CPI

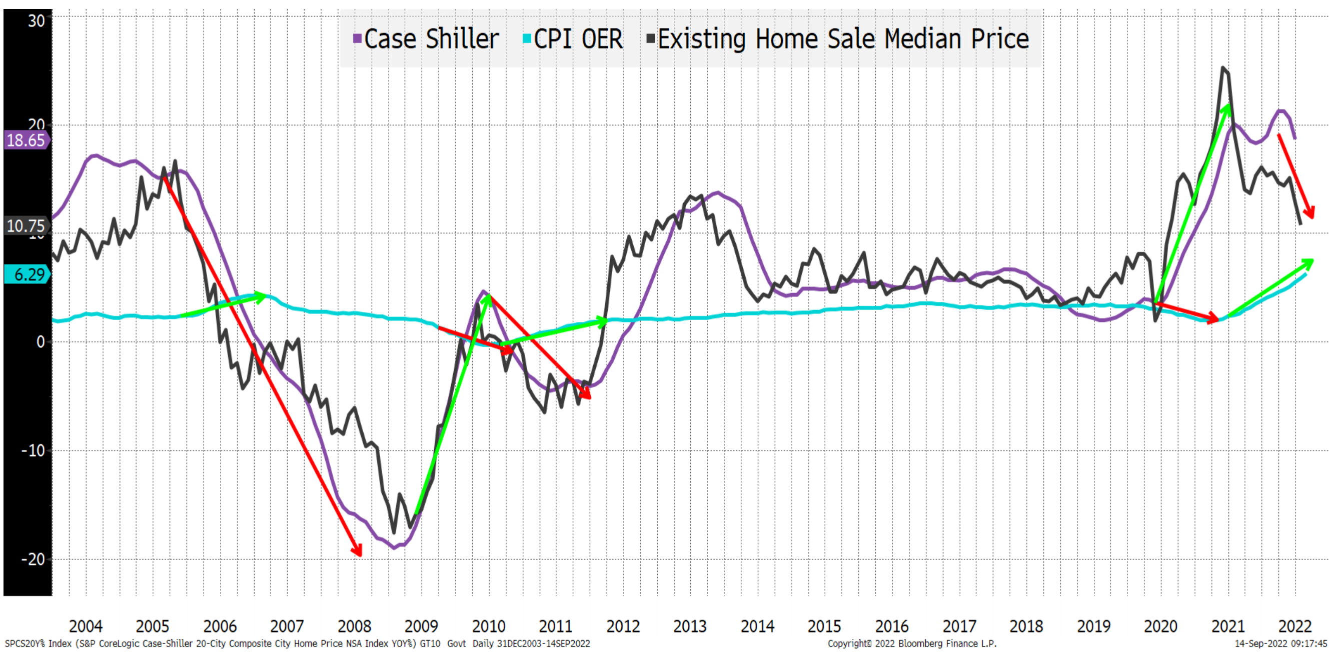
I was wrong yesterday. I thought that we would get a brief sell-off after a slightly higher than expected CPI print. The biggest miss was 0.6% in CPI ex Food and Energy for the month (versus an expectation of 0.3% and 0.3% last month). Almost all of the other misses in the report were quite small. Yet, the S&P 500 dropped over 4% and the Nasdaq dropped over 5%. The selling was relentless all day, rather than what I expected, which should have been buying after the initial algo and stop loss selling was done.

The 30-year Treasury went higher post the number, and although it recovered a bit after the auction (and finished with a lower yield on the day), it didn't help stocks in any way, shape, or form. The story was all about the 2-year, whether the Fed would raise rates 100bps in September, and how many meetings they would now opt for a 75bps hike. A pretty dramatic change in tone given the size of the miss (the reaction seems disproportionate to me, but I did get it wrong, so take that with a grain of salt).

The talk of a freight worker strike coming as soon as this Friday also likely had some influence on markets, as did the usual culprits of gamma (excessive options trading), positioning, and a general lack of liquidity across markets. But I want to address 2 things – housing and autos.

Housing

32.2% of the headline number is shelter, which rose 0.7% (vs 0.5% and 0.6% in the prior months).



This chart compares two measures of home costs to the Owner Equivalent Rent metric used in the CPI calculation. There is a very clear lag between the two. The OER is often moving in the opposite direction of home prices (only to inevitably catch back up). OER is rising as mortgage rates rise and home prices fall. This is possible, or maybe there is just a long lag due to how this metric is calculated. It is based on small sample sets and seems designed to be "smooth" – meaning that inflation last year was probably heavily understated, only to be overstated now. Maybe WFH or something can explain it better, but the lag effect makes a lot of sense to me, which means that we just sold off 5% on "inflation" data that doesn't reflect actual inflation. Maybe we are back to the "it's all we got" argument, but it doesn't make sense to me.

Vehicles

New vehicle prices (4% of CPI) rose 0.8% after rising 0.6% and 0.7%, while used cars and trucks (also 4% of the index) fell 0.1% after a decline of 0.4% last month.

There are three things that make me "curious" about the auto numbers:

- It seems odd, though not impossible, that the used vehicle market is rolling over while the new vehicle market isn't.
- Maybe all the EV price hikes that went into effect immediately after the Inflation Reduction Act was passed explain it.
- Maybe there is a difference between sticker price and what people actually pay (as there is at least anecdotal evidence that dealers went from charging premiums to maybe negotiating again).

I'm less convinced that the auto numbers are more incorrect than the housing numbers, but this is something we need to digest.

Bottom Line

I was wrong on the reaction to CPI (and bought the dip too early), but at least we are getting some relief on PPI and I think that over time, as economists point out what a small miss it really was (and as some of the other anomalies come out), markets will respond positively into and post the Fed meeting.

Buy more of the dip if you can.

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