Capital Market Review

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Right now, only one word matters—inflation.

All the positive news surrounding corporate earnings and a strong October jobs report, which combined to lead markets to record highs, has taken a back seat. Right now, only one word matters—inflation. Last week, the Consumer Price Index reported a year-over-year increase of 6.2%, the highest since 1990.

Economists have been calling inflation "transitory" since we first started seeing prices increase earlier this year. As we stated over the summer, we could have continued to call inflation transitory if it remained for another month or two. However, we are now at five consecutive months of inflation over 5%. Last summer, one of the most significant factors for inflation was the increase in car prices, most notably used cars. This would be considered transitory inflation; car prices can only increase by so much before demand decreases and directly affects prices.

Now, we are experiencing broad-based inflation. Over the past year, restaurant prices rose the most since 1982, gasoline prices are up 50%, furniture prices are up the most in 70 years, and the examples go on. But the point to take from this is that inflation is now hitting many market areas, including those that directly impact the consumer.

Since we are in an inflationary environment, where do we go from here? We can start with monetary policy. The Federal Reserve is beginning to do its part by decreasing its pandemic-driven monthly asset purchases, currently at $120 billion per month. At the pandemic's beginning, the Fed began purchasing assets to stabilize financial markets and hold interest rates low to promote recovery. Now, both conditions have been met; so, it makes sense to start unwinding asset purchases, followed by slowly increasing short-term interest rates. Fiscal policy is also an area of concern. President Biden's Build Back Better plan may need revamping. Does a growing economy with rising inflation need a couple more trillion dollars injected?

The critical point to remember is not to make rash investment decisions. Portfolios still need bonds--maybe shorter duration bonds as rates could rise as we fight inflation-- but nevertheless, bonds are still important. Equities are still needed, maybe even more so, to fight inflation. Moving to higher-quality stocks and less speculative growth could be beneficial. But for the most part, no changes are better than drastic ones. Diversified portfolios are built to handle many environments, including inflation. To end on a more lighthearted note, there were two consumer items that actually dropped in price throughout October on a seasonally-adjusted basis: airline fares and alcohol. So, to paraphrase country singer Dierks Bentley, maybe it's time to use remaining vacation time and get "Drunk on a Plane."

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