



**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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## The Black Widow Returns

In 1989 I wrote a report titled “Dividends: The Black Widow of Valuation”. The report demonstrated that investing for high income can sometimes be extremely risky despite the irresistibility of higher dividend yield. Certainly, income-oriented equity portfolios tend to have lower long-term betas than do portfolios focused on capital appreciation. However, strategies based on stretching for yield have a long history of surprising investors with unanticipated risks.

Investors today seem to be as myopic toward the risks of income investing as they were in 1989. MLPs, REITs, emerging market debt, and other income categories all seem to have risks that investors today are largely ignoring. One must remember that excess returns in the financial markets are always accompanied by excess risk. Yields that are abnormally high typically carry abnormally high risks as well, and a proper assessment of those risks should never be taken for granted.

The deflation of the global credit bubble remains our primary investment focus. The problems related to oil, Greece, Puerto Rico, China, Brazil, gold, and other credit-related investments should not be a surprise given the secular deflation of the global credit bubble. Yet, investors’ unwillingness to accept the end of the 1998-2008 credit paradigm has caused considerable financial market volatility.

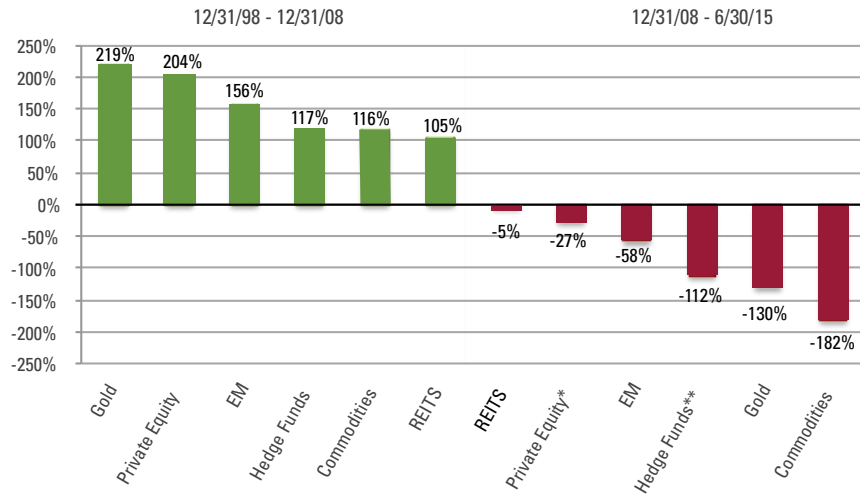
### Credit-related assets continue to underperform

Credit-related asset classes continue to underperform. This seems perfectly normal as the global credit bubble deflates and as credit conditions return to something more normal than that seen from 1998 to 2008. Chart 1 compares the relative performance versus the S&P 500® of credit related asset classes from 1998 to 2008 with their relative performance from 2008 to present. Credit-related asset classes outperformed old-fashioned stocks handily as the credit bubble was inflating. However, they have underperformed stocks as the credit bubble has deflated.

This makes perfect sense to us and, as mentioned, this is the central tenet of our portfolios. However, it does not appear as though most investors share our concern. In fact, some credit-related asset classes are still considered “safe” or “opportunistic” by many investors.

**Credit-related asset classes outperformed old-fashioned stocks handily as the credit bubble was inflating. However, they have underperformed stocks as the credit bubble has deflated.**

**CHART 1:  
Credit-Related Asset Class Performance  
Relative to the S&P 500**



\*Private Equity Performance available through 12/31/14  
 \*\*Hedge Fund Performance available through 5/31/15  
 Source: Richard Bernstein Advisors LLC, MSCI, Standard & Poor's

**Credit DEFLATION, not inflation**

Monetary theory states that credit, not printing money, is the life blood of inflation. Chuck Clough, the former Chief Investment Strategist at Merrill Lynch and one of my mentors, once said that it is impossible to get abnormal inflation without it being preceded by abnormal credit creation. Accordingly, the credit bubble produced the highest rate of inflation in the US in nearly 20 years (the US CPI hit 5.6% in July 2008 versus 6.3% in October 1990).

On the following page, Chart 2 demonstrates how difficult it is to get inflation during the deflation of a global credit bubble. The chart portrays the overall OECD inflation rate. The recent readings are the second lowest since 1971.

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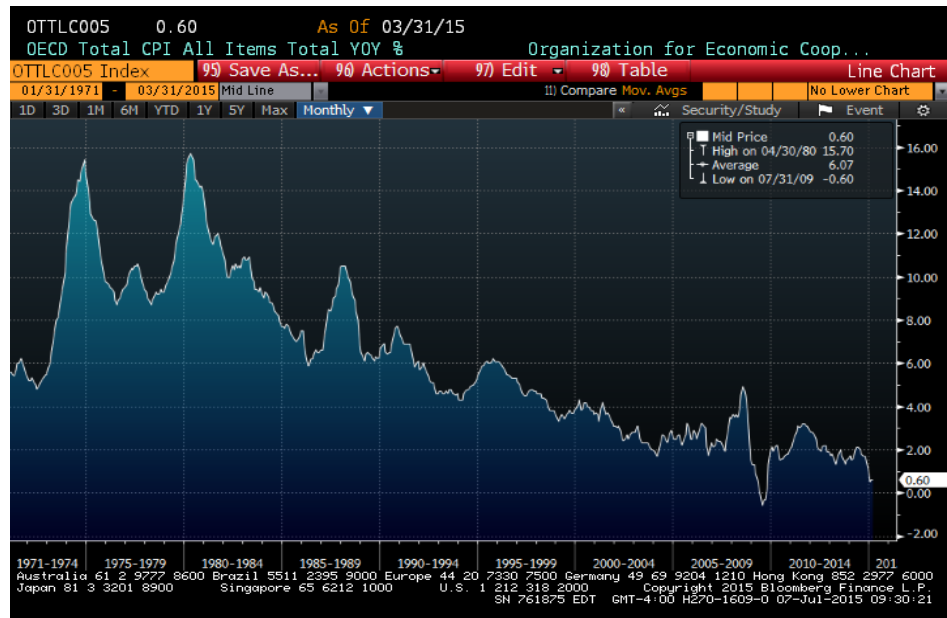
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It should be no surprise that debt-related problems are cropping up around the world given this deflationary backdrop. Inflation can “cure” debt problems in that borrowing entities can pay back loans with cheaper currencies and inventory profits. However, deflation typically exacerbates debt problems. So, why are investors surprised by Greece or Puerto Rico?

CHART 2:

Global CPI: Second lowest reading since 1971

This demonstrates how difficult it is to get inflation during the deflation of a global credit bubble.



Source: Bloomberg LP.

### Anything for yield

Investors have been surprised by debt problems around the world because they have continually ignored the ramifications of the deflating global credit bubble. Investors seem to have been lulled into a false sense of security by higher yields and/or promises of capital appreciation from distressed prices. High yield is generally attractive when nominal growth is accelerating (nominal growth equals the sum of real growth and inflation). In the absence of both accelerating real growth and inflation, marginal credits tend to have higher default probabilities.

Among equities, MLPs seem to fit this description. We pointed out in earlier reports\* that investors' belief that MLPs are defensive income investments does not seem to match the industry's fundamentals. The industry is highly correlated to oil prices (commodities are a credit-related asset class), industry cash flows are tied to contracts which seem suspect as counterparty risk increases, and the overall industry is cash flow negative. Chart 3 points out that MLPs (represented by the S&P MLP Index) are in a bear market, but most MLP investors don't yet seem concerned.

**MLPs (represented by the S&P MLP Index) are in a bear market, but most MLP investors don't yet seem concerned.**

**CHART 3:  
MLPs are now in a bear market**



Source: Bloomberg LP.

\*Earlier reports

**Are MLP Returns Correlated To Oil Prices?**

**2015 Year Ahead Continuing to Deflate the Global Credit Bubble**

**Commodity Caution**

The recent performance of high dividend yielding stocks around the world already qualifies as a correction, and a full-blown bear market should probably not be ruled out. Chart 4 shows the performance of the MSCI World High Dividend Yield Index. The index's history shows that higher yielding stocks tend to be much more cyclical than most investors might expect. In the last twenty years, the index has declined 29% and 64% during bear markets. The index is down a bit more than 10% over the past year or so.

Few have questioned higher yielding stocks' ability to maintain dividends during a period of global debt deflation. One would think that investors might question nominal cash flow growth during this period, but so far that doesn't seem to be happening. Higher yield equity strategies remain immensely popular despite the risks associated with such strategies.

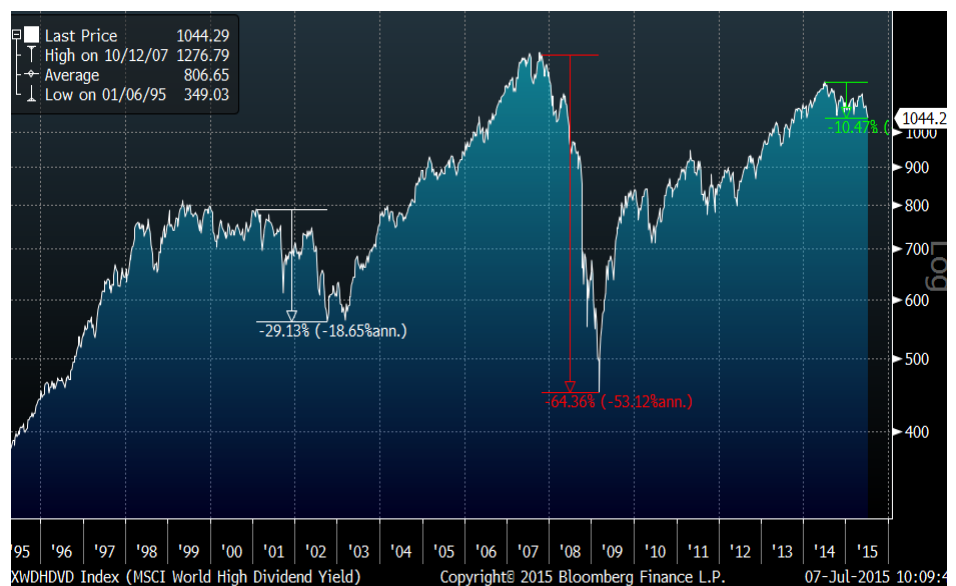
### It's sustainability, not yield, that's important

We think blindly investing for yield carries considerable risks in the present deflationary environment, and we prefer to focus on the sustainability of dividends rather than the absolute yield. Yields can sometimes be abnormally high because the market price is anticipating a future dividend cut. We try to avoid such situations by looking at fundamentals that suggest a high probability of continued payment. We don't want to get bitten by the alluring Black Widow.

The index's history shows that higher yielding stocks tend to be much more cyclical than most investors might expect. In the last twenty years, the index has declined 29% and 64% during bear markets.

CHART 4:

Global High Dividend Yield equities are now in a bear market



Source: Bloomberg LP.

## 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.

### **US Dollar: InterContinentalExchange (ICE) US Dollar Index (DXY)**

The ICE US Dollar Index, indicating the general international value of the USD, averages the exchange rates between the USD and six major world currencies, using rates supplied by some 500 banks.

### **Gold: Gold Spot USD/oz Bloomberg GOLDS Commodity.**

The Gold Spot price is quoted as US Dollars per Troy Ounce.

**Commodities: S&P GSCI® Index.** The S&P GSCI® seeks to provide investors with a reliable and publicly available benchmark for investment performance in the commodity markets, and is designed to be a "tradable" index. The index is calculated primarily on a world production-weighted basis and is comprised of the principal physical commodities that are the subject of active, liquid futures markets.

**REITS: THE FTSE NAREIT Composite Index.** The FTSE NAREIT Composite Index is a free-float-adjusted, market-capitalization-weighted index that includes all tax qualified REITs listed in the NYSE, AMEX, and NASDAQ National Market.

**Hedge Fund Index: HFRI Fund Weighted Composite Index.** The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2,000 single-manager funds that report to the HFR (Hedge Fund Research) database. Constituent funds report monthly net-of-all-fees performance in USD and have a minimum of \$50 million under management or a twelve (12)-month track record of active performance. The Index includes both domestic (US) and offshore funds, and does not include any funds of funds.

### **Private Equity: The Cambridge Associates LLC U.S.**

**Private Equity Index®.** The Cambridge Associates LLC U.S. Private Equity Index® is an end-to-end calculation based on data compiled from 986 U.S. private equity funds (buyout, growth equity, private equity energy and mezzanine funds), including fully liquidated partnerships, formed between 1986 and 2012. Pooled end-to-end return, net of fees, expenses, and carried interest. Historic quarterly returns are updated in each year-end report to adjust for changes in the index sample.

**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.

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**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.

**MLPs: The S&P MLP Index:** The S&P MLP Index provides investors with exposure to the leading partnerships that trade on the NYSE and NASDAQ and includes both Master Limited Partnerships (MLPs) and publicly traded LLC's, which have similar legal structure to MLPs and share the same tax benefits.

**Global High Dividend Yield: The MSCI World High Dividend Yield Index:** The MSCI World High Dividend Yield Index is a free float market capitalization weighted index that includes only securities that offer a meaningfully higher than average dividend yield relative to the MSCI World Index and that pass dividend sustainability screens.

**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 \$3.4 billion collectively under management and advisement as of June 30, 2015. RBA acts as sub advisor for the Eaton Vance Richard Bernstein Equity Strategy Fund, the Eaton Vance Richard Bernstein All Asset Strategy Fund and the Eaton Vance Richard Bernstein Market Opportunities 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 and on select RIA platforms. RBA's investment insights as well as further information about the firm and products can be found at [www.RBAadvisors.com](http://www.RBAadvisors.com).

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