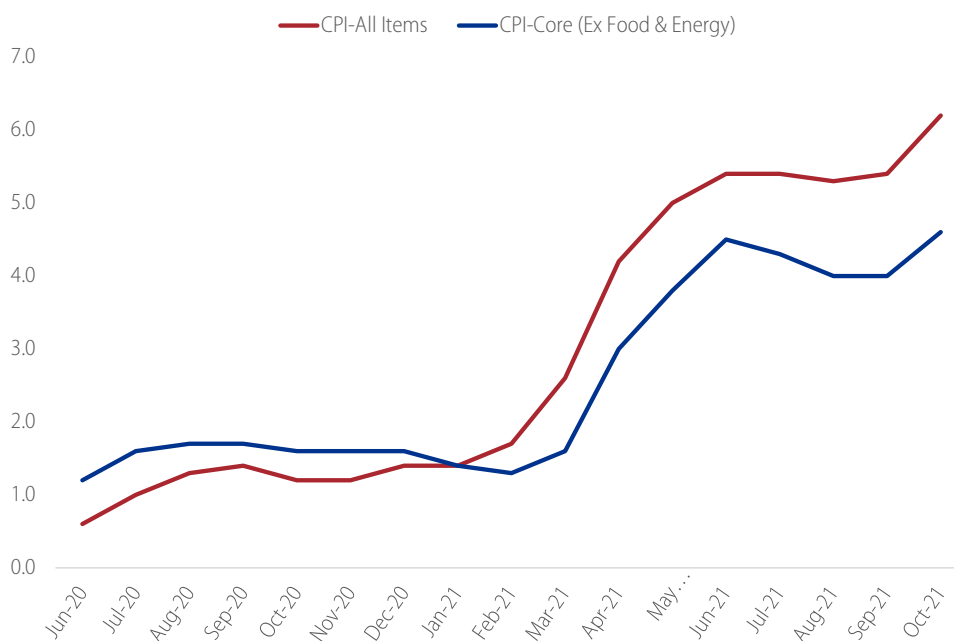


## Bond Yields Rise as Consumer Inflation Heats Up

The headline consumer price index jumped +0.9% in October, matching the largest single month gain in more than 13 years, while core CPI rose +0.6%, the highest in four months. Both October increases were well above the median forecast. On a year-over-year basis, headline CPI climbed +6.2% to a three-decade high, and *more than quadruple the +1.4% pace from just nine months earlier*. Core CPI, which excludes the volatile food and energy components, was up +4.3% on an annual basis, the most in 30 years.

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



Source: Bureau of Labor Statistics

Prices were up across all major categories, defying the Fed’s transitory assertion, although the majority of significant cost increases were clearly pandemic-related. Prices on new and used cars continued to climb as the global microprocessor squeeze keeps the vehicle supply frustratingly light. The chip shortage is generally expected to last *at least another year*, although analyst firm IDC warns that this lack of supply could flip to an oversupply by 2023 as new production facilities are fired up.

Energy prices were up +4.8% for the month, *contributing a third of the headline gain*. Within the energy category, gasoline prices jumped another +6.1%, while fuel oil prices rose by +12.3%, the most since 2007. As winter approaches, few expect the cost of energy to retreat.

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*The chip shortage is generally expected to last at least another year, although analyst firm IDC warns that this lack of supply could flip to an oversupply by 2023 as new production facilities are fired up.*

*The cost of groceries and gasoline are the most apparent Main Street inflation gauges and both are rising at a disconcerting pace, pushing expectations higher.*

Overall food prices climbed +0.9% for the second straight month, and +5.3% year-over-year. The cost of groceries and gasoline are the most apparent Main Street inflation gauges and both are rising at a disconcerting pace, pushing *expectations* higher.

*The financial markets had accepted the fact that prices would be climbing, but with every passing month inflation has only crept higher.*

Housing costs, which make up a disproportionate share of CPI, are also on the rise as landlords hike rents, and rising home values trickle their way into the index.

The producer price index (released earlier this week) showed a +0.5% rise in final demand and an annual increase of +8.6%, the highest since the BLS began releasing annual numbers in 2010. Producers prices are more volatile and typically have less of a market impact, but the fact that producer costs are on the rise doesn't signal near-term relief for consumers.

The financial markets had accepted the fact that prices would be climbing, but with every passing month inflation has only crept higher. Between now and yearend, demand for holiday goods will surge, while transportation-constrained supply struggles to keep up. By February, consumer demand typically eases, which should allow supply to make up ground . . . assuming the fifth covid wave is minor.

The bottom line is that the inflation problem is global, growing and affecting most of the economy. As a result, it will be frontpage news for several more months, and will impact politics and the financial markets for much of 2022.

Bond yields are up big in early trading, with the 2-year and 3-year Treasury yields currently offered at 20 month highs. Investors now expect Fed officials will begin raising the overnight funds rate sooner and more aggressively. However, the QE taper begins next week and will conclude eight months later. The taper process has to completely wrap-up before rate hikes can begin. If bottlenecks have cleared by next summer and inflation is in retreat mode as *expected*, the Fed will have time to assess the taper impact before taking the next step.

## Market Indications as of 10:20 A.M. Central Time

DOW	Down -29 to 36,291 (HIGH: 36,432)
NASDAQ	Down -56 to 15,830 (HIGH: 15,982)
S&P 500	Down -4 to 4,682 (HIGH: 4,702)
1-Yr T-bill	current yield 0.16%; opening yield 0.12%
2-Yr T-note	current yield 0.50%; opening yield 0.42%
3-Yr T-note	current yield 0.82%; opening yield 0.73%
5-Yr T-note	current yield 1.19%; opening yield 1.09%
10-Yr T-note	current yield 1.52%; opening yield 1.46%
30-Yr T-bond	current yield 1.87%; opening yield 1.83%

*The paper/commentary was prepared by Hilltop Securities Asset Management (HSAM). It is intended for informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product. Information provided in this paper was obtained from sources that are believed to be reliable; however, it is not guaranteed to be correct, complete, or current, and is not intended to imply or establish standards of care applicable to any attorney or advisor in any particular circumstances. The statements within constitute the views of HTS and/or HSAM as of the date of the document and may differ from the views of other divisions/departments of affiliates Hilltop Securities Inc. In addition, the views are subject to change without notice. This paper represents historical information only and is not an indication of future performance. Sources available upon request.*

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