

Strong Start by Europe and Japan as Policy Pendulum Swings



From right to left:

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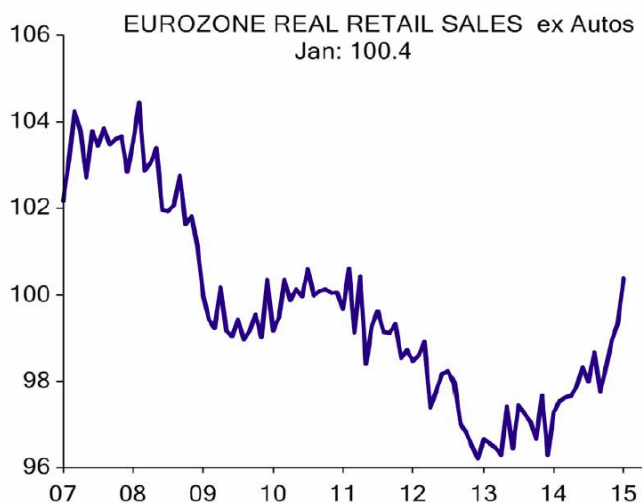
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Eurozone stocks are up 15% so far this year compared to 1% for the S&P 500 (see Weekly Chart). The prospect of monetary policy easing in Europe, combined with somewhat better economic data, has ignited the rally, in our view. Cyclically, Europe is where the US was several years ago – policymakers want to see the data improve and so do investors. The chart below shows the recent acceleration in Eurozone retail sales, which have been stronger than expected, no doubt in part helped by declining oil prices.

Eurozone stocks are up 15% so far this year compared to 1% for the S&P 500; however, euro weakness has limited this year's gains of Eurozone stocks to 5.5% in dollar terms.

RiverFront has hedged most of its euro and yen exposure and, as a result, our portfolios' developed international positions have benefited this year.



Source: Evercore ISI; past performance is no guarantee of future results.

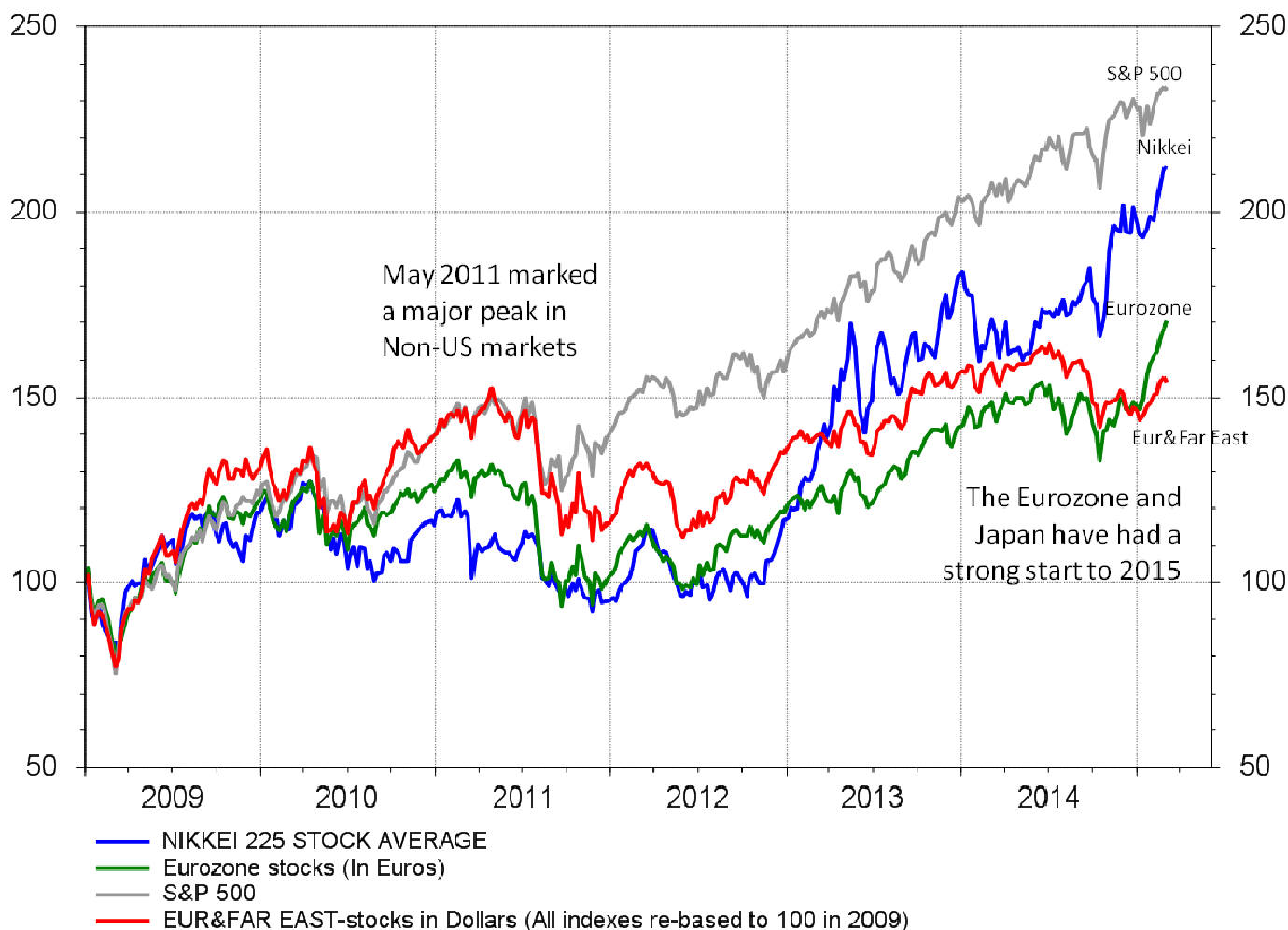
By contrast, improving US data hastens the moment when the Federal Reserve will raise interest rates from zero. Thus, Friday's announcement of continued strong employment data caused both bonds and stocks to sell off. US stocks also face other headwinds. Labor market strength is accelerating wage growth and raising unit labor costs, which will pressure profit margins. Non-farm hours worked rose 4.9% in the fourth quarter, the fastest quarterly pace since the fourth quarter of 1998 and double the average quarterly gain since 2000. With output rising only 2.6%, productivity fell. Finally, the dollar continues to strengthen, breaking out to 12-year highs versus the euro and retesting December's high versus the yen.

Euro weakness has limited this year's gains of Eurozone stocks to 5.5% in dollar terms. RiverFront has hedged most of its euro and yen exposure and, as a result, our portfolios' developed international positions have benefited this year. This has helped offset some of the underperformance by international stocks in 2014. In our

2015 Outlook, *The Policy Pendulum Swings*, we made the case for a stronger dollar and for outperformance by the Eurozone and Japan, especially in local currency terms. The chart below shows that trend playing out so far. For it to continue, earnings growth in Japan and especially the Eurozone will need to outpace those in the US. We believe they will.

An analysis of Eurozone earnings by RiverFront's Chris Konstantinos has revealed a two-speed Europe. Companies that generate more than 50% of sales outside Europe surpassed 2007's peak profits in 2010 and have continued to climb; they also generate a return on equity (ROE) of 15%, comparable to that in the US. In contrast, average Eurozone ROE is only 8% and earnings are still well below previous peaks. We are currently positioned in the Eurozone's global companies, watching for signs of a pickup on the domestic side.

THE WEEKLY CHART: JAPAN AND EUROPE PLAYING CATCH-UP



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

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Nikkei 225 Stock Index is a stock market index for the Tokyo Stock Exchange (TSE). The Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market. It is not possible to invest directly in an index.