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Commentary – Market update

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Markets: Stock futures were once again lower this morning as investors continue to worry about increased inflation. There is no doubt we have signs of inflation ramping up; the real issue is whether the price pressures will be temporary. That is, will increased price pressures force the Federal Reserve to tighten policy sooner than expected? Today we had the first indicator with data for April reported on consumer prices (CPI). Details are below. Following the CPI report, bond yields are higher with the 10-year Treasury now trading at 1.65%. As of 8 a.m., S&P 500 futures are down -0.7% (Dow -110, Nasdaq -1.4%).

United States : CPI

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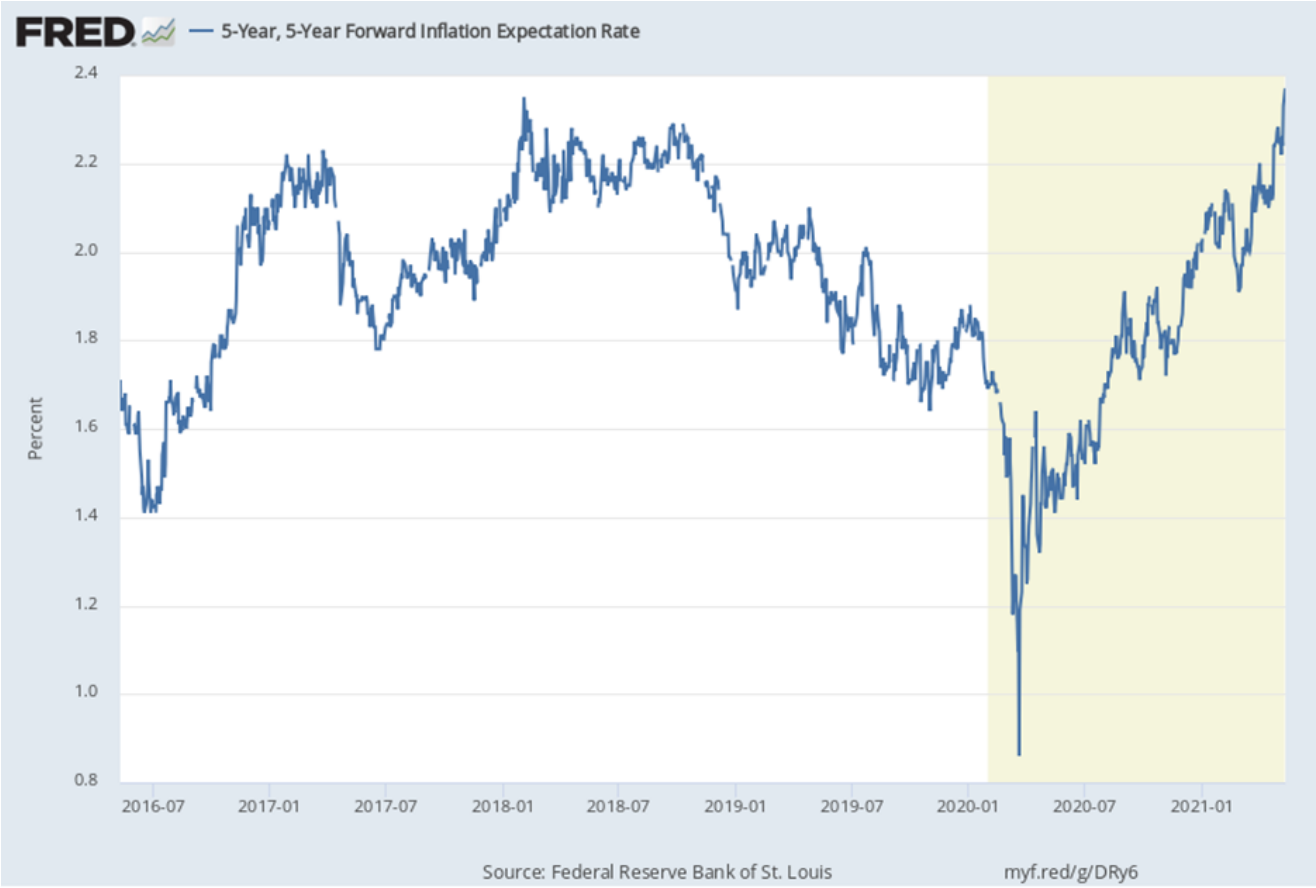
	Prior	Consensus	Consensus Range	Actual
CPI - M/M	0.6 %	0.2 %	0.1 % to 0.5 %	**0.8 %**
CPI - Y/Y	2.6 %	3.6 %	2.9 % to 3.8 %	**4.2 %**
Ex-Food & Energy- M/M	0.3 %	0.3 %	0.2 % to 0.4 %	**0.9 %**
Ex-Food & Energy- Y/Y	1.6 %	2.3 %	2.0 % to 2.4 %	**3.0 %**

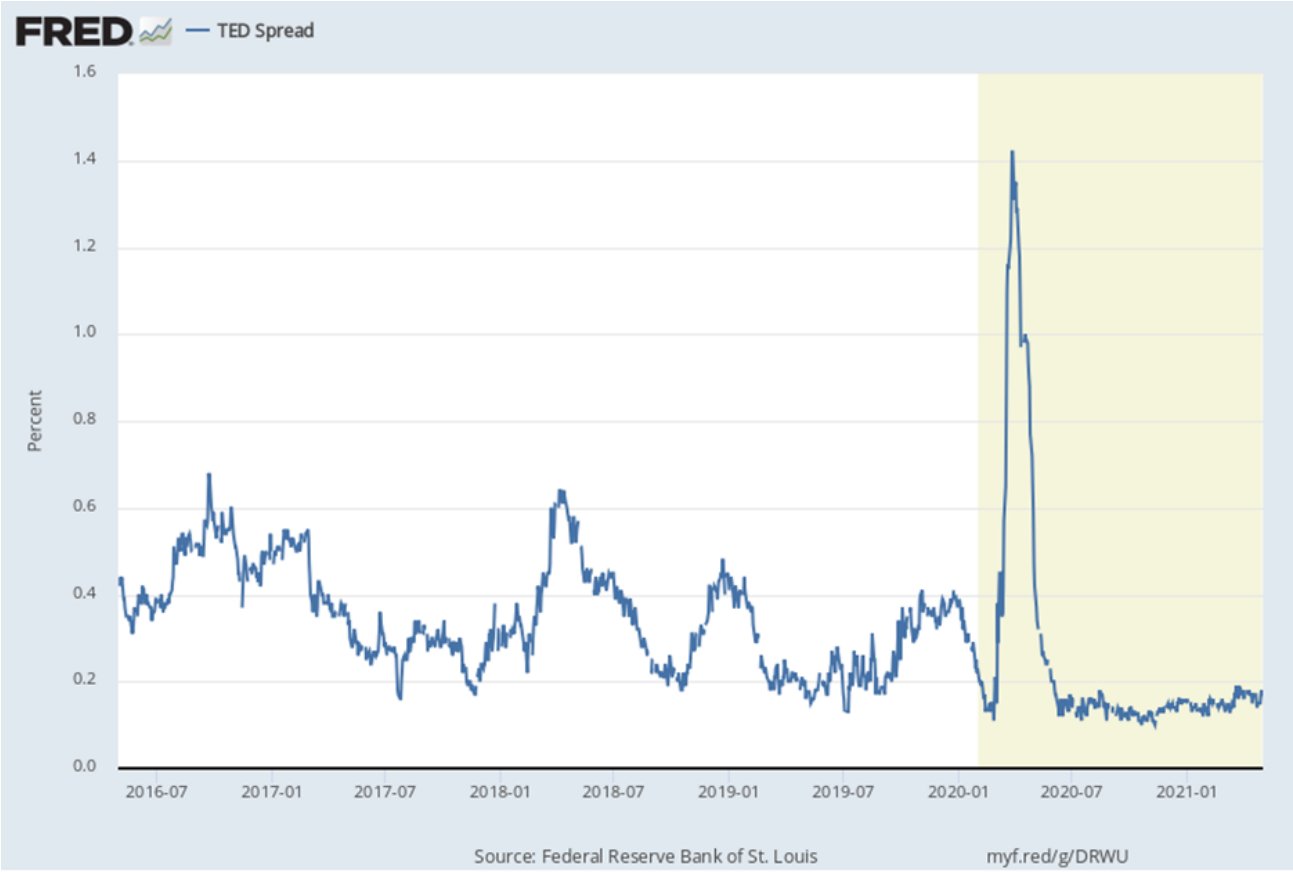
Key Items to Watch this week: The first report was consumer prices (CPI) reported this morning. CPI exceeded consensus, with an annualized pace of 4.2%, above the expectation for a 3.6% increase in prices for April (vs. 2.6% a month ago, annualized). Tomorrow, producer prices are reported, with a consensus of a headline 5.9% annualized increase (vs. prior 4.2%). Other reports to watch are initial claims tomorrow and retail sales on Friday. Bond market participants will be focused on the 10-year and 30-year Treasury note and bond offerings today and tomorrow, respectively. These are the most

interest-rate sensitive securities, and markets will be tested with additional supply in the midst of increased volatility.

Inflation and Credit Risk: With inflation concerns a topic of conversation these days, we wanted to review some of the metrics used for determining future expected inflation. The simplest is probably the breakeven between the yield on Treasury Inflation Protected Securities (TIPS) and the like maturity Treasury. This gives us an approximation of expected inflation over that time period. For example, the 5-year Treasury note is trading at a yield of 0.84% and the 5yr TIPS at -1.88**%.** This translates to a 5-year inflation expectation of 2.72%. Similarly, the 10-year Treasury/TIPS are 1.65% and -0.89% respectively, given a 10-year inflation expectation of 2.54%. The Federal Reserve prefers a measure of forward-looking inflation expectations, using a 5-year, 5-year forward inflation expectation. This is the estimate of future (i.e., 5 years from now) inflation for the following 5 years and is used in part to remove short term volatility in inflation. The graph and link for this are below – current estimate is 2.37%.

Finally, one way we monitor credit risk in the markets through want is called the TED spread (ED stands for Eurodollars / Libor), so this is the 3-month Libor yield minus the 3-month T-bill. This gives us a proxy for credit risk over time and is included in the bottom chart. The stabilization of the TED spread after the spike in the spring of 2020 can be attributed largely to the Fed's low interest rate and asset purchase and support policies.





Sources

Federal Reserve, Bloomberg, Barron's

About the Author

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Ivan Gruhl is Vice President, Chief Investment Officer, for Avantax℠, leading the combined Portfolio Management Group of Avantax Wealth Management℠ and Avantax Planning Partners℠. In Ivan's 38 years in the financial services industry, he most recently served as the Chief Investment Officer for Avantax Planning Partners (previously HKFS) and has been with the company for 10 years.

Prior to joining Avantax Planning Partners, Ivan was VP of client investment development at Aviva Investors, where he developed and marketed separately managed account (SMA) and mutual fund products to institutional investors. He spent the prior 23 years with Lehman Brothers in New York, where he was Senior Vice President in the capital markets area. At Lehman, Ivan headed the Lehman bond index franchise and led a portfolio advisory team for managing institutional investor portfolios. During his time at Lehman, he was involved in various roles including trading futures, corporate bond sales, and research.

Ivan has a Bachelor of Business degree in Finance from Pacific Lutheran University, and a master's degree in Finance from the Stern School of Business at NYU. He is a Chartered Financial Analyst (CFA) and holds the Series 7 and 63 licenses.

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