CITY NATIONAL ROCHDALE
AN RBC/CITY NATIONAL COMPANY

NOVEMBER 3, 2022

ON THE RADAR

FAQs on the Markets and Economy

What does the strong jump in Q2 Gross Domestic Product (GDP) mean about the economy?

Q3 GDP grew 2.6% after declining in the two previous quarters.

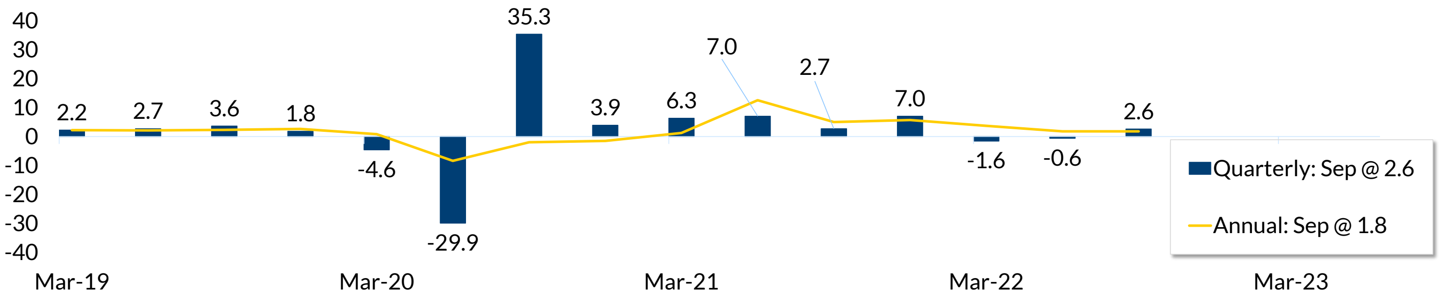
The gain more than offset the decline in the year's first half. The quarterly change helped maintain the annual rate at 1.8% *(see chart)*. The underlying details were not very encouraging. Most of the gain came from a narrowing of the trade deficit. Construction activity fell at an accelerating rate, with residential plunging 26.3% and nonresidential down 15.3%.

The report reveals that the economy is probably not in a recession now. But the pace of growth is losing momentum – housing is contracting, and consumer spending is slowing. This, of course, is the intended consequence of the Fed's actions. This week, the Fed raised its policy rate by another 75 basis points, to between 3.75% and 4.00%, with Chair Powell warning "incoming data since our last meeting suggest that the ultimate level of interest rates will be higher than previously expected." We believe there is a 60% chance of a recession in the next 12 months.

KEY QUESTIONS

- **What are we learning from Q2 earnings season?**
- **Is the federal debt returning to normal levels with the pandemic behind us?**
- **How are higher interest rates impacting the Federal Reserve's income?**

GDP: Quarterly & Annual Change
%, annualized, Seasonally Adjusted Annual Rate (SAAR)



Source: Bureau of Economic Research, September 2022
Please note: Information is subject to change and is not a guarantee of future results.

What are we learning from Q2 earnings season?

U.S. equity markets have rallied recently, as Q3 earnings have in large part exceeded expectations.

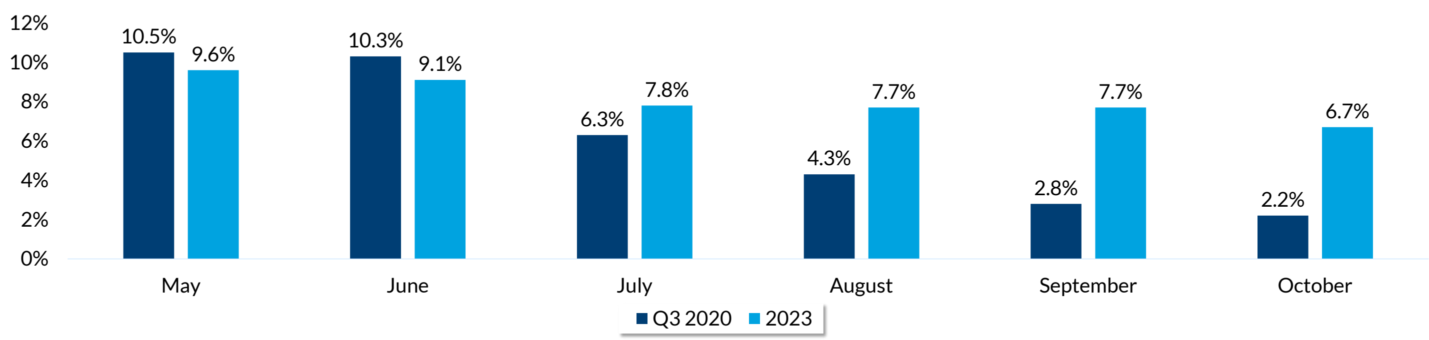
Despite several high-profile tech misses, with a little over half of the companies in the S&P 500 having now reported, 75% have delivered consensus-beating results. However, some perspective is in order. These better-than-expected results have come against notably lowered estimates. As recently as May, Q3 S&P 500 earnings were forecast to rise by 10.5%. By the end of Q2, that number was down to 2.8%, Moreover, if the energy sector was excluded, the index's overall earnings growth rate would fall to -5.1%.

Corporate America continues to have several headwinds working against it, including slowing economic growth, rising cost pressures amid high inflation, ongoing supply chain issues, geopolitical instability in Europe and Asia, and significant currency drag from a very strong dollar. As a result, company revenue projections are now slowing and still elevated margins are beginning to experience more and more pressure.

Over the last couple of months, we have argued that earnings estimates would likely be revised lower to reflect the more challenging macroeconomic backdrop and rising recession risk. While earnings growth forecasts for next year have declined recently to 6.7% from about 10% at the start of the year, we continue to think they remain too optimistic. In a scenario where the economy enters a mild recession next year, we would expect earnings growth to stagnate or even contract.

Given this, we continue to recommend caution over the near term. Although equity valuations are adjusted over the first half of the year, the earnings adjustment process likely has a ways to go. 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 outlook, particularly with 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 ahead before a sustainable recovery in equity prices can begin.

Evolution of Consensus S&P Earnings Growth Estimates



Source: FactSet

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

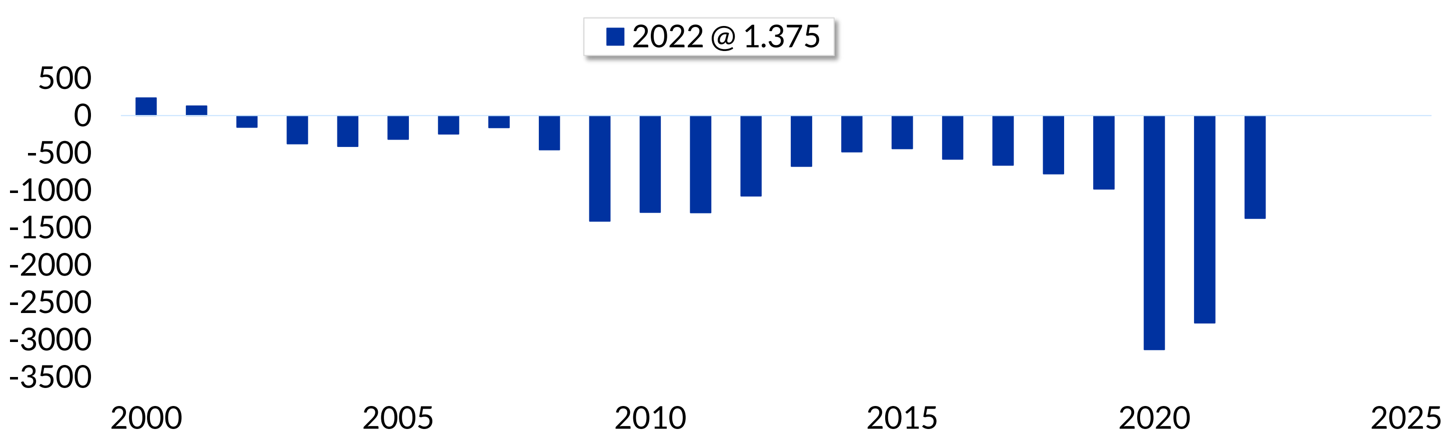
Is the federal debt returning to normal levels with the pandemic behind us?

The federal government's fiscal year ended on September 30.

This past year the government had a deficit of $1.4 trillion; it was cut in half from $2.8 trillion the year before. Revenues increased in all the major categories, particularly from individual income taxes due to the vibrant labor market. Spending declined significantly due to the reduction in pandemic stimulus programs. Back in 2019, before the pandemic, the deficit was $1.0 trillion.

The 2022 deficit would have been closer to $1.0 trillion, but a couple of outliers pushed it up. An estimated $379 billion for the long-term cost of the president's student loan forgiveness program and $62 billion in benefits that would usually be spent in October but with the 1st falling on a Saturday had to be paid in September.

Federal Debt
$, billions



Source: U.S. Treasury, September 2022

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

How are higher interest rates impacting the Federal Reserve's income?

As rates rise, the Federal Reserve is paying out more to financial institutions than the income it earns. This may not immediately impact government finances, but long-term repercussions are unavoidable.

The Fed's operating model is simple. It accrues operating expenses and receives income from its portfolio and any leftover "profit" is paid to the U.S. Treasury each year. These transfers have always been positive, but the structure is becoming more complicated considering the breadth of quantitative easing and the shift toward balance sheet reduction.

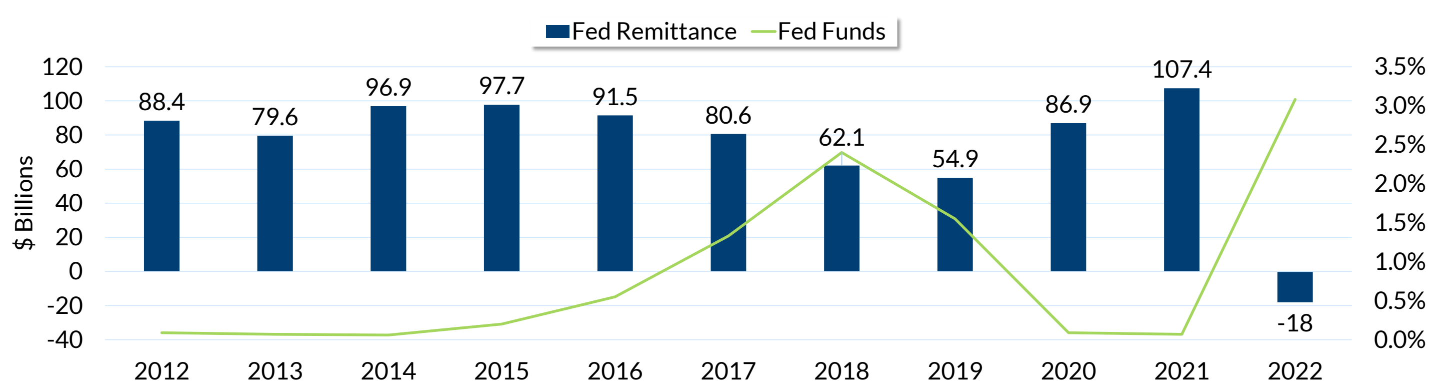
The Fed's balance sheet has climbed from $1.0 trillion to $8.3 trillion over the past 14 years, the average interest rate it receives is approximately 2.0%. Annually, this equates to a cash flow of around $167 billion. But as the Fed raises interest rates, its expenses are increasing as the interest it pays on reserves and its overnight reverse repurchase program (RRP) is climbing. Currently, this equates to annual expenses of about $185 billion, a shortfall of $18 billion. Considering the projections for interest rates, the Fed will post an annual loss of over $80 billion next year.

After the 2008 crisis, the Fed studied this phenomenon. The proposed solution is to write an IOU in the amount of the shortfall to the Treasury classified as a "deferred asset." The IOUs will continue to accumulate if income remains negative, and once net income becomes positive, the Fed will start paying off the deferred obligation. Essentially, the Fed is offsetting current losses by pledging its future earnings for repayment.

Given the Fed's status as a monetary institution, it cannot become insolvent, but the U.S. Treasury will be accruing a liability. If left unfunded, the Treasury may be forced to issue more debt and it will become an eyesore to Congress, which will generate negative public headlines. While the Fed's ability to conduct monetary policy under these conditions is not in question, the situation may pressure the tools designed to facilitate market liquidity, most notably its repo operations and the interest paid on excess reserves.

It will be important to watch the market response and the Fed's reaction while it continues to tighten financial conditions.

Annual Fed Remittance to Treasury vs. Fed Funds Effective Rate



Sources: Federal Reserve, Bloomberg

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

IMPORTANT DISCLOSURES

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.

Certain statements contained herein may constitute projections, forecasts, and other forward-looking statements, which do not reflect actual results and are based primarily upon a hypothetical set of assumptions applied to certain historical financial information. Certain information has been provided by third-party sources, and although believed to be reliable, it has not been independently verified, and its accuracy or completeness cannot be guaranteed.

Any opinions, projections, forecasts, and forward-looking statements presented herein are valid as of the date of this document and are subject to change.

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

Investing in international markets carries risks such as currency fluctuation, regulatory risks, and economic and political instability.

There are inherent risks with fixed-income investing. These may include, but are not limited to, interest rate, call, credit, market, inflation, government policy, liquidity, or junk bond risks. When interest rates rise, bond prices fall. This risk is heightened with investments in longer-duration fixed-income securities and during periods when prevailing interest rates are low or negative.

Investing involves risk, including the loss of principal.

This material is available to advisory and subadvised clients, as well as financial professionals working with City National Rochdale, a registered investment adviser and a wholly owned subsidiary of City National Bank. City National Bank provides investment management services through its subadvisory relationship with City National Rochdale.

Readers are cautioned that such forward-looking statements are not a guarantee of future results and involve risks and uncertainties, and actual results may differ materially from those statements.

Indices are unmanaged, and one cannot invest directly in an index. Index returns do not reflect a deduction for fees or expenses.

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

Any opinions, analysis, and expectations mentioned herein are as of November 3, 2022, unless otherwise noted or sourced.

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.