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Richard Bernstein Advisors



Richard Bernstein Advisors LLC (RBA) is an investment manager focusing on longer-term investment strategies that combine top-down, macroeconomic analysis and quantitatively-driven portfolio construction. We strive to be the leading provider of innovative investment solutions for investors, and our competitive edge is our researchdriven macro style of investing.

Our top-down macro approach differentiates our firm from the more common, traditional bottom-up approach of most asset managers. Our extensive array of macro indicators allows us to construct portfolios for clients that are innovative, risk-controlled, and focused on overall portfolio construction instead of individual stock selection.

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Please stop saying everyone is so bearish

There is a broadly held notion that investors remain bearish with respect to equities. However, investor sentiment has become decidedly more bullish as is typical in late-cycle environments. Consider the following:

- It remains difficult to say that investors are "euphoric" with respect to public equity, but their euphoria becomes quite evident if one included private equity and venture capital. Investors continue to pour assets into those "hot" asset classes while ignoring the opportunities in other equity classes.
- Consensus has swiftly shifted in favor of cyclical stocks, yet implied probabilities continue to show that investors believe there is no chance of the Fed raising rates all the way out to January 2021.
- Despite the popular notion that flows are pouring into fixedincome assets, equity ETF flows year-to-date appear to be gaining ground versus fixed-income ETF flows.
- **4.** Investors' rather perplexing sudden recognition that the US stock market has "new highs" is fueling momentum strategies.

Investors might not be ebullient, but their behavior is increasingly typical of late cycles. Testing the fire extinguisher?

Lured by past outperformance: Venture vs. Emerging Markets

In several earlier reports, we highlighted that Empirical Research Partners' analysis showed nominal flows to venture capital and private equity funds have now eclipsed the flows into US equities during the late-1990s Technology Bubble. There is also roughly \$2 trillion dollars of "dry powder" (i.e., capital committed by investors but not yet called by managers) waiting to be invested globally in venture capital and private equity.

One basic rule of investing is that return on investment is highest when capital is scarce. These recent data suggest that private markets are not starved for capital. Rather, these asset classes seem historically flush with capital.

Investors are clearly chasing returns as they do toward most cycles' end. Charts 1 and 2 show this emotional buying is quite typical. The first chart shows compounded returns for the Thomson Reuters Venture Index and for the MSCI Emerging Market Index from 2000 to 2009. 2000 (the start point in the chart) was the end of the Technology Bubble, but consensus remained that technology-related investments were a critical part of any growth portfolio. Emerging Markets were at the other end of investors' emotional scale because EM had suffered a series of financial catastrophes and were accordingly unpopular. However, Emerging Markets outperformed Venture during the following decade by nearly 1,400 basis points per year.

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Enthusiasm for Emerging Markets grew as the asset class outperformed, and by 2009/2010 Emerging Markets were considered a critical part of a portfolio. In fact, investors at that time were so enamored with Emerging Markets that many wouldn't even consider our portfolios because those portfolios had little or no EM exposure.

Venture Capital significantly outperformed EM over the subsequent decade by almost 20 percentage points per year. These asset classes' popularity has, of course, reversed again, and today an allocation to Venture Capital is now considered essential. Those who believe that the global economy is in an unprecedented period of innovation and disruption should review how similar VC funds' marketing literature looked in 2000.

CHART 1: Thomson Reuters Venture Index vs. the MSCI Emerging Market Index (Dec. 2000 – Dec. 2009)



Source: Bloomberg Finance L.P.

CHART 2: Thomson Reuters Venture Index vs. the MSCI Emerging Market Index (Dec. 2009 – Oct. 2019)





Nirvana for cyclicals?

Cyclical stocks have quickly become the consensus favorite based on an anticipated resolution to the myriad of trade disputes. Yet, investors believe that the Fed will be "on hold" or lowering rates for the foreseeable future. That makes absolutely no sense.

Cyclicals outperform the broader market when nominal profits and economic growth increase. Because the economy is in a late-cycle phase, the growth necessary to propel cyclical outperformance would normally coincide with the Fed raising rates.

Chart 3 shows the probability of the Fed raising rates at their meetings going out to January 2021. The current market derived probability of a rate hike is 0%! So, either investors' bullishness for cyclicals or the 0% probability of a rate hike over the next 15 months is wrong. Investors evidently foresee a very bullish nirvana for cyclicals.

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Meeting	ike Prob	Cut Prob	0.5-0.75	0.75-1	1-1.25	1.25-1.5	1.5-1.75	Fwd Rate
12/11/2019	0.0%	9.3%	0.0%	0.0%	0.0%	9.3%	90.7%	1.5
01/29/202	0.0%	23.1%	0.0%	0.0%	1.4%	21.7%	76.9%	1.5
03/18/202	0.0%	32.4%	0.0%	0.2%	3.9%	28.4%	67.6%	1.4
04/29/202	0.0%	39.1%	0.0%	0.5%	6.3%	32.2%	60.9%	1.4
06/10/202	0.0%	43.4%	0.1%	0.9%	8.1%	34.3%	56.6%	1.4
07/29/202	0.0%	47.3%	0.1%	1.4%	9.9%	35.8%	52.7%	1.4
09/16/2020	0.0%	52.7%	0.3%	2.3%	12.6%	37.6%	47.3%	1.3
11/05/2020	0.0%	55.0%	0.4%	2.8%	13.8%	38.0%	45.0%	1.3
12/16/2020	0.0%	60.2%	0.6%	4.1%	16.6%	38.8%	39.8%	1.3
Historical Anal	ysiz for Me	eting 01/27	/2021	4) Add/Rem	ove Series			
Probability of Hike 0.5 Probability of No Change (15-175) 39			<i>~~</i>			$\sim \sim$		
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May 31 Jun 14	Jun 28	34(15	Jul 31 Aug	15 Aug 30	Sep 16	Sep 30	Oct 15	Oct 31

CHART 3: Probability of Future Fed Rate Hikes

Source: Bloomberg Finance L.P.

Equity flows picking up

Although flows to bond ETFs and funds continue to outpace equity flows, there is increasing evidence that the tide is starting to turn. BAML reported recently that their client flows into ETFs now showed year-to-date equity ETF flows were greater than bond ETF flows (see chart 4). Of course, this omits mutual funds, but it is nonetheless a fact that has been largely overlooked.



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CHART 4:





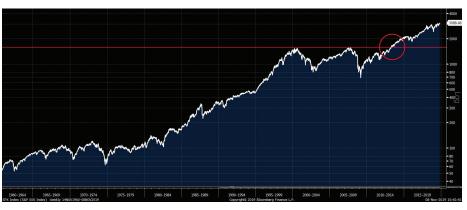
Source: Bank of America Merrill Lynch

The wonderment of "new highs"

The S&P 500[®]'s first "new all-time high" for this cycle was in 2013 as shown in chart 5. Investors generally ignored the market's earlier rallies because investors were VERY bearish (sentiment was excellent) and were still licking their wounds from 2008's bear market.

Everyone seems to have forgotten that bull markets are always a series of "new highs," and investors have been reacting more positively to recent highs and adding to equity allocations and equity beta. 6+ years after the first "new all-time high" and 10+ years into the bull market investors are finally celebrating the market's achievements. History shows well that investors swallow the hype and get more bullish in latecycles, and they appear to be doing it again.





Source: Bloomberg Finance L.P.



Please stop saying everyone is so bearish

During most of this bull market, investors questioned our bullishness by suggesting that "everyone is so bullish." Of course, their assessment of market sentiment reflected their own biases. Investors were generally bearish not bullish, and that sentiment backdrop helped propel the bull market.

Today, momentum investing is in vogue, equity allocations are rising, equity betas are being increased, and our incremental bearishness is being questioned by those saying, "everyone is so bearish and cautious."

As in most late-cycle environments, investors are now getting bullish. We prefer to err on the side of caution. We may be early because no one can precisely predict a market top, but many investors typically lament holding on too long into the throes of a bear market.

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To learn more about RBA's disciplined approach to macro investing, **please contact your local RBA representative**.

INDEX DESCRIPTIONS:

The following descriptions, while believed to be accurate, are in some cases abbreviated versions of more detailed or comprehensive definitions available from the sponsors or originators of the respective indices. Anyone interested in such further details is free to consult each such sponsor's or originator's website.

The past performance of an index is not a guarantee of future results.

Each index reflects an unmanaged universe of securities without any deduction for advisory fees or other expenses that would reduce actual returns, as well as the reinvestment of all income and dividends. An actual investment in the securities included in the index would require an investor to incur transaction costs, which would lower the performance results. **Indices are not actively managed and investors cannot invest directly in the indices.**

Thomson Reuters Venture Capital Index: The Thomson Reuters Venture Capital Index is designed to measure the value of the US-based venture capital private company universe in which venture capital funds invest.

S&P 500[®]: The S&P 500[®] Index is an unmanaged, capitalizationweighted index designed to measure the performance of the broad US economy through changes in the aggregate market value of 500 stocks representing all major industries.



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EM: The MSCI EM Index is a free-float-adjusted, marketcapitalization-weighted index designed to measure the equitymarket performance of emerging markets.

About Richard Bernstein Advisors

Richard Bernstein Advisors LLC is an investment manager focusing on long-only, global equity and asset allocation investment strategies. RBA runs ETF asset allocation SMA portfolios at leading wirehouses, independent broker/dealers, TAMPS and on select RIA platforms. Additionally, RBA partners with several firms including Eaton Vance Corporation and First Trust Portfolios LP, and currently has \$9.0 billion collectively under management and advisement as of September 30th, 2019. RBA acts as sub-advisor for the Eaton Vance Richard Bernstein Equity Strategy Fund, the Eaton Vance Richard Bernstein All-Asset Strategy Fund and also offers income and unique theme-oriented unit trusts through First Trust. RBA is also the index provider for the First Trust RBA American Industrial Renaissance® ETF. RBA's investment insights as well as further information about the firm and products can be found at <u>www.</u> <u>RBAdvisors.com</u>.

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