IN THIS ISSUE

MARKET BRIEF 2

ECONOMY 4

EQUITY 5

FIXED INCOME 6

ALTERNATIVES 7

DISCLOSURES 8

MARKET REVIEW
AUGUST 2021

RCB BANK

Trust & Wealth Management

INFLATION OUTLOOK

Over the last 18 months, the inflation outlook shifted 180 degrees from the stagnant price pressures experienced during most of the 2010s to concerns this year about elevated inflation. Price levels in the U.S. accelerated rapidly this spring after the vaccination rollout and a reopening economy unleashed pent-up demand. The large-scale fiscal stimulus packages and consumers' reduced options for spending on services led to personal savings swelling to nearly $6 trillion in March, compared to around $1.2 trillion at the end of 2019. Households subsequently pumped trillions into the economy in the second quarter as their savings were drawn down to $1.7 trillion in June. The massive rebound in consumer spending was met with supply shortages due to production bottlenecks and worker shortages. The mismatch between demand and supply, among other factors, has pushed year-over-year inflation above economists' average projection. With the economy facing inflation near multi-decade highs, many investors may find themselves questioning the durability of the recent spike in price levels.

TEMPORARY INFLATION SPIKE

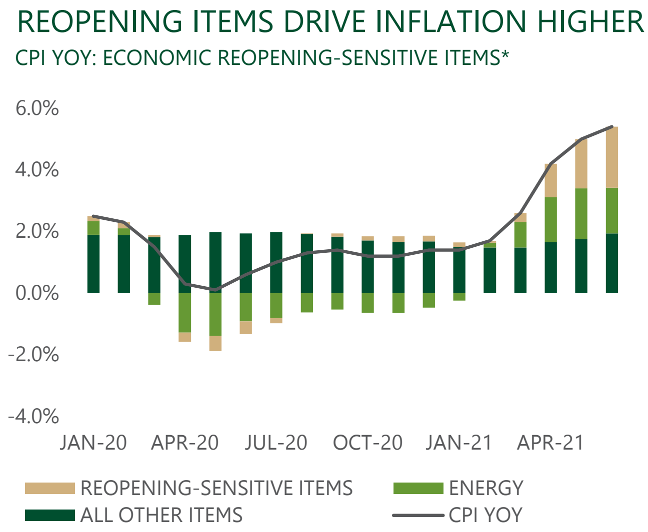
The Federal Reserve has consistently communicated their expectation that the recent surge in inflation will be temporary. Over the last few months, declines in U.S. Treasury bond yields and market-based measures of investors' inflation expectations suggest some investors have come around to the Fed's view. Supporters of the temporary inflation spike perspective note the recent pick up in year-over-year inflation was largely due to base effects and unsustainable price increases in a few pandemic-affected items.

The base effect refers to the sunken base level of prices a year ago against which current prices are compared for the year-over-year change calculation. The drop in demand for many goods and services last spring and summer lowered those items' prices and set up inflation for a strong rebound as prices normalized. For example, the price of West Texas Intermediate (WTI) crude oil was above $60 per barrel at the beginning of 2020. After the pandemic hit, the price of WTI plunged to below $20 last April, excluding the brief anomaly when oil prices went negative. WTI's price steadily recovered over the last year and reached $60 in late February. The recovery in oil prices led to the energy component of the Consumer Price Index (CPI) rising over 20% year over year in each of the three last CPI monthly reports.

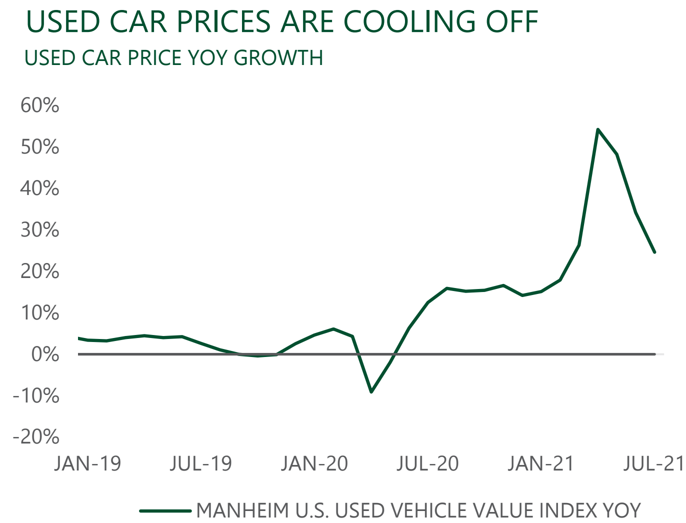
By definition, the base effect has a temporary impact on inflation and will gradually fade in the coming months as inflation calculations incorporate the recovering base level prices from the second half of 2020. Additionally, a reversal of the base effect will likely create a headwind for inflation measures in 2022 as elevated prices for a significant number of CPI components will count toward the base level for next year's year-over-year calculation.

A deeper look into the underlying categories of inflation indexes reveals that the majority of inflation's recent move higher is driven by just a few items that are sensitive to the economic reopening. Bloomberg economists estimate 55% of CPI's increase in June came from six categories including used cars, rental cars, vehicle insurance, lodging (e.g. hotels), airfares, and food away from home (e.g. restaurants). Adding energy prices to the group increases their proportion of overall inflation to 66%. Used cars were the standout, as the category's 45% price jump over the last year accounted for an enormous 21% of CPI's 5.4% year-over-year increase in June, despite used cars' weight in the CPI being only 3%.

Soaring used car prices are a byproduct of the semiconductor shortage constraining new car supply amid the recovery in car demand. Semiconductors are an increasingly critical component of cars with electronics accounting for about 40% of a vehicle's value. The limited supply of cars also drove up rental car prices since rental car companies downscaled their fleets during the pandemic by selling hundreds of thousands of cars to reduce expenses and raise cash. Taiwan Semiconductor Manufacturing Company, the leading manufacturer of outsourced semiconductors, expects the automotive semiconductor shortage to start easing this quarter after the company increases production. The upward pressure on used car prices already appears to be abating. The Manheim Used



Source: U.S. Bureau of Labor Statistics
*Reopening-sensitive items: Used Cars, Rental Cars, Car Insurance, Lodging, Airfare & Food Away From Home



Source: Bloomberg. Past performance does not guarantee future results.

Vehicle Value Index indicates used car prices peaked in May and are heading lower. Price pressures in other areas of the global supply chain, such as commodity inputs, also appear to be starting to ease. The CRB Raw Industrials Price Index, which tracks prices of 22 economically sensitive commodities, shows that prices of some raw materials have begun to cool off.

Labor shortages have been another source of constrained supply. According to the National Federation of Independent Business (NFIB), 93% of small businesses reported few or no qualified applicants for open positions in July. A convergence of factors is expected to improve the labor supply in the second half of this year. First, because the stimulus packages' enhanced unemployment benefits exceed the former wages for some lower-wage workers, the stimulus funds have likely created a disincentive for these individuals to return to work. This distortion should subside in September when the enhanced benefits are set to expire nationwide. Several states that ended the enhanced benefits early saw an uptick in job applicants in recent months. Second, the labor force participation rate has recovered less for mothers with young children than for nonparents because of the former group's child care responsibilities. Schools reopening in the fall should help to alleviate that issue. Third, President Biden's decision to let President Trump's work-based visa ban expire in March should lead to renewed migration to the U.S.

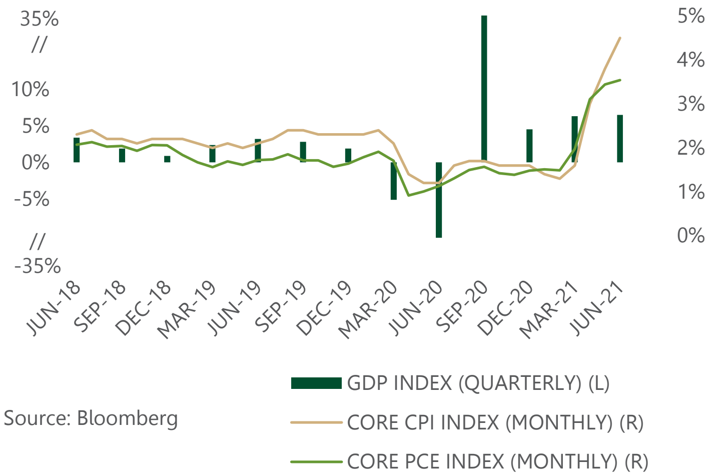
While moderating inflation seems like the most likely path forward, there are potential near-term risks to inflation staying stubbornly high. Housing rental price growth accelerated to 2.3% in June, but remains well behind the surging pace of home prices. The S&P CoreLogic Case-Shiller Home Price Index rose 16.6% year over year in May, up from 14.8% in April. Sharper increases in rental prices could provide a sustained boost to inflation given rent accounts for almost a third of the CPI. Similarly, wage growth has not accelerated substantially, and could pick up if businesses more aggressively increase compensation to attract workers. Stronger wage growth would provide more fuel for consumer spending. If supply chain bottlenecks last longer than expected, prices could get pushed even higher. Lastly, if high inflation is sustained for long enough it can become self-reinforcing by altering inflation expectations and behavior among businesses and consumers.

NEW INFLATION REGIME

Easing supply chain bottlenecks, fading base effects, and improving labor supply later this year will likely lead to inflation moderating over the next several quarters. However, long-term structural shifts could result in inflation remaining somewhat elevated compared to the middling 1.8% average CPI seen during the 2010s. First, the baby boomer generation is retiring in large numbers. Retirees continue to spend down their wealth while no longer contributing to economic output. Having a growing proportion of the population cease economic production against a backdrop of continued consumption could be inflationary. Second, globalization has suppressed inflation in recent decades, but appears to have peaked and potentially entered a phase of retreat. Many companies are planning to re-shore manufacturing production back to the U.S. to make supply chains more resilient and dependable in response to the pandemic disruptions. Third, the Federal Reserve modified its inflation targeting policy in August 2019 and switched to targeting an average inflation rate of 2% over time instead an explicit 2% target. The policy shift means the Fed will start tolerating inflation above 2% for a period of time to make up for periods when inflation was below 2%. Lastly, politics could contribute to inflation through raising minimum wages. On balance, inflation's shift from temporary tailwinds to secular tailwinds may lead to a new regime of modestly higher inflation compared to the previous decade.

ECONOMY

GDP AND CONSUMER PRICES
JUNE 2018 THROUGH JUNE 2021



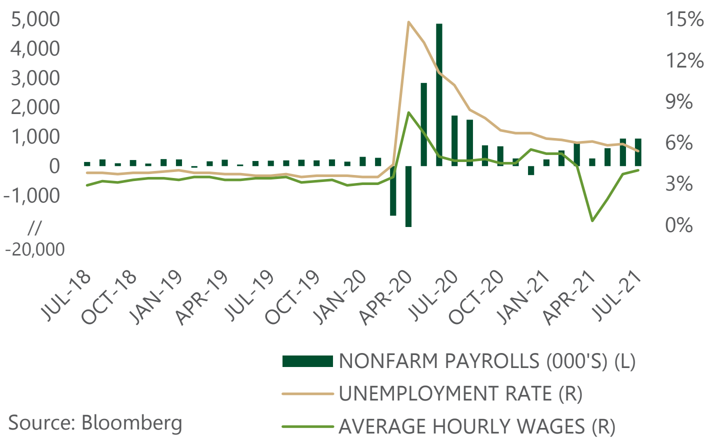
Source: Bloomberg

U.S. economic activity grew at a 6.5% annualized rate in the second quarter, less than the 9.4% expected by economists. Strong consumer spending growth of 11.8% was partially offset by rising imports and a 5% decrease in federal government spending despite the rising budget deficit.

The Core Consumer Price Index (CPI) jumped 4.5% year over year in June, which was the biggest monthly gain since September 1991. Supply chain bottlenecks and heightened demand as the economy reopens further are among the root causes for stronger inflation.

Core Personal Consumption Expenditure, the Federal Reserve's preferred inflation measure, was moderately lower than CPI at 3.5% which was in line with expectations.

LABOR MARKET
JULY 2018 THROUGH JULY 2021



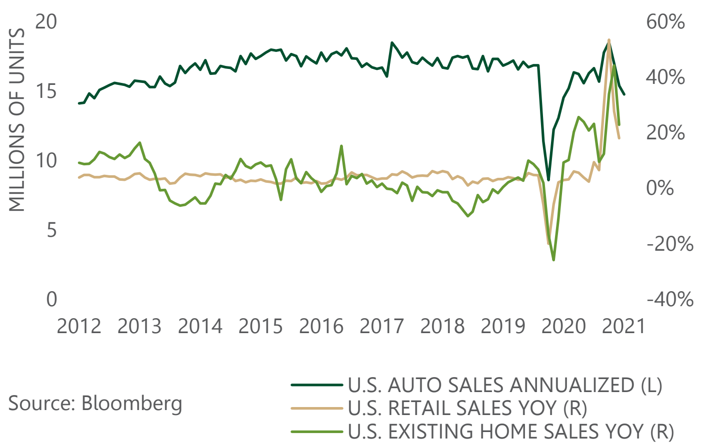
Source: Bloomberg

The U.S. labor market added 943,000 jobs in July while the unemployment rate dropped to 5.4% from 5.9% in June. June's payroll growth was revised higher to 938,000 from 850,000.

As expected, the leisure and hospitality sectors led the jobs gains as busy restaurants continue to hire workers to keep up with demand. Additionally, strong job gains were seen in education, and professional and business services.

The number of Americans in the labor market was little changed in July as the participation rate moved to 61.7% from 61.6% in June. This rate is 1.7% lower than the pre-pandemic participation rate of 63.4% in January 2020.

HOUSING, AUTO AND RETAIL SALES
MAY 2017 THROUGH MAY 2021



Source: Bloomberg

U.S. vehicle sales fell in July for the third consecutive month to a seasonally adjusted annual rate of 15.2 million units. The slowdown in auto sales from the 15-year high in April was due to the ongoing semiconductor shortage causing limited supply and higher prices, as well as the resurgence of COVID-19 cases.

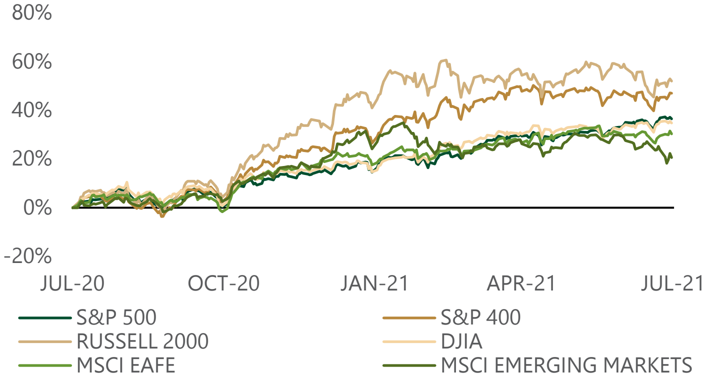
U.S. retail sales rose 18% over the last year, led by sales of clothing, vehicles, electronics, and appliances.

U.S. existing home sales are up 23% from a year ago as housing demand remains strong despite surging prices and light inventory. Sales improved on a month-over-month basis after falling for five consecutive months.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, JULY 2020 THROUGH JULY 2021



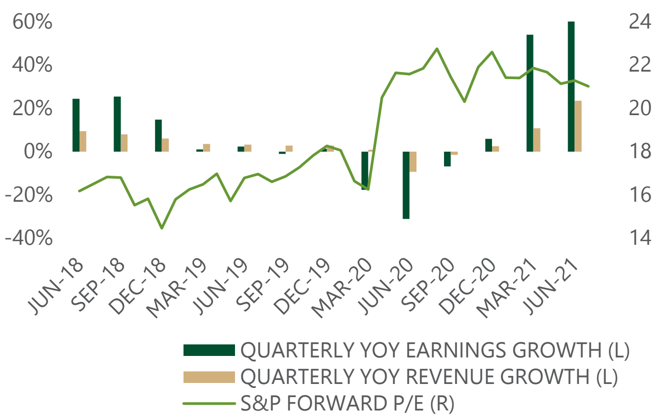
Source: Bloomberg. Past performance is no guarantee of future results.

The S&P 500 led global equity markets in July with a 2.38% return. The index's sixth straight monthly gain extended its performance this year to 17.99%. Strong second quarter corporate earnings results somewhat overshadowed concerns about the resurgence of COVID-19 cases in some developed countries and volatility in Chinese stocks.

Emerging markets lagged in July as a correction in Chinese stocks led the MSCI Emerging Market index down 6.67%. The MSCI China index's 13.81% plunge in the month was due to increased regulatory pressure on technology and education companies. China's recent actions sparked worries that regulatory crackdown could intensify further or spread to other sectors.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, JUNE 2018 THROUGH JULY 2021



Source: Bloomberg

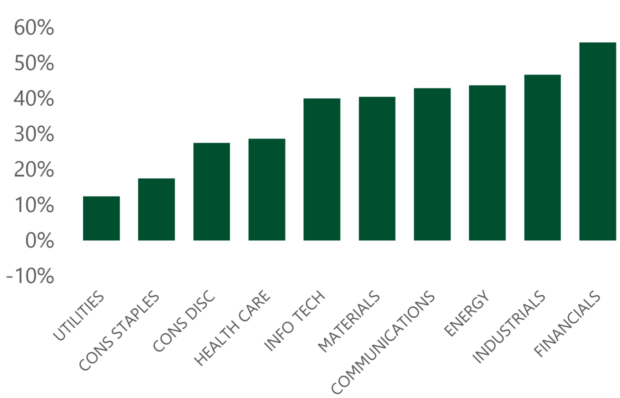
Second quarter earnings reporting season is winding down with over 400 companies in the S&P 500 reported thus far. Earnings growth of 93.89% is the highest growth rate since the previous recession recovery in 2009.

Analysts continue to underestimate the strength of the earnings recovery having initially projected 65.85% earnings growth for the quarter. Almost 90% of companies beat analysts' expectations, well ahead of the average beat rate of 64% and the highest level on record going back to 1992.

The positive tone of companies' guidance suggests the outlook is still improving. Analysts revised their earnings expectations upward for coming quarters including 28.46% and 19.72% growth in the third and fourth quarters, respectively.

S&P 500 SECTORS 12-MONTH PRICE RETURNS

JULY 2020 THROUGH JULY 2021



Source: Bloomberg

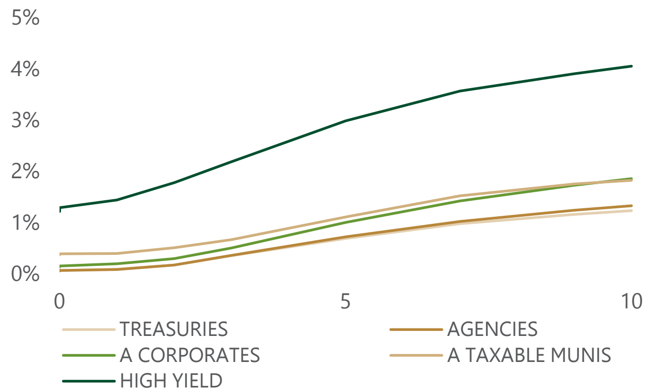
The stock market's rotation back into growth stocks that began last quarter carried into July. The further decline in bond yields and expectations for moderating economic growth supported growth stocks' momentum. The S&P 500 Growth index outperformed the S&P 500 Value index by 10.02% over the last 2 months and moved ahead of the value index year to date.

The energy sector finally cooled off in July after gaining 45.64% in the first half of the year. The sector's 8.27% monthly decline was attributed to profit taking and the COVID-19 Delta variant resurfacing concerns about oil demand. The financial sector also declined in the month amid lower bond yields and additional flattening of the yield curve.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF JULY 2021



Source: Bloomberg

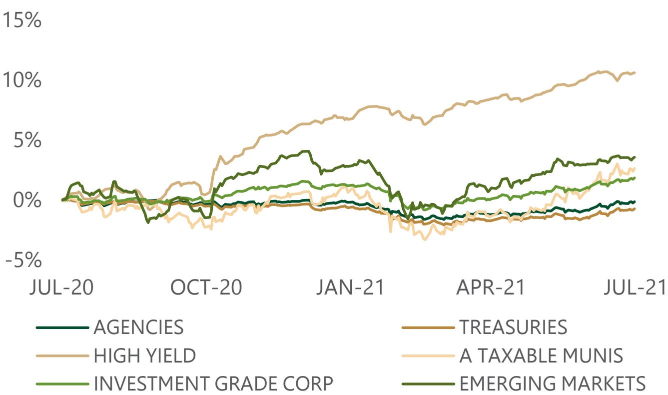
The U.S. Treasury yield curve flattened in July. The middle to long end of the curve shifted downward while the short end remained relatively unchanged. Yields on the five-year and ten-year maturities declined by 0.18% and 0.24% respectively.

Shorter dated U.S. Treasury yields out to three-year maturities remain anchored at historically low levels amid guidance from Federal Reserve officials that the central bank's policy rate will stay at the zero bound for the foreseeable future.

Single A Taxable Muni yields are considerably higher than single A corporate bond yields from zero to seven years out despite having the same credit rating and taxability status.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

JULY 2020 THROUGH JULY 2021



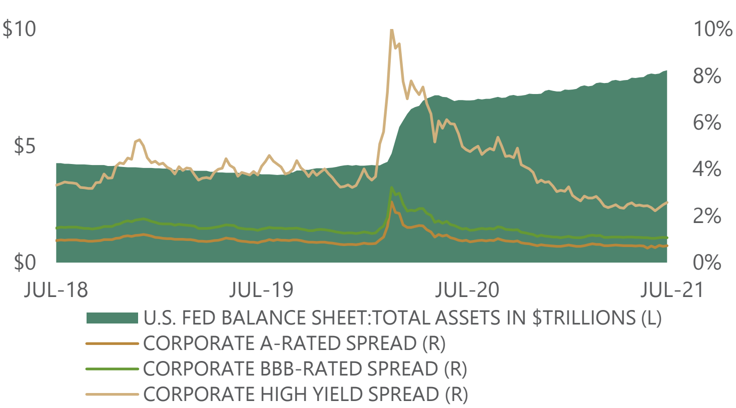
Source: Bloomberg. Past performance is no guarantee of future results.

A reduction in economic uncertainty over the last year has enabled corporate bonds to significantly outperform Treasuries, especially high yield bonds. The two highest quality sectors in the accompanying chart, U.S. Treasuries and U.S. Agencies, posted a negative twelve-month return.

Domestic high yield corporate bonds also outperformed emerging market bonds despite each of the segments having similar credit quality. The U.S.'s head start with getting its population vaccinated compared to emerging market economies has contributed to the performance difference.

FED BALANCE SHEET EXPANSION AND CREDIT SPREADS

JULY 2018 THROUGH JULY 2021



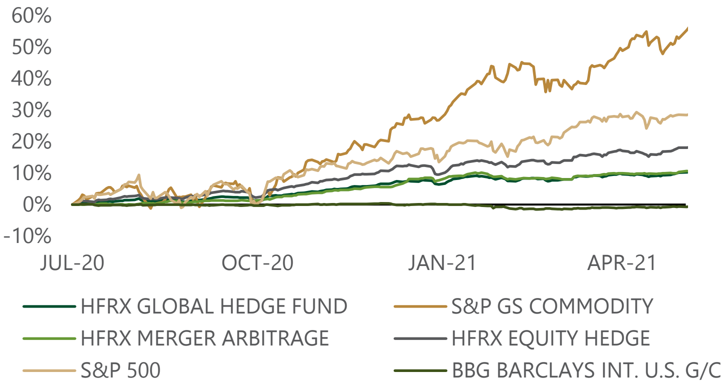
Source: Bloomberg

The Federal Reserve's balance sheet has expanded by roughly 95% during the pandemic to $8.2 trillion in July from $4.2 trillion in February 2020. The Fed decided in their July meeting to continue their $120 billion monthly asset purchases of Treasuries and agency mortgage-backed securities to support the economy.

Fed officials noted the economy has made progress toward their employment and inflation goals. The Fed will assess the progress toward these goals in the coming months to determine when to begin tapering their asset purchases. The next Fed meeting is scheduled for late September.

ALTERNATIVES

ALTERNATIVES, 12-MONTH RETURNS
JULY 2020 THROUGH JULY 2021



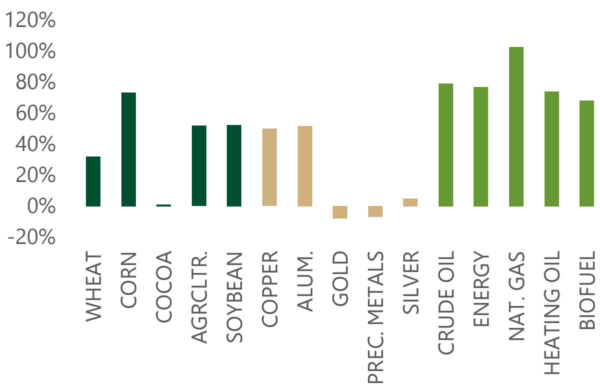
Source: Bloomberg. Past performance is no guarantee of future results.

The breakneck pace of price gains across the commodities complex has cooled in recent months. Concerns about a potential deceleration of global economic growth and the impacts of a normalization of monetary policy have partially offset the impact of supply chain bottlenecks.

The S&P GSCI, a trade-weighted commodity index, experienced a more modest gain of 4.2% over the last two months after surging 52.4% over the seven-month period spanning November through May.

Hedged equity strategies were the best performing areas of the hedge fund universe in July. Event-driven, equity market neutral and commodity trend-following strategies were among the weakest groups during the month.

COMMODITIES, 12-MONTH SPOT RETURNS
JULY 2020 THROUGH JULY 2021



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

Copper and iron ore prices reset marginally lower over the course of June and July following attempted crackdowns by regulators in China aimed at speculation in its domestic markets. Building uncertainty about the policy reaction to recent inflationary pressures in the U.S. has also been a headwind for industrial metal prices.

Hot weather electricity demand and tight supplies in the U.S. have boosted natural gas prices more than 30% over the last three months to $3.91 per million Btu on July 31.

Gold prices fell 7.0% in June before partially recovering in July. Weakness was driven by the U.S. Federal Reserve's communication that it would likely speed up the pace of its policy tightening.