CITY NATIONAL ROCHDALE
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On the Radar

FAQS ON THE MARKETS AND ECONOMY

What are we learning from Q2 earnings season?

For the fifth consecutive quarter, S&P 500 earnings are coming in much stronger than expected. With nearly all companies reported, Q2 EPS is tracking at 90% growth year over year, 25 percentage points higher than expectations when the quarter began. Momentum on the revenue side is perhaps even more impressive with the index's 25% growth rate the highest reported since FactSet began tracking this metric in 2008.

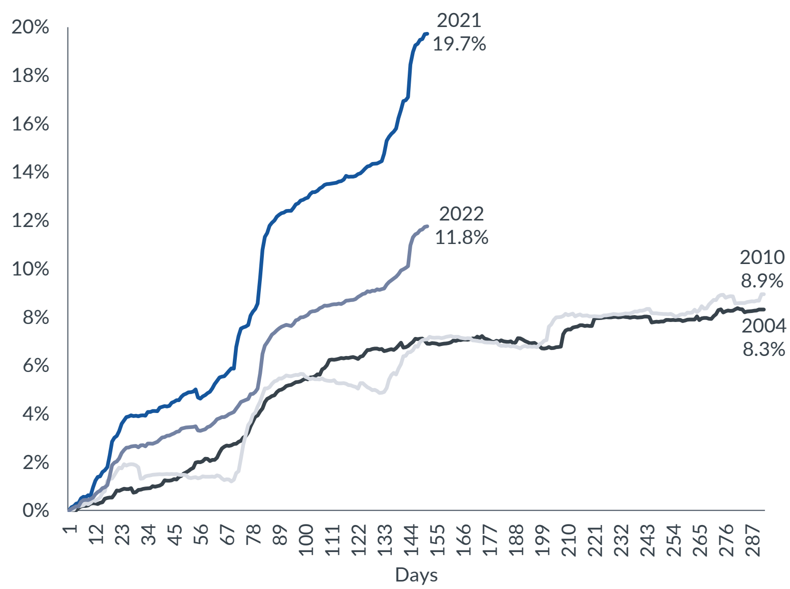
While part of Q2's strong growth rates reflect easy comparisons to the year-earlier period when corporate sales were hit hard by pandemic lockdowns, a number of other factors help explain these striking results, including: better than expected progress on reopening, booming manufacturing activity, a strong credit environment, rising commodity prices and a weakening dollar. In fact, Q2 earnings are on track to reach a new all-time quarterly record, 31% above the pre-COVID 2019 period.

Looking forward, earnings expectations continue to rise at a fast pace, even compared with other post-recession recoveries. Since the start of the year, 2021 earnings have been revised higher by 20%, and 2022 earnings by 12%, vs. 9% in 2010 and 8% in 2004. This suggests that analysts aren't focusing on special one-time factors driven by the lockdowns, but rather on an enduring growth cycle developing over the next couple of years.

The strength of earnings growth during the past several quarters has enabled stocks to grow into elevated valuations and the backdrop for corporate profitability should continue to be favorable,

Comparing Recovery Years

(Change in Consensus Earnings Estimates From Beginning of Year)



Source: FactSet.

supported by increasing global vaccinations, further normalization of economic activity and ongoing policy support. However, the second quarter is also expected to represent the peak in the earnings growth rate this cycle and history shows the deceleration in profit expansion is suggestive of more modest returns for stock prices from this point on.

KEY QUESTIONS

Have inflationary pressures peaked?

What does China's recent regulatory actions mean for investors?

Have inflationary pressures peaked?

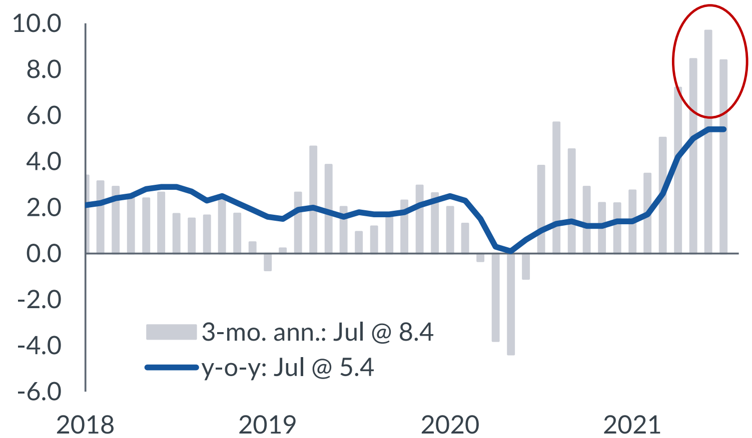
It is a little early to know for sure, but they may have peaked. July's CPI report came in at 5.4%, the same level as June's report. Core-CPI actually declined to 4.3% from 4.5%.

The July report showed the price categories that have been associated with the supply constraints and strong reopening demand have begun to ease. This gives a small win for "Team Transitory Inflation." But price pressures are starting to broaden out, which means inflation will stay on the high side for some time.

The streak of outsized inflation gains is probably over. The July monthly gain was 0.5%; the previous three months averaged 0.8%. Although this is good news, the return to pre-pandemic inflation levels remains in the distant future – the higher transient prices will be with us longer than previously thought. This belief has been substantiated in recent weeks with many corporate announcements suggesting that supply chain normalization may not be complete until late next year.

CPI

% change, seasonally adjusted



Source: Bureau of Labor Statistics as of July 2021.

What does China's recent regulatory actions mean for investors?

While the last few months have been challenging for EM Asia equity investors, Chinese equities especially have experienced a dramatic correction with China's regulatory scrutiny of tech, education and online platforms rattling investors.

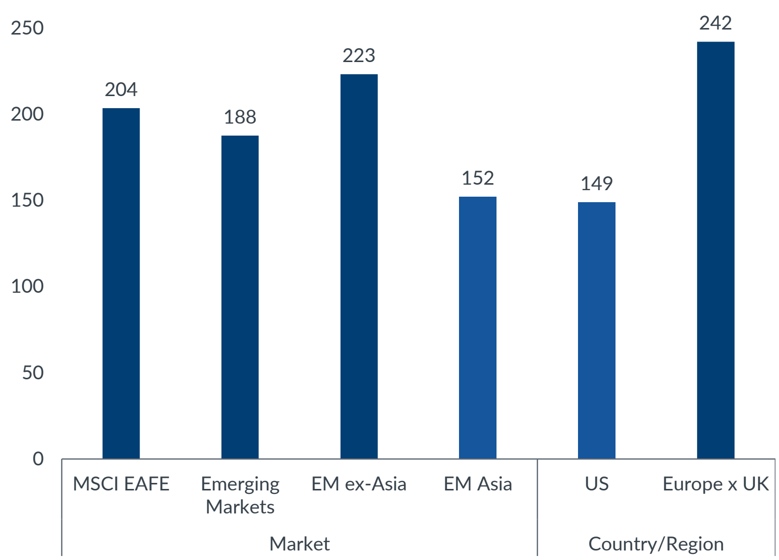
The developments reflect renewed focus from policymakers on their long-term strategic goals, with particular efforts to curb inequality and ensure healthy competition across all sectors. Given the uncertainty though caused by government action as well as their potential to cause headwinds for profitability, productivity and innovation, we have updated our proprietary 4Ps regional equity analysis to reflect recent developments.

Still, we think the long-term investment case for Chinese and Emerging Asia equities more broadly remains strong, with the region's outlook for superior structural growth, supported by high investment rate, a rising middle class and robust urbanization trends, that should fuel domestic consumption.

In the near term, recent market stabilization is positive and we continue to view EM Asia equities in general as attractive particularly after the sell-off. However, sentiment may remain vulnerable until the breadth and duration of China's regulatory actions becomes clearer. Investors will need to take a patient approach, but many excellent companies appear to be oversold and are now trading at significantly discounted valuations.

Global Equity Markets Summary Score Analysis

(Lower=Better)



The 4P analysis is a proprietary framework for global equity allocation. Country rankings are derived from a subjective metrics system that combines the economic data for such countries with other factors including fiscal policies, demographics, innovative growth and corporate growth. These rankings are subjective and may be derived from data that contain inherent limitations.

Source: CNR Research.

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