April 18, 2016

THE WEEKLYVIEW

Better News Globally: Oil Prices and China Stabilize

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Global growth is tepid, few would dispute that, but markets are typically influenced by changes at the margin. Global stocks and most risk assets, including oil, bottomed on February 11. Since then, the S&P 500 stock index and non-US stocks (as measured by Datastream) are up about 14% as of Friday.

Despite our consistent view that lower oil prices are a net benefit to the world, it is undeniable that stocks in the US and especially outside the US have struggled to make any ground since mid-2014, when oil prices peaked.

As our Weekly Chart (page 2) shows, the decline in oil prices was exacerbated by a surge in the dollar since oil is priced in dollars. (In the chart the dollar is inverted to show the relationship more clearly). Our chart shows that international markets in dollar terms rarely outperform when the dollar is rising (2011 – 2015) and generally outperform when it is falling (2002 – 2008, indicated by the arrow on the chart). It is also important to note that in 2015 developed international markets did better than the US in local currency terms – benefitting domestically from the strong dollar, which is why it was so important to be hedged back into the dollar.

All this begs the question of why the markets have turned up in the last month and why international markets have led the rally. We believe it is because of perceptions of the risk of a 2016 recession.

There was real fear in the first six weeks of 2016 that falling commodity prices were indicating an impending global recession, with the greatest fears focused outside the US. The bears were pointing to this and other market indicators, such as declining corporate bond prices relative to government bond prices (i.e., widening credit spreads), to justify falling stock prices. Although our risk management team was fully engaged, we consistently argued that we thought these fears were overblown, hence our return to a fully invested position. The stabilization of oil prices above $35 per barrel and the subsequent rise in corporate bond prices and stocks reflect that the data continues to show slow economic growth and not recession, in our view.

A technical factor that has amplified these moves has been the activity of sovereign wealth funds, the large pools of capital that some nations (especially those with significant commodity reserves) chose to accumulate during the good times. As commodity prices fell, they became forced sellers in order to meet their domestic budgets; in turn, traders anticipated more selling every time commodity prices, especially oil, fell, leading to a self-sustaining momentum trade until oil reversed in price.

Another important factor has been China. Since the summer of 2015, there has been speculation that the Chinese currency would devalue significantly, and China has had to use its capital surplus to defend its currency against those speculators. Since China's currency is still tightly controlled by the state, the speculators have so far failed to greatly influence the exchange rate.

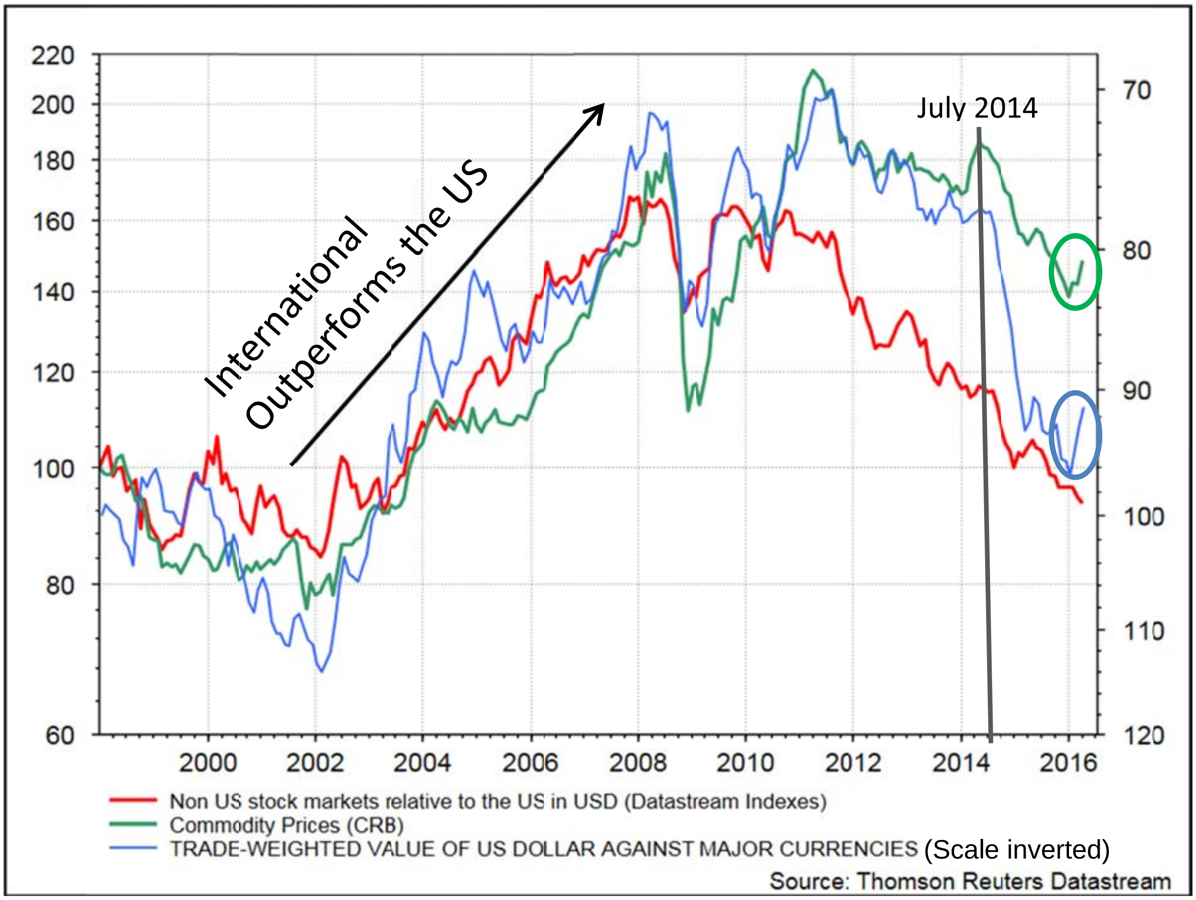
In addition, China has focused its attention on doing "whatever it takes" to improve the domestic economy. The latest data out of China seem to show that the government's push to improve economic activity is starting to work:

1. First-quarter Nominal GDP rose 7.2% year over year (Y/Y), the fastest growth since the fourth quarter of 2014;
2. Retail sales were up 10.5% Y/Y in March; and
3. Investment was up 11% Y/Y in March. Fixed asset growth seems to have stabilized in the first quarter at around 10%, down from an unsustainable 25% in 2011.

As these are all government data points, we should question the levels, but we believe it is important to notice the trends, which are stabilizing and even starting to rise. Most private economists we follow on China concur with a stabilization message.

In conclusion we believe the data around the world is not living up to the bears' view of an imminent recession, but rather supports our view of slow growth, which allows central banks to remain very supportive and makes the case for holding onto stocks — especially overseas stocks.

THE WEEKLY CHART: INTERNATIONAL RELATIVE PERFORMANCE LINKED TO DOLLAR AND COMMODITY PRICES – RECENT STABILIZATION IS HEALTHY



Past performance is no guarantee of future results.

Important Disclosure Information

Past performance is no guarantee of future results.

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Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market. It is not possible to invest directly in an index.

Buying commodities allows for a source of diversification for those sophisticated persons who wish to add this asset class to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any commodity purchase represents a transaction in a non-income-producing asset and is highly speculative. Therefore, commodities should not represent a significant portion of an individual's portfolio.

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.

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