STRATOS INVESTMENT MANAGEMENT

INFLATION: CPI

FEBRUARY 2024
MARKET COMMENTARY

Inflation data came in a bit hotter than expected with the Bureau of Labor Statistics reporting this morning (February 13, 2024) that its Consumer Price Index (CPI) rose 3.1% on a twelve-month basis versus expectations for a rise of 2.9%. The core rate, which removes more volatile food and energy components, rose 3.9% versus expectations for a rise of 3.7%. While the headline CPI number was smaller than December's 3.4% reading, that it came in higher than expected seems to indicate that inflation, potentially, is not cooling as quickly as hoped.

The shelter component rose 6%, contributing nearly two-thirds of the increase. The largest increase within the components of CPI was transportation services, which rose 9.5%. Also contributing to the bigger than expected CPI number was food away from home which rose 5.1%.

The biggest decline(s) in the data came from gasoline (all types) which declined 6.4%, Fuel oil, which saw a decrease of 14.2%, utility gas service, which fell 17.8%, and used cars and trucks slipping 3.5%.

We have been concerned that the inflation data may not cool as rapidly as expected. Since the market had pivoted from interest rates being higher for longer for much of 2023 to (initially) six rate cuts in 2024, in our mind the biggest risk was that the data would not end up supporting the markets easier money expectations. In fact, given the increase in the price component of the ISM services data for December 2023, we viewed higher than expected inflation data as the biggest risk to the markets and the economy. (ISM is the Institute for Supply Management. They provide information on the outlook for both the manufacturing and services sector of the economy. Included in both the manufacturing and services releases is information on prices.)

As we write this comment Dow futures are down 300 points. We would also expect that expectations regarding the probability of rate cuts during the first half of this year will also decline. In our experience, when everyone expects the same thing to happen (in this case rate cuts in the first half of the year) the biggest danger is that the data doesn't corroborate the expectation.

Given the difficulties faced by the retail sector in 2023 and job losses in technology recently, among other things, our belief has been that the US economy had experienced a rolling recession from the back half of 2022 into 2023 and that the economy would avoid a "classic" recession. Assuming that to be true, the likelihood of significant, rapid rate cuts should have been smaller than the market expected. If inflation doesn't cool as much as expected, then the Fed will likely be on hold for longer than expected.

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Source: US Bureau of Labor Statistics, Consumer Price Index Summary, Tuesday, February 13. 2024.

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