



**Richard Bernstein**, Chief Executive  
and Chief Investment Officer

### Richard Bernstein Advisors

Richard Bernstein Advisors LLC (RBA) is an independent investment adviser 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 research-driven 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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## Income + Tariffs + Inflation = Underperformance

There is a headline-grabbing kerfuffle regarding new US tariffs on imported steel and aluminum, which come on top of tariffs previously placed on solar panels and washing machines. At RBA, our policy of remaining “annoyingly dispassionate” during a fire-charged political environment leads us to focus on an investment issue that virtually no one is discussing.

**Investors have flocked for years to income-oriented strategies in both the bond and equity markets, yet those strategies are the ones most at risk from US tariffs. Tariffs, by definition, are always inflationary, and inflation is the enemy of income.**

### Tariffs are, by definition, ALWAYS inflationary

Investors need to remember that tariffs, by definition, are always inflationary. When a country is accused of dumping its goods that means the country is gaining market share by selling goods at unreasonably and unprofitably low prices. The tariff is meant to equate the dumping country’s prices with those of domestic producers in order to stem or reverse the ill begotten gain in market share. Tariffs are by definition inflationary because prices increase from an alleged artificially low price to a more normal and less competitive price. The price increase might be warranted or not, but the reality is that prices always increase as a result of a tariff.

Another way to understand why prices always increase when tariffs are imposed is based on simple economics of supply and demand. Tariffs restrict the supply of goods. If one assumes that demand does not fall, then “Economics 101” highlights that coupling reduced supply and consistent demand results in higher prices. Reducing competition rarely results in lower prices.

Of course, there is a chance that higher prices actually reduce demand, and defeat the tariff’s ultimate goal of increasing demand for domestic producers. Domestic companies might gain market share, but the overall market could shrink in response to higher prices as other products substitute for the tariffed products. This is not theoretical. A major auto company has already stated that they may simply accelerate their use of carbon fiber if tariffs significantly distort steel and aluminum prices.

**Inflation hurts income strategies**

Inflation expectations troughed in June 2016 (!), and have been gradually rising since then. It seems immaterial from an investment point of view whether this increase in inflation expectations is secular or merely cyclical because investors are largely ill-positioned for any increase in inflation. Chart 1 shows that the 10-year T-note yield troughed roughly 3 weeks after inflation expectations troughed. The sizeable flows into fixed-income investments ran unabated until only recently despite the increase in yields.

Disinflation and deflation seem to be so ingrained into investors' psyche that investors refuse to believe that inflation expectations are rising, and they do not seem aware how poorly their income-oriented portfolios are performing. Chart 2 shows the performance of stocks and bonds since inflation expectations troughed on June 16, 2016. Since that date, stocks have outperformed bonds on an annualized basis by more than 20% PER YEAR!

Chart 3 shows the performance of US economic sectors since June 2016. Income-oriented sectors (Real Estate, Telecom, and Utilities) have been the three worst performing sectors since inflation expectations troughed. More important, sectors that generally benefit from rising prices have significantly outperformed. The opportunity cost of investing in fixed-income or in income-oriented stocks instead of pro-inflation investments has been massive.

The backup in interest rates has been fundamentally-based. As is typical in a late-cycle environment, inflation pressures begin to grow and interest rates increase. Instituting tariffs on top of these normal late-cycle developments suggests that income-oriented investors should be much more concerned about inflation than they are currently.

**10-year T-note yield troughed roughly 3 weeks after inflation expectations troughed. The sizeable flows into fixed-income investments ran unabated until only recently despite the increase in yields.**

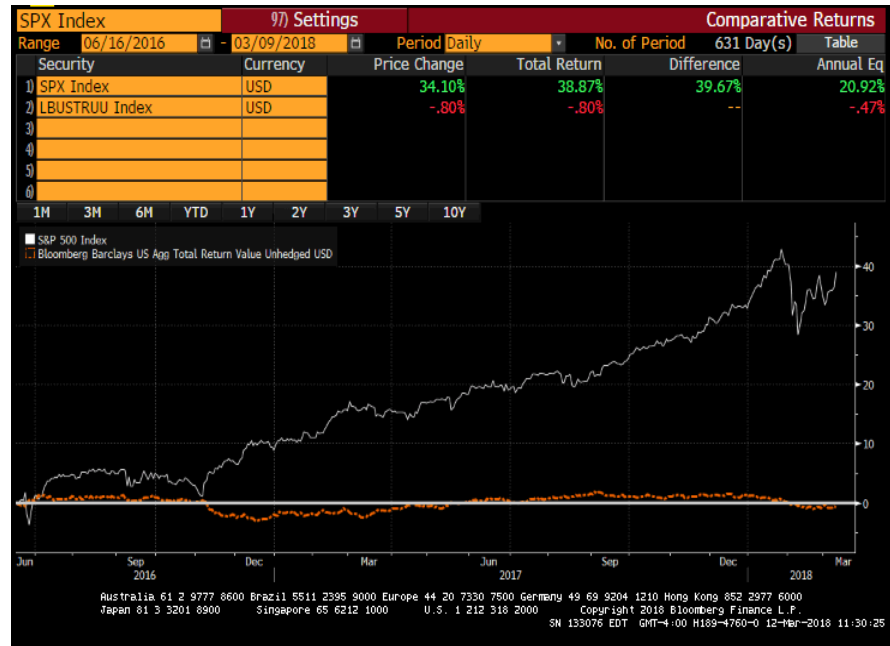
**CHART 1:  
10-Year T-Note Yield  
(Daily Mar. 9, 2008 – Mar. 9, 2018)**



Source: Bloomberg Finance L.P.

**CHART 2:**  
Stocks vs. Bonds since June 16, 2016

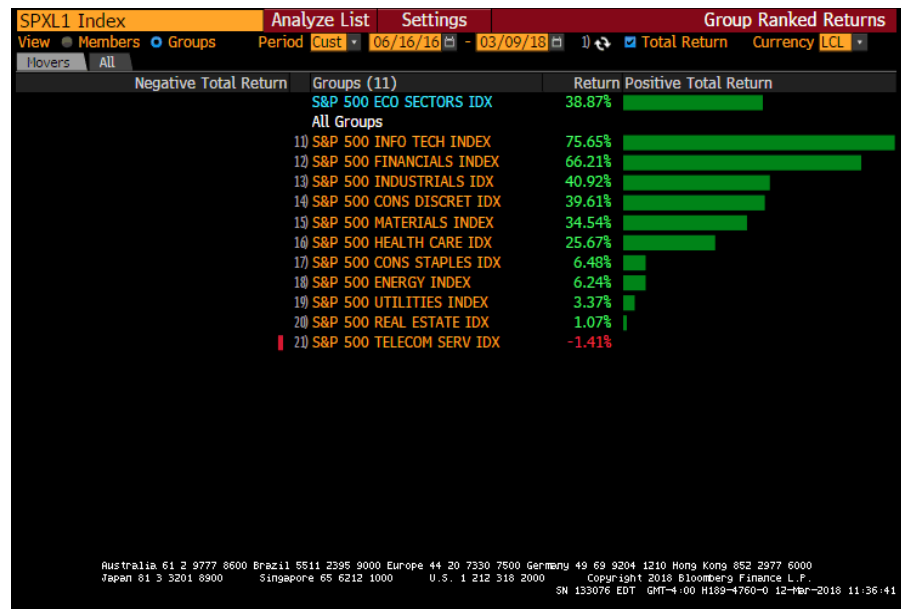
The performance of stocks and bonds since inflation expectations troughed on June 16, 2016. Since that date, stocks have outperformed bonds on an annualized basis by more than 20% PER YEAR!



Source: Bloomberg Finance L.P. For Index descriptors, see "Index Descriptions" at end of document.

**CHART 3:**  
S&P 500® Sector Performance since June 16, 2016

Income-oriented sectors (Real Estate, Telecom, and Utilities) have been the three worst performing sectors since inflation expectations troughed. Sectors that generally benefit from rising prices have significantly outperformed



Source: Bloomberg Finance L.P. For Index descriptors, see "Index Descriptions" at end of document.

**RBA Investment Process:**

- Quantitative indicators and macro-economic analysis are used to establish views on major secular and cyclical trends in the market.
- Investment themes focus on disparities between fundamentals and sentiment.
- Market mis-pricings are identified relative to changes in the global economy, geopolitics and corporate profits.

**Putting fuel on normal late-cycle pricing power**

The global economy has significantly changed during the past nine years. As there would be during any economic cycle, there have been early-, mid-, and late-cycle periods. It is RBA's contention that the US is currently entering a very traditional late-cycle period, and late-cycle periods are often characterized by production bottlenecks and rising inflation. That fundamental backdrop is well underway.

Tariffs could be the fuel on the pricing power fire. There are already production bottlenecks forming within the economy, and pricing power is returning to corporate America. Tariffs are likely to cause prices to increase more than they might normally.

Most investors' portfolios are not allocated for even a small increase in inflation. The performance of popular fixed-income and equity income strategies has been miserable since inflation expectations troughed in June 2016. Most important, though, is that the underperformance of these popular strategies has come before tariffs were introduced. It would be extraordinarily unique to see these strategies outperform when confronted with even more inflation prone regulation and policies.

The risks in the financial markets are not from inflation. Rather, the risk is that most investors are very poorly positioned for the changing inflation environment, which now includes tariffs.

*To learn more about RBA's disciplined approach to macro investing, please contact your local RBA representative.*  
[www.rbadvisors.com/images/pdfs/Portfolio\\_Specialist\\_Map.pdf](http://www.rbadvisors.com/images/pdfs/Portfolio_Specialist_Map.pdf)

**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.**

**S&P 500®: Standard & Poor's (S&P) 500® Index.** The S&P 500® Index is an unmanaged, capitalization-weighted 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.

**Stocks: Standard & Poor's (S&P) 500® Index.** The S&P 500® Index is an unmanaged, capitalization-weighted 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.

**Bonds: The Bloomberg Barclays US Aggregate Bond Index:** The Bloomberg Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

**Sector/Industries:** Sector/industry references in this report are in accordance with the Global Industry Classification Standard (GICS®) developed by MSCI Barra and Standard & Poor's. The GICS structure consists of 11 sectors, 24 industry groups, 68 industries and 157 sub-industries.

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**About Richard Bernstein Advisors**

Richard Bernstein Advisors LLC is an independent investment adviser. RBA partners with several firms including Eaton Vance Corporation and First Trust Portfolios LP, and currently has \$7.2 billion collectively under management and advisement as of February 28<sup>th</sup>, 2018. RBA acts as sub advisor for the Eaton Vance Richard Bernstein Equity Strategy Fund and 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<sup>®</sup> ETF and the First Trust RBA Quality Income ETF. Additionally, RBA runs ETF asset allocation SMA portfolios at UBS, Merrill Lynch, Morgan Stanley Smith Barney, Wells Fargo, RBC, Janney and on select RIA platforms. RBA's investment insights as well as further information about the firm and products can be found at [www.RBAdvisors.com](http://www.RBAdvisors.com).

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