Rod Smyth
DIRECTOR OF INVESTMENTS

Kevin Nicholson, CFA®
GLOBAL FIXED INCOME CO-CIO

Chris Konstantinos, CFA®
CHIEF INVESTMENT STRATEGIST

Doug Sandler, CFA®
HEAD OF GLOBAL STRATEGY

Rebecca Felton
SENIOR MARKET STRATEGIST

Rob Glownia, CFA®
SENIOR PORTFOLIO MANAGER

- **We believe investing is emotional.**
- **Greed and especially fear can cause us to make poor long-term decisions.**
- **We offer some strategies to help overcome our emotions.**

How We Behave

THE VALUE OF 'EMOTIONAL ALPHA'

A study by Amos Tversky and Daniel Kahneman in 1992, showed that for most people, the distress of loss is twice as powerful as the pleasure from an equivalent gain. The experience of the COVID-19 pandemic on investor behavior during the sharp decline and subsequent recovery has reminded us of how often bear markets can cause investors to abandon a long-term investment plan due to short-term emotions. It is easy to understand why someone might be panicked when the value of their stocks falls by a third in just 22 days.

As an investment manager who works with advisors, we believe that helping clients manage their emotions and complete their investment journey is one of the most important services we can collectively provide.

EMOTIONAL ALPHA

In investing jargon, alpha (the first letter of the Greek alphabet) is used to describe the value of numerical performance that exceeds a benchmark. Emotional alpha is a term we use to define the value of helping a client navigate market swings without making decisions purely on emotion. We submit that changes in asset allocation have the biggest impact on long-term returns. For example, consider an investor who is 100% invested in stocks and sells 20% of their portfolio during a bear market when the news is usually at its most dire. Let's say the market falls another 10% after the sale but ends up 10% higher than its previous peak over the next year. If that investor still has 20% cash, their return will be 20% lower than it would have been if they had done nothing. Considering this example in hindsight is different from living it: emotional alpha is helping investors make reasonable decisions in times of both fear and euphoria. We believe that when we at RiverFront make tactical adjustments (such as raising cash temporarily) in our balanced portfolios it can potentially offset the emotional urge for the investor to take action themselves. Our job is to be sure to reinvest that cash so it can participate in the market's recovery.

During this year, the investment journey has been charged with emotion. In hindsight we know that the S&P 500 (at the time of this writing) has recovered 90% of what it lost from the peak in February, but imagine how you might have felt if the market had lost more of its value and the decline had lasted longer. We should recognize that the fear experienced by owning stocks while they are falling is a part of investing in the stock market and so it is good to be as emotionally prepared as possible. With interest rates so low, we believe investors looking for higher returns are likely to have larger allocations to stocks making their portfolios more volatile. Thus, emotion management is even more important.

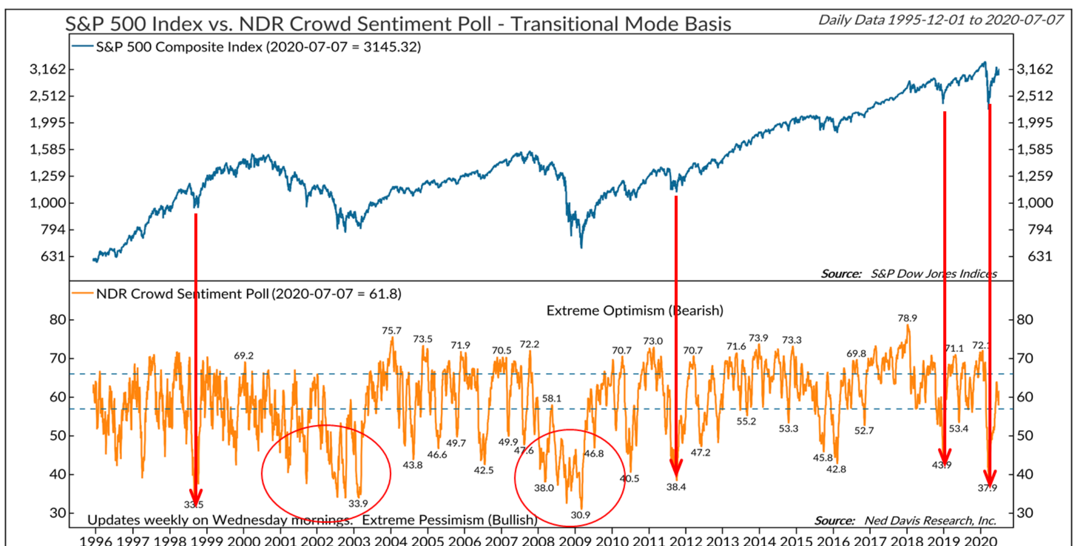
WAYS TO COMBAT FEAR

- **Don’t make decisions in isolation, seek out a financial ‘emotion counselor.’** There is a reason that most pension funds and endowments create clear asset allocation targets and have a board of trustees. A trusted financial advisor can play that role for individuals.
- **Know yourself.** Risk tolerance is personal, and so a portfolio tailored to your personality may be very important in offsetting the risk of failing to achieve your investment goals. Learning your emotional tolerance for ‘statement risk’ or unrealized losses is hard to do theoretically. We believe starting to invest small amounts at a young age can help you to become more comfortable with volatility. Also recognize that your risk tolerance may change as you get older, especially at the point of retirement when you move from accumulating wealth to distributing it.
- **Clear communication.** At RiverFront we believe passionately in open communication to build trust. We communicate our views of market moving events and how we are responding to them through written publications, videos, and conference calls.
- **Trusting a process.** Our mantra is ‘process over prediction.’ If you believe in a process, we believe you are much less susceptible to make an emotionally driven decision that deviates from that process.

MEASURING FEAR

Extreme fear or pessimism is often *but not always* associated with market lows. One of our three rules is “Beware the Crowd at Extremes” and one of our favorite gauges of investor sentiment is the Ned Davis Crowd Sentiment Poll.

Ned Davis Research has combined a group of indicators reflecting investor sentiment which highlight what an emotional journey investing can be. The table below the chart shows that better returns are generally achieved during periods of investor pessimism than investor optimism. The chart itself shows that market bottoms often coincide with extreme fear, as measured by low readings on this indicator, which is why we believe managing emotions can be so valuable, especially in times of distress. We have drawn four arrows where the market low coincided with the areas of strong pessimism. *Importantly however no indicator is a panacea* and so we have also shown two circles where this indicator captured multiple intermediate lows during the prolonged bear markets of 2000-2003 and 2007-2009. In seeking to make tactical



S&P 500 Index Performance **Full History:** 1995-12-01 to 2020-07-07		
NDR Crowd Sentiment Poll is	% Gain/ Annum	% of Time
Above 66.0	-3.19	25.79
57.0 - 66.0 From Above	0.52	17.90
57.0 - 66.0 From Below	20.66	19.42
Below 57.0	11.10	36.45
Buy/Hold = 6.91% Gain/Annum		

S574A

Disclosures: Past performance is no guarantee of future results. Shown for illustrative purposes. Not indicative of RiverFront portfolio performance. Index definitions are available in the disclosures.

judgments we don't look at investor sentiment in isolation but combine measures of sentiment with central bank policy (Don't Fight the Fed) and the slope of the 200-day moving average (Don't Fight the Trend). In the recent decline we believe it was the combination of investor fear combined with massive Federal Reserve intervention (and government stimulus programs) which caused the S&P 500 to bottom on March 23rd. Despite the market's recovery it is worth noting that sentiment is still well below 'extreme optimism.'

In summary: Emotion is a constant presence for investors. History tells us that acting on both fear and greed can lead to poor decision making and so we believe a strategy for emotion management is very valuable.