WHAT ECONOMIC INDICATOR HAS BEEN FLYING UNDER THE RADAR? INFLATION

Kevin Flanagan — Head of Fixed Income Strategy
06/20/2018

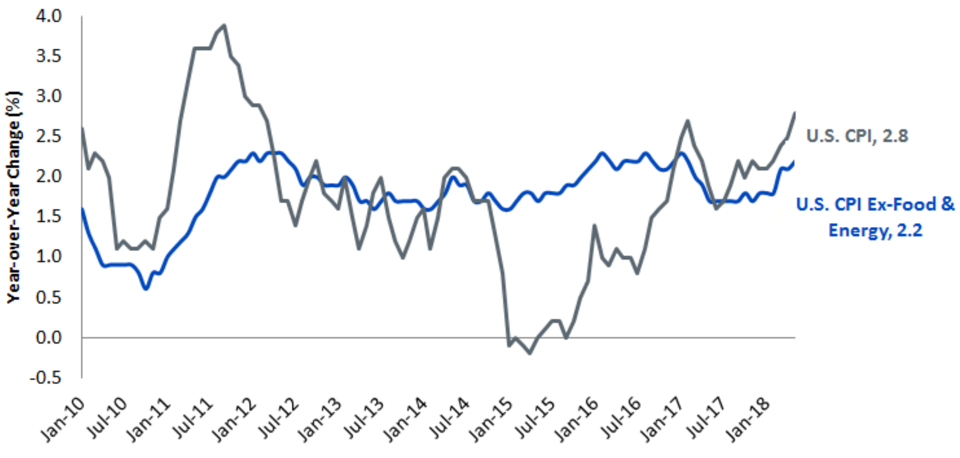
Over the last week to 10 days, investors have been presented with a whole host of news. There have been summits of various kinds as well as central bank meetings of the G-3 (U.S., eurozone and Japan). For good reason, each of these events has generated its own individual headlines, but one particular development has essentially flown under the radar. Indeed, during the period under review, the Bureau of Labor Statistics released its latest report on inflation, the Consumer Price Index (CPI)—and the trend that is beginning to take shape in 2018 is that inflation appears to be on the rise.

Interestingly, the money and bond markets have been down this road before, as 2017 also got off to an ascending trajectory. However, in hindsight, last year's trend proved to be a false start, as early demand pressures quickly gave way to a declining trend, and the year-over-year increase for headline CPI finished 2017 at +2.1%, identical to 2016.

Through the first five months of the current calendar year, the trend has been decidedly up. To be sure, in each of the first five months of 2018, the CPI's annualized increase has revealed a higher reading. As a result, the year-over-year increase has risen from +2.1% in December 2017 to +2.8% in May of this year. The current figure is the highest reading since 2012. A similar pattern has been observed with CPI, excluding food and energy. This core measure of inflation has risen 0.4 percentage points from the end of last year and now stands at +2.2%.

U.S. CPI vs. U.S. CPI ex-Food & Energy

Year-over-Year Change from 1/ 31/2010 to 5/31/2018



Source: Bureau of Labor Statistics, as of 6/12/2018. Past performance is not indicative of future results.

While the U.S. Treasury (UST) market may have been preoccupied with the aforementioned news events, the Federal Reserve (Fed) certainly has taken note. No, this renewed increase in inflation was not an integral factor behind the FOMC's decision to raise rates at last week's meeting, but based upon the policy statement and Chairman Powell's post-convocation presser, the Fed appears to be rather pleased with the direction inflation is finally headed. In fact, Powell stated that recent inflation data has been encouraging, but on the other hand warned that "we don't want to declare victory" yet. For the record, the Fed's preferred inflation measure, the personal consumption expenditure (PCE) price index, has also made some progress. The overall PCE gauge has hit the FOMC's inflation target of +2.0% the last two months, while the core measure resides just below, at +1.8%, but it, too, appears poised to make a run at this goal.

Conclusion

Let's conclude with the UST market. The UST 10-Year yield has, thus far, really not shown any visible concern on where inflation has been headed of late. One could make the case that the market has already discounted the current trend. In fact, the break-even inflation rate, or the difference between the yield on a nominal bond (such as the U.S. Treasury 10-Year note) and an inflation-linked or real yield bond with the same maturity (such as the 10-Year U.S. Treasury Inflation-Protected Securities or TIPS), has been mired in the same range-bound pattern since January. In my opinion, the potential difference maker that could grab the Treasury market's attention would be if there was a "breakout to the upside" on the wage front in the months ahead.

Unless otherwise stated, data source is Bloomberg, as of June 15th 2018.

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.

For more investing insights, check out our Economic & Market Outlook

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)

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

Eurozone (EZ) : Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

Inflation : Characterized by rising price levels.

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.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Personal Consumption Expenditure (PCE) Price Index : measure of price changes in consumer goods and services in the U.S. economy.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Break-even inflation rate : For a given bond maturity, for example five years, the interest rate on the five-year nominal bond minus the interest rate on the five-year inflation adjusted bond; meant to approximate expected inflation over that time frame, in this case five years.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Nominal Treasury : Rate on the treasury security not adjusted for inflation.

Treasury Inflation-Protected Securities (TIPS) : Bonds issued by the U.S. government. TIPS provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, you are paid the adjusted principal or original principal, whichever is greater.