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SUMMARY

- We believe there are positive fundamentals in place that can lead to higher stock prices a year from now.
- We are encouraged by the rebound in corporate earnings, the healthy consumer, a robust housing market, improving employment and a patient Federal Reserve.
- We are concerned by signs of inflation, COVID-19 trends, global tensions, and above-average valuations.

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Encouraging Signals Outweigh Realistic Concerns

Looking Ahead to 2022 with 'Realistic Optimism'

Stock valuations are driven by future expectations. That mindset proved beneficial to equity investors who were willing to look towards the future with optimistic expectations for a re-opened world and the resultant economic recovery. They have been rewarded with positive returns over the past twelve months, but now that we are in recovery mode, what comes next? Our Three Tactical Rules* shape our view as we look out over the next ninety days. Looking longer term, however, we also consider many qualitative inputs to help inform decision making. No one of these, individually, is enough to prompt a decision. Our views on these variables, combined with our tactical signals, inform portfolio positioning. Here are some of the themes we are watching now.

**Our Three Tactical Rules are: "Don't Fight the Fed," "Don't Fight the Trend," and "Beware of the Crowd at Extremes".*

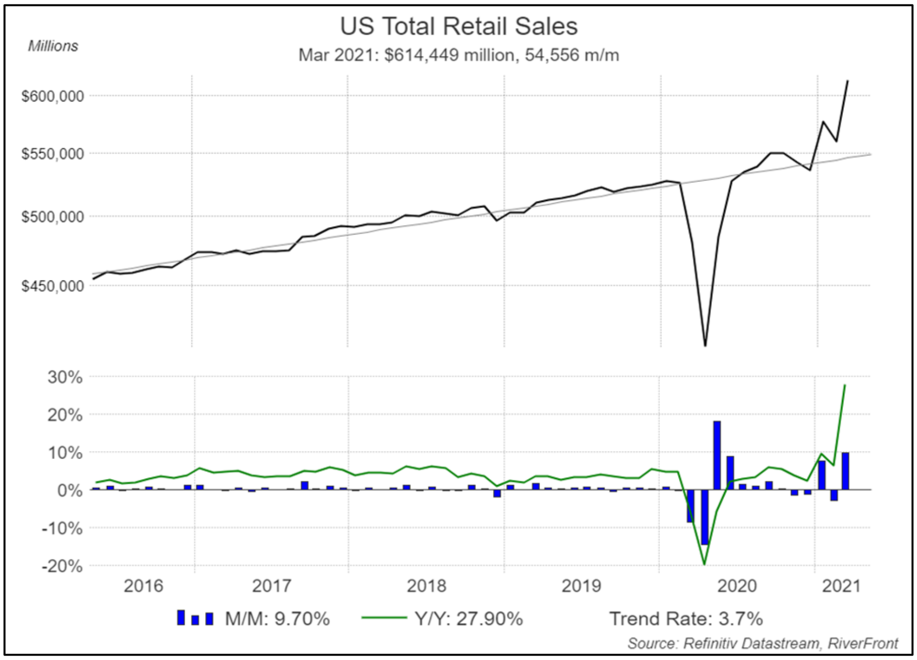
We are encouraged by:

The strong recovery in S&P 500 corporate earnings

Every earnings reporting period since the onset of the pandemic has been marked by above consensus results, but none better than those of the first quarter of 2021. Over 400 companies in the index have reported, and 86% of those have had positive earnings surprises. Revenues have also come in above expectations. According to FactSet, the blended growth rate for the quarter could be almost 50% year over year. The sector with the highest growth for the quarter is Consumer Discretionary with industries such as automobiles, apparel, and specialty retail leading the way. For calendar year 2021, earnings for the S&P 500 are now projected to grow at a year-over-year rate of 32% and revenues are estimated to increase by approximately 11%. While corporate earnings are only one of several financial components used to gauge a company's performance, first quarter results give a sense of the magnitude of the progress since the depths of the pandemic shutdown.

A healthy consumer

We place a great deal of emphasis on the consumer because consumer spending is approximately 70% of US GDP (Gross domestic product) . Consumer sentiment indicators are now trending higher. Stimulus checks have contributed to the health of consumer balance sheets. Data from the Federal Reserve Bank of New York shows that, on average, consumers have saved about one-third of the monies received, used roughly one-third of it to pay down debt, and spent the remainder. That spending has translated into a rebound in retail sales with March retail sales rising almost 10% (illustrated in chart below) owing to purchases on cars, apparel, and sporting equipment. Additionally, the improvement in the categories of restaurants and bars as well as other food and beverage services is evidence of the pent-up demand for a return to normal. We expect these trends to continue as we move into the summer months and more restrictions are lifted.



Past performance is no guarantee of future results. Shown for illustrative purposes. Not indicative of RiverFront portfolio performance.

The robust housing market

In the March 8th edition of the Weekly View, entitled *Housing is an Important Key to Economic Growth…Fortunately it is Getting Back on Track*, we discussed the importance of the housing market as a barometer for the US economy. We believe the combination of favorable demographics, low relative interest rates for the foreseeable future, and the trends towards increased workplace flexibility bode well for future sales trends. There is also evidence that strength in the housing market can translate into higher levels of consumer spending and investments. Economic studies have shown consumers who purchase homes also spend money on home-related durable goods as well as increased expenditures on home improvements and maintenance. Add in the increased employment opportunities afforded by new home construction, and we see it as natural to conclude that a robust housing market is good for the economy.

Improving employment trends

The employment recovery has been uneven and small businesses have been disproportionately negatively impacted due to lockdown restrictions and an inability to hire qualified workers. This was evidenced by April's non-farm payroll report, which was short of expectations by over 700,000 jobs. While the unemployment rate is still high when compared to the pre-pandemic low of 3.5%, the drop from its high in the mid-teens in April 2020 to the most recent report of 6.1% shows significant progress in the right direction. Within the past week, there has been additional encouraging news as it relates to small businesses. The Paychex/IHS Markit Small Business Jobs Index increased in April by over 4% and is now back to the pre-pandemic peak seen in February 2020. The data in the Paychex/IHS report reflected that as more businesses have resumed regular operations and vaccines have become more widely available, growth is improving across some of the all-important services sectors such as construction and leisure and hospitality.

An unwavering Federal Reserve

As the US economy recovers, Wall Street watches closely for signs that the Federal Reserve is going to blink as it relates to a change the current accommodative stance. At a press conference following the release of the most recent FOMC statement, Chairman Jerome Powell stated, "It is not time yet" when asked about a potential change in policy. With over 8 million fewer US jobs now, versus prior to the pandemic, he noted that it will take time to reach their goal.

We are Concerned by:

Signs of inflation

Often, management comments around current conditions and future expectations play a more prominent role during earnings reporting season than the actual results. We have been watching closely for warnings regarding the negative impact of higher corporate taxes, but that has not materialized thus far. Instead, the word used with increasing frequency is inflation as input costs have been steadily rising. Separately, Treasury Secretary Janet Yellen recently fueled concerns over inflation by saying, "It may be that interest rates will have to rise somewhat to make sure that our economy doesn't overheat, even though the additional spending is relatively small relative to the size of the economy." Equity markets reacted negatively to Secretary Yellen's comments prompting her to reiterate her support of the Fed's independence in setting interest rate policy.

COVID-19 trends

In the US, COVID-19 case numbers, hospitalizations, and fatalities have trended lower. However, in countries such as Japan and India, the current trends are negative as cases and fatalities climb. There are fears that new variants are overwhelming vaccination efforts. Some countries have had to impose lockdowns again. Comments by Japanese government officials have even cast doubt over the upcoming Olympic games in Tokyo. Despite the encouraging statistics in the US, the director of the C.D.C said in mid-April that she was "really worried about the rollbacks of restrictions in some states" citing the new variants and the 'stall' in the decline of new cases. The concern is that we could lose ground in the fight against the virus.

Global tensions

At this time, geopolitical tensions are simmering on multiple fronts. Worries about China deploying warplanes in Taiwanese airspace, Russia's recent military buildup at the Ukrainian border, and North Korea's umbrage over President Joe Biden's remarks regarding that country's nuclear arsenal have created situations on multiple fronts that require monitoring. Trying to quantify these types of tensions can be difficult, but what we know is that uncertainty can create anxiety for investors. Currently, markets are signaling a lack of concern around these issues, and we believe that complacency alone requires us to watch each of these situations for potentially negative developments.

Above average valuation

According to Factset, US Large Cap equities are trading at valuation levels that are above their five and ten-year averages but then interest rates are well below those averages, making stocks more attractive on a relative basis. We discussed valuations in the February 16 Weekly View, Valuations Are Elevated…. And That Is Okay in Our View. At that time, the price/earnings multiple for the S&P 500 was 22x forward earnings. Since that publication, the index has appreciated by about 7% and the forward price/earnings multiple still stands at 22x. We have grown into the multiple, so to speak, as earnings have exceeded expectations. To reiterate, markets are forward looking. Above average valuations are a condition, not necessarily a catalyst for stock prices to turn lower. However, the earnings growth in 2022 is unlikely to meet or exceed that of 2021. As previously noted, FactSet forecasts 2021 earnings growth for the S&P 500 to be 32%. Consensus for 2022 is for growth to be in the low double-digits. We question whether above-average valuations are warranted if the rate of earnings growth decelerates next year – even if it is being measured against the extraordinary pace for this year. The term 'headwind' is appearing more frequently in forward looking Wall Street strategy pieces as 2022 comes more clearly into view. We believe it is reasonable to believe this year's rate of recovery will not be matched going forward. The slowdown in the rate of growth may be exacerbated by the expected changes to the corporate tax structure.

Conclusion:

Because stocks have risen so fast in such a short period of time, one of our three rules (Beware of the Crowd at Extremes) is suggesting caution. For that reason, we think that stocks may make little progress over the next few months as the political rhetoric over President Biden's spending and tax plans heats up. However, as we look to the second half of 2021 and into 2022, we think the strong economic and earnings recovery will outweigh current concerns, and stocks will be higher a year from now.

Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.

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.

Definitions: Don't Fight the Fed – 'Supportive' means the Fed's monetary policy regarding inflation and employment is in what we believe based on our analysis to be the investors' best interest; 'Against' means the Fed's monetary policy, in our view, is going against the investors' best interest; 'Neutral' means the Fed's monetary policy is neither supportive or against the investors' best interest in our view. Don't Fight the Trend – Terms correlate to the 200-day moving average as it relates to the equity indexes: 'Positive' means that the trend is rising, 'Flat' means the trend is flat, 'Negative' means the trend is falling. Beware the Crowd at Extremes – Terms correlate to the NDR Crowd Sentiment Poll and its measurement of Extreme Optimism (Bearish), Neutral, or Extreme Pessimism (Bullish).

Index Definitions:

Standard & Poor's (S&P) 500 Index TR USD (Large Cap) measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

The Paychex | IHS Markit Small Business Employment Watch draws from the payroll data of approximately 350,000 Paychex clients to gauge small business wage and employment trends on a national, regional, state, metro, and industry basis.

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