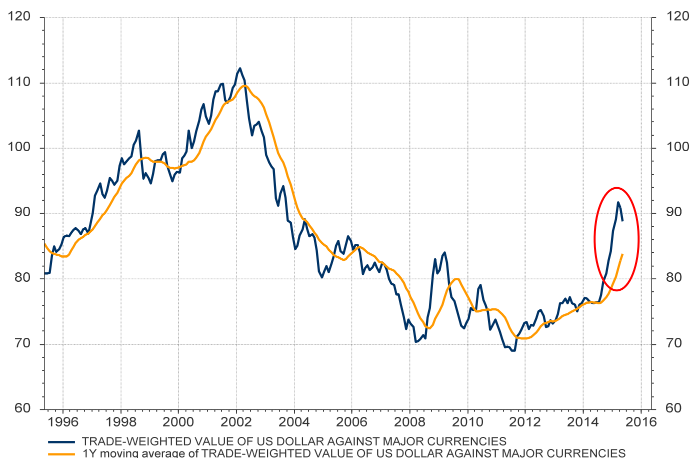
Trends and Counter-Trends

Rod Smyth
CHIEF INVESTMENT STRATEGIST

We believe some important themes have been established over the last year, many of which are currently experiencing counter-trend reversals. Our primary themes are as follows:

1. The dollar is currently in an up-trend.
2. US bond yields are bottoming.
3. International stock markets have begun to outperform the US market.

The Dollar: A Correction In A Primary Up-Trend



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

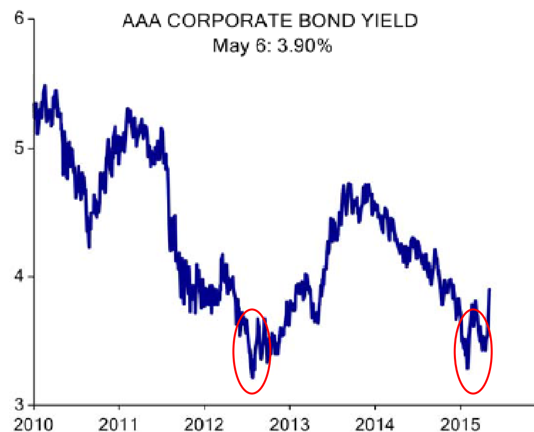
We expect US growth to rebound and the euro's downtrend to resume as investors anticipate the first US rate hike and the ECB continues its QE program for the next 16 months.

The Federal Reserve produces a monthly index of the dollar's value against a trade-weighted basket of major world currencies, and this is shown above. Following a long bottoming process from 2008 to mid-2014, the dollar has risen very strongly over the last year, establishing a powerful new up-trend, represented here by the one-year moving average. The logic of this makes sense to us, as does the recent pullback. The dollar began to rise in late 2011 as it became clear that the US economy was recovering, while Japan and Europe returned to recession. The pace of the dollar's advance was capped by the US' aggressive quantitative monetary easing (QE). As the end of US QE approached last September and the likelihood of a European QE program increased, the euro fell dramatically, causing a big upside break-out in the dollar. However, recent US economic data has been weak. Consumers have apparently chosen to save some of the windfall they have enjoyed due to low oil prices and, as a result, the energy sector has cut investment and employment. In contrast, European and Japanese growth has accelerated. We expect US growth to rebound and the euro's downtrend to resume as investors anticipate the first US rate hike and the European Central Bank (ECB) continues its QE program for the next 16 months.

We believe the S&P 500 will be an easier benchmark to beat in 2015, and we see the recent relative weakness in local currency international markets as a buying opportunity.

US bond yields bottoming: We have argued for a year (most recently in our March 2nd Weekly View) that US bond yields need to be understood in a global context and that US yields were being held down by German yields. The sharp rise in German yields (10-year yields have risen from 0 to 0.8% in just two weeks) has led to a rise in US yields despite the

weaker economic data. Reflecting on the chart below, which shows the yields on the highest quality US corporate bonds, we believe that the low in early 2015, which matched the low in mid-2012, could mark the bottom for this cycle.



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

The relative performance of international stock markets (in local currency) has turned up: At RiverFront, we were significantly underweight international developed markets during their relative decline in 2010 and 2011; but we began to increase weightings following ECB chairman Mario Draghi's summer 2012 commitment to do "whatever it takes" to restore confidence in the euro and growth to the eurozone. We went into 2014 overweight these markets and we suffered the consequences, as these markets underperformed.

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

The chart above shows the performance of the MSCI Europe, Australasia, and Far East (EAFE) index in local currency terms relative to the S&P 500 over the last five years. It is indexed to 100 at the beginning of 2010 and also shows the one-year moving average, or primary trend. During the first quarter of 2015, this index recovered all of its 2014 underperformance, causing the primary trend to turn up. We believe the S&P 500 will be an easier benchmark to beat, and we see the recent relative weakness in international markets as a buying opportunity.

Past performance is no guarantee of future results.

RiverFront Investment Group, LLC, is an investment advisor registered with the Securities Exchange Commission under the Investment Advisors Act of 1940. The company manages a variety of portfolios utilizing stocks, bonds, and exchange-traded funds (ETFs). Opinions expressed are current as of the date shown and are subject to change. 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.

The MSCI EAFE Index is an equity index that captures large and mid cap representation across Developed Markets countries around the world, excluding the US and Canada. 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.