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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Certainties for an uncertain world

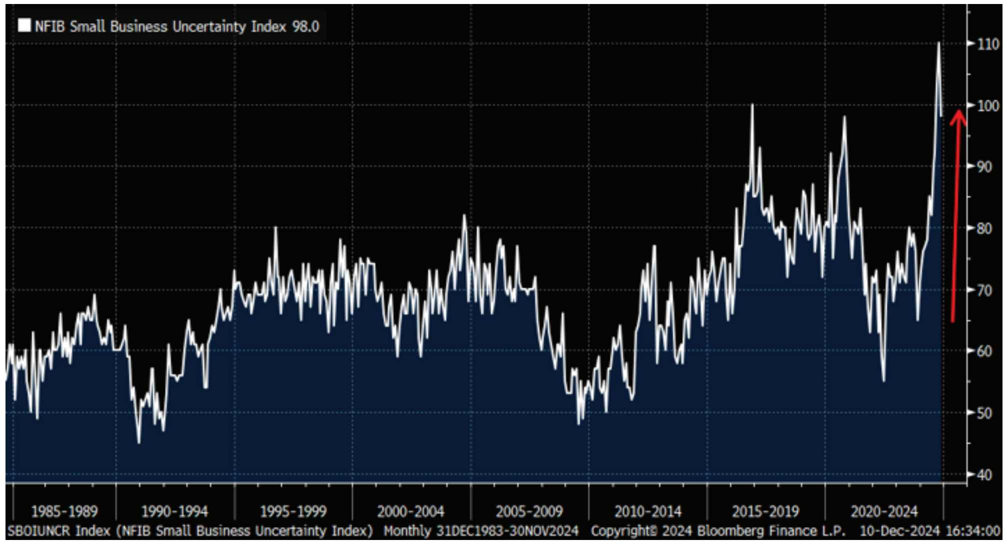
There is one word to use as investors enter 2025: uncertainty. Of course, investing risk and uncertainty are always present within the financial markets, but the breadth of uncertainty seems much larger than normal.

Beyond the typical uncertainty, investors are now facing uncertainty regarding Fed policy, fiscal policy under the new administration, trade and tariffs, business and regulatory policies, the effects of deglobalization, and even the ongoing strength of the labor market.

This chart shows the level of uncertainty within the National Federation of Independent Business's small business survey. Small businesses believe they are facing the most uncertain environment in the 40-year history of the survey. They foresee a more tentative business environment than they anticipated even during the pandemic.

CHART 1:

NFIB Small Business Uncertainty Index
(Dec. 1983 – Nov. 2024)

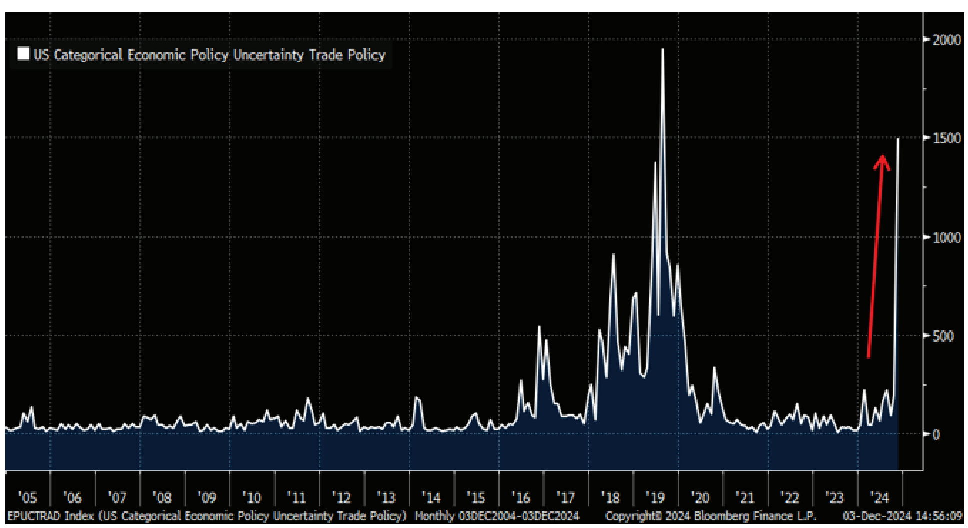


Source: Bloomberg Finance L.P.

Uncertainty regarding globalization and trade has spiked as well. Whereas trade uncertainty is not as high as it was after tariffs were initiated in 2018, the recent spike in uncertainty is extreme.

CHART 2:

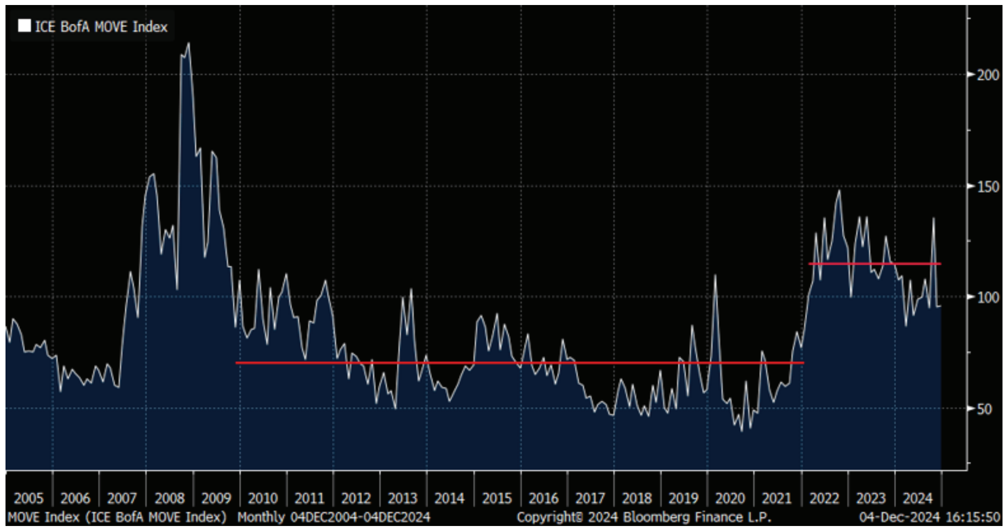
US Categorical Economic Policy Uncertainty Trade Policy
(Dec. 2004 – Nov. 2024)



Source: Bloomberg Finance L.P.

Fixed-income volatility and uncertainty have jumped as well. The BofA MOVE Index, which measures volatility in the US treasury bond market, appears to have returned to levels not seen since the global financial crisis and is secularly higher than the levels seen over the prior 10-15 years.

CHART 3:
ICE BofA MOVE Index
(Dec. 2004 – Nov. 2024)



Source: Richard Bernstein Advisors LLC, BofAML US Strategy

5 Certainities (?)

Within this truly unclear investment landscape, there are 5 factors we think are relative certainties in this uncertain world that together argue for stronger nominal growth than is current consensus.

1. Starting 2025 with a healthy economy - The Atlanta Fed's GDPNow, a real-time tracker of the economy, is currently forecasting fourth quarter growth greater than 3%. Investors will probably be starting 2025 with a much healthier economy than many perceive.

2. The Fed could make easy financial conditions even easier – The Fed seems to want to lower interest rates despite that financial conditions are very easy. The nominal economy seems likely to accelerate as financial conditions ease further and liquidity increases from its already plentiful levels.

3. Profits are accelerating – It's rare that the Fed cuts interest rates when profits growth is as strong as it currently is. Because profits growth spurs employment and capex, the combination of the Fed cutting rates and accelerating profits could provide a very powerful boost to the already strong economy.

4. Tariffs and ongoing deglobalization – Deglobalization will probably spur secular inflation because production will move from more efficient to less efficient locales. Tariffs, if enacted, will likely add to shorter-term inflation because of the lack of domestically produced substitutable goods. Tariffs could stymie overall economic growth as would a large and sizable consumption tax, but higher prices would precede and could actually cause weaker economic growth.

5. Tax cuts – It is unclear whether taxes will be meaningfully cut under the new administration, but it is a good guess that taxes will not increase, and the net result will be stimulative.

Portfolio Construction: Certainty vs Uncertainty

These five relatively certain factors imply stronger nominal growth (real growth plus inflation) than investors currently expect, and our portfolios are currently positioned for that positive surprise.

The three fundamental components of RBA's research are profits, liquidity, and sentiment. Profits are already accelerating, and additional fiscal and monetary stimulus might help further the upturn. Existing easy financial conditions combined with additional Fed rate cuts implies liquidity will continue to be abundant. Sentiment is the more difficult of the three right now and we'll discuss that below.

Overall, these factors lead us to construct our portfolios to benefit from more growth, more inflation, or both. Within equities, we are overweighted cyclical stocks: Industrials, Energy, Mid/Small Caps, and Emerging Markets excluding China. One always should remember the cycle, by definition, is determined by cyclical companies and our overweight to cyclical industries, value, and smaller capitalization stocks reflects that cyclical exposure.

Within our fixed-income portfolios, we are shorter duration than benchmark because unanticipated strong nominal growth implies that short-term instruments outperform longer-term ones, and that credit outperforms quality. Complicating matters, longer-term credit spreads are historically narrow, so our current credit exposure is exclusively at the short end of the yield curve.

We expect fixed-income volatility to remain elevated, which suggests a more tactical approach to fixed-income investing might continue to be beneficial. Our use of fixed-income ETFs in a more volatile market should allow us to more easily re-orient portfolios for unanticipated changes to duration, quality, or sector than if we constructed traditional fixed-income portfolios.

Some have questioned our preference for smaller capitalization stocks given we think longer-term interest rates might rise. They believe that higher rates are bad for smaller companies because they are often more highly leveraged than large cap ones.

There is a tug-of-war during every period of rising rates between companies' financial leverage and operating leverage. Financial leverage is debt financing's boost to operating income, whereas operating leverage reflects the accelerating marginal profitability of a highly capital intensive company during an economic upturn.

So, rising rates do negatively impact financial leverage of smaller companies, but stronger nominal growth (i.e., the reason rates are going up) spurs the operating leverage. History suggests smaller companies' positive operating leverage generally wins versus their negative financial leverage.

But it's still an uncertain environment

Even though we believe the 5 mentioned factors to be relative certainties, 2025 will likely be a year of uncertainty, and it's important to consider what could change during the year.

If we are correct and nominal growth proves stronger than is current consensus, then the Fed might have to reverse course and raise rates during the second half of 2025. Such a reversal might increase market volatility because most economic forecasts currently suggest the Fed will continue to cut rates throughout 2025 and into 2026.

The current market is at least somewhat speculative, and speculation thrives on excess liquidity. If the Fed were to shift to a tightening bias, investors might see some of the markets' risk-taking fervor subside.

A second consideration is when does the profits cycle peak? We currently project peak earnings growth in the first or second quarter of 2025. A peak in the profits cycle by itself is not sufficient to cause a bear market, but the combination of the Fed hiking rates into a decelerating profits cycle has historically been a fillip for higher volatility.

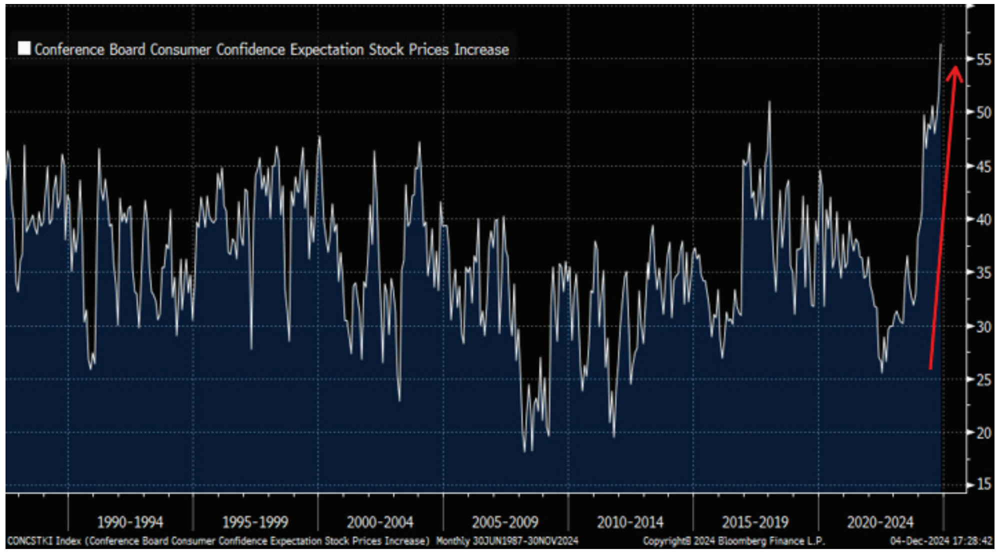
Third, sentiment is worrisome because investors appear to be universally very bullish. In some cases, even historically so. Equity allocations are high, portfolio betas are high, and investors are shunning diversification for concentration.

The Conference Board's Consumer Confidence Survey shows individual investors are the most bullish they've been in the roughly 40-year history of the survey. Diversification is no longer viewed as a risk-reduction tool, but rather as a hindrance to performance. That could be a precarious sentiment backdrop given the potential for increased volatility in the 2nd half of 2025.

CHART 4:

Conference Board Consumer Confidence Expectation Stock Prices Increase

(Jun. 1987 – Nov. 2024)



Source: Bloomberg Finance L.P

Asset managers are also very bullish. CFTC data shows that asset managers have the second most extreme net-long position in the history of the data. Although these data are not necessarily useful for market timing, it does further support the notion that investors are very bullish.

Such universal bullishness among both private clients and institutions should be a cautionary note for any investor with even a small contrarian streak.

CHART 5:

CFTC Asset Manager Net Long

(Jun. 2006 – Dec. 03, 2024)

Source: Bloomberg Finance L.P

Richard Bernstein Advisors

First half certainty gives way to second half volatility

Overall, we enter 2025 anticipating that nominal growth will be stronger than investors expect and accordingly are cyclically positioned in our equity and fixed-income portfolios. Risks could increase around mid-year, and more defensive positioning might be appropriate at that point.

2025 is ripe with uncertainty, but for the time being, we're taking the over on nominal growth. However, that stronger nominal growth might be the catalyst for second half market volatility.

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 $15.6 billion collectively under management and advisement as of September 30, 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**.