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SUMMARY

- Government bond yields have moved up quickly since December, spooking stock investors, in our view.
- Bond yields are reflecting both positive news about the economy, as well as investor concerns over inflation.
- We believe the stock bull market will remain intact but are watching the 5% yield level on the 10-year closely.

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Not Time Yet for Stocks to Worry About Rising Rates

For the stock market, Christmas came early. The 'Santa Claus' rally began after the election and petered out in early December. Since then, there has been a bit of a correction in US markets, with declines most pronounced in value and small cap stocks. The culprit, in our view, has been rising bond yields and excessive investor optimism. Government 10-year bond yields briefly eclipsed 4.80% last week, from a low of 4.15% in mid-December and 3.6% back in September (Chart 1, below). Rising interest rates have hurt more cyclical industries, hence the underperformance by small caps and value sectors.

Chart 1: Big Move Up in Rates Since December

Source: LSEG Datastream, RiverFront. Data daily as of January 16, 2025. Chart shown for illustrative purposes only. Past performance is no indication of future results.

Sentiment Less Frothy, But Concerns Over Inflation Linger

Let us look at the two factors we believe have led to the recent weakness in stocks. First, investor sentiment became a bit frothy in the wake of optimism over incoming President Trump's deregulation policies. The good news is that the recent selloff has essentially removed the froth, with NDR Research's Daily and Weekly crowd sentiment polls now both back in the 'neutral' zone. We view this sentiment drop as the type of healthy reset necessary for a continuation of a bull market… but admit that the fast recent rise in bond yields is more of a concern to us.

Historically, 10-year bond yields are sensitive to both growth and inflation expectations, in our view. As markets collectively shift their view of economic growth higher, generally bond yields remain elevated as demand for 'recession insurance' - how government bonds are often viewed, given their minimal default risk - tends to drop. The Federal Reserve also tends to be less likely to lower interest rates when growth is strong, as monetary stimulus is not necessary when consumer and business confidence abounds. We view rising rate dynamics for growth reasons as generally 'benign' for the stock market because stronger economic growth is generally correlated to stronger corporate earnings growth, one of the most important intermediate term drivers of stocks. In our view, the increase in rates from September through the election was largely driven by rising growth expectations.

However, a more concerning reason for bond yields to rise is if inflation concerns rise, and future inflation expectations embedded in bond markets become unmoored. We believe this dynamic has been in place since December, with investors now focusing on the unknown inflation impacts of some of Trump's potential tariff policies. Rising inflation expectations are potentially negative for stock markets because high inflation tends to sap the valuation multiples investors assign to future earnings, causing stock prices to drop... even if earnings trends do not suffer. Furthermore, if inflation causes rates to rise above certain thresholds and stay elevated, the second order effect on the economy and thus corporate earnings can also be negative, in our view. This is because prohibitively high rates can spook corporate managers, choke off capital expenditures and raise costs for businesses and consumers.

U.S. Bull Market Should Remain in Place if Rates Stay Below 5%...As We Are Expecting

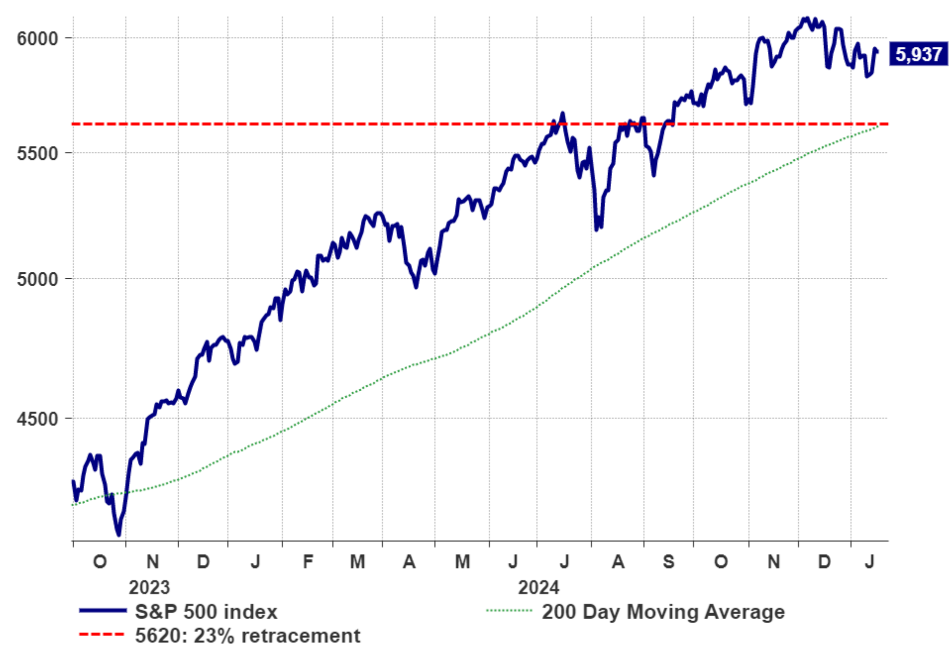
We believe that 10-year Treasury yields below 5% are not a threat to the bull market in stocks. Last week's relatively benign inflation data - with both core consumer and producer prices growing slower than expected - seemed to support this view, as bond yields fell from recent highs and stocks rose. **Only if 10-year yields start trading meaningfully above this 5% 'watch zone' (see red dotted line on Chart 1, previous page) do we believe this bull market is threatened. We assign only a roughly 20% probability of this happening over the next 12 months, as outlined in our recently published 2025 Outlook.**

In our Outlook, our 10-year yield target is 4.75% by the end of the year in our Base Case (highest probability) scenario, a level not far from current levels. If yields do not move meaningfully higher from current levels, we believe stocks can find their footing as we remain optimistic about US economic and earnings growth. In this environment small-and-mid-cap companies should also respond positively and recover from the recent sell-off.

In terms of technical risk management levels on the S&P 500, the index has not yet come close to testing the 23% retracement of its rally from the October 2023 low at around 5600 (red dashed line, Chart 2, right), which also corresponds to the current 200-day moving average (green dotted line). Thus, we continue to regard any dips that halt before that level as just 'noise.'

We continue to favor equities over fixed income in our asset allocation portfolios, particularly in our longer-term focused, more risk-tolerant portfolios where we have a larger relative pro-equity positioning. In our shorter-term portfolios we like the yield opportunities in Treasuries and high yield bonds, and thus the magnitude of our stock overweight is lower.

Chart 2: S&P 500 WITH RIVERFRONT SUPPORT LEVELS



Source: LSEG Datastream, RiverFront. Data daily as of January 17, 2025. Chart shown for illustrative purposes only. Past performance is no indication of future results.

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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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.

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.

A small-cap stock is a company with a market capitalization between $250 million to $2 billion. The precise figures used can vary among different brokerages, so this is a guide to their classification.

The 10-year Treasury bond yield is the interest rate the U.S. government pays to borrow money for a decade, serving as a benchmark for other interest rates and a key indicator of investor sentiment about economic conditions.

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

Dividends are not guaranteed and are subject to change or elimination.

The 200-day simple moving average (SMA) is considered a key indicator by traders and market analysts for determining overall long-term market trends. It is calculated by plotting the average price over the past 200 days, along with the daily price chart and other moving averages.

Definitions:

A Santa Claus rally refers to the sustained increases found in the stock market during the last five trading days of December through the first two trading days of January.

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

A recession is a significant, widespread, and prolonged downturn in economic activity. A common rule of thumb is that two consecutive quarters of negative gross domestic product (GDP) growth indicate a recession. However, more complex formulas are also used to determine recessions.

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

US small and mid cap equities include equities of companies with a market capitalization below $10 billion. 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.

High yield bonds are debt securities often referred to as "high-yield" or "junk" bonds issued by corporations. High-yield bonds tend to pay higher interest rates because they have lower credit ratings than investment-grade bonds. High-yield securities (including junk bonds) are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.

Treasuries are government debt securities issued by the US Government. Treasury securities typically pay less interest than other securities in exchange for lower default or credit risk. With relatively low yields, income produced by Treasuries may be lower than the rate of inflation.

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.

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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