Richard Bernstein Advisors

The Leaders In Pactive® Management

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Richard Bernstein, Chief Executive and Chief Investment Officer

Gee, this time isn't different

The underlying investment story since the stock market's trough in March 2009 has been investors no longer believe in the business cycle. Each cycle has unique characteristics and catalysts, but history shows well that business cycles still exist and tend to follow a very common pattern.

The current business cycle, contrary to popular belief, has both existed and followed the typical course. The current cycle, however, has been elongated. The economy developed more slowly than investors expected, but the cycle nonetheless had early- and mid-cycle periods. Whereas economists have largely been disappointed by this cycle's anemic growth, investors have benefitted greatly from its muted, but abnormally long path.

We commented many months ago that the US economy was entering the late-cycle phase. Investors again ignored the business cycle and the signs indicative of a late-cycle period. In particular, investors disregarded the inflation pressures that were building. Inflation expectations have been rising since mid-2016 (see Chart 1), yet flows into bond funds and ETFs went unchecked.

The recent market volatility seems to be a result of investors finally realizing that the business cycle isn't dead. Later-cycle inflation is becoming more obvious, and the market has needed to recalibrate valuations, earnings expectations, and asset allocations to the suddenly "new" inflationary environment.

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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CHART 1:
Inflation Expectations : 5 Yr 5Yr Forward Breakeven
(Weekly, Feb. 13, 2013 – Feb. 7, 2018)

Source: Bloomberg Finance L.P.

The elongated cycle

In 2010, RBA suggested that the bull market might be one of the longest in modern history, and positioned our portfolios accordingly. We thought the cycle would rejuvenate, but it would be elongated because of the constraining effects of the deflating global credit bubble. Early-cycle sectors tend to be very credit-sensitive (housing, autos, and retailing), but credit conditions remained tighter than normal even as the economy recovered. The combination of unusually tight credit standards, fiscal policies that were contractionary, and increasing financial regulation and oversight limited early-cycle growth. The positive though was that the economic boom often sought by politicians was replaced by slow consistent growth that proved to be investors' nirvana.

Normal cyclical events have occurred, but they have occurred more slowly and gradually than in a typical cycle. The yield curve is a good example. Chart 2 compares the slope of the yield curve during this cycle to those of past cycles. Note how long it has taken during this cycle for the yield curve to invert (it still hasn't!). History will remember this cycle as an elongated one.

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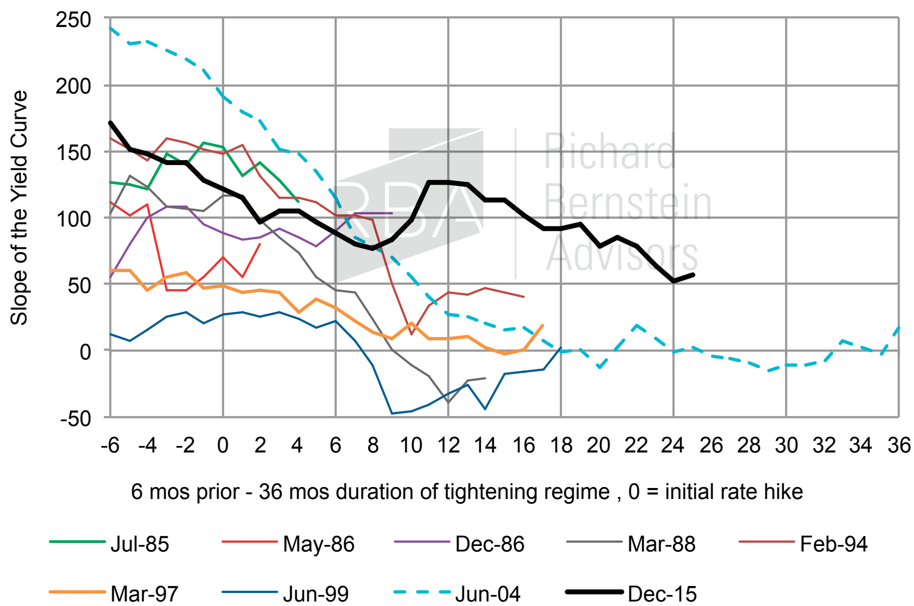
CHART 2:
Fed Tightening Regimes & The Slope of the Yield Curve (10/2s) from 1985 on



Source: Richard Bernstein Advisors LLC., FRB

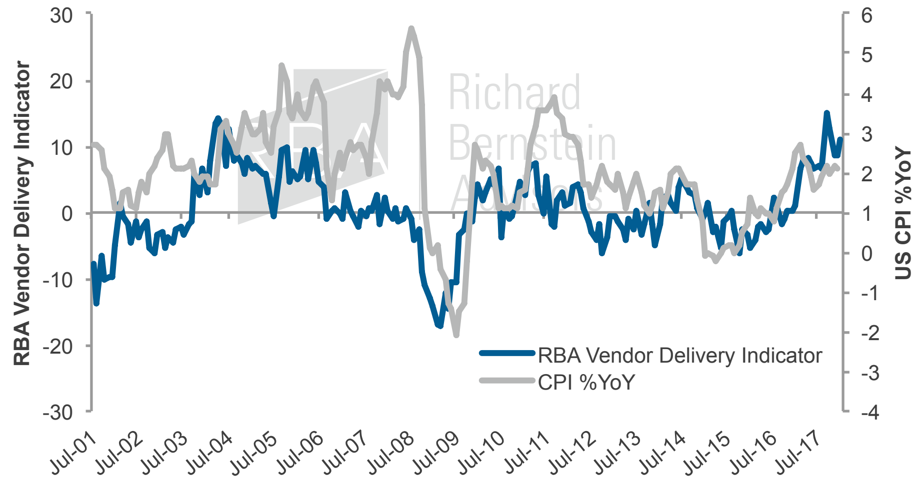
Late-cycle bottlenecks

The late-cycle is often characterized by economic growth that outstrips the growth in capital spending and causes production bottlenecks, and that certainly describes the current environment. Vendor delivery time is a simple indicator of potentially increasing inflation, and measures how long it takes for suppliers to fulfill orders. Longer fulfillment times indicate that demand is greater than available supply, and that prices could increase.

Chart 3 is RBA's indicator of vendor delivery time, which incorporates common delivery statistics. Vendor delivery times have been increasing and normal cyclical bottlenecks are forming. That implies further upward pressure on the CPI.

It's important to reiterate that bottlenecks are normal in a later-cycle environment. Unfortunately, investors played ostrich with respect to inflation and ignored the standard indicators' warnings that portfolios positioned for deflation/disinflation might underperform. The increase in market volatility suggests that investors finally caught on.

CHART 3:
US CPI %YoY vs. RBA Vendor Delivery Indicator
(Jul. 2001 – Jan. 2018)



Source: Richard Bernstein Advisors, LLC., FRB, Bloomberg Finance L.P.

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Our portfolios remain flexible

RBA's "go anywhere" macro strategy affords us great flexibility to adapt our portfolios to many different environments. When inflation expectations began to trough in 2016, we significantly repositioned our portfolios to take advantage of nominal economic growth and profits growth that might be stronger than investors expected. To date, we continue to have inflation as a major theme within our portfolios.

Cyclical sectors make up the bulk of our equity positioning: Technology, Financials, Materials, and Emerging Markets. We remain very short duration within our fixed-income portfolios to help protect against rising long-term interest rates. Currently, our bond holdings have a duration of only about 20-25% of benchmark duration. In addition, we still hold gold and/or gold miners.

Volatility is always unsettling. However, we think our disciplined approach that relies on fundamentals and not events (like volatility spikes) will continue to benefit our investors.

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.](www.rbadvisors.com/images/pdfs/Portfolio_Specialist_Map.pdf)

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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.

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 $7.1 billion collectively under management and advisement as of January 31st, 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® 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**.