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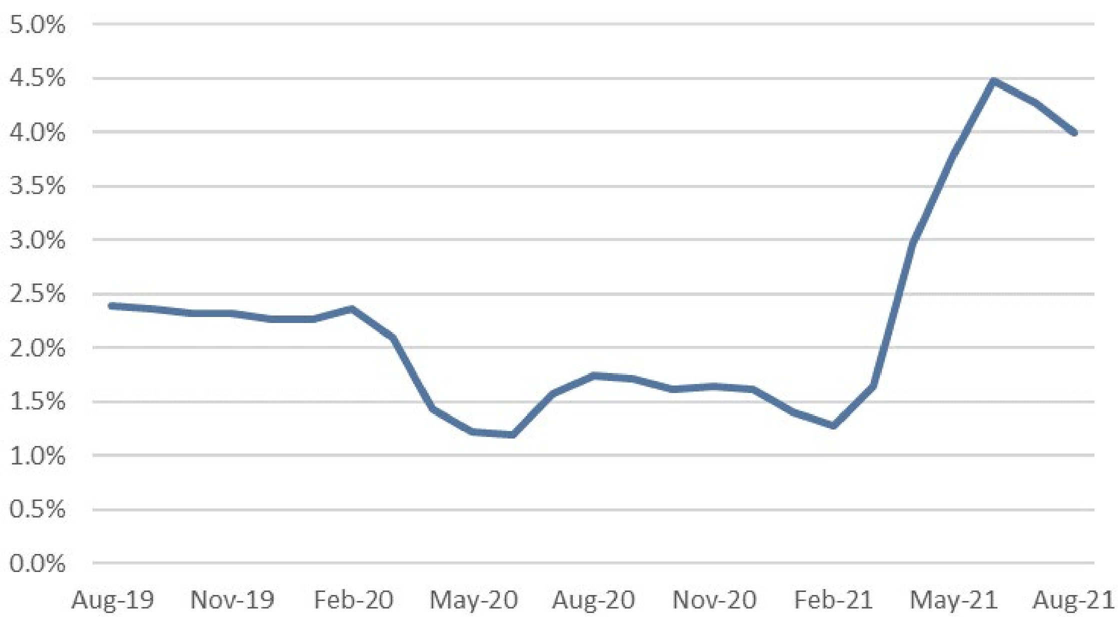
WEEKLY MARKET UPDATE
September 20, 2021

MARKET COMMENTARY

Fig. 1: Inflation remains high but has started decelerating



Sources: Bloomberg, Mill Creek

A *second derivative* is a mathematical concept that refers to the rate of change of a rate of change. When you are driving a car, your speed is the *first* derivative (a rate of change). Your acceleration is the *second* derivative (the rate of change of your speed). As economic data is released over the next 6 months, the second derivative of that data will be more important than the first when judging the state of the economy.

The most recent print of the Consumer Price Index (CPI), released last Tuesday, provides a good example. The year-over-year change in core CPI as of August was 4.0% on a year -over-year basis. However, the second derivative of inflation (the rate of change of the rate of change) has declined. Inflation was annualizing at 4.5% in June, 4.3% in July, and is now at 4% for August. The car is going too fast but is slowing down.

These data points add credence to our view that, following a temporary period of higher inflation, we'd see inflation slowly moderate back to a longer-run average of 2.5%. We published that view at the end of last year, when inflation was around 1.5%, bond market participants expected inflation to remain below 2% for 15 years, and the median investment bank forecaster still expected inflation to average 2% in 2021. Those forecasts were wrong then, and the unfortunate fearmongering around out-of-control inflation is wrong now.

Inflation will remain elevated well into 2022. Supply chain disruptions will continue to create cost pressures. Housing inflation, which has remained subdued thus far, is starting to creep upward. There are 10.9 million job openings in the US and a slowdown in employment gains could result in sustained labor cost pressures. But these issues are *risks* to the trend that bear watching, not the most likely outcome at this point.

QUICK LINKS

- House View Summary
- Q2'21 Macroeconomic Outlook
- Q2'21 Equity Outlook
- Q2'21 Fixed Income Outlook
- Q2'21 Private Equity Outlook

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