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SUMMARY

- We anticipate a more challenging investment environment.
- We continue to favor stocks over bonds but believe more active management will be required to navigate these challenges.
- A trusted and experienced guide is critical, in our view.

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Global Warming...and We are not Talking About the Weather

A 'Warming' Investment Environment Can be Expected to Create Challenges for Investors

Nobody said that investing is easy, but we have a feeling that it is about to get significantly more stressful, as we have all learned over the last three trading days. The favorable tailwinds of cheap valuations, low interest rates, and benign geopolitics are diminishing. This statement does not make us bearish, and we continue to favor stocks over bonds. However, we recognize that stocks and bonds will need to work harder for their gains by delivering earnings and cashflow growth, rather than simply being pushed along by strong macroeconomic tailwinds.

Tactical View of the Market:

The global sell-off we are experiencing was triggered by disappointing jobs data late last week, leading markets to dramatically reprice the risk of a US recession. We believe both stock and Treasury markets are overreacting to a single summer payroll datapoint that was likely skewed by extreme weather, and that the economy overall remains solid. ISM Services data released Monday morning suggests to us that the bulk of the US economy continues to expand, as does earlier composite PMI data. Despite some volatility around high-profile announcements, earnings season has also been generally positive in our view. Before extrapolating too much into the last few days' movements, we would note that at least one 10%+ drawdown in a calendar year is a historically routine occurrence, even in the context of an otherwise healthy bull market. These types of selloffs can actually help recalibrate overly optimistic investor sentiment, serving as a useful reset of expectations that can allow a market to make further future gains.

For the S&P 500, we see important near-term technical support at 5,070 (what we would consider a relatively benign retracement of the strong rally that started last October) as well as the important psychological level of 5,000, which happens to represent a level near the 200-day moving average of the primary market uptrend. We expect the S&P 500 to hold this 5,000 level. However, in keeping with our motto of 'Process Over Prediction', we recognize that sometimes these sentiment-driven selloffs can push markets further down than fundamentals would otherwise suggest. Thus, we must be alert to overreactions, and our risk management processes are currently on high alert.

Here Are Why Things Are Heating Up

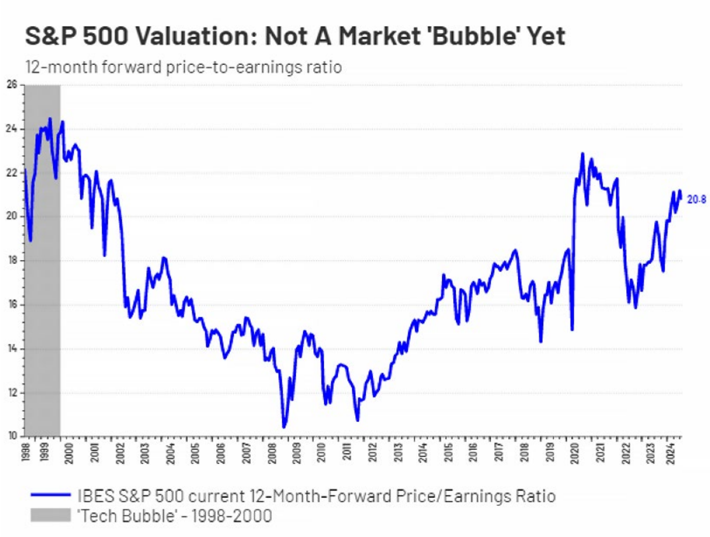
The cool breezes of sub-2% inflation and extraordinary economic stimulus are fading:

- **Rate tailwind dissipating:** The Fed is likely to lower short-term rates as they take a more balanced approach to adhere to their dual mandate (stable prices and full employment). In our view, this translates into cutting rates over the next few years to the rate of inflation, which we see as 2.5-3%. That means the 1-2% yields of the last decade are likely gone for the foreseeable future. We also don't expect the Fed's rate cuts to lead to much easing in long-term rates, which dictate borrowing rates on homes and autos. Instead, we anticipate that the 10-year Treasury Note will remain around 4%. While the Fed's likely next move is to lower rates, as long as inflation remains a threat, they will be less committed to 'easy' monetary policy. Their hyper-sensitivity to inflation data means that they can be expected to quickly change their stance if warranted, leading to more uncertainty and volatility in financial markets.

- **Economy may be slowing:** Throughout 2024 there have been signs that the positive effects from the enormous Covid-related monetary and fiscal stimulus programs have dissipated. Slowing economic activity can create a more difficult operating environment for public and private companies and thus challenge profitability. While we do not see a recession on the near-term horizon, we do anticipate challenges for several sectors and industries including retail, regional banking, branded consumer goods and pharmaceuticals.

Valuations have also gotten hot: We have always believed that valuation is a 'blunt instrument' when it comes to stock-picking, meaning that it tends to work best only at the extremes. Unfortunately, we expect valuation challenges (See chart, below) to remain over the next few years and perhaps even be exacerbated. This is because secular bull markets, like the one we are currently in, nearly always end in stock market bubbles. During bubbles some stocks remain expensive for longer than one would expect while other stocks remain cheap for equally lengthy periods.

This environment can be frustrating for traditional value investors. Furthermore, these periods are occasionally punctuated by strong counter-trend reversals, like the one we are currently experiencing with the weakness in US tech and the hearty bounce in US small-caps. Counter-trend reversals are particularly difficult because they challenge your viewpoints and carry with them a significant risk of whipsaws.



Source: LSEG Datastream, RiverFront; data monthly as of 08.01.24. Chart shown for illustrative purposes only. Past performance is no indication of future results. You cannot invest directly in an index.

Geo-Politics are on fire: A relatively benign geo-political environment has slowly given rise to a much less stable world order. In addition to the two 'hot wars' taking place between Russia/Ukraine and Israel/Palestine, the number of cold wars brewing is also escalating (China/US, China/Taiwan, North Korea/South Korea/Japan). Political stability is also an issue with almost half the world's population going to the polls in 2024 for national elections. Uncertainty and volatility are the by-products of elections, particularly with leading candidates across the globe moving off center and representing more extreme views. The US presidential election in November may get the most press, but election surprises have already occurred in countries like France, Mexico and India in 2024. Finally, the cooperative/collaborative environment that has existed among developed nations since the fall of the Berlin Wall in 1989 seems to be reversing with nationalism (anti-globalization) growing in popularity in many countries. Growing nationalism can be expected to challenge cross-border economic agreements and raise global tensions.

Conclusion: Investment Implications to the 'Global Warming' Theme:

1. **Don't let uncertainty paralyze implementation:** Without strong tailwinds, low valuations or macroeconomic certainty, investing can be scary. However, a well-prepared financial plan typically considers difficult investment environments just like this. In fact, this is one of the reasons that financial plans are so useful…they can provide clarity when the environment is murky. For this reason, we think it is especially important not to second guess your financial plan.

2. **Fundamental security selection matters more when valuations are high:** With earnings multiples near multi-decade highs, companies will need to deliver earnings and cashflow to 'grow into' their high valuations. Those companies that have simply benefitted from the 'rising tide' will face a more difficult future. Our emphasis on security selection is evident in our global portfolios that now hold a greater share of more granular investment vehicles and individual stocks as opposed to the more diversified securities we had previously favored. As a result, we feel our portfolios are more nuanced and less reliant on broad stock market strength or lower interest rates for returns.

3. **Flexibility will be important:** The future we anticipate will be dynamic and volatile, which calls for investment strategies that can quickly adapt to a changing world. Additionally, the more difficult environment will likely lead to more forecasting errors that will need to be corrected. Portfolio managers that are humble and flexible will more often outperform those that are overconfident and static.

4. **Time for a partner:** We believe that now, more than ever, investors need partners. Particularly the types of partners that have experience navigating a dynamic macro landscape. As the world heats up, we would like to be the partner that cools things down.

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.

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All charts shown for illustrative purposes only. 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.

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.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

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.

Index Definitions:

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.

Definitions:

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

The 200-day moving average is a popular technical indicator which investors use to analyze price trends. It is simply a security's average closing price over the last 200 days.

The Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors. It consists of a diffusion index that summarizes whether market conditions, as viewed by purchasing managers, are expanding, staying the same or contracting. The purpose of the PMI is to provide information about current and future business conditions to company decision-makers, analysts and investors.

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

Diversification does not ensure a profit or protect against a loss. 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.

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Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.

Valuation is the analytical process of determining the current or projected worth of an asset or company. Many techniques are used for doing a valuation. Among other metrics, an analyst placing a value on a company looks at the business's management, the composition of its capital structure, the prospect of future earnings, and the market value of its assets.

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