CITY NATIONAL ROCHDALE
AN RBC/CITY NATIONAL COMPANY

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# ON THE RADAR

## FAQs on the Markets and Economy

## What did the Fed decide at their recent monetary policy meeting?

This past week, the Fed took a very hawkish stance. They have now come to realize that inflation will not self-correct. So, to get inflation back toward its target rate of 2.0%, the Fed must move the federal funds rate above what they view as a neutral rate—the hypothetical rate that neither stimulates nor constricts economic growth. This should slow the economic growth rate to bring inflation back under control.

The Fed plans on seven hikes of 25 basis points this year and three or four hikes next year.

The Fed is also making plans to reduce the size of its bond holdings. During the pandemic, the Fed bought intermediate- and longer-term bonds to help push those interest rates down. It worked well, as many households refinanced their debt. That is not needed anymore. It is believed the Fed will announce the plans to reduce the size of its $9 billion bond portfolio at its next meeting in May.

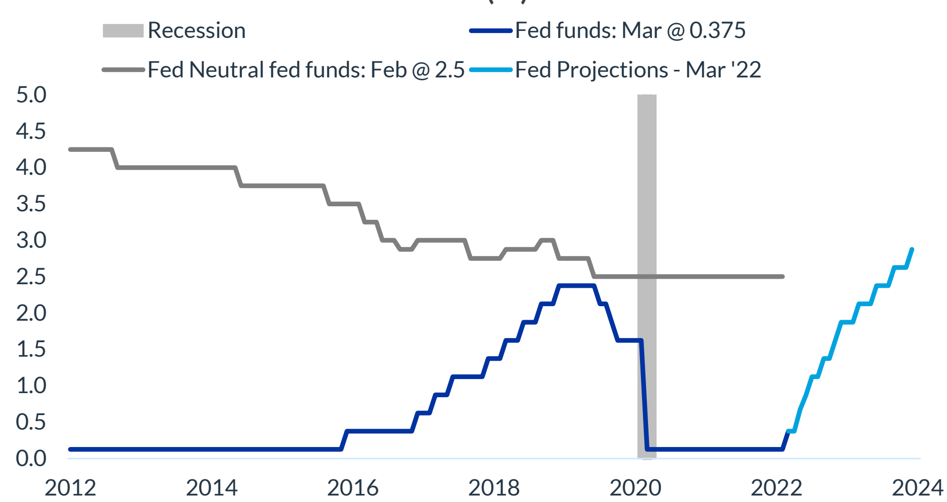
### KEY QUESTIONS

**Is the consumer still going to be the economy's driving force this year?**

**Has the outlook for US equities changed?**

**Are credit spreads on the rise?**

Fed Funds and Neutral Fed Funds (%)




Source: Federal Reserve, March 2022.

# Is the consumer still going to be the economy's driving force this year?

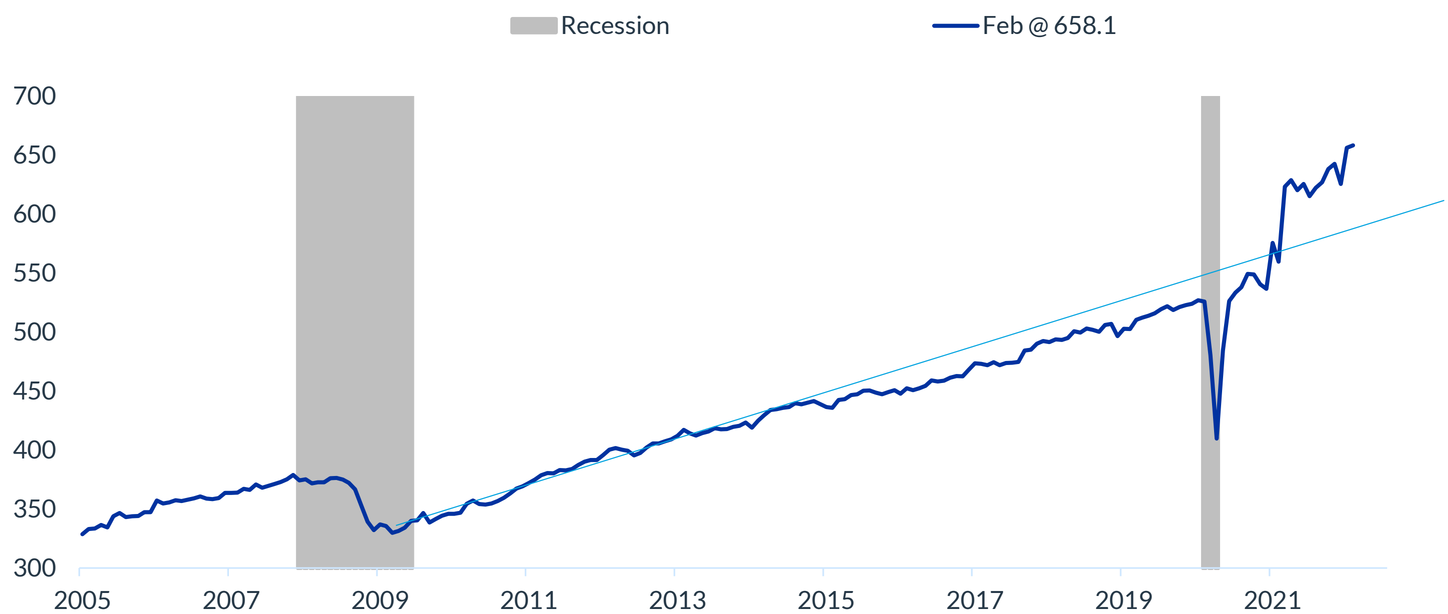
## Yes, we still believe households with a solid balance sheet with high cash levels will continue their strong spending habit.

The year is off to a good start due to a rebound from a slow pace of spending in December, which was a result of the omicron outbreak. The monthly change was a meteoric 4.9% in January, and February grew at 0.3%. The yearly change stands at 17.6% (it averaged 4.3% for the 10 years before the pandemic).

Over the past year, one of the strongest sectors for growth has been restaurant sales, which leaped 33%. This reflects the drop in COVID-19 cases and the increased comfort that many have with going out in public.

### Retail Sales

*monthly value, seasonally adjusted, $, billions*




**Source: U.S. Census Bureau, as of February 2022.**

# Has the outlook for US equities changed?

## While uncertainty over the fallout from the Ukraine-Russia war remains, and warrants a more cautious approach in the near term, we continue to believe that the strength of underlying US fundamental conditions should offer broader support to stock prices over the intermediate to longer term.

The crisis has exacerbated global inflationary pressures on a number of fronts. Not only are we seeing higher oil and gas prices, but also higher wheat and grain prices, as well as some further disruption to supply chains, particularly in key metal commodities like palladium, used in auto manufacturing.

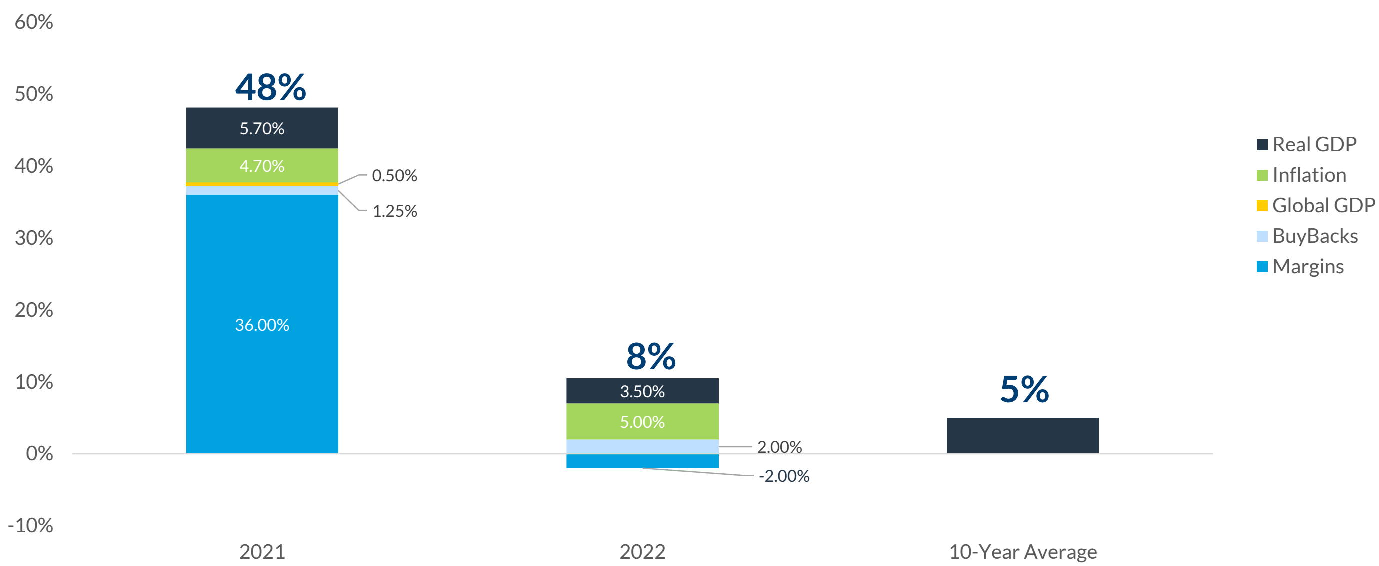
Although these headwinds will likely be a drag on US growth, the good news is that household and corporate balance sheets remain very healthy and well positioned to handle a period of higher prices. Meanwhile, the US is now a net exporter in oil, natural gas and coal. The rise in global prices will likely provide an offsetting boost to growth from higher US energy investment.

As a result, we expect the overall impact on the US economy to be relatively modest, especially compared to Europe, where recession risk has risen meaningfully due to the region's heavy reliance on Russian energy imports and more extensive trade relationships.

Importantly for investors, the outlook for US earnings remains solid. While we have modestly reduced our expectations for corporate profits in 2022, given the impact to margins from higher input costs and the likely prospect of reduced US sales to Europe, our S&P 500 base case for EPS growth of 8% is still above the long term average of 5–7%.

As we do get more clarity on the crisis, we would expect to see a rebound in markets, especially given that conditions may be oversold. Corrections tend not to become prolonged bear markets when the outlook for economic and corporate profit growth remains positive.

### CNR S&P 500 EPS Estimates




Source: CNR Research.

# Are credit spreads on the rise?

In times of heightened geopolitical risk, it's helpful to reference the impact of historical events on corporate credit. Current investment-grade credit spreads of 121bps are above the 5-year average of 114bps, yet still near the 10-year average of 123bps.

Meanwhile, credit fundamentals are currently stronger than they have been over the past 5 years. While it is rational to assume that the market is mispricing credit risk, we do not believe that credit risk is the main driver of spread movements today.

The challenge with the current selloff is that it started from such a low level. Even after the large move higher in risk this month, the market is not close to the peaks of most prior conflicts. Moreover, geopolitical events have not triggered significant prolonged losses historically, but this could change rapidly if the market believes economic growth will be affected.

The table below shows that Gross Domestic Product (GDP) growth in the current quarter of market weakness is much stronger than in most of the prior conflict periods. This is what makes the market weakness unusual – it is being driven by inflation concerns as well as the external shock from the Ukrainian invasion, not by falling GDP growth or weakness in corporate profitability.

CNR continues to maintain a neutral to respective benchmark positioning for our total return strategies, as market signals are getting lost in the noise. Passive income-based strategies can currently benefit from higher spreads, which provide higher overall yields and opportunities for total return.

## GDP Growth

| Conflict | Date | Beginning Spread | Ending Spread | Spread Change | % Change | Duration (Days) | GDP Growth |
|---|---|---|---|---|---|---|---|
| Kuwait War | 1/17/1991 | 144 | 154 | 10 | 7% | 62 | 4.5% |
| Kosovo War | 3/24/1999 | 104 | 102 | -2 | -2% | 63 | 6.0% |
| 9/11 & Afghan War | 9/11/2001 | 152 | 202 | 50 | 33% | 94 | -1.6% |
| Iraq War | 3/12/2003 | 163 | 172 | 8 | 6% | 9 | 3.8% |
| Egypt Arab Spring | 1/25/2011 | 149 | 150 | 1 | 1% | 4 | 4.5% |
| Intervention in Libya | 3/19/2011 | 137 | 144 | 7 | 5% | 33 | 4.5% |
| Annexation of Crimea | 3/14/2014 | 109 | 113 | 4 | 4% | 17 | 4.3% |
| Intervention in Syria | 9/22/2014 | 98 | 126 | 28 | 29% | 49 | 4.6% |
| Average | | 132 | 145 | 13 | 10% | 41 | 3.8% |
| Russia/Ukraine | 2/10/2022 | 91 | 121 | 30 | 33% | | 6.9% |

Sources: Bloomberg and Bloomberg Indices.

Past performance 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.