

Leading Indicators Point to Slowing Inflation Ahead

Beyond price measures themselves, signs of improvement in one of this bear market’s big fears abound. *November 2022*

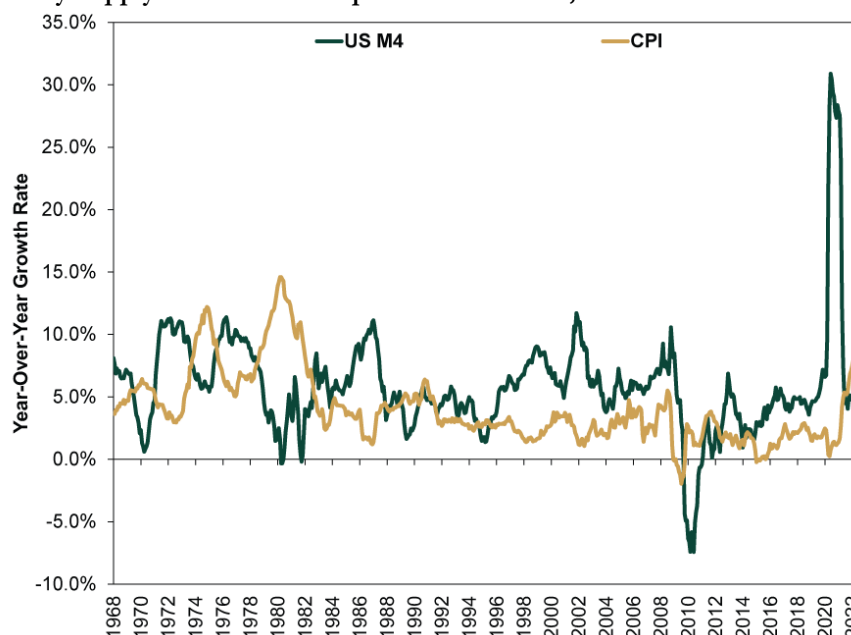
Recent US inflation readings have slowed some, offering investors a modicum of relief. But worry still abounds. Many fear that high inflation won’t subside anytime soon, with October’s readings a false dawn. Pundits say it is “too soon to celebrate” and argue the Fed has more work to do.^[i] Perhaps. Monthly inflation data variability is unpredictable. However, we see growing evidence inflation is likely to slow—and defang one of the bear market’s biggest fears this year.

From the headline consumer price index (CPI) and “core” CPI excluding food and energy to producer prices and import prices, inflation has come off the boil since the summer. Yet many argue other measures—like the median CPI or the “sticky price” CPI (a gauge of less-volatile prices)—continue to rise.^[ii] While we agree about not reading too much into short-term wiggles, we don’t think various inflation measures—or subsets of them—are any more telling than others. For example, as we showed in February, producer prices don’t reliably lead CPI. They are coincident, rising and falling together. Instead of poring over backward-looking inflation data—past prices, which never predict—we think it is more helpful to take cues from forward-looking measures, which indicate inflation is likely to subside over the coming year.

Exhibits 1 through 3 show a few leading inflation indicators. Now, as the charts also show, these aren’t super-precise gauges. Their lead times to CPI can vary—sometimes by a lot. They won’t pinpoint inflation’s peak, but together, we think the preponderance of evidence they provide gives a good sense of CPI’s likely general direction ahead.

Let us start with money supply. Monetarist theory states that inflation is always and everywhere a monetary phenomenon. So consider M4, the broadest measure of money including highly liquid “near money” substitutes like Treasury bills. Whatever you think of the accuracy of money supply measures, which seem somewhat questionable, the pattern is telling. M4’s most recent spike to over 30% y/y occurred in June 2020. Inflation began escalating about a year later as reopening commenced and demand surged, but M4 growth has since slowed dramatically. It crawled 1.9% y/y in September. Less money sloshing around the system means fewer dollars chasing (up until recently) supply-constrained goods.

Exhibit 1: Money Supply Deceleration Implies Inflation Will, Too



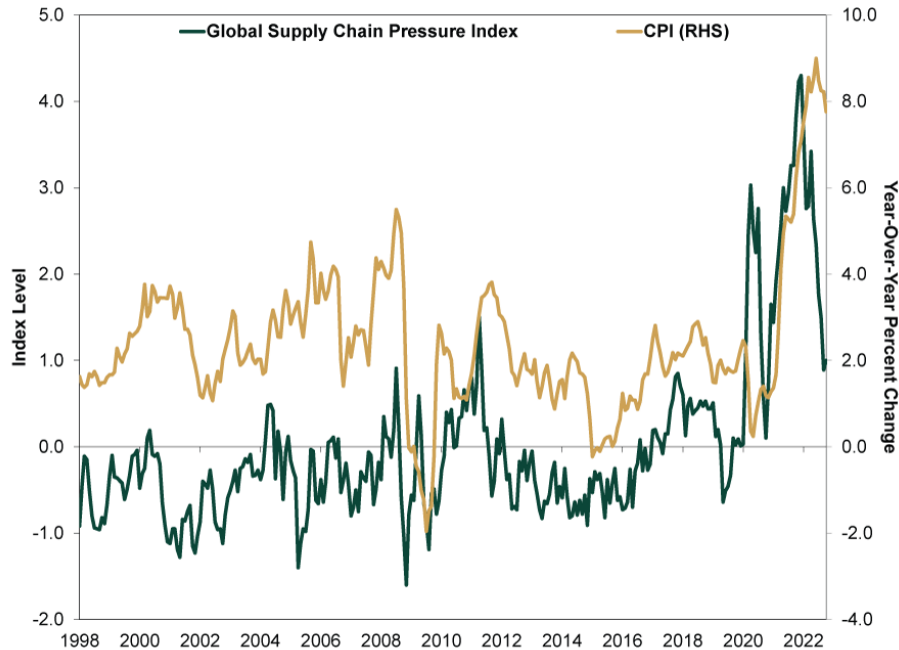
Source: Center for Financial Stability and Federal Reserve Bank of St. Louis, as of 11/17/2022. Divisia M4 (including US

FISHER INVESTMENTS EUROPE™

Treasuries), January 1968 – September 2022, and CPI, January 1968 – October 2022. Past performance is no guarantee of future returns.

Supply chain issues have featured prominently in this year's hot inflation, in our view. Yet improvements are showing. We have featured the New York Fed's Global Supply Chain Pressure Index (GSCPI) a couple times before as a good indicator price pressures are easing. The GSCPI has dropped from over 4.0 late last year to around 1.0 recently. That still shows elevated pressure, but it has eased substantially from the peak.

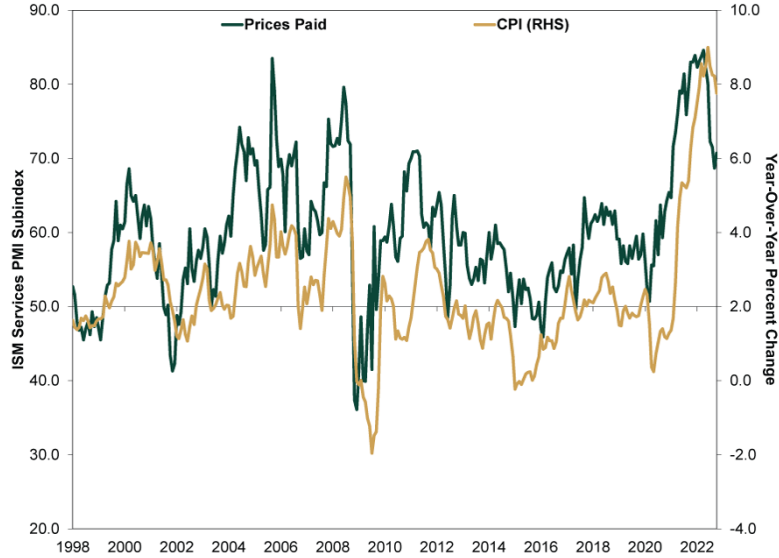
Exhibit 2: Global Supply Chain Pressure Easing Helps Relieve Price Pain



Source: Federal Reserve Banks of New York and St. Louis, as of 11/17/2022. Global Supply Chain Pressure Index and CPI, January 1998 – October 2022. Past performance is no guarantee of future returns.

The Institute for Supply Management (ISM) prices paid purchasing managers' subindex for the *services* sector offers a separate look at input prices firms representing 71% of GDP are seeing.^[iii] Around 70% of services firms surveyed in October say the prices they pay are rising—historically elevated, like the GSCPI—but that has come down from nine straight months of readings above 80% through June. Meanwhile, the sister manufacturing survey showed more respondents noted *falling* input prices than rising.^[iv]

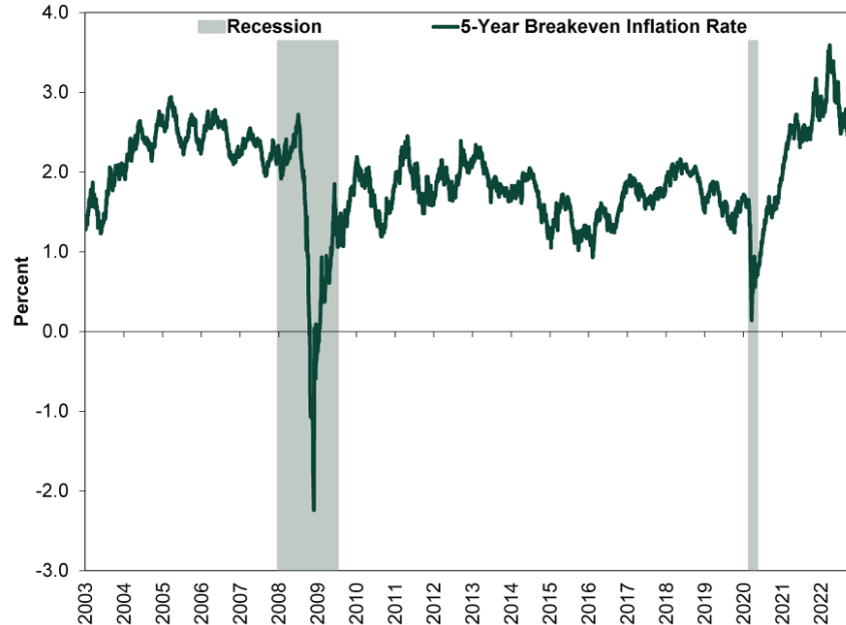
Exhibit 3: Services Firms Are Also Seeing Slower Price Growth



Source: FactSet and Federal Reserve Bank of St. Louis, as of 11/17/2022. ISM services purchasing managers' index (PMI) prices paid subindex and CPI, January 1998 – October 2022. Past performance is no guarantee of future returns.

Markets reflect likely easing inflation pressures, too. Exhibit 4 shows the average inflation rate over the next five years implied by the difference between 5-year Treasury and Treasury Inflation-Protected Securities yields has fallen to 2.3% from a high of nearly 3.6% in March.

Exhibit 4: The Bond Market Expects Inflation to Moderate

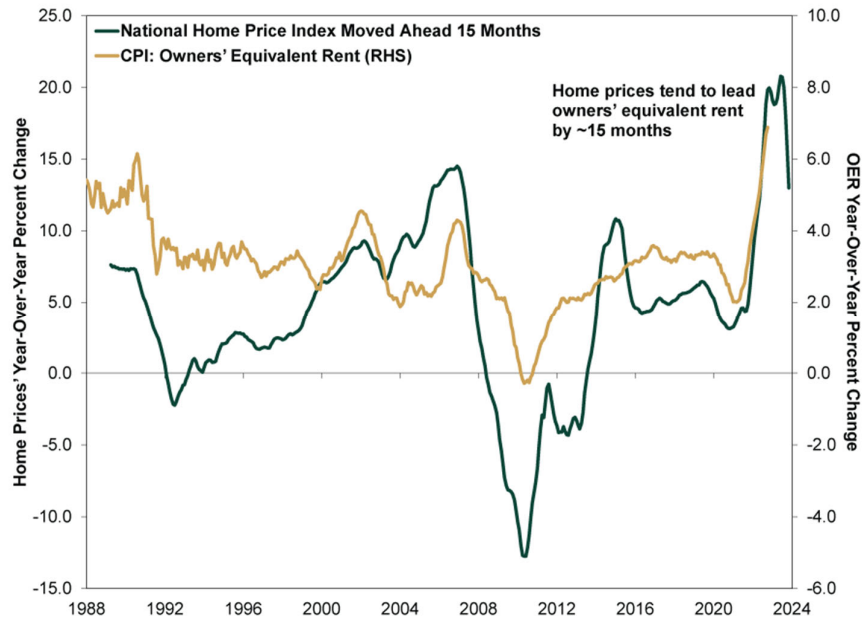


Source: Federal Reserve Bank of St. Louis, as of 11/17/2022. 5-Year Breakeven Inflation Rate, 1/2/2003 – 11/16/2022. Past performance is no guarantee of future returns.

Meanwhile, the S&P/Case-Shiller National Home Price Index has shown cooling prices for months now, and it typically leads shelter costs—among those “sticky” prices some warn are still rising. As Exhibit 5 shows, home prices tend to lead the CPI’s owners’ equivalent rent (OER) component—the single-largest

CPI category at a nearly 25% weight—by around 15 months. Now, OER is an illusory line item in CPI, because it represents the costs of what homeowners would pay *if* they rented their house. The BLS imputes it from the relatively small sample size of single-family home occupants renting their primary residence. But regardless, actual rental rates have decelerated to 4.7% y/y in October, down rapidly from January’s 17.4% peak, according to Realtor.com.^[v]

Exhibit 5: Home Price Growth and Rental Rates Starting to Decelerate



Source: FactSet and Federal Reserve Bank of St. Louis, as of 11/17/2022. S&P/Case-Shiller National Home Price Index, January 1988 – August 2022, and CPI: owners' equivalent rent, January 1988 – October 2022. The Home Price Index is pulled 15 months forward for illustrative purposes. Past performance is no guarantee of future returns.

Continually escalating grocery bills may also be in the rear-view before too long. The UN Food and Agricultural Organization (FAO) Food Price Index—international prices for food commodities the FAO measures—has steadily slowed since spring. From 34% y/y in March (when Russia invaded Ukraine, both major agricultural exporters), food prices were up 2% in October.^[vi] This may not yet show in falling prices you are paying, but it is an encouraging signal that upward pressure is abating.

Inflation was a key factor in souring sentiment this year, hurting stocks. We don't think inflation itself *fundamentally* caused 2022's bear market. After all, the US economy has (so far) avoided recession despite widespread fear—and an impending one in coming quarters isn't assured. Meanwhile, corporate profit margins and investment have held up rather resiliently. But now, signs of inflation pressure ebbing suggest that our inflation sentiment may be overdone—bringing relief. It may not come in a straight line—few economic or market factors do. But it does seem likely to come soon, almost no matter what you think drove inflation this year.

FISHER INVESTMENTS EUROPE™

Disclosure

Fisher Investments Ireland Limited

Fisher Investments Ireland Limited, an Irish private limited company, is registered, along with its trading name, Fisher Investments Europe (FIE), with the Companies Registration Office in Ireland (#623847 and #629724), authorised and regulated by the Central Bank of Ireland, is wholly owned by Fisher Asset Management, LLC, trading as Fisher Investments (FI).

FIE outsources portfolio management to the parent company FI. FI was established as a sole proprietorship in 1979, incorporated in 1986, registered with the SEC in 1987, and succeeded its investment adviser registration to a limited liability company in 2005. As of 30 September 2022, assets valued over \$156 billion USD. All assets as of 30 September 2022 in this document are preliminary and subject to reconciliation of accounts.

FI and its subsidiaries consist of four business units – Fisher Investments Institutional Group (FIIG), Fisher Investments US Private Client Group, Fisher Investments Private Client Group International, and Fisher Investments 401(k) Solutions Group. FIIG services significantly all of FI's institutional accounts. Fisher Investments US Private Client Group and Fisher Investments Private Client Group International serve a variety of equity, fixed income, and balanced assets for a substantial majority of the firm's private client accounts. 401(k) Solutions provides investment-related fiduciary and plan consulting services to employer sponsored retirement plans in the United States with less than \$20 million USD in assets. For separately managed accounts, we would like to propose a sub-advisory relationship where FIE serves as the investment manager and FI serves as the sub-investment manager. FI's Investment Policy Committee (IPC) is responsible for all investment decisions for the firm's strategies.

Unless otherwise specified, references to investment professionals, operations personnel, and middle and back office personnel are references to Fisher Investments employees. "We", "our," "us" and "the firm" generally refer to the combined capabilities of Fisher Investments and its subsidiaries. Investment in securities involves the risk of loss. Past performance is no guarantee of future returns.

Fisher Investments Europe Limited

Fisher Investments Europe Limited (FIE), along with its trading name, Fisher Investments UK (FIUK), authorised and regulated by the Financial Conduct Authority (FCA), is wholly owned by Fisher Asset Management, LLC, trading as Fisher Investments (FI). FIE outsources portfolio management to the parent company FI. FI is an investment adviser registered with the US Securities and Exchange Commission (SEC). As of 30 September 2022, assets valued over \$156 billion USD. All assets as of 30 September 2022 in this document are preliminary and subject to reconciliation of accounts. FI and its subsidiaries consist of four business units – Fisher Investments Institutional Group (FIIG), Fisher Investments US Private Client Group, Fisher Investments Private Client Group International, and Fisher Investments 401(k) Solutions Group. FIIG services significantly all of FI's institutional accounts. Fisher Investments US Private Client Group and Fisher Investments Private Client Group International serve a variety of equity, fixed income, and balanced assets for a substantial majority of the firm's private client accounts. 401(k) Solutions provides investment-related fiduciary and plan consulting services to employer sponsored retirement plans in the United States with less than \$20 million USD in assets. For separately managed accounts, we would like to propose a sub-advisory relationship where FIE serves as the investment manager and FI serves as the sub-investment manager. FI's Investment Policy Committee (IPC) is responsible for all investment decisions for the firm's strategies.

Unless otherwise specified, references to investment professionals, operations personnel, and middle and back office personnel are references to Fisher Investments employees. "We", "our," "us" and "the firm" generally refer to the combined capabilities of Fisher Investments and its subsidiaries. Investment in securities involves the risk of loss. Past performance is no guarantee of future returns.

[i] "Inflation Isn't Dead Yet," Editors, *Bloomberg*, 11/15/2022. "Wait, This Is The Inflation News Everyone Is Celebrating?" Editorial Board, *Issues & Insights*, 11/15/2022.

[ii] Source: Federal Reserve Bank of St. Louis, as of 11/17/2022. Sticky Price Consumer Price Index less Food and Energy, October 2022. "Are Some Prices in the CPI More Forward Looking Than Others? We Think So," Michael F. Bryan and Brent H. Meyer, Federal Reserve Bank of Cleveland, 5/19/2010. "Cleveland Fed: Median CPI Increased 0.5% and Trimmed-Mean CPI Increased 0.4% in October," Bill McBride, *Calculated Risk*, 11/10/2022.

[iii] Source: BEA, as of 11/17/2022.

[iv] Source: FactSet, as of 11/17/2022. ISM manufacturing PMI prices paid subindex, October 2022.

FISHER INVESTMENTS EUROPE™

[v] “October Rental Report: Rent Prices Fall for the Third Straight Month,” Jiayi Xu, Realtor.com, 11/17/2022.

[vi] Source: FactSet, as of 11/17/2022. FAO Food Price Index, March 2022 – October 2022.

The content contained in this article represents only the opinions and viewpoints of the Fisher Investments editorial staff. Further articles can be found at [marketminder.com](https://www.marketminder.com).