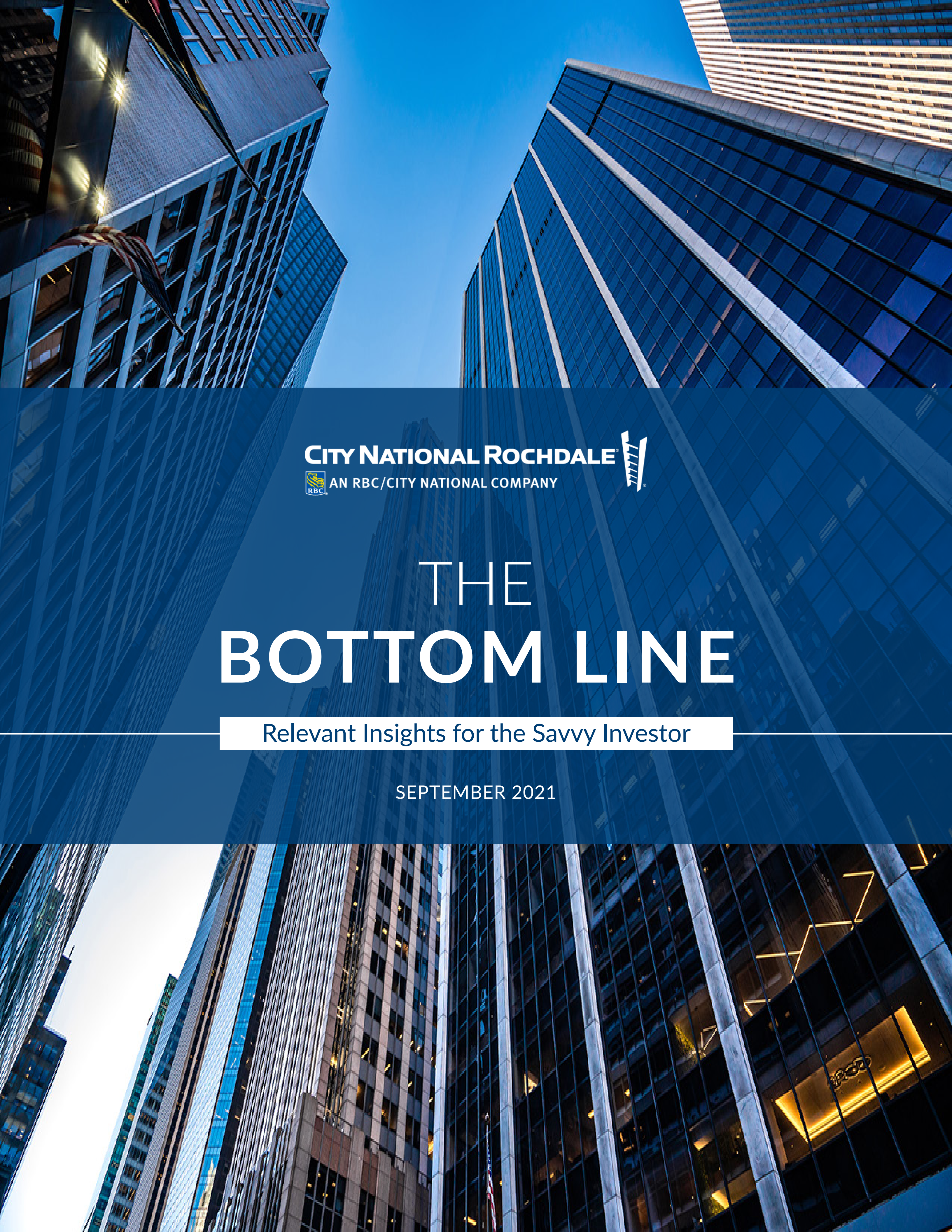


CITY NATIONAL ROCHDALE
AN RBC/CITY NATIONAL COMPANY

THE BOTTOM LINE

Relevant Insights for the Savvy Investor

SEPTEMBER 2021

THE ECONOMY IS SLOWING, NOT STALLING

The pace of economic growth appears to have peaked for this business cycle. The economic growth rate in Q2 was 6.6%, and this quarter's growth rate is expected to come in at a lower rate. Over the next 12–18 months, the rate of growth is likely to return toward the pace the economy experienced in the previous expansion (chart 1), which lasted about 10 years and averaged 2.3% per year.

The Q2 growth rate was the fastest rate since 2003, outside of last year's reopening. The growth was heavily driven by solid consumer spending due to the reopening of the economy and several stimulus checks sent to households. However, it was not a sustainable pace.

The outlook for the economy has changed rapidly. A month ago, the view for Q3 growth was much stronger than Q2's, based on the assumption that widespread vaccinations would ease the labor shortage, schools and offices would reopen, and business and leisure travel would bounce back. But that is not how it has been playing out. America's reaction to the surge in Delta variant cases (chart 2) has changed business and personal spending behaviors. Consumer sentiment fell to the lowest level in almost 10 years (chart 3), payroll growth has slowed, and the number of people flying has tapered off.

The good news is that the pace of growth does not appear to be stopping; it is simply slowing toward a sustainable pace. This expansion is expected to last for some time due to robust fundamentals. Household balance sheets are solid, with household net worth increasing 23.0% in the past year and now standing at almost 720% of GDP (chart 4). Furthermore, households have more than $2.5 trillion in excess cash, providing a lot of dry powder for future purchasing power. Also, corporate balance sheets are fundamentally solid, resulting from their substantial gains in profitability.

This recovery/expansion, like most, has its ebbs and flows. The ebbs are centered on the cycle of COVID-19 cases and the lack of supplies, which is most pronounced with computer chips. But underlying all of this is the constant demand for goods and services, which is the key driver of sustainable economic growth.

CHART 1: GDP: Actual and Forecast

% change, quarter-over-quarter, annualized

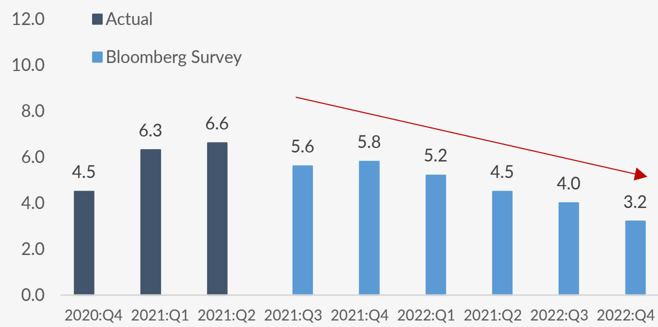


CHART 2: COVID-19 U.S. - Confirmed Cases: Daily Change

'000 weekly data, divided by 7

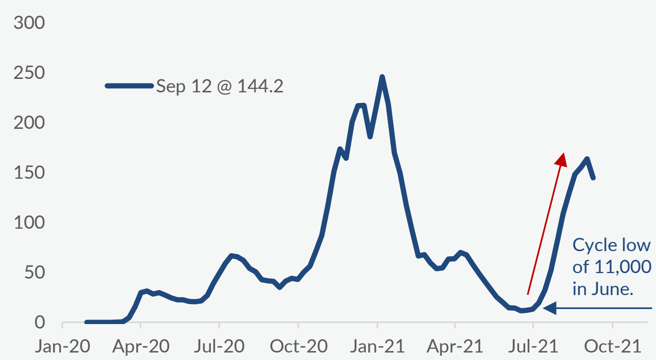


CHART 3: Consumer Sentiment: University of Michigan

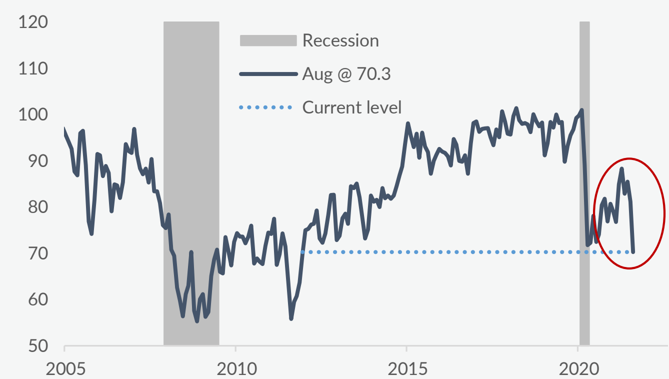
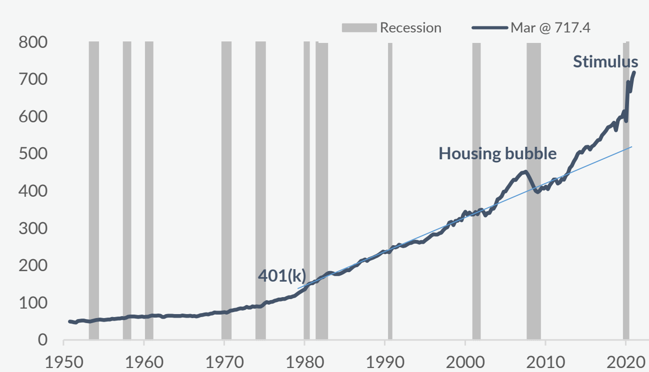


CHART 4: Household Net Worth as a Percent of GDP



Sources: Bureau of Economic Analysis, Bloomberg Survey, Bloomberg News, Johns Hopkins, University of Michigan, Federal Reserve.

Markets have remained resilient despite concerns about the Delta variant, weaker-than-expected economic data, and Fed policy uncertainties. Continued strength in earnings has helped support a steady rally in the S&P 500 this year with 54 new closing highs and only two 4% pullbacks. However, the second quarter is expected to represent the peak in the earnings growth rate this cycle, and history suggests a deceleration in profit expansion will bring higher volatility and more modest returns ahead.[1]

Investors in the bond market are still dealing with historically very low yields. Interest rates are not expected to increase anytime soon as the Fed plans to keep short-term interest rates low and inflationary pressures are viewed as temporary.

INFLATION

Inflationary pressures appear to have stabilized at 5.4%. With the end of summer, demand is beginning to decline. We may have hit a peak in inflation.[2]

LABOR

Job gains fell significantly in August due to COVID-19 concerns and end-of-season pullbacks after increasing about 1 million for June and July.[3]

THE FED

In November, the Fed is expected to announce plans to cut back on its bond-buying program. This is just a simple reduction in their stimulus, not a tightening.

HOUSING

Homebuilding has stabilized around 1.6 million units. The increased rate in demand has slowed of late due to surging home prices and lack of supply.[4]

COVID-19

The Delta variant continues to add uncertainty to the economic outlook, and it is not going away quickly. Fortunately, the national figures appear to be showing some stabilization in cases.[5]

OIL

Oil prices have stabilized below $70 a barrel. OPEC+ remains committed to its plan to increase production gradually.[6]

Sources

[1] Standard and Poor's

[2] Bureau of Labor Statistics

[3] Bureau of Labor Statistics

[4] U.S. Census Bureau

[5] CDC, Johns Hopkins

[6] Bloomberg Energy

Index Definitions

The Standard and 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.

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