Richard Bernstein Advisors

Pactive® Approach to Investing

Insights | January 2025

Narrow markets are the exception, not the rule

- 2023/24 was the narrowest market since 1998/99. The Nifty 50 period of the 1970s was the narrowest period before that.
- Narrow markets are unusual and not the historical norm because of capitalism and competition.
- Diversification is key to navigating post-bubble periods because bubbles deflate quickly and rarely reinflate.
- Investors seem unduly confident despite unusually narrow markets and as market risks seem to be increasing.

2023/24 was the narrowest stock market since 1998/99's technology bubble, which in turn was the narrowest market since the Nifty 50 period of the early 1970s. With only three such periods in the past 50 years, narrow markets are the exception and not the rule.

Chart 1 shows how unusual 2023/24's market has been. Just 30% of the constituents of the S&P 500® outperformed the index in 2023 and slightly less in 2024. That is similar to the 1998/99 period, and both are well below the long-term median of 48%.

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 that are innovative, risk-controlled, and focused on overall portfolio construction instead of individual stock selection.

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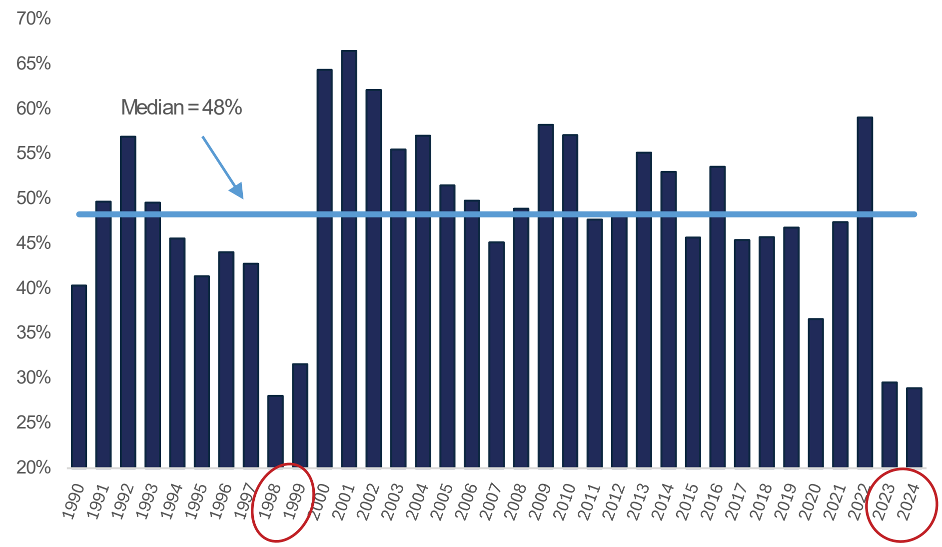
CHART 1:

S&P 500®: Percentage of Stocks that Outperformed the Index

1990-2024 (Price Returns)



Source: Richard Bernstein Advisors LLC, BofAML US Strategy

Some market observers have suggested the US equity market could be starting a new paradigm of narrow leadership during which only the biggest and most highly capitalized companies will outperform. Such prolonged narrow leadership would be counter to history and even suggests a break down in capitalism.

Competition and innovation are two critical parts to a successful capitalistic economy. Competition drives new product innovation and the improvement of existing products. In addition, thriving capitalism and the resulting competition can help constrain inflation by competition forcing lower prices to combat the risk of losing market share.

Extremely narrow leadership implies a scarcity of growth opportunities, i.e., there are very few companies that can grow. An extended period of narrow leadership, therefore, implies a terrible secular period during which the economy experiences an extended contraction/recession and the resulting scarcity of earnings growth forces companies to lay off workers and decrease capital spending.

Goldman Sachs commented last November[1] that the stock market's performance was the narrowest since the Great Depression. Narrow leadership makes economic sense during an economic depression because companies are trying to survive, let alone grow at a significant rate.

Unlike during the Great Depression, fundamentals haven't justified today's extraordinarily narrow leadership. 2023/24's economy was healthy and late 2022/early 2023's profits recession was quite mild compared to that during a depression.

[1] Goldman Sachs, "Top of Mind - Market Concentration: How Big a Worry?", November 25, 2024.

When narrow markets broaden, they do so suddenly and for years

If the recent market narrowness assumes that competition and innovation no longer matter, it may only be a matter of time before they broaden. When markets broaden from unusually narrow periods, however, they do so suddenly and for years.

The Goldman analysis also highlights that market volatility tends to significantly increase during the year after extremely narrow markets. Diversification typically constrains portfolio volatility, but narrow markets skew indices' constituent weightings toward fewer companies effectively making an index less diversified. Increased concentration towards a small number of cyclical companies makes the overall market more susceptible to company-specific risks.

Because narrow markets are the exception and not the rule, history shows that markets broaden for years after periods of extremely narrow market leadership. Investors, however, tend to wait for the abnormally narrow leadership to reassert itself rather than repositioning portfolios for a more normal market.

This was certainly the case after 1998/1999's narrow markets. Chart 2 shows S&P 500® sector performance during the final year of the Technology Bubble (3/31/99 – 3/31/00). Only 1 sector, Technology, outperformed the market during this period.

CHART 2:

The Final Year of the Tech Bubble

S&P 500® Sector Performance: Mar. 31,1999 – Mar. 31, 2000

Source: Bloomberg Finance L.P

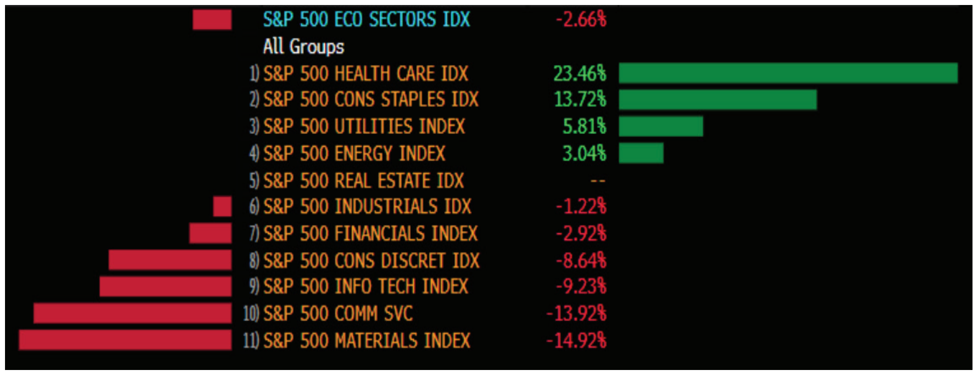
The following charts show the same sector performance for the 3 months, 6 months, 12 months, and 5 years after the bubble's burst. The Technology sector quickly started to underperform and didn't recover even after 5 years.

Diversification was critical to surviving the post-bubble period. Although the narrow leadership dragged down the overall market performance, many sectors posted significant positive returns.

CHART 3:

3 Months after the Tech Bubble Burst

S&P 500® Sector Performance: Mar. 31, 2000 – Jun. 30, 2000



Source: Bloomberg Finance L.P

CHART 4:

6 Months after the Tech Bubble Burst

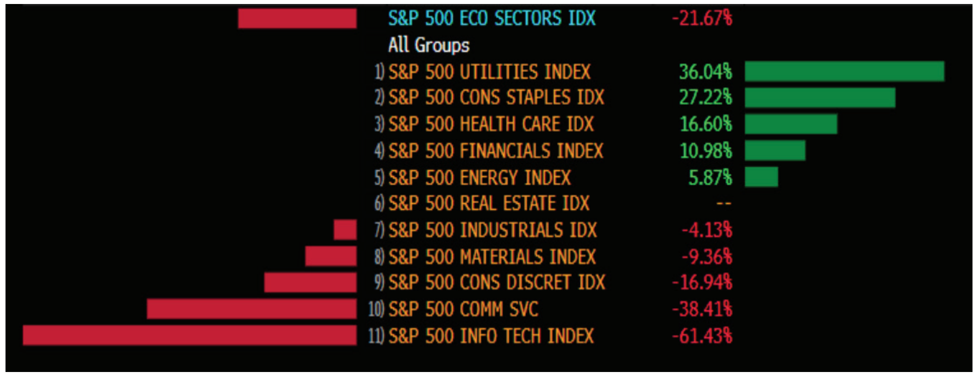
S&P 500® Sector Performance: Mar. 31, 2000 – Sep. 30, 2000

Source: Bloomberg Finance L.P

CHART 5:

1 Year after the Tech Bubble Burst

S&P 500® Sector Performance: Mar. 31, 2000 – Mar. 31, 2001



Source: Bloomberg Finance L.P

CHART 6:

5 Years after the Tech Bubble Burst

S&P 500® Sector Performance: Mar. 31, 2000 – Mar. 31, 2005

Source: Bloomberg Finance L.P

Investors are shunning diversification and seem unduly confident

Investors seem unduly confident despite the increased potential for volatility after narrow markets. Diversification today is considered a hinderance to performance by many investors rather than a risk reduction tool or one that might shift portfolios toward under-appreciated investments.

Chart 7 highlights the question in the Conference Board's Consumer Confidence Survey that asks whether respondents

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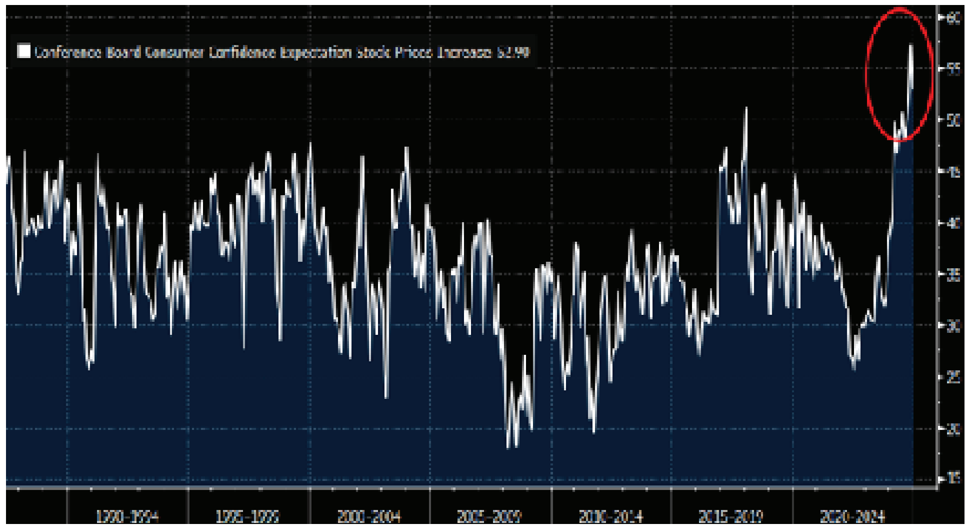
think the stock market will be higher in 12 months. The past two months' readings show a level of confidence in the stock market never seen in the survey's history.

CHART 7:

Conference Board Consumer Confidence Survey: Expectation Stock Prices Increase

(Jun. 30, 1987 – Dec. 31, 2024)



Source: Bloomberg Finance L.P

Investors' willingness to take risk is even more startling. Chart 8 shows individual investors' aggregate portfolio equity beta. Admittedly, we have re-published this chart from BofA Securities for many months. We thought it was extraordinary when their equity beta rose to 1.2, but it has continued to increase as the market continued to narrow. It is now an absolutely mind-boggling 1.7!

The juxtaposition of investors' historic confidence relative to the performance history when markets broaden from extremes suggests that investors might be ill-prepared for volatility.

CHART 8:
Top 10 GWIM Stocks, 1-YR Beta to SPX

Source: BofA Global Research. Reprinted by permission. Copyright © 2025 Bank of America Corporation ("BAC"). The use of the above in no way implies that BAC or any of its affiliates endorses the views or interpretation or the use of such information or acts as any endorsement of the use of such information. The information is provided "as is" and none of BAC or any of its affiliates warrants the accuracy or completeness of the information.

If volatility confronts overconfidence, then diversification might save portfolios

It appears that 2025 could be the year when investors' extreme confidence and willingness to take significant portfolio risk comes face-to-face with the volatility associated with the broadening of a speculative market.

Diversification is one of the basic tenets of investing, but investors' greed during speculative periods leads them to shun diversification because it looks stodgy, boring, and a lead weight on the potential for high returns. Themes regarding "The Magnificent 7", "US exceptionalism", and others reflect the current shunning of diversification.

At RBA, we have always thought it prudent to provide diversification to our investors' overall portfolios, and we continue to do so. If the stock market does indeed return to the historic norm of broader markets, our added diversification might prove beneficial.

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®: 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.
Magnificent 7: The Magnificent 7 (Mag 7) are a group of 7 widely-traded companies classified in the United States and representing the Communications, Consumer Discretionary and Technology sectors as defined by the Global Industry Classification Standard (GICS®) developed by MSCI Barra and Standard & Poor's. These consist of AAPL, AMZN, GOOGL, META, MSFT, NVDA and TSLA.

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 $16.1 billion collectively under management and advisement as of December 31, 2024. 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**.