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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Profits Recession Ahead

Investors see a myriad of unknowns right now, but we prefer to structure portfolios for the only two certainties we see for the next 6-12 months: 1) the Fed will be tightening and 2) profits will be decelerating. We've pointed out before this combination of events is not typically a good one for equity markets, and we now have our lowest equity beta and highest cash levels in years.

Chart 1 shows the combination of the Fed tightening and profits decelerating has been the worst combination for equity returns of the four possible. The probability of negative returns is the highest under the relatively certain scenario we envision.

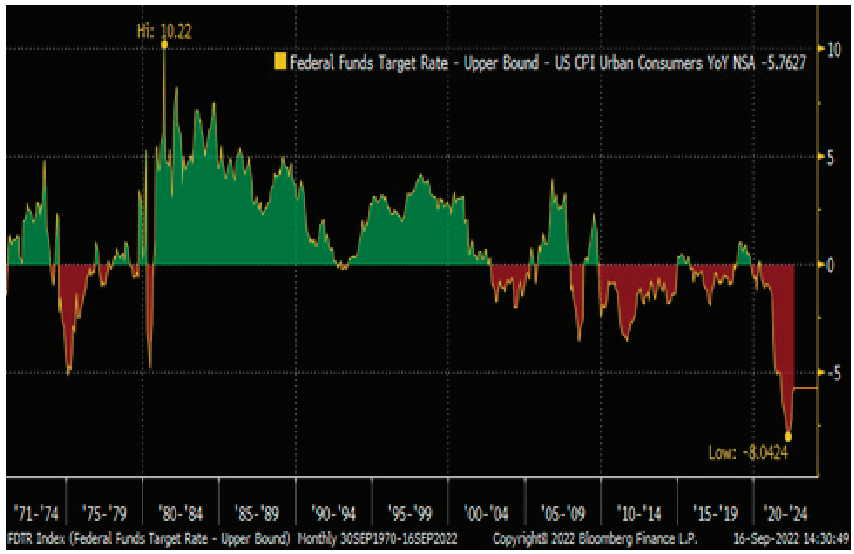
CHART 1:
S&P 500® Quarterly Total Returns
(Mar. 1971 – Jun. 2022)

		Fed	
		Easing	**Tightening**
Profits	**Accelerating**	3.5% Avg return/ 26% Probability of a loss	3.9% Avg return/18% Probability of a loss
	Decelerating	2.6% Avg return/ 29% Probability of a loss	1.7% Avg return/ 43% Probability of Loss

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

The real Fed Funds rate remains historically negative despite the Fed's repeated rate increases (see Chart 2), which suggests the Fed could be raising rates for some time to get inflation under control. Historically, it has been difficult to corral inflation without a positive real Fed Funds rate.

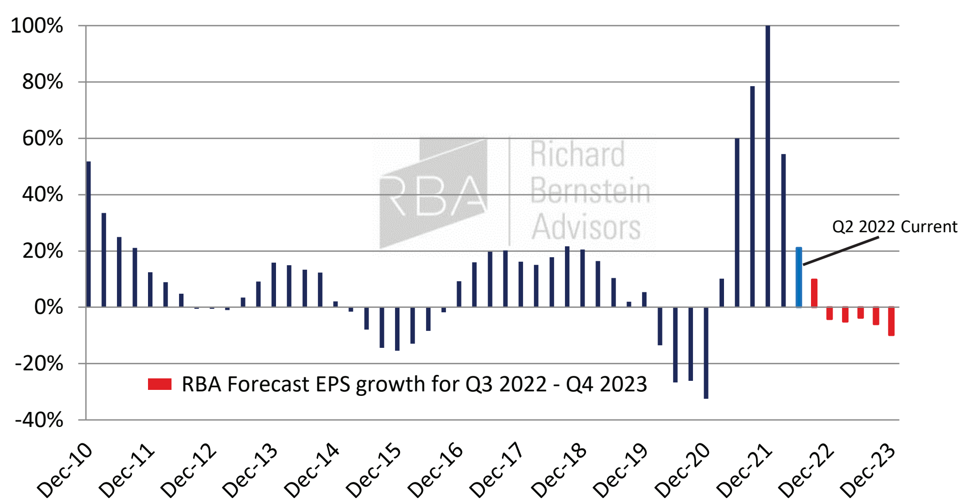
CHART 2:
Real Fed Funds Rate
(Sep. 30, 1970 - Sep. 16, 2022)



Source: Bloomberg Finance L.P.

Chart 3 shows the profits cycle for the S&P 500®. Profits are already starting to decelerate after the post-pandemic period of exceptionally strong earnings growth.

CHART 3:
S&P 500® Reported Y/Y Trailing EPS Growth
(Dec. 2010 – Jun. 2022)



Source: Richard Bernstein Advisors LLC., S&P Global, Bloomberg Finance LP., Factset. 2Q22 data is preliminary.

Performance is typically tied to relative earnings growth, and when profits decelerate stable earnings companies tend to outperform. These stocks' mundane earnings growth is simply too boring when the cycle accelerates, and they underperform. However, investors find their lower but more stable earnings patterns increasingly interesting when other companies' growth rates turn negative.

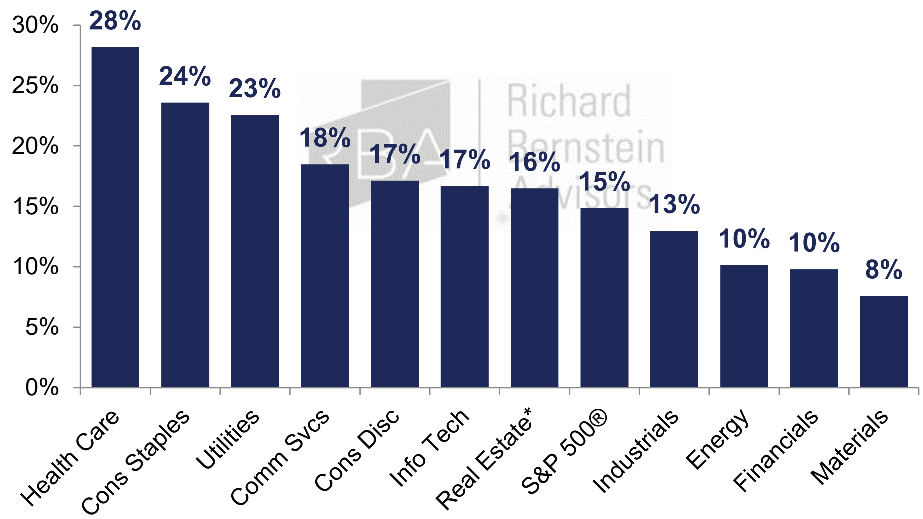
One has to remember that no matter what goes on in the economy, we all still eat. Consumers might switch from steak to bologna or from name brands to store brands during a recession, but they do tend to continue to eat when they stop buying discretionary or luxury goods.

Accordingly, defensive sectors (Consumer Staples, Health Care, and Utilities) tend to outperform when profits cycles decelerate, whereas more cyclical sectors tend to underperform (see Chart 4). RBA's portfolios are presently overweight all three traditionally defensive sectors.

CHART 4:

Average Performance When Profits Decelerate: S&P 500® Sectors

(Sep. 1989 – Dec. 2020 total returns)



Source: Richard Bernstein Advisors LLC.S&P Global, FTSE, Bloomberg Finance L.P. For Index descriptions see Index Descriptions at end of document. Dec. 2020 was the end of the last full profits deceleration cycle. Real Estate performance is proforma as it was not a stand alone sector until 9/30/16 and was included within the Financials Sector. We use the FTSE Nareit All Equity REITS Total Return Index as a proxy for its performance from 9/1989 through 10/2002 when the GICS Real Estate Industry Index performance becomes available for data from that point on. Communication Services was Telecom Services prior to GICS reclassification in 9/30/18.

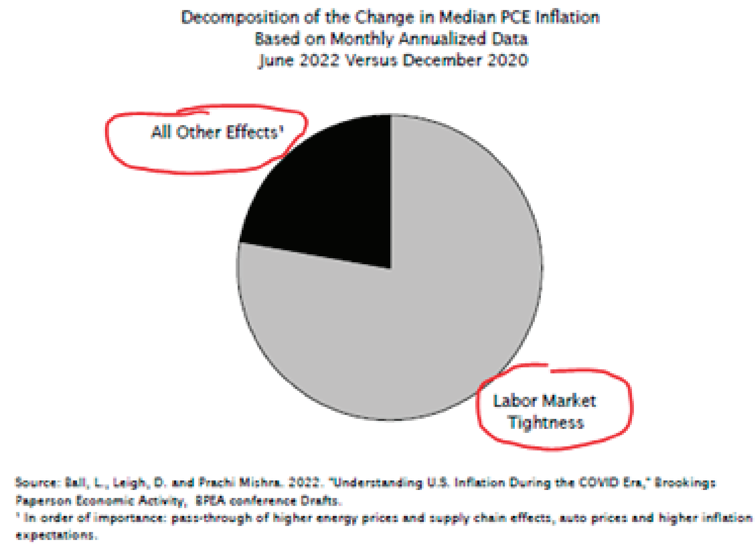
We are forecasting an official profits recession for the first half of 2023 (see red bars in Chart 3) and history suggests defensive and counter-cyclical strategies tend to outperform until the cycle eventually troughs and turns. It is very difficult to forecast exact growth rates, but we currently don't see such a turn in the profits cycle troughing until 4Q 2023.

Some have suggested these defensive sectors are unattractive based on their current valuations. However, history shows these sectors typically appear expensive going into profits recessions, but the scarcity of earnings growth take precedent over valuation during profits recessions. These sectors' valuations matter greatly, however, when the cycle turns more positive.

Profits recession will likely help the Fed fight inflation

A recent study by Empirical Research Partners, a highly rated independent research firm, highlighted the historically tight labor market has been a greater contributor to inflation than were supply chain disruptions. Based on their academic research, they conclude more than ¾ of the increase in inflation was attributable to the labor market (See Chart 5).

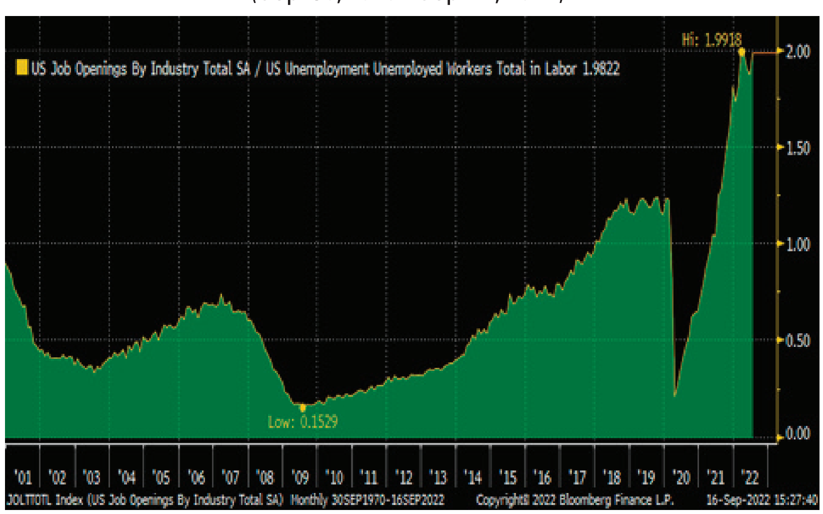
CHART 5:
Decomposition of the Change in Median PCE Inflation



Source: Empirical Research Partners

The recent employment data showed the US labor market actually got marginally tighter. Chart 6 shows the ratio of job openings to unemployed persons in the US. The ratio moved back to 2-to-1, i.e., there are two job openings for every person looking for a job, which suggests the US labor market is the tightest in recent history.

CHART 6:
Ratio of Job Openings to Unemployed Persons in the U.S.
(Sep. 30, 1970 - Sep. 16, 2022)



Source: Bloomberg L.P.

There is not much the Fed can do to increase the supply of labor to fight inflation, so they have to focus on stymying the demand for labor. Although politically and socially unappealing, the reality is the Fed must cause job losses to fight inflation. Of course, this would not be the case if productivity was improving, but last quarter's productivity was the worst in US economic history when measured on a year-to-year basis.

A sharp falloff in corporate profits might help the Fed fight inflation. Whereas companies tend to hire when earnings growth is strong, they tend to reduce the number of employees when cash flow and profits come under pressure. If we are correct and there is a full-blown profits recession in 2023, then it seems likely the demand for labor will subside. If the profits recession is deep enough, then wage inflation pressures should also subside.

Profits recession ahead

Popular discussion continues to focus on a dichotomy between growth and cyclicals. We think there is a third choice. Defensive stocks tend to outperform during downturns in the profits cycle, and they have yet to get the spotlight despite their improving relative earnings.

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®: 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.

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.

Real Estate Sector Performance Proxy through 10/2002: FTSE NAREIT All Equity REITS Total Return Index is a free float adjusted market capitalization weighted index that includes all tax qualified REITs listed in the NYSE, AMEX, and NASDAQ National Market.

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 $14.6 billion collectively under management and advisement as of August 31st, 2022. 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**.