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INFLATION: A BUMP IN THE ROAD OR ANOTHER TIDAL WAVE?

"Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. The sight of this arbitrary rearrangement of riches strikes not only at security but [also] at confidence in the equity of the existing distribution of wealth."

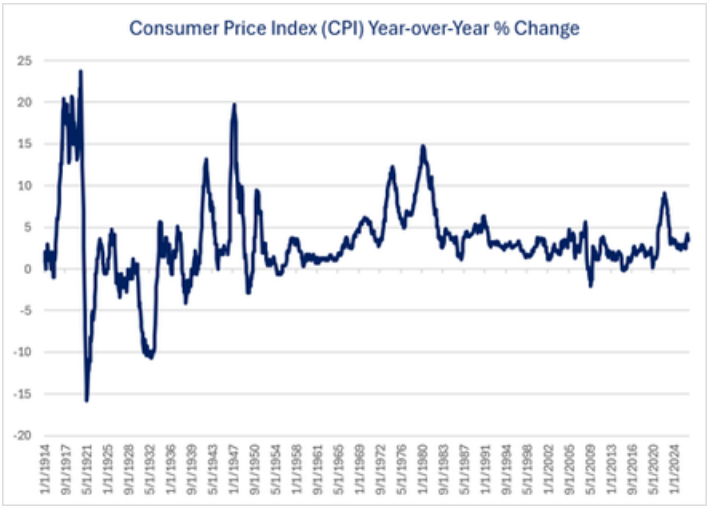
If you didn't believe in history rhyming, you'd probably Google (or ask ChatGPT) who recently said this. However, this quote is from a John Maynard Keynes book published in 1919! From the same passage: "as the inflation proceeds and the real value of the currency fluctuates wildly from month to month... the process of wealth-getting degenerates into a gamble and a lottery." Clients of ours know we have been keeping a close eye on leverage and speculation in the stock market. We wouldn't consider ourselves Keynesians by any means, but we must tip our cap to the man's ability to diagnose the societal ills of inflation.

Americans have a well-placed instinct to loathe inflation. Not only does inflation create qualitative problems, but it often leads the Federal Reserve to increase interest rates too high and cause a recession. With inflation data picking up steam this year, many are asking how high will this round of inflation go? Is a recession waiting on the other side?

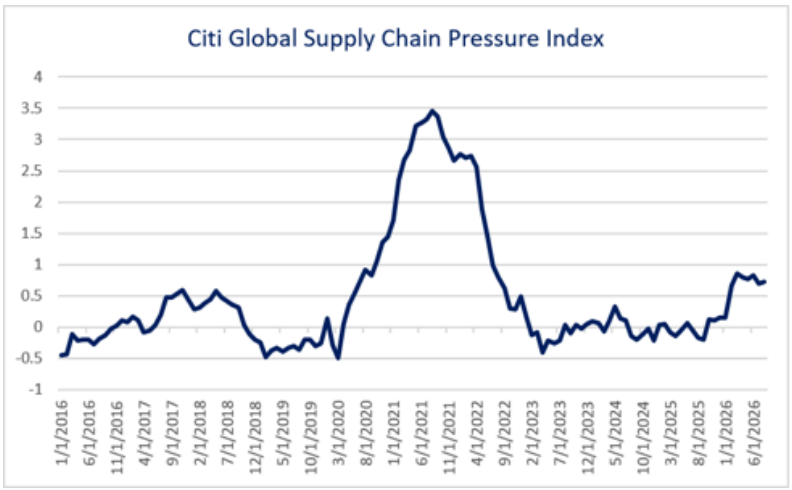
CHECKING IN ON THE COVID INFLATION DRIVERS

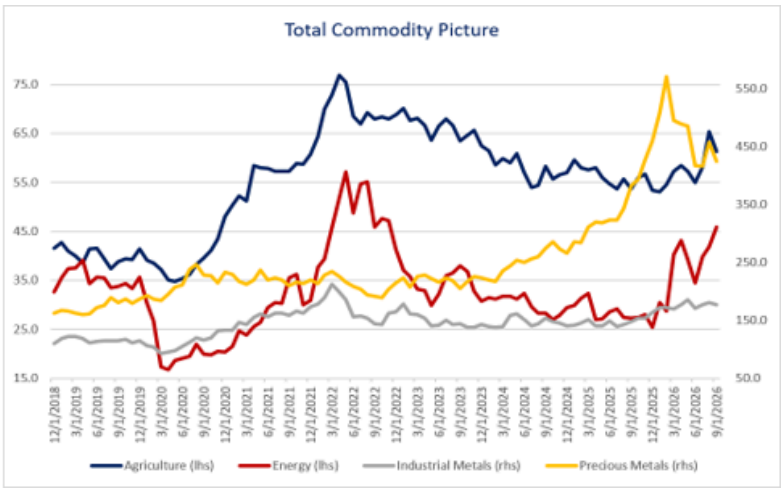
A quick study of history does suggest inflation tends to come in waves – very few peaks on the chart to the right are solo acts. Even more moderate periods of inflation like the early 2000's had a series of peaks over the course of ~8 years.

Thus, it is appropriate to review the drivers of the Covid burst of inflation to assess the current situation. As one might expect, the economic backdrop of 2026 is far different than 2022. Yet, the pernicious effects of war and associated rising energy cost do create some similarities for supply chain and commodity dynamics.



Source: Bloomberg, FBT Research





Source: Bloomberg, FBT Research

“However, the other two primary drivers of Covid inflation have much different fundamentals today. Higher interest rates and strained affordability are keeping a lid on shelter inflation, which is more than one-third of the Consumer Price Index. Additionally, the labor market is in balance versus experiencing a severe shortage during the economic reopening post-Covid. Wages are tame, job openings remain in equilibrium with applicants, and jobless claims remain low.



Source: Bloomberg, FBT Research

Although the supply dynamics of the economy are once again in focus, the demand side is significantly different. Yes, the federal government is still increasing the debt and spending at a pace too fast for comfort, but it is nowhere near the insanity of Covid. In fact, money supply as measured by M2 is up 5.7% year-over-year. While this sounds like a lot, it isn’t far from the norm over the past 40 years. M2’s fastest y/y growth rate during Covid was an eye-watering 27%.





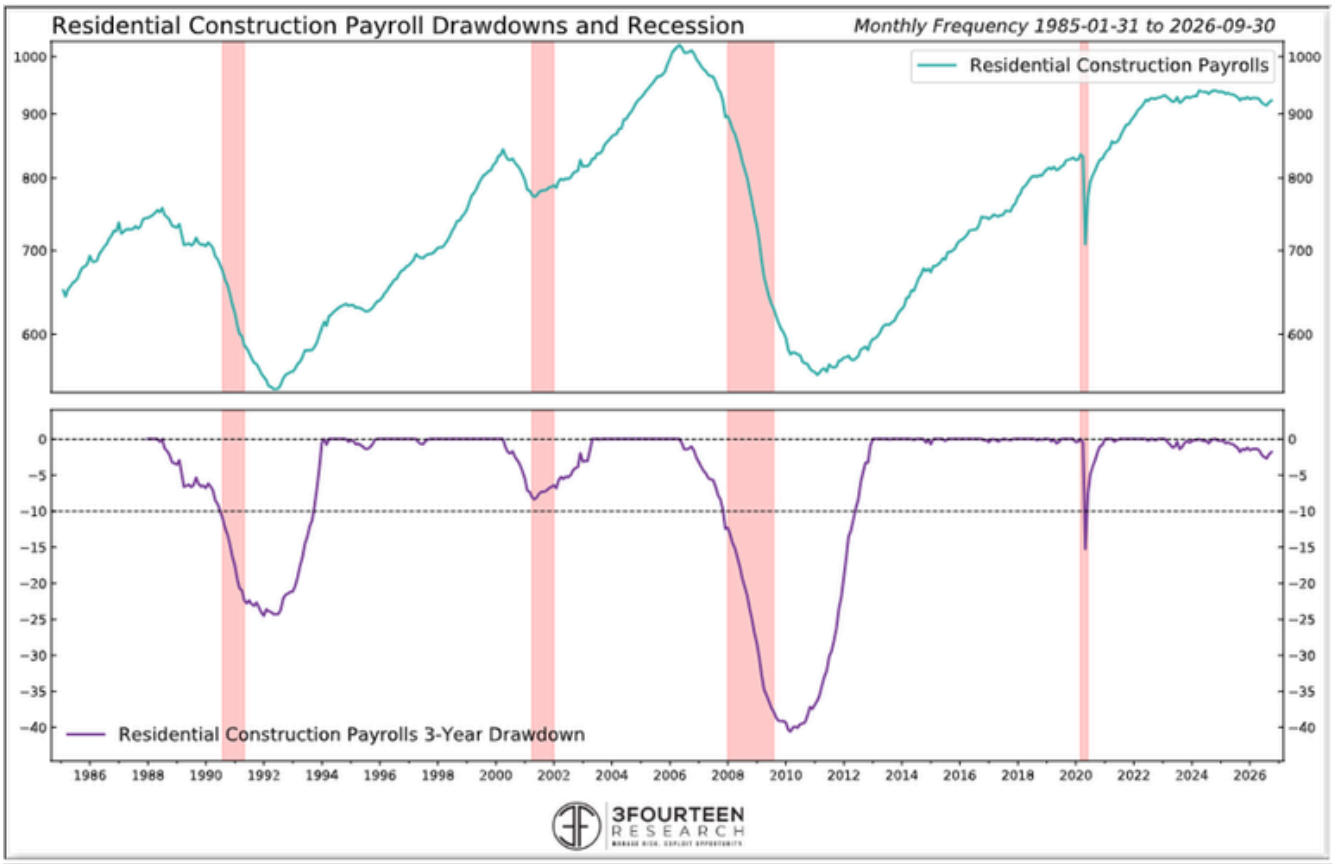
The economy is also undergoing what could end up being the largest investment cycle in history. This is naturally inflationary but the impact on consumer prices has been fairly muted as many inputs don't end up in a big portion of daily consumer spending. Furthermore, the rapid demand surge for capital in the AI race has led to a crowding out effect on many other parts of the economy, which have experienced weak demand and very low inflation. Thus, while inflation numbers have been running hot in the data center supply chain, the lack of feedthrough to consumers and the drain from other parts of the economy means the data center boom is not a meaningful concern for the broader inflation picture.

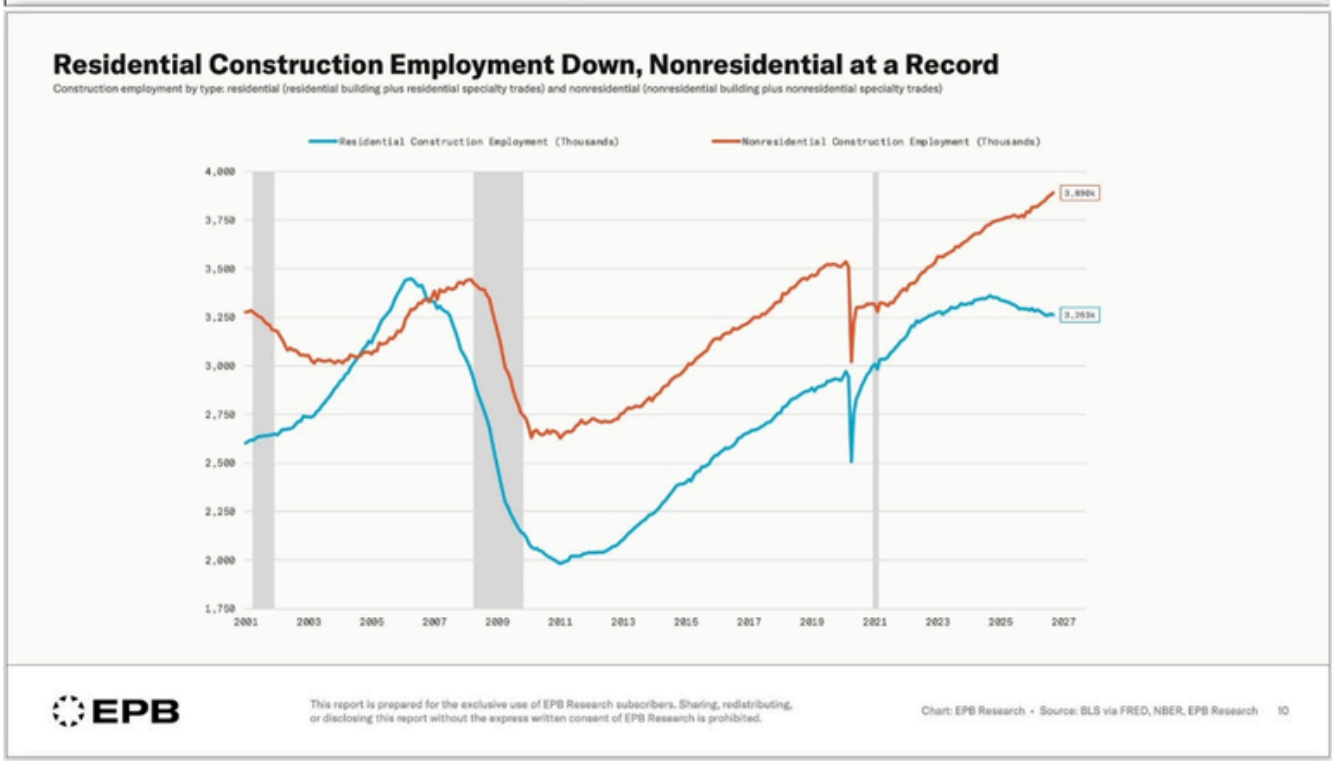
THE WET BLANKET OF HOUSING

If you are still uncertain about where we lean on the current acceleration in inflation, then our assessment of the housing / shelter view should clear it up. The new Federal Reserve chairman Kevin Warsh owes former chair Jerome Powell an ironic thank you for facilitating a housing bubble during 2020 and 2021. Due to strong consumer balance sheets, there hasn't been a spectacular crash in housing prices like 2008, but the market has been stagnant in both transactions and prices. This stagnation has partially allowed wages and general prices throughout the economy to start to catch up to housing prices, so the correction in home values has been in relative terms. The good news for Warsh is that there is still more to come in this process. At more than one-third of the weight of CPI, the stagnation that we expect to continue in housing prices will serve as a wet blanket on the total inflation numbers.

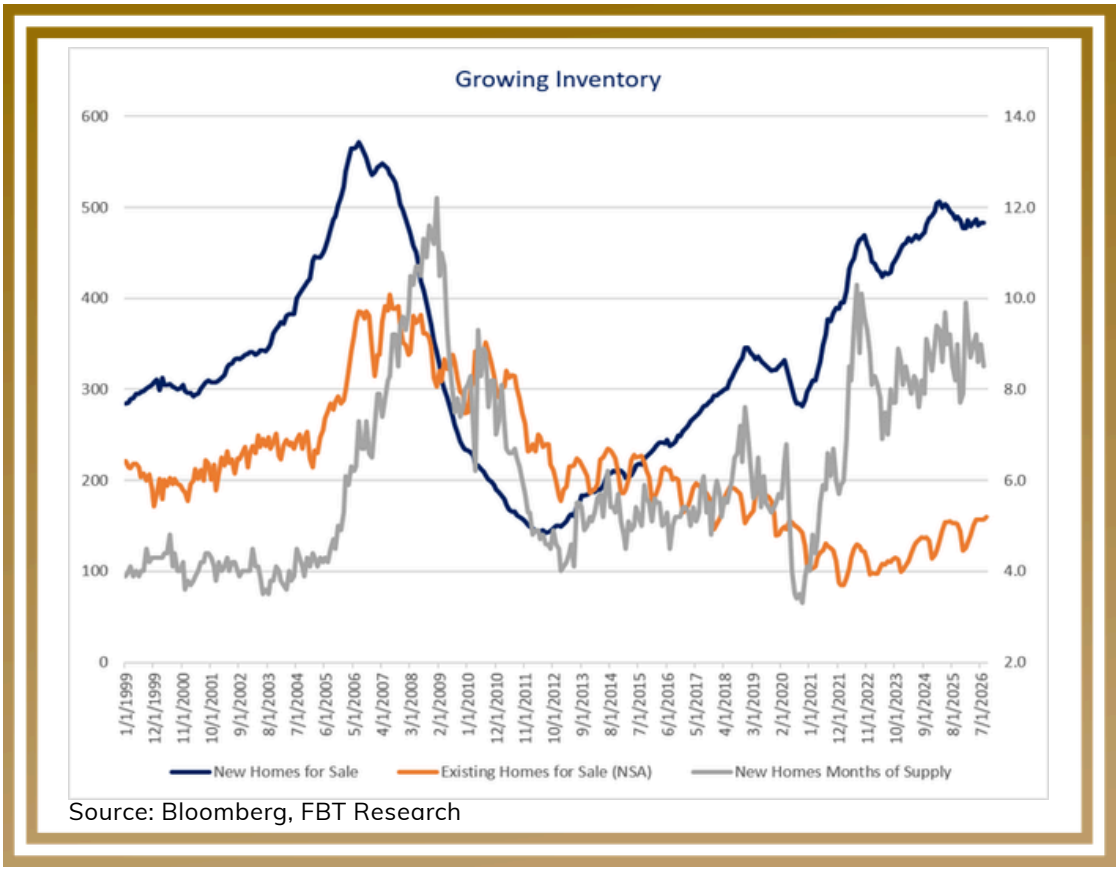


The landscape in housing, especially with mortgage rates now comfortably over 7%, is so bad that without the data center construction boom, we'd be debating recession instead of inflation. As history and research from 3Fourteen suggests, a decline in residential construction payrolls is typically a leading indicator for recession. Thankfully, the data center boom has allowed overall construction payrolls to continue expanding.





Even if rates do drop and help the mortgage math and thus demand, supply continues to improve – new home supply has been sufficient for years and at long last, existing home supply is normalizing.



Source: Bloomberg, FBT Research

WHAT DOES THIS MEAN FOR PORTFOLIOS?

It feels taboo to discuss anything other than AI these days, but the unprecedented move in long-term interest rates to end the third quarter has pressured many parts of the market. For 20 out of the last 25 trading days of the quarter, the 10-year Treasury yield went up – a record only achieved three other times in the last 60 years!

At the end of the day, inflation is a policy choice, and the Strait of Hormuz has a massive range of outcomes. The Fed can look through temporary energy price spikes, but sustained spikes force it to act as companies are eventually pressured to raise prices. Thus, oil is still in charge, but this isn't the 1970's – the U.S. is the swing producer now.

With those important caveats, we see the current inflation acceleration as a bump in the road. As such, we have been busy buyers of bonds over the past few weeks for clients that need them and are attracted to many beaten-down, rate-sensitive stocks. Poor policy decisions – both political parties seem addicted to money printing and the Fed is showing a reluctance to act decisively – still make us wary of getting too aggressive on duration. But balancing policy risk versus the possibility of data center construction slowing and an ensuing mild recession (remember, not much growth is occurring outside of data centers) makes bonds and stocks that are correlated to bonds an attractive place to put cash to work. To be clear, we aren't calling for a "top" in data center construction, but it has been curious to witness resilience in those stocks despite the fact that the AI project now requires outside financing and is dependent on market forces such as interest rates – this isn't 2023 anymore when the buildout was funded from free cash flow...

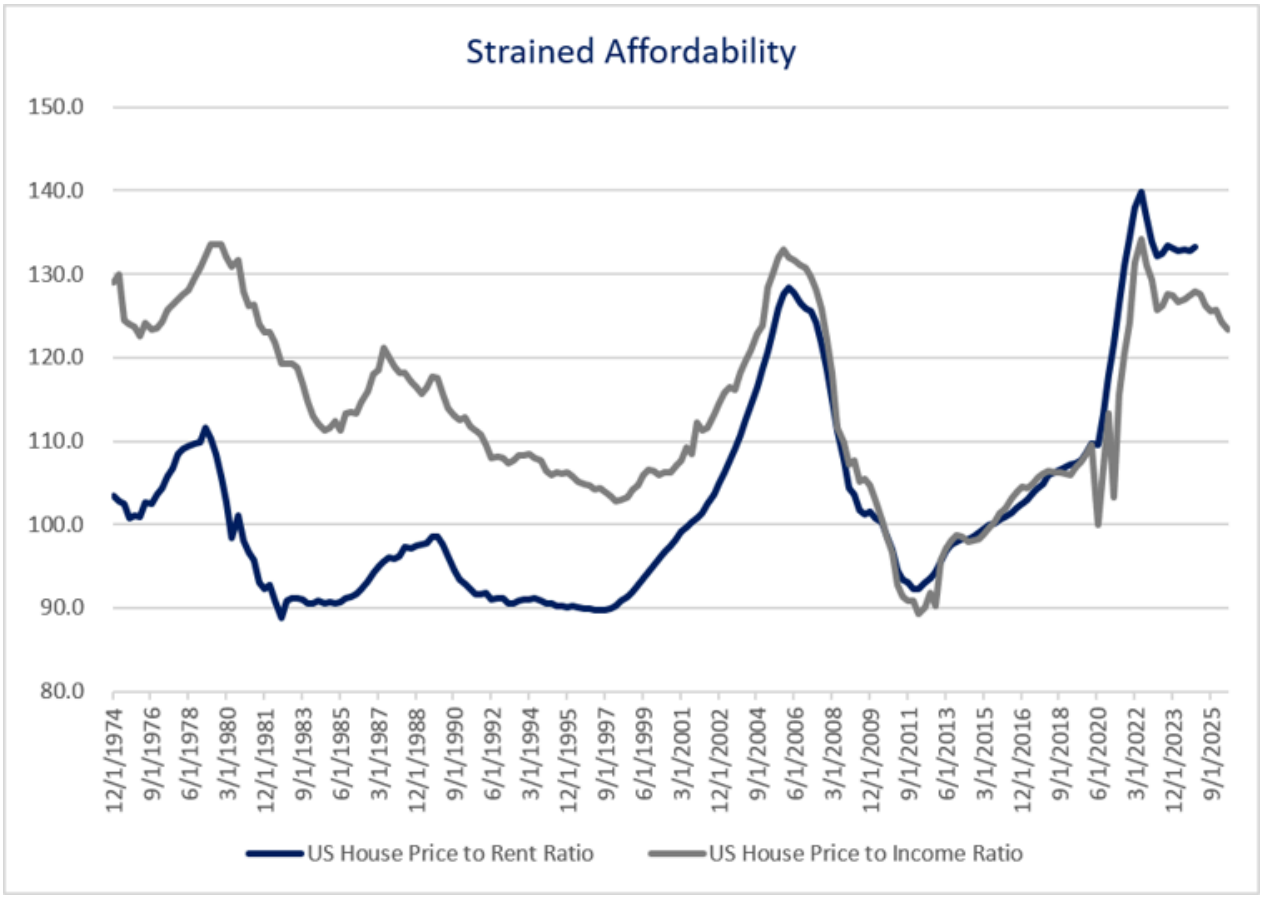
Sincerely,
Your First Bankers Trust Team

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Investment products are not FDIC insured, not guaranteed by the bank, and may lose value

CHART APPENDIX

Sources: Bloomberg, FBT Research, Goldman Sachs, JP Morgan, Bank of America, EPB Research, Schwab, Wall Street Journal



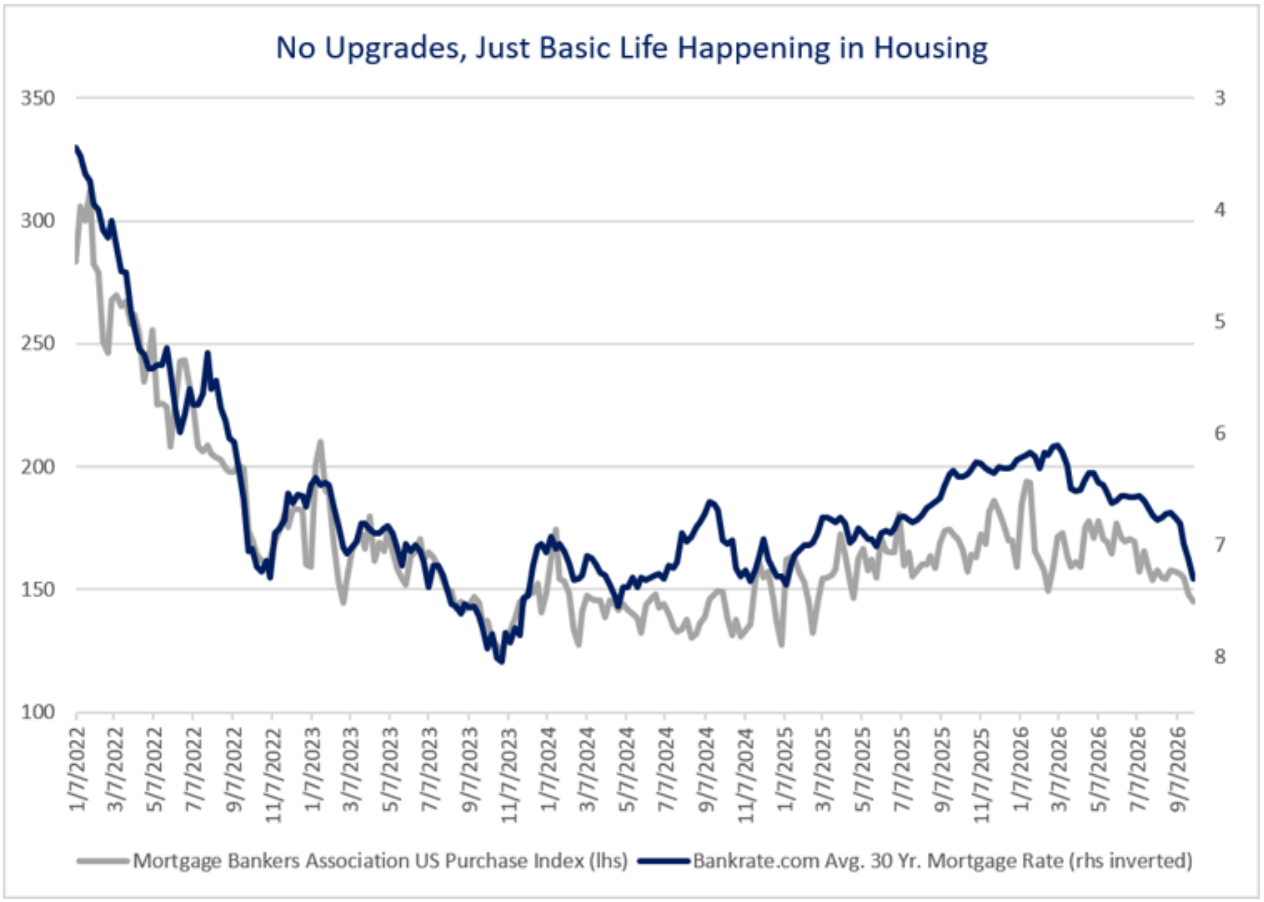
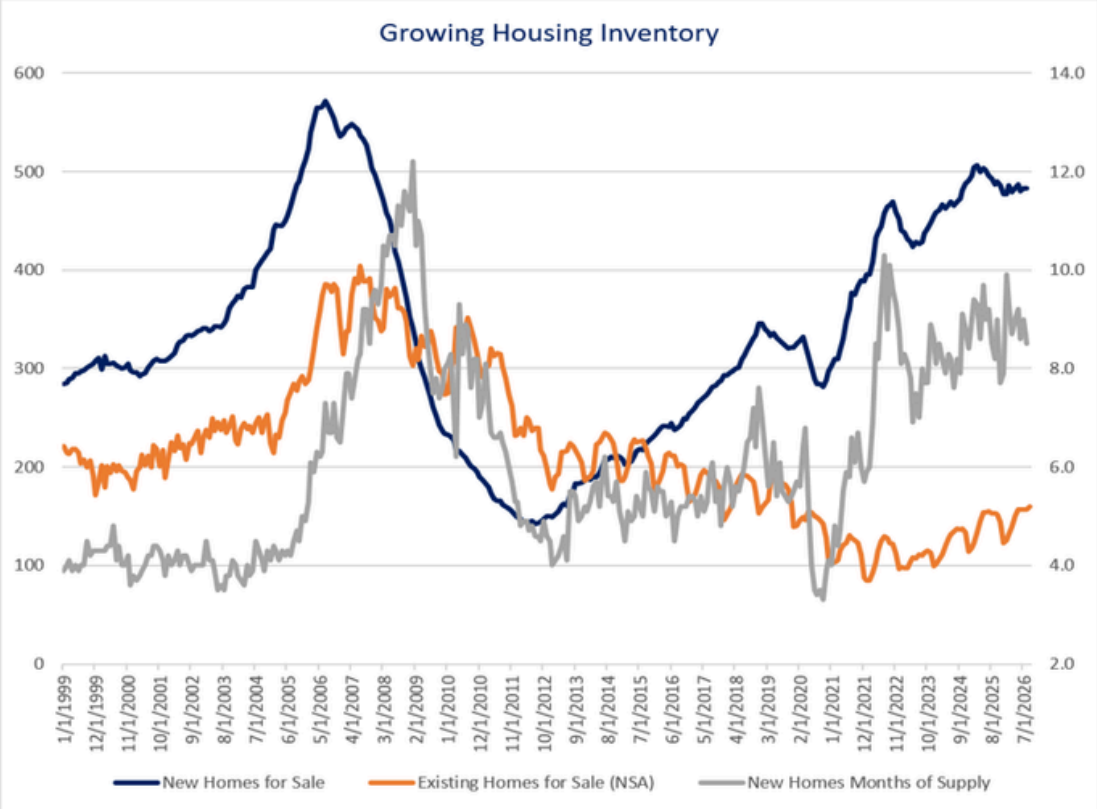
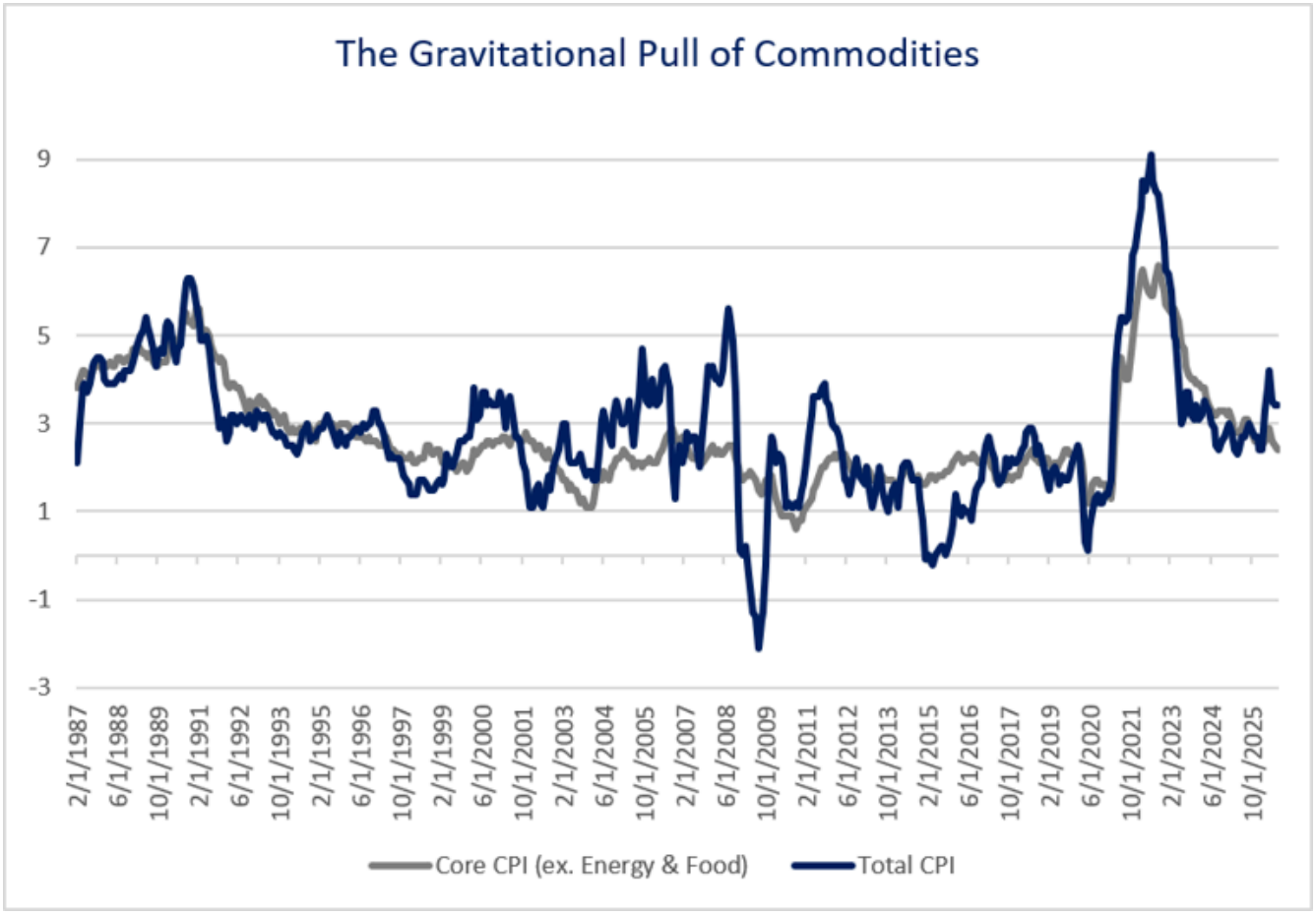


CHART APPENDIX



Category	Weightings in CPI - July 2026
Food	13.5%
Energy	7.3%
Transportation Commodities Less Motor Fuel	6.9%
Household Furnishings and Supplies	3.3%
Apparel	2.4%
Recreation Commodities	1.9%
Medical Care Commodities	1.4%
Other goods	1.3%
Alcoholic Beverages	0.8%
Education and Communication Commodities	0.8%
Shelter	35.3%
Medical Care Services	6.9%
Transportation Services	6.3%
Education and Communication Services	4.9%
Recreation Services	3.2%
Other Personal Services	1.6%
Water, Sewer and Trash Collection Services	1.1%
Household Operations	1.0%

CHART APPENDIX



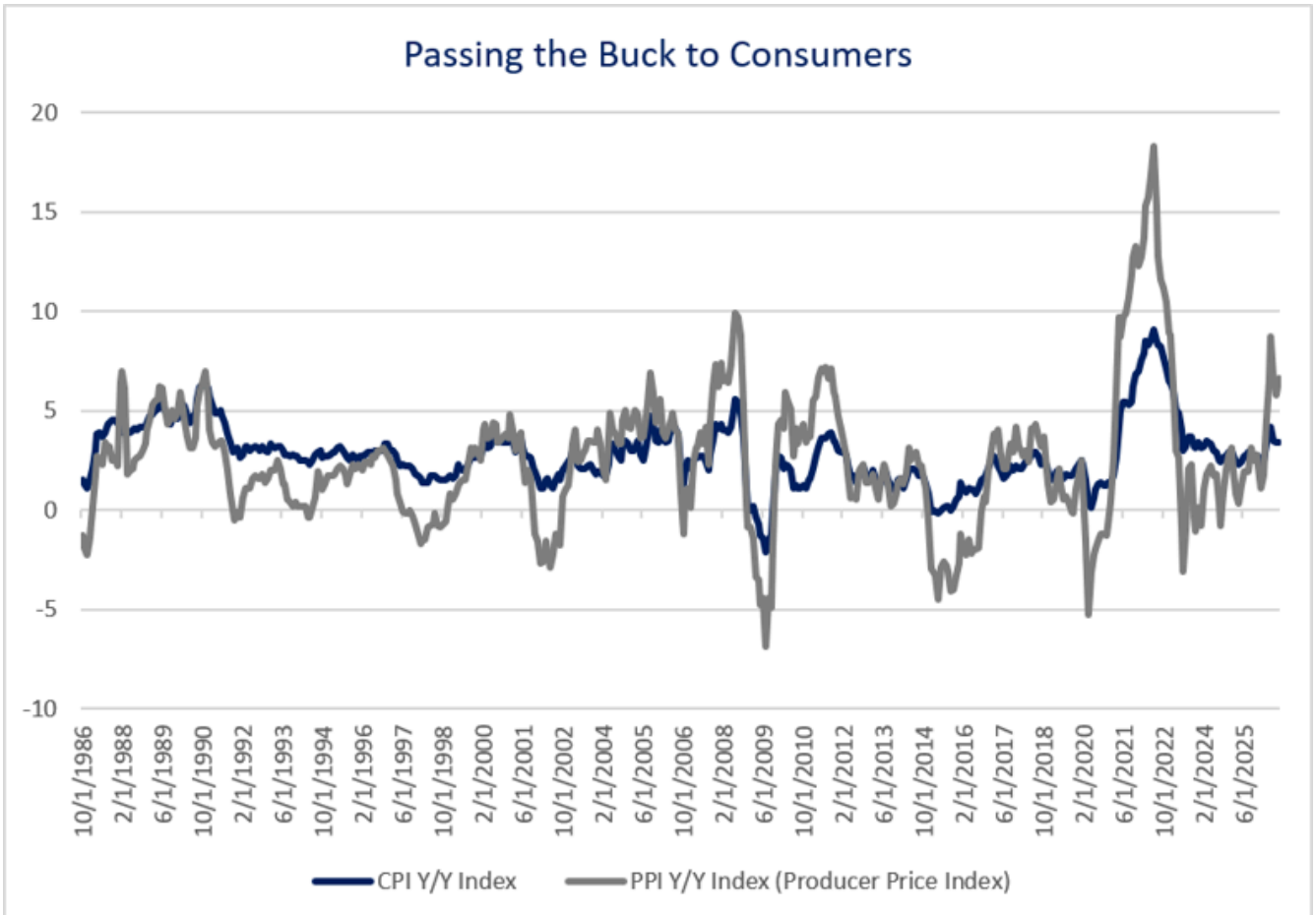
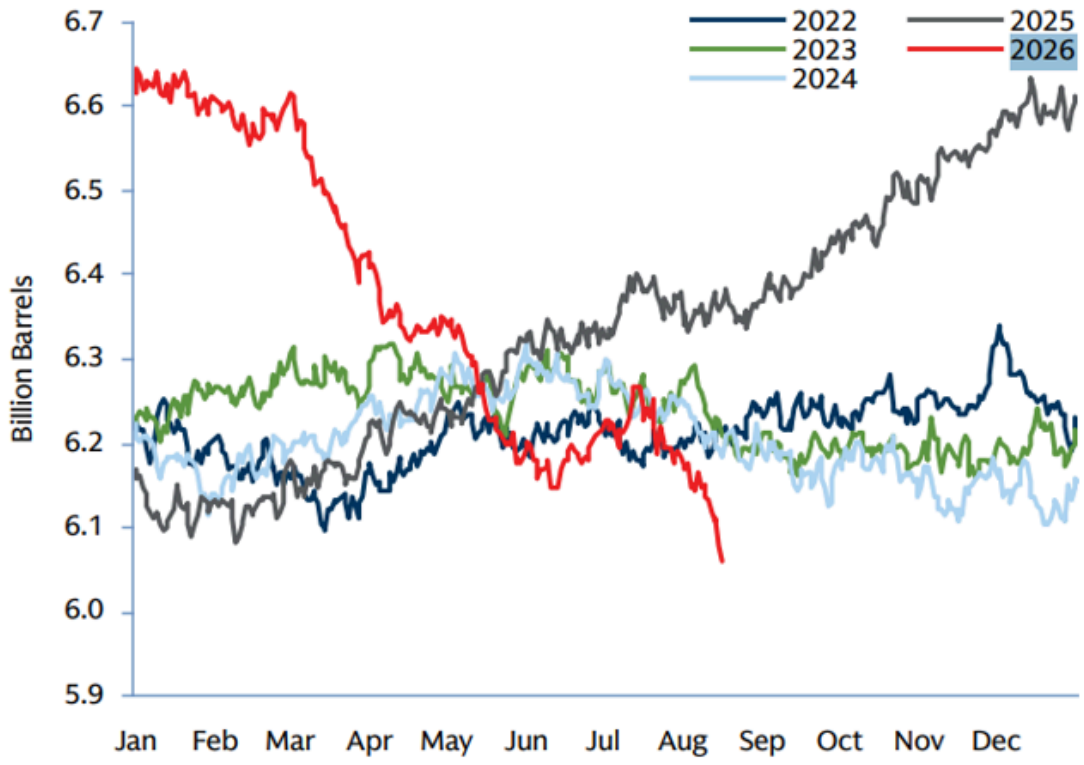


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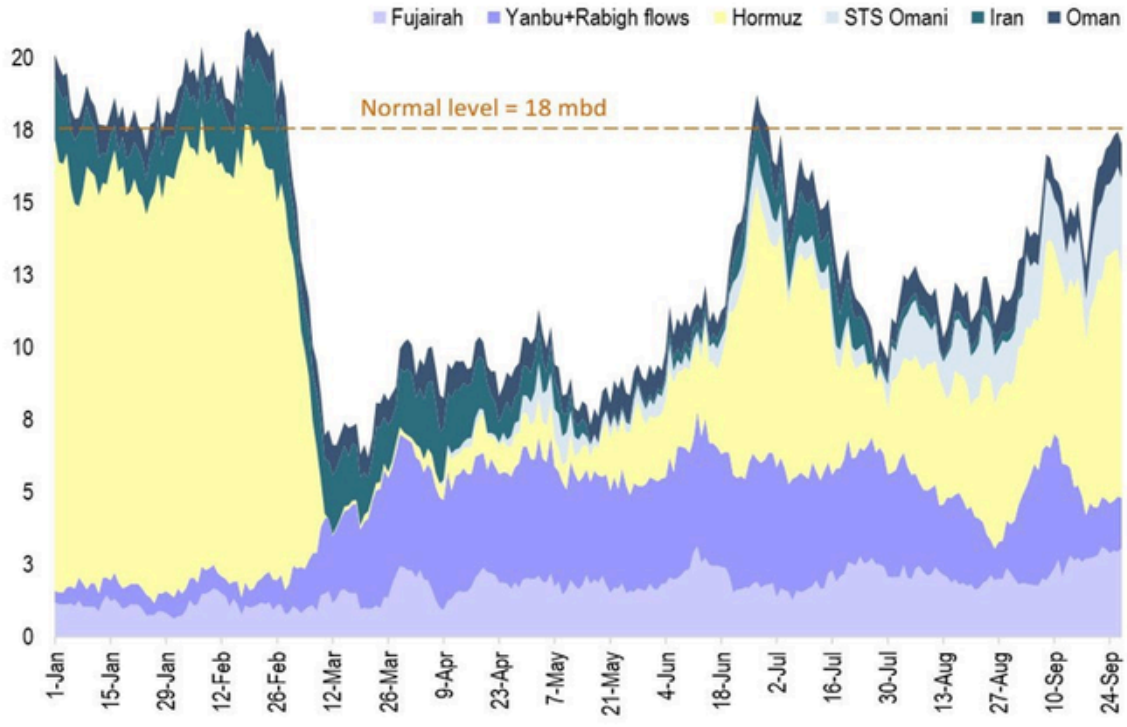
Exhibit 2: Global Observable Oil Inventories



Source: Investment Strategy Group, Kpler, IEA, DOE, Fujairah, Singapore Enterprise, Longzhong, OilChem, PAJ, ARA PJK, Euroilstocks, Bloomberg. Data as of August 31, 2026.

Figure 2: Middle East crude flows

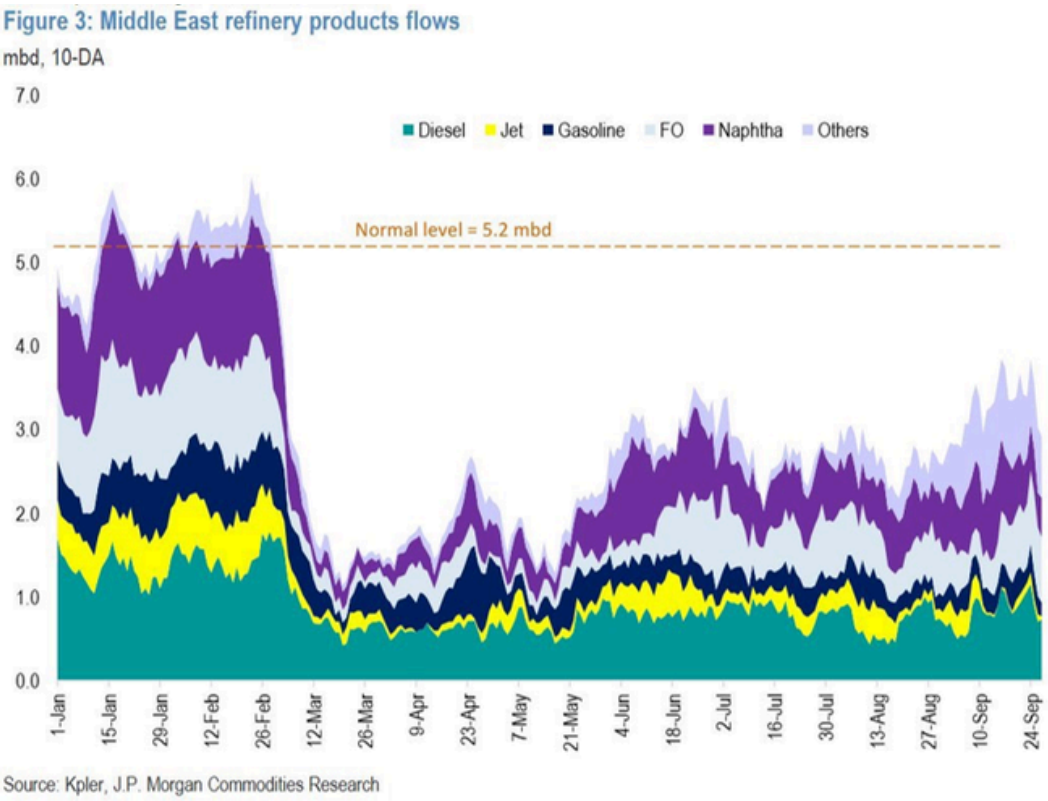
mbd, 10-DA



Source: Kpler, J.P. Morgan Commodities Research

CHART APPENDIX

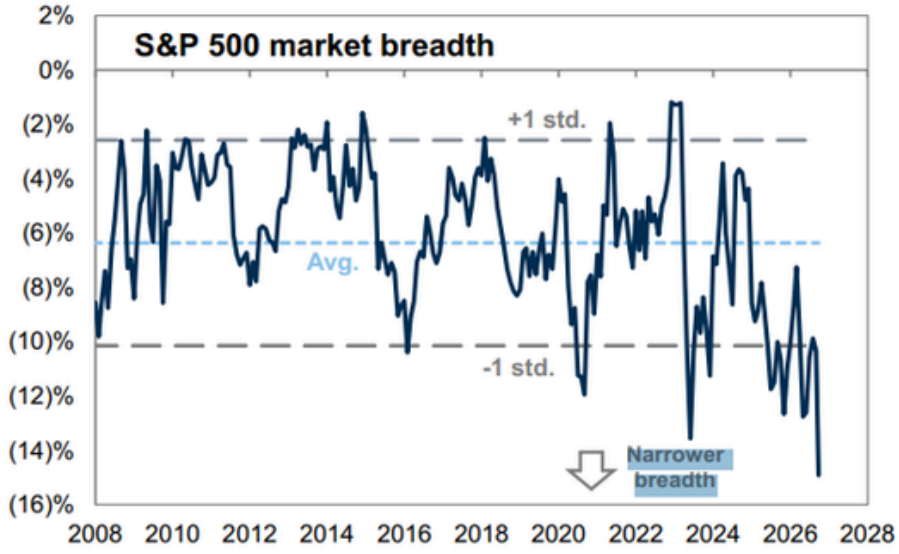
Figure 3: Middle East refinery products flows



Source: Kpler, J.P. Morgan Commodities Research

Market breadth and concentration

Exhibit 28: S&P 500 52-week market breadth



Market breadth is calculated as the difference between the distance of the aggregate S&P 500 Index from its 52-week high and the distance of the median S&P 500 constituent from its 52-week high. When the aggregate index is much closer to its 52-week high than is the median stock, market breadth is narrow.

Source: Goldman Sachs Global Investment Research

CHART APPENDIX

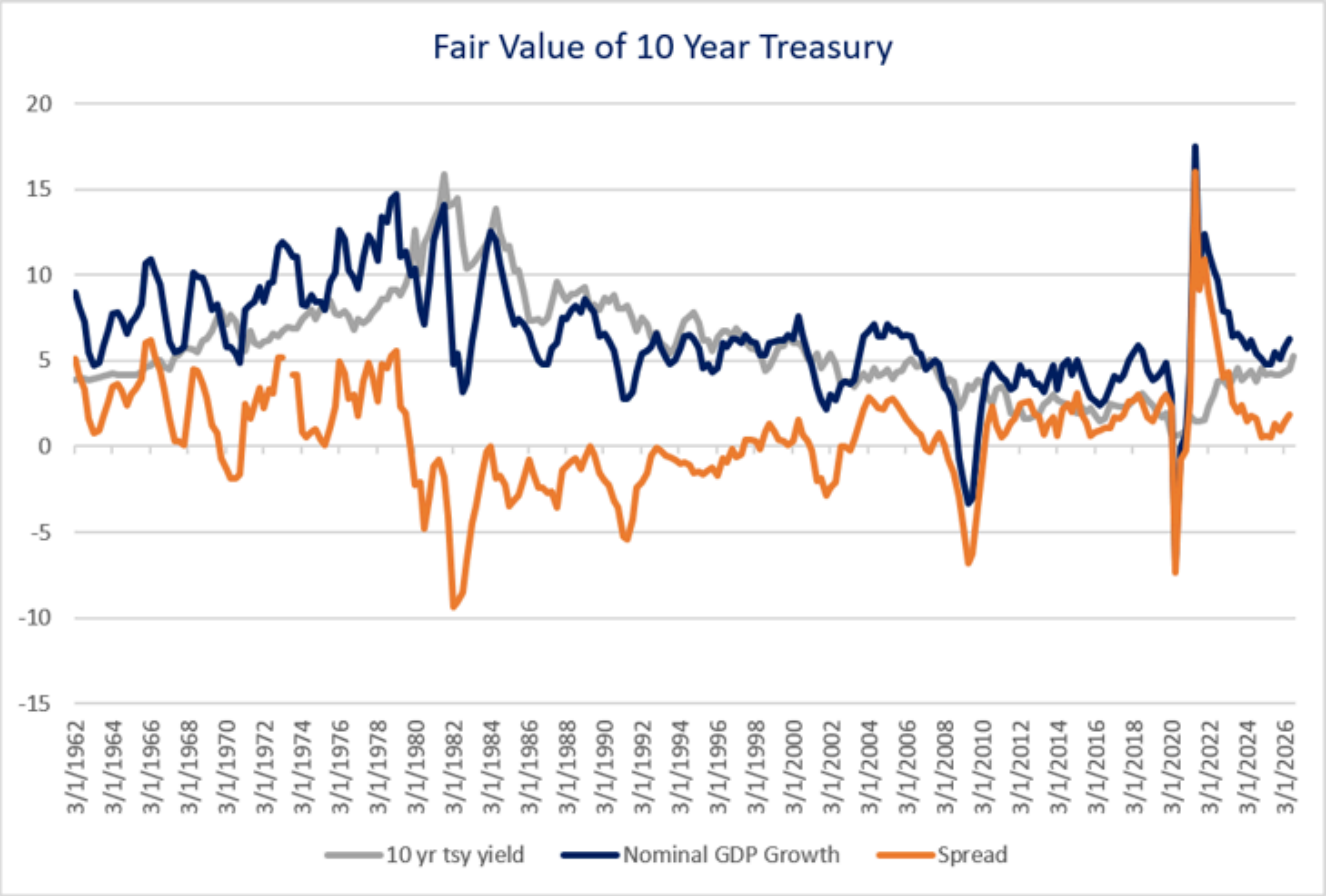
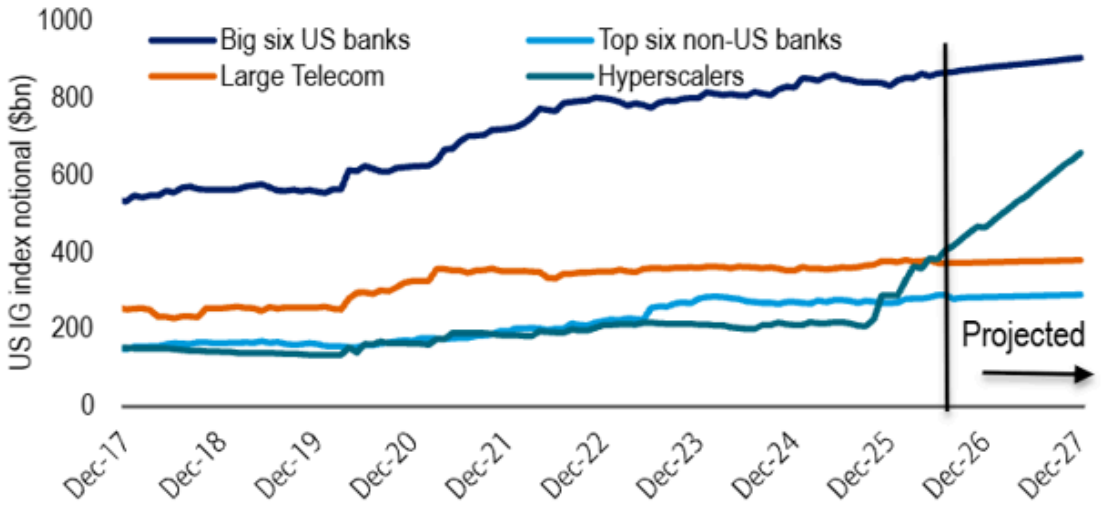


Exhibit 2: Hyperscaler US IG index notional relative to other large sectors

Hyperscaler US IG index debt could go from $288bn at YE-2025 to $659bn by YE-2027.

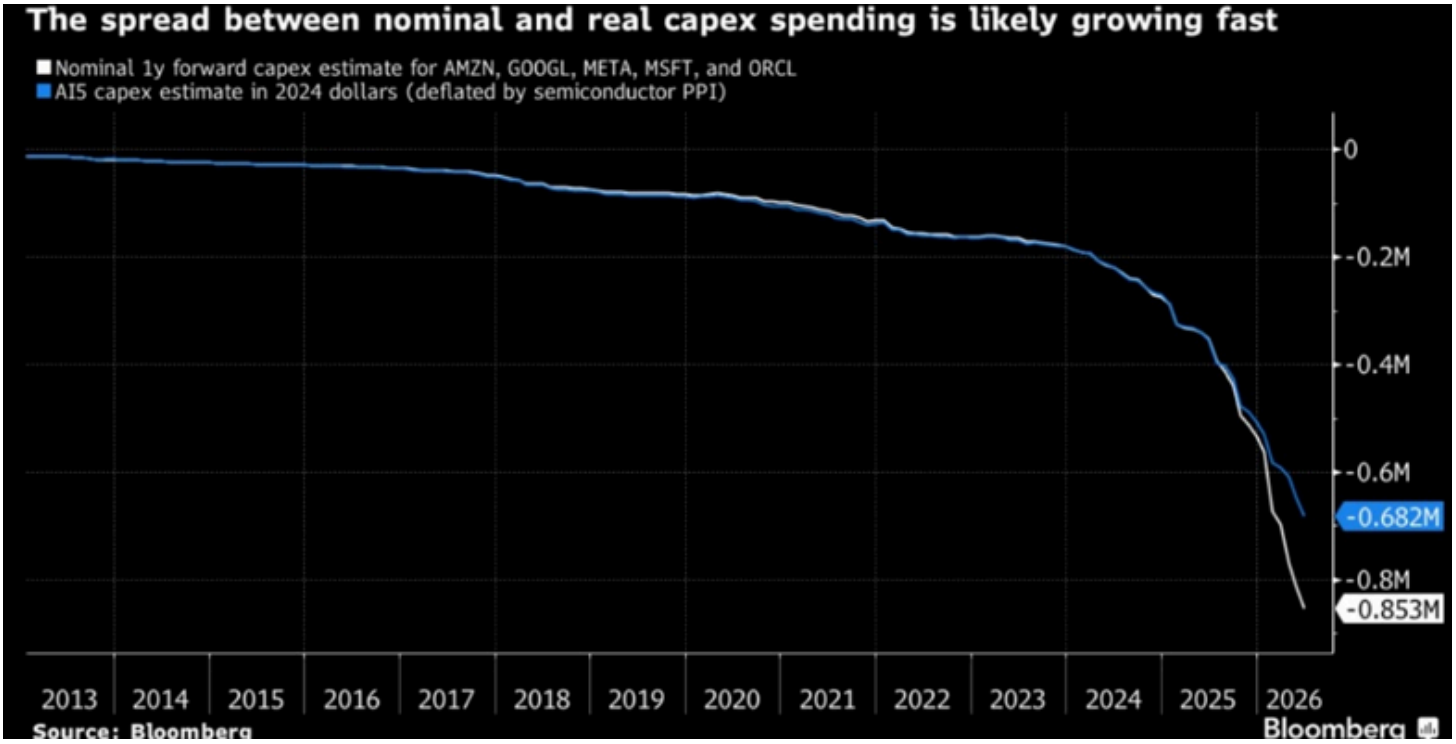


Note: assuming ~$200bn in USD hyperscaler supply for both 2026 and 2027. Hyperscalers include: AMZN, META, MSFT, GOOGL, ORCL.

Source: BofA Global Research, ICE Data indices, LLC

BofA GLOBAL RESEARCH

CHART APPENDIX



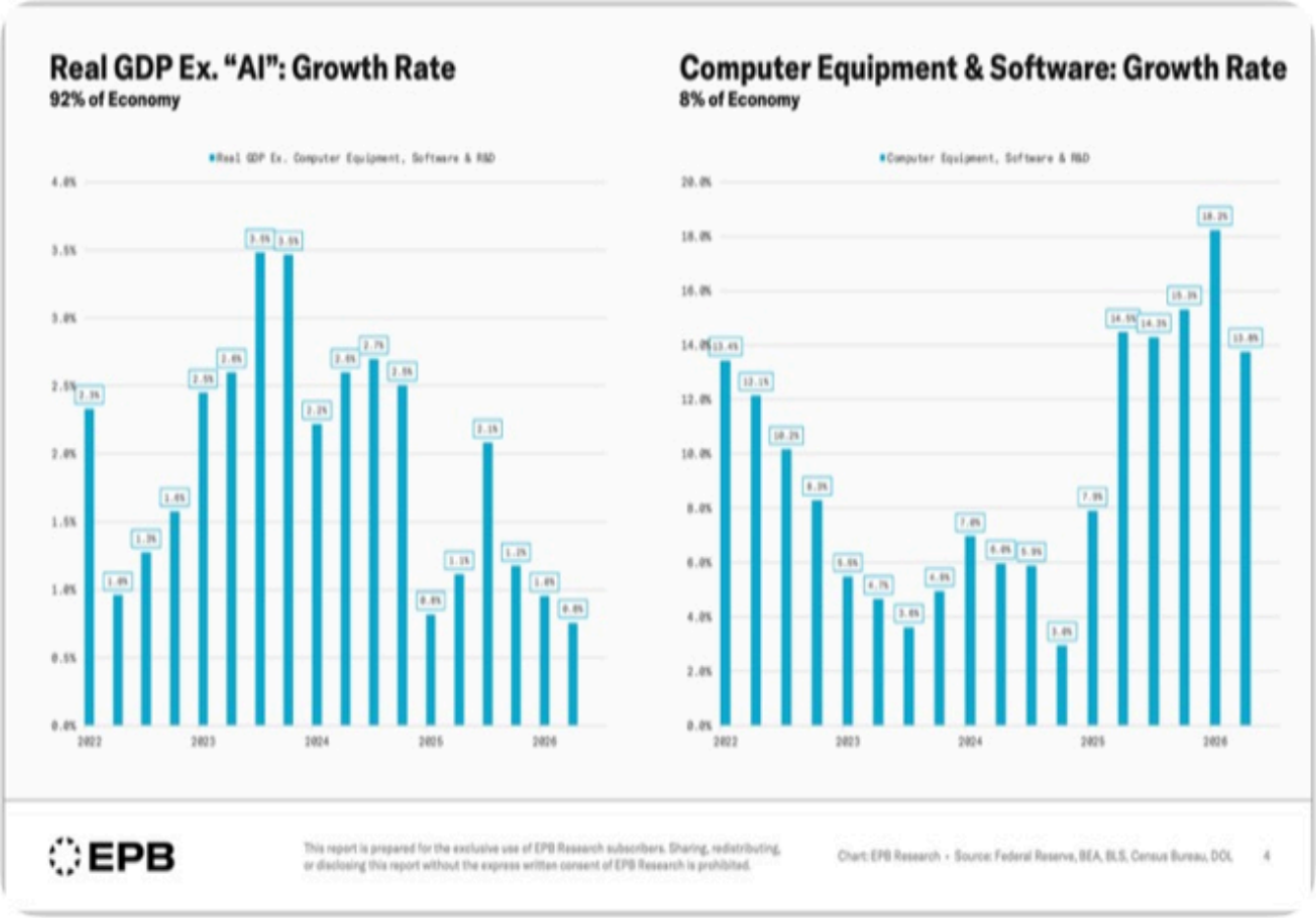
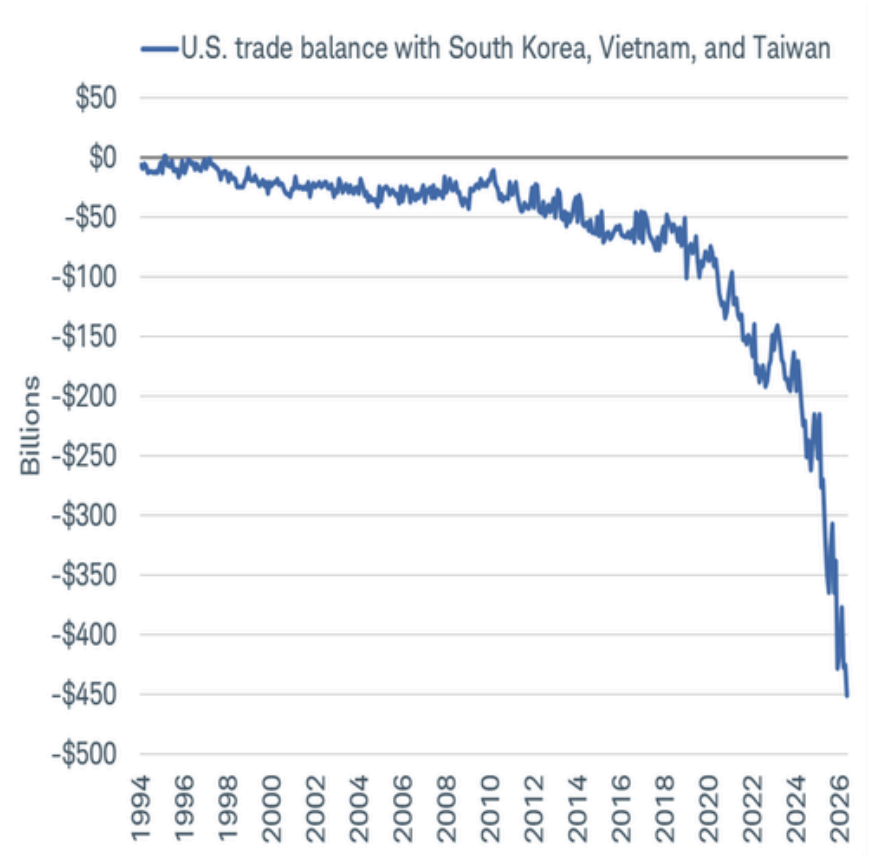


CHART APPENDIX



Source: Charles Schwab, Bloomberg, as of 5/31/2026.



Note: Seasonally adjusted, annual rate
Source: Commerce Dept.