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Delta manages portfolios at TD Ameritrade and Schwab.

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November 12, 2021

The Inflation Game

The Federal Reserve, treasury bond traders and equity investors are some of the key players in the inflation game. On one side, there is the inflation-is-transitory team which includes the Federal Reserve. On the other side, is the team that expects inflation to be higher-for-longer than what is priced into current market expectations.

Who wins this game may have important ramifications for stock prices. If inflation is higher and lasts longer, commodities and value stocks should outperform. If inflation is transitory, growth stocks should maintain their winning streak.

The Consumer Price Index (CPI) was up 6.2% year/year in October, the highest yearly gain since November 1990. Excluding food and energy, the CPI was up 4.6%, the largest increase since August 1991. On Wednesday, when this information was reported, the 10-year treasury rate jumped 9% higher. Major bank stocks traded higher as the NASDAQ 100 lost about 1.7% for the day. The loss in the NASDAQ (mostly growth) was more than twice the size of the decline in the Dow Jones Industrial Average (blend of value and growth) on Wednesday. With the move higher in rates, bond funds performed poorly.

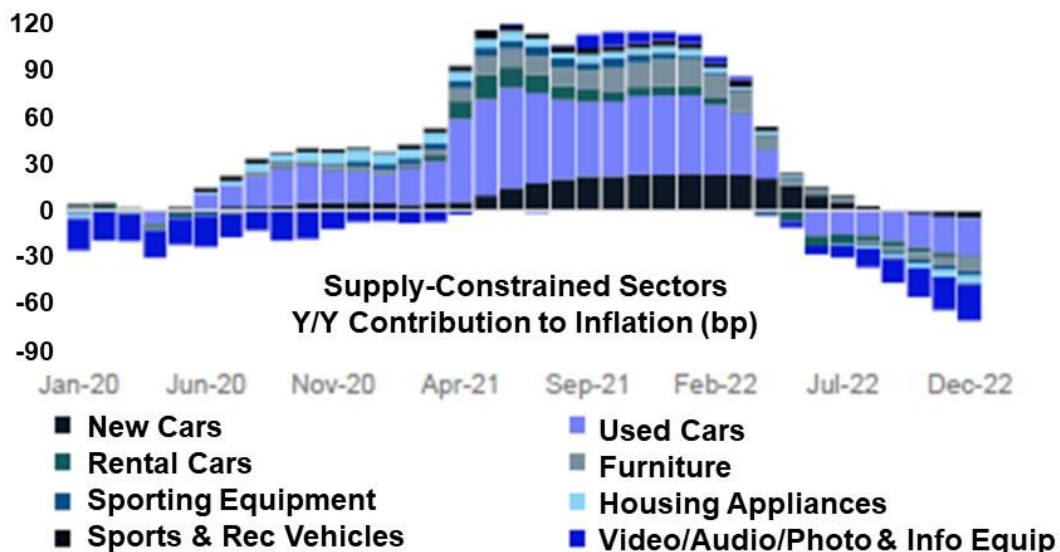
The chart below shows the spike in the core Personal Consumption Expenditures Index (PCE) which is the measure of inflation tracked most closely by the Federal Reserve.

Inflation Spike, Core PCE Inflation



The primary argument for believing inflation will be transitory is it is being mostly caused by supply/demand imbalances (supply chain problems) that will be resolved in 2022/23. The leading causes of supply problems have been Covid-driven factor shutdowns, disruptions in semiconductor production, port closures and congestion and widespread labor shortages. The typical car today uses about 300 semiconductors versus about 100 ten years ago. Fed Chairman Powell believes the supply shortages will work themselves out and inflation should move down to roughly 2%.

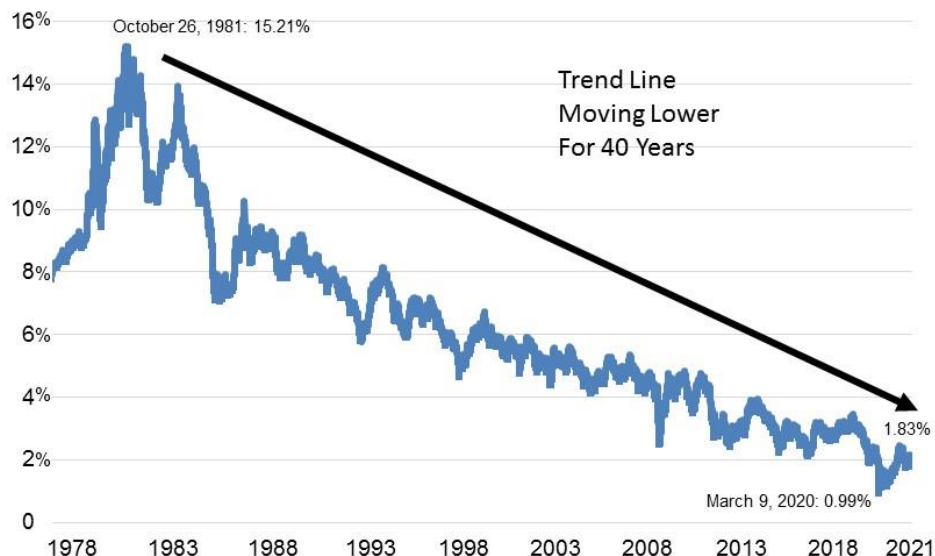
Inflation Pull Becomes Inflation Drag



Source: Goldman Sachs Asset Management

Inflation has been trending lower for decades as a result of globalization and technology. Below is the graph of the 30-year U.S. treasury rate which is partly driven by inflation.

30-Year US Treasury Yield 1978 - 2021



If you believe globalization and technology secular trends remain in place, it is much easier to believe inflation will be transitory.

No matter what the longer-term projections show, prices are rising very fast right now and the stock and bond markets lost some confidence this week that the transitory team will eventually win the inflation game.

Inflation becomes a problem for corporations/stocks if they are unable to pass-through higher labor and materials costs. In the third quarter, the blended net profit margin of the S&P 500 was 12.9%. This is higher than the year-ago profit margin of 10.9% and only slightly down from the record 13.1% achieved in the second quarter. Consensus analyst expectations are for S&P 500 net margins to be 13.3% in 2022 and 13.8% in 2023.

Stocks are an inflation hedge, especially if companies are able to pass on higher costs to consumers through higher prices. Transitory or permanent, stocks continue to be a relatively attractive investment in an inflationary environment.

Let Us Help You Position Your Portfolio – Give Us a Call Today

We have unique and sophisticated investment methods that seek to capture the stock market’s gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.



Delta Stock Market Dashboard

MARKET SENTIMENT IS

BULLISH

THIS WEEK’S NUMBER IS

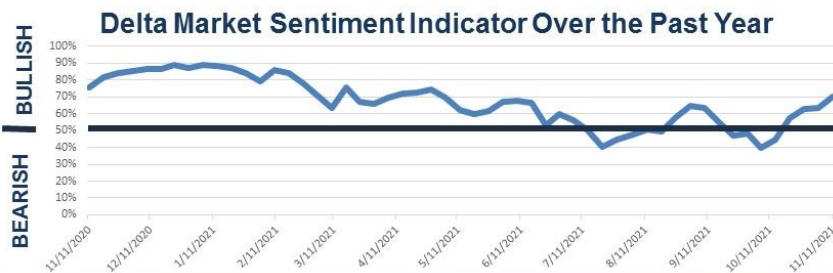
70.2

Our technical indicator increased from 63.6 to 70.2 this week

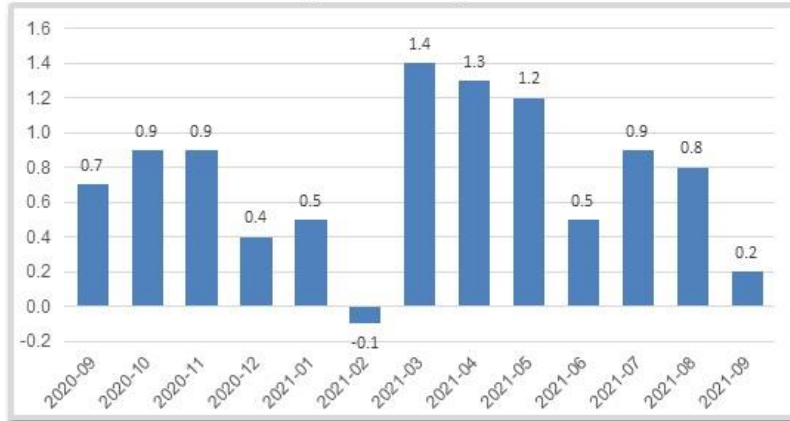
INDICATOR STATISTICS

Consecutive Bullish Weeks:	4
Cycle Inception Date:	10/21/2021
Range:	57.5 – 70.2
Mean:	63.5
Bullish Weeks YTD:	40
Bearish Weeks YTD:	5
*S&P 500	2.8%
*DJIA	1.4%
*NASDAQ	3.9%

* Percentage change during current cycle



Leading Economic Index % Change Monthly Sep 2020 – Sep 2021



Source: The Conference Board – last update 10/21/2021

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