

SEPTEMBER 2023



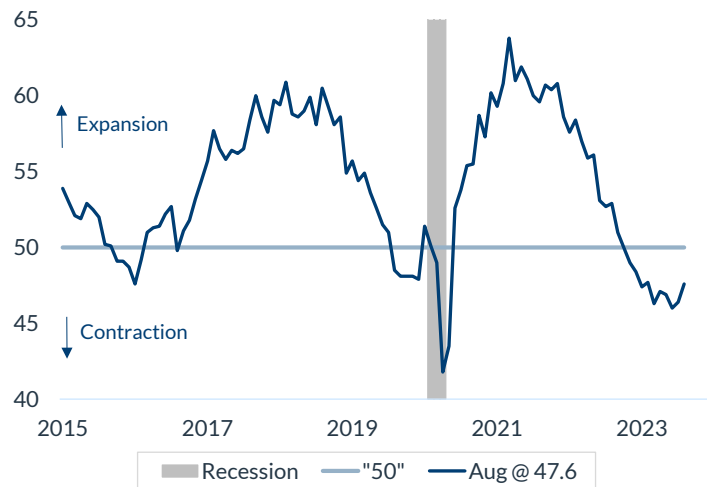
The Bottom Line

Relevant Insights for the Savvy Investor

Services: The Fire Is Not Out

The service sector continues to be the driving force of the economy. The manufacturing sector has been in the doldrums since last autumn as households have shifted spending to services and away from goods, and depleted inventories from the early pandemic days have been replenished.

CHART 1: ISM Manufacturing
 %, diffusion index, not seasonally adjusted

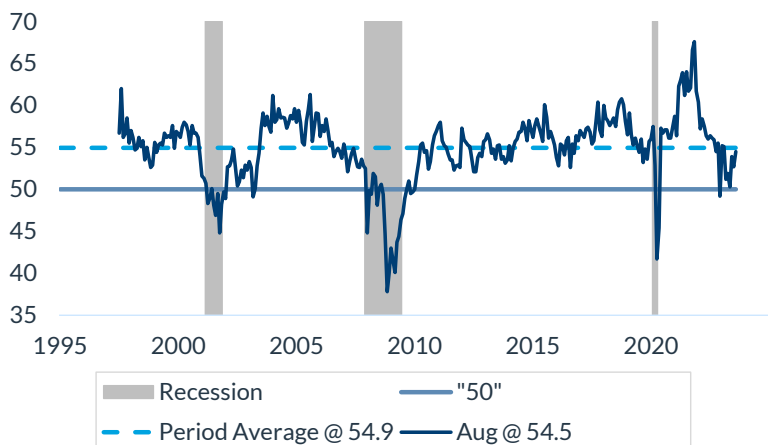


Source: Institute of Supply Management, as of August 2023.

The ISM-manufacturing index, which measures the change in manufacturing and production, has been below 50.0 (indicating contraction) for the past ten months (Chart 1). Based on history, this has always led to a recession, apart from the mid-1990s, when the Fed navigated a “soft landing.” The manufacturing sector is far more sensitive than the service sector to the Fed’s movement of interest rates. In this case, higher financing costs can often sway the purchase of big-ticket items that require financing, like vehicles, furniture, appliances, etc.

The ISM service index, on the other hand, has been growing at a blistering pace. It has been in the expansion territory almost the entire time since the pandemic (Chart 2). This summer, the

CHART 2: ISM Service Sector
 %, diffusion index, seasonally adjusted



Source: Institute of Supply Management, as of August 2023. Information is subject to change and is not a guarantee of future results.

Non-deposit Investment Products: ■ are not FDIC insured ■ are not Bank guaranteed ■ may lose value

spending on travel and entertainment has been robust. This has helped drive overall economic growth since the service sector accounts for about 75% of GDP and 86% of the workforce.

However, many fundamental economic changes do not support continued strong growth.

- **Income:** Gains in income are expected to slow as the number of new hires has been cooling, there are fewer job offerings and wage gains have been weakening. This is noticeable with fewer workers switching jobs, which is due to the decline in the wage premium for job switchers which has returned to pre-recession levels.
- **Savings:** The formidable savings increase created during the pandemic has decreased significantly. The San Francisco Fed estimates it will be gone this month, and Goldman Sachs believes it will be gone next June. With less savings to tap, the focus on continued economic growth will be on credit.
- **Credit:** The deleveraging that occurred in the early stages of the pandemic has reversed. The total amount of consumer debt is now 20% larger than at the end of 2019, just before the pandemic. Access to credit has become more difficult, and financing costs are much higher now than before the pandemic or even just a year ago. One cohort will be having a sudden increase in credit payments: those with student loans. After a three-year hiatus, student debt payments will begin in October. There is \$1.75 trillion in student debt and about \$29,000 owed per borrower on average¹. This will lead to reduced spending on goods and services.

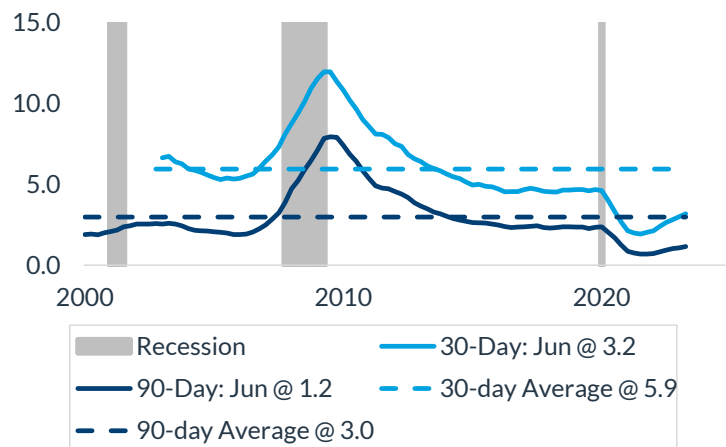
Speaking of credit, defaults have been picking up. Several retailers have noted this (Macy's, Nordstrom and Kohl's). This is the first step in the cycle of an increase in distressed

¹ Forbes, July 16, 2023

consumers. Store credit cards are usually the first wave of delinquency and default before they happen to regular credit cards, auto payments and mortgages (there is a hierarchy to debt payments, and retailers are at the bottom). Although delinquencies are picking up (Chart 3), they are well below long-term averages and do not pose a macroeconomic risk (Chart 4).

CHART 3: Delinquency Rates for All Consumer Loans

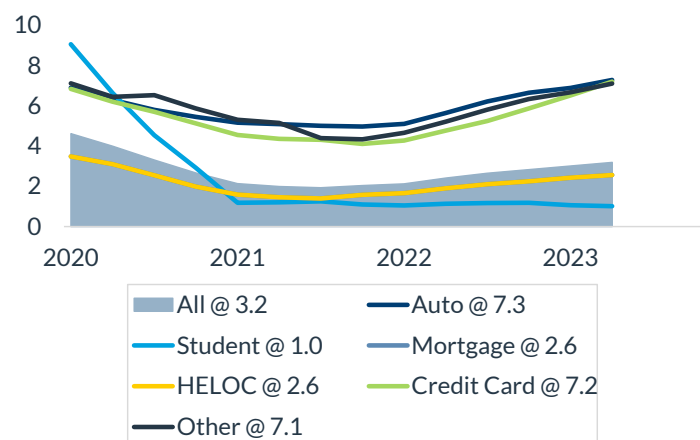
% , seasonally adjusted



Source: Federal Reserve Bank of New York Credit Panel/Equifax, as of June 2023.

CHART 4: 30-Day Delinquency Rates for Consumer Loans

% , seasonally adjusted



Source: Federal Reserve Bank of New York Credit Panel/Equifax, as of June 2023.

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

Non-deposit Investment Products: ■ are not FDIC insured ■ are not Bank guaranteed ■ may lose value

Market Trends

After a very strong first half of the year, equity market gains have become more challenging in recent weeks with the S&P 500 down 5% from its summer highs. While the path for a soft landing has widened, a downshift to a lower gear in growth is rarely smooth. With S&P 500 valuations expensive, higher volatility in the months ahead is likely and we would not be surprised by deeper pull-back in stock prices until investors gain greater clarity on the direction of economic growth, interest rates and Fed policy.



LABOR

The labor market is cooling without slowing sharply, with monthly job gains below the 2019 pre-pandemic levels, which should put lower pressure on wage growth.¹



THE FED

The Fed remains resolute in its battle against high inflation; Fed Chair Jerome Powell recently stated, “Two percent is and will remain our inflation target.”²



HOUSING

With the current mortgage rate above 7.0%, many homeowners have stopped looking for another home since their mortgage averages about half that rate.³



OIL

The recent increase in oil prices may slow the speed of inflation falling but will probably not prompt the Fed to raise rates again; oil is still below the highs of last October.⁴



INFLATION

The yearly change in inflation has increased in the past two months; it is just a reminder that it will be a long and bumpy road to reaching the target rate of 2.0%.⁵



FEDERAL DEBT

Federal debt has jumped this year due to lower tax revenue compared to last year (fewer capital gains) and some sizeable bi-partisan spending programs like the infrastructure bill.⁶

Non-deposit Investment Products: ■ are not FDIC insured ■ are not Bank guaranteed ■ may lose value

Sources

1. Bureau of Labor Statistics, August 2023
2. The Federal Reserve, August 2023
3. Freddie Mac, Bureau of Economic Advisors, September 2023
4. Bloomberg Energy, September 2023
5. Bureau of Labor Statistics, August 2023
6. U.S. Treasury, August 2023

Index Definitions

The consumer price index (CPI) measures the monthly change in prices paid by US consumers.

The S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the US.

Important Information

The information presented does not involve the rendering of personalized investment, financial, legal or tax advice. This presentation is not an offer to buy or sell, or a solicitation of any offer to buy or sell, any of the securities mentioned herein.

The views expressed represent the opinions of City National Rochdale, LLC (CNR) which are subject to change and are not intended as a forecast or guarantee of future results. Stated information is provided for informational purposes only, and should not be perceived as personalized investment, financial, legal or tax advice or a recommendation for any security. It is derived from proprietary and non-proprietary sources which have not been independently verified for accuracy or completeness. While CNR believes the information to be accurate and reliable, we do not claim or have responsibility for its completeness, accuracy, or reliability. Statements of future expectations, estimates, projections, and other forward-looking statements are based on available information and management's view as of the time of these statements. Accordingly, such statements are inherently speculative as they are based on assumptions which may involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such statements.

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 does not ensure a profit or protect against a loss in a declining market. Past performance is no guarantee of future performance.

City National Rochdale, LLC, is a SEC-registered investment adviser and wholly owned subsidiary of City National Bank. Registration as an investment adviser does not imply any level of skill or expertise. City National Bank and City National Rochdale are subsidiaries of Royal Bank of Canada. City National Bank provides investment management services through its subadvisory relationship with City National Rochdale, LLC.

Non-deposit Investment Products: ■ are not FDIC insured ■ are not Bank guaranteed ■ may lose value