



Weekly perspective on current market sentiment

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Last week's S&P 500 Index: +0.1%

How scary is inflation?

Key takeaways

- We expect energy prices to stay above their pre-war levels for most of the balance of 2026, and that likely affects gasoline, airfare, and grocery prices. But the inflation news isn't all bad.
- We think it's prudent to maintain exposure to longer-term themes (like the artificial intelligence [AI] boom, increased industrial automation, and more defense spending) but play them in a disciplined and selective way.

April inflation data rolled in last week, and simply put, it was not pretty. Topline Consumer Price Index (CPI) inflation climbed 3.8% year-over-year (YoY) from 2.4% in February. Eyeing upstream, wholesale inflation, the Producer Price Index (PPI) was downright ugly — jumping 6% YoY, the most since 2022. Import prices also turned up, rising 4.2% YoY in April after having experienced deflation (price declines) as recently as November. The downstream impact also became more apparent in transportation costs and airfares — not to mention persistent pressure from metals and other industrial inputs, feeding insatiable demand for semiconductors and AI hardware.

We expect energy prices to stay above their pre-war levels for most of the balance of 2026, and that likely affects gasoline, airfare, and grocery prices. But the inflation news isn't all bad. Core CPI (excluding food and energy) has been more subdued (below 3% YoY in April), held back by ongoing disinflation in rents, back-to-back declines in medical costs, and flat-to-lower car prices. Core services inflation remains reasonably contained as productivity gains restrain unit labor costs — the largest expense item for most businesses. As for wholesale (PPI) inflation in the pipeline, we think the AI hyperscalers (the largest providers and users of computing capacity) have the wherewithal — as demonstrated by extraordinary first-quarter profit margins — to foot most of that bill, helping limit the passthrough to the consumer.

So, how can long-term investors best manage portfolios in this environment? Instead of trying to make investment decisions based on day-to-day headlines, we think it's prudent to maintain exposure to longer-term themes but adjust when potential opportunities appear to add value. We see the most sustainable trends bringing technology increasingly into everyday life. Even before AI grabbed headlines, automation had been improving productivity, fueling spending, and helping drive employment and profit growth. AI should reinforce these dynamics, but the trend is still early and prone to overshooting in equity prices.

While we do favor the Information Technology sector, we also favor related trends in Industrials and Utilities, which build out AI capabilities but look less expensive to us. Within Industrials, we specifically see the most opportunity in Machinery and Electrical Equipment companies, which should continue to benefit from the data-center buildout, along with Aerospace and Defense, which also looks appealing as the U.S. rebuilds its weapons arsenal. Likewise, recent higher energy prices may offer opportunities to allocate money to industries that we believe are able to pass along price increases to their business customers, including Industrial Gases and Specialty Chemicals within the Materials sector (which we currently rate as neutral, or a full allocation).

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