January 2023 Market Update: A Deep Dive into CNR's Economic and Investment Outlook

Summary of January 25 Market Update Webinar

Weaker Economy & Mild Recession Anticipated for 2023

While further volatility and potential downside risks are expected to dominate the first half of 2023, historic perspective provides optimism for longer-term returns, according to the January 2023 market update presented by the leadership team of City National Rochdale.

Our view is that there is a 75% chance of a recession this year, which is higher than the Wall Street consensus, said Paul Single, managing director, senior economist and senior portfolio manager for City National Rochdale. However, the recession is anticipated to be mild, due to the strong labor market, strong corporate and consumer balance sheets, and a healthy banking system.

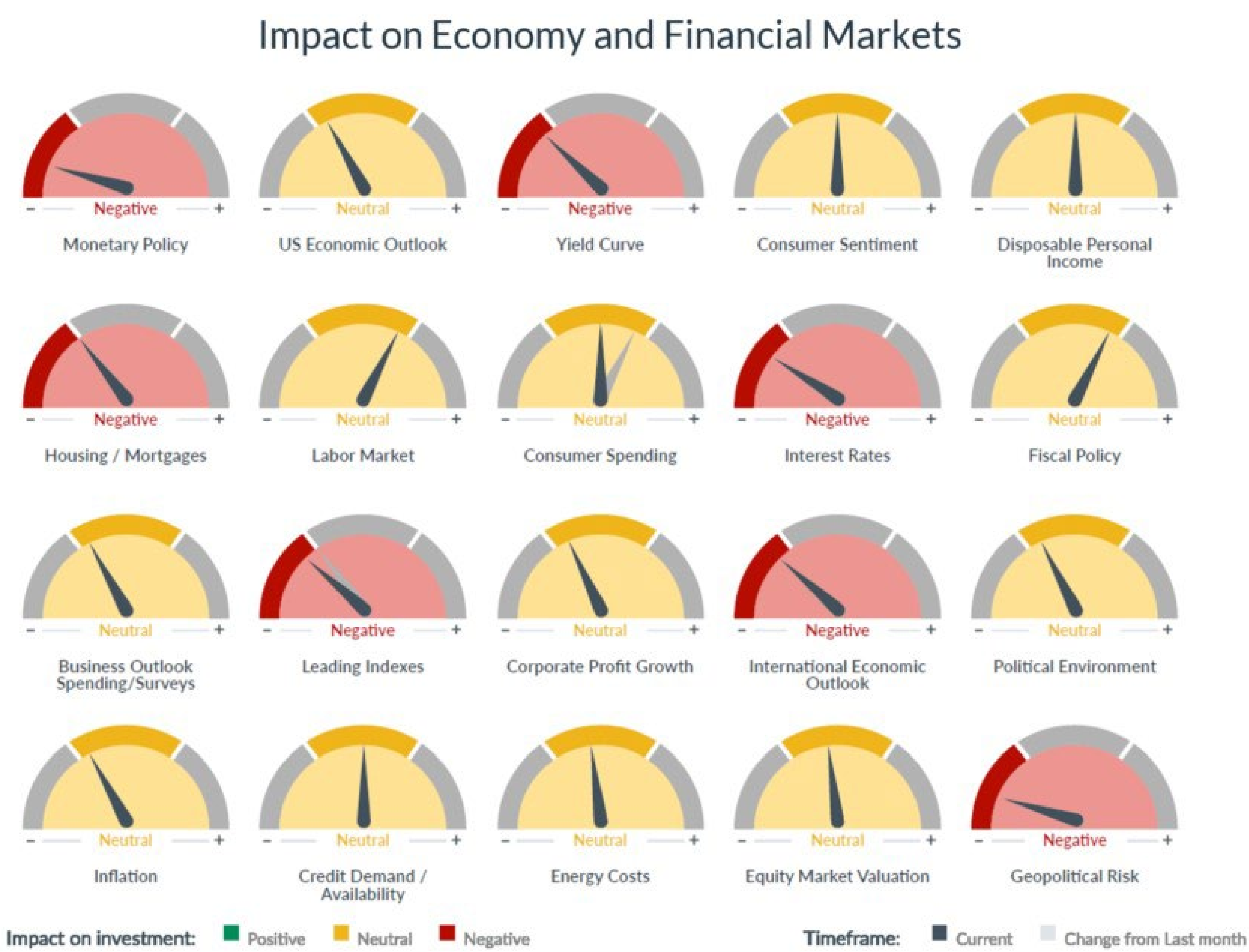
High Interest Rates, Inflation & Volatility to Continue in 2023

While there are encouraging signs of inflation moderating, these trends are likely happening too slowly for the U.S. Federal Reserve, Single said. Officials remain particularly concerned about service inflation in labor-intensive services.

The Fed is likely to keep interest rates higher for longer to push wages down to 2.5% to 3.5% growth, which would be consistent with the goal of inflation at 2%, Single said.

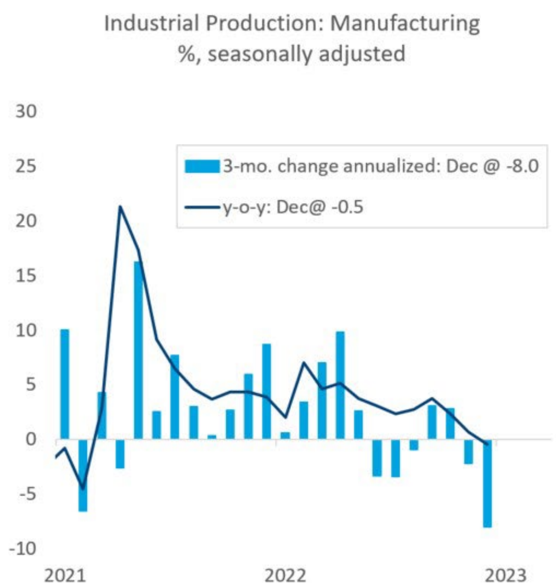
CNR’s Adjusted Outlook

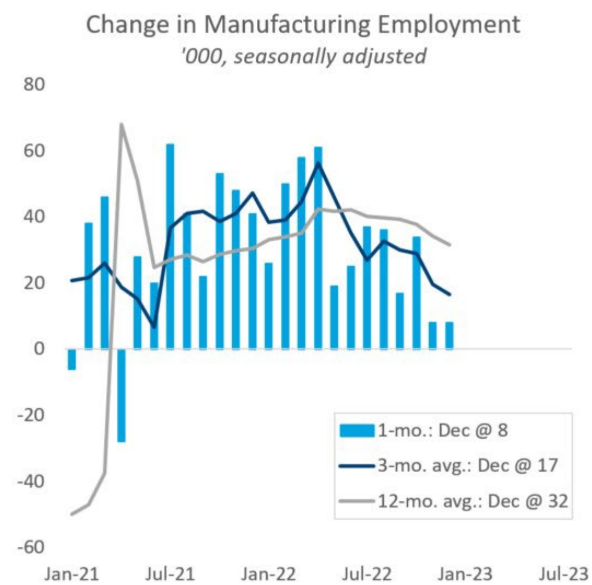
CNR Speedometers®, our forward-looking indicators for the next six to nine months, are all yellow or red this month.



Source: Proprietary opinions based on CNR Research, as of January 2023. Information is subject to change and is not a guarantee of future results.

“A little over a year ago, these were all green, and things have changed quite a bit since then, including the changes in both monetary and fiscal policy," commented Single. “All of this just means the slowdown in the economy is expected to continue, not that there's anything broken in our economy or any enormous imbalances in the economy." The slowdown in the economy, particularly of the housing market in 2022, is broadening to include a slowdown in consumer spending and the manufacturing sector, Single said. The combination of the slowing economy and recession fears is causing companies in the manufacturing sector to adjust their workforce and reduce overtime. However, ongoing labor shortages are likely to keep overall job losses below average recessions.





Sources: Federal Reserve, Bureau of Labor Statistics
Information is subject to change and is not a guarantee of future results.

The main takeaways for 2023 are that inflation is moderating, the rising risk of recession and the Fed is likely to continue increasing rates, although at a slower pace than in the past year, Single said. This economic outlook informs CNR's investment strategy.

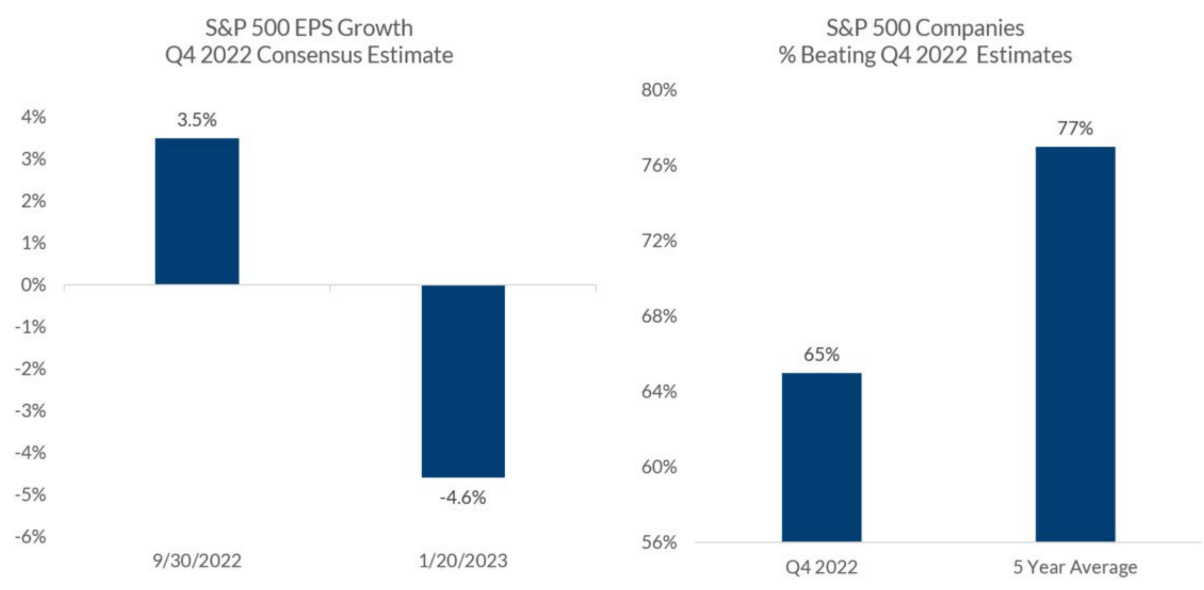
“We expect a more challenging first half of the year, followed by a better second half to get us to moderately positive equity returns for the full year," said David Shapiro, senior portfolio manager for City National Rochdale.

“As a result, we're maintaining a defensive position, underweight on stocks, emphasizing high quality companies under strong management to help us get through and come out better on the other side."

Until the economy bottoms, equities remain vulnerable, Shapiro said. High quality and income-producing U.S. stocks appear most resilient to earnings and geopolitical headwinds, and Rochdale continues to avoid international equity exposure.

How Long Will the Bear Market Continue?

While we believe the U.S. bear market is nearing an end, there are many critical issues to watch that are likely to have an impact on the market's direction, including the path of inflation, Fed tightening and the ongoing risk of exogenous shocks. However, what concerns CNR most is that consensus earnings estimates continue to be too high.



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

Last quarter's earnings expectations have already been revised significantly lower, from a consensus estimate of positive 3.5% as recently as September 2022, to an estimated decrease of 4.6% in January 2023. The fourth quarter of 2022 is now projected to show the first negative earnings growth since the third quarter of 2020, Shapiro said. Margins due to rising costs are the prime driver of lower-than-expected earnings.

Despite this, investors still seem to be counting on a soft landing with overall 2023 earnings growth expectations at a relatively healthy 4%. CNR's outlook calls for 2.5% earnings decline on a weighted average basis, but in a scenario where the economy enters even a mild recession, they think earnings growth could potentially decline even further, up to 10%.

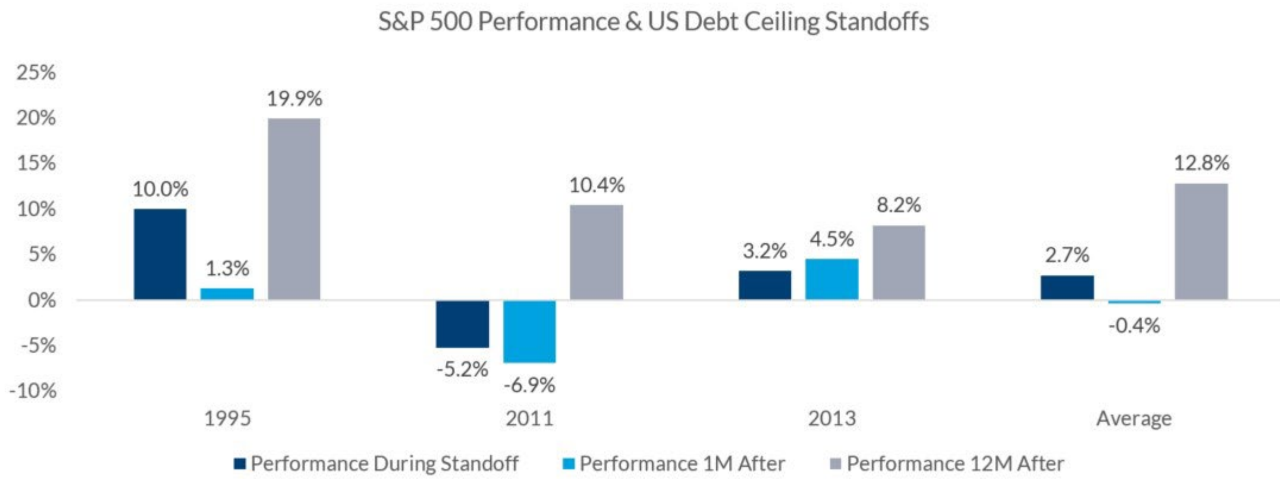
“We don't see a recession priced into values, so we expect more volatility to come," Shapiro said.

Sources: FactSet, CNR Research, as of December 31, 2022. Information is subject to change and is not a guarantee of future results.

Will the U.S. Debt Ceiling Cause Volatility?

Another source of potential volatility that is anticipated to dominate news cycles for much of the early part of this year is the debt ceiling. While most market experts believe that the debt ceiling limit jeopardizes the economy, it is used by politicians on both sides as a powerful tool for government spending and policies, Single said.

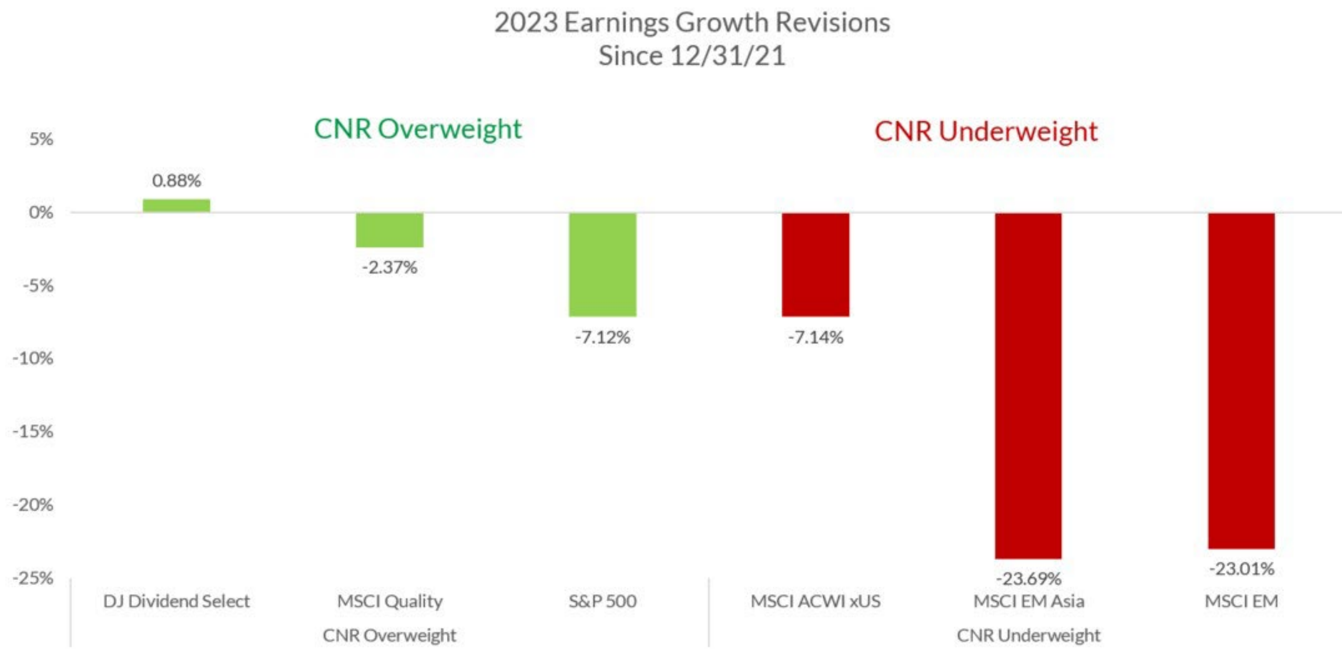
Debt Ceiling Standoff	Date	Performance During Standoff	Performance 1M After	Performance 12M After	Details
1995	Oct 1995 - Mar 1996	10.00%	1.30%	19.90%	Two periods of government shutdowns (5 and 21 days)
2011	May 2011 - Aug 2011	-5.20%	-6.90%	10.40%	S&P downgrades U.S. credit rating from AAA to AA+
2013	May 2013 - Oct 2013	3.20%	4.50%	8.20%	Government shutdown for 16 days



Sources: FactSet. Past performance is not a guarantee of future results.

Creating a Defensive Position During Market Volatility

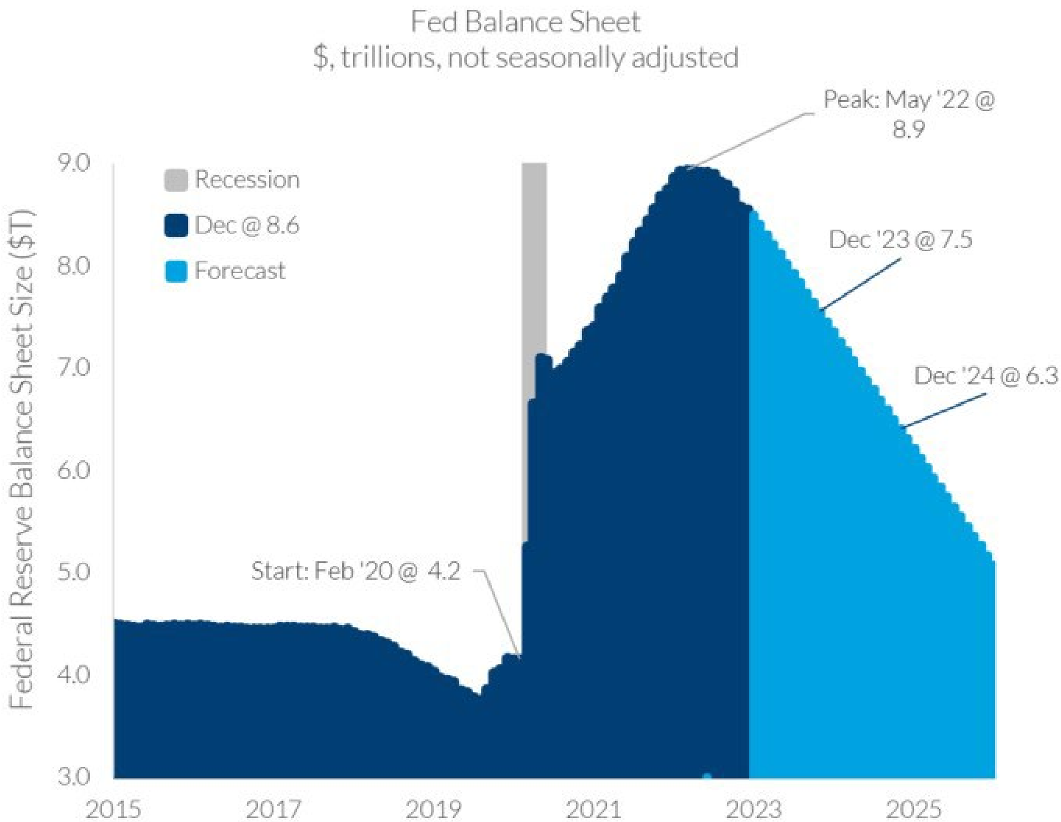
Our strategy has been to de-risk equity exposure and take a defensive position. Equity income in durable and resilient companies has lower volatility and should outperform the market, Shapiro said. Dividend income averaged 6% in 2022 and is anticipated to maintain growth in the mid-single digits in 2023, according to our analysis.



Source: FactSet, CNR Research, as of January 2023.
Information is subject to change and is not a guarantee of future results. See index definitions for more information.

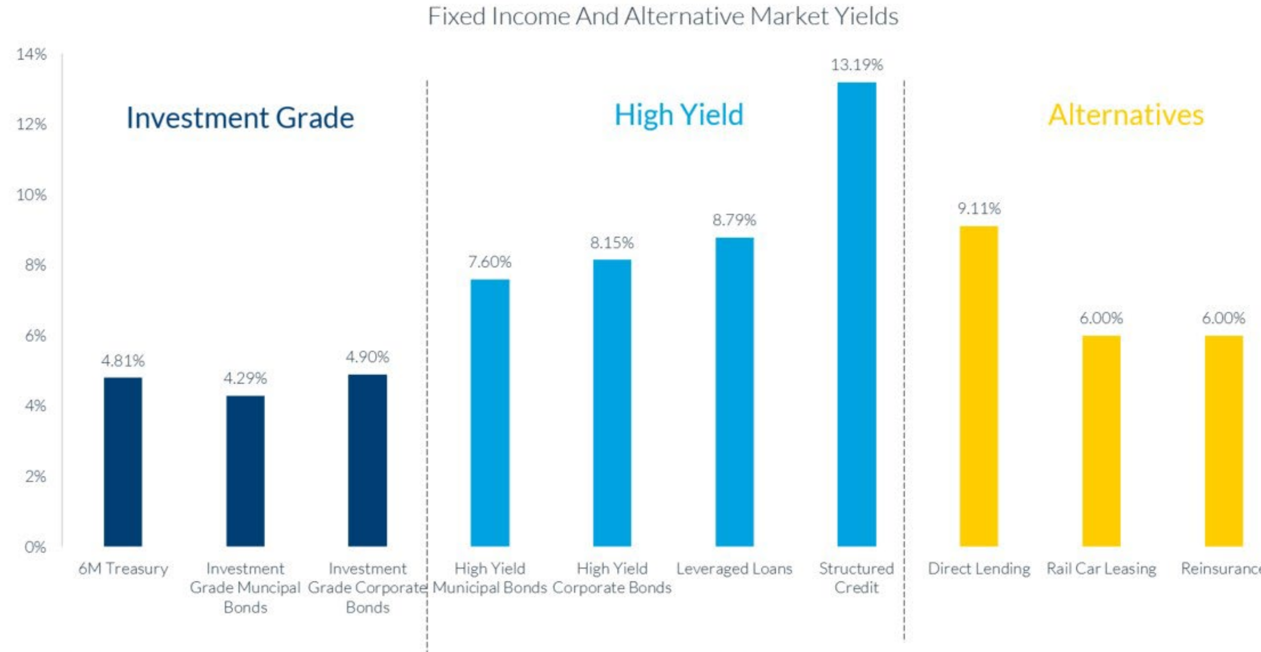
While Fed policies around interest rates have received the most attention in the past year, the Fed's policy of reducing its balance sheet continues to have an impact on the economy, said Charles Luke, Rochdale's director of fixed income.

The Fed isn't selling Treasuries or mortgages, but it is allowing them to mature, which effectively shrinks its balance sheet. Interest rates and the mortgage market are closely tied to the Fed's balance sheet, which can add to more volatility, which is why active portfolio management is essential, Luke said.



[1] Covers performance periods with GDP troughs in 1970, 1973, 1981, 1990, 2001 and 2008
Sources: Bloomberg, CNR Research, as of January 2023. Information is subject to change and is not a guarantee of future results.

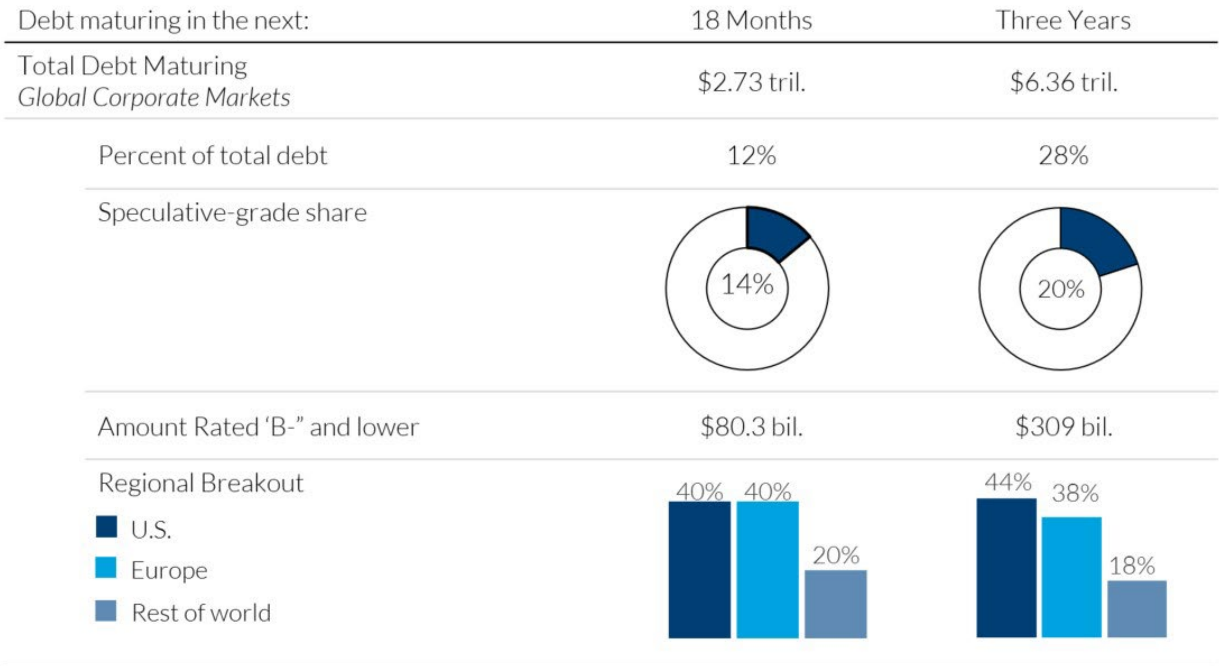
During the third quarter of 2022, we suggested that investors might want to look into taking on more bond exposure, which Luke said continues to be good advice. Higher yields allow for a more diversified fixed-income allocation.



High Yield Municipal Bond yield base rate of 4.49%, tax-adjusted at 37% federal and 2.8% Medicare surcharge tax.
Sources: Bloomberg, CNR Research, as of January 22, 2023. Information is not representative of any CNR product or service. Indices are unmanaged, and one cannot invest directly in an index. Index returns do not reflect a deduction for fees or expenses. Information is subject to change and is not a guarantee of future results. See index definitions for more information.

Will Defaults Increase Significantly in 2023?

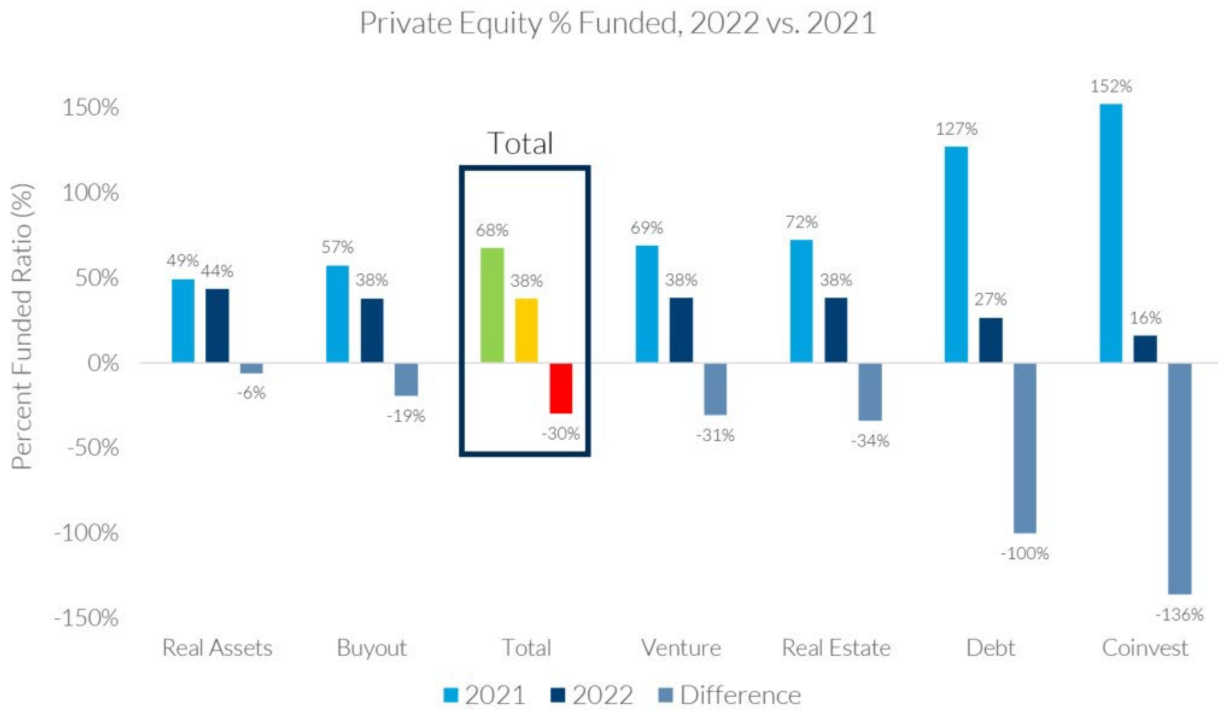
While a deep cycle of defaults is not anticipated, they may approach historical averages in 2023. However, extreme low interest rates in 2020 allowed many companies to refinance their debt or take out debt inexpensively. That means the maturity wall is farther out than usual, Luke said. There's a window of about 18 months before most debt matures, which gives corporations breathing room even in the face of a mild recession.



Debt maturing in the next:	18 Months	Three Years
Total Debt Maturing *Global Corporate Markets*	$2.73 tril.	$6.36 tril.
Percent of total debt	12%	28%
Speculative-grade share	14%	20%
Amount Rated 'B-" and lower	$80.3 bil.	$309 bil.
Regional Breakout: U.S.	40%	44%
Europe	40%	38%
Rest of world	20%	18%

Data as of July 1, 2022.
Sources: S&P Global Ratings Research, CNR Research. Information is subject to change and is not a guarantee of future results.

While there's plenty of money in the economy and in private equity, companies will find higher rates and fewer private equity firms willing to lend in 2023, Luke said. Funding levels are half of last year's volume and funds remain significantly below target raises, according to research by City National Rochdale.



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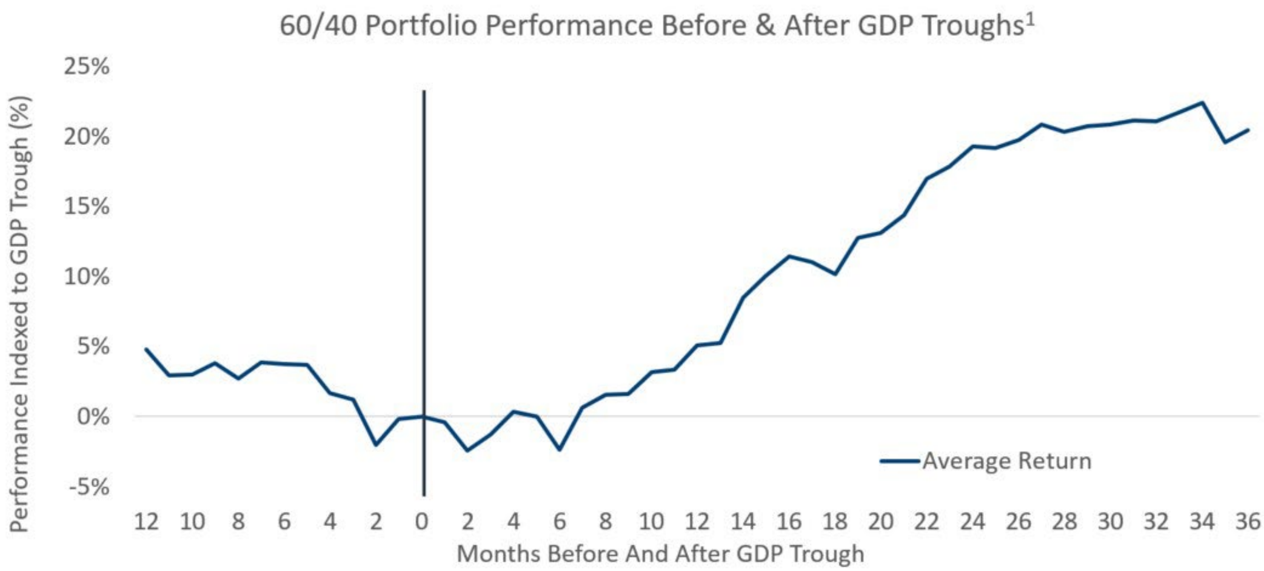
Potential for Returns in 2023

While it was a challenging year for most investors, one of the biggest surprises in 2022 was that bonds fell 13%, nearly double the next biggest decline on record. Historically, when fixed income declined by more than 5%, the average return 12 months later was 8%, which supports a shift to bonds for conservative positioning before a slowdown, Luke said.

While equity markets may continue to be vulnerable in the near term as economic growth slows, fixed income yields are at the most attractive levels in over 10 years. If we get any stabilization or rates drop based on the anticipation of slowing growth, returns will be positive, which supports CNR's current overweight position.



[1] Covers performance periods with GDP troughs in 1970, 1973, 1981, 1990, 2001 and 2008
Sources: Bloomberg, CNR Research, as of June 2022. Past performance is not a guarantee of future results. Information is not representative of any CNR product or service.
*60/40 split between Equities and Fixed Income. Equities index: S&P 500. Fixed Income index: Bloomberg US Aggregate Bond Index. Hypothetical value of assets held in untaxed portfolios invested in US stocks, and bonds. Stocks, and bond investments are represented by total returns of the S&P 500 and 50% IA SBBI US LT Government/50% IA SBBI US LT Corporate 1/1926-1/1976, Bloomberg US Aggregate 1/1976-present. Past performance is no guarantee of future results.

Overall, CNR sees a much more positive year for investors with balanced portfolios. “When GDP hits its low point, which we expect it to hit this year, on average after that we see limited downside," Luke said. “After about 12 months, we begin to see positive returns in a 60/40 portfolio."

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All investment strategies have the potential for profit or loss; changes in investment strategies, contributions or withdrawals may materially alter the performance and results of a portfolio.

Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be suitable or profitable for a client's investment portfolio.

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. The Intercontinental Exchange (ICE): The Intercontinental Exchange (ICE) is an American company that owns and operates financial and commodity marketplaces and exchanges.

The Bloomberg Aggregate Bond Index: "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. U.S. Treasury Yield Curve: refers to a line chart that depicts the yields of short-term Treasury bills compared to the yields of long-term Treasury notes and bonds.

Consumer Price Index (CPI): is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

Bloomberg Barclays US Aggregate Bond Index: 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.

MSCI Emerging Asia PE: The MSCI Emerging Markets Index is a selection of stocks that is designed to track the financial performance of key companies in fast-growing nations. It is one of a number of indexes created by MSCI Inc., formerly Morgan Stanley Capital International.

Global Equity Markets: a global market in which shares of companies are issued and traded, either through exchanges or over-the-counter markets. Diffusion Index: Used in technical analysis, a diffusion index measures the number of stocks that have advanced in price or are showing positive momentum. It is useful for determining the underlying strength of the stock market overall, as lots of stocks advancing show a strong market, while few(er) stocks advancing show a weaker market. In the stock market, the diffusion index is usually measured from day to day. Advancing stocks are those that moved up from the prior closing price.

6M T-Bills: The 6 Month Treasury Bill Rate is the yield received for investing in a US government issued treasury bill that has a maturity of 6 months.

2-Year Treasury Notes: negotiable debt obligations issued by the U.S. Treasury Department (other than a Stripped Treasury Security) having a remaining maturity of more than one year but not more than two years.

Liquidity Management: The liquidity index calculates the days required to convert a company's trade receivables and inventory into cash.

Investment Grade Municipal Bonds: Investment-Grade Municipal Bond Investment-grade municipal bonds are debt securities, issued by state and local governments carrying the lowest credit risk that a bond issuer may default. Investment Grade Municipal Bonds: Bloomberg Municipal Bond Inter-Short 1-10 Year Total Return Index.

Investment Grade Corporate Bonds: Investment grade corporate bonds are low-risk bonds. Because they are bonds, they are not tied to equity. Instead, they are like debt notes issued by a corporation. Investment Grade Corporate Bonds: Bloomberg Intermediate Corporate Bond Index.

High Yield Corporate Bonds: “U.S. High Yield Corporate” is represented using the U.S. High Yield Index.

High Yield Municipal Bonds: Bloomberg 60% Tax-Exempt HY / 40% LB Municipal Investment Grade Total Return Index.

Leveraged Loans: S&P LSTA Leveraged Loan Index, 6m T-Bills – ICE BofA 6-Month Treasury Bill Index, U.S. High Yield Corporate: 1-3 Years – ICE BofA U.S. High Yield 1-3 Year Index, Intermediate Municipal – Bloomberg 1-15 Yr Municipal Index, U.S. High Yield Corporate – Bloomberg U.S. High Yield Corporate Index, Intermediate IG Corporate – Bloomberg Intermediate Corporate Index, High Yield Municipal – Bloomberg 60% Tax-Exempt HY/40% LB Municipal Index.

Speculative Technology: Companies in early stages of business development with negative net income that provide technology products or services.

Digital Revolution: Companies that provide technology products or services, and/or use technology products and services in a manner that enhances their business.