**Casey Mullooly:** Hello and welcome back to the Mullooly Asset Podcast. This is your host Casey Mullooly back with you here for episode 413. We've got everyone back around the table here and we're ready to go. We're recording this in the second week of October and today the CPI release, which is the inflation reading, it's kind of become a big day here in the last couple of months for market participants. And you've probably seen at least the headlines because they're plastered everywhere. But the year-over-year inflation reading came out at 8.2%, which was slightly lower than what it was in September, but the core CPI number came in higher than expected at 6.6%. So there's a bunch of different numbers, a bunch of different ways to measure inflation. But just kind of wanted to start out talking about the elephant in the room here.

**Tom Mullooly:** The CPI is composed of a lot of different parts. Part of it is what they call the core CPI. Sometimes they'll refer to that as ex food and energy. And earlier this year when we had inflation at these kind of levels in the 8s, it was primarily because of gas. And now gas prices are dropping. As an aside, this month, natural gas went up quite a bit and that surprised a lot of people. But the price of gasoline, which affects everybody who drives a car, is down and has been falling. And so some of these other parts of the consumer price index, CPI, things like gasoline have been dropping, but other things have been continuing to increase.

**Casey Mullooly:** Yeah, I saw rent was one of the biggest components of that and that accounted for... About 40% of the increase alone was just from rent.

**Tom Mullooly:** Now, that's important to note because I think a lot of us here subscribe to Bill McBride's newsletter. He's a great follow on social media. He's totally plugged into the real estate market. He has been saying now for at least six weeks that what they refer to as OER, owner equivalent rent has been dropping. And so when you see these consumer price reports come out every month and they talk about rents increasing, you have to know that there is a lag built into these things. We're looking back and seeing where inflation has been over a period of time, not necessarily going forward, but where we've been.

**Brendan Mullooly:** The lag on that is from what I've gathered up to a year. And so a year ago people were talking about how owner's equivalent rent was showing that this was going to be a problem in the CPI data moving forward. So not unanticipated. However, we're still acting like it's a surprise when it comes out in the data. Of course, we all would like the number to go down because that seems like the only data point that matters now. But it's funny how that stuff just shifts over time because right now it seems like Fed announcements and CPI data releases are the only data points that matter in the market.

I remember not too long ago when the COVID rates were the only data point that mattered in the market while we were waiting for the vaccine to come out and all of that. That was swinging the market around on a day to day basis. And I'm sure we could think of what the in vogue data point was before that. And so not to say that these things don't matter, but it's funny how we just move on from these things and forget them over time because all of the data is what feeds into the market, but it's just at any one point in time, we just tend to get overly fixated on one point.

**Tom Mullooly:** So Tim, this morning we were talking about when the news came out about how the markets reacted very poorly, but the numbers themselves didn't really seem that far off.

**Tim Mullooly:** No. I mean, I was watching the futures this morning and they were up 300 points, but in the back of my head I was like, as soon as eight 30 comes around and the number comes out, it's going to plummet. And that's exactly what happened. Honestly, you refresh your homepage, it looks fake the way that it happens. It's just up 300 to immediately down 350 based on the number. And part of me thinks it, I mean, it's wishful thinking to say, but I feel like people just need to readjust their expectations when it comes to these kind of numbers because the headline number seem to peak in July or August around 9%. And the numbers themselves are coming down, they're just not coming down as fast as everybody wants it to be. And everyone wants instant gratification. It should be backed down to 2 or 3% by Christmas, I mean, we just need to accept the fact that that is not what is going to happen at this point, barring some kind of ridiculous event. It's not going to happen.

**Tom Mullooly:** Not at this point, but at some point we're going to get to a period where the year-over-year comparisons for inflation increases are going to level off and start to actually show negative numbers.

**Tim Mullooly:** Those numbers will be correct, but it's like then people will start to dig into, well, which numbers do you want to use to fit whatever kind of narrative you want to twist about the economy and the markets. Just using the eye test, I know here where you're talking about gas prices and they've been falling, driving down Route 35 here in Wild Township, gas prices have gone up about 20 cents over the last couple weeks. I mean, if gas prices are going to go back up and then what part of the economy, what industry is feeding into these headline numbers? I mean, it swings, so you don't really know what's going to happen in the next couple of months.

**Casey Mullooly:** So just to kind of recap, I know you touched on it there, Tim. So the data that was reported today was actually numbers from September, so the data comes out a month behind. In July, the year-over-year number, which was June's data peak at 9.1%, in August that was 8.5, September was 8.3, and then this month it was 8.2. So just kind of wanted to provide that context there. But to your point about the numbers starting to roll off, I know a couple weeks ago we talked about and reference the chart from Bespoke, which looked at just different scenarios of inflation rates increasing and what that would do to the numbers rolling off. So without a month-over-month increase of 0.7%, anything less than that next month, we'll get the headline number into the sevens. So that just kind of speaks to your point about how these things are measured and what we think we can expect moving forward.

I know the big talking point now is... There's kind of two camps. It's the Fed people saying that the Fed should wait because this data is all... There's a lag and they should kind of wait to see the full effect of their moves or they should get to their terminal rate as soon as possible. And they've been talking about getting that to four and a quarter or four and a half percent for... They've kind of been signaling that for several months now. They're all on the same page, which I know we've talked about before. But they've all said that they're kind of sticking to their plan here. It's kind of been the same thing for a couple of months now where we have the inflation reading number come out and then we see some sort of signs that it might be cooling in the weeks in between and then it comes out and it's worse than everyone expected. And that means that the Fed isn't going to pivot, which means that... Yeah, it just...

**Tom Mullooly:** Fed pivot is dumb. It just a dumb fantasy.

**Tim Mullooly:** I was going to say, I hate to break it to those people, but they're not going to do that.

**Casey Mullooly:** It's interesting though because I think we talk about how markets hate uncertainty and it's kind of like it's been the same story for the last six months. So why is anyone surprised at this point?

**Tom Mullooly**: It is interesting. Just to dial back for a minute or so, we talk about how year-over-year inflation will hopefully show negative numbers as we move forward. That we'll start to see inflation cool off and we'll actually have what they call, not deflation, but disinflation. We still have inflation, but it's coming down. In the 70s and into the early 80s we had years where we had 5, 5, 5, 6s, 7s, then we had 9s, at one point we had 11, and then the last year, 1981, we had 13% inflation. That is on top of the previous year's increase. So start stacking up all of those numbers and you can see how we got from 28 cents for a gallon of gas to almost $5 now.

**Brendan Mullooly:** I think that people should be careful what they wish for because we all want the number to come down and faster because we want the market to come back and faster. But getting there incrementally is probably better because at some point if we're talking about disinflation, then we're going to get scared about deflation, which is not... It's not a good thing. That means that economically we're in a bad situation. So that probably means that people have lost their jobs and other stuff is going wrong and...

Inflation stinks and nobody likes what the market has done this year. But I think that wishing for all those numbers to precipitously drop in such a way that it would get us back to the 2% inflation faster, like the get it over with narrative. I think the reason that the Fed isn't just taking us to whatever they consider to be their terminal rate is because it would break a bunch of stuff into the economy and cost a lot of people their jobs, real world ramifications that none of us want to bear. So we got to go slow and get there. And I guess we get to complain about it along the way because that's what we do in life.

**Tim Mullooly:** It's weird to watch people in the market and investors hope for some of these economic indicators to go up in terms of, they want to see the economy slow down and shrink. It's almost like it, a recession would be good because then the Fed would stop raising rates, which means stocks could go back up. And it's like you're rooting for jobless claims to go up and now mortgage rates are at 7% and people can't buy houses. And like Brendan's saying, there are real world ramifications to it just so that the Dow can get back to where it was a year and a half ago. It just feels weird to root for that.

**Tom Mullooly:** I want to be clear for everybody and for all the listeners to understand a recession is the last thing the Fed would want. And so they're super nervous about raising rates aggressively as they are now and be at the risk of flipping this economy, which is still really strong, flipping this economy into a recession because they're going to immediately have to pivot and they're going to lose whatever little credibility they have left, it will be gone. And so the last thing that the Fed wants is a recession. Maybe me and Uncle Jay Powell are the only ones out there who still think that they can stick a soft landing. And maybe I'm going to be wrong on that.

So the problem that we're running into, and Brendan, you and I talked about this this morning, is that we're starting to see other things start to break, not necessarily here at home in the US economy, but we're starting to see other countries... I mean, for goodness sakes, the UN, United Nations came out last week appealing to the Federal Reserve saying you have to stop these rate increases because with the rate increases, we see the dollar get stronger and stronger, and it is starting to really crush some of these other currencies and economies around the globe. It's really starting to do some damage.

**Casey Mullooly**: Yeah, no, we talked about two weeks ago now, the whole pension system almost failing or rumors that it was failing over in the UK.

**Tom Mullooly:** And now the UK they've had to pivot and move from quantitative tightening to quantitative easing. They're actually buying bonds back in the market.

**Brendan Mullooly:** The politicians are also walking back the nonsense that got us all into this in the first place.

**Casey Mullooly:** Yeah, they walked back tax cuts.

**Tom Mullooly:** Truss, she may have one of the shortest reigns as prime minister in the history of the UK.

**Casey Mullooly:** Yeah. We'll see how that all shakes out. One of the other things that came out today was a fact that the social security benefits are jumping 8.7%. There's a provision written into the Social security code. It's kind of like a inflation rider, so to speak, where they take the inflation data that's coming out and adjust the payments for those receiving social security. It's been a fixed income over the last year. These changes are going to go into effect in the beginning of 2023. I know last year, Brendan, we talked about the same thing. I think there was a 5.9% increase last year. So again, that's 8.7% increase to the monthly number that you receive from your social security check.

**Brendan Mullooly:** I think the big boon in this year is the fact that Medicare premiums won't be raising commensurately because a lot of people lamented last year that the increase they got was almost entirely eaten up by Medicare premiums jumping alongside it. So that should be a nice boost. And for all the hand wringing about social security as a system, it is one of the most valuable things to retirees out there. I mean, try to find an inflation adjusted annuity income any place else. You're not going to. They don't do them anymore.

**Tom Mullooly:** And it's nice to see because there were several years in a row, I believe it was 2014, '15, '16, where there was no cost of living adjustment.

**Brendan Mullooly:** There was no inflation, so they don't need one. So you get to choose your fighter because you can either have that economy where you're not getting an inflation adjustment, prices are staying flat, and I guess if you're an investor, your stocks are probably rising. You're not getting much on your fixed income during that period either. Now you can get a higher rate on safer investments, you get a boost in your monthly benefits, but your stocks are probably down. So you know can't have all of those positives at once. There's got to be something going the other direction.

**Tom Mullooly:** So what is someone who's got money in the market to do at this point? I mean, when this report came out this morning, Dow Futures, like Tim said, went from plus 300 to... At one point it was minus 500.

**Casey Mullooly**: How old is this hypothetical person?

**Tom Mullooly:** Right. Yeah.

**Casey Mullooly:** It depends.

**Tom Mullooly:** There's a lot that gets added into it. Because I think when you turn on the TV and whether you're watching CNBC or Fox News or Bloomberg News, there's people on there for eight months, nine months now saying you really should do something about your stock market portfolio. And I don't necessarily know if that's the right guidance. Every situation's going to be different, but it's a question we're getting asked every day.

**Casey Mullooly:** I think the message is the same as it has been over the last year that we've kind of been talking about this stuff. There's a difference between trading and there's investing, which we've talked about a lot over podcast, videos, blog posts, and if you're trading, then you should be the ones that are waiting for the 08:30 news to drop basically, and adjusting your position accordingly. That's what their job is. When you're investing for retirement, I think we have to pay attention to this stuff, but we always say to people, It's our job to worry about this stuff. It's our job to talk about this stuff so you can go and live your life and not have a crappy day because inflation reading came in hotter than expected.

**Tom Mullooly:** I think it's also important to just remind folks that when they're watching this financial entertainment channels, they're not talking to you. These are people who are getting on, who are actively trading their portfolios on a day to day, week to week basis. For the most part, that is not you. And so a lot of times folks turn away from the financial media and they're like, I'm confused because everyone on TV is saying that we should head for the hills, but really prices are starting to get pretty attractive. So what is it? What's the answer?

**Casey Mullooly:** Yeah, when you talk about a go forward basis, again, it's kind of do you want to look in the rear view mirror or do you want to look out the windshield where you're actually going? The story in pretty much all of the 2010s and into the last couple years here was valuations are too high, something has to happen. And you're earning no money on your fixed income. And now we're getting to a place where valuations actually look pretty attractive on a go forward basis. And you can get 4% at basically, I don't want to say no risk because there's always risk, but you can get 4% on your fixed income when that wasn't the case at this time last year. So to me, going forward, that is probably the most attractive it's been in a long time now. Yet it's unfortunate that your stock account is down now, but as we've said throughout this year, that's the price of doing business and investing for the long term. You have to withstand that stuff. There's no other way around it.

**Tom Mullooly:** Yeah, I think looking at what the bottom line is in your account on a day-to-day or even month-to-month basis is going to be very frustrating. Brendan's talked and written a lot about sunk costs and how we may have had money gained over previous years, we're giving some of that back now, but it doesn't necessarily mean that we've lost.

**Casey Mullooly:** What the market's doing this year is man made. It's the over-correction for keeping the markets afloat. During the whole COVID pandemic, we pretty much were in unchartered territories there. From a financial standpoint, we tried this thing out and now we're paying the price for it. Tim, to your point, it was like now we're in a spot where we're rooting for economic data that's not good, meaning jobs numbers basically. And during the whole pandemic in 2020, it was kind of this weird thing where the real life was horrible, but the market was doing great and it was this weird disconnect and now we're in the reverse of that, where in real life people are doing pretty well, but the market's not.

**Tim Mullooly:** Yeah, it's interesting. In 2020 when all of the stimulus and COVID relief and everything, they pumped a zillion dollars into the economy. There were a lot of people out there saying, this isn't going to end well. It's going to come back to bite us eventually. And now it's come back to bite us and everyone's surprised that it's biting us. It's like, well, the party wasn't going to last forever. Something was going to happen eventually. And it's like you said, it's the difference between long term investors and traders. But the knee jerk reactions, every time a piece of that economic data comes out, it's just like, Man, how are people still surprised that this is happening?

**Casey Mullooly:** Yeah. To that point, Nicholas Colas, who was actually on The Compound and Friends with the guys from Ritholtz. It was a pretty good podcast. He used to work for Steve Cohen and had some pretty interesting things to say. He was quoted in a Yahoo Finance article, will link it up in the show note. But at the time of this writing, the S&P 500 was down 23% year date, but nine single days make up the whole decline. Without those nine days, the market would actually be up 8.6% for the year. And he pointed out that the bad days largely occurred on days with bad macroeconomic or Federal related news.

**Tom Mullooly:** It's pretty amazing if you look at the headlines and we watch the news all the time here, and so we see what's going on when these headlines cross the tape. You would think, and I mentioned this on a video, that you would think that the S&P is not down 23%, but down 53% just based on the headlines. It seems terrible, but when you start digging into the numbers, it's down. We're not going to try and get cute about that, and honestly, I think it's pretty remarkable that with all of the inflation and crazy headlines that we've seen that we're not down more.

**Casey Mullooly:** We'll see how it shakes out. We will definitely be here to talk about it. This was episode 413. Tim, you're not saying anything about the Jets while we got a second?

**Tim Mullooly:** I got in trouble last week for saying that Jets were going to lose to the Dolphins, so they're going to beat the Packers. Why not?

**Casey Mullooly:** All right, here we go. Thanks as always for listening. We'll be back with you next week for episode 414.

Speaker 5: