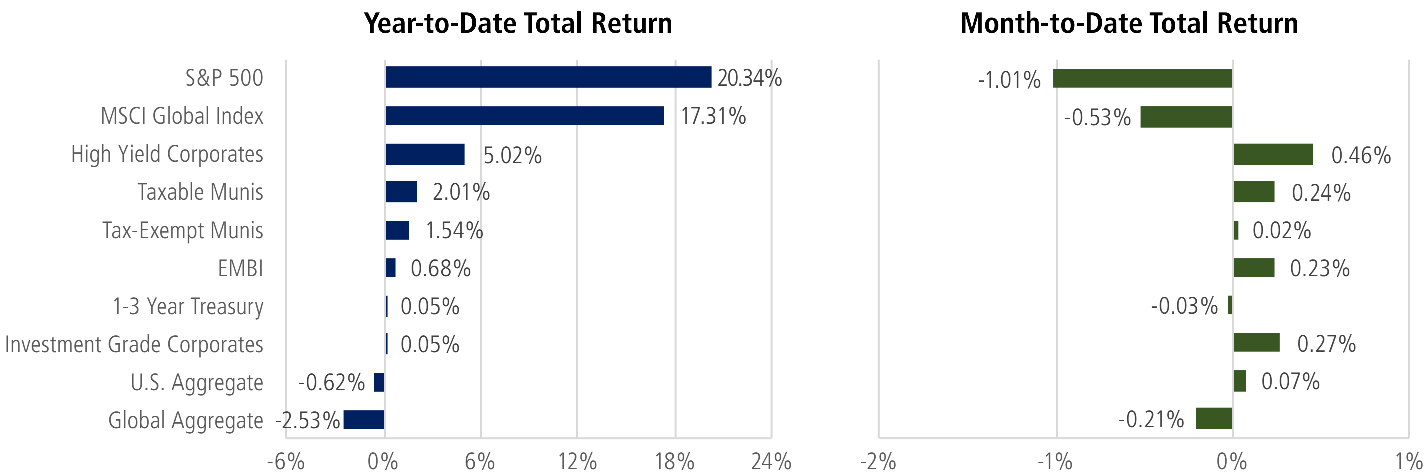
Week Ending: **September 17, 2021**

Too Soon To Call

Economic Overview:

The August U.S. Consumer Price Index (CPI) report buoyed the hopes of "Team Transitory"—the cadre of economists and investors expecting price pressures to abate soon. Indeed, both headline and core measures of inflation were softer than expected in August as price pressures for used vehicles, airfares, hotels, and rental cars faded. But we think it is probably too soon for a victory lap. First, the Delta variant dampened travel and leisure activity in August, impacting airfares and hotels. As Delta fades, price pressures could re-emerge. Second, core CPI is still uncomfortably high (up 4% year-over-year), and elevated readings are likely to persist into early 2022. Third, even if some price pressures continue to fade, others have emerged. Rents and owners' equivalent rent, which together make up roughly 40% of core CPI, have recorded robust increases this year. Plus, shelter costs will likely continue to rise as the labor market tightens. Our hunch: when the dust settles, core CPI will be rising at a 2-3% clip—sure, it's not 4-5%, but it's not zero either.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

- **High Yield:** High yield ETFs and loan funds have seen $2.8 billion and $3.3 billion of inflows respectively since the middle of August. This makes sense because a healthy fundamental environment plus the global search for yield should keep demand for high yield bonds and loans robust.

- **Corporates:** Second quarter earnings season was another solid period for most companies with revenue up an average 6.0% quarter-over-quarter, 5.9% year-over-year, and 1.4% when compared to pre-Covid levels. In addition, profit margins quarter-over-quarter and year-over-year are also moving in the right direction, up by 0.4% and 0.9% respectively. Per J.P. Morgan, higher inflation has, on average, been a credit positive for investment-grade corporations.

- **Securitized Products:** The Federal Housing Finance Agency (FHFA) reversed several late-stage policy changes from the prior administration this week. One day after reversing January's amendments to the Preferred Stock Purchase Agreement (PSPA), which included a cap on agency investor loans, they followed up with a new capital framework that should incentivize Fannie and Freddie to issue more credit risk transfer securities. Since the Supreme Court is now allowing the FHFA director to be fired at will, increased policy risk might be more synchronized with the election cycle.

- **Municipals:** This week, a number of tax-related proposals for the reconciliation process of the infrastructure bill were unveiled. Proposals included the resurrection of Build America Bonds (BAB), tax-exempt advance refundings, and higher taxes (which could improve muni demand). While the proposals are far from finalized, the impending news may cause issuers to take a wait-and-see approach in the coming months.

- **Equities:** The U.S. equity market fell for the second consecutive week on a relatively quiet week of headlines. Sector performances were mixed with materials and utilities leading markets lower, while energy and consumer discretionary posted gains for the week.