

In the Markets Now

A renewed selloff

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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AN INFLATION MISS AND A BEAR MARKET

May's inflation (CPI) came in unexpectedly hot—8.6% year-over-year growth—beating consensus expectations and setting a new 41-year high. The market sold off sharply on the news. Inflation has been high and rising for a year-plus, but in recent weeks the market found solace in the idea that inflation may have peaked. Goods prices were falling, wage growth was softening, and housing was cooling as rates rose. This meant that while the Fed would have to be aggressive (i.e. raising rates), they likely wouldn't have to be more aggressive than they'd already laid out and could potentially even ease at some point. Inflation was high but heading in the right direction. **The May inflation report burst that bubble with a machete.**

Markets now expect the Fed to tighten more aggressively than previously laid out. Higher interest rates mean a cooler U.S. economy, and therefore a higher chance of recession in the next couple of years. Market selloffs have historically been deeper and longer when associated with a recession, helping explain the downside volatility of the last few days. Further, the recent uptick in inflation can be largely attributed to energy and food—two items that 1) are somewhat out of the Fed's control; and 2) more directly impact consumer spending and sentiment. High gas prices are weighing on an already-burdened consumer.

Inflation hitting a cycle-high is also a problem for another reason: expectations. As Strategas CEO Jason Trennert writes, "Time is an important element in fighting inflation. The longer it takes to defeat, the more it gets reflected in longer-term inflationary expectations—wages, etc." Inflation has already been above 5% for a year, and consumers are starting to expect inflation to persist. This changes behavior. The Fed will want to stamp this out quickly, but they're already behind the curve.



So in the end, the story hasn't changed much—high inflation brings countless challenges—but Friday's report was a blow. Interest rates are already rising rapidly in response. Higher rates hit stock multiples (e.g. P/E ratios), while wage, transportation, and raw material inflation pressure firms' profits. Consumer spending has held in strongly, but is beginning to show signs of strain. The lingering question now is can US consumers and companies hold on long enough for inflation to come down? Time will tell.

For the long-term investor, the question is different: Should this volatility affect my financial plan or portfolio decisions? I'd argue the answer should almost always be no. Market turmoil is challenging, especially when amplified by the (often negative-leaning) 24/7 news cycle. But as always, it is worth reiterating that selloffs, bear markets, and recessions are both common and necessary. Since WWII, we have seen 13 recessions, 17 bear markets, and 42 corrections. The S&P 500 is also up over 450,000% in that same span (including dividends). **These facts don't make each individual bout of volatility any easier to bear—they all hit like a punch to the stomach—but volatility is an unavoidable part of the investor experience. A feature, not a bug.**

Ultimately, in times of market strain, [it helps to control what you can control, focus on your plan, and lean on your Baird Advisor.](#)

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