



# INFLATION OUTLOOK

Leeward Financial Partners, LLC

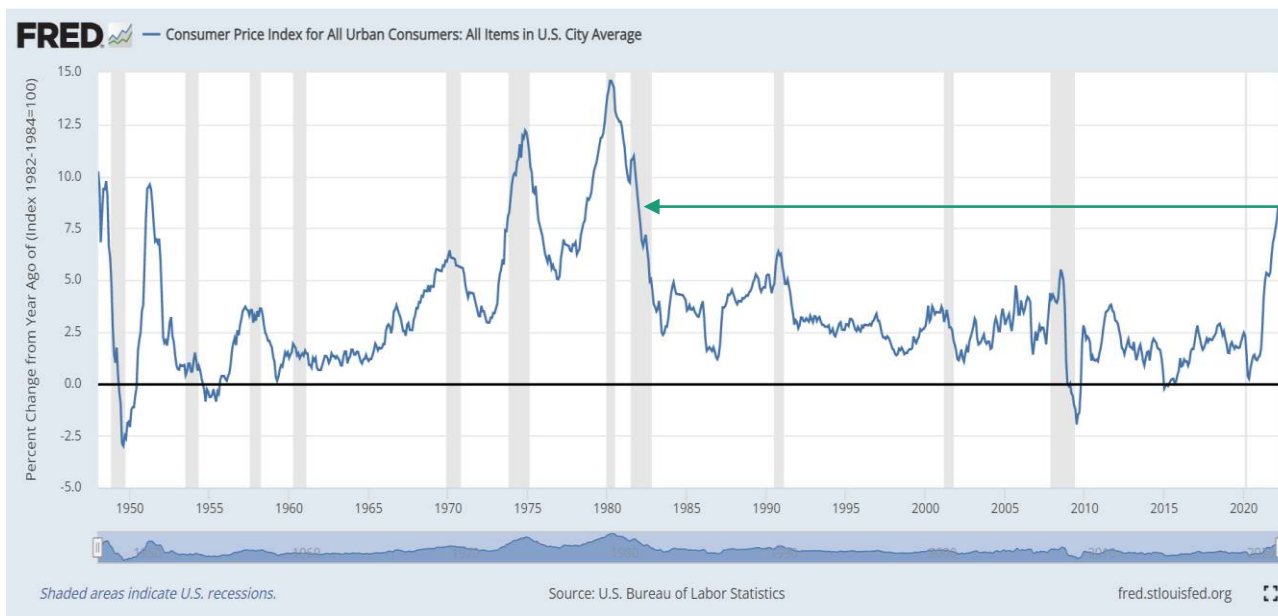
*Current thoughts*

*June 2022*



# Where are we right now?

Inflation, as measured by the one-year change in the Consumer Price Index, rose to 8.6% in May 2022, **the highest level since 1981.**



Source: FRED, as of 5/31/22

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Returns are price returns in U.S. dollar terms.

# What's driving inflation up?

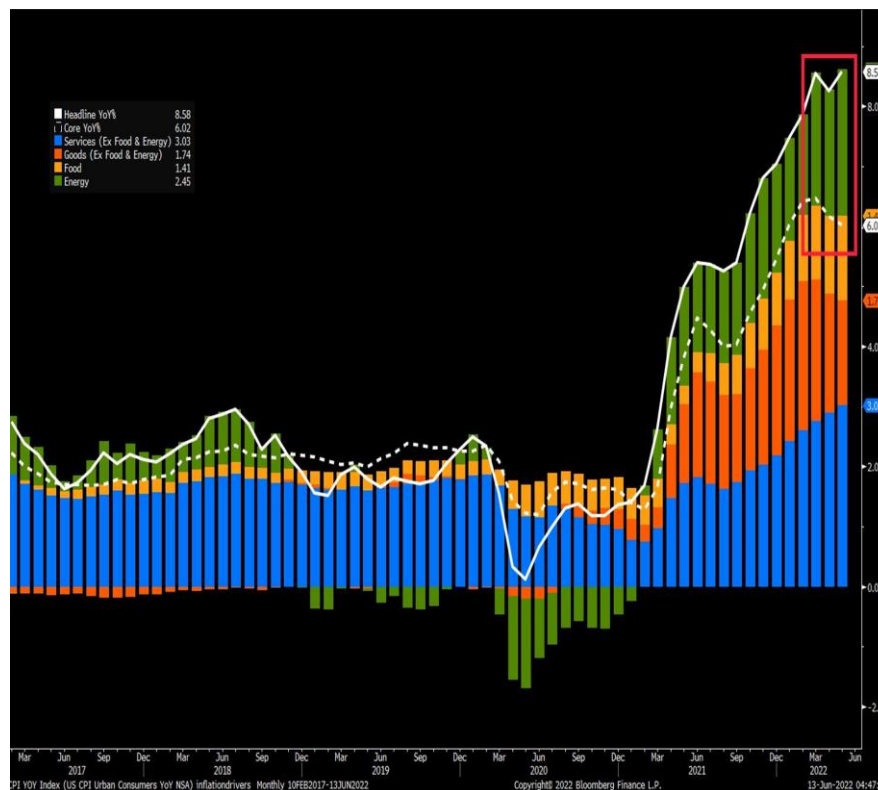
1. **A very strong labor market and high consumer demand**, bolstered by stimulus checks and low interest rates which are just now starting to rise
2. **Supply chain disruptions** increasing input product costs, which many companies then need to pass to customers by raising prices
3. **The War in Ukraine** is magnifying supply chain disruption-related inflation globally, particularly inflation of food and energy products
4. **Port closures in China** to limit the spread of Covid-19 have resulted in additional supply chain issues and higher transportation costs



# Inflation decomposition

The red box shows the **significant impact of the War in Ukraine on food and energy prices.**

Since energy is a baseline input to many goods and services, the surge in oil and gas prices contributes to measures of core inflation. For example, Airfare prices are directly impacted by energy costs.



Source: Bloomberg, BLS, as of 5/31/22



# A look under the hood

## MAY 2022 INFLATION REPORT

Table A. Percent changes in CPI for All Urban Consumers (CPI-U): U.S. city average

	Seasonally adjusted changes from preceding month							Un-adjusted 12-mos. ended May 2022
	Nov. 2021	Dec. 2021	Jan. 2022	Feb. 2022	Mar. 2022	Apr. 2022	May 2022	
All items.....	0.7	0.6	0.6	0.8	1.2	0.3	1.0	8.6
Food.....	0.8	0.5	0.9	1.0	1.0	0.9	1.2	10.1
Food at home.....	0.9	0.4	1.0	1.4	1.5	1.0	1.4	11.9
Food away from home <sup>1</sup> .....	0.6	0.6	0.7	0.4	0.3	0.6	0.7	7.4
Energy.....	2.4	0.9	0.9	3.5	11.0	-2.7	3.9	34.6
Energy commodities.....	4.2	1.3	-0.6	6.7	18.1	-5.4	4.5	50.3
Gasoline (all types).....	4.5	1.3	-0.8	6.6	18.3	-6.1	4.1	48.7
Fuel oil <sup>1</sup> .....	3.5	-2.4	9.5	7.7	22.3	2.7	16.9	106.7
Energy services.....	0.2	0.3	2.9	-0.4	1.8	1.3	3.0	16.2
Electricity.....	0.2	0.5	4.2	-1.1	2.2	0.7	1.3	12.0
Utility (piped) gas service.....	0.3	-0.3	-0.5	1.5	0.6	3.1	8.0	30.2
All items less food and energy.....	0.5	0.6	0.6	0.5	0.3	0.6	0.6	6.0
Commodities less food and energy commodities.....	0.9	1.2	1.0	0.4	-0.4	0.2	0.7	8.5
New vehicles.....	1.2	1.2	0.0	0.3	0.2	1.1	1.0	12.6
Used cars and trucks.....	2.4	3.3	1.5	-0.2	-3.8	-0.4	1.8	16.1
Apparel.....	0.7	1.1	1.1	0.7	0.6	-0.8	0.7	5.0
Medical care commodities <sup>1</sup> .....	0.1	0.0	0.9	0.3	0.2	0.1	0.3	2.4
Services less energy services.....	0.4	0.3	0.4	0.5	0.6	0.7	0.6	5.2
Shelter.....	0.5	0.4	0.3	0.5	0.5	0.5	0.6	5.5
Transportation services.....	0.7	0.0	1.0	1.4	2.0	3.1	1.3	7.9
Medical care services.....	0.3	0.3	0.6	0.1	0.6	0.5	0.4	4.0

Food and gas prices have risen rapidly over the last 12 months, as both categories have been influenced by the War in Ukraine.

Semiconductor shortages continue to weigh on the amount of cars being produced, keeping vehicle prices elevated.

Shelter costs (the cost of rent) are still posting slow and steady increases and are following a similar path to that of housing prices over the last several years.

Source: BLS, as of 5/31/22



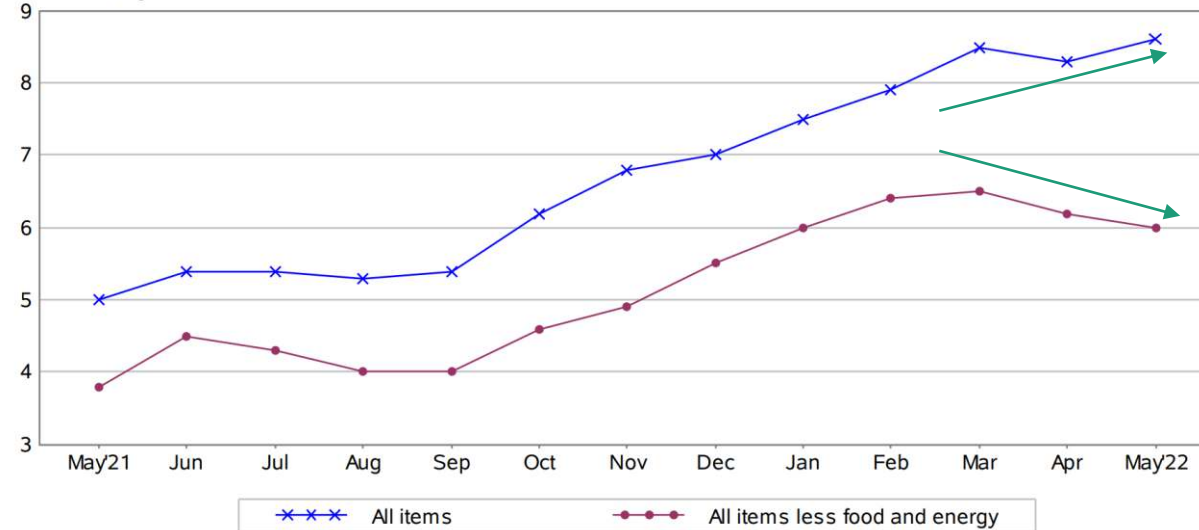
Good news or bad news?



# Good news

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, May 2021 - May 2022

Percent change



**The decline in the purple line means that inflation is starting to slow down** for things like refrigerators, vehicles, clothes, and other goods. This is good news.

The blue line includes food and energy and shows how strongly these categories impact inflation.

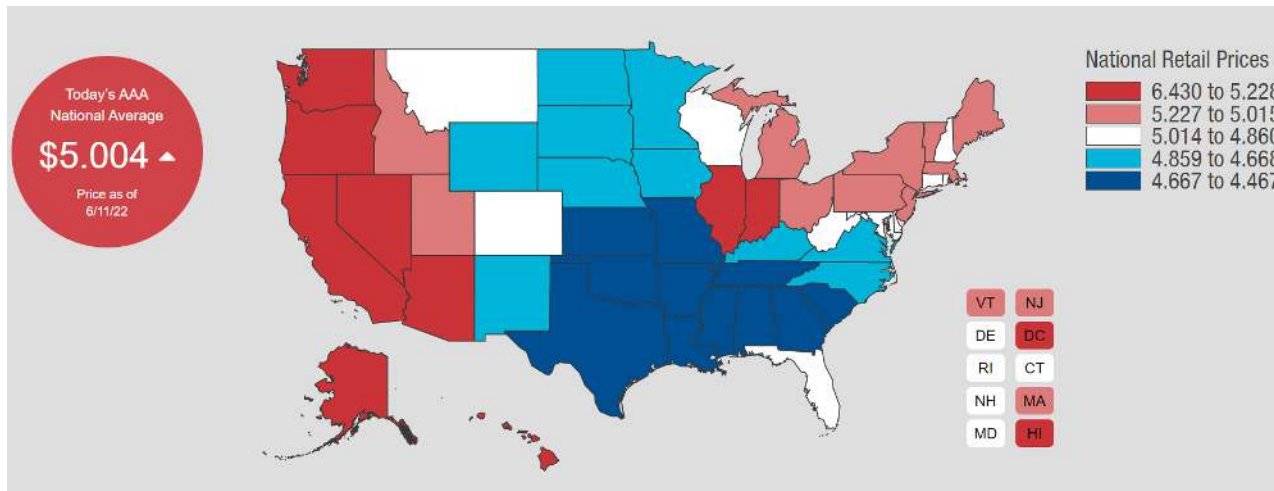
**The War in Ukraine is having a large impact on the blue line**, but not as much of an impact on the purple line. The purple line is **more important**.

Source: BLS, as of 5/31/22



# Bad news

## GAS PRICES



Source: AAA, as of 6/11/22

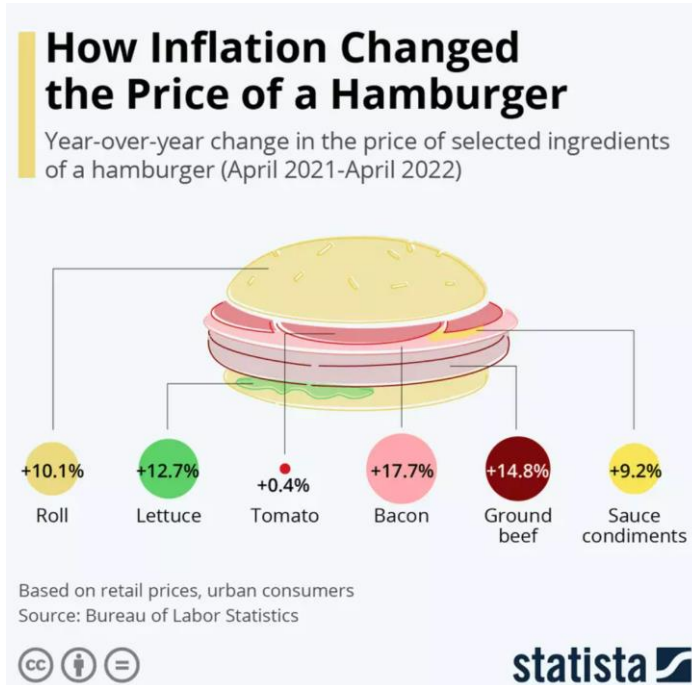
**The bad news is that energy are high and rising** and these costs hit lower-income people harder.

As we enter the summer driving season, **we expect gas prices may reach \$7/gallon** in many areas.





# Bad news



Source: Statista, as of 4/30/22

Food prices have risen over 10% over the last year.

The cost of eating in has risen 11.9%, and the cost of eating out has risen 7.4%.

The only food category that has gotten cheaper is our kids' lunches (elementary and secondary school lunches -44%), which is a function of tax-payer funded "free lunches" through the pandemic.



# Inflation expectations will change

## Inflation will be **lower, sooner, if:**

- Any **improvement on the Ukraine-Russia front** will reduce the risk for further price gains for food and energy products.
- **Easing in supply chain disruptions** slow down inflation for durable goods like vehicles and furniture

## Inflation will be **higher, longer, if:**

- Rising wages drive companies to raise prices further, prompting workers to demand pay that keeps up with inflation. **This is called a wage-price spiral.**
- **Shelter costs rise faster.** The cost of rent is increasing at a moderate rate and may accelerate. Shelter costs have risen 5.5% over the last year and may move higher.



# Our strategy



For Leeward client use only. Past performance does not guarantee future results.

# Stay invested

Missing just a few of the market's best days can hurt investment returns



Sources: RIMES, Standard & Poor's. As of 12/31/21. Values in USD.



# Adjust portfolios

- **Become more defensive:** This year, we have made multiple adjustments to make portfolios defensive and to shelter those portfolios from the erosive impact of inflation.
- **Invest in assets that benefit from inflation:** While narrow in scope, there are areas – commodities, energy, materials, and industrials – that do well in inflationary environments.
- **Minimize bond exposure:** Long-term bonds do not mix well with inflation. Short-term bonds and inflation-protected fixed income are more effective in inflationary environments.



# Scan for opportunities

- The market sell-off is **creating opportunities**. Many quality companies are oversold and look attractive to us.
- For example, higher inflation over the short term doesn't mean that the value of the entire US technology sector should be 30% lower than where it was in 4Q 2021.
- **Timing is key**. There is no reason to rush into oversold securities immediately. **Making sure investments participate** in a market recovery is most important.



Image Source: Innovating Society



# Negative markets are never fun

**We are in a bear market cycle.** Portfolio values are in decline, driven by inflation and negative news flow. Periods like this are uncomfortable and challenge conviction.

Fortunately (or unfortunately) **we have been here before.** Most market cycles are similar even if what creates a sell-off and recovery always seems to be different.

We are in a market bottoming process, but **any market recovery will take time** to develop. Experience has taught us that patience and consistency are paramount when navigating markets like the one we have today.

We have a good plan which we are working diligently on to execute.



The logo for Leeward Financial Partners features the word "LEEWARD" in a large, blue, serif font. A dark blue swoosh underline starts under the "L", goes under "EE", and then curves up and under "WARD". A small compass rose icon is positioned at the end of the swoosh, pointing towards the top right. Below "LEEWARD", the words "FINANCIAL PARTNERS" are written in a smaller, blue, all-caps serif font.

**LEEWARD**  
FINANCIAL PARTNERS

**Michael Emery, CFA**  
Partner  
mike@leewardfp.com

**James Ridgeway**  
Partner  
jim@leewardfp.com