

Summer Blues and a Lesson for the Next-Gen

Millennials and Gen Xers fascinate me. Not just because they are the future, but also because understanding them will be critical to understanding major economic and business trends. They have the option to learn from the mistakes of us boomers, a generation who has managed to spend our own money, our parents' money and much of our kids' money as we leave them with more national debt than any time outside a world war. But that's for another day.

A recent millennial story: This past weekend in Best Buy (already I reveal my age as I'm in the store) I am discussing TVs with a young saleswoman. "You know", I say, "the thing is, my wife and I find ourselves watching mostly streaming channels like Netflix." "Yeh", she says, "I haven't watched television in 2 years", by which I know she means that she hasn't watched traditional, cable-fed television. I know this because I too am the father of three aged 24, 26 and 28, so I am living this in real time and none of my children are currently attached to cable. We still pay for cable, to get internet and sporting events, and are wondering why; but then we have a land line phone – soo last century!

THE POWER OF COMPOUND INTEREST

There is, however, one thing that has not changed: the power of compounding. Let's look at an example... Assume for the sake of illustration, an investor saves \$1,000 a month for 20 years, with a 7% rate of interest, the investor will have saved \$240,000 and earned \$283,695.40 for an end value of \$523,965.40. Start 10 years earlier and the end value is \$1,227,087.49. Save for 40 years (twice as long) and it is 2,640,124.81, or more than 4 times the 20-year example.

Sadly, the risk-free rate on 20-year government bonds is currently only 2.5%, barely above the inflation rate, and the end value using a 2.5% rate, instead of 7%, is just \$311,622, and \$240,000 of that is the investor's own contributions.

This highlights the conundrum facing both young and old savers – to take no risk at all is to risk outliving your money, given the low rate of return of risk-free alternatives once adjusted for costs of living increases. But next-gen investors have one huge advantage on boomers – the benefit of time. The next 40 years could well include both crushing bear and soaring bull markets –but 40 years has historically been enough time to smooth out returns to something approximating the long-term after-inflation return of ~6.4% (Riverfront's long term total real return trend line). Because we are starting close to trend in the U.S. and below trend overseas, we believe the chances of trend like returns in shorter time frames such as 10 years are also high. *There is no guarantee that past trends will be replicated and past performance is no guarantee of future results.*

WHY THOSE WITH TIME SHOULD BE ROOTING FOR A BEAR MARKET ... AND WHY WE THINK THEY'LL HAVE TO WAIT

Well, a correction of some sort is underway in as far as the S&P 500 has now made a



Rod Smyth

CHIEF INVESTMENT
STRATEGIST



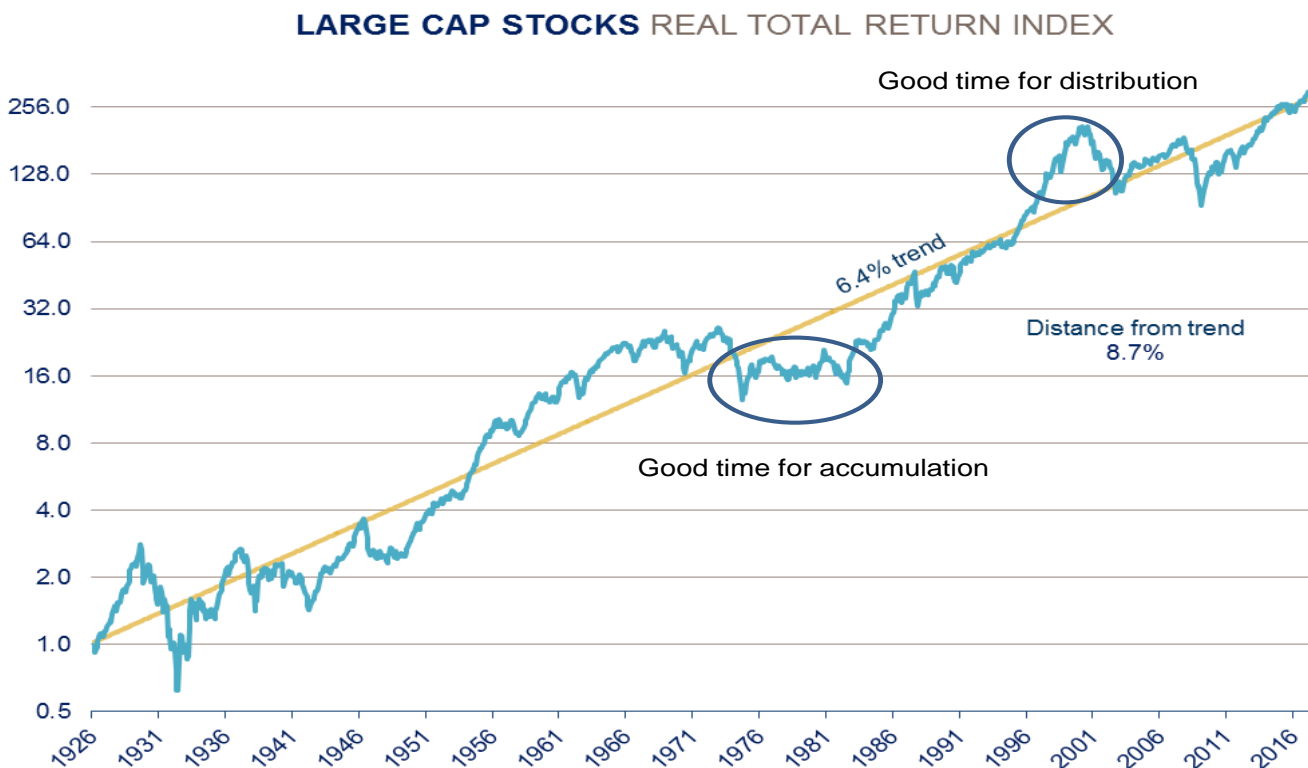
Chris Konstantinos

DIRECTOR OF INTERNATIONAL
PORTFOLIO MANAGEMENT

lower high and a lower low in the last 10 days. However, despite plenty of uncertainty in Washington, and President Trump's political agenda looking increasingly shaky, the S&P 500 is only down 2.2% from its high leaving it up 8.3% year to date. The Russell 2000 index of smaller companies, which jumped after Trump's election on the hope of tax cuts and other economic stimulus, is flat for the year and down almost 7% from its high in late July. We are not surprised by this correction, but our judgment has been that it is not 'tradable' (i.e. it will be hard to get out and back in profitably). We are believers in a sustainable, synchronized, low inflation period of modest global economic and earnings growth. Given the current political environment, we believe the odds of tax reform and infrastructure have diminished (we guess about 50%). This has been reflected in the lower value of the dollar, which we wrote about two weeks ago.

We also believe Next Gen investors who are saving monthly and plan to continue to do so for many years, should be rooting for a bear market, that we still think is at least a year or two away. The reason is that, in the earlier years of saving money and investing it each month, one is "putting pennies in the jar" so to speak. If we assume that stocks will still have bull and bear phases around a trend line, the lucky investor is accumulating while prices are falling and can enjoy the benefits of a bull phase with a larger savings pool. The opposite is true for the investor who is at or close to the distribution phase of their financial life. For this reason, we believe that investors who are accumulating savings and who have long time horizons (10 years +) should generally be invested in equities with the idea of remaining invested through the ups and downs over which the investor has no control. As distribution becomes closer, risk management, budgeting and planning become increasingly important.

CHART OF THE WEEK – Assuming an investor had patience, the chart below illustrates what we are describing above.



Source: RiverFront Investment Group, calculated based on data from CRSP 1925 US Indices Database ©2016Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Data from Jan 1926 through June 2017. Past performance is no guarantee of future results. It is not possible to invest directly in an index.

The Chart above is provided as an illustration, it is not a reflection of any RiverFront investor experience or portfolio performance.

Important Disclosure Information:

The comments above refer to generally to financial markets and not RiverFront portfolios or any related performance.

RiverFront Investment Group, LLC, is an investment adviser registered with the Securities Exchange Commission under the Investment Advisers Act of 1940. The company manages a variety of portfolios utilizing stocks, bonds, and exchange-traded funds (ETFs). RiverFront also serves as sub-advisor to a series of mutual funds and ETFs. Opinions expressed are current as of the date shown and are subject to change. They are not intended as investment recommendations. (continued on the next page...)

RiverFront is owned primarily by its employees through RiverFront Investment Holding Group, LLC, the holding company for RiverFront. Baird Financial Corporation (BFC) is a minority owner of RiverFront Investment Holding Group, LLC and therefore an indirect owner of RiverFront. BFC is the parent company of Robert W. Baird & Co. Incorporated ("Baird"), a registered broker/dealer and investment adviser.

These materials include general information and have not been tailored for any specific recipient or recipients. Accordingly, these materials are not intended to cause RiverFront Investment Group, LLC or an affiliate to become a fiduciary within the meaning of Section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974, as amended or Section 4975(e)(3)(B) of the Internal Revenue Code of 1986, as amended.

Past results are no guarantee of future results and no representation is made that a client will or is likely to achieve positive returns, avoid losses, or experience returns similar to those shown or experienced in the past.

Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Small-, mid- and micro-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies.

Index Definitions:

Standard & Poor's 500 Index (S&P 500) measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market.

Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

CRSP Universe Market Cap index information calculated based on data from CRSP 1925 US Indices Database ©2016 Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Used as a source for cap-based portfolio research appearing in publications, and by practitioners for benchmarking, the CRSP Cap-Based Portfolio Indices Product data tracks micro, small, mid- and large-cap stocks on monthly and quarterly frequencies. This product is used to track and analyze performance differentials between size-relative portfolios.

CRSP ranks all NYSE companies by market capitalization and divides them into ten equally populated portfolios. Alternext and NASDAQ stocks are then placed into the deciles determined by the NYSE breakpoints, based on market capitalization. The series of 10 indices are identified as CRSP 1 through CRSP 10, where CRSP 10 has the largest population and smallest market-capitalization. CRSP portfolios 1-2 represent large cap stocks, portfolios 3-5 represent mid-caps and portfolios 6-10 represent small caps.

(2017.117)