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Review and Outlook: We Favor Stocks and Corporate Bonds

3rd Quarter Review: This week, we will publish our October Chart Pack, which looks back at the markets in the 3rd quarter and discusses our outlook and current positioning. Stocks bottomed shortly after the Brexit vote and rebounded nicely during the 3rd quarter. Non-US stocks improved, led by emerging markets, and high yield bonds added another strong quarter. In the case of both emerging markets and high yield bonds, we believe 2016's strong returns should be viewed in the context of the tough year they both experienced in 2015. While high yield has more than recovered its 2015 losses, emerging markets are still below January 2015 levels. Both have been influenced by the commodity cycle and have been helped by the recovery in commodity prices this year.

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Asset Class (Index)	Returns % Change Q3 2016	Returns % Change YTD 2016
Bonds (Barclays Aggregate) Total Return	0.46	5.8
High Yield Bonds (BofA ML US HY Master II) Total Return	5.49	15.32
US Stocks (S&P 500) Total Return	3.85	7.84
Developed International Stocks (EAFE) Net Return	6.43	1.73
Emerging Market Stocks (EM) Net Return	9.03	16.02
Non-US Stocks (ACWI ex-US) Net Return	6.91	5.82

Source: Morningstar, RiverFront Investment Group. Past performance is no guarantee of future results. Please see the end of this piece for index definitions and disclosure information. Index returns are provided for informational purposes only and not indicative of RiverFront portfolio performance.

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Developed international markets also rebounded during the quarter, as markets' worst fears about the ramifications of the Brexit vote did not materialize, but returns for this group continue to lag in 2016.

Current Positioning and Outlook: Our major investment themes can be summarized as follows:

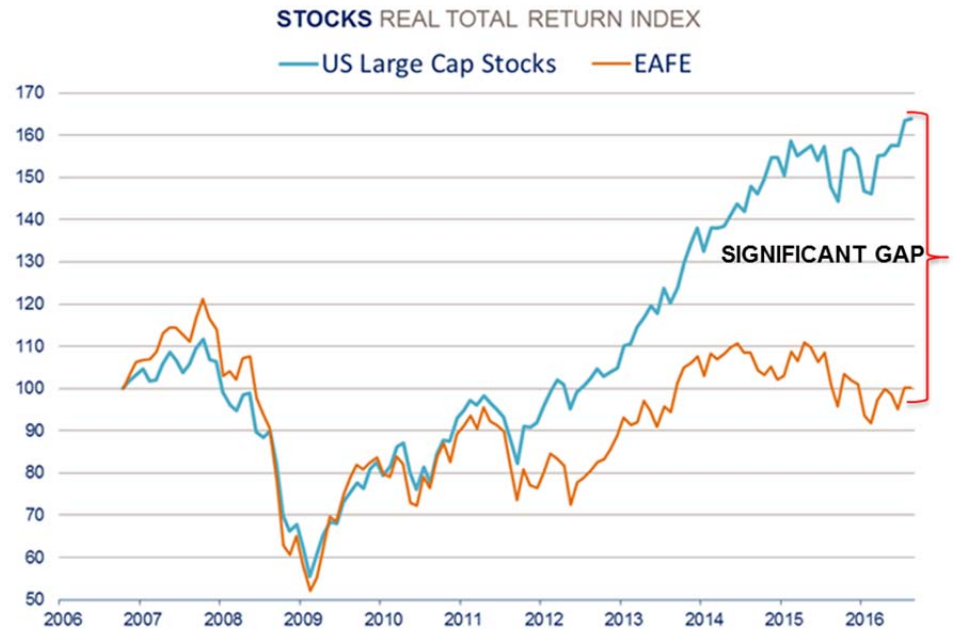
- **We prefer stocks over bonds.** With bond yields at historically low levels, we maintain our longstanding preference for stocks.

- **We have shorter maturities and prefer credit.** Within our bond portfolios, we returned to our longer term preference for corporate bonds (credit) and for shorter maturities. We like both investment grade and high yield corporate bonds. As a tactical measure, we owned long maturity government bonds as a hedge against the risks surrounding the Brexit vote, but these were sold during the quarter. In bonds, yield matters and the decline in corporate bond yields means our return expectations are lower.

- **We continue to hedge some of our overseas currency exposure.** We see further downside risk in the euro and the British pound, but recognize that these currencies are probably now becoming undervalued on a longer term basis, so the amount that we are hedged needs to be monitored closely.

Current Outlook: In the US, the question for us is whether the two issues dominating the headlines, Fed policy and the presidential election, will alter the course of the economy and earnings. Our view is that neither will have significant impact. Fed policy is still decidedly pro-growth. The debate within the Fed is whether the economy is strong enough to withstand another 25 basis point rise in short-term rates. We don't hear anyone advocating for a policy seeking to slow US growth. Thus, the question is whether the Fed could make a policy mistake by raising rates. We think they will be guided by the data and only raise in reaction to improving growth prospects. Regarding the election, the polls currently suggest a Clinton victory and the markets seem okay with that. We think the assumption built into current market levels is that gridlock will remain with Republicans controlling one or both houses of congress. In this event, despite the lively debate on many issues, we predict that policy is unlikely to change significantly.

THE WEEKLY CHART: WE EXPECT THE GAP TO CLOSE



Source: RiverFront Investment Group, MSCI, "US Large Cap Stocks" calculated based on data from CRSP 1925 US Indices Database ©2016 Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Past performance is no guarantee of future results. It is not possible to invest directly in an index. Please see the end of this article for index definitions and important disclosure information.

The chart above shows the performance for US stocks and developed international stocks in US dollar terms (EAFE), with both indexed to 100 in 2007. US stocks are now over 60% above 2007 levels, whereas EAFE stocks are flat.

Consistent with this data, US corporate earnings are currently well above previous peaks, and margins are close to record levels. The question for the US is, how much better can it get? International earnings and margins are below previous peaks and are recovering. With growth outside the US finally improving, we believe the strategic opportunity is overseas and that the gap will start to close.

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Duration is a measure of the sensitivity of the price of a fixed income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

Total Return (TR) includes interest, capital gains, dividends and distributions realized over a given period of time.

Net Total Return (NR) indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

RiverFront's Price Matters® discipline compares inflation-adjusted current prices relative to their long-term trend to help identify extremes in valuation.

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Index Definitions:

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.

MSCI EAFE Index US Dollar denominated is an equity index that captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada.

MSCI Emerging Markets Index US Dollar denominated is an equity index that captures large and mid-cap representation across 23 Emerging Markets (EM) countries.

MSCI All Country World Index ex US captures large and mid-cap representation across 22 of 23 Developed Markets countries (excluding the US) and 23 Emerging Markets countries. The index covers approximately 85% of the global equity opportunity set outside the US.

Barclays US Aggregate Bond Index is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The issues must be rated investment grade, be publicly traded, and meet certain maturity and issue size requirements.

Bank of America Merrill Lynch High Yield Master II Index tracks the performance of US dollar-denominated below investment grade rated corporate debt publicly issued in the US domestic market. Index constituents are capitalization-weighted based on their current amount outstanding times the market price plus accrued interest.

"US Large Cap Stocks" in Weekly Chart - Large cap universe used in the charts is defined by CRSP based on market capitalization. CRSP Stock File Capitalization Decile Indices are calculated for each of the Stock File Indices market groups. In these Market Segment Indices all securities (excluding American Depositary Receipts) on a given exchange or combination of exchanges are ranked according to capitalization and then divided into ten equal parts each rebalancing period. The largest securities are placed in portfolio 10 and the smallest in portfolio 1. The large cap universe is represented by portfolios 1 and 2.

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