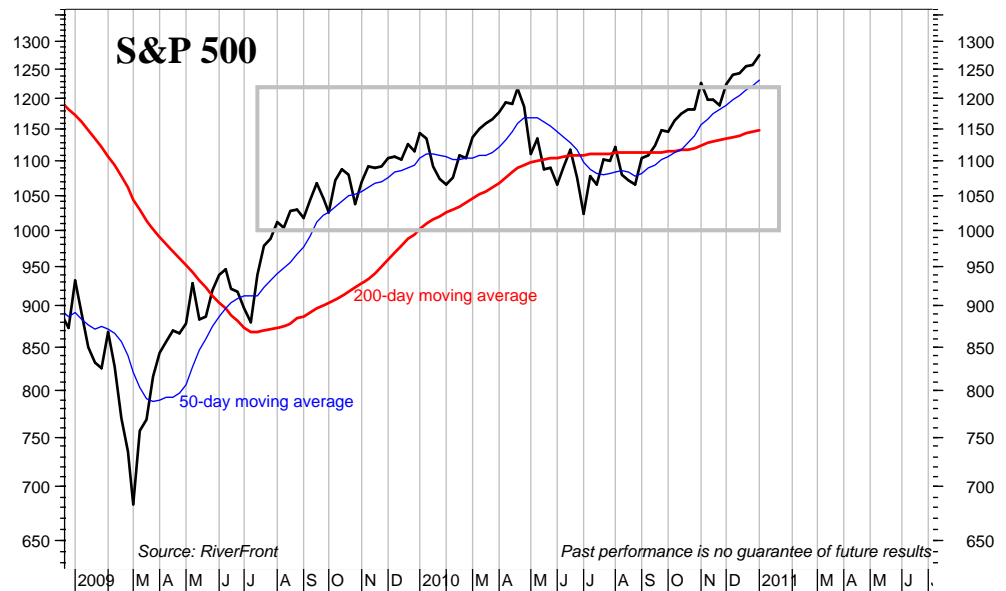




Two of Three Rules Positive, Sentiment Mixed

- We go into 2011 fully invested in risk assets relative to our strategic benchmarks. Our strategic benchmarks are overweight emerging markets and correspondingly underweight Europe and Japan. We see opportunities to increase developed international this year both through larger and smaller cap exposure, especially if the European Central Bank (ECB) pursues a more reflationary policy as we expect they will be forced to do by the deflationary consequences of the fiscal austerity being imposed on the weaker economies.
- During the fourth quarter of 2010, we lowered the risk of rising rates in traditional fixed income by holding our portfolio's duration to 1.5 years, which helped mitigate the effect of the substantial backup in longer dated bond yields that began in late August. Our stated preference for high-yield bonds is reflected in an overweight position, which is funded by a corresponding underweight to currencies of countries with low sovereign debt default risk. However, we have begun to increase our weighting to commodity currencies, beginning with the Australian dollar.
- Our 'Three Rules' clearly favor risk assets, with the one caveat that short-term sentiment is now in extreme optimism territory. Our first rule is *Don't fight the trend*: The primary trend (our proxy is the S&P 500's 200-day moving average) for nearly all risk assets is rising, albeit slowly, and most stock markets are trading above this trend. From a longer term perspective, the last quarter of 2010 was very positive, with stocks clearly breaking out of the 'decision box' (grey box in the chart) following the

November election. It should be noted, however, that the 200-day moving average is now around 1150 and so the market is becoming stretched to the upside. A very similar situation occurred last year, with the New Year rally only lasting until mid-January before a correction took place. Historically, the relationship can become more stretched than it currently is and we suspect that it will, given the strength of the markets as the New Year begins.

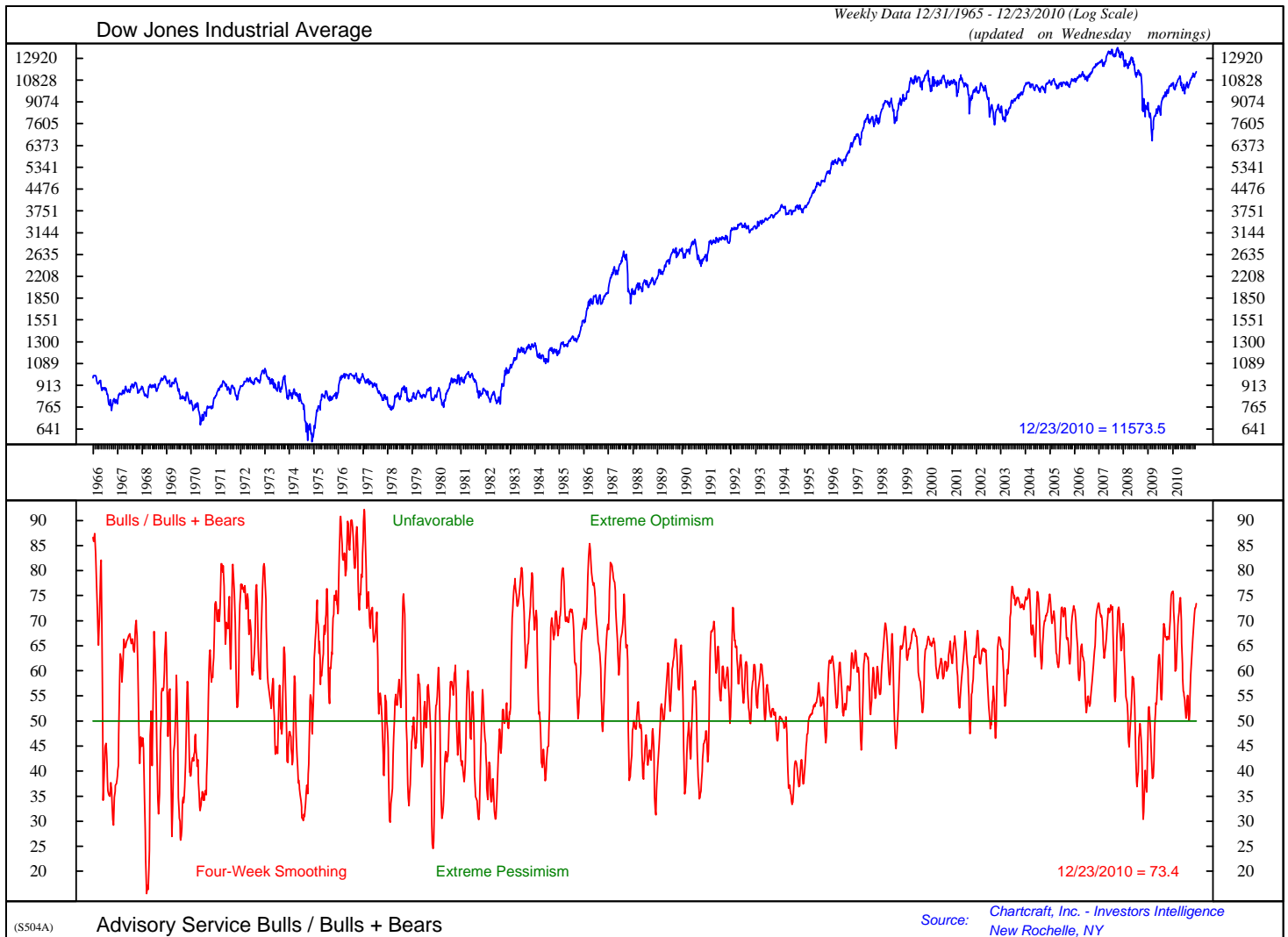


- Our second rule is *Don't fight the Fed*: The Fed's commitment to buy Treasury bonds to prevent yields from rising despite the US' massive deficit has been, and we believe will continue to be, supportive of stocks and commodities. In the short run, it may also prevent bond yields from rising too quickly. However, since the Fed's stated goal is higher inflation and stronger growth, we believe bond bulls are fighting the Fed. As mentioned above, we think an important issue in 2011 is whether the ECB reluctantly begins to expand its balance sheets. Without that, we see some form of debt restructuring in Ireland and Greece as inevitable and probable in Portugal.
- Our third rule, *Beware the crowd at extremes*, reflects the tendency of investors to be extremely optimistic around market peaks and extremely pessimistic around market lows, as show in the Weekly Chart. This is where the picture is

mixed. As we wrote in our *Outlook 2011: Buying Time*, longer-term measures of sentiment show that investors are still skeptical and consumer confidence is low. We regard this as a positive. There is an old adage that “a bull market climbs a wall of worry,” and we believe this is occurring. If we are right and earnings continue to grow next year, we believe the market will also rise. That said, two of our favorite measures of short-term sentiment are clearly showing excessive short-term optimism: The NDR Crowd Sentiment Poll reached 71.8% bullish last week, the highest in more than three years. Chartcraft’s survey of advisory services’ sentiment also is near peak bullish levels, based on the number of bullish advisors as a percent of bulls plus bears, as shown in the bottom panel of the chart below.

- With two of our three rules clearly positive and the third mixed, we are fully invested going into the year. The red flag raised by short-term sentiment suggests a correction at some point but not a change of trend, and we are hopeful that fourth-quarter earnings will continue to justify higher levels for stocks.

The Weekly Chart: Short-term, the crowd is quite optimistic



©Copyright 2011 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved.
 See NDR Disclaimer at www.ndr.com/copyright.html . For data vendor disclaimers refer to www.ndr.com/vendorinfo/ .

Past performance is no guarantee of future results

Rod Smyth, Bill Ryder, CFA, CMT & Ken Liu • 804-549-4800 • www.riverfrontig.com
 Riverfront Investment Group, 9011 Arboretum Parkway, Suite 110, Richmond, VA 23236

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 S&P 500 is an unmanaged, weighted index of 500 stocks providing a broad indicator of price movement. Individual investors cannot directly purchase an index. Technical analysis is based on the study of historical price movements and past trend patterns. There are also no assurances that movements or trends can or will be duplicated in the future.