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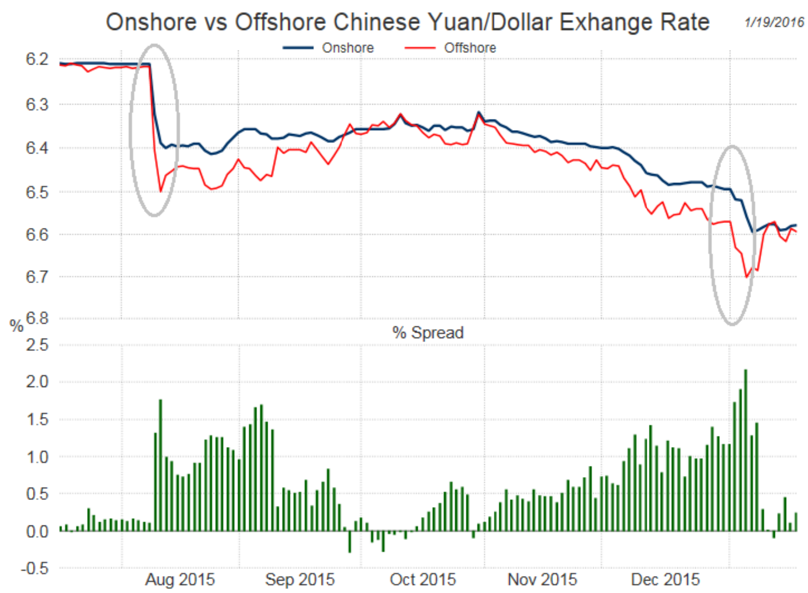
Why Are Stocks Falling?

China and the yuan: The stock market declines in August, November and January were all preceded by a decline in the yuan, and by an increased spread between the official exchange rate and the rate traded offshore (see circles in the chart below). This indicates to us that there is capital flight from China as investors there seek to protect themselves from further weakness and offshore investors speculate that the yuan will continue to fall. Furthermore, China is using significant reserves trying to manage the yuan's decline, and thereby depleting China's "piggy bank". This is money that could be used more productively on infrastructure spending, in our view. We do not expect this to be resolved quickly, but we do believe that a weaker yuan should ultimately help stabilize China's growth.



Source: RiverFront Investment Group, Thomson Reuters Datastream. Past performance is no guarantee of future results.

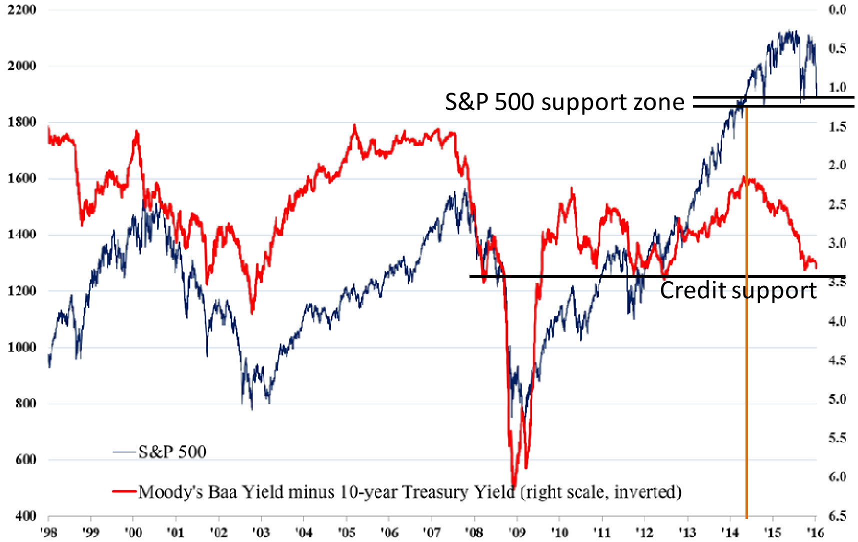
The post-9/11 world: In contrast to the post-Cold War "peace dividend," the US and various global allies have been deploying troops and resources overseas ever since 9/11. Recent attacks perpetrated by ISIS outside the Middle East represent a new chapter, adding to uncertainty and constraining valuations.

Oil prices: Sharply lower oil prices have damaged confidence and raised fears of a weaker global economy. We believe the primary reason is excess supply, and that low oil prices are ultimately a good thing for developed economies. Nonetheless, oil price stability seems to be a prerequisite for improving investor sentiment.

Credit markets: US credit spreads – the perceived risk in corporate bonds relative to Treasury bonds – are widening out, not just in high yield, but also in investment grade bonds. This is leading to a decline in confidence and thus a decline in stock prices (see Weekly Chart on page 2). In our view, the credit markets are a good indicator for both the economy and stocks. Stock investors tend to be optimists by nature; after all, they are investing in the future and will benefit if the outlook improves. Bond investors, in contrast, are simply hoping to get paid back and are quick to worry if repayment looks more uncertain.

Investors are fearful that credit markets are signaling another bear market, this time driven by the collapse in commodity prices. A notable difference from the last two bear markets (shown in the chart below) is that consumers benefit from falling commodity prices, whereas they were hurt by the bursting of the tech and real estate bubbles. Furthermore, thus far the decline in stocks and credit prices has been less severe. We are monitoring the support levels for both.

THE WEEKLY CHART: CREDIT HELPS EXPLAIN MARKET WEAKNESS



Source: RiverFront Investment Group, Ned Davis Research. Past performance is no guarantee of future results. Moody's long-term obligation ratings are opinions of the relative credit risk of fixed-income obligations with an original maturity of one year or more. They address the possibility that a financial obligation will not be honored as promised. Such ratings reflect both the likelihood of default and any financial loss suffered in the event of default.

The cash RiverFront has raised since November naturally begs the question of what our potential plans are for reinvestment. Below we outline three possible scenarios, the first of which is looking increasingly probable.

Scenario 1 — Breakdown

The S&P quickly drops into the 1840-1860 support zone. Such a powerful downward thrust in the market would likely take sentiment to very negative levels and improve the technical picture for equity markets (beware the crowd at extremes). This might provide a potential re-entry point.

Scenario 2 — V-shaped recovery

Earnings season and a series of central bank meetings over the next three weeks create the potential for good fundamental news to overwhelm the negative technical condition of the market. We have set a series of "buy stops" that would prompt us to reinvest a portion of the cash as the market breaks above these levels.

Scenario 3 — Sloppy sideways trading

The market could just grind sideways in a range until the technical and fundamental picture improves. A prolonged period of consolidation could turn our models more constructive and prompt us to out some of the cash to work.

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.

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.

In a rising interest rate environment, the value of fixed-income securities generally declines. Using a currency hedge or a currency hedged product does not insulate the portfolio against losses.

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.

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.

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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.