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Dollar Rises On US Strength, Oil Falls Despite Geopolitics

We believe that the recent dollar strength, along with oil weakness, help explain last week's new highs for US stocks. The rising dollar – up 3% since the end of June – is a reflection of both the consistent growth in the US and the recent slowdown in growth overseas, in our view. We have positioned RiverFront's portfolios for a stronger dollar by hedging most of our yen exposure, as well as about half our euro exposure.

The causes for falling oil prices – down 12.5% since mid-June – are complex. We see three primary factors:

1. *Structural and cyclical changes in demand*. Cyclically, European and Chinese demand has been weaker; structurally, increased fuel efficiency is gradually lowering the demand for gasoline.

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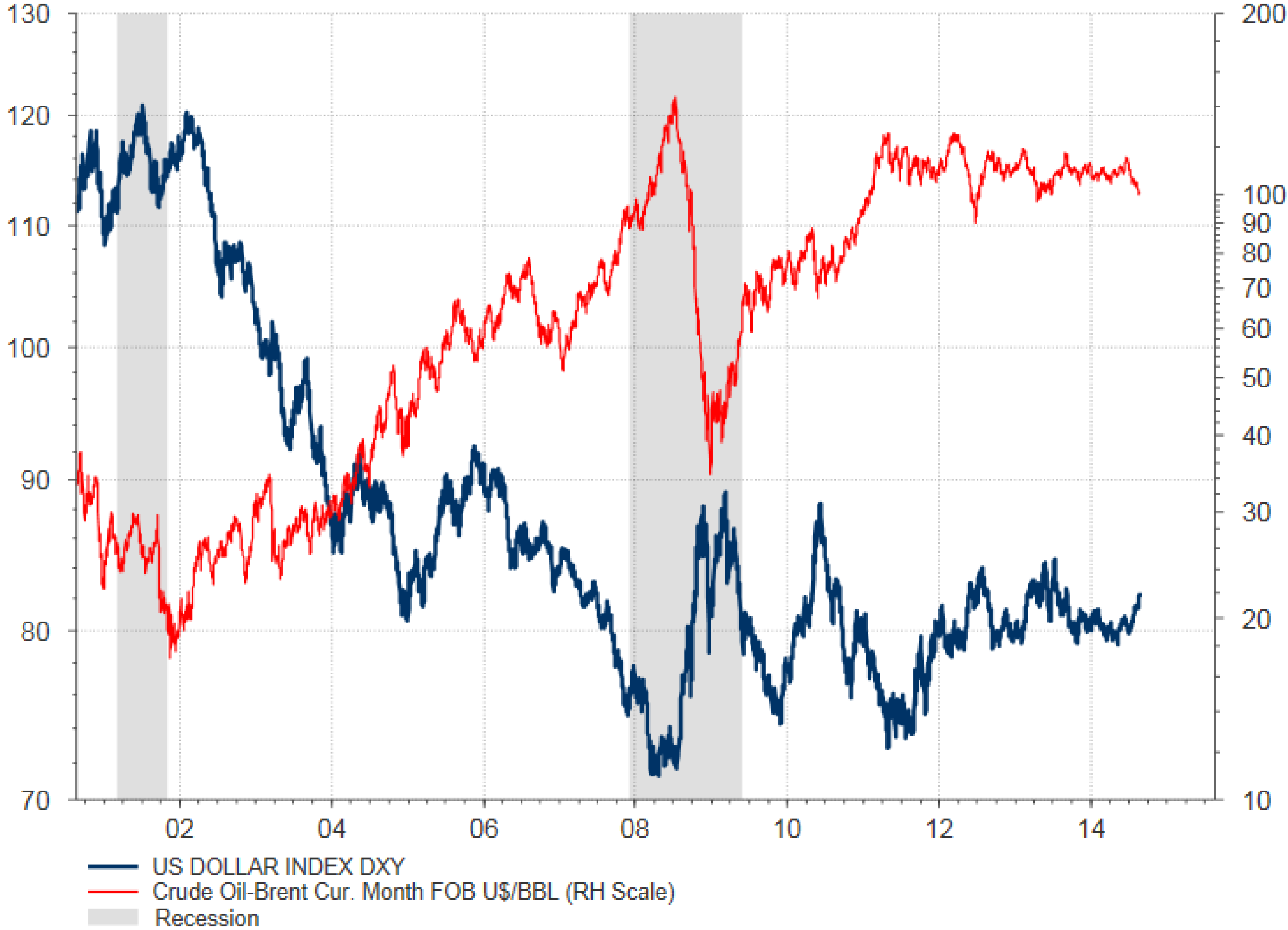
2. *Structural and cyclical changes in supply*. Structurally there has been a huge increase in US oil and gas production. US crude oil production rose by 48.6% from 2008 through 2013, according to the US Energy Information Administration; natural gas production rose by 28% from 2006 through 2013. Cyclically, the conflict in Iraq has prompted the Kurds to push for independence and increase oil production and export capacity.

3. *Investors appear less concerned about the risk of supply disruptions*. Oil prices rose 16.8% from mid-January to June as geopolitical tensions intensified in Ukraine and the Middle East.

As the US economic cycle matures, US stock returns will likely slow and foreign stocks will outperform, in our view.

A Desynchronized World: The world's economies and markets have become increasingly desynchronized since the 2008 financial crisis. China was the first to recover, going on a spending binge in 2009 that drove up consumer, commodity, and real estate prices, which has led to three years of fiscal and monetary austerity to regain control of inflation. The United States and United Kingdom have had the most stable recoveries, and Europe had a double-dip recession from which it has yet to recover. Thus, foreign stock markets have generally risen less than the S&P 500 since the global financial crisis. We think that as the US economic cycle matures, US stock returns will likely slow and foreign stocks will outperform. Diversification – which dampens volatility – will be especially important in a desynchronized environment, in our opinion.

THE WEEKLY CHART: OIL TO STABILIZE, DOLLAR TO STRENGTHEN



Source: Thomson Reuters Datastream. Past performance is no guarantee of future results.

The US dollar broke above an 11-month trading range last week. To put this into perspective, our chart shows the dollar index's decline from 2002 to 2008 and its subsequent trading range (thicker blue line, left hand scale). We see support just below 80, at the recent lows, and expect it to rise back towards 90 as both the euro and yen weaken further. The chart also illustrates a mild inverse relationship between the dollar and oil prices (thin red line, right hand scale). Between 2002 and 2008 oil prices were driven up by surging demand from China and tight supply. Since 2008, the dollar has been a safe haven currency and oil has been a global growth play. The two sometimes move independently of each other, and we expect oil to stabilize around current levels even as the dollar strengthens further.