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S&P 500 On Track to 2000 By Year End

We are encouraged, not intimidated, by US stocks at record highs, and we remain overweight stocks and underweight investment grade bonds. As we pointed out a year ago, new stock market highs do not necessarily foreshadow a bull market's demise (*The Weekly View*, 3/11/13). February's employment report suggests that that the private sector is strong enough to sustain economic growth as the Federal Reserve continues to taper. This is consistent with RiverFront's baseline scenario for the US economy to grow by 2.6% this year; a moderate growth rate relative to post-war history, which we think can be sustained for several years.

Better-than-expected earnings likely helped stocks recover their January losses and hit record highs in February. As of mid-January, fourth-quarter S&P 500 earnings were expected to be up 5.1% year over year. This jumped to 9.3% by the end of February, when most companies had reported results. Eight of the ten sectors are reporting higher earnings relative to a year ago, led by materials, financials, telecom services, and industrials. Furthermore, 63% of companies beat fourth-quarter sales estimates, above the average for the last four quarters (54%) and the previous four years (59%). S&P 500 earnings are estimated to grow about 10% in 2014, which supports our expectations for a 5% to 10% rise in the index to around 2000.

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Commodities – Wrong to lump them together: Precious metals, industrial metals, petroleum products, and soft commodities have historically moved in their own cycles most of the time and even in the short-term are driven by different forces (see Weekly Chart). There are periods, however, when commodities do move largely together, such as during 1970's inflation – which was sparked by the first oil crisis and sustained by a wage price spiral – and China's explosive growth from its entry into the World Trade Organization (WTO). These multi-year commodity bull markets attract investors to commodities as an asset class, which can make them more correlated for a few years.

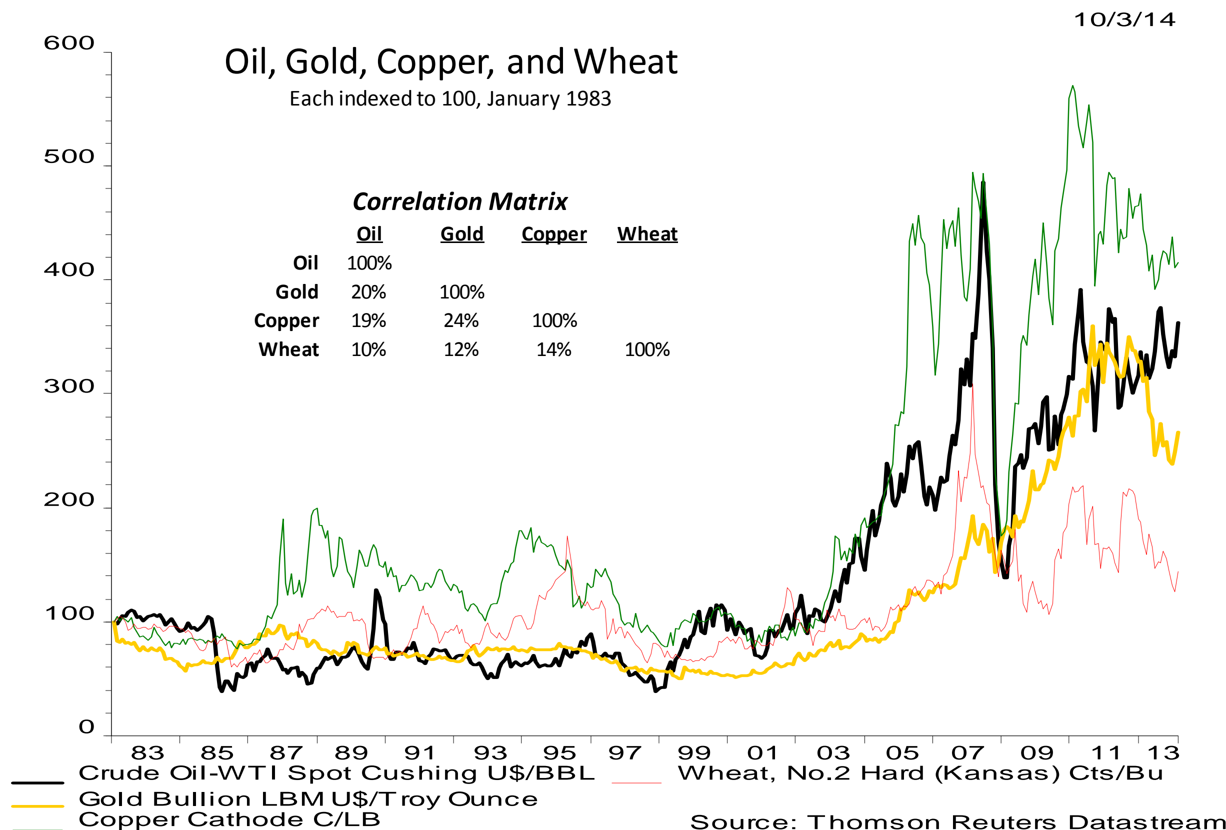
Despite short-term forces pushing commodity prices higher, from both value and economic perspectives, we are not commodity bulls and prefer to invest in certain sectors, such as energy, where we believe companies can grow earnings and share prices, and see sustained increases in demand.

We generally prefer to buy the producers: The arrival of commodity exchange traded funds and notes (ETFs and ETNs) has made it much easier for investors, who previously had to use the futures markets, to gain exposure. This has altered the balance between commodity producers/consumers (who typically seek to lock in prices by contracting to buy or sell at a future date) and speculators/investors, making the latter a larger group and thus potentially lowering returns compared to when the former group dominated and commodity contracts were primarily used as hedging vehicles. Furthermore, a main return component of using futures – the interest on the cash held as collateral – is now close to zero because interest rates are close to zero. There have been times towards the end of an economic cycles, typically when interest rates are rising and putting pressure on stocks, when commodity prices have outperformed commodity stocks, but that is not currently the case.

The CRB Commodity Index is up 10% year to date after bottoming last summer near its lows of 2012. We believe much of the rise so far has been the result of weather and geopolitical uncertainty. About 58% of the index is 'soft' (mostly agricultural) commodities and 18% energy-related commodities. Weather has obviously affected both of these

commodity sectors, and the impact of one of the coldest winters in the eastern US in the last few decades may continue to play havoc for several months. Further uncertainty due to geopolitical risk in Ukraine (*The Strategic View* 3/5/14) and a weaker US dollar have helped precious metals like gold and silver — another 18% of the index — to rise as defensive havens. The remainder of the index is in industrial metals such as copper, which will likely remain weak given waning Chinese demand as the economy restructures and rebalances away from infrastructure-heavy investment and towards services oriented to meeting consumer-led demand. Despite these short-term forces pushing commodity prices higher, from both value and economic perspectives, we are not commodity bulls and prefer to invest in certain sectors, such as energy, where we believe companies can grow earnings and share prices, and see sustained increases in demand.

THE WEEKLY CHART: COMMODITIES ARE NOT HOMOGENOUS



The low historical correlation between four major commodities, with occasional periods of high correlation, is highlighted in this week's chart. Movement among these commodities was mostly unrelated for almost 20 years. This changed for a few years after China entered the WTO in December 2001, and its double-digit economic growth in the early 2000s generated huge demand for a wide range of commodities. That period of above-average commodity correlation is now falling back to historical norms. The correlation matrix table within the chart highlights the low dependence that the weekly price changes of these commodities have had on each other over the last thirty years. Even gold and copper, the most highly correlated commodities in our chart, have had a relatively weak 24% correlation over the past 30 years. Values for the correlation coefficient range between -100% and +100%. A correlation coefficient of +100% indicates that the two commodities have a perfect, positive linear relationship.

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. The 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. It is not possible to invest directly in an index. Buying gold, silver, platinum or palladium allows for a source of diversification for those sophisticated persons who wish to add precious metals to their portfolios and who are prepared to assume the risks inherent in the bullion market. Any bullion or coin purchase represents a transaction in a non-income-producing commodity and is highly speculative. Precious metals should not represent a significant portion of an individual's portfolio. Buying commodities allows for a source of diversification for those sophisticated persons who wish to add this asset class to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any commodity purchase represents a transaction in a non-income-producing asset and is highly speculative. Therefore, commodities should not represent a significant portion of an individual's portfolio.