City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY OCTOBER 23, 2017

1. What are City National Rochdale's expectations for economic and investment outcomes over the next 12 months?

The U.S., Europe, and emerging market nations are experiencing a coordinated period of expanding economies, rising corporate profits, rising incomes, moderate inflation, and low interest rates.

Though we see some indications the U.S. economy is entering the later stages of the business cycle, the domestic expansion is expected to continue at a modest pace over the next year, provided there are no policy mistakes by the Fed (which is proceeding cautiously) or major disruptions on the geopolitical front.

We see continued growth for U.S. and global economies ahead; however, investors have fully priced in this positive outlook, and currently, we see few compellingly attractive asset classes, whether we look at equities or fixed income. Of course, our economic and financial market outlook can be materially and adversely impacted by political events, which we cannot predict.

Consequently, we have trimmed our expected returns for growth equities over the next 12 months. On the fixed income side, given our forecast of moderately rising rates, we are also trimming our projected returns for high yield fixed income asset classes.

Overall, we believe economic conditions, relative valuations, and earnings growth expectations continue to support our overweight to U.S. equities and opportunistic credit, as well as our underweight to investment-grade bonds. However, given the recent appreciation in financial markets, investors should lower expectations for portfolio returns over the next one to two years. Moreover, patience is warranted for new cash investment.

Forecasted Expected Returns (%), 12-Month Horizon

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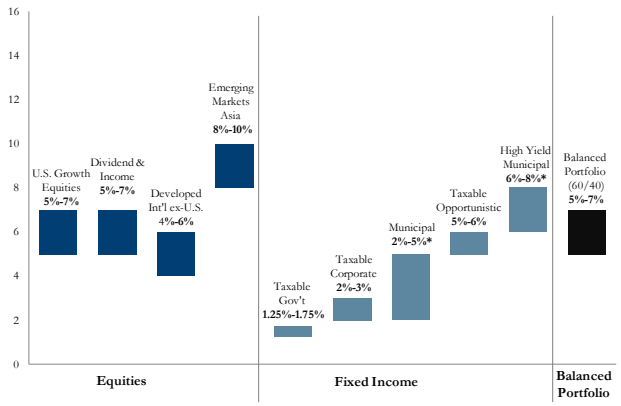

Source: City National Rochdale, as of October 2017

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. Who will be the next chair of the Federal Reserve?

It is not known yet, but President Trump is expected to make an announcement of his nominee before he leaves for a trip within the next two weeks.

Two of the likely nominees, current Fed Chair Janet Yellen and current Fed Governor Jerome Powell, would be expected to continue the current ultra-gradual policy of monetary tightening. The other likely nominees are Kevin Warsh, a former member of the Fed's board of governors, and John Taylor, a professor of economics at Stanford University and the developer of the "Taylor Rule," a mathematical model for monetary policy. Both have been critics of the Fed's current stance on monetary policy.

The economy is doing well, so one thought is to keep with the status quo. But others in Congress, especially conservatives, want the chairperson to be a champion of less banking regulation. The head of the Fed sets monetary policy for the world's largest economy, with consequences for global economic growth, stock prices, bond yields, and exchange rates.

PredictIt.org: Who Will Be the Next Fed Chair? (px per share, cents)

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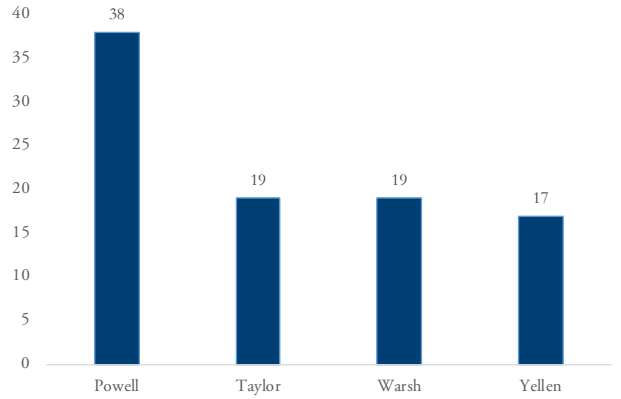


Source: PredictIt.org, as of October 18, 2017

3. Is the upturn in global growth sustainable?

There is good evidence that the synchronized upturn in global growth is going to continue for a year. In fact, with most of the world now growing in lockstep, the global economy appears set for a period of its strongest and broadest growth in more than a decade.

In the U.S., recent hurricanes should have only a short-lived impact, with growth forecasted to resume a modest, above-trend pace over the next several quarters. At the same time, the latest business surveys suggest that activity in the Eurozone, Japan, and China remains strong.

The recent breakout in global growth reflects a number of positive developments. A rise in corporate profits has helped revive capital investment, while strong labor markets and relatively depressed inflation are fueling consumer spending.

Together, these factors have lifted consumer and business confidence, which drive a positive feedback loop, where the pickup in global GDP and strengthening financial conditions are, in turn, further boosting spending and investment.

It is possible that heightened geopolitical risks (such as rising tensions with Korea, missteps in trade negotiations, or policy mistakes as major central banks begin to reverse years of ultra-accommodation), could at some point disrupt global activity and financial markets.

Still, the upswing in global growth is looking increasingly resilient and will likely to continue in 2018.

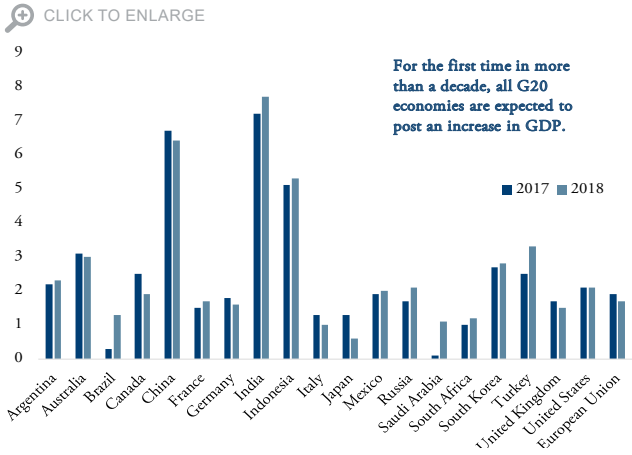
4. Is the recent slowdown in consumer spending a cause for concern?

Consumption growth has eased recently, from 3.3% in the second quarter to 2.0% or so in the third, but looks set to rebound over the rest of this year and into 2018. A good part of the recent slowdown can be blamed on hurricanes Harvey and Irma, which we expect to reverse now that rebuilding and replacement have begun. There has already been a surge in vehicle sales, as consumers start to replace the 300,000-plus vehicles damaged in the storms.

From a broader perspective, consumer fundamentals are in better shape than they have been in a very long time. American households today are generally employed, wealthier, and increasingly confident. Most encouraging has been the rapid rebound over the past few years in household income – a key determinant of spending growth.

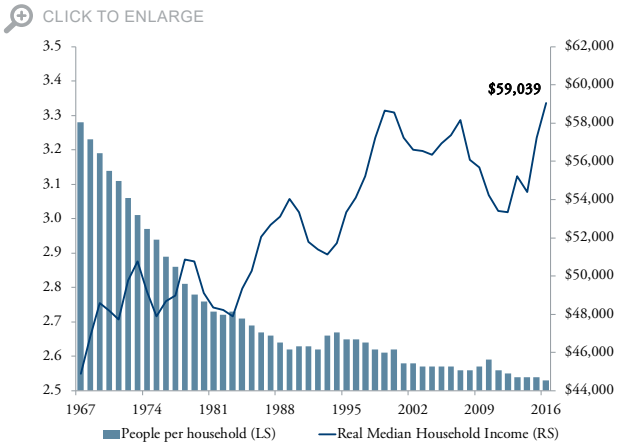
The Census Bureau recently reported that real median household income increased in 2016 for the fourth consecutive year and now stands at its highest level ever.

Global Synchronized Upturn (GDP Growth Forecasts)



Source: International Monetary Fund, as of July 1, 2017

Real Median Household Income



Source: U.S. Census Bureau, as of September 30, 2017

5. After the recent run-up, what can we expect from equities going forward?

Given recent price appreciation, more modest gains in the range of 5-7% should be expected for equities over the next year, and we believe it is wise to proceed cautiously for now in terms of initiating new positions in the U.S. and global markets.

The current environment of moderate economic growth, inflation, and interest rates is likely to keep the secular bull market moving forward, but investors should be aware that valuations have moved into the fully valued range and sentiment measures indicate markets may be growing too optimistic.

A good part of the recent run-up in share prices appears to be driven by renewed GOP focus on tax reform. Reduction in the corporate rate from 35% to the 25-30% range could be a significant boost to corporate earnings.

However, much of the potential benefits now appear to have been priced in by investors, and, given uncertainty of passage of a significant bill, our position is neutral at present.

Given recent market advances, downward equity price volatility remains a possibility in the quarters ahead until we know the outcome of proposed tax cuts.

6. Is City National Rochdale still positive on corporate credit?

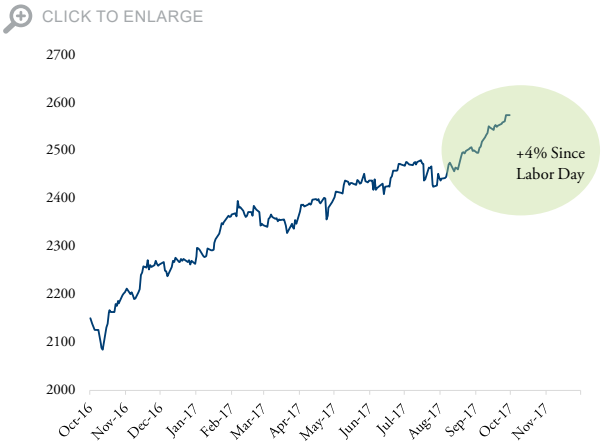
Yes, although the yield advantage that corporate bonds pay over treasury securities (credit spread) is near the 10-year low, it is still nearly 30 basis points above the all-time tightest spread.

We believe aggregate balance sheet leverage has peaked and is on a downswing while corporate earnings continue to impress.

In addition, despite a weakening from the 2012 peak, interest coverage ratios remain strong and above the long-term average.

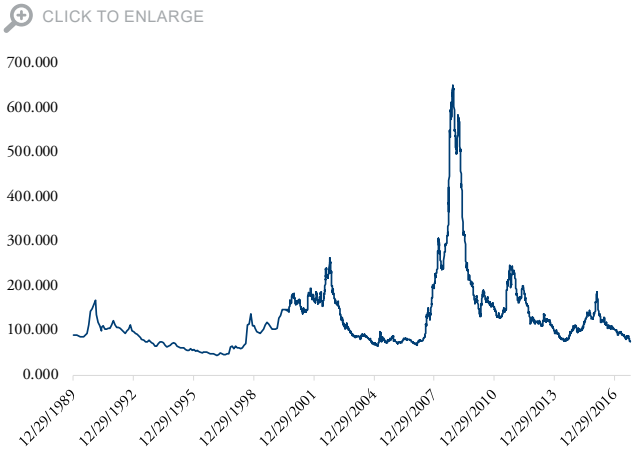
Given the still material yield pickup over government bonds and continued health of investment-grade corporate issuers, City National Rochdale remains positive on the asset class.

S&P 500



Source: FactSet, as of October 23, 2017

Intermediate Corporate — Option-Adjusted Spread*



* The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option.

Source: Barclays, as of October 17, 2017

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 Credit Bond Index measures the performance of investment grade corporate debt and agency bonds that are dollar denominated and have a remaining maturity of greater than one year and less than ten years.

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

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There are inherent risks with equity investing. These include, but are not limited to, stock market, manager, or investment style risks. 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 may include, but are not limited to, interest rate, call, credit, market, inflation, government policy, liquidity, or junk bond risks. 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.