The Sizemore Income Letter

August 12, 2022

Is Inflation Breaking?

By Charles Lewis Sizemore, CFA

U.S. producer prices actually fell in July. You and I aren't going to notice any impact on our spending for a while, but producer price inflation (PPI) generally flows through to consumer price inflation (CPI) on a slight lag. PPI dropped about 0.5% last month.

I don't want to get unduly excited about a single data point. And I should point out that, year over year, PPI inflation was still up about 9.8% in July.

But maybe… just maybe… we've seen the high water mark for inflation.

We'll see. The Fed has raised interest rates from zero to 2.5% in a very short window of time, and the economy is showing signs of cooling. So, a drop in the rate of inflation would suggest that the Fed's hawkishness is working.

But looking at the bigger picture, there is one glaring reason why inflation will likely stay somewhat elevated for a while and while the supply chain issues we've dealt with for two years won't be fixed overnight. We're still in the midst of the rolling back of 40+ years of globalization.

From China's 1978 opening to the 2020 pandemic, the most dominant trend in economics was globalization. This massively boosted productivity and helped to reverse the nasty inflation of the 1970s to the nearly non-existent inflation in place by 2019. Supply chains got longer and more complex every year as globalization wrung inefficiencies out of the system. The global economy was the proverbial fine-tuned machine.

Then COVID happened, and we all got a reminder of how fragile it all was. And if that wasn't the nail in the coffin, the Russian invasion of Ukraine and China's more muscular foreign policy certainly were.

No company can responsibly put itself at risk of having vital components stuck in a port somewhere due to virus restrictions. And no government can allow for the possibility its country's defense or economic security is put at that kind of risk, least of all by a rival that gets more hostile by the day. So, the trend for the next several years will be *onshoring*. Supply chains will be shorter and more will be made and assembled at home.

Ultimately, this probably will be a good thing. It will force major investment in technology and robotics that will make our economy vastly more efficient… and robust to externalities. But in the meantime, productivity is going to suffer and prices will likely be higher than they would have been. You can't undo 40+ years of globalization on a dime. The infrastructure isn't built, and labor shortages don't go away overnight.

I have no specific investment recommendations today based on this. But it's something we need to keep in mind. It's a lens we need to view the market through.

Moving on, I made one minor change in the portfolio. Healthcare Trust of America has been replaced with **Healthcare Realty Trust (NYSE: HR)** to reflect the merger in July. Rather than try to meld the two positions, I simply created a new entry in our stock stable with an entry date of July 20.

Otherwise, there's not much to report. The market is enjoying a nice bounce and has been trending higher for about two months. This is the largest and longest-sustained rally of 2022.

Does it have legs? We'll see. We saw real bargains in certain corners of the market, but the bear market never gave us the reset I would have expected in a true market regime change. I have skin in the game. Even when it was looking nasty out there, I recommended holding on to the core of your stock portfolio, even if we kept more cash on hand than usual. And we added several new positions close to the bottom in June, taking advantage of the pricing.

But my view hasn't changed. I STILL recommend holding on to your core positions and selectively adding at attractive prices. But I ALSO still recommend keeping more cash on hand than usual. I still expect a little more turbulence to come, so for the meantime I think it makes sense to be at least moderately defensive and to continue looking for opportunities outside of the stock market for diversification.

That's all I have for now. So, until next time, keep cashing those dividend checks!

Charles Lewis Sizemore, CFA

P.S.: Apart from writing this newsletter, I run a full-service wealth management firm along with my colleagues. At **Sizemore Capital Management**, we build income portfolios like those I write about in the *Sizemore Income Letter*. But we also do a lot more than that. We manage a suite of low-volatility strategies offering low correlation to the S&P 500. If you'd like for me to take a look at your portfolio and offer some recommendations, contact me at info@sizemorecapital.com.

Stock	Ticker	Entry Date	Buy Price	Recent Price	Stop Loss	Yield	Cumulative Dividends	Total Return	IRA Friendly?	Action
Cheniere Energy Partners	CQP	8/4/2022	$46.49	$48.67	$33.01	6.92%	$ -	4.70%	No	Buy
Citigroup Inc	C	6/23/2022	$47.34	$54.14	$32.57	4.39%	$ -	14.36%	Yes	Buy