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SUMMARY

- Markets react to decelerating inflation data, despite the Fed's concerns.
- All broad asset classes had positive performance in Q4; inflation-sensitive themes did best, in our view.
- Our strategy is to tactically add fixed income if yields rise and inflation-sensitive themes if earnings accelerate.

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Q4 2022 Recap: Markets and Fed Singing Different Tunes in Q4

WAITING FOR EARNINGS CONFIRMATION BEFORE WE SING ALONG

Quarterly Recap: Markets Key in on Slowing Inflation; Fed Continues to Warn of More/Longer Tightening

Financial markets and the Federal Reserve seemed to be at odds in the fourth quarter. The Fed and other central banks continued to raise interest rates aggressively and tried to convince investors that they will keep interest rates higher for longer due to the high level of inflation. Despite this, stock and bond markets delivered positive returns as investors focused on the deceleration in the inflation data, rather than the level. Investors seem to believe that, despite what they are saying, central banks will be able to pause, and perhaps begin lowering rates in 2023.

We tend to agree that inflation is cresting, particularly as energy prices decline and large companies begin to shed jobs. In our view, these are all encouraging signs that the Fed and its peers are making headway in their attempts to fight inflation. However, we also believe the Fed's insistence that the fight against inflation will take longer and be fiercer than most investors are expecting.

Against this backdrop, we see two ways that markets could continue to rise from here. The most likely upside scenario we see is that earnings and the economy remain resilient even as the Fed continues its current path. The second is that Q1 inflation data strongly decelerates, allowing Fed Policy to be less contractionary, a scenario we view as less likely. On the other hand, either a large breakdown in earnings or a re-acceleration of inflation, which would force the Fed to accelerate rate hikes, would lead to worse market outcomes, in our view. While we believe these negative scenarios are less likely, future earnings announcements and inflation data are critical inputs moving forward.

Returns Recap: Markets Bounce in Q4; Inflation-Sensitive Equities Lead

The dichotomy of elevated but cooling inflation also drove return differences in the equity market, in our view. This dichotomy led to cyclical-oriented stocks, whose business models benefit from inflation-driven revenue growth, to outperform growth-oriented stocks, whose share prices tend to react negatively to rising interest rates. As such, markets with less growth-oriented stocks – such as international equities, small cap US equities, and emerging markets – all outperformed the US in the fourth quarter (see chart, left). Apart from emerging markets and global equities, all of these value-oriented markets also ended up outperforming US Large Cap for the entire year.

BROAD ASSET CLASSES

Q4 2022	Q4 2022	Trailing Twelve Months
DEVELOPED INT'L EQUITIES	17.3%	-14.5%
GLOBAL EX-US EQUITIES	14.3%	-16.0%
US SMID CAP	10.3%	-14.0%
GLOBAL EQUITIES	9.8%	-18.4%
EMERGING MARKET EQUITIES	9.7%	-20.1%
US LARGE-CAP	7.6%	-18.1%
HIGH YIELD	4.0%	-11.2%
FIXED INCOME INV GRADE	1.9%	-13.0%
CASH	0.9%	1.5%
US TREASURIES	0.7%	-12.5%

Source: Morningstar. Data as of December 31, .2022. Chart shown for illustrative purposes only. Past performance is no guarantee of future results. Not indicative of RiverFront portfolio performance.

International markets outperformed the US for macro and micro reasons. From a macro perspective, international markets benefitted from their currencies rebounding versus the dollar. A combination of aggressive central bank moves overseas and lower risk from the war in Ukraine benefitted non-dollar currencies in the fourth quarter. As you can see from the table below, European markets benefitted from a 9% rise in their currencies, which when combined with strong 10.4% equity returns, led to a combined 19.3% gain. From a micro perspective, investors began to price moderate levels of inflation into value stocks. As earnings are reported, we will be looking for earnings growth to justify the rising stock prices. If these companies are able to deliver, we think it might set up international equities for long-term investment rather than short-term tactical trades.

International Market Returns	In USD		In Local		Currency Impact	
MSCI Total Return Net	**Q4 2022**	**Year Over Year**	**Q4 2022**	**Year Over Year**	**Q4 2022**	**Year Over Year**
Europe	19.3%	-15.1%	10.4%	-8.5%	9.0%	-6.5%
EAFE	17.4%	-14.0%	8.8%	-6.5%	8.6%	-7.5%
United Kingdom	17.0%	-4.8%	8.6%	7.1%	8.4%	-12.0%
China	13.5%	-21.9%	12.5%	-20.7%	1.0%	-1.2%
Japan	13.2%	-16.6%	3.2%	-4.5%	10.0%	-12.2%
Emerging Markets	9.7%	-20.1%	6.6%	-15.5%	3.1%	-4.6%
United States	7.6%	-18.1%	7.6%	-18.1%	0.0%	0.0%
Canada	7.4%	-12.9%	5.9%	-6.5%	1.5%	-6.3%

Source: Bloomberg. Data as of December 31, 2022. Chart shown for illustrative purposes only. Past performance is no guarantee of future results. Not indicative of RiverFront portfolio performance.

Finally, fixed income returns were still volatile for the quarter, but ended up being positive and better than cash for the first time this year. More volatile bonds that 'look like stocks', such as high yield, were the highest performers amongst fixed income, with default data still well below historical averages and yields starting the quarter elevated. Our belief continues to be that interest rates will ultimately rise from here, but that higher starting yields means that 2023 will not be a repeat of the challenging returns of 2022.

US Sectors: Inflation-Sensitive Stocks and Cyclical Stocks Beat Tech and Growth

Looking under the hood at US sectors (see chart, right), we see a similar theme where value-oriented sectors continued to outperform growth-oriented sectors, with more defensive sectors like Health Care and Consumer Staples returning positive results somewhere between value and growth. Our outlook here is the same as international – we will look carefully at Q1 earnings and guidance, which could provide evidence of a structural shift from a growth-stock led market to a value-led one.

US SECTORS

Sector	Q4	Trailing Twelve Months
Energy	22.7%	64.6%
Industrials	19.1%	-5.2%
Materials	15.0%	-11.9%
Financials	13.4%	-10.8%
Health Care	12.6%	-2.5%
Consumer Staples	12.5%	-0.2%
Utilities	8.5%	1.8%
S&P 500	**7.6%**	**-18.4%**
Information Technology	5.1%	-28.1%
Real Estate	3.7%	-26.1%
Communication Services	0.5%	-38.5%
Consumer Discretionary	-9.1%	-36.4%

Source: Factset. Data as of December 31, 2022. Chart shown for illustrative purposes only. Past performance is no guarantee of future results. Not indicative of RiverFront portfolio performance.

Defensive stocks held up remarkably well in 2022, as recession fears have entered the market, and earnings have been surprisingly resilient for these companies in the face of inflation. However, we are cautious on defensives looking into 2023, and we will be watching for evidence of increasing input cost pressures impacting profit margins.

Technology and Communication Services continued to lag the defensive and cyclical sectors, despite the respite in rate increases. We believe this is due to concerns about the profitability of these sectors. Real Estate also struggled, which we believe is due to the slowing of inflation, coupled with a slower recovery in office traffic and associated consumer spending, which also caused weakness in the discretionary companies.

Moving forward, we believe selection within sectors will be important. In 2023, we believe it will be key to identify cyclical stocks whose earnings merit the increase in multiples and equally important to identify growth-oriented stocks whose resilient earnings have been overly discounted.

Outlook: Cautiously Optimistic About 2023

2022 ended up being the worst year for balanced portfolios in over 50 years. The enthusiasm we feel for the "reset" in stock and bond valuations is somewhat tempered by our belief that the Fed will tend to be more aggressive than the market thinks, which will likely mean higher rates for longer. While interest rates starting at higher levels goes a long way to lower the risk of a repeat of 2022 fixed income returns, we believe that earnings will continue to decelerate (although less than current market consensus), and if inflation rears its head again, we could end up with a challenging first half of the year.

We continue to believe that a prudent path forward is to opportunistically add fixed income at higher yields, and to make allocations into inflation-sensitive equity sectors in markets as earnings come through. While this strategy may not perfectly time the bottom of market, we believe it is prudent to wait for signs of earnings confirmation before increasing our allocation to stocks.

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.

Index Definitions

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

S&P 1000 Index TR USD (US SMID Cap) is a combination of the S&P Mid Cap 400 Index TR USD & S&P Small Cap 600 Index TR USD.

MSCI EAFE Index NR USD (Developed International Equities) is designed to represent the performance of large and mid -cap securities across approximately 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the US and Canada. Net total return indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to nonresident institutional investors who do not benefit from double-taxation treaties.

MSCI Emerging Markets Index NR USD (Emerging Market Equities) is an equity index that captures large and mid cap representation across approximately 25 emerging markets (EM) countries.

MSCI Europe Index represents the performance of large and mid-cap equities across approximately 15 developed countries in Europe.

MSCI Japan Index designed to measure the performance of the large and mid cap segments of the Japanese market.

MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

MSCI United Kingdom Index (USD) is designed to measure the performance of the large and mid cap segments of the UK market.

MSCI Canada Index is designed to measure the performance of the large and mid cap segments of the Canada market.

The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market.

ICE BofA High Yield Index TR USD (High Yield) tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. Index constituents are capitalization-weighted based on their current amount outstanding times the market price plus accrued interest.

Bloomberg Capital US Treasury Index TR USD (Treasury Bonds) measures the performance of the US Treasury bond market.

Bloomberg US Aggregate Bond Index TR USD (Fixed Income Investment Grade) is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. The issues must be rated investment grade, be publicly traded and meet certain maturity and issue size requirements.

Bloomberg Capital 1-3 Month US Treasury Bill Index TR USD (Cash) includes all publicly issued zero-coupon US Treasury Bills with a remaining maturity between one and three months, are rated investment-grade and have an outstanding face value of $250 million or more.

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

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.

High-yield securities (including junk bonds) are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.

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.

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

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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