Rod Smyth
DIRECTOR OF INVESTMENTS

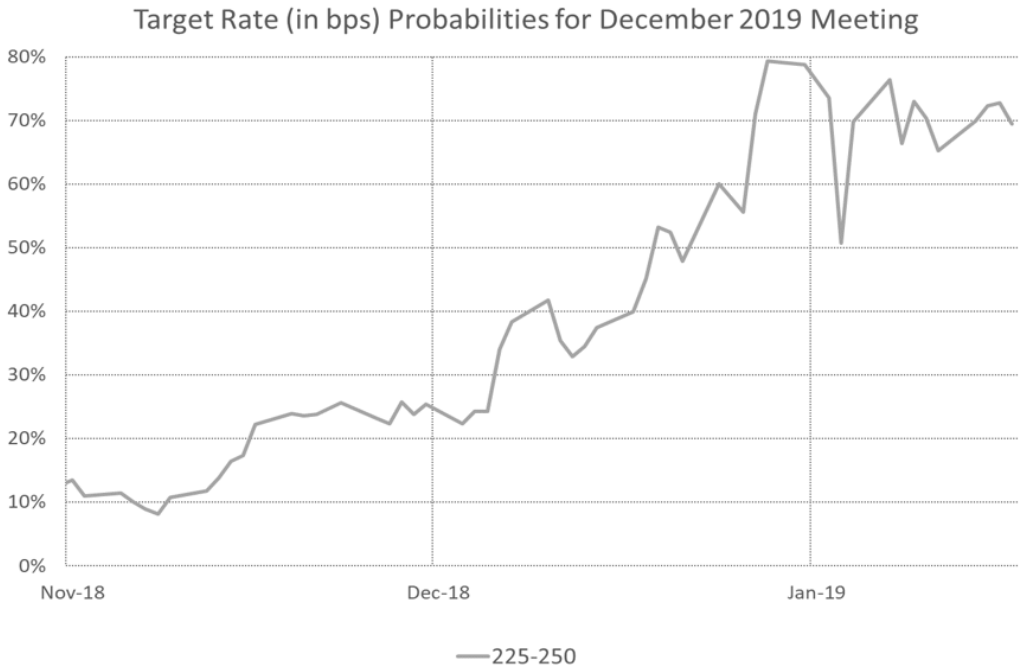
Doug Sandler, CFA
GLOBAL STRATEGIST

Chris Konstantinos, CFA
CHIEF INVESTMENT STRATEGIST, DIRECTOR OF INTERNATIONAL EQUITY

Encouraging News on Rates to Start the Year

In our 2019 *Outlook*, we identified three issues which we felt would have a significant impact on whether global stocks would enjoy a positive year – rates, resolution of trade, and risk of recession. To start the year, we are encouraged by the first of those, Federal Reserve Policy and short-term interest rates. While the Fed raised interest rates by a quarter of a percent in December, their language about future rate hikes has softened. Perhaps more relevant for financial markets has been the change in expectations about what they will do in 2019, which has been rather dramatic.

THE PROBABILITY OF NO RATE HIKES IN 2019 ACCORDING TO THE CME GROUP HAS RISEN DRAMATICALLY



Source: Chicago Mercantile Exchange (CME) Group, RiverFront. Past performance is no guarantee of future results. Not indicative of RiverFront performance. You cannot invest directly in an index.

We believe that the pace of rate hikes is slowing and that trade tensions are deescalating for now. We believe this increases the likelihood of a positive outcome for stocks in 2019.

The chart above requires some explanation. There is a market in which traders take views about the level of short-term interest rates in the future. It is called the Fed Funds Futures market. The chart above is the probability that the Fed Funds range at the end of 2019 will remain at current levels (2.25%-2.50%), as implied by the futures contracts for federal funds.

As you can see, the probability went from 10% in mid-November, i.e. traders thought rates would very likely rise in 2019, to 40% just before Christmas, to its current rate of 70%, suggesting that traders now think it quite likely that interest rates will not rise at all! For those of us who watch these things on a regular basis, such a move is considerable. We fully expect expectations to change through the year as they always do, but expectations about the path of Fed hikes has clearly changed, and we believe that is one important

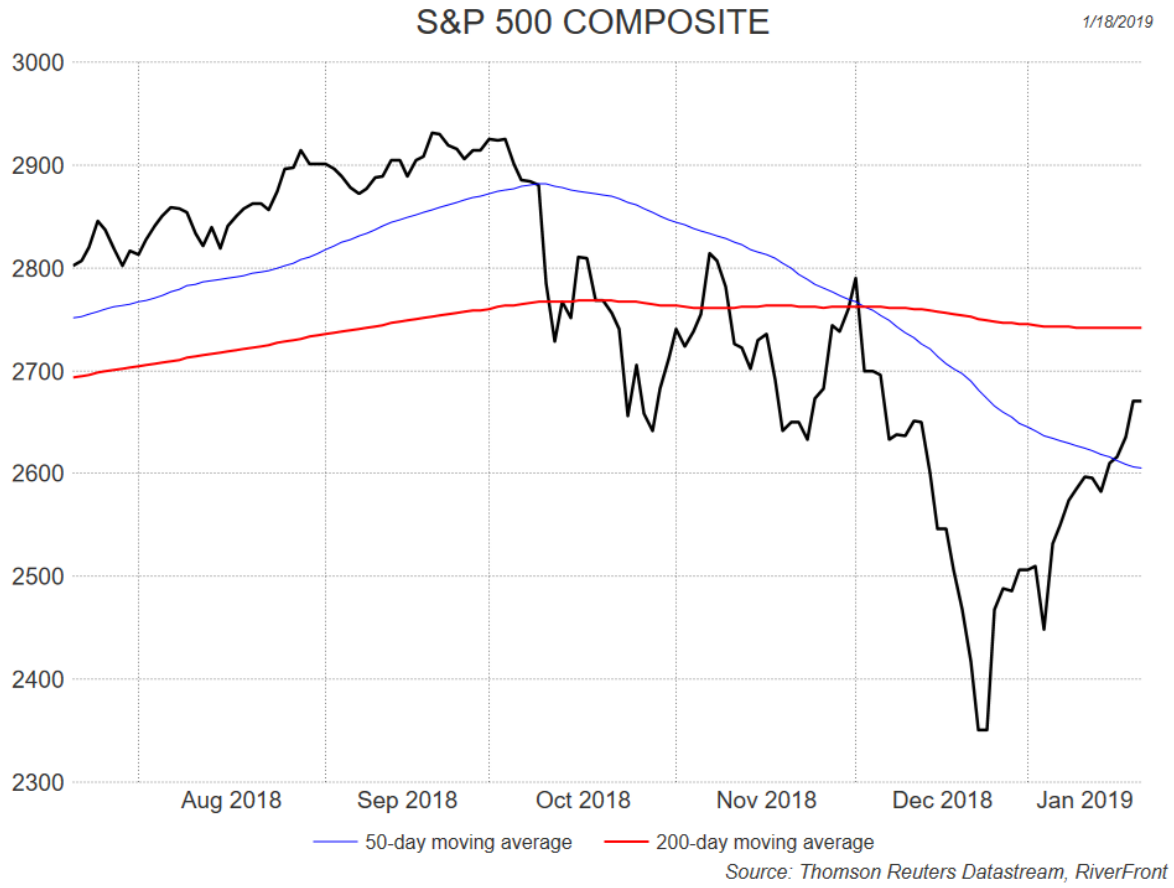
reason why global stock indexes around the world have risen four weeks in a row since Christmas. *Probabilities are determined by the CME Group RiverFront makes no assurance that interest rates will behave in accordance with these probabilities. See disclosures at the end of this publication for more information on fed funds futures and the CME Group's methodology.*

HINTS OF PROGRESS IN US/CHINA TRADE TALKS: CHINESE DATA COMES IN BETTER THAN EXPECTED

Both CNBC and Bloomberg reported that as part of the trade negotiations, China has offered a pledge to increase its annual imports of US goods by a combined value of over $1 trillion, with a view to reducing the annual trade deficit to zero by 2024. The trade deficit in 2018 between the two countries was $323 billion. On Friday, stocks rose to their high of the day when the news was released. We should expect highs and lows in this trade negotiation, but President Trump was playing "good cop", saying on Saturday that a deal "could very well happen…It's going well. I would say about as well as it could possibly go."

Lost in all the trade headlines over the long weekend, China released consumer and industrial output data that, while slower than historic growth rates, exceeded recent expectations. We believe policymakers in China are acutely aware of the need to support economic growth at or near current levels and are applying both fiscal and monetary stimulus. As in 2016, we expect these measures to be effective.

GOOD NEWS HAS PUSHED S&P 500 BACK INTO A 2600-2800 TRADING RANGE



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The S&P 500 has now retraced half of its October to December decline, which makes sense given the better news on interest rates and greater optimism on trade talks. It has broken back above its 50-day moving average but remains below its 200 day, which sits at 2750. As you can see from the chart, this is

the most powerful rally since October. Our base case outlook calls for some sort of trade deal, so we would expect the S&P to eventually succeed in breaking above it, but we think it will take greater clarity on the trade issue.

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

Information or data shown or used in this material is for illustrative purposes only and was received from sources believed to be reliable, but accuracy is not guaranteed.

CME Group, Fed Watch Tool's Assumptions and Interpretations (for more information, please visit: https://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html:

- *Probability of a rate hike is calculated by adding the probabilities of all target rate levels above the current target rate.*
- *Probabilities of possible Fed Funds target rates are based on Fed Fund futures contract prices assuming that the rate hike is 0.25% (25 basis points) and that the Fed Funds Effective Rate (FFER) will react by a like amount.*
- *Federal Open Market Committee (FOMC) meetings probabilities are determined from the corresponding CME Group Fed Fund futures contracts.*

Fed fund futures are a cash settled instrument based on the average daily effective Fed funds rate (published by the New York Fed) over the course of the contract delivery month.

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

It is not possible to invest directly in an index.

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.

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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.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

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