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SUMMARY

- Stocks ended the year strongly, overcoming headline concerns, in our view.
- We remain overweight stocks going into 2022, with a preference for the US.
- While we expect positive returns, we anticipate higher volatility.

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Quarterly Review – Q4 2021: Market Continues to Climb the ‘Wall of Worry’

US Powers Through Market Concerns; Emerging Markets Still Struggling

A popular investor adage during mature bull markets is “Climbing the wall of worry.” This is used when the market rises as bearish investors gradually shift their views and add to equity positions even in the face of uncertainty. The second half of 2021 brought uncertainty in the form of COVID-19, inflation, and Fed policy. However, the fourth quarter once again proved the adage correct, as markets climbed these multiple “walls of worry” to close the year near all-time highs.

The First ‘Wall of Worry’, October–November

The fourth quarter opened with the passage of the bipartisan Infrastructure and Jobs Act in early November, and the Fed’s effective communication around tapering, which initially calmed fears of runaway inflation. The perception of strong, sustainable earnings buoyed equities, and a period of relative geopolitical calm supported the upward climb of stock markets, particularly in the US.

This rally was temporarily halted in late November by fears around a new COVID-19 variant – Omicron – and the impact of increasing inflation. Headline US consumer inflation for October crossed 6% for the first time since 1990. This inflation spike forced the Fed to taper bond purchases faster than expected and to move up their rate hike probabilities in 2022. This spike also had the indirect effect of delaying the passage of a second phase of fiscal stimulus, called the Build Back Better plan, through a deeply divided Congress.

Climbing the Second ‘Wall’ in December

We believe the second “climb” is currently underway, reflecting investors’ increasing comfort with the Fed’s slightly hawkish shift to combat higher inflation. Investors are also settling into life with COVID-19 variants – milder outcomes, more testing, shorter quarantines, and lower likelihood of prolonged shutdowns. **Markets ended the year with a rally that erased losses from early December, netting +11.0% for the S&P (Standard & Poor), +2.7% for Developed International, and small losses in Emerging Markets (-1.3%), with Bonds flat (.01%) for the quarter.**

Performance: A Closer Look

| PERFORMANCE TOTAL RETURN PERCENTAGE AS OF 12/31/2021 | | | | US SECTORS | | | |
|--|--------|--------------------------|--------|------------------------|--------|-------------------------|--------|
| ASSET CLASSES | | | | | | | |
| Q4 2021 | TTM | | | Q4 2021 | TTM | | |
| | | | | Real Estate | 17.54% | | |
| | | | | Information Technology | 16.69% | | |
| | | | | Materials | 15.20% | | |
| | | | | Consumer Discretionary | 13.31% | Energy | 54.64% |
| | | | | Utilities | 12.93% | Real Estate | 46.19% |
| | | | | Consumer Staples | 12.84% | Information Technology | 35.04% |
| | | | | Health Care | 11.17% | Financials | 34.53% |
| US LARGE CAP | 11.03% | US LARGE CAP | 28.71% | US LARGE CAP | 11.03% | US LARGE CAP | 28.71% |
| US SMID CAP | 7.27% | US SMID CAP | 25.35% | Industrials | 8.64% | Consumer Discretionary | 27.28% |
| GOLD | 4.10% | DEVELOPED INT'L EQUITIES | 11.26% | Energy | 7.97% | Materials | 26.13% |
| DEVELOPED INT'L EQUITIES | 2.69% | HIGH YIELD | 5.36% | Financials | 4.57% | Health Care | 24.43% |
| HIGH YIELD | 0.66% | CASH | 0.04% | Communication Services | -0.01% | Industrials | 21.57% |
| TREASURY BONDS | 0.18% | FIXED INCOME INV GRADE | -1.54% | | | Communications Services | 21.21% |
| CASH | 0.01% | TREASURY BONDS | -2.32% | | | Utilities | 18.63% |
| FIXED INCOME INV GRADE | 0.01% | EMERGING MARKET EQUITIES | -2.54% | | | Consumer Staples | 17.67% |
| EMERGING MARKET EQUITIES | -1.31% | GOLD | -4.15% | | | | |

Source: RiverFront, Morningstar Direct. Past performance is no guarantee of future results. Shown for illustrative purposes. It is not possible to invest directly in an index. Returns through December 31, 2021. See disclosures for asset class definitions. Index returns are provided for informational purposes and are not indicative of RiverFront portfolio performance.

From an asset class perspective, the fourth quarter's performance themes resembled the year that preceded it. Most broad stock market indexes rose apart from emerging markets. Gains by far were the largest in the US, as international markets were acutely affected by geopolitics and COVID-19. Russia massed troops on the Ukraine border, and US/Chinese tensions escalated, with rumors of the US government delisting Chinese ADR's. In addition, China's economy was negatively affected by the government's stringent "Zero COVID" policy, and European economies were also impacted by more draconian lockdown responses than the US.

"Bonds that look like stocks" - aka High Yield Bonds - outperformed all other fixed income asset classes both in Q4 and for 2021. Gold, despite a strong Q4 recovery on the back of inflation fears, was the lowest returning asset class we track in 2021, as longer-term inflation expectations have stayed anchored.

Looking at US sectors a little more closely, Q4 favored Growth and Defensive Equity themes over cyclical, with Real Estate and Technology leading for the Quarter. While Energy was the best sector of 2021, it lagged on faltering oil demand and stagnant prices. Financials also underperformed as profit margins were hurt by falling long-term interest rates in the final month of the year.

Positioning for 2022: Stocks Over Bonds; Still Prefer US Over International

At RiverFront, our process is grounded in active management and the ability to be flexible, helping us navigate through periods of uncertainty. Interest rates are too low to offer attractive returns in all but the worst environments, which continues to point us towards stocks over bonds in our broad asset allocation. Heading into 2022, our process continues to favor US equities over international, with three distinct themes. The first theme consists of a mix of growth industries that benefit from the work-from-home environment and lower interest rates. The second is comprised of value stocks that stand to benefit from elevated levels of government stimulus, rising inflation, and higher levels of nominal GDP (Gross Domestic Product). The final theme is to incorporate covered call strategies ([See 07.19.2021 Weekly View: The Search for Income](#)), which can help generate additional income in a potentially volatile and range-bound equity market. For a more thorough explanation of covered call strategies see disclosures.

Within international markets we prefer developed markets to emerging ones. We see some selected opportunities in developed international if global economic growth continues to expand as we expect, given their more attractive valuations relative to the US. In contrast, we remain cautious on emerging market equities, particularly China, given the increased scrutiny and regulation of the corporate sector on the part of the Chinese government.

Given the challenges identified above around rates and inflation, we remain underweight fixed income in our balanced portfolios. We are also using a barbell approach to security selection here, owning shorter maturity corporate bonds (stronger economy to limit defaults) on one side and longer maturity Treasuries on the other. As a result, we have less bonds in the intermediate (7-15 year) part of the curve. We expect the slow path to higher rates to have a lot of volatility as policy shifts and equity market pullbacks occur and so will seek to buy long-term Treasuries when we feel their yields are at the top end of the range.

'Process over Prediction' – What We are Watching

The last four months of the year reinforced the importance of having a long-term plan (to stay invested through turmoil) as well as a tactical discipline (to identify times to make selection changes or pull back on equities after a market run). Our mantra of "Process Over Prediction" helped us remain overweight stocks despite these negative headlines since our three tactical rules remained positive ([See 12.13.2021 Weekly View: Looking Through the Windshield](#)), although we are now more cautious with regards to Fed policy. Historically, equity markets can go higher in the face of a new rate hike cycle ([See 12.20.21 Weekly View: 2022 Outlook Summary – 'Riding the Recovery'](#)), but overly hawkish actions from the Fed can damage investor sentiment.

We believe the US economy remains the strongest of the major world economies, and we would like to see evidence of earnings momentum improve overseas before we invest more internationally. We will also continue to seek opportunities to diversify our sources of return in the portfolio as rates move up or down and shift to Treasuries when market sentiment is near optimistic extremes.

Implications for Different Investor Outcomes

- **Accumulate:** The good news for Accumulate Investors is that the macroeconomic backdrop still favors equities. However, we think forward returns will be lower than in the last decade and volatility will be greater. As discussed above, we continue to seek opportunities in regions and sectors that have underperformed their peers in recent years.
- **Sustain:** At current bond yields, traditional sources of safety, like bonds, are likely not as effective as their historical results might suggest. We believe that stable growth-oriented equities will prove useful in this environment – the sustainable nature of their earnings and cash flows have proven to be a safer haven than more cyclical companies' earnings. We also believe covered call strategies will provide downside protection from transitory corrections.
- **Distribute:** With interest rates so low, it can be tempting to reach for yield. However, low risk-free rates have also driven up the prices of more risky income assets (high yielding dividend stocks and bonds, preferred stocks, and MLPs) increasing their risk should a meaningful correction occur. With this in mind, we have become more tactical in our security selection and have a total return focus. A total return focus helps Distribute Investors supplement income through systematic withdrawals rather than reaching for yield. We are also incorporating covered calls more heavily for Distribute Investors.

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.

A covered call refers to a financial transaction in which the investor selling call options owns an equivalent amount of the underlying security. To execute this an investor holding a long position in an asset then writes (sells) call options on that same asset to generate an income stream. The investor’s long position in the asset is the “cover” because it means the seller can deliver the shares if the buyer of the call option chooses to exercise.

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 27 emerging markets (EM) countries.

MSCI EAFE Index NR USD (Developed International Equities) is designed to represent the performance of large and mid -cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the US and Canada. Net total return indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to nonresident institutional investors who do not benefit from double-taxation treaties.

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 High Yield Index TR USD (High Yield) 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 one and three 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

For each outcome category (accumulate, sustain and distribute) RiverFront’s portfolio management team has assigned one or more RiverFront product(s) based on their assessment of the product’s investment objective as it relates to a typical client’s return and risk objectives when seeking investment outcomes of accumulating wealth, sustaining wealth and distributing wealth. The team has also designated RiverFront product alternatives for those clients looking to take more or less risk with the outcome category. The ‘more aggressive’ (or more risk) alternatives will generally have greater equity and international exposure as well as longer time horizon targets, while those designated as ‘more conservative’ (or less risk) will have fewer equities, a lower exposure to international and shorter time horizon targets. Since the risk assessments are dependent on the outcome category selected, RiverFront products may fall in multiple categories. All investments carry a risk of loss and there is no guarantee that an investment product or strategy will meet its stated objectives.

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