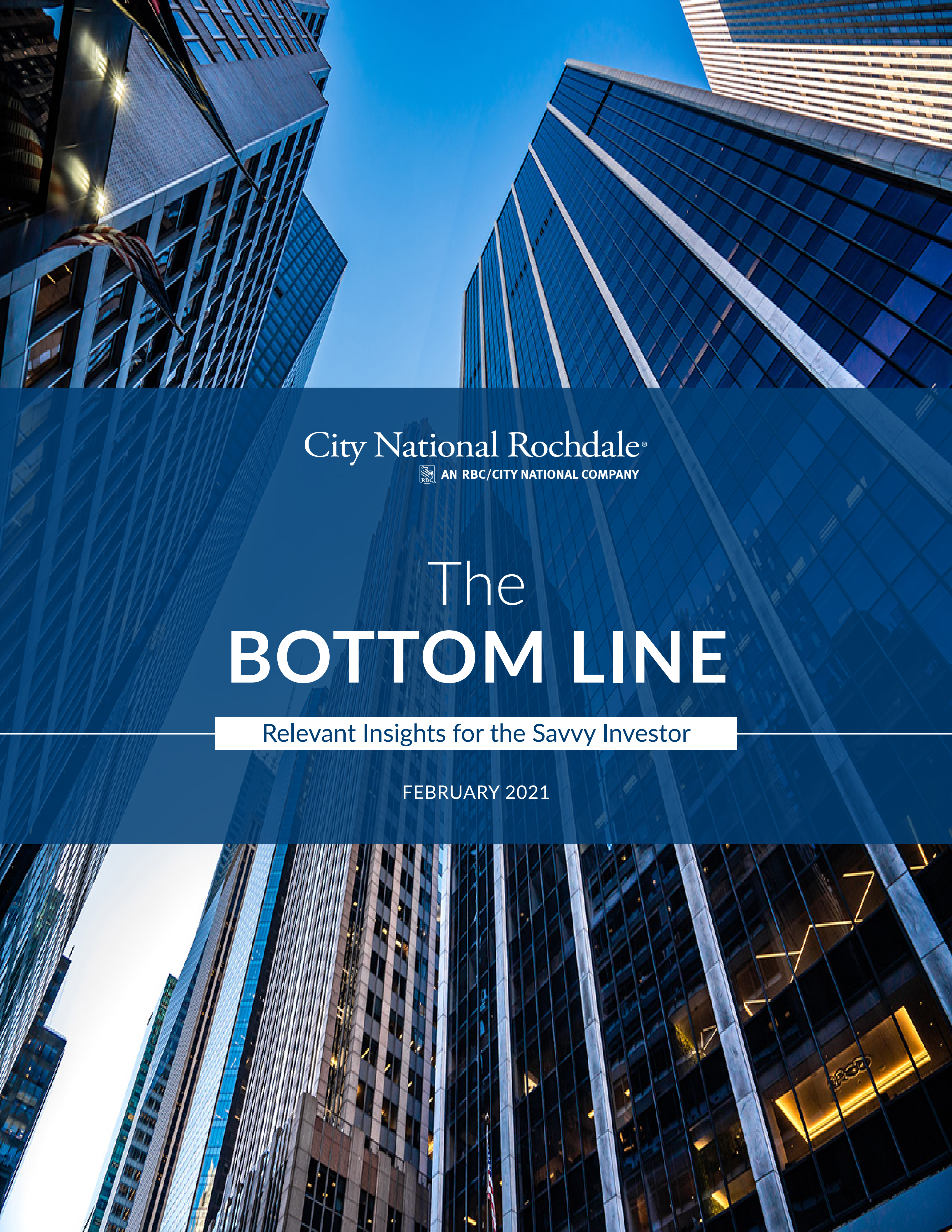


City National Rochdale®

AN RBC/CITY NATIONAL COMPANY

The BOTTOM LINE

Relevant Insights for the Savvy Investor

FEBRUARY 2021

INFLATION, OR THE LACK THEREOF

There are many articles in the news about the risk of inflation. We continue to believe that inflation is not a severe risk to the economy in the next few years.

That said, for 2021, inflationary figures will be volatile. Inflation currently registers at 1.5% for the change in the past year. In the spring of last year, during the worst of the pandemic, there were a couple months of negative inflation as household buying plunged and producers/retailers had to drop prices (chart 1-a). Those monthly figures will soon drop off the year-over-year calculation, and the yearly change will increase. But in the past summer, when the economy reopened and demand for goods and services was strong, prices shot up (chart 1-b). When those increases drop off the yearly calculation, inflationary pressures will recede. By autumn 2021, the yearly change in inflation should normalize to show the real trend of price pressures.

The Fed will not be spooked by those events and will look past these factors as transitory and will not adjust monetary policy. The Fed will continue to focus on fundamental changes to the economy that may cause long-term price pressures. Based upon the Fed's recent projection for inflation, it does not think it will get to 2.0% until the end of 2023 (chart 2).

The Fed has signaled its plans to keep the federal funds rate low even if inflation moves above the 2.0% level. The Fed will delay raising interest rates as inflation starts to pick up because it is committed to ensuring that the economy gets back on track, and that the recovery is sustainable and inclusive.

We believe a few thresholds need to be passed before the Fed starts to respond to higher inflationary pressures: 1) inflation has to sustain a rate above 2.0% for about a year or more; 2) the unemployment rate needs to be below full employment (NAIRU – non-accelerating inflation rate of unemployment) (chart 3); 3) inflationary expectations have to sustain a level above 2.0% (chart 4); and 4) need evidence of an inclusive recovery.

CHART 1: Inflation: Core Personal Consumption Expenditure

% change, seasonally adjusted

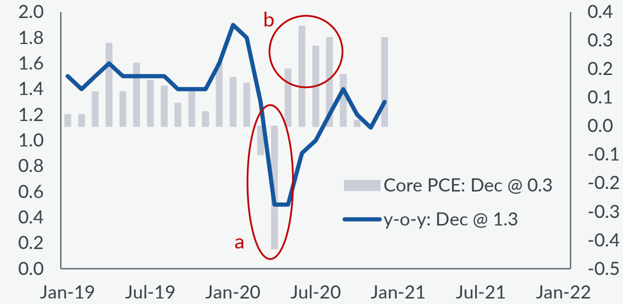


CHART 2: Inflation & FOMC Projections

% change, year-over year, core personal consumption expenditures

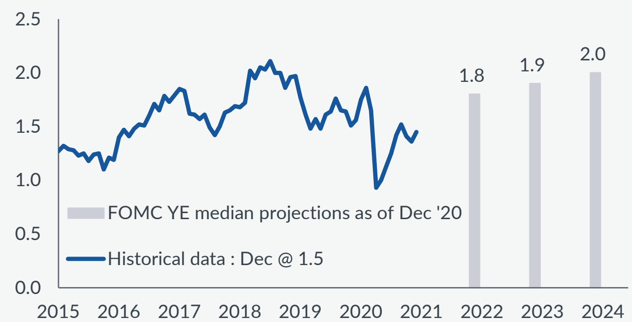


CHART 3: Labor Rates (%)

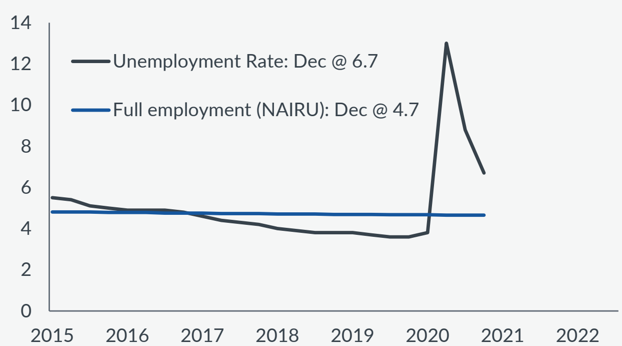
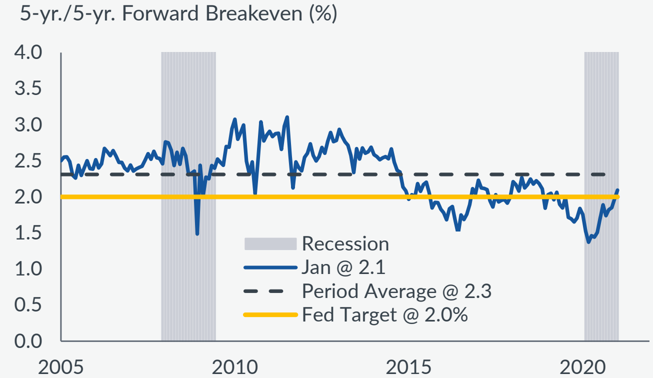


CHART 4: Inflation Expectations

5-yr./5-yr. Forward Breakeven (%)



Sources: Bureau of Labor Statistics, Federal Reserve Bank, Bureau of Economic Analysis, Congressional Budget Office, Bloomberg.

COVID-19

COVID-19 hospitalizations have begun declining and states are gradually reducing economic restrictions. The distribution of approved vaccines has accelerated, and positive data on multiple new vaccines indicates the potential for increased supply and reasonable effectiveness against new strains. Reduced virus spread and widespread vaccination should lead to economic normalization in mid-2021.[1]

LABOR

After six months of declining monthly payroll growth, the January report reversed the trend. Combine that positive news with improving coronavirus news, and the outlook for labor appears good.[2]

INFLATION

Inflation remained tame this past year despite the massive inventory shortages, shipping bottlenecks and rallies in many commodity prices. Inflation remains well below the Fed's goal and reflects an economy dealing with the pandemic's global economic slowdown.[3]

THE FED

The Fed remains committed to keeping interest rates low to ensure the economy gets back on track, and that the recovery is sustainable and inclusive. Its current plan is to keep the short-term interest rate at the near-zero level until the end of 2023.[4]

GDP

Economic output finished the final quarter up 4.0% and now stands just 2.5% below the previous peak. It has undergone a remarkable recovery from the pandemic due to the federal government's fast action (CARES Act) and the Fed dropping interest rates.[5]

HOUSING

Home prices are up 9.1% year-over-year, which is more than twice the long-term average gain. Growing demand, low mortgage rates, and lack of supply are putting pressure on prices.[6]

STOCK MARKET

Stocks have stumbled recently amid retail investor-driven volatility and signs of froth in more speculative areas of the market. Given the unprecedented rally from last February lows, a correction may be overdue, but we don't believe recent developments are a sign of an overall unhealthy market or a broader bubble.

Sources

[1]Center of Disease Control

[2]Bureau of Labor Statistics

[3]Bureau of Labor Statistics

[4]Federal Reserve Bank

[5]Bureau of Economic Analysis

[6]S&P CoreLogic Case Schiller