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SUMMARY

- The Fed is likely to raise rates again, in our view.
- The Trend is positive, this suggests to us an upside target of 4800 on S&P 500.
- Crowd Sentiment has us on alert for a pullback.

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Tactical Rules Give the Green Light

Portfolios Favor Stock Exposure

RED LIGHT	FLASHING RED	YELLOW LIGHT	FLASHING YELLOW	FLASHING GREEN	GREEN LIGHT

Since the last update of our Three Tactical Rules on June 6th, financial markets continue to grapple with whether inflation has fallen enough for the Fed to end its rate hiking cycle. While there has been no definitive answer, investors are becoming increasingly more comfortable with the idea that inflation will linger for some time above the Fed's 2% target. Hence, the focus has moved to earnings and Corporate America's ability to adapt to the new economic reality. Over the past 2 months, our tactical rules have had to adapt as well. We have seen "Don't Fight the Fed" move from a flashing red light to a solid red light, "Don't Fight the Trend" move from a flashing green light to a solid green light, and "Beware of the Crowd at Extremes" move from a solid green light to a flashing red light. While the individual rules have made significant changes in the last 2 months and collectively would align with a yellow light, the heatmaps we overlay on the tactical rules are more favorable in our view, and thus shift the combined quantitative signal to a solid green light.

Don't Fight the Fed: Fed is Prepared for Additional Hikes, Despite Inflation Easing

RED LIGHT

The Fed raised the fed funds target range to 5.25-5.50% at last week's meeting, and it left the door open for further hikes if the economic data shows little signs of slowing. The Fed sees inflation as being elevated despite headline inflation falling to 3% in June. The Fed is focused on core inflation which strips out the volatile categories of food and energy. Its preferred inflation gauge, core Personal Consumption Expenditures (PCE), currently sits at 4.1%, well above the 2% target. Additionally, the continued strength of the labor market has made the Fed more determined to slow the economy before declaring victory. Therefore, we believe that the Fed will raise rates once more this year despite the belief that the economy has yet to fully absorb the previous monetary policy moves. Our forecast is for the fed funds terminal rate to be 5.625% at year-end. This is 25 basis points higher than we expected previously. Given that we expect another rate hike, we believe that the Fed has moved back to a red light.

Internationally, the Bank of England (BoE) and European Central Bank (ECB) find themselves in similar positions to the Fed, having recently hiked interest rates to tame persistent inflation. The BOE raised its policy rate to 5% in June and is facing additional pressure to raise rates at its August 3rd meeting. As for the ECB, it raised its deposit facility to 3.75% and its main refinancing rate to 4.25% on July 27th, and like the Fed left the door open to do more, as inflation is still well above their 2% target. We believe the willingness of international central banks to contemplate additional hikes means they too have moved back to a red light.

Don't Fight the Trend: The Decisive Breakout Could Propel the S&P 500 to Test 4800

GREEN LIGHT

The trend on the S&P 500, which we define as the 200-day moving average, has accelerated since our last update, when the index was trading in a narrow range between 4050 and 4200. The decisive breakout above 4200, has the trend rising at an annualized rate of 28%. We believe the strength of the trend will continue for several months even if the S&P 500 holds its current level of 4580 (see chart below). Historically, a positive trend is good for future stock returns, and we believe that this time is no different. Thus, domestically our rule of "Don't Fight the Trend" is signaling a green light which calls for stock exposure above long-term targets, in our view.

Internationally, the trend of the MSCI All Country World ex-US index is also accelerating at a rapid pace. The international primary trend is currently rising at an annualized rate of 26% (see chart below). Much like its domestic counterpart, we believe the international trend will remain positive for several months, if current levels were to hold. Therefore, the international trend is also signaling a green light for higher stock exposure relative to long-term targets, in our view.

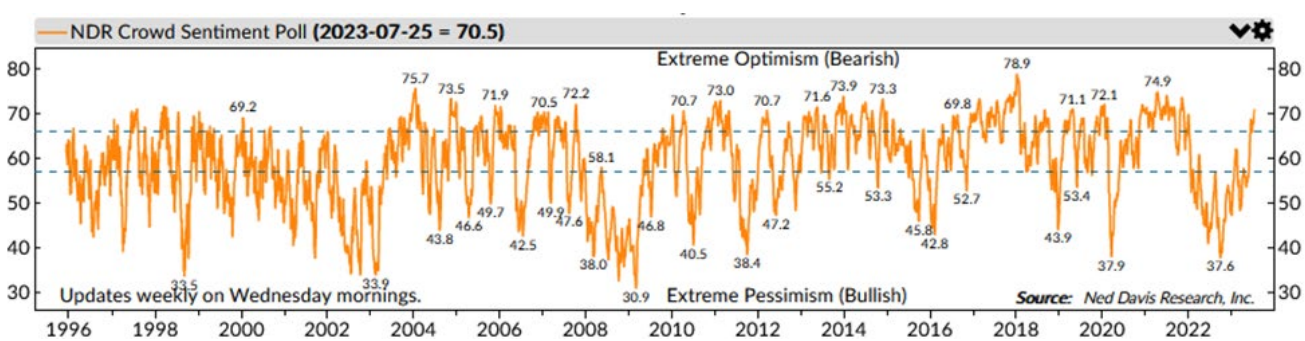
Data daily as of July 28, 2023. Charts shown for illustrative purposes. Not indicative of RiverFront portfolio performance. Index definitions are available in the disclosures.

Beware of the Crowd at Extremes: On Alert for a Pullback

FLASHING RED

We regard Crowd Sentiment as the contrary indicator of the Three Tactical Rules. Since the beginning of the year, the crowd has been either neutral or in extreme pessimism as investors attempted to handicap and navigate the evolving monetary policy landscape. The chart below shows a measure of investor sentiment as calculated by Ned Davis Research. When the line is high it shows extreme optimism, and when it is low, extreme pessimism. This is our preferred data source to measure investor psychology, though we use our own analytical framework from which to draw conclusions on sentiment.

Currently, the indicator is in extreme optimism and nearing all-time highs, which is negative for stocks. However, our quantitative process, which combines sentiment and trend, is positive. Therefore, we believe sentiment is only suggesting the possibility of a normal pullback in the greater uptrend. Thus, viewing the Crowd at Extremes through this lens only would indicate a flashing red light in our rating continuum.



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Conclusion: Signals are Mixed, but Quantitative Process Signaling a Greenlight.

The combined signals looking through the qualitative lens as discussed through this piece are signaling a yellow light and would warrant a neutral position in the portfolio's stock and fixed income composition. However, our quantitative process, which combines trend and crowd sentiment to forecast the probability of the S&P 500 having positive returns over the next three months, is signaling a green light. When we combine the qualitative and quantitative signals, we arrive at a more positive conclusion than the three rules would suggest in isolation. For this reason, we continue to favor stocks over bonds in our balanced portfolios.

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.

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.

MSCI ACWI ex USA Index captures large and mid cap representation across approximately 22 of 23 developed markets (DM) countries (excluding the US) and approximately 25 emerging markets (EM) countries.

Definitions:

Personal consumption expenditures (PCE), also known as consumer spending, is a measure of the spending on goods and services by people of the United States.

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 European Central Bank (ECB) is the central bank responsible for monetary policy of the European Union (EU) member countries that have adopted the euro currency. This currency union is known as the eurozone and currently includes 19 countries. The ECB's primary objective is price stability in the euro area.

The Bank of England (BoE) is the central bank of the United Kingdom. The BoE oversees monetary policy and issues currency. It also regulates banks, financial firms, and payment systems. Like other central banks, the BoE may act as a lender of last resort in a financial crisis.

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.

Don't Fight the Fed – 'Supportive' means the Fed's monetary policy regarding inflation and employment is in what we believe based on our analysis to be the investors' best interest; 'Against' means the Fed's monetary policy, in our view, is going against the investors' best interest; 'Neutral' means the Fed's monetary policy is neither supportive or against the investors' best interest in our view. Don't Fight the Trend – Terms correlate to the 200-day moving average as it relates to the equity indexes: 'Positive' means that the trend is rising, 'Flat' means the trend is flat, 'Negative' means the trend is falling. Beware the Crowd at Extremes – Terms correlate to the NDR Crowd Sentiment Poll and its measurement of Extreme Optimism (Bearish), Neutral, or Extreme Pessimism (Bullish).

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