*by* DOUG SANDLER, CFA

THE RIVERFRONT WRITING TEAM

REBECCA FELTON
Senior Market Strategist

CHRIS KONSTANTINOS, CFA
Director of Investments |
Chief Investment Strategist

KEVIN NICHOLSON, CFA
Global Fixed Income Co-CIO |
Co-Head of Investment Committee

DOUG SANDLER, CFA
Head of Global Strategy

ROD SMYTH
Chairman of the Board of Directors

SUMMARY

- Multiple events underscore the need for active portfolio management, in our view.
- We believe that the current environment exacerbates some of the inherent risks in popular benchmarks.
- Active managers with flexible mandates can navigate current market factors, in our view.

08.30.2021

# We Believe Now is the Time for Active Management to Shine

## If owning the 'best' of a 'bad bunch' is not your idea of a durable long-term investment strategy... Read on.

Multiple events underscore the need for active portfolio management strategies that are flexible and are thus less tethered to benchmarks, in our view. We believe flexible mandates are especially important in challenging times like today where the Delta variant is spreading, inflation is rising, the Fed will be tapering, and the data shows the economy slowing.

### 1. Bond yields and credit spreads remain near historical lows.

Credit spreads are the difference between the yields on corporate bonds and treasury bonds. Narrow spreads and low bond yields mean investors are not getting much extra return for taking risk. The price of getting it 'wrong' in a fixed income portfolio is potentially higher than the risk of getting it wrong in an equity portfolio. This is due to the asymmetric nature of fixed income returns, where bonds can go to zero like stocks, but unlike stocks, they rarely have the appreciation upside to offset losses. We believe some of the advantages of a flexible mandate include:

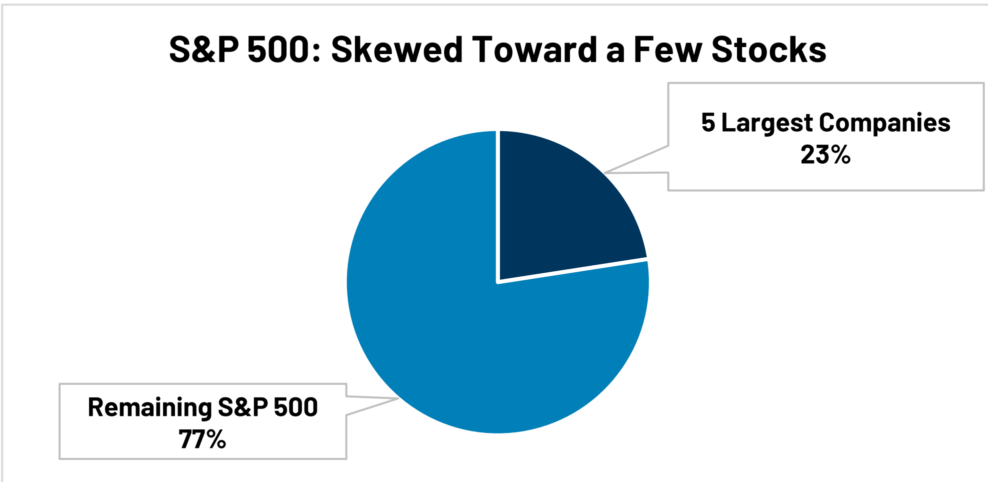
- **Ability to underweight bonds:** When interest rates rise and/or credit spreads rise, bond prices fall. The cleanest defense against both risks is to underweight bonds in balanced portfolios.
- **Ability to adjust sector allocations:** Bonds come in a variety of flavors, such as investment grade corporates, mortgage-backed, high-yield, and floating-rate securities. Each sector responds differently to changes in interest rates and credit spreads, which gives an investor with flexibility the opportunity to move within sectors. For example, floating-rate bonds tend to be more protective in rising rate environments.
- **Ability to shorten or lengthen a portfolio's duration:** Duration, which measures the length of time it will take a bond investor to get their money back, is particularly sensitive to changes in interest rates. Long-duration bonds, for example, are especially vulnerable to rising interest rates.

### 2. External pressure on America's largest companies is growing.

We believe that a company's stock price is the function of 1) the expectation of its future earnings and 2) investor's confidence in the company's ability to deliver those earnings. Therefore, when external pressures on a company rise, the expectation for its future earnings fall, as does investor's confidence. A quick glance at today's headlines highlight the growing pressures our nation's companies are experiencing from the government and the public. Government pressures include anti-trust regulations in the Technology and Communications sectors, trade restrictions in the Industrial, Consumer, and Materials sectors, and profitability limits in the Healthcare sector. There is also increasing public influence on issues that have traditionally been governed by free markets, such as wages, privacy, and corporate governance. Flexible mandate advantages include:

- **Ability to underweight/overweight sectors:** The S&P 500's sector concentration has increased significantly with the Technology and Communication sectors now (as of August 25, 2021) representing nearly 40%. In fact, the combined weighting of those two sectors is almost 2.5 times larger than the smallest five sectors combined (Staples, Real Estate, Materials, Utilities and Energy)!

- **Ability to underweight mega-caps:** The influence of mega-cap companies on the S&P 500 index has also risen significantly over time. Today, the five largest companies, each of which is in the Technology or Communication sectors, account for nearly 23% of the index (see chart). The risk of their outsized representation is compounded by the fact that they are each facing similar external risks related to their concentrated power in the marketplace. Managers with flexible mandates can steer away from mega-caps by favoring individual stocks over broad market-capitalization weighted indices.




*Source: www.slickcharts.com/sp500. Data as of August 30, 2021. Past performance is no guarantee of future results. Shown for illustrative purposes.*

- **Ability to favor companies who understand how to play the game.** When it comes to regulation and government spending, Strategas' Head of Washington Research, Dan Clifton, says it best: *'you can either be at the table or on the menu'*. What Dan is referring to is the growing power of lobbying. Companies with strong government relations can work with lawmakers on new legislation and are strongly positioned for targeted government spending. Portfolios that favor these types of companies will outperform those that do not, in our opinion.

### 3. Some Emerging Markets (EM) becoming less share-holder friendly.

China's crusade against corruption appears to have shifted to be a crusade against capitalism, and they are not the only ones. Flexible mandates allow global managers to limit this rising risk in their portfolios in several ways.

- **Ability to underweight China:** The Chinese Communist Party (CCP) has recently interfered with the free markets in several ways. Examples include reducing the autonomy of public and private companies, and also the 'Special Administration Region' of Hong Kong, attacks on several of China's largest for-profit companies and their billionaire CEOs, and the squelching of what would have been one of the world's biggest initial public offerings (IPO's). Going forward, President Xi Jinping has also stated his desire for a 'reunification' of Taiwan and greater 'social fairness' (wealth redistribution). Investors do not like uncertainty or government intervention, and we expect Chinese equities to struggle. China comprises nearly 35% of the MSCI Emerging Market Index, as of this writing.

- **Ability to underweight countries like Brazil and Russia:** The Brazilian and Russian governments also have a history of intervention to the detriment of shareholders. Combined, the two countries account for nearly 9% of the EM index.

- **Ability to underweight countries with weak currencies:** Several EM countries (Chile, Argentina, Columbia) have seen significant declines in their local currency. Not only does a weak EM currency reduce the value of stocks, but it also creates the potential for higher inflation. This in turn places a greater burden on their ability to service debt, which is often denominated in more resilient currencies like the US Dollar and the Euro.

**RiverFront is a believer in active management.** RiverFront's portfolios and the portfolios of our investment partners are designed to be flexible, providing the latitude to deviate from popular benchmarks when appropriate. We recognize that the current environment exacerbates some of the inherent risks in these benchmarks and believe that current portfolio positioning is reflective of that. If you are interested in the specifics of our portfolio's current positioning, please contact your financial advisor.

***Important Disclosure Information***

*The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Opinions expressed are current as of the date shown and are subject to change. Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.*

*Chartered Financial Analyst is a professional designation given by the CFA Institute (formerly AIMR) that measures the competence and integrity of financial analysts. Candidates are required to pass three levels of exams covering areas such as accounting, economics, ethics, money management and security analysis. Four years of investment/financial career experience are required before one can become a CFA charterholder. Enrollees in the program must hold a bachelor's degree.*

*Information or data shown or used in this material was received from sources believed to be reliable, but accuracy is not guaranteed.*

*This report does not provide recipients with information or advice that is sufficient on which to base an investment decision. This report does not take into account the specific investment objectives, financial situation or need of any particular client and may not be suitable for all types of investors. Recipients should consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.*

*Strategas Asset Management ("SAM") is a registered investment advisor wholly owned by Baird Financial Corp. ("BFC"). SAM is an affiliate of RiverFront but is operationally independent from RiverFront. The model portfolio is generated by SAM's affiliate, Strategas Securities, LLC ("STS"), a FINRA member broker-dealer and registered investment adviser. SAM, pursuant to an agreement with STS is authorized to offer and distribute model portfolios to its clients, including RiverFront. STS is also wholly owned by BFC and an affiliate of RiverFront. Baird, SAM, STS and RiverFront are all affiliated entities via their common ownership under BFC.*

*Principal Risks:*

*In a rising interest rate environment, the value of fixed-income securities generally declines.*

*Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.*

*When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit www.riverfrontig.com or contact your Financial Advisor.*

*Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.*

*Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.*

*Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.*

*Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.*

*High-yield securities (including junk bonds) are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities.*

*There are special risks associated with an investment in real estate and Real Estate Investment Trusts (REITs), including credit risk, interest rate fluctuations and the impact of varied economic conditions.*

*Mega cap is a designation for the largest companies in the investment universe as measured by market capitalization. While the exact thresholds change with market conditions, mega cap generally refers to companies with a market capitalization above $200 billion.*

*Index Definitions:*

*MSCI Emerging Markets Index captures large and mid cap representation across 26 Emerging Markets (EM) countries.*

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

*RiverFront Investment Group, LLC ("RiverFront"), is a registered investment adviser with the Securities and Exchange Commission. Registration as an investment adviser does not imply any level of skill or expertise. Any discussion of specific securities is provided for informational purposes only and should not be deemed as investment advice or a recommendation to buy or sell any individual security mentioned. RiverFront is affiliated with Robert W. Baird & Co. Incorporated ("Baird"), member FINRA/SIPC, from its minority ownership interest in RiverFront. 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, a registered broker/dealer and investment adviser.*