April 2024

Letter from the President: Q1 2024

Gregg Giaquinto

President

As City National Rochdale's newly appointed President, I am excited to take this opportunity to formally introduce myself and share with you what we have in store for the coming year. Since joining this firm in 2007, I have had the pleasure of working with top-tier investment management and research professionals to deliver the very best solutions to help Advisors and their clients meet their goals. I remain committed to delivering positive changes and ensure that we continue to earn your trust and partnership.

We are investing in people to help lead improved investment performance. We are launching new capabilities to provide more investment insights aligned with a goals-based approach to help clients achieve their personal aspirations. We are introducing improved digital experiences to make staying connected to your relationships easier. We are introducing new communication channels to enhance interactions with portfolio management teams. And we are focused on superior client experience.

These are some of the changes I am committed to delivering. I am dedicated to continuous improvements and always welcome your feedback, which you can share by emailing me directly at gregg.giaquinto@cnr.com. I am confident our future is bright and look forward to what we will achieve together.

April 2024

Market Update: Markets Adjusting to Higher for Longer

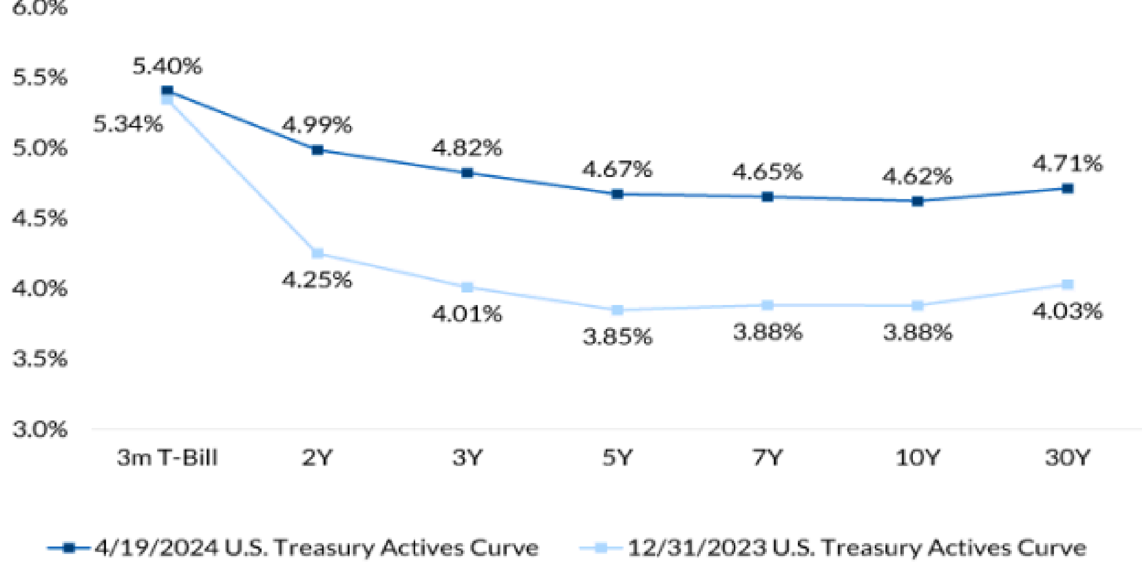
Charles Luke

Key Points

- Expecting positive, but more modest returns ahead and greater volatility
- Sticky inflation likely to keep the Fed patient on rate cuts
- Remain focused on holding quality positions in portfolios

As the calendar turned to 2024, fears of a recession had faded and the U.S. economy was bound for a soft landing. Economic growth was resilient, inflation was cooling and the Federal Reserve was poised to cut interest rates, providing a catalyst for market returns. Goldilocks was back! But we would soon learn that the economy wasn't paying attention to the speed limit. As the data rolled in, Q4 2023 GDP, inflation, retail sales and activity indexes surged above expectations, derailing hopes for rate cuts and sending U.S. Treasury yields back up to 4.7%. As luck would have it (...or not), inflation is sticky and can be volatile, reinforcing our belief in a higher-for-longer environment, and, while it appeared repricing was inevitable, the market shrugged and continued to advance on positive economic data.

Chart 1: U.S. Treasury Curve Comparison



Sources: Bloomberg, CNR Research, as of April 2024.

Information is subject to change and is not a guarantee of future results.

Our work suggests the U.S. economy is on solid footing, and we have recently lowered our risk of recession from 50% to 30%. However, growth is likely to moderate from the robust pace seen over the second half of 2023. We can't change the laws of physics. What goes up must come down, even if this economic environment stands out for its unique ability to resist gravity. The tried-and-true methods for understanding the economy are in a serious slump, and it's clear that high interest rates alone are insufficient to cause a recession. For now, there are no clear short-term vulnerabilities, which underpins our belief that an expansion can continue. But the same forces that power growth can put pressure on inflation, which is likely to keep rates high for longer than anticipated. This may not be the worst problem for the market, but it does change the dynamics for the Fed.

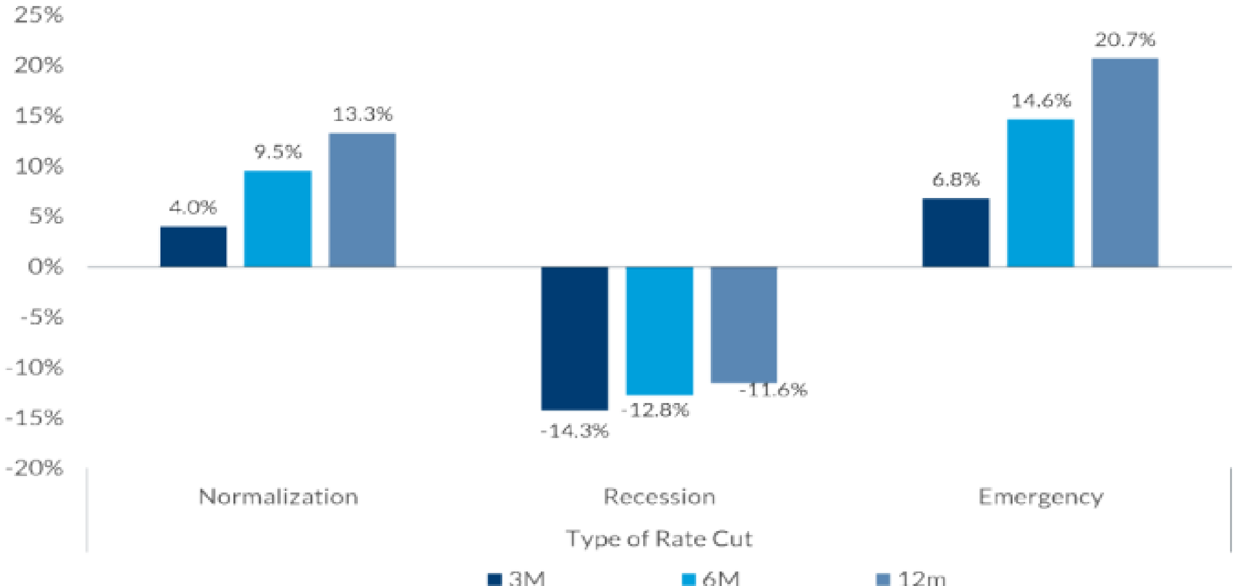
The markets are eager for the first rate cut, but the data dependency of the Fed is making it tough to stay on the projected path of two to three cuts this year. We would prefer the Fed act when there is clear confirmation of sustainably lower inflation instead of risking an overheated scenario. It's reasonable to assume the Fed is acutely aware of the double inflation top of the 1970s and is not interested in seeing double inflation for itself. The good news is that high policy rates will continue to create opportunities in the bond market, and current rate levels are attractive as an entry point for our clients comfortable with extending maturities. Given a consensus that the 10-year U.S. Treasury yield will fall before the end of 2024, we have high conviction it's a good trade.

What is very clear to us is that the Fed is done hiking interest rates. The big picture is still one in which monetary policy will become looser over the next 12 months, a helpful force for the economy and financial markets. Stock market performance is influenced by the stance of the Fed and, when rates are being normalized as opposed to being slashed in an emergency, stocks tend to do well. Going back to 1984, when rates were cut as part of a normalization process, the S&P500 rose 13.25% on average. There is a strong case that the equity market can continue to move higher, but at current valuations and with a more patient Fed, scrutiny of the current run is intensifying.

Over the past five months, the S&P500 is up 25.3%, which is the seventh time the index has gained more than 25% since WWII over a five-month span. The near-term historical experience is mixed and over one-month periods after hitting peak returns, the market has been essentially flat. However, over 12 months, the average return is 21.1%. So, it wouldn't be out of the ordinary to see a decline in the market, especially in light of the intensifying geopolitical conflicts, but we believe investors should stay the course and use any significant pullbacks as an opportunity to add to equity exposure. While we can't ignore the elevated anxiety over what's happening globally, a sustained selloff in stocks is much more likely to be caused by a U.S. domestic economic problem than an international war.

Chart 2: S&P 500 Performance

After First Fed Rate Cut



Sources: FactSet, St. Louis Fed, as of April 2024.

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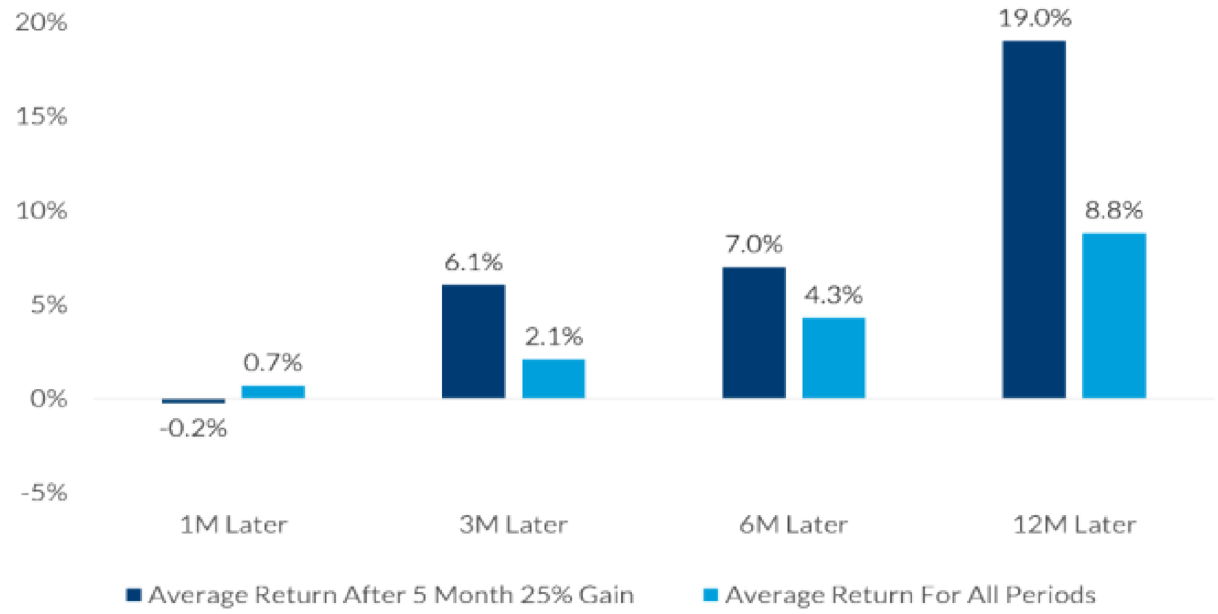
Still, valuation is quite high at over 21x, and the biggest risk to the market is likely twofold. First, any unwind of earnings expectations or a stumble during earnings season could result in a move lower. Second, the current level of interest rates will eventually become a headwind, especially if the Fed stays on hold. With very high expectations, earnings growth will need to come through to justify extended valuations; at market consensus above 11% for FY2024, there's quite a bit of downside to the estimates and limited upside. Given the amount of the liquidity that came into the market during the pandemic, the increase in rates has not been felt fully, but that clock is ticking. Together with rising geopolitical risk, it's very likely that we will see a stumble or two this year.

Chart 3: S&P 500 Performance



Source: Ned Davis Research, as of February 2024.

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Past performance is no guarantee of future results.

But we think we're ready for this. While our defensive exposure has come down, our core equity portfolio remains focused on quality, holding reasonably valued companies with strong fundamentals and growth prospects. For clients seeking additional capital appreciation, we've increased exposure to mid- and small-cap companies, which have lagged the rally but should benefit from improved confidence in the economic outlook and a broadening in market participation. History also suggests dividend stocks are attractively priced, and dividend growth can provide more income-oriented investors with the potential for a hedge against inflation.

In Fixed Income, we have yet to materially extend duration on a relative basis, but we are just fine with benchmark duration. The key is for investors with long-term time horizons and income needs to take the plunge into longer maturity strategies, especially if they are holding cash. While price appreciation in bonds may be limited until inflationary pressures abate, yield levels on high-quality fixed income continue to provide attractive opportunities. In fact, this is the first time in many years that investors have been able to take advantage of a divergence in asset classes. We see a rich set of opportunities across the bond market that was previously only a pipe dream two years ago.

Given the current economic advantages, asset allocation options and higher rates, we do expect positive returns to continue for well-balanced portfolios. However, going forward we expect more modest returns, and we are positioning portfolios to remain durable in an environment with structurally higher interest rates. As investors reset expectations within a longer-term market advance, more divergence is likely, which will demand greater flexibility and active management with an opportunistic approach to take advantage of any dislocations the market offers. We will be looking for such opportunities at some point in the months ahead to add quality investments to portfolios, as well as to think about diversifying portfolios for a potential broadening of market leadership.

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All investing is subject to risk, including the possible loss of the money you invest. As with any investment strategy, there is no guarantee that investment objectives will be met, and investors may lose money. Diversification may not protect against market risk or loss. Past performance is no guarantee of future performance.

There are inherent risks with equity investing. These risks include, but are not limited to stock market, manager, or investment style. Stock markets tend to move in cycles, with periods of rising prices and periods of falling prices.

There are inherent risks with fixed income investing. These risks may include interest rate, call, credit, market, inflation, government policy, liquidity, or junkbond. When interest rates rise, bond prices fall.

Index Definitions

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April 2024

Core Equity: Increasing Cyclical Exposure in Response to Improved Economic Outlook

Amy Chen

Director

Key Points

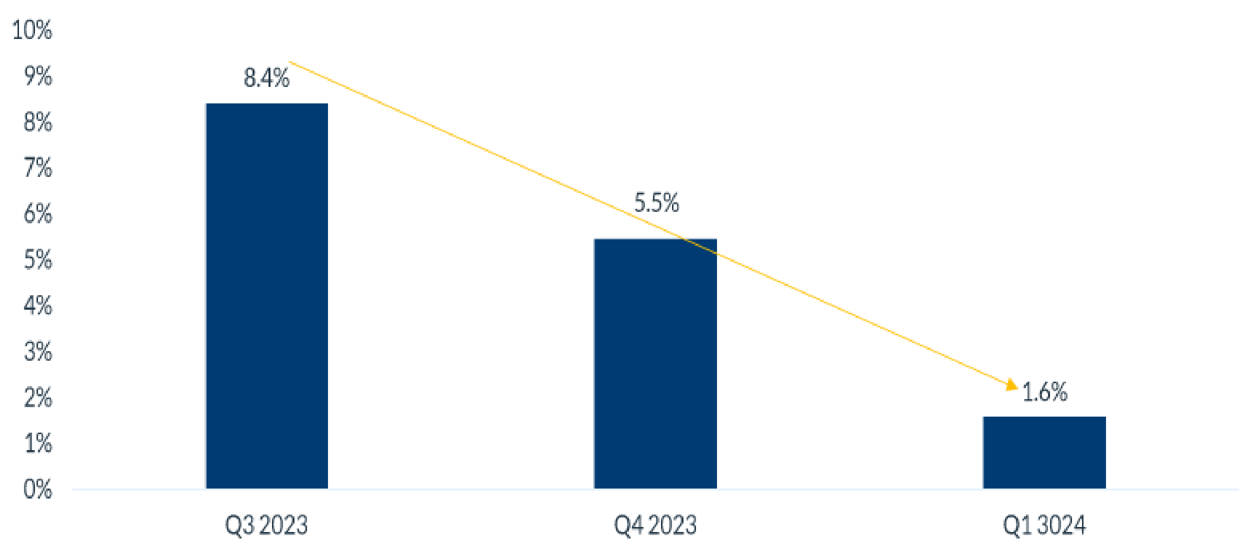
- Continue to focus on beneficiaries of key Digital Revolution theme.
- Proactive steps taken increase quality and upside return potential.

Since last fall, our confidence in the outlook for the U.S. economy has improved, as a resilient consumer and prospects for a normalization of monetary policy materially lower recession risk. Given this backdrop, the outlook for corporate profit growth has improved as well, and we have been methodically lowering our defensive tilt in core equity portfolios while increasing our exposure to stocks that would benefit from prospects of better and more sustained economic growth. We have also narrowed our focus on stocks in our digital revolution theme to those that are best positioned for spending on artificial intelligence.

The nonstop upward momentum in the equity markets from the October lows continued over the first quarter, with the S&P 500 rising 10.5%. Our Core Equity Strategy increased 8%, net of fees, while our Aggressive Core Strategy increased 9.6%, net of fees. As we exited Q1, our largest industry group overweights were in Financial Services +3.5% and Semiconductors +2.1%, and our largest underweights were Tech Hardware -2.7% and Health Care Equipment and services -1.9%. Performance lagged in the Core strategy as a result of negative stock selection in semiconductors, healthcare and pharmaceutical stocks that more than offset outperformance in Capital Goods, Financial Services and Consumer Staples.

Chart 1: CNR Core Equity Strategy

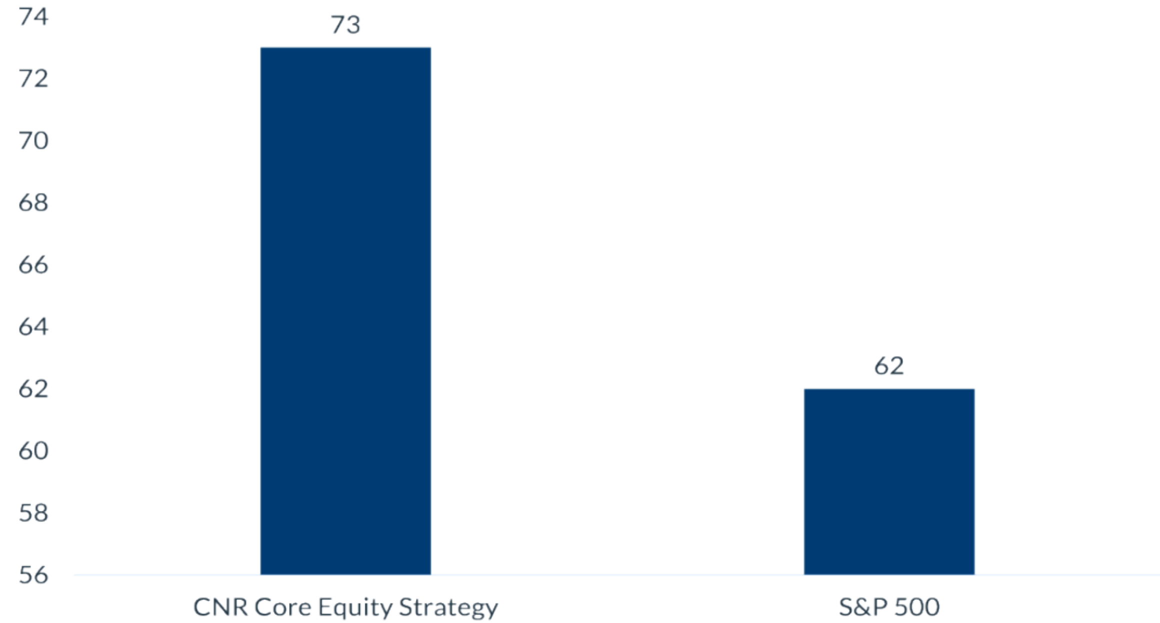
Defensive vs. Cyclical Tilt



Source: FactSet, CNR Research, as of March 2024.
Information is subject to change and is not a guarantee of future results.

In addition to increasing cyclical exposure in strategies, we have taken proactive steps to lower our tracking error, raise our quality rank and increase the upside potential of the portfolio by either taking profits in stocks that did very well in 2023 or selling stocks with fundamental disappointments. We are optimistic these adjustments will enhance the return potential of the strategy on both an absolute and relative basis.

Chart 2: Quality Rank



Source: FactSet, CNR Research, as of March 2024.
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Investing involves risk including loss of principal. The market price of a security may move up and down, sometimes rapidly and unpredictably. The securities of mid-cap companies may have greater price volatility and less liquidity than the securities of larger capitalized companies. Larger, more established companies may be unable to attain the high growth rates of successful, smaller companies during periods of economic expansion. Current and future holdings are subject to risk. There is no guarantee the fund will achieve its stated objective.

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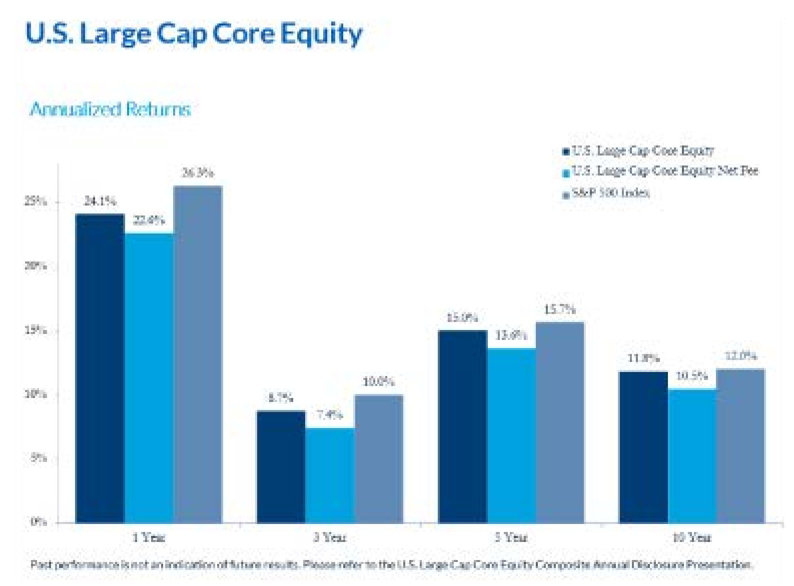
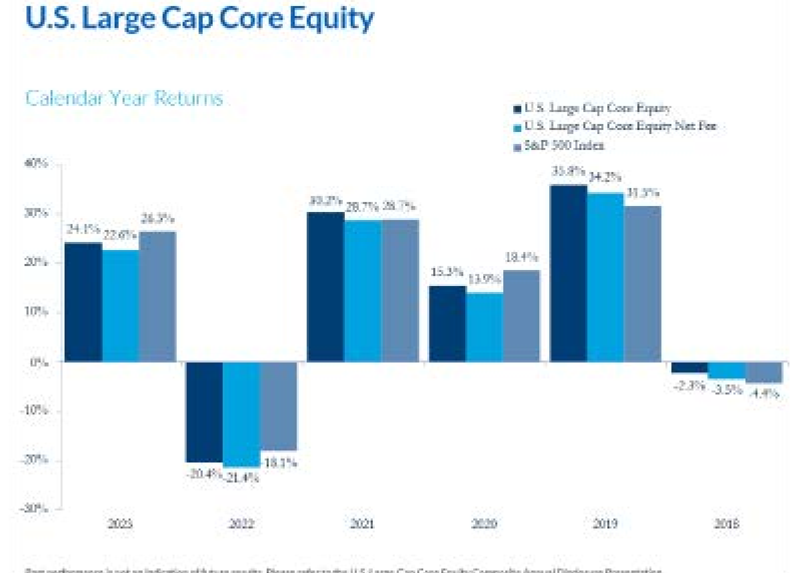
Definitions

P/E Ratio: The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its earnings per share (EPS).

City National Rochdale Proprietary Quality Ranking formula: 40% Dupont Quality (return on equity adjusted by debt levels), 15% Earnings Stability (volatility of earnings), 15% Revenue Stability (volatility of revenue), 15% Cash Earnings Quality (cash flow vs. net income of company) 15% Balance Sheet Quality (fundamental strength of balance sheet).

*Source: City National Rochdale proprietary ranking system utilizing MSCI and FactSet data.
**Rank is a percentile ranking approach whereby 100 is the highest possible score and 1 is the lowest. The City National Rochdale Core compares the weighted average holdings of the strategy to the companies in the S&P 500 on a sector basis. As of September 30, 2022. City National Rochdale proprietary ranking system utilizing MSCI and FactSet data.





U.S. Large Cap Core Equity

GIPS Report

	2022	2021	2020	2019	2018	2017	2016	2015
Composite Gross Return (%)	-20.4	30.2	15.2	35.8	-2.3	26.2	6.7	3.6
Composite Net Return (%)	-21.5	28.7	13.8	34.2	-3.5	24.7	5.4	2.4
Benchmark Return (%)	-18.1	28.7	18.4	31.5	-4.4	21.8	12.0	1.4
Internal Dispersion (%)	1.4	1.0	0.9	1.9	0.7	0.0	0.0	1.2
Composite 3-Year Standard Deviation (%)	20.5	16.2	16.9	10.7	10.6	10.1	11.0	11.1
Benchmark 3-Year Standard Deviation (%)	21.2	17.4	18.8	12.1	11.0	10.1	10.7	10.6
Number of Portfolios at Year End	18	22	14	11	6	≤5	≤5	≤5
Composite Assets at Year-End ($ M)	368	496	444	357	273	287	219	222
Firm Assets at Year-End ($ M)	53,106	55,027	46,025	42,715	34,339	32,862	26,272	22,584

City National Rochdale, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. City National Rochdale, LLC has been independently verified for the periods January 1, 2000 through December 31, 2020. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The U.S. Large Cap Core Equity Composite has had a performance examination for the periods January 1, 2013 through December 31, 2020. The verification and performance examination reports are available upon request.

1. City National Rochdale, LLC is a global multi-asset manager that invests in U.S.-based, International Developed, International Emerging and Alternative securities. City National Rochdale, LLC is a registered investment advisor and is an affiliate of City National Bank, its parent company. City National Bank is an affiliate of Royal Bank of Canada, its parent company. On July 1, 2013, Rochdale Investment Management was acquired by City National Bank and combined with City National Asset Management, a division of the Bank. For GIPS compliance purposes, Rochdale Investment Management and City National Asset Management continued to operate as separate firms through September 30, 2013.

2. The U.S. Large Cap Core Equity Composite includes all fully discretionary fee-paying portfolios that seek to provide capital appreciation, with current income as a secondary objective, through investment of 55-65 recommended equity securities of companies with large capitalization. The minimum account size for composite inclusion is $500,000. The composite was created and incepted on December 31, 2012. As of November 1, 2017 the U.S. Core Equity Composite has been renamed the U.S. Large Cap Core Equity Composite. A complete list of composite descriptions and broad distribution pooled funds, and broad distribution pooled funds is available upon request.

3. The benchmark used is the S&P 500 TR Index which is a commonly recognized, market capitalization weighted index of 500 widely held equity securities, designed to measure broad U.S. equity performance.

4. Gross of fee returns include the cost of brokerage commissions, but excludes the impact of management, custodial and other fees and the impact of any income taxes an investor might have incurred as a result of taxable ordinary income and capital gains realized by the accounts. Net of fee returns are calculated by deducting the highest annual fee of 1.25% applied to the quarterly gross returns. The management fee is as follows: up to 1.25% on the first $1 million, 1.00% on the next $4 million, 0.75% on the next $5 million and 0.50% thereafter. Returns include the reinvestment of income.

5. Internal dispersion is calculated using the equal-weighted standard deviation of the monthly gross returns of those portfolios that were included in the composite for the entire year.

6. The 3-Year Annualized Ex-post Standard Deviation measures the variability of composite gross returns and the benchmark returns over the preceding 36-month period. The Standard Deviation is not represented prior to 2015 because 36 monthly returns of the composite are not available since the creation date is 12/31/2012.

7. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

8. Valuations are computed and performance is reported in U.S. dollars.

9. Any composite account that has a cash flow of 50% or greater in a single transaction is eliminated from the composite for the current valuation period. The excluded account is eligible for the composite again at the next valuation period. This policy is effective as of 1/1/2014 and from inception through 12/31/2013 the maximum was 10%.

10. Past performance is not an indication of future results.

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April 2024

Equity Income:
Dividend Growth and Income

David A. Shapiro
Director

Tony Hu
Director

Key points:

- Over the last 10 years, attractive yielding dividend stocks have yielded an average of 4%, and grown dividend income +7% per year.
- Dividend income growth is a potential inflation offset and compounder of value.
- Attractive yielding dividend stocks provide both growing income and potential capital appreciation.

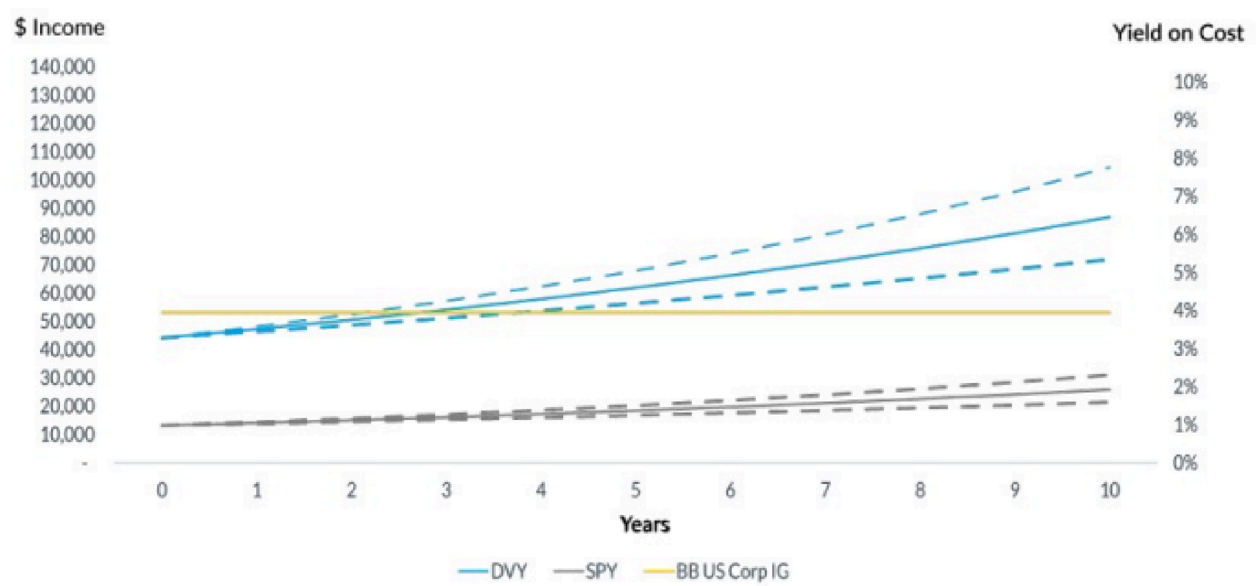
A key characteristic of our attractive dividend universe is its historically consistent, **relatively high yield, which can be a meaningful contributor to overall client portfolio income while providing potential equity upside**. We expect its income to grow over time, **with the potential to offset inflation and compound portfolio value.**

Let's take a look at the dividend universe vs. a couple of alternatives.

Over the last 10 years, our dividend universe has averaged a yield of 4%, more than twice as high as the average equity market yield[1] and approximately 50 bps higher than the average yield of corporate bonds[2]. During that time, our benchmark's dividend has increased at a 7% CAGR, slightly ahead of that of the S&P 500 and ahead of inflation (<3%). Fixed income is fixed.

The accompanying chart plots the hypothetical experience looking forward 10 years for these three asset classes using current yields and historical growth rates (the range around each solid line accounts for variance of +/-2% vs. the historical average) and assuming an initial investment in each of $1m. Within three years, dividend growth raises portfolio income of the attractive dividend universe above that of corporate bonds, even at today's compelling rates, and continues to grow from there. Income from the market portfolio never catches up.

Chart 1: Dividend Growth and Income



Source: Bloomberg, as of March 2024.

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DVY: The iShares Select Dividend ETF seeks to track the investment results of an index composed of relatively high dividend paying U.S. equities. The ETF has a fee of .038%.

SPY: The SPDR S&P 500 ETF Trust aims to track the Standard & Poor's (S&P) 500 Index, which comprises 500 large-cap U.S. stocks. The ETF has a fee of .09%.

Moreover, while yield to cost in this example ends up at an approximate 9% yield, history shows that the dividend portfolio is unlikely to trade there. Rather, history suggests **it is more likely that the portfolio continues to be priced around that 4% yield**. In order for that to be the case, for the yield to remain around that historical average, with income having roughly doubled, portfolio value would have to roughly double as well.

The appropriate mix of income, potential equity appreciation, and volatility is part of the mosaic that our portfolio managers build for clients. That mix can and should be adjusted, as appropriate, over time, based on evolving market conditions and client needs. That our **dividend universe provides consistently meaningful and historically growing income gives it an ongoing place in the conversation,** in our view.

Within the equity income strategy, given today's normalizing rates and inflation, we have biased stock selection in favor of dividend growth over yield, all else equal, to maximize its potential benefit as an inflation offset.

[1] **S&P 500 Index**

[2] **Bloomberg U.S. High Yield Corporate Index**

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The Bloomberg US Corporate Index measures the investment grade, fixed-rate, taxable corporate bond market.

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April 2024

Taxable Strategies: Continued Momentum in Credit Powers Fixed Income Returns

Charles Luke

Chief Investment Officer

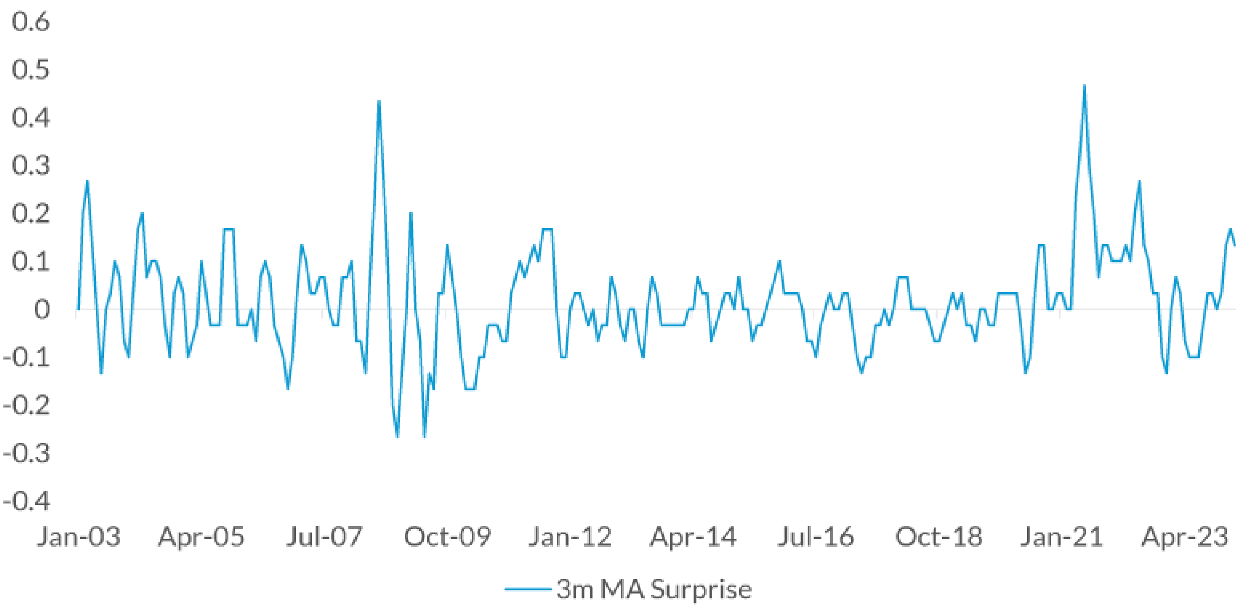
Key Points

- The early-year consensus that interest rates would fall has been challenged by price measures that have moved above expectations, creating concern over a second wave of inflation.
- Led by strong performance in leveraged loans and emerging market high yield bonds, opportunistic income thrived.
- Borrowers are taking advantage of increased demand to position for the impact of higher debt costs.

The first quarter of 2024 was characterized by positive economic data, fueling a wide trading range for interest rates. The 10-Year U.S. Treasury yield finished the quarter 0.3% above its 2023 closing level, but fluctuated from a low of 3.8% to a high of 4.4% - a range of 0.6%.[1] A portion of the volatility can be attributed to a data-dependent Federal Reserve, which continues to shift the expected timing of rate cuts. The early year consensus that interest rates would fall has been challenged by price measures that have moved above expectations, creating concern over a second wave of inflation. February CPI data marked the largest upside surprise since July 2022.[2] In our view, this continues to place a floor on the 10-year U.S. Treasury rate around 4.0%, and we expect a range over 2024 of 4.0% - 4.5%, with an increased probability of testing last year's 5.0% peak.[3]

Chart 1:CPI Surprise Index

(3-Month Moving Average)



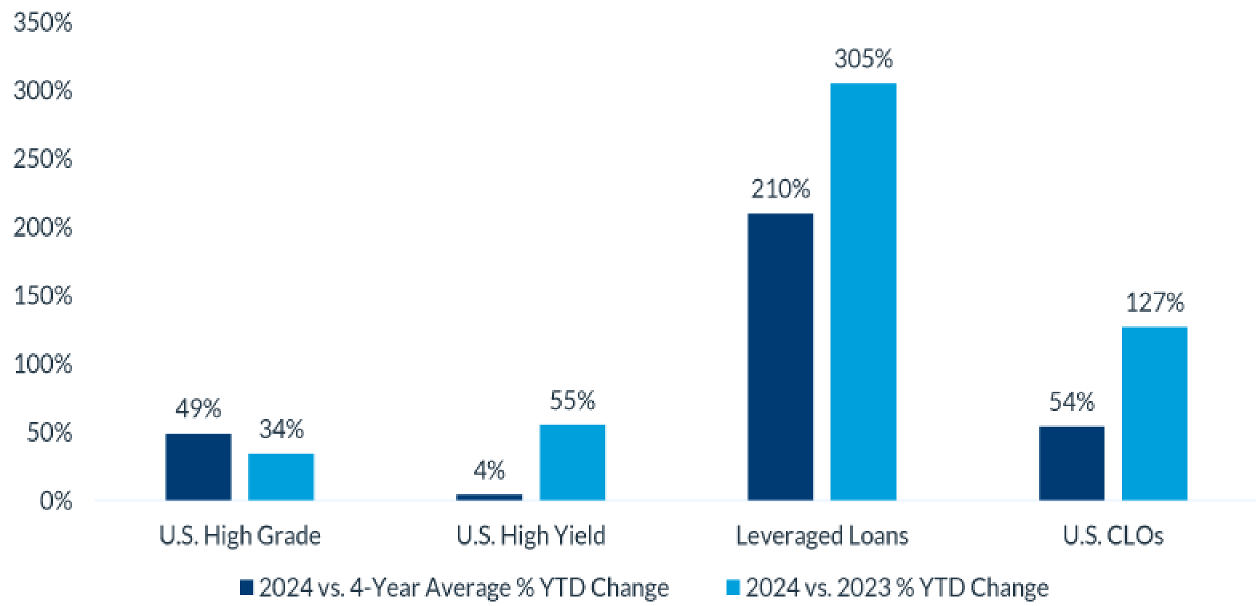
Source: Bloomberg, as of March 2024. Indexes are unmanaged and do not reflect a deduc-tion for fees or expenses. Investors cannot invest directly in an index. Past performance is no guarantee of future results.

Turning to performance, the Bloomberg U.S. Aggregate Bond Index, which represents investment grade bonds, fell -0.78%, suffering from the impact of higher interest rates.[4] Riskier sectors of the market rose as the economy remained resilient, and high starting yields helped to offset negative price moves. Led by strong performance in leveraged loans and emerging market high yield bonds, opportunistic income thrived. Indices for U.S. High Yield, Leveraged Loans and Emerging Market High Yield climbed substantially during the quarter, up 1.5%, 2.4% and 3.8%, respectively.[5]

While investors are now positioned for a soft landing, the shifting stance of the Federal Reserve is pointing to fewer rate cuts than expected. This may keep interest rates high, and, despite very little evidence to suggest credit quality is eroding, we are watching the market closely for any signs of weakness as a result. Given that concern, we prefer higher-quality positions across our bond portfolios.

Ultimately, the high yield market is performing well, based on two key factors: below-market fixed coupons locked in prior to the increase in interest rates,[7] and the lack of debt maturities in 2024.[8] Further, new issue activity in the first quarter jumped significantly, posting $93B in high yield bonds and $332B in Institutional Loans, 120% and 354% over Q1 2023, respectively.[9] Borrowers are taking advantage of increased demand to position for the impact of higher debt costs, and we expect the level of defaults to stay below the historical averages of previous credit cycles.

Chart 2: 2024 Issuance Comparisons



Source: Bloomberg, as of March 2024. Indexes are unmanaged and do not reflect a deduc-tion for fees or expenses. Investors cannot invest directly in an index. Past performance is no guarantee of future results.

[1,3] U.S. 10-Year Treasury, Source: Bloomberg, Ticker: GT10 Govt, Closing Levels.

[2] U.S. Bureau of Labor Statistics, U.S. Personal Consumption Expenditure Core Price Index YoY, Source: Bloomberg, Ticker: PCE CYOY.

[4] Bloomberg U.S. Aggregate Bond Index, Source: Bloomberg, Ticker: LBUSTRUU.

[5] Bloomberg High Yield Corporate Bond Index, Source: Bloomberg, Ticker: LF98TRUU, Leveraged Loans: Morningstar LSTA Leveraged Loan Index, Source: Bloomberg, Ticker: SPBDAL, Emerging Market High Yield: ICE BofA High Yield U.S. Emerging Markets Liquid Corporate Plus Index, Source: Bloomberg, Ticker: EMHY.

[7] Bloomberg High Yield Corporate Bond Index coupon field, Source: Bloomberg, Ticker: LF98TRUU, Field: CPN.

[8,9] JPM, High-Yield Bond and Institutional Loan Maturity Schedule, as of February 9, 2024.

Past performance is no guarantee of future results.

Index performance is provided as a benchmark. It is not illustrative of any particular investment. Indices are unmanaged, and one cannot invest directly in an index. Index returns do not reflect a deduction for fees or expenses.

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All investing is subject to risk, including the possible loss of the money you invest. As with any investment strategy, there is no guarantee that investment objectives will be met, and investors may lose money. Diversification may not protect against market risk or loss. Past performance is no guarantee of future performance.

There are inherent risks with fixed income investing. These risks may include interest rate, call, credit, market, inflation, government policy, liquidity, or junkbond. When interest rates rise, bond prices fall.

Municipal securities. The yields and market values of municipal securities may be more affected by changes in tax rates and policies than similar income-bearing taxable securities. Certain investors' incomes may be subject to the Federal Alternative Minimum Tax (AMT), and taxable gains are also possible. Investments in the municipal securities of a particular state or territory may be subject to the risk that changes in the economic conditions of that state or territory will negatively impact performance. These events may include severe financial difficulties and continued budget deficits, economic or political policy changes, tax base erosion, state constitutional limits on tax increases and changes in the credit ratings.

Index Definitions

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are

available for the U.S. and various geographic areas. Average price data for select utility, automotive fuel, and food items are also available.

Bloomberg Barclays US Aggregate Bond Index (LBUSTRUU): The Bloomberg Aggregate Bond Index or “the Agg” is a broad-based fixed-income index used by bond traders and the managers of mutual funds and exchange-traded funds (ETFs) as a benchmark to measure their relative performance.

Bloomberg US High Yield Index: The Bloomberg US Corporate High Yield Index measures the performance of non-investment grade, US dollar-denominated, fixed-rate, taxable corporate bonds.

U.S. High grade: This data represents the effective yield of the ICE BofA US High Yield Index, which tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market.

Bloomberg: LF98TRUU Index: The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded. This is the total return index level.

Bloomberg Investment Grade Index: The Bloomberg US Investment Grade Corporate Bond Index measures the performance of investment grade, corporate, fixed-rate bonds with maturities of one year or more.

A leveraged loan is a type of loan that is extended to companies or individuals that already have considerable amounts of debt or poor credit history.

The Bloomberg Global High Yield Index is a multi-currency flagship measure of the global high yield debt market. The index represents the union of the US High Yield, the Pan-European High Yield, and Emerging Markets (EM) Hard Currency High Yield Indices.

A collateralized loan obligation (CLO) is a single security backed by a pool of debt.

Non-deposit investment Products are: • not FDIC insured • not Bank guaranteed • may lose value

April 2024

Tax-Exempt Strategies: Municipals Bounce but Stay the Course

Michael Taila

Managing Director

William D. Black

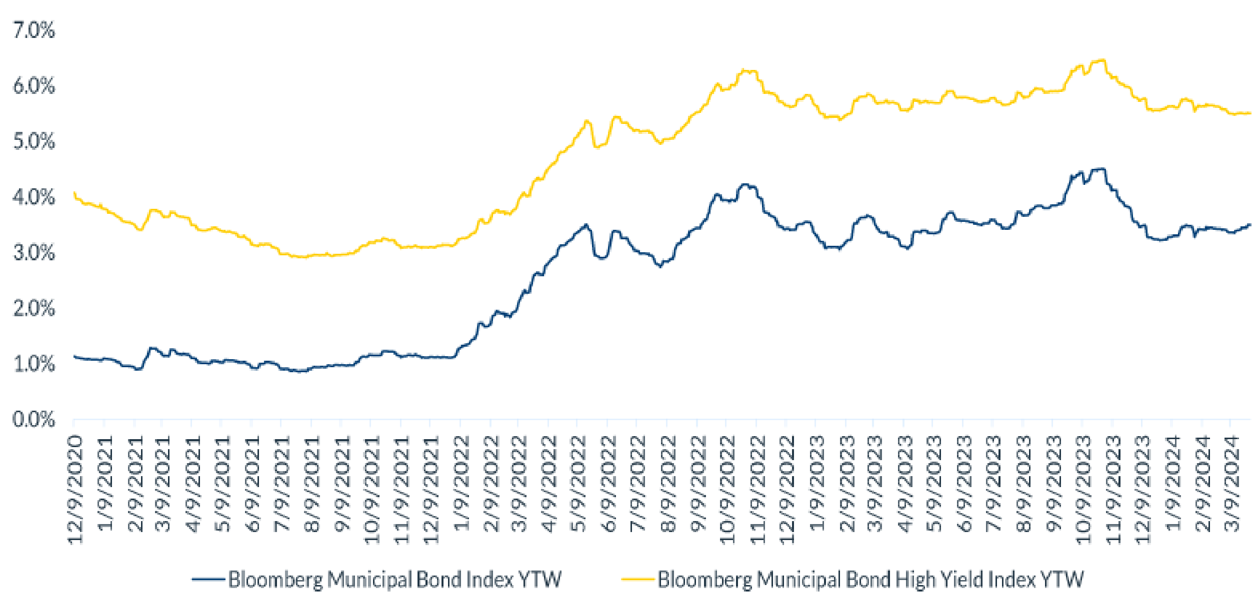
Managing Director

Key Points

- Absolute yields tick higher, underscoring long-term value.
- Supply deficit and ample liquidity propel high-yield prices.
- Credit fundamentals benefit from extended economic glide path.

Municipal bonds carefully confronted financial market volatility to deliver favorable relative performance to begin the year. Notwithstanding the whipsaw in rates, Bloomberg indices reported investment-grade (IG) municipal bonds posted a slightly negative return of 39 bps for the quarter, while high-yield municipals (HYM) rewarded their investors with a 1.5% total return. To give perspective, U.S. Treasuries closed out the first quarter in the red 96 bps. The comparatively strong showing of IG and HYM bonds is attributable to solid investor demand, as evidenced by positive net municipal mutual fund flows YTD of nearly $8 billion and the favorable impact of income accrual on fluctuating bond prices. **Absolute municipal bond yields remain a linchpin to their value proposition for long-term investors seeking attractive tax-efficient cash flow and forward-return potential.** According to Bloomberg indices, IG and HYM index yield-to-worst (YTW) settled at 3.5% and 5.5%, respectively, at quarter-end, translating into taxable-equivalent yields[1] of 5.9% and 9.3%, respectively. Municipal bonds historically benefit from a lower correlation to other asset classes, which tends to reduce portfolio volatility over time, thus currently available yields offer a compelling entry point for investor portfolios.

Chart 1: Yield-to-Worst (YTW) for IG and HYM Bonds Remain Attractive



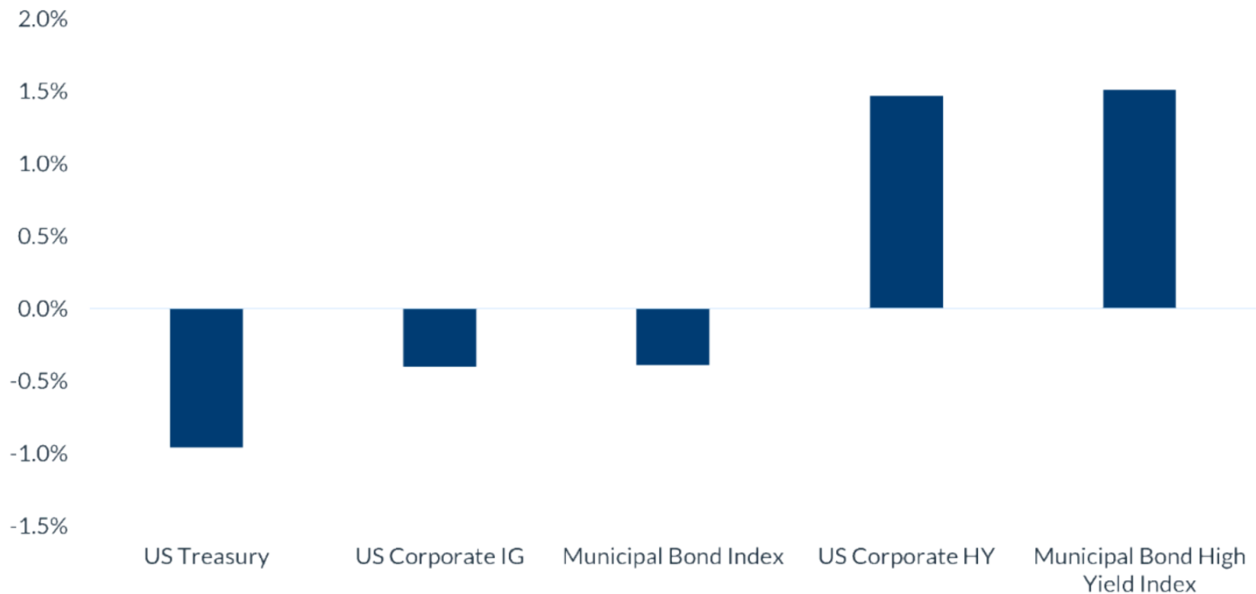
Source: Bloomberg, as of March 29, 2024.

All sources are Bloomberg indexes.

Indexes are unmanaged and do not reflect a deduction for fees or expenses. Investors cannot invest directly in an index. Information is subject to change and is not a guarantee of future results.

Technical factors often play a significant role in the price behavior of municipal bonds. Gross issuance reached approximately $100 billion during the quarter, or a 25% increase YoY. Despite the strong trend of municipal market supply, deal flow in the HYM space underwhelmed demand. **The lack of traditional HYM supply has bolstered liquidity and improved secondary market trading conditions as product scarcity benefited security prices.** Moreover, as the probability of an economic correction this year dissipates, HYM investors have become more comfortable with risk. Credit spreads, as measured by the YTW differential of the Bloomberg Municipal High Yield Index relative to the Bloomberg Municipal (IG) Index AAA and BBB YTW, have declined since the beginning of the year by approximately 40 bps and 15 bps, respectively. These trends are likely to continue in the near term; however, dislocation in the Treasury market or changes in expectations for Fed policy could have implications. With the perceived belief that the rate cycle has likely plateaued, longer-duration assets have garnered increased attention, contributing to the favorable first-quarter performance.

Chart 2: 1Q 2024 Fixed Income Asset Class Returns



Source: Bloomberg, as of March 29, 2024.

All indices used in the chart above are Bloomberg.

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The resilient economy continues to underpin municipal credit conditions. Moody's reported a third consecutive year of upgrades outpacing downgrades in 2023. **Reserve funds of state and local governments remain at or near record levels, while many revenue enterprises have either reached or exceeded their pre-pandemic operations.** Should budget performance decelerate or turn negative, most issuers are well-positioned to manage through a period of instability. Within HYM, troubled borrower activity remains in line with the quarterly experience of last year, with continued pressure in a few sectors, like senior living, albeit trends are beginning to improve in some regions. Credit selectivity, security structure, and sector orientation are key considerations in navigating the market.

[1]Taxable-equivalent yield – this is based on 37% marginal + 3.8% Medicare Surcharge

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Bloomberg risk is the weighted average risk of total volatilities for all portfolio holdings. Total Volatility per holding in Bloomberg is ex-ante (predicted) volatility that is based on the Bloomberg factor model.

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Index Definitions

Bloomberg Municipal Bond Index: The Bloomberg US Municipal Bond Index measures the performance of investment grade, US dollar-denominated, long-term tax-exempt bonds.

Bloomberg Municipal High Yield Bond Index: The Bloomberg Municipal High Yield Bond Index measures the performance of non-investment grade, US dollar-denominated, and non-rated, tax-exempt bonds.

S&P Leveraged Loan Indexes (S&P LL indexes) are capitalization-weighted syndicated loan indexes based upon market weightings, spreads and interest payments. The S&P/LSTA Leveraged Loan 100 Index (LL100) dates back to 2002 and is a daily tradable index for the US market that seeks to mirror the market-weighted performance of the largest institutional leveraged loans, as determined by criteria. Its ticker on Bloomberg is SPBDLLB.

Bloomberg US Corporate Bond Index: The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

Bloomberg US High Yield Index: The Bloomberg US Corporate High Yield Index measures the performance of non-investment grade, US dollar-denominated, fixed-rate, taxable corporate bonds.

Bloomberg Investment Grade Index: The Bloomberg US Investment Grade Corporate Bond Index measures the performance of investment grade, corporate, fixed-rate bonds with maturi es of one year or more.

Investment Grade (IG) Municipal Bond Index: The Bloomberg US Municipal Bond Index measures the performance of investment grade, US dollar-denominated, long-term tax-exempt bonds.

High Yield (HY) Municipal Bond Index: The Bloomberg Municipal High Yield Bond Index measures the performance of non-investment grade, US dollar-denominated, and non-rated, tax-exempt bonds.

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April 2024

The Fed: The Fed Has Its Work Cut Out for Itself

Paul Single

Managing Director

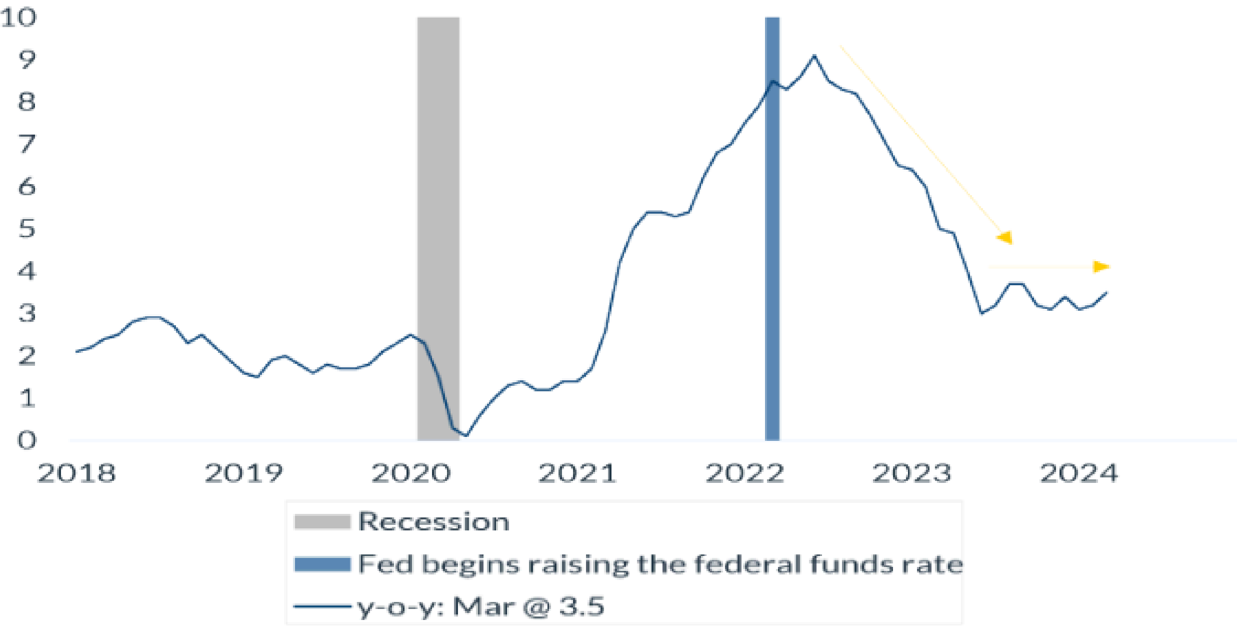
Key Points

- Growth last year was 3.1%, well above the trend rate of 2.0% to 2.5%. Many elements have offset the Fed's restrictive policy.
- The lower pace of borrowing should produce less spending.

The Federal Reserve is in a challenging situation right now. Despite quickly raising the federal funds rate 525 basis points in a little over a year to 5.375%, to a level generally deemed very restrictive, **economic growth has yet to show signs of slowing.** Growth last year was 3.1%, well above the trend rate of 2.0% to 2.5%, with most of that growth coming from household spending (68%). This continued demand has kept pressure on inflation, helping to prevent inflation from declining toward the Fed's goal of 2.0% (see chart 1).

Chart 1: CPI

% change y-o-y, seasonally adjusted



Source:Bureau of Labor Statistics, March 2024

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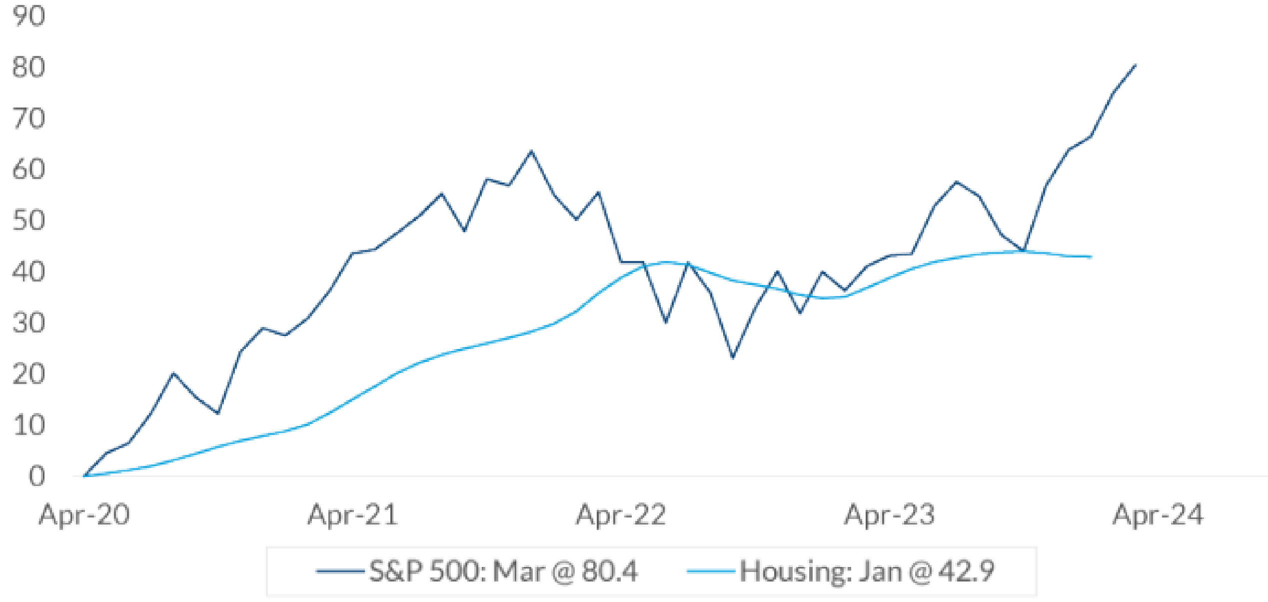
Although the federal funds rate is a powerful monetary policy tool used by the Fed to adjust the pace of economic growth, many elements in the economy have offset the Fed's restrictive policy. The strength in labor gains (almost 3 million people have been hired in the past 12 months; anything above 2 million in a year is considered strong) and wage increases have provided households with income that is growing faster than inflation that is available for spending. The rallying stock market and home values (see chart 2) have created additional wealth for households. With its sizeable annual deficit, the federal government has offered more economic stimulus. With its enormous balance sheet derived from its quantitative easing, the Fed increased bank reserves, helping to make bank loans more acceptable for borrowers.

Chart 2: Change in the Value of Assets

% cummulative change since recession end (April 2020)



Source: S&P Dow Jones Indices, S&P/Case-Shiller, as of March 2024.

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Despite all that offsetting stimulus to the high level of interest rates, **it appears the increases in interest rates are beginning to take their toll on the economy.** Consumers have been increasingly complaining about the high-interest rates on loans. **This has helped reduce the demand for credit, which has been declining for well over a year.** The growth rate in the first quarter was just a 2.9% annual rate, which is about the same pace as last year's 2.3% but well below the 2022 pace of 11.9%, and the multi-decade average is 8.2%.

The lower pace of borrowing should produce less spending, helping to reduce inflationary pressures and allow the Fed to lower interest rates in the year's second half.

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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 US It is not an exact list of the top 500 US companies by market cap because there are other criteria that the index includes.

The Dow Jones Industrial Average (DJIA) is a stock market index that tracks 30 large, publicly-owned blue-chip companies trading on the New York Stock Exchange (NYSE) and Nasdaq.

The Case-Shiller Index, formally known as the S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index, is an economic indicator that measures the change in value of U.S. single-family homes on a monthly basis.

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