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Why We Reduced Euro Exposure *Before* ECB Meeting

In the current environment where monetary policy has had a major impact on interest rates, currencies, and thus most financial assets, the lead up to last week's European Central Bank (ECB) meeting was full of anticipation. The widely expected view, which was bolstered by ECB chair Draghi's remarks during November, was that the announcement would consist of a monetary stimulus trifecta: (1) lowering already negative interest rates; (2) extending the timeframe of the current Quantitative Easing (QE) program; and, (3) increasing the monthly size of the program. In the month leading up to the meeting, European bond yields declined and the euro fell from 1.10 to 1.05 per dollar.

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Our portfolios remain partially hedged because ultimately, we believe Draghi is very committed to following the Federal Reserve's path of encouraging risk taking and penalizing risk aversion as a means to promoting growth and some inflation. We therefore believe the euro will fall further before its long-term decline is over, but judge it prudent to gradually reduce the position as opportunities arise.

JOBS DATA MAKES DECEMBER FED HIKE VERY LIKELY:

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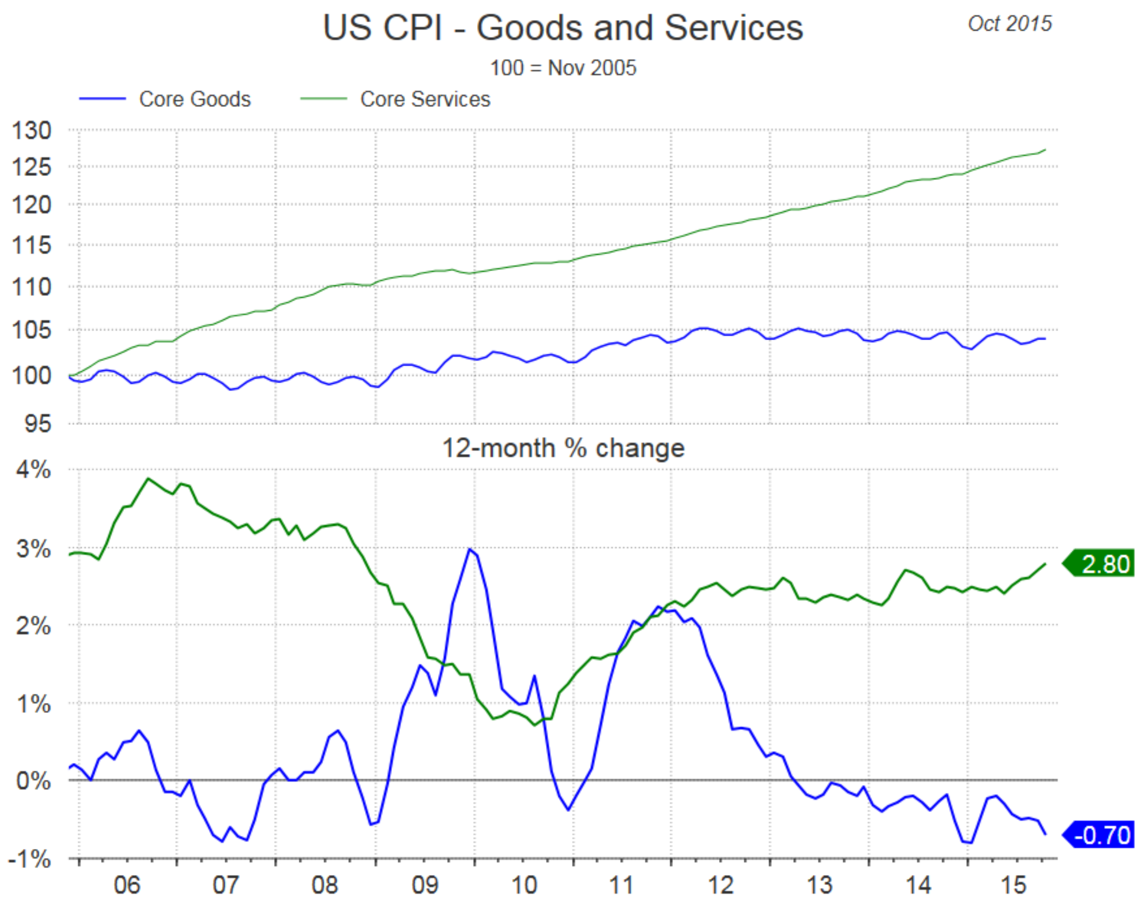
The last piece of the Fed rate hike puzzle fell into place on Friday when the Bureau of Labor Statistics (BLS) reported that 211,000 jobs were added in November. This is right in line with the average gain for 2015 and shows a healthy labor market. With the unemployment rate at 5% the US looks to be close to full employment, and a rate hike is now widely expected. While we recognize the symbolic importance of a first rate hike, we believe that the path of future rate hikes is of much greater significance. Fed chair Janet Yellen has been very clear that short-term interest rates below the rate of inflation is the "new normal," so we expect her to reiterate that the pace of rate increases will be slow and "data dependent," in keeping with the tepid 2-3% pace of economic growth. We are anticipating a slightly faster pace of economic growth in 2016, as the energy sector becomes less of a drag and the benefits of lower oil prices continue to boost consumer spending. We therefore expect a gradual rise in long-term rates and single digit gains in US stock indices.

One of the main factors dragging on both US and global growth has been the manufacturing sector, especially energy and industrial materials. This was confirmed by the monthly purchasing surveys all over the world, where manufacturing was hovering around levels consistent with zero growth, and non-manufacturing was healthy rather than robust. The chart below highlights pricing in both groups and illustrates the stark differences in growth. Services pricing has shown steady growth between 2% and 3%, whereas goods prices have been falling since mid 2013.

THE WEEKLY CHART: BIG DIFFERENCE BETWEEN GOODS AND SERVICES



Source: RiverFront Investment Group, Thomson Reuters Datastream. It is not possible to invest directly in an index.

Index Definitions

The ***United States Consumer Price Index (CPI)*** *produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.*

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