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*Low Unemployment, Strong Stock Markets and Low Volatility have given us much to be thankful for in the last year.*

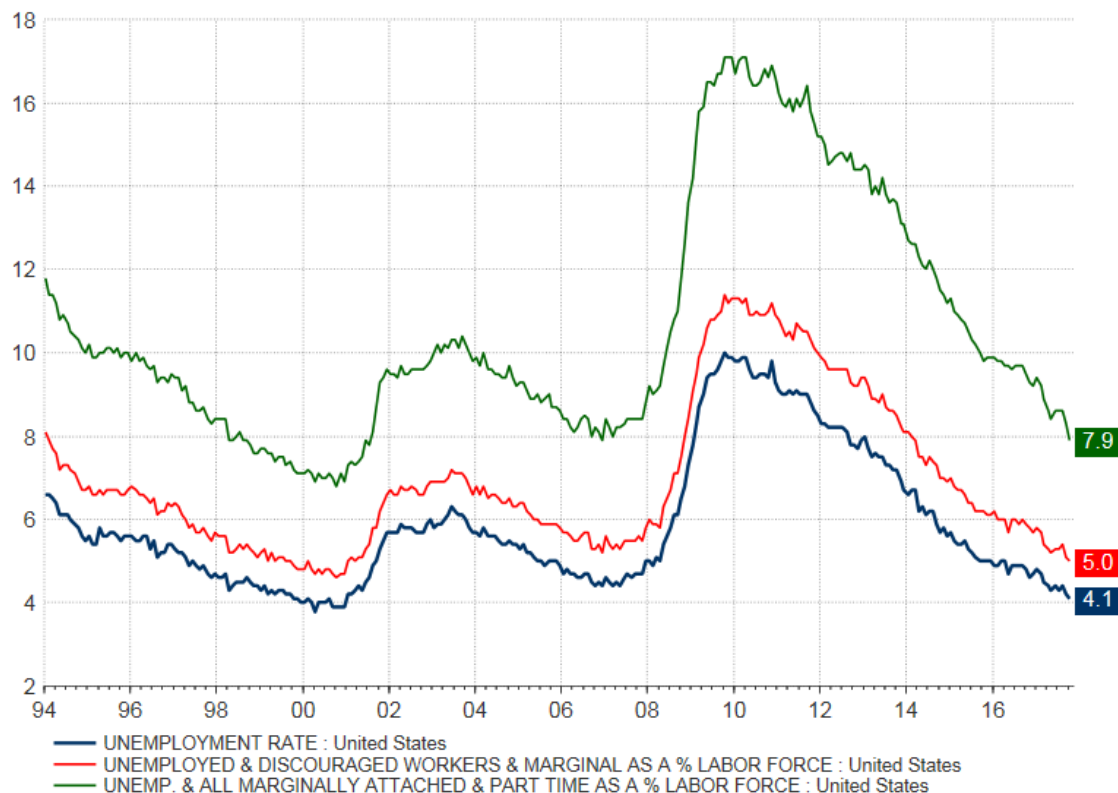
*Recognizing that the outsized returns and low volatility of the last year are historically unusual, we suggest investors say “thank you” and prepare for mean reversion.*

## 3 Reasons to Be Thankful, and What They Mean

### 1. LOW UNEMPLOYMENT AND LOW INFLATION

Any way you look at it, the jobs market has improved significantly in the last eight years. In November 2009, the unemployment rate was peaking around 10%; most recently, it is down to 4.1%. At the time, many commentators pointed out that broader measures of unemployment also calculated by the Bureau of Labor Statistics (BLS) which includes discouraged workers, marginally attached workers and those working part time for economic reasons were much higher, which was true. However, as our chart shows, it is not unusual for these broader measures to be higher; but since the peak, they have fallen proportionately. As investors we should celebrate falling unemployment as a sign of economic improvement. Indeed, historically speaking the best gains from stock markets tend to occur when unemployment is falling towards previous lows. The question for the new Fed Chairman and his committee is: “how much lower can unemployment fall before generating rising inflation?”

- WHAT IT MEANS:** Long-term inflation expectations are currently very low. Thus a 2.3% yield on US 10-year Treasuries suggests to us that Treasury investors have little protection against rising inflation. At Riverfront we still prefer stocks to bonds and within bond portfolios we prefer corporate bonds and shorter maturities.



Source: Thomson Reuters Datastream, RiverFront

### 2. ABOVE AVERAGE RETURNS FROM STOCKS

Powered by returns from overseas markets, the trailing 12 month total return for the MSCI All Country World Index is 24%, and the index currently stands at an all-time high. By any standards this is something to be thankful for. While the magnitude of the returns is somewhat higher than we were expecting a year ago, it is directionally consistent with the optimistic scenario in our 2017 outlook. Looking back, we believe these returns make sense in the context of a synchronized global economic expansion that began in the summer of 2016, and has led to positive earnings surprises around the

world as highlighted in last weeks' Weekly View. We also need to recognize that history suggests the long-term trend for stock returns is around 6.5% over inflation. At Riverfront we look at future returns in the context of the starting point, relative to the trend. According to Price Matters®, a year ago US stocks were close to trend, emerging market stocks were 23% below and developed international stocks were 40% below. *Index returns provided for illustrative purposes only. Past performance is no indication of future results. You cannot invest directly in an index.*

- **WHAT IT MEANS:** For non-US stocks, the last year has been a “catch up” process towards trend, whereas the returns in the US have taken them above trend. We build mean reversion into our forward expected returns, so by definition our expected returns will be lower. However, even assuming a business cycle recession and a bear market, over the next 5 to 10 years we still expect stocks to outperform bonds, and maintain our preference for non-US stocks.

### 3. **LOW VOLATILITY**

Perhaps the greatest gift for those invested in stocks has been the lack of volatility. Over the last 12 months, pullbacks in the MSCI All Country World Index have been limited to around 3% and the daily trading range has shrunk; thus measured volatility is at or close to record lows. This is unusual and once again, history tells us that volatility is mean reverting, so “enjoy it, but don't get used to it” is our advice. As we wrote in our weekly of May 5<sup>th</sup>, **low volatility is not a reliably bearish signal**. While high levels of volatility are often associated with market lows, the inverse is not true. It must be said, however, that since high volatility is associated with investor anxiety and uncertainty, low volatility does suggest complacency. We also believe that there are billions of dollars in momentum trading strategies that have been frustrated by this period of low volatility which will likely exaggerate the upturn when it comes.

- **WHAT IT MEANS:** Our advice is to be sure that your portfolio is consistent with your tolerance for normal levels of volatility, which include 5-10% and sometimes 15% corrections as a normal part of investing in a bull market, and take advantage of the current environment to reposition if necessary.

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*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.*

*Mean reversion is the tendency of a variable, such as a stock price, to converge on an average value over time.*

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

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