City National Rochdale
AN RBC/CITY NATIONAL COMPANY

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ON THE RADAR

FAQs on the Markets and Economy

What did Fed chair Powell say at the annual economic symposium held at Jackson Hole, Wyoming?

Powell's speech was short (about eight minutes long) and he did what he needed to do;

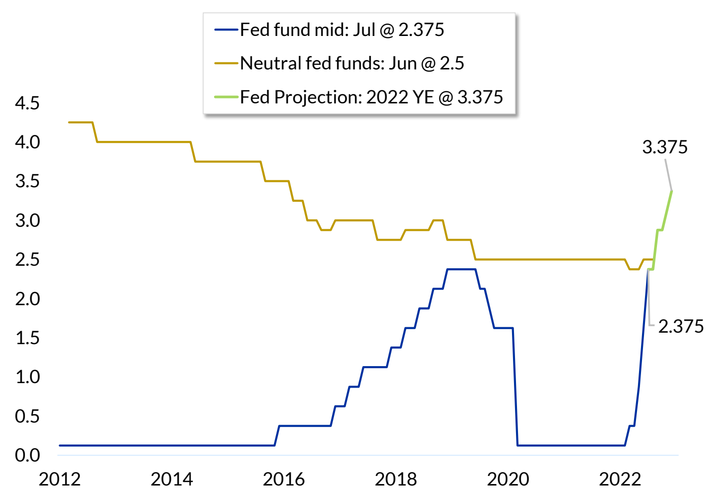
Powell made sure the whole world knew that the Fed was focused on reducing inflation to the target rate of 2.0%.

Doing so will take time, the pace of economic growth may slow, and the unemployment rate may rise due to the Fed's actions. Nevertheless, he emphasized that the Fed will successfully bring inflation back under control. He made no nuanced statement that could be interpreted as dovish. As a result, Wall Street firms are now touting the mantra "higher for longer."

There were four key points that he delivered.

- The Fed has a solid commitment to restoring price stability.
- To achieve that goal, the Fed will have to move short-term interest rates into restrictive territory.
- The pace of interest rate hikes will slow sometime, someday.
- The Fed has no plans to pivot toward interest rate cuts.

Federal Funds & Neutral Federal Funds (%)



Source: Federal Reserve

KEY QUESTIONS

- What does the strong labor market mean for the Fed?
- What have we learned from the Q2 earnings season?
- Should you be concerned about your high-yield bond portfolio?

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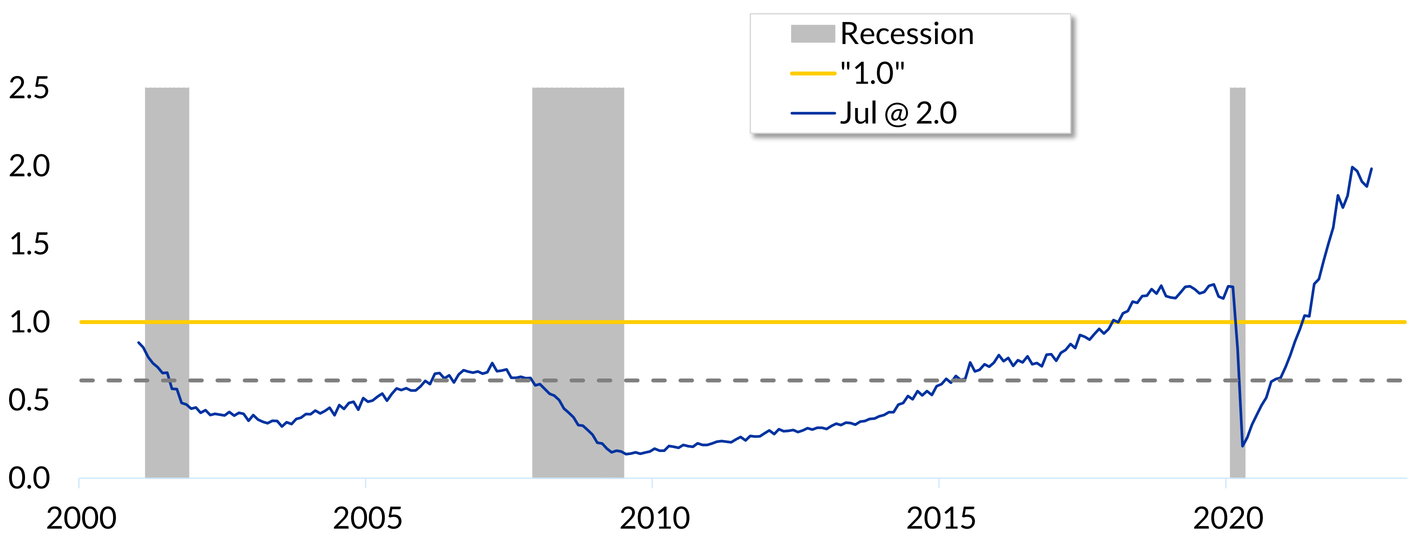
What does the strong labor market mean for the Fed?

It makes it very difficult for the Fed. This is a story of good news being bad news.

The good news is that the labor market is very strong — something every central banker wants. The bad news is that with inflation so high, the Fed's job of fighting inflation has gotten harder. Just as Powell said at the Fed's Economic Symposium in Jackson Hole, the labor market maintains impressive momentum. There is an imbalance between labor demand and labor supply, which is keeping wages high. This is a concern for the Fed since higher wages lead to higher inflation.

The demand for workers is so strong that there are now two jobs available for each person looking for a job, which compares to the long-term average of 0.6 jobs available for every job-looker (chart). This means the Fed will have to keep upward pressure on interest rates to help lower the demand for goods and services, which in turn lowers the demand for workers, which will lower the rapid wage-price appreciation.

Number of Job Openings per Job Seeker
seasonally adjusted



Source: Bureau of Labor Statistics

What have we learned from the Q2 earnings season?

With nearly all companies now reported, Q2 S&P 500 earnings grew by 8.9% from a year ago, led by strong growth from the energy sector.

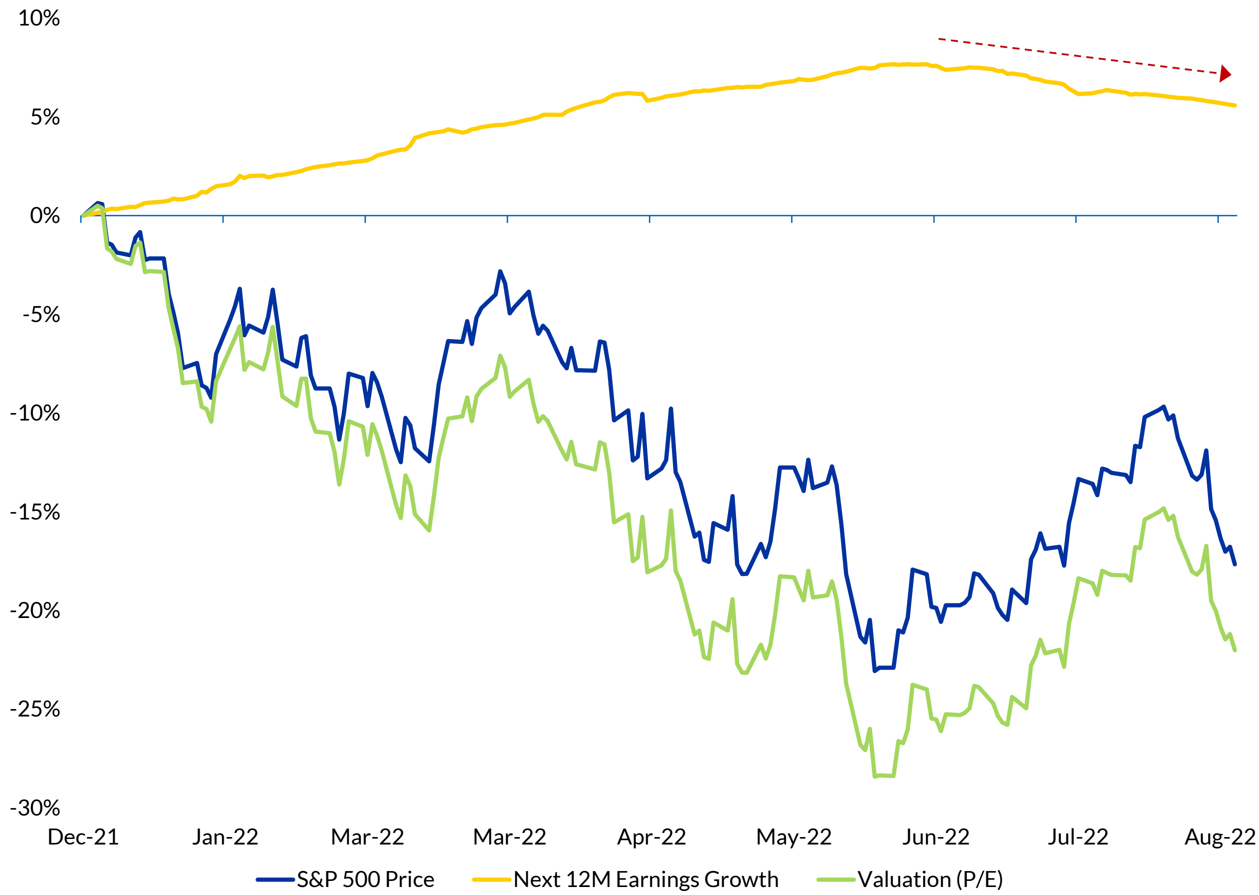
Overall, the results highlight some resiliency to corporate profit conditions driven by continued strong pricing power and the relatively solid financial position of households.

However, companies are not immune to increasing economic challenges and a more cautious forward guidance is emerging. Although revenue growth has stayed strong, helped by high inflation, companies have been citing a growing number of headwinds including rising wages, higher commodity and input costs, a stronger dollar and softer demand that could lead to earnings disappoints ahead. Margins in particular have plenty of scopes to fall from near record-high levels.

In market downturns, the initial phase of the decline has typically been driven by a drop in valuations, which is then followed but a lowering of analyst estimates for earnings. While valuations adjusted over the first half of the year, the earnings adjustment process has only just begun and we think that expectations remain too optimistic given elevated uncertainty around the outlook and rising recession risk.

For investors, this means it remains too early to signal the all-clear sign and that further downside is possible in the coming months before equity markets find a durable bottom.

Next Twelve Months Earnings Per Share Indices



Source: Factset

Should you be concerned about your high-yield bond portfolio?

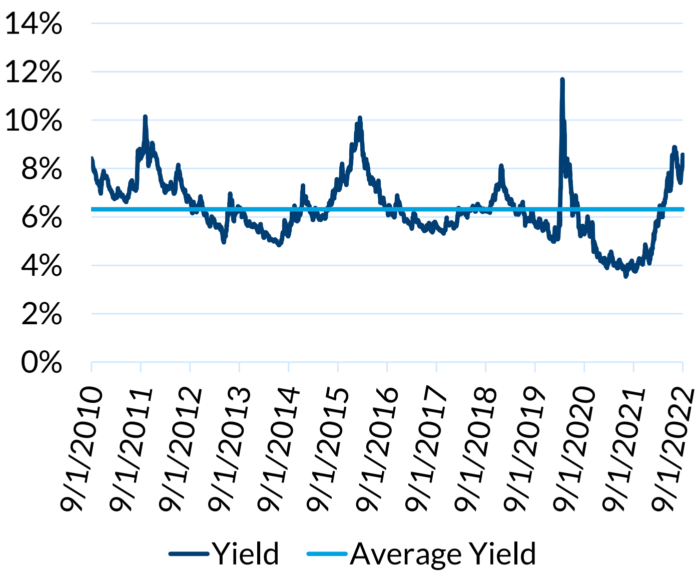
The U.S. corporate bond market has not escaped the broader bond sell-off, especially as concerns over the potential decline in growth in addition to geopolitical factors have led to concern over risk in the asset class.

However, hand-wringing over the sector's credit outlook may be overdone. The trailing 12-month default rate for high-yield or "junk" debt is only 1.3%, nearly 3.5% below the average since 1996 and 7.3% below the pandemic peak.[1] Only eight companies out of more than 300 issuers have defaulted in 2022.[2] Further, over the past 12 months, for every one downgrade, there have been two upgrades, reflecting increasing quality in the market.[3]

Another factor driving the market is the contraction of available supply. By 2022, the high-yield market has shrunk by a record $124B.[4] It seems strange that the market is shrinking at the same time credit quality is rising, but, after the robust issuance in 2020 and 2021, debt maturities have been extended and balance sheets are already flush with cash at historically low fixed interest rates. 2020 issuance increased 44% over 2019 and 2021 issuance increased 17% over 2020 for a total combined issuance of nearly $1T post-pandemic.[5] There simply isn't a need for corporations to come to market in a rising rate environment and the record-setting amount of issuance created a runway for corporations to survive a shallow economic downturn.

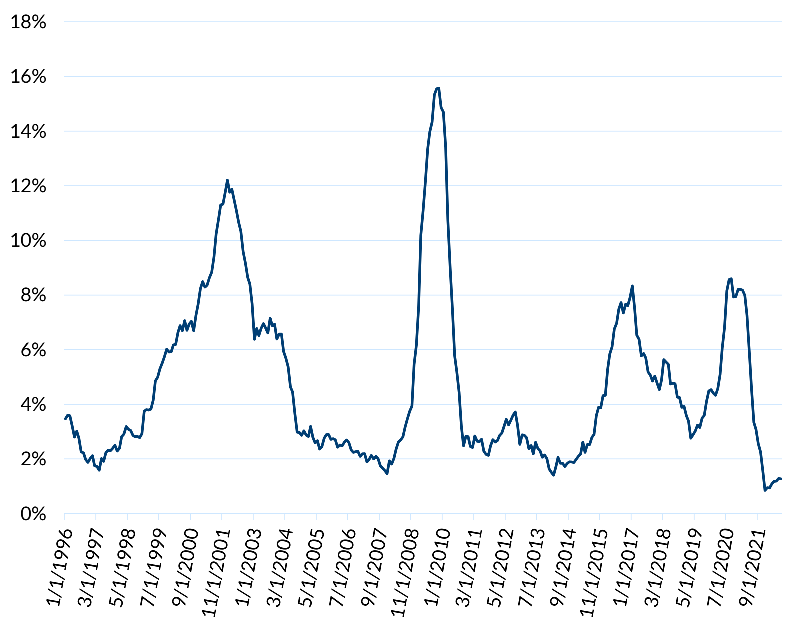
Combine the positive credit trends and reduced issuance with yields approaching 9% and the return versus risk comparison becomes attractive for the long-term investor, even if volatility continues.[6]

Bloomberg U.S. High Yield Index
Yield-to-Worst



Source: Bloomberg

U.S. High Yield Corporate Defaults
Moody's July Default Report



Source: Bloomberg

[1] Moody's Investors Service July 2022 Default Report
[2] Moody's Investors Service July 2022 Default Report
[3] Moody's Investors Service July Default Report
[4] J.P. Morgan Credit Strategy Weekly Update, August 26, 2022
[5] Bloomberg U.S. High Yield Corporate Debt League Tables
[6] Bloomberg U.S. High Yield Index

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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.

CalPERS: The California Public Employees' Retirement System, also known as CalPERS, is an organization that provides numerous benefits to its 2 million members, of which 38% are school members, 31% are public agency members and 31% are state members.

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.

4P: The 4P analysis is a proprietary framework for global equity allocation. Country rankings are derived from a subjective metrics system that combines the economic data for such countries with other factors, including fiscal policies, demographics, innovative growth and corporate growth. These rankings are subjective and may be derived from data that contain inherent limitations.

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

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