City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY APRIL 10, 2017

1. What are City National Rochdale's expectations for economic and investment outcomes in 2017?

We continue to overweight U.S. growth and dividend equities and to underweight bonds.

Given the potential pro-growth policies, including tax cuts and stimulus spending, we see corporate profit growth likely improving over the next two years, supported by a longer economic expansion.

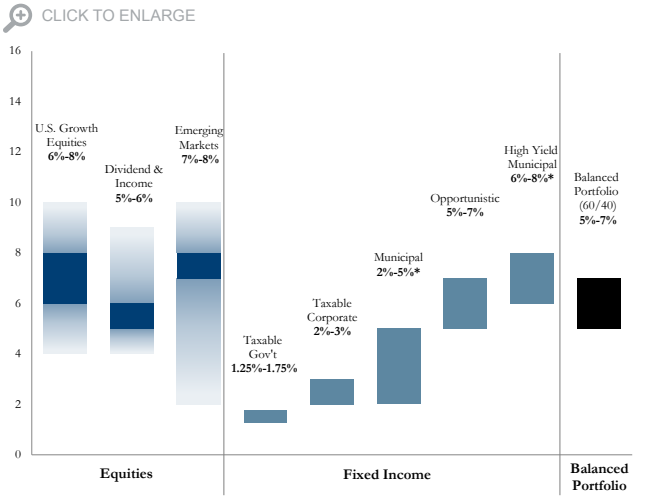
Inflation from faster wage increases may cause interest rates to rise moderately. Depending on the specifics of tax cuts and spending increases, they may cause higher deficits.

Surveys of consumer and business optimism have reached multi-year high levels, which real economic growth in the U.S. and globally validate.

Equity investors should benefit, while fixed income investors could experience downward bond value pressure as interest rates rise.

However, as the legislative process elongates and new expected U.S. fiscal proposals are delayed, downward equity price volatility is possible.

Forecasted Expected Returns (%) 12-Month Horizon



The range of outcomes upward and downward reflect what could go right and what could go wrong during the new Trump administration.

Source: City National Rochdale, March 2017
Forecasted expected returns represent City National Rochdale's opinion for these asset classes, are for illustrative purposes only, and do not represent client returns. The expected returns presented for these asset classes do not reflect any deductions for City National Rochdale fees or expenses. Actual client portfolio and investment returns will vary.

***Forecasted expected returns for HY Municipal and Municipal FI represent the taxable equivalent return at a 43.40% tax rate.**

2. What is the Fed doing with its large holding of government securities?

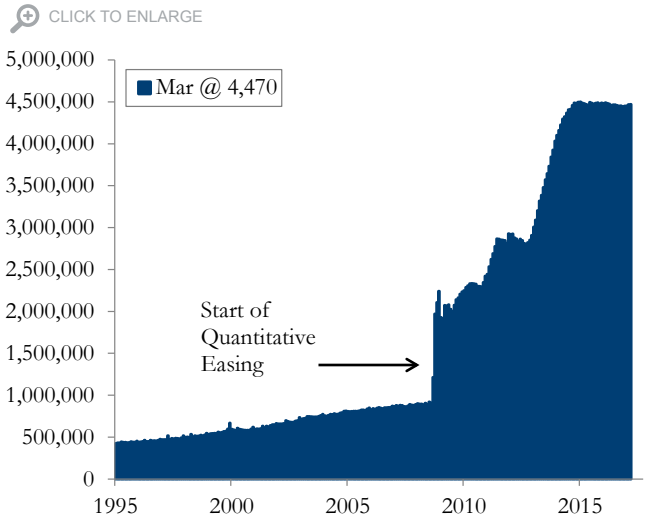
As a result of the various rounds of quantitative easing (QE) to stimulate the economy, the Fed has amassed $4.5 trillion in government securities on its balance sheet.

Now that the economy is strong enough for the Fed to withdraw some of the stimulus it created, and having raised the federal funds rate three times, the Fed believes it should also reduce the size of its government holdings.

The Fed has indicated that it plans to reduce its government holding over the next several years.

Reduced demand for bonds by the Fed suggests that rates will be pressured higher, all else being equal. Fed officials are painfully aware of the 2013 Taper Tantrum and thus are expected to do this gradually and transparently. While biased higher, rates should be little impacted by this removal of stimulus.

Federal Reserve Bank Balance Sheet ($)



Source: Federal Reserve Bank

3. Are renewed concerns from the OECD and IMF, among others, over a hard landing in China's economy justified?

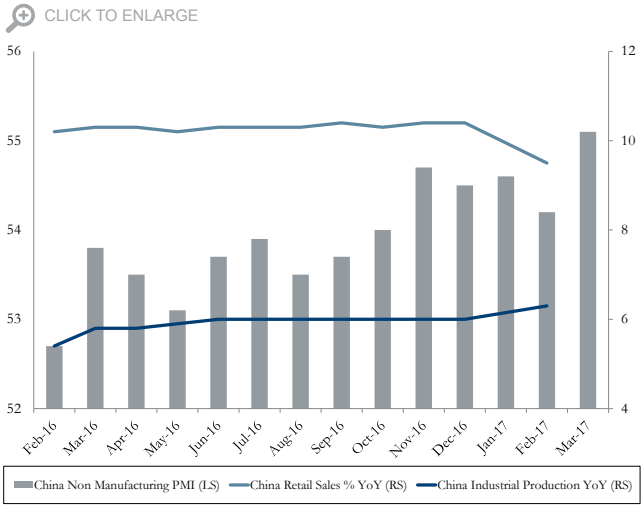
We don't think so. We expect China's GDP growth rate to average around 5-6% over the next few years. We do not foresee an economic collapse.

Chinese authorities are working to rebalance their economy from one based primarily on low-end manufacturing to one where growth is led by consumption of goods and services. We believe this will take a decade or longer. Recent economic data has shown resilience, and the outlook ahead is supported by positive fundamentals that include demography, income growth, urbanization trends, and saving/investment behavioral characteristics.

Concerns about excessive debt also appear exaggerated, as most Chinese debt is held within the country, giving the government greater control over handling any default, while strict capital controls prevent mass capital flight.

Structural reform will take many years to bear fruit, but policy initiatives are likely to remain growth-supportive. Our focus continues to be on sectors and companies that should benefit from these long-term structural tailwinds in China, as well as other emerging Asian economies.

Chinese Economy Showing Signs of Stability and Resilience



Source: Bloomberg

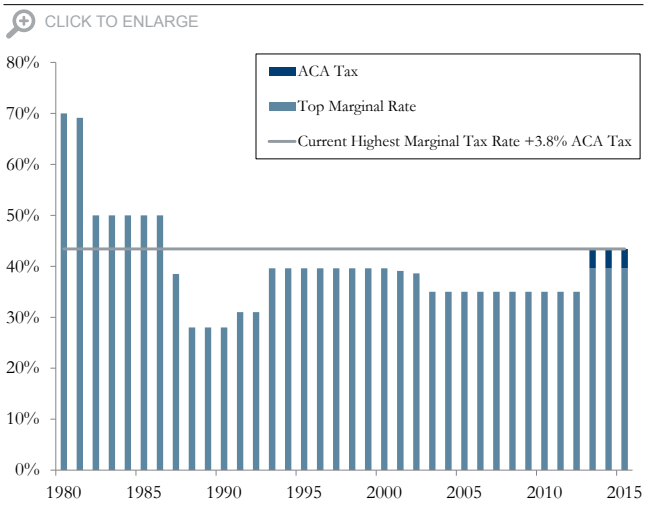
4. Will municipals still offer value for investors if personal income taxes are reduced?

Some investors have expressed concern that lower top marginal tax rates will reduce the attractiveness of municipal bonds for investors.

The proposed tax reforms reduce the current seven tax brackets to three brackets, with the highest marginal tax rate declining from a high of 39.6% to 33.0%.

Municipal bonds will still offer value for many investors. Since 1980, the top marginal rate has changed eight times, with no large impact on the municipal market. This is likely because the average tax rate for municipal holders is between 23% and 28%, which is below the maximum tax rate.

Historical Highest Marginal Income Tax Rates



Source: Citi Research

5. Will consumer spending pick up?

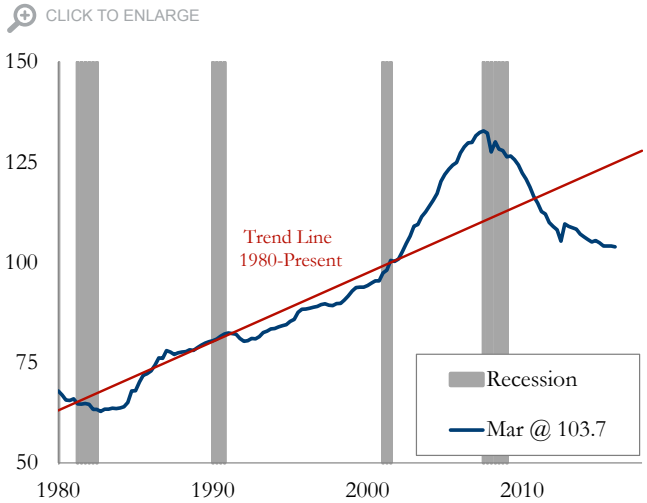
Q1 consumption growth is expected to come in at a paltry 1.0%, less than half the average rate of this expansion.

It is being held down by reduced spending on utilities (due to warm weather, especially in the northeast).

We expect it will bounce back to a more normal level of 2.0%-2.5%.

There is little doubt that consumers are in the best financial shape in decades. Households are well-positioned to increase spending, as debt burdens have been trending downward since the end of the financial crisis, the saving rate is relatively high, and consumer sentiment has been trending upward

Ratio of Household Debt to Disposable Income



Source: Bloomberg Intelligence

6. Is the earnings outlook improving?

U.S. companies are poised to report their strongest earnings in over two years, with S&P 500 EPS on track to grow 9.1% over the first quarter.

Revenue is also expected to pick up for S&P 500 companies overall, after many relied on cost-cutting to improve profits during the recovery from the financial crisis — an encouraging sign for investors who are looking for more sustainable growth.

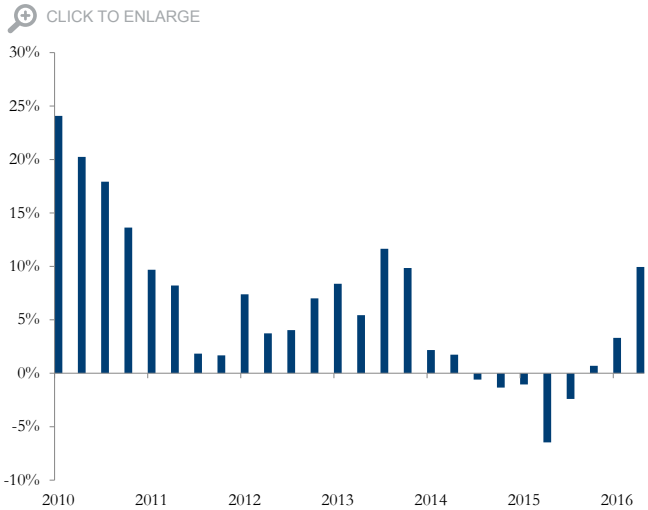
Improving corporate health and solid U.S. economic data have supported stocks since the second half of last year, helping the rally weather shifts in fiscal policy expectations.

Importantly, the global economy has entered the second quarter with improving economic momentum, which has helped fuel the recent strength in earnings growth.

Looking forward, the new administration's tax cut plan and other fiscal proposals are designed to drive more cash flow into business and consumer pockets, which could enhance economic activity if spent and invested.

Delays in policy implementation may cause market volatility in the near term. However, we are focusing not only on potential benefits to 2017, but 2018 as well, and expect earnings to grow at a solid 8-10% over the next 12 months.

S&P 500 EPS Growth



Source: S&P

Important Disclosures

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Any opinions, projections, forecasts, and forward-looking statements presented herein are valid as of the date of this document and are subject to change.

There are inherent risks with equity investing. These risks include, but are not limited to, stock market, manager, or investment style. Stock markets tend to move in cycles, with periods of rising prices and periods of falling prices.

Investing in international markets carries risks such as currency fluctuation, regulatory risks, and economic and political instability. Emerging markets involve heightened risks related to the same factors as well as increased volatility, lower trading volume, and less liquidity. Emerging markets can have greater custodial and operational risks, and less developed legal and accounting systems, than developed markets.

There are inherent risks with fixed income investing. These risks may include interest rate, call, credit, market, inflation, government policy, liquidity, or junk bond. When interest rates rise, bond prices fall. This risk is heightened with investments in longer duration fixed-income securities and during periods when prevailing interest rates are low or negative.

Investments in below-investment-grade debt securities which are usually called "high-yield" or "junk bonds," are typically in weaker financial health and such securities can be harder to value and sell and their prices can be more volatile than more highly rated securities. While these securities generally have higher rates of interest, they also involve greater risk of default than do securities of a higher-quality rating.

The yields and market values of municipal securities may be more affected by changes in tax rates and policies than similar income-bearing taxable securities. Certain investors' incomes may be subject to the Federal Alternative Minimum Tax (AMT), and taxable gains are also possible.

Investments in the municipal securities of a particular state or territory may be subject to the risk that changes in the economic conditions of that state or territory will negatively impact performance. These events may include severe financial difficulties and continued budget deficits, economic or political policy changes, tax base erosion, state constitutional limits on tax increases, and changes in the credit ratings.

Floating rate loan securities generally trade in the secondary market and may have irregular trading activity, wide bid/ask spreads and extended trade settlement periods. The value of collateral, if any, securing a floating rate loan can decline, may be insufficient to meet the issuer's obligations in the event of non-payment of scheduled interest or principal or may be difficult to readily liquidate.

Investments in emerging markets bonds may be substantially more volatile, and substantially less liquid, than the bonds of governments, government agencies, and government-owned corporations located in more developed foreign markets.

Returns include the reinvestment of interest and dividends.

Investing involves risk, including the loss of principal.

As with any investment strategy, there is no guarantee that investment objectives will be met and investors may lose money.

Past performance is no guarantee of future performance.

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.