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.

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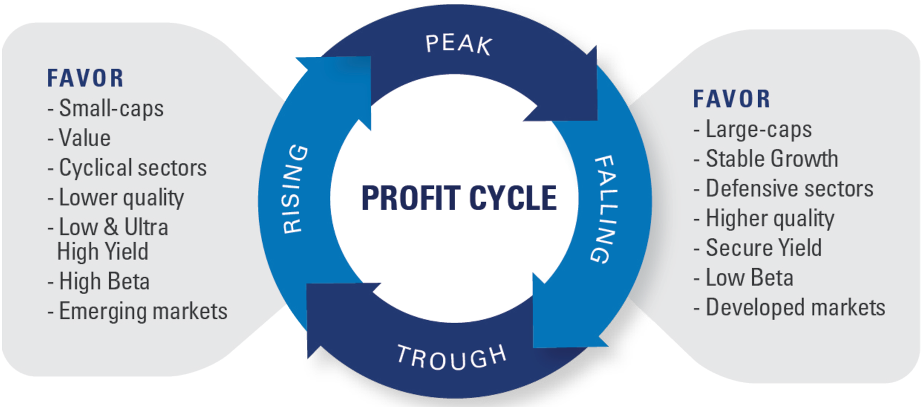
2021: Embrace the profits cycle



The direction of the overall stock market in 2021 could be very misleading and could mask a significant shift in underlying market leadership. In other words, the stock market might do well or not, but the potential for a major shift in market leadership could present significant investment opportunities.

The biggest story for 2021 might not be "the market," but rather a significant shift in market leadership and sector, style, and size performance that is currently unimaginable to many investors. Innovation, disruption, intangible assets, and long time-horizon investing could give way to ugly cyclicals, unknown small caps, downtrodden value, real assets, and investors' demand for immediate strong earnings growth.

Many have called for this type of rotation for some time and have been repeatedly disappointed. Our time-tested research suggested it was probably premature to have previously expected such a large-scale rotation. However, fundamentals are changing and 2021 is likely to be the year the rotation begins. History suggests such rotations can be powerful and provide considerable investment opportunities for those investors willing to embrace the profits cycle.

Investors who presently tout innovation and disruption as investment themes have to remember secular stories are always interrupted by cycles. Market leadership, outside of true bubbles, always shifts as fundamentals change. The business cycle isn't dead and relative earnings still do drive equity performance.

Monetary and fiscal stimulus

Any discussion regarding 2021's outlook has to start with a review of 2020's monetary and fiscal stimulus. We have commented many times regarding the US's historic money growth (US M2 growth is up about 25% year-to-year), but the political standoff in Washington suggests to many that fiscal stimulus has been paltry. That is not true. One could legitimately argue additional stimulus is needed, but it is critical to realize there is considerable fiscal stimulus already in the works.

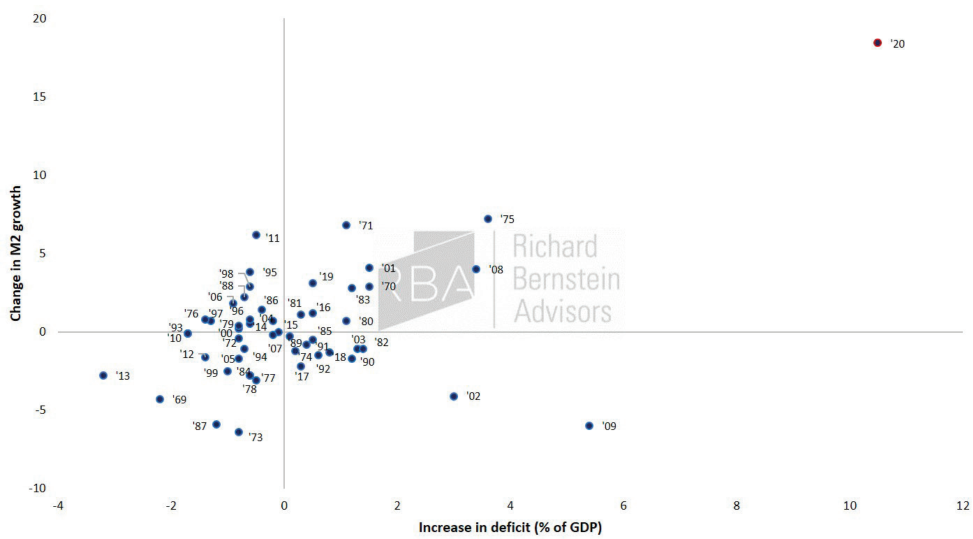
Chart 1 shows the year-by-year change in M2 growth (i.e., the second derivative of M2) plotted versus the year-by-year change in the federal budget deficit as a percent of GDP. Data points upward and to the right signify years during which greater incremental monetary and fiscal stimulus occurred, whereas data points downward and to the left represent years in which there were incremental contractionary policies.

2020 stands out as an historic year for both monetary and fiscal stimulus. Investors have been confused how the stock market could advance in the face of a global pandemic, but this chart shows how extreme both the monetary and the fiscal policy responses have been. It also seems unlikely either monetary or fiscal policy makers will quickly reverse course once the post-pandemic economy begins to stabilize for fear of de-stabilizing an uncertain backdrop.

CHART 1:

Annual changes in M2 money supply growth vs. annual changes in federal deficit/surplus as a percentage of GDP

(1969 - 2020*)



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

*Note 2020 is based on November year-to-date figures.

This chart also gives some insight regarding past cycles. Note:

1. **1987**: Contractionary monetary and fiscal policies might have contributed to the stock market crash.
2. **2012 - 2013**: One of the reasons the last cycle's economic growth might have been so anemic was both monetary and fiscal policies were contractionary despite a weak post-GFC economy. The US government "sequester" in 2013 reversed some post-GFC government spending, and 2013 turned out to be the most incrementally contractionary year in the study.
3. **2019 - 2020**: There are not many periods with back-to-back stimulus. 1970/71 and 1980/81 were the only similar periods. The 1970s led to early-stages of the inflation spiral and the 1980s was quickly reversed by a very aggressive Federal Reserve which kept money growth slowing throughout much of the early- to mid-1980s.

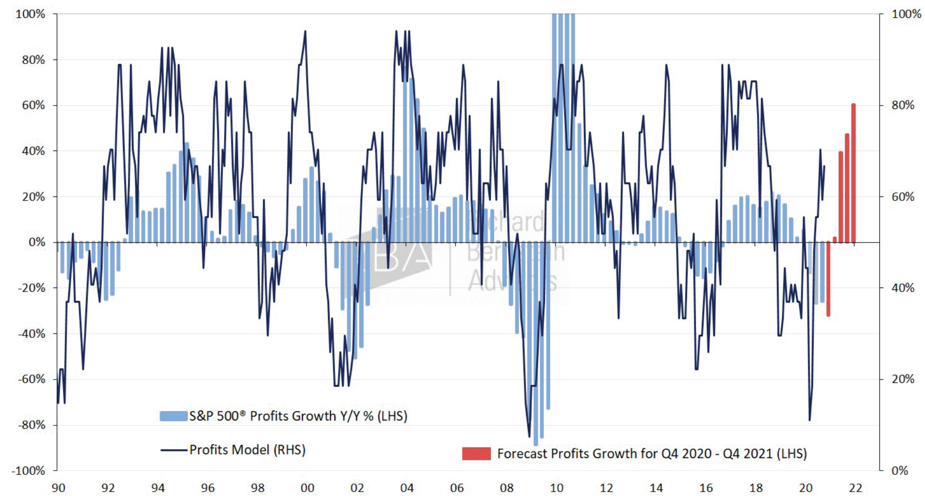
Profits could grow...a lot

This stimulus background alone might be a solid argument for stronger corporate profits growth in 2021, but there are other factors that together argue for a substantial upturn in the profits cycle.

First, earnings in 2021 will have very easy comparisons to 2020's pandemic-depressed earnings. One could pooh-pooh easy comparisons, but every cycle begins with easy comparisons. By definition, it's impossible to start a cycle with difficult comparisons.

Second, our models that forecast profits cycles have decidedly turned more optimistic (see Chart 2). These models focus on the basic building blocks of corporate profits: units, pricing power, and margins, and all three in generalized terms seem likely to improve during 2021 versus 2020. In particular, pricing power is already decidedly expanding for many of the most basic materials in the economy. That is a critical positive because the deepest cyclical companies tend to be commodity related. It would be highly unusual to have an upturn in the profits cycle not powered by the most cyclical companies. After all, the cycle is determined by…cyclicals.

CHART 2:
Richard Bernstein Advisors US Profits Model vs. S&P 500® Reported EPS Growth



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

The profits cycle fuels sector/size/style rotations

Our 1995 book, *Style Investing – Unique Insight for Equity Management*, outlined the cyclical factors that determine rotations between various equity market segments: growth/value, large/small, high quality/low quality, etc. By far, profits cycles are the most important determinant of market segments' performance.

When profits cycles decelerate, markets become "Darwinistic" and survival of the fittest determines stock performance. Fewer and fewer companies can maintain their earnings growth as overall economic conditions worsen and investors gravitate toward a smaller universe of growing companies and bid up those companies' valuations. Simply put, the price of earnings growth appreciates as growth itself becomes increasingly scarce. Decelerating profits cycles, therefore, favor the performance of growth over value, large over small, and high quality over low quality.

However, markets tend to broaden when profits cycles accelerate. An increasing number of companies begin to grow their earnings and investors no longer need to pay a high valuation to invest for growth. In effect, investors can increasingly comparison shop for growth. Accelerating profits cycles accordingly favor the performance of value over growth, small over large, and low quality over high quality.

Charts 3 through 6 show how various market segments and sectors perform when profits cycles accelerate and decelerate, and this empirical evidence strongly supports the theory described in *Style Investing*.

CHART 3:

Profits Cycle Accelerations: excluding the Tech Bubble*
Trough to Peak Asset Class Performance
(09/1989 - 09/2020 Total Returns)

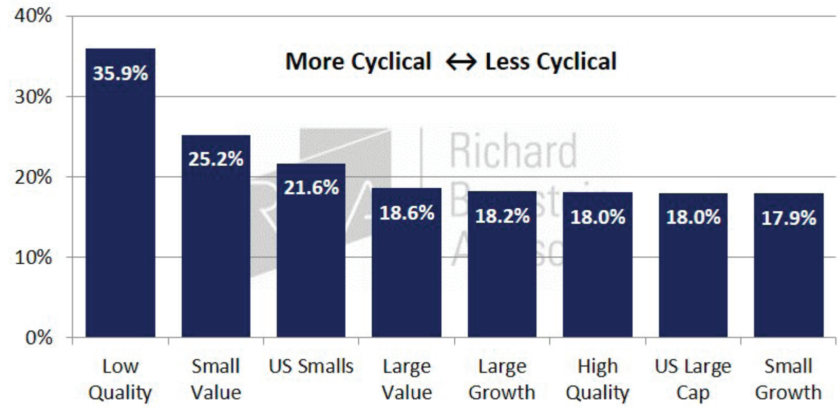


CHART 4:

Profits Cycle Decelerations: excluding the Tech Bubble Implosion**
Peak to Trough Asset Class Performance
(09/1989 - 09/2020 Total Returns)

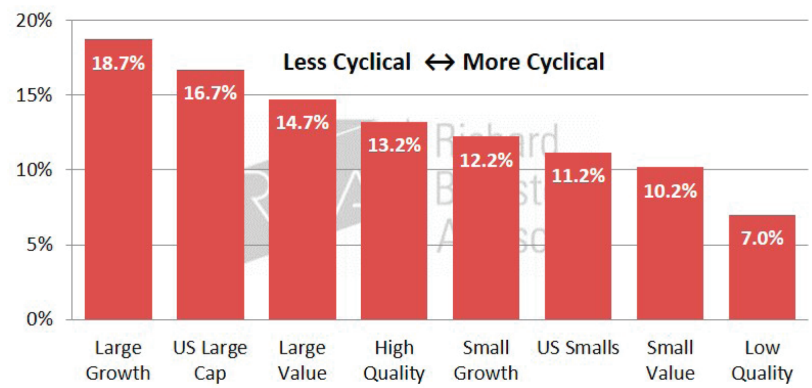


CHART 5:

Profits Cycle Accelerations: excluding the Tech Bubble*
Trough to Peak S&P 500® Sector Performance
(09/1989 - 09/2020 Total Returns)

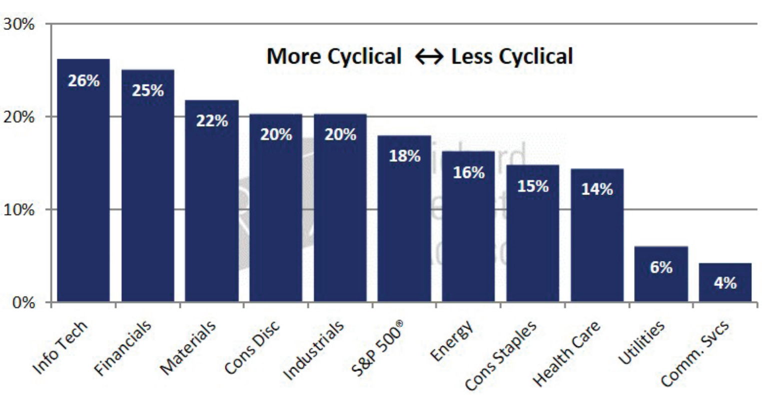


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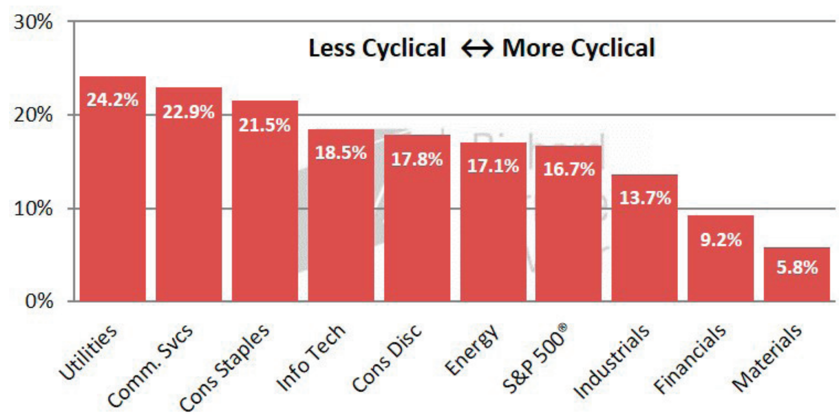
CHART 6:

Profits Cycle Decelerations: excluding the Tech Bubble Implosion**
Peak to Trough S&P 500® Sector Performance
(09/1989 - 09/2020 Total Returns)



Source: Richard Bernstein Advisors LLC, S&P Global, Russell, BofA, Bloomberg Finance L.P. For Index descriptors, see "Index Descriptions" at end of document.

*excludes the tech bubble profits acceleration from 12/98-3/00 to avoid skewing due to its extremes. Real Estate excluded as it was classified as an industry within Financials until Sep. 2016.

**excludes the post tech bubble profits recession from 3/00-12/01 to avoid skewing due to its extremes. Real Estate excluded as it was classified as an industry within Financials until Sep. 2016.

Embrace the business cycle

"This time is different" has historically been the kiss of death for investors because the statement assumes the traditional business cycle has somehow been repealed. History shows the business cycle is never repealed and "this time is different" comments are eventually proved wrong. Every cycle has its unique features, but the business cycle remains.

The profits cycle has historically been the key to equity market segments' relative performance, and the key to 2021's stock market could be a significant rebound in corporate profits. Optimists, who believe profits will indeed rebound, should probably err on the sides of value, small, cyclical, and low quality during 2021.

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To learn more about RBA's disciplined approach to macro investing, [please contact your local RBA representative.]

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.

S&P 500® Value: S&P 500® Value Index: The S&P 500® Value Index is a 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. Prior to 12/19/2005 this index represented the S&P 500® /Barra Value Index

S&P 500® Growth: S&P 500® Growth Index: The S&P 500® Growth Index is a 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. Prior to 12/19/2005 this index represented the S&P 500® /Barra Growth Index.

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.

Large Cap: 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.

Small Cap: 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.

Large Growth: Russell 1000 Growth Index. The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Large Value: Russell 1000 Value Index. The Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Small Growth: Russell 2000 Growth Index. The Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.

Small Value: Russell 2000 Value Index. The Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

High Quality: The BofA A+ Quality Index: BofA Quality indices: each month BofA groups all of the stocks in the BofA US research coverage universe based on their Standard and Poor's quality ranking. The returns are calculated based on the subsequent months' average price return of each group assuming monthly rebalancing.

Low Quality: The BofA C&D Quality Index: BofA Quality indices: each month BofA groups all of the stocks in the BofA US research coverage universe based on their Standard and Poor's quality ranking. The returns are calculated based on the subsequent months' average price return of each group assuming monthly rebalancing.

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 $11.4 billion collectively under management and advisement as of November 30th, 2020. 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**.