IN THIS ISSUE

MARKET REVIEW

MAY 2021

RCB BANK

Trust & Wealth Management

U.S. MANUFACTURING RESURGENCE AMID SUPPLY CHAIN RESHUFFLE

Over the last few decades, companies' efforts to move manufacturing operations out of the U.S. to countries where manufacturing costs are lower resulted in the U.S. and other developed economies becoming less dependent on industrial manufacturing. This embrace of globalized supply chains contributed to the U.S. manufacturing sector shrinking by 6.7 million jobs from the industry's peak employment in 1979 through 2019. Meanwhile, the overall U.S. labor market expanded by over 60 million jobs during that period. As a result of the steady decline in domestic manufacturing, the U.S. manufacturing sector accounted for 8% of total employment in 2019, about one-third of what it was in 1979.

Disrupted supply chains due to the coronavirus pandemic highlighted the risks of countries relying too heavily on overseas manufacturing largely focused in Asia. The health care sector was a prime example last year as the U.S. faced challenges early in the pandemic to supply enough medical products including pharmaceuticals, ventilators, and testing kits. According to the Food and Drug Administration (FDA), over 70% of pharmaceutical manufacturing facilities that supply the U.S. are in foreign countries, including 13% located in China. The U.S. supply of antibiotics was particularly at risk during the pandemic. According to the Council on Foreign Relations, over 90% of antibiotics used in the U.S. are produced in China. Many of these Chinese manufacturing facilities shut down in the early days of the pandemic.

POTENTIAL U.S. MANUFACTURING RESURGENCE

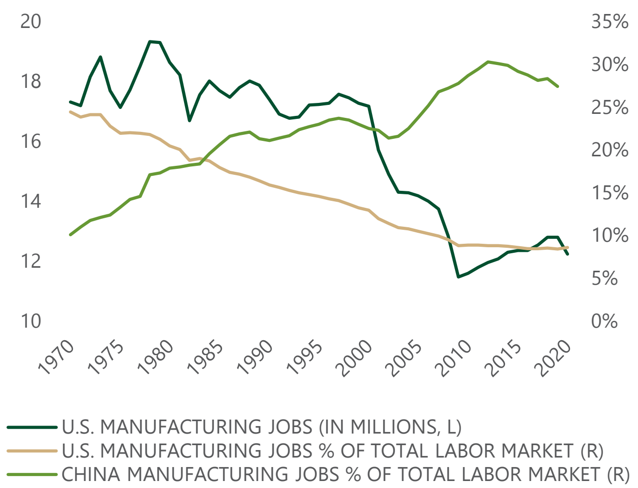
Many businesses are reassessing their globalized manufacturing operations after the pandemic exposed the vulnerabilities of extended global supply chains. Efforts to make them more resilient and dependable are expected to gradually result in the movement of manufacturing away from the globalization model that is increasingly focused in east Asia. A UBS survey conducted last summer of 450 Chief Financial Officers at U.S. firms showed 76% of survey participants with manufacturing production in China have moved, or are planning to move, capacity out of China. Their relocation plans would result in moving nearly half of their China production elsewhere. The U.S. is a target to relocate manufacturing for 82% of the companies shifting production. Canada, Japan, and Mexico are the other top countries targeted for relocating production due to their close physical proximity to U.S. consumers and/or their strategic alliance with the U.S.

One of the long-standing catalysts for outsourcing manufacturing to China has been lower labor costs. However, China's cost advantage has steadily weakened over the last two decades due to the country's rising labor costs. According to the U.S. Department of Commerce, Chinese manufacturing wages averaged 13.3% annual growth from 2000 to 2015. This rate of growth has led to U.S. manufacturing wages becoming roughly four times higher than wages in China on a currency-adjusted basis, compared to 20 times higher in 2008. Some countries in Asia, including India, Indonesia, and the Philippines, have lower labor costs than China, but their logistics infrastructure is less developed, which may dampen their attractiveness as a replacement for Chinese manufacturing. As a result, bringing manufacturing back to the U.S., a process referred to as re-shoring, is a serious consideration for many companies despite higher labor costs. Andrew Obin, head of Industrials/Multi-Industry equity research at Bank of America, has noted recently, "companies are more willing to accept higher prices to reduce supplier and transport risks…shortage concerns revealed that the supply chains of the future need to be more flexible and closer to the end-consumer."

Policymakers in Washington have proposed legislation to help entice businesses to bring manufacturing back to the U.S. For instance, in April, a bipartisan group of 12 Senators and 5 House Representatives reintroduced the Endless Frontier Act. The proposed legislation includes $100 billion in funding over five years for research and manufacturing of key technologies such as semiconductors, robotics, communications technology, biotechnology, and advanced materials. Additional political support was proposed by Senators Elizabeth Warren, Tina Smith, and Marco Rubio through reintroducing legislation in April to help rebuild the country's medical manufacturing capacity with $5 billion in funding for domestic production. Lastly, President Biden's proposed $2.3 trillion infrastructure package allocates $300 billion to support domestic manufacturing. The $300 billion includes $50 billion allocated to the Department of Commerce to help fund production of "critical goods" and another $50 billion for semiconductor production.

MANUFACTURING GLOBALIZATION

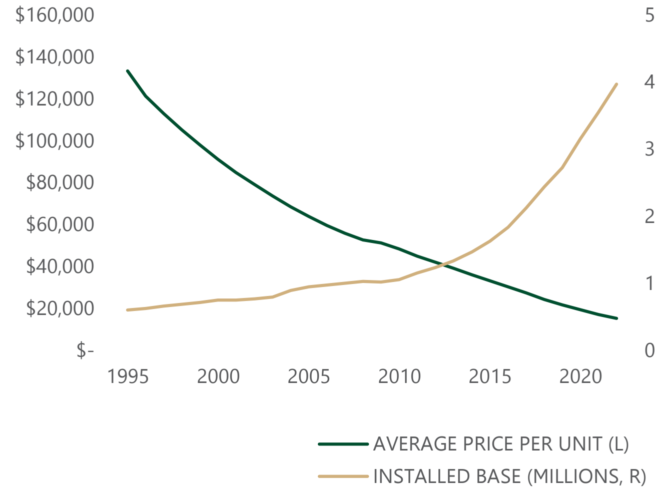
U.S. & CHINA MANUFACTURING JOBS



Source: Federal Reserve Bank of St. Louis & World Bank. Past performance does not guarantee future results.

CHEAPER ROBOTS DRIVE MORE AUTOMATION

INDUSTRIAL ROBOT PRICE AND INSTALLED BASE



Source: Ark Invest & International Federation of Robotics. Past performance does not guarantee future results.

The remaining $200 billion would go to other areas including clean energy, small businesses, and regional investment hubs.

ECONOMIC BENEFITS FROM MORE MANUFACTURING

Reviving domestic manufacturing could have far reaching economic effects for the broader economy through new jobs, higher wages, and increased capital expenditure and research and development (R&D). According to the Economic Policy Institute (EPI), manufacturing has the third highest employment multiplier among U.S. industries, behind utilities and real estate. A 2019 EPI report showed that each new manufacturing job created results in approximately 7.4 new indirect jobs in other industries through increased demand for suppliers' materials and services. Additional indirect jobs can also be created in unrelated industries resulting from the income spent by the new manufacturing and supplier employees. The Bureau of Economic Analysis estimates every additional dollar of manufacturing revenue produces $1.33 in output from other industries, the largest economic multiplier effect among all U.S. industries. A growing manufacturing industry can also help the economy by offering higher wages for skilled workers. U.S. manufacturing workers earn 13% more in hourly compensation than comparable non-manufacturing workers, according to the EPI.

Bank of America's equity research team estimates that shifting all U.S. companies' manufacturing from China to the U.S. would cost $1 trillion in capital expenditure over five years. This figure only includes costs related to relocating manufacturing operations in the U.S. and does not include the likely higher operating costs in the U.S. While it is unlikely U.S. companies will move all their Chinese manufacturing to the U.S., every 5% of production re-shored would increase U.S. capital expenditure by $50 billion. That would be a meaningful amount given U.S. capital expenditure totaled $493 billion in 2020. On a more granular level, Bank of America estimates every $10 billion in re-shored manufacturing revenue would create $3.8 billion in capital expenditure spending.

Increased domestic manufacturing would likely lead to more spending on R&D. Developing new manufacturing products and services tends to be more capital intensive than other industries. According to the National Science Foundation, R&D as a percentage of revenue for domestic manufacturers is 5.5% compared to 3.6% for non-manufacturing industries. Jared Woodard, Head of the Research Investment Committee at Bank of America, recently noted "economists have found that $1 of R&D investment generates between $8 and $9 of GDP."

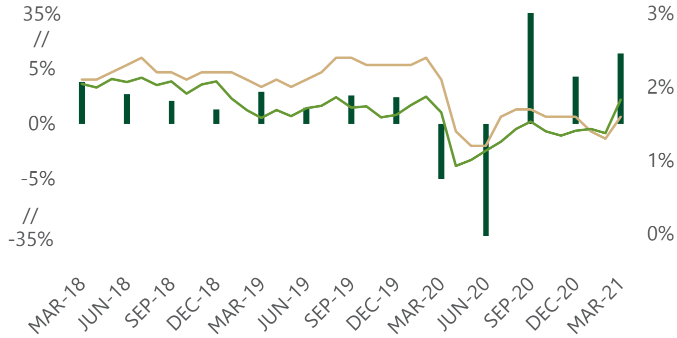
AUTOMATION

U.S. manufacturing job growth from re-shoring may be constrained by automation and a shortage of skilled workers. A Bank of America survey among all its equity research analysts, who cover more than 3,000 companies globally, showed U.S. businesses almost unanimously plan to use more automation to help mitigate the higher labor costs associated with re-shoring. Increased use of automation for re-shoring will likely act as an accelerator for the growing trend in industrial robot adoption. Additionally, a lack of skilled workers and the plummeting cost of industrial robots contributed to the installed base of industrial robots doubling over the last five years. With regard to the shortage of skilled workers, a pre-pandemic survey from the National Association of Manufacturers showed that finding qualified workers was one of the manufacturing industry's top challenges. Manufacturing's labor shortage has been partially driven by the industry's aging workforce and gradual retirement of the baby boomer generation. Around one-quarter of manufacturing's workforce are age 55 or older. The labor shortage situation may be partially alleviated by President Biden's $2.3 trillion infrastructure plan allocating $152 billion for industry-specific job training programs which includes manufacturing. In next month's Market Brief, we will take a closer look at the potential economic effects of increased automation across industries.

ECONOMY

GDP AND CONSUMER PRICES

MARCH 2018 THROUGH MARCH 2021



Source: Bloomberg

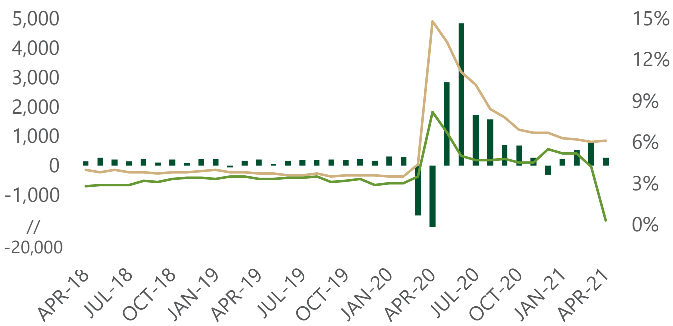
Economic activity in the U.S. accelerated in the first quarter at an annualized pace of 6.4%, slightly slower than the median Bloomberg forecast of 6.7%.

The rise in GDP reflected an acceleration of the economic recovery and was sparked by a 10.7% surge in consumer expenditures, which is the largest component of the domestic economy. Consumer spending was most likely boosted by a surge in COVID-19 vaccinations and two rounds of stimulus payments.

The Core Consumer Price (CPI) index rose 0.3% in March and was up 1.6% year over year. The Core Personal Consumption Expenditure (PCE) index rose 0.4% in March and climbed 1.8% year over year. Any forthcoming acceleration in inflation has been described in advance as transitory by Federal Reserve policymakers.

LABOR MARKET

APRIL 2018 THROUGH APRIL 2021



Source: Bloomberg

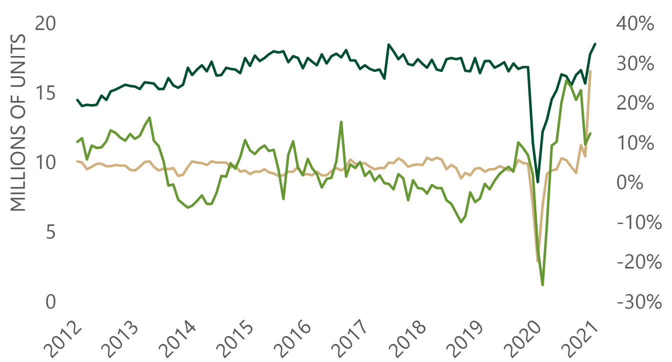
April hiring activity missed expectations despite strong vaccination trends and easing lockdown restrictions. The U.S. added 266,000 jobs in April compared to consensus expectations of 1,000,000. March job gains were revised lower to 770,000 from 916,000.

The unemployment rate in April also underwhelmed, increasing from 6.0% to 6.1% compared to expectations of 5.8%. Average hourly earnings rose 0.7% in April to $30.17 from a month earlier.

The leisure and hospitality industry continued its employment recovery by adding 331,000 jobs in April as more parts of the country opened up. Total industry payrolls are still 17% below the all-time peak of 16.92 million in February 2020.

HOUSING, AUTO AND RETAIL SALES

APRIL 2017 THROUGH APRIL 2021



Source: Bloomberg

U.S. auto sales jumped sharply in April to a seasonally adjusted annual rate of 18.5 million units, the highest level since 2005.

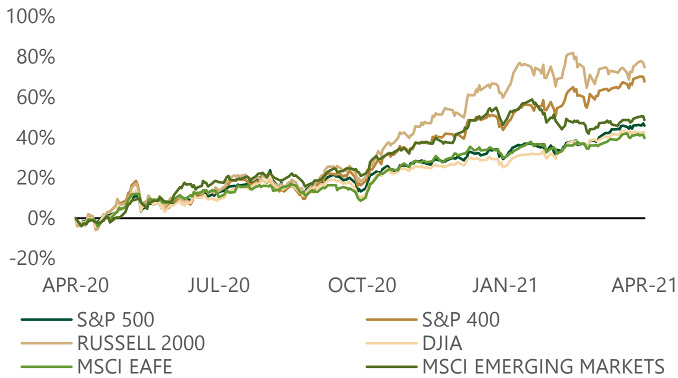
Domestic retail sales climbed 9.7% in March and 27.9% on a year-over-year basis. The March increase was the second largest in government data going back to 1992. Receipts at restaurants and apparel retailers jumped 13.4% and 18.3%, respectively, during the month.

According to National Association of Realtors data, March sales of existing homes in the U.S. fell 3.7% from the previous month, but were up 12.3% on a year-over-year basis. A combination of low mortgage rates and constrained supply has propelled the median sales price of an existing home in the U.S. to a record high $329,100 compared to $280,700 one year ago.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, APRIL 2020 THROUGH APRIL 2021



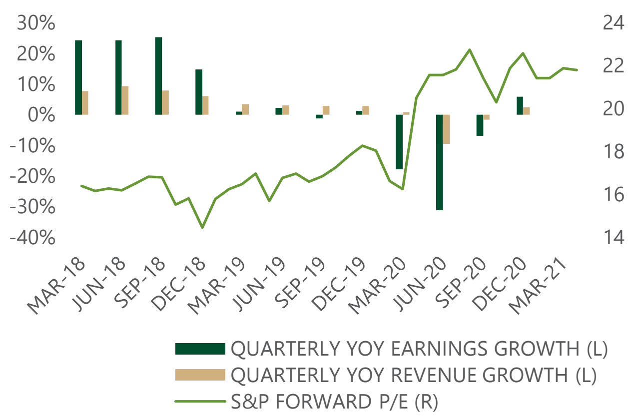
Source: Bloomberg. Past performance is no guarantee of future results.

Equity markets experienced another strong month with the S&P 500 index rising 5.34% in April after gaining 4.38% in March. April's gains occurred against a backdrop of strengthening economic data, easing COVID-19 restrictions, and robust first quarter earnings.

The rotation into cyclical stocks took a breather in April as growth stocks regained market leadership. In April, the S&P 500 Growth index outperformed the S&P 500 Value index for the first month this year. Moderately lower interest rates and impressive earnings reports helped some mega capitalization stocks post double-digit monthly returns.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, MARCH 2018 THROUGH APRIL 2021



Source: Bloomberg

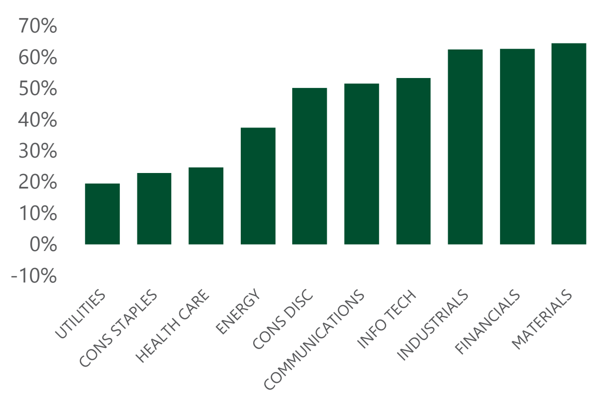
U.S. corporate earnings have staged a much stronger recovery in the first quarter than analysts projected. Of the 438 S&P 500 companies that have reported quarterly results thus far, 86.71% have exceeded analysts' profit expectations. Earnings are on track for 50.50% growth in the period compared to analysts' initial estimate of 23.89% growth.

The financials and discretionary sectors are rebounding the most with earnings growth above 100%. Industrials was the only sector with a contraction in earnings.

Analysts continue to revise their earnings expectations upward for the coming quarters. Earnings are projected to rise 56.59% in the second quarter, 21.42% in the third quarter and 31.44% for the full year after contracting 13.04% in 2020.

S&P 500 SECTORS 12-MONTH PRICE RETURNS

APRIL 2020 THROUGH APRIL 2021



Source: Bloomberg

The real estate sector led all S&P 500 sectors in April with an 8.28% gain boosted by an unexpected increase in the sector's first quarter earnings and lower interest rates.

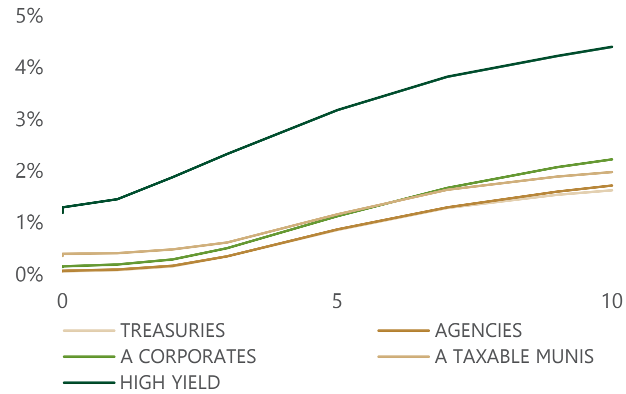
The communications and consumer discretionary sectors were right behind real estate as both rose by more than 7% in April. Communications' largest members by weight, Alphabet (GOOGL) and Facebook (FB), are benefiting from a strong recovery in digital advertising. The discretionary sector's outperformance was heavily driven by Amazon's (AMZN) 12.07% monthly gain.

The financials sector also performed well despite the pause in the rotation into cyclical stocks and lower interest rates. Financials' first quarter earnings growth is on pace to beat analysts' estimates by a massive 55%.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF APRIL 2021



Source: Bloomberg

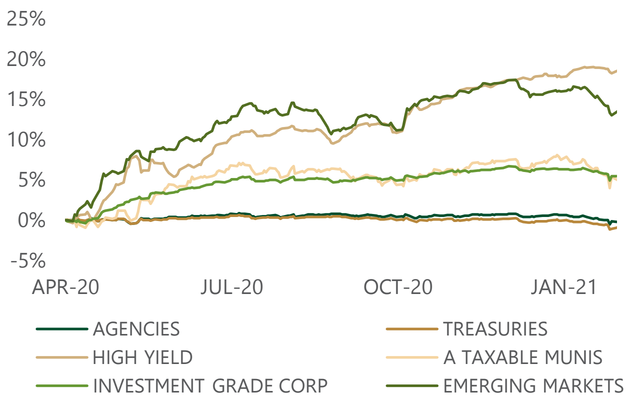
The U.S. Treasury yield curve broke its bear-steepening trend in April, as yields across the maturity spectrum shifted modestly downward during the month.

Yields on the 10-year U.S. Treasury note closed April at 1.63%, which was lower than its 1.74% level on March 31, but slightly higher than its closing level of 1.51% on January 31, 2020 shortly before the WHO declared a global pandemic.

Market commentators pointed to overstretched short positioning in the Treasury market heading into April, ongoing Fed purchases and an uneven labor market recovery as potential factors that drove the stabilization in yields.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

APRIL 2020 THROUGH APRIL 2021



Source: Bloomberg. Past performance is no guarantee of future results.

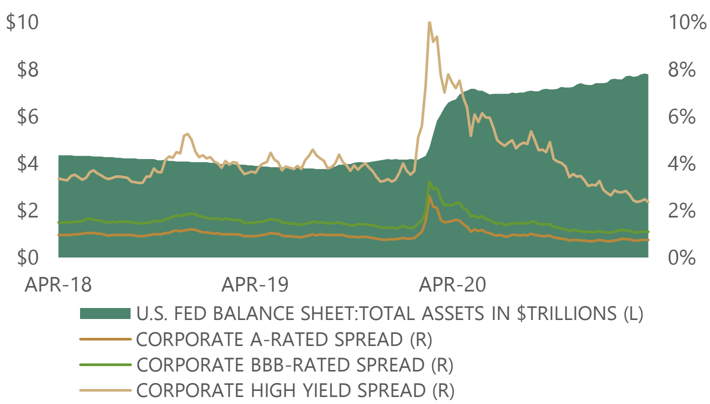
The fixed income segments with more credit risk shown in the accompanying chart have outperformed their more conservative counterparts in the last 12 months.

Indexes representing the U.S. Treasury and Agency markets recorded modest declines of 1.2% and 0.4%, respectively, from April 2020 to April 2021. Meanwhile, indexes representing U.S. high yield and emerging markets bonds posted total returns of 19.7% and 14.0%, respectively, over the period.

The two fixed income segments with more middle tier credit profiles (Taxable Municipals and Investment Grade Corporates) generated similar returns of 5.3% and 5.1%, respectively, over the last 12 months despite navigating somewhat different operating environments.

FED BALANCE SHEET EXPANSION AND CREDIT SPREADS

APRIL 2018 THROUGH APRIL 2021



Source: Bloomberg

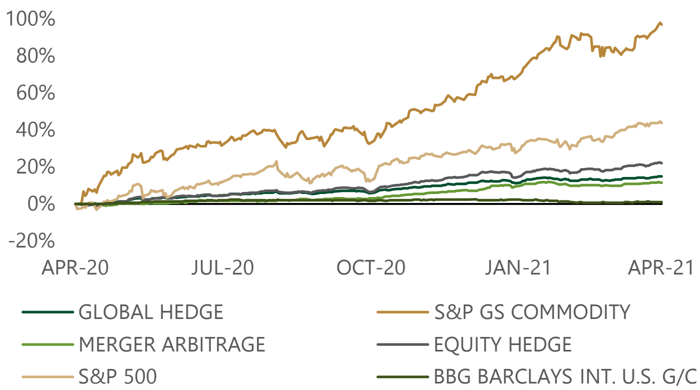
The U.S. Federal Reserve's balance sheet has swelled roughly 85% in fourteen months from $4.2 billion in February 2020 to $7.8 billion in April.

Fed officials indicated in their April FOMC statement that they will continue to purchase $80 billion in Treasury securities and $40 billion per month in agency mortgage-backed securities until further notice.

As seen in the accompanying chart, Fed policy support helped spreads steadily decrease throughout most of 2020. Investment grade credit spreads have remained stable thus far in 2021, while high yield spreads have continued to tighten.

ALTERNATIVES, 12-MONTH RETURNS

APRIL 2020 THROUGH APRIL 2021



Source: Bloomberg. Past performance is no guarantee of future results.

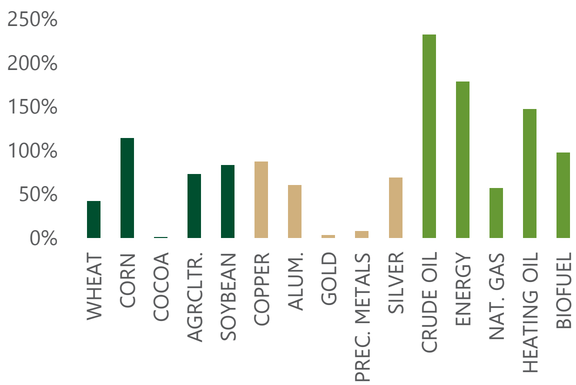
A basket of trade-weighted commodities climbed 8.2% in April after rising 13.5% in the first quarter. The positive backdrop for the broad commodity complex has been driven by an acceleration of global economic growth, improving consumer confidence, rising housing prices and instances of supply constraints.

Hedged equity and event driven strategies were the best performing areas of the hedge fund world in April. Meanwhile, equity market neutral and relative value arbitrage strategies were among the weaker performing hedge fund styles during the month.

The HFRX Global Hedge Fund Index generated a 14.7% return over the last 12 months compared to 43.6% for the S&P 500 and 1.1% for the Bloomberg Barclays Intermediate U.S. Government/Credit Index.

COMMODITIES, 12-MONTH SPOT RETURNS

APRIL 2020 THROUGH APRIL 2021



Source: Bloomberg. Past performance is no guarantee of future results.

Driven by strength in energy, industrial metals and agricultural commodities, the broad commodities asset class outpaced the S&P 500 over the 12-month period ending April 30 by 50.8%.

U.S. crude oil prices have been supported recently by OPEC and its allies' agreement to only incrementally ease output cuts from May to July. Wheat, corn and soybean prices have benefited from a combination of U.S. farmers' modest planting intentions and instances of challenging weather conditions.

In April, the price of copper climbed to its highest level in almost a decade. A major tailwind for the metal has been a growing awareness that the plans of advanced economies to implement environmentally focused infrastructure projects will likely lead to substantial increases in global copper demand.