RIVERFRONT INVESTMENT GROUP

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THE WEEKLY VIEW

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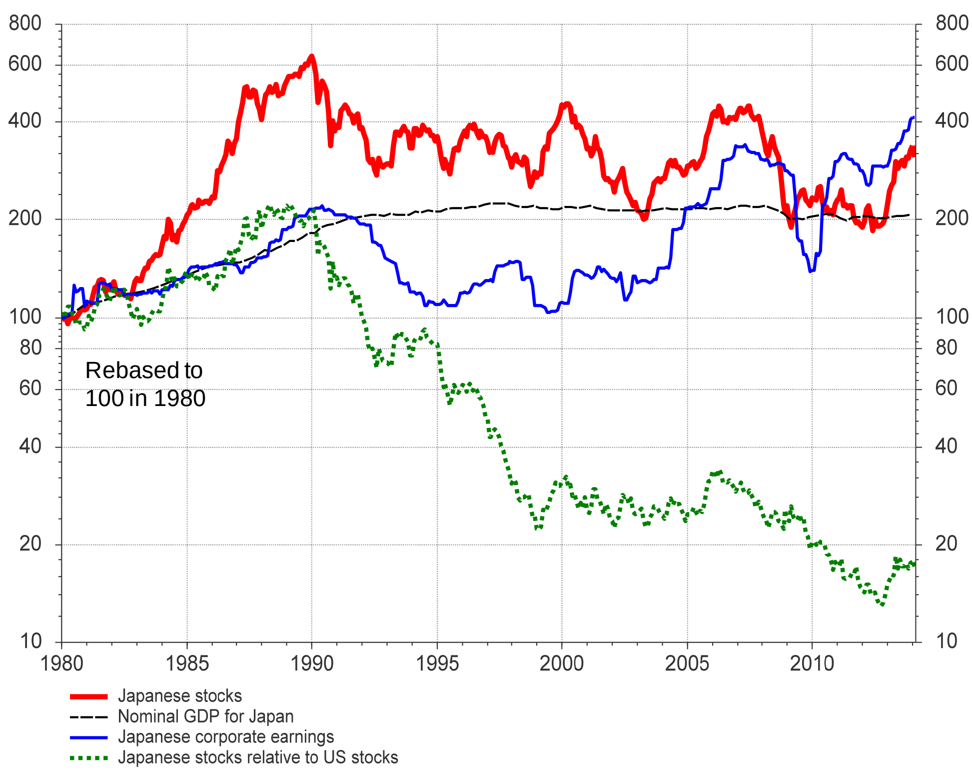
We regard the recent weakness in Japanese stocks as a buying opportunity and believe the Bank of Japan, Prime Minister Abe, and corporate Japan are seeing the benefits of their commitment to re-start growth and end deflation.

Since 2004, corporate Japan has cut costs sufficiently to triple earnings despite zero economic growth. We think this is impressive.

Adding to Japan

We think Japan is one of the most attractive markets in the world based on our expectations of return versus risk over the next 12 months. This view is not consensus. There are growing doubts about Japan's commitment to structural reform and worries about the impending consumption tax hike. These concerns have been reflected in Japanese stocks' weak start in 2014, especially relative to Europe and the US. We regard this as a buying opportunity and believe the Bank of Japan, Prime Minister Shinzo Abe, and corporate Japan are seeing the benefits of their commitment to restart growth and end deflation. Since we expect further yen weakness (see Weekly Chart), we have increased our Japan exposure on a currency-hedged basis.

Corporate Japan has restructured: Since 2004, corporate Japan has cut costs enough to triple earnings (blue line in chart below) despite zero economic growth (black line). We think this is impressive. In the 1980s, Japanese companies took strong economic growth for granted. Corporate earnings grew in line with the economy (the blue and black lines moved together) and Japanese stocks (red line) rose much faster than earnings and outperformed relative to US stocks (green line). Just as with the NASDAQ in the late 1990s, Japanese price-to-earnings ratios (PEs) rose to more than 100.

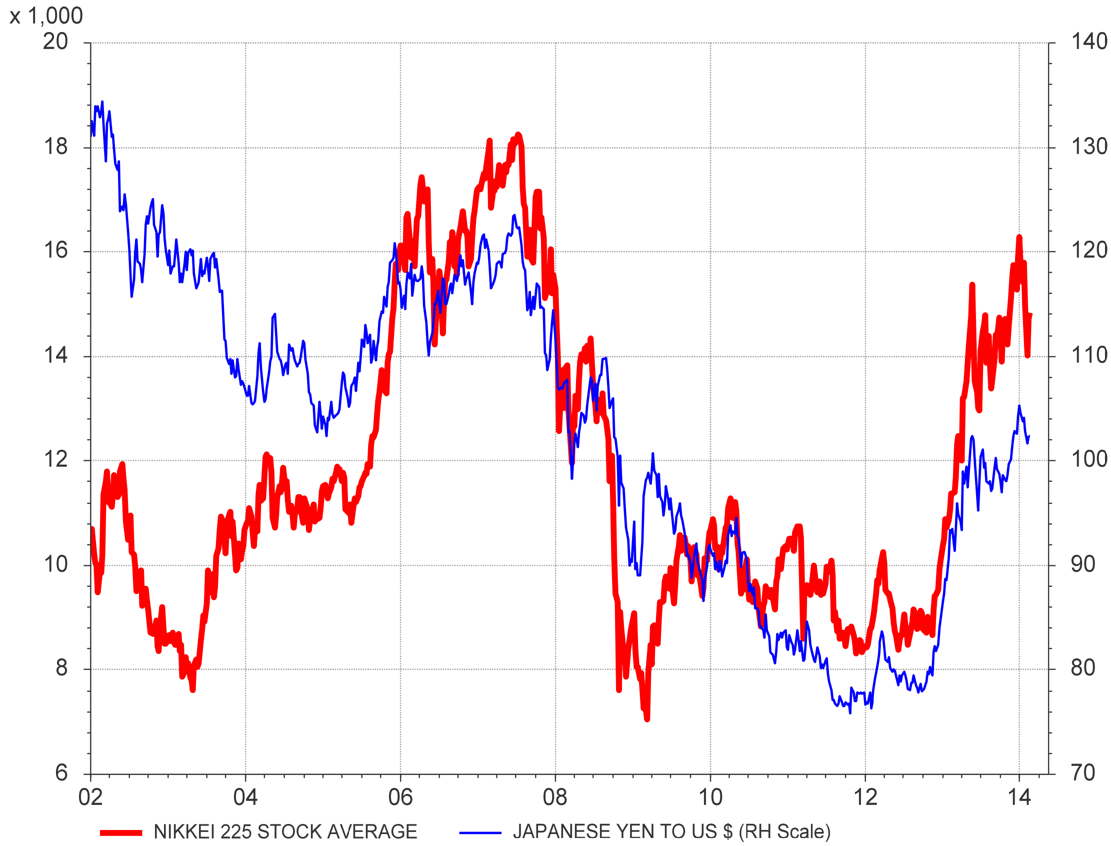


Source: Thomson Reuters Datastream; Past performance is no guarantee of future results.

Japanese stocks have endured 25 years of relative underperformance and thus, with stock prices lower and earnings higher, Japanese PEs are in line with the rest of the world. In fact, due to 40% earnings growth last year, Japan was one of the few developed world stock markets that did not experience PE multiple expansion over the past year.

For 12 years starting in 1992, successive governments and corporate leaders in Japan avoided admitting that growth would not bounce back. Earnings plummeted as the government failed to address bad bank debt and corporations refused to cut costs. The late-1990s global boom provided a reprieve, and so it was not until the recession in the early 2000s that corporate Japan decided to change. Since then, despite constant deflation, which has offset any volume growth in Japan's economy, corporate earnings have tripled. Japan's labor productivity has been among the world's best over the last 10 years, but it has not helped the domestic economy. One year ago, the government of newly elected Prime Minister Abe persuaded the Bank of Japan to adopt a radical policy of Federal Reserve-style balance sheet expansion (Quantitative Easing) to weaken the yen, combat deflation, and reignite nominal GDP growth. Stocks, real estate, corporate profits, and inflation have all responded. Now Abe is urging companies to share some of the gains with their workers through annual bonuses and wage agreements. We see many signs that Abenomics has been effective, from improving confidence and retail sales among Japan's consumer base, to increased business confidence and capital expenditures at the corporate level. We believe nominal GDP growth will rise around 2% in 2014 if nuclear power restarts allow energy imports to decline.

THE WEEKLY CHART: THE YEN AND THE NIKKEI HAVE BEEN LINKED FOR 10 YEARS



Source: Thomson Reuters Datastream; past performance is no guarantee of future results.

A weakening yen (stronger dollar) has been critical to jump starting Japan's stock market. We believe the dollar will continue to rise versus the yen (blue line, right scale) and that this will help drive the Nikkei higher. Japan's challenges of a declining population and the developed world's worst budget deficit argue for a weaker currency. The Bank of Japan's continued commitment for further aggressive balance sheet expansion in 2014, the only country still doing so, also strengthens the weak-yen case. We do not believe the bears give enough credit to corporate Japan for their restructuring efforts over the last 10 years, and that they are underestimating the resolve of policymakers to restore top-line growth. Japan needs growth to tackle its long-term debt. Now that Japan has changed from a nation of savers to a nation with significant debt, we believe policy will favor debtors and Japan's reflation efforts will continue.