Weekly CIO Letter

21 JULY 2026

Disinflation Without Contraction

June delivered a more favorable inflation mix without clear evidence of an economic break.

ASTRO WALLENIUS INVESTMENTS

Executive Summary

The latest U.S. economic data delivered a combination that financial markets have been waiting for: inflation slowed materially, while productive activity remained broadly intact.

Consumer prices declined by **0.4% in June**, the largest monthly decrease since April 2020. Core inflation, excluding food and energy, was unchanged during the month. Over twelve months, headline inflation slowed from 4.2% to **3.5%**, while core inflation declined from 2.9% to **2.6%**.

Producer prices also fell during the month, largely because of lower energy and goods prices. Yet annual producer inflation remained elevated, showing that the disinflation process is progressing unevenly through the economy.
At the same time, industrial production increased slightly in June and expanded at a 4.0% annualized rate during the second quarter. Capacity utilization remained below its historical average, suggesting that the economy still has room to grow without immediately recreating broad inflationary pressure.

The macroeconomic mix has improved. Inflation is cooling without a corresponding collapse in activity.

That is constructive. It is not yet an all-clear signal.

1. Inflation Relief Is Broader Than the Headline

The most visible development in June was the sharp reversal in energy prices.

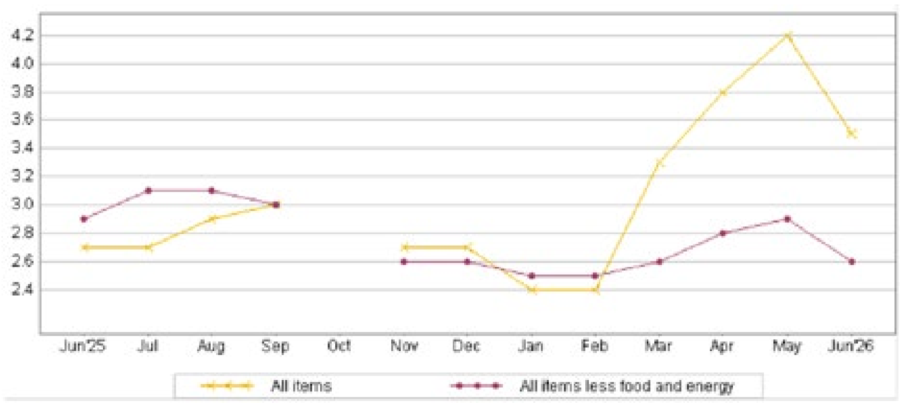
The energy component of the Consumer Price Index fell **5.7%** during the month, including a 9.7% decline in gasoline prices. This more than offset modest increases in food and shelter.

However, the report was not exclusively an energy story.
Core consumer prices were unchanged, services excluding energy were also unchanged and shelter inflation slowed to **0.1%**, its smallest monthly increase since January 2021. Several previously persistent categories—including motor vehicle insurance, medical care and transportation services—declined during the month.

This suggests that disinflation is beginning to broaden beyond volatile commodity components.

The distinction is important. A temporary fall in energy prices can reduce headline inflation quickly. A sustained reduction in shelter and service inflation is more relevant to the medium-term policy outlook.

12-month percent change in CPI for All Urban Consumers



Source: U.S. Bureau of Labor Statistics

NOTE: The Oct 2025 data values are not available due to the 2025 lapse in appropriations.

2. Producer Inflation Reveals the Remaining Fault Line

The producer-price data delivered a similar monthly message, but a less reassuring annual one.

The Producer Price Index for final demand declined **0.3% in June**, following increases of 0.6% in May and 1.1% in April. Prices for final-demand goods fell 1.4%, while prices for final-demand services increased 0.2%.

The decline in goods prices was heavily influenced by energy. Final-demand energy prices fell 6.4%, with gasoline prices declining 12.0%. By contrast, several service categories, including financial and retailing margins, continued to increase.

The annual picture remains less benign.

Final-demand producer prices were **5.5% higher** than a year earlier. Final-demand goods inflation stood at 7.9%, while services inflation was 4.6%. The index excluding food, energy and trade services increased 5.1% over twelve months.

The inflation impulse has weakened at the margin, but businesses are still operating with materially higher input and service costs than a year ago.

This creates an important distinction for investors. Lower monthly inflation may improve market sentiment quickly, but corporate margins depend on whether cost relief persists and whether companies can maintain pricing without damaging volumes.

Selected PPI final-demand price indexes

Chart 1. One-month percent changes in selected PPI final demand price indexes, seasonally adjusted

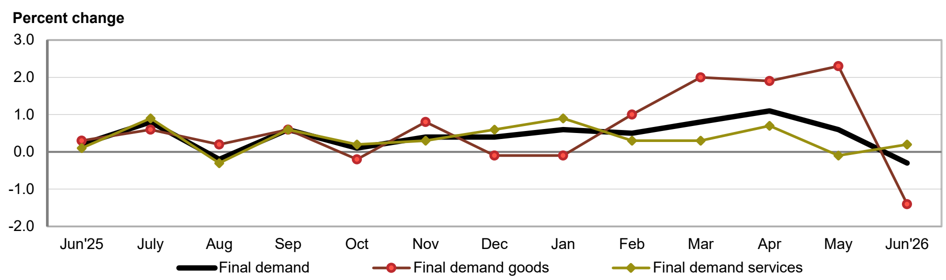
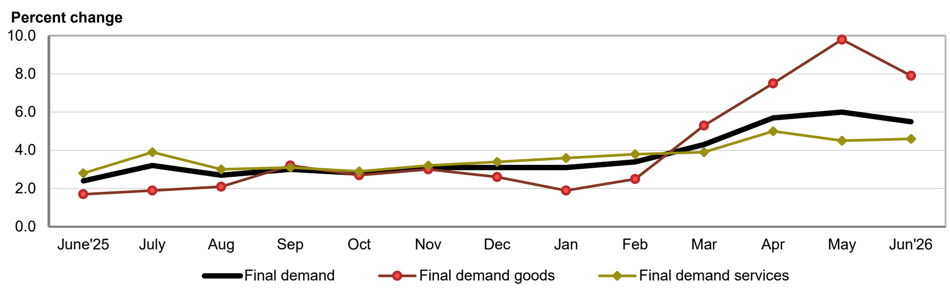


Chart 2. Twelve-month percent changes in selected PPI final demand price indexes, not seasonally adjusted



Source: U.S. Bureau of Labor Statistics

3. Industrial Activity Has Not Broken

Inflation moderation would be less constructive if it were accompanied by a rapid contraction in productive activity. The June industrial report does not show such a break.

U.S. industrial production increased **0.1% in June** and expanded at a 4.0% annualized rate during the second quarter. Manufacturing output was unchanged in June but increased at a 4.7% annualized rate over the quarter.

Total industrial production was 1.1% higher than a year earlier. Business-equipment production was 5.4% higher, while mining output increased 2.4%. Consumer-goods production remained weaker, declining 1.2% over twelve months.

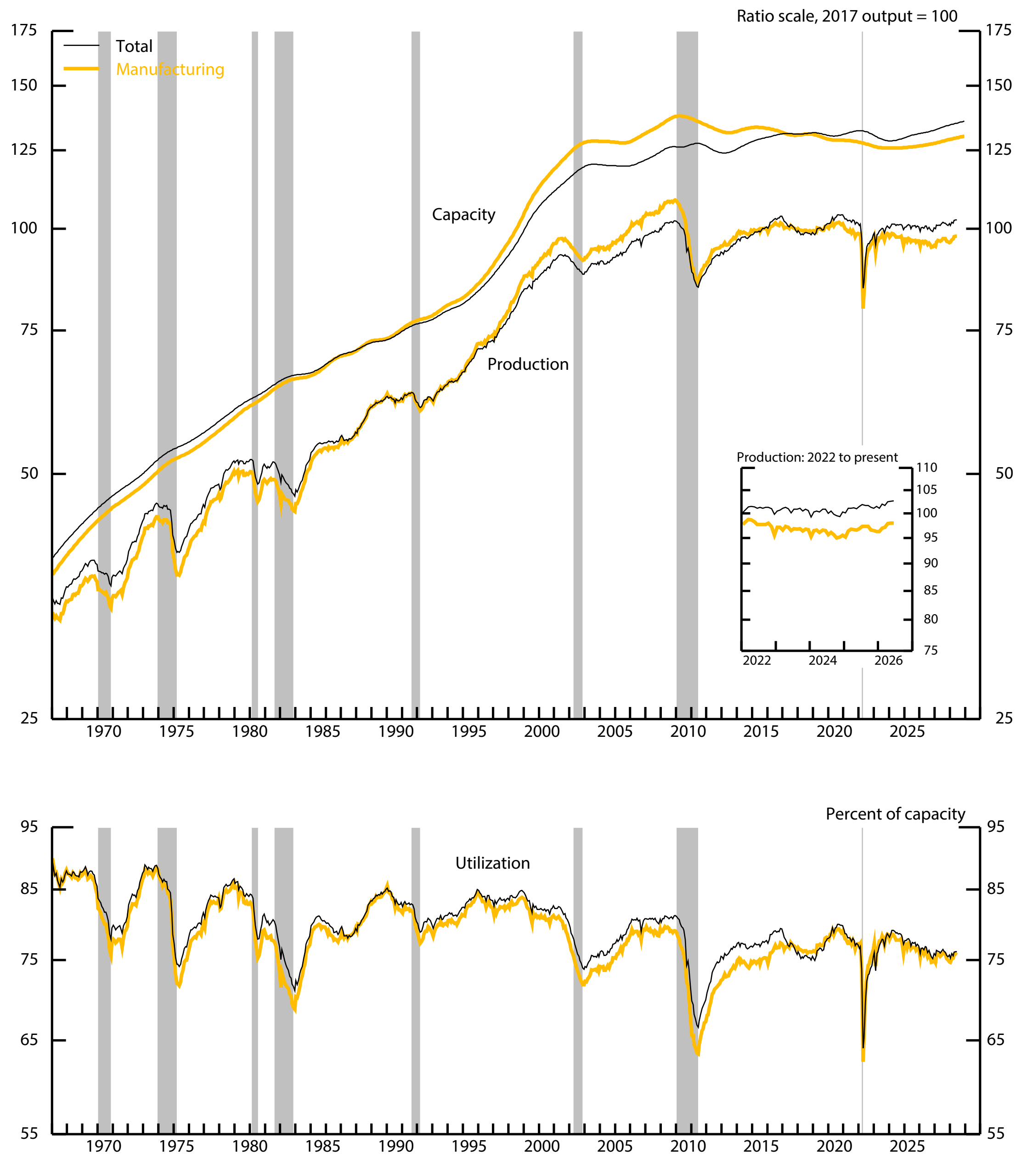
The economy is not operating at full industrial capacity.

Total capacity utilization stood at **76.1%**, 3.3 percentage points below its long-term average. Manufacturing utilization was 75.7%, 2.5 percentage points below its historical average.

This combination—positive output growth and below-average capacity utilization—indicates moderate expansion rather than overheating.

It also helps explain why inflation can slow without requiring an immediate collapse in production or employment.

Industrial Production, Capacity and Utilization



Source: Board of Governors of the Federal Reserve System

Implications for Markets and Portfolios

Fixed Income

Slower inflation improves the risk profile of high-quality fixed income. It reduces the probability that investors will require progressively higher inflation compensation across the entire yield curve.

However, the persistence of annual producer inflation argues against treating one month of favorable data as confirmation of a rapid or uninterrupted monetary-easing cycle.

A balanced duration profile remains more defensible than a portfolio built around a single, categorical policy forecast.

Global Equities

The environment is becoming more favorable for companies capable of converting lower input costs into stronger margins.

The benefit will not be evenly distributed.

Businesses with weak pricing power may pass cost relief directly to consumers. Companies facing rising service, labor or financing expenses may experience less margin improvement than headline inflation suggests.

Balance-sheet strength, cash generation and operating efficiency remain more important than broad exposure to economic growth alone.

Real Assets and Inflation Protection

The decline in energy prices materially improved the June inflation data. It also demonstrates how rapidly the inflation outlook can change when commodity prices reverse.

Inflation-sensitive assets may remain useful as portfolio insurance, but their role should be calibrated rather than based on a permanent assumption of rising energy prices.

Portfolio Construction

A more favorable macroeconomic mix should not be interpreted as a reason to abandon diversification.

The appropriate response is to improve portfolio resilience:

- preserve exposure to high-quality fixed income;
- avoid excessive concentration in companies dependent on aggressive pricing;
- retain selective inflation protection;
- maintain sufficient liquidity for rebalancing.

Risks to the Central Thesis

The first risk is that the June inflation decline proves temporary. Energy remains 15.7% more expensive than a year earlier, and another supply disruption could quickly reverse the monthly improvement.

The second is that producer inflation is passed through to consumers with a delay. Annual final-demand inflation remains substantially above the current core consumer-inflation rate.

The third is that industrial data overstate the strength of the broader economy. Industrial production covers manufacturing, mining and utilities, while services account for a much larger share of U.S. economic activity.

The fourth is that below-average capacity utilization reflects weak demand rather than healthy spare capacity. If production growth slows further, the current disinflation process could become associated with broader economic deterioration.

The current evidence supports moderation, not complacency.

At Astro Wallenius, we believe the most relevant development this week was not simply that inflation declined.

It was that inflation declined while productive activity remained positive.

This distinction matters.

Markets often interpret weaker inflation as evidence of weaker growth. June's data presented a more constructive alternative: energy and goods prices reversed, core consumer inflation moderated and industrial production continued to expand. The improvement is meaningful, but incomplete.

Annual producer inflation remains elevated. Services costs remain persistent. Industrial capacity is underutilized, but not uniformly strong. One favorable month cannot resolve these tensions.

The most credible interpretation is that the economy is moving toward a better balance between inflation and activity—not that the cycle has become risk-free.

For long-term investors, this environment rewards measured adjustments rather than aggressive repositioning.

The objective is to participate in improving fundamentals while preserving protection against the possibility that inflation, energy markets or policy expectations reverse again.

Final Thoughts

Disinflation is most valuable when it arrives without destroying demand, investment or productive capacity.

June moved the economy closer to that outcome.
Whether the improvement becomes durable will depend less on one headline number and more on three conditions:

- whether service inflation continues to moderate;
- whether producer costs stop feeding into final prices;
- whether activity remains positive without renewed capacity pressure.

For now, the evidence supports cautious optimism.
Not certainty.

Weekly CIO Letter

21 JULY 2026

ASTRO WALLENIUS INVESTMENTS

astrowallenius.com

Meydan Grandstand - 5853+R78 - D69 - Nadd Al Shiba First
Dubai - United Arab Emirates