CITY NATIONAL ROCHDALE
AN RBC/CITY NATIONAL COMPANY

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ON THE RADAR

FAQs on the Markets and Economy

How aggressively is the Fed reducing the risk of inflation?

Fed officials have stated that reducing inflation is of paramount importance.

At the recent FOMC meeting in March, the Fed raised the federal funds rate by 25 basis points to 0.375% and announced its plans to increase the federal funds rate to 1.9% by year-end. At times, they may increase the rate by 50 bps.

The Fed will also start to reduce the size of its bond portfolio, which may put upward pressure on longer-term interest rates. The portfolio grew in the past two years from about $4 trillion to about $9 trillion (see chart). The Fed bought bonds to help push down intermediate- and longer-term interest rates to stimulate the economy.

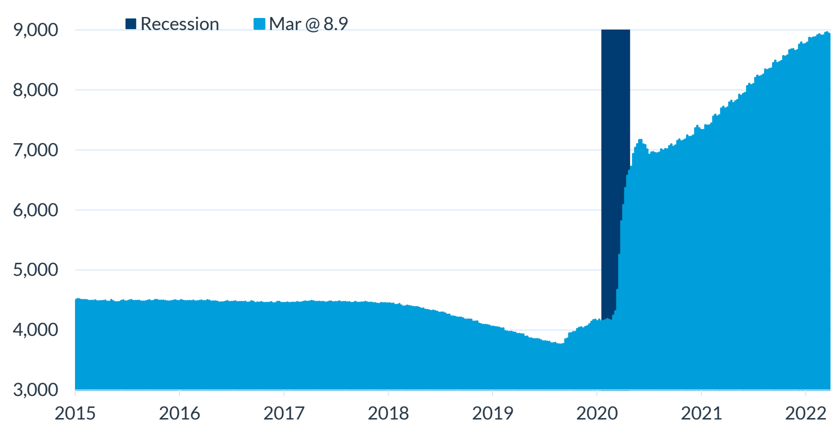
Since that is no longer needed, they will allow a preset amount of bonds to mature each month without reinvesting the proceeds. The Fed will allow $95 billion in bonds to mature each month; this is a much faster pace than the last time it reduced its portfolio (2017-2019) when it allowed $50 billion to mature each month.

The Fed also believes inflationary pressures will subside due to a decrease in federal spending, an increase in the number of people working and a decline in demand due to the higher borrowing costs.

KEY QUESTIONS

- Is the labor market still robust?
- Are shorter-term municipal yields providing investor opportunities?
- Is the outlook for stocks still positive?

Fed Balance Sheet
$, trillions, not seasonally adjusted



Source: Federal Reserve, March 2022

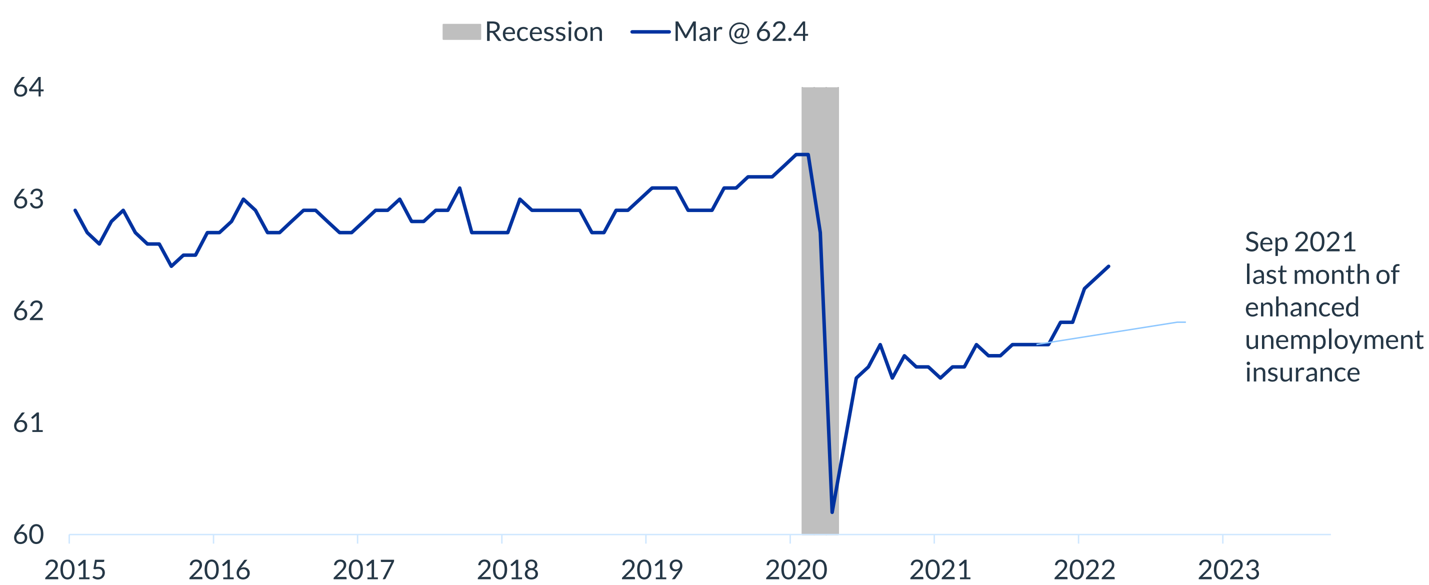
Is the labor market still robust?

The March labor report was another strong report.

The unemployment rate fell to 3.6%, the lowest level of this expansion and the lowest rate since the pre-recession low of 3.5%. Nonfarm payroll increased by 431,000, and the previous two months were revised up by 95,000. Wages continue to grow and stand at 5.6% y-o-y. The labor force participation rate (percent of the working-age population working or looking for a job) continues to increase and now stands at the highest rate since the recession, but still well below the pre-recession rate (see chart). Higher wages, reduced savings, and a healthier workplace are the key reasons people are returning to the labor force.

The continued strength in employment gains gives the Fed more reason to continue tightening monetary policy and it increases the Fed's chances to raise the federal funds rate by 50 basis points at their next meeting in May.

Labor Force Participation Rate
percent, seasonally adjusted



Source: Federal Reserve, March 2022

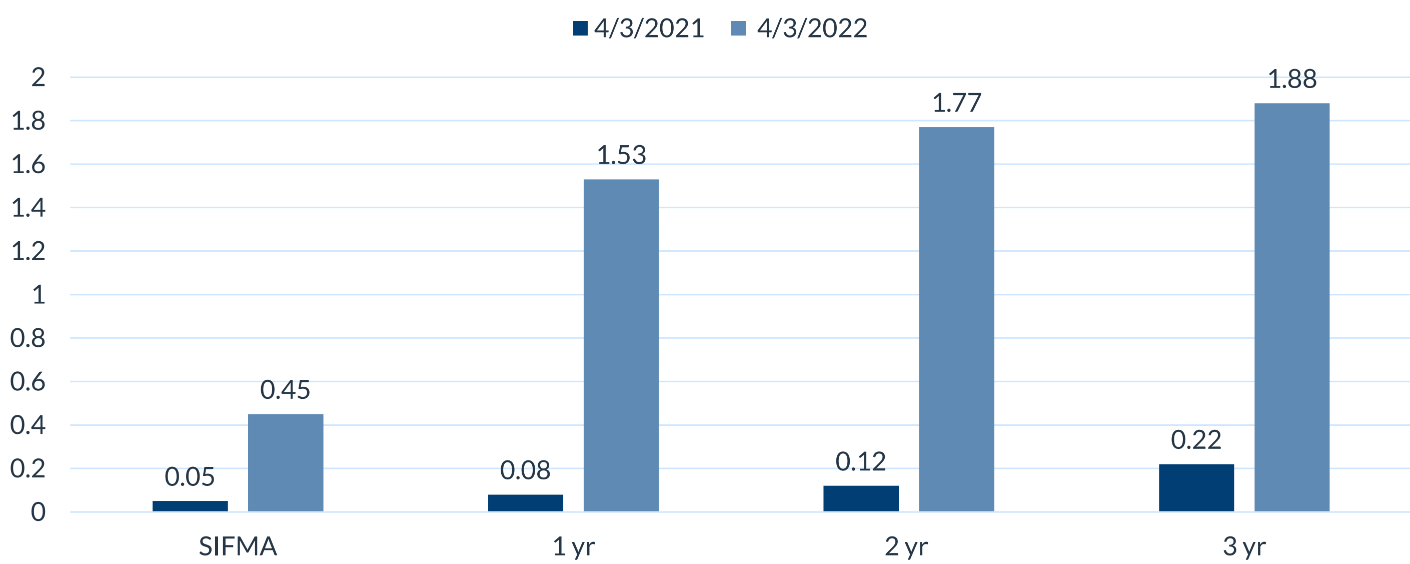
Are shorter-term municipal yields providing investor opportunities?

In March, the Fed raised its benchmark rate by 25 bps and signaled that a more aggressive tightening campaign is likely to follow this year to help temper inflation.

As a result, market pricing reflects a hawkish FOMC with shorter maturity yields experiencing a sharp rise since the beginning of the year. The SIFMA Index, a reference rate of 7-day municipal securities, exceeds 50 bps for the first time since 2020. Other security structures, like fixed-rate bonds and commercial paper, benefit from higher yields that offer investors attractive opportunities relative to 1-month Treasury bills. As the fed funds rate increases this year, variable rate demand obligations (VRBOs) and other floating rate securities should rise in tandem, paving the way for shorter-term investments to play a more important role in liquidity management and corporate cash portfolios.

Shorter-term strategies could unlock appreciable value compared to a year ago. Investors can shift duration risk given the flatness of the yield curve while being more "flexible" to take advantage of opportunities that consider the full range of monetary policy decisions. With fed funds anchored at or near zero in 10 of the past 13 years, a market previously starved of yield now offers more attractive risk-adjusted portfolio yields that better balance client objectives against duration uncertainty in the current environment. For example, a 1-3yr liquidity management strategy could currently earn approximately 1.4% gross yield (2.3% taxable-equivalent) versus a meager 20 bps a year ago (or 35 bps taxable-equivalent). As market volatility continues and evidence of a waning appetite for longer-term bonds persists, lower-duration, shorter-term securities help provide a defensive buffer and relative value opportunity within portfolios.

Short-Term Rates 1 year ago vs. Today



Source: Bloomberg
Past performance or performance based upon assumptions is no guarantee of future results

Is the outlook for stocks still positive?

U.S. equity markets have rebounded nearly 6% from March lows, climbing several walls of worry, including the ongoing war in Ukraine, higher inflationary pressures, and an increasingly more aggressive Fed.

Although the path forward for stocks has gotten tougher, we continue to see scope for modest gains over the next 12 months.

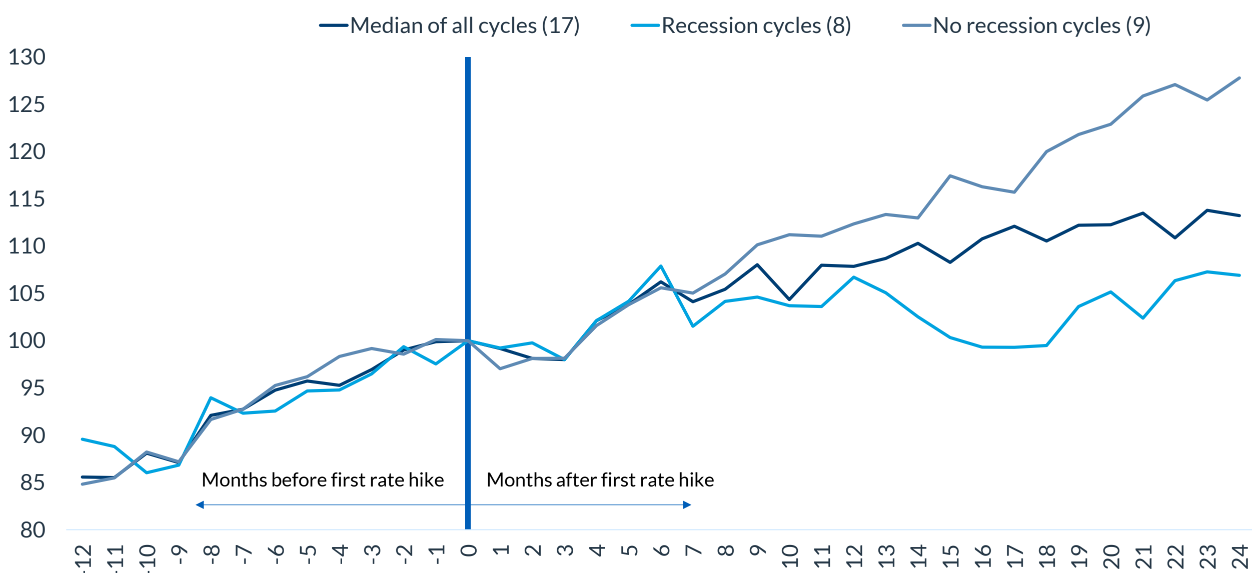
So far incoming economic data has been resilient. Corporate and household fundamentals remain strong, and the US economy is far more insulated from the direct impacts of the Ukraine War than other regions of the world, particularly Europe. The primary risk from the war has come from inflationary pressures driven by the global shock to energy and food supplies. Nevertheless, we still expect inflation to begin to move downward over the second half of 2022 as base effects turn favorable and reopening pressures moderate.

It should also not be lost that while interest rates are now rising, they still remain very low by historical standards. Although we think Fed tightening, and the implications that has for interest rates across the yield curve, could eventually pose a more credible headwind to economic momentum and stock market gains, our base-case view remains that the U.S. economy is not heading into a recession in 2022.

For investors, history shows that in most cases, after an initial period of flat returns, stocks have performed well during Fed tightening cycles. Even tightening cycles that preceded recessions saw higher equity returns on average 12 and 24 months later.

While we suspect markets will remain volatile until the uncertainty surrounding these key concerns subsides, we don't think the bull market has yet run its course and that the strength of underlying fundamental conditions should offer broader support to stock prices over time.

Median S&P 500 Level
(1954-2018, normalized, with level at first hike =100)



Source: RBC Global Asset Management, RBC Wealth Management, Bloomberg; data range: 1954-2018, normalized, with level at first hike =100

Past performance or performance based upon assumptions is no guarantee of future results

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INDEX DEFINITIONS

S&P 500 Index: The S&P 500 Index, or Standard & Poor's 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market cap because there are other criteria that the index includes.

Muni Bond: A municipal bond is a debt security issued by a state, municipality or county to finance its capital expenditures, including the construction of highways, bridges or schools. These bonds can be thought of as loans that investors make to local governments.

Bloomberg Barclays U.S. Corporate High Yield Bond Index: measures the USD denominated, high-yield, fixed-rate corporate bond market.

Dow Jones Select Dividend Index: The Dow Jones U.S. Select Dividend Index looks to target 100 dividend-paying stocks screened for factors that include the dividend growth rate, the dividend payout ratio and the trading volume. The components are then weighted by the dividend yield.

The SIFMA Municipal Swap Index: The Securities Industry and Financial Markets Association Municipal Swap Index is a 7-day high-grade market index comprised of tax-exempt Variable Rate Demand Obligations (VRDOs) with certain characteristics. The Index is calculated and published by Bloomberg. The Index is overseen by SIFMA's Municipal Swap Index Committee.