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May CPI

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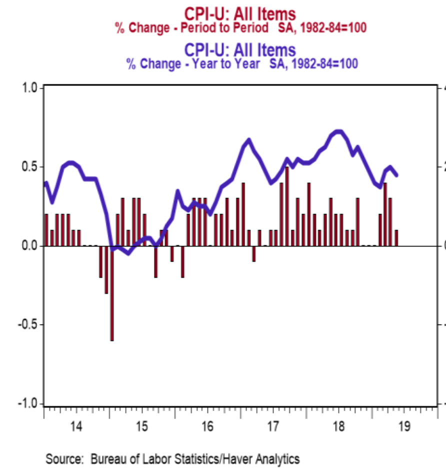
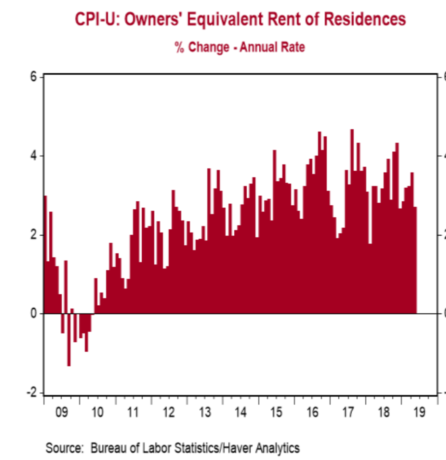
- The Consumer Price Index (CPI) rose 0.1% in May, matching consensus expectations. The CPI is up 1.8% from a year ago.
- Food prices rose 0.3% in May, while energy prices declined 0.6%. The "core" CPI, which excludes food and energy, also increased 0.1% in May, coming in below the consensus expected rise of 0.2%. Core prices are up 2.0% versus a year ago.
- Real average hourly earnings – the cash earnings of all workers, adjusted for inflation – rose 0.2% in May and are up 1.3% in the past year. Real average weekly earnings are up 1.0% in the past year.





Implications: Consumer prices rose 0.1% in May and are up 1.8% in the past year, while "core" prices – a more reliable gauge of inflation that strips out the typically volatile food and energy components – rose 0.1% in May and are up 2.0% in the past twelve months. Given the Fed's 2% inflation target, that should be a signal that everything is looking A-OK. Not too fast, not too slow, just right. So when we see headlines that core inflation readings "[Bolster] the Case for Fed Rate Cuts", we can't help but wonder if we are looking at the same report. A look at the details of today's report makes the fear of low inflation even more confusing. Headline inflation is up 1.8% in the past year, but up at a 1.9% annualized rate over the past six months, and a 3.3% annualized rate in the past three months. In other words, broad-based inflation is already near 2% and rising. In addition, the Cleveland Fed's median CPI series, which adjusts for both upside and downside outliers, shows inflation up 2.7% in the past year. No matter how you cut it, inflation is in-line with Fed targets, and shows no signs of the economic paralysis that bond markets are pricing in. Medical care and housing costs – up 0.3% and 0.1%, respectively, in May - continue to be key drivers pushing "core" prices higher, while higher prices for airfares, education, and new vehicles more than offset declining costs for used cars and trucks as well as car insurance. We believe these data, as well as strength in trend inflation (which is far more important than single month readings) don't support the case for rate cuts. Moreover, unemployment is 3.6%, initial claims are near historic lows and there are 1.6 million more job openings than unemployed people. That's not to say some dovish Fed members won't alter down their forecasts for rates through 2019 and into 2020, but the data, if anything, suggests higher rates would be the more appropriate path based on economic fundamentals alone. As the year progresses and worst-case scenarios aren't realized, possibly catalyzed by resolution of trade tensions, we expect a return of confidence to the financial markets and a shift back towards a more "risk on" environment, putting upward pressure on longer-term interest rates. Among the best news in today's report was that real average hourly earnings rose 0.2% in May and are up 1.3% in the past year. With the strength in the labor market noted above, we believe that the trend higher will continue in the months ahead. Healthy consumer balance sheets, a strong job market, inflation in-line with Fed targets, and the continued tail winds from improved tax and regulatory policy, all reinforce our belief that the economy is on very solid ground.

CPI - U *All Data Seasonally Adjusted Except for Yr to Yr*	May-19	Apr-19	Mar-19	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.1%**	0.3%	0.4%	3.3%	1.9%	1.8%
Ex Food & Energy	**0.1%**	0.1%	0.1%	1.6%	1.9%	2.0%
Ex Energy	**0.1%**	0.1%	0.2%	1.6%	2.0%	2.0%
Energy	**-0.6%**	2.9%	3.5%	25.6%	0.6%	-0.5%
Food	**0.3%**	-0.1%	0.3%	1.8%	2.9%	2.0%
Housing	**0.1%**	0.3%	0.3%	3.0%	3.0%	2.8%
Owners Equivalent Rent	**0.3%**	0.3%	0.3%	3.7%	3.5%	3.4%
New Vehicles	**0.1%**	0.1%	0.4%	2.4%	1.2%	0.9%
Medical Care	**0.3%**	0.3%	0.3%	3.8%	2.4%	2.1%
Services (Excluding Energy Services)	**0.2%**	0.3%	0.3%	2.9%	2.8%	2.7%
Real Average Hourly Earnings	**0.2%**	-0.1%	-0.3%	-0.7%	1.1%	1.3%

Source: U.S. Department of Labor