Richard Bernstein Advisors

The Leaders In Pactive® Management

Insights

July 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.

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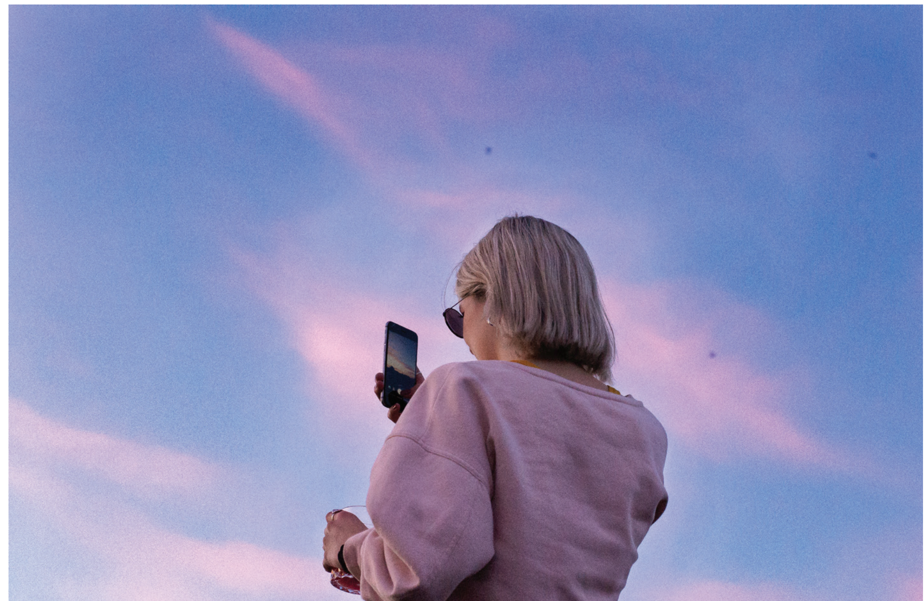
One for Millennials and Gen Z



I was 25 years old in 1984 and had finally saved enough to start thinking about the future and starting an Individual Retirement Account (IRA). Intuition told me that an investment with hopefully a time horizon of at least 40 years was somehow unrelated to the day-to-day stories of "the market." My intuition has been proven correct, and hopefully today's Millennials and Gen Z will take these simple lessons to heart as they too begin to seriously consider the future.

Lesson #1: Income vs. Hype

In a book I wrote more than 20 years ago, I asked the question: Building wealth isn't difficult, so why don't people do it?

The book pointed out there are some simple wealth-building concepts everyone should use, but a litany of supposedly newer, better, more exciting investments lure investors away from the time-tested strategies. As in Greek mythology, there is always a Siren's Song of exciting opportunities coaxing investors to take significant yet unseen risks.

Compounding dividend income is one of the simplest methods of building wealth, but seems much too boring to many investors. No one brags about compounding dividends to friends relative to the exciting growth opportunity one invested in that is a sure "get-rich-quick."

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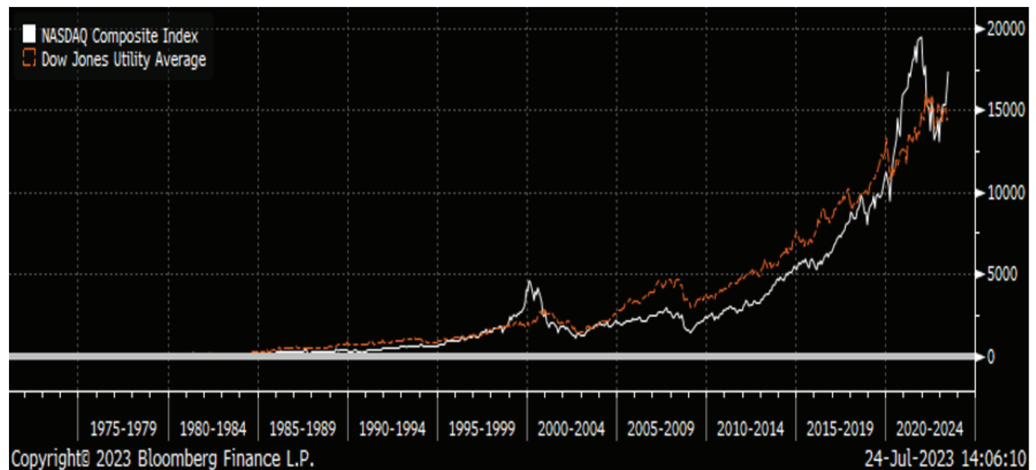
Chart 1 shows the compound returns of the NASDAQ Composite and the Dow Jones Utility Index since NASDAQ's inception in February 1971 (i.e., 52 years). NASDAQ surpassed the returns of the Utility Index only during frothy periods like the 1999/2000 Technology Bubble and the current speculative post-pandemic surge.

It's often stated that dividends are for investors closer to retirement age, whereas growth is a more appropriate strategy for younger investors. History shows, however, that compounding dividends is a viable strategy for all investors regardless of age. It's not sexy, but it has pretty consistently worked.

CHART 1:
NASDAQ vs Utilities
(Feb. 5, 1971 – July 24, 2023)



Source: Richard Bernstein Advisors LLC, Bloomberg Finance LLP. For index descriptors, see "Index Descriptions" at end of document.

Lesson #2: Bad companies make good stocks over the long-term

Investors tend to equate good companies with good stocks. Realistically, though, the goal of long-term investors should be to invest in good stocks regardless of the quality of the company, and it turns out bad companies tend to make the better stocks over the long-term.

Chart 2 shows the performance since 1986 (i.e., 37 years) of stocks grouped by S&P Common Stock Ranking. The rankings are formulaic and based on both the stability and growth in earnings and dividends over a ten-year period. The performance of companies ranked B or worse has been better than that of companies ranked B+ or better. The extreme case is B- companies outperformed A companies by 250 bp/year!

Thus, it's important for long-term investors to remember bad companies make good stocks over the long-term.

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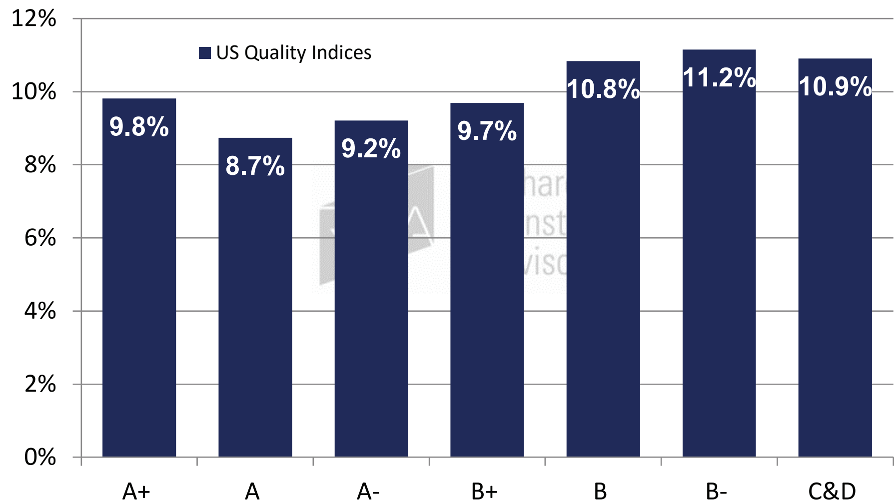
CHART 2:
Performance by Quality
(Jan. 1986 thru Jun. 2023, price returns, annualized)



Source: Richard Bernstein Advisors LLC., BofA US Equity and Quant Strategy, Standard & Poor's. For index descriptors, see "Index Descriptions" at end of document.

Lesson #3: Realize worthwhile risk-taking often means investing in unattractive assets

Perhaps the most important axiom of long-term investing is return on investment is highest when capital is scarce. In other words, one should mimic the one banker in a town with a thousand borrowers and try to avoid being a 1,000th banker in a town with one borrower.

Longer-term investment returns are just a function of the supply and demand of capital. When capital is scarce relative to demand, the odds are one's returns will be higher. When there is an over abundance of capital, the odds are one's returns will be lower.

The global equity markets' supply of and demand for capital seems to ebb and flow through time, and perhaps the best example is the relative performance of venture capital and emerging markets through time. Both equity categories are considered higher risk, but interestingly they perform quite differently decade by decade as capital flows toward one and then back to the other.

Charts 3, 4, 5, and 6 show the performance of the Refinitiv Venture Capital Index against the MSCI Emerging Market Index by time period. The relative performance shifts significantly decade by decade suggesting that capital flows back and forth between these two riskier equity asset classes.

Venture capital has outperformed over the past decade and investors have invested tremendous amounts chasing that outperformance. That might suggest this may be a better entry point for longer-term investors in emerging markets than there might be in venture capital.

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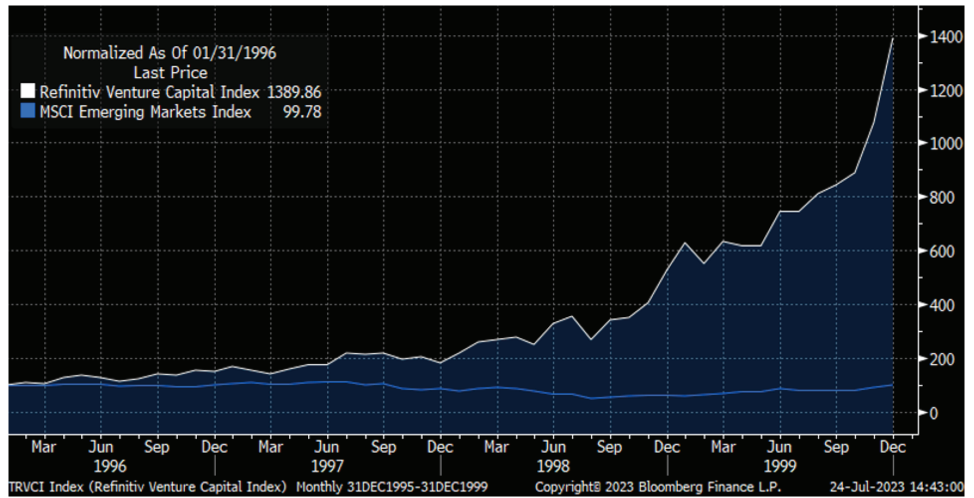
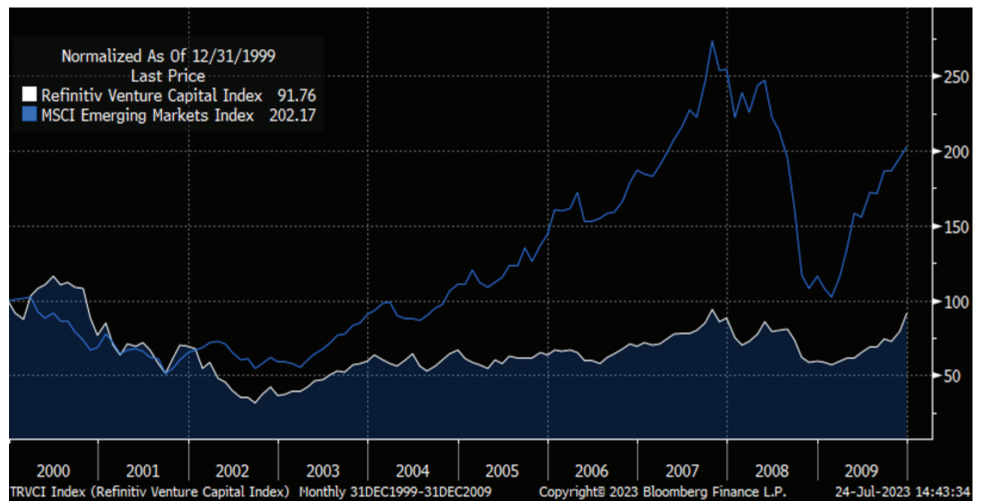
CHART 3:
Refinitiv Venture Capital vs. MSCI Emerging Markets
(Dec. 1995 – Dec. 1999)



Source: Richard Bernstein Advisors LLC, MSCI, Refinitiv, Bloomberg Finance LLP. For index descriptors, see "Index Descriptions" at end of document.

CHART 4:
Refinitiv Venture Capital vs. MSCI Emerging Markets
(Dec. 1999 – Dec. 2009)



Source: Richard Bernstein Advisors LLC, MSCI, Refinitiv, Bloomberg Finance LLP. For index descriptors, see "Index Descriptions" at end of document.

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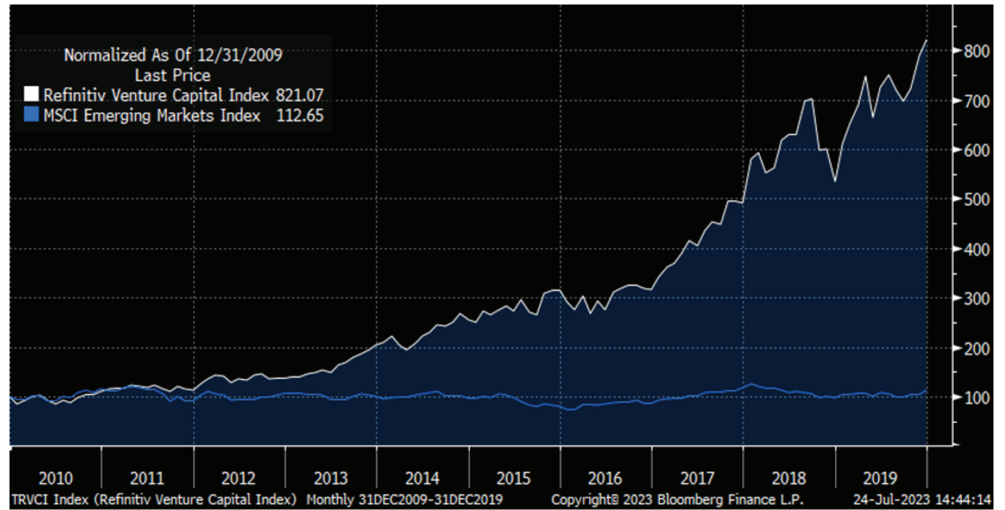
CHART 5:

Refinitiv Venture Capital vs. MSCI Emerging Markets

(Dec. 2009 – Dec. 2019)

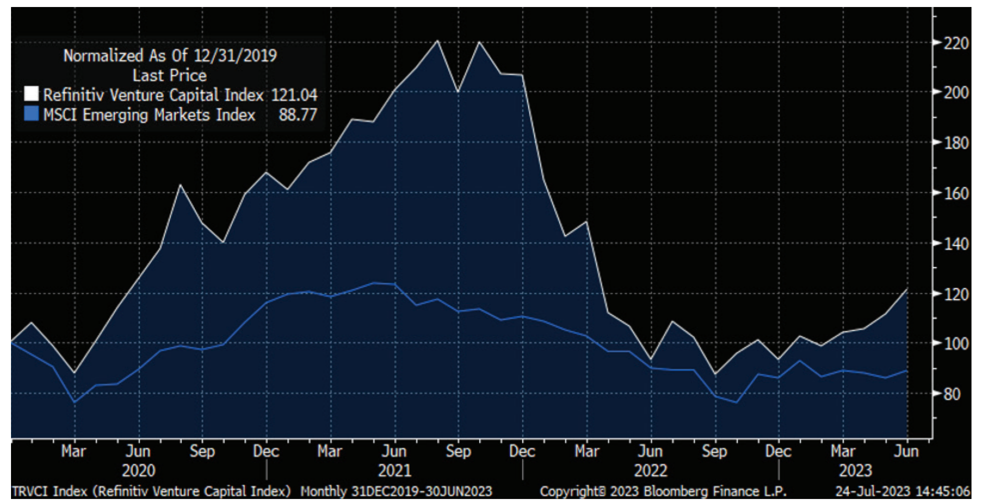


Source: Richard Bernstein Advisors LLC, MSCI, Refinitiv, Bloomberg Finance LLP. For index descriptors, see "Index Descriptions" at end of document.

CHART 6:

Refinitiv Venture Capital vs. MSCI Emerging Markets

(Dec. 2019 – July 24, 2023)



Source: Richard Bernstein Advisors LLC, MSCI, Refinitiv, Bloomberg Finance LLP. For index descriptors, see "Index Descriptions" at end of document.

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Lesson #4: Understand the definition of "long term"

Most investors typically say they are long-term investors until their portfolio starts to underperform. Then they often quickly turn into traders who chase the latest hot investment.

That emotional reaction to underperformance tends to stem from a combination of a bad initial investment decision (i.e., not understanding #1, #2, and #3) combined with a lack of understanding of the term "long term."

One can make bad investment decisions, but time tends to heal poor decisions so long as one is patient. Chart 7 shows the returns of hypothetical investors who bought NASDAQ in March 1999, which was a full year before the Technology Bubble peaked.

It would have taken roughly 11 years for an investor to break even on this investment, but ultimately NASDAQ did recover and provide good returns for investors. However, one did have to wait 11 years to break even, which would have tested most investors fortitude.

Understanding that the long term is indeed long is a critical component of successful investing.

CHART 7:
The NASDAQ Composite
(Mar. 1999 – Jul. 24, 2023)

Source: Richard Bernstein Advisors LLC, Bloomberg Finance LLP. For index descriptors, see "Index Descriptions" at end of document.

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Everyone claims to be a long-term investor, but few truly are

News cycles today are full of hair-on-fire events, i.e., the best or the worst ever seen by mankind. We often joke that we're seeing unprecedented use of the word unprecedented.

Such a hyperbolic world is very unrealistic, and long-term investors must remember to stick to a plan. Remembering that dividends are important, that bad companies typically make good stocks, that return on investment tends to be highest when capital is scarce, and that the definition of long-term can significantly improve long-term performance and, at the same time, probably lower one's blood pressure and limit emotional portfolio mistakes.

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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.**

NASDAQ: The NASDAQ Composite Index. The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Utilities: The Dow Jones Utility Average: The Dow Jones Utility Average is a price-weighted average of 15 utility companies that are listed on the New York Stock Exchange and are involved in the production of electrical energy. The average as it is known today began on January 2, 1929 with a base value of 50.

US Quality Indices: The BofA US equity and quant strategy 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. The A+ stocks Index is the highest quality and C&D are the lowest among the S&P quality ranking scores.

Emerging Markets: MSCI Emerging Markets (EM) Index. The MSCI EM Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of emerging markets.

Refinitiv Venture Capital Index: The Refinitiv Venture Capital Index replicates the performance of the Refinitiv Venture Capital Research Index with liquid, publicly-listed assets and is published daily. The Refinitiv Venture Capital Research Index measures the aggregate gross returns of the U.S. venture capital industry, by tracking the performance of individual U.S. venture capital-backed private companies, which are not available for public investment. The index uses Refinitiv Private Company Data and is published quarterly.

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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 $16.2 billion collectively under management and advisement as of June 30, 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**.

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