



Odometer vs. Speedometer!

Odometer vs. Speedometer

Most people don't drive by staring at the odometer ... they watch the speedometer. The odometer tells you how far you've gone. The speedometer tells you what's happening now. Markets work in a similar fashion. The level matters, but the rate of change in both growth and inflation is what actually alters behavior, expectations, and decision making.

Every cycle has a moment when the narrative stops evolving. Inflation is assumed to be sticky. Prices are assumed to stay high. Growth is assumed to be fragile. Once assumptions harden, debate narrows ... and that is often when the data begin to diverge from perception.

For most people, inflation is not an economic theory or a policy debate ... it is a weekly routine. Filling up the car. Buying groceries. Paying the mortgage or rent. Paying insurance. When those costs stop rising as quickly, behavior changes ... even if incomes do not suddenly surge.

Over the past several months, that pressure has quietly begun to ease. Housing costs are rolling over on a rate of change basis. Energy prices have compressed meaningfully. Many food categories are no longer accelerating. These are not small details. Together, they represent the largest inputs into inflation and the most visible costs in everyday life.

IN THIS ISSUE:

- Odometer vs. Speedometer
- The math behind the heavy lifting
- Why this matters
- Economic growth ... testing the "Goldilocks" Quad 1 setup
- Consumer health and Real income ... the engine behind growth
- Looking forward
- Conclusion ... watching the right gauge

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That disconnect between what people experience, what the data are signaling, and what markets ultimately respond to is where this discussion begins.

The math behind the heavy lifting

Inflation continues to cool, not solely because prices are suddenly falling, but more so because the rate of increase keeps slowing ... both sequentially and year over year (YoY).

Headline CPI rose +0.20% month over month (MoM) in November, decelerating from the roughly +0.23% print in October and +0.28% in September, while the year over year rate fell -18 basis points from +2.92% to +2.74%.

Core inflation is telling the same disinflationary story when viewed through a rate of change lens. Core CPI increased +0.16% month over month in November, decelerating from the roughly +0.21% print in October and the +0.27% number from September, while the year over year rate slowed -39 basis points from +3.02% last month to +2.63% ... the lowest level in nearly four years.

Prices are still rising on a monthly basis, but the pace of increase continues to step down incrementally, confirming that underlying inflation pressure is easing rather than re accelerating ... this is disinflation by definition ... not theory.

The more important signal lies beneath the headline.

Shelter, which represents over one third of CPI, continues to roll over YoY as lagged rent and Owners' Equivalent Rent (OER) finally reflect what spot housing markets have been signaling for some time.

At the same time, oil ... the second largest CPI input when considering its downstream effects ... has already undergone a meaningful deceleration, with WTI crude down roughly -26% from its peak near \$80 and approximately 16 to 17% lower year over year. That compression in energy prices works its way through gasoline, transportation, and food distribution with a lag, but the direction of travel is clear.

Layer food on top of that, and the math becomes even harder to ignore. A growing list of food categories, including highly visible items like eggs, along with dairy, proteins, and several packaged goods, have seen prices roll over or materially decelerate as input costs ease and pricing power weakens.

With housing, which represents roughly 34% of CPI, slowing ... oil and energy inputs decelerating (accounting for roughly another third of CPI when downstream effects are considered) and food inflation no longer accelerating, the math becomes increasingly restrictive.

This makes it difficult to envision a meaningful re acceleration in inflation during the first half of the year ... outside of a temporary March bump driven solely by year over year base effects rather than a renewed inflationary impulse.

This backdrop is not new to us. Back in Q1 2025, when much of the commentary centered on tariffs reigniting inflation, we took the other side of consensus. Our work at the time emphasized that any apparent inflation reheat would likely be muted, narrow, and transitory, driven by base effects and timing rather than a renewed cycle of broad price acceleration.

We argued that tariffs needed time to work through the system, that producer prices were already decelerating, and that true inflationary pressure would require sustained demand and pricing power...neither of which the data supported.

That view stood in sharp contrast to the prevailing narrative from policymakers, mainstream media, and many economists who treated tariffs as inherently inflationary. Yet as the months have passed, the data have done what data tend to do...they have resolved the debate.

Housing rolled over. Oil compressed. Food inflation cooled. And the feared tariff driven inflation surge never materialized in the way consensus expected. This is precisely why our process remains anchored in rate of change analysis rather than headlines, and why staying on the other side of consensus, when supported by the data, continues to matter.

It's difficult to have read our 1Q2025 note and not come to this conclusion:

Any reheat in inflation would likely prove muted and transitory ... driven more by base effects and timing than by a renewed cycle of broad price acceleration. While tariffs may lift select goods categories briefly, the broader inflation impulse was already slowing.

We furthered this discussion in our 3Q2025 note, stating:

"Back in Q1, we wrote that any apparent reheat in inflation would be muted, tariff led, and transitory ... a base effect mirage rather than a new inflation cycle. Tariffs would lift certain goods categories briefly, but broad producer prices were decelerating, and the pass through would fade."

That history matters ... not because it proves a point, but because it frames what comes next.

Why this matters

Inflation is not just an academic exercise ... it is a primary input that shapes interest rate expectations, asset valuations, and investor behavior. When inflation is decelerating rather than reaccelerating, the

backdrop changes materially ... not because inflation disappears, but because the direction of travel shifts. Getting that distinction right matters far more than reacting to the latest headline.

As shelter, energy, and food collectively slow, the environment becomes less restrictive for consumers and businesses alike, easing pressure on real incomes and margins at the same time.

Within the Hedgeye framework, a deceleration in inflation creates the conditions for a Quad 1, *Goldilocks environment* ... with growth accelerating concurrently ... falling inflation alongside improving economic growth has historically supported risk assets, as algorithms, factor models, CTAs, volatility-controlled funds and passive flows respond to improving real growth expectations and easing price pressures.

Therefore, disinflation, when coupled with real GDP growth can be a tailwind rather than a headwind! Which begs the question...

Economic Growth ... testing the “Goldilocks” Quad 1 setup

With inflation clearly decelerating, the next and more important question becomes what is growth as measured by GDP doing?!

The most recent GDP data once again “surprised experts” as real GDP growth showed a significant acceleration in the third quarter, coming in at approximately +2.33% YoY, up from roughly +2.08% in the prior quarter, with quarter over quarter growth running north of +4.00% on an annualized basis. From a rate of change perspective, this matters more than the absolute level ... growth is not just positive ... it is re accelerating.

Digging beneath the headline, consumption was the primary driver of the acceleration. Real consumer spending remained firm, supported by improving real incomes as inflation pressures eased. This is an important distinction. Even as nominal growth moderates, disinflation allows real purchasing power to stabilize and, in some cases, improve. That dynamic helps sustain demand and supports broader economic momentum, particularly in a consumption driven economy like the U.S.

As a simple example, consider the excess capacity for Americans to spend when they are filling up the gas tank at \$2.28 per gallon vs. \$3.25 ... That’s an extra \$16 dollars in disposable income one has to spend EVERY TIME they fill up their gas tank (assuming a 16.25-gallon tank).

Now ... extrapolate that out in a country with roughly 234-million drivers and 290-million registered (cars, trucks, SUVs).

The reality is, and data supports, domestic demand ... particularly consumption ... continues to underpin growth. Business investment remains mixed, but the drag from inventories has diminished, and government spending continues to provide a steady baseline of support.

Consumer health and real income ... the engine behind growth

With growth accelerating at the headline level, the next step is to understand what is actually driving that momentum. The answer remains the same as it has for much of this cycle ... the consumer. Recent GDP acceleration was not the result of a one-time distortion or financial engineering ... it was consumption led, and that distinction matters when evaluating durability.

The most important development for consumers has been the improvement in real income dynamics. While nominal wage growth has slowed from earlier peaks, inflation has slowed faster ... that shift changes the math!

As price pressures ease, real purchasing power stabilizes and, in many cases, improves ... even without accelerating nominal income. From a growth perspective, this is supportive rather than contradictory. Consumers do not need wages to surge to keep spending if the cost of living is no longer rising at the same pace as we illustrated in the gasoline example above.

This pressure relief shows up directly in consumption behavior. Spending has remained resilient, particularly across services, where demand tends to be more stable and less sensitive to short term price swings.

Lower inflation in essentials such as housing related costs, energy, and food frees up marginal dollars that can be redirected rather than withdrawn from the system. That dynamic does not require excess optimism ... it simply requires conditions to stop deteriorating.

Importantly, this is not a story of consumer excess. Balance sheets are not uniformly strong, and spending growth is uneven across income cohorts. But the consumer does not need to accelerate spending aggressively to support GDP growth ... stabilization alone can sustain expansion when inflation is decelerating. That is exactly what the most recent data suggest.

As long as real incomes continue to benefit from easing price pressures, consumption remains capable of supporting growth at the margin. Whether that support strengthens or fades will depend less on sentiment and more on the interaction between inflation, employment, and income ... which ultimately determines how much capacity consumers have to keep spending.

Looking forward

The growth trajectory implied by the data remains constructive in the near term. The current path points to continued acceleration into the fourth quarter and early next year, with growth expected to remain above trend before moderating later in the cycle.

At the same time, growth and inflation do not move in straight lines. Even within a supportive quarterly backdrop, shorter term shifts in the rate of change can create meaningful swings in market behavior. These transitions are not simply noise ... they often reflect real changes in how growth and inflation are interacting beneath the surface, showing up first in volatility, then in factor rotation, and eventually in market leadership.

Periods where growth is accelerating alongside easing inflation tend to support broader risk appetite, often accompanied by contracting volatility. From an investing regime perspective, this is what we refer to as a Goldilocks environment, or Hedgeye Risk Management Quad 1 ... and it is the environment the data have been transitioning toward in recent weeks.

So long as inflation continues to decelerate and growth does not meaningfully roll over, the near-term setup remains more constructive than prevailing narratives suggest. That does not mean risks disappear. A mild reacceleration of inflation in March driven by base effects could create short term volatility, rotation, and leadership shifts that will need to be actively risk managed.

The reality is that no one knows precisely how those short-term dynamics will play out. That uncertainty is exactly why we focus on signals rather than forecasts. In markets dominated by algorithms, factor exposures, and passive flows, shorter term momentum signals alongside longer term trend signals have become increasingly important for navigating regime shifts given the moves have become ever so violent, with rallies being progressively more narrow in breadth in recent years.

Markets respond to changes in the data well before they show up in earnings reports or headlines. Appreciating how and when these transitions occur helps provide context for volatility and reduces the temptation to overreact to every pullback or narrative shift.

At the same time, these rallies where positive returns are distributed to a much smaller group of individual equities due to the proportion in which they are held within indices given their exposure to a larger number of ETFs, thus ... passive flows, have had us adjust our models to be more active at the index and sector levels.

The headline story matters far less than the speed of change underneath it. When the data are improving at the margin ... even if the world still feels messy ... markets often respond long before consensus does. The adjustments we've made reflect today's ever changing and extremely dynamic landscape.

Conclusion ... watching the right gauge

At the beginning of this note, we said markets work a lot like driving ... the odometer tells you where you have been ... but the speedometer tells you what is happening now. That distinction matters because the world is still anchored to the odometer. Prices are still higher than they were a few years ago ... but markets and economies do not turn on what feels familiar ... they turn on what is changing.

The rate of change data are telling a more constructive story. Inflation is decelerating meaningfully in the areas that matter most to households ... housing, energy, and food. That easing in pressure is not just a CPI input ... it is real cash flow for consumers. When people are no longer getting squeezed at the gas pump and the grocery store at the same pace ... spending and demand tend to hold up better than consensus expects ... and that supports growth.

In a market dominated by passive flows, factor exposures, algorithms, and systematic strategies, these shifts can matter even more. The market does not need perfection ... it needs incremental improvement. Less bad is not a consolation prize ... it is often the early stage of what becomes good.

None of this means we fall asleep at the wheel. The road will not be smooth. There will be windows where inflation appears to reaccelerate on a year over year basis ... and where volatility and leadership rotate. The job is not to be surprised by those moments ... it is to anticipate them, measure them, and respond with discipline.

So, as we move forward, the question is simple ... are you watching the odometer ... or the speedometer?!

This is exactly the type of environment where process matters more than predictions. At Other Side Asset Management, our work begins by understanding the full financial picture – not just portfolios, but income, expenses, taxes, insurance, and long-term planning – and stress testing those decisions across different market regimes. Whether markets feel calm or chaotic, our goal is the same: help families make confident decisions grounded in data, discipline, and a plan designed for real life.

If you'd like to see how this framework applies to your own situation, we offer a complimentary, comprehensive retirement income plan – no obligation, no product pressure – simply clarity.

As always ... Good investing!



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