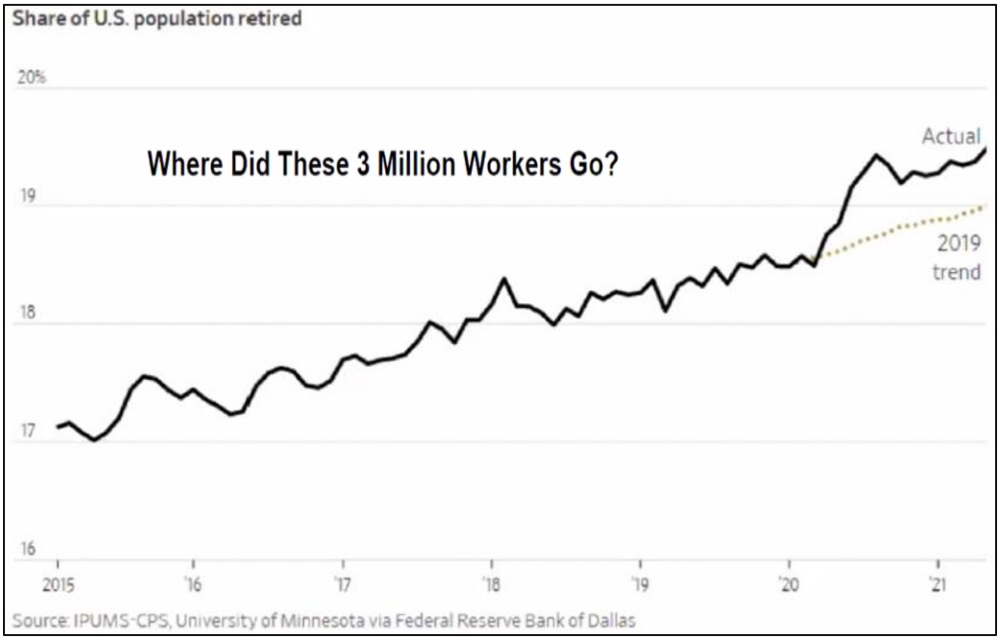
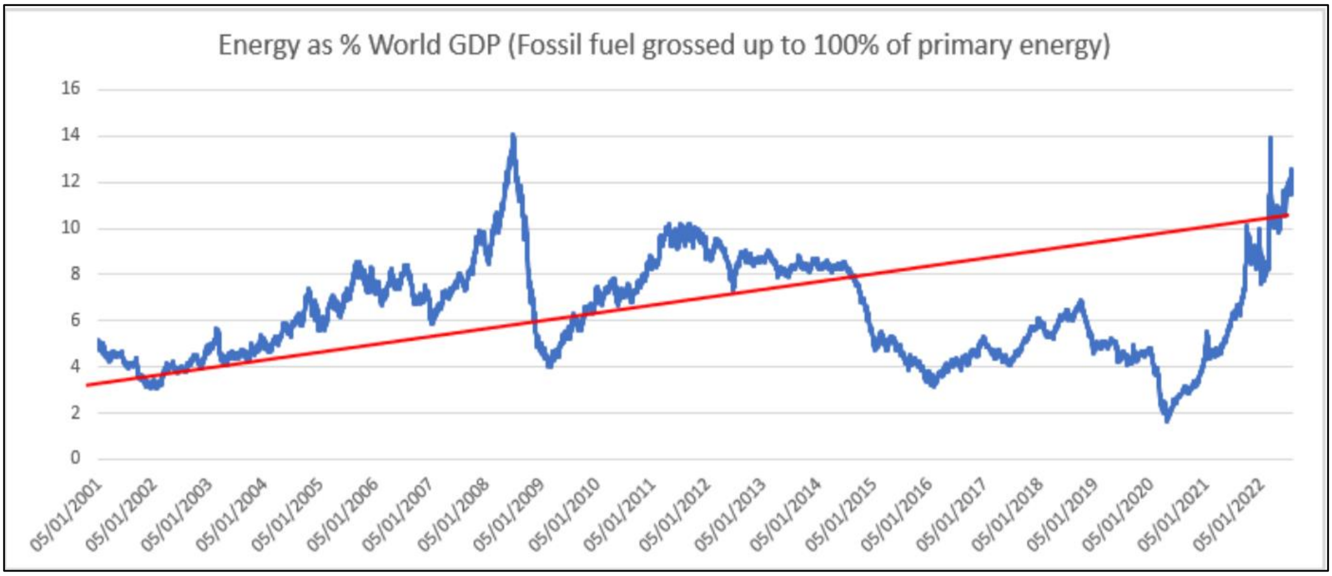
Inflation is Inflationary!

- Month on month inflation prints continue to remain sticky; but, market behavior says ‘transitory’ is not dead with swaps contracts pricing in *2-3% range after 2024*. Markets have accepted that inflation will normalize over a *slightly longer time frame*; but, still don’t seem to be prepared for ‘inflation volatility’ or ‘discrete step on step rise in inflation’
- Recession effect on economy will be based on whether bear markets are due to ‘Disinflationary’ or ‘inflationary’ trends. *Disinflation* - Brutal in beginning but eventually fed put kicks in; *Inflation* - drop & then sideways movement & eventually an even bigger drop once markets realize that the fed put is missing.
- What is good for the market is bad for the economy, given negative correlation between the two. Markets are cheering for recession *(disinflationary)* as it is expecting that as growth (due to high inflation) falls, Fed steps in which will ultimately save the market. However, current set up is for an ‘Inflationary’ recession.
- Among the 76 sub-indices rolled into CPI, *70% are rising above 5%* irrespective on slowdowns. So, even if there is disinflation, it could likely be in the range of 7.5 – 8% till September. For instance, haircuts (which is just labour & rent) is rising above 6.2%.
- Labor force - There were *excess retirements* of 1.5 mn people as opposed to pre-covid trend & structural shortage of workers with median age of truck workers & farmers being 55 and 59 each.
- Data in Europe on tourism, mobility & consumer spending does not indicate any demand destruction yet. In the US wages for regular workers is growing by 11% YoY as economic momentum has not yet declined. We will need substantial decline in these indicators before we call out ‘Recession”
- Normalization of banks loan to deposit ratio to pre-covid loans would require $2.5 trn in loans; which amounts to a *new spending package* in itself. There is room for the consumer to lever up as household debt service repayments as a % of personal income is ~9% which is a 40-year low.

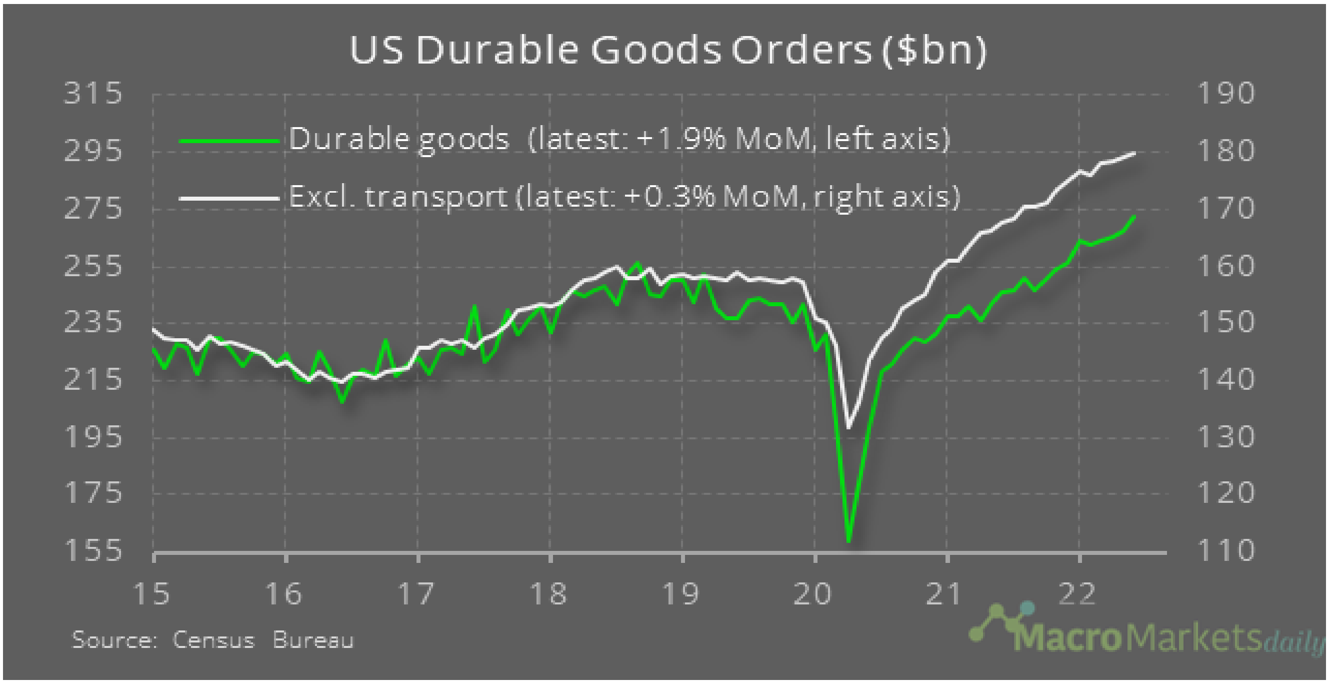


There is a high chance that inflation averages between 5 to 10% in the next 5 years as opposed to the Federal Reserve’s forecast which is expecting inflation to normalize.

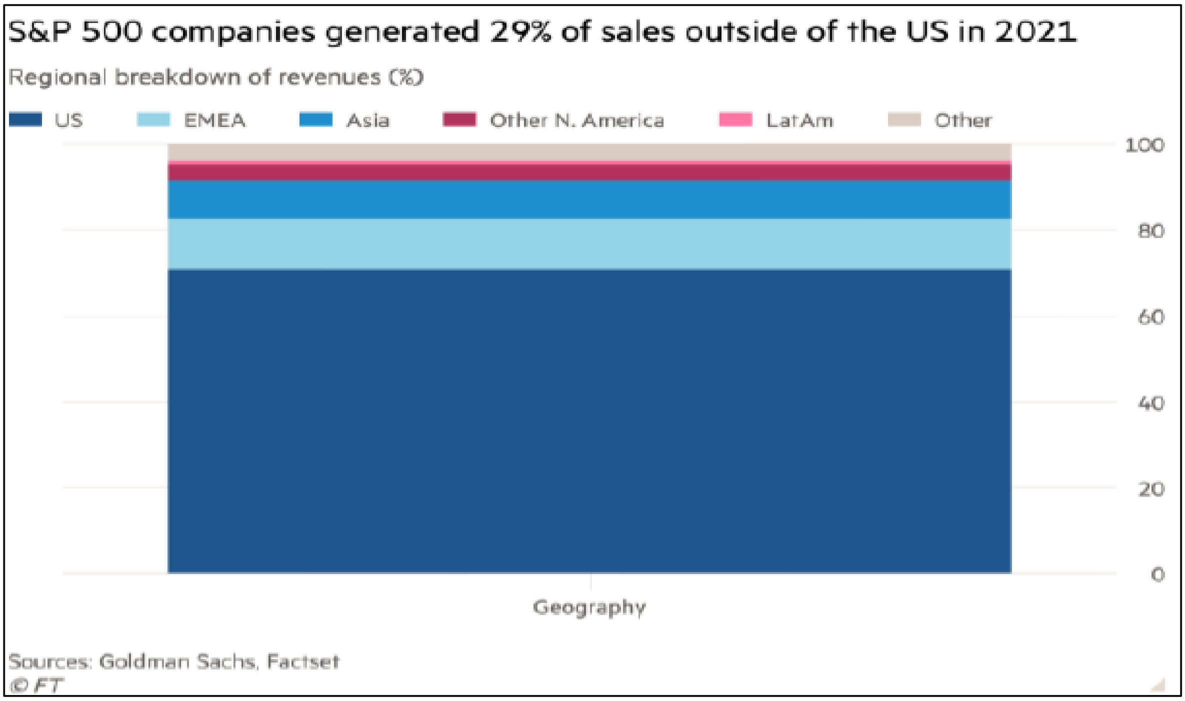
Source: Stonex



Energy rose to 12.58% of world GDP. This is based on Brent oil, a 50:50 mix between U.S. natural gas and Asian LNG, and Australia's Newcastle coal, all grossed up to 100% of the primary energy mix. Rising energy as % of world GDP is bad news for Global economy



Decent gain in US durable goods orders in June, albeit only because of a big jump in defense aircraft orders. The monthly increase in Defense aircraft and parts Durable new orders soared by $10.5 billion (not seasonally adjusted), the third biggest print on record, and not too far off the $13.4 billion record set in the weeks after the Sept 11 war.

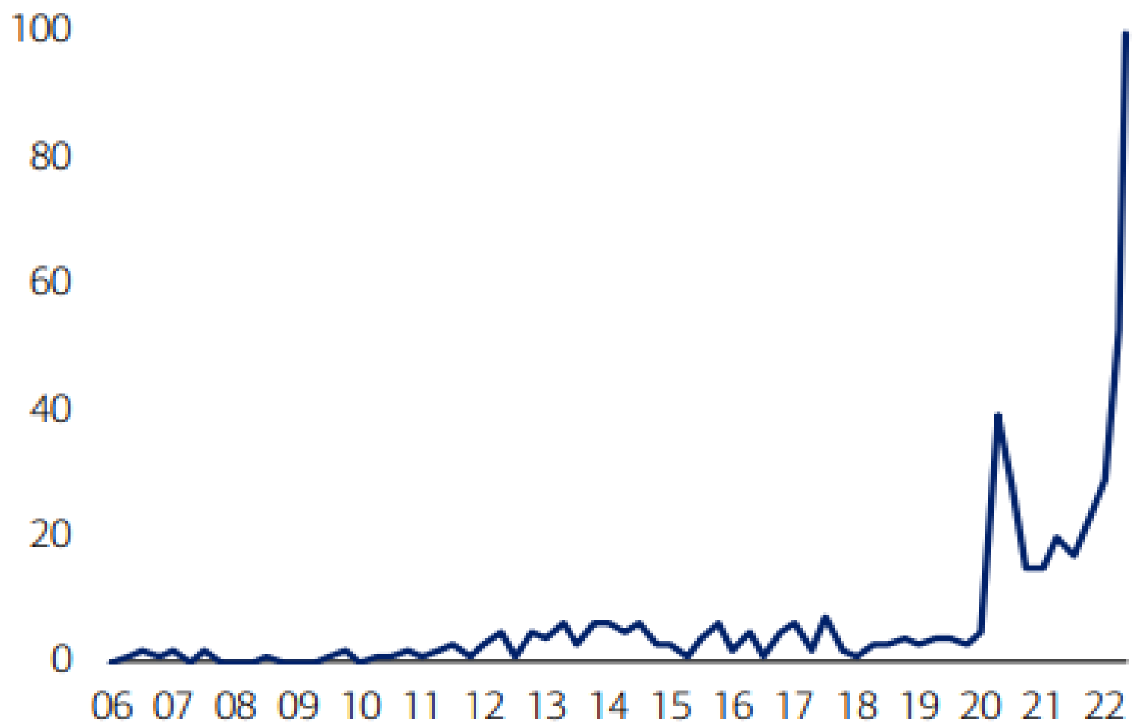


Strong Dollar has wiped billions off US corporate earnings. Goldman Sachs estimated that 59% of sales for tech companies in S&P 500 were generated outside of the US. That is far above the average US large-cap publicly traded company; S&P 500 groups as a whole made 29% of their $14tn of revenues in 2021 abroad.

US 10-yr yield at 2.80%. S&P 500 '22 EPS model of $220. Earnings/price (4,000) =~5.5%. At 5.5%, subtract 10-yr of ~2.80% to calculate Equity Risk Premium 2.7%, above risk-free rate.

Exhibit 22: Mentions of re-shoring skyrocketed

Companies mentions of re-/near-/on-shoring (100=max; 2006-7/22/22)



Source: AlphaSense, BofA Global Research

BofA GLOBAL RESEARCH

Companies mentioning “Reshoring” in their con calls have gone through the roof. As per a separate survey done by BOFA, the top 3 destinations for reshoring are Vietnam, Mexico and India.