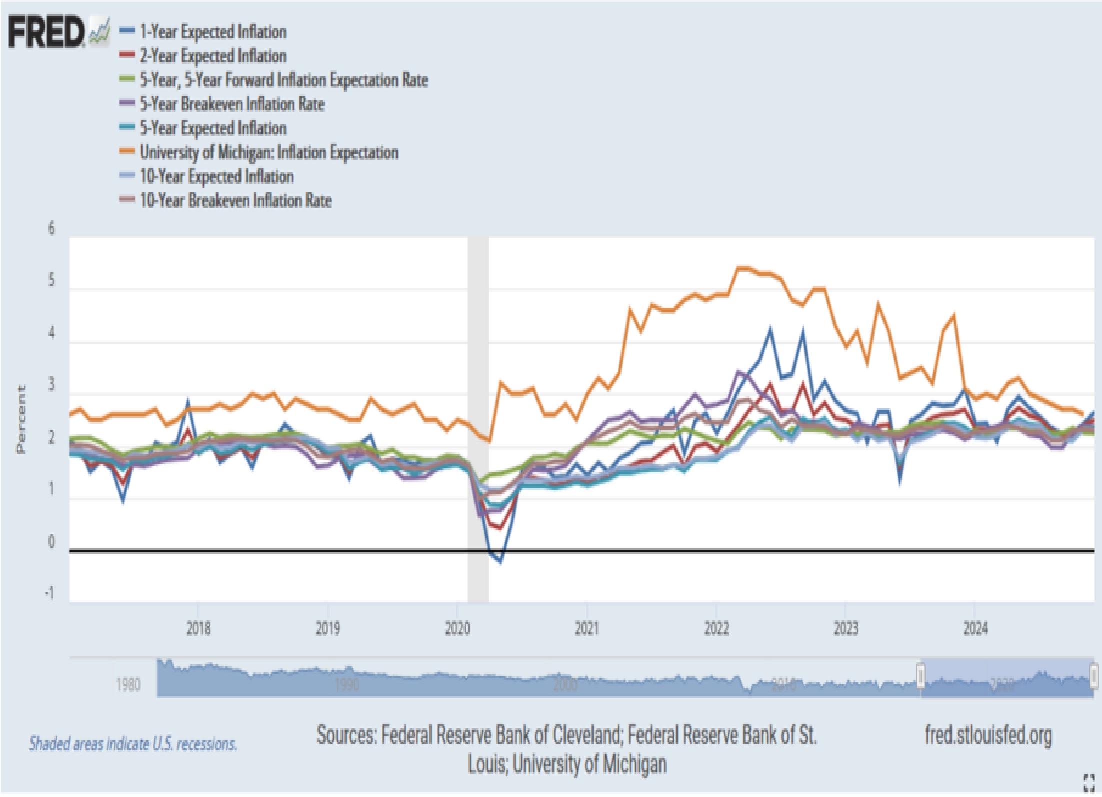
The Inflation Narrative Versus Reality

Fed rate cuts, tariffs, deficits, California wildfires, and other narratives bolster a growing concern that inflation will surge again. While those narratives are concerning, and some may have merit, market and survey-based inflation expectations do not confirm them.

The Fed and almost all economists use two types of gauges to measure inflation expectations: surveys and market-based measures. The graph below shows eight well-followed inflation expectation measures spanning expected inflation rates for the next year to ten years. Nothing in the eight graphs warns us that inflation expectations are starting to trend higher.

The table below the graph provides details on the inflation gauges since 2021. Only two have increased since June 2024. Those two, 5- and 10-year inflation expectations, are up a mere 15bps and 4bps, respectively. All other inflation expectation gauges have declined since June. The data show that the inflation narrative is a fear that is not grounded in reality. That can certainly change, but market and survey data argue that the term bond premium is misguided.

Inflation Narrative vs. Reality



	1yr. Exp Infl	2yr. Exp Infl	5yr. Exp Infl	UM Infl Exp	10yr. Exp Infl	5x5 Infl Exp	5yr. BE Infl Exp	10yr. BE Infl Exp
Maximum (2021-2024)	4.23	3.18	2.55	5.40	2.45	2.46	3.41	2.88
Minimum (2021-2024)	1.68	1.39	1.31	2.60	1.43	2.05	1.97	2.11
Current	2.65	2.49	2.34	2.70	2.32	2.24	2.36	2.30
Change Since June	-0.08	-0.09	-0.07	-0.30	-0.05	-0.06	0.15	0.04

What To Watch Today

Earnings

Wednesday Jan 15	EPS	Consensus	Previous	Revenue	Consensus	Previous	MarketCap	Fiscal	Time
JPMorgan JPM:US		3.95	3.97		41.25B	39.9B	$700.8B	Q4	PM
Wells Fargo WFC:US		1.34	0.86		20.49B	20.48B	$248.86B	Q4	PM
Goldman Sachs GS:US		8.12	5.48		12.15B	11.32B	$183.15B	Q4	PM
BlackRock BLK:US			9.66			4.63B	$147.15B	Q4	AM
Citigroup C:US		1.22	0.84		19.45B	17.4B	$135.23B	Q4	PM
Bank Of New York Mellon BK		1.51	1.28		4.64B	4.31B	$55.13B	Q4	PM
Synovus Financial SNV:US		1.15	0.80		565.59M	488.68M	$7.48B	Q4	PM
Home Bancshares HOMB:US		0.53	0.48		256.7M	245.6M	$5.48B	Q4	PM

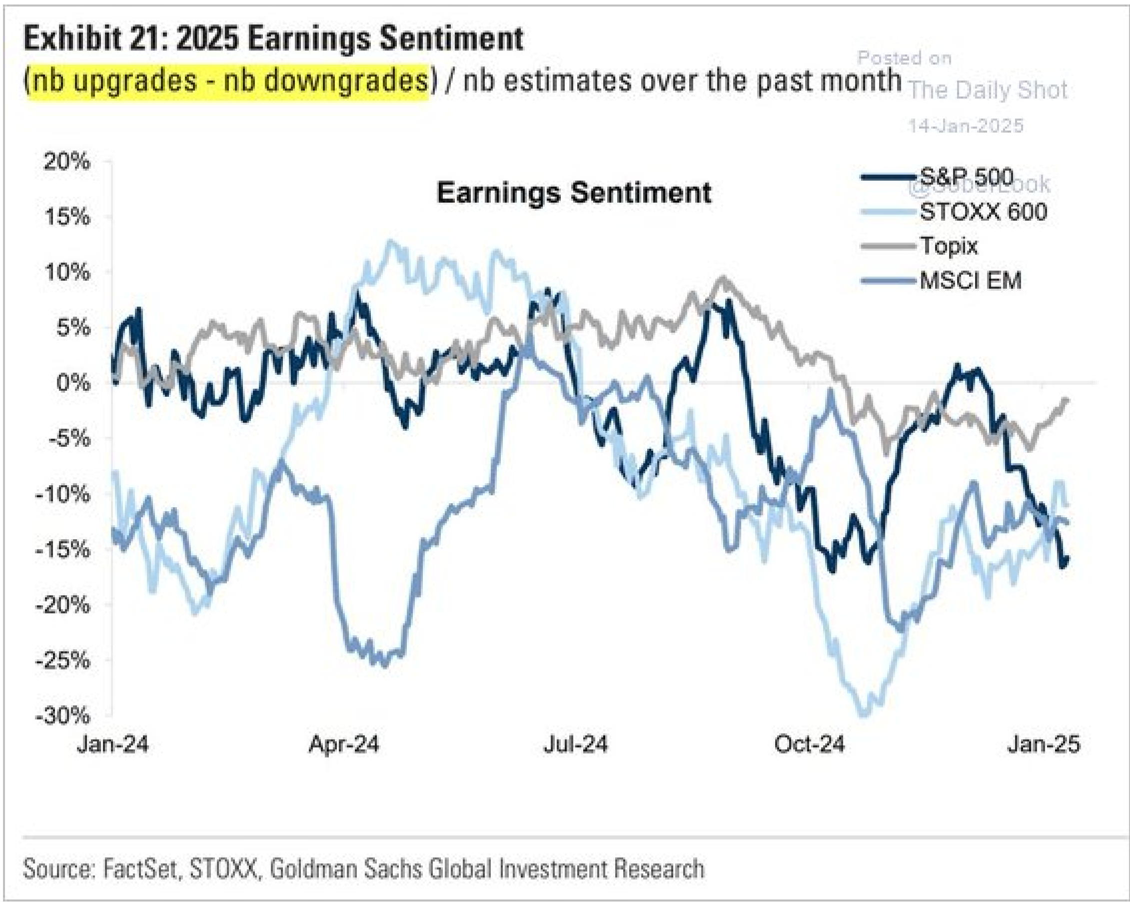
Economy

Wednesday January 15 2025			Actual	Previous	Consensus	Forecast
06:00 AM	US	MBA 30-Year Mortgage Rate JAN/10		6.99%		
06:00 AM	US	MBA Mortgage Applications JAN/10		-3.7%		
06:00 AM	US	MBA Mortgage Market Index JAN/10		168.4		
06:00 AM	US	MBA Mortgage Refinance Index JAN/10		401.1		
06:00 AM	US	MBA Purchase Index JAN/10		127.7		
07:30 AM	US	Core Inflation Rate MoM DEC		0.3%	0.2%	0.3%
07:30 AM	US	Core Inflation Rate YoY DEC		3.3%	3.3%	3.3%
07:30 AM	US	Inflation Rate MoM DEC		0.3%	0.3%	0.4%
07:30 AM	US	Inflation Rate YoY DEC		2.7%	2.9%	2.9%
07:30 AM	US	CPI DEC		315.49		315.6
07:30 AM	US	CPI s.a DEC		316.441		317.4
07:30 AM	US	NY Empire State Manufacturing Index JAN		0.20	3	3.1
08:20 AM	US	Fed Barkin Speech				
09:00 AM	US	Fed Kashkari Speech				

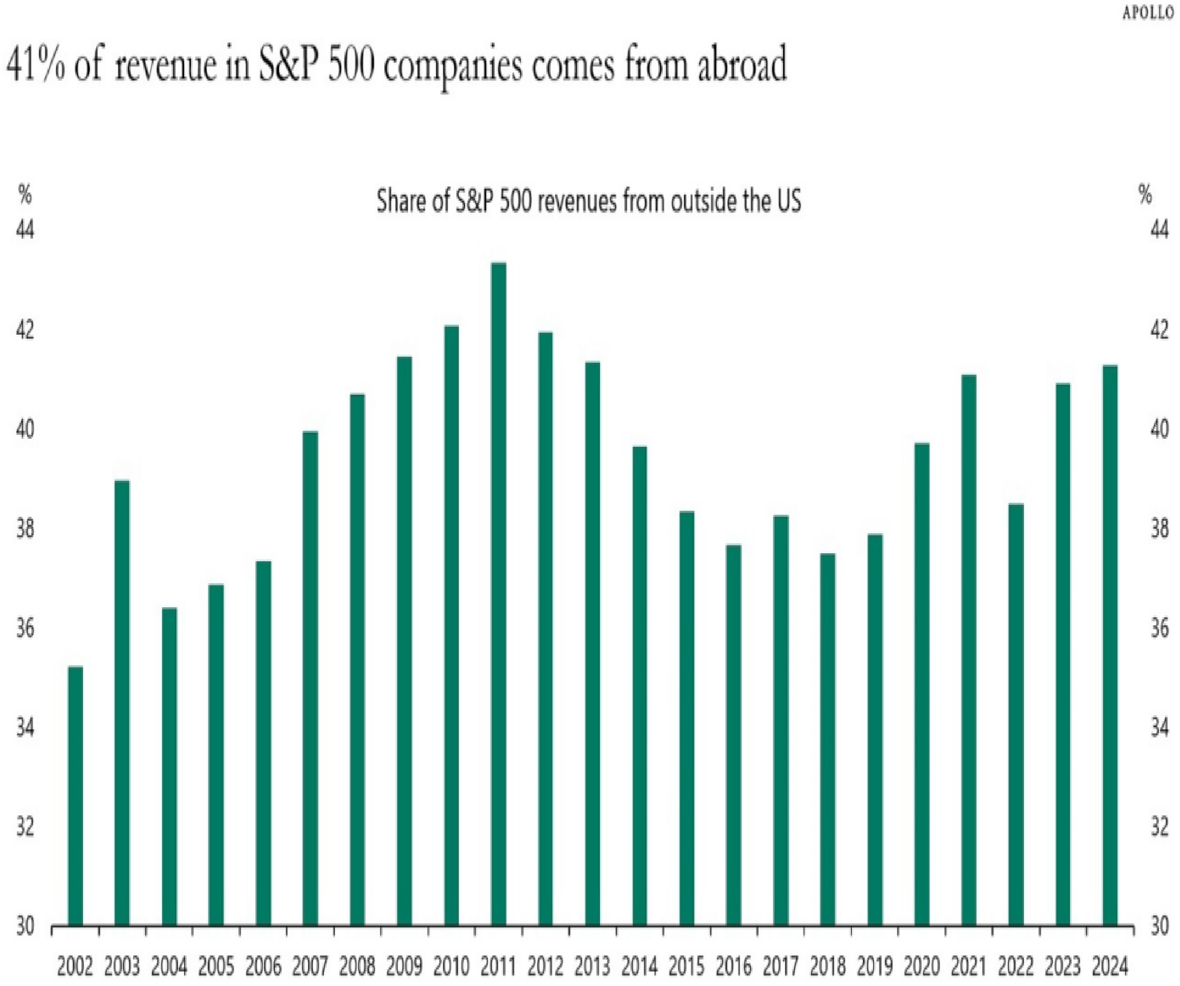
Market Trading Update

As noted ***yesterday,*** today is the all-important CPI *(inflation)* number that the markets are glued to regarding their expectations for the Fed?s next move. While the bond market has traded off, along with stocks, on expectations for a *?hotter-than-expected?* print, there is a decent possibility the number could be weaker given the Producer Price Index (PPI) number yesterday. Given the market?s short-term oversold condition and a sharp drop in sentiment, an inline or softer CPI print this morning could lead to a rather sharp rebound in market prices.

We will see what happens and trade the market accordingly. However, TODAY also kicks off earnings season. As we have discussed recently, earnings growth in Q4 is expected to be around $209/share, but analysts expect nearly $250/share by the end of 2025. Notably, those expectations have declined since the beginning of 2024 as economic growth continues to slow.

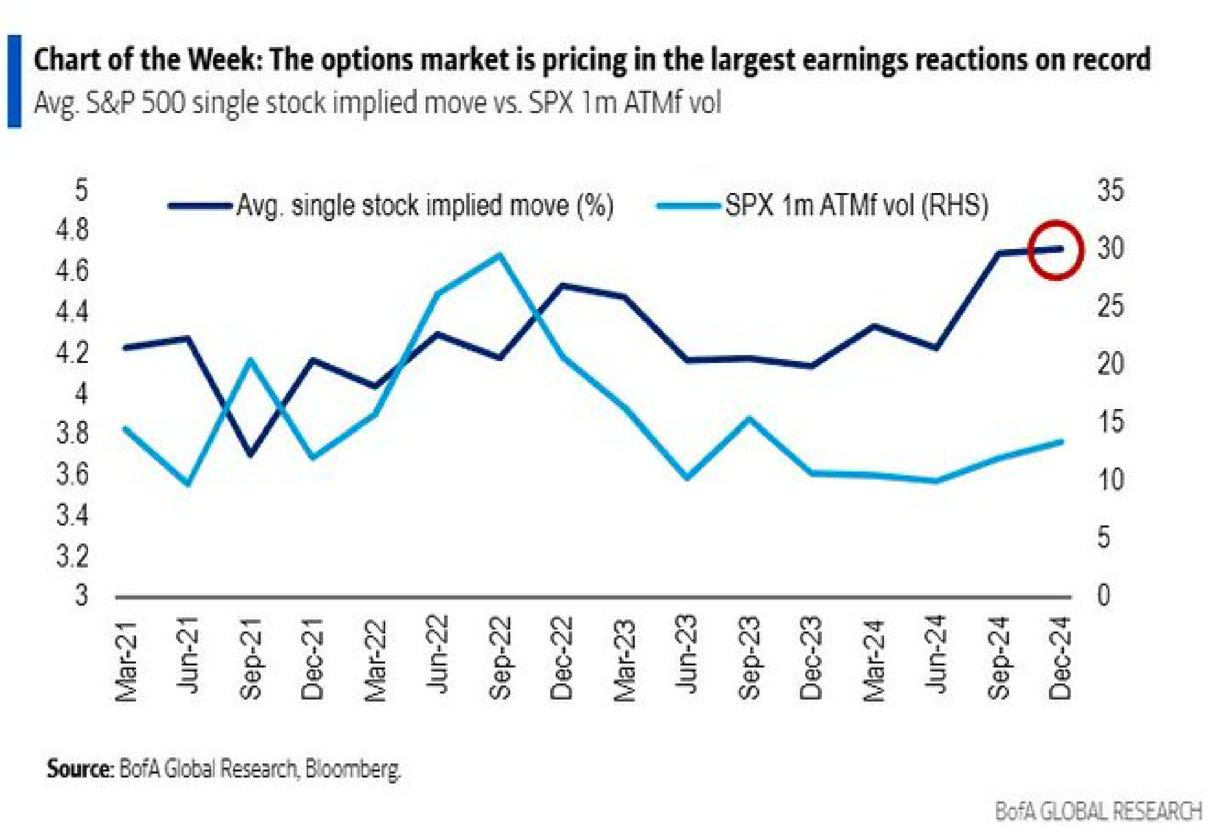


The most significant risk to earnings is slowing international growth. While the U.S. is still growing rather strongly, the rest of the world is on the verge of slipping into a recession. This is important because 41% of corporate revenue is derived from international markets. When you combine weak economic growth with a strong dollar, which increases the costs of products bought from the U.S., the risk to earnings is notable.



In other words, there is more than a small risk that we could see an increase in missed earnings and more significant price swings based on disappointing results. [Bloomberg] made this point yesterday.

> *?Traders are bracing for one of the most volatile earnings periods in stock market history. At least, that?s what they are positioning for two days before big banks kick off the reporting cycle in the US. Options traders expect individual stocks in the&#2013266080;S&P 500 Index&#2013266080;to move 4.7% on average in either direction after reporting their results, the largest earnings-day moves on record, according to Bank of America Corp strategists?*



Since analysts expect earnings to grow by 7.5% in Q4, the risk of disappointment is high. Furthermore, equity selection will separate portfolio performance over the next month. Manage risk and exposures, particularly given the recent stretch of market weakness.

Does A Weak PPI Imply A Weak CPI?

PPI was weaker than expected, coming in at +0.2% versus expectations of +0.3%. Core PPI, excluding food and energy, was flat at 0%. Expectations were calling for a +0.2% increase. PPI has a decent impact on PCE, which will be reported later this month. Moreover, when the PPI comes out before CPI, as it is this month, a weaker-than-expected PPI often leads a weaker CPI.

The following review by Brent Donnelly of Spectra Markets is courtesy of Walter Bloomberg (@DeItaone):

> *Weak PPI means weak CPI, not always but often, writes Brent Donnelly of Spectra Markets. Recently, it?s somewhat rare for the Labor Department to publish PPI data before CPI data in a given month, but before 2018, it was the norm. Looking back at 10 years of history: When headline and core PPI both fall short of expectations?as they did in this morning?s release of December data?CPI for the same month has come in hot only 21% of the time. In such cases, it meets expectations 39% of the time and it too is softer than expected 39% of the time, Donnelly finds. That suggests that Wednesday?s December CPI is now less likely to come it higher than Wall Street expects. Economists*

had been forecasting a 0.3% rise in consumer prices.

United States Producer Prices Final Demand Less Foods and Energy MoM

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Core producer prices in the United States, which exclude food and energy costs, were unchanged from the previous month in December of 2024, halting the 0.2% increase from the previous month, and contrasting with market expectations that it would accelerate to a 0.3% increase. It was the first period where producer prices refrained from rising since July. On an annual basis, core consumer prices rose by 3.5%. source: U.S. Department of Labor

Tactically Bearish As Risks Increase

Could a *?crash?* happen? Yes. **However, bear markets rarely happen all at once.** In most bear markets, the market showed plenty of warning signs well before the *?bear?* came out of hibernation. Such gave investors ample time to exit the market, reduce risks, and raise cash to minimize the eventual reversion to capital. Even a simple technical signal, such as when the market violates the 48-week simple moving average, allowed investors to exit risk well before the rest of the correction occurred. Did you get out right at the top? No. Did you get back in at the exact bottom? No. Did you participate in most of the advance and avoid most declines? Yes.

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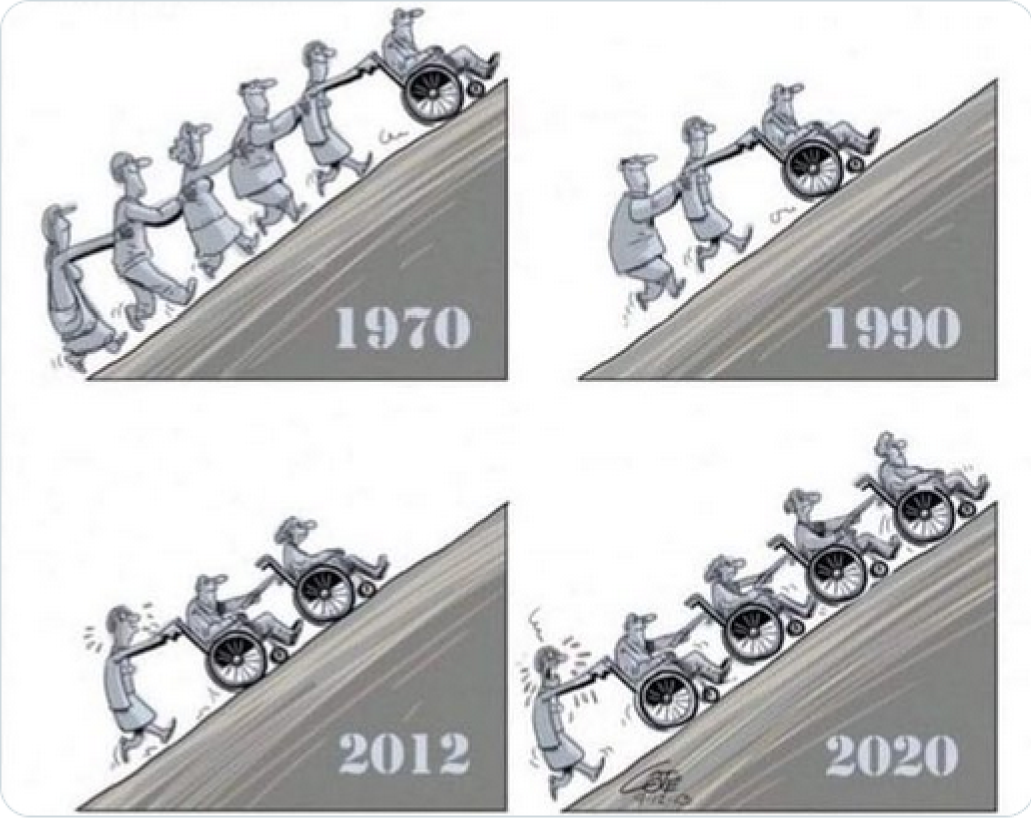
This summarizes the impact of demographics on European pension systems really well



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