16 November 2026

Market Ethos

The latest market insights from Richardson Wealth



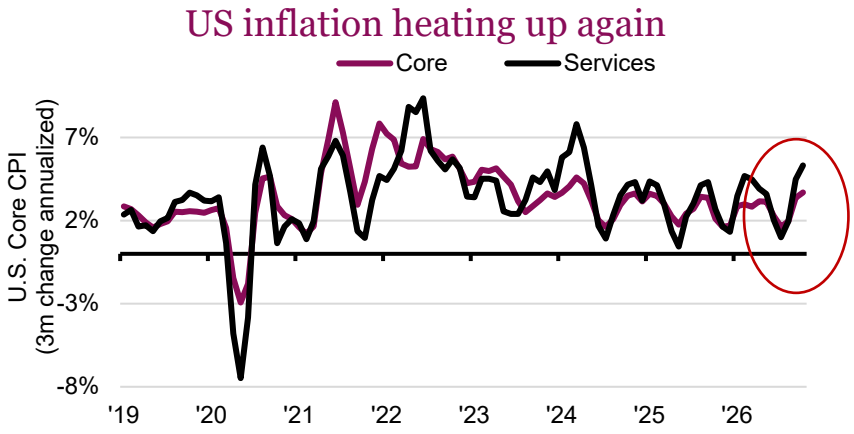
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Reading the signals

The inflation spike in 2021 and 2022 remains pretty fresh in investors' minds. Recall how most were convinced it would simply be 'transitory', driven by the abrupt stop and start of the global economy due to COVID? Instead, core inflation in both Canada and the U.S. rose to a 6-7% pace before coming back down over the past few years. With the benefit of hindsight, this spike was logical: we shut down the economy, everyone stopped spending, then reopened it up to a populace with excess savings and accumulated pent-up demand to do stuff. And that stuff didn't necessarily mean going back to work. Prices spiked and wage growth rose to try luring workers back.

Then again, inflation is a very slow process so perhaps a two-year spike is transitory after all. It's just that in our current society's mental model, with shorter attention spans, anything that lasts longer than a couple weeks is now labelled a secular trend. More pertinent, there has been a recent uptick of inflation data raising some alarm bells. To get a better idea of the inflation pace, we will first turn to the 3-month annualized pace instead of the more often quoted year-over-year. It simply reacts more quickly, which makes it more useful.



Source: Bloomberg, Purpose Investments

There is a bit more inflation risk that has been building. Globally, we have seen a mild uptick, similar to the U.S. Of course, elevated energy prices are a big contributor. While that doesn't directly impact core inflation data, it does so indirectly. And the longer energy prices remain elevated, the more the impact grows. Many other commodity prices are up as well, including copper. On the demand side, the growth in global manufacturing has certainly contributed to higher input prices, and that will impact end prices. Even China, often an exporter of deflationary pressure, doesn't seem to be doing so anymore. China Producer Price Index is up 5.7%, certainly on the historical high side.

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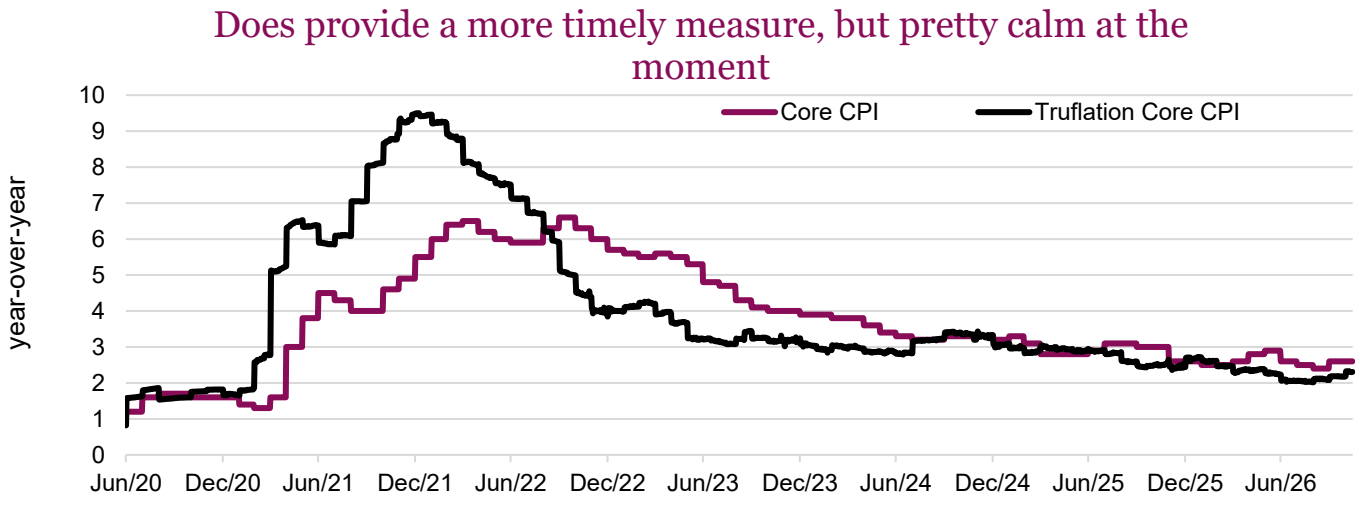


Source: Bloomberg, NFIB

Some inflation does make sense and shouldn't be too alarming. It would be natural to have some inflation, given a global economy that is doing well and strong investment demand building data centers. AI should help productivity over time and will ease inflation pressures. But the building of the AI infrastructure is certainly inflationary. We would become more worried if wages started to rise or if inflation break evens turned up. So far these factors are muted.

Let's turn to some alternative data. Consumer Price Index data comes from the U.S. Bureau of Labor Statistics and is calculated monthly across 75 urban areas from about 6,000 households and 22,000 establishments. Housing is based on owner-occupied rent, which has a pretty big weight and is often subject to some skepticism. There are also adjustments for improvements and substitutes. It is quality work with a very thoughtful process that has evolved over decades. But we do now live in a data-rich world, and there are rising alternative sources. Truflation is a private data provider that amalgamates daily prices across an estimated 15 million items.

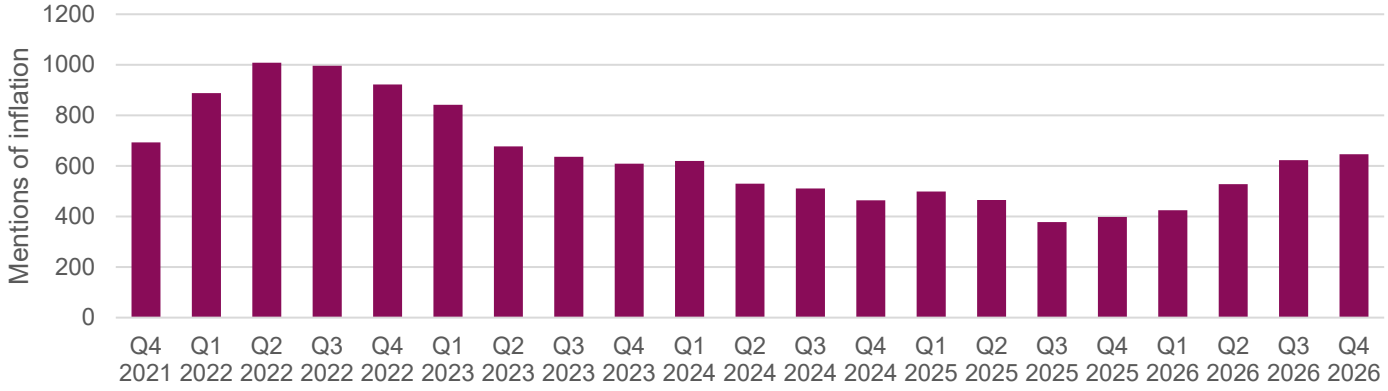
We are not saying one is better than the other, only that they are different, which has benefits and drawbacks. Using alternative data to support or refute trends in the more popular government data is the difference between taking the guided tour and digging deeper. So far, we are not seeing any rise that would get us overly worried on the inflation front.



Source: Bloomberg, Truflation, BLS, Purpose Investments

Another alternative data source is at the company level. The following chart measures the frequency of companies talking about inflation during earnings conference calls. While this has risen somewhat, it remains well below levels seen heading into the inflation spike of 2022.

Mentions of inflation on earnings calls is starting to rise



Source: Bloomberg, Truflation, Purpose Investments, S&P 1500 earnings transcripts

Final thoughts

Taken in totality, inflation risk has risen a bit over the past few months. If these trends continue to build in the coming months or quarters, we will become more worried. For now, however, we remain in the camp that inflation is not high on our list of things to worry about. But it has risen enough to warrant some inflation protection within portfolios. This can take the form of real assets or cyclical equities that often benefit from rising inflation.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*This report is authored by Craig Basinger, Chief Market Strategist at Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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