MV Capital Management Weekly Market Flash

The Inflation Question

August 16, 2013

The latest data points on US inflation trends reminds us once again that the much-anticipated road to rising interest rates is likely to not be anything resembling a predictable, linear trajectory. The July Producer Price Index, which measures price trends at the wholesale level, edged up 0.1% for a 1.2% year-on-year gain. The more closely watched Consumer Price Index came in at 0.2%, meeting consensus expectations and running at 2% year-on-year. As the Fed heads towards its first period of reckoning for the future of QE in September, the question of relatively low inflation hovers over the proceedings.

Elusive Targets

With regard to inflation and QE tapering, the concern is that if demand for credit is naturally soft – i.e. muted growth and modest price levels are keeping a lid on business and individual borrowing – then anything that has the effect of edging up interest rates could make a bad situation worse. There will be one more reading each of the PPI and CPI between now and the Fed's September FOMC meeting when the world will be watching to see if the QE smoke is white or black. Arguably the September inflation readings will be the most influential in the year to date.

Meanwhile, At the Bull

Corporate earnings provide another aspect of the picture. The outlook as measured by analyst expectations has turned considerably less rosy. At the start of the year forecasts for 3Q and 4Q earnings growth for companies in the S&P 500 were 9.5% and 15.9% according to FactSet. With 2Q behind us those estimates have been pared back to 4.3% and 10.8% respectively. Meanwhile, the latest burst of the 2013 rally took prices on the S&P 500 to new record highs in early August. So…prices up, earnings down, and the result is higher P/E valuations. The current level of 16.1x (twelve trailing months) on the S&P 500 is not much above its most recent 10 year average annual rate of 15.8x, but the trend is moving higher.

Putting It All Together

Inflation and corporate earnings are both windows on growth, which continues to be the most vexing part of the equation. It is probably fair to say that the absence of a clear and compelling growth story is what makes the current stock market rally – which after all has been surging along practically unabated since the first trading day of 2012 – a sort of Rodney Dangerfield of bull markets, getting no respect. When you take financial companies out of the equation, earnings for the S&P 500 have actually declined through the second quarter. But that is still impressive compared to the even more growth-challenged rest of the world. Investors would seem, at this point, to be ready to trade their QE morphine for a compelling tale (with supporting data) of global growth. We'll know more soon about how close we are to that trade.

Masood Vojdani
President& CEO

Katrina Lamb
Head of Investment Strategy & Research

Investment Advisory Services offered through MV Capital Management, Inc., a Registered Investment Advisor. MV Financial Group, Inc. and MV Capital Management, Inc. are independently owned and operated.

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by MV Capital Management, Inc.), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from MV Capital Management, Inc. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. MV Capital Management, Inc. is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the MV Capital Management, Inc.'s current written disclosure statement discussing our advisory services and fees is available for review upon request.