ON THE RADAR

FAQs on the Markets and Economy

May 23, 2024

Has inflation returned to its disinflationary trend?

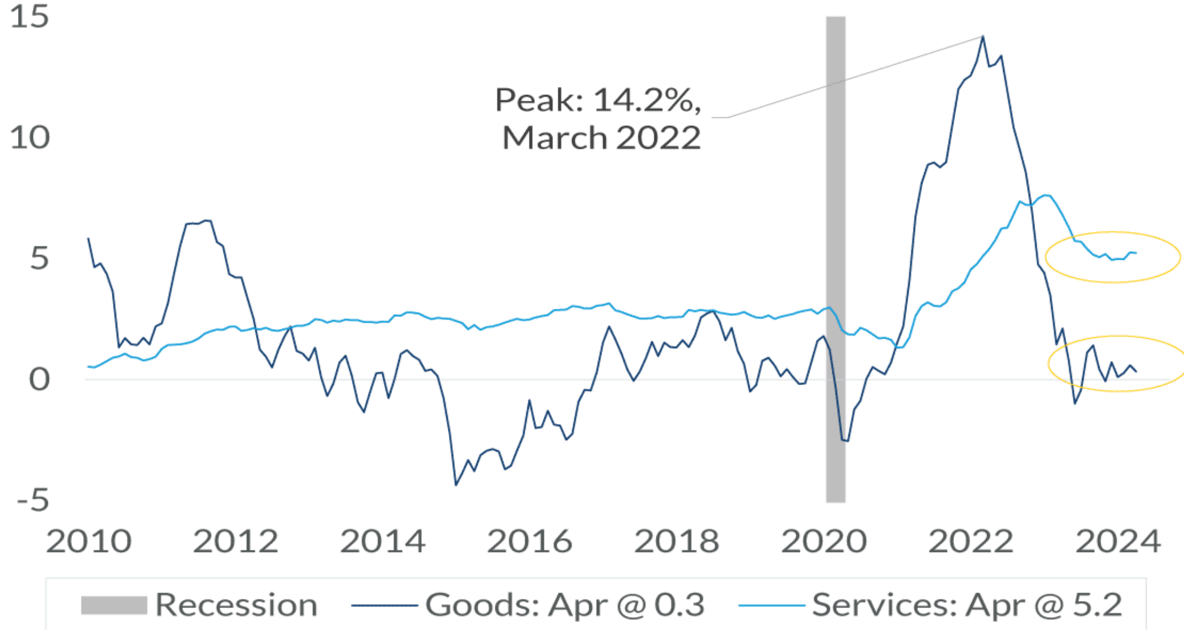
The April release of consumer price index (CPI) data gave the first glimmer of hope that the hot inflation reports of the previous three months may be behind us. In the first quarter, inflation grew at an annualized 4.6%, significantly higher than the prior quarter's annualized growth of 1.9%.

The April release is just one month, but combined with other April economic releases showing moderate employment and retail sales growth, it has lifted expectations that disinflation will resume.

The cause of the price pressures has remained the same. The bifurcation between goods prices and service sector prices continues. Goods prices (about a third of the weighting of CPI) have increased just 0.3% in the past year, while service prices (the remaining two thirds) remain sticky and are up 5.2% (see chart below). The breadth of price increases in the service sector is broad, with shelter prices (about 60% weighting of service prices) up 5.5% year over year and an annualized 5.0% for the past three months. All other service costs (the remaining 40%), often called "SuperCore," are up 4.9% year-over-year and an annualized 6.3% for the past three months.

CPI: Goods and Services

% change, year-over-year, seasonally adjusted



Source: Bureau of Labor Statistics as of April 2024.

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

The service prices are the Fed's focus. With the high interest rates, labor demand is expected to continue to moderate, reducing wage pressures, which should lead to lower service inflation.

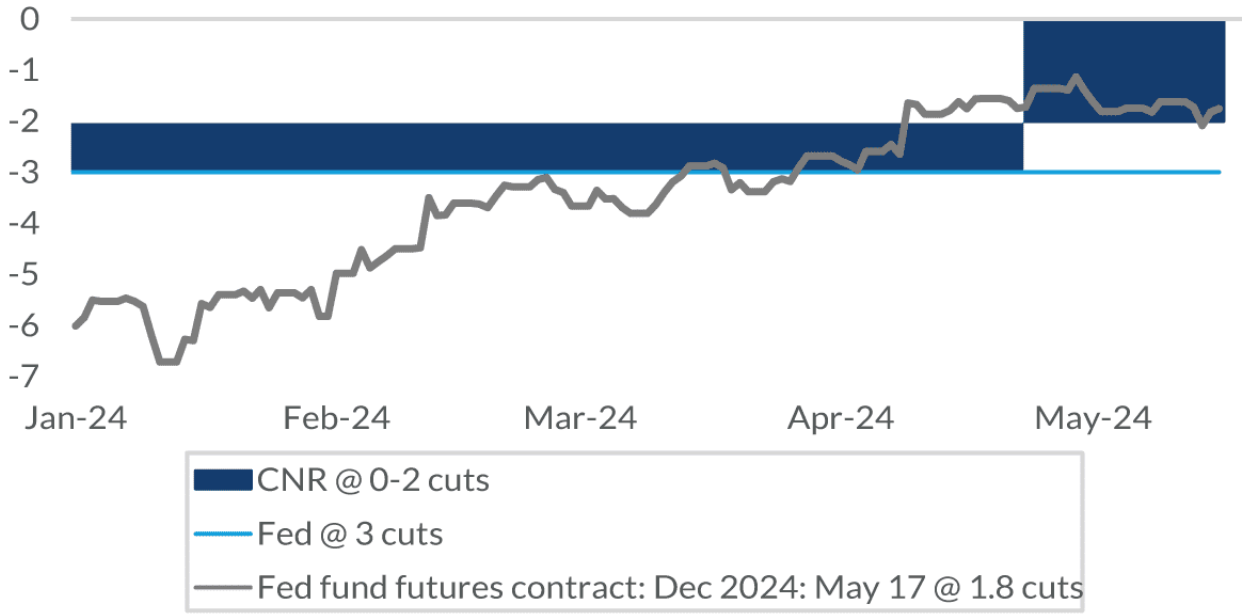
Will the Fed be able to cut interest rates this year?

The Fed plans to cut the federal funds rate by 75 basis points (bps) this year; it will probably be three cuts of 25 bps each. They update their forecast every quarter, and this forecast is two months old.

Market expectations for the Fed cutting interest rates have been all over the board this year. In January, the expectation was for almost seven cuts. However, as the first quarter economic data showed robust consumer spending and elevated inflation, expectations of Fed activity fell to about just one cut this year (see chart below).

Federal Funds Forecast: 2024 YE

number of 25 bp cuts in the federal funds rate



Source:Federal Reserve Bank, Bloomberg's WIRP page, CNR Research, as of May 17, 2024.

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But the April employment, consumer price index (CPI) and retail sales reports gave the market some relief for Fed cuts. Until those reports, the Fed was on the sidelines regarding interest rate cuts. They have been waiting for the disinflationary trend to restart. Price pressures are now moving in the right direction. Yes, it is just one month's reports, but the possibility of lowering interest rates has resumed. The Fed will still want to see a few months of positive inflation data before signaling that its confidence has been restored that inflation is on a sustainable path toward 2.0%.

City National Rochdale® believes the Fed will cut rates up to two times this year.

How are Q1 earnings doing?

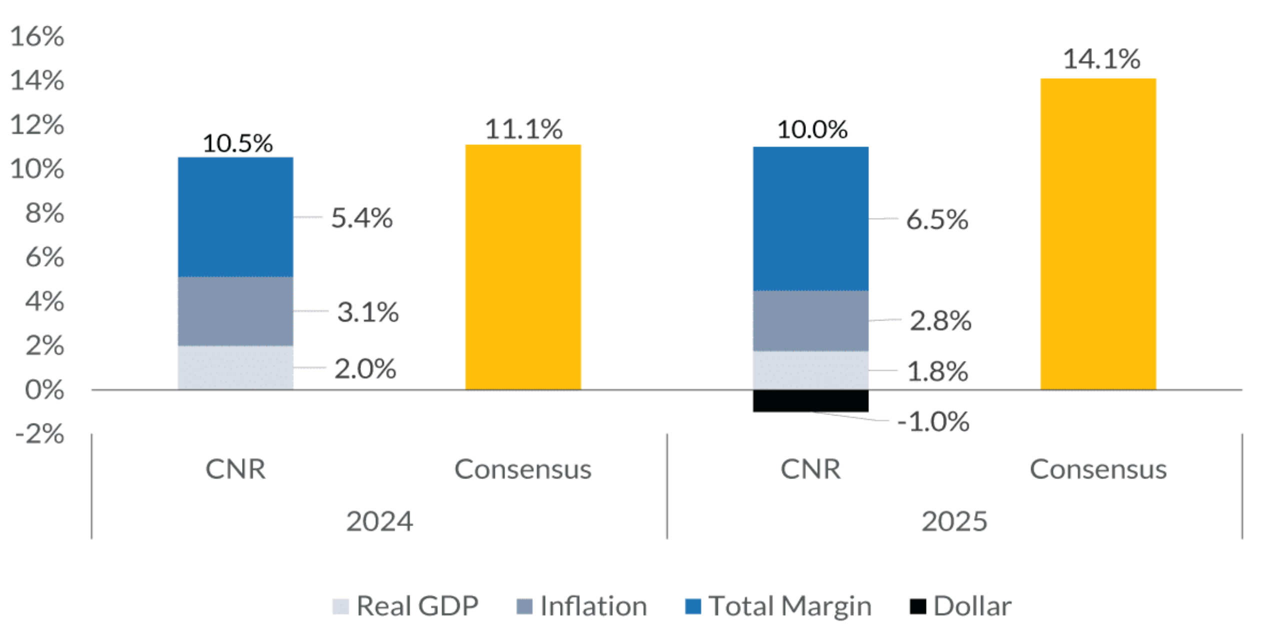
Major U.S. equity indexes are back at record highs, and much of the credit can be placed on better than expected corporate earnings. With Q1 reporting season coming to a close, earnings have exceeded analyst estimates by 8.5%, which is the biggest upside surprise since the third quarter of 2021. Backing these results has been moderating but still healthy economic demand that has translated into near 4% revenue growth, and easing input-cost inflation that has boosted profitability.

The strength of Q1 results along with positive company guidance has provided additional confidence for investors that earnings are on track to grow a little more than 10% in 2024. Consensus earnings estimates historically start out on the optimistic side, but tend to be reduced over the course of the year by about 4%. That has not been the case so far this year, with analyst's 2024 estimates actually rising a bit over the past month, despite worries about interest rates and the economy.

From a sector perspective, communication services, consumer discretionary and tech continue to stand out for their strong growth, but other sectors such as industrials, financials and consumer staples are also delivering solid results. All told, eight of the 11 sectors in the S&P 500 are now reporting year-over-year earnings growth. A broadening of earnings performance should help lagging sectors catch up, but it also provides a stronger foundation to help extend the bull market.

Besides earnings, equity markets have also found some comfort in declining bond yields. After a brief jump to a six-month high of 4.7% in April, the 10-year Treasury yield has fallen back below 4.5% in May, driven by expectations that the Fed will be able to deliver its first interest-rate cut later this year. Uncertainty around the Fed policy outlook, sticky inflation and the upcoming U.S. presidential election could still be catalysts for volatility in the months ahead. Nevertheless, the combination of rising corporate profits, continued economic expansion and the potential for more downside than upside in yields should provide a positive backdrop we think for further equity-market gains.

S&P 500 Earnings Growth Forecasts



Source: Factset, as of May 2024.

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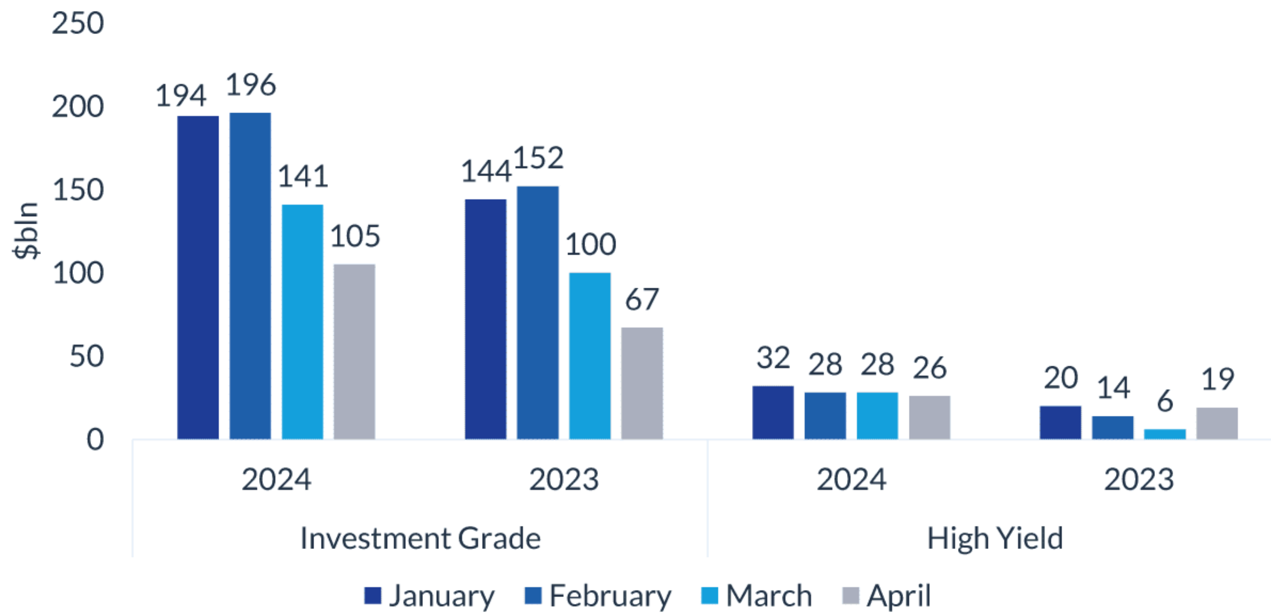
Are corporate borrowers still issuing new debt?

Despite a significant increase in interest rates, corporate borrowers continue to issue debt at a torrid pace in 2024. Year-to-date (YTD) investment grade corporate gross issuance reached $636 billion at the end of April, its second highest total on record and a 37% year-over-year increase. High-yield corporate markets have seen similar trends, hitting $113 billion in gross issuance through April 2024, a 92% year-over-year increase.

2024 YTD Gross Corporate Issuance



Source: J.P. Morgan, as of April 2024.

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Borrowers continue to use debt proceeds primarily for "general corporate purposes" (the costs of running a business on a day-to-day basis); however, refinancing also remains a priority, particularly in the high-yield space.

Roughly 22% of investment grade and an impressive 81% of high-yield issuance is being used to refinance older, more expensive debt outstanding, as well as to push maturity dates further into the future. In fact, the average maturity of new investment grade debt hitting the market is 10.2 years, its highest mark since 2021.

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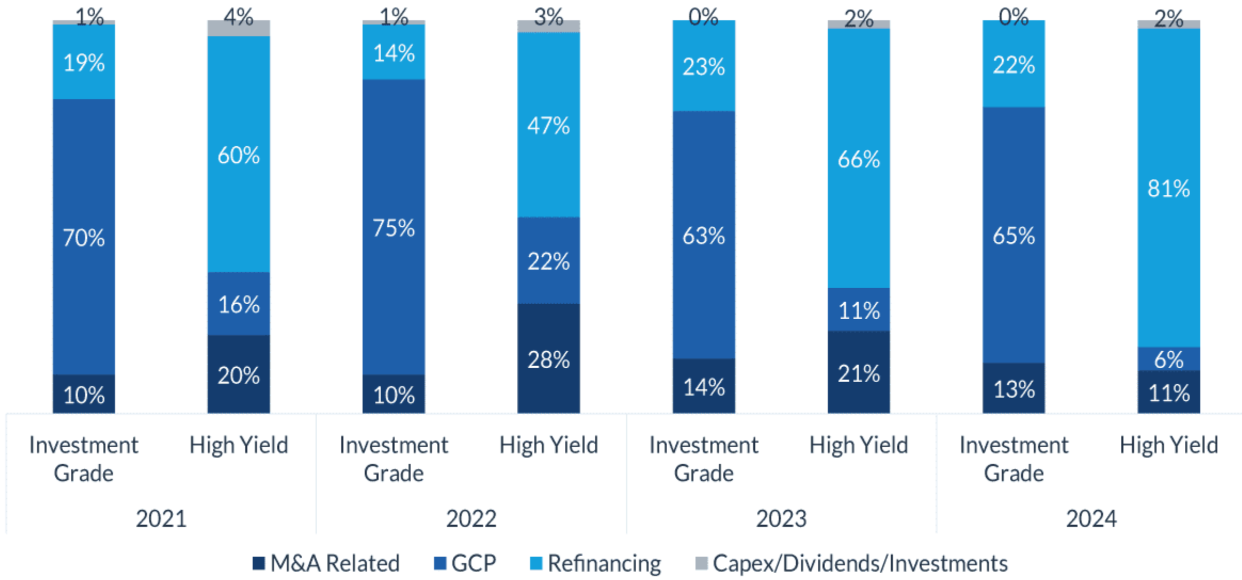

Source: J.P. Morgan, as of April 2024.

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This maturity extension should allow companies to focus on navigating more volatile market conditions and help stave off financial hardship as economic growth continues to cool.

Lastly, though interest coverage ratios (the ratio of operating income to interest expense on debt outstanding) have weakened in 2024, debt service costs remain largely manageable and are only ~2% higher for newly issued investment grade bonds.

uncertainties. Actual results, performance or events may differmaterially from those expressed or implied in such statements.

All investing is subject to risk, including the possible loss of the money you invest. As withany investment strategy, there is no guarantee that investment objectives will be met andinvestors may lose money. Diversification does not ensure a profit or protect against a lossin a declining market. Past performance is no guarantee of future performance.
Equity securities. There are inherent risks with equity investing. These risks include, but are not limited to stock market, manager or investment style. Stock markets tend to move in cycles, with periods of rising prices and periods of falling prices.

Fixed Income securities. There are inherent risks with fixed income investing. These risks 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.

High yield securities. Investments in below-investment-grade debt securities, which are usually called "high yield" or "junk bonds," are typically in weaker financial health. 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.

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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 Investment Grade Municipal Index: The Bloomberg Municipal Index measures the performance of the Bloomberg U.S. Municipal bond market, which covers the USDdenominated Long-Term tax-exempt bond market with four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

The Bloomberg Municipal High Yield Bond Index measures the performance of non-investment grade, US dollar-denominated, and non-rated, tax-exempt bonds.

MSCI EAFE Index. The MSCI EAFE (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization weighted index that is designed to measure developed equity market results, excluding the US and Canada.

DEFINITIONS

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.