CITY NATIONAL ROCHDALE
AN RBC/CITY NATIONAL COMPANY

DECEMBER 20, 2022

ON THE RADAR

FAQs on the Markets and Economy

What did the Fed decide at its year-end meeting?

The Fed is singularly focused on reducing the rate of inflation.

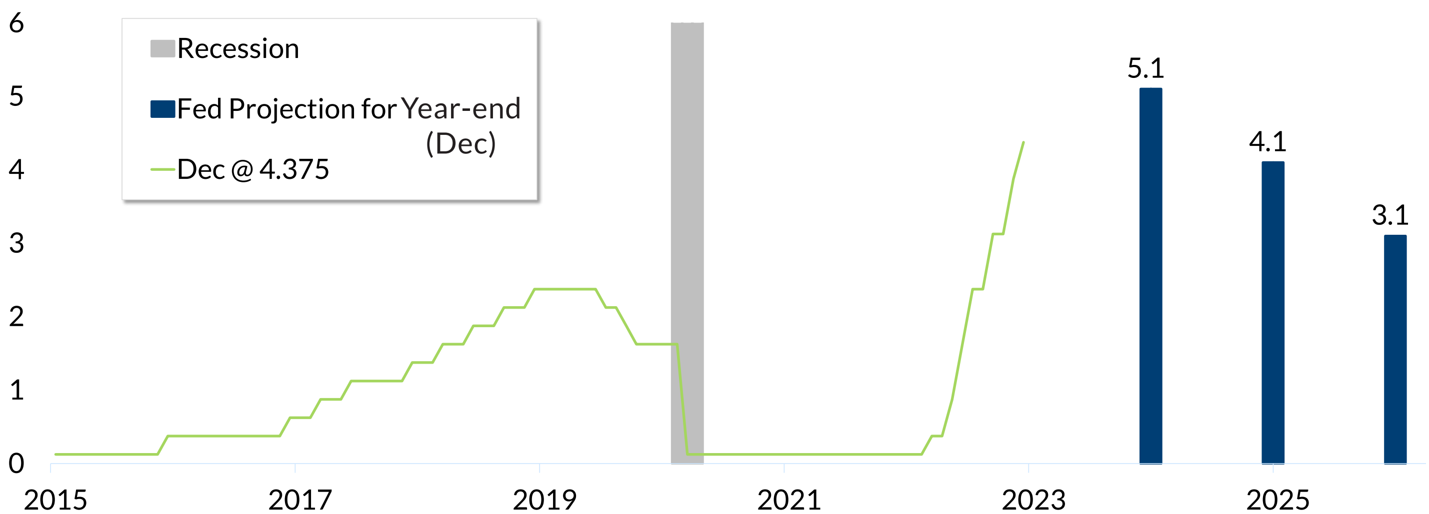
As a result, the Federal Reserve will raise interest rates higher than previously thought and plan to keep them higher for a longer period to prevent inflation from becoming entrenched in the economy. This will take its toll on labor, as the Fed expects the unemployment rate to increase to 4.6% next year from the present level of 3.7%.

In regard to forecasted interest rate increases of the federal funds rate, the Fed is moving slower but aiming higher. It raised the federal funds rate by 50 basis points (bps) to a median of 4.375%. It is less than the 75 bps hikes of each of the past four meetings. Looking into next year, the Fed plans on another 75 bps hike to a terminal rate of 5.1%, which is higher than its previous forecast of 4.6%. Then in 2024, it plans to cut interest rates by a full percentage point, and the same is planned for 2025 *(see chart)*.

KEY QUESTIONS

- Has inflation turned the corner, headed downward?
- What's behind the recent market pullback?
- What is the near-term outlook for investment-grade municipal bonds?

Federal Open Market Committee (FOMC) Projections — Federal Funds
%, midpoint



Source: Federal Reserve, December 2022

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

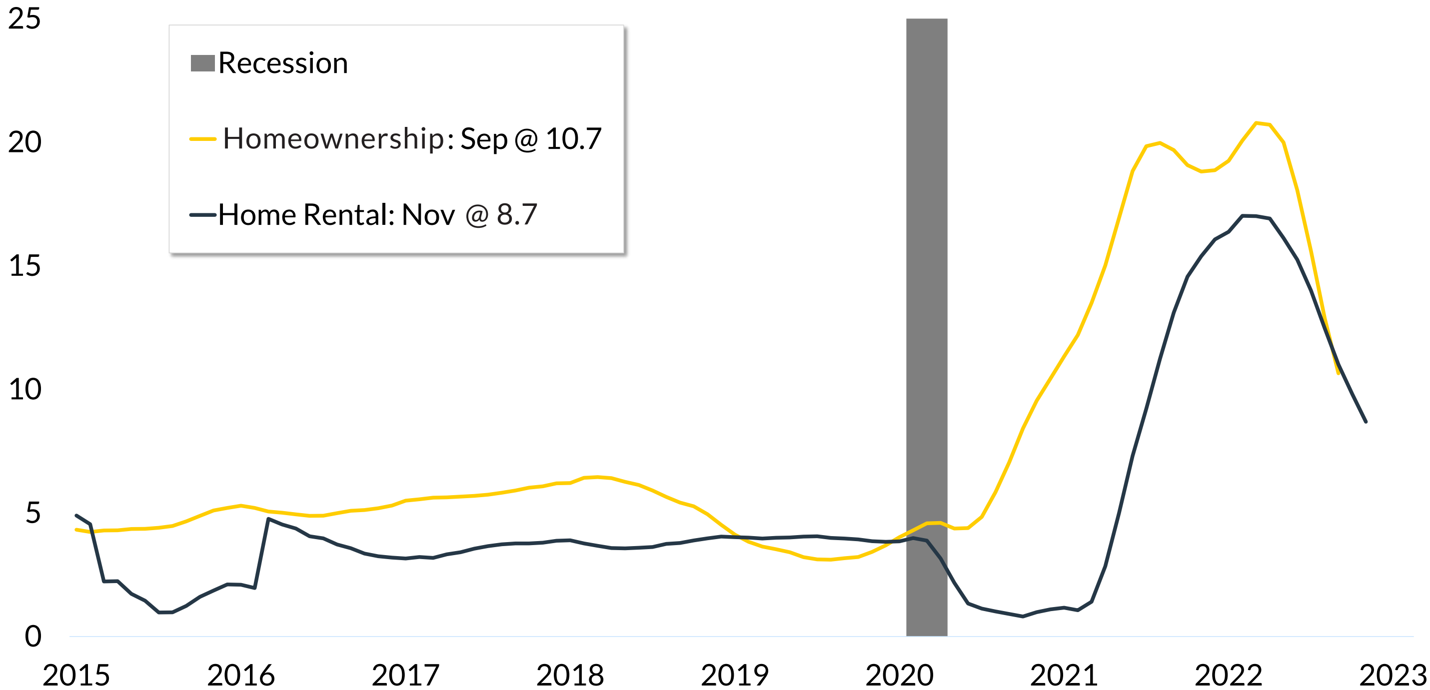
Has inflation turned the corner, heading downward?

For the second month in a row, CPI was shocked by the downside versus market expectations.

November's Consumer price index (CPI) was 0.1% month over month and 7.1% year over year and the yearly change now stands at the lowest level since last December and 2 percentage points below June's high of 9.1%. The report was full of good news. The inflation of goods continues to slow as supply chain improvements pass through to lower costs. Service inflation was up a little, but excluding shelter, it was unchanged last month. Energy prices continued to fall (gasoline was down 2%).

Shelter costs are the largest component of CPI, and controlling these costs is needed to bring down overall inflation. Unfortunately, these prices rebounded after slowing down in October. It is keeping inflation for shelter on an upward trend. But under the weight of high mortgage rates, market data for home purchases and rentals has already turned a corner, and price increases are eroding *(see chart)*. The data isn't picked up right away under the current methodology used to calculate this part of CPI, but it should start to show up in the first quarter of 2023.

Housing Costs
% change, year over year



Sources: S&P CoreLogic Case-Shiller, Zillow, Inc. November 2022
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What's behind the recent market pullback?

After a strong start to the fourth quarter and continuing signs of moderating inflation, U.S. equities have turned negative again in December amid mounting fears that the Fed's tightening campaign will go beyond what is necessary and push an already slowing economy into recession.

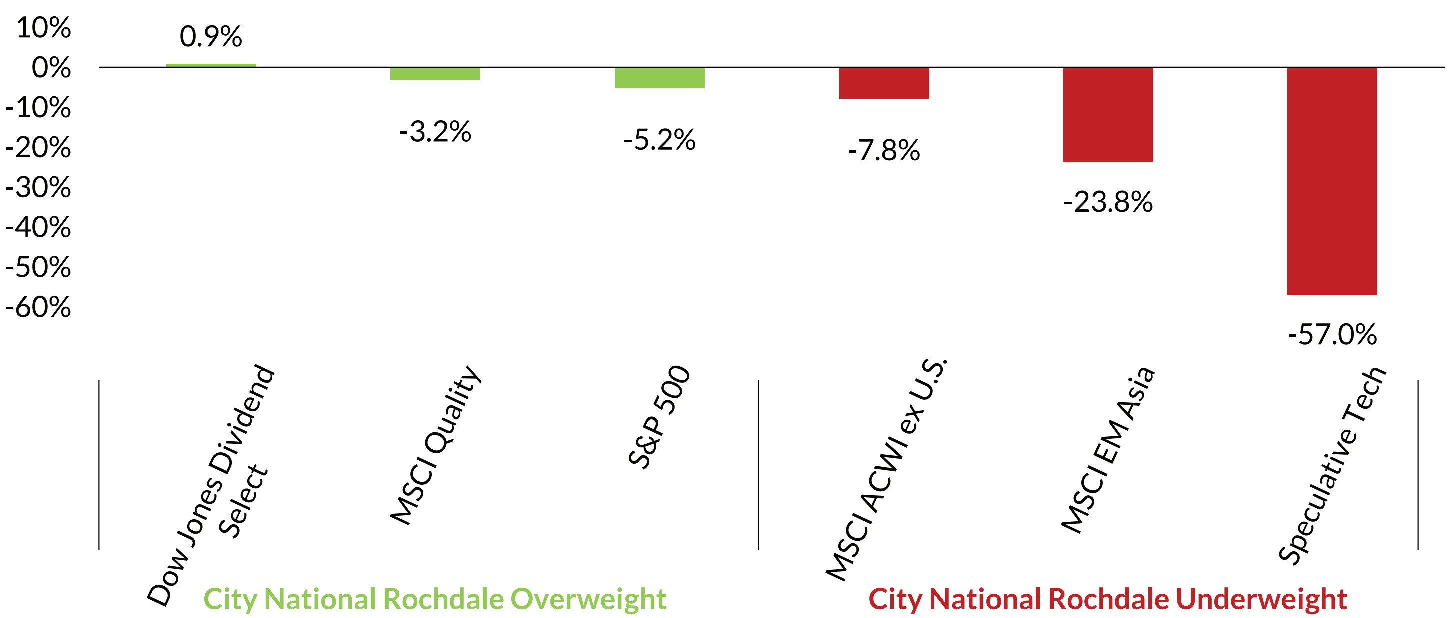
While we expect better stock and bond returns to eventually take shape in 2023, the recent swings in market sentiment are also a good reminder that history shows that the journey to a Fed pivot could be a volatile one.

With the Fed reaffirming its commitment to reining in inflation, investor attention has begun to focus more on the implications of higher-for-longer interest rates on the economy and corporate profits. For some time, we have argued that earnings estimates would likely have to be lowered to reflect the challenging macroeconomic backdrop and rising recession risk ahead. Although consensus expectations for 2023 have declined over the past couple of months, they remain at a healthy 5.3%, suggesting further downward revisions are likely. In a scenario in which the economy enters a mild recession next year, we would expect earnings growth to stagnate or even contract.

Given this, markets will likely continue to be vulnerable in the near term, and we remain happy with the de-risking steps we've made this year, including our overall modest underweight in equities. Earnings revisions in areas we have been emphasizing, such as U.S. dividends and quality stocks, have held up better on a global basis and especially compared to speculative technology stocks.

Bottoming will be a process that could take some time to play out, and further swings in sentiment are likely as investors gain greater clarity on the path for rate hikes and inflation and weigh their implications for the economy and corporate profits. In particular, we suspect further downward earnings revisions could be a catalyst for additional market declines before a sustainable recovery in equity prices can begin.

2023 Earnings Growth Revisions
Since 12/31/21



Sources: FactSet, City National Rochdale Research, as of December 2022.
Please note: Information is subject to change and is not a guarantee of future results.

What is the near-term outlook for investment-grade municipal bonds?

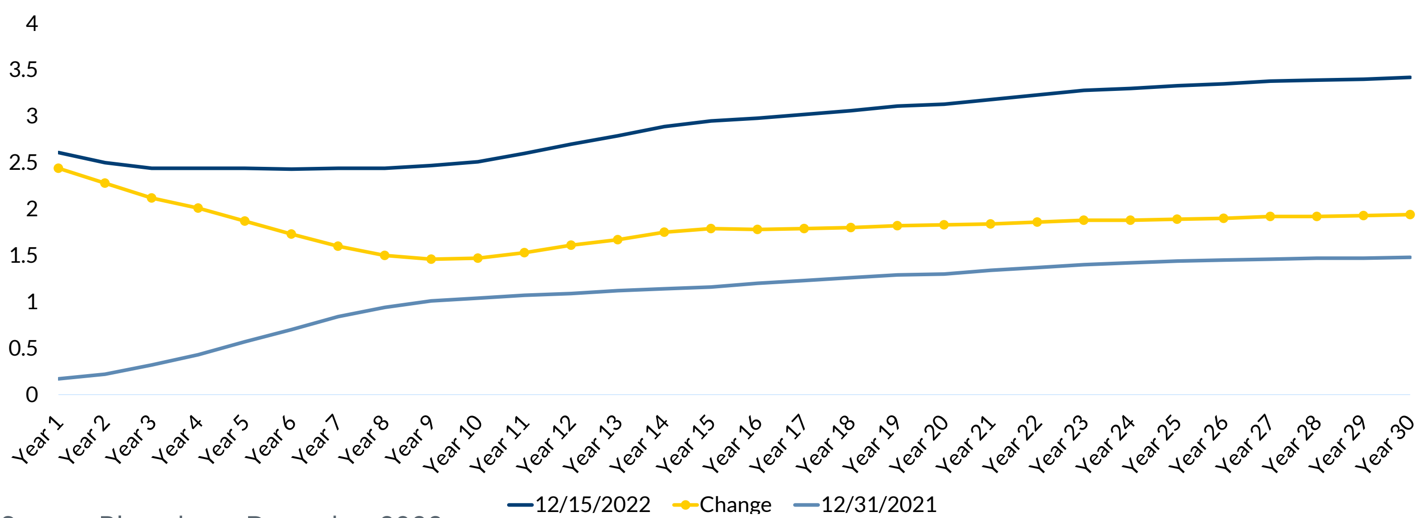
As municipal bond investors anxiously await turning the page on a volatile and challenging performance year, an air of cautious optimism is developing among market participants heading into 2023.

Since November, price gains in investment-grade (IG) municipal bonds of more than 5% potentially signal a shift in the tone of the market, per Bloomberg indices, given more visibility surrounding future Fed policy actions that would seemingly lead to a more constructive technical backdrop for the asset class in the coming months. While IG municipal valuations will fluctuate with the Treasury market and supply–demand dynamics, nominal municipal yields are substantively higher today than a year ago, 175 bps on average across the curve, supporting a more attractive entry point for investors in the new year.

While municipal bond mutual fund redemptions hit a record year to date in 2022 of $115 billion, per Lipper, the magnitude of fund outflows has diminished in recent weeks. We anticipate some improvement, at least through the first half of 2023, as tax loss selling fades and the projected Treasury rate volatility moderates, but continued rotation within the market among mutual funds, ETFs, and institutional and retail is mandated. New-issue bond supply in the municipal market was lower year over year by nearly 20%, per Bloomberg, contributing to pockets of demand. Seasonal weakness in bond supply should persist through the first quarter of 2023. At the same time, consensus estimates call for muted growth in gross issuance next year, with advance refunding declining but offset by a marginal increase in new project financings (i.e., infrastructure).

Municipal issuer fundamentals benefited over the past two fiscal years from better-than-expected revenue collections and federal stimulus associated with the pandemic that bolstered their overall budgetary positions. Per agency data, rating trends have been mostly positive over the past eight quarters. Still, credit quality is at its cyclical peak, with economic softening and inflationary pressure likely to weigh on issuer operations, albeit unevenly over the near to medium term. Sector and security selection remain critical tenets of successful municipal bond investing, with sound research and analysis helping to support overall portfolio management.

Municipal Yields Sharply Higher Than a Year Ago



Source: Bloomberg, December 2022

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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.