From right to left:

Rod Smyth
CHIEF INVESTMENT STRATEGIST

Bill Ryder, CFA, CMT
DIRECTOR OF QUANTITATIVE STRATEGY

Ken Liu
GLOBAL MACRO STRATEGIST

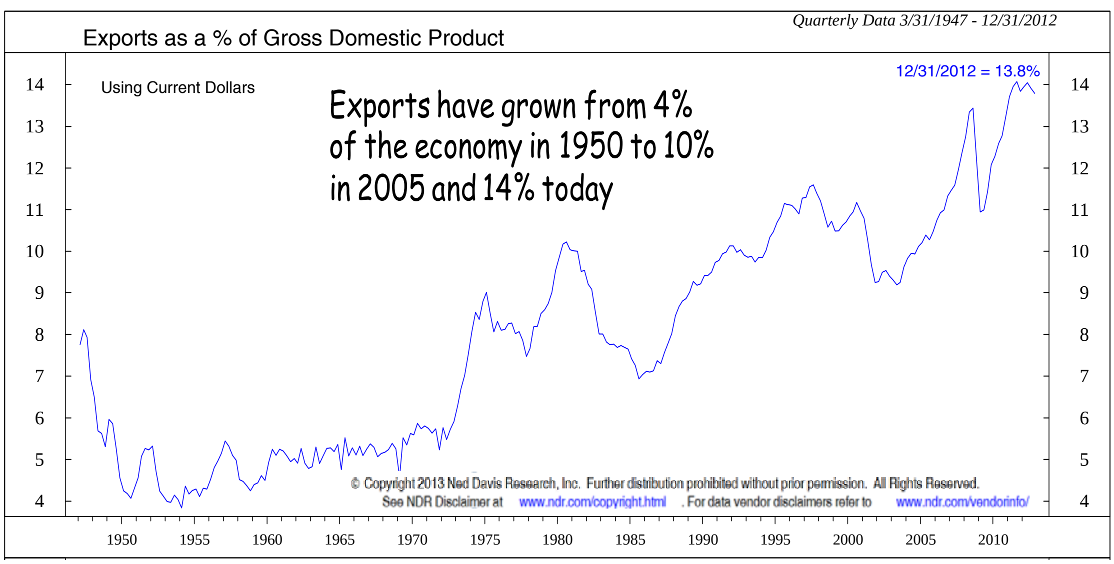
The US is attracting capital from overseas as countries, companies, and investors seek to participate in the US' highly competitive economy.

We now own a portion of our international exposure on a currency-hedged basis.

The Implications of a Stronger Dollar

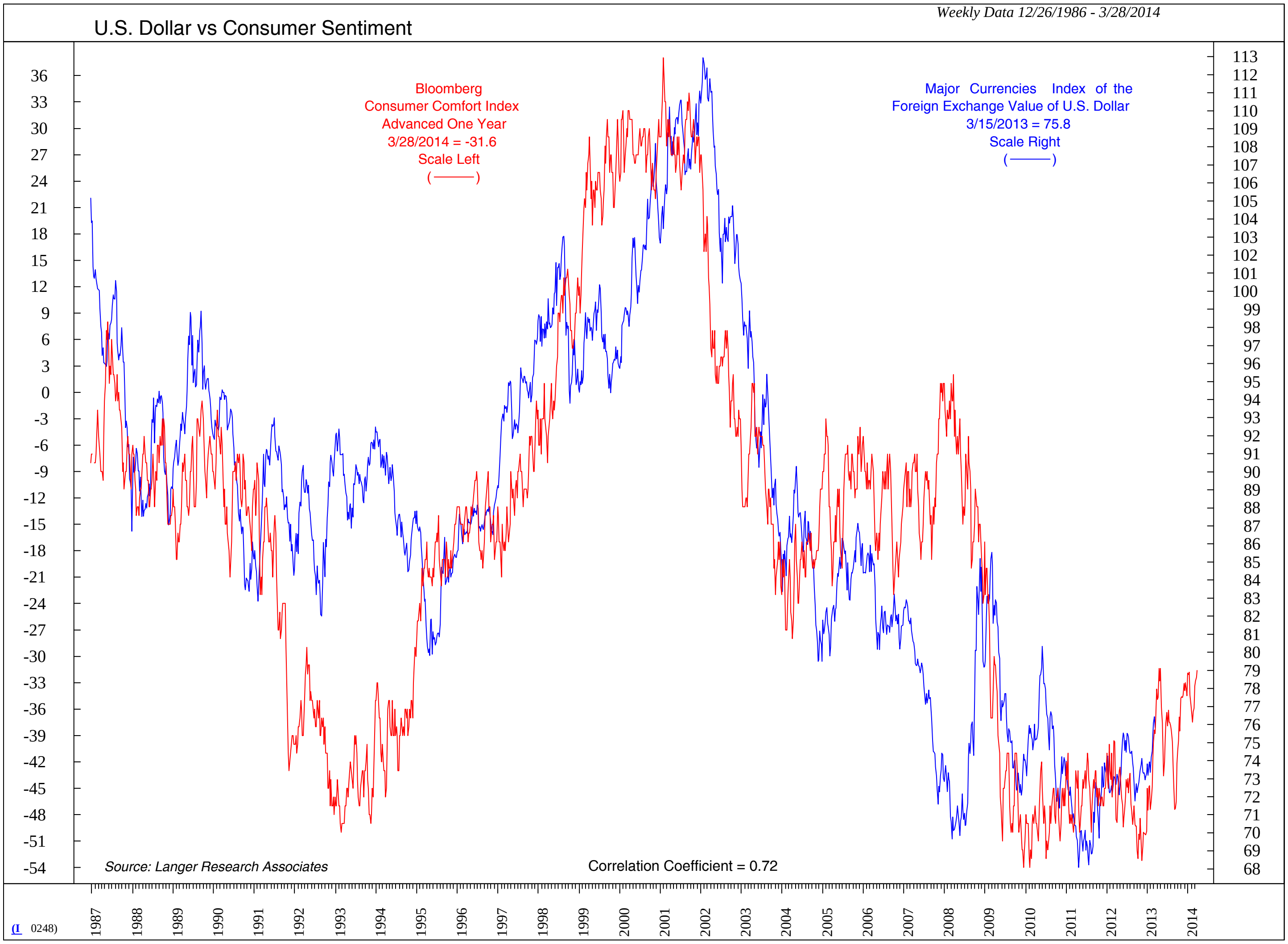
We believe the US dollar has bottomed after a decade of weakness (see Weekly Chart, page 2) and see several reasons why its strength will continue. First, the US economic recovery is gaining steam, led by business spending and, at long last, housing. Second, the US rebound is occurring at the same time its major trade partners are experiencing weaker economic growth. Third, as a consequence, US monetary policy is likely to become incrementally more restrictive relative to other developed market currency blocs.

In the aftermath of the global financial crisis, a rising dollar has been largely associated with 'risk-off' trading – periodic stock market corrections and bond strength when investors were unnerved by global events. Recently however, the dollar and stocks have risen together, reflecting increasing risk appetite and 'animal spirits'. We think a big factor is the energy and manufacturing 'renaissance' that we have written about previously, which has helped boost exports to record levels as a percentage of the US economy (see chart below). The US is attracting capital from overseas as countries, companies, and investors seek to participate in the highly competitive US economy. We like the US industrial sector and believe the strength in housing and manufacturing will also benefit US banks. We also like some of the smallest companies, known as 'microcaps,' which have a domestic focus and offer some potential takeover targets. In contrast, a stronger dollar makes commodity sectors less attractive as commodities that were held as a weak-dollar hedge are sold.



While we still expect the Federal Reserve to remain extraordinarily accommodative over the next year or so, we expect no increase in the pace of asset purchases (quantitative easing, or QE). With Europe mired in recession and Japan in deflation, the motivation for their central banks to increase asset purchases is rising. Japan has already started – the yen has fallen 22% since last September – and we think Europe will follow. Thus, as the US economy and labor markets improve, investors are likely to favor the dollar.

THE WEEKLY CHART: CONSUMER CONFIDENCE SHOULD BOOST US DOLLAR



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Past performance is no guarantee of future results

Consumer sentiment has been a useful guide to the dollar's direction. The chart above shows consumer sentiment (red line, left scale) moved ahead by one year and the US dollar against 'major currencies' — mainly the euro, yen and pound — (blue line, right scale) since 1987. The relatively high correlation of 0.72 suggests that higher consumer confidence will lead to a stronger dollar over the next year. Consumer confidence peaked in 2000 but after two recessions and two wars, it has started to rise from very depressed levels. We think this is fundamentally justified given the housing market recovery, better employment growth, more investment spending, and higher profits.

As a result, a portion of RiverFront's international equity exposure is now on a currency-hedged basis. For this portion, we own the companies and eliminate the impact of currency movements, so our portfolios can benefit if foreign markets rise but their currencies weaken. Our first such position was yen-hedged Japan, purchased in November last year, to which we have added several times. Last week we hedged the euro exposure in some of our European holdings.

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