

## **Sevens Report Alpha Webinar:**

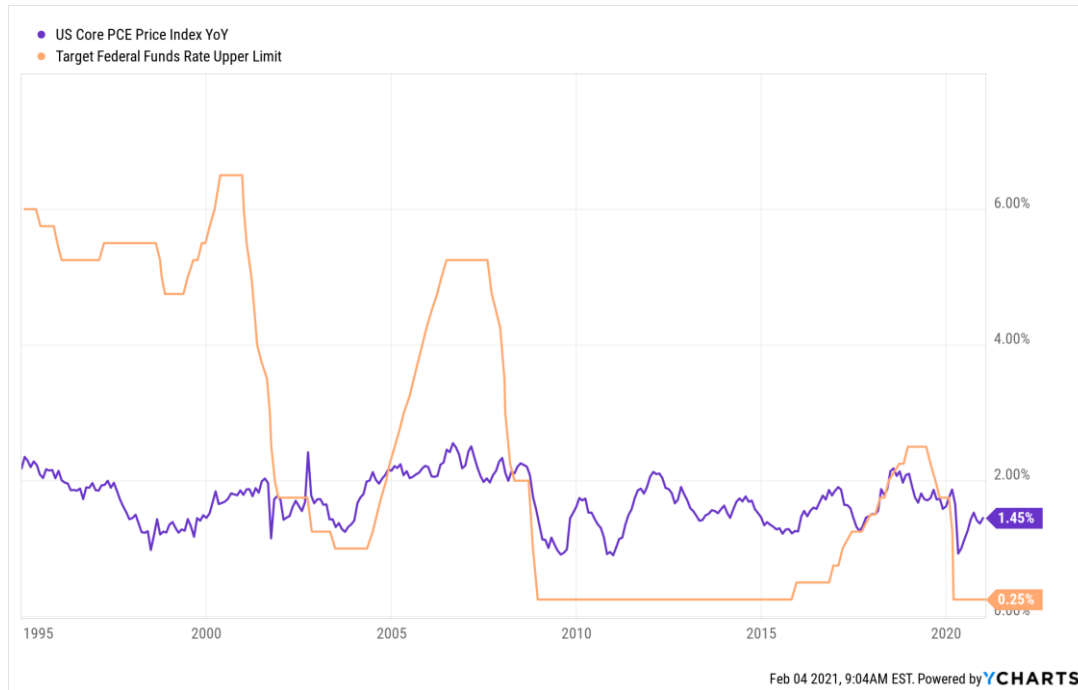
### **Inflation**

**Thursday, February 4<sup>th</sup>, 2020**

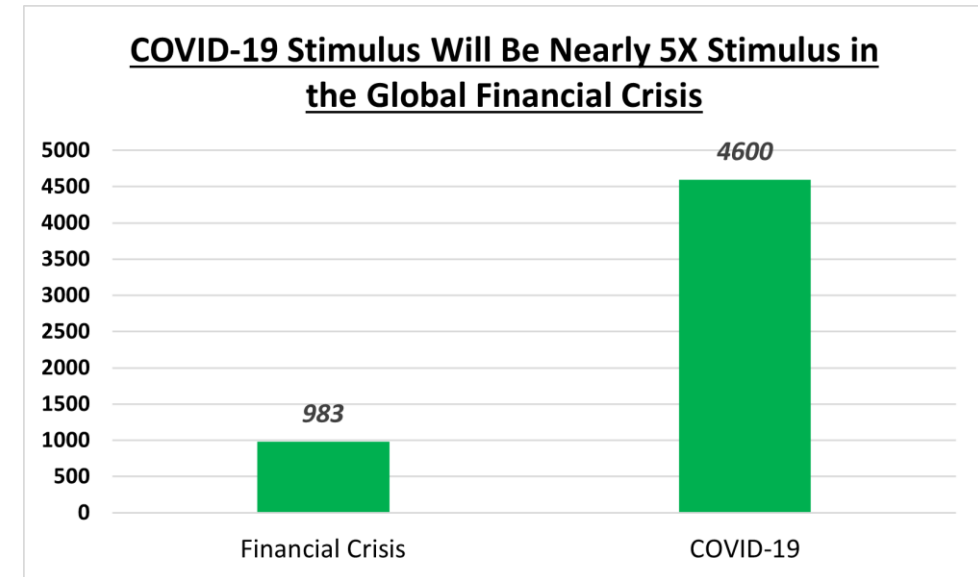
**Tom Essaye, President Sevens Report Research**

## Inflation Context: The Fed Wants Inflation More So Than Anytime in 20+ Years

### Fed's Average Inflation Target

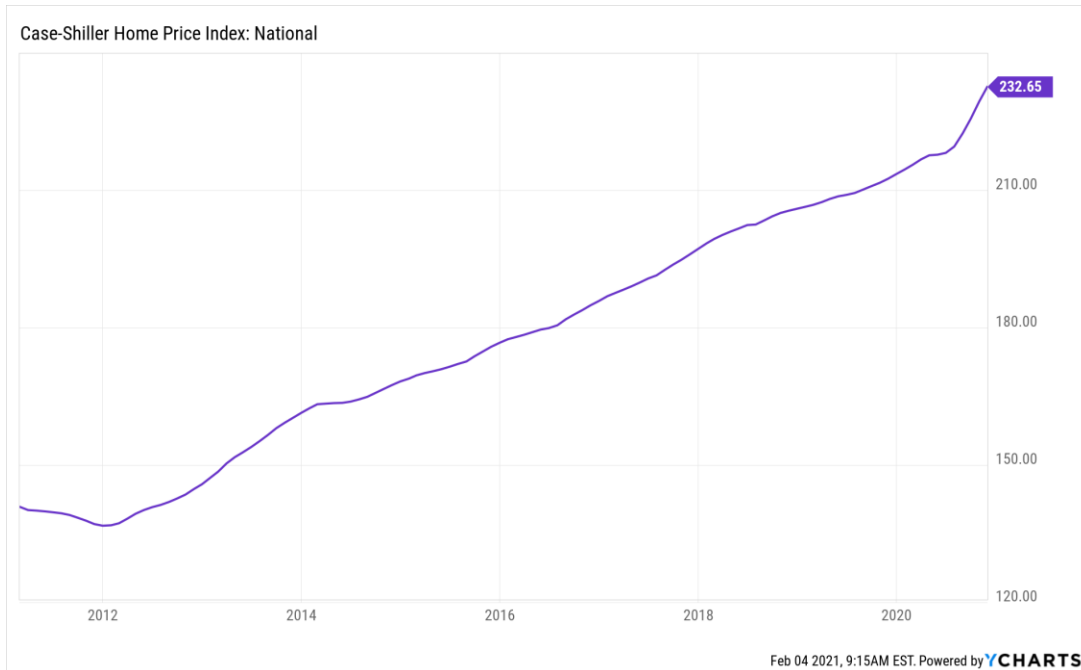


### Historic (and Still Growing) Stimulus

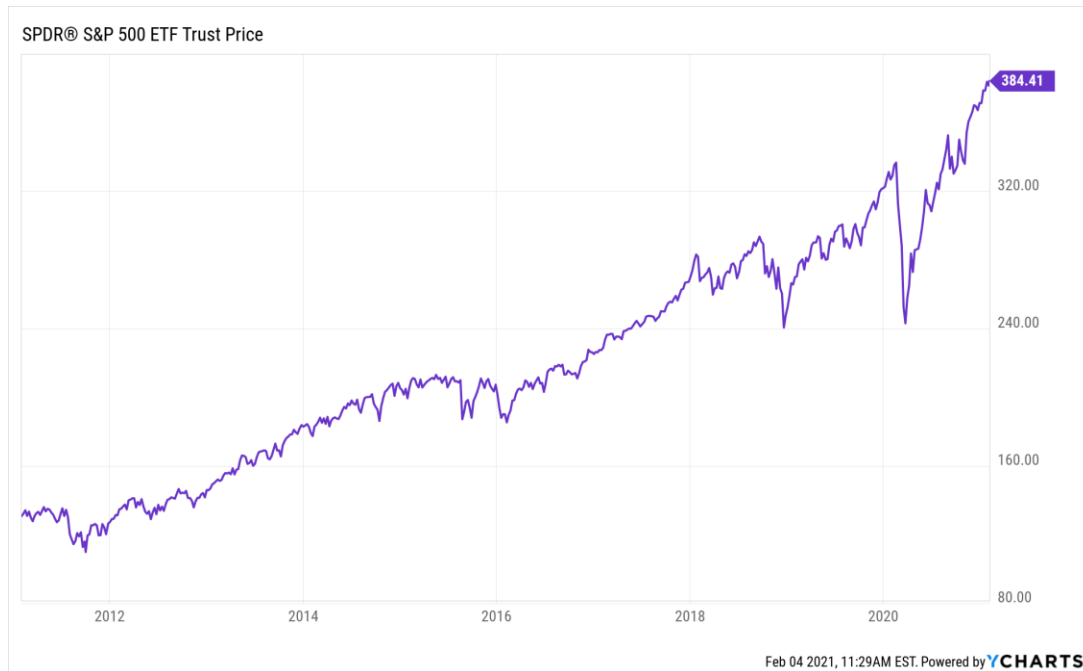


**Two Types of Inflation: Asset Inflation and Consumer Price Inflation**

## Asset inflation: Inflation People Have Experienced Over the Past Decade

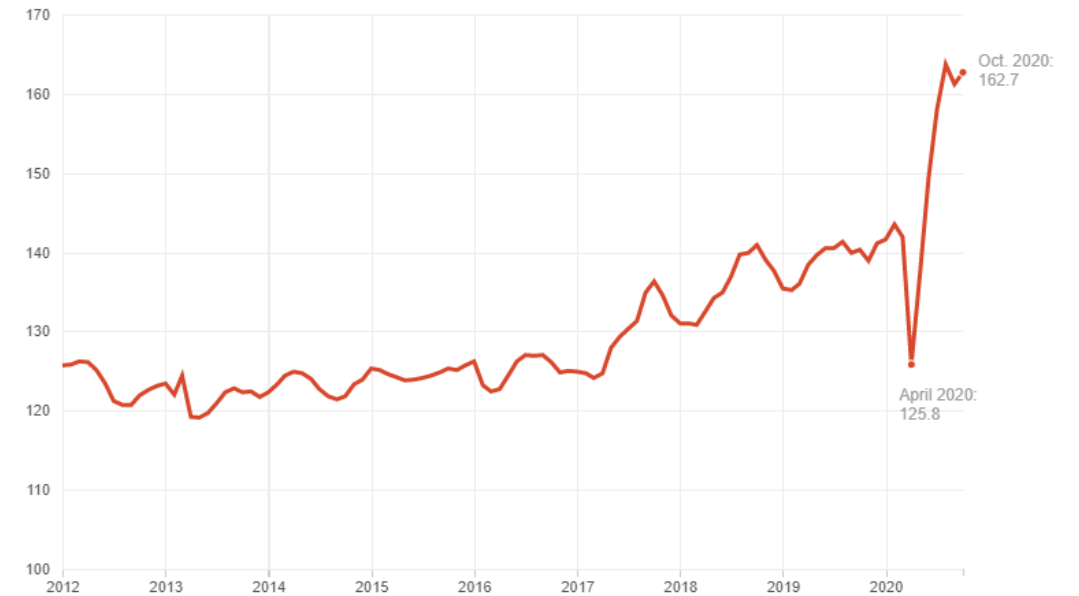


## Asset inflation: Inflation People Have Experienced Over the Past Decade



### Wholesale Used-Car Prices Soar

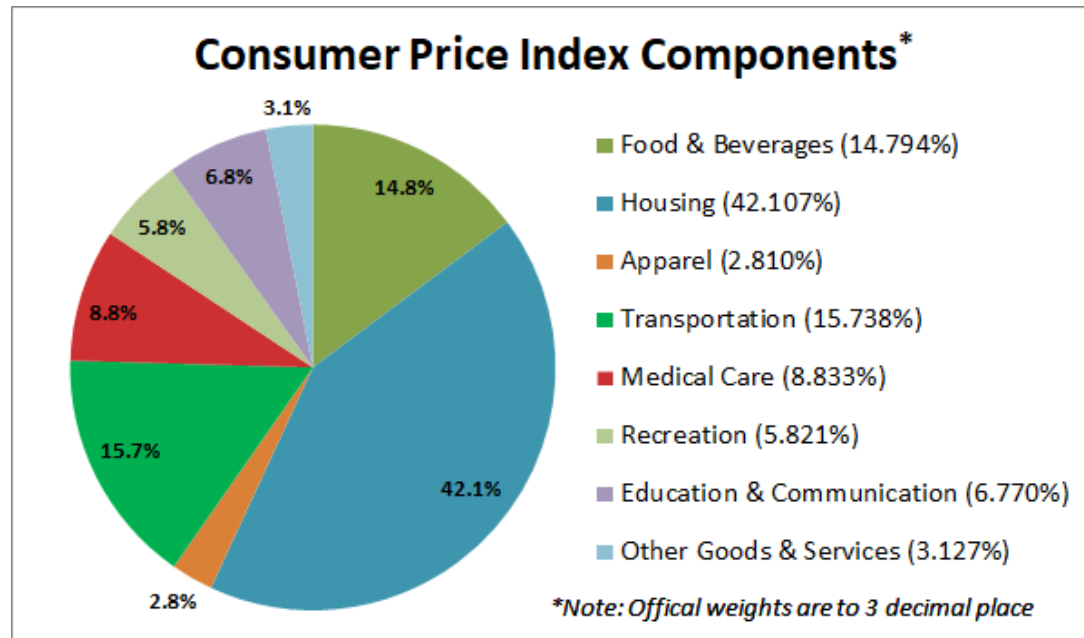
The [Manheim Used Vehicle Value Index](#) tracks wholesale used-vehicle prices over time, based on millions of transactions per year. The data reflect a brief pandemic-induced fall, then a sharp increase in prices this summer.



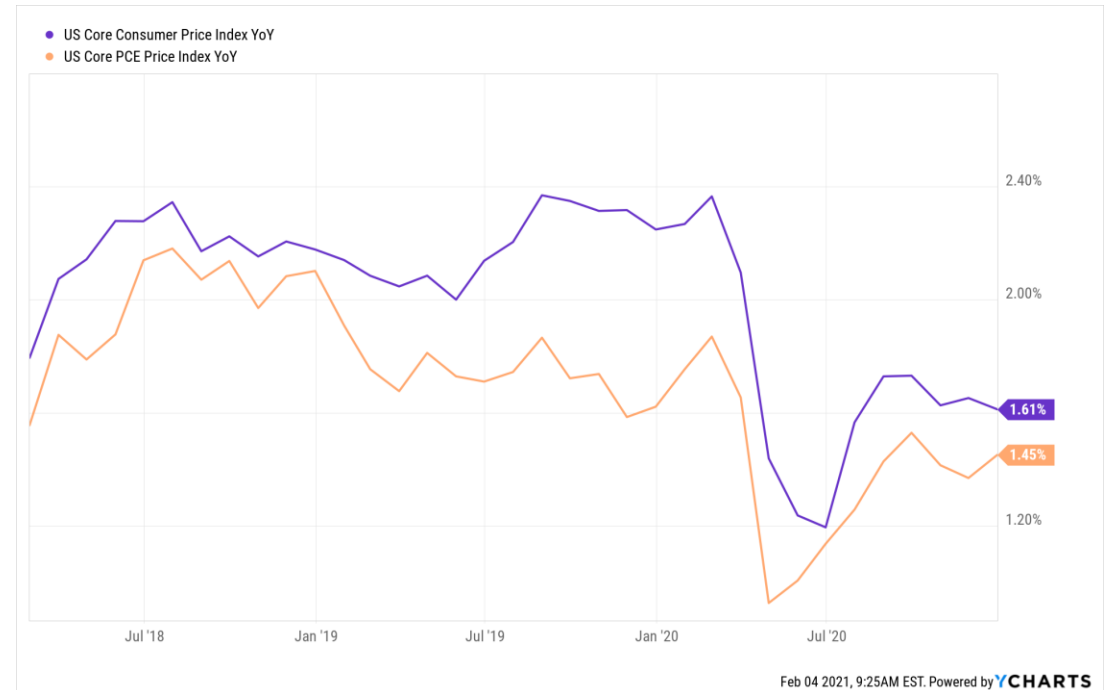
Source: Manheim Auctions

Credit: Connie Hanzhang Jin/NPR

## Consumer Price Inflation: How the Fed Measures Inflation

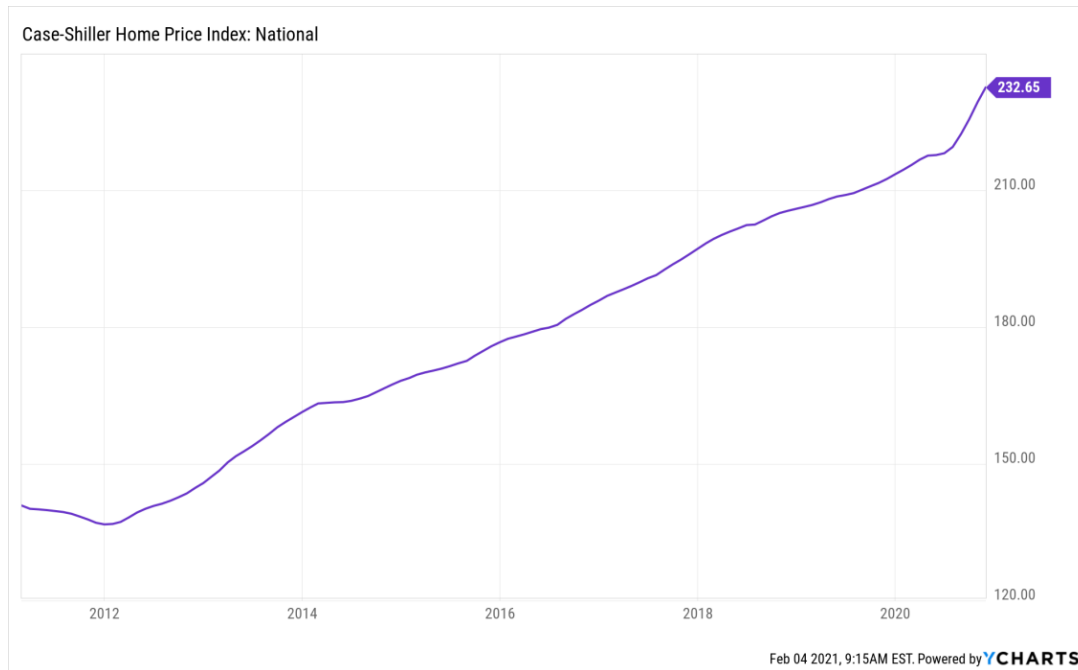


Source: BLS; The most recent annual reweighting was in December 2019.

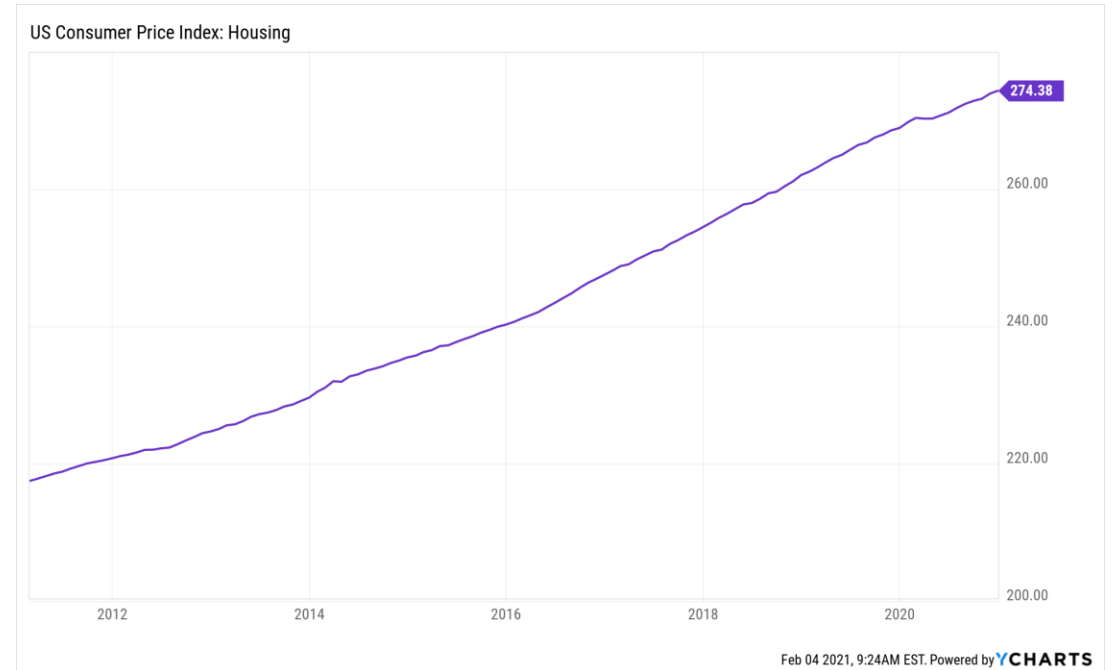


## Two Types of Inflation: What's the Difference?

Since 2012 the Case-Shiller National HPI has increased 70%.



Since 2012 the US CPI Housing metric has increased 24%.



## Takeaways

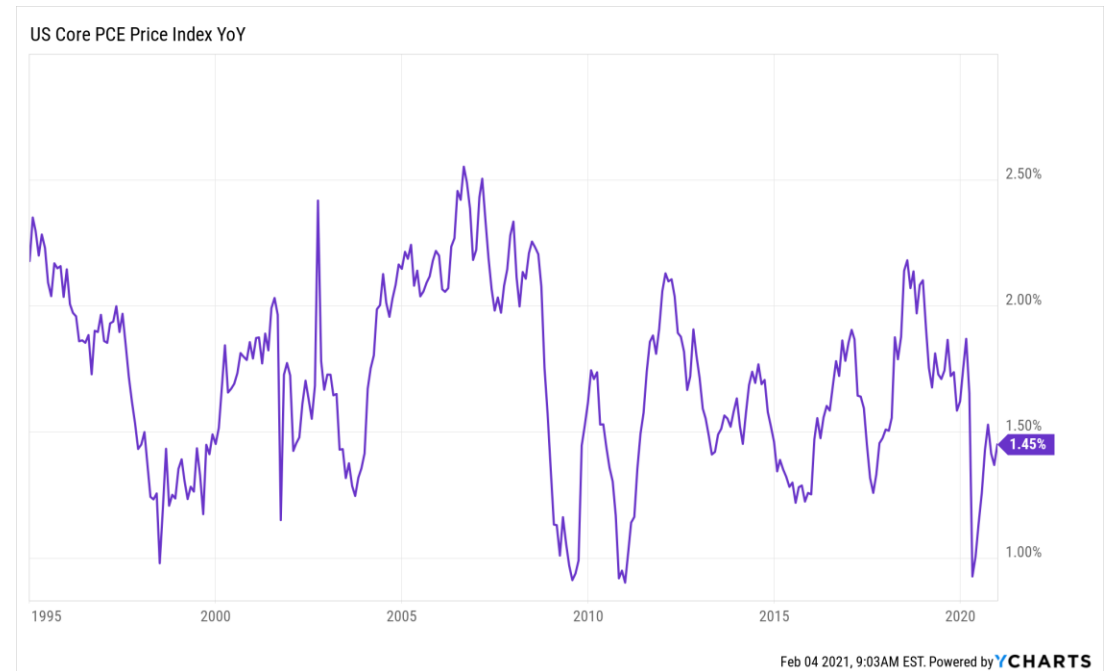
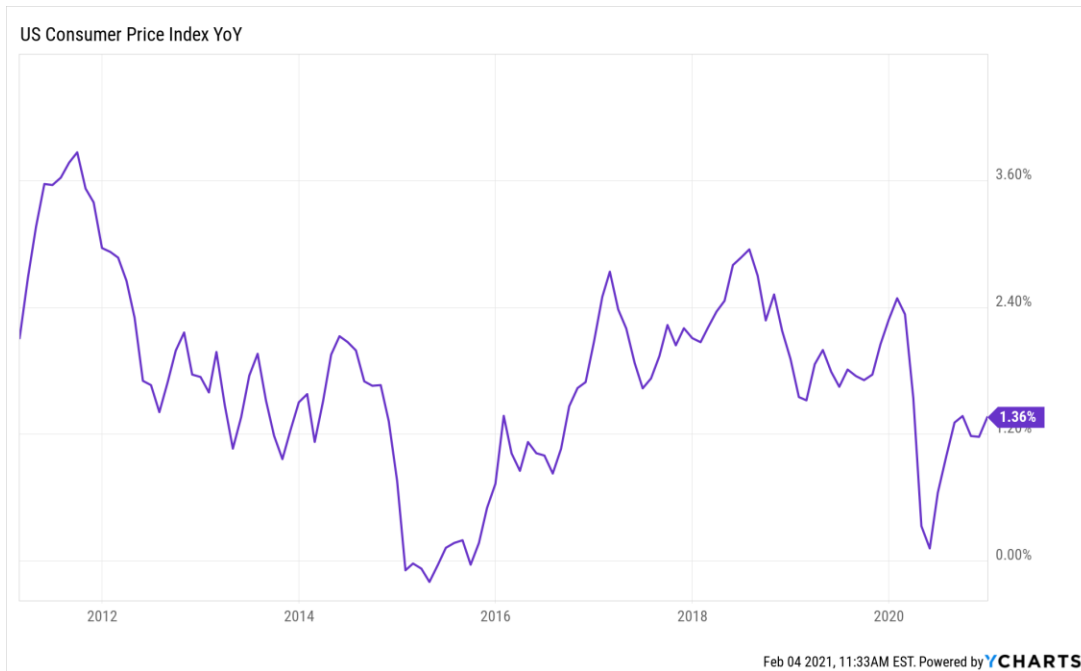
CPI and the Core PCE Price Index matter because they trigger Fed rate hikes, which obviously impacts stocks. But, with the average inflation target in place, presumably we should see both CPI and Core PCE rise to levels last seen decades ago before the Fed hikes rates. That's bullish for stocks, commodities, inflation, and Treasury yields.

Asset inflation is something we all need to be exposed to. The biggest loser in periods of asset inflation is cash, because it provides no return (actually a negative return) while asset prices increase, making future purchases more expensive. Put plainly, during asset inflation, we need to own stuff (stocks, land, cars, boats, planes, equipment, bonds, etc.) and the more stuff people own, the better more hedged they are against asset inflation.

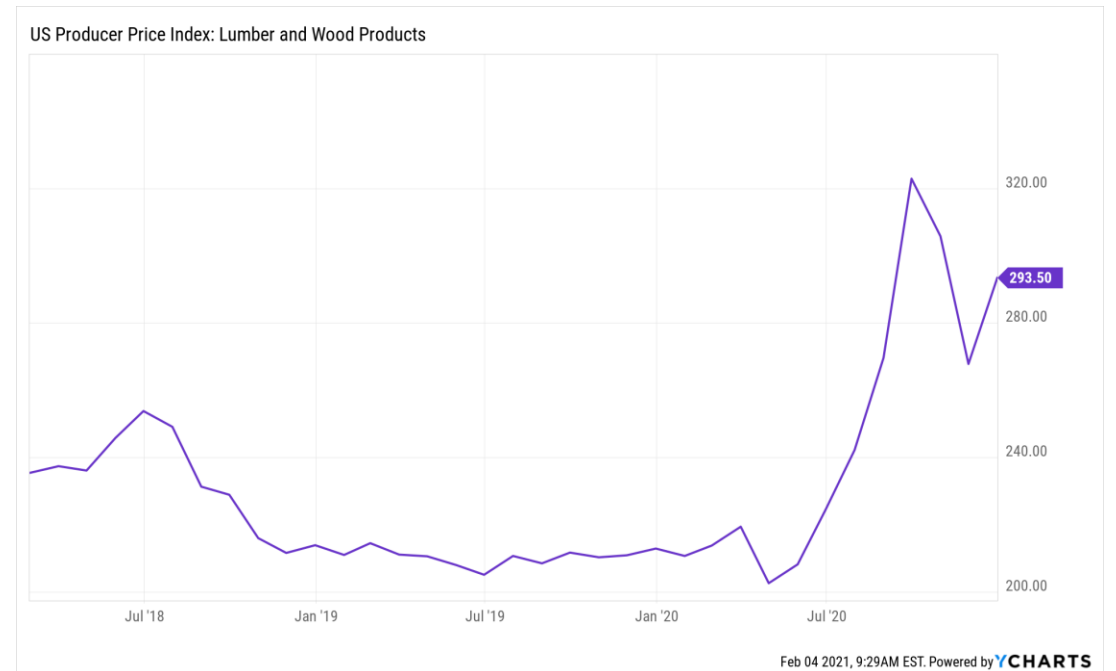
We need to monitor both types of inflation to help clients outperform.



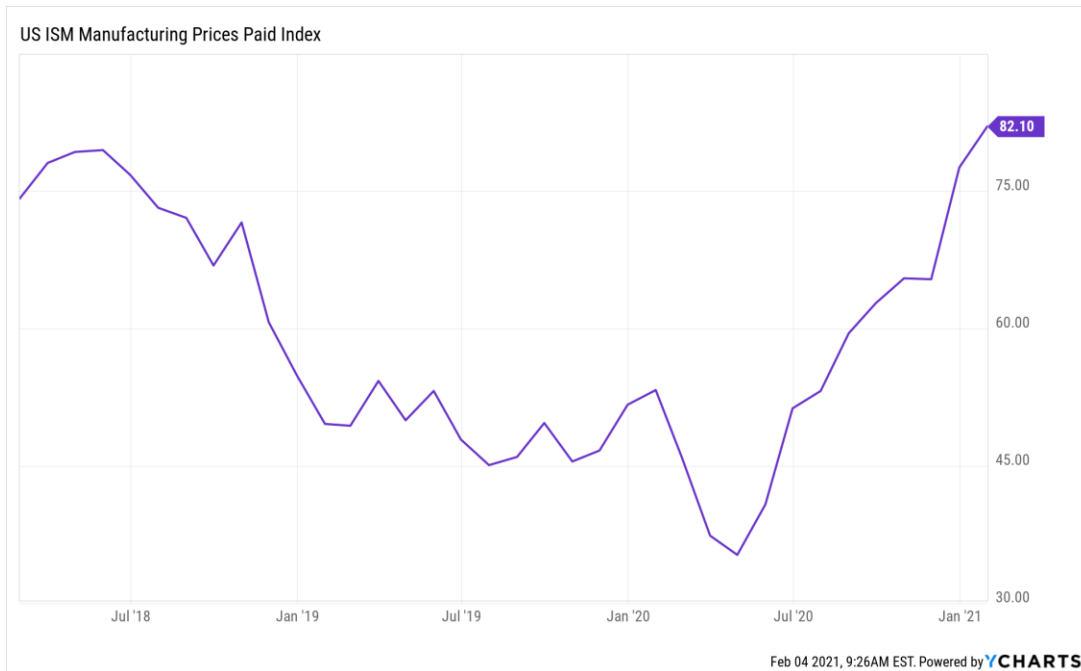
## Current Trends in Inflation: Consumer Inflation Subdued (No Fed Rate Hikes)



## Current Trends in Inflation: Asset Inflation is Strong



## Current Trends in Inflation: Signs of Consumer Inflation Are Rising, as Are Expectations.



## Inflation Wildcard to Watch: The U.S. Dollar

### DXY US Dollar Currency Index

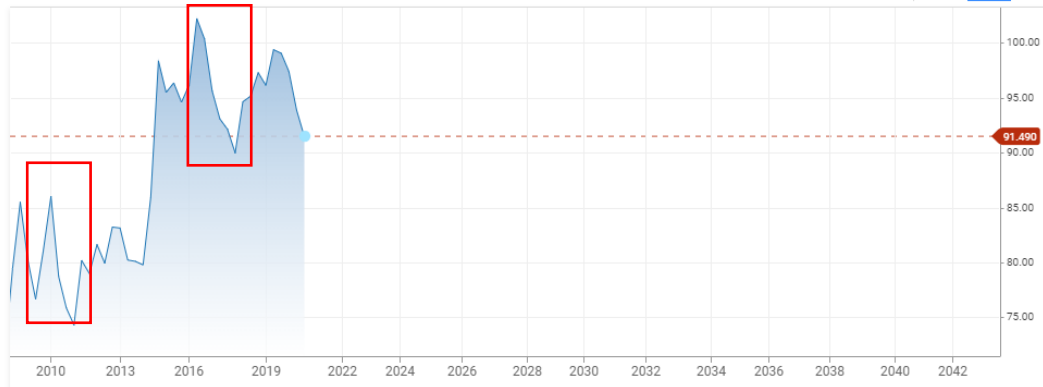
.DXY:Exchange  
RT Quote | Exchange | USD

Last | 11:56 AM EST

**91.49** ▲ +0.32 (+0.35%)

1D 5D 1M 3M 6M YTD 1Y 5Y ALL

+ Comparison



SUMMARY

NEWS

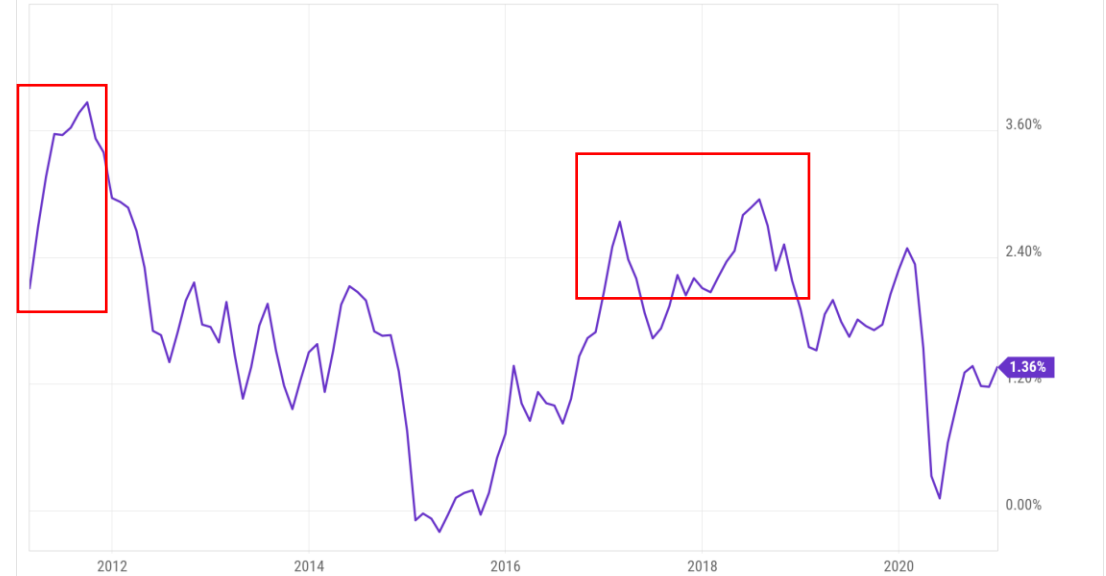
PROFILE

EXPORT

WATCHLIST +

52 week range  
89.21 - 102.99

### US Consumer Price Index YoY



Feb 04 2021, 11:33AM EST. Powered by **YCHARTS**

1.36%

## Takeaways

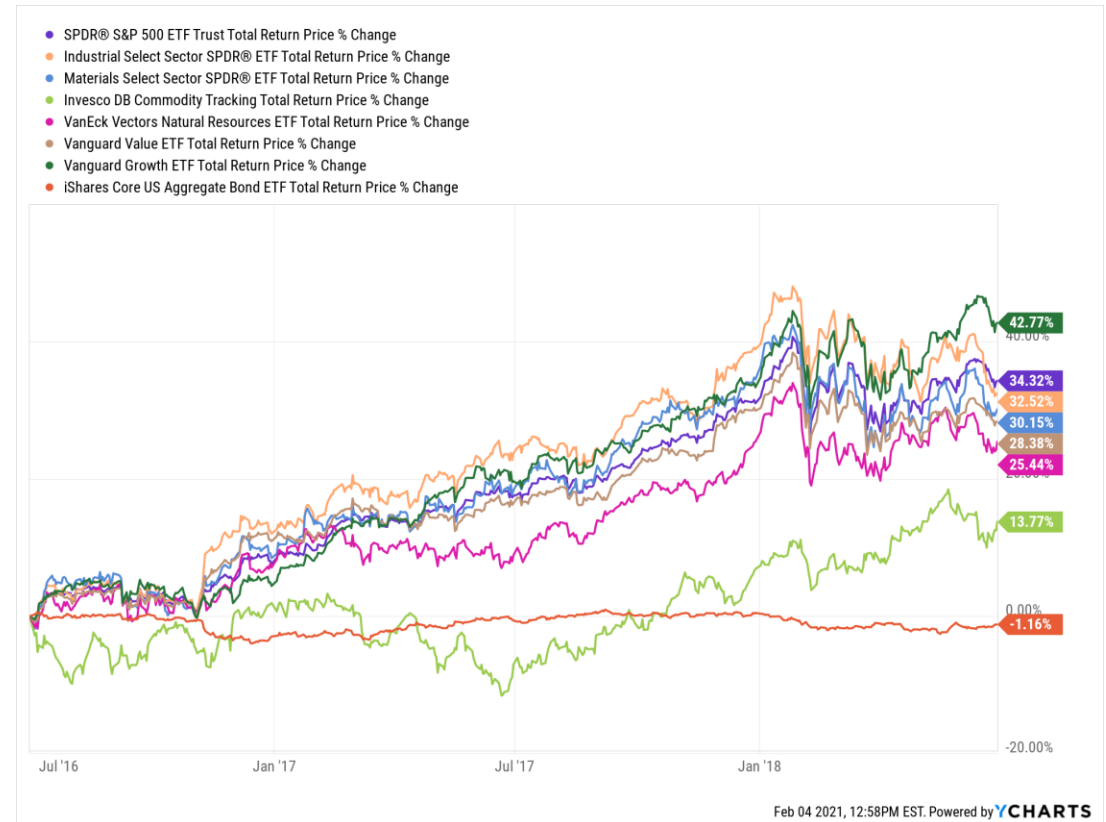
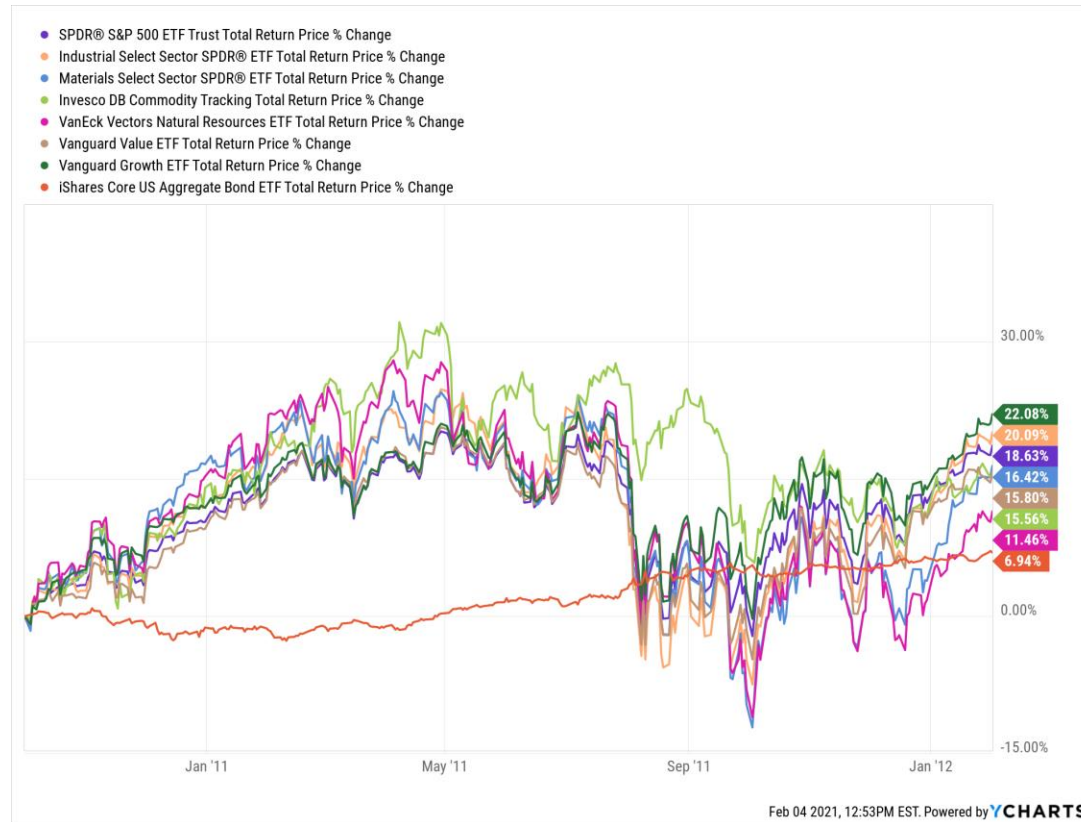
Inflation pressures are building.

First, asset inflation is very much occurring at a quickening pace.

Second, consumer inflation is starting to accelerate, in part due to the more than 10% decline in the dollar over the past few quarters.

We should expect both types of inflation to accelerate in the coming months/quarters, especially if the Fed is serious about its “Average Inflation Target.”

## What Outperformed/Underperformed The Last Time Inflation Rose?



## What Outperformed/Underperformed The Last Time Inflation Rose?

- Observations:
  - Every time period is different, but in both instances, cyclical sectors (XLI/XLB) traded well, **and that reinforces our preference for more cyclical exposure.**
  - Growth outperformed value in both instances, but we don't know what sectors were "growth" or "value" back then. **To us, this reinforces the need for a more balanced approach.**
  - Commodities performance was mixed. Commodities and hard asset stocks handily outperformed initially in the first period, but consistently lagged during the second period. Part of that was due to the collapse in oil, and we'd imagine this instance of inflation looks a lot more like the first than the second due to the presence of ongoing stimulus.
  - Both periods were positive for stocks.
  - European stocks lagged in both instances because of political uncertainty.

## Alpha Strategies Based on This Analysis

- Industrials & Infrastructure Spending (VIS/PAVE). 11/17/2020.
- Cyclical Rotation to Value (RSP/VTV/RPV). 11/3/2020.
- Small Caps (IJR/VBK/SXLV). 1/28/2020.
- High Growth Tech (ARKK/XITK). 5/15/18 & 4/23/19.
- Hard Assets (GNR/RLY). 9/18/18.
- Floating Rate Funds: (FLOT/USFR/SRLN/EFB). 8/6/18.