City National Rochdale®
AN RBC/CITY NATIONAL COMPANY

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On the Radar

FAQS ON THE MARKETS AND ECONOMY

What does a Biden/Blue Wave mean for the market?

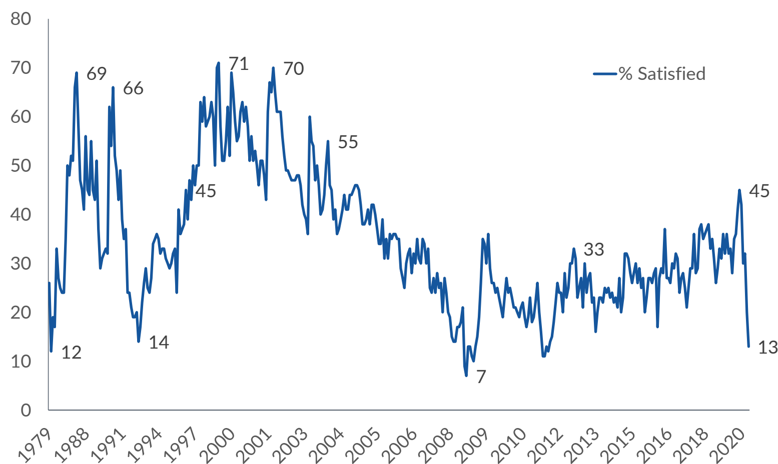
We believe the probability of a Democratic sweep in November is now somewhat greater than 50%. While it's too early to confidently make projections, and much can still change before Election Day, history shows that incumbent presidents tend to get voted out of office when the economy is doing poorly. Polling data, including surveys of consumer attitudes about the direction of the country, suggest the Democrats currently have strong momentum.

With potential rollbacks in corporate tax rates and re-regulation prominent parts of the Democratic Party agenda, the consensus view is that a Biden victory will be a negative for equities. However, there are also reasons not to be so bearish.

Typically there is a big difference between campaign rhetoric and policy reality. History suggests that presidential challengers typically campaign at an extreme only to converge toward the center post-election. Given the current economic weakness, business recovery and job gains are likely to be prioritized by a new Biden administration over policies that could dampen economic growth.

Other Biden policy proposals, including infrastructure spending, trade, immigration and an increased federal minimum wage, could also be net positive for S&P 500 earnings and help offset the corporate tax headwind.

Satisfaction With the Way Things Are Going in the United States



Source: Gallup as of July 2020.

If a Blue Wave does materialize, investors could potentially react negatively at first, but markets have historically performed well regardless of the composition of political party control.

KEY QUESTIONS

Is more fiscal stimulus forthcoming?

What did we learn from the recent labor report?

Is inflation picking up?

Why is CNR still underweight in European equities?

What is the global outlook?

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Is more fiscal stimulus forthcoming?

Much of the economic strength we have seen over the past two months can be directly attributed to the unprecedented aid coming out of Washington. Trillions of dollars have already been spent to keep families and small businesses afloat during the pandemic, and it has worked.

While there is general agreement that more aid is needed, the risks of no near-term action have been climbing in part due to better than expected job numbers and new executive actions out of the White House. These steps won't, in our view, come close to filling the fiscal gap.

The sticking point continues to be reconciling the priorities between Democrats and Republicans, as well as the size of additional spending. Many issues are on the table, including enhanced unemployment payments, another round of direct cash payments, increased assistance to state and local governments, funding for schools and students, hazard pay, and liability immunity.

Our sense is that a compromise will ultimately be reached somewhere in the $1-1.5 trillion range, providing additional relief to businesses, households and states. Both parties have incentive to get something done, and there is room for negotiation.

The challenge on timing, though, is that neither party is likely motivated to strike a deal during their political conventions, which take place over the next two weeks. So, legislating is on hold unless some new pressure point emerges from the market or elsewhere.

The question as to what happens next will likely depend on what the climate looks like afterward — who wins the Washington blame game, how the economy is performing, whether the markets apply pressure and where are the election polls after the conventions.

Consumer Price Index (%)

Republican Plan	Elements	Democratic Plan
$200 a week through September, then 70% of wages	Unemployment	Continue $600 a week until January 2021
$1,200 per person, $2,400 per married couple, $500 per child	One-time stimulus checks	$1,000 per person, $2,400 per married couple, $1,200 per child (up to three)
$0	States and Cities	$1 trillion
$105 billion	Schools	$430 billion

Source: City National Rochdale Research.

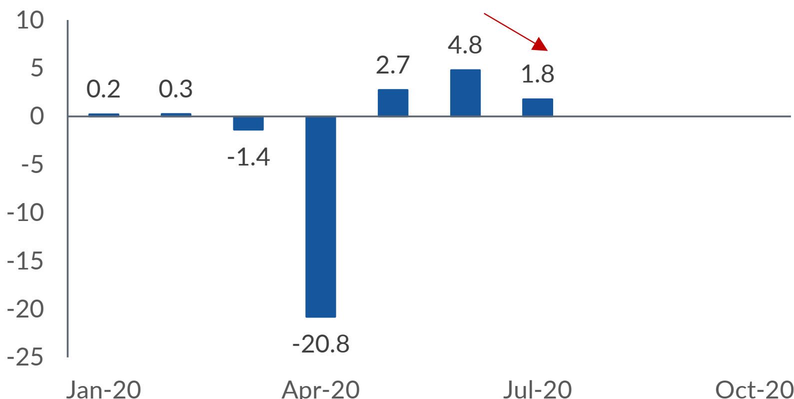
What did we learn from the recent labor report?

July's nonfarm payroll grew 1.8 million, a significant increase, but not as big as 4.8 million in June or 2.7 million in May. It shows the recovery continues on an upward trajectory, but the pace of hiring is slowing (see chart). So far, 42% of the jobs lost from the pandemic have been recovered. Payrolls remain 12.8 million below their pre-pandemic level.

The unemployment rate fell to 10.2% from 11.1% in June.

We are now getting to the stage that the remaining lost jobs will be harder to make up. The economy is facing some headwinds. The PPP loans were capped at two and a half months of payroll, and most were issued two and a half months ago; therefore, several jobs may be at risk of being eliminated again. This may already be happening. A study out of Cornell University has found that about one-third of the workers called back to work were subsequently laid off again. Also, the termination of the enhanced unemployment benefit ($600 per week) at the end of July will reduce household income for the nearly 30 million Americans receiving the aid. Less spending money means less spending, which means less income for those that benefited from the spending.

Nonfarm Payrolls ('000)
millions, monthly change



Source: Bureau of Labor Statistics as of July 2020.

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Is inflation picking up?

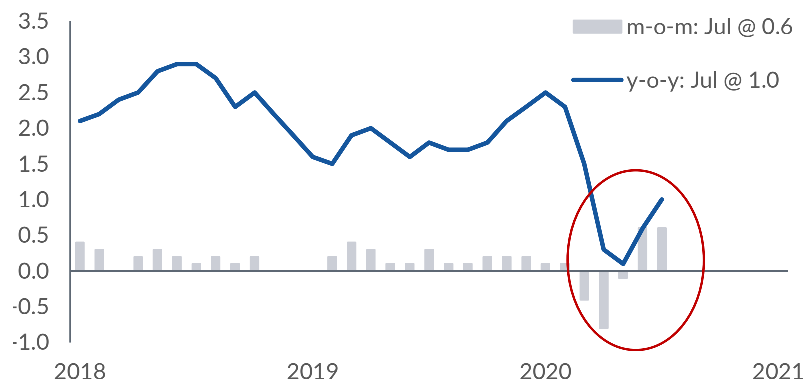
The Consumer Price Index jumped 0.6% m-o-m in June and July, a reversal of three monthly declines due to the lockdown (see chart).

This jump reflects a recovery in prices of goods and services that were at the epicenter of the pandemic. For example, motor vehicle insurance prices increased by 9.3% m-o-m, airfares are up 5.4% m-o-m, and energy prices are up 5.1%. On the other side of the coin, food prices, which surged during the lockdown, fell 0.4% in July.

The good news about the increase in prices of the past two months is that it has eradicated the fears of deflation that were prevalent in the early stages of the pandemic.

We do not see this sharp jump in inflation as a signal that inflationary pressures will pick up. We see it as just an unwinding of the sharp price declines that occurred when the economy was in lockdown. The fundamentals are not there for higher prices. The economy is about 10% smaller than it was just six months ago; this creates an enormous output gap that limits price pressures. Also, about 30 million people are collecting unemployment benefits. That glut will stay with us for some time, keeping wages under pressure.

Consumer Price Index (%)



Source: Bureau of Labor Statistics as of July 2020.

Why is CNR still underweight in European equities?

Progress in stemming the COVID-19 outbreak, recovering economic activity, and recent political developments have been encouraging, but Europe's outlook still faces a number of short- and long-term headwinds.

Our concerns have been the region's weak domestic growth, higher exposure to global/trade headwinds, negative yields that affect banks' profitability, a less favorable sector representation in the market structure, and the politics that hinder market/economic reforms. These issues, which led to its past underperformance, are unlikely to ease going forward.

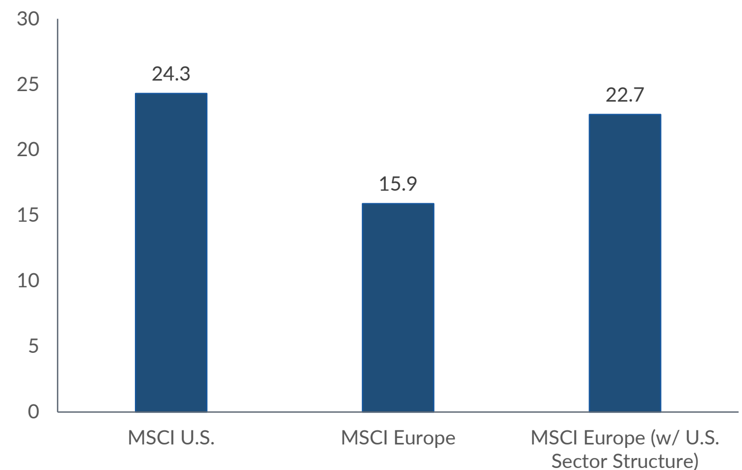
While the recent agreement on a European Recovery Fund is certainly encouraging, this is a small step down a long and difficult road toward a common fiscal framework, and we remain hesitant to view this initiative as a definitive turning point in the EU.

Overall, European growth expectations are set to continue to meaningfully lag behind U.S. given structural challenges. Although the initial rebound in the Eurozone economic activity has been a little quicker than anticipated, we think that the economy will likely remain smaller than its pre-crisis level until well beyond 2021.

The challenge facing investors today is how to construct portfolios in a slow and uncertain macroeconomic environment. Given this, we remain overweight U.S. equities due to the greater share of high-quality and growth companies, and underweight Europe due to more cyclical exposure and therefore less resilience to a downside scenario.

Euro valuations, meanwhile, are not cheap on a historical basis and are just as pricey as U.S. equities on a sector-adjusted basis.

P/E Multiple



Source: MSCI, Ned Davis Research as of July 31, 2020.

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What is the global outlook?

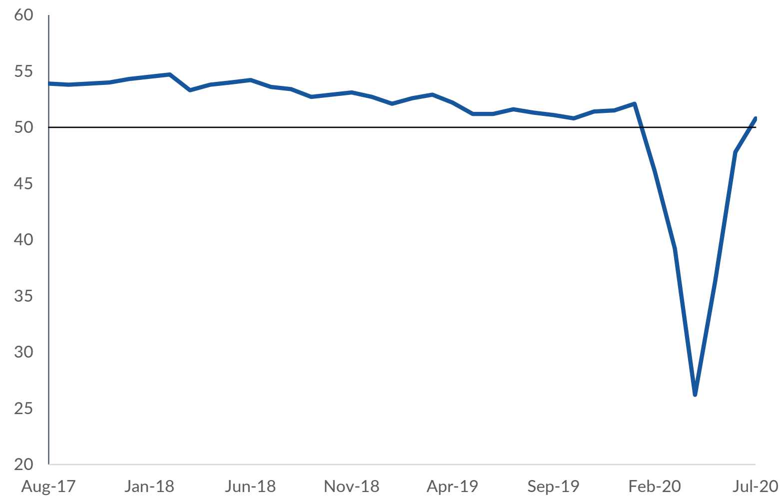
After the worst recession outside of wartime in 100 years, high-frequency global indicators are signaling that the world economy is moving past the worst of COVID-19 contraction.

The Global PMI rose above 50 in July for the first time in six months to indicate expanding output across the combined manufacturing and service sectors.

Even so, global activity remains far below pre-virus levels, and beyond an initial bounce back in activity as some businesses reopen, recoveries across economies will likely be slow going and uneven.

Households and firms will remain cautious until a widely available vaccine is developed and the threat of the coronavirus is finally contained, preventing a full V-shaped recovery. While policy is set to remain supportive, the recent huge impetus must ultimately be wound down with adverse effects.

The path of recovery for each country and region will likely be highly dependent on a number of factors, including the path of the virus, the effectiveness of each country's healthcare responses and degree of government restrictions, each economy's exposure to sectors most impacted by the virus, and the scale of each country's fiscal support.



Source: JP Morgan, IHS Markit as of July 31, 2020.

China and emerging Asia are among the furthest along the road to recovery, and we expect them to stay in the lead, while economies in Europe and Latin America lag behind.

In all, it will probably be a few years before the global economy returns to its pre-virus path.

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Investing involves risk, including the loss of principal.

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Past performance is no guarantee of future performance.

Index Definitions

The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

JP Morgan Global Composite PMI gives an overview of the global manufacturing and services sectors. It is based on non-opinion based monthly surveys of over 16,00 purchasing executives from 32 of the world’s top economies, including the U.S., Japan, Germany, France and China which together account for over 85 percent of global GDP.

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