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Checking in on Our '3 Rs': So Far, So Good

FED POLICY AND TRADE RHETORIC ENCOURAGING THUS FAR IN 2019

In our 2019 ***Outlook***, our base case scenario pointed to a positive outcome for stock markets for 2019…but that outlook was highly dependent on the path of key market drivers that we called the '3 Rs': **Rates, Resolution of Trade, and Recession Risk**.

While a month certainly doesn't make a year, the facts on the ground suggest that our '3 Rs' are thus far **mostly trending somewhere between our 'base' and 'optimistic' case, including positive news on both trade and Fed interest rate policy this past week.**

Global stock markets have responded accordingly, with big rallies year-to-date in most regions and the S&P 500 now having retraced more than two-thirds of its recent weakness after its best January in 30 years. RiverFront's tactical allocation process has also responded to these improving fundamentals by putting some excess cash to work in various asset classes which we view as having been overly punished in the fourth quarter selloff, including US small-caps and international equities. In our long-horizon portfolios, we focused our international additions on emerging market securities.

While we believe the S&P 500 will have a harder time in the near-term breaking through the various resistance levels (see chart below), the trajectory, breadth and strength of this technical bounce has been encouraging. With the 200-day around 2750, we expect stocks to consolidate in a range between 2600-2800. We think it will take a breakthrough on the US/China trade front to push through this resistance.

CHART OF THE WEEK: S&P 500 SUPPORT AT 2600, RESISTANCE AT 2750-2800

January's economic news has mostly trended somewhere between our 'base' and 'optimistic' case for the year…and the stock market has responded accordingly.

Source: Thomson Reuters Datastream, RiverFront; as of Feb 2019

Past performance is no guarantee of future results. Not indicative of RiverFront performance. You cannot invest directly in an index.

HOW JANUARY'S NEWS HAS BEEN TRENDING RELATIVE TO OUR 2019 OUTLOOK SCENARIOS

PESSIMISTIC CASE	BASE CASE	OPTIMISTIC CASE
Brexit outcome remains highly uncertain	China growth slowing but stabilizing	Fed's dovish mtg last week
Italy now in recession	US earnings season mixed but positive on whole	US dollar down year-to-date; emerging market currencies up
Eurozone PMIs continue to weaken	Japan export economy slow, but consumer solid	US/China trade talks constructive
		US PMIs rebounded
		US Payrolls strong
		Oil above $60

Source: RiverFront. Past performance is no guarantee of future results. The table above depicts RiverFront's predictions for 2019 using three scenarios (Pessimistic, Base and Optimistic). The assessment is based on RiverFront's Investment Team's views and opinions. Please note that these predictions reflect RiverFront's views as of the date of this publication. These views are subject to change and are not intended as investment recommendations. There is no representation that an investor will or is likely to achieve positive returns, avoid losses or experience returns as discussed for various market classes. The Purchasing Managers' Index (PMI) is an indicator of economic health for manufacturing and service sectors. The purpose of the PMI is to provide information about current business conditions to company decision makers, analysts and purchasing managers.

RATES: MARKET RECEIVES A LATE CHRISTMAS GIFT FROM THE FED THIS WEEK

The US Federal Reserve surprised many in their meeting last week by deemphasizing the likelihood of future interest rate hikes. While bond markets had been increasingly anticipating fewer rate hikes since December (see our *Weekly View* from 1/22/19 for more on this), even ultra-doves were surprised when the Fed inserted language suggesting that they are open to lowering rates in '19, should a worsening of US or global economic conditions call for it.

This 'dovish' (accommodative) turn is an important positive for risk markets, in our opinion. Our first rule of tactical asset allocation is 'Don't Fight the Fed', and it appears that Jay Powell and company are actively trying to ease financial conditions to offset heightened global political or economic risks. Easing financial conditions are generally good for stock markets. We believe a lot of 2018's major valuation drop was due to the market recalibrating its view towards more restrictive Fed policy going forward. This suggests that stock multiples may be able to elevate from here if a higher probability of an accommodative Fed is repriced. A more dovish Fed has also helped halt the rise in the US dollar, which we believe is particularly positive for emerging market stocks and currencies.

RESOLUTION OF TRADE: US/CHINA 'BODY LANGUAGE' CONTINUES TO IMPROVE

In our *Outlook*, we stated that "*Despite profound ideological differences that run much deeper than just trade, both sides have something to gain from a face-saving agreement".* Last week witnessed potentially improving 'body language' around this all-important trade dynamic. The Chinese Vice-Premier travelled to Washington to meet with top US officials, including US Trade Representative Robert Lighthizer, a noted China skeptic, as well as President Trump. Judging from the tone of POTUS's tweets about 'good intent and spirit' and comments from Lighthizer after the meetings that 'significant progress was made', we believe that legitimate attempts are being made by both sides to find a face-saving agreement in '19. Treasury Secretary Steve Mnuchin and Lighthizer are expected to travel to China in mid-February for more talks, while President Trump and Chinese President Xi are likely to meet later that month, increasing hopes that the outlines of a deal can be reached before the March 1 trade deadline.

RECESSION RISK: US SOLID, ASIA STABILIZING…EUROPE STILL THE WEAK SPOT

We stated in our *Outlook* that risk of recession is the central fear for markets. We continue to believe the fear of this is overblown. With last week's big upside surprise in both nonfarm payrolls and the ISM manufacturing surveys, the US continues to trend towards a low probability of recession in the next 12 months, in our opinion. US earnings season is also shaping up well so far, particularly off of lower expectations since the fall; roughly three-fourths of companies have beaten most recent earnings estimates. Outside of the US, the export-oriented parts of Japan and China continue to struggle with trade uncertainty, but both nations' consumers and service economies appear in better shape. Our view continues to be that China will stabilize in the 2nd half of this year on the back of fiscal stimulus, and that Japan's domestic economy and consumer is more stable than many appreciate, due to rising wages, a tight labor market, and strong housing and tourism trends.

Clearly, the softest major economy in the world continues to be Europe, and the continued chaos around Brexit, France's 'yellow vest' protests, and Italian political intrigue is not helping. Despite cheap valuations, we remain underweight European stocks. In particular, we believe markets are not currently focused enough on the tail risk of a no-deal Brexit happening, though we believe in the 11th hour the UK and EU will likely kick the can down the road further than the end of March.

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The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Past results are no guarantee of future results and no representation is made that a client will or is likely to achieve positive returns, avoid losses, or experience returns similar to those shown or experienced in the past.

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

It is not possible to invest directly in an index.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared with the 2016 strategic allocations for each portfolio, as opposed to compared with the portfolios' composite benchmarks.

Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

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.

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.

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.

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

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