City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY AUGUST 15, 2016

1. What expectations should investors have for portfolio returns?

Over the next year we anticipate returns below historical averages, tempered by the effects of global monetary policy and the influence of global economic growth.

U.S. equities are now at record highs, supported by a modest but improving corporate profit outlook. However valuations, while not excessive, do appear "full & fair," limiting upside potential to below historical returns.

From a risk/return perspective, we are therefore considering whether a reduction to our modest overweight in growth stocks is warranted. Our current allocation to U.S. high dividend stocks is expected to be maintained, but is subject to watch as well given rising valuation considerations.

Nearly two years ago, we 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, limiting clients exposure to challenges now confronting Europe.

We continue to maintain our exposure in EM Asia which is focused on healthy growing domestic consumption and new-economy businesses in the region.

In fixed income, we are maintaining our current positioning across government, IG, and HY bonds. While IG bonds appear fully valued and yields are historically low, potential uncertainty ahead reinforces core fixed income's role as a stabilizer in volatile markets.

Forecasted Expected Returns (%) 12-month Horizon

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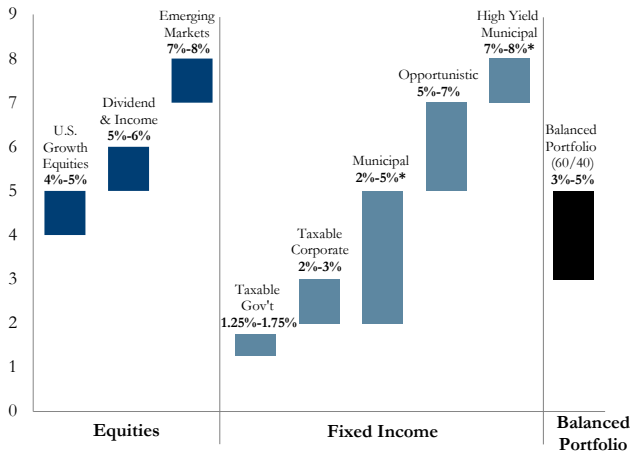

Source: City National Rochdale, July 2016
Forecasted expected returns represent City National Rochdale's opinion for these asset classes, are for illustrative purposes only, and do not represent client returns. The expected returns presented for these asset classes do not reflect any deductions for City National Rochdale fees or expenses. Actual client portfolio and investment returns will vary.

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

2. How is the global economy holding up Post-Brexit?

Growth around the world, including the U.S., has been little affected thus far.

Brexit's immediate fallout appears to be limited to the British economy.

The UK looks to be headed for a recession, and may have already begun to contract.

However, activity and sentiment measures in the Eurozone are holding up better than initially expected.

It's still early, but a combination of stable economic data, improving financial conditions, and better political sentiment in the EU appear to have reduced the contagion effects for now.

Brexit: One Month Later

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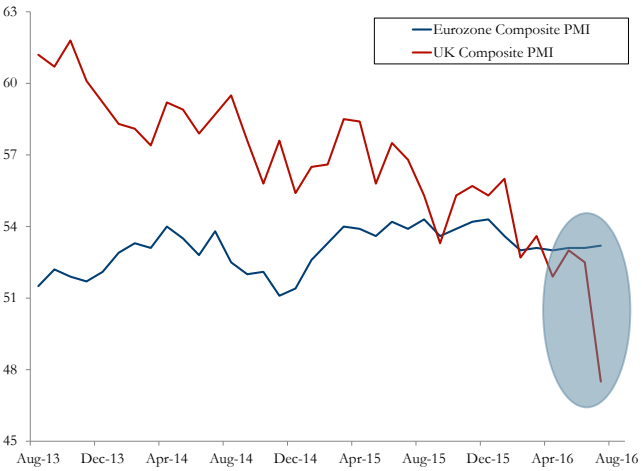


Source: Bloomberg, July 31, 2016

3. How important have the recent labor reports been?

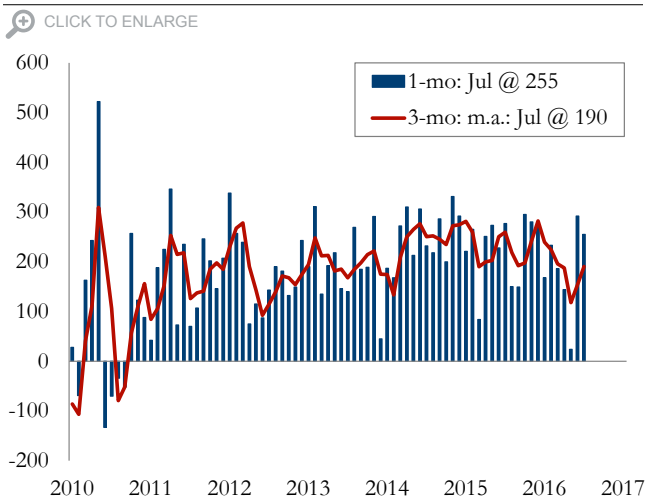
The pickup in hiring the past two months indicates that the labor market is healthy and that domestic demand remains solid.

Despite volatility in the monthly payroll numbers, the trend for hiring is strong and continues to be supportive for consumer spending.

After seven years of expansion more Americans are working than ever before and the unemployment rate has fallen to 4.9%, less than half the peak of 10.0% reached in October 2009.

In addition, the recent pickup in average hourly earnings to 2.6% y-o-y, from its multi-year trend rate of 2.0 to 2.2%, gives US consumers an important new support for their spending that should help sustain economic growth.

Monthly Change in Nonfarm Payrolls ('000)



Source: Bureau of Labor Statistics

4. What is the significance of the flattening of the yield curve?

Investors concerned about rising interest rates should consider the difference between short and long term rates.

Short term rates are heavily affected by the Fed, while longer term rates more reflect expectations for inflation and economic growth.

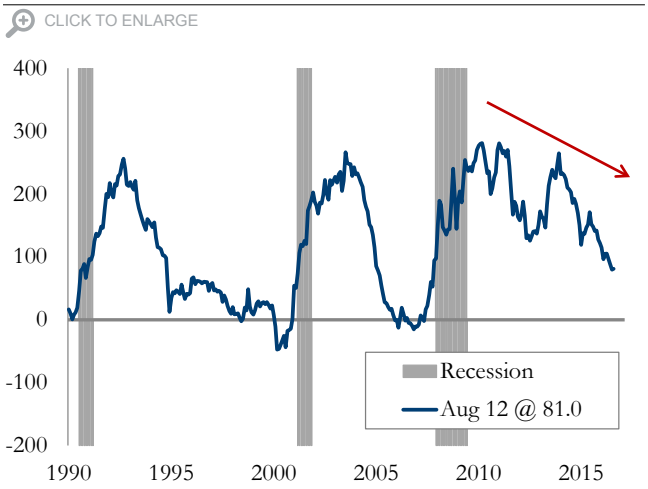
Understanding the slope of the yield curve (difference between long-term and short-term interest rates) therefore is necessary for investors to navigate the appropriate balance between return and risk.

The yield curve is normally positive, reflecting investors need to be compensated with higher yields for the added risk of investing in longer-term bonds.

The yield curve has been flattening these past few years.

Investors are buying longer-term bonds despite the lower relative yield. They are confident that inflationary pressures will continue to stay low and continued buying pressure from an insatiable appetite from central banks will prevent longer-term rates from moving up.

Slope of the Yield Curve (10-year yield minus 2-year yield, bps)



Source: Bloomberg

5. How is Q2 earnings season shaping up and did it impact our view of S&P 500 EPS growth?

The recent rise in US equity markets to record levels can in good part be attributed to investors improving expectations for corporate profits.

Q2 EPS season has been better than initially expected, with 70% of companies reporting results that were higher than recently reduced estimates.

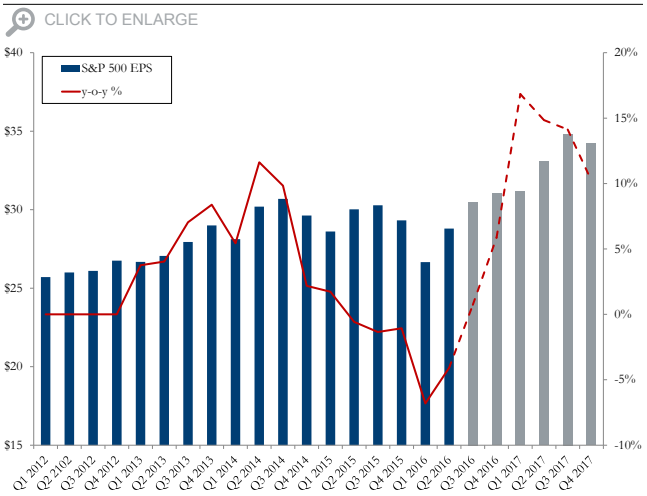
While headline S&P 500 EPS growth is likely to be -3.5%, that's significantly better than the -5.5% estimate going into the quarter.

Excluding energy the EPS growth rate improves to +0.3%.

After peaking in early 2014, expectations are now for S&P 500 EPS to return to positive growth and all time record levels by Q4 2016 or Q1 2017.

The results reinforce our view that a trough in EPS growth has occurred and we maintain our view of 3-5% EPS growth through 2017.

S&P 500 Earnings



Source: Thomson Reuters Baseline. Gray bars/dotted line represent estimates.

6. How much of a concern is the slump in productivity growth?

The trend in productivity remains exceptionally weak and is one factor holding back real GDP growth.

Isolating the reasons behind the slump in productivity growth, which actually began as far back as 2004, is very difficult.

Part of the reason can be explained by the fading boost from the IT revolution and the aging population.

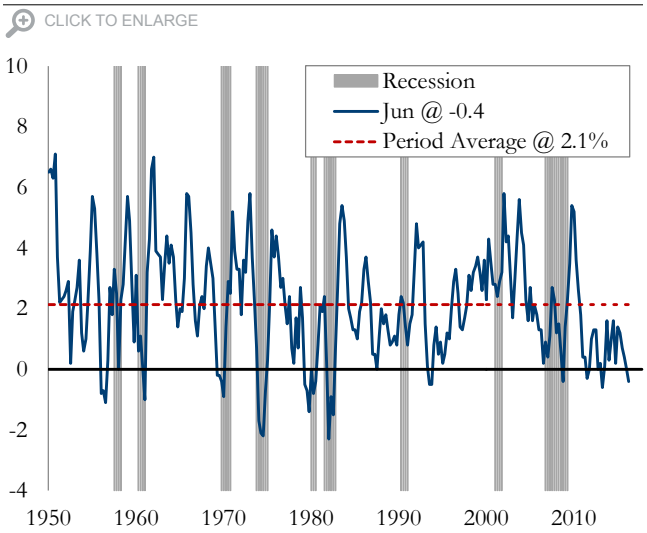
The financial crisis may have also triggered a temporary decline, as credit constraints limited innovation and investment and the resulting recession led to some labor and capital hoarding.

But productivity growth has weakened even more in recent years, even as the utilization rates for labor and capital have returned to normal.

The U.S. economy will eventually see a resurgence in productivity growth, but it is very hard to know exactly when that might be or what will spark it.

Until productivity begins to recover, the economy is likely operating close to its economic potential even with 2% or so GDP growth and low prospects for a meaningful acceleration.

Productivity (%, y-o-y)



Source: Bureau of Economic Analysis

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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.

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Past performance is no guarantee of future performance.