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Three Rules Suggest Bull Market to Continue

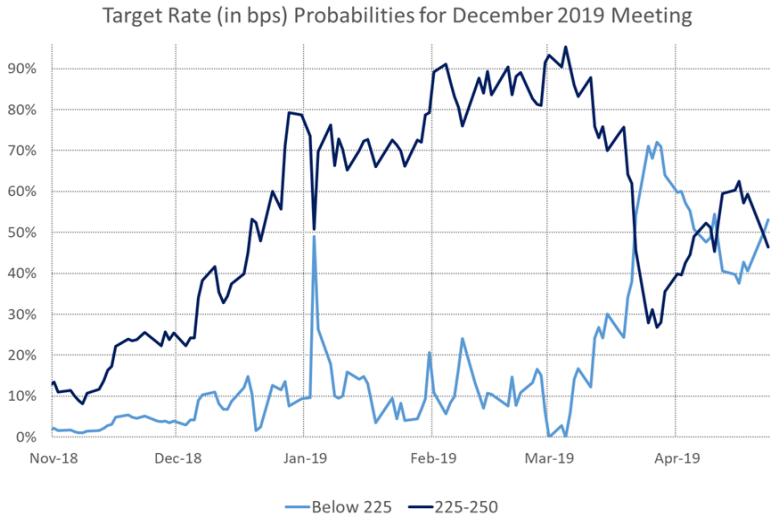
Seven weeks ago, we updated our three tactical rules: 1.) Don't Fight the Fed, 2.) Don't Fight the Trend, and 3.) Beware of the Crowd at Extremes. A lot has transpired in that short period of time. First, the Federal Reserve officially announced a revised balance sheet normalization plan that would slow the runoff of Treasuries and mortgages starting in May and ending in September of this year. Second, the S&P 500 rose over 150 points from 2783 to its current level of 2939. Finally, additional progress was made in the trade negotiations between the US and China, China's economic data improved, and earnings season in the US is off to a better than expected start; influencing investor sentiment. Below you will find a summary chart highlighting changes in the three rules since our March 11th, *Weekly View*:

	March 11th	April 29th
Don't Fight the Fed	***Supportive***	***Supportive***
Don't Fight the Trend	***Flat***	***Positive***
Beware of the Crowd at Extremes	***Extreme Optimism***	***Extreme Optimism***
Positioning	***Prefer Equities over Bonds***	***Prefer Equities over Bonds***

Opinions are subject to change and not intended as investment recommendations.

DON'T FIGHT THE FED: Investors should not go against the policy guidance of central bankers in the US or abroad. Current Condition: Supportive for US and International

Now that the Federal Reserve rate hiking campaign has been taken off the table and the Fed has stated its willingness to allow inflation levels to run above its 2% target for an extended period, we believe that the Fed continues to be supportive. The Fed's pausing has helped facilitate lower mortgage rates and to reinvigorate a slowing housing market. The range for the fed funds rate is currently between 2.25 and



Source: Chicago Mercantile Exchange (CME) Group, RiverFront. Past performance is no guarantee of future results. Not indicative of RiverFront Performance.

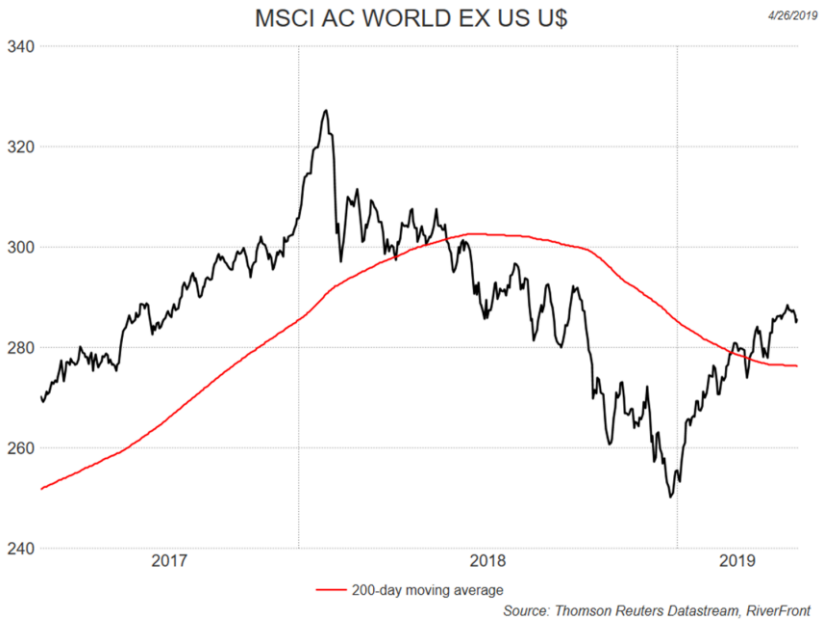
2.50%. Since our last update, the probability of the fed funds rate being unchanged through December 2019 has fallen to 36% due to the market pricing in a 64% chance of at least one rate cut before year-end; a scenario that did not exist in March (chart above). Although we believe that traders are now overly optimistic about the prospects of a rate cut we recognize that the Fed is willing to respond quickly to softer data. Thus, for now we believe the Fed is on the investor's side.

Internationally, while the backdrop of central bank policy is accommodative in Europe and Asia, we believe further stimulus is necessary given the tepid trajectory of growth, hence our neutral view. In China, the Peoples' Bank of China (PBoC) is providing its own version of quantitative easing and we view the central bank guidance as bullish.

DON'T FIGHT THE TREND: Investors should determine the direction and strength of the trend and make investment decisions accordingly. Current Condition: US: Positive, International: Flat

The trend, which we define as the S&P 500's 200-day moving average (smooth line, right chart), flattened after the S&P 500's high of 2940 in September 2018. The subsequent 6 months consisted of the S&P 500 trading in a range. However, now that the S&P is nearing its all-time trading high, the trend has steepened and turned positive. This is a significant change from seven weeks ago, reflecting accelerating momentum due to investors embracing the return of Chinese growth and better than expected first quarter earnings by US companies. We wrote on March 11th that the trend was at a crossroad. If it turned positive, the odds for a positive return over the next three months would improve above the long-term average when combined with current sentiment levels. However, a decidedly negative turn of the trend would warrant caution. The former scenario is playing out and therefore we rate the trend overall as 'bullish'.

Internationally, the positive economic growth in China combined with de-escalating trade tensions has turned the trend from negative to flat as shown by the smooth line in the chart (bottom right) of the MSCI All-Country World ex- US Index. We are encouraged by the index rising above its 200-day moving average.



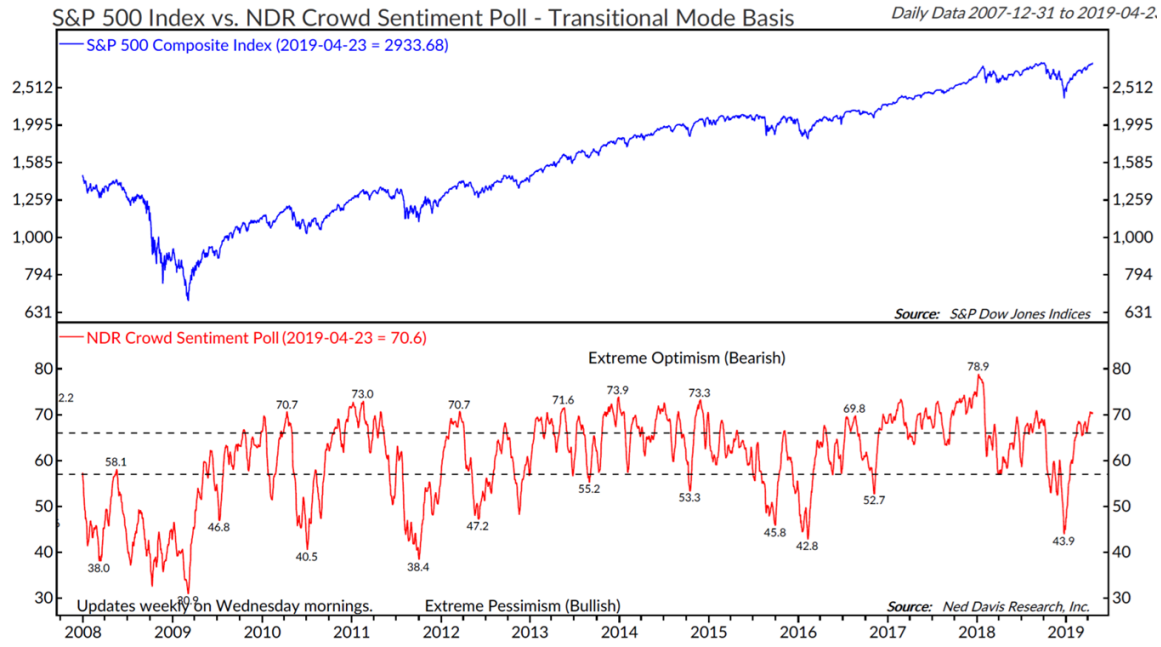
Past performance is no guarantee of future results. Shown for illustrative purposes and not indicative of RiverFront performance. See disclosures for index definitions.

BEWARE OF THE CROWD AT EXTREMES: Sentiment is a contrary indicator at extremes. Analyze sentiment by determining if it is sustainable at current levels. If sentiment is identified to be unsustainable, then as investors we should be willing to lean in the other direction and be prepared to act more aggressively once the condition changes**.** Current Condition: US: Extreme Optimism, International: Neutral

Given the S&P 500's strong start to 2019, investors' fear of "missing out" could drive the crowd to reach higher extremes of optimism, as sidelined investors are enticed to chase returns. We use Crowd Sentiment Polls from Ned Davis Research (NDR) to help gauge whether the "Crowd" has reached optimistic or pessimistic extremes. As can be seen in the chart below, NDR's sentiment poll has moved further into "extreme optimism" territory over the last seven weeks, suggesting that we should continue to be more cautious going forward. Extreme optimism can resolve itself in one of two ways; either the market can decline making investors less optimistic, or simply consolidate (trend sideways) until the condition fades.

We have found judging the "Crowd" to be important, however we recognize that crowd sentiment signals often require additional interpretation. For instance, when extreme optimism is combined with a positive trend, which is the current condition in the US, markets have historically tended to grind higher over time. Today, we believe that the US market will encounter some resistance at the S&P's historical highs and will be range-bound until it can 'work-off' the high levels of investor optimism.

While there is no comparable sentiment indicator for international equities, we judge international sentiment to be relatively neutral.



THE FINAL VERDICT:

We believe the Fed is on the investors' side, the trend is positive, but the 'crowd' is too optimistic. Net/net the conditions for our three tactical rules have improved from neutral to positive. Therefore, we believe that it is appropriate to remain slightly overweight equities given our view of the low probability of a recession and reasonable valuation levels.

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

It is not possible to invest directly in an index.

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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.

MSCI ACWI ex USA Index captures large and mid-cap representation across 22 of 23 developed markets (DM) countries (excluding the US) and 23 emerging markets (EM) countries.

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