

APRIL

2016

Quarterly Update

Economic and Investment Management Perspectives

THIS ISSUE

Markets Recover from Early Quarter Selloff

In Defense of the Economic Recovery...

Municipals Turn In Strong Quarterly Performance

Innovation Is Alive and Well in the U.S. Economy

Dollar's Quarterly Decline Is Worst in Years

City National Rochdale®
INVESTMENT MANAGEMENT



From the Desk of

GARRETT D'ALESSANDRO, CFA, CAIA, AIF®

After what the media repeatedly trumpeted as the worst-ever start to a new year, equities rebounded to finish the first quarter slightly ahead and once again deliver the lesson that maintaining a long-term perspective is essential to successful investing. As we have stressed, volatility is part and parcel of today's markets, something to be monitored carefully, but certainly not a determinant of strategy.

As the recent volatility indicates, many investors are nervous. They are concerned about geopolitical developments, monetary policy, uneven corporate earnings, an aging economic recovery and bull market, an unusual – to put it mildly – election year, and a nagging feeling that the U.S. economy just isn't firing on all cylinders.

Without making light of those concerns, our view is that the U.S. economy is performing relatively well, all things considered, that high-quality companies are continuing to innovate – especially in the digital space – and that the rise in interest rates is likely to be gradual and judicious. Overseas, the ongoing and increasing reliance on central banks to maintain economic growth is worrying, especially since no one knows what the long-term repercussions of negative interest rates may be. Europe, China, and Japan all face significant challenges that will take time to resolve and the outcomes may be hard to predict. Although their specific issues are different, the same is also true for emerging market economies.

In terms of what continues to be sluggish economic growth in the U.S., it is worth remembering that longer can be a corollary of slower. An environment of low interest rates, subdued inflation, lower energy prices, expanding payrolls, higher household net worth, and rising consumer confidence is simply not a recipe for recession. Although growth in overall corporate earnings in 2016 is unlikely to be robust, there are opportunities in both the equity and fixed income arenas that can be identified through fundamental research and leveraged with astute investment management.

We value your relationship and welcome hearing from you. If there is something you would like to discuss, please contact your advisor or portfolio manager. If I can be of assistance to you, please contact me directly at garrett.dalessandro@cnr.com.



Garrett R. D'Alessandro, CFA, CAIA, AIF®
Chief Executive Officer, City National Rochdale

OUR CONTRIBUTORS

Bruce Simon, CFA, CPWA®
Chief Investment Officer

Steve Denike
Portfolio Strategy Analyst

Greg Kaplan, CFA
Managing Director, Director of Fixed Income

Tom Galvin
Managing Director, Senior Portfolio Manager

Neela Datta
Senior Equity Analyst

Paul Single
Managing Director, Senior Portfolio Manager

Alan Rose
Senior Vice President, Senior Trader Foreign Exchange

This material is available to advisory and subadvised clients of City National Rochdale, LLC, a Registered Investment Advisor and a wholly owned subsidiary of City National Bank.

For additional information about the investment management services provided by City National Rochdale, please call (800) 245-9888 or visit cnr.com.

Markets Recover from Early Quarter Selloff

By Bruce Simon, CFA, CPWA®

First quarter equity market performance was clearly a tale of two halves. Fear dominated the first half of the quarter as U.S. economic activity slowed and investors worried about a more painful downturn ahead. Indeed, after nearly seven years of modest but uninspiring economic growth in the U.S., some people naively observed that a recession was “overdue.” Between the seemingly endless freefall of oil prices, heightened warnings from a sharp selloff in high-yield bonds, and ongoing weakness in overseas economies, there was plenty to be worried about. Some observers even compared the state of the economy to early 2008, just before the S&P 500 collapsed by more than 50%. No doubt this kind of talk did little to instill confidence in the investing public.

However, by mid-February, things started to turn around. The tone of U.S. economic data began to improve, oil prices staged a sharp rebound off the lows in the mid-\$20s, and credit spreads began to tighten. Over the course of the next few weeks, the stock market recovered nearly all of the 10.3% loss sustained up to that point. After all the bouncing around, the S&P 500 finished the quarter with a nominal gain of 1.4%.

For the first time in a while, the MSCI Emerging Markets Index outperformed the U.S., jumping 5.7% in the quarter. A large part of the story was the sharp rebound in Brazilian equities, which make up 5.7% of the Index and soared 28.5% in the quarter, despite high inflation, negative GDP growth, and a huge corruption scandal at the highest levels of government. The MSCI EAFE Index of developed market stocks continued to flounder, falling 3.0%. Japan was especially soft, as attempts by the government to weaken the yen by forcing bond yields into negative territory had the opposite effect.

U.S. high-yield bonds followed a similar path as equities, recovering early quarter losses to finish with a gain of over 3%. Taxable investment-grade bonds posted a gain of 3.5%, while tax-exempt issues rose by 1.7% in the quarter, benefiting from the Fed’s reduced expectations about the pace of rate hikes in 2016.

Despite all the doom and gloom expressed at the early part of the year, we felt at that time (and we continue to believe) that the likelihood of a U.S. recession in 2016 was quite low. Severe bear markets are usually accompanied by economic recessions, but we were encouraged by the fact that few of the normal recession signals were flashing caution. Initial unemployment claims remained at multi-year lows, indicating that the job market remained healthy. Recessions are often preceded by a **spike** in oil prices, not a 75% decline as we had just experienced. And importantly, despite the Fed’s first rate hike in December, monetary policy is likely to remain quite supportive of economic growth for some time to come.

Now that U.S. stocks have recovered their 2016 losses and recession fears have at least temporarily subsided, further stock market gains are likely to be dependent on a rebound in earnings growth. Unfortunately, S&P 500 earnings have been falling on a year-over-year basis for the last several quarters, and first quarter results are expected to continue this trend. Clearly, companies are having trouble growing earnings in the face of weak overseas economies and rising wage pressures here at home as the job market tightens. We believe earnings growth will resume in the latter part of 2016, but gains are likely to be modest. As a result, we expect only mid-single digit returns for the broad market averages this year. In our view, successful equity investing going forward will require: 1) a focus on those companies that can deliver above-average earnings growth, 2) a discerning eye on price, and 3) lots of patience.

All returns cited are in USD. Index returns include the reinvestment of dividends.

In Defense of the Economic Recovery...

By Steven Denike

You've heard it time and again. This is the worst economic expansion of the post-World War II era. Since the Great Recession ended in June 2009, the economy has grown at just a 2.1% annual pace – over a full percentage point worse than the 3.2% average rate of growth experienced over the last 70 years, and far below the 4.7% average of recoveries alone. Indeed, by many metrics, this has been a subpar recovery.

However, some historical context is useful here and we believe post-war recession recoveries are the wrong frame of reference. Typically, the deeper the recession, the stronger the recovery has been. But, as the name conveys, the Great Recession was not an ordinary recession (it was caused by a full-blown financial crisis). To understand why growth has been so disappointing we need to examine what happened after similar crises in the past.

Nearly a decade ago, economists Carmen Reinhart and Kenneth Rogoff did just that by studying the aftermath of a set of significant credit collapses around the globe. What they found was prescient. The contractions in economic output and employment resulting from such financial crises are severe, with prolonged and deep declines in asset prices and an explosion of government debt.

However, their key finding was that even once the economy begins to recover, its rate of growth does not quickly snap back in strength. Rather, the necessary periods of deleveraging that follow the collapse of credit bubbles lead to recoveries that are slow and protracted, a length of time measured in years not months. Follow-up studies by the International Monetary Fund found that as much as a decade after such crises, real GDP is substantially lower than it would otherwise have been.

From this perspective and given the headwinds confronting it, the U.S. economy has come a long way and, in many respects, deserves more credit than it has received. For example, more than 13.1 million jobs have been created during this expansion, and the unemployment rate is now back down to 5% (not far from where it was before the recession began). Household net worth, thanks in large part to the

equity bull market and recovering home prices, is nearly \$20 trillion higher today. Real disposable personal income has grown 15%, total business sales are up 6%, and the federal deficit has improved to prerecession levels.

Still, despite all the progress made, the economy has failed to break out of its roughly 2% annual growth pattern, and there is little to suggest it will do so anytime soon. The reasons for this are not yet entirely clear. Some have argued that a “secular stagnation” is to blame, with slow population growth and limited innovation causing a decline in private investment that creates a self-fulfilling prophecy of slow growth. Others, including former Fed chair Ben Bernanke, cite a “global savings glut” where investment is held back by changing demographics as well as specific trade and economic policies of certain countries.

While both these theories have their merits, neither seems to offer a definitive explanation, or a quick fix to break out of the slow growth trend. There is, however, a silver lining. The virtue of the painful period of deleveraging that followed the recession is that it has left business, bank, and household balance sheets in their healthiest shape in decades. However, the slow growth that has accompanied it has prevented excesses from rebuilding.

The current economic expansion, which will turn seven years old in June, has already lasted far longer than the 58-month average of post-war recoveries. Still, it is important to remember that expansions do not die of old age. Instead, they are typically ended by a combination of rising imbalances and significant central bank tightening. Right now, none of the usual warning signals are flashing: no overinvestment, no overconsumption and no overaggressive policy action.

None of this is to say there are no risks on the horizon. But the natural tendency for economies is to grow, and barring an exogenous shock, we think this expansion (while aging), may still have plenty of room to run. More of the same may not be exciting, and we share the frustration of most Americans over the uneven, slow pace of growth that we are experiencing. However, we also think that one of the longest expansions in U.S. history is nothing to scoff at either.

Municipals Turn In Strong Quarterly Performance

By Greg Kaplan, CFA

Investment Grade Municipals

Domestic and global growth concerns drove market interest rates lower in the first quarter, leading to solid performance for investment grade fixed income. While the 20 basis point drop in the 10-year municipal yield trailed the 40 basis point drop in the 10-year Treasury, municipals performed well thanks to the seasonal “January effect” when low issuance meets heavy reinvestment needs. The Barclays Municipal Bond Index returned 1.67% during the quarter, versus 3.03% for the Barclays Aggregate Bond Index, and 1.4% for the S&P 500. On a risk-adjusted basis, municipals outperformed most other asset classes, including investment grade corporate bonds. Investor inflows into municipal mutual funds also supported demand, with funds taking in over \$14 billion in new assets in the quarter according to Lipper (more than all of 2015). Most of these flows went into intermediate and long funds as well as high-yield funds, while money market assets continued to shrink in anticipation of money market reform later this year.

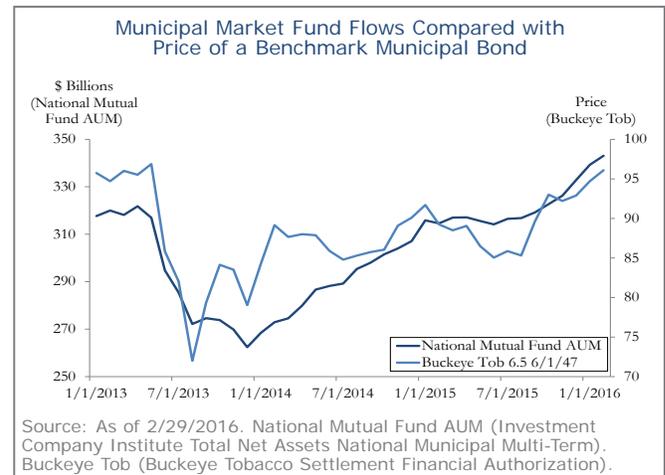
With a dovish shift from the Fed and mixed economic indicators, the question for many bond investors is: Where do we go from here? On an absolute basis, municipal yields are near cyclical lows. On a tax-adjusted basis, however, municipals remain attractive compared to U.S. Treasuries and other investment grade fixed income. Corporate credit experienced high volatility, while municipals remained stable and credit quality – with a few well-known exceptions (e.g., Puerto Rico, Chicago) – continues to improve. With two more Fed rate hikes possible this year and late cycle forces building, we believe investment grade municipals will continue to be a solid, albeit below-trend performer, in the near term. We see opportunities in certain sectors, with security selection a key driver for outperformance.

City National Rochdale’s New Strategy

City National Rochdale has formalized a new municipal “Inter-long” strategy focusing on longer parts of the yield curve with attractive risk/reward characteristics. This underserved part of the municipal curve has performed well historically, as inflation expectations remain muted and most rate volatility has been contained in shorter maturities more sensitive to the Fed. We believe this will continue and we will see opportunities for longer-term investors to capture inefficiencies in this space while boosting tax-exempt income.

High Yield

The Barclays High Yield Municipal Bond Index returned 2.74% during the quarter, producing one of the better asset class returns. Investor inflows exceeded new high yield municipal supply, continuing last year’s trend. The chart below compares the price of a benchmark high yield municipal, the Buckeye tobacco settlement bond maturing in 2047, with cumulative high yield municipal fund flows. The chart shows the strong impact that demand (represented by fund flows) has upon high yield municipal bond prices, and why monitoring these factors is very important. We see demand remaining strong this quarter as the tax-adjusted yield remains very attractive on a relative basis, and default rates remain at cycle lows.



Excluding Puerto Rico, traditional high yield municipal debt, such as bonds backed by senior living, land development, healthcare, and transportation appear to be fairly priced versus investment grade bonds. We believe that careful credit analysis, maintaining a diversified portfolio of securities, and uncovering overlooked opportunities are the best ways to achieve outperformance for the rest of 2016.

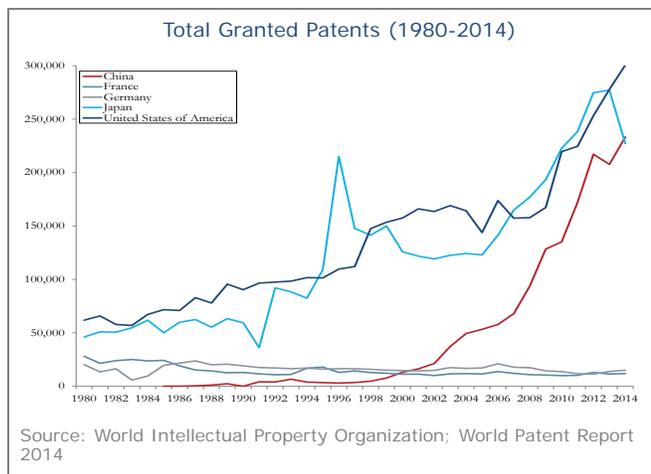
All returns cited are in USD. Index returns include the reinvestment of dividends.

Innovation Is Alive and Well in the U.S. Economy

By Tom Galvin and co-author Neela Datta

Doom and gloom permeated investor psychology during much of the first quarter, with fears about recession, terrorism, weak corporate earnings and monetary policy dominating the conversation. Some observers even suggested that technological advances and innovation are slowing, diminishing future growth prospects. We believe the opposite is true, as evidenced by an explosion in recent innovation and the promise of more.

To compete successfully in the information age, companies and countries must innovate consistently and continually. We believe one indicator is the number of patents granted. As the chart shows, since 1980 the U.S. and Japan have led in patents granted, with China emerging as a source of innovation since 2000. Germany and France have lagged consistently, throwing into question their ability to compete. While the path from patents to commercial product to market success admittedly can be daunting, we see this chart as evidence that the future is bright when it comes to new products and that the U.S. is a clear leader. This lead is particularly pronounced in the computer and medical areas where the U.S. has recently been granted twice as many patents as its closest competitor.



The world is clearly benefiting from the internet’s ability to connect people, share information more freely, lower costs, increase availability to products and enhance productivity. Innovative business models such as Uber and Airbnb should continue to enhance the utilization of real world assets through the internet,

GPS systems, and clever programming that enables just-in-time pricing based on demand. The defense industry is likely to see increased use of drones and the introduction of “Ironman”-like body armor. Innovations in healthcare should continue as new drugs are developed, the cost of genome sequencing continues to drop and the industry moves to innovative monitoring and care of patients with chronic diseases. Blockchain technology appears to hold strong potential for new digital currency applications.

The Digital Revolution has been a key investment theme in our Core Equity holdings for several years. Video anywhere continues to grow as consumers engage content, especially video and social media sites, anywhere and anytime on smartphones and tablets made by companies like Apple. We also own Facebook and Google, two marquee technology companies benefiting from the trend of advertising dollars moving away from print and television and onto mobile and desktop. Mobile traffic is growing 50% every year, and we believe the growth potential still looks strong. We have positions in Visa and Mastercard, companies that are continuing to innovate in digital payments. These companies are well-positioned as digital replaces cash and checks and as the middle class in emerging markets increasingly adopt credit cards. We own consumer companies that leverage technology to stay ahead of peers. Starbucks, one of our holdings, has used a mobile payment app and order system to increase customer loyalty and drive strong traffic growth and same-store sales. Disney has cleverly used My Magic +, a wearable device that serves as a ticket, digital wallet and room key. Disney is also rolling out demand-based pricing in its theme parks, with benefits that include improved guest experiences, reduced wait times and increased throughputs to the parks and their restaurants and attractions. At Home Depot and Lowes, customers can order products online and pick them up in the store, enhancing the shopping experience.

In summary, while investors remain rightfully concerned about macro risks, robust innovation is propelling select, high-quality companies that are a mainstay of our Core Equity strategy.

Dollar's Quarterly Decline Is Worst in Years

By Paul Single and co-author Alan Rose

The first three months of 2016 marked the worst quarter for the U.S. dollar in several years, ending a lengthy rally that had seen the greenback achieve a cumulative gain of more than 30% since May 2014. The WSJ Dollar Index, which measures the dollar against a basket of 16 currencies, declined 4% in the first quarter, its biggest drop since the third quarter of 2010.

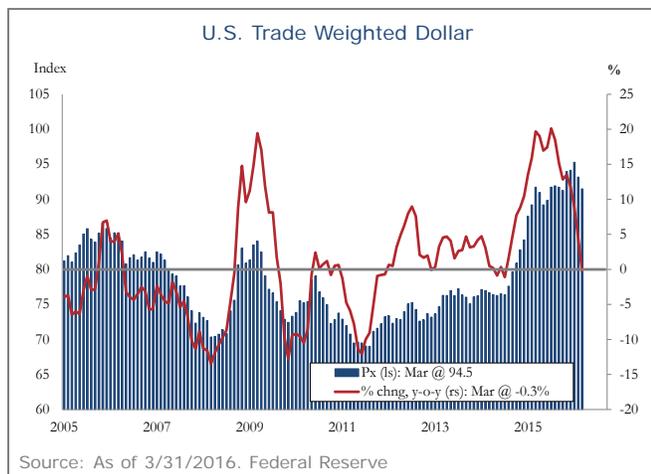
There have been significant changes in the value of the dollar since the onset of the Great Recession. Moving to stimulate the economy, the Federal Reserve Board cut short-term interest rates to nearly zero and launched numerous forms of quantitative easing. This helped push down intermediate and longer-term interest rates, causing the dollar to weaken and helping exporters in the manufacturing sector by making their products more competitive in overseas markets. However, as time moved on, the dollar began to stabilize as the U.S. economy bottomed before other G7 countries and currency markets factored in a slower rate of global economic growth.

In 2011, the dollar's strength began to build up steam as a divergence in the monetary policies of G7 countries began to take hold. The Fed had front-loaded much of its stimulative measures, with other countries later following suit and cutting their own interest rates amidst a weak global economy and deteriorating trade flows. Beginning in 2014, the dollar began to rise sharply as commodity and energy prices collapsed, damaging the currencies of resource-reliant emerging market nations.

The first-quarter trend reversal and decline in the dollar caught many by surprise. The U.S. economy continues to outpace growth in most other industrialized countries and the Fed has begun to raise rates, factors that normally are bullish for a currency. However, currency markets reacted based on a change in expectations of future central bank actions. Specifically, the Fed turned more dovish in terms of its guidance on further rate increases this year. After indicating at the end of 2015 that there might be four quarter-point rate hikes in 2016, the Fed subsequently signaled that only two such increases were likely. In other words, after initially projecting that rates might rise by 100 basis points this year, the Fed is now suggesting that the increase might be only half that. By contrast, the Bank of Japan, the European Central Bank and the central banks of Sweden, Denmark and Switzerland have all pushed their rates into negative territory, attempting to spur home-country economic growth by weakening their currencies.

Changes in the value of the dollar can have wide-ranging effects on the earnings of U.S. companies. As mentioned, a weaker dollar generally is beneficial to export-oriented firms, including many domestic manufacturers. Conversely, the dollar's prior strength generated headwinds for many U.S.-based multinationals that generate a significant portion of their revenues abroad.

As for the future of movements in the dollar, we anticipate that it will trade in a fairly narrow range this year, without the significant type of change we saw in the first quarter. While foreign central banks are expected to continue to use monetary policy as a tool to weaken their own currencies, there is still a significant uncertainty as to the trajectory of interest rate increases by the Fed and the growth prospects of the global economy. We are monitoring developments closely and factoring them into our investment strategies.



All returns cited are in USD. Index returns include the reinvestment of dividends.

Important Disclosures

The information presented does not involve the rendering of personalized investment, financial, legal, or tax advice. This presentation is not an offer to buy or sell, or a solicitation of any offer to buy or sell, any of the securities mentioned herein.

Certain statements contained herein may constitute projections, forecasts, and other forward-looking statements, which do not reflect actual results and are based primarily upon a hypothetical set of assumptions applied to certain historical financial information. Certain information has been provided by third-party sources and, although believed to be reliable, it has not been independently verified, and its accuracy or completeness cannot be guaranteed.

Any opinions, projections, forecasts, and forward-looking statements presented herein are valid as on 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, 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. 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 below-investment-grade debt securities and unrated securities of similar credit quality, commonly known as "junk bonds" or "high-yield securities," may be subject to increased interest, credit, and liquidity risks.

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. Emerging markets bonds can have greater custodial and operational risks, and less developed legal and accounting systems than developed markets.

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

Returns include the reinvestment of interest and dividends.

Investing involves risk, including the loss of principal. Diversification may not protect against market loss or risk.

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.

The MSCI Emerging Markets (EM) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. As of June 2007 the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

The Barclays Aggregate Bond Index is comprised of U.S. government, mortgage-backed, asset-backed, and corporate fixed income securities with maturities of one year or more.

The Barclays U.S. Municipal Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed tax exempt bond market. The index includes state and local general obligation, revenue, insured, and pre-refunded bonds.

The Barclays U.S. Municipal High Yield Index measures the non-investment grade and non-rated U.S. dollar-denominated, fixed rate, tax-exempt bond market within the 50 United States and four other qualifying regions (Washington, DC, Puerto Rico, Guam and the Virgin Islands).

The Wall Street Journal Dollar Index (WSJ Dollar Index) is an index (or measure) of the value of the U.S. dollar relative to 16 foreign currencies.

Indices are unmanaged, and one cannot invest directly in an index. Index returns do not reflect a deduction for fees or expenses.

Non-deposit Investment Products: ■ are not FDIC insured ■ are not Bank guaranteed ■ may lose value