Rod Smyth
CHIEF INVESTMENT STRATEGIST

For the S&P 500, the move above its 200-day moving average (and above the top of the "Decision Box" that we wrote about in last week's Weekly View) is very encouraging.

The missing link in the financial market recovery from the early October lows has been corporate bonds, especially lower quality bonds.

We are concerned by this, but not yet alarmed… A widening beyond 3.5% would cause us some alarm and call into question the rally in stocks (see Weekly Chart).

Stocks Rise To Resistance

Last week, most stock markets around the world rose to natural technical resistance levels and some broke through. For the S&P 500, the move above its 200-day moving average (and above the top of the "Decision Box" that we wrote about in last week's *Weekly View*) is very encouraging. The 200-day moving average is no longer falling, and the 50-day has turned upwards. Our belief is that the US market is likely to consolidate its gains pending next week's data for the month of October.

Emerging markets, where the 200-day moving average has been falling all year, has not yet recovered one-third of the decline from last September's peak. We continue to believe that emerging markets are suffering from both structural and cyclical challenges.

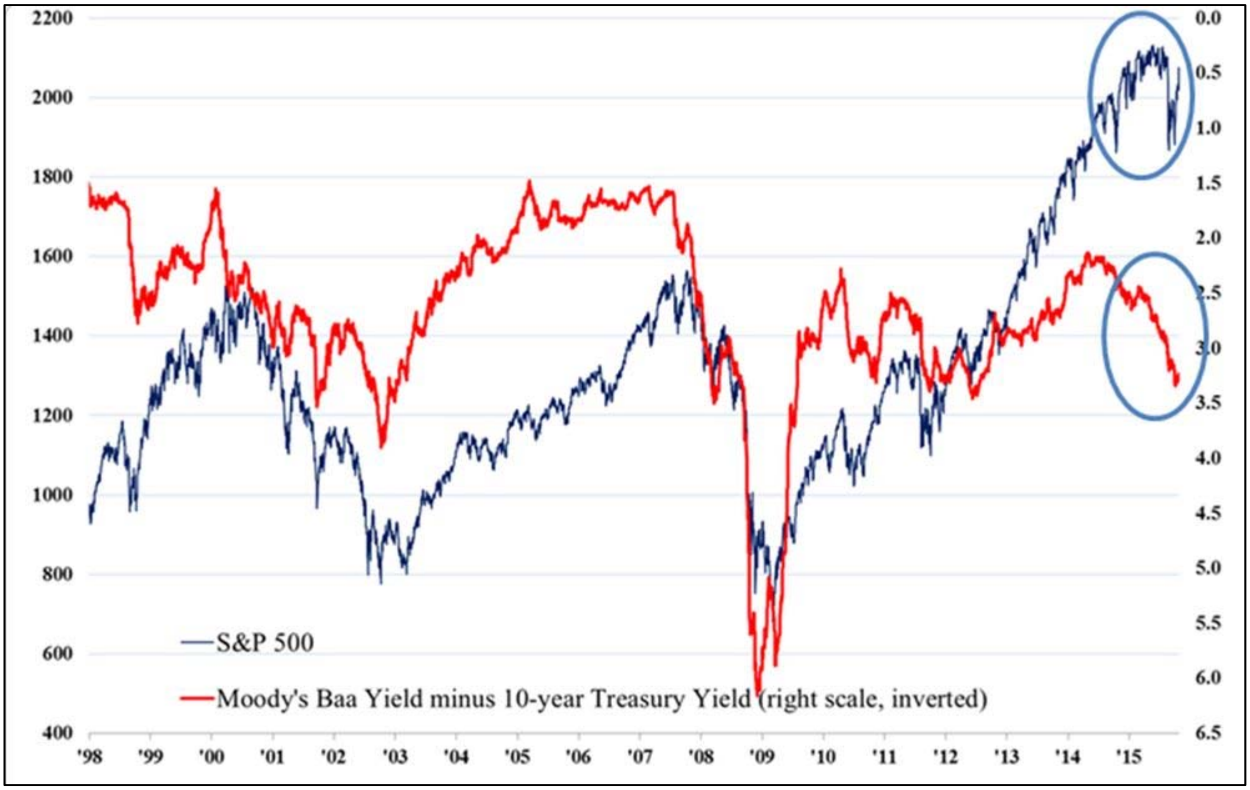
The euro fell 3% last week, mostly because of remarks by European Central Bank (ECB) president, Mario Draghi, who indicated that the ECB is considering further monetary stimulus in December. In local currency terms, euro-area stocks outperformed the US, but in US dollar terms they did not; thus, RiverFront's portfolios benefited from our currency hedge on the euro. Germany led the advance, with the Frankfurt DAX index rising 6.9%. Finally Japanese stocks, where the 200-day has continued to rise throughout the summer, matched the US advance of 2% (in US dollar terms). The yen was little changed.

The missing link in the financial market recovery from the early October lows has been corporate bonds, especially lower quality bonds. While corporate bond prices have risen in the last month, the spread between corporate bond yields and Treasuries has barely narrowed (see the Weekly Chart on page 2). We are not yet alarmed by this data, but we will continue to monitor the spreads going forward. We believe that the continued widening of spreads largely reflects the amount of corporate debt issued by the oil, gas, and mining sectors prior to the plunge a year ago in commodity prices. Indeed, the performance of corporate bonds in those sectors is mirrored by their persistent decline in the stock market.

One of our consistent messages this summer has been that we regard the fears over China's short-term economic outlook as exaggerated. Furthermore, we believe that those who look at the Shanghai Composite Stock Index as a leading indicator of China's economy fail to recognize that its composition and, more importantly, the locals who speculate in it make it a poor predictor of economic or earnings fundamentals. We should remember that the index doubled between July 2014 and May 2015, a time when growth in China was already slowing.

In our view, a more realistic reason for its rise and fall was the anticipation of its components being included in the MSCI global indexes, and then the announcement this summer that they would not. We have added to our China exposure by buying US industrial companies that have been beaten up by the decline in China's investment spending. We believe these companies could benefit as China's economy stabilizes and starts to improve as a result of increased fiscal and monetary policy stimulus.

THE WEEKLY CHART: CREDIT, THE MISSING LINK



Source: RiverFront Investment Group, Ned Davis Research. Past performance is no guarantee of future results. See below for relevant index definitions.

In the chart above, we show the S&P 500 (left scale dark line) and the spread between Baa corporate bond yields and 10-year Treasury yields – in our view, an indicator of investor confidence in corporate bonds. This indicator is shown with the spread narrowing when the line rises. In a growing economy, we would expect the spread to average around 3%. Notice how it widened to 6% in the great recession of 2008/2009 and then led stocks higher. A widening beyond 3.5% would cause us some alarm and call into question the rally in stocks.

Important Disclosure Information

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.

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.

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.

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

In a rising interest rate environment, the value of fixed-income securities generally declines. Obligations rated Baa by Moody's are judged to be medium-grade and subject to moderate credit risk and as such may possess certain speculative characteristics.

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.

Index Definitions

It is not possible to invest directly in an index.

German Stock Index (DAX) is a total return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange. The equities use free float shares in the index calculation.

Shanghai Composite Stock Index is a capitalization-weighted index that tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

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.