Richard Bernstein Advisors

The Leaders In Pactive® Management

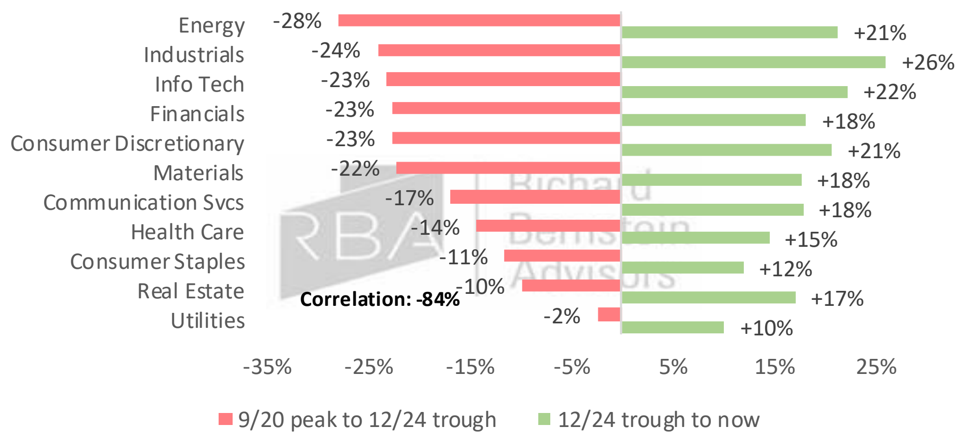
RBA Quick Insights

Look forward, not backward

At RBA, the profits cycle is the most important input to our process, with our major portfolio shifts tending to coincide with inflection points in the profit cycle. As earnings growth has begun to slow for the first time since 2015, we have shifted the composition of our portfolios to emphasize stable growth and quality over beta and cyclicality. Our research suggests that markets continue to appreciate as the profit cycle slows, but higher quality companies with more stable earnings and cash flows tend to outperform because investors increasingly avoid the companies who are most negatively impacted by the slowing economic and corporate profit backdrop.

While the fear that drove the emotional "run" on markets in the fourth quarter has reversed course, benefitting beaten-down high beta cyclicals, it seems unlikely that cyclicals will outperform for a prolonged period if growth continues to slow. It is no coincidence that the market rebound has been led by the very sectors and asset classes that led the way down. As shown in the chart below, the correlation between US sector performance before and after the December trough has been an impressive -84%, confirming that the recent rally has had more to do with reversing what happened in 2018 than where fundamentals are trending in 2019. Our recent changes should not be viewed as short-term trades in response to market volatility. Rather, they are meant to position for the current market backdrop of slowing profits growth.

S&P 500® sector performance: 2018 peak to trough vs. post-trough (as of 2/22/19)



Source: Richard Bernstein Advisors LLC, S&P, Bloomberg

Dan Suzuki, CFA
Portfolio Strategist

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Please feel free to call your regional portfolio specialist with any questions:
Phone: 212 692 4088
Email: marketing@rbadvisors.com

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