
NEXT SUMMER'S CPI REPORTS MAY BE LOWER THAN YOU THINK

Jeff Weniger – Head of Equity Strategy
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My mind is on July 12, 2023—the day next year's [CPI](#) for the month of June will be released.

That month is my best guess for the one that is most likely to print a notably low year-over-year growth rate in [inflation](#). It's the first month to "roll off" all the ugly month-over-month readings that came in 2022's first half. You can see them on the left side of figure 1.

I'm not sure many investors realize it, but the last half year or so hasn't seen much inflation (over and above the spike into the summer). The last five monthly CPI growth rates were 0.0%, 0.1%, 0.4%, 0.4% and 0.1%.

If you look at the various scenarios for the months from now until summer 2023, a handful of "normal" reports can easily put YoY CPI in the 2%-3% area. We all talk about inflation coming down, but it's my inkling that not many investors truly believe CPI's first digit could be a "2" so soon.

Figure 1: YoY CPI Scenarios for June 2023

Monthly CPI Readings That Will be Rolled Off in the June 2023 CPI Report		Monthly CPI Change							
Month	Monthly CPI Change		Actuals	Theoretical Monthly Change	Theoretical Monthly Change	Theoretical Monthly Change	Theoretical Monthly Change	Theoretical Monthly Change	Random 0.0-0.4%
Nov. 2021	0.7%	Jul. 2022	0.0%						
Dec. 2021	0.6%	Aug. 2022	0.1%	← Compounding Those...			...With These...		
Jan. 2022	0.6%	Sep. 2022	0.4%						
Feb. 2022	0.8%	Oct. 2022	0.4%						
Mar. 2022	1.2%	Nov. 2022	0.1%						
Apr. 2022	0.3%	Dec. 2022		0.0%	0.1%	0.2%	0.3%	0.4%	0.0%
May 2022	1.0%	Jan. 2023		0.0%	0.1%	0.2%	0.3%	0.4%	0.4%
Jun. 2022	1.3%	Feb. 2023		0.0%	0.1%	0.2%	0.3%	0.4%	0.3%
		Mar. 2023		0.0%	0.1%	0.2%	0.3%	0.4%	0.1%
		Apr. 2023		0.0%	0.1%	0.2%	0.3%	0.4%	0.2%
		May 2023		0.0%	0.1%	0.2%	0.3%	0.4%	0.0%
		Jun. 2023		0.0%	0.1%	0.2%	0.3%	0.4%	0.4%
				...Gives You a June 2023 CPI That Shows Year Growth of:					
				1.0%	1.7%	2.4%	3.1%	3.9%	2.4%

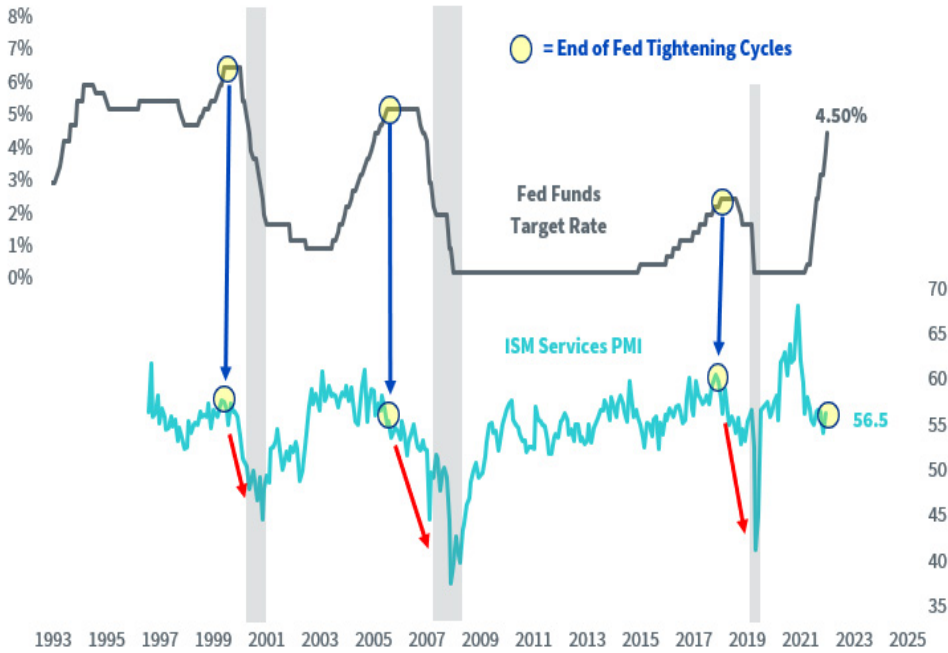
Source: BLS, as of November 2022. All numbers beyond November 2022 are hypothetical.

There is the real possibility all my scenarios could be wildly inaccurate. Between the war in Ukraine and persistent wage inflation manifesting in a surprise spending impulse by the consumer, maybe we will see some reports that resemble what we had to bear this past spring.

Nevertheless, I'm thinking [disinflation](#) for 2023's first half. Consider the services sector, which has held up strongly. Strength in indexes such as the [ISM Services PMI](#) has been one of the core arguments for those who assert the economy will avoid a second dip into recession.

However, my worry is that the ends of Fed tightening cycles often break things (figure 2).

Figure 2: Fed Funds Points to Lower Services [PMI](#)

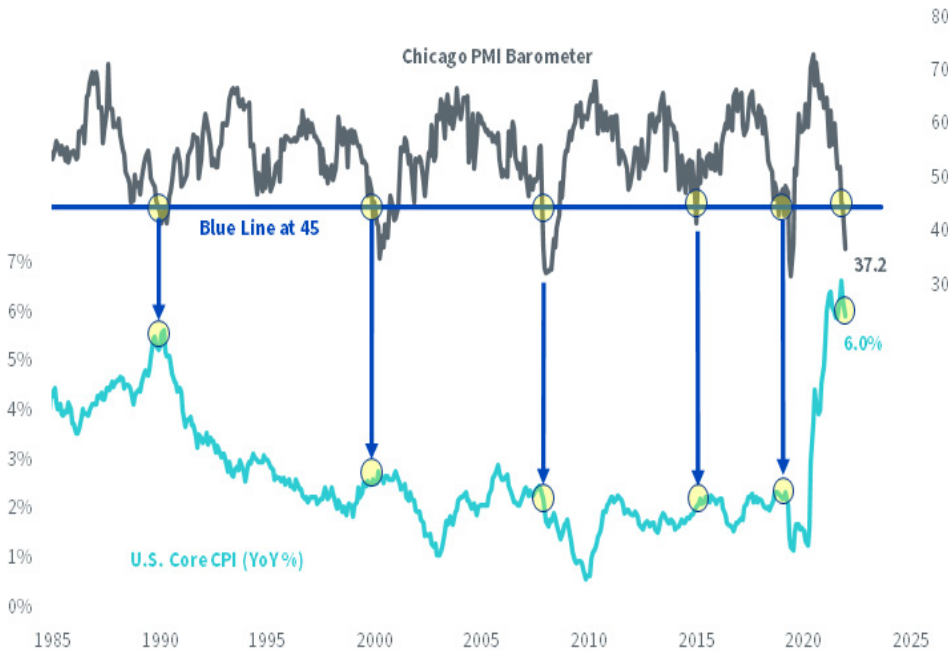


Sources: Refinitiv, ISM, as of November 2022.

The [Chicago PMI](#) has already long since broken below the line of demarcation between expansion and contraction at the 50 mark; it came in at 37.2 in November.

In figure 3, I've added a line at 45 to show periods when most of us would conclude that conditions are recessionary. I think it puts a gravitational pull on core CPI, which excludes food and energy.

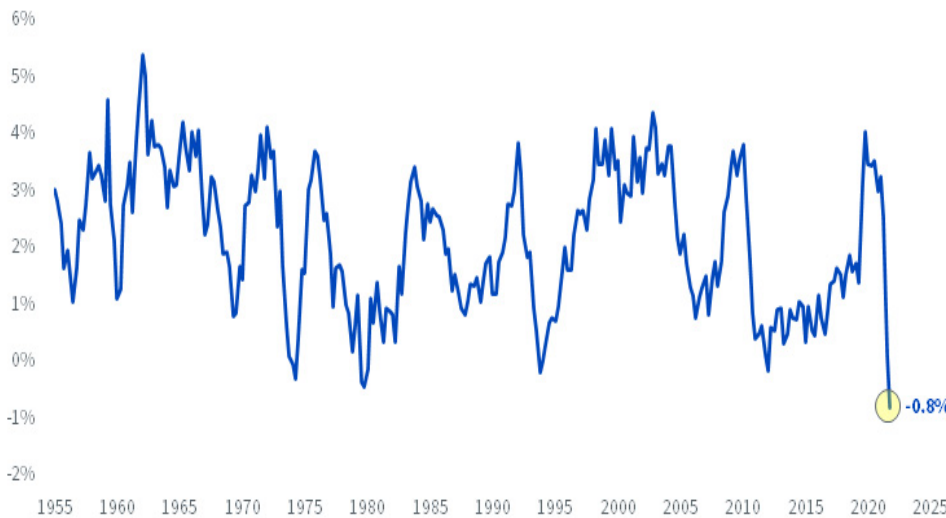
Figure 3: The Chicago PMI Is Indicating Acute Economic Contraction



Sources: Refinitiv, Chicago Fed, BLS, as of November 2022.

One of the key drivers of inflation this year has been robust wage growth. However, the U.S. has a productivity problem that is unprecedented (figure 4). It would be reasonable to anticipate hiring freezes and layoffs may be thematic in 2023.

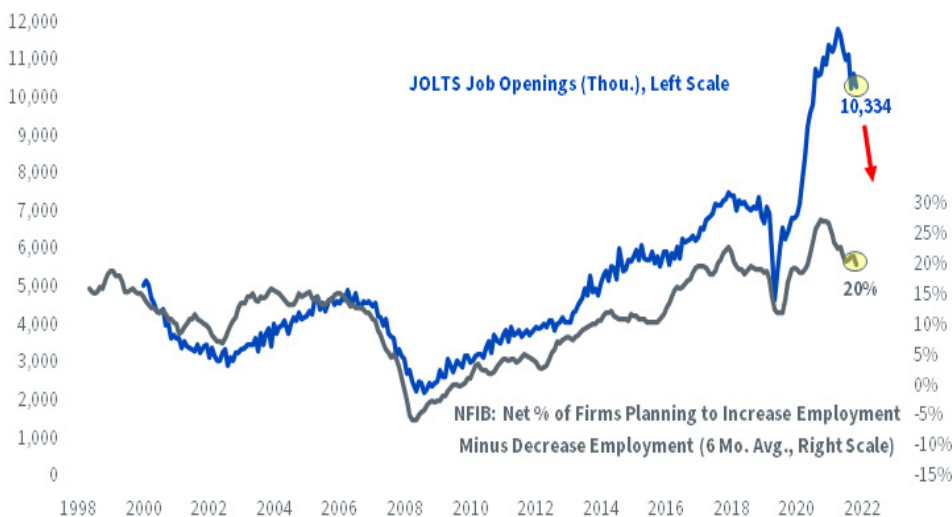
Figure 4: 2-Year Annualized Growth Rate, U.S. Output per Hour, All Persons



Sources: Bureau of Labor Statistics, U.S. Department of Labor, Refinitiv, as of Q3/2022.

The NFIB survey of small businesses is moving in the wrong direction when it comes to hiring intentions. Because of a surplus of unproductive workers, I think the current 10.3 million job openings will decline (figure 5).

Figure 5: Small Business Hiring Plans Are Back to Pre-Covid Levels



Sources: Refinitiv, BLS, NFIB, posing small business employment plans over the proximate three months. Jobs Open and Labor Turnover Survey (JOLTS) data, as of October 2022; National Federation of Independent Business (NFIB), as of November 2022.

When it comes to the whole economy, the NFIB survey looks like a demand destruction situation (figure 6). I could easily see the unemployment rate heading above the [Fed's](#) 4.4%-4.7% range that it is predicting for the end of 2023.

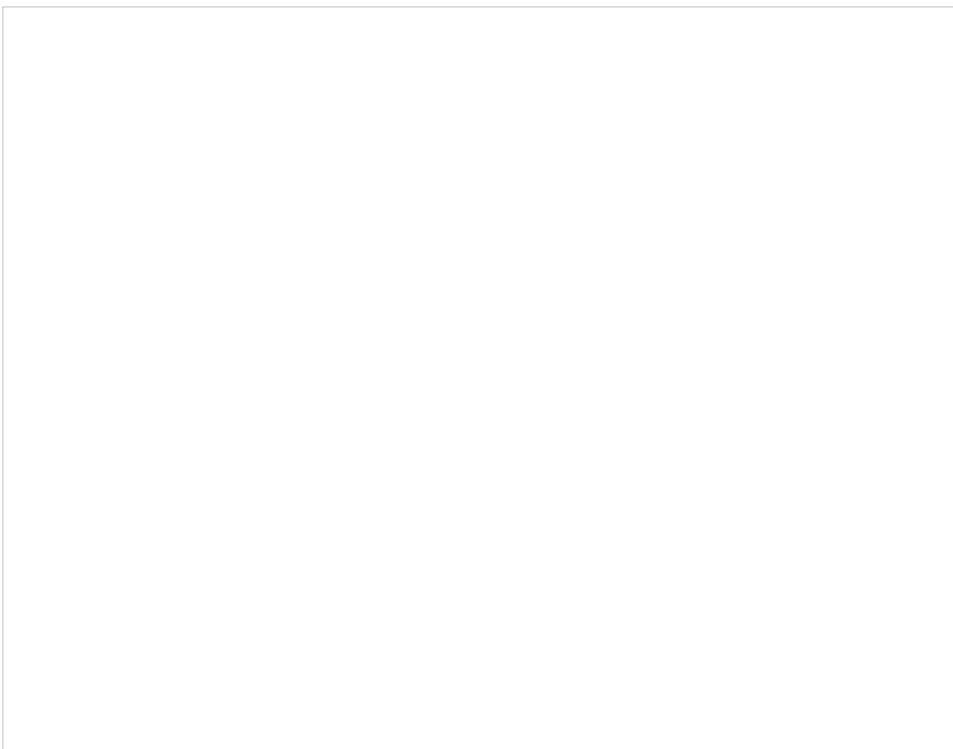
Figure 6: NFIB Survey, % Expecting Improved Economy Minus % Expecting Deteriorating Economy



Source: National Federation of Independent Business (NFIB), as of October 2022.

Another area of demand destruction is from the aftershocks of the burst in China’s property bubble. Figure 7 covers cement production. Normally, declining production of a good should be inflationary, but in this case, I worry that it’s declining because building activity has come to a standstill.

Figure 7: A Portrait of China’s Industrial Contraction: Cement Production



In the U.S., we also have an activity dilemma—in housing. Courtesy of a national average conforming mortgage rate of 6.27%, homebuilders are reporting a drying up in foot traffic (figure 8).

I’m hard pressed to see how we could get big inflation in things like refrigerators, landscaping equipment, paint and the hundred other things you spend money on when you move houses.

Figure 8: Homebuilder Sentiment Has Collapsed



When I look forward in 2023, I see a Federal Reserve that anticipates unemployment will only rise to a 4.4%-4.7% range, which I think is an underestimate. I see a Federal Reserve that is fighting early 2022's inflation demons even as the clock ticks over to 2023.

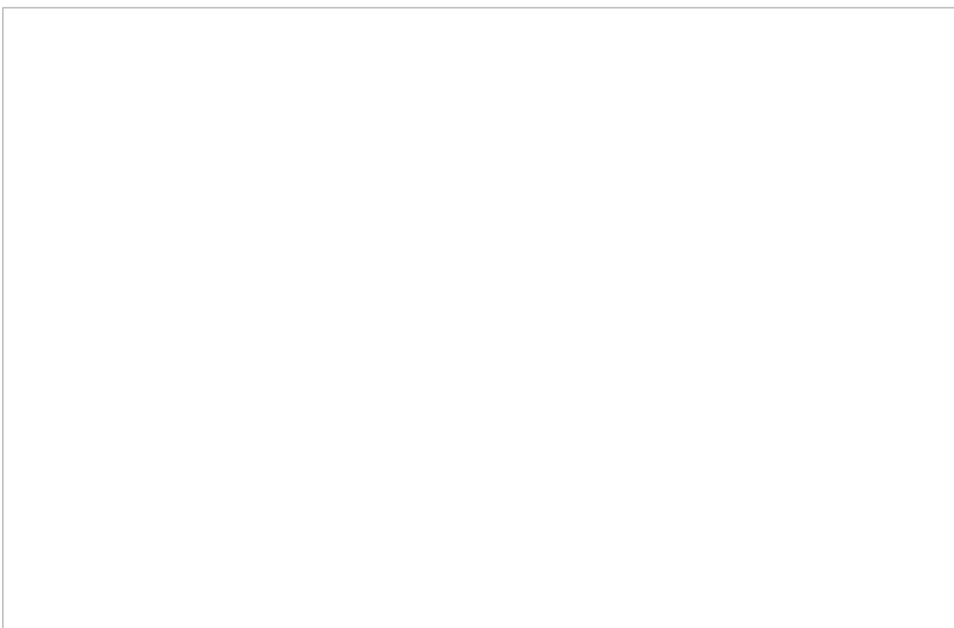
A policy mistake.

If you want to talk about [large-cap value](#), I tend to go toward ideas like the [WisdomTree U.S. High Dividend Fund \(DHS\)](#). We were very happy to see that one thrive in 2022's [bear](#) market.

For those who are seeking something in large-cap core, one that had a nice 2022 is the [WisdomTree U.S. Quality Dividend Growth Fund \(DGRW\)](#). Figure 9 shows the image that comes up if you use our ["DPD" tool](#) to check its performance on the website. It was one of our darlings in 2022, as you can imagine.

If I'm right about 2023, it's a year of job losses, hiring freezes, frustrated realtors and sub-50 PMIs. I'm not sure why anyone would prefer the [S&P 500](#) to [DGRW](#) if that is what we are walking into.

Figure 9: YTD performance, DGRW vs. the S&P 500



For DGRW's performance, click [here](#).

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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.

Disinflation: Term used to describe instances of slowing inflation, different from deflation in that price levels are still increasing overall, just at a slower rate.

ISM Services PMI: The ISM Services PMI (formerly the ISM Non-Manufacturing Index) provides a detailed look at the economy from a non-manufacturing standpoint.

Purchasing Managers' Index (PMI): An indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A reading above 50 indicates an expansion of the manufacturing sector compared to the previous month; below 50 represents a contraction while 50 indicates no change.

Chicago PMI: Measures the performance of the manufacturing and non-manufacturing sector in the Chicago region.

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

Large-Capitalization (Large-Cap): A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Bear market: A sustained downturn in market prices, increasing the chances of negative portfolio returns.

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.