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 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.

Bubble? 5 for 5.

When I used to teach at the NYU/Stern Graduate Business School, we'd cover what determines a financial bubble. Based on my readings of financial history, I came up with five characteristics of a financial bubble. Portions of the current market are exhibiting all 5 characteristics.

The five characteristics are:

1. Increased liquidity.
2. Increased use of leverage.
3. Democratization of the market.
4. Increased new issues.
5. Increased turnover.

One should note that valuation is not a defining characteristic of a bubble. Of course, bubbles center on overvalued assets, but valuation alone does not imply a financial bubble. **The difference between mere speculation and financial bubbles is speculation resides within the financial markets, but bubbles pervade society. Today, financial speculation is clearly pervading society**.

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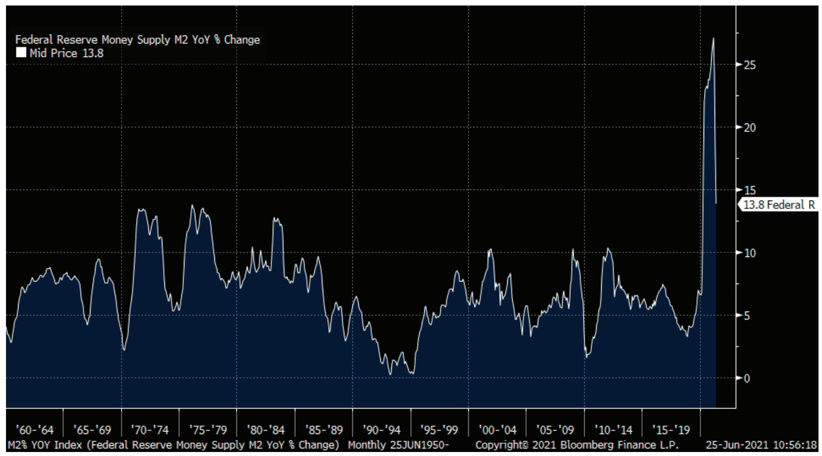
Increased liquidity

"Liquidity", regardless of how one measures it, has dramatically increased in the United States. Chart 1 shows the dramatic increase in M2 growth in response to the pandemic. Although there may be structural reasons why this record growth occurred and one can argue regarding its longevity, there is no denying that liquidity has significantly increased.

CHART 1:
US Money Supply Growth
(Jan. 31, 1960 - May 31, 2021)



Source: Bloomberg Finance L.P.

However, the transmission mechanism between monetary policy and the real economy appears broken. Bank lending is the conduit through which monetary stimulus affects the real economy, but after the Global Financial Crisis a combination of factors has limited bank lending and, as a result, the Fed's stimulus has increasingly been trapped within the financial markets and fueled speculation rather than healthy economic activity.

The first restricting factor is the relatively flat yield curve resulting from the Fed's purchases of bonds, i.e., quantitative easing. The yield curve is a simple representation of banks' lending margins (i.e., they pay short-term deposit rates and receive long-term lending rates), and a flatter curve implies lending margins are narrower.

The Fed's own research shows steeper yield curves do incent lending, and yet the Fed has purposely flattened the yield curve. One could argue lower long-term interest rates have stimulated high-multiplier sectors such as housing, but the broader economy has not significantly benefitted from the increase in liquidity because bank lending has been restrained.

The second factor restricting lending are the restrictions on bank leverage after the Global Financial Crisis. A flatter curve by itself might not restrict lending because banks might have in the past used leverage to make a smaller lending margin more profitable. However, that is no longer possible under the post-GFC regulations.

Chart 2 shows the relationship between the slope of the yield curve and the Fed's Survey of Senior Lending Officers Survey. The slope of the curve does indeed lead banks' willingness to lend.

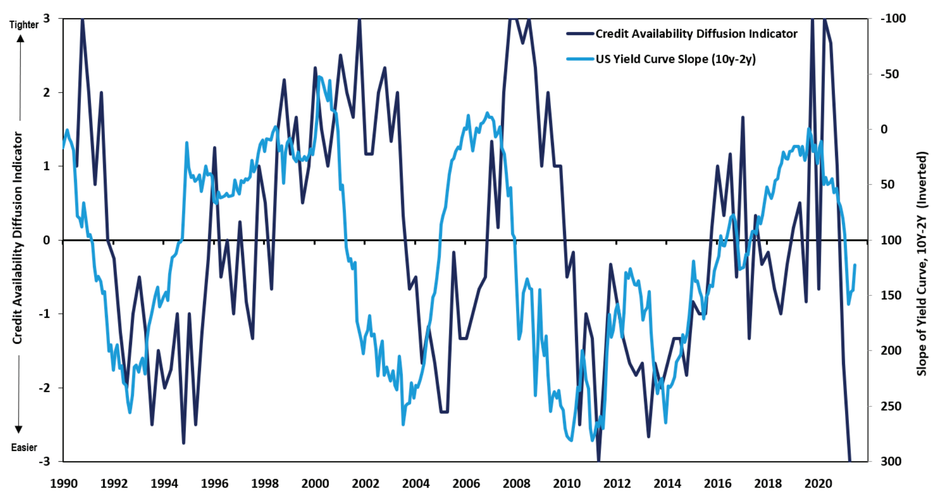
The traditional banking system's leverage may have been constrained, but that doesn't necessarily appear to be the case for other lenders. The popularity of private debt reflects non-regulated lenders' ability to use leverage to improve lending margins. Unfortunately, the overall balance sheet of the private lending industry is much smaller than the balance sheet of the traditional banking system, so the bulk of the Fed's liquidity can't get into the real economy.

Characteristic #1: CHECK. The Fed has provided historic levels of liquidity in response to the pandemic, but liquidity has been trapped in the financial markets and fueled speculation.

CHART 2:

US Credit Availability Diffusion Indicator vs. 10y-2y Yield Curve Slope

(Jan. 31, 1990 - Jun. 29, 2021)

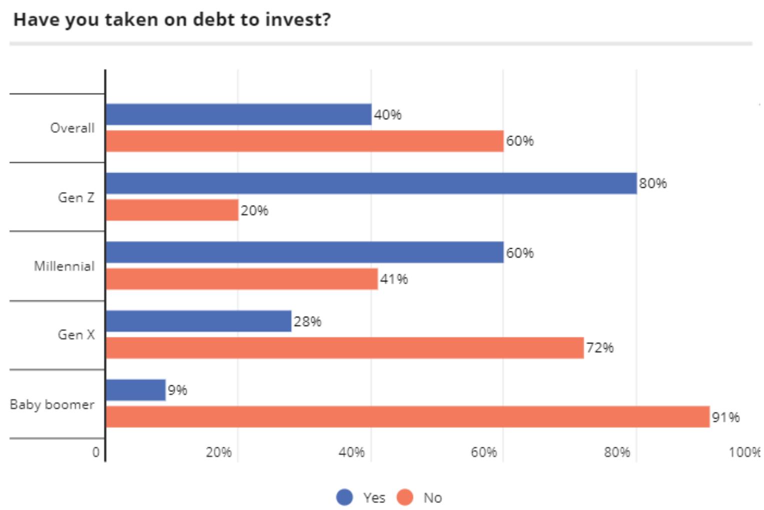


Source: Richard Bernstein Advisors LLC, Federal Reserve Board, Bloomberg Finance L.P.

Increased use of leverage

Although lending to the real economy might be constrained, that does not appear to be the case within the financial economy. Investors have increased the leverage used in their investment processes. A recent survey by MagnifyMoney showed 40% of individual investors overall, 80% of Gen Z investors, and 60% of Millennials had borrowed to invest in the stock market. Nearly half of those surveyed borrowed $5,000 or more.

CHART 3:
Individual Investors Debt Survey



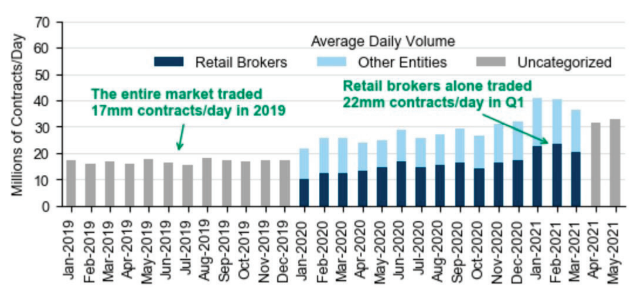
Source: MagnifyMoney survey of 994 investors conducted March 30-April 6, 2021. Totals may not add to 100% due to rounding.

However, borrowing isn't the only way to increase leverage. Investors have gravitated to the embedded leverage within single stock options. Chart 4 (courtesy of Goldman Sachs) shows how retail brokers place more single stock options trades than the entire size of the options market two years ago.

CHART 4:
Retail investors' average daily listed option volume

Exhibit 3: Retail investors' average daily listed option volume in Q1 exceeded the entire listed market's average daily volume in 2019

Average daily US-listed single stock and ETF option volume, in millions of contracts; retail brokers' total based on PFOF data; 2019 and 2Q 2021 are not categorized because data is not available.



Source: Goldman Sachs Global Investment Research, Company filings, OptionMetrics

Characteristic #2: CHECK. Investors, especially individual investors, are using more leverage to invest.

Democratization of the market

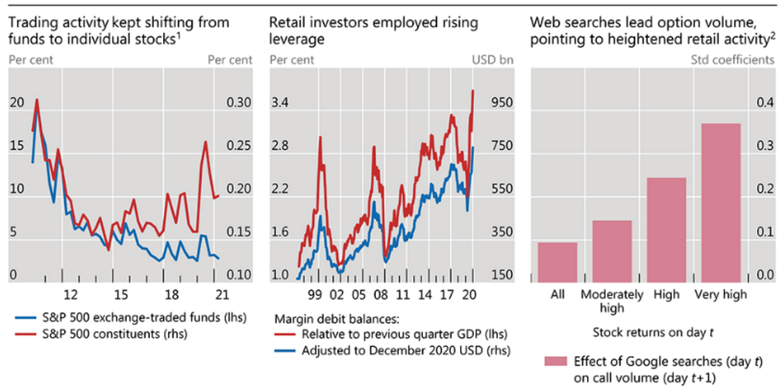
Despite the associated noble intentions, every financial bubble includes a democratization of the market: "everyone should get to play". The spread of individual investor chatboards, expanded trading platforms, meme stocks, and the like all suggest the current speculative fervor includes everyone.

A recent study by the Bank for International Settlements (BIS) highlighted the increase of individual investors' stock trading as well as those investors' increased use of leverage in their transactions. In addition, the study confirms the Goldman Sachs study regarding individual investors increasingly using options to gain additional leverage as shown in Chart 5 below.

Characteristic #3: CHECK. The market is democratized.

CHART 5:
Democratization of the market

The influence of retail investors continued to increase



[1] Average value of daily turnover within a given quarter divided by market value at the end of the previous quarter. Exchange-traded funds include S&P 500 trackers from (tickers in parentheses): iShares (IVV), State Street Global Advisors (SPY) and Vanguard (VOO). [2] Shows coefficients from regressions of call option volume for Amazon, Apple, Google, Facebook and Tesla on lagged values of Google Trends' "Interest over time". These values are obtained from searches of the expression "X options", where X is one of the five companies above. Returns are "moderately high/high/very high" if they are 0.5/1/1.5 standard deviations higher than the mean.

Sources: Bloomberg; FINRA; Google; Refinitiv Eikon; BIS calculations.

© Bank for International Settlements

Increased new issues

Every financial bubble includes a deluge of new issues. Investors' insatiable desire to hold assets translates to an extremely cheap cost of capital for issuers. Issuers have historically tried to take advantage of a period of an extraordinarily cheap cost of capital by issuing debt, equity or, as they are today, simply hoarding capital until something attractive comes along. Today's Special Purpose Acquisition Companies (SPACs) are a prime example of the last category.

SPACs are blind pools of capital searching for investments. SPAC managers are compensated so their personal returns are very good regardless of the success of the investments they make. Investors have no insight into future investments, must assume SPAC managers will act as fiduciaries, and are simply taking a flier on both the SPAC manager having skill and the resulting investments providing superior returns.

The highly speculative nature of SPACs hasn't deterred investors at all. Charts 6 and 7 below (courtesy of SpacInsider.com) show both the number of SPAC IPOs and the average size of SPAC IPOs have grown substantially.

Characteristic #4: CHECK. The most speculative of speculative IPOs has substantially increased.

CHART 6:
SPAC IPO Deal Count

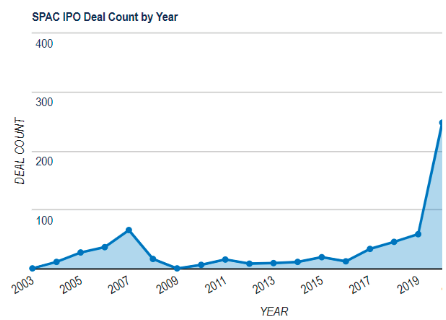
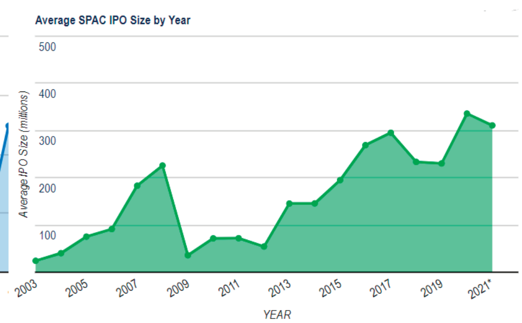


CHART 7:
Average SPAC IPO Size



* 2021 as of: Jun 25, 2021 10:54 AM ET

Source: SpacInsider.com

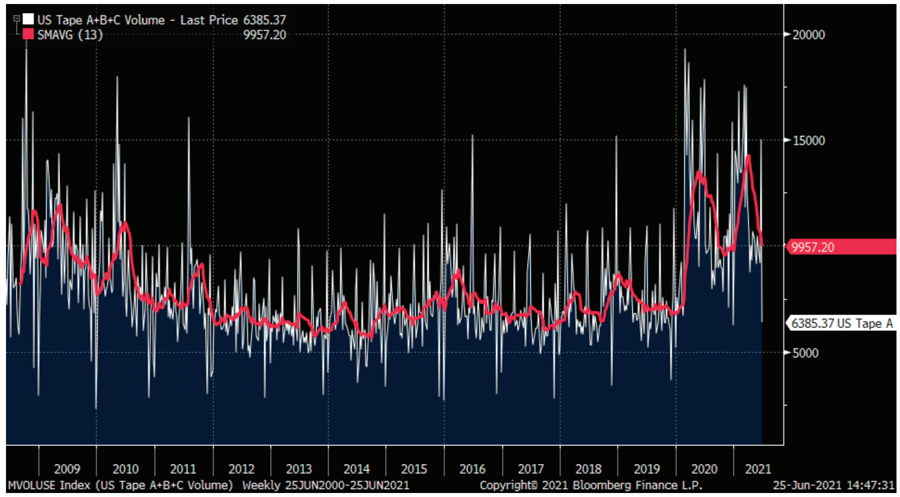
Increased turnover

Trading volume tends to increase significantly during financial bubbles. For example, day traders boosted trading volume during the Technology Bubble and flipping condos spurred turnover during the Housing Bubble. Today's speculative period is fitting that historical norm.

We showed earlier options volumes have indeed increased. Chart 8 below shows total US trading volume (the red line is the 13-week moving average). The latest data has calmed a bit, but the current figure is still 25% above the average for the entire time period

Characteristic #5: CHECK. Trading volumes are elevated relative to history.

CHART 8:
Total US Trading Volume
(Jun. 13, 2008 - Jun. 25, 2021)



Source: Bloomberg Finance L.P.

Is the entire market at risk?

These five characteristics seem to indicate there is a bubble within the equity market, but that does not imply the entire equity market is at risk. Over the last three years, only three of the eleven S&P 500® economic sectors have outperformed the market (See Chart 9), and those three sectors (Technology, Communication Services, and Consumer Discretionary) are at the center of the bubble. The remainder of the market has lagged, and the energy sector is actually down more than 15%. The Russell 2000 small cap index's performance would rank about 8th or 9th in the table, so the broader market has indeed been left behind.

CHART 9:
S&P 500® Sector Performance
(Jun. 30, 2018 - Jun. 25, 2021)

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

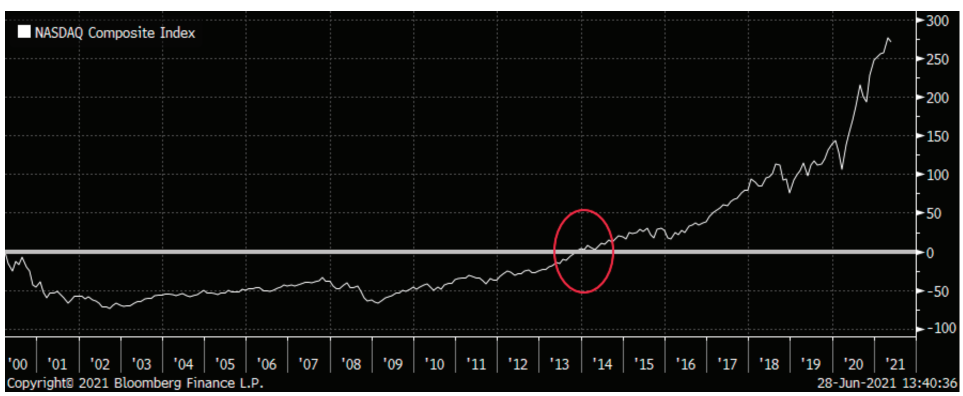
We continue to view the market as a seesaw with "the market" being the fulcrum of that seesaw. Being on the correct side of that seesaw over the next several years might be more important than having a view on "the market" and the resulting overall equity allocation.

Our portfolios remain focused on the conservative side of the seesaw: Energy, Materials, Financials, Industrials, and smaller capitalization cyclicals. In addition, our non-US weight within our equity portfolios is the highest in RBA's history because non-US markets have not participated in the bubble to the same degree and seem to present attractive opportunities.

The entire market doesn't necessarily seem at risk, but momentum strategies focused on the market's bubble leadership seem very risky to us. History shows well bubble assets often take a long time to recover. Chart 10 shows the performance of NASDAQ from the peak of the Technology Bubble in March 2000. Measured on a total return basis, investors in NASDAQ at the bubble peak did not break even for 14 years!

We strongly doubt investors today are thinking about breaking even in 14 years. The odds seem high this bubble, as have all others, will leave investors disappointed.

CHART 10:
Nasdaq Composite Index
(Mar. 31, 2000 - Jun. 28, 2021)



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

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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.**

S&P 500®: S&P 500® Index: The S&P 500® Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad US market. The index includes 500 leading companies covering approximately 80% of available market capitalization.

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.

Russell 2000: Russell 2000 Index. The Russell 2000 Index is an unmanaged, market-capitalization-weighted index designed to measure the performance of the small-cap segment of the US equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index.

Nasdaq: The Nasdaq Composite Index: The NASDAQ Composite Index is a broad-based market-capitalization-weighted index of stocks that includes all domestic and international based common type stocks listed on The NASDAQ Stock Market.

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 $14.3 billion collectively under management and advisement as of May 31st, 2021. 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 **www.RBAdvisors.com**.