RIVERFRONT INVESTMENT GROUP

Weekly View

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SUMMARY

- The first quarter reminds us how much bond prices can fluctuate; bonds are not without risk.
- We think that yields can go higher, perhaps up to 2.20%.
- Should ten-year yields rise another 0.5%, it will take nearly 3 years of income to cover the price loss.

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Know Your Fixed Income Neighborhood

Since the beginning of the year, the yield on the ten-year Treasury has risen by approximately 80 basis points, delivering a return of -6.37%, which brings to the forefront that bonds can lose value when yields rise, especially when yields start at such low levels (see table below). While this is not the first time that bonds have underperformed in history, the move up in yield of the 10-year Treasury resembles that of the Taper Tantrum that began in May 2013. The Taper Tantrum was a reaction to the Federal Reserve (Fed) announcing that it was going to reduce its bond buying program known as Quantitative Easing (QE). In just a month, the 10-year Treasury yield went from 1.63% to 2.13%, eventually peaking in September at 3.00%. It is often stated that history is our guide and if we do not know our history, we are doomed to repeat it. Therefore, as fixed income investors we must know our fixed income neighborhood; whether our bonds have long or short maturities.

Returns of Asset Classes by Calendar Year (as of 03.31.2021)

2011	2012	2013	2014	2015	2016
Treasury Bonds 9.81%	Emerging Market Equities 18.22%	US SMID Cap 35.87%	US Large Cap 13.69%	US Large Cap 1.38%	US SMID Cap 22.49%
Fixed Income Inv. Grade 7.84%	Developed Int'l Equities 17.90%	US Large Cap 32.39%	US SMID Cap 8.54%	Treasury Bonds 0.84%	High-Yield 17.49%
High-Yield 4.38%	US SMID Cap 17.4%	Developed Int'l Equities 23.29%	Fixed Income Inv. Grade 5.97%	Fixed Income Inv. Grade 0.55%	US Large Cap 11.96%
US Large Cap 2.11%	US Large Cap 16.00%	High-Yield 7.42%	Treasury Bonds 5.05%	Cash 0.03%	Emerging Market Equities 11.19%
Cash 0.07%	High-Yield 15.59%	Cash 0.05%	High-Yield 2.50%	Developed Int'l Equities -0.39%	Fixed Income Inv. Grade 2.65%
US SMID Cap -0.92%	Fixed Income Inv. Grade 4.21%	Fixed Income Inv. Grade -2.02%	Cash 0.02%	US SMID Cap -2.11%	Developed Int'l Equities 1.51%
Developed Int'l Equities -11.73%	Treasury Bonds 1.99%	Emerging Market Equities -2.6%	Emerging Market Equities -2.19%	High-Yield -4.64%	Treasury Bonds 1.04%
Emerging Market Equities -18.42%	Cash 0.08%	Treasury Bonds -2.75%	Developed Int'l Equities -4.48%	Emerging Market Equities -14.92%	Cash 0.26%

2017	2018	2019	2020	10 YEAR AVERAGE	Q1 2021
Emerging Market Equities 37.28%	Cash 1.82%	US Large Cap 31.49%	US Large Cap 18.40%	US Large Cap 14.49%	US SMID Cap 14.88%
Developed Int'l Equities 25.62%	Treasury Bonds 0.86%	US SMID Cap 25.14%	Emerging Market Equities 18.31%	US SMID Cap 12.44%	US Large Cap 6.17%
US Large Cap 21.83%	Fixed Income Inv. Grade 0.01%	Developed Int'l Equities 22.66%	US SMID Cap 12.98%	High-Yield 6.85%	Developed Int'l Equities 3.48%
US SMID Cap 15.33%	High Yield -2.26%	Emerging Market Equities 18.42%	Treasury Bonds 8.00%	Developed Int'l Equities 6.43%	Emerging Market Equities 2.29%
High-Yield 7.48%	US Large Cap -4.38%	High-Yield 14.41%	Developed Int'l Equities 7.82%	Emerging Market Equities 5.07%	High-Yield 0.90%
Fixed Income Inv. Grade 3.54%	US SMID Cap -10.3%	Fixed Income Inv. Grade 8.72%	Fixed Income Inv. Grade 7.51%	Fixed Income Inv. Grade 3.90%	Cash 0.02%
Treasury Bonds 2.31%	Developed Int'l Equities -13.36%	Treasury Bonds 6.86%	High-Yield 6.17%	Treasury Bonds 3.40%	Fixed Income Inv. Grade -3.37%
Cash 0.82%	Emerging Market Equities -14.58%	Cash 2.21%	Cash 0.54%	Cash 0.59%	Treasury Bonds -4.25%

Source: Morningstar Direct, RiverFront. 10-year average is the average of the annual returns listed for each category. Past performance is no guarantee of future results. Diversification does not guarantee a profit or eliminate the risk of loss. Index returns are provided for informational purposes and are not indicative of RiverFront portfolio performance. Q1 2021 data through March 31, 2021.

Historically, fixed income has played an important role in investors' portfolios. For some, fixed income served as the income vehicle in portfolios that allowed investors to retire and live comfortably, receiving the interest payments without touching their principal. For others, fixed income was used to help offset the risk in the equity portion of their portfolio. Owning bonds provided peace of mind for investors who bought high quality US Treasuries. Unfortunately, times have changed as the bull market in bonds drove yields to historic lows and signs of yields reversing course create added risk for bond investors. We believe that it is important for investors to understand the impact of yield movements prior to investing in the asset class, as we have seen a significant move up in rates to start 2021.

Eight years have passed since the Taper Tantrum but somehow it feels like déjà-vu, as the 10-year Treasury currently yields near 1.70% and the US economy is accelerating after a year of pandemic lockdowns. Additional pressure on bonds will likely come from the growing fiscal policy that has added nearly $3 trillion of stimulus over 5 months and proposed a $2.25 trillion infrastructure deal in concert with the Fed's $120 billion per month in monetary stimulus. These conditions are leading some analysts to predict that the Fed will not be able to stick to their zero-interest policy and will have to raise interest rates earlier than the 2023 timeframe that most expect. While yields have already moved up considerably over the first 3 months of the year, using the Taper Tantrum as our guide, we could see yields rise another 50 basis points to around 2.20%.

How long to recover your losses – an example:

Based on the approximate yield on the 10-year Treasury of 1.70%, if bond yields rise to 2.20%, that equates to a decline in the price of the ten-year Treasury of approximately 4.75%. It would take 2.79 years of receiving income of $17 per $1,000 bond just to cover a 50-basis point move higher in yields as illustrated in the chart below.

Assumptions	1.70% 10-yr yield	2.20% 10-yr yield
Principal	$1,000	$1,000
Interest rate	1.70%	2.20%
Annual income	$17	$20
Maturity	10 years	10 years
Payments per year	2	2
Number of periods	20	20
Total Cashflow at Maturity	**$1,184.45**	**$1,244.58**

Assumptions	2.20% 10-yr yield
Principal	$1,000
Maturity (in years)	10
Duration (in years)	**9.5**
Basis point move up	50
Price Return	**-4.75%**
Principal Loss	$47.50
Annual Income (per bond)	$17.00
Loss Recovery (in years)	2.79

Cashflow calculation *= principal * (1+ int. rate/payments per year)* $^{\text{number of periods}}$

Annual income *= principal * interest rate*

Price return *= duration * - basis point move*

Principal Loss *= principal * price return*

Annual income *= principal * interest rate*

Loss Recovery *= principal loss/annual income*

Disclosures: Past performance is no guarantee of future results. Shown for illustrative purposes. Not indicative of RiverFront portfolio performance.

Traditionally, investing in treasuries has been viewed as a risk-free investment because investors received semi-annual interest payments and their principal back at maturity. However, to think bonds are without risk is a misnomer. As we have illustrated investors can face the risk of principal erosion if yields move dramatically higher and they elect to sell the bond prior to maturity. Under this scenario, interest payments are used to offset principal losses when calculating the total return of the investment prior to maturity. For those investors that choose to hold the bond until maturity, they are foregoing their true earning potential as they will be earning a below market interest rate.

While we have focused on interest rates moving higher from current levels, it is possible that rates could go lower if the economic recovery hits a snag. Therefore, it is important that we point out, if yields were to fall by 50 basis points, there would be a positive 4.75% price return on the 10-year Treasury if sold prior to maturity but the investor would not be maximizing their income potential. We point out these nuances, so that investors understand the implications of interest rate moves prior to making an investment.

Here at RiverFront, we believe that given the abundance of fiscal and monetary stimulus it is more likely that the 10-year Treasury yield will rise to 2.20% than fall to 1.20%. Thus, we continue to underweight fixed income as we expect equities to provide a better total return for our investors. By knowing the fixed income neighborhood, we understand the ramifications of our decisions, and we believe it is important for individual investors who have experience various parts of the bond bull market to do the same.

Important Disclosure Information

The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Opinions expressed are current as of the date shown and are subject to change. Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

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

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 benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit www.riverfrontig.com or contact your Financial Advisor.

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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.

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A basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. (bps = 1/100th of 1%)

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