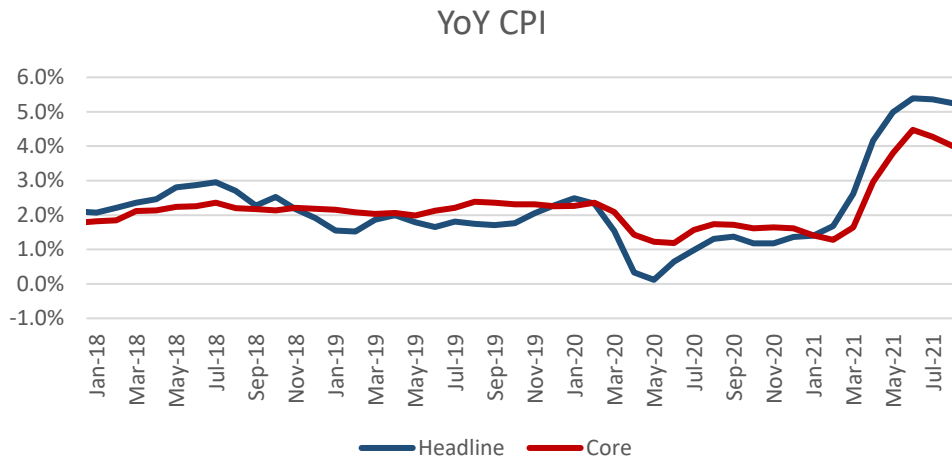


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The Transitory Debate...Continues

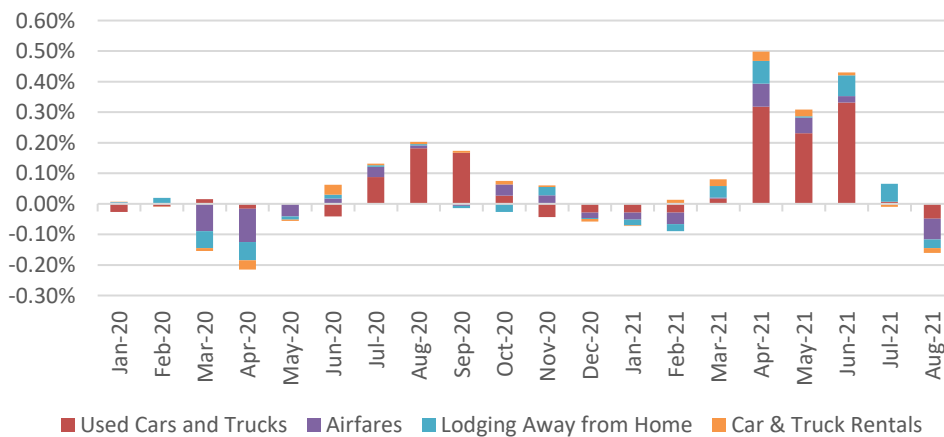
After soaring to new highs in Q2, headline and Core CPI finally softened some in July and further in August. Core CPI touched a nearly 30 year high of 4.5% YoY high in June before slipping to 4.3% in July and 4.0% in August.



Source: Bureau of Labor Statistics and New Century Advisors

Four high-flying reopening-sensitive sectors, used cars and trucks, airfares, hotels, and car and truck rentals, which combined total just over 5% of CPI, had accounted for more than half the Q2 rise in total CPI. They fell back to earth in July and turned negative in August, bolstering the narrative that the rise in inflation will prove to be entirely transitory.

"The COVID Four" - Contribution to total MoM CPI



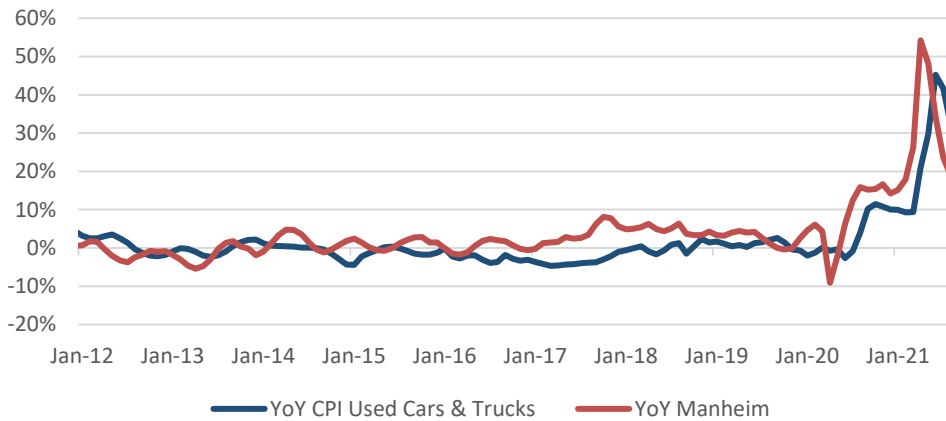
Source: Bureau of Labor Statistics and New Century Advisors

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Indeed, if wholesale used car prices are any judge, and the chart below suggests they likely are, then used car and truck prices within CPI could see further downside in the months ahead.

Used Car Prices: Manheim vs. CPI

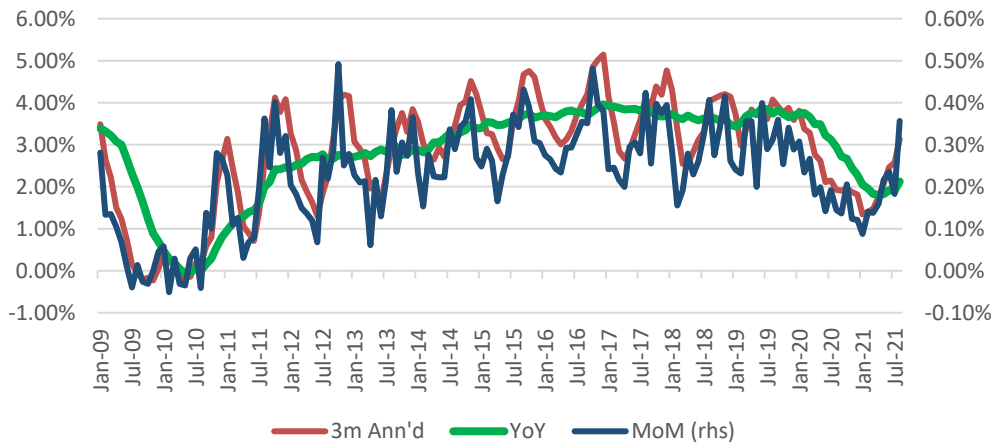


Source: Bureau of Labor Statistics and New Century Advisors

But let's tap the brakes on the transitory discussion for just a moment. The transitory nature of the four highly-volatile and reopening-sensitive sectors shown above was never in dispute. Their rapid ascent drew the headlines, but their subsequent decline sheds little light on the rest of the index. Looking elsewhere within CPI we find ourselves still very much in the middle of the inflation woods.

Consider housing. Rent and owner's equivalent rent combine to form nearly a third of CPI and 40% of core CPI. They both fell sharply during COVID but have slowly started to turn higher, with the August MoM rent print the highest in nearly two years.

NSA CPI Rents



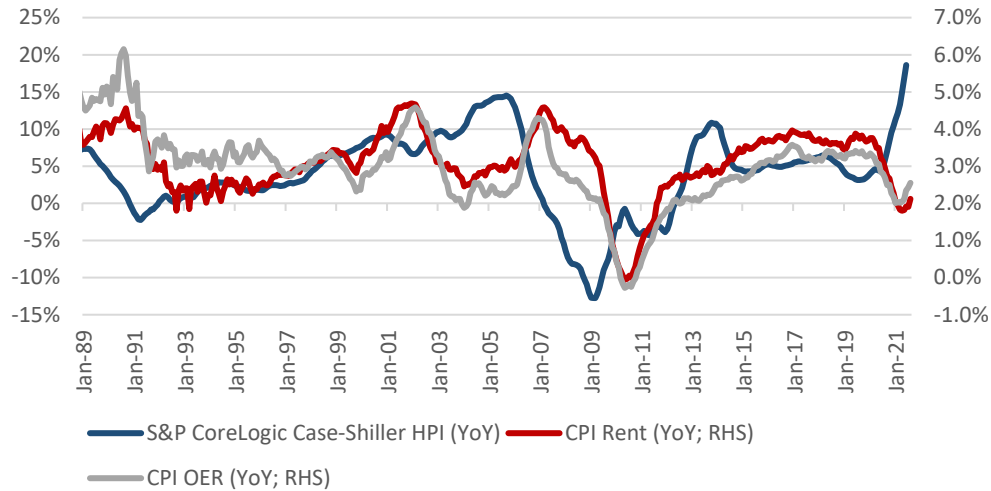
Source: Bureau of Labor Statistics and New Century Advisors

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Sharply rising home prices suggest that the rent move higher has only just begun.

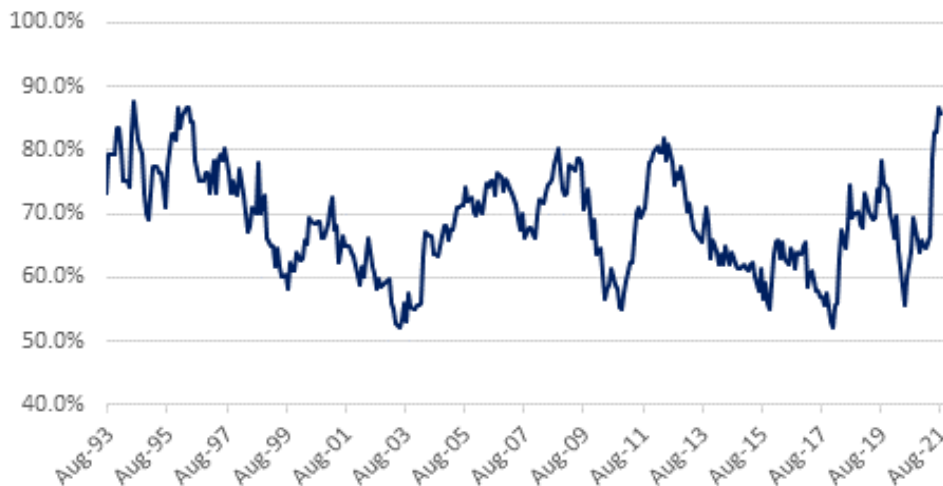
Home Prices vs. Rent & OER



Source: Bureau of Labor Statistics and New Century Advisors

The 800lb gorilla in the inflation room has only just started to wake up. But housing is hardly alone within core CPI. The core CPI diffusion index, the percent of components that are rising on a YoY basis, sits at 86%, a more than 25 year high.

Core CPI Diffusion Index

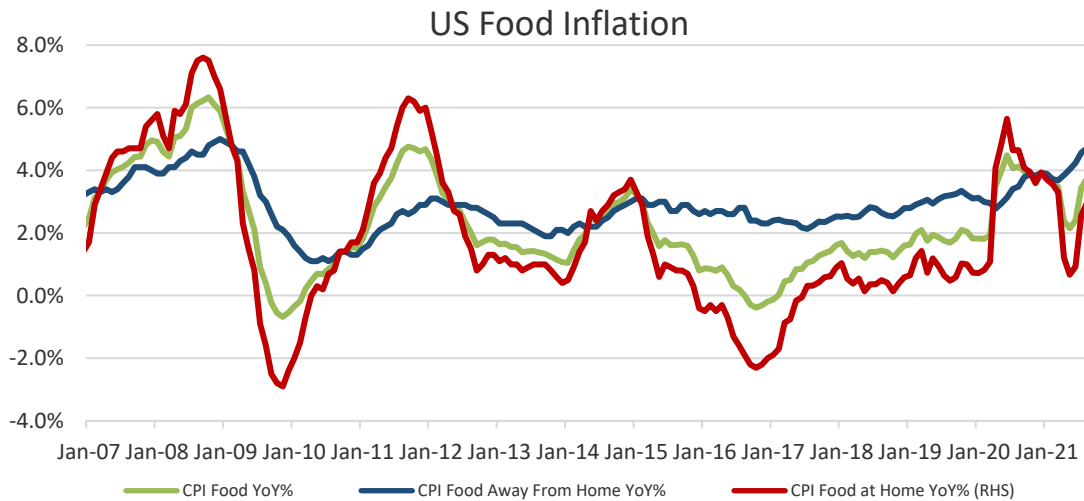


Source: Inflation Insights, LLC

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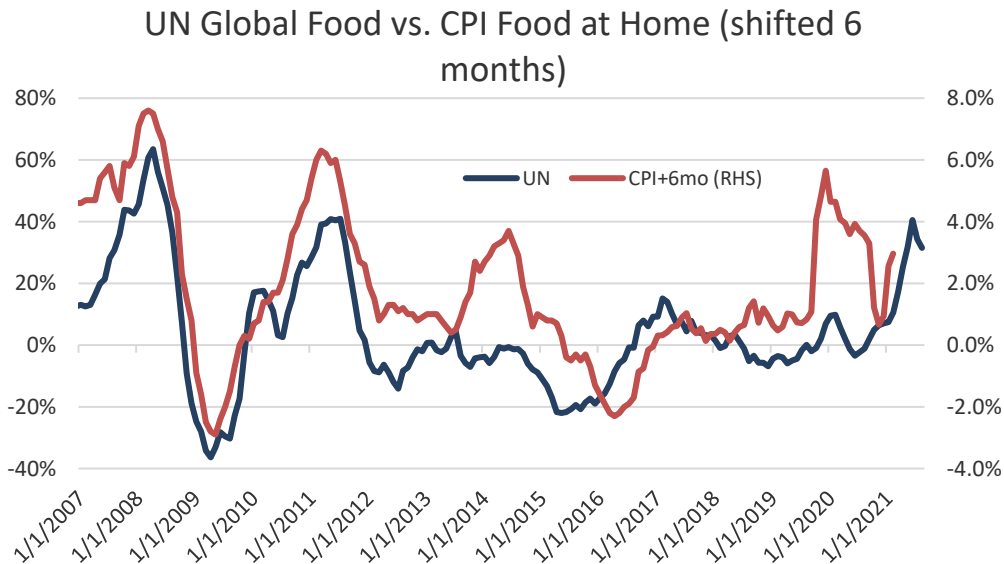
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Then there's food. People may not need to fly, but they need to eat. Food prices were one of the few sectors that spiked higher during the initial lockdowns last year. They've since normalized but have started to tick higher once again.



Source: Bureau of Labor Statistics and New Century Advisors

Global food prices remain elevated, just off decade-long highs, suggesting further upside to domestic food prices here in the US. Climate change and the increased incidence of droughts and floods adds further upside risk.

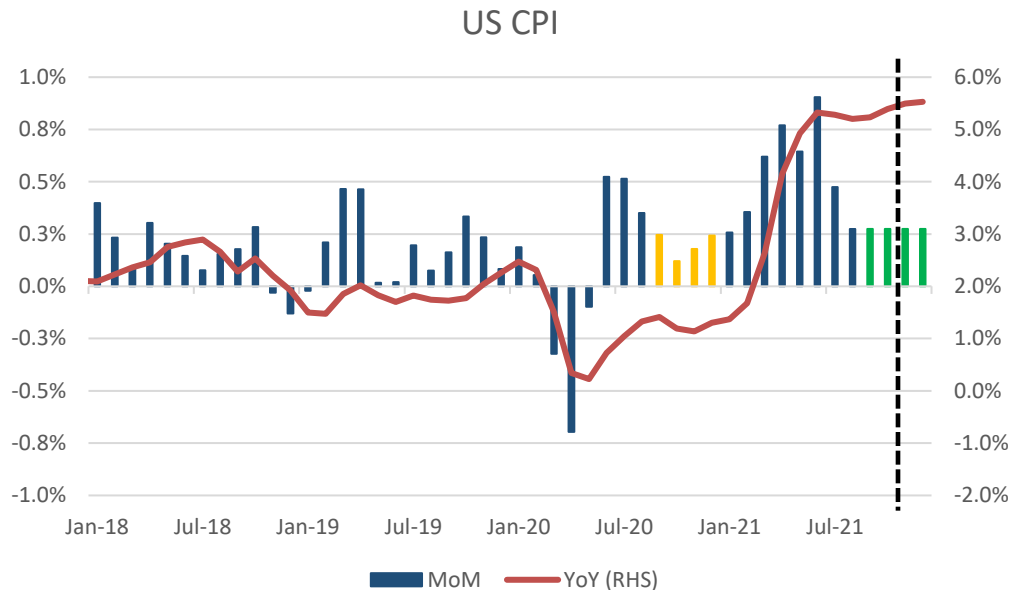


Source: Bureau of Labor Statistics and New Century Advisors

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Finally, as we look to the remainder of 2021, the bar for YoY CPI to remain elevated is extremely low. While August's 0.3% MoM rise in headline CPI was the softest gain since January, it was still higher than any of the prints from the last four months of 2020 (the yellow bars in the chart below). In other words, if August's 'weak' CPI print is repeated over the remaining four months of 2020 (the green bars, to the right of the dashed vertical line), then YoY CPI will actually rise further, closing the year north of 5.5%.



Source: Bureau of Labor Statistics and New Century Advisors

To be clear, we don't know where inflation is headed. But neither does Team Transitory. We likely won't know for several more months.

For more information on any of the data, trends, or trading strategies in this piece, or to discuss how New Century Advisors might help your fixed income allocation, please contact Leigh Talbot, CFA, Director of Client Relations at 240-395-0012 and ltalbot@ncallc.com

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