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What's driving the global market today?

May 15, 2021

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In April 2021, US inflation jumped up significantly by +0.8%. Year over year, this has moved the core Consumer Price Index (CPI) inflation rate to 3%.[1] The Federal Reserve has mentioned in the past that they would not consider tightening unless inflation surpasses 2% on a sustained basis.[2]

To put everything into perspective…

An annual inflation of 3% was last seen in 1996 according data compiled by Investing.com.[3] Economists were expecting something around +0.3% on a month-to-month basis, which is lower than the actual number we're seeing today.[4] As a result, US 10-year Treasury Bills went up a few basis points.[5] This surprise is considered negative by market participants as US equities were broadly sold off, while the NASDAQ went down by ~2.67% on May 11, 2021. The Canadian equity market is relatively better than the Dow and Nasdaq due to its high cyclical and financial exposures.[6]

This is largely a result of temporary factors (hotels and airlines reopening after pandemic restrictions and increasing their prices) and can also be contributed to supply shortage, for example in the automobile industry.[7]

And finally, relative to the Canadian dollar, the US dollar has been weak recently.

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[1] Guildford, Gwynn. May 13, 2021. Consumer Prices Jumped as Economic Recovery Picked Up. *The Wall Street Journal.*
[2] Board of Governors of the Federal Reserve System. August 27, 2020. "Why does the Federal Reserve aim for inflation of 2 percent over the longer run?" https://www.federalreserve.gov/faqs/economy_14400.htm. Accessed June 10, 2021.
[3] U.S. Core Consumer Price Index (CPI) YoY. June 10, 2021. https://www.investing.com/economic-calendar/core-cpi-736. Accessed May 15, 2021.
[4] Preston, Lesley. "US Consumer Price Index (May 2021)". https://economics.td.com/us-cpi. Accessed May 15, 2021.
[5] Pellejero, Sebastian. May 12, 2021. Treasury Yields Climb Following Consumer-Price Data. *The Wall Street Journal.*
[6] MSCI Canada Index (CAD). https://www.msci.com/documents/10199/9618fa38-f8fe-4c50-9136-a82d8d70c78f. Accessed May 15, 2021.
[7] Pickerte, Read. May 12, 2021. "U.S. Consumer Prices Jump Most Since 2009, Outpacing Estimates" https://www.bloomberg.com/news/articles/2021-05-12/consumer-prices-in-u-s-increase-by-most-since-2009. Accessed on May 15, 2021.

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My two cents. (It's too early and too soon to worry!)

We should know from day one that the current monetary stimulus is not going to be long term. That said, the Federal Reserve won't be making any knee-jerk moves based on transitory factors and base effects. I believe that the Federal Reserve will not tighten unless they see that price increases: 1) last for a while, and 2), are built into our inflation expectation.

In my opinion, it's too early and too soon to call for higher interest rates. I think the Federal Reserve will openly communicate their intention if they think they need to increase rates in the short term. Remember, the CPI has more to do with services than goods, and it is likely that once we see higher wage growth due to employment growth, we can be more certain about higher interest rates. However, as students of economics, we learned from our text books that central banks are usually behind the curve. So I would not be surprised if inflation runs a little higher before they start tightening. On one hand, higher interest rates and inflation could negatively impact on high growth stocks and traditional bonds. On the other hand, banks, insurance companies, and commodity producers might benefit from this, from a historical perspective. Therefore, it is crucial that your portfolio is well-diversified!

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