Rod Smyth
DIRECTOR OF INVESTMENTS

Doug Sandler, CFA
GLOBAL STRATEGIST

Chris Konstantinos, CFA
CHIEF INVESTMENT STRATEGIST

Stocks in a Decision Box, Tactical Indicators Neutral: Time for Nuanced Risk Management

STOCKS HAVE MOVED FROM A LOW VOLATILITY UPTREND IN 2017 TO A MORE VOLATILE TRADING RANGE: The S&P 500 peaked on Friday, January 26th at 2870 (see Weekly Chart p.2) and over the next two weeks fell around 200 points (about 7%) finding a floor around 2600. Since then it has bounced around in a range between 2600 and 2800 testing both levels more than once. **We like to call this a decision box,** in which the positive news from earnings both in the US and overseas is weighed against the dual concerns of interest rates and trade. We have observed this kind of pattern many times in the past when good and bad news are equally obvious. Typically, a break out of the box either up or down is followed by continued momentum in that direction.

PAUSE IN STOCK MARKETS MAKES SENSE TO US:

The initial decline in February followed a spike in prices and investor optimism (reflected in the relative strength index – RSI – in the lower clip of our chart). The Relative Strength Indicator (RSI) is a technical momentum indicator that compares the magnitude of recent gains to recent losses in an attempt to determine overbought and oversold conditions of an asset.

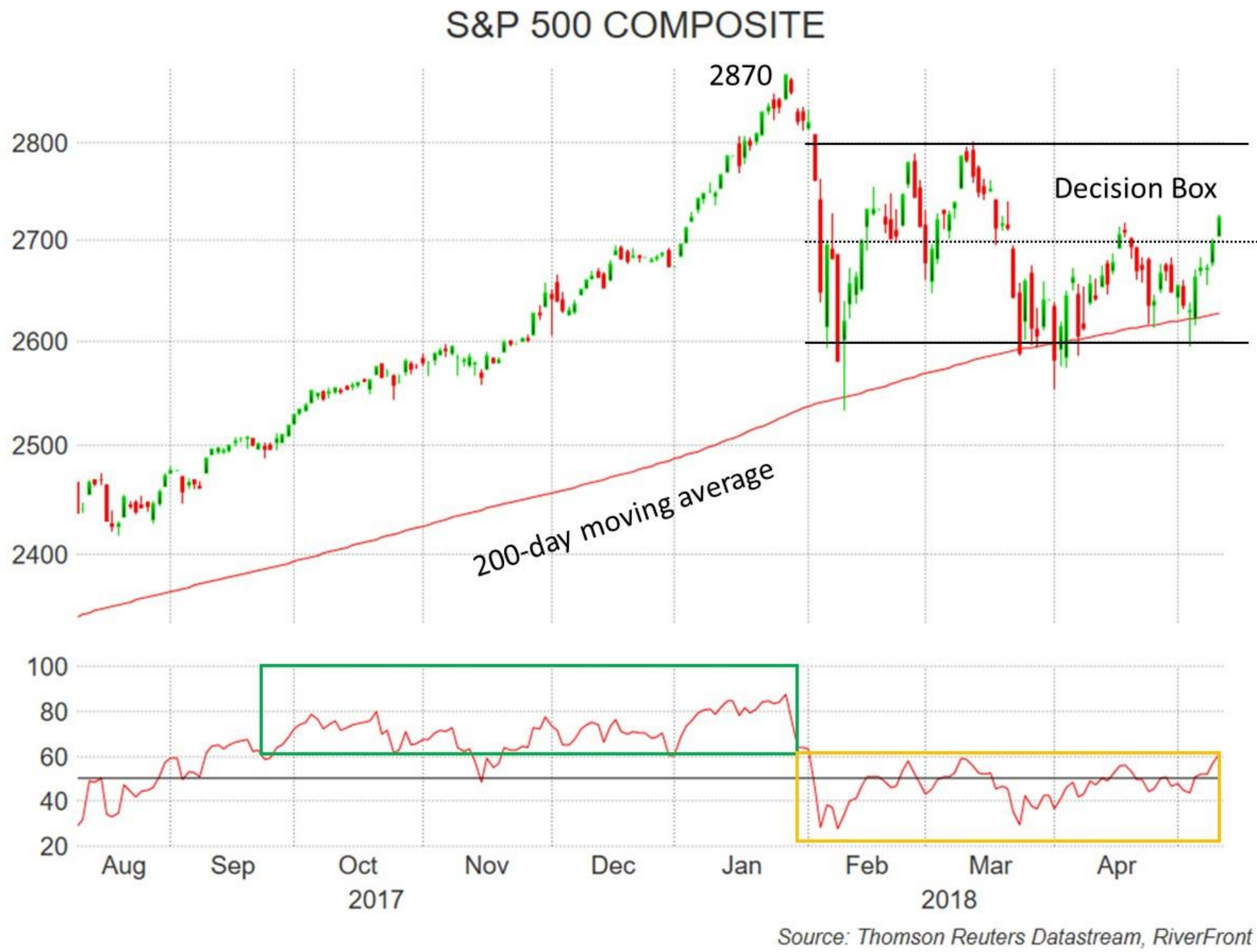
We believe February's decline was mostly in response to rising long and short-term interest rates as investors fretted about how far the Fed would raise rates in response to strong 2017 global growth. The second decline in March had more to do with fears surrounding global trade, and especially the prospect of a trade war with China, in our opinion. Compounding these fears were concerns about a rise in the dollar which has surprised investors and taken the momentum out of emerging markets. All of these factors warranted a pause in the unsustainable pace of the 14-month uptrend in our view.

DEPLOYING NUANCED RISK MANAGEMENT BASED ON TIME HORIZON:

Last week as we reviewed our technical indicators, which combine relative strength and price momentum, Chief Market Strategist Kevin Nicholson concluded that nearly all the countries and regions we follow were giving neutral signals. These readings represented a deterioration in our short-term indicators, which contrasted with the equity overweight in all our balanced portfolios.

While our opinion is that the eventual break of the decision box will be to the upside, we recognize that it is hard to have high conviction predicting the outcome of a trade negotiation when the stakes are high and both sides have staked out hardline positions. We therefore decided to reduce risk slightly in our more risk averse, shorter-time-horizon portfolios in the middle of the decision box. **We think it is prudent to keep our more risk averse investor portfolios close to a neutral position, while giving our longer-time frame portfolios some more leeway to allow the bulls to potentially triumph.**

THE WEEKLY CHART: US STOCKS ARE IN THE MIDDLE OF THEIR 3-MONTH TRADING RANGE



Source: Thomson Reuters Datastream, RiverFront. Past performance is no guarantee of future results.The chart above is shown for illustrative purposes only and is no indication of RiverFront portfolio performance.

In the chart above, we show the two factors that go into our tactical model: investor sentiment (bottom panel) and price trends (top panel). We like to use the slope of the 200-day moving average to determine the primary trend of price, and one of our preferred measures of sentiment is the Relative Strength Index (RSI). The price action at the end of last week took the S&P 500 closer to the upper end of the box as investors anticipated a better outcome to the trade talks with China. Our tactical model typically suggests better odds for the market in a 3-month window when RSI is above average as it was for most of 2017 and the long-term trend is positive. Currently the trend is positive, but RSI has been trading in a below average zone, hence the neutral tactical readings from the model.

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Index Definitions

***Standard & Poor's 500 Index** (S&P 500) measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market. It is not possible to invest directly in an index.*