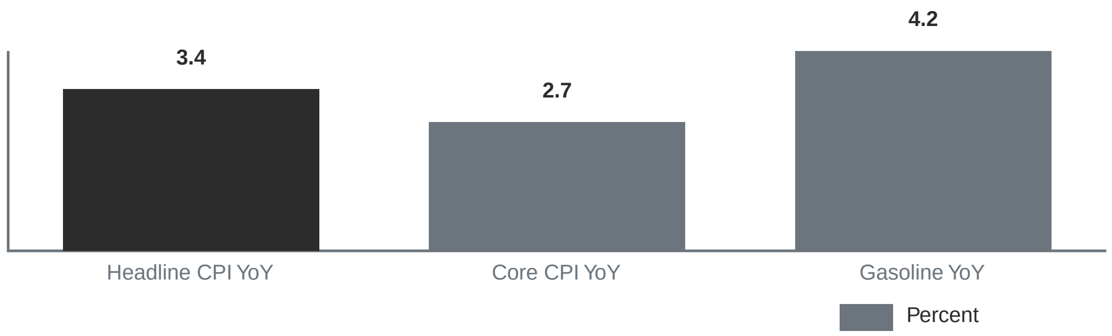
Stagflation Stress Test: Oil, Services CPI, and the Cross-Asset Playbook

Research Team *May 19, 2026*

Entering the third week of May 2026, markets face a configuration that policy makers dread and portfolio managers must plan for: rising headline inflation from energy, sticky core services, and labor data that is cooling but not collapsing. The Federal Reserve held at 3.5% to 3.75% in May with a live June meeting; oil remains elevated on Gulf supply risk; supercore services have decelerated only gradually. This is not 1970s stagflation, but a stagflation-lite stress test, growth positive yet slowing, inflation above target with mixed drivers, and the Fed constrained from both cutting aggressively and hiking. This report builds on our oil-shock and FOMC work with an integrated scenario matrix and cross-asset positioning guide.

May 2026 Inflation Snapshot (Illustrative)



Source: Illustrative; BLS and energy components (May 2026)

Key Takeaways:

• Headline CPI can rise on oil while core services remain sticky, creating a policy bind that delays cuts even as growth momentum softens.

• **Three scenarios dominate:** soft landing with oil fade, sticky inflation with hold, and growth scare plus oil spike (worst-case for 60/40).

• Nominal bonds face two-sided risk; TIPS and gold help when inflation and geopolitics compound; energy equities hedge supply tails.

• Equities favor quality, pricing power, and defensives over rate-sensitive cyclicals in the base sticky-inflation case.

• **Portfolio takeaway:** barbell inflation hedges (gold, energy, TIPS) with quality equities and front-end carry, avoid naked long duration until core confirms.

Executive Summary

Stagflation-lite means the Fed cannot easily declare victory on inflation or growth. Supply-driven energy moves lift headline CPI and consumer pain indices; core ex energy progress is real but uneven in services. Labor markets show normalization, slower hiring, stable layoffs, without a recession signal. Markets price a reduced June cut probability when gasoline rises, even after soft payrolls. Cross-asset correlations become unstable: equities and nominal Treasuries can both struggle if growth and inflation disappoint together. The playbook favors hedges that work when policy is stuck, plus equity quality that survives margin compression.

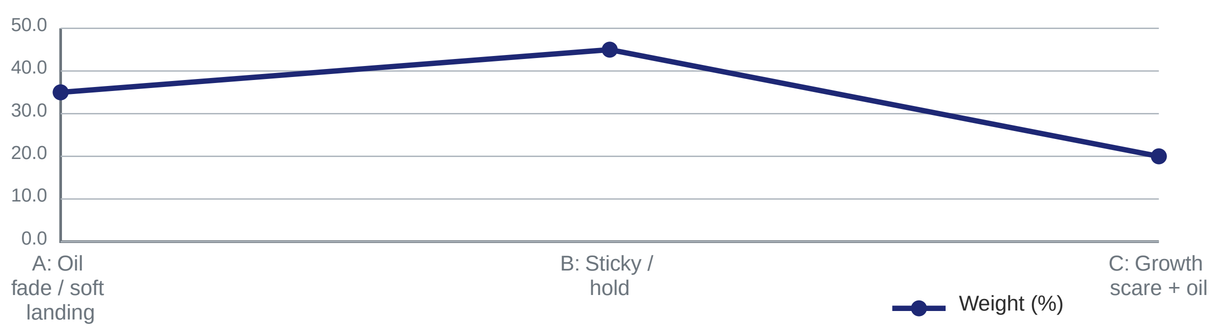
The Stagflation-Lite Inputs

Oil and gasoline pass through to headline CPI with a short lag; a sustained $15 to $20/bbl move from pre-shock levels can add several tenths to annual headline inflation over two to three months. Core services, shelter, insurance, medical, and other sticky categories, have cooled from 2024 peaks but remain above pre-pandemic norms. Wages are growing slower than in 2022 to 2023 but still above productivity in some sectors, limiting rapid disinflation. Real consumer spending has held up thanks to balance sheets and labor income, but confidence surveys reflect gasoline and political uncertainty.

Scenario Matrix: Three Paths Into June

Scenario A , Soft landing, oil fade: Diplomatic progress or supply relief pulls crude lower; headline CPI eases while core continues gradual disinflation. June cut or strong dovish hold; bull steepening, quality growth and duration rally. Scenario B , Sticky inflation, hold: Oil stays firm, core services sticky, labor merely normalizes. Fed holds with patient language; front-end supported, belly volatile, equities range-bound with high dispersion, energy and gold outperform cyclicals. Scenario C , Growth scare plus oil spike: Payrolls weaken sharply while energy re-accelerates, the worst mix for traditional 60/40. Defensives, gold, and short duration outperform; credit spreads widen selectively.

Scenario Probability Tilt (Illustrative, Late May 2026)



Source: Illustrative; AVANTAS Research Analysis

Cross-Asset Implications by Scenario

Nominal Treasuries: Scenario A favors duration; B and C favor barbell and front-end carry over long bonds. TIPS and breakevens: rise with oil and de-anchoring risk in B and C; partial give-back in A. Equities: quality and pricing power win in B; cyclicals need A; C favors staples, utilities, health care. Credit: IG quality holds in A and B; HY vulnerable in C. Commodities: energy tactical overweight in B and C; gold strategic hedge across scenarios. FX: dollar mixed, haven demand vs rate differential; EM fragile in C.

Portfolio Toolkit: Hedges Beyond Oil

Gold for policy and geopolitical tails; energy equities for supply risk with earnings leverage; TIPS when realized inflation validates breakeven moves; reduce naked long-duration when oil and breakevens rise together. Equity overlays: overweight quality, underweight airlines and margin-sensitive consumer discretionary; consider low-beta factors in Scenario C. Rebalance triggers: large moves in oil, Michigan inflation expectations, and two consecutive core CPI surprises.

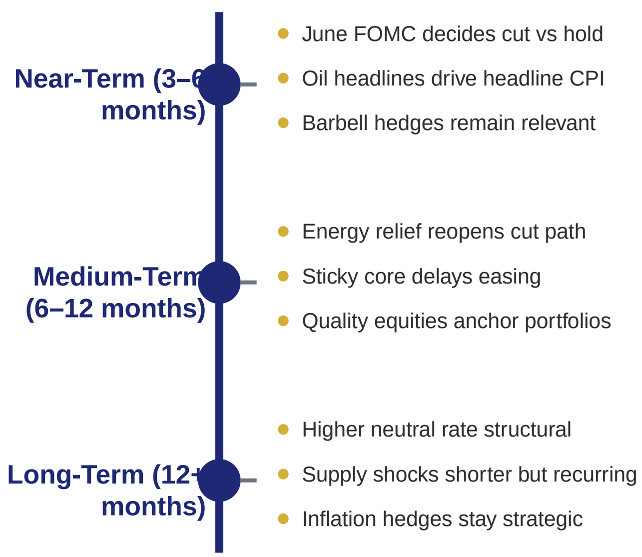
What to Watch Before June FOMC

May CPI and PCE (headline vs core); payrolls, unemployment, and jobless claims; gasoline retail prices and WTI; Michigan and market-based inflation expectations; Fed speakers on look-through vs persistence; credit spreads and equity volatility for growth-scare signals.

Timeline and Outlook

Near-term (3 to 6 months): June FOMC and summer data decide whether Scenario A or B dominates; oil headlines remain pivotal. Medium-term (6 to 12 months): If energy normalizes and core converges, traditional cut-and-rally dynamics return; persistence keeps barbell and hedge weights elevated. Long-term (12+ months): Supply diversification and energy transition reduce but do not eliminate shock frequency; higher neutral rates remain structural.

Timeline Overview



Source: AVANTAS Research Analysis

Risk Factors

Escalation keeping oil elevated through summer; de-anchored inflation expectations; labor shock forcing cuts into sticky CPI; credit event amplifying growth scare; fiscal surprises widening term premium.

Conclusion

Stagflation-lite is the base case for late May, not recession, not clean disinflation. Position for policy stuck in the middle: inflation hedges, quality equities, and barbell rates until data resolves the June window.

Asset Class Impact

Nominal Treasuries: Neutral barbell; tactical duration only on soft inflation prints. TIPS: Neutral to overweight. Gold: Overweight hedge. Energy equities: Overweight tactical. Quality equities: Overweight. Cyclicals / airlines: Underweight in base case. IG credit: Neutral quality. HY: Underweight or selective. USD: Neutral.

Asset Class Impact

Underweight · Neutral · Overweight

Asset	View	Commentary
Nominal Treasuries	Neutral	Neutral barbell. Two-sided when breakevens rise.
TIPS	+1	**Neutral to overweight if inflation persists.**
Gold	+1	**Overweight. Policy and geopolitical hedge.**
Energy Equities	+1	**Overweight tactical. Supply and earnings beta.**
Quality Equities	+1	**Overweight. Pricing power in sticky CPI.**
Cyclicals / Airlines	-1	**Underweight base case. Margin squeeze.**
IG Credit	Neutral	Neutral quality.
HY Credit	-1	**Underweight or selective. Vulnerable in Scenario C.**

Source: AVANTAS Research Analysis