RIVERFRONT INVESTMENT GROUP

April 7, 2014

THE WEEKLY VIEW

From right to left:

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Asset Allocation Impact Trumps Electronic Trading

‘Rigged’ was a deliberately inflammatory adjective used last week to describe the impact of certain high frequency trading on the stock market. ‘Rigged’ suggests that investors be wary of stocks but, in our opinion, it would be a mistake to forgo the long-term benefits of investing in stocks based on the recent debate over high frequency trading. This is especially true while the Federal Reserve is deliberately keeping interest rates low (perhaps a more appropriate use of the ‘R’ word). We believe the choice of assets in the context of a long-term investment plan has far more impact on investment success than whether you pay a penny more or a penny less for the trade. This is why RiverFront devotes so much time to determining the optimal asset allocations for a variety of risk tolerances and investment horizons.

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Today, electronic trading, rather than the physical trading on the floor of a stock exchange, dominates the stock market. In an earlier era, firms of ‘specialists’ were granted the right to make a market in certain stocks — profiting from their knowledge of all bid/offer spreads — in return for providing liquidity as the buyer or seller of last resort. For individual investors, the costs for buying and selling stocks were higher than they are today. In 2001 the stock market went decimal — the minimum price change for a share of stock became one cent, where it had previously been 6.25 cents, or 1/16th of a dollar. This made the specialist’s role more difficult, moved more trading onto electronic exchanges, and increased the importance of speed and computer algorithms in trading. RiverFront’s traders have been aware of high frequency traders for years. Our senior trader, Will Wall, says, “It seems pretty clear that the evolution of stock markets has been towards a substantially lower cost of trading. High frequency traders sometimes work against us and sometimes work in our favor, much of the time they are not involved in the securities we are trading.”

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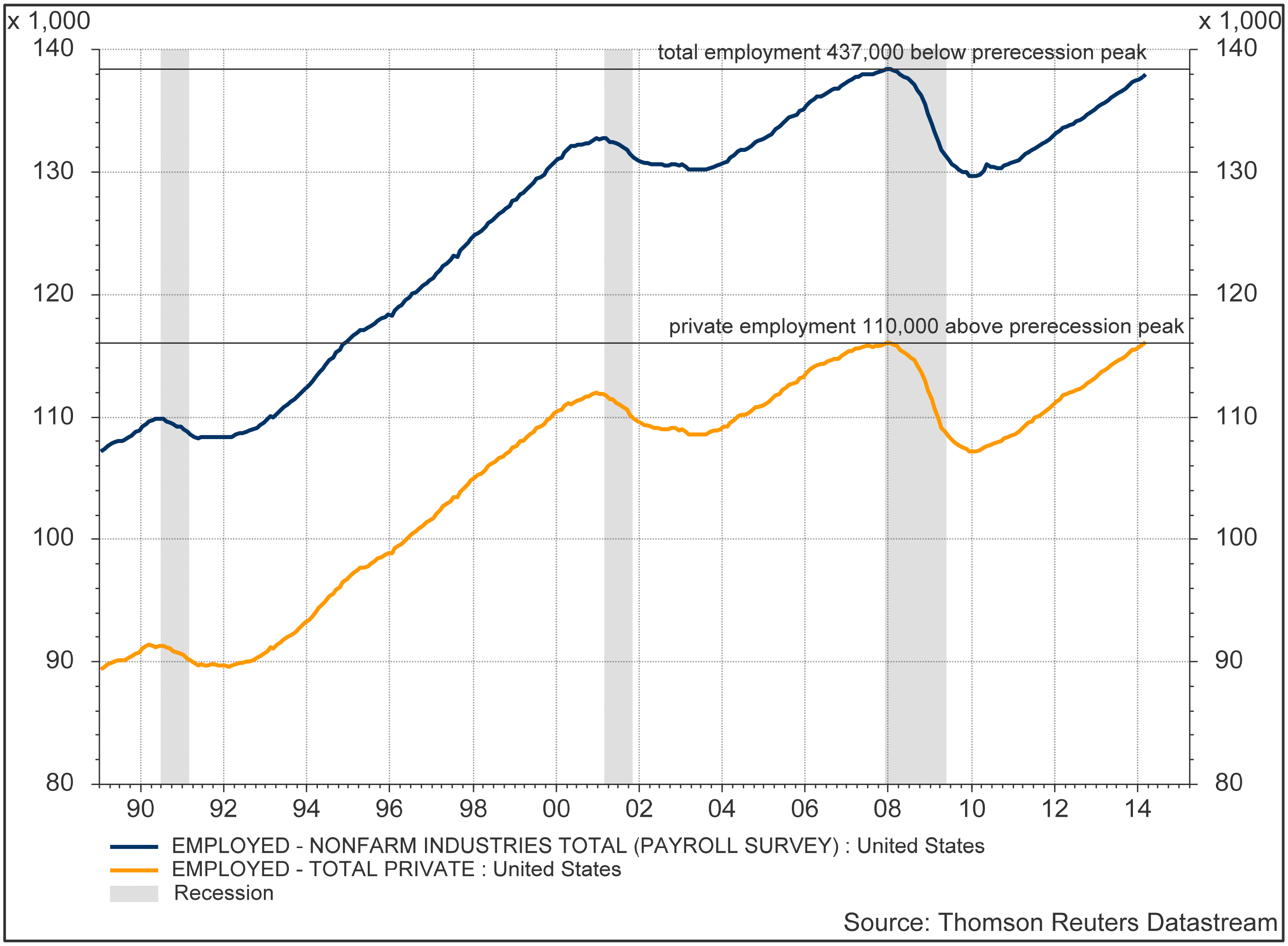
Private payroll employment rose by 192,000 in March and is now 110,000 above its pre-recession January 2008 peak — a new high (see Weekly Chart). We think there are two main takeaways from last Friday’s employment report.

First, private sector demand, with help from the Fed, will likely continue to drive economic growth. Aggregate payrolls (hours worked times hourly earnings) reaccelerated to 4% year-over-year growth in March after dipping to 3.3% in February. The economy appears to be rebounding from a severe winter, and evidence from purchasing managers indexes (PMIs) suggests investors should expect growth to continue. For example, the new orders indexes for manufacturing and non-manufacturing PMIs both rose in March, suggesting further expansion in business activity is likely. Similarly, global PMIs also rose further into expansion territory last month, signaling that the US is not alone in its recovery.

Our second takeaway is that considerable 'slack' remains in labor markets, which will keep the Fed from tightening monetary policy this year and well into 2015. The unemployment rate is unchanged at 6.7% and the broader measures of employment that the Fed monitors are still substantially underutilized. Last week, Fed Chair Janet Yellen said that monetary policy will remain extraordinarily accommodative with the goal "to encourage consumers to spend and businesses to invest, to promote a recovery in the housing market, and to put more people to work... this extraordinary commitment is still needed and will be for some time, and I believe that view is widely shared by my fellow policymakers at the Fed." A globally synchronized expansion, with inflation and interest rates low and central banks still trying to shepherd a recovery, means that investors should remain overweight stocks, in our view.

THE WEEKLY CHART: SLOW STEADY JOB GROWTH



Total nonfarm payrolls, which includes government workers, is 437,000 below its peak but will likely move into expansion territory this summer given its current pace. Private employment just surpassed its pre-recession peak. However, we believe this should not be considered a 'full recovery' since, over the last six years, employment has essentially been flat while population growth has increased 4.8%.