City National Rochdale

INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY MAY 31, 2016

1. What expectations should investors have for portfolio returns?

After a long positive period for equities, we believe we are now in the later phases of this bull market and investors should reset expectations for more moderate returns.

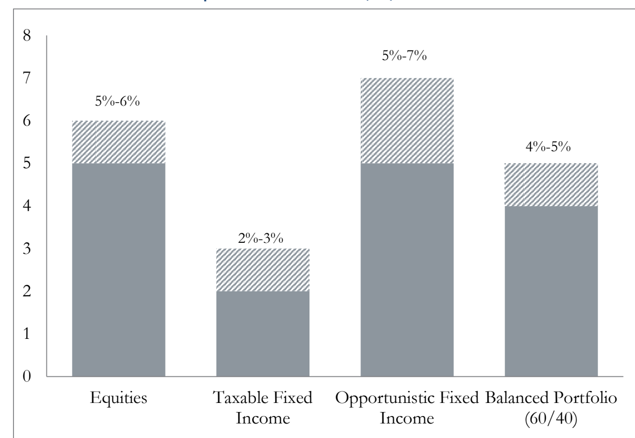
While we would not consider equity valuations expensive, they do appear full and fair, and further stock gains will likely be driven by earnings growth rather than multiple expansion.

Our outlook for modest economic and earnings growth supports a total return for equities of 5%-6% over the next 12 months.

Combined with expected returns for traditional fixed income of between 2%-3%, and 5%-7% for opportunistic fixed income, a balanced portfolio can therefore be expected to earn approximately 4%-5% *(see chart).*

While not as impressive as the double digit gains experienced earlier in the cycle, we believe these nominal returns should still be viewed slightly more favorably than they otherwise would be in a higher inflation environment.

Forecasted Expected Returns (%) 12-month Horizon



Source: City National Rochdale, May 2016

2. Will economic growth rebound in the second quarter?

Although the disappointing start to the year added to the sense of unease over the strength of the current expansion, early indications are that growth is rebounding at a solid rate in the second quarter and we continue to believe the risk of recession remains low.

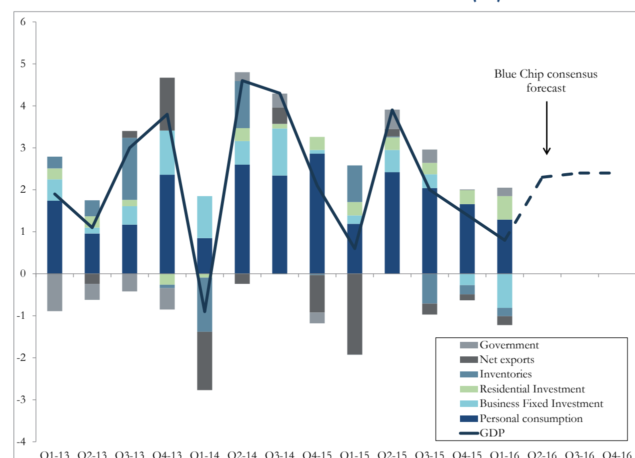
Better retail sales, home building, and industrial production data, along with a turn-around in forward-looking business activity indices, all suggest domestic demand is again gaining traction.

Most encouraging is what appears to be a pickup in real consumer spending, which is on track to increase at a 3% annual rate in the second quarter, versus about 2% in the first quarter.

Looking ahead, we expect the drag from energy investment and the stronger dollar to continue to weigh on the economy.

However, low gas prices, solid job growth, and improving income gains should help the consumer continue to carry the economy forward.

GDP and Sector Contributions (%)



Source: Bureau of Economic Analysis, Q1 2016

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

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

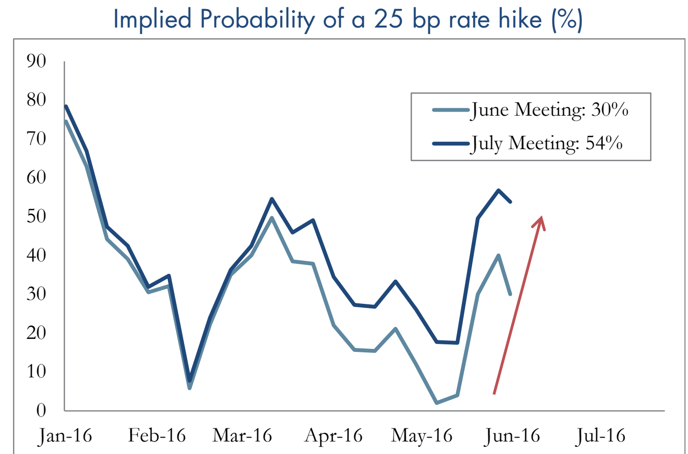
3. Will the Fed raise interest rates this summer?

In the past month, there has been a growing probability that the FOMC will vote to increase the federal funds rate at their mid-June or late-July meeting.

We believe the economy is strong enough to handle a 25 bp increase. The economy is near full employment, inflation is trending toward the Fed's target level of 2.0%, and the international financial markets have calmed down from earlier this year.

Back in March, the Fed stated that it planned to raise interest rates 50 bps this year.

City National Rochdale expects a 25 bps rate hike this summer and another one in December.



Source: Federal Reserve Bank, Chicago Board of Trade, Bloomberg
As of May 26, 2016

4. What's behind the disconnect between strong job growth and slow economic growth over this expansion?

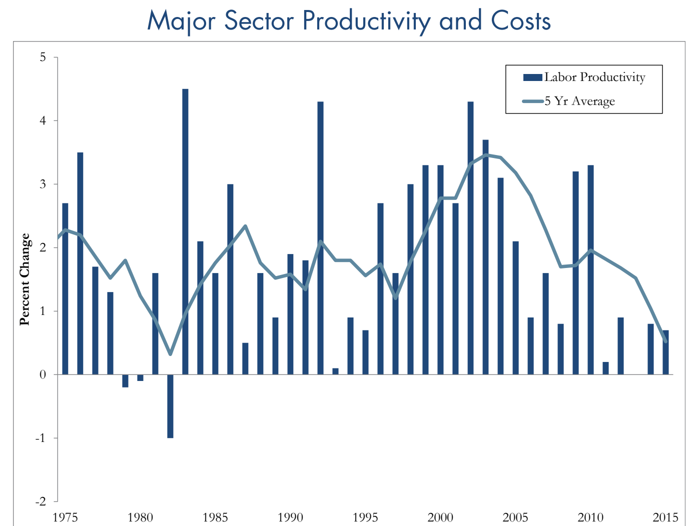
An economy's long-term growth is a product not only of gains in its workforce, but increases in productivity (or output per worker) as well.

Unfortunately, labor productivity has barely increased over the last five years, falling to a 0.5% annual rate, the lowest level since the early 1980s.

Despite the strength in hiring, this means that even with GDP growth of 2.0%, the economy is likely operating close to its economic potential.

The question of why productivity growth is stalling is a source of some debate, but output per worker has been trending lower since it peaked at more than 3% in the early 2000s and this declining trend can be self-reinforcing.

More workers, plus static output, drives labor costs up and profits down, limiting the ability of businesses to invest in the capital equipment needed to make workers more efficient and the economy grow faster.



Source: U.S. Bureau of Labor Statistics, 2015

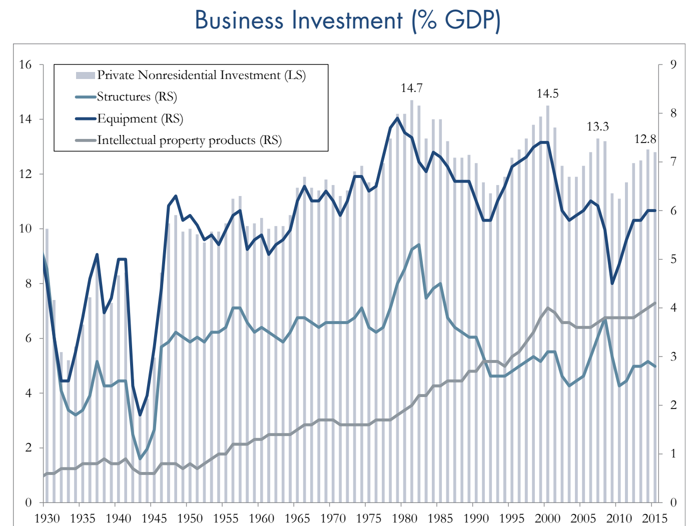
5. Has business investment been unusually low this expansion?

Contrary to conventional wisdom, total business investment is back to 12.8% of GDP (in-line with 50 year average of 12.6%) and not far from the 13.8% peak pre-recession.

Equipment (and structure) investment has been trending lower over the past 35 years, but this is largely a result of the decline in manufacturing as a percent of the economy.

Offsetting this has been a corresponding upward trend in non-tangible investment in intellectual property products, such as research and development.

This doesn't mean the outlook for business investment is encouraging. With the stronger dollar still hitting manufacturers and the slump in energy prices devastating the mining sector, the growth rate of equipment investment will likely remain muted over the next year.



Source: U.S. Bureau of Economic Analysis, as of May 27, 2016

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

6. Why is City National Rochdale overweight U.S. equites?

We remain confident on the longer-term outlook for U.S. equites, as there is little evidence of an impending downturn in U.S. economic activity, which is often a necessary condition for a severe decline in equity prices.

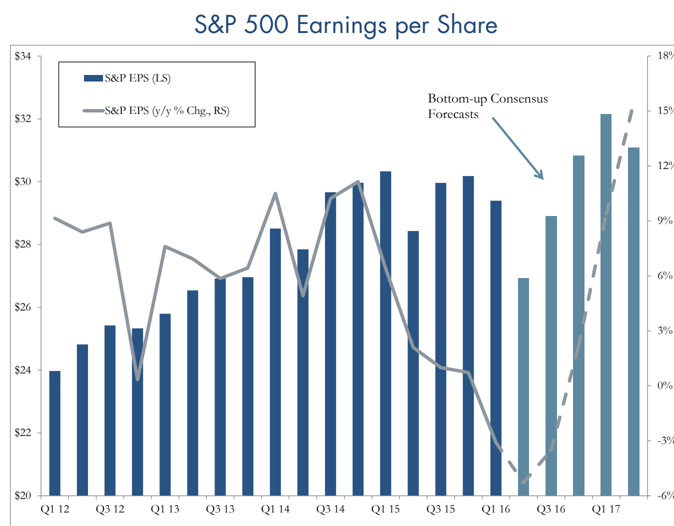
Moreover, after several disappointing quarters, U.S. earnings growth is expected to turn positive again in the second half of this year.

Diminishing headwinds of lower oil prices on the energy sector and the strong dollar on manufacturing, along with modestly improving domestic demand, support our view of a 4-5% improvement in S&P 500 earnings over the next 12 months.

High Dividend & Income stocks are also benefitting from the slow but steady U.S. economic environment, which, in turn, is supporting attractive dividend yields and growth in the dividend in a range of 3-6%.

Even the more modest total return expectations for 2016 for U.S. equites of 5-6% still look attractive relative to the historically low yield offered in traditional fixed income.

S&P 500 Earnings per Share



Source: Factset, Q1 2016

7. Why is City National Rochdale overweight High Yield Taxable/High Yield Muni?

We believe there is a yield advantage of higher credit risk assets versus investment grade assets. Both high yield taxable and high yield municipal bonds may provide diversification benefits as well as potential return enhancements to core strategies.

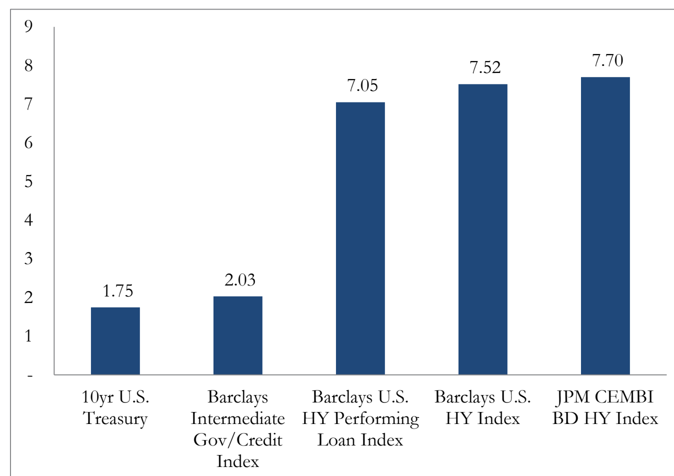
High Yield Municipal:

- Tax-adjusted yields are hard to beat for high tax-bracket investors.
- While credit spreads are at cyclical tights, we don't see an end to the credit cycle in the near future.
- Puerto Rico's pending restructuring is priced into the market.
- Demand for municipals is likely to remain robust and supply light. This will provide continued strong technical underpinnings to the market.

High Yield Taxable:

- Despite low or negative yields in many global bond markets, yields on U.S. and EM HY Corporates and Leveraged Loans range from 6-10%.
- Corporate credit quality outside commodity related issuers remains healthy with default rates still below long term norms, leverage metrics within reasonable historic levels and firms have continued accessibility to the capital markets.
- Favorable technical underpinnings due to reduced new issuance, particularly in the EM sector.

Selective Yields (%, yield to worst)



Source: Bloomberg, Barclays Capital, JP Morgan

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

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 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.

High yield bonds offer a higher yield and carry a greater risk of loss of principal and interest and an increased risk of default or downgrade than investment grade securities.

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.

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.

Investments in commodities can be very volatile and direct investment in these markets can be very risky, especially for inexperienced investors.

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.

The Barclays Capital U.S. Intermediate Government/Credit Bond Index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years.

The Barclays U.S. High Yield Bond Index covers the universe of fixed rate, non-investment grade debt, including corporate and non-corporate sectors. Pay-in-kind (PIK) bonds, Eurobonds, and debt issues from countries designated as emerging markets are excluded, but Canadian and global bonds (SEC registered) of issuers in non-emerging market countries are included. Original issue zero coupon bonds, step-up coupon structures, and 144-As are also included. Please note an investor cannot invest directly in an index.

The Barclays U.S. High Yield Loan Index is an unmanaged index that provides broad and comprehensive total return metrics of the universe of U.S.-dollar denominated syndicated term loans. The index is shown as a broad measure of market performance. Performance between a fund and an index will differ. You cannot invest directly in an index.

The JP Morgan Corporate Emerging Market Bond Index (CEMBI) Broad High Yield is the below investment-grade portion of the CEMBI Broad index. The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries.

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