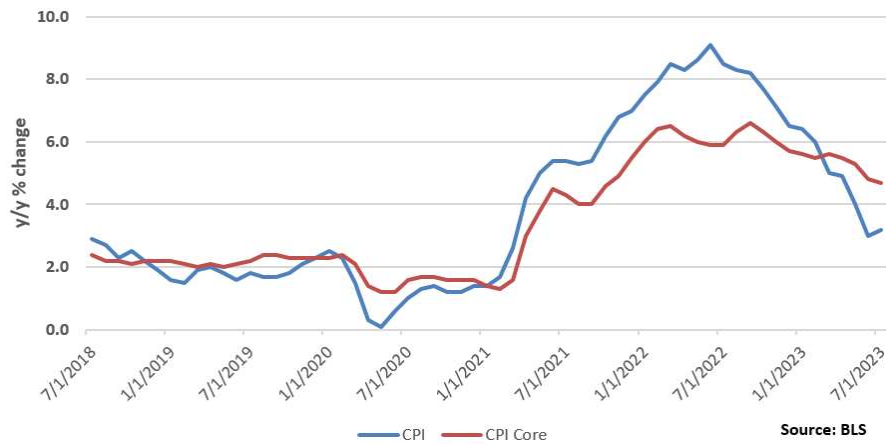


**Monthly Fixed Income Insight**  
**August 2023**

## Progress on Inflation – Shelter Prices in Focus

July’s CPI report reflected a recent moderation in inflation pressures with a weak 0.2% monthly gain on both the headline and core measures. Although the disinflation trend was broad based, steep declines in airfares and used car prices were notable contributors to the softening in consumer prices. The report brought the annual pace of inflation to 3.2% and 4.7% for headline and core inflation, respectively, compared to recent highs of 9.1% and 6.6%. Shelter prices are currently the primary source of core inflation, but we believe rents will be heading lower in the months ahead, providing the impetus for the next leg lower in consumer prices.

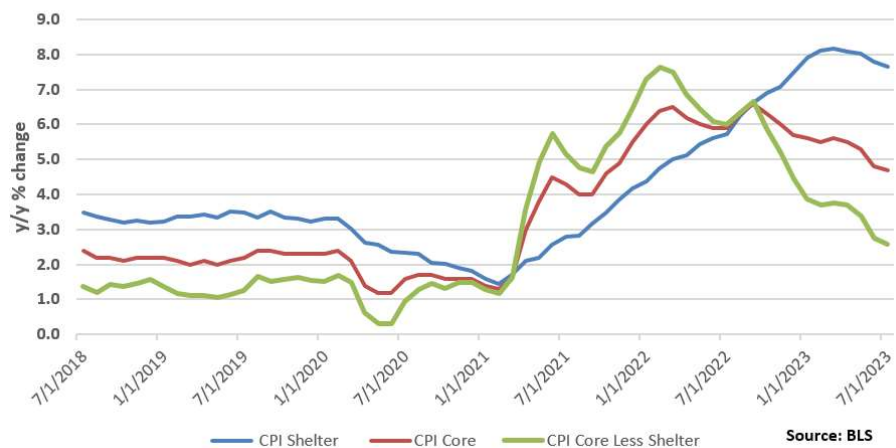
### CPI Inflation Progress to 2% Target



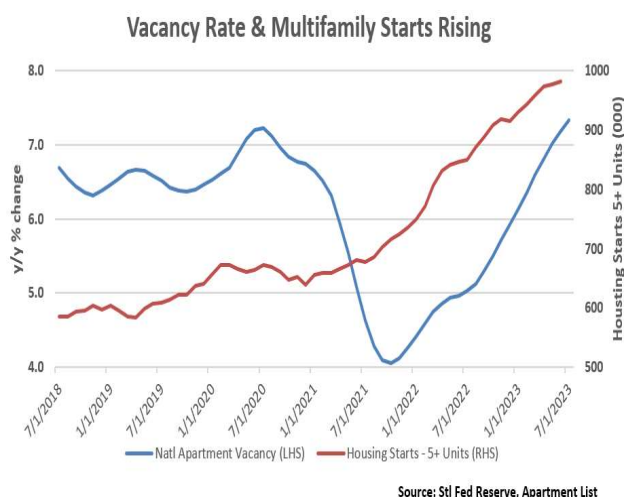
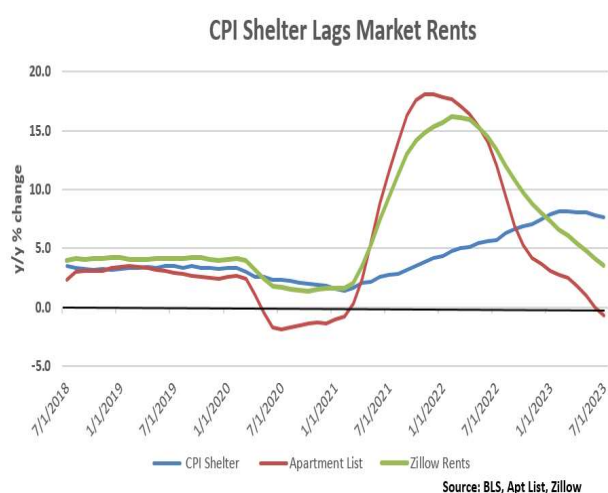
## Gimme Shelter

As the graph below highlights, despite declines in overall inflation, shelter inflation remains elevated, rising to 7.7% over the past year, well above the 3%-4% annual pace prior to the pandemic. Following the pandemic, a dramatic rise in home prices, reduced apartment construction, and robust fiscal and monetary stimulus combined to create a surge in shelter prices. Shelter is the largest expense for households and comprises 35% of overall CPI and 44% of the core CPI.

### CPI Shelter Remains Elevated



The CPI shelter data attempts to capture the entire housing stock including estimates for owner’s equivalent rent and rent of primary residences. Because rents for existing tenants change in line with the terms of leases and rental agreements, and many leases are for 12 months, existing tenants typically do not face a price change within the 12-month period of the lease. As a result, shelter prices are more “sticky” and price changes can sometimes take longer to appear in the calculation of CPI than in current asking-rent indices such as Zillow and Apartment List. The market-based indices are leading indicators for the CPI Shelter component as the current asking-rent indices like Zillow and Apartment List capture price changes on new leases which gradually roll into the price changes for the CPI Shelter Index (left chart). The asking-rent indices led shelter prices to the upside, with Zillow and Apartment List peaking at 16.1% and 18.1% on an annual basis. Subsequently, both measures have declined rapidly, and the Apartment List measure is now in negative territory compared to last year. The “sticky” CPI Shelter component has just now peaked, and we believe will follow the lead of the asking-rent indices lower. In addition, rising apartment vacancies, which have returned to early pandemic highs and increased multifamily construction should soften landlord pricing power and dampen rental inflation (right chart).



## Conclusion

Shelter is the biggest component of CPI inflation and is set to decline over the next six months. Current asking-rents have softened considerably from the peak and CPI for shelter should follow on a lagged basis. Rising vacancies and construction will shift the pricing power away from landlords in favor of renters. We believe declining shelter inflation will pave the way towards the long road back to the Federal Reserve’s 2% inflation target.

### Past performance is no guarantee of future results.

#### Disclaimers:

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