OUTLOOK2013

EMERGING FROM POLICY PURGATORY

RiverFront Investment Group

December 2012

POLICY PURGATORY

HIGHLIGHTS

THE ECONOMY: Emerging from Policy Purgatory. Policy purgatory with respect to monetary policy ended in 2012, as the central banks of the US, Europe, and likely Japan committed to potentially unlimited monetary accommodation. Thus for the first time since 2009, almost every central bank in the world is 'all in' with their most powerful monetary tools. This simultaneous monetary easing is a powerful tailwind for equity markets across the globe.

While monetary policy has emerged from purgatory, fiscal and economic reform policies in the US, Europe and China have not. We believe that intensifying political and market pressures will force a resolution to outstanding issues over the next several months, allowing financial markets to emerge from the shadows of policy purgatory. If fiscal policies and economic reforms implemented in 2013 are as consistently favorable for financial markets as the monetary policies of 2012 then economic growth could accelerate with equity markets posting returns of 10% to 15%.

Our 2013 baseline scenario assumes that the full impact of the fiscal cliff is avoided but Washington's sour political atmosphere lowers the odds of a 'Grand Compromise' for long-term deficit reduction, in our view. In this 'muddle through' scenario, stock market gains will likely be limited to between 5% and 10%. We think any resolution to the fiscal cliff will require the US to take its first steps away from aggressive fiscal stimulus in 2013. We expect the fiscal cliff agreement to have a modest impact on the overall budget deficit and subtract approximately one percentage point from 2013 economic growth. The recovering housing market should offset this fiscal drag and keep the economy growing at about a 1.5% pace.

FIXED INCOME: Continue to Prefer Risk Assets Over Treasuries. Our fixed income allocations continue to favor risk assets over Treasuries. However, after four consecutive years of strong returns, valuations across the credit markets have deteriorated sharply and future returns will likely be more moderate. High yield is our favorite fixed-income asset class in 2013; we expect total return of around 6%, which is about equal to its current yield, with minimal capital appreciation. Although longer-duration Treasury prices could rise during risk-off episodes, we believe that their risk/reward profile is strongly skewed to the negative.

The Federal Reserve used its printing press to keep interest rates below the rate of inflation throughout the 1940s and early 1950s. This financial repression strategy caused bond investors to lose between 40% and 50% relative to inflation. We believe the Fed will emulate this post-World War II strategy because if it allows short-term interest rates to rise to about 3.5%, the combination of rising interest rates and rising debt would add more than $1 trillion to the annual budget deficit by 2017.

GLOBAL STOCKS: Global stocks offer attractive value; the most compelling opportunities are overseas. We are bullish on US equities in 2013 as we were in 2012 for two primary reasons: US corporations are in great financial shape and US equities are attractively priced relative to history. We anticipate another positive year of between 4% to 7% returns for US equities — roughly in line with corporate America's 6% long-term rate of earnings growth — and believe that the most likely risk to our forecast is that we are too conservative. Our portfolios are 'beta-neutral' with a bias toward large-cap, dividend growing stocks.

We believe that Asia ex-Japan and certain parts of Europe offer the best combination of upside potential and risk/reward for 2013. We believe European stocks have significant potential for multiple expansion from historically depressed levels. This undervaluation is reflected in both Riverfront's proprietary Price Matters® framework and more traditional valuation gauges.

We believe that emerging markets will outperform broad global indexes in the first half of 2013 given their above-average growth potential, attractive valuations and leading indicators that suggest a bottom in the global economy. We expect overlooked parts of cyclical Asia in the ASEAN region (e.g. South Korea, Singapore and Hong Kong) to outperform the broad emerging index. We have less enthusiasm for India, Latin America, emerging Europe and the Middle East/Africa in 2013.

RiverFront's 2013 Economic Scenarios and Market Forecasts

POLICY OUTCOME	10% PROBABILITY **PESSIMISTIC** *Political Gridlock*	60% PROBABILITY **BASELINE** *Muddling Through*	30% PROBABILITY **OPTIMISTIC** *Politicians Deliver*
US	Fall off the fiscal cliff	Fiscal cliff resolved, no long-term budget fix	"Grand Compromise"
Europe	Crisis in Spanish bonds after refusing ECB/IMF oversight	Low Spanish bond yields remove pressure to reach agreement with ECB/IMF	Spain agrees to ECB/IMF oversight requiring growth-enhancing reforms
China	No stimulus, re-regulation and closing of economy	Aggressive fiscal stimulus but no major economic reforms	New leadership team embraces an aggressive stimulus and economic reform agenda
US Gross Domestic Product	-1.5%	1.6%	2.7%
S&P 500 Return Range	-10% to -15%	5% to 10%	10% to 15%
US 10-year Interest Rates	1.25%	2.25%	3.0%
10-year Treasury Total Return	5% to 7%	-1% to -3%	-6% to -8%
High-Yield Bonds	-5% to -7%	5% to 7%	7% to 9%
Emerging Market Debt (USD)	-3% to -5%	3% to 5%	3% to 5%

Source: RiverFront Investment Group

This table links our optimistic, baseline and pessimistic scenarios with the major political issues faced by the US, Europe and China that will have the greatest impact on the global economy in 2013, in our view. Our assessment of each scenario's probability is also shown. Each scenario includes our expectations for GDP, stocks and interest rates. We assume that China's policy decisions will drive outcomes across all the emerging markets. RiverFront's opinions are subject to change and actual events may reflect some combination of the scenarios referenced in the table.

We place a high probability on our baseline scenario (60%) both because of the tendency of politicians to chart a middle path and the many ways this scenario could be achieved. For example, political gridlock leading to a pessimistic set of policies in the US might be somewhat offset by an optimistic outcome in Europe, resulting in a muddle through scenario for the global economy. Unlike the uniformly positive monetary policies and market advances in 2012, diverse policy outcomes could lead to more diverse returns across global equity markets in 2013.

THE ECONOMY:
Emerging from Policy Purgatory

Policy decisions — or indecisions — of governments and central bankers around the world have driven financial markets for much of the past four years. Uncertainty over the outcome of these policy choices has kept markets edgy and volatile compared to historical norms, a condition we have described as 'Policy Purgatory.'

We believe that policy purgatory with respect to monetary policy ended during 2012, as the central banks of the US, Europe, and likely Japan committed to potentially unlimited monetary accommodation. The Federal Reserve replaced 'on again, off again' quantitative easing (QE) with an open ended commitment to print $85 billion a month until unemployment drops to 6.5%. The European Central Bank's offer of unlimited support for Italy and Spain has, after three years of uncertainty and crises, provided a theoretically unlimited financial backstop for these highly indebted countries. The Bank of Japan intends to print money until inflation reaches 1%, and with the election of Shinzo Abe that inflation target is likely to become 2%. Finally, there was renewed monetary easing across the emerging markets in 2012, especially in China and Brazil.

While monetary policy has emerged from purgatory, fiscal and economic reform policy in the US, Europe and China has not. We believe that intensifying political and market pressures will force a resolution to outstanding issues over the next several months, allowing financial markets to emerge from the shadows of policy purgatory.

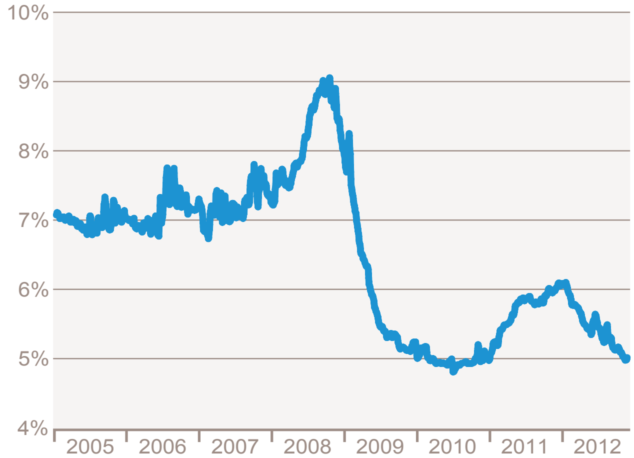
If fiscal policies and economic reforms implemented in 2013 are as consistently favorable for financial markets as the monetary policies of 2012, then economic growth could accelerate with equity markets posting another year of 10% to 15% returns. However, we do not expect many politicians to implement appropriate long term solutions. Instead, once again, most are likely to cobble together a series of short-term policies that defer many of the difficult decisions and needed reforms. In this 'muddle through' scenario, we believe that equity markets could still rally 5% to 10% thanks to both the extraordinary monetary stimulus started in 2012 and relief that a worse outcome was avoided.

We must acknowledge the risk, although unlikely in our view, that politicians from Washington to Brussels to Beijing will all fail to reach even short-term solutions. The dire consequences of such a failure are the primary reason why we believe that politicians will forge compromises at the last minute. However, the emotional nature of the issues makes an irrational stalemate a possibility. In this scenario aggressive monetary policy only softens the impact of failed political processes, the global economy likely lapses into recession and equity markets give back most of their 2012 advance.

CENTRAL BANKS ARE 'ALL IN'

The world's central bankers resolved some of the uncertainty over economic policy with definitive monetary policy guidance that we believe is extremely favorable for financial markets. The US Federal Reserve is purchasing $85 billion of government securities every month (both Treasuries and mortgage-backed securities) until unemployment drops to 6.5%. The European Central Bank (ECB) has pledged unlimited support for Italian and Spanish bond markets, provided they submit to budgetary and policy oversight from the rest of the Euro Bloc. Thus, after three years of market uncertainty, the ECB has assured a sufficient backstop for the funding needs of these highly indebted economies. Even the Bank of Japan will likely commit to aggressive asset purchases (QE) until Japanese inflation rises above 2%.

These extraordinary open-ended policy commitments, combined with aggressive interest rate cuts in most emerging markets (see chart on right) suggest that for the first time since 2009, almost every central bank in the world is 'all in' with their most powerful monetary tools. This coordinated monetary easing is a powerful tailwind for equity markets across the globe.



EMERGING MARKET CENTRAL BANKERS ARE ONCE AGAIN LOWERING INTEREST RATES

Emerging market policy interest rates, equally weighted, 5-day average

Source: Datastream, RiverFront Investment Group

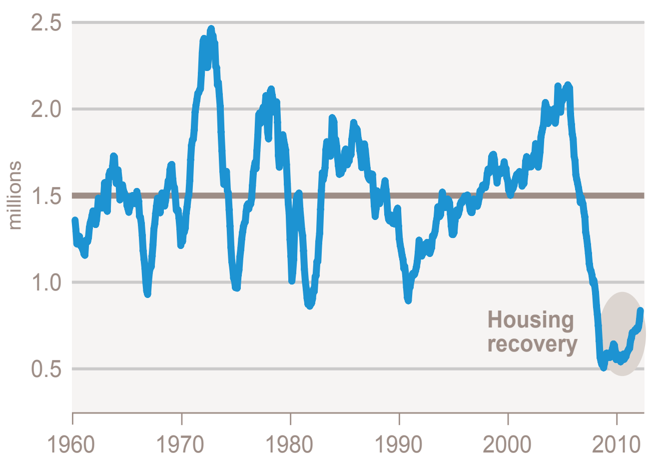
THE US: HIGHER TAXES OFFSET BY IMPROVING HOUSING

Since the onset of the financial crises in 2008, the US has pursued the most consistently aggressive policies among the world's economies to help support economic growth. Unlike most central banks, the Federal Reserve never retreated from its zero interest rate policy, periodically enhanced this stimulus with asset purchases (QE), and has now committed to aggressive QE every month for the foreseeable future. Similarly, the US has attempted to stimulate its economy with various spending and tax-reduction programs, prompting unprecedented peacetime deficits in each of the past four years. Unlike the austerity programs in Europe, the US government has made no effort to reign in its rapid accumulation of debt thus far.

Our baseline scenario for 2013 assumes that the combination of tax increases and spending cuts known as the fiscal cliff will be avoided, but that no 'Grand Compromise' is reached for long-term deficit reduction. We think any resolution to the fiscal cliff negotiations will require the US to take its first steps away from aggressive fiscal stimulus in 2013. We expect the fiscal cliff agreement to have a modest impact on the overall budget deficit and subtract approximately one percentage point from 2013 economic growth.

Fortunately for the US economy in 2013, we believe that this fiscal tightening will occur in an environment of improving consumer balance sheets and a reviving housing market. As a result, the private sector should be able to offset much of the economic drag from higher taxes and reduced government spending.

Housing starts are climbing rapidly, and, after four years of subtracting from GDP, housing is poised to add a small amount of growth in 2012. The Congressional Budget Office (CBO) estimates that the US economy requires approximately 1.5 million new homes per year to accommodate new household formation and replace worn-out housing stock. We believe that housing starts could increase to this 1.5 million pace in 2013,



US HOUSING STARTS CLIMBING FROM 50-YEAR LOWS

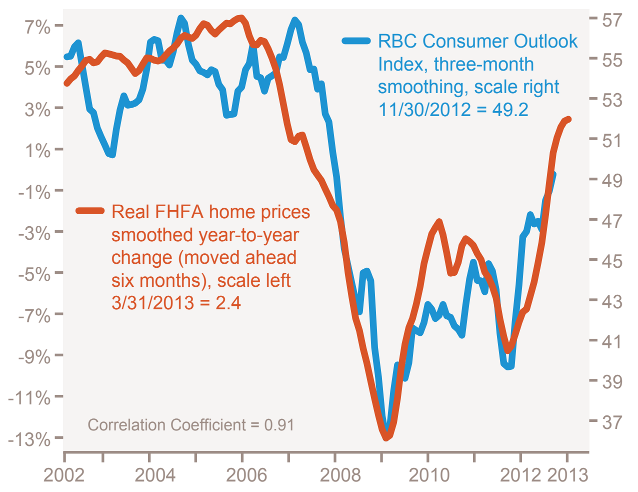
Seasonally adjusted annual rate, 3-month average in millions

Source: Datastream, RiverFront Investment Group

HOME PRICES LEAD CONSUMER SENTIMENT

Consumer outlook vs. real home prices (moved ahead 6 months)

Source: Ned Davis Research



ending a four-year period of depressed activity that worked through the overbuilding of the 2000s. Such acceleration in home construction could add between 0.5% and 1.0% to the overall economy.

In addition, home prices are a primary driver of consumer confidence. If home prices stay on their current trend, the direct contributions of housing to the overall economy could be equaled by the impact of improved home prices on the much larger consumer spending component of the economy. Thus, despite the higher taxes and lower expenditures likely to result from fiscal-cliff negotiations, our baseline forecast is for a continuation of slow but steady 1.5% to 2.0% economic growth.

GRAND COMPROMISE: A LONG-SHOT UPSIDE SCENARIO

Accelerating from new normal growth rates (1% to 2%) will require politicians to move beyond the short-term fiscal-cliff negotiations and actually enact a plan to control the US government's growing debt obligations. Philosophical disagreements about the best way to rein in unsustainable government deficits lower the odds of a 'Grand Compromise,' but President Obama may surprise investors by actively pursuing such an agreement in 2013. Like all second-term presidents, President Obama will be increasingly concerned about his long-term legacy. History will not be kind if President Obama bequeaths the current fiscal chaos to his successor.

Business leaders and consumers know that controlling our debt will likely require tax increases and spending cuts well beyond the levels likely to be incorporated in a fiscal-cliff compromise. Although these changes in fiscal policy will subtract from economic growth, most of them would not take effect for many years. By contrast, certainty for tax and spending policies (whose taxes go up and whose spending is cut) could unleash some of the cash companies are holding due to uncertainty. Thus we believe that a definitive plan for maintaining the long-term fiscal viability of the US could push growth rates well above new normal levels in 2013.

Conversely, allowing current fiscal-cliff negotiations to fail would likely push the US back into recession in 2013, even with aggressive Fed policy and an improving housing market. We believe that the survival instincts of Congressional Republicans and President Obama's legacy concerns make this outcome unlikely.

EUROPE — WILL IT FINALLY ABANDON "HOOVERNOMICS"?

One by one, European policymakers have abandoned tight monetary and fiscal policies as a prescription for their debt crises. We have described the European strategy as 'Hoovernomics' due to its similarity with those implemented by the Hoover administration in the early years of the Great Depression. The ECB's long-term refinancing operations (LTRO) program and interest rate reductions have reversed the restrictive monetary policies of 2010 and 2011. The ECB has further agreed to provide unlimited financial support to Spain and Italy if they agree to policy oversight by the rest of Europe. The conditions of this policy oversight provide an opportunity for Europe to abandon the last elements of Hoovernomics.

We believe that peripheral Europe's debt problems are a symptom of the real problem: uncompetitive labor costs. For much of the post-WWII era, these countries have embraced labor and regulatory policies that elevated labor costs relative to less-restrictive economies, such as Germany. Until the advent of the euro, peripheral Europe tended to compensate for higher labor costs by periodically devaluing their currencies, essentially cutting worker pay through a cheaper currency and lower standard of living.

By entering a currency union, these countries lost their cost reduction mechanism (currency devaluation) but continued to embrace labor policies that kept their costs high relative to competitors. Consequently, labor costs in Greece, Italy, Spain, etc. are much less competitive than in Germany, and few businesses see these economies as attractive locations for new facilities. For example, Airbus depends on support from the French government, yet it will locate its new production facility in Alabama.

Although labor costs are peripheral Europe's primary problem, European policymakers have spent most of their time and political capital since the onset of their debt crises on forcing bailout recipients to meet stringent budget deficit targets. Since political realities assure that deficit reduction packages rely predominately on tax increases, these austerity requirements have helped drive these economies into deep recessions/depressions (similar to the large US tax increases in 1930 and 1931).

For the euro to survive over the long run, Italian and Spanish labor costs must fall into alignment with those of Germany, in our view. Market hopes for such a policy transition were heightened when the president of the International Monetary Fund, a main proponent of austerity, contended in a CNBC interview that "austerity on top of austerity doesn't work" and that the IMF should focus on requiring reforms in labor laws and tax policies in the future. Unlike mandated tax hikes and spending cuts, requiring badly-needed economic reforms could stimulate rather than impede economic growth in European economies.

We believe that low-cost ECB funding, when combined with austerity plans already in place, should be sufficient to bring European budget deficits under control. Should Spain and Italy reach such an agreement then European equity markets could soar, celebrating the virtual elimination of Spanish and Italian default risk as well as the potential for faster economic growth stemming from the required reforms.

The main risk to this optimistic view is that opposition to labor market reforms prevents Spain and Italy from reaching an agreement with the ECB, IMF and other oversight bodies. The ECB's offer to support Spanish and Italian bond markets allowed these countries' borrowing rates to decline sharply, removing the immediate pressure to reach an agreement. So long as markets remain content with the offer of support and do not demand an explicit support agreement with the ECB, then Spain and Italy can enjoy the fiscal benefits of lower borrowing costs without incurring the political costs of economic reforms. Politicians may seek to prolong this 'solution' as long as possible, keeping markets uncertain about long-term policies and therefore reducing potential economic and equity market gains in 2013.

If markets begin to worry that agreement will not be reached, rates could quickly climb back to levels that jeopardize Spain's and Italy's fiscal solvency. We believe that should borrowing costs rise, that will quickly push Spain and Italy to reach an agreement that authorizes ECB support for their bond markets — failure to do so could lead to default and the end of the euro. This should persuade politicians to endure the inevitable protests and rioting that will accompany implementation of an oversight agreement.

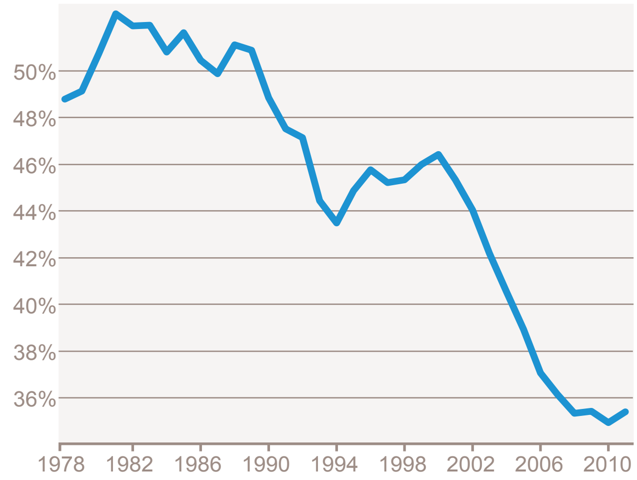
CHINA — NEW LEADERSHIP AND HOPES FOR A NEW DIRECTION

China's economic miracle of the past 20 years has been driven predominantly by investment spending, mainly on infrastructure that facilitated the migration of more than 300 million citizens from farms to rapidly expanding cities. Expanding exports also supplemented economic growth for much of the last decade, but as China grew to become the world's second-largest economy, its size relative to potential export markets brought an end to export-driven growth. China's new leadership team hopes to transition from dependence on investment spending and exports to a more balanced economy in which consumer spending plays a larger role. Their predecessors supported this vision by allowing double-digit wage gains for much of the past five years and enhancing the social safety net.

CHINESE CONSUMERS OFFER A POTENTIAL SOURCE OF GROWTH

Chinese household spending as a % of nominal GDP

Source: Ned Davis Research



Despite these policy changes, consumer spending has failed to improve from a low 36% of GDP (see chart on left). We believe this strategy will continue to fail until the extensive policies and economic structures that depress domestic consumption in favor of exports are dismantled.

Since consumption is not growing fast enough to offset decelerating export growth, China's new leadership team must choose between allowing GDP growth to dip below the politically unpalatable level of 5% or finding alternative sources of growth. Embracing a renewed commitment to economic reform offers the best hope for China's long-term future, in our view, but incoming President Xi Jinping and Premier Li Keqiang have reputations as cautious status quo politicians. With little evidence of imminent sweeping reforms, we believe that China's new leadership will opt for the same old script of investment-driven growth. Ample opportunity remains for productive infrastructure investment (Shanghai hotels are among the most technologically advanced in the world, but guests must brush their teeth with bottled water), and we expect that the new leadership team will greatly increase the current $150 billion infrastructure initiative.

Although we anticipate that the new Chinese leadership team will opt for a cautious approach, we must acknowledge that outside observers are often surprised by the policies that follow China's once-in-a-decade leadership transitions. Few predicted that Jiang Zemin and Zhu Rongji would enact such bold economic reforms in the late 1990s and early 2000s, and even fewer predicted that reform efforts would grind to a halt under their successors. A renewed commitment to economic reform by Xi and Li would be a big upside surprise to global financial markets, while any unexpected retreat from existing economic reforms (increased trade barriers, additional restrictions on foreign investment, etc.) could put further downward pressure on Chinese equity prices.

A SOLUTION FOR THE US DEBT PROBLEMS

In their book, *This Time Is Different*, economists Carmen Reinhart and Kenneth Rogoff argue that once a government's debts become unsupportable then governments must resort to one of three debt-reduction strategies:

1. **Default:** Simply refuse to repay the owed obligations (e.g. Russia in 1998, Argentina in 2000, Greece currently and for much of its existence).
2. **Lower standard of living:** Endure higher taxes and fewer government services as debt obligations are repaid (e.g. Brazil and Korea in the 1990s, Portugal and Ireland currently).
3. **Financial repression:** Print enough money to lower interest rates below the rate of inflation and keep rates there until debts are inflated away (e.g. US and Great Britain post WW II, China in the 1990s, much of the world economies currently).

Default or lower living standards typically occur only if the indebted country cannot print the currency in which it has borrowed. If the country owes its own currency, then depressing interest rates by printing more of that currency (financial repression) tends to be the least painful way to reduce excessive debt.

The Fed used its printing press to keep interest rates below the rate of inflation throughout the 1940s and early 1950s in response to the large debt burden left over from World War II. This financial repression strategy caused bond investors to lose between 40% and 50% relative to inflation. Importantly, losses of this magnitude were not reflected in the market value of bond portfolios (by keeping interest rates low the Fed prevented bond prices from falling). Rather, each year bond investors earned somewhat less than the rate of inflation and losing a modest amount every year for 14 years compounded the pain of purchasing power losses.

The Fed had little choice but to inflict these purchasing-power losses on bond investors because rising interest rates could have caused the US budget deficit to spiral out of control. The potential budgetary impact of rising interest rates on a highly indebted government was clearly illustrated in a recent Congressional Budget Office (CBO) report: if the Fed allows short-term interest rates to rise to about 3.5%, the combination of rising interest rates and rising debt would add more than $1 trillion to the annual budget deficit by 2017.

We believe that this budget reality compels the Fed to emulate its post-World War II financial repression strategy. Should the Fed continue this strategy in the next few years, as much as half of the associated purchasing power losses could be borne by foreign creditors such as the central banks of China and Japan. The ability to shift much of the cost of reducing US debt burdens to foreign institutions may be an added incentive for the Fed.

FIXED INCOME:

Continue to Prefer Risk Assets Over Treasuries

Given RiverFont's positive baseline expectations for both the global economy and a resolution of the fiscal cliff, we continue to favor risk assets over Treasuries within our fixed income allocations. However, after four consecutive years of strong returns, valuations across the credit markets have deteriorated sharply and future returns will likely be more moderate. Our range of expected returns for various sectors of the fixed income market under RiverFront's pessimistic, baseline, and optimistic scenarios are in the table on page 2.

POSITIVE FACTORS FOR RISK ASSETS:

- **Don't Fight the Feds.** Every major central bank is now providing some form of extraordinary policy accommodation. This will continue to improve global liquidity conditions and is supportive for global risk assets.
- **Strong demand for yield will likely continue.** High-yield funds had record inflows during 2012, which will likely continue in 2013. With US short-term rates pinned near 0% for the foreseeable future and Treasury yields across the curve near all-time lows, investors will be forced further out the risk spectrum in search of reasonable yields.
- **Easy access to credit at record low rates.** Corporations set a new record for debt issuance during 2012. Strong institutional and retail demand for corporate debt will likely continue in 2013, allowing easy credit market conditions to continue.
- **Defaults will likely remain low.** Consistent with our expectation for moderate economic growth, easy access to credit, and limited maturities for the next couple of years, corporate defaults are likely to remain low.
- **Credit spreads seem high given low levels of expected defaults.** Across the various credit sectors, risk premiums remain near their long-term averages but are high compared to previous times of below-average current (and expected) default rates.

NEGATIVE FACTORS FOR RISK ASSETS:

- **Yields across fixed-income markets are near record lows.** Treasury yields — the benchmark for pricing risk assets — remain near record lows. Thus, despite roughly average spreads, yields across the credit spectrum (high yield, emerging markets, corporate, mortgage backed securities) are also near record lows. Low absolute yields will limit capital gains potential going forward.
- **Credit metrics have likely peaked.** JP Morgan aggregate data shows a deterioration in credit statistics began in 2012, as EBITDA (earnings before interest, taxes, depreciation and amortization) fell slightly and leverage rose. In addition, the ratio of credit upgrades to downgrades has been falling and downgrades now slightly exceed upgrades). After years of balance sheet repair and stewarding cash, we believe that corporations will likely begin to increase activities that are less bond-holder friendly such as stock buy-backs, higher dividends and an increase in mergers and acquisition.

FIXED INCOME STRATEGIES FOR 2013 — FROM MOST TO LEAST ATTRACTIVE

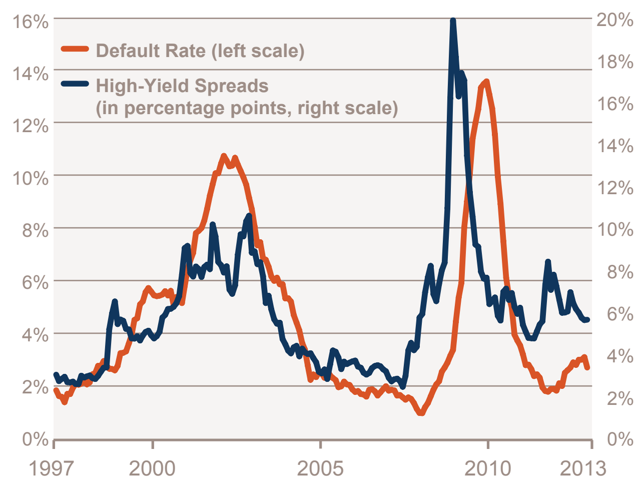
High-Yield Bonds (Current Yield 6%): Yields are currently about two percentage points less than a year ago, when high yield was also our top pick for the fixed income market. The majority of this decline has come from risk premiums falling about 1.8 percentage points, while falling Treasury yields accounted for the remaining 0.2 percentage point. The sharp drops in yield contributed to a year-to-date total return of almost 15.5%. Despite these near-record low yields, we think high-yield bonds once again offer the best fixed-income return potential in 2013. We do not expect yields to drop much further, which will limit any capital appreciation. However, with current spreads (5.2 percentage points) near their long-term average, we believe they can absorb a moderate increase in Treasury yields without negatively impacting their price. Thus, in our baseline case, high yield has a 'coupon clipping' year with minimal capital appreciation and defaults. This produces a total return of between 5% and 7%, which is about equal to its current yield.

HIGH-YIELD BOND YIELDS AT RECORD LOWS BUT...

High-Yield Bonds, Yield to Worst

Source: Bank of America, Merrill Lynch

Emerging Market Debt in US$ (Current Yield 4%): Yields are currently about 1.7 percentage points less than a year ago, when emerging market debt was our second favorite fixed income market. As with high yield, the vast majority of the drop came from shrinking risk premiums. Given its longer duration (7.5 years), the smaller drop in yields translated into a year-to-date return of almost 18%. As with high yield, emerging market debt's absolute yield of just over 4% is near its historic low. In contrast with high yield, emerging market debt spreads (2.5 percentage points) are also well below their historic average. We think that these factors will limit any potential capital appreciation. Fiscal conditions in emerging economies generally remain strong relative to those of the developed world, as emerging economies have benefited from stronger economic growth, a sharp rise in commodity prices, and have not been burdened with the legacy costs of bailing out their financial systems. However, credit improvement in these economies has likely peaked, as these countries begin to seek ways to foster growth, including more fiscal spending. Thus our baseline case for Emerging Market Debt (US$) returns is between 3% and 5%, which is also near to its current yield.



... SPREADS OVER TREASURIES ARE ABOUT AVERAGE AND DEFAULTS ARE MINIMAL

High-Yield Bonds, Default Rate and Spreads

Source: Moodys, Bank of America, Merrill Lynch

Corporate Bonds (Current Yield 2.8%): Yields are currently about 1.1 percentage points less than they were a year ago, when corporate bonds were also our third pick for the fixed income market. Once again, shrinking risk premiums account for nearly the entire decline. The corporate bond index's longer duration (6.8 years) helped translate that yield drop into a year-to-date return of around 10%. Corporate bond spreads of 1.5 percentage points are about near their historic average, but well off their all-time lows. Conversely, its yield of 2.8% is near its all-time low, which is likely to limit capital appreciation in 2013. Shorter-term corporate bonds (7 years or less) can continue to provide an element of safety to portfolios, as the Fed is likely to keep short-term interest rates pegged near 0% for the next couple of years, or until the unemployment rate falls to 6.5%. This is likely to keep the yield curve relatively steep, allowing shorter-term corporates to roll down the yield curve, potentially providing small, incremental capital appreciation. When the yield curve slopes upward, as a bond approaches its maturity date its yield falls, and when yields fall prices normally rise, all else being equal. In addition, if shorter rates rise or risk premiums widen, their returns should be less negatively impacted than longer-dated corporates. From a risk/reward standpoint, it is possible for investors to capture more yield on short-term corporate bonds than on a 10-year Treasury (1.8%), with incremental credit risk but less interest rate risk.

Long-term Treasuries (Current Yield 3%): With the Fed keeping short-term Treasury yields near 0% in 2013, they offer little investment opportunity compared to short-term corporate bonds. In addition, the shorter durations of short-term Treasuries make price gains unlikely in a 'risk-off' market. Longer-term Treasury (10- to 30-year maturities) yields are close to all-time lows and could see significant price declines if rates increase. Although longer-duration bond prices could rise during risk-off episodes, their risk/reward profile is strongly skewed to the negative. Since our baseline economic and fiscal expectations are relatively benign, we are unlikely to employ the portfolio insurance these securities can provide, because we view them as too expensive. With the Fed's $85 billion monthly Treasury and mortgage backed securities (MBS) purchases, and short-rates at 0% for the foreseeable future, we do not see longer-term yields rising sharply during 2013. However given these securities' long duration, even a small interest rate increase can lead to significant price declines. For example, if the 30-year Treasury yield (currently 3%) rises to 4%, its price would likely decline 17% to 18%.

GLOBAL STOCKS:

Global Stocks Offer Attractive Value; the Most Compelling Opportunities Are Overseas

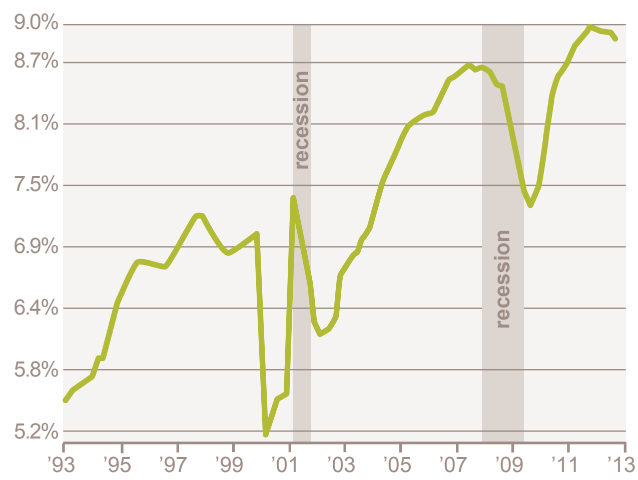
The tailwinds provided by simultaneous accommodative global monetary policy in 2012 are unlikely to be matched by uniformly positive fiscal policy initiatives in 2013, and so we expect global stock market returns to be more diverse. We do not expect much progress on long-term US fiscal and budget reform but we believe US corporations are in great financial shape and US equities are attractively priced relative to history. Thus, we are bullish on US stocks and expect modest returns of between 4% to 7% in 2013. The most likely risk to this forecast is that it is too conservative. Monetary policy also is highly accommodative overseas but we see greater potential for progress on fiscal initiatives than in the US. Consequently we have tilted our equity exposure to overseas markets versus the US. We find compelling value in international equities on both a strategic (long-term) and tactical (short-term) basis. In particular, we believe that Asia ex-Japan and certain parts of Europe offer the best combination of upside potential and risk/reward for 2013 across the globe.

US STOCKS: THE COMPELLING LONG-TERM STORY CONTINUES

We are bullish on US equities in 2013 as we were in 2012 for two primary reasons: US corporations are in great financial shape and US equities are attractively priced relative to history. However, with the S&P 500 up 15% over the past 12 months, we expect more modest appreciation in 2013. We anticipate another positive year of between 4% and 7% returns for US equities — roughly in line with corporate America's 6% long-term rate of earnings growth — and believe that the most likely risk to our forecast is that we are too conservative. Our portfolios are 'beta-neutral' with a bias toward large-cap, dividend growing stocks.

US CORPORATIONS ARE IN GREAT FINANCIAL SHAPE

We believe the condition of an asset — real or financial — is the most important thing to consider when making a purchase and US stocks are in great condition, in our view. US companies are enjoying near-record levels of profitability thanks to a more diversified global customer base, minimal cost pressures and a highly productive workforce. We expect profitability to remain high in 2013 as still-elevated unemployment constrains wage growth, 2% interest rates provide low-cost funding to finance stock buy-backs and acquisi-



NEAR-RECORD PROFITABILITY

S&P 500 (Ex-Financials) Net Profit Margin %

Note that P/E multiples expanded nearly two points in 2012.

Source: Intrinsic Research

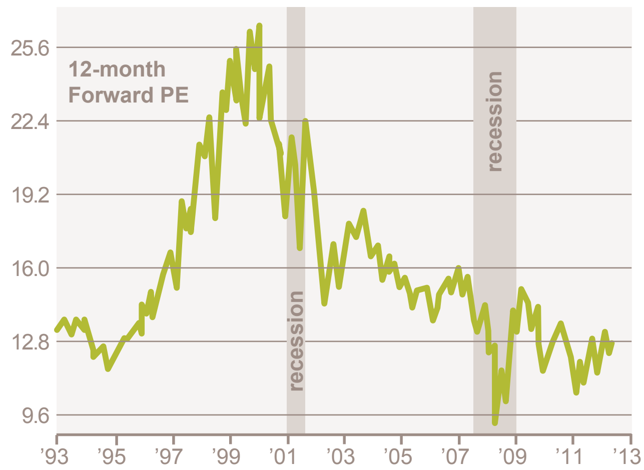
tions, and sub-$100 oil and sub-$4 natural gas hold down energy input costs. Additionally, American companies are 'right-sized' for a slower growth environment, in our view, having cut costs and improved efficiencies over the past four years. We think they can benefit from significant operating leverage given any resurgence in global growth.

US EQUITIES ARE ATTRACTIVELY PRICED

VALUATIONS BACK TO EARLY 1990s LEVELS

S&P 500 price to 12-month forward earnings estimate

Source: Intrinsic Research



The S&P 500's current price multiple of 13 times 2013 estimated earnings is similar to early-1990s valuation levels. We think this valuation is appropriate given the current low-economic-growth environment and we do not foresee further multiple expansion until earnings growth reaccelerates. Without multiple expansion, broad market US equity returns will likely be less than half those of 2012, when the S&P 500 had a full two-point multiple expansion.

OUR SECTOR STRATEGY: BETA-NEUTRAL, LARGE-CAP DIVIDEND GROWERS

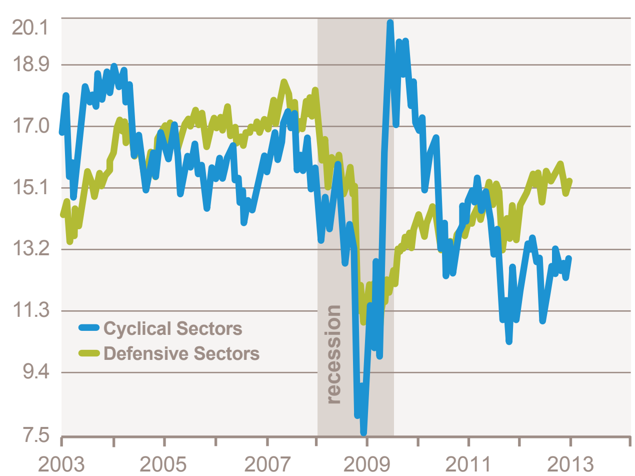
We think a 'beta-neutral' portfolio of dividend-growing, large-cap companies will outperform the market in 2013.

- **Beta-Neutral:** Valuation differences between sectors and industries generally appear consistent with the relative risks inherent in today's uncertain economic and political climate. In other words, investors have already bestowed valuation premiums or discounts to stocks based on their historical performance during uncertain times. Consequently, the domestic equity portion of our portfolios is beta-neutral — taking no more or no less risk than the overall market — and we have roughly a benchmark allocation to the more-cyclical sectors: Industrials, Materials, Consumer Discretionary and Information Technology. We recommend avoiding the traditional defensive tactic of overweighting Utilities, Telecommunication Service and Healthcare, Consumer Staples since these defensive sectors' current valuations already incorporate a 'safety' premium (see chart).

DEFENSIVE SECTORS' PE REFLECT A LARGE SAFETY PREMIUM

Price/EPS Forward 12 Months Comparison

Source: Intrinsic Research



Beta measures volatility relative to a benchmark. A result greater than 1.0 implies that a security is more volatile than the benchmark; a result less than 1.0 suggests that the security is less volatile than the benchmark. Betas may change over time.

- **Large Caps:** Companies with the largest market capitalizations currently trade at a significant discount to their mid- and small-cap peers. Some investors attribute this valuation disparity to large-cap companies' more limited growth opportunities, believing that faster-growing small- and medium-sized corporations are entitled to higher valuations. We disagree and do not view large companies as intrinsically less valuable than smaller ones. In fact, during the 1990s investors paid premium valuations for large-caps based on their historically 'safer' and 'more predictable' earnings. Furthermore, earnings growth and company size are not inextricably linked in our view. Growth is ultimately a function of many factors including, but not limited to, the company's addressable market, its products and services and management's decisions. Well-run, large companies offering superior products to growing markets can grow at an above-average pace, regardless of size. We view the large-cap/small-cap valuation disparity as excessive and expect their relative multiples to converge. The S&P 500's PE based on estimated 2013 operating earnings is 12.6 vs. 15.5 for S&P's small-cap index according to Standard & Poor's. We think large-cap companies' are better positioned to benefit from the fast-growing emerging markets and will be the catalyst for this convergence.

- **Dividend-Payers:** After outperforming the S&P 500 by 7.6% 2011, dividend stocks underperformed by about 2.1% in 2012 (based on the WisdomTree LargeCap Dividend Index). We believe 2012's underperformance can be mostly attributed to worries of higher dividend tax rates in 2013. We do not expect further multiple contraction for dividend-growing companies because most of their valuations did not rise when the tax cuts were enacted in 2003. Furthermore, we believe that their current yield advantage over bonds and the likelihood that upcoming tax policy is less punitive than worst-case expectations should provide a tailwind when fiscal cliff uncertainties are resolved. Finally, RiverFront's research, along with a number of peer and academic studies, shows that companies that consistently increase dividends have outperformed the broad market over most time periods. Our conclusions from these studies — which span multiple years, presidential administrations, and tax regimes — suggest that the favorable tax treatment for dividend-paying stocks may be only one of their many attributes. For these reasons, dividend-growing companies make up the majority of RiverFront's US equity portfolio exposure.

INTERNATIONAL STOCKS: VALUE AND GROWTH OPPORTUNITIES

EUROPE: ATTRACTIVE VALUATIONS AND CENTRAL BANK SUPPORT TRUMP LACK OF GROWTH

Many of the reasons to underweight Europe over the last few years — excessive debt, anemic growth, and uncompetitive labor costs in the periphery — still exist in some form (see pages 5-6). Our cautious optimism has less to do with a positive view of European earnings in 2013 (our base case assumes consensus estimates are too high) but rather, we believe there is potential for significant multiple expansion off historically depressed levels. This undervaluation is reflected in both Riverfront's proprietary Price Matters® framework and more traditional valuation gauges.

The biggest difference between our 2013 European view versus our pessimism at the beginning of 2012 is the ECB's policy reversal under current president Mario Draghi. During the year he has been at its helm, the ECB has clearly embraced American-style central bank balance sheet expansion and offered unlimited backstop support to nations who agree to austerity and labor market reform oversight. This has had a calming effect on both European sovereign bonds and risk markets.

After five years of substantial underperformance versus both the US and world indices, investors appear to have little interest in Europe. This aversion is reflected in Bloomberg's most recent global investor poll and recent data from institutional fund flows of overseas investors. While we agree that enduring reforms must take root in Europe before investors will start believing in the region's prospects, we think stock prices will likely rise long before this is clear. We also believe that the euro crisis of the last few years is a powerful catalyst in forcing needed structural reform.

For our European exposure, we look for a blend of financial discipline, cyclicality and globally competitive companies. We believe Germany, and to a lesser extent Switzerland and the UK, meet this criteria.

JAPAN: MAYBE IT'S DIFFERENT THIS TIME

Japan is a frustrating study in contrasts. It has suffered from multiple decades of deflation caused by political and central bank missteps exacerbated by a corporate culture slow to react to changing dynamics and an aging population. Japan's stock market has thus far proved to be the ultimate value trap — it appears cheap but deserves to be due to perennial shareholder value destruction among many of its public companies.

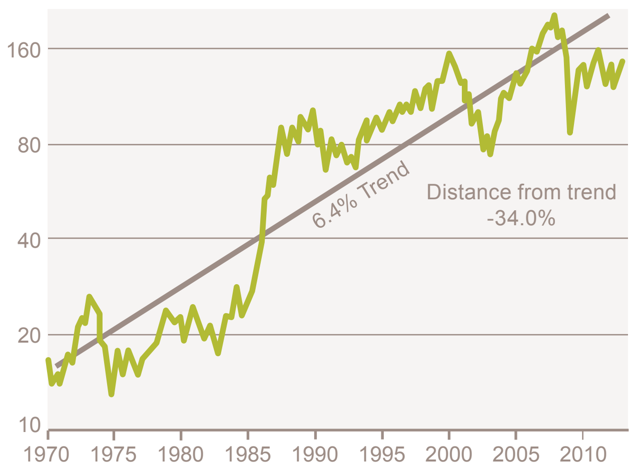
Recent optimism surrounding political reform has generated both yen weakness and some initial positive momentum in Japan's stock market. We find this an intriguing start but are wary of confusing political rhetoric with concrete steps towards stemming deflation. Given Japan's dismal track record on monetary policy, we remain skeptical until structural reforms and central bank actions are proven effective. However, we recognize that with Japan's public companies collectively trading below book value, there is meaningful upside potential if Japan can move beyond its typically reactionary attitudes towards money printing.

DEVELOPED WORLD INTERNATIONAL STOCKS ARE MORE THAN 30% BELOW TREND

EAFE Real Total Return Index

Source: RiverFront Investment Group, MSCI

Past performance is no guarantee of future results.



We have increased our Japanese weighting recently but look for evidence of policy that creates a weaker yen and needed stimulus to Japan's moribund economy before adding to our positions. We prefer to own Japanese equities by hedging out yen exposure, since we believe that any positive change in Japan must start with a structurally weaker yen in order to fuel improvements in global competitiveness for their economically meaningful export industries.

EMERGING MARKETS — GROWTH POTENTIAL IN A LOW-GROWTH WORLD

We believe that emerging markets will outperform broad global indices in 2013, given their above-average growth potential, leading economic indicators that suggest accelerating global growth, and attractive valuations based on both our Price Matters framework and conventional valuation measures. We recently increased our broad emerging exposure, including the larger members of the index (e.g., China, India and Brazil) due to oversold conditions and evidence of improving global growth. However, if these larger emerging markets outperform as we expect, we will look for tactical opportunities to shift our exposure further towards countries that get less attention than these emerging market heavyweights but are structurally better able to leverage global economic growth. We believe a portfolio that combines equity exposure from cyclical non-China Asia (Korea, Singapore, Hong Kong) with the domestic demand-driven growth of the ASEAN region (Association of Southeast Asian Nations — Malaysia, Indonesia, Thailand and the Philippines) will have growth and valuation characteristics similar to the broad index but offer better long-term growth potential.

Singapore is part of ASEAN but its highly developed, export-driven economy resembles the more cyclical countries like Hong Kong and Korea, in our view.

While China offers tremendous growth potential, unreliable economic data, lack of transparency, and inscrutable politics present challenges for both local and foreign investors (see page 7). However, urbanization and a quickly rising Chinese middle class will create economic opportunities for much of Asia. Thus, we view ancillary countries such as Korea, Hong Kong, and Singapore as attractive parts of cyclical Asia that can benefit from the rise of the Chinese consumer, yet have long-term structural advantages over China. Korea in particular has attractive valuation and earnings growth potential similar to China, with a more developed environment for growth (e.g. superior infrastructure, innovation culture and educational level of workforce) and an index dominated by successful multi-national companies.

We also see long-term growth potential in the ASEAN region. ASEAN is more expensive than cyclical Asia based on forward estimated earnings, but we think it deserves this premium, partly because ASEAN demographics are more attractive than cyclical Asia and its expected earnings growth is superior. ASEAN economic growth has been more stable than the rest of the region recently, reflecting its orientation towards domestic consumption, an important defensive feature in a growth-challenged world over the next few years. We believe ASEAN nations' politics and balance sheets have vastly improved from the late-1990s 'Asian Contagion' and we regard ASEAN as safer than China in terms of transparency, fiscal health and general corporate governance. If global economic growth rebounds by more than we expect, however, ASEAN's defensive nature may restrain the region's relative stock performance.

We have less enthusiasm for India, Latin America, emerging Europe and the Middle East/Africa in 2013. Brazil and India, despite their favorable demographics, continue to struggle with below-potential growth as inflation constrains progress and limits policy options. Additional headwinds include Brazil's poor corporate governance and India's political gridlock along with infrastructure and social/educational mobility issues. Of the two, we find India's companies and positioning more attractive but believe that opportunities for both countries lie beyond 2013. We are interested with the more stable areas of Latin America such as Mexico and Chile and will be alert for any tactical opportunities in those countries.

IMPORTANT DISCLOSURES

The S&P 500 is an unmanaged, weighted index of 500 stocks providing a broad indicator of price movement. Individual investors cannot directly purchase an index.

Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability.

Dividends are not guaranteed and are subject to change or elimination.

Technical analysis is based on the study of historical price movements and past trend patterns. There are also no assurances that movements or trends can or will be duplicated in the future.

In a rising interest rate environment, the value of fixed-income securities generally declines.

High-yield bonds, also known as junk bonds, are subject to greater risk of loss of principal and interest, including default risk, than higher-rated bonds.

Standard deviation is a measure of the dispersion of a set of data from its mean. The more spread-apart the data is, the higher the deviation.

RiverFront Investment Group, LLC is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. RiverFront Investment Group, LLC manages a variety of asset allocation portfolios utilizing stocks, bonds, and Exchange-Traded Funds.

Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances.

Mortgage backed securities are subject to prepayment and extension risk ; as such, they react differently to changes in interest rates than other bonds. Small movements in interest rates may quickly and significantly reduce the value of certain mortgage backed securities.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

MSCI EAFE Index measures the equity market performance of developed markets, excluding the US & Canada. The index consisted of indices from 22 developed markets. Individual investors cannot directly purchase an index.

WisdomTree LargeCap Dividend Index measures the performance of the large-capitalization segment of the US dividend-paying market. The Index comprises the 300 largest companies ranked by market capitalization from the WisdomTree Dividend Index.

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