

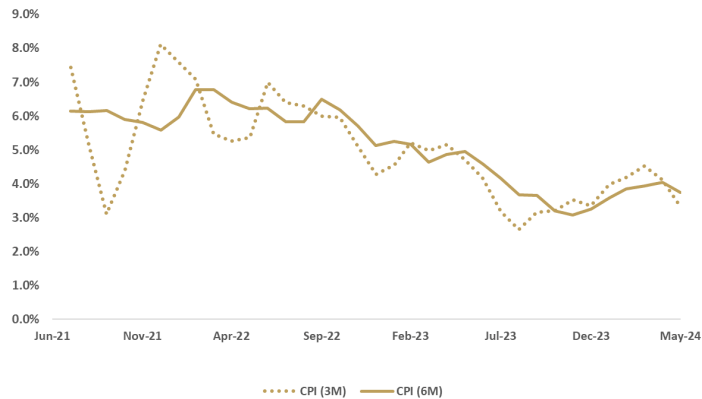
Positive News on the Inflation Front

A few months ago, an unorthodox economic theory began to gather attention. Rather than constraining economic activity, could higher interest rates instead be stimulating it? The question seemed timely. Despite interest rates at 16-year highs, the U.S. economy expanded by an average of 4% in the second half of last year. Following that unexpected economic surge was a surge in consumer prices. In the first quarter of this year, the core Consumer Price Index accelerated to an average 3-month annualized run rate of 4.2% during the first quarter. Higher rates were supposed to dampen demand, not stimulate it.

In a previous *Weekly Update*, we acknowledged that higher rates should improve the spending power of certain segments of the U.S. population, particularly Baby Boomers with savings. But we were not prepared to suggest that, in aggregate, higher rates would prove stimulative. In our view, higher rates would do their work of slowing economic activity and lowering consumer prices. Last week's Consumer Price Index (CPI) report brought positive news on that front: both headline and core inflation surprised to the downside, with 3-month annualized core inflation decelerating to 3.4%. While one report does not make a trend, the May CPI report was a positive one, both for consumers and for traditional economic theory.

CHART OF THE WEEK

Core Inflation (CPI)
3 & 6-Month Annualized Rates



Source: Bloomberg

| Index Returns (%) | | | | | | |
|-----------------------|-------|--------|-------|-------|--------|-------------|
| Equities | Level | 1 Week | QTD | YTD | 1 Year | 3-Year Ann. |
| S&P 500 | 5473 | 2.14 | 4.50 | 15.53 | 25.99 | 11.30 |
| Russell 1000 Growth | 3690 | 4.09 | 8.91 | 21.34 | 35.66 | 12.81 |
| Russell 1000 Value | 1711 | -0.83 | -2.65 | 6.09 | 13.36 | 6.41 |
| FTSE High Dividend Yi | 415 | 0.13 | -1.42 | 7.56 | 15.05 | 8.63 |
| S&P Small and Mid Cap | 16169 | -0.20 | -3.91 | 3.40 | 13.05 | 3.96 |
| MSCI EAFE | 2319 | -2.51 | -0.94 | 4.99 | 9.42 | 3.54 |
| MSCI EM | 1082 | 0.53 | 3.69 | 6.23 | 7.42 | -4.55 |

* Bloomberg U.S. Large Cap Dividend Yield Total Return Index used as substitute for index characteristics.

| Index Characteristics | | | | | | |
|-----------------------|-------|--------|-------|-------|--------|-------------|
| Equities | Level | 1 Week | QTD | YTD | 1 Year | 3-Year Ann. |
| Fixed Income | Yield | 1 Week | QTD | YTD | 1 Year | 3-Year Ann. |
| U.S. Aggregate | 4.87 | 1.10 | 0.51 | 0.11 | 3.35 | -2.76 |
| U.S. Int. Gov/Credit | 4.73 | 0.67 | 0.67 | 0.76 | 4.30 | -1.06 |
| U.S. Corporates | 5.35 | 0.97 | 0.45 | 0.45 | 5.93 | -2.74 |
| High Yield | 7.88 | 0.27 | 0.83 | 2.50 | 10.42 | 1.83 |
| Municipals (1-10) | 3.36 | 0.53 | -0.29 | -0.63 | 2.65 | -0.30 |

| Levels (%) | | | | | | |
|----------------------|------|----------|----------|---------|----------|-----------|
| Key Rates | Last | 1 Wk Ago | Last Qtr | Prev YE | 1 Yr Ago | 3 Yrs Ago |
| 2-yr Treasury | 4.77 | 4.84 | 4.62 | 4.25 | 4.69 | 0.21 |
| 10-yr Treasury | 4.28 | 4.41 | 4.20 | 3.88 | 3.72 | 1.51 |
| 30-yr Treasury | 4.41 | 4.54 | 4.34 | 4.03 | 3.81 | 2.10 |
| 3-mo. LIBOR | 5.66 | 5.61 | 5.56 | 5.59 | 5.52 | 0.13 |
| 6-mo. CD rate | 5.39 | 5.43 | 5.35 | 5.28 | 5.58 | 0.14 |
| Prime Rate | 8.50 | 8.50 | 8.50 | 8.50 | 8.25 | 3.25 |
| 30-yr fixed mortgage | 7.32 | 7.28 | 7.25 | 6.99 | 6.99 | 3.17 |

| Levels | | | | | |
|------------|--------|----------|---------|-----------|--|
| Currencies | Last | 1 Wk Ago | Prev YE | 3 Yrs Ago | |
| DXY | 105.26 | 105.23 | 101.33 | 91.89 | |
| \$ per € | 1.07 | 1.07 | 1.10 | 1.19 | |
| \$ per £ | 1.27 | 1.27 | 1.27 | 1.39 | |
| ¥ per \$ | 157.86 | 157.13 | 141.04 | 110.21 | |

| Levels | | | | | |
|-------------|--------|----------|---------|-----------|--|
| Commodities | Last | 1 Wk Ago | Prev YE | 3 Yrs Ago | |
| Oil (WTI) | 81.57 | 77.90 | 71.97 | 56.29 | |
| Gasoline | 3.45 | 3.45 | 3.12 | 3.07 | |
| Natural Gas | 2.64 | 3.13 | 2.51 | 3.25 | |
| Gold | 1924 | 2317 | 2063 | 1774 | |
| Copper | 8350 | 9630 | 8464 | 9289 | |
| Wheat | 604 | 627 | 628 | 639 | |
| BBG Index | 241.82 | 241.52 | 226.43 | 192.38 | |

LAST WEEK IN REVIEW

- **Consumer Price Index (May):** Downside surprise and a welcome break from higher inflation in the first quarter. MoM: 0.0% HL, 0.2% Core. YoY: 3.3% HL, 3.4% Core.
- **FOMC Rate Decision:** Target rate unchanged at 5.25-5.50%. Dot plot suggests only one 0.25% cut this year.
- **Producer Price index (May):** Further support that inflation is moving lower. MoM: 0.0% HL, 0.0% Core. YoY: 2.2% HL, 2.3% Core.

THIS WEEK

- **Retail Sales (May):** 6/11
- **Housing Starts & Permits (May):** 6/20
- **Leading Economic Index (May):** 6/21
- **Existing Home Sales (May):** 6/21

S & P SECTOR RETURNS

