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SUMMARY

- Slower economic growth is a detour not a derailment, in our view.
- Headline headwinds impacted third quarter results, but we believe the recovery remains on track.
- We believe utilizing a barbell approach to manage portfolios is useful to navigate volatile markets.

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Quarterly Review: Markets Encountered a Detour, Not A Derailment, During Q3 2021

Concerns Over Slower Growth Dampened Investor Enthusiasm

A flat quarter for Stocks and Bonds. The third quarter of 2021 began with optimism around strong corporate earnings, positive economic momentum, and consumers with cash to spend and places to go. Negative headlines received scant attention. More economically sensitive 'value' stocks seemed to be taking the reins from less cyclical 'growth' stocks as confidence increased that COVID-19 had loosened its grip on our daily lives. By mid-August, however, the Delta variant had crashed the recovery party and worrisome headlines garnered more attention from anxious investors. Some Wall Street strategists grew cautious and lowered growth forecasts, and some companies lowered future earnings guidance owing to higher costs associated with supply chain disruptions and labor shortages. Despite these short-term issues, we believe the recovery from the pandemic remains on track, acknowledging the road ahead could be bumpy as headline headwinds persist.

A September correction. A review of the trailing twelve-month (TTM) data reveals that investors have remained positive with all equity asset classes rising with the reopening of the global economy. However, the quarter ended on a sour note as the S&P fell almost 5% in September, eliminating the earlier gains from July and August. This illustrates the impact of headline damage as US small/mid-cap and emerging markets equities were the worst performing asset classes during the period. The slump in emerging market equities began in July as concerns grew over headlines around the Chinese government's regulatory crackdown on multiple industries. Small and mid-cap stocks seemed to be most vulnerable to anxieties over the potential for slowing growth as supply chain disruptions and labor shortages dominated the news. The fact that high yield was the strongest performer of all asset classes during the quarter underscored investors' continued search for yield as rates remained relatively low and equities became more volatile.

The table below shows the performance of asset classes on the left and US equity sectors on the right. Returns for both the third quarter and past twelve months are shown. The table is anchored by US Large-Cap equities, which are shaded, and allows for easier comparison to see higher and lower relative performance by each asset class and sector.

Performance: A Closer Look

ASSET CLASSES				US SECTORS			
Q3 2021		TTM		Q3 2021		TTM	
HIGH YIELD	0.94%	US SMID CAP	47.66%	FINANCIALS	2.74%	ENERGY	82.99%
US LARGE-CAP	0.58%	US LARGE-CAP	30.00%	UTILITIES	1.78%	FINANCIALS	59.13%
TREASURY BONDS	0.09%	EAFE	25.73%	COMMUNICATIONS SVCS	1.60%	COMMUNICATIONS SVCS	38.39%
FIXED INCOME INV. GRADE	0.05%	EMERGING MKT EQUITIES	18.20%	HEALTH CARE	1.43%	REAL ESTATE	30.53%
CASH	0.01%	HIGH YIELD	11.46%	INFORMATION TECHNOLOGY	1.34%	REAL ESTATE	30.53%
EAFE	-0.45%	CASH	0.05%	REAL ESTATE	0.88%	US LARGE-CAP	0.58%
GOLD	-1.15%	FIXED INCOME INV GRADE	-0.90%	US LARGE-CAP	0.58%	US LARGE-CAP	30.00%
US SMID CAP	-2.10%	TREASURY BONDS	-3.30%	CONSUMER DISCRETIONARY	0.01%	INDUSTRIALS	28.96%
EMERGING MKT EQUITIES	-8.09%	GOLD	-7.64%	CONSUMER STAPLES	-0.31%	INFORMATION TECHNOLOGY	28.90%
				ENERGY	-1.66%	MATERIALS	26.48%
				MATERIALS	-3.51%	HEALTH CARE	22.56%
				INDUSTRIALS	-4.23%	CONSUMER DISCRETIONARY	19.15%
						CONSUMER STAPLES	11.34%
						UTILITIES	11.01%

Performance Total Return Percentage as of 9/30/2021

Source: RiverFront, Morningstar, Factset. Past performance is no guarantee of future results. Shown for illustrative purposes. Not indicative of RiverFront portfolio performance.

Heightened anxieties also impacted sector returns as performance zigzagged from week to week from those considered more ‘defensive’ back to those associated with a pro-growth environment. An examination of the returns for the eleven sectors in the S&P 500 also reveals the impact of headline anxieties as cyclical sectors were among the worst performers during the quarter. The supply chain disruptions have resulted in some high-profile companies lowering guidance in the Industrials sector which had a negative impact on performance during the quarter. Other cyclicals such as Energy and Materials also fell victim to worries over slowing growth during the third quarter.

Turning to some positive performers, strong balance sheets and expectations for higher interest rates kept the Financials sector at the top of the leaderboard for the period. Perhaps the most noteworthy performance came from the Utilities sector which has been out of favor throughout the recovery phase. We believe the strength in Utilities was a signal that nervous investors sought greater diversification into more defensive segments of the market until the growth path becomes clearer.

The Divergence in Performance During the Quarter Strengthened Our Belief in the Barbell Approach

At RiverFront, our process is grounded in active management and the ability to be flexible, helping us navigate through periods of uncertainty. Throughout much of 2021, our asset allocation process has favored US equities over international and we have taken a barbell approach to selection. In the US, one side of the barbell consists of a mix of growth industries that benefit from the work-from-home environment and the other side of the barbell is comprised of value stocks that stand to benefit from high levels of government stimulus. We also have exposure to quality branded consumer companies whose near-term prospects have been dampened by the pandemic.

Within International equities, we prefer developed markets where we find relative valuations attractive but continue to take a “show-me” approach as growth remains slower than that of the US. We are cautious on Emerging Market equities given the increased scrutiny and regulation of the corporate sector on the part of the Chinese government.

Turning to fixed income, we remain underweight in our balanced portfolios. We are also using a barbell approach to security selection, owning short and intermediate maturity corporate bonds on one side and long maturity Treasuries on the other, to act as a shock absorber in case of equity market weakness.

Process over Prediction

September was the worst month for equities since the spring of 2020 and it served as a stark reminder of what happens when uncertainties intersect with a bull market. Our mantra of “Process Over Prediction” helped us remain overweight stocks despite these negative headlines since our three tactical rules remained positive (as noted in the September 20, 2021 edition of the Weekly View: [The Three Tactical Rules Remain Bullish, but Proceed with Caution](#)). We expect this period of consolidation can continue, but ultimately, we believe the US economic recovery remains on track and equity markets will move higher over course of the next twelve months.

Given this, our message for the three types of investors is:

- **Accumulate:** Market consolidations are not tradeable events, in our view, for long-term investors.
- **Sustain and Distribute:** An unbalanced portfolio can make it more difficult to endure rising volatility. In keeping with this, we reduced our equity allocations earlier in the summer to bring our balanced portfolios closer to alignment with their long-term strategic allocations. We continue to prefer equities to fixed income in our balanced strategies.

Important Disclosure Information

The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Opinions expressed are current as of the date shown and are subject to change. Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

Chartered Financial Analyst is a professional designation given by the CFA Institute (formerly AIMR) that measures the competence and integrity of financial analysts. Candidates are required to pass three levels of exams covering areas such as accounting, economics, ethics, money management and security analysis. Four years of investment/financial career experience are required before one can become a CFA charterholder. Enrollees in the program must hold a bachelor's degree.

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

High-yield securities (including junk bonds) are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.

Small-, mid- and micro-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies.

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

When referring to being “overweight” or “underweight” relative to a market or asset class, RiverFront is referring to our current portfolios’ weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit www.riverfrontig.com or contact your Financial Advisor.

Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.

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.

Sectors based on Global Industry Classification Standard (GICS) a standardized classification system for equities developed jointly by Morgan Stanley Capital International (MSCI) and Standard & Poor’s. The GICS hierarchy begins with 11 sectors and is followed by 24 industry groups, 67 industries, and 147 sub-industries.

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

Asset Class Definitions:

S&P 1000 Index TR USD (US SMID Cap) is a combination of the S&P Mid Cap 400 Index TR USD & S&P Small Cap 600 Index TR USD.

MSCI EAFE Index TR USD (Developed International Equities) is an equity index that captures large and mid cap representation across developed market countries around the world, excluding the US and Canada.

MSCI Emerging Markets Index NR USD (Emerging Market Equities) is an equity index that captures large and mid cap representation across 23 emerging markets (EM) countries.

Bloomberg Capital US Treasury Index TR USD (Treasury Bonds) measures the performance of the US Treasury bond market.

Bloomberg US Aggregate Bond Index TR USD (Fixed Income Investment Grade) is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The issues must be rated investment grade, be publicly traded, and meet certain maturity and issue size requirements.

ICE BofA Merrill Lynch High Yield Index TR USD (High Yield) which tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. Index constituents are capitalization-weighted based on their current amount outstanding times the market price plus accrued interest.

Bloomberg Capital 1-3 Month US Treasury Bill Index TR USD (Cash) includes all publicly issued zero-coupon US Treasury Bills with a remaining maturity between 1 and 3 months, are rated investment-grade, and have an outstanding face value of \$250 million or more.

LBMA Gold Price PM (\$/OZt) (GOLD) – the London gold price per troy ounce of gold for delivery in London through a member of the LBMA authorized to effect such delivery, stated in U.S. Dollars, as calculated and administered by independent service provider (S) and published by the LBMA on its website at www.lbma.org.uk

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