City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY JANUARY 17, 2016

1. What are City National Rochdale's expectations for portfolio returns in 2017?

Given the potential pro-growth policies of a Trump administration, we see corporate profit growth improving over the next two years, supported by a longer economic expansion. Inflation from faster wage increases may cause interest rates to rise further. Federal spending may increase, and lower tax revenues may lead to higher annual deficits in the next few years.

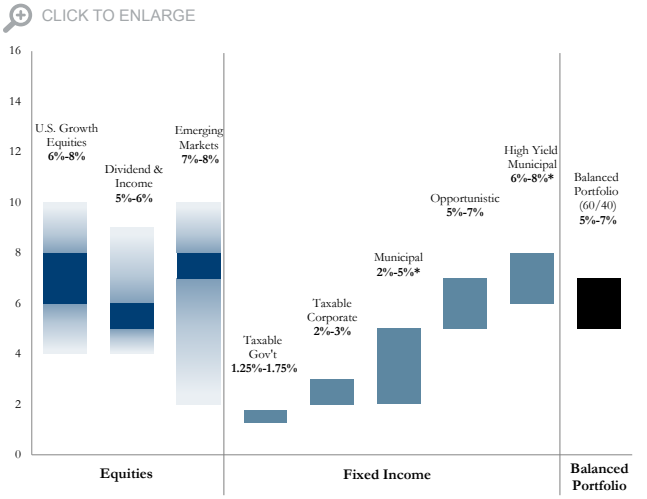
Equity investors will primarily benefit in 2017, while fixed income investors will likely experience downward bond value pressure as interest rates rise.

Surveys of consumer and business optimism have reached multi-year high levels. Historically, when business executives and consumers feel better, spending increases. However, with investors making so many assumptions, it would not be surprising to see some downward equity price volatility as the legislative process takes hold.

Since timing equity markets to avoid short-term volatility is not realistic, we will continue to overweight U.S. growth and dividend equities and watch carefully for the longer-term benefits of Trump's potential policies to materialize.

Our confidence in a longer economic cycle and improving corporate profits supports our preference towards equities over bonds. **We are no longer on reduction watch for equities.**

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, January 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 represent the taxable equivalent return at a 43.40% tax rate.**

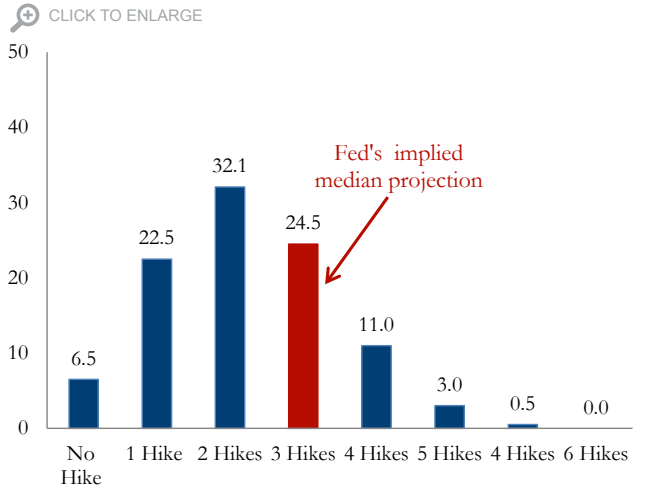
2. Were there meaningful takeaways from the December FOMC meeting minutes?

Last week, the Fed released the minutes of their mid-December meeting, where they unanimously agreed to hike the federal funds rate by 0.25%. The minutes, which give greater detail of the two-day meeting, set a more hawkish tone.

Most of the members shifted their growth forecasts upward and see less downside risk than previously. This might help explain why the Fed now thinks they will raise the funds rate three times in 2017, up from September's expectation for two rate increases.

The market isn't fully on board with the projected three rate increases; they currently expect only two. Remember, last year the Fed expected to raise the funds rate four times, but in the end only raised it once, as one thing or another got in the way.

Implied Probability of the Number of 2017 Fed Hikes of 25 bps (%)



Source: Bloomberg, Chicago Board of Trade

3. What is the 2017 outlook for U.S. equities?

We believe the U.S. secular bull market will continue through 2017, though with higher volatility and perhaps somewhat more modest returns.

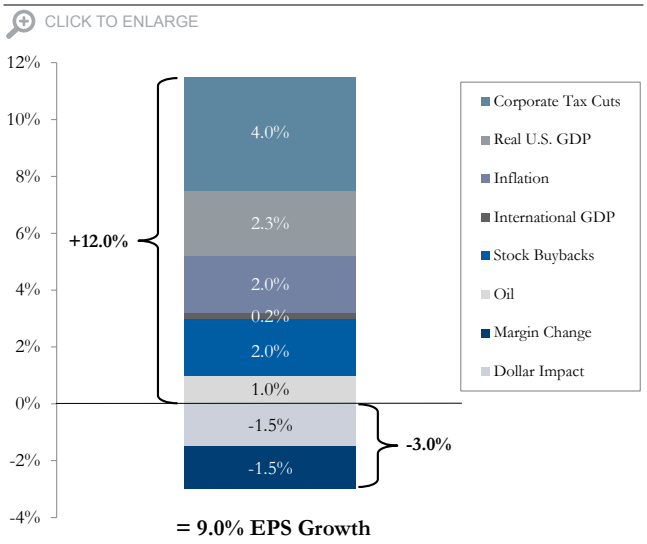
Market enthusiasm over near-term growth prospects appear warranted to a degree, so long as the President-elect does not follow through on his more extreme anti-trade campaign rhetoric.

The new administration's proposals for substantial fiscal stimulus are largely designed around bringing forward economic activity, which is constructive for stocks over bonds.

A likely reduction in the corporate tax rate, in particular, should help boost an already improving corporate earnings environment. Under these assumptions, we have raised our 2017 S&P 500 EPS forecast from $130 to $134.

Although valuations are already full, against a new reflationary outlook, equity prices may also benefit from further modest multiple expansion.

EPS Building Blocks



Source: City National Rochdale projections

4. Is City National Rochdale's outlook for Emerging Asia equites still positive?

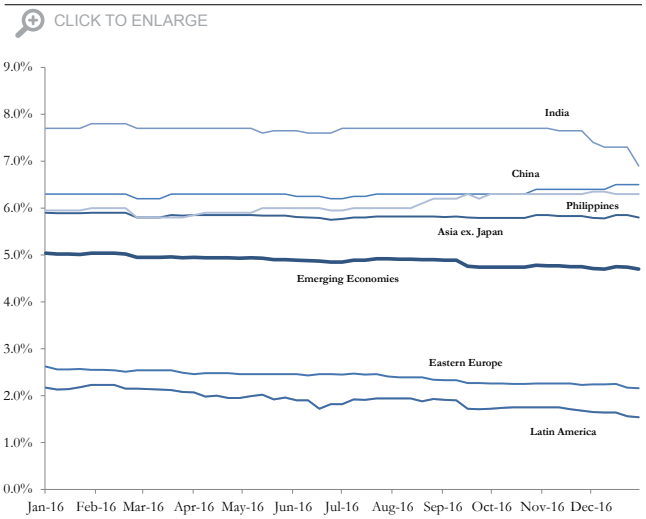
We continue to view the outlook favorably for those with a 7-10 year investment horizon, though we believe that volatility is likely in the near-term.

Uncertainty over the future direction of U.S. foreign and trade policy, as well as the prospect of a stronger dollar, have played a large part in the recent decline. Over the next several weeks and months, we expect to get more clarity on U.S. policies, which should help settle markets.

We believe Emerging Asia equity valuations are still relatively inexpensive, both on a historical basis and relative to other geographies, and corporate profit expectations are improving. Moreover, the region's growth outlook remains resilient, supported by positive fundamentals including demography, income growth, urbanization trends, and saving/investment behavioral characteristics.

Our focus remains on sectors and companies that should benefit from these long-term structural tailwinds, and our strategy is not directly impacted by the potential trade retaliation initiatives of a Trump administration.

YoY % GDP Growth Estimate for 2017



Source: Bloomberg, as of January 6, 2017

5. What is the 2017 outlook for dividend & income equities?

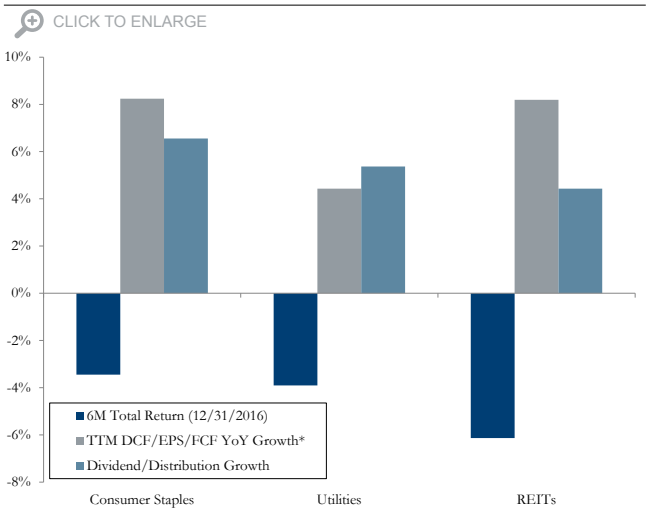
While valuation is a concern, we continue to maintain our overweight to dividend & income equities. We are invested in companies that we feel can continue their solid operating results under the new Trump administration, which is what drives the dividend and ultimately the long-term total return.

The main pressing issue post-election is the upward movement of interest rates and the general concern over a higher rate environment.

From our past research, we have found that dividend stocks can do well in a higher rate environment, provided that the economy is growing and that dividend stocks can grow their earnings along with the improved economy.

Going forward, we feel that modest return expectations in the 5-7% range, as driven by yield (actual) and growth in yield (projected), are realistic.

HDI Still Offers Attractive Opportunities



Source: FactSet
*TTM DCF/EPS/FCF YoY Growth: Trailing Twelve Month Discounted Cash Flow/Earnings Per Share/Free Cash Flow Growth

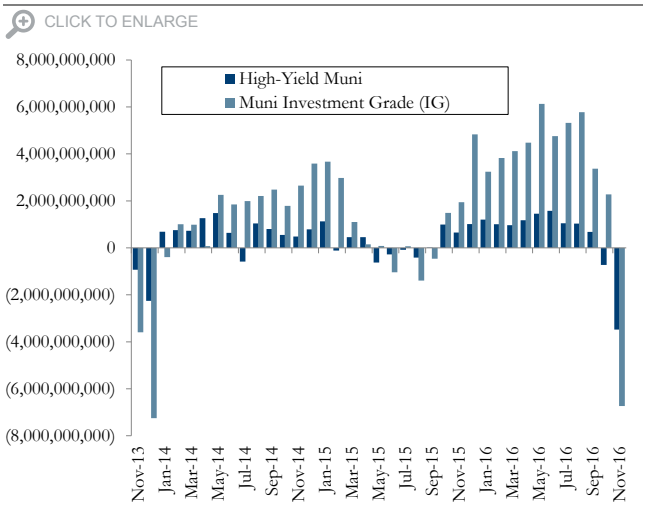
6. Are the fundamental and technical factors attractive for buying high yield municipals?

Yes, despite the sell-off that occurred over the past couple of months. Post-election sell-off in municipal bonds caused high yield municipal bond yields to increase by 140 bps.

Much of this was caused by heavy redemptions of high yield mutual funds due to the post-election fear of upcoming higher inflation and potential lower tax rates.

Credit quality continues to remain healthy. As redemptions slow and relative value is recognized, we believe the outlook is positive for the sector.

Estimated Net Fund Flow



Source: Bloomberg, as of November 30, 2016

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. 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.

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.