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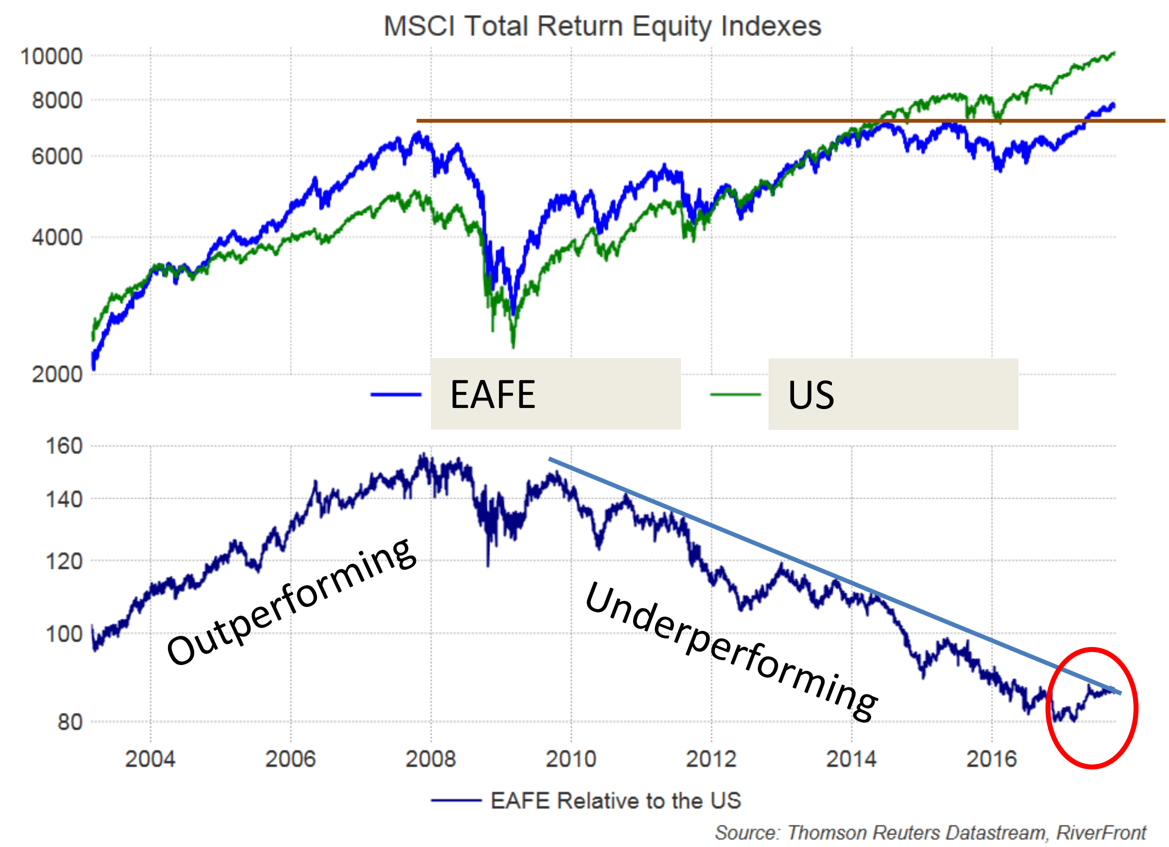
International Outperformance: Early Days In Our View

Non-US stock markets have now outperformed the US for four consecutive quarters. We wrote about this in July, but it is still the case that the following questions dominate those we are being asked:

1. **Are we due a correction, and if I have cash, should I invest now or wait?**
2. **Is it too late to allocate more money to international?**

Taking the second question first, let's look at the relative performance of developed international stock markets to the US. In the top clip of the chart below, we show the performance of the MSCI EAFE (Europe, Australasia and Far East) index (blue line) and the MSCI US index (the green line). You can see that directionally their movements are similar (i.e. closely correlated), but there are times when one does better than the other. In the bottom clip we look at the difference in relative performance. The bottom clip shows that relative performance goes in cycles. EAFE performed materially better than the US in the years leading up to the stock market collapse of 2008. The last seven years have seen the US lead global markets higher, significantly outperforming. It's worth noting that, over the past half-century, returns between US and non-US stocks have been virtually identical. *Past performance is no guarantee of future results.*

Outperformance of International Markets Relative to the US Only in Early Stages



Past performance is no guarantee of future results. Data from March 2003-October 2017. Total Return includes interest, capital gains, dividends and distributions realized over a given period of time.

We think this chart demonstrates several points:

1. The red circle in the lower clip shows that the outperformance by EAFE over the last year is modest (historically speaking) so far, and has yet to break above the light blue downtrend line. **If**

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We think market timing is a precarious business and we strongly advise investors who want to deploy cash to start the process and add in installments over several months, taking emotion and market timing out of the decision.

we are right and international markets are going to outperform the US in the coming years, they have a long way to go to erase some of the underperformance of the last seven years. Thus in our view, as our title says: it's only early days. For our opinion to be validated, we think the relative performance must break the down-trend line and begin a new up-trend.

2. From a technical perspective, we think it is very significant that, when re-invested dividends are included (total return), EAFE has finally broken above its highs from 2007 (its "lost decade"), shown by the brown line in the top clip. Since US stocks broke out from *their* lost decade, they have continued higher ever since. We think the economic growth cycle in Europe and Japan has many more years to go which we believe will drive earnings and stock prices higher.
3. In our opinion, investors who have not diversified their stock portfolios globally are being presented with an attractive opportunity to switch from the US to International. To answer the question of how much international, we think that depends on your holding timeframe and risk tolerance. Our asset allocation portfolios that have a timeframe of five years or more have between 23% and 63% of the portfolio in international stocks. The longer the timeframe and thus the greater tolerance for volatility, the greater the allocation to international stocks, in our view.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities.

After a strong year, are we due a correction? If I have cash, should I invest now or wait?

Oh, if we had a penny for every time this question comes up! Our most consistent answer is that timing is difficult and so we strongly advise investors who want to deploy cash to start the process and add in installments over several months, taking emotion and market timing out of the decision. Today, that is just what we would advise as our timing tools are still projecting above average odds that stocks will be higher over the next three months, despite sentiment in the US being quite stretched to the upside. This is because the primary trend is in a uptrend. New highs on markets are not a danger signal in our view, but rather confirmation of the bull market. A correction is always possible at any time, and an unexpected negative surprise could trigger it, but we believe the odds favor remaining strategically and tactically bullish.

Through September 30th the MSCI World Index is up 17% and 5% for the quarter. The returns have been evenly distributed, with the US a slight laggard and emerging markets doing the best (+28%). While this is above the baseline estimate we made at the beginning of the year, we believe the gains have been justified by earnings growth.

Fear and Greed have always dominated investor emotions, but since the 2008 stock market collapse, fear and caution have been most prevalent in our view. There is an old adage that a bull market climbs a "wall of worry" and this bull market certainly seems to us to be following that pattern. Two things would cause us to be strategically concerned:

1. Excess optimism expressed in excessive valuations, which for Riverfront would mean stocks moving significantly above their long-term trends. This is not currently the case for the majority of stock indexes we follow.
2. An impending global economic downturn that would cause earnings to fall. We do not foresee this over the next year, rather we believe we will see mildly accelerating economic momentum and no major increase in inflation expectations.

Conclusion: In our asset allocation portfolios, we retain our preference of stocks over bonds. Within our stock allocation we continue to believe global markets have further upside potential, especially those overseas.

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Important Disclosures Continued:

Past results are no guarantee of future results and no representation is made that a client will or is likely to achieve positive returns, avoid losses, or experience returns similar to those shown or experienced in the past.

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

Diversification does not ensure a profit or protect against a loss.

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.

Strategies seeking higher returns generally have a greater allocation to equities. These strategies also carry higher risks and are subject to a greater degree of market volatility.

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.

Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.

Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.

In a rising interest rate environment, the value of fixed-income securities generally declines.

The comments above refer to generally to financial markets and not RiverFront portfolios or any related performance.

Index Definitions:

MSCI USA Index *is designed to measure the performance of the large and mid cap segments of the US market. With 632 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.*

MSCI EAFE Index *is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The Index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 21 countries.*

MSCI World Index *-- is a stock market index of 1,500 stocks of all the developed markets in the world, as defined by MSCI. The index includes securities from 24 countries but excludes stocks from emerging and frontier economies.*

It is not possible to invest directly in an index.

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