GUGGENHEIM

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Macro Alert
Inflation: Time For a Reality Check

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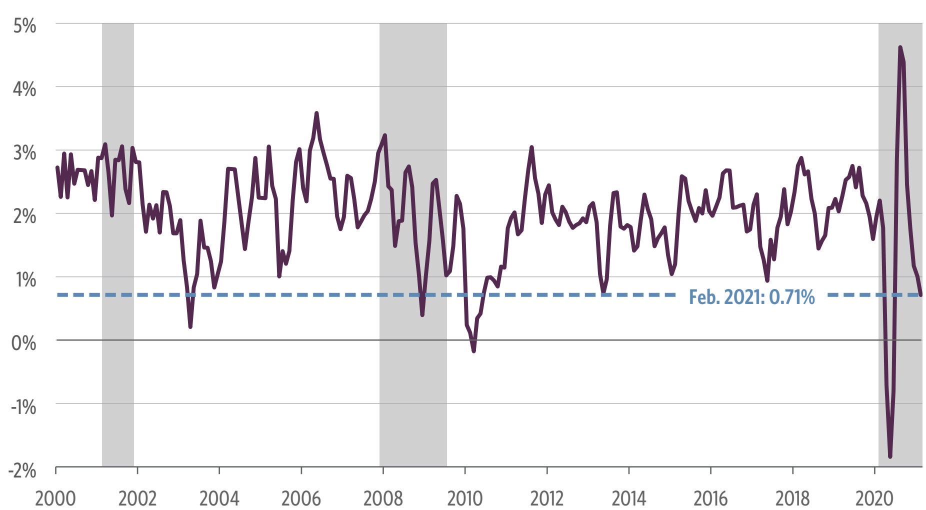
Our view is that inflation will generally remain subdued in coming years, allowing the Fed to point to cumulative shortfalls from its two percent goal to support delaying the start of policy tightening.

Market participants have been focused on the prospects for a sharp rise in U.S. inflation amid massive fiscal and monetary easing and a COVID-19 vaccination program that continues to gather pace. Our view is that inflation will generally remain subdued in coming years, allowing the Fed to point to cumulative shortfalls from its two percent goal to support delaying the start of policy tightening.

Incoming data support our view that underlying inflation is slowing, not accelerating. The release of CPI data for February last week showed that core inflation decelerated to just 0.7 percent on a three-month annualized basis from 1.0 percent in the three months ending in January. As seen in the chart below, this is one of the lowest prints we've seen in the last several decades.

Core CPI Inflation
3-Month Annualized Rate of Change



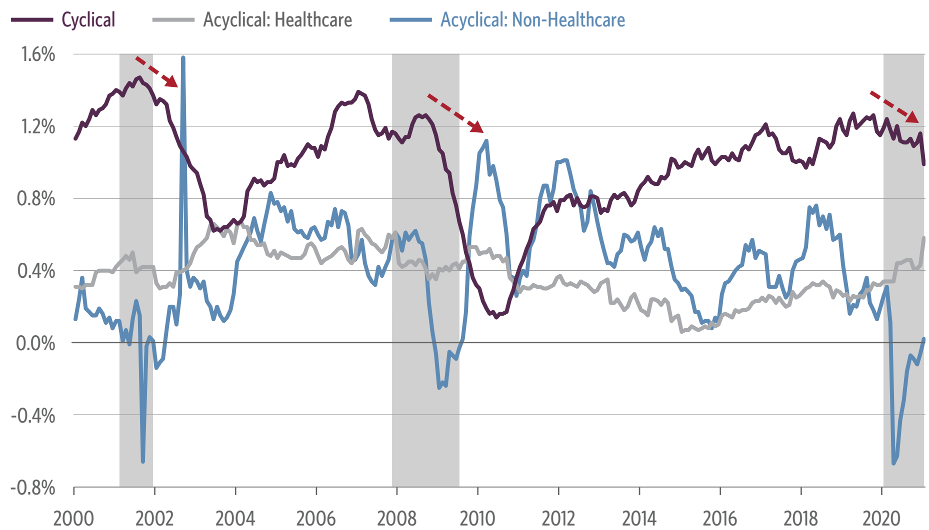
Source: Guggenheim Investments, Haver Analytics, BLS. Data as of 2.28.2021. Shaded areas represent periods of recession.

The passage of $1.9 trillion in fiscal stimulus last week certainly bolsters the growth outlook, but we believe that our out-of-consensus view on inflation will be validated once 1) we get through the next few months of noise from base effects in the year-over-year numbers and 2) the lagged effects of the 2020 economic contraction begin to show up in the cyclical components of core inflation.

As the chart below illustrates, the typical post-recession weakness in the most cyclically-sensitive components of core PCE inflation is just beginning. The full impact on core inflation from last year's sharp decline in activity will take several more quarters to be felt, given the historical tendency for core inflation to lag real GDP growth by 18 months.

Major Components of Core PCE Inflation: The Cyclical Decline is Just Beginning

Contribution to Core PCE YoY% Inflation by Category



Source: Guggenheim Investments, Haver Analytics. Data as of 1.31.2021. Shaded areas represent periods of recession.

In light of our inflation views—and given the recent backup in Treasury yields—we believe that the balance of risks is skewed toward lower bond yields, particularly in the front end and belly of the yield curve.