by DOUG SANDLER

THE RIVERFRONT WRITING TEAM

REBECCA FELTON
Senior Market Strategist

ADAM GROSSMAN, CFA
Global Equity CIO |
Co-Head of Investment Committee

CHRIS KONSTANTINOS, CFA
Director of Investments |
Chief Investment Strategist

KEVIN NICHOLSON, CFA
Global Fixed Income CIO |
Co-Head of Investment Committee

DOUG SANDLER, CFA
Head of Global Strategy

ROD SMYTH
Chairman of the Board of Directors

SUMMARY

- Headlines are dominated by the tragic situation in Ukraine.
- Market impact will be felt through inflation and thus the Fed, in our view.
- While we believe that stocks will be higher by year-end...active asset allocation can be the best defense against volatility.

3.21.2022

Current Market Situation Nerve Wracking

Active Asset Allocation Can Help

It is hard to believe, but the end of the first quarter is nearly here, and a lot has changed in the minds of investors. In late January, as COVID-19 cases started to wane, the economy was re-opening and the market was hitting new highs, I remember thinking... "Why wouldn't I want to own stocks?" Today, with the Federal Reserve (Fed) raising rates and the largest invasion since World War II occurring in Europe, many are now asking the opposite question... "Why would I ever want to own stocks right now?" The sudden change in sentiment makes this a good time to revisit our views on some of the key topics affecting the market.

We believe the direction of inflation and the Fed's response remain the key market drivers: Inflation dictates the magnitude and pace of future Fed rate hikes, which ultimately impacts borrowing costs for consumers and the valuations assigned to stocks, bonds, commodities, and real estate. Barring a dramatic escalation of the Russia/Ukraine crisis, we believe that the future direction of inflation will be the most important determinant of financial returns in 2022 because it will determine the magnitude of interest rate increases. The impact of the events in Ukraine is that it makes the Fed's job more difficult and increases the potential for a policy mistake. Unfortunately, regarding inflation, there has been little evidence of improvement. February's consumer price index (CPI) report, for example, was higher than January and is now rising at a 7.9% annual rate. The recent jump in energy prices following Russia's invasion will likely cause this number to continue to rise in next month's report.

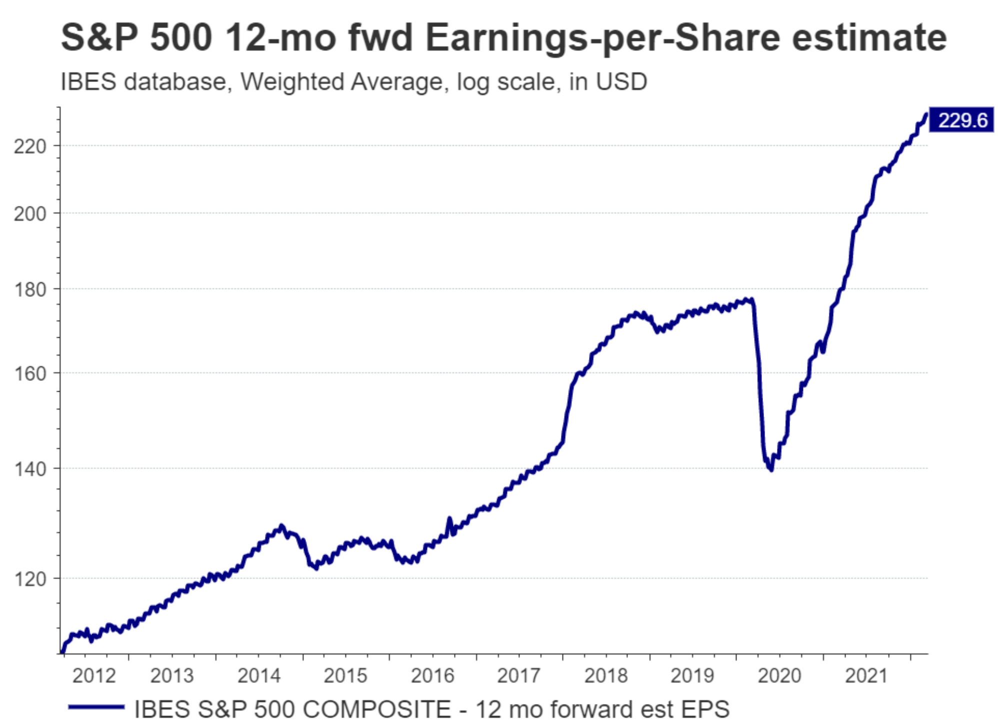
For those looking for a glimmer of hope, February's core producer price index (PPI) rose at the lowest rate since November 2020 at 0.2% month/month. The reduction may be a result of consumers and businesses 'hunkering down' amidst the stock market sell-off and Russia news. Changes in PPI often trickle down to CPI in later months, but it is far too early to determine if the most recent reading indicates a change in the longer-term trend. Ultimately, we expect inflation to reduce as supply and demand imbalances self-correct but recognize that may not happen as quickly as we originally anticipated.

The Fed raising rates should not end the bull market: As expected, the Fed raised interest rates for the first time in over two years and signaled to the market that six more increases in 2022 were likely. Coincidently, seven - 25 basis point rate hikes equate to a Fed Funds rate of 1.75% - 2.00%, which is slightly below where the Federal Funds (Fed Funds) rate was before COVID-19. Given that the economy could handle a higher Fed Funds rate prior to COVID-19, we believe it should be able to handle a similar rate today with the economy fully recovered and the employment rate nearly recovered. As we noted in our 1/10/22 *Strategic View: Let the Fed Do the Worrying* , we viewed the Fed's decision to raise rates as an endorsement for the economy's health - a market positive, in our opinion. While few investors appreciate Fed hikes, we believe that overall, the market prefers certainty to uncertainty, and may explain why stocks were up significantly following the announcement.

Stock Valuations have become more attractive: At the beginning of the year, one of the least attractive things about the stock market was its' high valuation. For that reason, our base case return scenario for US stocks was a modest 6-8% with high volatility, despite our expectation for a relatively strong economy. At the time, the S&P 500 was around 4800 and was trading for roughly 21 times 2022 estimated earnings. Today, the market multiple is about 2 multiple points cheaper (19x), making stocks more attractive to us. Not only has the broad US stock market gotten cheaper, but the valuations on some of the most speculative stocks have been eviscerated. Over the long run, we view that as a good thing, because it lessens the likelihood of a 'mega-bubble bursting', ala the 2000 tech bubble, which brought down the entire stock market and the economy.

The stock market's lower valuation is a mirage if earnings subsequently collapse, and thus we are watching analyst earnings revisions closely. However, so far earnings forecasts have stayed robust. It is interesting to note that research analysts continue to expect earnings growth over the next twelve months. Currently, analysts estimate the S&P 500 12-month forward earnings at close to $230 per share, a meaningful increase over the last year (Chart, right).

Volatility is here to stay: There is a reason that the cover of our *2022 Outlook* was adorned with a photo of John Travolta atop a mechanical bull in the 1980 film *Urban Cowboy*- we expected markets to 'buck' heavily in 2022 and try to throw investors out of their portfolios and carefully constructed financial plans. Thus far, the 'bucking' has been the result of stubbornly high inflation and Russian aggression, neither of which we anticipate disappearing from the radar screen anytime soon.



Source: Refinitiv Datastream, RiverFront data monthly as of 3/18/22. Chart shown for illustrative purposes only.

Message to investors: We believe that the investing landscape will remain challenging throughout 2022. While challenging, we continue to expect that stocks will end the year at prices above where they started. The prospects for investment grade bonds, on the other hand, seem far less attractive, in our view. Low starting yields and rising interest rates make meaningful returns unlikely. Additionally, we do not think that bonds should be relied upon to provide much downside protection while the Fed is raising interest rates since principal depreciation may more than offset the income a high-quality bond generates. In a challenging, volatile environment, we think active asset allocation becomes even more important. Given this is RiverFront's business model, such a recommendation may not be surprising. Our rationale is that volatile markets can influence investors into abandoning their investment plans at the worst times. Active asset allocation is designed to navigate these environments by increasing and decreasing equity exposure in a manner that gives an investor the confidence to stick with their plan. Mistakes will be made, and course corrections will be required, but we believe that these shifts will make a difference in portfolio returns and allow investors to sleep at night.

Important Disclosure Information:

The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Opinions expressed are current as of the date shown and are subject to change. Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

Chartered Financial Analyst is a professional designation given by the CFA Institute (formerly AIMR) that measures the competence and integrity of financial analysts. Candidates are required to pass three levels of exams covering areas such as accounting, economics, ethics, money management and security analysis. Four years of investment/financial career experience are required before one can become a CFA charterholder. Enrollees in the program must hold a bachelor's degree.

Information or data shown or used in this material was received from sources believed to be reliable, but accuracy is not guaranteed.

All charts shown for illustrative purposes only. Information or data shown or used in this material was received from sources believed to be reliable, but accuracy is not guaranteed. This report does not provide recipients with information or advice that is sufficient on which to base an investment decision. This report does not take into account the specific investment objectives, financial situation or need of any particular client and may not be suitable for all types of investors. Recipients should consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.

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

The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living. The CPI is one of the most frequently used statistics for identifying periods of inflation or deflation.

The federal funds rate is the target interest rate set by the Federal Open Market Committee (FOMC). This is the rate at which commercial banks borrow and lend their excess reserves to each other overnight.

The producer price index (PPI), published by the Bureau of Labor Statistics (BLS), is a group of indexes that calculates and represents the average movement in selling prices from domestic production over time. It is a measure of inflation based on input costs to producers.

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.

A basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. (bps = 1/100th of 1%)

RiverFront Investment Group, LLC ("RiverFront"), is a registered investment adviser with the Securities and Exchange Commission. Registration as an investment adviser does not imply any level of skill or expertise. Any discussion of specific securities is provided for informational purposes only and should not be deemed as investment advice or a recommendation to buy or sell any individual security mentioned. RiverFront is affiliated with Robert W. Baird & Co. Incorporated ("Baird"), member FINRA/SIPC, from its minority ownership interest in RiverFront. RiverFront is owned primarily by its employees through RiverFront Investment Holding Group, LLC, the holding company for RiverFront. Baird Financial Corporation (BFC) is a minority owner of RiverFront Investment Holding Group, LLC and therefore an indirect owner of RiverFront. BFC is the parent company of Robert W. Baird & Co. Incorporated, a registered broker/dealer and investment adviser.

To review other risks and more information about RiverFront, please visit the website at www.riverfrontig.com and the Form ADV, Part 2A.