A Letter to the Post-Boomer Generation

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I am the proud father of three children between the ages of 23 and 27. Almost half of RiverFront's employees are under 40. What advice can we offer regarding their financial lives? This letter is written to the children of baby boomers and to their parents, who may be seeking to advise their children.

Start saving as soon as possible, every bit counts. Albert Einstein called the power of compounding the eighth wonder of the world (see weekly chart). Let's illustrate with an example used by renowned pension expert Keith Ambachtsheer, as discussed in his book *The Future of Pension Fund Management*.

- He considers the example of someone who makes $60,000 a year, saves for 40 years of their working life, and lives in retirement for 20 years. He further assumes that they will need $40,000 (two-thirds of their salary) per year in retirement, a fairly standard assumption in the pension industry. Finally he assumes that $20,000 a year will be covered by social security. (Today the average Social Security payment for retirees is $16,000 per year and, if funded, this amount should grow with inflation.)
- In Ambachtsheer's example, savings will need to cover the remaining $20,000 per year for 20 years. Here is where the power of compounding comes in. Let's consider two cases — one where the return on the investment is zero, and another where the return is 4% a year.
- Assuming a zero rate of return, our wage earner will need to accumulate $400,000 to fund 20 payments of $20,000 in retirement. ***This works out to be about 17% of their pay***, which is pretty onerous, in our view.
- In contrast, with just a 4% rate of return during both the 40 saving years and the 20 retirement years, our wage earner ***only needs to save 5% of pay during their saving years – a huge difference.***

Like any example, this one raises many questions: Will social security be offered to our GenXers and Millennials? What about people who live longer than 20 years in retirement? Can anyone afford to save for 40 years of their total working life? What is abundantly clear is the importance of saving at least 5% (preferably more) and investing in assets that will return at least 4%. The good news is that 4% is a very conservative assumption, in our view. We recommend a goal of saving 10% of income, and starting as soon as possible.

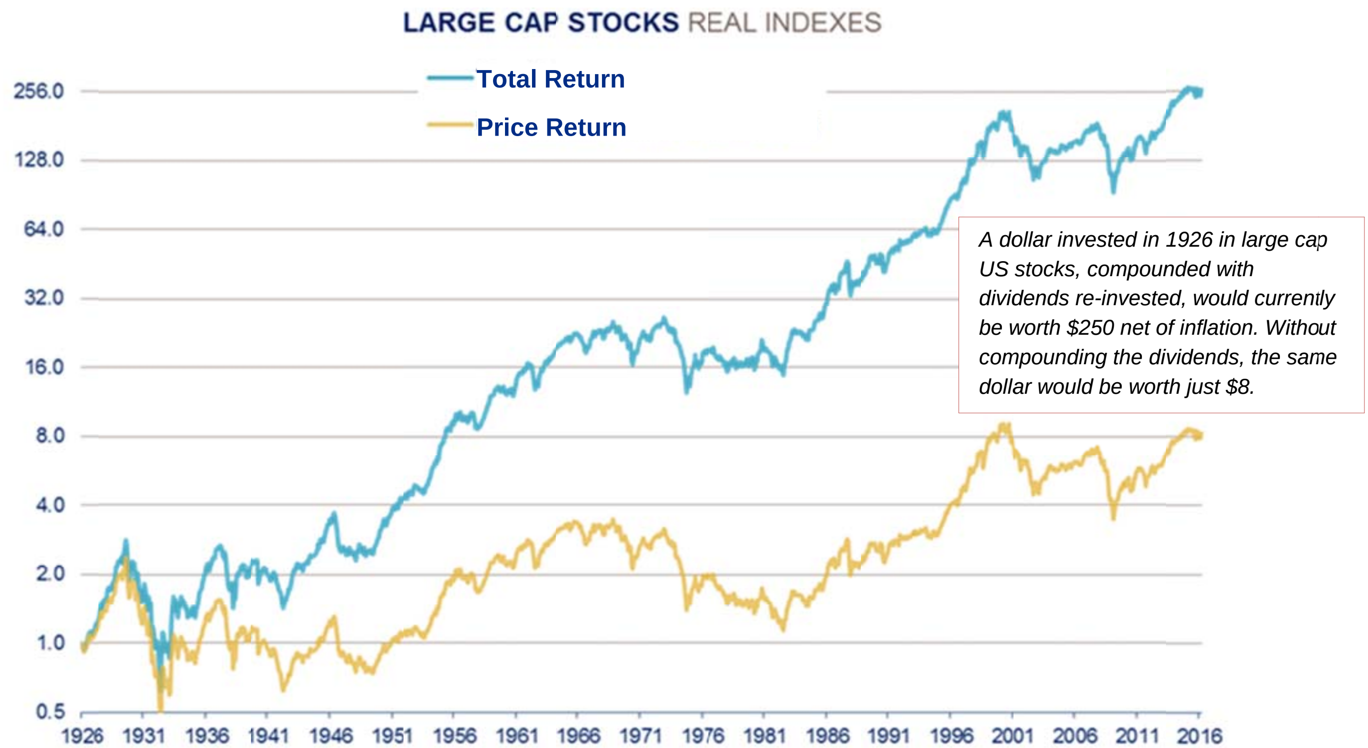
In an environment of some inflation, one should hope that pay will keep pace with inflation, but in RiverFront's view, assuming a return of 4% **above** inflation is not only reasonable, it is conservative over a 40-year saving horizon.

Plan on living longer and working longer: The post WWII social security model is broken. When pension models became popular and government pensions were widely introduced, most countries had many more workers than retirees, and the average lifespan for those reaching retirement was much lower. According to the official social security website (www.ssa.gov), in 1930 life expectancy at birth was 58 for men and 62 for women. *Only half of men who reached the age of 21 could expect to live to 65, the retirement age.* For those who made it to 65 in 1940, when social security payments began, another 12.7 years for men and 14.7 years for women could be expected.

Today those numbers are almost 19 and 21 years beyond 65, according to the social security site, and the number is likely to grow. As we have illustrated, it takes 40 years of saving (not 40 years of working) to seek to fund a 20-year retirement if social security is there, and of course, these are just averages. In the future, it may be possible to give people a more accurate and personal life expectancy number. For those of you who are planners, work back from that date and use your savings rate and expected return to think about a retirement date. There are Financial Advisors with sophisticated financial planning software available to help you.

In the early years, do not be alarmed by market declines. Investing is an emotional experience, which is where advice can help. Bull and bear markets (significant rises and significant declines in price) will likely happen during your saving years. Think about it — you would probably much prefer to see declines in the early years, while you have less money and are adding every year or every pay period. Assuming what you are investing in goes up over time, you want to have prices at their lowest when you are buying and at their highest as you approach retirement. Emotionally, we like to see our money grow, even in the early years, but logically we should recognize that when we are "putting pennies in the jar," lower prices are a good thing as long as we believe markets will go up over time. If we do not believe that, then we shouldn't be investing.

WEEKLY CHART: THE POWER OF COMPOUNDING – REINVESTING DIVIDENDS



Source: RiverFront Investment Group, 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. Data from Jan 1926 through Feb 2016. Past performance is no guarantee of future results. It is not possible to invest directly in an index.*

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* *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.

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