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SUMMARY

- Falling oil prices are a moderating influence on inflation, reducing 'Stagflation' risk.
- This is positive for US stocks. However, low oil prices are a negative for the energy sector, in our view.
- Tariff uncertainty delays Fed action.

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Inflation Continues to Cool

Falling Oil Prices Create Deflationary Tailwind

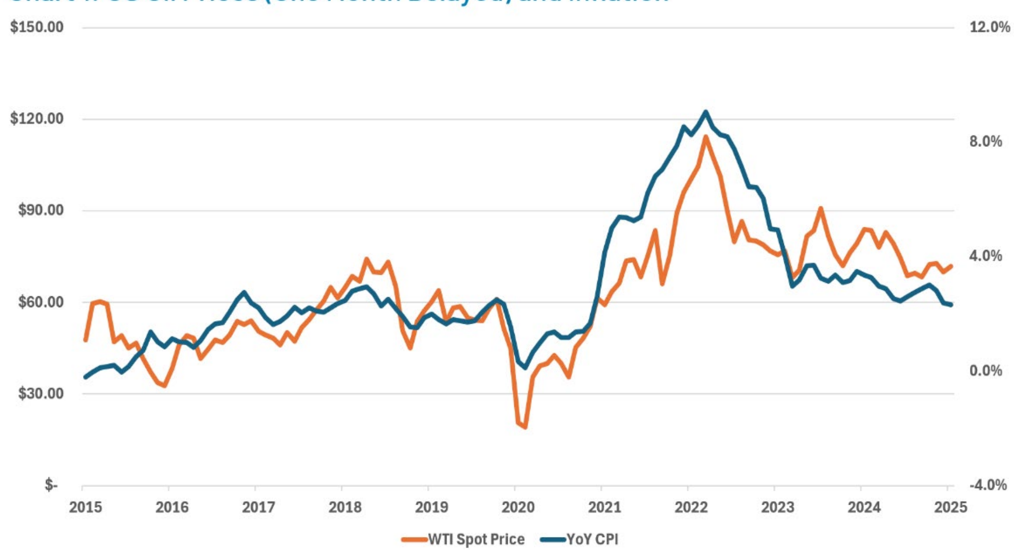
The April Consumer Price Index ('CPI') report was released last Wednesday and gave the Federal Reserve another positive data point in its inflation fight, as did Thursday's negative Producer Price Index ('PPI'). Headline CPI fell for the fourth consecutive month and is trending towards the Fed's stated, long-term inflation target of 2% (see chart 1, below). While consumer prices are unlikely to have been affected much by tariff policy yet, it appears from parsing PPI that companies are trying to shield consumers from large price increases. Regardless, we still view this as a positive sign, given the concern surrounding those tariffs and their effects on inflation. We have spilled much ink over the last several weeks discussing tariffs and instead would like to focus on oil prices and their impact on inflation. Oil prices are particularly interesting since they tend to be both a direct and indirect driver of inflation… meaning they impact core CPI and other indicators that the Fed is watching, even when oil prices are explicitly removed.

Inflation and Oil Prices: Closely Correlated

One of the major reasons we believe we have seen a continued downward trend in CPI is lower oil prices. In fact, looking at Chart 1 (below) we can see the relationship between WTI oil prices (left axis) and CPI (right axis).

This chart illustrates a strong relationship between the price of oil at the beginning of the month and the eventual CPI print for that month and shows the two data sets have a high correlation of roughly 0.8. As stated above, oil prices, as an input of CPI, directly drive inflation, but energy only makes up 7% of the CPI basket. Therefore, there must be second order effects present that cause the correlation between oil prices and CPI. Additionally, the correlation

Chart 1: US Oil Prices (One Month Delayed) and Inflation



Source: FactSet, RiverFront, data monthly, as of 04.30.2025. Chart shown for illustrative purposes only. Past performance is no indication of future results.

between CPI ex-Food and Energy ('Core CPI') is equally robust. As its name suggests, core CPI removes price changes in energy, so any correlation between oil prices and core CPI must come from second order effects.

Last month, the Organization of the Petroleum Exporting Countries ('OPEC') announced an increase in their output that, along with concerns about the global economy, sent West Texas Intermediate (WTI) prices below $60 per barrel. While they have recovered to the low $60's in the past couple of weeks, we believe the leading relationship between oil and CPI implies that May should provide further relief on the inflation front.

Conclusion: Falling Inflation Positive for Stocks...

Within the framework of our scenario analysis, which we discussed in last week's *Weekly View*, **relatively tame inflation moves our probabilities more towards positive scenarios for the US stock market and reduces the odds of 'Stagflation'.** Specifically, if inflation remains benign, it allows the Fed more room to support the economy with rate cuts, if necessary. Lower rates are also a key element of a 'Value Rotation.' For most value-centric sectors such as cyclical industrials, materials and smaller-capitalization companies, their debt and interest expenses are very close to market interest rates. As such, when the Fed reduces rates, these companies can get a reprieve from this debt burden and their 'operating leverage' (how much of a company's top-line revenue can be converted into bottom-line earnings and cash flow) can be unlocked.

While falling oil prices give optimism for continued moderate inflation, the impact of tariffs still looms. If high tariffs come back on to the negotiating table, the moderating of inflation becomes much less certain. Even with lower blanket tariff rates of around 10%, the effect on CPI is likely to be a one-time increase of at least a percent, in our view. All of this is especially important given the Fed's 'data dependent' stance. As demonstrated by their current pause, the Fed is willing to let economic data play out completely before they return to their cutting cycle; the Fed is not willing to over-extrapolate a single data point to justify cutting interest rates. Instead, we believe the Fed is going to wait for tariff negotiations to play out before they access their impact, especially while the job market remains resilient. As such, we currently are not expecting a cut this year, meaning any value rotation is placed on the back burner.

...But a Headwind for the Energy Sector

While we still believe 'breakevens' (the price of oil that makes drilling a certain well economically beneficial for an energy company) for the US energy sector are below current oil prices, the recent fall in price has made this margin tighter. Additionally, as we discussed above, we have recently reduced our probabilities of an entrenched 'Stagflation' scenario. In RiverFront's asset allocation portfolios, we have utilized US energy allocations in the past to help hedge the portfolio against the risk of this particularly negative scenario. Taking both falling oil prices and the change in our scenario analysis, we have reduced our energy exposure and are now currently close to neutral energy weight relative to our benchmarks. The energy positions we do hold have a focus on US energy over international energy producers. In our longer-time horizon portfolios, we also emphasize individual energy companies with a strong management team and access to investment grade debt.

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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.

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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.

Definitions:

Stagflation is an economic cycle characterized by slow growth and a high unemployment rate accompanied by inflation. Economic policymakers find this combination particularly difficult to handle, as attempting to correct one of the factors can exacerbate another.

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

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 Producer Price Index (PPI) is a measure of inflation at the wholesale level. It's compiled from thousands of indexes that measure producer prices by industry and product category. The index is published monthly by the U.S. Bureau of Labor Statistics (BLS).

The Organization of the Petroleum Exporting Countries (OPEC) refers to a group of 12 of the world's major oil-exporting nations. OPEC was founded in 1960 to coordinate the petroleum policies of its members and to provide member states with technical and economic aid.

West Texas Intermediate (WTI) is a grade of crude oil and one of the main three benchmarks in oil pricing, along with Brent and Dubai Crude. WTI is considered a high-quality oil that is relatively easy to refine.

Interest rate sensitivity is a measure of how much the price of a fixed-income asset will fluctuate as a result of changes in the interest rate environment. Securities that are more sensitive have greater price fluctuations than those with less sensitivity. This type of sensitivity must be taken into account when selecting a bond or other fixed-income instrument the investor may sell in the secondary market. Interest rate sensitivity affects buying as well as selling.

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.

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