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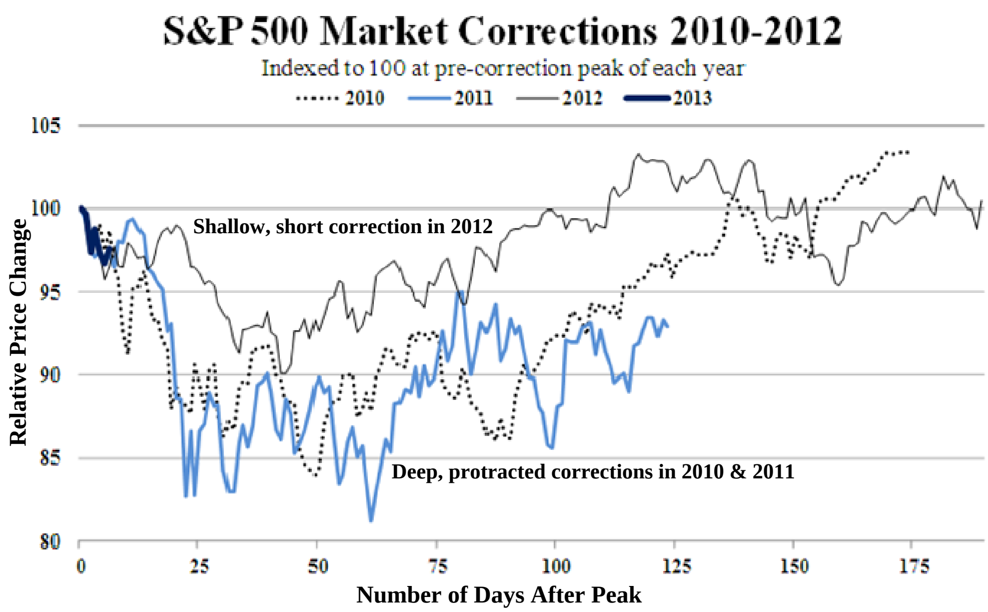
OUR INVESTMENT STRATEGY

- *Overweight US equities and use any significant pullbacks as an opportunity to increase weighting in undervalued higher volatility sectors such as industrials, materials, and select areas of energy (e.g., oil services)*
- *Overweight Japan and increase overweight if Europe or emerging markets continue to disappoint*
- *Neutral weight for Europe, but looking to move back to an overweight position if policy improves as we expect*
- *Underweight emerging markets; looking for a bounce from oversold conditions. Evaluate positioning based on Chinese policy developments and move further underweight if China continues current policy direction*

Don't Panic, It's a Normal Pullback

The S&P 500 climbed almost without interruption from a low of 1353 last November to 1593 on April 11, 2013. Since that peak, economic data has softened, and markets have dropped about 3%, prompting fears of market declines similar to the volatile summers of 2010 and 2011.

After rising at a 40% annualized pace for nearly six months, we think equity markets are due for a pullback and/or period of consolidation. We believe that the deep and protracted market declines of 2010 and 2011 are extremely unlikely. Rather, we expect any pullback will be short and relatively shallow, with a worst-case scenario resembling the brief 10% decline seen in 2012 (see chart below). Since that 2012 market correction, the Federal Reserve has committed to printing $85 billion per month; the Bank of Japan (BOJ) has committed to twice that level of Quantitative Easing (QE) as a percentage of its economy; and the European Central Bank (ECB) has pledged unlimited support for Italy and Spain. All this liquidity flooding into financial markets should limit the depth and duration of any pullback, in our view. Thus, investors may experience only a minimal correction to about 1530 (which was almost hit on April 18th). The next level of strong support is at 1500, and we would expect a worst-case correction to find support at about 1470.



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

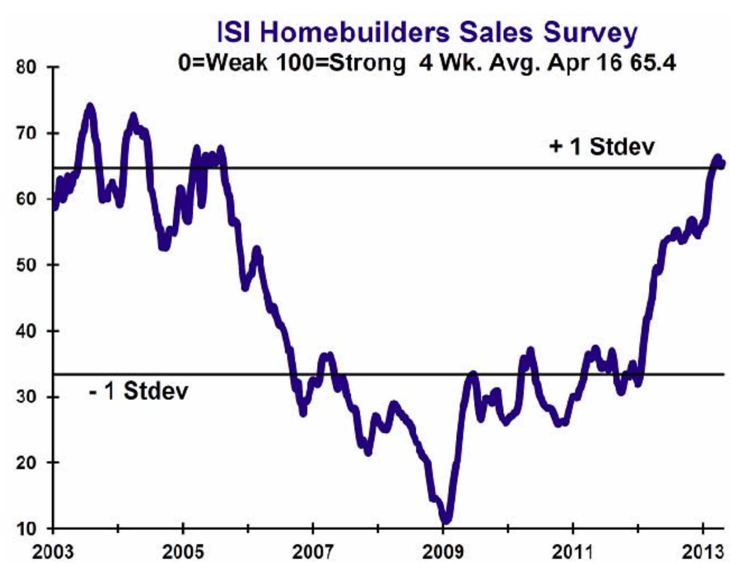
We believe that the "Optimistic Scenario" from our 2013 Outlook is playing out in the US (see circled scenario in table below), although the political maneuvering leading to that outcome is different than we expected. As a result, we think the S&P 500 is likely to finish the year well above 1600 and could approach our fair value level of about 1700. Overseas, Japan is also executing an Optimistic Scenario set of policies that should allow it to continue posting the best returns of all the major global equity markets. Europe has thus far embraced "Muddling Through" policies, with the initial bailout proposal for Cyprus raising concerns that it could make the kind of policy mistakes outlined in our "Pessimistic Scenario." Despite this start to the year, more recent policy developments in Europe are encouraging, and we expect these policies plus a more aggressive ECB to help European markets catch up to the US by the end of 2013. Finally, emerging markets rise and fall based upon China, in our view, and the new Chinese leadership team has thus far embraced the policy options in our Pessimistic Scenario. With investor sentiment for emerging markets now overwhelmingly negative, any positive policy developments should prompt a market recovery. Unless new Chinese policies diverge sharply from existing trends, we will likely use any rebound in emerging markets as an opportunity to further underweight our strategic targets.

POLICY OUTCOME	PESSIMISTIC *Political Gridlock*	BASELINE *Muddling Through*	OPTIMISTIC *Politicians Deliver*
US	Debt ceiling negotaitions fail and US defaults	Sequestration repealed/fudged & no long-term budget fix implemented	"Grand Compromise" or Sequestration Remains in Effect
Europe	Crises in Spanish bonds after refusing ECB/ IMF oversight	Low Spanish bond yields remove pressure to reform, ECB remains cautious	Growth-enhancing reforms enacted in exchange for austerity relief, ECB eases monetary policy
China	No stimulus, re-regulation & continued crack down on real estate	Modest fiscal stimulus and renewed appreciation of yuan	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	1.2%	2.0%	2.5%

Source: RiverFront Investment Group; This table links our pessimistic, baseline, and optimistic 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.

US Outlook — Not Too Hot, Not Too Cold

The US began 2013 with $259 billion in tax increases resulting from fiscal cliff negotiations; these have been joined in recent weeks by $85 billion in sequestration spending cuts. This powerful economic headwind from Washington is being offset, as we expected, by a recovery in the housing and automotive industries (see adjacent ISI Homebuilders Sales chart), two sectors of the economy that until this year have been mostly absent from the economic recovery. The delicate balance between fiscal drag out of Washington and the acceleration in two critical areas of the economy is a "Goldilocks" level of economic growth — fast enough to avoid recession, yet not so fast that the Fed is likely to curtail QE purchases in the near future.



Source: ISI; Stdev – Standard Deviation: a measure of the dispersion of a set of data from its mean. The more spread apart the data is, the higher the deviation.

Furthermore, although the net result is an economy still mired in an anemic 1.5 – 2.5% growth, the sources of that growth provide a much healthier and more stable foundation for the US economy, in our view.

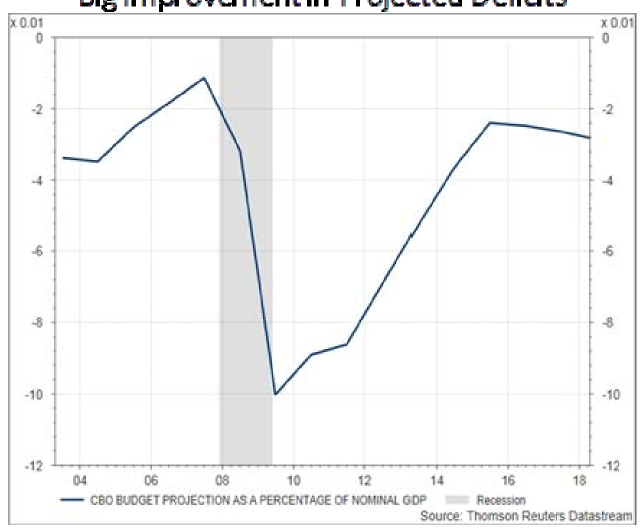
A combination of mortgage refinancing, defaults, and the passage of time to pay off car loans has reduced consumer debt payments as a percent of take-home pay to the lowest level in the past 30 years. With consumer debt burdens reduced, debt-dependent sectors of the US economy (especially housing and automobiles) are recovering. Thus, while fiscal drag may result in another year of subpar economic growth, 2013 will be the first year in which growth shifts from an unsustainable dependence upon government deficit spending to a more healthy reliance on a recovering private sector.

US Deficit Reduction: Ugly Process, Acceptable Outcome

In our 2013 Outlook, we assumed that a key element of our Optimistic Scenario – a long-term plan for deficit reduction – could only occur through a "Grand Compromise" between the President and Congress. Although we did not place a high probability on such an agreement, we thought there was an even lower probability that our leaders would allow the politically painful cuts associated with sequestration to take effect. If a Grand Compromise proved elusive, we expected Congress and the President to avoid the consequences by agreeing to defer implementation of sequestration spending cuts (kicking the can further down the road).

To our surprise, the President and Congress could not reach agreement on how to defer the sequestration spending cuts. Thus, these cuts have taken effect in recent weeks and appear likely to stay in place indefinitely. After the initial shock wears off, the economic drag of these cuts will not be large in 2013, because they have been largely offset by spending on Hurricane Sandy relief. However, these cuts have a substantial long-term impact on expected budget deficits over the coming decade when combined with the fiscal cliff tax hikes. In fact, according to the Congressional Budget Office (CBO), the current budget deficit projections are almost as good as the likely outcome from any potential Grand Compromise (see adjacent chart on projected deficits).

Tax Hikes and Sequestration: Big Improvement in Projected Deficits



Although the political process has been ugly and the means for reducing the deficit are suboptimal, the US has arrived (almost by accident) at a long-term plan to control its deficit spending over the coming decade.* Equity investors have apparently responded to this improved fiscal environment by pushing prices up to the low end of our Optimistic Forecast (10% to 15%).

** Entitlement reform is needed to address deficits beyond this time frame.*

DEVELOPED INTERNATIONAL EQUITIES

Japan: Optimistic Scenario

Japan is taking forceful action to break out of its economic malaise for the first time in 20 years. In his first four months in office, Prime Minister Shinzo Abe cleaned house at the BOJ, replacing the cautionary old guard that had presided over 20 years of deflation with a new team of reformers. Led by Governor Haruhiko Kuroda, the new leadership team at BOJ has announced a QE plan twice the size of the Fed's when measured as a percentage of the economy (see chart below). Unlike the US, Japan's QE is also accompanied by aggressive fiscal stimulus.

Abe's economic plan also calls for reform of the social, legal, and economic structures that have hampered Japan's adaptability, and therefore its growth, in a highly dynamic global economy. Although Abe has yet to release a detailed plan, Japan's recent entry into the Trans-Pacific Partnership negotiations has greatly increased expectations that Abe will fulfill his reform commitments: "Within the next few months, I will make certain to everyone that change is taking place."

Japanese membership in a trans-pacific free trade zone would require Japan to embrace reforms in virtually every area of its economy and could prompt vastly increased trading volumes and associated investments within emerging Asia, Japan and the US. With Japanese equities among the cheapest in the world despite their recent advance, we intend to remain overweight.

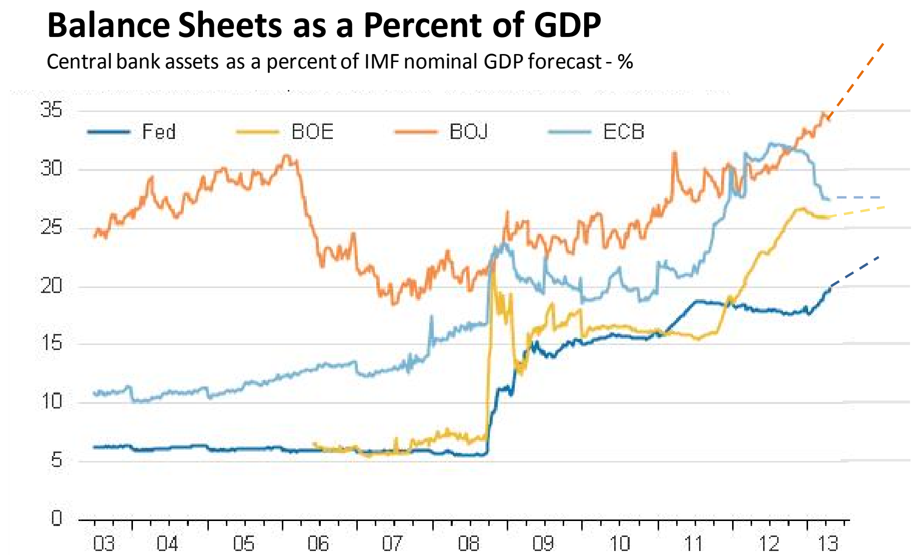


Chart Source: Historical -- Thomson Reuters Datastream (Reuters graphic/Scott Barber 4/22/13); Forward-looking projections (2013-14) -- RiverFront Investment Group; Fed – US Federal Reserve; BOE – Bank of England; BOJ – Bank of Japan; ECB – European Central Bank. Past performance is no guarantee of future results.

Europe: Muddling Through (with hope for improvement)

While the US and Japan appear to be moving down our Optimistic Scenario for economic policy, Europe has yet to implement badly needed monetary stimulus and economic reforms. Prior to 2012, Europe pursued a policy we called "Hoovernomics" – a combination of tight monetary policy and budget austerity similar to the Hoover administration's strategies preceding the Great Depression. New ECB leadership helped spur changes in these disastrous policies, as incoming President Mario Draghi initiated a €1 trillion lending program (long-term refinancing operation [LTRO]) and pledged to backstop Italian and Spanish debt markets if they sign on to policy oversight.

While these policy initiatives helped stabilize the European banking system and significantly lowered Italian and Spanish borrowing costs, the ECB thus far has done little to spur economic growth. As shown on the chart of central bank balance sheets above, the Fed and the BOJ have aggressive plans to expand their balance sheets. By contrast, the ECB's balance sheet, after expanding sharply early in Draghi's term, has been contracting in recent months. Meanwhile, reform efforts have slowed as lower borrowing costs reduce pressure on Italy and Spain to sign on to policy oversight, and the European Union's (EU's) mishandling of the Cyprus bailout has undermined investor confidence in EU decision making. This "Muddling Through" policy combination (ECB keeps borrowing costs low but little else is accomplished) has allowed European equities to rise, but at a much slower pace than US and Japanese alternatives.

We believe that pressures are building for Europe to resume its move away from Hoovernomics in both monetary and fiscal policies. Politicians typically adhere to an economic theory until it conflicts with a political reality. With Europe's economic weakness now spreading to Germany and its Chancellor, Angela Merkel, facing reelection in September, Germany's opposition to more aggressive and creative monetary policies may soften in the coming months.

With respect to fiscal policy, the European Union's recent modifications to its oversight agreements with bailed out countries (Greece, Ireland, Portugal, and Spain) are a big step in the right direction, in our view. These modifications give bailout recipients more time to meet their budget deficit targets. In exchange for requiring fewer tax increases and spending cuts, the EU is asking for accelerated labor market reforms. This is exactly the right policy prescription, in our view, with reduced austerity requirements and labor market reforms both helping to spur economic growth. In addition, by giving the leaders of the bailed out countries a negotiating win (less austerity), the EU has provided political cover for them to accelerate badly needed but politically difficult reforms.

After a Muddling Through start to the year, we see a potential transition to an Optimistic Scenario set of policies (monetary stimulus and accelerated economic reform) during the summer. If we are correct, then European markets could close their performance gap with the US by the end of the year.

Emerging Markets: The China Syndrome

For the past several years, the performance of emerging market equities relative to the US has been largely a function of China's performance. If China works, then the rest of the emerging markets work; if China falters, then the major emerging markets that depend upon Chinese demand for their commodities (Latin America, South Africa, Russia) or manufactured products (Taiwan, Korea) also struggle, in our view.

We expected China's new leadership to start their term with an aggressive stimulus plan. Instead, they have resumed their predecessors' aggressive campaign to dampen real estate speculation. Lacking a clear catalyst for continued 8% economic growth in China, emerging market equities have posted losses in 2013 despite strong gains in the rest of global equity markets.

Given the lack of transparency in China's governing process, investors have to look for clues for future policy direction. We believe that Chinese leaders have wide discretion over the economic data they publish. Therefore China's disappointing first-quarter GDP figure contains a potential message. The lower-than-expected growth rate (7.7% year-over-year growth, compared to expectations of about 8.0%) combined with renewed appreciation in China's currency should significantly dampen inflation expectations. This could allow China to announce a stimulus package without reversing the recent progress in tamping down inflationary pressures.

With investor consensus now overwhelmingly negative towards emerging markets, any positive policy developments should prompt a rebound in emerging market stocks. Unless new Chinese policies represent a fairly sharp departure from existing trends, we are likely to use any recovery in emerging markets as an opportunity to go further underweight our strategic targets.