RIVERFRONT INVESTMENT GROUP

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THE WEEKLYVIEW

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Outlook 2015 Highlights: The Policy Pendulum Swings

The Economy: Euro QE + Cheap Oil = Stronger global growth. Our theme for 2015 – The Policy Pendulum Swings – is designed to capture our view that 2015 will see not only a policy swing from the US to Europe, but also highlight that the global economic clock is always ticking. It is now six years since markets bottomed and the global economy started to dig its way out of the 'Great Recession'. US policymakers were the first among major economies to recognize the deflationary risks posed by the collapse of property prices and the global financial crisis. Their proactive stance has led to faster economic growth, higher asset prices, and a full recovery in corporate profits and profit margins. When combined with a stronger dollar and cheap oil, we think non-US developed world growth will accelerate in 2015 and give a greater boost to share prices overseas than in the US, which has enjoyed decent growth for several years. QE (Quantitative Easing) is central bank purchases of assets, primarily bonds.

Stocks: Time to rightsize expectations, the Fed's pendulum is swing away from extreme policy easing. We are bullish on US stocks, but we only expect single-digit annual returns between now and the next US recession. If recession is many years away, as we expect, then we believe the risk/reward tradeoff for stocks versus bonds or cash remains compelling. We expect the S&P 500 to rise to around 2200 in 2015 with a potential trading range of between 1870 and 2380 versus its year-end level of 2058.

Our portfolios will continue to favor industries and companies that can deliver superior, dependable earnings growth relative to the market at reasonable prices. A few of these selection themes we have chosen to position in the portfolios include: **Large-caps over Small and Mid-Caps:** Large-caps are more attractively valued and less sensitive to rising interest rates and falling commodity prices than their small and mid-cap peers. **Non-Rate Sensitive Dividend Stocks:** We have a natural bias toward dividend stocks, especially when they are valued similarly to the broad market, as they are currently. **Consumer-Related:** Strong payroll growth, rising wages, low interest rates, and the rebate that comes from falling energy prices should keep consumer spirits high in 2015 and spur spending.

Bonds: Not chasing yields lower – overweight credit, keeping maturities short. At every point along this year's journey to lower yields, the risk/reward of buying long-term bonds continued to look very poor to us. We know how pure momentum strategies can lead to whipsaw; so with our longer term conviction favoring credit, we have not allowed momentum to drive our decisions. We believe that buying 10-year Treasuries at 2.25% in the hope that they might fall to 1.75%, when their post-WWII range is 2% to 16%, boarders on irresponsibility. We have sought instead to add value through credit selection. Short maturity high yield bonds (5 years or less) currently yield 3 to 4 percentage points more than the Barclays US Aggregate Bond Index, where the weighted average maturity is 7 years.

International: The Policy Pendulum Swings Overseas. During most of 2014, the Federal Reserve continued its Quantitative Easing (balance sheet expansion) program while the ECB's (European Central Bank) balance sheet contracted as previous loans to banks rolled off and they did not add to their holdings. 2015 will be very different, in our view. The Fed's QE program has ended and they are likely to raise interest rates in the next year. In contrast ECB chairman Mario Draghi has pledged to add around 1 trillion euro in QE. We think this leads to a stronger dollar and better stock market returns in Europe and Japan.

Our expected returns for Eurozone and Japanese multinationals are higher than for US stocks, especially in local currency terms, hence our strategy of hedging these currencies back to the dollar. Currencies are often accurate barometers of policy action, and we believe the weak yen is accurately reflecting the unprecedented determination of the Abe administration to reignite a recovery in economic growth and corporate earnings. What's more, the evidence of corporate earnings and the performance of the Nikkei index clearly show it is working. In emerging markets, we go into the year underweight. We expect emerging markets to have a difficult time in 2015, and are forecasting total return and reward-to-risk ratios that are inferior to developed international stocks for the upcoming year. However, this broad view comes with an important nuance; we strongly favor emerging Asia over Latin America, Africa, and Eastern Europe.

The Weekly Chart links RiverFront's three scenarios, Pessimistic, Baseline, & Optimistic, with the major policy issues that we believe will have the greatest impact on the global economy in 2015. We focus on the biggest economic blocks: United States (US), Europe (EU), and Emerging Markets (EM). Our assessment of each scenario's probability is also shown. Each scenario includes our expectations for gross domestic product (GDP), stocks, ten-year bond yields, and the dollar.

THE WEEKLY CHART: RIVERFRONT'S 2015 SCENARIOS AND FORECASTS

	PESSIMISTIC Europe & China: too little, too late	BASELINE Europe QE + Cheap Oil	OPTIMISTIC Return of the US Consumer
PROBABILITY	15%	55%	30%
OIL PRICES	$40 or below	Stabilizes at $50 to $70	Slight recovery to $60 to $80
POLICY OUTCOME US	US pulled down with rest of world	Low gas prices spur consumption	Fed raises rates faster than anticipated
POLICY OUTCOME EU (EUROZONE)	Europe fails to contain deflation	ECB embraces QE	ECB QE plus accelerating exports to US
POLICY OUTCOME EM (EMERGING MARKETS)	China hard landing; Russian default	China buys time	Rising tide lifts EM economies
US GDP (% YEAR-OVER-YEAR GROWTH)	0.7	3.0	3.6
LOCAL CURRENCY STOCK MARKET RANGE (%)	US, EAFE*: -10 to -20 EM: -15 to -25	US, EM: 5 to 10 EAFE*: 15 to 20	US, EM: 10 to 15 EAFE*: 20 to 25
US 10-YEAR BOND YIELDS (%)	1.25	3.00	4.25
DOLLAR	Unclear vs. Europe/ Japan, up 20% vs. EM	Up 10% vs. Europe, up 5% vs. Japan and EM	Up 15% vs. Europe, up 5% vs. Japan and EM

Source: RiverFront Investment Group

* Europe, Asia, Far East