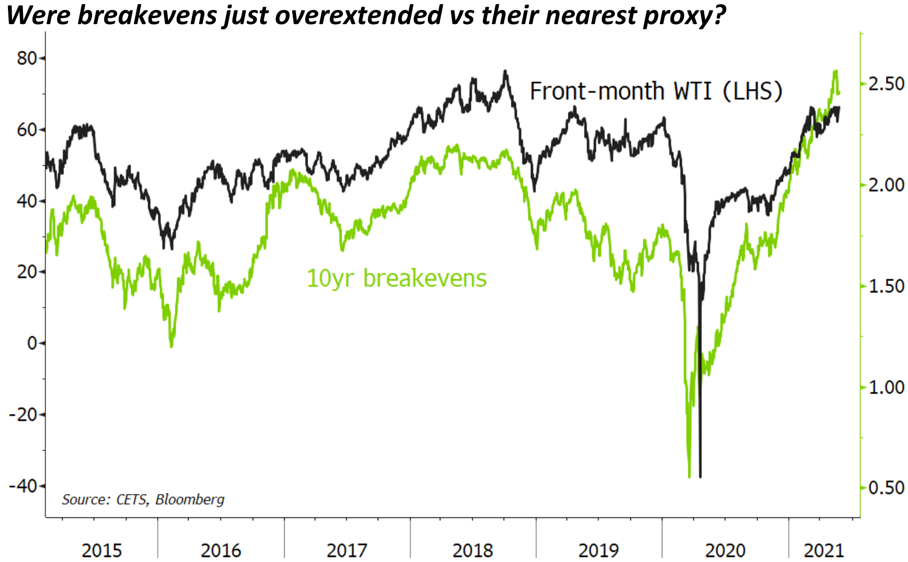
First, I suppose we should examine the commodity complex where the 17% drop in lumber (*to the same level it was trading 4 weeks ago, I might add*), a 20% drop in iron ore, 5% drop in copper has unearthed a wave of narratives that somehow peak commodity prices are now in place given China's more interventionist approach to local speculation and monopolies. Whilst there's a clear argument to be had as to how much of an influence recent Chinese policy has enabled global commodities to rally, it's worth putting into context two items: 1) our commodities team give a detailed breakdown as to why this is unlikely to halt the ultimate path higher (see **here** from Ed Morse), and; 2) the rally from the lows in the broad commodity complex is hardly unprecedented, with the BCOM Index rallying 45% over the past year. That would make it the second shallowest bull market going back to 1960, which doesn't exactly chime with the magnitude of government spending packages and the global green infrastructure push accompanying it.

Peak commodities? Also unlikely.

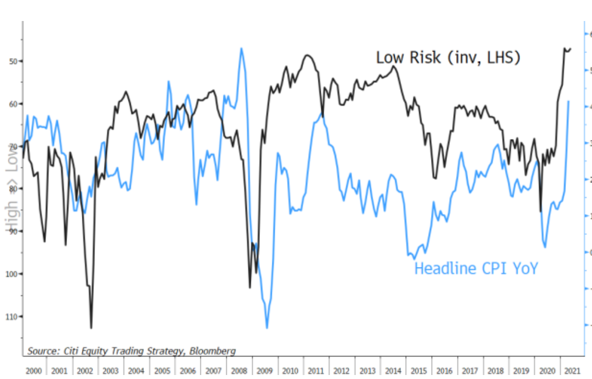


But in any case, the last time I checked it wasn't the price of lumber of iron ore that really drove the inflation narrative. We could certainly make the argument that oil contributes a sizeable chunk to headline inflation, but in the face of a potential doubling of Iranian crude exports globally, I would argue that WTI has held in pretty well given the trajectory of recent news flow. Please correct me if I'm wrong here, but the largest contributions to inflation over time were shelter/housing, food, medical costs and employment. And last time I checked, the US housing market was on fire, the average consumer food basket is up 10%yoy, and I don't recall seeing any headlines talking about *lower* wage costs. I find it remarkable that a handful of Fed speakers communicate the same 'transitory' message in recent days/weeks, and coupled with a sloppy TIPS auction last Thursday (… and to be fair, the Treasury has been flagging they were to increase TIPS supply going forward), investors are now taking this as a cue that peak inflation is in place. Yet nothing has changed.

Were breakevens just overextended vs their nearest proxy?

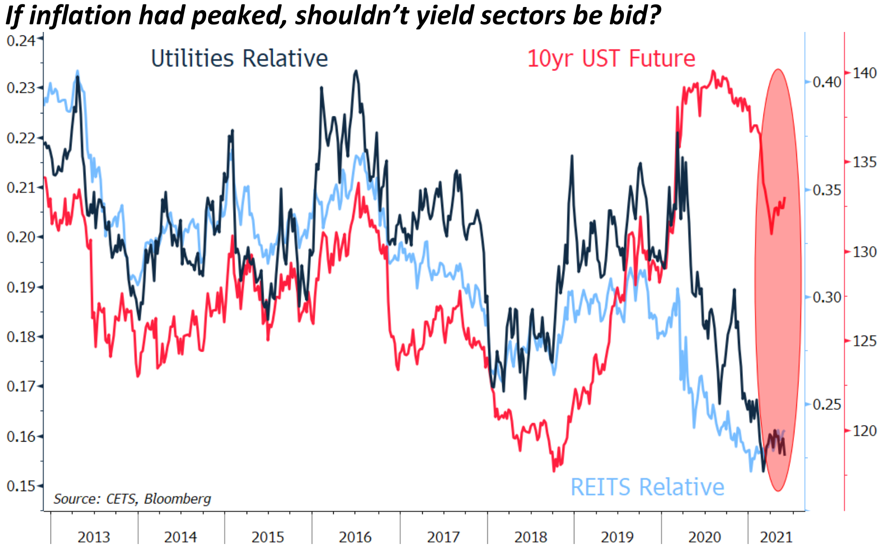


But equities have not been displaying this degree of concern regarding a shift in inflation/rates narrative over the medium term. Yes, Value is down from the recent highs but let's not forget that the start of the month saw one of the largest weekly rallies *ever*. Yes, Tech has bounced but it's been pretty anaemic in the context of where this sector was trading back in February. And yes, I managed to **top tick** the Energy sector again, and yet crude continues to flirt with a $66 resistance level that as we enter the summer driving season with USD making fresh 12-month relative lows that we will see mid-70s in WTI before long. **But what investors may not have picked up on are the medium-term indicators within the equity market that continue to signal to structurally higher inflation:** Low Risk (CIISLRUT) remains close to all-time lows (inverted on the first chart below), whilst our inflation basket (CGPRINFN) has tracked sideways in recent weeks rather than show any signs of weakness.



I understand the anti-inflation arguments, many of which centre around the notion that government support for unemployment benefits either expire in September, or have already started to expire at a state level. Equally, I cut my teeth as an analyst focusing on commodities for the first five years of my career and am sadly all-too-well versed in the gyrations and volatility that accompany base and bulks. Against these potential near-term headwinds, I see stickiness in wage pressures (is anyone going to cut wages now the wheels are set in motion?), ongoing supply chain problems (**How long is ‘transitory’?**), and just anecdotally looking at anything from my Whole Foods cart cost, through to used watch prices as evidence that what is happening currently does not have a flash-in-the-pan feel to it. Even linear parts of the equity market continue to cry foul of lower yields with sectors like Utes and REITS displaying little evidence of appetite to own yield-sensitive parts of the market right now.

If inflation had peaked, shouldn’t yield sectors be bid?



So bottom line for investors is they need to weigh the near-term noise and the (repetitive) message of the Fed against the large dataset of equities – i.e. companies themselves – that paint an ongoing inflationary narrative beyond just commodity gyrations and crypto volatility. The opportunity here is to stick with the inflationary narrative, and use dips in your preferred expressions (custom basket, **cyclical sectors**, commodities, and so on) to add length and conviction. That wasn’t really a typical ‘what happened today’ email, but given the catch up of the past few days, it felt apt to run through what happened ‘recently’ and help straighten things out.

Alty

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