Richard Bernstein Advisors

The Leaders In Pactive® Management

Insights

May 2023

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.

The seesaw becomes extreme

We've described the past several years' stock market as a seesaw in which the "market" was the fulcrum of the seesaw. On one side of the seesaw sit the highly speculative growth sectors of the market (Technology, Communications, and Consumer Discretionary) coupled with innovation, disruption, and meme stocks. On the other side of the seesaw, sit virtually everything else in the global equity markets.

The seesaw tilted significantly toward the speculative side during 2020 and 2021, but then significantly tilted in the other direction during 2022. The S&P 500® Growth Index outperformed the Value Index by an annualized 20 percentage points from 12/31/19 to 12/31/21. But then the Value Index outperformed the Growth Index by 24 percentage points from 12/31/21 to 12/31/22. (See Chart 1)

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CHART 1:
Growth vs. Value
(Dec. 31, 2019 – May 19, 2023)

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

Leadership becomes extremely narrow

The seesaw is now tilting back toward the speculative side in a tremendous way. The stock market's leadership has become extremely narrow, meaning only a small number of stocks are outperforming and contributing to the market's year-to-date advance.

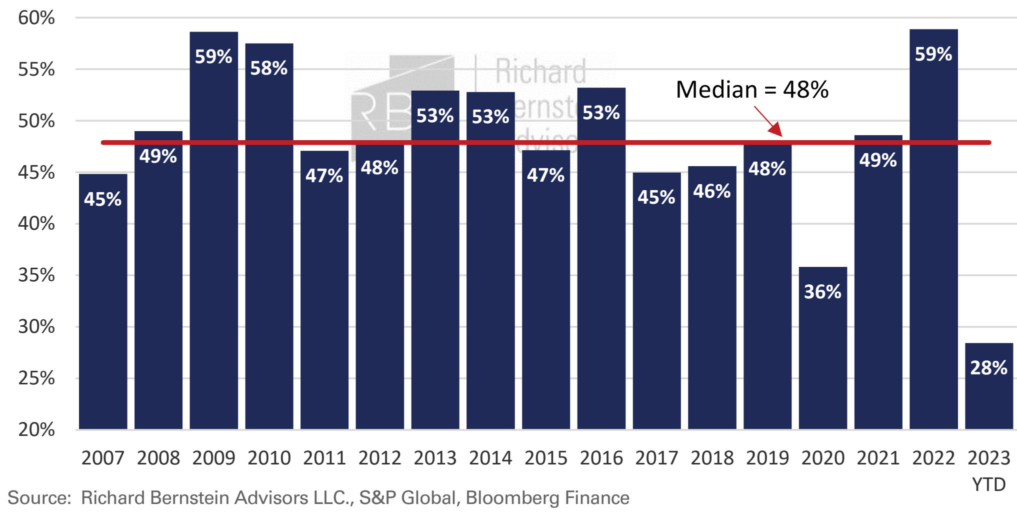
A simple method of measuring market breadth is the percent of the S&P 500® companies that outperform the index. Historically, improving economic conditions broaden the market as more companies benefit from the improving economy. As cycles mature, however, markets tend to become more "Darwinistic," (i.e., survival of the fittest) because fewer companies can maintain their growth as the economy weakens.

Chart 2 shows the percent of S&P 500® companies that outperformed the index each year. 2023 has been the narrowest equity market since the financial crisis. Only 28% of the S&P 500® companies have outperformed the index so far during 2023. This is clearly extreme and probably unwarranted because the market today is even narrower than during the pandemic in 2020 despite that today's economy is obviously much healthier than that during the pandemic.

CHART 2:

Percent of Stocks Outperforming the S&P 500®

Annual 2007-2023 YTD thru May 18, 2023 (Total Returns)



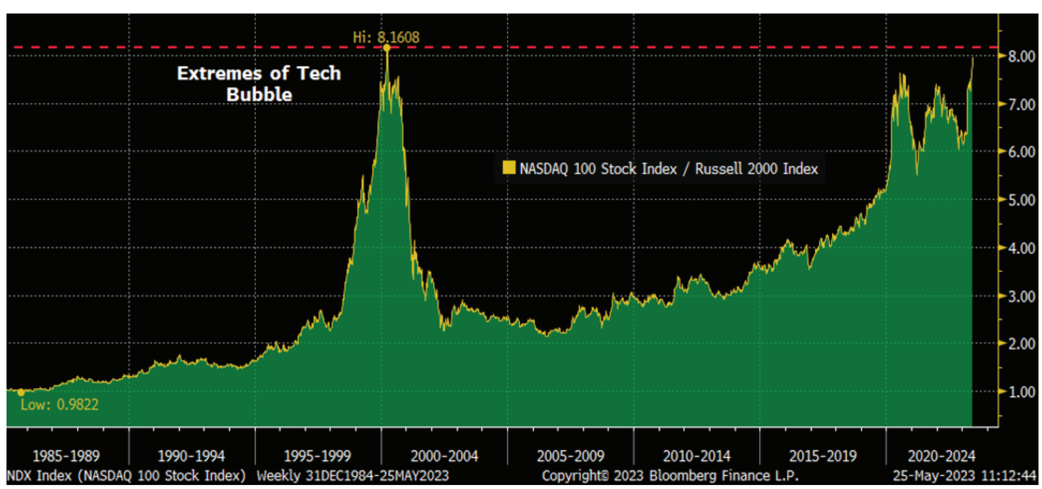
Source: Richard Bernstein Advisors LLC., S&P Global, Bloomberg Finance

The relative performance between the most speculative larger capitalization growth stocks and the broader market has also reached an extreme. In fact, the current performance difference between the Nasdaq-100® and the Russell 2000 indices is currently mimicking that seen during the most extreme points of the Technology Bubble in 1999.

CHART 3:

Nasdaq 100® vs. Russell 2000

(Jan. 31, 1985 – May 25, 2023)



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

Aren't there any other growth stories?

Historical evidence suggests that the present remarkably narrow leadership is not without precedent. Previous periods have witnessed instances where investors underestimated the abundance of growth stories available in the market.

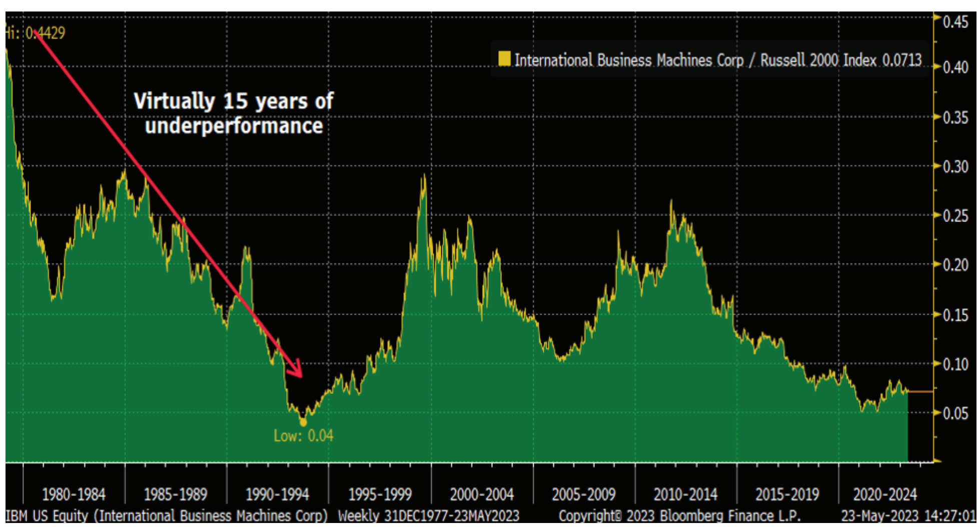
Some market observers have noted that Microsoft (MSFT) and Apple (AAPL) are now nearly 15% of the S&P 500®'s market capitalization, which is the largest proportion any two stocks have comprised of the S&P 500® since IBM and AT&T in 1978. (Note: RBA may own all four stocks in various portfolios.)

Investors unrealistically believed there were essentially only two growth stories in 1978. Of course, that was incorrect, and the stocks' performance did not recover from those unrealistic expectations.

Chart 4 shows the relative price between IBM and the Russell 2000. After the 1978 peak, IBM effectively underperformed the Russell 2000 for most of the next 15 years. A similar analysis for AT&T is impossible because of the early-1980s divestiture of the Bell Operating Companies, but few investors today consider either stock to be a market bellwether.

We strongly doubt investors today could imagine Apple and Microsoft underperforming the broader market for the next 15 years, but 1978's investors probably felt the same way about IBM and AT&T.

CHART 4:
IBM vs. Russell 2000
(Dec. 31, 1978 – May 23, 2023)



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

We aren't the bears in the room. Are you?

We find it amusing that people say our views are so bearish when we actually believe the current menu of investment opportunities is very large. We do not particularly like the sectors and speculative assets that have become so popular, but they all reside on one side of the seesaw and that seat is up high in the air right now.

The implied economic forecast of investing in that side of the seesaw seems immensely bearish. The implication is the global economy will be so weak that only a handful of companies will be able to grow. That is a very bearish, almost dire, forecast of corporate survival.

On the other hand, the other seat on the seesaw contains all the other investment opportunities in the US and around the world. This is the side of the seesaw that dominates our portfolios.

Our view of the world seems very optimistic relative to the implied forecast that only a handful of companies can grow. We strongly doubt a global depression that might justify a Nifty 2 is imminent and believe the dire forecast implied by the market's performance extremes will be proven wrong.

Investment opportunities seem plentiful relative to recent market action and investors' momentum-dominated portfolios.

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 economy through changes in the aggregate market value of 500 stocks representing all major industries.

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®-100: The NASDAQ-100 Index is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No security can have more than a 24% weighting. The index was developed with a base value of 125 as of February 1, 1985. Prior to December 21,1998 the Nasdaq 100 was a cap-weighted index.

S&P 500® Value: The S&P 500® Value Index is a free-float-adjusted, market-capitalization-weighted index. All the stocks in the underlying parent index are allocated into value or growth. Stocks that do not have pure value or pure growth characteristics have their market caps distributed between the value & growth indices.

S&P 500® Growth: The S&P 500® Growth Index is a free-float-adjusted, market-capitalization-weighted index. All the stocks in the underlying parent index are allocated into value or growth. Stocks that do not have pure value or pure growth characteristics have their market caps distributed between the value & growth indices.

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 $15.7 billion collectively under management and advisement as of March 31, 2023. 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**.