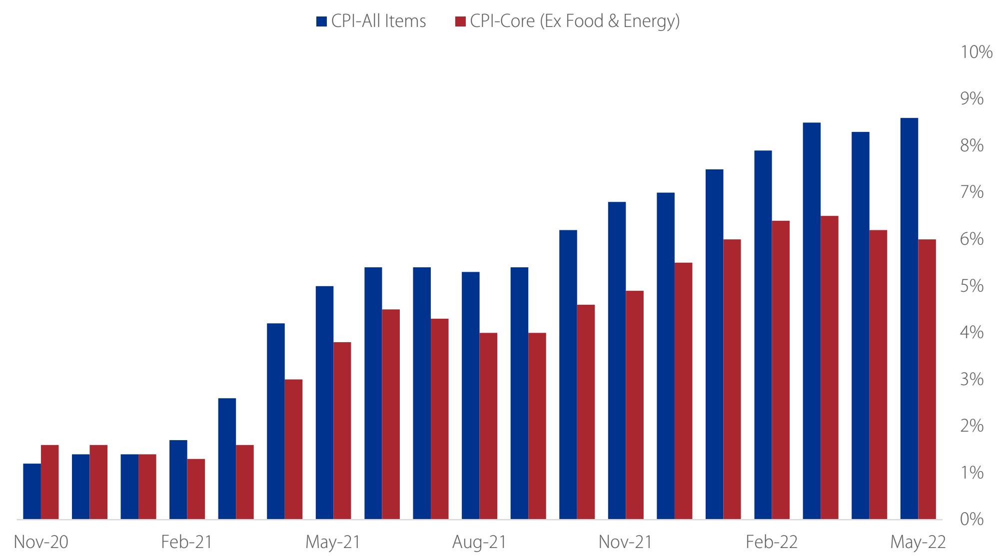
Markets Tumble as Inflation Reaches Another 40-year High

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

Stocks and bonds continued to sell off after headline consumer prices reached a new four-decade peak in May. The overall consumer price index (CPI) climbed +1.0% last month, well above the +0.7% median forecast and more than tripling the April increase. On a year-over-year basis, overall CPI rose from +8.2% to +8.6%, the highest since 1981.

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



Source: Bureau of Labor Statistics

Most analysts were expecting prices to heat up after a somewhat tepid April report which had benefited from a brief cooling of energy prices. In May, energy resumed its ascent, led by a +4.1% increase at the pump. On a year-over-year basis, gasoline is up an alarming +48.7%. The optics of this increase continue to drive inflation expectations, and given the fact that the price of gas has reached fresh highs in early June, it isn't out of the question that headline CPI grinds even higher.

Given the fact that the price of gas has reached fresh highs in early June, it isn't out of the question that headline CPI grinds even higher.

The May increase was broad-based with overall energy up +3.9% (34.6% year-over-year), shelter costs +0.6% (5.5% yoy), new vehicles +1.0% (12.6% yoy), used vehicles +1.8% (16.1% yoy) and food +1.2% (10.1% yoy).

The *food at home* category was up +1.4% during the month, double the increase of *food away from home*. This suggests the average American can't dodge higher food prices by simply not eating out.

The food at home category was up +1.4% during the month, double the increase of food away from home. This suggests the average American can't dodge higher food prices by simply not eating out.

Core CPI, which excludes food and energy prices, rose +0.6% in May and is now up +6.0% on a year-over-over basis, a slight decline from the +6.2% April print, but above the +5.9% forecast. The core is driven primarily by the cost of shelter, another

Please see disclosure starting on page 2

category that isn't likely to turn lower this summer.

This was an ugly report. Inflation is still far too hot, and the markets are turning to the Fed to douse the fire. Fed officials recognize the overriding problem is a lack of supply, but they can only influence the demand side. After enacting the first 50 bp hike in over 20 years at the May FOMC meeting, Fed officials have telegraphed 50 bp increases for both the June 15 and July 27 meetings. These moves have been effectively priced-in for months. The prevailing thought had been that by the September meeting, prices would have cooled down enough that the committee would be able to decelerate to quarter point increases going forward. *This morning's data doesn't support that scenario.*

This was an ugly report. Inflation is still far too hot, and the markets are turning to the Fed to douse the fire.

After digesting today's report, the bond market has now fully priced in 50 bps moves in June, July and September, with almost 225 bps of tightening between now and year end. The Fed meets next week, and the market's attention will be focused on what Chairman Jay Powell says Wednesday afternoon at the post-meeting press conference. Despite today's uncomfortable report, a 75 basis point increase isn't likely next week but Powell could set the table for more aggressive action in the coming months.

After digesting today's report, the bond market has now fully priced in 50 bps moves in June, July and September, with almost 225 bps of tightening between now and year end.

Market Indications as of 9:27 A.M. Central Time

DOW	Down -774 to 31,499 (HIGH: 36,800)
NASDAQ	Down -367 to 11,387 (HIGH: 16,057)
S&P 500	Down -108 to 3,910 (HIGH: 4,797)
1-Yr T-bill	current yield 2.40%; opening yield 2.25%
2-Yr T-note	current yield 2.96%; opening yield 2.82%
3-Yr T-note	current yield 3.13%; opening yield 3.01%
5-Yr T-note	current yield 3.18%; opening yield 3.08%
10-Yr T-note	current yield 3.11%; opening yield 3.05%
30-Yr T-bond	current yield 3.18%; opening yield 3.17%