(From right to left)

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We expect eurozone stock markets can perform in-line with corporate earnings growth in 2016, which we expect to see in the high single-digit/ low double-digit range for the broad eurozone index.

Eurozone: Policy and Earnings Are Key

Stock prices tend to be dictated by two components over time: (1) the trend of corporate earnings; and (2) the valuation the market is collectively willing to assign to those earnings. Of those two, we believe corporate earnings trends hold the key to Europe's stock performance in 2016. We believe the eurozone is in the early innings of a positive earnings cycle. For instance, few have noted that 2015 marked the first year in quite a while in which eurozone large-cap companies out-earned their US peers – a trend likely to continue in 2016, in our opinion. This positive cycle comes after a lengthy and pronounced drought (by our calculations, European earnings are still roughly 30% below their 2007 peak) and should be aided by an accommodative European Central Bank (ECB), a relatively weak euro, and low energy input costs. Unfortunately, these tailwinds are largely absent in the UK, where earnings are likely to remain disappointing.

As for valuation, our base-case scenario in the eurozone assumes no meaningful price-to-earnings expansion from current levels. This is largely due to the fact that earnings multiples already expanded from 2012 to mid-2015, in effect anticipating some of this coming positive earnings cycle. With the forward earnings multiple dropping nearly 2 percent since this summer's stock price weakness, it is possible to build an even more optimistic scenario for the eurozone, noting that low inflation and interest rates have historically created the condition for higher-than-average valuations. But this would require headline risk in Europe decreasing in 2016. With elevated sensitivity surrounding geopolitics, controversy over ECB policy, and volatility in emerging market economies, we acknowledge that European headlines may remain challenging and markets volatile in 2016.

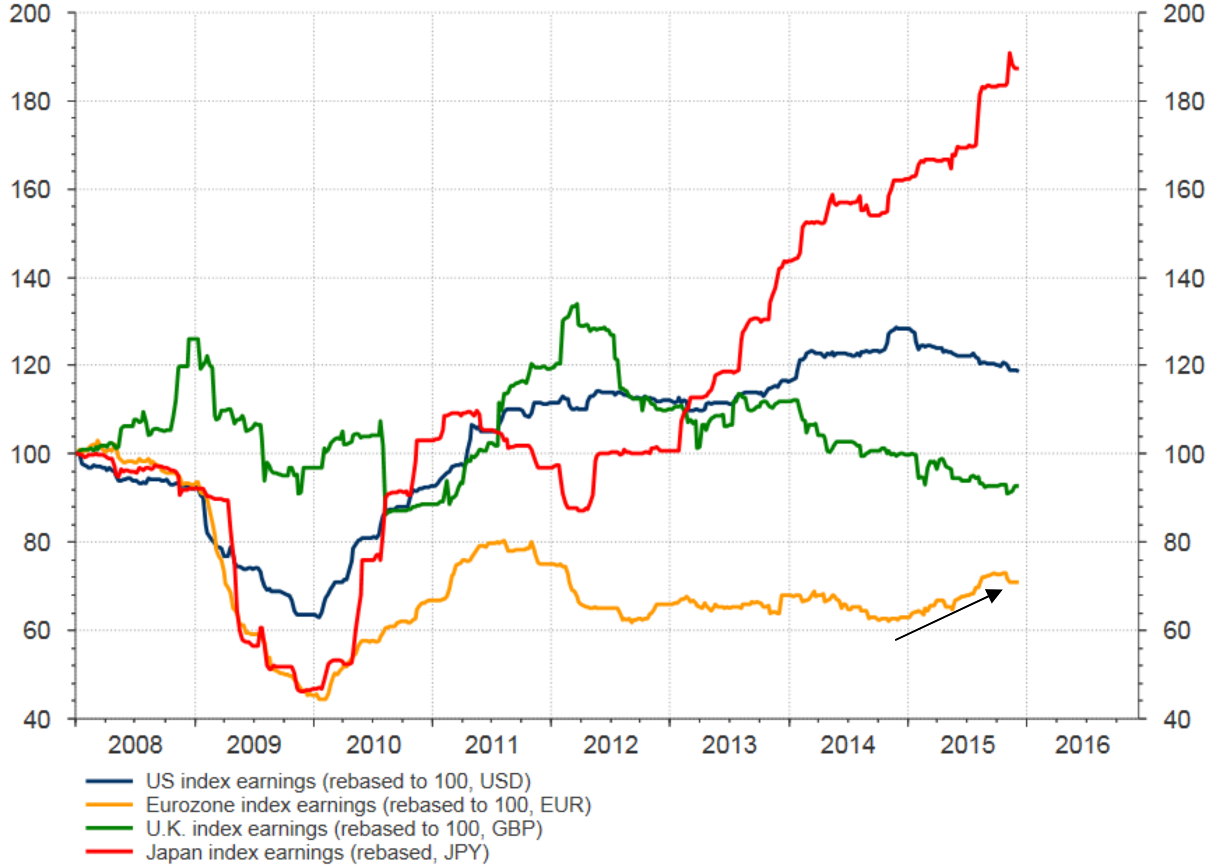
Based on both rate differentials and relative size of central bank balance sheets, our view is that the euro will likely resume its downward trend versus the dollar at some point in 2016. If this happens, it would suggest that US investors should continue to hedge at least part of their euro exposure relative to the US dollar in 2016. This would also suggest to us that eurozone corporate earnings will continue to be aided by currency.

As demonstrated by the aftermath, equity and currency market sentiment got ahead of itself going into the December 3rd ECB meeting; thus, stock bulls and euro bears alike were momentarily punished (see *Weekly View* dated December 7, 2015, for more on this). However, we disagree with the prevailing market view that the ECB, by disappointing markets in December, has permanently damaged its credibility. In a year dominated by ugly headlines (Greece, refugee crisis, terrorism, etc.) it is easy to lose sight of just how far ECB policy progressed in 2015. January's Quantitative Easing (QE) announcement was the region's first-ever experiment with QE and negative interest rates, a move many once thought was politically infeasible. Also lost in the recent volatility is the fact that the ECB's December announcement marks a meaningful "re-up" commitment to easing policy, along with an implicit agreement that the QE will continue as long as needed for inflation to return. Historical precedent with QE programs in Japan and the US strongly suggest that this expansion of QE in Europe will continue to boost earnings (see Chart of the Week, below).

EUROZONE BOTTOM LINE: REMAIN OVERWEIGHT – POSITIVE EARNINGS SHOULD TRUMP NEGATIVE HEADLINES

We expect eurozone stock markets can perform in-line with corporate earnings growth in 2016, which we expect to see in the high single-digit/ low double-digit range for the broad eurozone index. We continue to favor eurozone consumer-facing sectors and other global businesses, as well as selected low volatility areas. We continue to hedge out a meaningful exposure of the euro from our portfolios. We remain underweight commodity-sensitive sectors and financials.

CHART OF THE WEEK: Eurozone Earnings Just Beginning to Accelerate



Souce: Thomson Reuters Datastream. Past performance is no guarantee of future results. It is not possible to invest directly in an index.

Important Disclosure Information

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.

Using a currency hedge or a currency hedged product does not insulate the portfolio against losses.

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

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared with the 2015 strategic allocations for each portfolio, as opposed to compared with the portfolios' composite benchmarks.

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