RIVERFRONT INVESTMENT GROUP

Weekly View

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SUMMARY

- We recognize that 'balanced' portfolio returns have disappointed investors in 2022.
- However, we believe this year's painful returns are a historical anomaly.
- At current valuations, the balanced portfolio is NOT dead, in our view.

11.28.2022

The Balanced Portfolio is Not Dead...We Believe it has Been Resurrected

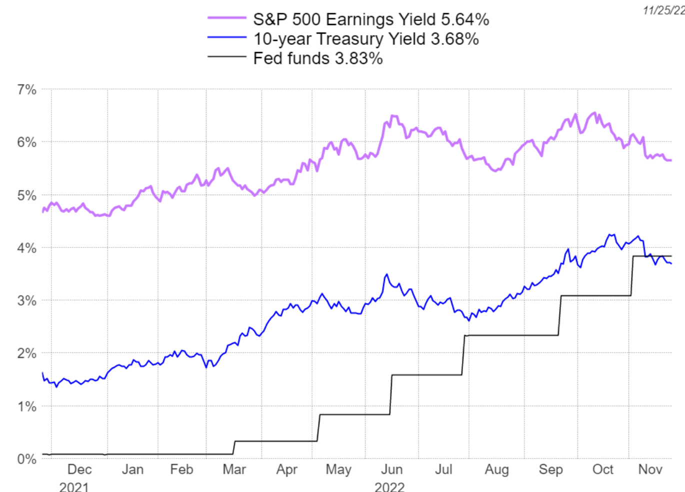
Much has been written recently about the death of the 'balanced' portfolio, which is a portfolio that blends both stocks and bonds. However, we believe that the Mark Twain quote "the rumors of my demise have been greatly exaggerated" more accurately describes the state of the balanced portfolio market. **In our view, the balanced portfolio is far from dead... we believe it has been recently resurrected.**

Critics are Looking Through the Rearview Mirror, In Our View

We believe the argument against the balanced portfolio can be summed up in two ways. First, in early 2022, critics, including us (see table, next page) argued that low interest rates and expensive stock valuations negatively impacted the long-term return expectations for balanced portfolios. Second and more recently, critics have complained that balanced portfolios have performed poorly in 2022 and have failed to display the protective characteristics that investors have become accustomed to. While the second point is factual, we believe the new levels of both stock valuations and bond yields mean both points are now 'rearview mirror thinking' and we prefer to make investment decisions based on the view ahead.

We Believe that the View Through the Windshield has Improved Significantly

Stock and bond valuations are much improved from the beginning of 2022. Looking forward, we see a view that is very different than what lies in the rear-view mirror. For one thing, yields in the fixed income markets have risen significantly across all maturities. Fed Fund target ranges, for example, have risen from around 0.00-0.25% to 3.75 – 4.00% in the space of ten months and the 10-year Treasury Note now yields 3.75%, up from 1.5% at the beginning of the year (See Chart, right). Valuations on stocks have also come down significantly from where they started this year. On January 1, 2022, the S&P 500 was valued at a 21.7x forward Price-to Earnings (P/E) ratio, which was equal to 4.6% earnings yield, or earnings/price. As of Friday (November 25, 2022), forward P/E's on the S&P 500 have contracted to roughly 17.4x and a 5.7% earnings yield. We believe higher yields on bonds and lower P/E's on stocks set the stage for better returns in the future for balanced portfolios.



Source: Refinitiv Datastream, RiverFront. Data daily as of November 25, 2022. Shown for illustrative purposes only. Past Performance is no guarantee of future results.

Back in March 2022, low bond yields and high stock valuations led to relatively low long-term capital market assumptions (LTCMAs). As can be seen in the accompanying table (below), our 2022 base case LTCMAs were just 4.9% for US large-cap

stocks and 1.5% for US bonds. In early 2023 we will try to assign a value as to 'how much better' we expect returns to be when we release our annual capital market assumptions (CMAs). Assuming stocks and bonds are at similar levels to where they are today, we anticipate the increase in our CMAs to be meaningful.

SUMMARY: 2022 Long-Term Equity Capital Market Assumptions			
	Pessimistic: Bear Case	Base Case	Optimistic: Bull Case
Us Large-Cap Stocks TOTAL RETURN FORECAST *(nominal, annualized)*	1.5%	4.9%	8.4%
Developed International Stocks (USD) TOTAL RETURN *(nominal, annualized)*	1.4%	6.6%	10.8%
Emerging Market Stocks (USD) LONG-TERM RETURN FORECAST TOTAL RETURN *(nominal, annualized)*	1.5%	6.5%	10.5%
US AGGREGATE BOND INDEX, TOTAL RETURN FORECAST *(nominal, annualized)*	2.7%	1.5%	0.9%

Shown for illustrative purposes. Index and asset class definitions are available in the disclosures. The table above depicts RiverFront's predictions as of March 10, 2022 for 2022 using three scenarios (Pessimistic (Bear), Base, and Optimistic (Bull)). The assessment is based on RiverFront's Investment Team's views and opinions as of the date of publication. Each case is hypothetical and is not based on actual investor experience. These views are subject to change and are not intended as investment recommendations. There is no representation that an investor will or is likely to achieve positive returns, avoid losses or experience returns as discussed for various market classes.

Bonds: Higher Yields = Greater Future Protection, In Our View

We expect that many investors with balanced portfolios are suffering from 'statement shock' in 2022. Balanced investors are not used to their portfolios declining as much as the stock market during periods of weakness. Investors have become accustomed to better returns from their balanced portfolios during market routs as in the Financial Crisis of '08-'09 or the pandemic sell-off of 2020. During those periods, yields declined, and bond prices increased because the issue was recession and the Fed was cutting interest rates, which helped offset falling stock prices. This year the Fed has raised rates significantly.

As a result, asset class returns in 2022 have been very different with bonds and stocks down roughly the same 13% to 14%. Therefore, no matter the mix (30/70, 50/50, 60/40 or 80/20), returns have been similar to a 100% stock portfolio thus far in 2022. A combination of very low starting yields and an inflation shock led to negative returns that were highly unusual. In fact, according to The Daily Shot/Bank of America, this is only the fourth year in over 300 where the global bond market has experienced such negative returns as a percent of GDP (the others being 1721, 1865 and 1920). Given the rarity of its occurrence (about every 100 years), it would be difficult, if not foolhardy to construct portfolios anticipating a similar environment in the future since historically one would be wrong far more often than one would be right. Going forward, bond yields are now high enough, in our view, that they have room to decline if the economy goes into recession and equities encounter additional difficulties. In a recession, we think the Fed is more likely to cut rates allowing bond prices to rise, which can help offset some stock market losses.

Conclusion: The Case for Balanced Portfolios is Now Compelling, In Our View

If you are going on a road-trip, as many did over the Thanksgiving holiday, the length of the journey is dependent upon the starting point, the destination, and the average travelling speed. For example, a destination that is 100 miles away and can be made by interstate will be much quicker than one that is only reachable by back roads, or one that is longer. Similar rules can be applied to investing. Each of us is traveling toward an investment destination, like retirement, college funding or endowing a favorite cause. Our arrival time is also dependent on the length of the journey and the travelling speed. When yields are low and stock valuations are high, which they were last year, one can expect the length of the journey to be long since the speed of travel will be slow. As yields rise and stock valuations fall, long-term portfolio returns have historically accelerated, shortening the length of the journey. Therefore, due to our improved long-term outlook for balanced portfolios, we think investors for balanced accounts can expect attractive returns again.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. 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. Please see the end of this publication for more disclosures.

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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All charts shown for illustrative purposes only. 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.

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.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

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.

Index Definitions:
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.

Gross Domestic Product (GDP) is the monetary value of all finished goods and services made within a country during a specific period. GDP provides an economic snapshot of a country, used to estimate the size of an economy and growth rate.

Large Cap: US equities of companies typically in S&P 500® Large Cap Index which measures the performance of 500 Large Cap stocks, which together represent about 80% of the total US equities market.

Developed International Equities are non-US equities in developed countries (typically as defined by MSCI EAFE Index).The MSCI EAFE Index is an equity index which captures large and mid cap representation across Developed Markets countries around the world, excluding the US and Canada. With 927 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.*

Emerging market equities are non-US equities in emerging market countries (typically as defined by MSCI Emerging Markets Index). The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 838 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. 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.

The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

P/E Ratio (TTM): The Price/Earnings Ratio or P/E Ratio is a valuation metric that assesses how many dollars investors are willing to pay for one dollar of a company's earnings. It's calculated by dividing a stock's price by the company's trailing 12-month earnings per share from continuous operations. Negative P/E ratios are excluded.

Definitions:

Interest rate sensitivity is a measure of how much the price of a fixed-income asset will fluctuate as a result of changes in the interest rate environment. Securities that are more sensitive have greater price fluctuations than those with less sensitivity. This type of sensitivity must be taken into account when selecting a bond or other fixed-income instrument the investor may sell in the secondary market. Interest rate sensitivity affects buying as well as selling.

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