



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.

CONTACT RBA

Website: RBAadvisors.com

Twitter: @rbadvisors

Phone: (212) 692-4088

Some things to watch other than viruses

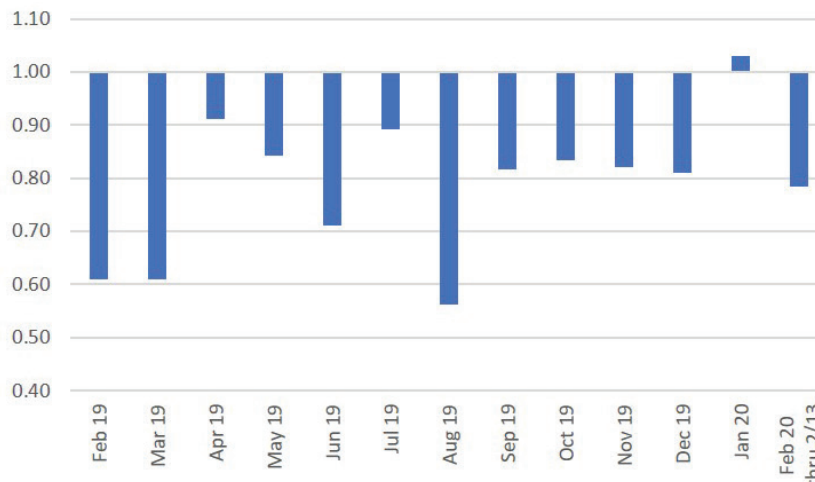
Investors have somewhat myopically focused on the coronavirus. The humanitarian effects of the virus, of course, are horrible, and everyone hopes a cure or vaccine can be found quickly. However, investors should not forget traditional fundamentals. Because of the attention being paid to the implications of the virus's spread, investors maybe overlooking some important fundamental developments.

Virus-related estimate revisions

Analysts have not yet significantly lowered company earnings estimates because of the coronavirus. Chart 1 shows monthly estimate revisions for Chinese stocks' 2020 earnings. Estimates are being revised down, but so far monthly downward revisions during 2019 were often worse than have been recent downward revisions.

It is uncertain whether this means analysts view coronavirus as a short-term event, and earnings shortfalls during 1H20 will be made up in 2H20, or whether they believe it will not have any meaningful effect at all. If it is the latter, then global equity markets could see considerable volatility when estimates are suddenly revised. We do expect 2H20 earnings to rebound smartly from virus-depressed results, but one should not rule out unexpected volatility along the route to 2H20.

CHART 1:
China: CY 2020 1-Month Estimate Revision Ratio
(Feb 28, 2019 – Feb 13, 2020)



Source: Richard Bernstein Advisors, LLC, FactSet.

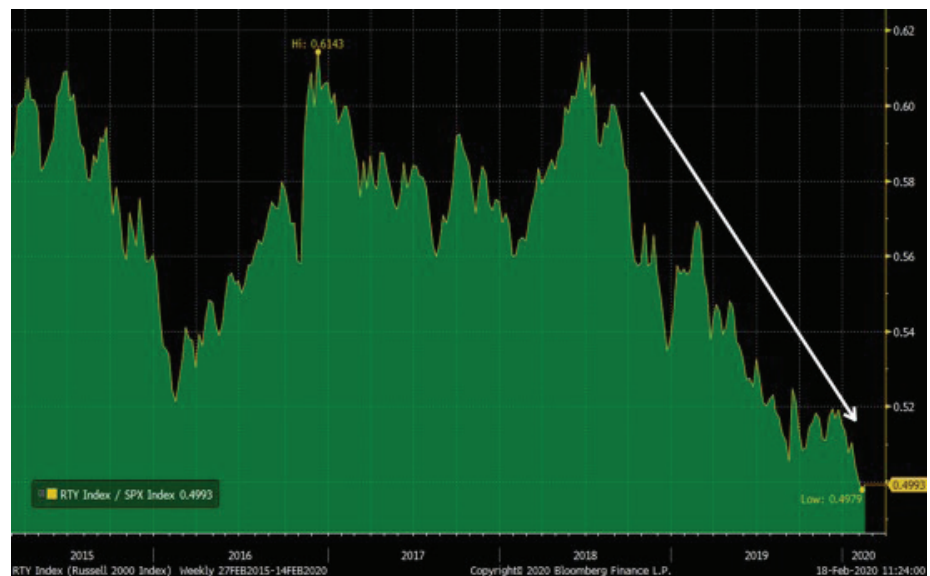
If the US economy is so strong, why are small caps underperforming?

Smaller capitalization stocks in any country are typically a play on their respective domestic economy. Although the S&P 500® gets approximately 50% of its sales from outside the US, smaller capitalization stocks derive most of their sales from within the US.

When the US economy is revving up, smaller capitalization stocks tend to outperform larger capitalization stocks because they are a purer play on the domestic economy. For example, the Russell 2000® outperformed the S&P 500® by more than 300 bp per year during the first five years of the current cycle (i.e., from March 31, 2009 to March 31, 2014) when the economy was recovering strongly.

The current consensus is the US economy is healthy, but the stock market apparently does not fully agree with that view. The Russell 2000® has been underperforming the S&P 500® since mid-2018 (see Chart 2). The stock market's narrow leadership reflects this as well. If the broad economy were doing as well as is widely thought, then why would performance be largely attributable to only a handful of stocks?

CHART 2:
Russell 2000® vs. S&P 500®
(Feb 27, 2015 – Feb 14, 2020)



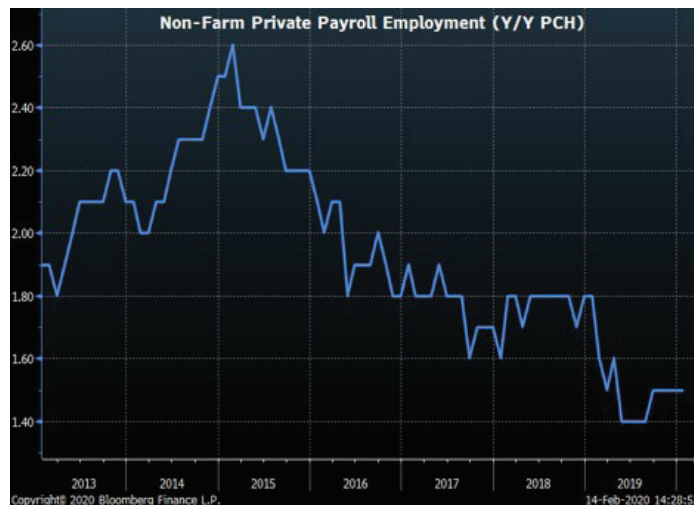
Source: Bloomberg Finance L.P.

Employment growth is following slowing profits growth

The labor markets remain tight and consensus is employment is strong. That is not totally correct. Chart 3 shows the year-to-year percent change in non-farm private sector payroll employment. Employment is growing at a paltry 1.5% (close to the lowest growth of the cycle) despite the perception that employment growth is “robust”.

This makes perfect sense when one considers 2019’s slowing profits growth. GAAP earnings growth for the S&P 500® exceeded 20% for 2018, but will be only about 3-5% for 2019 when fully reported. Profits growth is a substantial driver (although not the sole driver) of employment, and employment growth during 2019 indeed slowed as profits growth slowed.

CHART 3:
US Employment Growth
(Jan. 2013 – Dec. 2019)



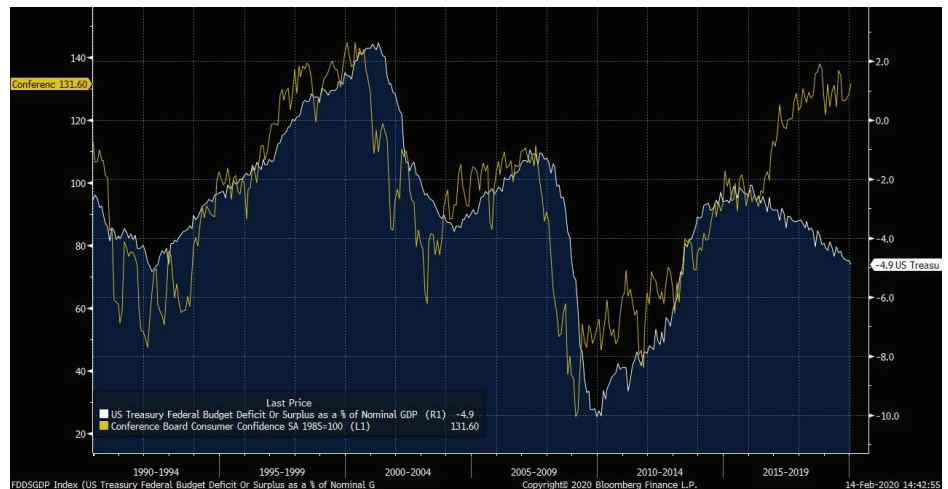
Source: Bloomberg Finance L.P.

Budget deficit growing faster than Joey Chestnut can eat hot dogs

To some extent, consumer confidence is a contrary signal. Consumer confidence is typically abnormally low during recessions and the early stages of economic recovery, but confidence tends to be very high during late cycles. Labor markets tend to tighten, unemployment tends to be lower, incomes tend to grow, and purchasing power is perceived to be strong during the latter stages of an economic expansion.

The current late-cycle environment seems to fit the historical norm in that consumer confidence is quite high. Only consumer confidence during the late-1990s was higher than today’s, but there is a major difference between today’s environment and that earlier period of confidence.

CHART 4:
Consumer Confidence vs. The Budget Deficit as a % of Nominal GDP
(Jan. 1990 – Jan. 2020)



Source: Bloomberg Finance L.P.

Chart 4 highlights the growing gap between consumer confidence and the budget deficit as a percent of GDP. Consumer confidence during the late-1990s was fueled by a strong economy which gave rise to a budget surplus. This cycle's strong consumer confidence is based on a rapidly growing budget deficit. (A larger budget deficit is represented by a larger negative number on the right scale of the chart.)

Historically, the federal deficit contracts as the economy strengthens, but this cycle is so far an anomaly. Consumer confidence in most late-cycles is driven by the private sector, but the current late-cycle confidence has been spurred by government stimulus.

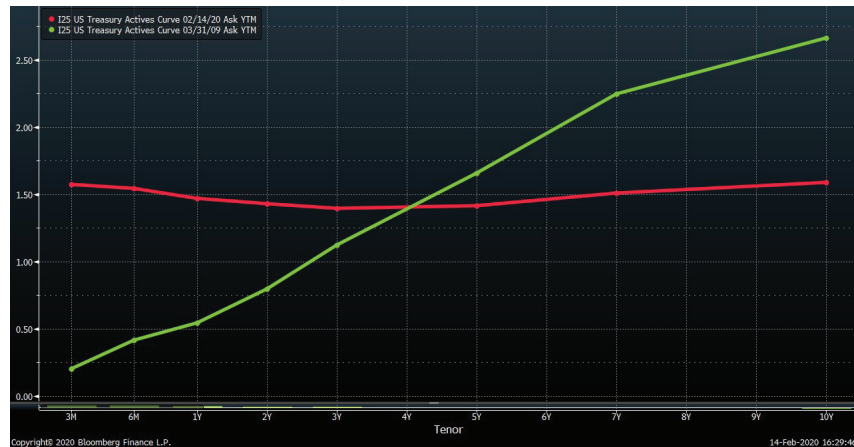
The yield curve doesn't lie

Very late cycles are characterized by flat or inverted yield curves that investors ignore because they believe there is a "technical" reason why the curve has inverted which negates the curve's normal warning signals. That rationalization appears to be happening again.

Chart 5 compares the yield curve at the beginning of the bull market (March 2009) with the recent curve. The yield curve was very steep in 2009 and correctly signaled both that the economy would recover and a bull market would result. Investors generally ignored that signal and sat out much of the bull market preferring cash and fixed-income to equities.

The yield curve today is extraordinarily flat, but investors are bullish and once blaming the flat curve on technical reasons (negative rates outside the US, the Fed's quantitative easing program, etc.). Investors always need to remember that the reason why the yield curve inverts is irrelevant when compared to the fact that the curve is inverted.

CHART 5:
Yield Curves
(March 2009 – Feb. 2020)



Source: Bloomberg Finance L.P.

The flat curve does not imply that a bear market and a recession are imminent. There have historically been considerable lag times between when the curve inverts and the subsequent bear market and recession. However, history strongly suggests it is imprudent to get more bullish when the yield curve is flat or inverted. Rather, the curve has been a reliable signal to gradually calm down.

More going on than one realizes

The coronavirus has the sad potential to be a human tragedy, but investors should not myopically focus solely on the potential pandemic. There are many fundamental issues that investors seem to be ignoring. We believe those fundamentals ultimately drive market performance.

Late-cycles, like the current one, are like a Siren's song to investors. The story sounds sweet, but the potential for smooth sailing is slimmer than investors believe. At RBA, we certainly hope the virus is a passing consideration, but whether it is or not we will continue to squarely focus on fundamentals.

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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.

Indexes are not available for direct investment.

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

S&P 500®: 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.

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.

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 \$9.2 billion collectively under management and advisement as of January 31st, 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 www.RBAdvisors.com.

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