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FFG Market Pulse Newsletter, Q2 2022

I have spoken to many of you regarding inflation and how there needs to be clarity of when we will see evidence of peaking. This is the key question that will dictate how the rest of 2022 will take shape. Why is the inflation question the most important one to answer? It is because inflation and inflation expectations will drive Federal Reserve policy decisions which in turn will influence financial conditions, interest rates, lending and consumer spending. In our opinion, the Fed will likely continue to tighten financial conditions in the next meeting on July 26th because inflation is still elevated. In all likelihood, at the July meeting, interest rates will be raised another 0.50% or 0.75% just as they did in June. The following Fed meeting in September will also likely accompany another interest rate increase. With that said, going forward we could be setting up a change in the inflation paradigm in the second half of 2022.

We at FFG are making the call that we believe that the evidence of inflation peaking is now manifesting itself and that we have likely seen the worst of inflation. Here are various data points which we feel is evidence of this thesis.

-Since hitting a peak of 5.3% in March, the Federal Reserve's preferred measure of inflation, the core PCE (personal consumption expenditure) has now dropped to 4.7% in May. This is the lowest annual increase since November 2021. This is the third favorable inflation reading just this week after the University of Michigan Inflation expectations came in lower for basically the first time in almost a year and also Germany's June CPI (Consumer Price Index) unexpectedly fell.

-Most commodity prices have now appeared to have peaked in the near term. Some prime examples:

- Oil Futures early June high of $121 is now trading $106 with futures pricing in sub $100 barrels in coming months. Oil prices coming down is probably the most important inflation single data point. This is because oil prices are so closely tied to manufacturing and transportation that any easing of oil prices will help ease prices across the board. This is also the biggest contributor to headline inflation and something that can drastically change consumer sentiment.
- Gasoline Futures early June high of $4.32 is now trading $3.62 with November futures prices currently at $2.96. Keep in mind that there is a series of federal and state taxes that we also pay when we fill our cars at the pump which is why retail gas prices are higher than these prices. However, retail gas prices are lower across the board since the beginning of the month.
- Corn Futures April High of $824 and are now 8% lower @$760. Future month's forecast prices going to $650 in September.
- Wheat Futures May high of $1285 is now 27% lower @$930. This is the lowest price in 4 months and the first time it has reached this level since Russia invaded Ukraine in late February.
- The same holds true over the previous weeks or months on other commodities such as Natural Gas, Copper, Lumber, Cotton and Soybeans.

-Container Shipping Rates across the world are down 30-40% from their highs and are getting close to pre-pandemic levels.

- Shanghai to Los Angeles down 33%
- Shanghai to New York down 35%, lowest shipping rates in a year

-Commentary from big box retailers such as Walmart and Target who have recently spoke to high levels of inventory. This inventory will have to be sold at a discount over the course of coming months and expect a wave of discounts starting with 4th of July sales. This will have a deflationary weighting to some consumer goods. These are tell-tale signals that the great inflation trade of 2022 is likely peaking or has peaked and thus will influence our investment portfolio construction philosophy. This would suggest that a reduction in commodity-type exposure, such as oil, could be in order. Those proceeds can go into our large cash coffers which we have been accumulating over the previous months. Having this large cash position creates the ability to take advantage of opportunities both systematically and strategically as we have been awaiting a pivot in the overwhelming theme of inflation. We take the words systematically and strategically very seriously because even with the belief that inflation has peaked it does not mean it has completely gone away. We will stay diligent in our approach to portfolio construction given the fluid environment.

We hope everyone has a wonderful 4th of July holiday!

Scott Verlangieri, AIF®

CFO, Fiori Financial Group