How has the recent improvement in various economic indicators affected the market’s perception of future Fed action?

It has been wild ride for this metric. Back in the autumn, when the economic outlook was very strong (unemployment at cycle low of 4.7% and PMI manufacturing at cycle high of 60.8), the stock market hit an all-time high. The federal funds futures market was expecting at least two rate hikes by the Fed in 2019 (chart).

Now, with the stock market within spitting distance of the Sept 20, 2018 highs, the federal funds futures market does not share that enthusiasm. Following about five months of trading down in yield, this metric has an implied probability of a chance of an interest rate cut this year.

Although much of the domestic economy is close to what it was six months ago, there are some parts that are not as strong. The most notable change is the Federal Reserve’s outlook. The Fed is no longer expecting to hike interest rates twice this year, like they did back then. Now, they are on hold for the remainder of the year. The federal funds futures market is representing the new tone.

**KEY QUESTIONS**

What is City National Rochdale's current thinking about the Fed and monetary policy?

What is the outlook for the global economy?

With the market back at record highs, is City National Rochdale still bullish on U.S. equities?
What is City National Rochdale’s current thinking about the Fed and monetary policy?

We continue to believe the Fed will not make any changes to the federal funds rate this year. The federal funds futures market has been a wild ride since last summer.

Back in the autumn, when the Fed was planning on three rate hikes in 2019, economic/market reports were strong (unemployment at cycle low of 3.7%, manufacturing PMI above 60, S&P 500 at record highs), the futures market was expecting three hikes in 2019 (chart).

Now, much of the economic data is slightly less robust than last autumn, the stock market has hit new record highs and the Fed has a more dovish tone (they have no hikes planned for this year) and the federal funds futures market is implying the funds rate will stay stable with a slight chance of a cut.

This probably represents the belief by some that the Fed needs to cut rates to get inflation back up to 2.0%. At this stage, we do not believe the Fed will lower rates to try to boost inflation.

What is the outlook for the global economy?

Amid elevated uncertainty in many advanced economies and signs that higher tariffs are weighing on international trade, Global prospects continue to moderate and become more divergent. For the third time in the last 6 months, the IMF has cut its forecast for global growth in 2019. The world economy is now expected to expand at just 3.3%, the lowest rate since the financial crisis.

However, much of this can be attributed to weakened conditions in many advanced economies, particularly in Europe. The IMF has slashed its outlook for the euro area to 1.3% this year, down 0.3 point from three months ago. Although Europe has shown indications of stabilization after last year’s slowdown, economic prospects remain poor, with more exposure to trade uncertainty and slower global demand. Political risk is also high, business confidence has softened and we remain skeptical of the ECB’s ability to boost growth.

In contrast, economic data from Emerging Asia is beginning to show signs of improvement as policy across the region turns more supportive and recent developments in U.S.-China trade negotiations have offered encouragement that a more damaging trade war will be avoided. City National Rochdale has taken these diverging outlooks into consideration with our recent decisions to reduce equity exposure in non-US developed markets and to increase exposure to Emerging Asian equities.
With the market back at record highs, is City National Rochdale still bullish on U.S. equities?

Yes. In our view, the recovery in stocks has been justified by fundamentals, and we see few warning signs signaling recession or the end of the bull market. However, the pace of recent gains is likely to moderate and a consolidation period or pullback is possible over coming months. Actions that the White House will take during the month of May remain an important event we are monitoring.

Since the SP 500 was last at all-time highs, the underpinnings of the bull market have changed a bit. US economic and profit growth is more modest, but Fed policy is more supportive and trade tensions with China appear to have eased. Most of this has now been priced into the market. At the same time, valuations, while still reasonable, are no longer as compelling as they were in late December.

Modest but rising corporate earnings will likely be the key to driving markets higher for the balance of the year. Over the current bull market, we have seen five 10%+ corrections. The reasons behind each of those pullbacks were different, but the driving force behind each rebound has been the same – an expanding economy, earnings growth, and low interest rates.

With the S&P 500 now above the previous record high of September 2018, have corporate credit spreads also recovered?

Credit spreads, which are the yield advantage for owning a corporate bond over a treasury security, increased in Q4, indicating more perceived risk. Corporates, like many other "risk assets" underperformed safer assets during that period of time. The stock market swoon was probably the most notable.

The poor performance was due to several reasons, most markedly: communication blunders by the Fed, slower economic growth overseas, and trade concerns and weaker economic data surprises. Since then, the Fed has moved to a more dovish position, China appears to have reversed course and is on an upward trajectory, trade negotiations appear to be improving and economic data has been much stronger.

Credit spreads have recovered most of the widening. They currently stand at 111 basis points, just 6 basis points wider than their lows of early October (chart).
What is City National Rochdale’s investment outlook for 2019?

Given our positive assessment of the fundamental backdrop, we remain bullish on equities in general for 2019 and continue to see attractive prospects in the opportunistic fixed income class. Still, we believe investors should prepare for more moderate returns in the year ahead and continued volatility.

The investment landscape has grown more challenging as investors adjust to more typical late-stage expansion conditions of higher inflation, rising interest rates and less accommodative monetary policy. Meanwhile, concerns over global growth, trade tensions and other geopolitical risks mean markets will likely continue to be subject to periodic swings in sentiment and potential pullbacks.

None of this means there are not more worthwhile gains ahead for investors, but it does highlight the value of active management and the need for investors to become more selective. Our equity and fixed income research teams have made deliberate risk-mitigating changes to help fortify client portfolios against the type of turbulence we have recently experienced, while leaving them well-positioned to take advantage of opportunities, should they present themselves.

One-Year Forecasted Returns (%)

Source: City National Rochdale. As of April 2019. Forecasted expected returns represent City National Rochdale’s opinion for these asset classes, are for illustrative purposes only and do not represent client returns. The expected returns presented for these asset classes do not reflect any deductions for City National Rochdale fees or expenses. Actual client portfolio and investment returns will vary.

*Forecasted expected returns for HY Municipal and Municipal FI represent the taxable equivalent return at a 43.40% tax rate.
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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.

Emerging markets involve heightened risks related to the same factors as well as increased volatility, lower trading volume, and less liquidity. Emerging markets can have greater custodial and operational risks, and less developed legal and accounting systems, than developed markets.

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.

Investments in below-investment-grade debt securities, which are usually called "high-yield" or "junk" bonds, are typically in weaker financial health, and such securities can be harder to value and sell and their prices can be more volatile than more highly rated securities. While these securities generally have higher rates of interest, they also involve greater risk of default than do securities of a higher-quality rating.

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.

Investments in emerging markets bonds may be substantially more volatile, and substantially less liquid, than the bonds of governments, government agencies, and government-owned corporations located in more developed foreign markets.

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

Returns include the reinvestment of interest and dividends.

Investing involves risk, including the loss of principal.

As with any investment strategy, there is no guarantee that investment objectives will be met, and investors may lose money.

Past performance is no guarantee of future performance.

Index Definitions

The Standard & Poor’s 500 Index (S&P 500) is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. 

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