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SUMMARY

- Fed reinforces its current narrative of higher rates for longer.
- Negative returns and higher yields in Q3 despite strong earnings...
- ...which keeps us overweight stocks.

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Q3 Recap: Too Much of a Good Thing; When Good News is Bad News

Quarterly Recap: Inflation is Improving, and Earnings are Strong, but the Fed's Interest Rate Path is Unchanged; this Led to a Disappointing Q3 for Investors

After two quarters of strong markets, the third quarter started on an optimistic note; inflation had been declining and earnings were holding in. However, this optimism didn't last; both stocks and bonds had negative returns in Q3, despite declining inflation and strong earnings. This quarter reminded investors that markets look ahead and not in the rearview mirror, and short-term prices are often driven by how data surprises relative to expectations.

In this quarter, the dominant surprise for the market was the Federal Reserve's tone, in our view. According to probabilities implied by bond pricing, consensus viewed rate cuts as likely, potentially starting as early as Q1 2024. The combination of a summer rally in oil and inflation remaining higher than expected led to a clear and unambiguous message from the Federal Reserve that suggested rates would remain higher for longer.

Bond yields rose markedly throughout September as the Fed's message of "higher rates for longer" became reflected in prices, a trend that has continued unabated into the first week of October. Stock markets in the near-term implicitly price off interest rates, both from a profitability viewpoint as well as from a valuation one. With regards to profits, interest costs detracted from profits, thus the message of "higher for longer" overwhelmed what appears to us to have been a pretty good Q3 earnings season. From a valuation multiple standpoint, higher rates tend to make stocks less attractive relative to bonds and cash. All of this took what might have appeared from a distance as 'good news' (lower inflations, improving growth, improving earnings) and turned it into a challenging third quarter.

Returns Recap:

Table 1: Q3 2023 Asset Class Performance

	PERFORMANCE TOTAL RETURN PERCENTAGE AS OF 09/30/2023	
Broad Assest Classes	Q3 2023	Trailing Twelve Months
CASH	1.3%	4.6%
HIGH YIELD	0.5%	10.2%
EMERGING MARKET EQUITIES	-2.9%	11.7%
US TREASURIES	-3.1%	-0.8%
FIXED INCOME INV GRADE	-3.2%	0.6%
US LARGE-CAP	-3.3%	21.6%
GLOBAL EQUITIES	-3.4%	20.8%
GLOBAL EX-US EQUITIES	-3.8%	20.4%
DEVELOPED INT'L EQUITIES	-4.1%	25.6%
US SMID CAP	-4.4%	13.9%

Source: Factset, Morningstar. Data as of September 30, 2023. Chart shown for illustrative purposes only. Past performance is no guarantee of future results. Not indicative of RiverFront portfolio performance. See disclosures at the end of this publication for description of asset classes and the indices for which the returns above are based. Returns above do not reflect any fees or costs associated with investing in the applicable asset classes. It is not possible to invest directly in an index.

The quarter created a tough environment at the asset class level, with Cash and High Yield Bonds being the only two segments with positive returns. Emerging markets, while still the lowest performing equity market over the past 12 months, performed slightly better than the other broad markets during the quarter, in large part due to their elevated commodity exposure relative to the other major broad equity market segments. Small caps, which have arguably the highest sensitivity to US rates, fell the most of all major segments, and developed International and US equities were in the middle. The good news is that the longer-term positive technical trends are still intact for US markets, in our opinion (see last's week's *Weekly View*), although all of the markets are now more susceptible to rollovers in momentum.

US Sectors: Energy Rides the Oil Wave; Comm Services Leads a Weak Growth Pack

Looking at US sectors, the major differentiator of performance appeared to be rising costs of capital, skepticism about tech-related earnings that were not immediately evident, and a lift from oil prices. Energy was the leader due to solid earnings in the sector coupled with a tailwind of rising oil prices. The two largest communications services companies displayed unexpectedly strong profitability against a backdrop of angst around valuations of technology which we believe drove this sector to positive returns. Defensive sectors struggled under the weight of rising interest costs, with consumer staples, utilities, and real estate amongst the worst performing sectors.

Table 2: Q3 2023 US Sector Performance

PERFORMANCE TOTAL RETURN PERCENTAGE AS OF 09/30/2023

US Sector	Q3 2023	Trailing Twelve Months
Energy	12.2%	30.1%
Communication Services	3.1%	38.5%
Financials	-1.1%	11.7%
Health Care	-2.7%	8.2%
S&P 500	**-3.3%**	**21.6%**
Materials	-4.8%	18.0%
Consumer Discretionary	-4.8%	13.7%
Industrials	-5.2%	24.5%
Information Technology	-5.6%	41.1%
Consumer Staples	-6.0%	7.3%
Real Estate	-8.9%	-1.9%
Utilities	-9.2%	-7.0%

Source: Bloomberg. Data as of September 30, 2023. Chart right shown for illustrative purposes only. Past performance is no guarantee of future results. Not indicative of RiverFront portfolio performance. Returns above do not reflect any fees or costs associated with investing in the listed sectors. the applicable asset classes. It is not possible to invest directly in an index.

International: Developed Markets still lead Emerging markets

A look at specific international markets uncovers a few themes. China, while still the weakest market year over year, held up better than every market in the table below except Japan and the UK, and its primary reason for being negative for US investors was weakness in the yuan. More generally, the major themes that drove international returns appeared to be Energy and Value, which favored the UK, Japan, and China. While Canada has a large contingent of energy companies, its banking and materials companies struggled, making Canada an outlier among commodity producers.

Table 3: Q3 2023 Global Region Performance

International Market Returns	In USD		In Local		Currency Impact	
MSCI Total Return Net	**Q3 2023**	**Year Over Year**	**Q3 2023**	**Year Over Year**	**Q3 2023**	**Year Over Year**
United Kingdom	-1.5%	24.9%	2.6%	14.2%	-4.1%	10.7%
Japan	-1.6%	25.9%	1.6%	29.8%	-3.2%	-3.9%
China	-1.9%	5.2%	-2.0%	5.5%	0.0%	-0.2%
Emerging Markets	-2.9%	11.7%	-1.4%	10.9%	-1.5%	0.8%
United States	-3.3%	21.6%	-3.3%	21.6%	0.0%	0.0%
Canada	-4.0%	11.5%	-2.0%	9.7%	-2.1%	1.8%
EAFE	-4.0%	26.3%	-1.2%	21.0%	-2.8%	5.4%
Europe	-5.0%	28.8%	-2.1%	19.5%	-2.9%	9.4%

Source: Bloomberg. Data as of September 30, 2023. Chart shown for illustrative purposes only. Past performance is no guarantee of future results. Not indicative of RiverFront portfolio performance. Returns above do not reflect any fees or costs associated with investing in the listed sectors. the applicable asset classes. It is not possible to invest directly in an index.

Forward Outlook: Remain Constructive on US Stocks; Markets Likely to Remain Range-Bound in Near-Term

The third quarter proved to be a sharp departure from the first half of the year, and the beginning of Q4 appears to be a continuation of that trend. We continue to see markets trending towards a version of our 'Base' case from our 2023 Outlook, in which the US economy slows some but stays solidly positive, and inflation also moderates but persists at a higher level than pre-pandemic averages.

In this scenario, we foresee the Fed will be proven correct and interest rates will likely need to go higher to combat inflation. If this plays out, we think equity investors should expect volatility and range-bound markets between 4200-4600 on the S&P 500 in the near-term, before resolving to the upside at some point, likely in 2024. This is an environment where we believe the 'P.A.T.T.Y' theme ('Pay Attention to the Yield' - a focus on investments with strong yields and free cash flows to support them) would be an effective strategy.

Importantly, a PATTY strategy is not the same as a high dividend strategy. Dividend stocks have underperformed significantly in 2023 due to their sensitivity to rising interest rates. The PATTY theme, on the other hand, is about companies that can generate significant current earnings and cashflow yields, which may or may not be paid out in dividends (see July *Weekly View* on P.A.T.T.Y. and September *Weekly View* on High Dividend Yielding Stocks). We think total returns for these types of companies will continue to move higher over time, due to more resilient earnings and cash flow.

In conclusion, we continue to slightly favor stocks over bonds in our balanced portfolios. We currently favor US stocks across our balanced portfolios and are tactically becoming more cautious on international.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.

Index Definitions

Standard & Poor's (S&P) 500 Index TR USD (US Large Cap) measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Standard & Poor's (S&P) 1000 Index (US SMID Cap) - the S&P MidCap 400 Index and the S&P SmallCap 600 Index are combined to form the S&P 1000.

MSCI EAFE Index NR USD (Developed International Equities) is designed to represent the performance of large and mid -cap securities across approximately 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the US and Canada. Net total return indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to nonresident institutional investors who do not benefit from double-taxation treaties.

MSCI Emerging Markets Index NR USD (Emerging Market Equities) is an equity index that captures large and mid-cap representation across approximately 25 emerging markets (EM) countries.

MSCI Europe Index represents the performance of large and mid-cap equities across approximately 15 developed countries in Europe.

MSCI Japan Index designed to measure the performance of the large and mid cap segments of the Japanese market.

MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

MSCI United Kingdom Index (USD) is designed to measure the performance of the large and mid cap segments of the UK market.

MSCI Canada Index is designed to measure the performance of the large and mid cap segments of the Canada market.

The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market.

MSCI ACWI Index (Global Equities) is designed to represent performance of the full opportunity set of large- and mid-cap stocks across approximately 23 developed and approximately 25 emerging markets.

MSCI ACWI ex USA Index (Global ex US Equities) captures large and mid cap representation across approximately 22 of 23 developed markets (DM) countries (excluding the US) and approximately 25 emerging markets (EM) countries.

ICE BofA High Yield Index TR USD (High Yield) tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. Index constituents are capitalization-weighted based on their current amount outstanding times the market price plus accrued interest.

Bloomberg Capital US Treasury Index TR USD (Treasury Bonds) measures the performance of the US Treasury bond market.

Bloomberg US Aggregate Bond Index TR USD (Fixed Income Investment Grade) is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. The issues must be rated investment grade, be publicly traded and meet certain maturity and issue size requirements.

Bloomberg Capital 1–3 Month US Treasury Bill Index TR USD (Cash) includes all publicly issued zero-coupon US Treasury Bills with a remaining maturity between one and three months, are rated investment-grade and have an outstanding face value of $250 million or more.

In a rising interest rate environment, the value of fixed-income securities generally declines.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero).

Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

High-yield securities (including junk bonds) are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.

Buying commodities allows for a source of diversification for those sophisticated persons who wish to add this asset class to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any commodity purchase represents a transaction in a non-income-producing asset and is highly speculative. Therefore, commodities should not represent a significant portion of an individual's portfolio.

Dividends are not guaranteed and are subject to change or elimination.

Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.

Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.

Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Small-, mid- and micro-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit www.riverfrontig.com or contact your Financial Advisor.

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