On The Mark

Beyond the inflation headlines

July 16, 2021

Key Takeaways

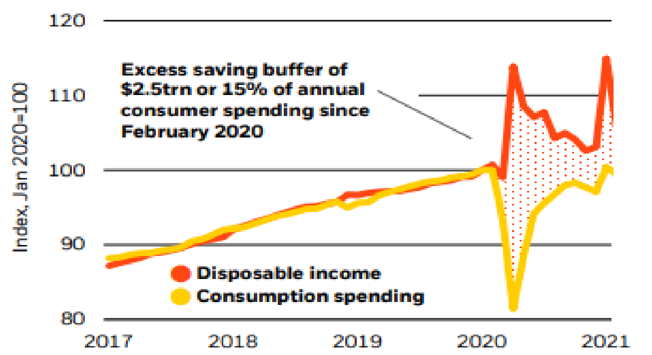
- Inflation concerns remain central in 2021.
- While there are a number of factors contributing to rising inflation, the risk of runaway remains low.
- For investors the key going forward is to watch for sustained and broader price increases, not just short-term price spikes.

Inflation remains a topic of concern in 2021. There are two key measures of inflation, the Consumer Price Index (CPI) and the Federal Reserve's (Fed) preferred measure of Core Personal Consumption Expenditures Price Index (PCE). Both indexes have shown near-term spikes in price increases, well above the Fed's target of 2%. The latest reading for CPI increased 5.4% from June 2020 to June 2021, the highest 12-month increase since August 2008.[1]

For investors, the million-dollar question is whether today's price increases are the start of a lasting trend that could derail the economy or merely a transitory period from the economic reopening. While it's challenging to answer that question with certainty, a closer look at what is driving the price increase may help investors prepare for what's next.

Prices rise when demand exceeds supply and demand is often high when consumers have cash to spend. In the U.S., some consumers are flush with cash right now because they were unable to spend on typical purchases during the shutdown. In addition, congress supplied the economy with trillions of dollars in fiscal support. While the pandemic did lead to financial devastation for many, and fiscal support partially or fully replaced lost income, not everyone was impacted. Many consumers remained employed and collected additional financial support during a turbulent time for all. This historic environment contributed to an excess savings buffer of $2.5 trillion, or 15% of annual consumer spending, since February 2020.[2]

U.S. disposable income vs. consumer spending

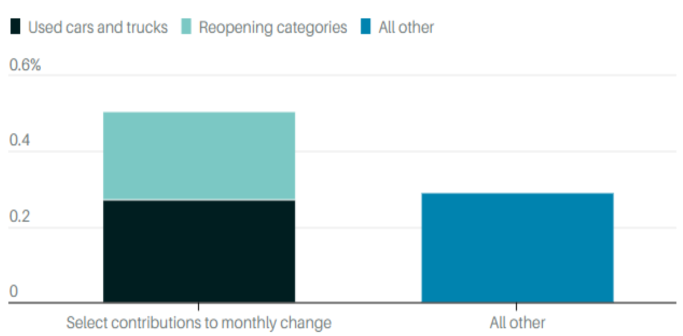


Source: BlackRock Investment Institute, Bureau of Economic Analysis, U.S. Treasury Department, with data from Haver Analytics, April 2021. Chart shows U.S. nominal household disposable income (orange line) and nominal personal consumer spending (yellow line).

In addition, increased demand has been met with supply disruptions as companies are just catching up after being shut down. According to Barron's, the majority of price increases in spring of 2021 were in categories such as travel, lodging, used cars, and in select areas of the economy that were especially hard hit by the pandemic - these normally account for just 13% of consumer spending.[3] While these categories have seen prices rise rapidly, prices for airline tickets and hotels still remain below prepandemic levels. In other words, because prices

Most the increase in the CPI came from categories with a combined weight of 13%.

Sources of one-month change in the consumer-price index in April

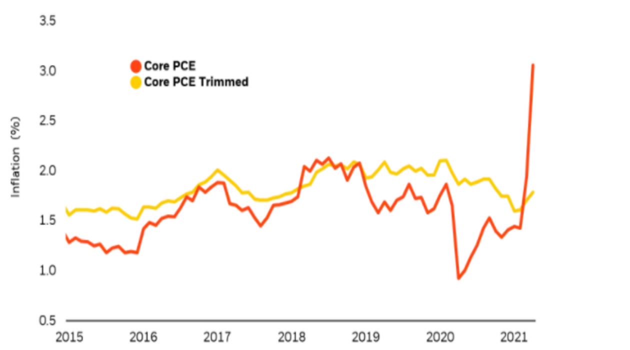


Note: Reopening categories are hotels and motels, food away from home, car rental, event admissions, motor vehicle insurance, and airline fares
Source: Bureau of Labor Statistics; Barron's calculations

collapsed in the spring of 2020, measuring inflation year-over-year will appear extremely high from a low baseline.

Finally, it's important that investors don't mix short-term price hikes with broad inflation. Price increases in select areas tied to the unique challenges of the economic reopening is not the same as broad-based inflation. When the outliers mentioned earlier are accounted for, the inflation data as measured by the Core PCE Trimmed shows prices closer to 2% rather than the sharp spike seen in the broad Core PCE index.[4]

Controlling inflation measures for outliers



Source: Bloomberg, as of June 8, 2021. Based on the Core Personal Consumption Expenditures Price Index (Core PCE) and the Dallas Trimmed Mean Core PCE Index (Core PCE Trimmed).

While there are a number of factors contributing to rising inflation, the risk of runaway inflation remains low. Improvements to supply shortages and reduced fiscal benefits should potentially alleviate concern over long-term inflation. For investors, the key going forward is to watch for sustained and broader price increases, not just short-term price spikes.

[1] https://www.bls.gov/news.release/pdf/cpi.pdf
[2] https://www.blackrock.com/us/individual/literature/whitepaper/systematic-fixed-income-outlook-summer-2021.pdf
[3] https://www.barrons.com/articles/retirement-challenges-help-51625849597
[4] https://www.blackrock.com/us/individual/literature/whitepaper/systematic-fixed-income-outlook-summer-2021.pdf

AssetMark, Inc.

1655 Grant Street
10th Floor
Concord, CA 94520-2445
800-664-5345

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