CITY NATIONAL ROCHDALE
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# On the Radar

FAQS ON THE MARKETS AND ECONOMY

## Is recent volatility a concern?

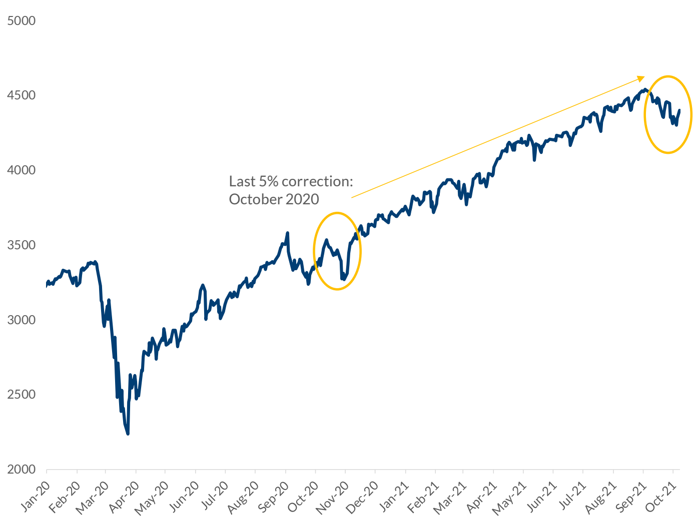
After an unusually long period of complacency, volatility has returned to markets. Concerns over Fed tapering and rising bond yields, the U.S. debt ceiling, inflation pressures, slowing economic and earnings growth projections, and Chinese property markets have all played a role in driving recent swings in sentiment and provided the catalyst for the S&P 500's first 5% pullback in nearly a year, the 13th-longest streak on record.

We don't think any of these concerns pose a significant threat to the long-term outlook and that the steadiness and strength of the rally this year have probably prompted more headlines and reactions to this most recent dip than are necessarily warranted. Even the best markets need a breather now and then.

Still, for now, investors have more questions than answers, and a more balanced landscape of risks does raise the prospect of further volatility in the coming months and a potential market correction.

Corrections, though, are often healthy events, helping to eliminate excesses that have built up after an extended period of market optimism and setting a firmer foundation for future gain. We think this bull market still has a lot of room to run and that the combination of sustained economic expansion, robust earnings growth and ongoing policy support will ultimately remain a tailwind for stock prices. Given this, investors may want to use any weakness ahead as an opportunity to add to core positions.

**S&P 500 Index**




Source: Bloomberg.

### KEY QUESTIONS

Will the Fed start tapering off its bond purchases soon?

Was the weak labor report a concern?

What is the debt ceiling and what is happening now?

# Will the Fed start tapering off its bond purchases soon?

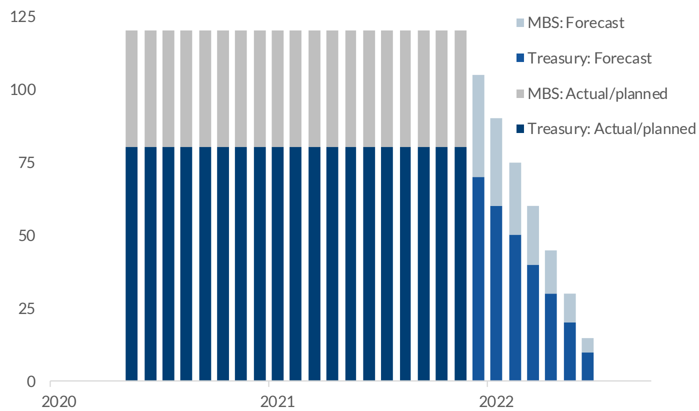
The Fed is expected to announce the start of its plans to reduce its bond-buying at its next meeting on November 2-3. It will gradually reduce the purchases each month and will end next summer.

This is not a tightening of monetary policy; all the Fed is doing is stopping the purchases of additional bonds onto its balance sheet. The balance sheet is highly simulative and currently stands at $8.5 trillion, about twice its size two years ago. Relative to GDP, it currently stands at 37.5%, up from 19.2% before the recession started, and well above the 25.5% it peaked at last time around.

Unlike the 2013 taper tantrum, when 10-year yields jumped about 100 bps, this time, the Fed prepared the markets for the termination of bond purchases. This time, the Fed took baby steps in preparing the market for the eventual end of asset purchases. Since December of last year, the Fed has been talking about the conditions needed for the taper. This past April, the Fed indicated that the FOMC would begin discussions about tapering, and it spoke about tapering during its summer meetings.

**The Fed Bond Buying Program**

*$, billions, purchase per month*




Sources: Federal Reserve, City National Rochdale.

# Was the weak labor report a concern?

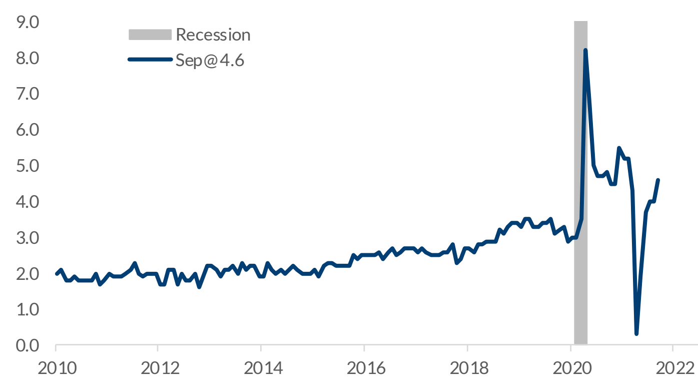
The nonfarm payroll gain in September was 194,000, well below the forecasted level of 500,000. A big part of the miss was due to seasonal adjustments of education jobs. The unemployment rate fell to 4.8% from 5.2%.

The labor market is not as weak as the NFP headline implies. On the contrary, there are almost 11 million job openings, and businesses continue to struggle to find workers. As a result, they have increased wages to attract potential workers, and the average hourly earnings now stand at 4.6% year-over-year. It appears that the mismatch in skills and location of workers will take time to correct itself.

We do not believe this will alter the Fed's plan to taper its bond purchases, which is expected to be announced at its upcoming meeting on November 2-3.

**Average Hourly Earnings**

*% change, year-over-year*



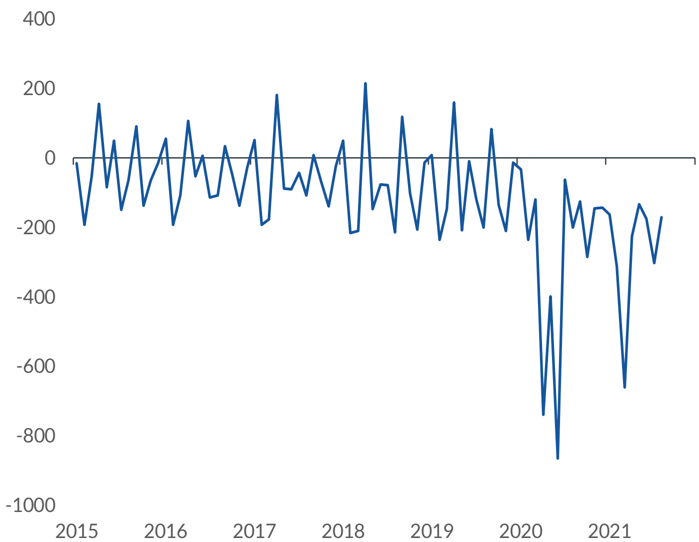

Source: Bureau of Labor Statistics.

# What is the debt ceiling and what is happening now?

The congressionally imposed debt ceiling limits the amount of outstanding federal debt. Breaching the ceiling reduces cash flow for debt payments and funding for operations. An extended period above the ceiling would affect the global economy, as an event of default would impair the perception of U.S. credit quality and reduce the buyer base. Knock-on effects such as lower GDP would affect everyday households due to missed social program payments and higher consumer interest rates.

After weeks of political brinksmanship by both Democrats and Republicans, a deal was reached on October 7 for a short-term debt ceiling increase through early December. This allows more time for Democratic majorities to pass a long-term solution using a process known as "reconciliation." The temporary extension will allow Congress to focus on the $1 trillion bipartisan infrastructure bill and the $3.5 trillion Build Back Better bill, allowing a sharper focus on a debt ceiling deal over November.

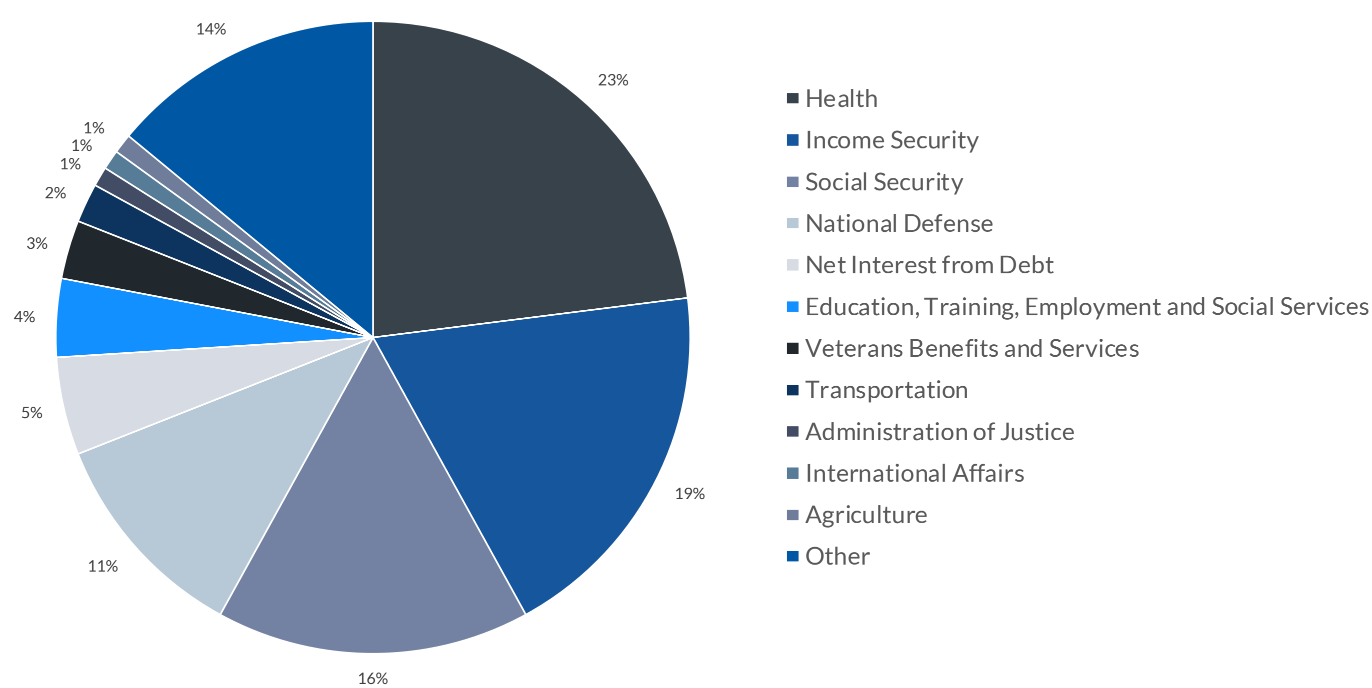
**Federal Surplus or Deficit**
*billions ($)*




Source: Bloomberg.

The extension is a positive development and signals that bipartisan cooperation has increased. It is in the best interest of Congress to reach a long-term resolution.

**Federal Spending by Category 2020**




Source: Office of Management and Budget.

**Index Definitions**

The S&P 500 Index is a market-capitalization-weighted index of the 500 largest publicly traded companies in the U.S.

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