Craig Sullivan, CFA, CAIA®
Tia Simser
Chris Eckert

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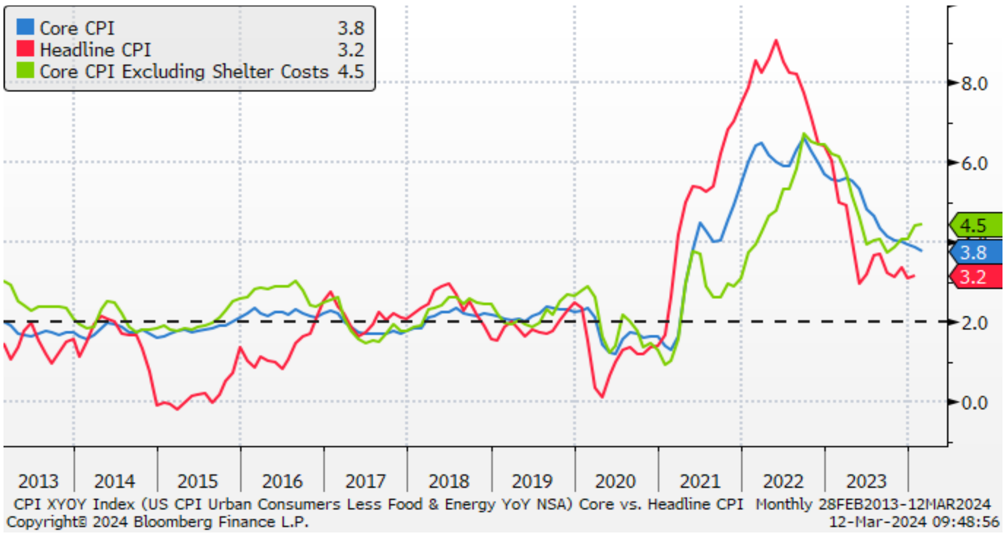
CPI – Still Hot



- Inflation readings for February once again surprised to the upside with headline inflation increasing to 3.2% (from 3.1%) and core (which excludes food and energy prices) inflation declining by less than expected to 3.8% (from 3.9%).
- Today's report follows a hot report in January and adds evidence that inflation is proving more stubborn than expected.
- Gas prices and shelter costs were the primary drivers of headline inflation.
- Part of the increase in headline inflation was driven by higher gas prices.
- The moderation in owner's equivalent rent (OER) suggests that the jump in January was likely a one-off, rather than signaling stickier rent inflation.
- The persistence of inflation is due in large part to the ongoing strength of the labor market which is allowing consumers to feel comfortable about spending down savings or borrowing to spend.
- Therefore, the 'last mile' to get inflation back sustainably below 3% is likely to require more loosening in the labor market.
- The strength of the consumer is highlighted by the increase in core CPI ex shelter (aka 'super core') which is a measure that the Federal Reserve (Fed) has noted they are watching closely.
- Following this morning's release, market-implied expectations for rate cuts softened modestly, with investors now pricing a ~70% chance of a rate cut by the Fed's June meeting. However, the timing of rate cuts may need to be pushed out if inflation data does not show signs of cooling over the coming months.
- Over the past several months we have been adding more floating rate exposure to core fixed income portfolios based on our view that there is the *potential* for inflation to remain stubborn, which would move out the timing of rate cuts, benefitting floating rate securities.

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