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Macro Alert
The Coming Disinflation

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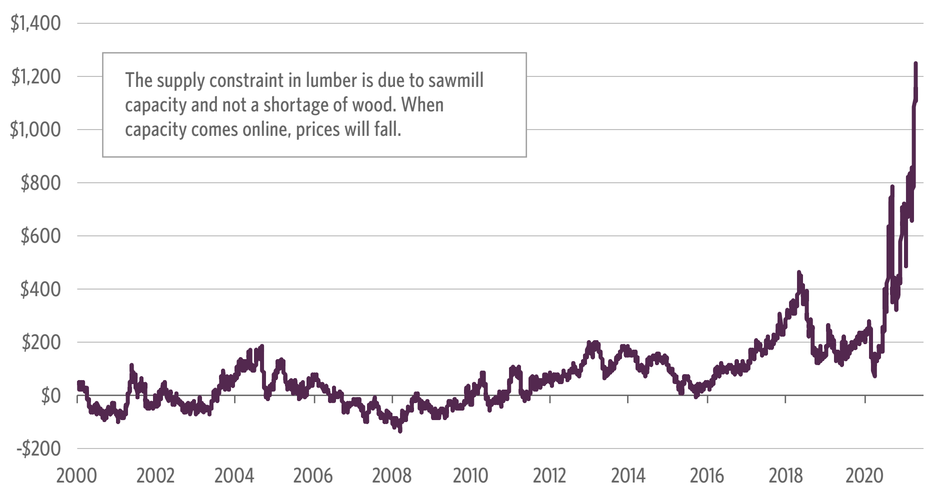
Further inflation scares in the coming months that drive any bond selloff should be seen as a buying opportunity. Our analysis suggests that the secular disinflationary headwinds of the past few decades will ultimately prove more lasting than a rise in prices due to temporary supply shortages.

Supply chain disruptions are widespread in everything from semiconductors to lumber, contributing to fears that higher inflation is on the way. These disruptions are being exacerbated by surging demand as the economy reopens and fiscal policy provides a strong tailwind for consumption.

A Picture of Supply Constraint: The Spread of Lumber Prices to Raw Timber Prices
$/Thousand Board Feet



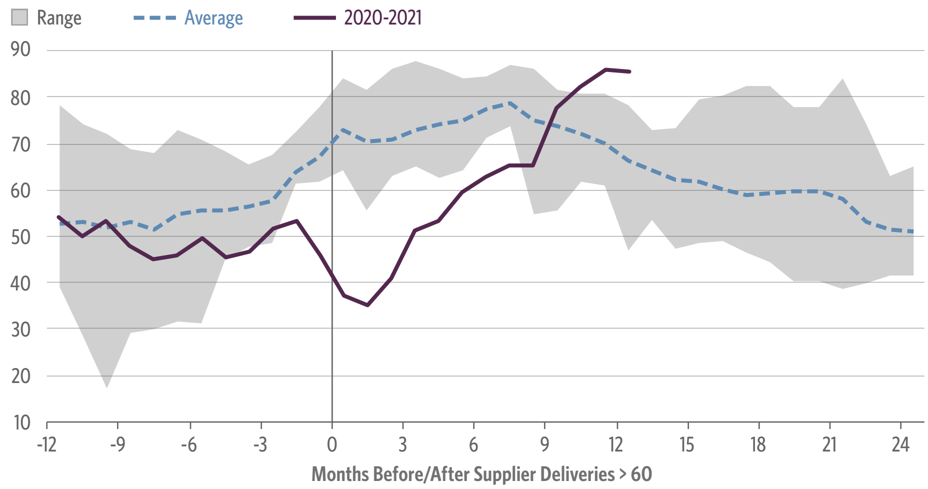
Source: Guggenheim Investments, Bloomberg. Data as of 4.26.2021. Stumpage is based on the Timber Mart-South US Louisiana Pine Sawtimber Stumpage Spot index and is converted to thousands of board feet at a ratio of 7.7.

While these supply issues may be a near term challenge, investors need to realize that these types of price pressures, typical in an economic rebound, are more like one-off adjustments than the kind of sustained inflation that would prompt the Federal Reserve (Fed) to react. The Fed has repeatedly referred to the coming inflation as transitory, so it is really 2022 inflation that will drive monetary policy.

Several factors suggest inflation will slow by next year. As the chart below shows, higher prices from supply bottlenecks in the manufacturing sector are typically short-lived. High prices and an improving COVID situation will bring more capacity online by the end of 2021, in turn dampening inflation pressure next year.

History Shows Manufacturing Supply Chain Pressures Will Ease

ISM Manufacturing Prices (Diffusion Index) Around Supply Disruptions (1980–Present)

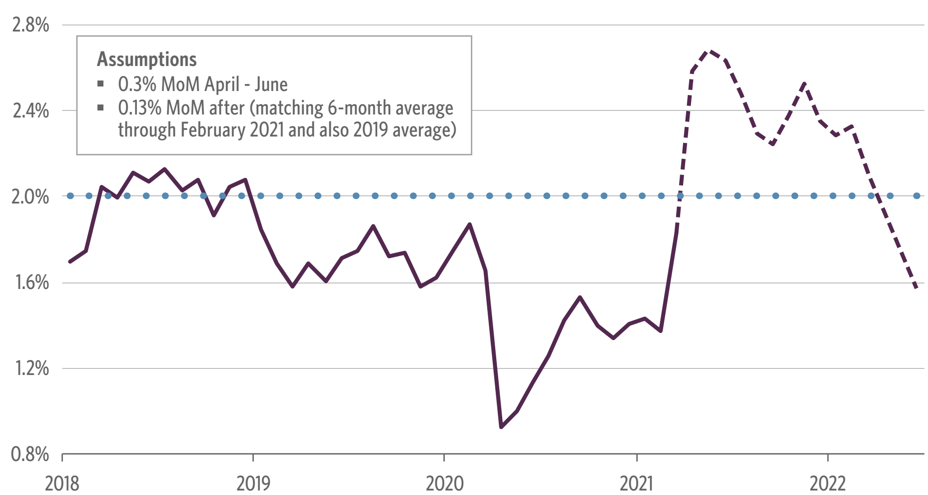


Source: Guggenheim Investments, Haver Analytics. Data as of 3.31.2021. Supply disruptions are defined as ISM Manufacturing Supplier Deliveries Subindex rising above 60. Seven historical episodes are covered by the range and average.

Additionally, large sequential price increases over the next few months will mean a high base effect when doing year over year comparisons in mid-2022, thwarting the Fed's efforts to reach and overshoot 2 percent on a sustained basis.

Base Effects Will Reverse in 2022

Core PCE, YoY%



Source: Guggenheim Investments, Haver Analytics. Data as of 3.31.2021. April through June assumed to increase 0.3 percent month over month, slightly less than the March increase. Monthly changes fall to 0.13 percent thereafter, the average seen in the six months through February 2021 and near the 0.14 percent average of 2019. Core PCE – personal consumption expenditures index, excluding food and energy.

Sustained inflationary pressure will need to come from the much larger service sector. One of the largest weights in core PCE is healthcare, where the expiration of pandemic-related policies will create a drag of over 15 basis points on YoY core PCE inflation next year. Ongoing labor market slack will further restrain inflation, especially as labor supply increases with more vaccinations and the expiration of federal unemployment benefits this September.

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