City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY JULY 18, 2016

1. How does Brexit affect your portfolio strategy?

Over a year ago, City National Rochdale reduced European equity exposure in client portfolios to just 5%, significantly less than the typical allocation of 10%-20% in a normal global asset allocation universe. This prescient investment decision means our clients have not been exposed to the same extent of volatility as investors who have a more normal allocation to European equities.

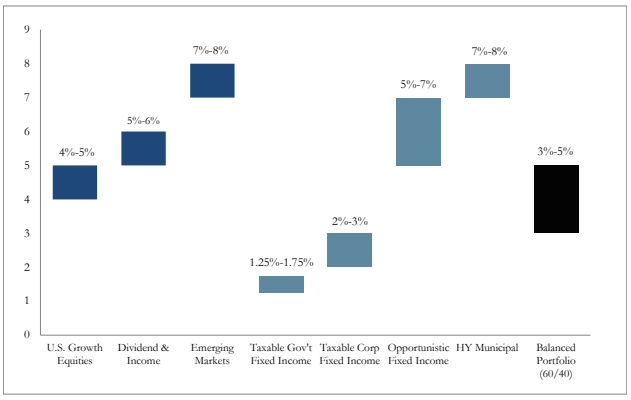
As of now, we expect to hold our modest European portfolio position. We are evaluating risks and the relative attractiveness of particular asset classes in light of recent developments.

For U.S. equities, now at record highs, we are considering whether the volatile and uncertain times ahead warrant a reduction to our modest overweight to growth stocks. Our current allocation to U.S. high dividend stocks is to be maintained.

Our exposure in EM Asia is focused on domestic consumption and new-economy businesses, which will not see any material impact from Brexit on companies' earnings at this point.

In fixed income, we will maintain our current positioning across government, investment grade, and high yield bonds. While yields on IG bonds are low, given potential uncertainty, fixed income assets require careful monitoring of credit quality.

Forecasted Expected Returns (%) 12-month Horizon



Source: City National Rochdale, June 2016
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 represents the taxable equivalent return at a 43.40% tax rate.

2. Is monetary policy losing its effectiveness?

We believe the impact of monetary policy has become asymmetrical.

Refinancing mortgages and consumer debt at low rates has helped households reduce debt costs to 30 year lows, which has increased consumer spending.

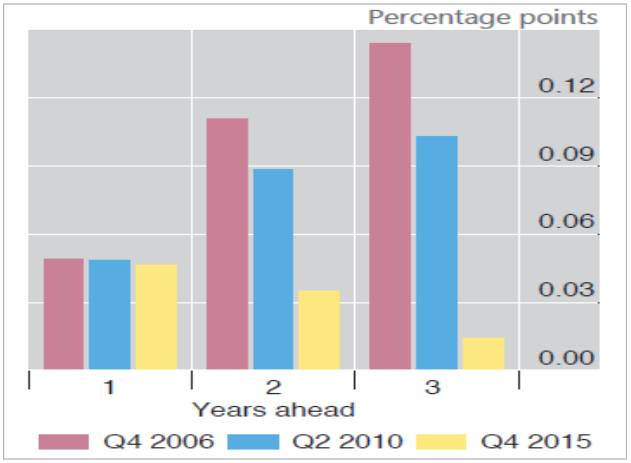
But, there is a limit to how much spending can be stimulated at this point in the economic cycle. There are now signs that the effectiveness of lower rates is fading.

A recent BIS study shows the significantly lower impact from 2006 to 2010 to 2015 on subsequent 1, 2, and 3 years ahead of economic activity *(see chart)*.

At the same time, however, historically lower rates are hurting banks and savers.

Unfortunately, we believe this implies lower and slower growth for longer.

Weaker Response of Output Gap to Interest Rates Over Time*



Source: BIS, July 2016
*Impulse responses to a two-year interest rate shock in a quarterly vector auto regression (VAR) for the United States, featuring the output gap, core CPI inflation, the spread between 10-year BAA corporate bond and government bond yields, and the difference between the two year government bond yield and the conventionally estimated natural rate. Time-varying VAR coefficients are estimated with a Bayesian approach, with priors set to estimates in the Q2 1986–Q4 2006 sample.

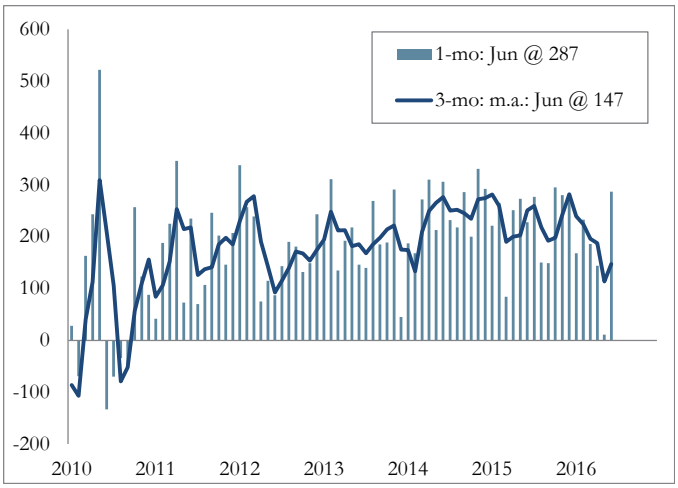
3. Is the labor market going to support future consumer spending?

Job growth in June surged 287,000; well above the 77,000 average of the two previous months.

Job gains were broad based, and along with strength in other labor market indicators, suggest that employment growth will continue to support the consumer and spending.

At this stage of the economic cycle (seven years old), a moderation in employment growth is natural, but jobs continue to expand at a pace strong enough to keep the expansion on stable footing.

Change in Nonfarm Payrolls ('000)



Source: Bureau of Labor Statistics, June 30, 2016

4. How low can interest rates go?

With many countries having seriously low government interest rates, we believe the decline in rates is near its end point. They have been on a downward trend for several years.

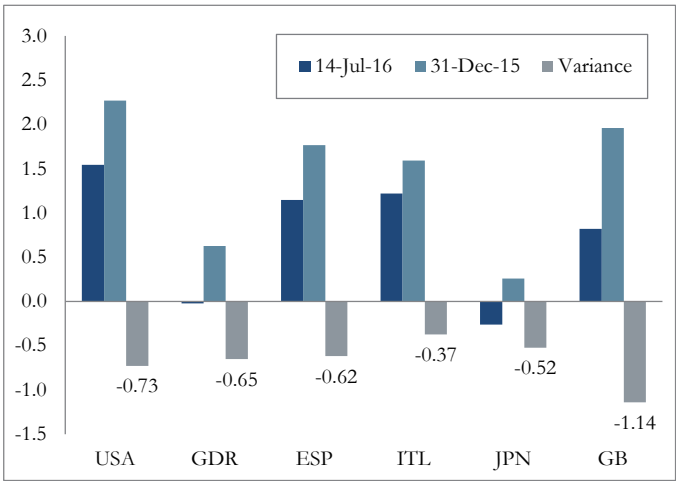
Three of the G-10 countries have 10-yr sovereign debt in the negative territory.

Interest rates are now at levels once thought of as inconceivable. But, at or near these very low levels investors will likely stop investing in government fixed income and just hold cash. Meaning the primary cause of the decline in rates is likely near its end point.

There are several reasons for this trend:

- Low inflation expectations
- Expected slow global growth (secular stagnation)
- Massive buying by central banks (Q.E.)
- Flight to quality

10-yr Government Yields (%)



Source: Bloomberg, July 14, 2016

5. Has the Brexit vote affected Fed policy?

Initially, it did.

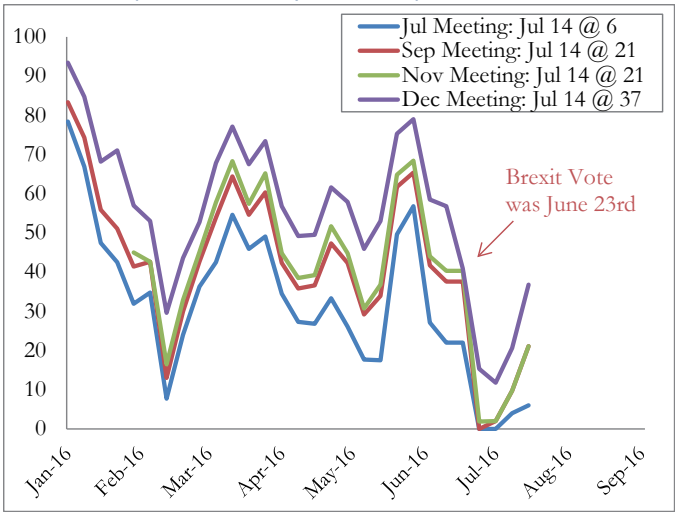
Many economists revised their forecasts for an interest rate hike this year because heightened uncertainty has negative consequences:

- Lower business investment spending
- Lower trade
- Lower consumer spending

Until the consequences of uncertainty are better understood, raising rates should be done only if there is little negative economic impact.

The probability of a Fed hike by year-end is back to 32.5%; it hit an inter-week low of 6.0%. It is still below the pre-Brexit vote level of 41.3%

Implied Probability of a 25 bp rate hike (%)



Source: Chicago Board of Trade, Bloomberg, July 14, 2016

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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.

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.

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.