

# WE AREN'T DONE WITH INFLATION

Jeff Weniger — Head of Equity Strategy  
10/28/2021

I think the September [Consumer Price Inflation \(CPI\)](#) report measured prices on Neptune, not Earth.

You do not have to live in a piping hot housing market like the ones in Scottsdale, Austin or Miami to know that the shelter subcomponent of CPI seems way off: a 3.2% year-over-year increase is just not in the ballpark.

You know it, I know it, everyone knows it: houses, apartments, condos—their prices all zoomed over the last year, everywhere. But according to the Bureau of Labor Statistics (BLS), apparently not (figure 1).

**Figure 1: A Snip from the September CPI Report**

**Table 1. Consumer Price Index for All Urban Consumers (CPI-U): U.S. city average, by expenditure category, September 2021**  
[1982-84=100, unless otherwise noted]

Expenditure category	Relative importance Aug. 2021	Unadjusted indexes			Unadjusted percent change		Seasonally adjusted percent change		
		Sep. 2020	Aug. 2021	Sep. 2021	Sep. 2020- Sep. 2021	Aug. 2021- Sep. 2021	Jun. 2021- Jul. 2021	Jul. 2021- Aug. 2021	Aug. 2021- Sep. 2021
Alcoholic beverages.....	1.007	257.730	264.315	264.980	2.8	0.3	0.3	0.3	0.2
Tobacco and smoking products <sup>1</sup> .....	0.606	1,183.975	1,254.482	1,263.542	6.7	0.7	0.5	0.1	0.7
Services less energy services.....	58.085	345.880	355.423	355.962	2.9	0.2	0.3	0.0	0.2
Shelter.....	32.552	327.116	336.284	337.451	3.2	0.3	0.4	0.2	0.4
Rent of primary residence.....	7.600	342.910	349.710	351.255	2.4	0.4	0.2	0.3	0.5
Owners' equivalent rent of residences <sup>2</sup> .....	23.555	336.095	344.327	345.824	2.9	0.4	0.3	0.3	0.4

Source: Bureau of Labor Statistics, September 2021.

"If someone were to rent your home today, how much do you think it would rent for monthly, unfurnished and without utilities?"

As if most homeowners have any clue what their place would rent for, the BLS tabulates [inflation](#) in owner-occupied housing by asking this question about Owners' Equivalent Rent (OER)—what homeowners think about a subject that they probably don't think much about.

For those of us who believe *house prices* may be the best gauge of *house prices*, it doesn't work that way.

Because of this snag in the data collection, here is what happens.

Say neighborhood rents start shooting higher. The first people to realize it are, no surprise, landlords and renters. The rest of the neighborhood—homeowners—may have some fuzzy inkling that rents are going higher, but they are not fully aware of the details. There's no finger on the pulse.

Many homeowners who last year figured their home would rent for \$1,000 are telling the BLS that it would rent for maybe the same amount—because they are unaware it could very well fetch \$1,100 or \$1,200 now.

Consider four recent reports on both prices and rents:

- Redfin, the listings website, wrote on September 29, 2021 that “housing market asking prices are up 12%, to an all-time high.”
- On September 30, 2021, the National Association of Realtors calculated that median listing prices were up 8.6% YoY.
- Zumper, the property search company, puts rent appreciation on both one-bedroom and two-bedroom apartments in the double digits.
- [The S&P/CoreLogic Case-Shiller Home Price Index](#) was +19.7% in the year to August, with little indication the September data will show any deflation.

These are all way off from the 3.2% increase in the all-encompassing shelter component of the CPI. It’s a matter of logic that our new high-price and high-rent world will start to be reflected, with a lag, in future CPI reports.

### A Six-Handle on the October CPI Report?

There is another critical matter at hand: October CPI, which will be published on November 10, may easily exceed the monthly growth rate we witnessed last October.

In that month, CPI was flat. Come to think of it, last November was also tame (figure 2). That is a much different situation from the big inflation months of summer 2020.

**Figure 2: October and November 2020 Were Not Big Inflation Months**

U.S. Consumer Price Inflation (Month-over-Month)			
2020		2021	
December	0.4%	December	???
November	0.2%	November	???
October	0.0%	October	???
September	0.2%	September	0.4%
August	0.4%	August	0.3%
July	0.6%	July	0.5%
June	0.6%	June	0.9%
May	-0.1%	May	0.6%
April	-0.8%	April	0.8%
March	-0.4%	March	0.6%
February	0.1%	February	0.4%
January	0.1%	January	0.3%

Source: Bureau of Labor Statistics, through September 2021.

Which means that, arithmetically, it does not take much “oomph” in this October’s action to keep the year-over-year growth rate north of 5%. In fact, figure 3 lays out some very achievable scenarios that could lead to CPI touching 6%, at least for the October report.

I am not saying it’s probable, but it is certainly possible.

**Figure 3: October CPI Report Scenarios**

If October's Month-over-Month Rate Is:	Then October's Year-over-Year Rate Is	If October's Month-over-Month Rate Is:	Then October's Year-over-Year Rate Is
-0.4%	5.11%	0.4%	5.95%
-0.3%	5.22%	0.5%	6.06%
-0.2%	5.32%	0.6%	6.17%
-0.1%	5.43%	0.7%	6.27%
0.0%	5.53%	0.8%	6.38%
0.1%	5.64%	0.9%	6.48%
0.2%	5.74%	1.0%	6.59%
0.3%	5.85%	1.1%	6.69%

Source: WisdomTree Calculations.

The natural concern for 2022 is whether Corporate America can maintain its [profit margins](#) in the face of rising labor costs. After all, sometimes it takes the landlord to drop the rent bomb on you before you finally get the courage to ask the boss for a raise.

A profit margin pinch is coming.

When you break apart the often cited [quality smart beta](#) factor, [return on equity \(ROE\)](#), you see that profit margins are a key driver of the metric. Slash margins and you have a problem (figure 4).

**Figure 4: Breaking Apart ROE with the DuPont Equation**

$$\begin{aligned}
 \text{Return on Equity (ROE)} &= \text{Net Profit Margin} \times \text{Asset Turnover} \times \text{Financial Leverage} \\
 \text{Return on Equity (ROE)} &= \frac{\text{Net Profit}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}
 \end{aligned}$$

Take a look at the [WisdomTree U.S. Quality Dividend Growth Fund \(DGRW\)](#), which has an ROE of 28.2%, owing to robust margins. For comparison, the [S&P 500](#)'s ROE is 16.9%<sup>1</sup>.

If you like the methodology that it uses, we also have several other strategies in other asset classes that tap into the same "quality dividend growth" concept.

<sup>1</sup> Source: WisdomTree DPD, as of 9/30/21.

#### Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

#### Related Blogs

- + [Thin-Margin Companies Will Feel Inflation's Pinch](#)
- + [July U.S. Dividend Update in Charts](#)
- + [Fed Watch: When Doves Cry](#)

#### Related Funds

- + [WisdomTree U.S. Quality Dividend Growth Fund](#)
- + [WisdomTree U.S. SmallCap Quality Dividend Growth Fund](#)

View the online version of this article [here](#).

## **IMPORTANT INFORMATION**

**U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## **DEFINITIONS**

**Consumer Price Index (CPI)** : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

**Inflation** : Characterized by rising price levels.

**Quality** : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

**Smart Beta** : A term for rules-based investment strategies that don't use conventional market-cap weightings.

**Return on Equity (ROE)** : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**DuPont Equation** : At the DuPont Corporation, Donaldson Brown created the concept that Return on equity (ROE) is broken down into the interaction between profit margin, by asset turnover, and the equity multiplier. These three pieces multiplied together are equal to ROE.

**S&P 500 Index** : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.