

## International: Changing the Mix



Chris Konstantinos, CFA  
DIRECTOR OF INTERNATIONAL  
PORTFOLIO MANAGEMENT

*Heading into 2016, Riverfront believed that the likelihood of global recession was low; that central banks weren't out of accommodation options; and that international markets represented strong long-term value. Our conviction in these themes has not changed.*

Heading into 2016, Riverfront believed that the likelihood of global recession was low; that central banks weren't out of accommodation options; and that international markets represented strong long-term value. *Our conviction in these themes has not changed.* What has surprised us is that aggressive central bank actions have not continued to strengthen the US dollar (USD). Rather, the USD has been volatile but weaker versus many major currencies year-to-date (YTD), especially the Japanese yen. For its part, the Chinese yuan (still linked to the USD) has operated in a relatively stable range, helping to calm market fears (for more on our views of recent central bank moves and their implications, see *Weekly View* dated March 15, 2016).

These currency trends accompanied by the recent stabilization in oil have important implications that we believe suggested a need to rebalance our portfolios. At a big picture level, our international trades last week achieved three main goals:

### 1. Increased our international weighting to commodity-levered stocks and currencies

The recent USD weakness and yuan stability have been supportive of risk assets, particularly for commodity-levered currencies. Despite their recent strength, many commodity currencies have been in a downward spiral since 2013, acting as the shock absorber for those regions' growth in the face of declining commodity prices. Because of this multi-year weakness, they are now more attractively valued than they were a few years ago on a purchasing power basis. In addition, real (i.e. inflation-adjusted) interest rates are now positive in many of these regions, a distinct improvement versus 2013.

Commodity currencies are often positively correlated to their respective equity markets; unsurprisingly, commodity equities have also had a strong YTD move. However, it's important to note that YTD strength doesn't even come close to negating those markets' poor overall performance since 2013 in USD terms (see *Chart of the Week* on page 2). If currency volatility remains lower going forward, these markets will have lots of further potential for positive catch-up. Commodity prices, including oil, have appeared to find support and may be in the process of putting in what we believe to be a messy intermediate-term bottom.

The lower volatility in international currencies lessens the need to hedge as significant a portion of our non-USD denominated assets, in our opinion. Thus, we sold meaningful portions of our currency-hedged ETFs in Europe and Japan, replacing them with unhedged international equity assets primarily in commodity-exporting regions. With this trade our portfolios have moved closer to a roughly 50/50 ratio of hedged to unhedged international equities.

### 2. Increased our international portfolio dividend yield

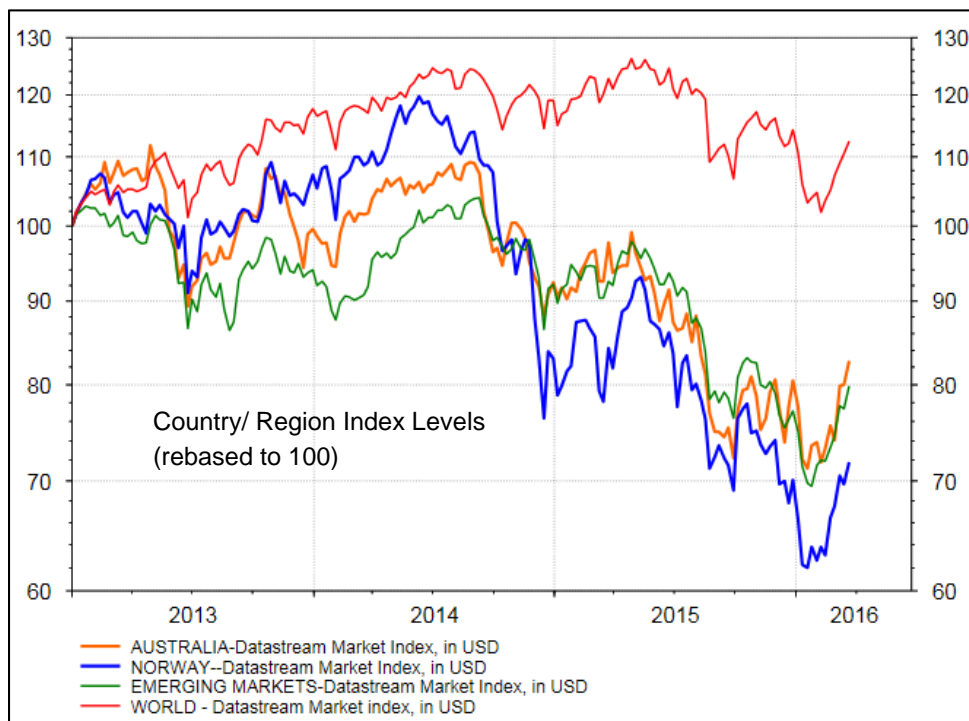
In selecting a basket of commodity-sensitive equities, we chose to focus at this time on Australia and Norway. Both Australia and Norway's markets possess a well-above-average dividend yield, a favorable characteristic in a world where over half of developed international sovereign bond issuance is at negative rates. Both countries demonstrate attractive valuation relative to historical levels, in our opinion, and better-than-average recent earnings revision trends as well. In addition, we purchased a broad developed international dividend ETF to further augment dividend yield.

In our longer time-horizon portfolios, we also instituted our first position in emerging market stocks since August of last year. While we still prefer developed international to emerging on a fundamental basis, we acknowledge that the same pro-cyclical forces that are positive for Australia and Norway should be supportive for emerging market currencies and stocks. We chose to institute this position in a very broad manner with the use of a broad diversified emerging markets ETF.

### 3. Increased the small-cap portion of our European equity exposure

We decided to increase our position in European small-cap stocks. We view the European Central Bank monetary policy enhancements disclosed two weeks ago as likely to help shore up the European banking system and to increase economic activity in Europe. This improves prospects for domestically focused companies and allows for smaller companies to source capital more cheaply, both of which we believe to be positives small-cap stocks. According to JP Morgan, European small-cap stocks have similar valuations to their large-cap brethren, despite higher sales and earnings growth potential and more inherent operating leverage.

### THE WEEKLY CHART: COMMODITY-LINKED MARKETS HAVE LOTS OF CATCHING UP TO DO SINCE THE 2013 “TAPER TANTRUM”



Source: Thomson Reuters Datastream, Riverfront Investment Group. Past performance is no guarantee of future results. It is not possible to invest directly in an index. Data shown is from 1/1/2013 - 3/24/2016.

#### 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.

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.

ETFs are subject to substantially the same risks as those associated with the direct ownership of the securities comprising the index on which the ETF is based. Additionally, the value of the investment will fluctuate in response to the performance of the underlying index. ETFs typically incur fees that are separate from those fees charged by RiverFront. Therefore, investments in ETFs will result in the layering of expenses.

Small-, mid- and micro-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies.

Dividends are not guaranteed and are subject to change or elimination.

RiverFront Investment Group, LLC, is an investment advisor registered with the Securities Exchange Commission under the Investment Advisors Act of 1940. The company manages a variety of portfolios utilizing stocks, bonds, and exchange-traded funds (ETFs). Opinions expressed are current as of the date shown and are subject to change. They are not intended as investment recommendations.

It is not possible to invest directly in an index.

Copyright ©2016 RiverFront Investment Group. All rights reserved.