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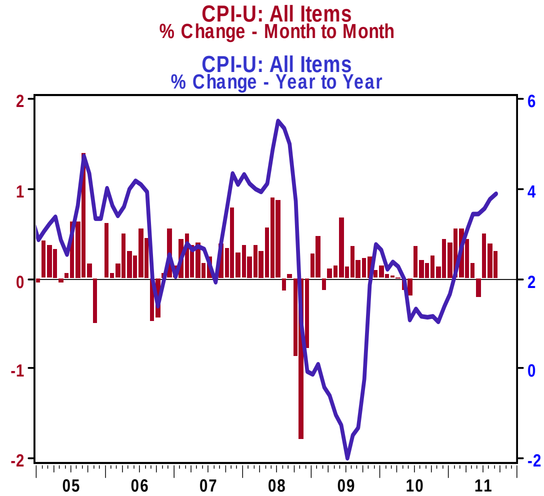
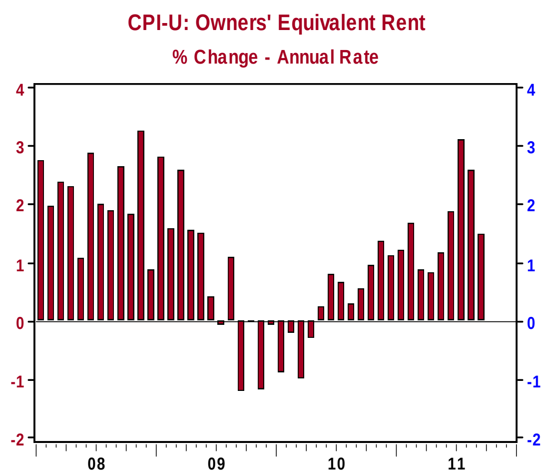
September CPI

- The Consumer Price Index (CPI) rose 0.3% in September, matching consensus expectations. The CPI is up 3.9% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) rose 0.4% in September and is up 4.6% in the past year.
- The increase in the CPI was mostly due to a 2.0% increase in energy prices. Food prices were up 0.4% and the "core" CPI, which excludes food and energy, was up 0.1%, below the consensus expected increase of 0.2%. Core prices are up 2.0% versus last year.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – fell 0.1% in September and are down 1.9% in the past year. Real *weekly* earnings are down 1.7% in the past year.

Implications: While consumer price inflation matched consensus expectations in September, it's important to realize that there was no pull back in price pressure given the two hot inflation readings in July and August. Consumer prices are now up 3.9% versus a year ago and up at a 4.8% annual rate in the past three months. "Cash" inflation, which excludes the government's estimate of what homeowners would pay themselves in rent, is up 4.6% in the past year. In our opinion, this is a more accurate measure of the inflation actually being felt by consumers. Energy prices have been a driving force behind recent overall consumer price inflation, and the Federal Reserve has openly said it focuses more on "core" prices, which exclude food and energy. Yet core prices show a similar acceleration trend. Core prices are up 2.0% in the past year and an even faster 2.5% in the past six months. This is at the upper end of the Fed's so-called target range, yet we don't expect the Fed to change its accomodative monetary policy stance anytime soon. In fact, given recent comments from regional Fed presidents, the Fed will likely continue to focus on the employment side of its dual-mandate. We think this is a mistake. If the Fed clings to easy monetary policy as it has publicy said it will, inflation will not be a short run, temporary problem. It will turn into a serious, long-term economic threat.



Sources: Bureau of Labor Statistics /Haver Analytics



Source: Bureau of Labor Statistics /Haver Analytics

CPI - U All Data Seasonally Adjusted	Sep-11	Aug-11	Jul-11	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.3%**	0.4%	0.5%	4.8%	3.1%	3.9%
Ex Food & Energy	**0.1%**	0.2%	0.2%	2.1%	2.5%	2.0%
Ex Energy	**0.1%**	0.3%	0.3%	2.7%	2.9%	2.4%
Energy	**2.0%**	1.2%	2.8%	26.6%	5.3%	19.3%
Food and Beverages	**0.4%**	0.5%	0.4%	5.3%	4.7%	4.5%
Housing	**0.2%**	0.2%	0.2%	2.6%	2.1%	1.8%
Owners Equivalent Rent	**0.1%**	0.2%	0.3%	2.4%	1.8%	1.5%
New Vehicles	**0.0%**	0.0%	0.0%	0.0%	5.0%	3.6%
Medical Care	**0.2%**	0.2%	0.2%	2.8%	3.0%	2.8%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.2%	2.3%	2.1%	2.0%
Real Average Hourly Earnings	**-0.1%**	-0.6%	0.0%	-2.7%	-1.0%	-1.9%

Source: U.S. Department of Labor