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- First quarter market returns were strong across the board.
- We remain constructive on the long-term outlook for equity markets.
- We think investors with shorter time horizons should exercise prudence in their overall equity weightings given the relatively high expectations built into stock prices.

Time Horizon Matters, Especially Now

Recent Rebound Dictates Prudence for Risk-Averse Investors

Over the last few weeks we have written about two of the risks facing investors:

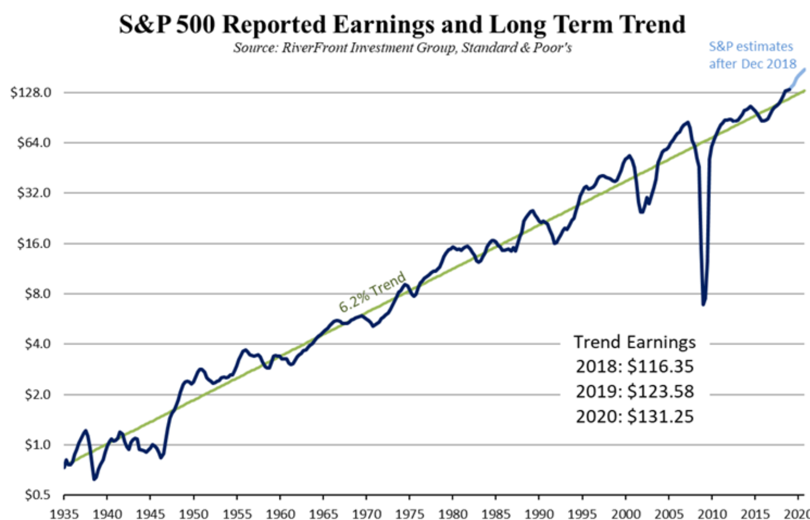
1. **US recession:** We think the Fed's decision to halt its rate hikes makes recession less likely. While this continues to be our view, we acknowledge it is a delicate balance.

2. **Brexit**: It seems that a no-deal, or "hard" Brexit – the worst outcome for markets in our view – has become less likely. Yet, we freely admit that, since Prime Minister Teresa May and Parliament are unable to agree on anything, it would be foolish to assume any outcome (good or bad) is off the table.

Throughout the first quarter of 2019, the market has agreed with our views. That optimism was a central part of our 2019 Outlook, but stocks have achieved in the first quarter more than we had expected for the year in our base case scenario. We think that alone justifies the small reduction in equities we have recently made in our shorter horizon portfolios.

US Earnings Are Above Trend and Forecasts Are Optimistic

The chart (right) shows reported earnings for the S&P 500 since 1935 and our Price Matters® trend line. S&P forecasts $155 for this year and $176 for 2020. The 2020 forecast, if achieved, would be 34% above its own 6.2% trend. That is rarified air and suggests a high level of optimism. Thus, our issue is not that we are pessimistic, but a concern that others are too optimistic. We are very conscious at this stage of the US economic cycle, that investors with shorter time horizons are going to be most affected by the next downturn in earnings, whenever it

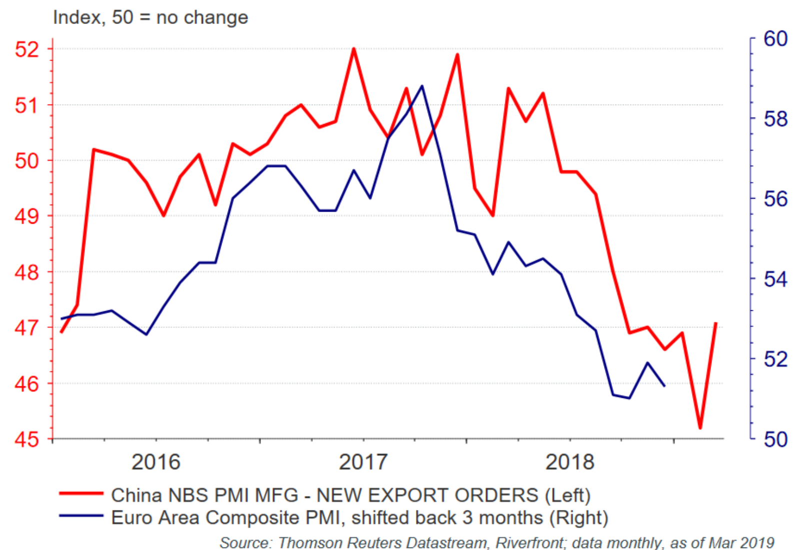


Source: RiverFront Investment Group, Standard & Poor's. Past performance is no guarantee of future results. Shown for illustrative purposes only, not indicative of RiverFront performance. Trend, according to Price Matters® is the slope of an exponential growth function that closely tracks a real (inflation-adjusted) long term Index for that Asset Class. Distance from Trend is the distance of the trend line relative to the current index level expressed as a percentage.

occurs. We don't believe earnings will fall in 2019, but estimates are optimistic relative to trend earnings (see chart). A decline in earnings will likely lead to a period of digestion/consolidation for US stocks and on occasions such a decline has ushered in the next bear market. For longer horizon investors the prospect of a cyclical bear market is not a tremendous concern in our view since US markets have typically recovered from cyclical bear markets within a year or so. However, even a short bear market can be nerve-racking for investors who are naturally risk averse.

The Biggest Short-Term Variable: The Economic Trajectory of China

China is the epicenter of global growth. The impact that China has on global growth has expanded dramatically in the last decade, serving as the engine for both developed and emerging markets, largely due to its fast-growing economy. To that point, global growth has suffered in the last year as China's economy has struggled. Recently, there are signs of improvement as both the manufacturing and service industries have begun expanding again, according to recently released Purchasing Managers Indices. This improvement could be an early indication that both China's domestic (service) and its export (manufacturing) economies are finally benefitting from the country's stimulus efforts. The impact could be broad reaching. Emerging market economies should benefit when China growth accelerates because they can export their raw materials that are used for infrastructure and inputs in the supply chain. Additionally, economies like Germany and Japan that export industrial machinery and automobiles to China should also benefit. This can be shown in the chart (above), which shows that the levels of the Chinese Purchasing Manager Index (PMIs) leads the levels of the PMIs in Europe by roughly three months. Therefore, this week's surprise uptick in China's PMIs is an encouraging sign.



We are excited to see the recent uptick in Chinese growth. However, the outcome of the ongoing US/China trade talks will be an important determinant of the sustainability of improving economic conditions in China. We ultimately expect a favorable outcome given that both sides need each other, but we recognize that markets may be a little ahead of themselves assuming the situation has been solved.

Why Shorter Horizon Investors Should Be Prudent

Following a strong first quarter for markets, during which stocks around the world have seen double digit gains and bond yields have fallen, we have concluded that it is prudent to reduce US stocks slightly in our Moderate Growth and Income portfolio models and re-invest the proceeds in short maturity bonds.

Why Longer Horizon Investors Can Afford to Be a Little More Patient

In our 2019 estimates of 5 to 10-year returns, our expectations for US and especially non-US stocks are still well above our expected returns from bonds. Naturally, this is built into our strategic positioning whereby our longer horizon portfolios have considerably more stock exposure. We reserve the right to reduce stock exposure if our views turn less sanguine from here; but the bar is higher for risk reduction in these portfolios. The longer time

horizon and higher tolerance for short term volatility makes us comfortable to remain with our positioning at the current time.

Important Disclosure Information

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

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.

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

It is not possible to invest directly in an index.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmark for each portfolio.

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.

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.

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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