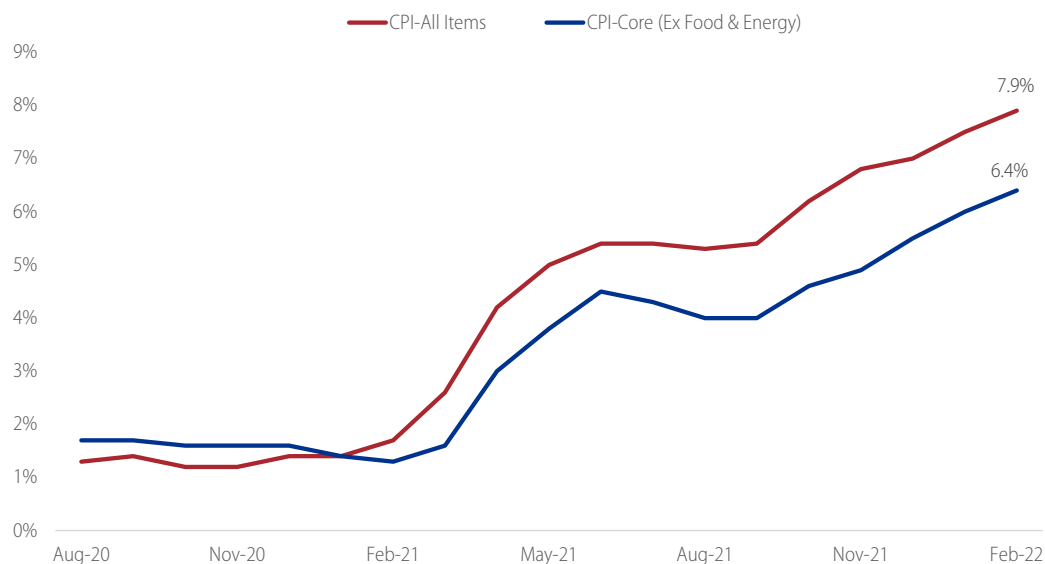


CPI Climbs, but Even Higher Prices Still Ahead

The headline consumer price index (CPI) rose +0.8% in February and +7.9% year-over-year, *yet another 40-year high*. Major contributors to the headline gain last month were gasoline prices (+6.6%), food at home (+1.4%) and rent of shelter (+0.6%). All three of these categories are expected to rise further, suggesting overall CPI is almost certain to climb well above +8.0% in March. Other notable increases last month included airfare (+5.2%) and lodging (+2.2%), both highlighting the sharp decline in COVID cases and a corresponding increase in travel. On a positive note, new car and truck prices rose by just +0.3% in February, while used vehicle prices actually declined by -0.2% and are now up by "just" +41.2% year-over-year.

Core CPI (excluding food and energy), rose +0.5% for the month and +6.4% year-over-year, *also the highest level in nearly four decades*. Both of these matched the median forecast. In a sense, the core increase may be a bigger concern as it factors out the more volatile components and better reflects true inflation. Like headline CPI, the core probably hasn't peaked. The biggest contributor (shelter cost) promises to accelerate in the coming months as rental prices across the nation continue to move higher.

Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

The Fed's in a tough spot, now just days away from the March FOMC meeting. The fact that CPI was no higher than forecast provides some comfort, but with WTI crude surging from \$95 per barrel at the end of February to close at \$123.70 on Tuesday, the March inflation reading could be quite alarming. On the other hand, with gasoline up +25% over just the past 30 days to an average of \$4.32, consumers will certainly feel the pinch. A sharp spike in pump prices has historically signaled recession on the horizon. As Fed officials hike rates to slow demand, they'll need to be mindful of the

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Director
512.481.2012
greg.warner@hilltopsecurities.com

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fact that the economy has already begun to weaken. The Atlanta Fed's most recent *GDPNow* measure for the first quarter showed a +0.5% rate of growth. On a related note, inflation-adjusted weekly earnings were down -2.6% in February, indicating that rising prices are consuming recent wage increases and hampering spending capacity.

With all of this in mind, Fed officials are still expected to announce a 25 basis point increase in the overnight funds rate next Wednesday. The March meeting will also provide an updated dot plot. Although the Fed's interest rate outlook seldom comes to pass, it will give us an indication of their current mindset.

On the other side of the Atlantic, the European Central Bank unexpectedly announced it would begin winding down its asset purchases in May and expects to complete the taper as soon as the third quarter. The ECB was less clear about the timing of any rate hikes. ECB President Christine LaGarde called the Russian invasion of Ukraine a "watershed moment" for Europe and indicated substantial upside risk to inflation, in particular energy prices. Like the Fed, the ECB recognizes the importance of getting inflation under control, *or at least creating a hawkish appearance*. At the same time, Europe is facing an even more severe economic impact. Goldman Sachs reported earlier this week that it expects second quarter GDP growth in Europe to be *negative*. Tightening rates during a recession would be highly unusual, but not unprecedented.

Bond yields are higher in early trading with the 10-year Treasury note climbing back above 2% for the first time in almost a month. Stocks were up briefly in early trading, but have since retreated. *If there's one certainty right now, it's that volatility isn't going anywhere.*

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Market Indications as of 10:01 A.M. Central Time

DOW	Down -357 to 32,929 (HIGH: 36,800)
NASDAQ	Down -274 to 12,981 (HIGH: 16,057)
S&P 500	Down -47 to 4,231 (HIGH: 4,797)
1-Yr T-bill	current yield 1.15%; opening yield 1.08%
2-Yr T-note	current yield 1.72%; opening yield 1.67%
3-Yr T-note	current yield 1.89%; opening yield 1.84%
5-Yr T-note	current yield 1.94%; opening yield 1.88%
10-Yr T-note	current yield 2.00%; opening yield 1.94%
30-Yr T-bond	current yield 2.38%; opening yield 2.33%

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