

Weekly Market Flash

Inflation and the Fed

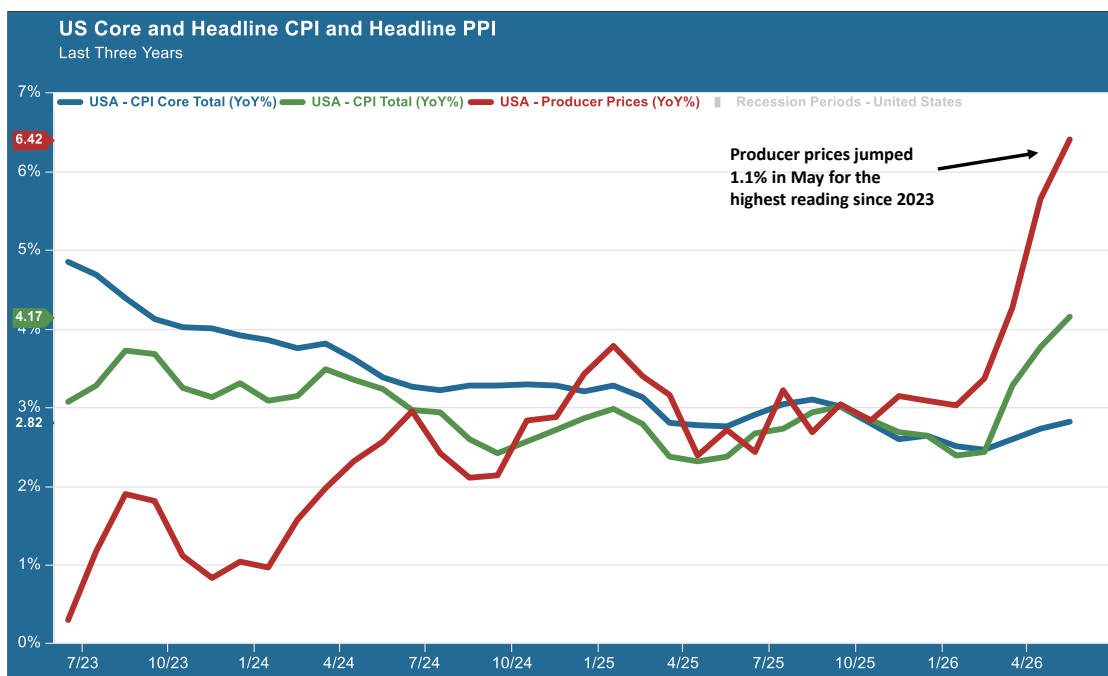
June 12, 2026

As of this past Wednesday’s market close, the S&P 500 had retreated by around 4.5 percent from its recent all-time high, set on June 2. The Nasdaq, home to a bevy of the AI-related names central to the market’s fortunes this year, had given up 7.1 percent from its most recent high water mark. There’s nothing particularly unusual about a drawdown of these magnitudes after a sustained run upwards. We make a note of every time the S&P 500 loses five percent or more followed by a recovery of at least that much, something which has happened 90 times since the beginning of the twenty-first century.

As always there are multiple factors at play. Stretched valuations have caused another round of second-guessing on the AI narrative, as we discussed in our commentary next week. The SpaceX IPO and subsequent (expected) debuts by Anthropic and OpenAI could add more third-guessing and fourth guessing to this space, with near-term risks both to the upside and downside. What concerns us more broadly, though, is the specter of inflation that has been looming over everything for the past several months. On Thursday the European Central Bank became the first of the G7 central banks to raise interest rates following the recent cycle of monetary easing, citing higher inflationary risks and also revising its growth estimates down. That sets up a challenge that the Fed will face when the FOMC meets next week.

Shades of 2022

The stock market has been impressive (some might say complacent) in its efforts to ignore that the war in the Middle East is still going on, three and a half months after it started, without an obvious path to conclusion. Investors do seem to have wised up enough, though, to stop engaging in rapturous cartwheels every time Axios comes out with yet another “deal is just around the corner” headline. Inflation had been sticky before the war started, but it has since gone from sticky to uncomfortably higher.



Energy, of course, has been the main influencing factor pushing prices skyward as both the headline consumer price index (CPI, in green) and producer price index (PPI, in crimson) show. But core CPI (blue), which excludes energy as well as food prices, has also trended up since the war started. Producer (wholesale) prices in particular are rising by more than any time since 2022-23, at the peak of the post-Covid inflationary spike. Higher energy prices mean higher input costs for pretty much any business, and either those costs will get eaten by the business itself (lower profit margins) or get passed onto the consumer (higher prices for you and us).

It could be worse. Oil prices, while higher than before the war, are lower than some of the worst-case scenarios being spun after the Strait of Hormuz closed, which had crude oil prices pushing up past \$150 per barrel. That hasn't happened for several reasons, including a dramatic decrease in oil imports by China, which has been relying on other sources including inventories and alternative energies to meet its needs. But the longer the war persists, the more households and businesses will build higher inflationary expectations into their budgeting plans. Once these expectations become structural, they are very hard to dislodge – this is how inflation turned into a decade-long problem in the 1970s.

The Jobs Puzzle

But inflation is not the only macro variable putting pressure on the near-term outlook for stocks. Last Friday's jobs numbers went over like a lead balloon. Meaning, of course, that the BLS report itself was upbeat, with 172,000 nonfarm payroll gains versus 100,000 expected, and the unemployment rate staying put at 4.3 percent. This was one of those time-honored "good news is bad news" events, as the Fed is even less likely to take a dovish position on rates when conditions in the labor market are healthy.

But are things actually all that great for jobs? Layoffs keep happening in large numbers. The May report on layoffs by Challenger, Gray and Christmas was up 16 percent from April and the highest number of layoffs for any May since 2020 (when pandemic-related layoffs were in full swing). The job market for recent college graduates is in terrible shape, with AI-generated resumes getting ghosted by AI hiring algorithms and nary a human to be found in the process. So far the evidence is anecdotal, but some concerning signs are evident. Additionally, the upbeat BLS May jobs report is thought to be due in no small part to one-off hiring in areas like hospitality and leisure ahead of the World Cup, which began this week.

So, we have lots more questions than answers. Again, we see the potential for near-term risks skewing either up or down. Uncertainty can cut both ways. But inflation seems set to remain a problem, potentially beyond the rest of this year, and we would very much like to be proven wrong on this front.

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