Richard Bernstein Advisors

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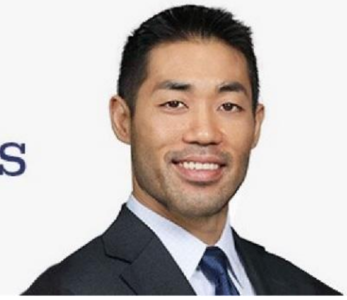
RBA Quick Insights



October 21st, 2021

It's never too early to sell a bubble

Which bubble camp are you in?

Back in June, we put out a piece making the case for why we think our criteria for financial bubbles have now been met in long duration assets like technology, innovation, disruption, and cryptocurrencies. We heard two types of responses: "duh" and "you just don't get it, boomer" (speaking for myself, I'd like to point out I am NOT a boomer). Given today's elevated valuations and extreme market concentration, it's clear most people are in the "you just don't get it" camp, which isn't surprising in the least. How can you have a bubble if everybody agrees there's a bubble?

Recognizing the bubble is only the first step in dealing with the bubble

Recognizing the existence of a bubble is a critical step in assessing risk, but it opens up the bigger question of how to manage that risk. As we often point out, if we knew exactly when the bubble was going to end, investing would be easy: simply own the most speculative bubble assets right up until the peak and then sell it all. While we have no doubt some investors think they can do just that, history suggests most will fail. In our view, the only prudent alternative to trying to time the bubble is to steadily shift exposures away from the epicenter of the bubble.

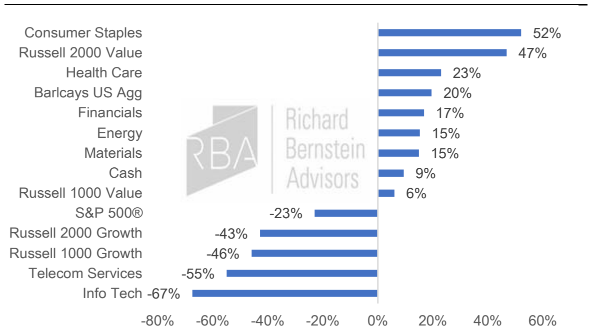
Where is capital scarce today (i.e. what's the anti-bubble)?

By their nature, bubbles attract an overabundance of capital, thereby creating enormous investment opportunities from the resulting capital scarcities in other parts of the market. In the two years following the Tech bubble peak, Tech and Telecom stocks led the way down with losses exceeding 50%, growth indices fell over 40% and the S&P 500® declined more than 20%. The scarcity of capital at the time was in defensive assets (Staples, Health Care, bonds, etc.) and small cap value stocks (the antithesis of the sought-after secular growth stocks), including Financials and Energy. Having been left behind in the hype surrounding the internet bubble, these stocks did far more than simply cushion portfolios. Consumer Staples stocks and small cap value stocks both surged over 45% even as the major market indices were tumbling (Chart 1).

Timing a bubble may be easier than you think

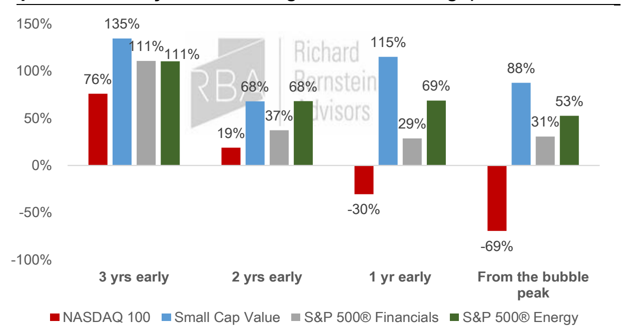
What if you reduce exposure too early? A critical distinction between a bubble and a typical investment peak is that you can essentially sell a bubble at any time and it will be additive to your longer-term wealth creation. Chart 2 below illustrates that had you sold Tech and bought the other side of the market seesaw (i.e. small cap value, Financials, Energy), **you could have been three years early and still had superior returns**. *For this analysis, we gave the market two years to recover from the trough, but the conclusion holds true 3, 4 and 5 years post-trough.*

Chart 1: Select winners and losers: 2-year returns starting March 27, '00



Source: Richard Bernstein Advisors LLC, Bloomberg

Chart 2: Bubble vs. anti-bubble returns relative to 2000 peak (all periods end 2 years following the bubble trough)



Source: Richard Bernstein Advisors LLC, Bloomberg

Note: all periods begin relative to 3/27/00 peak and end on 10/9/2004

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