City National Rochdale®
INVESTMENT MANAGEMENT

On the Radar

FAQs ON THE MARKETS AND ECONOMY APRIL 9, 2018

1. Is City National Rochdale's outlook still positive for 2018?

Corrections are always unsettling, and at times they can cause us to lose sight of the positives. For investors, we believe the most important thing to keep in mind is that outlook for the economy continues to be quite strong and that bear markets rarely occur outside of economic downturns.

However, the investment landscape is growing more challenging and will likely become more volatile as investors adjust to a more typical late-stage expansion environment of higher inflation, rising interest rates and less accommodative monetary policy. None of this means there are not more worthwhile gains ahead for investors, but it does highlight the value of active management and the need for investors to become more selective.

Beginning in 2017, both our equity and fixed income research teams made deliberate risk mitigating portfolio decisions. These decisions have already resulted in better performance for our client portfolios during the increased volatility in early 2018.

Within equities, we have methodically lowered our ownership of companies that were not rock solid with respect to earnings growth, steadiness of earnings and resilient business models. Today, our emphasis is primarily on steady growth companies rather than on cyclical earnings growth.

For fixed income portfolios, we have made a number of changes in response to prospects of higher interest rates, such as shortening duration, while also increasing credit quality in recognition of late-cycle indicators.

One-Year Forecasted Expected Returns (%)

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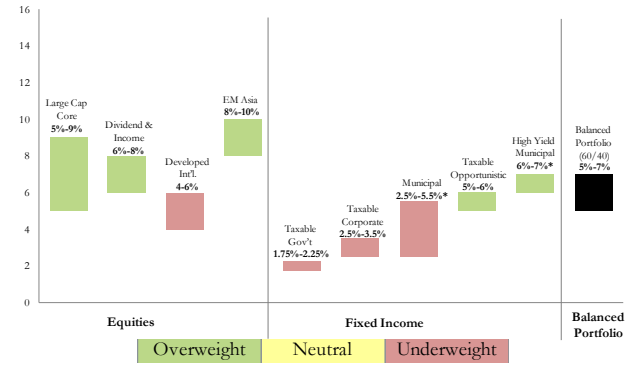

Source: City National Rochdale. As of April 2018.

Forecast 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. How has the bond market changed in this economic expansion?

There have been two significant changes. First, the amount of corporate debt has increased 120% since the end of the recession as companies have taken advantage of leveraging their balance sheet with low interest rate debt.

The other issue is the increase in BBB-rated debt, the lowest rung on the investment-grade credit ladder. It now makes up 49% of the investment-grade index. Back at the end of the recession it was just 36%.

For investors, this is an important change. Although default rates remain low, an economic could trigger an elevation in delinquencies and defaults.

At City National Rochdale, our credit analysis and evaluation process is consistently applied throughout the economic cycle for bonds we purchase and hold within our clients' portfolios.

Taxable Bond Market – Investment Grade ('000)

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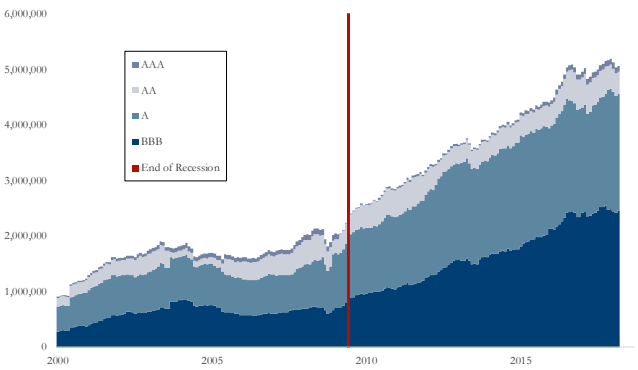

Source: Bloomberg Barclays Index. As of March 31, 2018.

3. What is behind recent equity market volatility and is it a concern?

The biggest story of 2018 has been the return of more normal financial market volatility, after a year and a half in which stock prices grew steadily without interruption and investors were seemingly impervious to any hint of bad news.

That since has changed as markets have begun to grapple with a number of concerns including rising trade tensions and the potential that firming inflation will lead to a more aggressive Fed.

After an extended period of extraordinarily unusual calm, investors can be forgiven for forgetting that volatility spikes in the capital markets are not unusual.

In fact, the recent dip is well within the normal range of market volatility. On average, the S&P 500 experiences a decline of 10% or more in almost half of all calendar years since 1980 and in all but six of those instances, the market ended the calendar year within positive territory.

While sharp moves like we have recently been experiencing in stock prices can be unnerving, we believe that the strong economic and earnings environment should support a continuation of the bull market, albeit with further volatility, some elevated risks, and more modest returns.

For more information about recent developments in trade, look for City National Rochdale's Special Bulletin scheduled for publication later this week.

S&P 500 Return (%)

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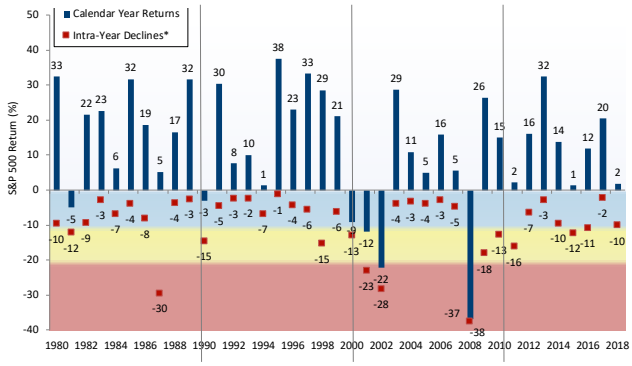

Source: FactSet. As of March 2018.
*Intra-year declines are the largest declines within the calendar year

4. What did the Fed decide at their recent meeting?

The Fed raised the median Federal Funds Rate by 25 bps to 1.625%, the first of three planned increases for this year.

Most interestingly, they gave a boost to the Federal Funds Rate projections for 2019 and 2020 (chart).

It is important to note that the pace of tightening remains gradual.

The Fed is not trying to choke off economic growth. The rate increase is probably in response to the projected increases in economic growth, which is due in part to the tax cut and accompanying fiscal stimulus. The Fed now has projections of GDP for 2018 (now at 2.7%, previous projection was 2.5%) and in 2019 (now at 2.4%, previous projection was 2.1%). In 2020, growth is projected to move back 2.0%, about the trend rate of this expansion.

Inflation is expected to remain stable around 2.0%

The unemployment rate is expected to drop to 3.6%, a level we have not seen since the 1960s.

Federal Funds Rate & FOMC Projections (%)

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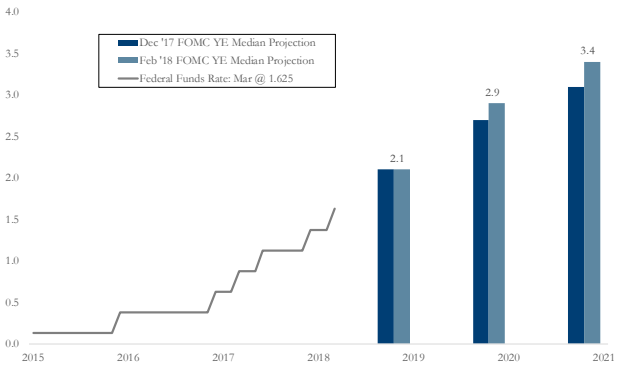


Source: Federal Reserve Bank. As of March 31, 2018

5. Why have retail sales been weakening?

Consumption makes up about two-thirds of GDP. Monitoring the monthly retail sales report, which has some components that feed into the GDP calculation, makes this report an important leading indicator.

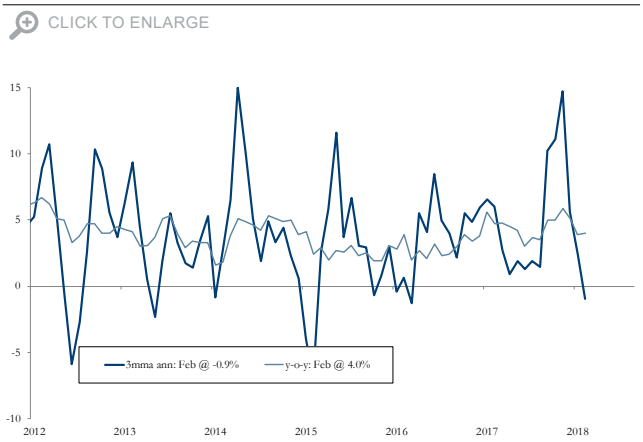
Retail sales have fallen for the past three months (0.1% for each month). This has brought the yearly change down from a recent high of 5.9% in November to the current 4.0% (chart).

Part of the recent declines have been a result of bad weather. For the Northeast and Midwest, that is normal. But the South, which is not prepared for hostile weather, is ill-equipped to handle the ice and snowstorms. This can have an economic impact by reducing the temptation to go out and shop.

Another part of the decline could be a payback from very strong sales in September (up 2.0%, the highest level since 2010). That was high due to a rebound in purchasing following Hurricane Harvey.

We believe the recent weakness is unlikely to be the start of a sustained downturn. Retail sales is expected to return to the five-year trend growth rate of 3.5% to 4.0%.

Retail Sales (% Change)



Source: U.S. Economic Census. As of February 2018

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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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 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.

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

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.