Markets Sigh as Hot December CPI isn't any Hotter

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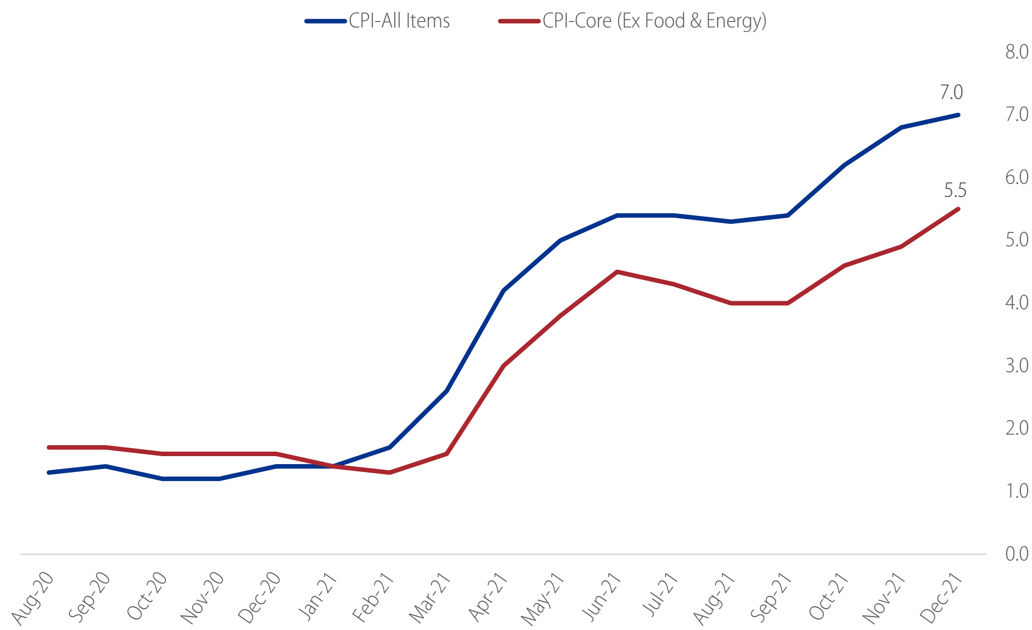
The headline consumer price index (CPI) rose +0.5% in December and +7.0% on a year-over-year basis, *the largest annual gain since June 1982*. In 2020, headline consumer prices increased by just +1.4%, and in 2019, consumer prices rose at a +2.3% pace. As eye-popping as this morning's +7.0% annual increase appeared, it was right on top of the median forecast. The fact that it wasn't any worse, with assurances that Fed officials have already begun the process of cooling demand, has prompted an early rally in stocks and a mixed (evolving) bond market response.

Core CPI, which excludes food and energy prices, rose +0.4% in December and +5.5% year-over-year, *a new 30-year high*. This was a bit higher than expected, but the markets seem more focused on the headline.

Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

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Noteworthy drivers of the December increase were used vehicles (+3.5% monthly / +37.3% annual); new vehicles (+1.0% monthly / +11.8% annual); shelter costs (+0.4% monthly / +4.1% annual); food (+0.5% monthly / +6.3% annual); and clothing (+1.7% monthly /+5.8% annual).

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Overall energy prices were lower (-0.6%) in December, but still up +29.3% year-over-year. Gasoline prices were down -0.5% in December following a +6.1% jump in November, and are now up "just" +49.6% year-over-year.

Prescription drug costs rose +0.1% in December and were *unchanged* year-over-year, while non-prescription drug prices decreased -0.4% during the month and rose by just +0.8% for the year.

To a large degree, the markets have already factored-in higher prices …for a few more months anyway. The Fed is on track to address the problem by completing its taper in March and is now expected to begin tightening interest rates shortly thereafter. Although it's possible that most inflation measures may be nearing a peak, it's unlikely that inflation will move significantly lower on an annual basis until late spring. Because inflation had turned sharply higher in April 2021, the bar for outsized year-over-year price increases this summer will be much harder to meet. Assuming the supply chain issues continue to resolve themselves, inflation should settle down as the year progresses. *But, the Fed isn't waiting.*

As much as Powell's comments and recent economic data will direct and influence the day-to-day financial markets, the COVID cloud will determine how the near-term future unfolds.

Yesterday, Fed Chairman Powell, in his (re)confirmation hearing in front of the Senate Banking Committee reiterated that the Fed expects to end new QE asset purchases in March. He also said that the FOMC is likely to begin shrinking the Fed's $8.8 trillion balance sheet later this year. *Neither of these admissions were a surprise*. Powell was confident the Fed would be able to keep inflation under control, but in the event that inflation were to persist, the FOMC would respond more aggressively. Powell's reassuring comments prompted a bond rally yesterday and halted what was shaping up to be a six-day equity market skid.

As much as Powell's comments and recent economic data will direct and influence the day-to-day financial markets, the COVID cloud will determine how the near-term future unfolds. Over 1.4 million new COVID infections were identified on Tuesday, pulling the 7-day moving average above 750k, triple the high point from a year ago. The seven-day average for hospitalizations topped 145k on Tuesday, up roughly 90% in just the last two weeks. The spread isn't expected to peak for another two weeks.

Market Indications as of 9:30 A.M. Central Time

DOW	Up 116 to 36,368 (HIGH: 36,800)
NASDAQ	Up 122 to 15,275 (HIGH: 16,057)
S&P 500	Up 31 to 4,744 (HIGH: 4,797)
1-Yr T-bill	current yield 0.44%; opening yield 0.40%
2-Yr T-note	current yield 0.89%; opening yield 0.89%
3-Yr T-note	current yield 1.21%; opening yield 1.21%
5-Yr T-note	current yield 1.50%; opening yield 1.50%
10-Yr T-note	current yield 1.73%; opening yield 1.74%
30-Yr T-bond	current yield 2.08%; opening yield 2.07%