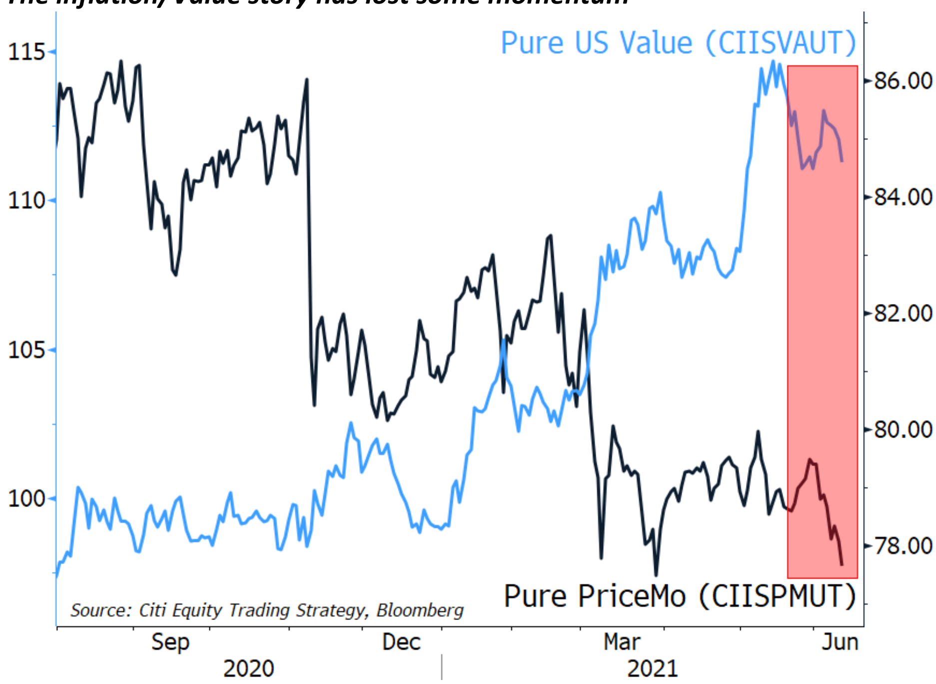
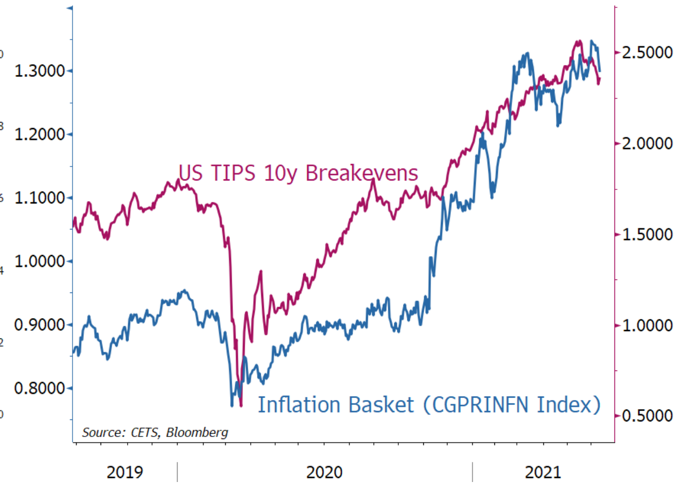
Nice to get through the day where anything in meme stocks was pushed to the bottom of the points of discussion today. Let's be very clear about today's better-than-expected CPI print: the beats came across the board, with the transitory camp opining that 30% of the monthly jump again came from volatile factors like used cars, whilst the sticky inflation camp would have pointed to the upswing in owners' equivalent rent that registered a multi-year high. So if there was [something for hawks and doves alike](), markets were left at the mercy of two forces: the Fed's willingness to change messaging for the June FOMC meeting (or the updated projections next week) and/or the positioning in the market. It goes without saying that the latter spoke on behalf of the former as today simply represented – rightly or wrongly – an ongoing unwind of inflation positioning across the board. We'll come on to some details in just a moment, but look no further than the 70bp drop in Value *in conjunction* with a 55bp drop in PriceMo as evidence that the now-consensus (and pro-momentum) inflation trade was dealt a small blow today.

The inflation/Value story has lost some momentum



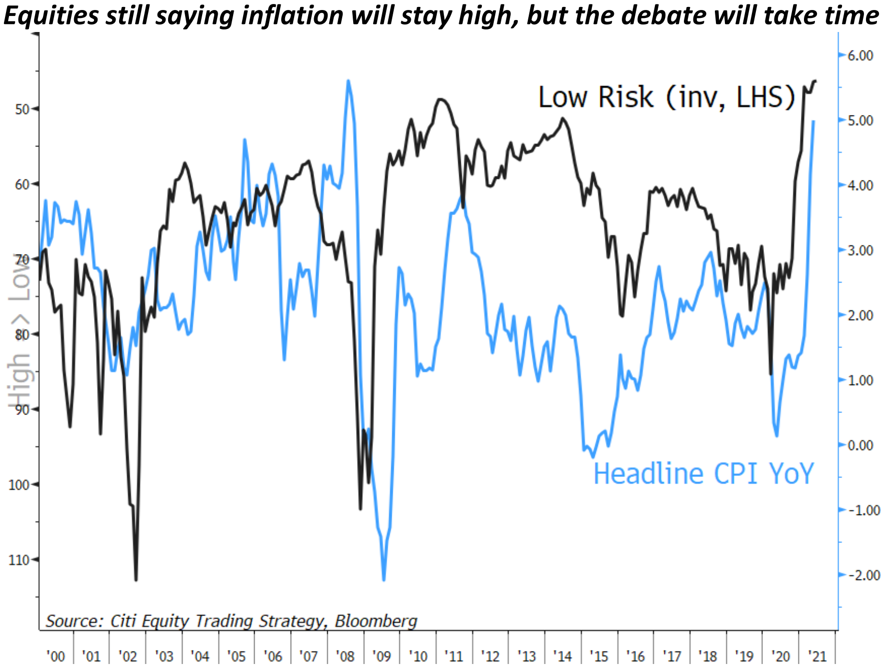
The Treasury market again stole the show as the duration sell off lasted no more than an hour before ending the cash session at the lowest yields since early March. Although our CTA model gets a little fuzzy around the futures roll (so we have to take an average of the two contracts to calculate a trigger threshold), the 2mm+ TY1s that went through today on top of the 1.8mm turnover yesterday was well in excess of the 100d ADV of 1.1m contracts and in my mind sufficient evidence that CTA funds have covered the bulk of residual shorts in place since the Q4'20. There is of course room for this length to now grow, although I have my suspicions that we may be reaching the nadir for 10yr yields given these 3m lows are not being supported by either the thematic or quant baskets within the equity world, even if things like our Inflation basket (CGPRINFN) took a 1.8% hit today.

CTA funds have likely closed out the bulk of shorts, and yet the equity market remains unwavering in the pro-inflation view



So what happened today to cause the reversal? In short, the price action both today, and to a lesser extend the rest of this week, I would argue is a combination of gross risk unwind (as evidenced by the PMOM reversal) ahead of the summer period, and the transitory inflation cohort making the case that the May CPI data represents the apex of price increases given June onwards starts to see harder base effects. Add on top that despite the growing chorus of **ex-Fed members** that are questioning the current magnitude of stimulus, the FOMC appear to be pretty unwavering in their current trajectory, and as well as some near-term uncertainty regarding the scope and magnitude of an **infrastructure bill**, we arrive at a short-term speedbump for the inflation trade. And that's fine: no one can say with certainty what the inflation trajectory looks like 3-6m out (although you hopefully have seen this author's **views** aplenty), and the 'transitory' vs 'sticky' perspectives are not going to be reconciled by looking at one or two data points. Obvious signs of further inflation accelerants within the equity world have indeed paused: SMID has failed thus far to break through the Q1 relative highs, and Low Risk hovers close to all-time lows, but equally has yet to set new records. Unfortunately that probably means we remain in a holding pattern until next week's updated Fed projections, the June FOMC meeting, or indeed Jackson Hole… did someone say it's going to be a long summer?

Equities still saying inflation will stay high, but the debate will take time to resolve

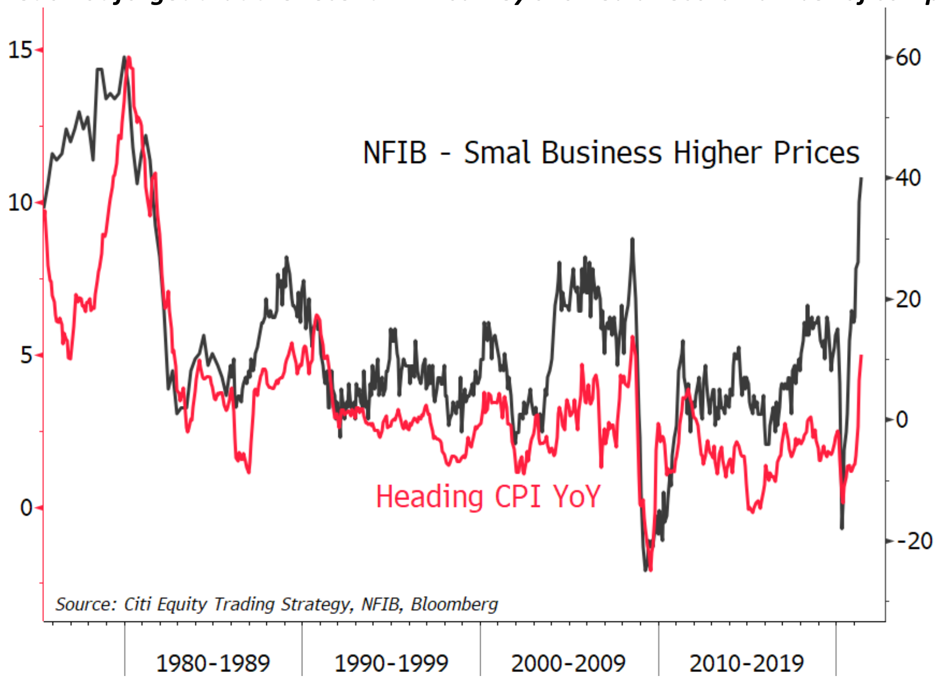


Here's some nice stats to perhaps sway you a little. I was asked to check with a couple of sector analysts as to whether they're seeing upwards pricing pressures beyond what would be considered transitory (i.e. a few months). Here were their summarized replies:

Retail: *The message was supply chains are tight, but everyone seems happy to have lean inventory b/c they all like the P&L impact to margins. And no one iss saying they want to become more promotional. Several of the mgmt teams think covid was a pivot point to the whole industry finding inventory religion, which will result in structurally higher margins vs pre-pandemic levels (and they think it will be sticky*). ***Full note*** on recent company access day.

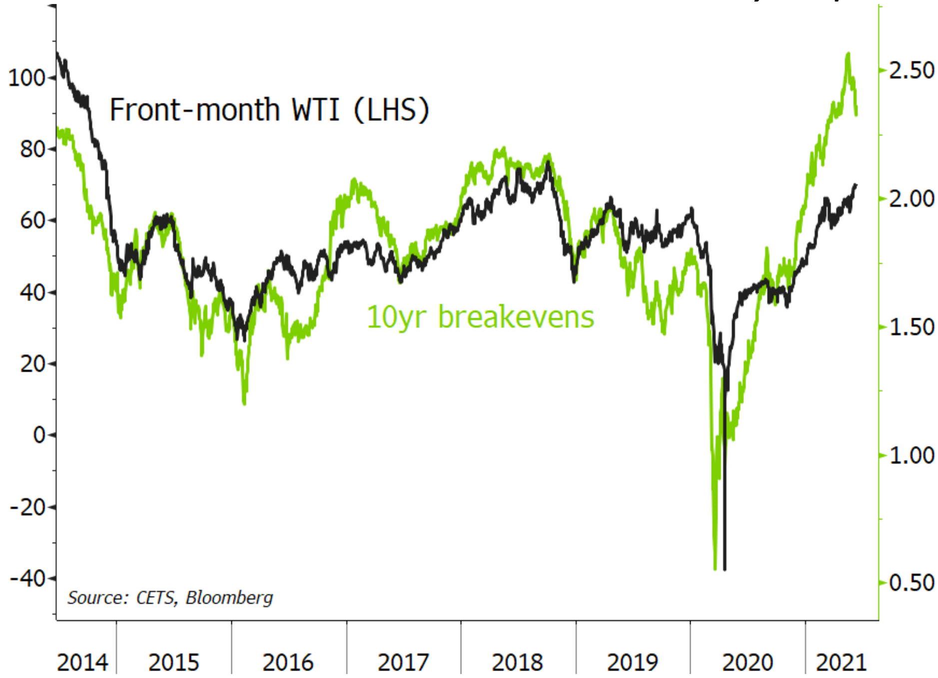
Transportation: *Companies are definitely feel very good about their pricing power and most believe its sustainable into 2022. That said, we haven't seen a huge step up in restocking, which means that the tightness could ease as new capacity enters the market. So while there is likely to still be upward pressure on freight rates, we could see the magnitude of that pressure ease in 2H and into 1H21.*

Let's not forget that the recent NFIB survey showed a record number of companies seeing higher prices*

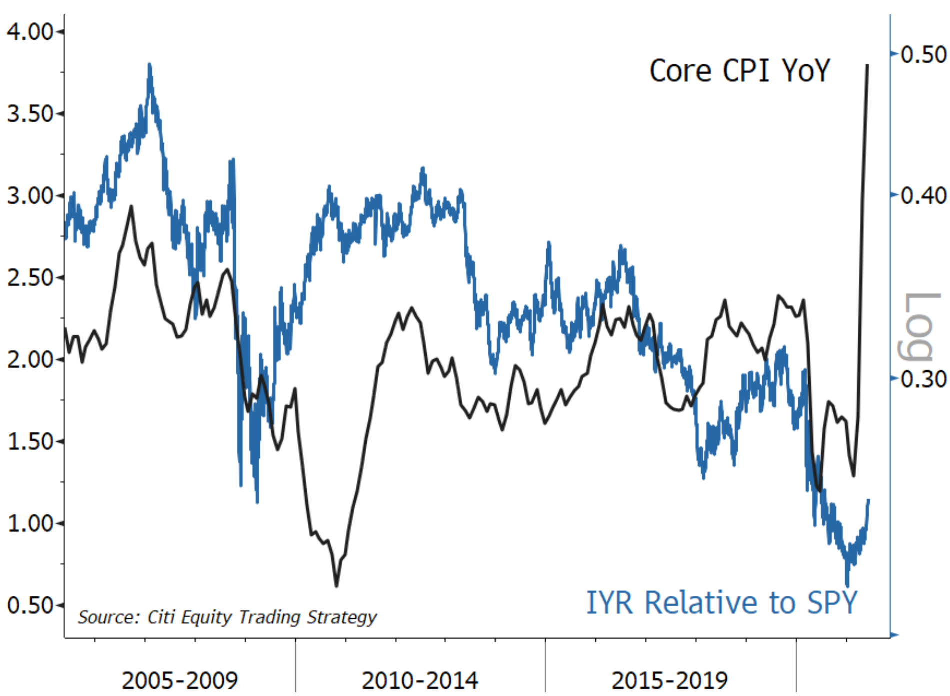


As I've mentioned on a few occasions though, the price action we are seeing in equities is not really supported with real volumes. Despite the fact that SPX rallied to new all—time highs today, it was accompanied by negative breadth for a second consecutive day (*and that was despite 7 sectors outperforming*), and consolidated tape volumes ran 15% below the 100d average. That is not in itself a cause for concern, but it does give pause for thought as to whether there is any kind of structural regime shift out of the themes that have worked so far this year, and based on the evidence witnessed today, the answer is a pretty resounding 'no'. Value/inflation narratives may have paused but it's not like there's been a surge in Growth or Quality outperformance recently (the opposite in fact as Value is one of only two factors in positive territory YTD). If anything the current environment reminds me a little of the late March and April environment where Value just simply didn't work (largely due to a risk parity releveraging that focused on large market cap), but then went on to powerful new highs in May as more data added fuel to the fire. Look at the oil market today as a perfect example where spot prices plunged over a $1 on an Iranian sanctions headline that was completely misinterpreted by the algos (and thus reversed in short order) as another indication that the path sadly will not be linear, but it's quite obvious that even if OPEC+ ramp production from July onwards, then we will likely be faced with a supply deficit by Q4. Pro-cyclical/Value corners of the market are obviously more crowded and consensus than 3m/6m ago, which will invariable create roadblocks, but should not detract patient investors from being rewarded over the medium term. One client pointed out to me today that investors still have twice the exposure to FB than they do to the entire oil sector, for example…

Trust the oil market more than breakevens to determine the cyclical path



And that leads me on to a reiteration on an idea from earlier in the **week** (and last **week** for that matter) that investors should still consider diversification *within* the inflationary narrative, rather than exclusively focus on cyclical/commodity sectors. REITs may have outperformed again today largely in sympathy with the drop in UST yields, but the structural thesis to own them in an *inflationary* environment should not be overlooked either: short term, property stocks behave like stocks, but longer term, property stocks behave like property. Which means they're levered (good in a higher inflationary environment), have pricing power (good in a higher inflationary environment), and still offer an attractive yield (2% vs SPY 1.2%). I'm reposting the same chart below that illustrates that the RV pair of IYR vs SPY has historically illustrated a loose relationship with changes in core CPI (which would make sense as that contains a large part of owners' equivalent rent). Not perfect, but food for thought if investors are worried about inflation but looking to diversify away from pure cyclical/commodity sectors.



And I managed to get through the whole note without mentioning the 27% drop in GME. The irony being that the worse the company did the more it went up. Now that it actually delivered 'good' numbers, it got punished… such is the upside-down world of getting '**memed**', and more entries for the **Bizarro Chronicles**.

Alty

Alexander Altmann
Head of US Equity Trading Strategy
Office +1 212 723 1999

Market Commentary and a not a product of Research. Intended for Institutional use.

All charts/data sourced from CETS, Bloomberg and Citi, unless otherwise indicated.