

Will US Inflation Resurge? – Market Commentary

October was unusual in that US Big Tech led once again with Nvidia rising +9.3%, yet the broader market was negative on rising US Treasury yields. While Growth outperformed Value in a rising rate environment we think this is due to Tech's underlying stronger performance with the balance of the Growth market falling behind Value.

Within Developed Markets, the US outperformed, relatively speaking, returning -0.9% for the S&P 500 with a similar return for the Nasdaq, vs -2.0% for the broader MSCI World benchmark.

Emerging Markets underperformed Developed Markets at -4.4% with the FTSE/JSE ALSI falling relatively less at -3.4% in USD terms. The ZAR return was -0.9% due to +2.6% in USDZAR depreciation.

We summarise these global market returns in Table 1 below.

Table 1. South African and global equity returns (USD) for October 2024*

	Oct-24	YTD 2024
FTSE/JSE ALSI (ZAR)	-0.9%	14.8%
FTSE/JSE ALSI (USD)	-3.4%	18.8%
MSCI World	-2.0%	16.5%
MSCI EM	-4.4%	11.7%
MSCI Value	-2.2%	13.8%
MSCI Growth	-1.8%	19.1%
S&P 500	-0.9%	20.6%
Nasdaq 100	-0.8%	19.0%

*Total return indices, Source: Factset

Much is seemingly being made of the October US inflation data – CPI increased +2.6% and PCE, the Fed's preferred gauge, increased +2.3%. The source of the concern is that the inflation indicators have turned up (mildly) seemingly affirming one of several macro views in the market, namely that the US is likely to see a resurgence in inflation, not least because of the Fed pivot to easing monetary policy. A +0.5% rise in the US 10-year Treasury yield, to +4.3%, appears to be adding fuel to the fire.

The espoused view is that the US (and therefore the rest of the world) is about to experience a second bout of inflation similar to the 1970s, an alarming prospect.

If true/correct, bond yields should be expected to trend higher, leading to new capital losses for both bonds and equities, in a manner similar to that seen in 2022 when the vaunted 60/40 equity/bond portfolio provided no protection.

What has happened to inflation indicators?

Chart 1 below presents US CPI, Core CPI and PPI.

Per Chart 1 CPI has been on a declining trend since March 2024 up to the most recent uptick. Core CPI is more or less level at +3.3% while goods inflation, interestingly, appears to have been on an uptrend since June 2023.

Examination of the underlying data, not illustrated here, also reveals a strong near -12% contribution by Energy (Oil) in October.

Chart 1. US CPI, Core CPI and PPI



Source: Factset

What are the causes?

Consideration of the past is an important part in formulating a view of where we are headed with inflation.

During the pandemic various economists were at pains to point out that supply chain disruptions were a primary cause of inflation and the supply of money “doesn’t matter anymore”.

We present a chart of M2 money supply and inflation in the US since 1960, including the much-mentioned 1970s period in Chart 2 below.

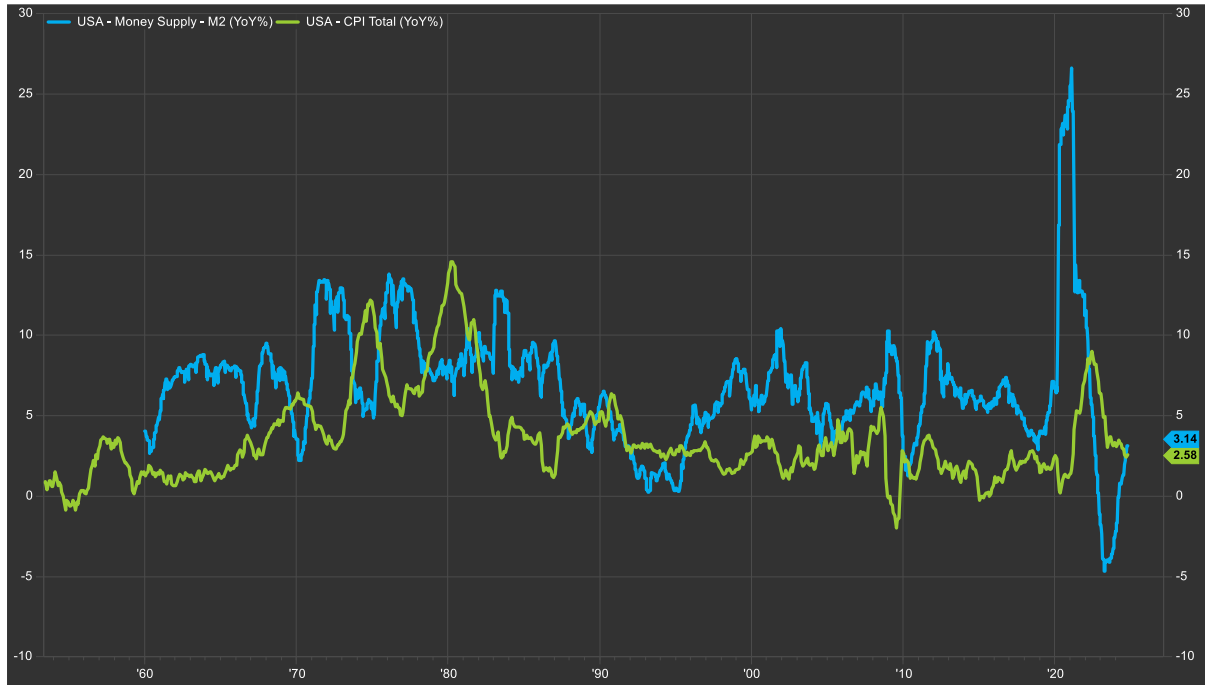
Per the chart, the 1970s experienced 3 full waves of inflation. Each of these was driven by economic and/or geopolitical events – the US abandonment of Bretton Woods in 1971, the Arab oil embargo in 1973, and the Iranian Revolution of 1979. But each of these was also accompanied by money supply growth impulses, clearly discernible in Chart 2. It is a safe suggestion that economic changes and geopolitics might be underlying drivers but money is an enabler, and inflation cannot occur without growth in the money supply. It was this observation that led to the famous quote that “money is always and everywhere a monetary phenomenon” and led to the development of the Monetarist school of economic thought in order to explain the economic developments of the day. Further, it was only in 1974 that the theoretical framework of an independent central bank controlling inflation through monetary policy, taken for granted today, was formulated and then implemented from the early 1980s.

What does this say about today?

History rhymes, as usual. We do not pretend to have insight into whether it was the money supply growth in 2020 and 2021 that caused the inflation or the supply chain disruptions. We do note that we have had an exogenous event, accompanied by a sharp increase in

money supply (the sharpest since WWII) and we had an accompanying strong inflation episode.

Chart 2. US CPI and money supply growth



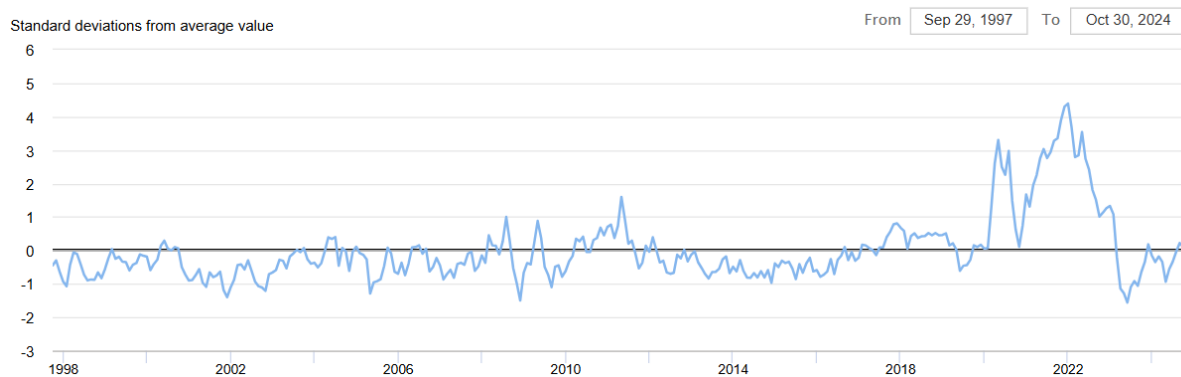
Source: Factset

Per Chart 2 also, since then money supply has experienced an equally unusual sharp contraction, has since recovered and is currently running at just over 3% p.a. growth.

What about the supply chain disruptions?

Chart 3 below presents the New York Fed’s Global Supply Chain Disruption Index.

Chart 3. Global Supply Chain Pressure Index



Source: www.newyorkfed.org

A quick glance at Chart 3 suggests disruptions are well and truly behind us.

Rising bond yields

Finally in Chart 4 below, we consider US 10-year Treasury and TIPS i.e. nominal and real yields.

Chart 4. US 10-year nominal and real yields



Source: Factset

While the October uptick is admittedly sharp, it remains an uptick, not a trend, and bond yields are down at the time of writing in November. The point of the above chart, however, is that most of the increase in nominal yields was driven an increase in real yields as opposed to the bond market pricing in an increase in inflation. Breakeven inflation did move marginally higher from +2.2% to +2.3%.

Notably also, per Chart 4 above, even in 2022, one could argue the rise in nominal yields was not driven by rising inflation expectations but by the normalisation of real yields. This however is the subject of a different market commentary.

Trump tariffs

Yet another issue is the prospect of Trump tariffs (which was not clear in October prior to the US election). Inflation did indeed rise in the first part of the US President-elect's first term. For the purposes of this commentary we suggest only that it is not conclusively established that tariffs are inflationary, or how inflationary. Much depends on the structure of the economy in question. We also point out again, that sustained inflation would require a money supply impulse. Here much would depend on the Fed's independence under the incoming President, and commentary is speculative.

Conclusion

Per the reviewed data points inflation does not appear to be a threat. Surprises are always possible, most importantly from the oil price. The US recent emphasis on no disruption to Iranian oil supply and the incoming US administration's focus on further increasing US oil supply suggest a concerted effort to avoid higher oil prices.

In addition bond yields once again appear to have been driven by movements in real yields as opposed to rising inflation expectations.

The net effects of all the above, however, remain the negative returns in global markets in October ...