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SUMMARY

- Rate cuts could stimulate hiring and earnings growth…the 'Fed' is on investors' side.
- The 'Trend' continues to rise at a fast pace but has begun to decelerate.
- The 'Crowd' has more room for optimism given the improvement in financial conditions.

10.1.2024

# Tactical Rules Remain Bullish:

## Flashing Green Light – Crowd Will Determine Path Forward

Since our last update of the Three Tactical Rules on August 13, 2024, stock markets have made new all-time highs due to monetary policy easing. We believe that the biggest beneficiary of the Fed's rate cutting cycle will be stocks, as our three 'Tactical Rules' are leaning bullish. From a tactical perspective, our collective assessment of "Don't Fight the Fed", Don't Fight the Trend", and "Beware of the Crowd at Extremes" is an overall rating of "flashing green light", unchanged from previously. However, there has been improvement underneath the surface with improvement in both the Trend and the Crowd.

### *'Don't Fight the Fed'*: Fed Kicks the Rate Cut Door Down

GREEN LIGHT

The Fed kicked off its rate-cutting campaign with an aggressive 50-basis point cut, highlighting the need to maintain a balance between price stability and full employment. While the focus was previously on inflation, it has now shifted to the labor market; the unemployment rate has risen from the January 2023 20-year low of 3.4% to its current 4.2%. The headline unemployment rate is still low by historical standards; however, it is the rate of change that has the Fed concerned. Hence, the Fed is determined to get ahead of the problem by loosening financial conditions, which could help to stimulate hiring and increase corporate earnings growth. The Fed has moved to the next phase of normalizing rates, and our tactical rule of "Don't Fight the Fed" remains a green light.

Internationally, the Bank of England (BOE) and the European Central Bank (ECB) both have begun cutting their policy rates as well. However, the international central banks have taken a slower approach opting to move in 25-basis point increments. The BOE cut its rate by 25-bps in August and then held rates steady at its September meeting to ensure that inflation did not reignite. The ECB for its part, cut rates in June and September by 25-basis points. While the speed of monetary policy easing is different at each of the major central banks, we believe the major central banks are fully aligned with "Don't Fight the Fed" and are on the investor's side.



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## *'Don't Fight the Trend'*: Trend is Peaking Domestically

GREEN LIGHT

The trend on the S&P 500, which we define as the 200-day moving average, continues to rise at a fast pace, but has begun to slow down. Given how fast the pace has been over the past year-and-a half, this deceleration is not only understandable, but also healthy, in our view. Currently, the trend is rising at an annualized rate of 29% but we believe it will fall to mid-20s or lower depending on the path of the index in the final 3 months of the year. It is encouraging that even if the S&P rises above 6000 by year-end, the trend will not rise much above its current pace. This is a plus in our opinion because it indicates that the trend will be rising at a more sustainable pace, and thus will likely keep sentiment from rising too much as well, which is beneficial for above average returns. Historically, a positive trend is good for future stock returns, and we believe that this time will not be different as the combination of dovish Fed and strong earnings are the catalysts for further upside in the S&P 500. Domestically our rule of "Don't Fight the Trend" is signaling a green light.

*Source: Bloomberg, RiverFront. Data daily as of September 27, 2024. Chart shown for illustrative purposes. Not indicative of RiverFront portfolio performance. Index definitions are available in the disclosures.*

## *International Trend*: Healthy but Decelerating

GREEN LIGHT

Internationally, the trend of the MSCI All Country World ex-US index has decelerated since our last update in August. The international primary trend is currently rising at an annualized rate of 17% and is decelerating faster than its domestic counterpart. If the MSCI All Country World ex-US index remains at the current level or trades at 329 or higher, we believe the international trend will remain positive through year-end, which reiterates the higher probability of receiving above average returns over the next 3 to 6 months. Hence, the international trend is still signaling a green light.

*Source: Bloomberg, RiverFront. Data daily as of September 27, 2024. Chart shown for illustrative purposes. Not indicative of RiverFront portfolio performance. Index definitions are available in the disclosures.*



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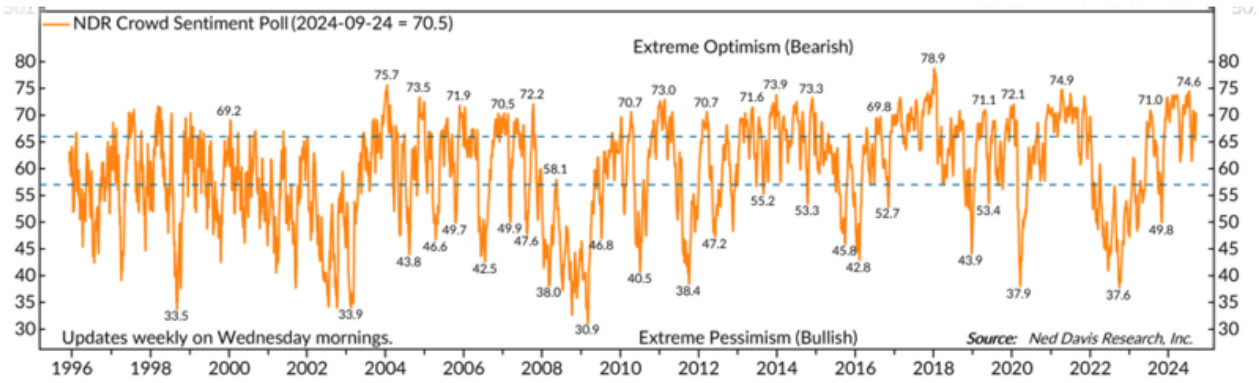
## *Beware of the Crowd at Extremes*: Optimism is Neutral

FLASHING YELLOW

We regard Crowd Sentiment as the contrary indicator of the Three Tactical Rules. The chart below shows a measure of investor sentiment as calculated by Ned Davis Research (NDR). When the line is high it shows extreme optimism, and when it is low, extreme pessimism. This is our preferred data source to measure investor psychology, though we use our own analytical framework from which to draw conclusions on sentiment.

Crowd sentiment picked up after the Fed announced its 50-basis point rate cut on September 18th. The NDR Daily Sentiment Poll rose from extreme pessimism into the neutral zone, while the Weekly Sentiment Poll moved up into extreme optimism. Historically, we have given more weight to the Weekly Poll for this publication, despite incorporating both measures of sentiment in our overall rating. In our view, the Daily tends to be a good indicator of investors' 'real time' opinion on financial markets, while the Weekly gives longer term perspective of the Crowd. The Daily reading is currently firmly in the Neutral zone, while the Weekly is indeed in the Optimism zone, but not at the extreme upper end of NDR's range (see chart below). Therefore, our 'mosaic' opinion of the indicators in aggregate is that of a 'flashing yellow light' rating.

Internationally, our rating is the same as the US, using a combination of short- and long-term momentum tools (combining the relative strength index with the primary trend). In short, the crowd is clearly more optimistic than our last update, but the financial conditions have also improved, creating room for higher potential optimism readings. Therefore, we view the Crowd overall as a flashing yellow light.

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## Conclusion: The Tactical Rules Signal a Flashing Green Light

FLASHING GREEN

The tactical rules signal a "flashing green light" due to a more accommodating Fed, the trend decelerating to a more sustainable pace, and a more disciplined crowd. The flashing green light signal serves as confirmation that accommodative monetary policy is good for the stock market over the next 3 to 6 months. Given that we believe that the stock market will be the biggest beneficiary of the Fed's rate cuts, the three rules give us greater conviction to maintain the portfolio's composition favoring stocks over bonds, with a bias towards domestic stocks over international stocks in our balanced portfolios.

Internationally, the tactical rules signal a "flashing green light", driven by dovish central banks, a positive trend, and lower relative strength. While international markets appear slightly more attractive on a short-term tactical basis, we will continue to temper our enthusiasm for the asset class until we see earnings growth improve.



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*Index Definitions:*

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

*MSCI ACWI ex USA Index captures large and mid cap representation across approximately 22 of 23 developed markets (DM) countries (excluding the US) and approximately 25 emerging markets (EM) countries.*

*Definitions:*

*The 200-day moving average is a popular technical indicator which investors use to analyze price trends. It is simply a security's average closing price over the last 200 days.*

*The European Central Bank (ECB) is the central bank responsible for monetary policy of the European Union (EU) member countries that have adopted the euro currency. This currency union is known as the eurozone and currently includes 19 countries. The ECB's primary objective is price stability in the euro area.*

*The Bank of England (BoE) is the central bank of the United Kingdom. The BoE oversees monetary policy and issues currency. It also regulates banks, financial firms, and payment systems. Like other central banks, the BoE may act as a lender of last resort in a financial crisis.*

*The relative strength index (RSI) is a momentum indicator used in technical analysis. RSI measures the speed and magnitude of a security's recent price changes to evaluate overvalued or undervalued conditions in the price of that security.*

*Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.*

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