CITY NATIONAL ROCHDALE
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ON THE RADAR

FAQs on the Markets and Economy

How hawkish was the Fed at its recent meeting?

The Feds new motto seems to be: Supersize it!

The Fed has made a very hawkish move. It has barreled ahead with the third hike of 75 bps. Its plan for the rest of the year implies another 75-bps hike at the next meeting in November and a 50-bp hike at December's meeting. It was just a few months ago that rate increases of this magnitude would be shocking, but they are now becoming routine.

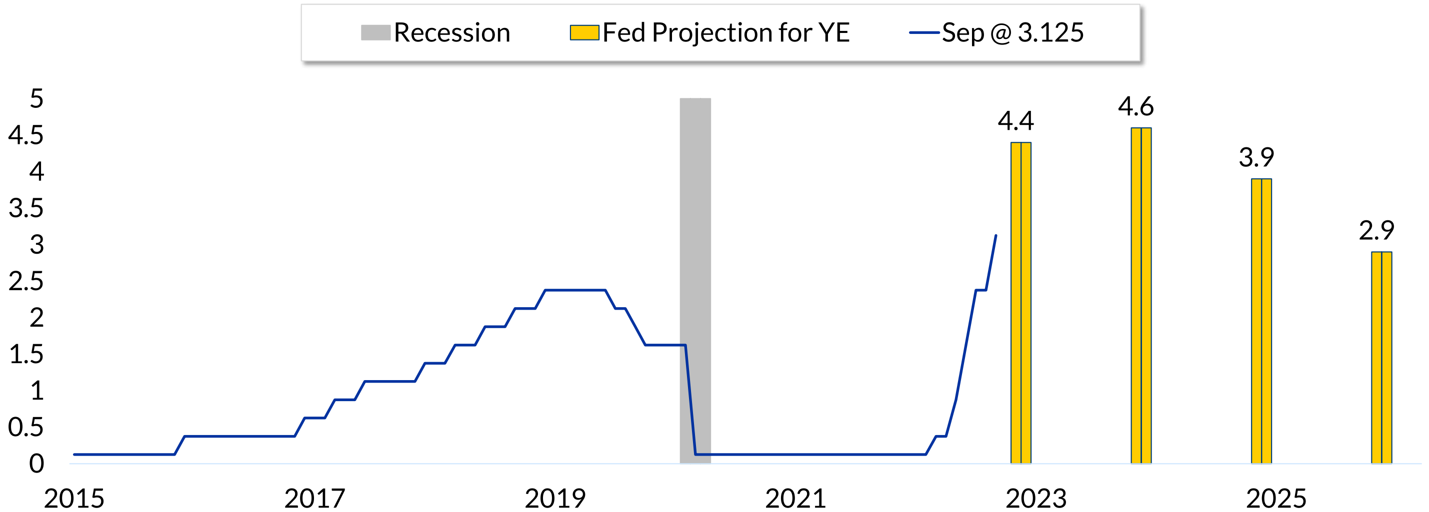
The Fed continues to believe it will be able to arrange a soft landing for the economy. But it will be a bumpier ride than previously thought. The growth rate should crater this year at 0.2%. However, the Fed expects the pace next year to pick back up to 1.2%. This is despite the significant jump in financing costs for households and businesses and a higher unemployment rate.

There were some modest revisions to the overall economic forecast. They reflect slower growth, higher unemployment, higher inflation, and higher federal funds. That is consistent with the trend so far this year.

KEY QUESTIONS

- **Are the higher mortgage rates starting to impact the price of homes?**
- **With recession risk increasing, how is the High Yield bond market responding?**

FOMC Projections - Federal Funds
%, mid-point



Source: Federal Reserve

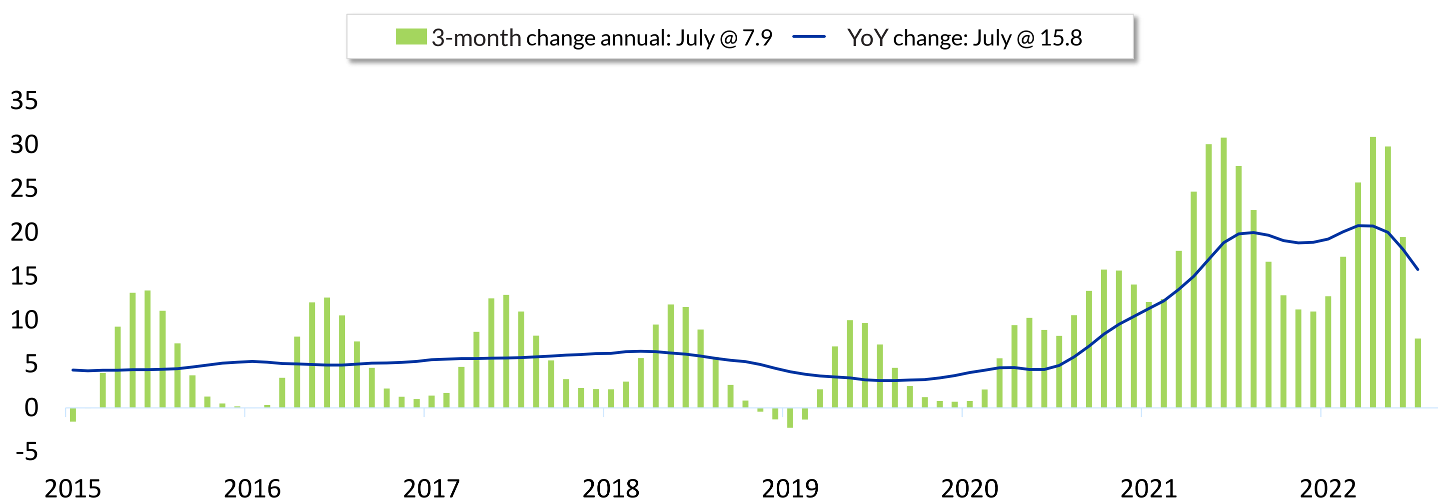
Are the higher mortgage rates starting to impact the price of homes?

With mortgage rates currently above 7.0%, well above the 3.0% rate of a year ago, the affordability of homes has significantly plummeted.

It has reduced demand for homes, which is being reflected in the price. The pace of price increases has slowed considerably since mortgage rates started to increase this past spring.

The recent peak in the yearly change of home prices occurred back in March at 20.8% YoY. That change has now shifted down to 15.8%. The more recent price movement shows the pace of weakness intensifying; for the past three months, prices have been up just at a 7.9% annualized rate *(see chart)*. For some perspective, the long-term average of price gains is about 5.0%.

Home Prices: S&P CoreLogic Case Shiller
% change, not seasonally adjusted



Source: S&P CoreLogic Case Shiller

With recession risk increasing, how is the High Yield bond market responding?

In light of higher interest rates and the increased probability of a recession, credit stress is strangely absent.

The base case remains that defaults will normalize toward long-term averages of 4%, up from the current level of 1.5%, as inflation slows and the Fed moves interest rates quickly.

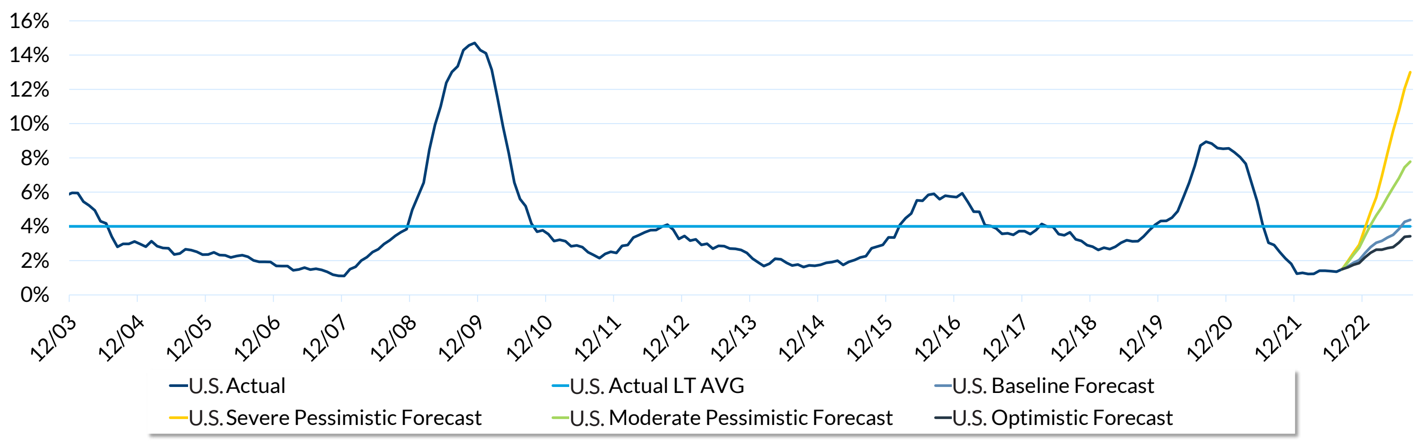
Jerome Powell has spoken multiple times about the economic pain likely to come from policy tightening, and the committee's growth and unemployment forecasts were recently revised in a more pessimistic direction.

Corporate fundamentals remain strong. However, GDP growth in advanced economies is set to contract next year, driven by a European recession. Central banks are expected to keep tightening for the rest of 2022, given high inflation and tight labor markets. 2023 may prove to be a difficult year driven by a more challenging macroeconomic backdrop for U.S. corporations, pressuring fundamentals that have provided support for credit markets.

Corporate leverage has held steady in recent quarters, although consensus estimates continue to point toward significant deleveraging, which means better margins and less debt. But the margin equation is tricky and had declined by 0.9%. For retail companies, inventories are also a problem as sales growth is slowing.

Given CNR's outlook for "Higher for Longer" interest rates, coupled with ongoing elevated levels of market volatility, we continue to remain neutral to respective benchmarks in our total return strategies. The time for more material over-/underweight allocations will come, but more clarity is needed from markets and the Fed.

Exhibit 11 U.S. speculative-grade default rates
(actual and forecast)



Source: Moody's Investors Service

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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.

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

Moody's Investors Service, often referred to as Moody's, is the bond credit rating business of Moody's Corporation, representing the company's traditional line of business and its historical name. Moody's Investors Service provides international financial research on bonds issued by commercial and government entities.

CPI: A consumer price index (CPI) is a price index, i.e., the price of a weighted average market basket of consumer goods and services purchased by households. Changes in measured CPI track changes in prices over time.

MOVE Index: Bloomberg Ticker "MOVE" — statistic is computed by ICE BofA.