

June 13, 2022

Weekly Viewpoint

Investors Get Burned by Hot Inflation Report

Performance for Week Ending 6.10.2022

The Dow Jones Industrial Average (Dow) finished down 4.58%, the Wilshire 5000 Total Market IndexSM (Wilshire 5000SM) fell 5.09%, the Standard & Poor's 500 Index (S&P 500) slumped 5.05% and the Nasdaq Composite Index (NASDAQ) closed off 5.60%. Sector breadth was negative with all 11 of the S&P sector groups closing lower. The Financials (6.77%) was the worst performer followed by Technology (-6.38%) and Real Estate (-6.15%).

Index*	Closing Price 6/10/2022	Percentage Change for Week Ending 6/10/2022	Year-to-Date Percentage Change Through 6/10/2022
Dow	31392.79	-4.58%	-13.61%
Wilshire 5000	38860.55	-5.09%	-19.81%
S&P 500	3900.86	-5.05%	-18.16%
Nasdaq	11340.02	-5.60%	-27.52%

Market Observations: 6/6/22 – 6/12/22

The major market indices finished the week lower as a hotter than expected report on consumer inflation suggested that the Fed will need to maintain its aggressive stance on policy tightening. Data from the Labor Department showed the Consumer Price Index (CPI) rising by a higher-than-expected pace during the month of May. The CPI increased 8.6% on a year-over-year basis and exceeded the consensus forecast of 8.3%. Shelter, food, and gas were the largest contributors. The so-called core CPI, which strips out the more volatile food and energy components, rose 0.6% from the prior month and 6% from a year ago, also above forecasts. According to Bloomberg's World Interest Rate Probability function, fed fund futures are now discounting 50 basis point rate hikes at each of the next three FOMC meetings.

Fed Meeting on Tap: The Federal Open Market Committee (FOMC) is scheduled to meet on Tuesday and Wednesday, and they are expected to follow through on recent signaling of a 50bp rate increase at the meeting.

Fed Chairman Powell is also likely to reiterate that the Committee expects to raise rates by 50bps at the July meeting. The strong May CPI data have meaningfully lowered the probability that the Fed will be able to downshift the pace of policy tightening at the September meeting. In addition, with the University of Michigan's long-term inflation expectations survey increasing to the highest level since 2008, policymakers are likely to maintain a more hawkish bias until they have convincing evidence of a downshift in pricing pressure. Although the likelihood seems small, there could be some risk that Powell opens the door to a 75bps hike at the July meeting.

Inflation Deflating Sentiment: Consumer sentiment plunged in early June amid persistent inflation pressures and the sharp jump in gasoline prices. The June reading of the University of Michigan's consumer sentiment index declined 8.2 points to 50.2, the lowest reading in the history of the survey. Despite the stronger than expected CPI reading, the report showed that household inflation expectations for the year ahead held roughly steady at 5.4%, the top end of a range that has persisted since March, but still matching the highest reading since November 1981. Notably, five-to-ten-year inflation expectations picked up 0.3ppts to 3.3%, which is the strongest pace of the current cycle and the highest since June 2008. The surge in gasoline prices to record levels will likely continue to filter into household inflation expectations if elevated prices persist into the summer. Household sentiment will likely remain historically depressed in the near term as inflation is likely to remain sticky and pocketbooks continue to feel the squeeze from widespread price pressures.

Tale of Two Halves? While the near-term outlook for the markets will remain clouded by the situation in Ukraine, elevated levels of inflation and concerns over the Federal Reserve's response to inflation, we think as we move into the second half of the year things will begin to stabilize. The US economy remains in good shape and the probability of a recession in the coming quarters remains low. Consumer balance sheets are strong and net worth is near all-time highs. Money market mutuals have over \$4.5 trillion in cash and corporate buyback activity is expected to remain strong. Supply chain issues have also started to ease. Importantly, the earnings environment remains solid with high single digit growth expected this year and next. If there has been a silver lining to the recent market weakness, it's been that valuation levels have moved lower with the S&P selling for just over 16x the 2023 estimate and 15x the 2024 estimates. While still not a cheap market, it is much less expensive than we've seen in recent years.

The Week Ahead: As mentioned above, the focal point of the week ahead will be the two-day FOMC meeting where the Fed is expected to lift rates by a half percent. The Fed will also roll out an updated Summary of Economic Projections report, which includes the closely watched "dot plot." Investors will parse through the data for insight into the Fed's path beyond the June meeting. In addition to his after-meeting press conference, Fed Chairman Powell will give the opening remarks at an inaugural conference on the international role of the US dollar. In terms of the data calendar, it will be a busy week with data focused on consumer trends, production, and the housing market. The resilience of producers will be in focus with May PPI (Tuesday), June Philadelphia Fed business outlook (Wednesday), May industrial production and capacity utilization (Friday). April business inventories will also be released, giving us some additional insight on corporate stockpiling. Another important data point will be May retail sales on Wednesday, as markets try to assess the strength of the US consumer amid inflationary pressures. Finally, a slew of housing market data is due. This includes the June NAHB housing

market index (Wednesday) and May building permits and housing starts (Thursday). The impact of rising mortgage rates will be in focus.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

This material contains opinions of the author, but not necessarily those of Guggenheim Partners, LLC, or its subsidiaries. The opinions contained herein are subject to change without notice. Forward looking statements, estimates, and certain information contained herein are based upon proprietary and non-proprietary research and other sources. Information contained herein has been obtained from sources believed to be reliable but are not assured as to accuracy. Past performance is not indicative of future results. There is neither representation nor warranty as to the current accuracy of, nor liability for, decisions based on such information. No part of this material may be reproduced or referred to in any form, without express written permission of Guggenheim Partners, LLC.

Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Partners Advisors, LLC, Guggenheim Corporate Funding, LLC, Guggenheim Partners Europe Limited, Guggenheim Partners Fund Management (Europe) Limited, Guggenheim Partners Japan Limited, GS GAMMA Advisors, LLC, and Guggenheim Partners India Management. Securities offered through Guggenheim Funds Distributors, LLC, an affiliate of Guggenheim, SI, GFIA and GPIM.

© 2022 Guggenheim Investments. All rights reserved

#53005