DIAMOND HILL

INVESTED IN THE LONG RUN

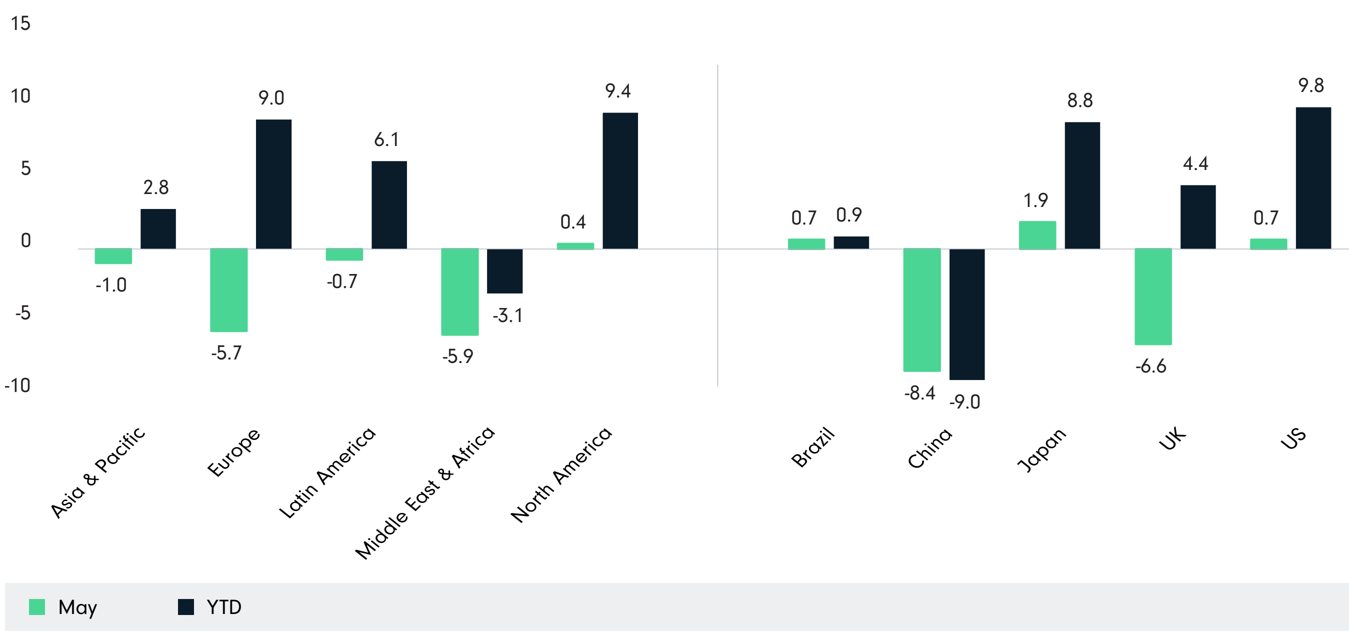
The Inflation Situation

Jun 2023

Several global markets were down in May, with the MSCI ACWI Index ending the month in negative territory (-1.0% in USD terms). On the high end, Taiwan (+7.3%), South Korea (+4.8%), India (+3.0%) and Japan (+1.9%) all delivered positive returns. Stocks in the US basically traded flat with the Russell 3000 Index posting a +0.4% return. On the downside, Canadian stocks fell -5.4%, while stocks in Europe were down -5.7% due in part to weakness in the United Kingdom (-6.6%), France (-7.1%) and Germany (-5.0%). China and Hong Kong were among the weakest performing major markets with stocks down -8.4% and -8.7%, respectively.

Globally, technology stocks were the notable winners in May, advancing 8% in USD terms (based on the MSCI ACWI ex USA Index). All other sectors experienced declines. Holding up the best were the industrials, health care and financials sectors, with losses in the 2-4% range. Energy, real estate and consumer staples were the weakest, closing the month down more than -7%.

Exhibit 1 — May and YTD Returns for Major Markets (USD) (%)

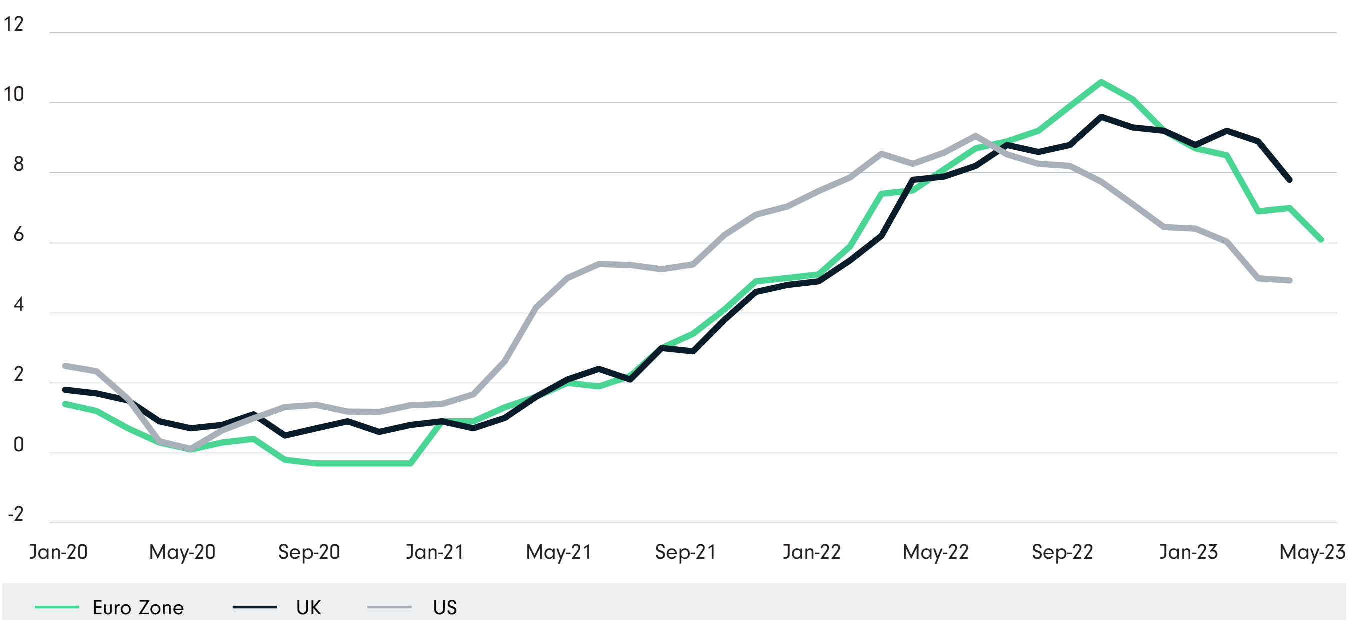


Source: FactSet, as of 31 May 2023.

Global central banks continue to maintain their focus on taming inflation, though recent events have caused policy makers to consider the scale and pace of future hikes. Case in point, the recent banking crisis in the US gave the Federal Reserve reason to lift rates by only 25 basis points in May. A pause at its next meeting would give the Fed time to assess the impact of its 10 prior increases in addition to knock-on effects due to the banking crisis. But Fed governor Philip Jefferson said, "A decision to hold our policy rate constant at a coming meeting should not be interpreted to mean that we have reached the peak rate for this cycle. Indeed, skipping a rate hike at a coming meeting would allow the committee to see more data before making decisions about the extent of additional policy firming." All this as the labor market continued to show resilience with US employers adding 339,000 jobs in May. As the month ended, all eyes were on Washington as debt ceiling negotiations took place — the Senate passed a bill that extended the debt ceiling for two years just days before the deadline.

Euro zone inflation fell to a 15-month low in May (down to 6.1% from 7% in April). Food prices remain high but energy prices, which rose after Russia invaded Ukraine, have moderated. Inflation in Germany and France hit their lowest levels in a year — German inflation fell to 6.3% in May, down from 7.6% in April and French inflation fell to 6% in May, down from 6.9% in April. Additionally, inflation in Spain dropped to its lowest level in almost two years — down to 2.9% in May from 3.8% in April. While improved inflation reports could provide the European Central Bank (ECB) an opportunity to pause interest rate increases, expectations still suggest a 25-basis point increase at its June 15 meeting and another increase later this summer. ECB president Christine Lagarde recently stated that prices remained "strong", and that the ECB would continue increasing rates to bring down inflation as long as necessary.

Exhibit 2 — Inflation, CPI (%)



Source: Organization for Economic Cooperation and Development (OECD), Inflation (Consumer Price Index) indicator, 2023.

India's GDP increased 6.1% in the fiscal fourth quarter compared to the year-earlier period driven by domestic demand for goods and services. Economists have suggested that the strength of the economy has been due in part to the fact that India did not implement the huge fiscal stimulus programs during the pandemic that other economies did, thus it has not been as negatively impacted from the withdrawal of those programs.

Despite a strong GDP reading (4.5% in Q1), China's economy continues to show signs of weakness as industrial production and profits, retail sales and credit growth have softened. The country's property market also remains under pressure as sales have slowed.

Short of any exogenous events, investors will keep a mindful eye on the progression of monetary tightening policies around the globe and the subsequent economic impacts. While at times sentiment may feel negative, it's worth noting that stocks in most major global markets are trending at a healthy clip this year (MSCI ACWI Index is up nearly 8%) — developed markets are trending higher, up 8.8%, while emerging markets have advanced just 1.2%, largely due to China weakness.

MSCI ACWI Index measures the performance of large- and mid-cap stocks in developed and emerging markets. **Russell 3000 Index** measures the performance of roughly 3,000 of the largest US companies. **MSCI ACWI ex USA Index** measures the performance of large- and mid-cap stocks in developed (excluding the US) and emerging markets. The indexes are unmanaged, market capitalization weighted, include net reinvested dividends, do not reflect fees or expenses (which would lower the return) and are not available for direct investment. Index data sources: MSCI, Inc. and Russell. See diamond-hill.com/disclosures for a full copy of the disclaimer.

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