City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY DECEMBER 21, 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 the U.S. economy is likely entering the last stage of the current business cycle, the domestic expansion is expected to continue at a modest pace over the next year, provided the Fed proceeds cautiously and no major disruptions arise on the geopolitical front.

While we expect continued growth for U.S. and global economies in 2018, investors appear to have fully priced in this positive outlook, and at the moment we see few compellingly attractive asset classes, whether we look at equities or fixed income.

Consequently, we have trimmed our expected returns for growth equities over the next few years. For investment grade and high yield fixed income investors, we have also trimmed projected returns given our expectations for moderately rising rates (see chart).

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

Forecasted Expected Returns (%), 12-Month Horizon

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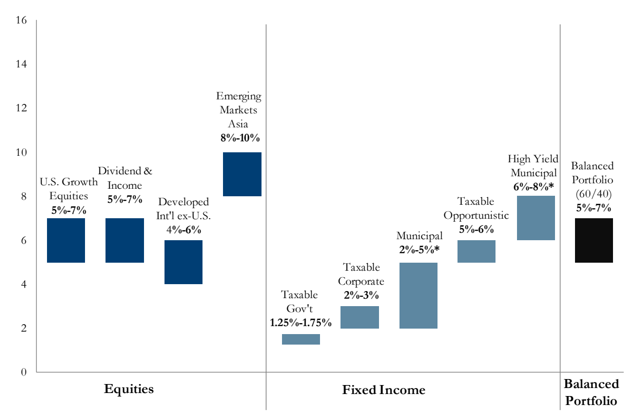

Source: City National Rochdale, December 2017

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. What part of the economy is showing the most promise for faster GDP growth?

The investment sector of GDP has had the strongest growth in the past year (4.2%) and in this expansion (6.1%) (see chart). The investment sector of GDP makes up 17% of GDP.

The investment sector is benefiting from improvements in the sub sector of equipment investment. This sub sector has performed well this year, bouncing back from the manufacturing downturn in 2015/16. It is getting further help from the stronger global economy and a lower value of the U.S. dollar, which is down more than 5% this year, and has driven a revival of exports.

Furthermore, with capacity utilization back at the long-term average, companies are being pressed to invest in machinery so they can maintain market share. If the Republicans' plan to cut the headline corporate tax rate and allow immediate expensing of capital investment gets passed into law, that could provide further stimulus.

GDP Sector Growth (%)

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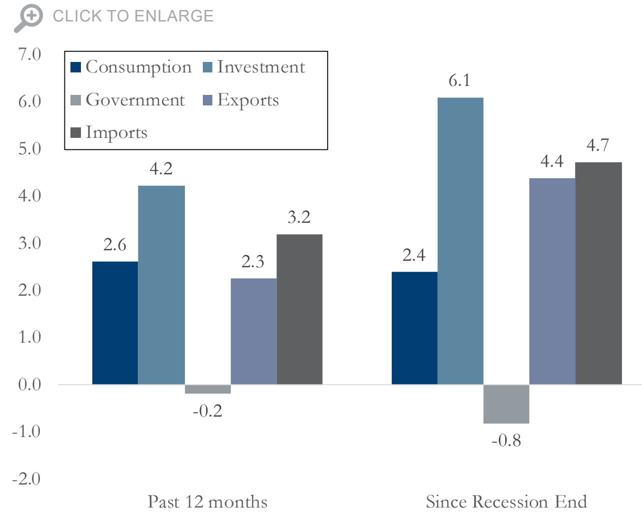

Source: Bureau of Economic Analysis, as of September 2017

3. What are the implications of the flatter yield curve?

The flattening of the slope of the yield curve has been a popular and reliable leading indicator for past recessions.

In each recession since the late 1960s, the differential between short- and long-term interest rates approached zero or inverted before the onset of the recession. This year there has been a persistent narrowing of the yield curve; it started the year at 125 bps and is currently at 57 bps.

We do not believe the recent flattening is a forebear of a recession. The current flattening is occurring for reasons not seen in past expansions.

Fed monetary policy is pushing up short-term interest rates, which is normal for an expansion. What is different this time around is the very low level of inflation and the massive amount of quantitative easing, which is putting downward pressure on long-term interest rates. Normally, in an expansion, longer-term interest rates move up with higher inflationary fears – they move up at a slower pace than short-term interest rates, thus the flattening.

Economic fundamentals have been improving for some time. That along with the federal tax cut should keep the U.S. economy on its upward trajectory.

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

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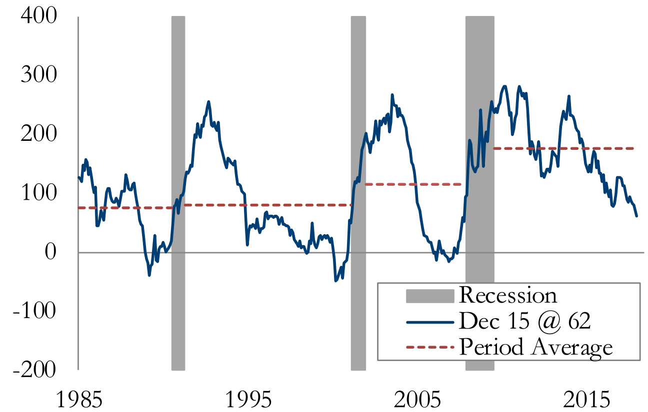

Source: Bloomberg, as of December 15, 2017

4. How will the Fed change under new leadership?

Jerome "Jay" Powell has been nominated as the new chair of the Federal Reserve. He is a trained lawyer and current member of the Fed's Board of Governors. He will be the first non-economist to run the Fed since the early 1970s, when G. William Miller, a former Textron executive, held that job. In Powell's five years on the Fed, it has been reported that he has learned a great deal of economics and has earned the respect of staff economists.

The board is changing. With Yellen's departure and NY president Bill Dudley resigning, the number of economic Ph.D.s. on the FOMC will drop to just eight. For the past few years there has been an average of 13. But the big variable ahead will be the nominations of other members of the Fed's Board of Governors. There are four openings for the seven-member board. Who gets nominated, be they doves or hawks, will heavily influence the direction of the Fed.

The Fed still plans on raising the funds rate three times in 2018; but, because inflation remains low, the market is more skeptical and is currently expecting just two rate hikes.

Implied Probability of a 25 bps Rate Hike by March (%)

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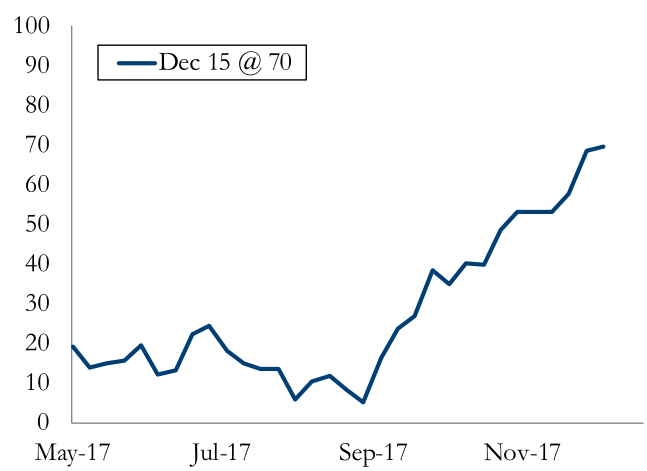

Source: Chicago Board of Trade, as of December 15, 2017

5. After the strong performance we've seen so far this year, what can investors expect from equities over the next 12 months?

We believe the current backdrop of moderate economic growth, inflation, and interest rates is likely to keep the secular bull market moving forward. However, given the recent appreciation in prices, more modest gains should be expected over the next year.

The YTD returns seen so far appear justified as investors have responded to a rebound in corporate profits and improving global demand, as well as the increasing likelihood of a significant reduction in the corporate tax rate.

Assuming tax cuts are implemented sometime by the second half of 2018, we think U.S. corporate earnings could increase by about 8-10% over 2018, which should help support higher equity prices. Further modest multiple expansion is also possible in this environment.

Downward equity price volatility is likely to be a possibility until the outcomes of tax policy, healthcare, and regulatory changes out of Washington are known.

Year-end 2018 Estimates

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Year-End 2018 Estimate: No Tax Cut (30% Probability)

S&P 500 EPS		Fwd. P/E					
CNR Estimate	Y/Y Change	17.5	18	18.5	19	19.5	20
		Expected Total Return*					
$138.00	4.5%	-7%	-4%	-2%	1%	4%	6%
		2,415	2,484	2,553	2,622	2,691	2,760

Year-End 2018 Estimate: Assuming Half-Year Tax Benefit (70% Probability)

S&P 500 EPS		Fwd. P/E					
CNR Estimate	Y/Y Change	17.5	18	18.5	19	19.5	20
		Expected Total Return*					
$145.00	9.8%	-2%	1%	3%	6%	9%	12%
		2,538	2,610	2,683	2,755	2,828	2,900

25%	Downside Risk
50%	Base Case
25%	Upside Potential

*Assumes reduction in corporate tax rate to 22.5%. Based on S&P 500 Index value. As of November 30, 2017.

6. Has the outlook for Europe improved?

Yes, the Euro Zone appears to have turned a corner as progress continues on key structural reforms (particularly labor) across member states. The European Commission recently increased its 2018 GDP forecast for the EU to 2.1% from 1.8%, because of resilient private consumption, falling unemployment, stronger global demand for exports, and more pro-growth policy initiatives. Investment is also picking up amid favorable financing conditions and considerably brighter economic sentiment as uncertainty has faded.

Although growth is still wildly divergent among countries, the economies of all member states are now expanding and their labor markets are improving (see chart).

Importantly, the expansion underway in Europe appears to be only at its mid-cycle stage (compared to late-cycle in U.S.) and still has significant room for growth before the economy is operating at potential. This continuing slack is a key support for the expansion, helping to keep the cost of doing business (i.e., labor and interest rates) lower, and for a longer period.

EU Member States: 2018 GDP Growth Forecasts

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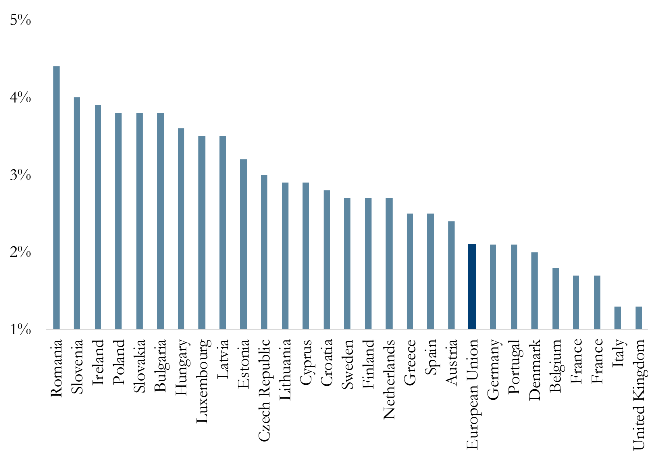

Source: European Commission, as of Fall 2017

Index Definitions

The Standard & 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.

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Returns include the reinvestment of interest and dividends.

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Past performance is no guarantee of future performance.