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Expecting Minor Near-Term Resistance for Stocks

The S&P 500's 39% annualized run rate from last November's low through its early April record high appears due for a downshift. Over the past three months, the S&P 500 has broken out above its two previous bull market peaks – the March 2000 high of 1527 and the October 2007 high of 1565 – and closed last week just 0.7% below its April 11th record high of 1593. In light of the recent rally's unsustainable (in our view) pace and the round number of 1600 looming, we think it would be natural for the S&P 500 to have a period of consolidation or even pull back by a modest amount before moving higher. In a pullback, we expect support around 1530 and then 1500 to 1470, the 38% and 50% retracements of the November-April rally. However, as long as the Federal Reserve, the Bank of Japan, and the European Central Bank remain committed to providing open-ended monetary stimulus, we expect the depth and duration of any stock pullbacks to be limited.

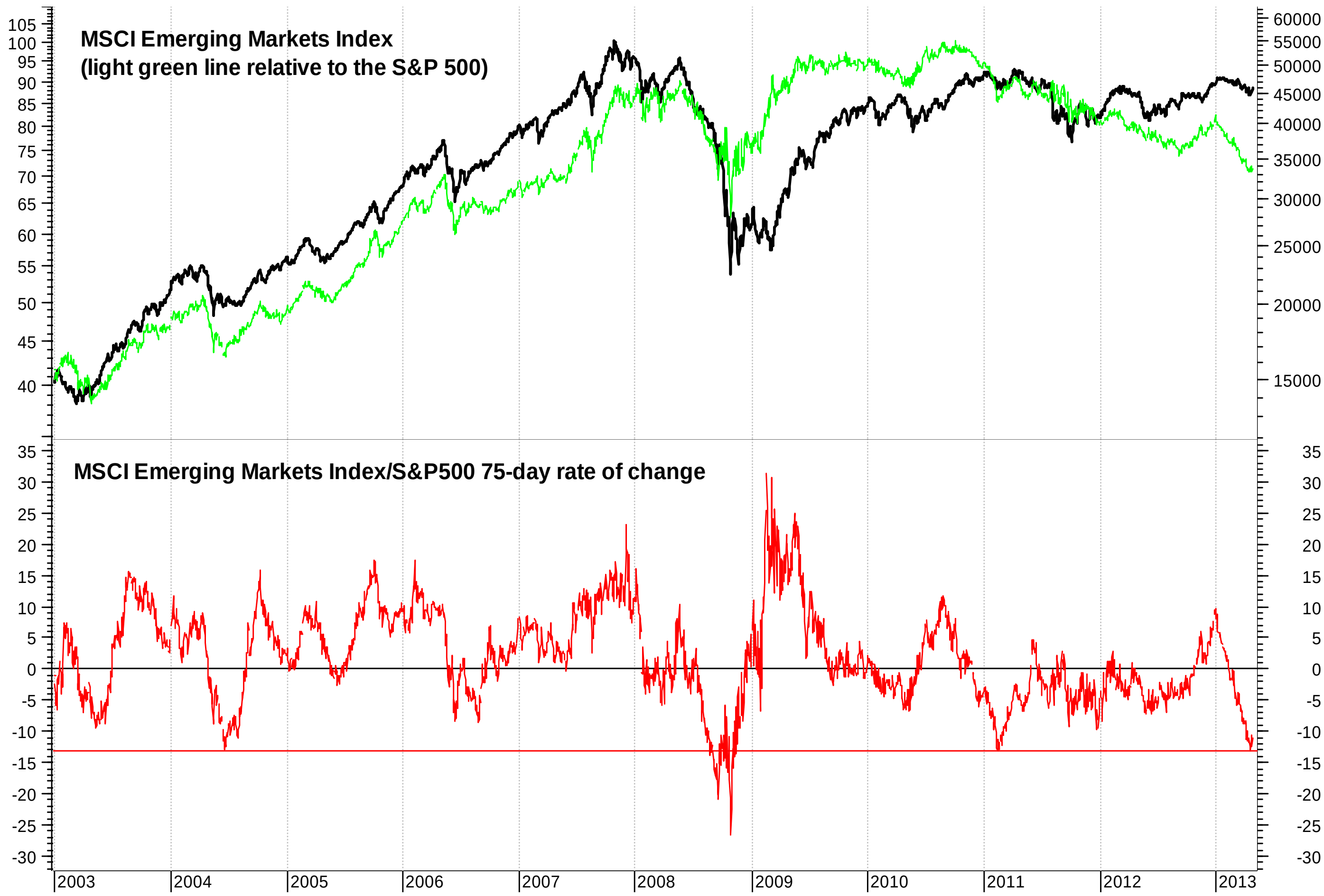
Source: RiverFront Investment Group; Past performance is no guarantee of future results.

The blue line running through the candlesticks in the chart above highlights the 39% annualized run rate of the S&P 500's November to April rally, which we see as unsustainable. The two dashed horizontal lines mark the 2000 and 2007 bull market peaks. Breaking through these levels is a bullish sign technically, and we believe it is fundamentally justified by the current higher level of earnings. That said, these peaks also present a shorter-term potential psychological challenge, as buyers at the time of those peaks are likely to get nervous about another bear market and sell, having made back their bear market losses. We think the primary trend (our proxy is the 200-day moving average, the red line in the chart) is a more important intermediate-term indicator for stocks. The

200-day moving average had flattened following the S&P 500's 7% decline into November but has since resumed its uptrend, which is bullish for stocks based on our historical analysis.

We are concerned about emerging markets. As detailed in last week's *Strategic View*, we had 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. Unless new stimulative Chinese policies are introduced, we are likely to use any recovery in emerging markets as an opportunity to go further underweight our strategic targets. The issue is timing, and one of our technical tools suggests we may get a better opportunity. *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.*

THE WEEKLY CHART: EMERGING MARKET RELATIVE DECLINE OVERDONE, SUGGESTS A BOUNCE



Source: RiverFront Investment Group, FactSet Research Systems; Past performance is no guarantee of future results.

The MSCI Emerging Market Index fell 6.5% from its January 3rd peak through its mid April low. Relative to the S&P 500 (the light green line in the top panel of the chart, left scale), the decline was worse, down 13% peak to trough, as shown in the bottom panel which tracks the 75-day rate of change of the relative strength line. This magnitude of relative decline is somewhat unusual – it has happened only three other times over the past ten years, including the 26% relative decline that came during the height of the financial crisis when Lehman Brothers went bankrupt. Following the recent extreme relative underperformance, we are expecting emerging markets to recover and so plan to judge whether to reduce our exposure further if that occurs, especially if there are no positive policy developments coming from China.

Past performance is no guarantee of future results. 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. 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. 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. The MSCI Emerging Markets Index measures equity market performance of emerging markets. The index consists of 21 emerging market country indices. It is not possible to invest directly in an index.

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