RIVERFRONT INVESTMENT GROUP

Weekly View

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Don’t Forget About Growth!

Conversation With Our Stock Selection Team, Part Two

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SUMMARY

- No bubble in mega-cap tech, currently.
- We believe anti-trust is an unlikely, though negative risk.
- We prefer both growth *and* value to defensives and international.

One of my favorite aspects of working at Riverfront is working with the four associate portfolio managers that make up our equity selection team. This team performs analysis on individual equities that provides useful insights into how we position our portfolios. Over the past two weeks, we wanted to provide our clients with some of the insights they have uncovered. - Adam Grossman, CFA

Adam Grossman:

Last week, I talked with Dan and Kaetlin about ‘value’ investing, so today I wanted to bring Taylor and Diego in to touch on the flip side of that coin… ‘growth.’ To make sure we are all speaking the same language, table 1 illustrates how Riverfront categorizes value and growth on a sector basis.

One big theme for “growth’ investing in 2025 is the potential for an ‘Artificial Intelligence’ (AI) Bubble. Taylor, can you touch on our thoughts on this subject?

Table 1: Riverfront's Value and Growth Definition

Value	Growth
Energy	Technology
Industrials	Communication Services
Materials	Consumer Discretionary
Financials	

Taylor Bryan:

That’s a great question. I think when people discuss a ‘bubble’ forming, they are mostly focused on the largest technology companies that continue to be relative winners. To this end, I think it’s important to start by looking at these companies from a bottom-up fundamental perspective. Cutting to the chase, when looking at the largest technology companies through a discounted cash flow, or ‘DCF’ lens (see our DCF analysis Weekly View), **we do not currently see the type extreme or widespread overvaluation that would be typical in a bubble.** In fact, we see a handful of these companies as being attractively valued, using reasonable future growth estimates. The biggest reason for this is these companies’ ability to generate excess cash.

Cash flow from these companies is being generated from stable profit streams that are mostly unrelated to AI. This fact is key because it allows the company to self-fund AI growth opportunities, without pressure to immediately generate profit. **Essentially, you have the consistent profit stream of a staple company attached to the strong organic growth prospects typical within technology.**

Importantly, while a lot of the focus on AI is about future demand, we are currently seeing AI-driven demand across the technology sector and widespread adoption from consumers and businesses. Specifically, within semiconductor producers and cloud providers, we are seeing more demand than current supply and capacity can meet. We see this as confirmation of our belief that AI will be a long-term revenue growth driver.

Adam Grossman:
That makes a ton of sense. Moving to you, Diego. One other risk that is on the mind of a lot of investors is anti-trust action. What are your thoughts on this and do you view risk rising with the new presidency?

Diego Marti-Vertiz:
Man, you saved your softball questions for Dan and Kaetlin! Anti-trust is definitely a risk that we consider when looking at our current mega cap growth positions. Piggybacking off Taylor's comments, the stable and diverse cash flows of large growth companies is core to our thesis, so the forced divestitures that often come with anti-trust litigation would definitely affect our views on the space.

However, we believe any sort of widespread anti-trust action is unlikely for two main reasons. First, legally proving a monopoly is difficult, especially since these industries continue to rapidly evolve. These large growth companies have been in the crosshairs for years and the lack of action so far underscores this difficulty. Second, we believe that the consumer is actually better off due to the network effects created by these companies' large installed user bases and the integrated nature of these companies. When thinking of historic monopolies, one of the core tenets of antitrust regulation was based on harm to the consumers. Current big tech growth companies have organically created businesses that work together to create a better product.

Tying it all together, we need to keep an eye on anti-trust actions because of our investment's sensitivity to it, but still view it as an unlikely outcome.

Diego Marti-Vertiz:
Adam, we have discussed over the past two weeks how we like certain things in both growth and value. As the equity CIO, how do you bring this all together, when it comes to portfolio construction?

Adam Grossman:
I think our conversations over the past two weeks make it clear that we think 2025 will be a year where value begins to work, but we also aren't ready to fully move on from large cap growth quite yet. We incorporate this dichotomy into our portfolios in two ways.

First, from an allocation perspective we are overweight the US relative to our composite benchmarks. This overweight allows for a greater allocation in both the growth and value selection we prefer in the US.

Second, from a selection perspective, we are underweight 'defensive' sectors, such as healthcare, REITs, and utilities. Our bottoms-up work leads us to a preference for both 'growth' *and* 'value' over these 'defensives.' However, we do also acknowledge that this tilt increases the equity risk within our portfolios. To partly offset this, we adjust other portions of our equity selection and our fixed income selection. For instance, within equity we hold positions in alternative equity income strategies. These strategies provide the portfolio with some downside protection, in our view, as well as the type of income that would traditionally come from 'defensive' sectors. Within fixed income, we hold long maturity treasuries. This position acts as 'dry powder' and a recession hedge for the portfolio, in our view.

Thank you, Taylor and Diego, for sitting down with me! I can't wait to continue this series in the new year.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.

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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.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Index Definitions:

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

Dividends are not guaranteed and are subject to change or elimination.

Definitions:

Discounted cash flow (DCF) refers to a valuation method that estimates the value of an investment using its expected future cash flows. DCF analysis attempts to determine the value of an investment today, based on projections of how much money that investment will generate in the future.

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

A recession is a significant, widespread, and prolonged downturn in economic activity. A common rule of thumb is that two consecutive quarters of negative gross domestic product (GDP) growth indicate a recession. However, more complex formulas are also used to determine recessions.

Artificial intelligence (AI) refers to the simulation of human intelligence by software-coded heuristics. Nowadays this code is prevalent in everything from cloud-based, enterprise applications to consumer apps and even embedded firmware.

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

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.

US Equities include stocks listed in the United States. Stocks represent partial ownership of a corporation. If the corporation does well, its value can increase, and investors can 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). Small/mid-cap equities, MLPs, REITS and alternatives equities are types of US Equities and assume further risks described below.

US large cap equities include equities of companies with a market capitalization of over $10 billion. Although large cap equities are generally considered to be safer securities, large cap equities are still subject to the risks associated with stocks.

Alternative equities include non-traditional equity strategies such as hedged or income enhanced strategies through the use of derivatives. Alternative investment strategies typically carry a higher risk of loss. Hedged products do not insulate a portfolio against losses and there is no guarantee that income enhanced *strategies will provide the expected income. A covered call option involves holding a long position in a particular asset, in this case US common equities, and writing a call option on that same asset with the goal of realizing additional income from the option premium. Certain ETFs use a covered call strategy. By selling covered call options, the fund limits its opportunity to profit from an increase in the price of the underlying index above the exercise price but continues to bear the risk of a decline in the index.*

Treasuries are government debt securities issued by the US Government. Treasury securities typically pay less interest than other securities in exchange for lower default or credit risk. With relatively low yields, income produced by Treasuries may be lower than the rate of inflation.

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.

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