Economic Momentum Slowing

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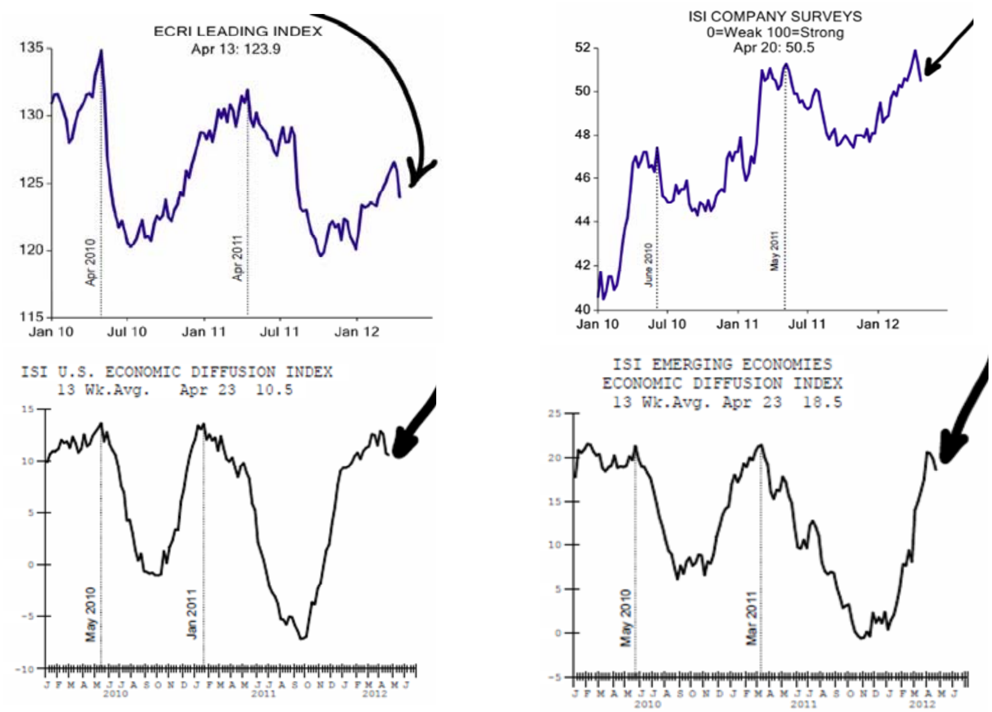
- As parts of Europe fall back into recession, accelerating US economic momentum has stalled and started to roll over. Given the experience of the last two years, stock returns will likely be influenced by how much economic weakness develops this summer. **Our view is that any slowdown will be less than last year, but we have recently become somewhat more defensive in our overall stock weightings and our stock positioning.**



Source: ISI Group Inc.

- Several gauges of economic activity are reflected in the charts above. To varying degrees, they show the weakness in each of the last two summers, and the strong recovery that followed the weakness. In recent weeks they have all rolled over. Top left is the Economic Cycle Research Institute's leading index, which has captured the turns in the economy but has underplayed overall economic strength, in our opinion. The bottom two charts measure economic news flow for US and emerging markets; when the line is rising and above zero, there is typically more good news than bad news.
- We particularly like the top right chart, which is ISI's proprietary company survey index. Each week ISI contacts more than 300 companies in a very wide variety of manufacturing and service industries to get real time feedback on the economy. Due to the sudden recent drop in their surveys, ISI sent up a "flare" alert. We are trying to decide if our more conservative portfolios should have a larger position in cash and/or short-term bonds heading into the summer. Among our considerations is the knowledge that Federal Reserve chairman Bernanke last week reaffirmed his

willingness to inject further money into the bond market (QE3) should the economy weaken, so we can feel relatively confident of monetary support. In contrast, we are concerned about the budgetary side, or 'fiscal cliff.' Between now and November, investors will be trying to assess the likelihood of a renegotiation of the Bush era tax cuts, which are set to expire next year. In the absence of a deal, which would seem to be in the interests of both parties once the election is over, growth in 2013 would likely suffer a fiscal shock. As ever, our fundamental assessment will be supplemented by a technical view.

- We continue to expect (as we wrote in our March 26 *Weekly View*) that US stocks will have either a sideways consolidation period or a pullback of 5% to 8%. The March 19th peak of 70.7% bullish in the Ned Davis Crowd Sentiment Poll for Stocks preceded the S&P 500's peak by two weeks and had made us alert for a pause in stock's strong first-quarter performance. Furthermore, given the growing concerns of a US economic slowdown, we find it difficult to see significant upside for the S&P 500 over the next few months, especially after the 29% rally from its October low through the April 2nd high. From a technical perspective, the S&P 500's 200- and 50-day moving averages continue to trend higher, the index is currently only 1% below its April peak and pullbacks have not exceeded 4.5%. The excessive optimism has been worked off, and the weekly sentiment poll has fallen to the low end of its neutral range (but remains 20 percentage points above extreme pessimism levels that would make us begin to look for a strong stock market rally). Additionally, central banks continue to push down global short-term interest rates as they have for the past seven months (don't fight the Fed), unlike 2010 and much of 2011 when global short rates were rising. **In the event of a pullback, we see initial support for the S&P 500 around 1340 (the 23.6% retracement level of the October-April rally and the March low) and then just below 1300 (the 38.2% retracement level, October's peak, and a five-day consolidation zone in January).**

THE WEEKLY CHART: STOCKS CONSOLIDATING FIRST-QUARTER GAINS

Source: RiverFront Investment Group; Past performance is no guarantee of future results

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