



Tim Anderson, CFA, Chief Fixed Income Officer

March 10, 2010

## Risk Appetites Return After Brief Hiatus

- The combination of abating risk aversion and a less-bad job outlook has led to a renewed bid for risk assets over the past few weeks. In response, we have been increasing our portfolios' allocations to corporate and high yield bonds and are now significantly overweight high yield against our strategic benchmarks. However we remain about neutral to our benchmarks in total alternative fixed income, as the overweight to high yield has been funded by underweighting emerging market debt. Although both of these sectors have rebounded sharply off their early to mid-February lows, we still believe that high yield has a better risk-reward profile going forward. We also believe that leveraged loan funds remain an attractive option within the high yield space.
- The equity markets and riskier sectors of the fixed income market have staged a strong comeback over the past few weeks, due in large part to the decline in global sovereign risk premiums. Credit default swap (CDS) spreads on Greek debt, a measure of the market's default expectations, have declined by 138 basis points ("bps"=1/100<sup>th</sup> of 1%) over the past month to around 284 bps, which is still more reflective of an emerging market country. Last Thursday, Greece successfully placed its second major bond deal this year, a 5 billion euro issue (\$6.8 billion) at a 6.3% yield. The successful deal, which was about three times oversubscribed, came after Greece announced another round of fiscal austerity measures that included a mix of pay cuts and pension freezes for civil servants and various sin tax hikes (alcohol, cigarettes). While the global markets have responded favorably to these budget moves, the citizens of Greece have not, as sporadic rioting has been reported.
- In addition to favorable news on the sovereign front, the risk markets got another boost from the U.S. Employment report last Friday. The job report showed a loss of 36,000 jobs during February, about half of market expectations, and the unemployment rate remained at 9.7%.

### Risk Markets – Broad-Based Improvement

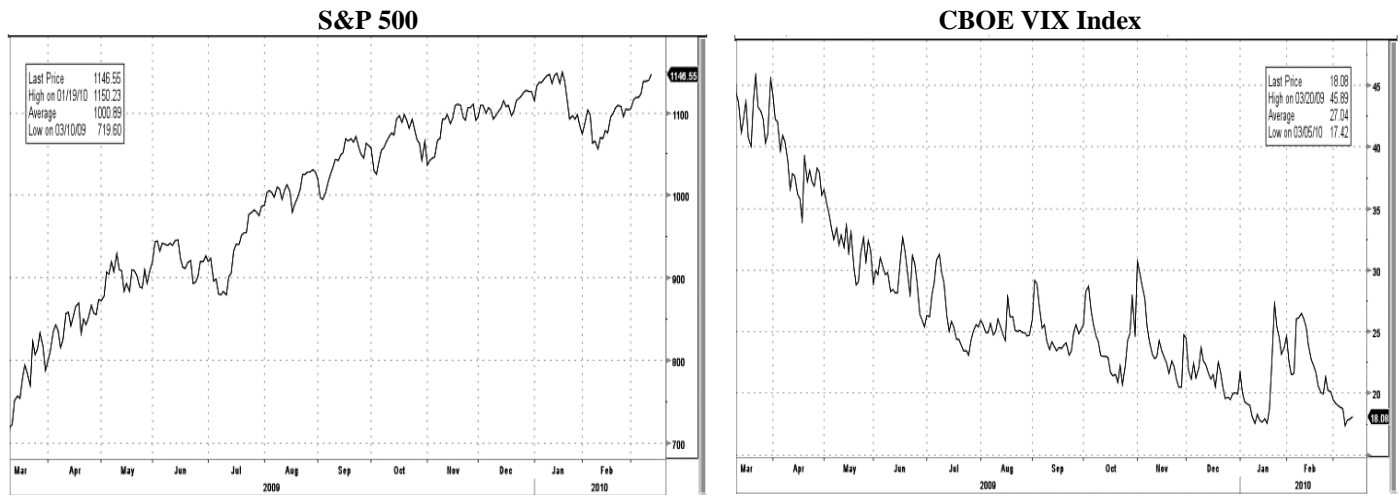
**Equity Markets.** The S&P 500 has risen about 8.5% from its 2/8/10 low and is now testing its 1/19/10 high of 1150. In addition, the Chicago Board Options Exchange Volatility Index (VIX) Index dropped below 18 after spiking above 26 in early February. The VIX measures the implied volatility of S&P 500 index options and is often referred to as the "Fear Index."

**Corporate Bonds.** Corporate bond risk premiums (spreads) are currently 177 bps, having tightened 14 bps from their recent peak of 191 on 2/16/10. Corporate spreads are now 13 bps tighter on the year and only 1 basis point off their mid-January low of 176.

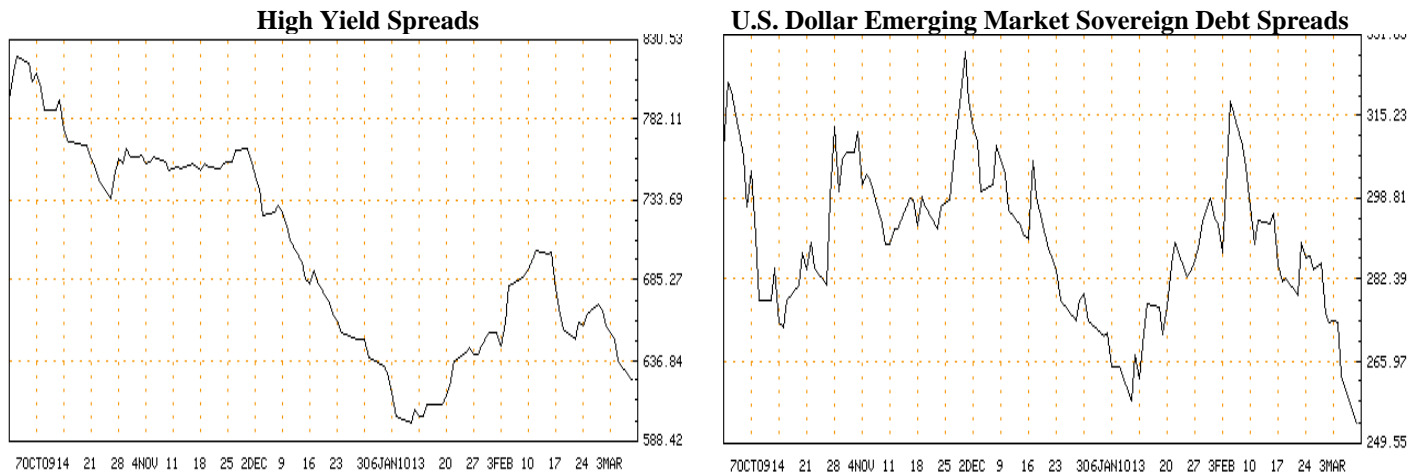
**High Yield.** High yield risk premiums are currently 623 bps, having tightened 80 bps from their recent peak of 703 bps on 2/12/10. High yield spreads are now 16 bps tighter on the year, but remain 24 bps above their mid-January low of 599 bps. Positively, the doors to the capital markets have swung wide open again for the riskiest issuers, after having been nailed shut for a couple of weeks. On a fundamental basis, Moody's high yield default rate fell to 11.6% in February from 12.5% in January. Moody's now expects the default rate to drop to 2.7% by February 2011. *High-yield securities are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.*

**Emerging Market Sovereign Debt.** Risk premiums on the U.S. Dollar Emerging Market Sovereign Debt Index are currently 253 bps, having tightened 65 bps from their recent peak of 318 bps on 2/5/10. Spreads are now 21 bps tighter on the year and have surpassed their previous low of 258 bps in mid-January. *Investments in international and emerging markets securities include exposure to risks including currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability.*

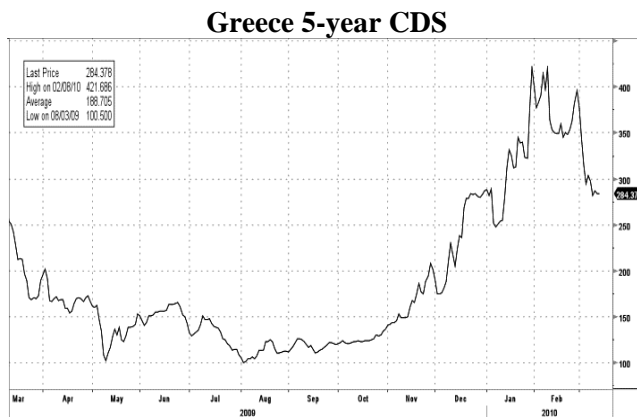
The charts below show the broad-based improvement for risk assets over the past 6 to 12 months, as well as the brief mid-January to mid-February hiccup.



Source: Bloomberg; Past performance is no guarantee of future results.



Source: Bloomberg, Bank of America/Merrill Lynch; Past performance is no guarantee of future results.



Source: Bloomberg; Past performance is no guarantee of future results.

Tim Anderson, Chief Fixed Income Officer • 804-549-4806 • [tanderson@riverfrontig.com](mailto:tanderson@riverfrontig.com) • [www.riverfrontig.com](http://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. Investors must make their own decisions based on their specific investment objectives and financial circumstances.